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What Our Students have to say....

BALAJI R

Scored exemption in 2 subjects. Thanks and respect to my beloved faculties Sathya Sir, Suraj Sir, Yogita Mam, Varun Sir, Shiva Teja Sir, Pranay Sir, IndigoLearn team and forum friends.

Ahil Varshan

Thank you so much
It is because of you Tax classes I was able to pass in Paper 4 The GST fast track course of Shiva Teja sir helped me a lot

GURRAM JANVITHA

Thanks to Shiva Teja Sir, Suraj Sir, Sathya Sir. Had a great journey with IndigoLearn.

Suhani Kochar

Very well explained sir
Thank you so much sir

Sai Suparna Puttu

Thank you for your support and blessing to us.

Soniya S

You have been a great support to my success...I successfully cleared my group-1 exam especially taxation with the help of those classes I could clear exam..
Thank you so much IndigoLearn

Preethi S

Taxation was very hard to understand for me in my 1st attempt. But thanks Shiva Teja Sir for exceptional Taxation lectures, I scored 61. I would strongly recommend him. Your passion and clear explanations made learning enjoyable.

Prachi Khetal

Thank you so much sir for this video lec, it is really very helpful.

Abhiram

I have taken taxation revision class for CA Inter. From past 2 attempts I failed and got low marks in tax but in May 2024 I have secured 72 marks in taxation that is because of the detailed revision class by CA Shiva Teja Sir, it helped me a lot while revising for the tax

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Unit-2 Issue, Forfeiture and Re-issue of Shares

Illustrations

Question: 1

JHP Limited is a company with an authorised share capital of Rs.10,00,000 in equity shares of Rs.10 each, of which 6,00,000 shares had been issued and fully paid on 30th June 2016. The company proposed to make a further issue of 1,00,000 of these Rs.10 shares at a price of Rs.14 each, the arrangements for payment being:

- a. Rs.2 per share payable on application, to be received by 1st July 2016;
- b. Allotment to be made on 10th July 2016 and a further Rs.5 per share (including the premium) to be payable;
- c. The final call for the balance to be made, and the money received by 30th April 2017.

Applications were received for 3,55,000 shares and were dealt with as follows:

- i. Applicants for 5,000 shares received allotment in full;
- ii. Applicants for 30,000 shares received an allotment of one share for every two applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment;
- iii. Applicants for 3,20,000 shares received an allotment of one share for every four applied for; the money due on allotment was retained by the company, the excess being returned to the applicants; and
- iv. the money due on final call was received on the due date.

You are required these transaction (including cash items) in the Journal of JHP Ltd.

Question: 2

A company had an authorised capital of Rs.10,00,000 divided into 1,00,000 equity shares of Rs.10 each. It decided to issue 60,000 shares for subscription and received applications for 70,000 shares. It allotted 60,000 shares and rejected remaining applications. Up to 31-3-2017, it has demanded or called Rs.9 per share. All shareholders have duly paid the amount called, except one shareholder, holding 5,000 shares who has paid only Rs.7 per share.

Prepare a balance sheet assuming there are no other details.

Question: 3

A company invited applications for 10,000 equity shares of Rs.50 each payable on:

1. Application Rs.15;
2. Allotment Rs.20,
3. on first and final call Rs.15.

Applications are received for 10,000 shares and all the applicants are allotted the number of shares they have applied for and instalment money was duly received by the company.

Show Journal entries in the books of the company.

Question: 4

On 1st April 2017, A Ltd. issued 43,000 shares of Rs. 100 each payable as follows:

- Rs.20 on application;
- Rs.30 on allotment;
- Rs.25 on 1st October 2017; and
- Rs. 25 on 1st February 2018

By 20th May, 40,000 shares were applied for and all applications were accepted. Allotment was made on 1st June. All sums due on allotment were received on 15th July; those on 1st call was received on 20th October.

Journalise the transactions when accounts were closed on 31st March 2018.

Question: 5

Pant Ltd. invited applications for 50,000 equity shares at Rs.50 each, which are payable as on application Rs.20, on allotment Rs.10 and on first and final call Rs.20. The company received applications for 60,000 shares. The directors accepted application for 50,000 shares and rejected the rest.

Show Journal entries if company refunded the application money to rejected applicants and allotment money was received for 45,000 shares.

Question: 6

The Delhi Artware Ltd. issued 50,000 equity shares of Rs 100 each and 1,00,000 preference shares of Rs.100 each. The Share Capital was to be collected as under:

Particulars	Equity Shares Rs.	Preference Shares Rs.
On Application	25	20
On Allotment	20	30
First Call	30	20
Final Call	25	30

All these shares were subscribed. Final call was received on 42,000 equity shares and 88,000 preference shares.

Prepare the cash book and journalise the remaining transactions in the books of the company.

Question: 7

On 1st October 2017 Pioneer Equipment Limited received applications for 2,50,000 Equity Shares of Rs. 100 each to be issued at a premium of 25 per cent payable as:

On Application Rs.25
On Allotment Rs.75 (including premium)
Balance Amount on Shares As and when required

The shares were allotted by the Company on October 20, 2017 and the allotment money was duly received on October 31, 2017.

Record journal entries in the books of the company to record the transactions in connection with the issue of shares

Question: 8

JHP Limited is a company with an authorised share capital of Rs.10,00,000 in equity shares of Rs.10 each, of which 6,00,000 shares had been issued and fully paid on 30th June, 2016. The company proposed to make a further issue of 1,00,000 of these Rs.10 shares at a price of Rs.14 each, the arrangements for payment being:

- Rs.2 per share payable on application, to be received by 1st July 2016.
- Allotment to be made on 10th July 2016 and a further Rs.5 per share (including the premium) to be payable.
- The final call for the balance to be made, and the money received by 30th April 2017.

Applications were received for 3,55,000 shares and were dealt with as follows:

- Applicants for 5,000 shares received allotment in full

- ii. Applicants for 30,000 shares received an allotment of one share for every two applied for, no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment.
- iii. Applicants for 3,20,000 shares received an allotment of one share for every four applied for, the money due on allotment was retained by the company, the excess being returned to the applicants.
- iv. the money due on final call was received on the due date.
- You are required to record these transactions (including cash items) in the Journal of JHP Limited.

Question: 9

Shreyas Ltd. did not receive the first call on 10,000 equity shares @ Rs. 3 per share which was due on 1.7.2016. This amount was received on 1.4.2017.

Open Calls in arrears account and journalise the entries in the books of the company on 1.7.2016 and 1.4.2017. Also show an extract of Balance Sheet on 31.3.2017.

Question: 10

Rashmi Limited issued at par 1,00,000 Equity shares of Rs.10 each payable:

- Rs.2.50 on application;
- Rs.3 on allotment;
- Rs. 2 on first call and balance on the final call.

All the shares were fully subscribed. Mr. Nair who held 10,000 shares paid full remaining amount on first call itself. The final call which was made after 3 months from first call was fully paid except a shareholder having 1000 shares who paid his dues amount after 2 months along with interest on calls in arrears. Company also paid interest on calls in advance to Mr. Nair.

Give journal entries to record these transactions

Question: 11

A Ltd forfeited 30,000 equity shares of Rs.10 fully called-up, held by Mr. X for non-payment of final call @ Rs.4 each. However, he paid application money @ Rs.2 per share and allotment money @ Rs.4 per share. These shares were originally issued at par.

Give Journal Entry for the forfeiture

Question: 12

X Ltd forfeited 20,000 equity shares of Rs.10 each, Rs. 8 called-up, for non-payment of first call money @ Rs. 2 each. Application money @ Rs. 2 per share and allotment money @ Rs.4 per share have already been received by the company.

Give Journal Entry for the forfeiture (assume that all money due is transferred to Calls-in-Arrears Account).

Question: 13

X Ltd. forfeited 5,000 equity shares of Rs.100 each fully called-up which were issued at a premium of 20%.

Amount payable on shares were:- on application Rs.20; on allotment Rs.50 (including premium); on First and Final call Rs.50. Only application money was paid by the shareholders in respect of these shares.

Pass Journal Entries for the forfeiture.

Question: 14

Mr. Shami has applied for 1,000 shares of Company XYZ Ltd. paying application money @ Rs. 2 per share but has been allotted only 600 shares. The shares have a face value of Rs.10 and a premium of Rs. 2 per share, which are payable as: on Allotment- Rs.5 (including premium) and on final call Rs. 5. Now in case

Mr. Shami doesn't pay allotment money and final call and his shares are forfeited, then following entry will be passed on forfeiture:

Question: 15

Mr. Long who was the holder of 2,000 preference shares of Rs.100 each, on which Rs. 75 per share has been called up could not pay his dues on Allotment and First call each at Rs.25 per share. The Directors forfeited the above shares and reissued 1500 of such shares to Mr. Short at Rs. 65 per share paid-up as Rs.75 per share.

Give Journal Entries to record the above forfeiture and re-issue in the books of the company.

Question: 16

Beautiful Co. Ltd issued 30,000 equity shares of Rs.10 each payable as

- Rs.3 per share on Application,
- Rs.5 per share (including Rs.2 as premium) on Allotment and
- Rs.4 per share on Call.

All the shares were subscribed. Money due on all shares was fully received except from Ram, holding 500 shares, who failed to pay the Allotment and Call money and Shyam, holding 1,000 shares, who failed to pay the Call Money. All those 1,500 shares were forfeited. Of the shares forfeited, 1,250 shares (including whole of Ram's shares) were subsequently re-issued to Jadu as fully paid up at a discount of Rs.2 per share.

Pass the necessary entries in the Journal of the company to record the forfeiture and re-issue of the share. Also prepare the Balance Sheet of the company.

Question: 17

X Co. Ltd. was incorporated with an authorized share capital of 90,000 equity shares of Rs.10 each. The company purchased land and buildings from Y Co. Ltd for Rs.4,00,000 payable in fully paid-up shares of the company. The balance of the shares was issued to the public, which were fully subscribed and paid for.

You are required to pass Journal Entries and to prepare the Balance Sheet.

UNIT 3 : ACCOUNTING FOR BONUS ISSUE AND RIGHT ISSUE

Illustrations

Illustration – 1

Following items appear in the trial balance of Bharat Ltd. (listed company) as on 31st March, 20X1:

Particulars	Amount (Rs.)
40,000 Equity shares of Rs. 10 each	4,00,000
Capital Redemption Reserve	55,000
Securities Premium (collected in cash)	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Solution: Illustration 1

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Capital Redemption Reserve A/c	Dr.	55,000	
Securities Premium A/c	Dr.	30,000	
General Reserve A/c (b.f.)	Dr.	15,000	
To Bonus to Shareholders A/c			1,00,000
(Being Bonus issue of one share for every four shares held)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital A/c			1,00,000
(Being Bonus shares allotted or Capitalisation of profit)			

Working Note:

Number of Bonus shares to be issued- $(40,000 \text{ shares} / 4) \times 1 = 10,000 \text{ shares}$

Value of Bonus shares = 10,000 shares of ₹10 each = ₹1,00,000

Illustration – 2

Following is the extract of the Balance Sheet of Solid Ltd. as at 31st March, 20X1:

Particulars	Amount (Rs.)
Authorised capital:	
10,000 12% Preference shares of Rs. 10 each	1,00,000
1,00,000 Equity shares of Rs. 10 each	<u>10,00,000</u>
	<u>11,00,000</u>
Issued and Subscribed capital:	
8,000 12% Preference shares of Rs. 10 each fully paid	80,000

90,000 Equity shares of Rs. 10 each, Rs. 8 paid up	7,20,000
Reserves and Surplus:	
General reserve	1,60,000
Revaluation reserve	35,000
Securities premium (collected in cash)	20,000
Profit and Loss Account	2,05,000
Secured Loan:	
12% Debentures @ Rs. 100 each	5,00,000

On 1st April, 20X1 the Company has made final call @ Rs. 2 each on 90,000 equity shares. The call money was received by 20th April, 20X1.

Thereafter the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue if the company has passed necessary resolution at its general body meeting for increasing the authorized capital.

Solution: Illustration 2

Journal Entries in books of Solid Ltd.

Particulars		Dr. (₹)	Cr. (₹)
20X1			
April 1	Equity Share Final Call A/c	Dr.	1,80,000
	To Equity Share Capital A/c		1,80,000
	(Final call of ₹2 per share on 90,000 equity shares due as per Board's Resolution dated ...)		
April 20	Bank A/c	Dr.	1,80,000
	To Equity Share Final Call A/c		1,80,000
	(Being Final Call Amount Received)		
April 20	Securities Premium A/c	Dr.	20,000
	General Reserve A/c	Dr.	1,60,000
	Profit and Loss A/c (b.f.)	Dr.	45,000
	To Bonus to Shareholders A/c		2,25,000
	(Bonus issue @ 1 share for every 4 shares held by utilising various reserves as per Board's Resolution dated...)		
April 20	Bonus to Shareholders A/c	Dr.	2,25,000
	To Equity Share Capital A/c		2,25,000
	(Capitalisation of profit)		

Balance Sheet (Extract) as at 30th April, 20X1 (after bonus issue)

Particulars	Notes	Amount (₹)
I. Equity and Liabilities		
(1) Shareholders' funds		
(a) Share capital	1	12,05,000
(b) Reserves and Surplus	2	1,95,000
(2) Non-current liabilities		
(a) Long-term borrowings	3	5,00,000

		19,00,000
--	--	-----------

Notes to Accounts

No		₹	₹
1	Share Capital		
	Authorised share capital		
	1,12,500 Equity shares of ₹10 each	11,25,000	
	10,000 12% Preference shares of ₹10 each	1,00,000	12,25,000
	Issued, subscribed and fully paid share capital		
	1,12,500 Equity shares of ₹10 each, fully paid (Out of above, 22,500 equity shares @ ₹10 each were issued by way of bonus)	11,25,000	
	8,000 12% Preference shares of ₹10 each	80,000	12,05,000
2	Reserves and Surplus		
	General Reserve	1,60,000	
	Less : Used for Bonus	(1,60,000)	Nil
	Revaluation Reserve		35,000
	Securities Premium	20,000	
	Less: Utilised for bonus	(20,000)	Nil
	Profit & Loss Account	2,05,000	
	Less: Utilised for bonus issue	(45,000)	1,60,000
	Total		1,95,000
3	Long-term borrowings		
	Secured		
	12% Debentures @ ₹100 each		5,00,000

Illustration - 3

A company offers new shares of Rs. 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is Rs. 150. Calculate the value of a right. What should be the ex-right market price of a share?

Solution: Illustration 3

Cum Right (Market) Price = ₹150

Issue Price = 100 + 25% of 100

$$= 100 + 25 = ₹125$$

Ratio = 1:4

$$\text{Theoretical Ex - Right Price} = \frac{4 \times ₹150 + 1 \times ₹125}{4+1}$$

$$= \frac{₹725}{5} = ₹145$$

Value of Right = Market Price - Theoretical Ex - Right Price

$$= ₹150 - ₹145 = ₹5$$

*This Method is Recommended for Exams

OR

$$\begin{aligned}\text{Value of Right} &= \frac{\text{Theoretical Ex - Right Price} - \text{Issue Price}}{\text{No. of Shares Held}} \\ &= \frac{₹145 - ₹125}{4} = ₹5\end{aligned}$$

OR

$$\begin{aligned}\text{Value of Right} &= \frac{\text{Market Price} - \text{Issue Price}}{\text{No. of Shares Held (After Rights)}} \\ &= \frac{₹150 - ₹125}{5} = ₹5\end{aligned}$$

Illustration 4

Following is the extract of the Balance Sheet of Manoj Ltd. as at 31st March, 20X1

	Rs.
Authorised capital:	
30,000 12% Preference shares of Rs. 10 each	3,00,000
4,00,000 Equity shares of Rs. 10 each	<u>40,00,000</u>
	<u>43,00,000</u>
Issued and Subscribed capital:	
24,000 12% Preference shares of Rs. 10 each fully paid	2,40,000
2,70,000 Equity shares of Rs. 10 each, Rs. 8 paid up	21,60,000
Reserves and surplus:	
General Reserve	3,60,000
Capital Redemption Reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and Loss Account	6,00,000

On 1st April, 20X1, the Company has made final call @ Rs. 2 each on 2,70,000 equity shares. The call money was received by 20th April, 20X1. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the relevant extract of the balance sheet as on 30th April, 20X1 after bonus issue.

Solution: Illustration 4

Journal Entries in the books of Manoj Ltd.

Particulars		Dr. (₹)	Cr. (₹)
20X1			
April 1	Equity Share Final Call A/c	Dr. 5,40,000	
	To Equity Share Capital A/c		5,40,000
	(Final call of ₹2 per share on 2,70,000 equity shares due as per Board's Resolution dated ...)		
April 20	Bank A/c	Dr. 1,80,000	
	To Equity Share Final Call A/c		1,80,000
	(Being Final Call Amount Received)		
April 20	Securities Premium A/c	Dr. 75,000	
	Capital Redemption Reserve A/c	Dr. 1,20,000	

	General Reserve A/c	Dr.	3,60,000	
	Profit and Loss A/c (b.f.)	Dr.	1,20,000	
	To Bonus to Shareholders A/c (Bonus issue @ 1 share for every 4 shares held by utilising various reserves as per Board's Resolution dated...)			6,75,000
April 20	Bonus to Shareholders A/c	Dr.	6,75,000	
	To Equity Share Capital A/c (Capitalisation of profit)			6,75,000

Extract of Balance Sheet as at 30th April, 20X1 (after bonus issue)

Particulars	Amount (₹)
Authorized Capital	
30,000 12% Preference shares of ₹10 each	3,00,000
4,00,000 Equity shares of ₹10 each	40,00,000
Issued and subscribed capital	
24,000 12% Preference shares of ₹10 each, fully paid	2,40,000
3,37,500 Equity shares of ₹10 each, fully paid (Out of the above, 67,500 equity shares @ ₹10 each were issued by way of bonus shares)	33,75,000
Reserves and surplus	
Profit and Loss Account	4,80,000

Value of right share = Cum-right value of the share – Ex-right value of the share (working Note)

$$= ₹190 - ₹176 = ₹14 \text{ per share}$$

Working Note:

= (Cum-right value of the existing shares + Rights shares x Issue Price) / (Existing No. of shares + No. of right shares) = (₹190 X 4 Shares + ₹120 X 1 Share) / (4 + 1) Shares

$$= ₹880 / 5 \text{ shares} = ₹176 \text{ per share}$$

UNIT 4 - Buy-Back Of Securities

1. Illustrations

1. Illustration

M Ltd. furnishes the following summarized balance sheet as at 31st March 2011.

Liabilities	Rs. in (‘000)	Rs. in (‘000)
Equity and liabilities		
Share capital:		
Authorized capital:		5,000
Issued and subscribed capital		
3,00,000 equity shares of Rs.10 each fully paid up	3,000	
20,000 9% preference shares of Rs.100 each (issued two months back for the purpose of buy back)	2,000	5,000
Reserves and surplus:		
Capital reserves	10	
Revenue reserves	4,000	
Securities premium	500	
Profit and loss account	1,800	6310
Non- current liabilities – 10% debentures		400
Current liabilities and provisions		40
Total		11,750
Assets	Rs. in (‘000)	Rs. in (‘000)
Fixed Assets Cost	3,000	
Less: Provision for depreciation	250	2,750
Non-current investments at cost		5,000
Current assets, loans and advances (including cash and bank balances)		4,000
Total		11,750

The company passed a resolution to buy back 20% of its equity capital @Rs.15 per shares. For this purpose, it sold its investments of Rs.30 lakhs for Rs.25 lakhs. You are required to pass necessary journal entries. [Source – ICAI]

Solution 1

Journal entries in the books of M Ltd

Date	Particulars	Dr ₹ (‘000)	Cr ₹ (‘000)
31 st March 2011	Bank A/c Dr Profit and Loss A/c Dr To Investment A/c (Being investment sold at a loss)	25,00 5,00	30,00
	Equity share capital A/c (60,000 x ₹10) Dr Premium on buy-back A/c Dr To Bank A/c [Note : 1] (Being buy-back of 60,000 shares at ₹50 each)	6,00 3,00	9,00

	OR		
	Equity share capital A/c (60,000 x ₹10) Dr	6,00	
	Premium on buyback A/c Dr	3,00	
	To Equity share buy-back A/c		9,00
	(Being amount due on buy-back of equity shares)		
	Equity share buy-back A/c Dr	9,00	
	To Bank A/c		9,00
	(Being Payment made for buy-back of equity shares)		
	Securities Premium A/c Dr	3,00	
	To premium on buy-back A/c		3,00
	(Being premium on buy-back written off against securities premium)		

Note: 1 No. of shares bought back

1	Total No. of shares	3,00,000
2	% of buy-back	20%
3	No. of bought back (1 x 2)	60,000
4	Buy-back price	₹15 per share
5	Total amount paid (3 x 4)	9,00,000

Note: 2

1	Face value of shares bought back	600
2	Face value of shares issued for buy-back	2,000
3	Shortfall	0
4	Capital Redemption Reserve	No

2. Illustration

Anu Ltd. (a non-listed company) furnishes you with the following summarized balance sheet as on 31st March 2011.

	Rs. (in crores)	Rs. (in crores)
Sources of funds		
Share capital:		
Authorised		100
Issued:		
12% redeemable shares of Rs. 100 each fully paid	75	
Equity shares of Rs.10 each fully paid	25	100
Reserves and surplus:		
Capital reserves	15	
Securities premium	25	
Revenue reserves	260	300
Total		400
Application of Funds		
Fixed assets: cost	100	
Less: Provision for depreciation	(100)	Nil
Non-current investments at cost (Market value Rs 400 Cr.)		100

Current assets	340	
Less: Current liabilities (Trade Payables)	(40)	300
Total		400

The company redeemed preference shares on 1st April 2011. It also brought back 50 lakhs equity shares of Rs. 10 each at Rs.50 per shares. The payment for the above were made out of the huge bank balances, which appeared as a part of current assets. The company redeemed preference shares on 1st April 2011. It also brought back 50 lakhs equity shares of Rs. 10 each at Rs.50 per shares. The payment for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

- pass journal entries to record the above.
- prepare balance sheet as at 1.04.2011 [Source ICAI]

Solution 2

(i) Journal entries in the books of Anu Ltd

Date	Particulars	Dr ₹ (Crores)	Cr ₹ (Crores)
31 st March 2011	12% Preference share capital A/c Dr To preference shareholders A/c (Being Preference shares due for redemption)	75	75
"	Preference shareholders A/c Dr To Bank A/c (Being preference shareholders paid)	75	75
"	Revenue reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Preference share redeemed) [Note:1]	75	75
31 st March 2011	Equity share capital A/c (50 lakhs x ₹10) Dr Premium on buy-back A/c (50 lakhs x ₹40) Dr To share buy-back A/c (50 lakhs x ₹50) (Being Equity shares due for buy-back)	5 20	25
"	Share buy-back A/c Dr To Bank A/c (Being amount paid for equity share bought back)	25	25
"	Securities premium A/c Dr To Premium on buy-back A/c (Being premium on shares bought back written off against securities premium)	20	20
"	Revenue reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Equity shares bought back by debiting revenue reserve) [Note :2]	5	5

(ii) Balance sheet of Anu Ltd as at 1.4.2011

Particulars	Notes	₹ (in crores)
-------------	-------	------------------

1	A	Equity and Liabilities		
	B	Shareholder's funds		
		Share capital	1	20
2	A	Reserves and Surplus	2	280
	B	Current liabilities		
		Trade Payables		40
		Total		340
		Assets		
		Non-current assets		
1	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
		Current assets		
2	A	Trade receivables		140
	B	Cash and Cash equivalents	5	100
		Total		340

Notes to accounts

S.no	Particulars		₹ (in crores)
1	Share Capital		
	Authorised, issued and subscribed share capital: 200 lakhs Equity shares of ₹10 each fully paid		20
	Total		20
2	Reserves and Surplus		
	Capital reserves		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilisation for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3	Property, Plant and Equipment		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4	Non-Current Investments		
	Non-Current Investments at cost (Market value ₹400 Crores)		100
5	Cash and Cash Equivalents		
	Cash and Cash Equivalents as on 31.3.2011		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

Note: 1

₹ (crores)

1	Face value of preference shares redeemed	75
2	Face value of shares issued for buy-back	0
3	Capital Redemption Reserve to be created (1-2)	75

Note: 2

₹(crores)

1	Face value of shares bought back	5
2	Face value of shares issued for buy-back	0
3	Capital Redemption Reserve to be created	5

3. Illustration

Dee Ltd. (a non-listed company) furnishes the following summarized balance sheet as at 31st March 2011.

Liabilities	Rs. ('000)	Rs. ('000)
Share capital:		30,00
Authorised capital		
Issued and subscribed capital:	25,00	
2,50,000 equity shares of Rs.10 each fully paid up 2,000, 10%	2,00	
preference shares of Rs.100 each		
(issued two months back for the purpose of buy back)		
Reserves and surplus:	10,00	
Capital reserves		
Revenue reserves	30,00	
Securities premium	22,00	97,00
Profit and loss account	35,00	
Current liabilities and provision		14,00
Total		1,38,00
Assets		
Fixed assets		93,00
Investments		30,00
Current assets, loans and advances (including cash and bank balances)		15,00
Total		1,38,00

The company passed a resolution to buy back 20% of its equity capital @ Rs. 50 per shares. For this purpose, it sold all of its investment for Rs.22, 00,000.

You are required to pass necessary journal entries and prepare the balance sheet.

Solution 3**Journal entries in the books of M Ltd**

Date	Particulars	Dr ₹ ('000)	Cr ₹ ('000)
31 st March 2011	Bank A/c Dr Profit and Loss A/c Dr To Investment A/c (Being investment sold at a loss)	22,00 8,00	30,00
"	Equity share capital A/c Dr Premium on buyback A/c Dr To Equity share buy-back A/c (Being amount due on buy-back of equity shares)	5,00 20,00	25,00
"	Equity share buy-back A/c Dr	25,00	

	To Bank A/c (Being Payment made for buy-back of equity shares)		25,00
"	Securities Premium A/c Dr To premium on buy-back A/c (Being premium on buy-back written off against securities premium)	20,00	20,00
"	Revenue reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Equity shares bought back by debiting revenue reserve)	3,00	3,00

**Balance Sheet of Dee Limited as at 1st April, 2011
(After buy-back of shares)**

Particulars		Notes	₹ (‘000)
1	Equity and Liabilities		
	Shareholder's funds		
	A Share capital	1	22,00
	Reserves & Surplus	2	69,00
2	Non-Current liabilities		
	A Long-term borrowings		
3	Current liabilities & Provision		14,00
	Total		1,05,00
	Assets		
	Non-current assets		
1	A Property, plant and equipment		93,00
	Investments		
2	Current assets		12,00
	Total		1,05,00

Notes to accounts

S.no	Particulars		₹ (‘000)
1	Share Capital		
	Authorised, issued and subscribed share capital:		
	2,50,000 Equity shares of ₹10 each fully paid		20,00
	2,000, 19% Preference shares of ₹100 each (issued two months back for the purpose of buy-back)		2,00
2	Total		22,00
	Reserves and Surplus		
	Capital reserves		
	Capital redemption reserve		10,00
	Securities premium		3,00
	Less: Utilisation for buy-back of shares	22,00	
	Revenue Reserve	(20,00)	2,00

	Less: transfer to Capital redemption reserve	30,00	
	Profit and loss A/c	(3,00)	27,00
	Less: Loss on investment	35,00	
		(8,00)	27,00
	Total		69,00

4. Illustration

Perrotte Ltd. (a non- listed company) has the following capital structure as on 31.03.2011.

	Particulars	Rs. (in crores)	Rs. (in crores)
(1)	Equity shares capital (shares of Rs.10 each fully paid)		330
(2)	Reserves and surplus		
	General reserves	240	—
	Securities premium account	90	—
	Profit and loss account	90	—
	Infrastructure development reserves	180	600
(3)	Loan funds		1,800

Shareholders of Perrotte Ltd. on the recommendation of their Board of Directors, have appeared on 12.09.2011 a proposal to buy back the maximum permissible number of equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs.25 per shares and in order to induce the existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% over market. You are also informed that the infrastructure development reserves are created to satisfy income-tax Act requirements.

You are required to compute the maximum number of shares that can be brought back in the light of the above information and also under a situation where the loan funds of the company were Rs.1, 200 crores or Rs. 1,500 crores. Assuming that the buyback is completed by 09.12.2011, show the accounting entries in the company's books in each situation.

Solution 4

Journal entries in the books of Perrotte Ltd

Date	Particulars	Dr ₹ ('000)	Cr ₹ ('000)
31 st March 2011	Equity share capital A/c Dr Premium on buyback A/c Dr To Equity share buy-back A/c (Being amount due on buy-back of 3.75 crores equity shares of ₹10 each @ ₹30 per share)	37.5 75	112.5
"	Equity share buy-back A/c Dr To Bank A/c (Being Payment made for buy-back of equity shares)	112.5	112.5
"	Securities premium A/c Dr To Premium on buy-back A/c	75	75

	(Being premium on shares bought back written off against securities premium)		
"	General reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Equity shares bought back by debiting General reserve)	37.5	37.5

Working Notes:

1. Shares Outstanding Test

	Particulars	
A	Paid up share capital	₹ 330 Crores
B	Face value per share	₹ 10
C	No. of shares(A/B)	33 Crores Shares
D	25% of Shares outstanding	8.25 Crore Shares

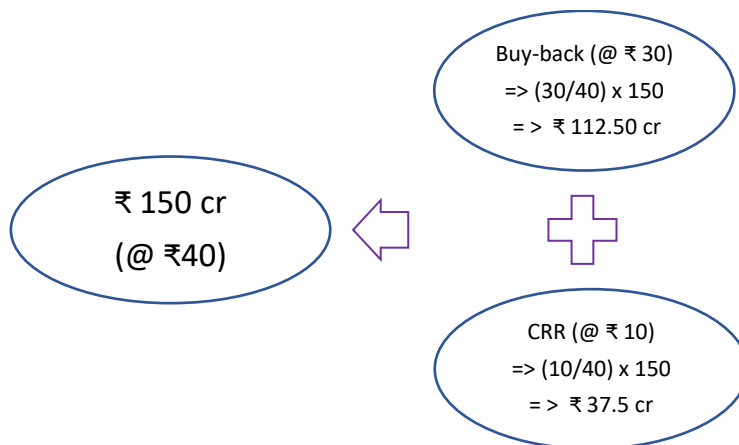
2. Resource Test

	Particulars	₹
A	Eq share capital (Paid up)	330 Crores
B	Preference share capital (Paid up)	0
C	Free Reserves : General Reserves -240cr Profit and loss A/c - 90cr Securities Premium - 90cr	420 Crores
D	Shareholders funds (A+B+C)	750 Crores
E	Max. Resources that we can use for buy-back ⇒ 25% of (D)	187.5 Crores
F	Buy-back price (₹25 + 20%)	30
G	Max. No. of Shares can bought back ⇒ (E/F) = 187.5 / 30	6.25 Crore shares

3. Post Buy-back Debt Equity Ratio Test

	Particulars	When Loan fund is		
		₹ 1,800 Crores	₹ 1,200 Crores	₹ 1,500 Crores
A	Minimum Eq Shares (Post Buy-back)	900 Cr.	600 Cr.	750 Cr.
B	Equity Before Buy-back (Refer Working Note : 2)	750 Cr.	750 Cr.	750 Cr.
C	Is Buy-back possible?	No [on account of inadequate equity]	Yes	No [on account of inadequate equity]

⇒ Reduction permissible from shareholders funds on account of buy back = ₹150 cr
(including CRR)



⇒ Max. No. of shares can be bought-back = $112.5/30 = 3.75$ Crores

Summary

	Particulars	When Loan fund is		
		₹ 1,800 Crores	₹ 1,200 Crores	₹ 1,500 Crores
A	Shares Outstanding Test	8.25 cr	8.25 cr	8.25 cr
B	Resource Test	6.25 cr	6.25 cr	6.25 cr
C	Post Buy-back Debt Equity Test	0	3.75 cr	0
D	Maximum No. of shares that can be bought back (Least of A,B,C)	0	3.75 cr	0

UNIT 5 - ACCOUNTING FOR EMPLOYEE STOCK OPTION PLANS

1. Illustration

A Company has its share capital divided into shares of Rs.10 each. On 1st April, 20X1 it granted 10,000 employees' stock options at Rs 40, when the market price was Rs.130. The options were to be exercised between 15th March, 20X2 and 31st March, 20X2. The employees exercised their options for 9,500 shares only; the remaining options lapsed. The company closes its books on 31st March every year.

Show Journal Entries

Solution 1

Journal entries

Date	Particulars	Dr ₹	Cr ₹
15 th March 20X2 to 31 st March 20X2	Bank A/c (9,500 x 40) Dr Employee compensation expenses A/c [9,500 x (130-40)] Dr To Equity share capital A/c (9500 x 10) To Securities premium A/c [9,500 x (130-10)] (Being allotment of shares for 9500 options, ₹ 40 exercise price, ₹ 130 issue price)	3,80,000 8,55,000	95,000 11,40,000
31 st March 20X2	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being expenses charged off to Profit and Loss A/c)	8,55,000	8,55,000

2. Illustration

ABC Ltd. grants 1,000 employees stock options on 1.4.20X0 at Rs 40, when the market price is Rs. 160. The vesting period is 2½ years and the maximum exercise period is one year .300 unvested options lapse on 1.5.20X2. 600 options are exercised on 30.6.20X3. 100 vested options lapses at the end of the exercise period.

Show Journal Entries.

Solution 2

Journal entries

Date	Particulars	Dr ₹	Cr ₹
31 st March 20X1	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 1 recognized) [Note:1]	48,000	48,000
31 st March 20X1	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 1 expenses charged off to Profit and Loss A/c)	48,000	48,000

31st March 20X2	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 2 recognized) [Note:2]	48,000	48,000
31st March 20X2	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 2 expenses charged off to Profit and Loss A/c)	48,000	48,000
31st March 20X2	Employee stock option outstanding A/c Dr To General reserves A/c (Being Employee stock option outstanding A/c reduced) [Note:3]	12,000	12,000
31st March 20X3	Bank A/c (40 x 600) Dr Employee stock option outstanding A/c (120 X 600)Dr To Equity share capital A/c (10 X 600) To Securities premium A/c (150 X 600) (Being allotment of share for 600 options vested & exercised)	24,000 72,000	6,000 90,000
31st March 20X3	Employee stock option outstanding A/c Dr To General reserves A/c (Being vested option lapsed transferred to General reserves)	12,000	12,000

Note: 1 [31/3/20X1]

No. of options	1,000
Cost per option (160-40)	120
Total cost for 2.5 years (1000 x 120)	1,20,000
Cost for 1st year	=1,20,000x1/2.5 =48,000

Note: 2 [31/3/20X2]

No. of options	1,000
Cost per option (160-40)	120
Total cost for 2.5 years (1000 x 120)	1,20,000
Cost upto 31/3/20X2	=1,20,000x 2/2.5 =96,000
Less:Expenses charged off upto end of previous period	=(48,000)
Current period cost	48,000

Note: 3 [30/09/20X3] or [31/3/20X3]

No. of options	700
Cost per option (160-40)	120
Total cost for 2.5 years (1000 x 120)	84,000
Cost already incurred	96,000

=> **Extra cost of ₹ 12,000 should be reduced from Employee stock option outstanding A/c.**

3. Illustration

Arihant Limited has its share capital divided into equity shares of Rs.10 each. On 1- 10-20X1, it granted 20,000 employees' stock options at Rs.50 per share, when the market price was Rs. 120 per share. The options were to be exercised between 10th December, 20X1 and 31st March, 20X2. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal Entries (with narration) as would appear in the books of the company upto 31st March, 20X2.

Solution 3

Journal entries

Date	Particulars	Dr ₹	Cr ₹
15 th December 20X1 to 31 st March 20X2	Bank A/c (16,000 x 50) Dr Employee compensation expenses A/c [16,000 x (120-50)] Dr To Equity share capital A/c (16,000 x 10) To Securities premium A/c [16,000 x (120-10)] (Being allotment of shares for 16,000 options, ₹ 50 exercise price, ₹ 120 issue price)	8,00,000 11,20,000	1,60,000 17,60,000
31 st March 20X2	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being expenses charged off to Profit and Loss A/c)	11,20,000	11,20,000

4. Illustration

Ajanta grants 120 share options to each of its 460 employees. Each grant is conditional on the employee working for Ajanta over the next three years. Ajanta has estimated that the fair value of each share option is Rs.12. Ajanta estimates that 25% of employees will leave during the three-year period and so forfeit their rights to the share options. Everything turns out exactly as expected.

Required:

Calculate the amounts to be recognized as expense during the vesting period

Solution 4

Year	Calculations	Expenses for period	Cumulative Expenses
		₹	₹
1	55,200 options x 75% x ₹12 x 1/3 years	1,65,600	1,65,600
2	(55,200 options x 75% x ₹12 x 2/3 years) - ₹ 1,65,600	1,65,600	3,31,200
3	(55,200 options x 75% x ₹12 x 3/3 years) - ₹ 3,31,200	1,65,600	4,96,800

5. Illustration

Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.20X1 for Rs.20, depending upon the employees at the time of vesting of options. Options would be exercisable within a year it is vested. The market price of the share is Rs.50 each.

These options will vest at the end of year 1 if the earning of Choice Ltd. is 16%, or it will vest at the end of the year 2 if the average earning of two years is 13%, or lastly it will vest at the end of the third year if the average earning of 3 years will be 10%. 5,000 unvested options lapsed on 31.3.20X2. 4,000 unvested options lapsed on 31.3.20X3 and finally 3,500 unvested options lapsed on 31.3.20X4.

Following is the earning of Choice Ltd:

Year Ended on	Earning (in %)
31.3.20X2	14%
31.3.20X3	10%
31.3.20X4	7%

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass journal entries for the above.

Solution 5

Journal entries

Date	Particulars	Dr ₹	Cr ₹
31 st March 20X2	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 1 recognized and amortised over vesting period) [Note:1]	14,25,000	14,25,000
31 st March 20X2	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 1 expenses charged off to P&L A/c)	14,25,000	14,25,000
31 st March 20X3	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 2 recognized and amortised over vesting period) [Note:2]	3,95,000	3,95,000
31 st March 20X3	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 2 expenses charged off to Profit & Loss A/c)	3,95,000	3,95,000
31 st March 20X3	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 3 recognized and amortised over vesting period) [Note:3]	8,05,000	8,05,000
31 st March 20X3	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 3 expenses charged off to Profit & Loss A/c)	8,05,000	8,05,000

31st March 20X4	Bank A/c (85,000x20) Dr Employee stock option outstanding A/c (85,000x30) Dr To Equity share capital A/c (85,000 X 10) To Securities premium A/c (85,000X40) (Being allotment of share for 85,000 options vested & exercised) [Note:4]	17,00,000 25,50,000	8,50,000 34,00,000
31st March 2022	Employee stock option outstanding A/c Dr To General reserves A/c (Being ESOP outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to capital reserves A/c)	75,000	75,000

Note: 1 [31/3/20X2]

1	Total No. of employees as on 1/4/20X2	1,000
2	Options per employee	100
3	Total no. of options (1x2)	1,00,000
4	No. of unvested options lapsed	5,000
5	Best estimate of options that would be vested (3-5)	95,000
6	Cost per option (50-30)	30
7	Total cost (5x6)	28,50,000
8	Vesting period : As earnings % of 1 st year is 14%, which is not $\geq 16\%$. Options cannot be vested on 31/3/20X2) ⇒ It is assumed that they would be vested on 31/3/20X3 (i.e. 2 years of vesting)	
9	Total cost should be divided over 2 years ⇒ Cost for 31/3/20X2	=28,50,000 x $\frac{1}{2}$ = 14,25,000

Note: 2 [31/3/20X3]

1	No. of options as on 31/3/20X2	95,000
2	Less: Unvested option lapsed as on 31/3/20X3	4,000
3	No. of options expected to be vested (1-2)	91,000
4	Cost per option	30
5	Total cost (3x4)	27,30,000
6	Actual earning over 2 years [refer Note : 1]	12%
7	AS (6) is not $\geq 13\%$ options will not be vested as on 31/3/20X3	-
8	It is assumed that they would be vested on 31/3/20X4 (i.e. 3 years of vesting)	-
9	Cost to be charged off in 31/3/20X3	=[(27,30,000x2/3)-14,25,000] =3,95,000

Note: 3 [31/3/20X4]

1	No. of options as on 31/3/20X3	91,000
2	Less: Unvested option lapsed as on 31/3/20X4	3,500

3	No. of options expected to be vested (1-2)	87,500
4	Cost per option	30
5	Total cost (3x4)	=26,25,000
6	Actual average earning over 3 years	10.33%
7	AS (6) is >10% options will be vested as on 31/3/20X4 => Total cost should be charged off to over 3 years as nesting condition is met .	-
8	Cost to be charged off in 31/3/20X3	=26,25,000-14,25,000- 3,95,000 =8,05,000

Note: 4 Exercise period

1	No. of options Vested	87,500
2	No. of options exercised (850 employees x 100)	85,000
3	Vested options which lapsed (1-2)	2,500

6. Illustration

P Ltd. granted option for 8,000 equity shares of nominal value of Rs.10 on 1st October, 20X0 at Rs. 80 when the market price was Rs. 170. The vesting period is 4 1/2 years, 4,000 unvested options lapsed on 1st December, 20X2, 3,000 options were exercised on 30th September, 20X5 and 1,000 vested options lapsed at the end of the exercise period. Pass Journal Entries for above transactions

Solution 6

Journal entries

Date	Particulars	Dr ₹	Cr ₹
31 st March 20X1	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 1 recognized and amortised over vesting period) [Note:1]	80,000	80,000
31 st March 20X1	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 1 expenses charged off to P&L A/c)	80,000	80,000
31 st March 20X2	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 2 recognized and amortised over vesting period) [Note:2]	1,60,000	1,60,000
31 st March 20X2	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 2 expenses charged off to Profit and Loss A/c)	1,60,000	1,60,000
31 st March 20X3	Employee stock option outstanding A/c Dr To General reserves A/c (Being Accumulated cost outstanding on unvested % lapsed options- 4,000, transferred to General reserves A/c) [Refer guidance note]	1,20,000	1,20,000

31st March 20X3	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 3 recognized and amortised over vesting period) [Note:3]	80,000	80,000
31st March 20X3	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 3 expenses charged off to Profit and Loss A/c)	80,000	80,000
31st March 20X4	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 4 recognized and amortised over vesting period) [Note:4]	80,000	80,000
31st March 20X4	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 4 expenses charged off to Profit and Loss A/c)	80,000	80,000
31st March 20X5	Employee compensation expenses A/c Dr To Employee stock option outstanding A/c (Being expenses for year 3 recognized and amortised over vesting period) [Note:5]	80,000	80,000
31st March 20X5	Profit and Loss A/c Dr To Employee compensation expenses A/c (Being year 4 expenses charged off to Profit and Loss A/c)	80,000	80,000
31st September 20X5	Bank A/c (3,000x80) Dr Employee stock option outstanding A/c (3,000x90) Dr To Equity share capital A/c (3,000x10) To Securities premium A/c (3,000x160) (Being allotment of share for 3,000 options vested & exercised)	2,40,000 2,70,000	30,000 4,80,000
31st September 20X5	Employee stock option outstanding A/c Dr To General reserves A/c (Being no liability is required to be transferred) [Note:6]	90,000	90,000

- Note: 1** (8,000 options x ₹ 90)/4.5 years] x 0.5 = ₹ 80,000
Note: 2 (8,000 options x ₹ 90)/4.5 years] x 1 = ₹ 1,60,000
Note: 3 (4,000 options x ₹ 90)/4.5 years] x 1 = ₹ 80,000
Note: 4 (4,000 options x ₹ 90)/4.5 years] x 1 = ₹ 80,000
Note: 5 (4,000 options x ₹ 90)/4.5 years] x 1 = ₹ 80,000
Note: 6 1,000 options x ₹ 90

Guidance Note:

Liability created but no longer required related to lapsed options has to be credited general reserves

Alternatively,

Journal entries to be passed at the year ended 31/3/20X3

31st September 20X5	Employee stock option outstanding A/c Dr To General reserves A/c (Being excess liability ,after considering the Year 3 liability to be transferred to P&L , Transferred to General reserves)	40,000	40,000
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UNIT 6 - REDEMPTION OF DEBENTURES

Illustrations

Illustration – 1

X Ltd. issued 1,00,000; 9% Debentures of Rs.50 each at a premium of 10% on 30th June, 2019 redeemable on 31st March 2021. The issue was fully subscribed. The Company decided to create DRR on 31st March, 2020 and invest in Fixed Deposit Earnings interest @ 10% p.a. on 1st April 2020 to meet the legal requirement. Tax was deducted at source (TDS) by bank @ 10%.

Pass journal entries for issue and redemption of debentures along with interest on investment.

Solution: Illustration 1

Date	Particulars		Dr. (₹)	Cr. (₹)
30-6-x1	Bank A/c To Debenture Application A/c	Dr.	55,00,000	55,00,000
30-6-20x1	Debenture Application A/c To 9% Debenture A/c To Securities Premium A/c (Being Allotment of Debentures)	Dr.	55,00,000	50,00,000 5,00,000
31-3-x2	Profit & Loss A/c To Debenture Redemption Reserve A/c (Being Creation of DRR as per the statute)	Dr.	5,00,000	5,00,000
31-3-x2	Interest on Debenture A/c To Bank A/c (1,00,000 × 50% × 9% × 9/12) (Being Interest on Debentures paid)	Dr.	3,37,500	3,37,500
31-3-x2	Profit & Loss A/c To Interest on Debenture A/c	Dr.	3,37,500	3,37,500
1-4-x2	DRR Investment A/c To Bank (Being Creation of DRR Investment)	Dr.	7,50,000	7,50,000
31-3-x3	Bank A/c To DRR Investment A/c To Interest on DRR investment A/c (Being Redemption of DRR investment)	Dr.	8,25,000	7,50,000 75,000
31-3-x3	Interest on DRR Investment A/c To Profit & Loss A/c (Interest Received on DRR Investment Transferred to P&L)	Dr.	75,000	75,000
31-3-x3	9% Debentures A/c To Debenture Holder A/c	Dr.	50,00,000	50,00,000
31-3-x3	Debenture Holder A/c To Bank	Dr.	50,00,000	50,00,000
31-3-x3	DRR A/c To General Reserve (Being Balance on DRR transferred to General Reserve)	Dr.	5,00,000	5,00,000

Illustration - 2

On January 1, Rama Ltd., had 500 Debentures of Rs.100 each outstanding in its books carrying interest at 6% per annum. DRR balance is standing in books at

12,500/-. In accordance with the powers in the deed, the directors acquired debentures from the open market for immediate cancellation as follows:

March 1 Rs.5,000 at 98.00/- (cum interest)

Aug. 1 Rs. 10,000 at 100.25/- (cum interest)

Dec. 15 Rs. 2,500 at 98.50/- (ex-interest)

Debenture interest is payable half-yearly, on 30th June and 31st Dec.

Show ledger accounts of Debenture and Debenture interest for the first year, ignoring income-tax.

Solution: Illustration 2

Working Note:

Date	Face Value	Purchase Price (₹)	Amount Paid (₹)	Interest	Ex-Interest
Mar -1	5,000	98	4,900 (Cum)	50 (5,000 × 6% × 2/12)	4,850
Aug - 1	10,000	100.25	10,025 (Cum)	50 (10,000 × 6% × 1/12)	9,975
Dec - 15	2,500	98.5	2531.25	68.75 (2,500 × 6% × 5.5/12)	2,462.5

6% Debentures (1st Half)

Date	Particulars	Debit ₹	Date	Particulars	Credit ₹
1 st Mar	To Bank	4,850	Jan. 1	By Balance b/d	50,000
1 st Mar	To Profit on Cancellation	150			
30 th June	To Balance c/d	45,000			
		50,000			50,000

Interest on Debentures (1st Half)

Date	Particulars	Debit ₹	Date	Particulars	Credit ₹
1 st Mar	To Bank	50	30 th June	By Profit and Loss	1,400
30 June	To Bank A/c	1,350			
		1,400			1,400

6% Debentures (2nd Half)

Date	Particulars	Debit ₹	Date	Particulars	Credit ₹
1 st Aug	To Bank	9,975	Aug. 1	By Balance b/d	45,000
1 st Aug	To Profit on Cancellation	25			
15 th Dec	To Bank	2,462.5			
15 th Dec	To Profit on Cancellation	37.5			
31 st Dec	To Balance c/d	32,500			
		45,000			45,000

Interest on Debentures (2nd Half)

Date	Particulars	Debit ₹	Date	Particulars	Credit ₹
1 st Aug	To Bank A/c	50	30 th June	By Profit and Loss	1093.75
15 th Dec	To Bank A/c	68.75			
31 st Dec	To Bank A/c	975			
		1093.75			1093.75

Illustration - 3

The following balances appeared in the books of Paradise Ltd as on 1-4-20X1:

1. 12 % Debentures Rs. 7,50,000
2. Balance of DRR Rs. 1,00,000
3. DRR Investment 1,12,500 represented by 10% 1,125 Secured Bonds of the Government of India of Rs. 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-20X2, balance at bank was Rs. 7,50,000 before receipt of interest. The investment was realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 20X2:

1. Debentures Account
2. DRR Account
3. DRR Investment Account
4. Bank Account

Debenture Holders Account.

Solution: Illustration 3

12% Debenture Account

Date	Particulars	₹	Date	Particulars	₹
31-03-X2	To Debenture Holders A/c	7,50,000	1-4-X1	By Balance b/d	7,50,000
		7,50,000			7,50,000

DRR Account

Date	Particulars	₹	Date	Particulars	₹
			1-4-X1	By Balance b/d	25,000
31-03-X2	To General reserve A/c	75,000	1-4-X1	By Profit & Loss A/c (75,000 - 25,000) WN1	50,000
		75,000			75,000

DRR Investment Account (10% GOI Bonds)

Date	Particulars	₹	Date	Particulars	₹
------	-------------	---	------	-------------	---

1-4-X1	To Balance b/d	1,12,500	31-03-X2	By Bank	1,12,500
		1,12,500			1,12,500

Bank Account

Date	Particulars	₹	Date	Particulars	₹
31-03-X2	To Balance b/d	7,50,000	31-03-X2	By Debenture holders A/c	8,25,000
31-03-X2	To Interest on DRR Investment (10% × ₹100 × 1,125)	11,250		By Interest on Debentures	90,000
	To DRR Investment A/c	1,12,500			
31-03-X2	To balance c/d	41,250			
		9,15,000			9,15,000

Debenture Holders Account

Date	Particulars	₹	Date	Particulars	₹
			31-03-X2	By 12% Debentures	7,50,000
31-03-X2	To Bank A/c	8,25,000		By Premium on redemption of debentures (7,50,000 × 10%)	75,000
		8,25,000			8,25,000

Working Note:

1. Closing balance required in DRR (10% of 7,50,000) = 75,000

Illustration - 4

Sencom Limited issued Rs.1,50,000 5% Debentures on 30th September Year 0 on which interest is payable half yearly on 31st March and 30th September. The Company has power to purchase debentures in open market for cancellation thereof.

The following purchases were made during the year ended 31st December Year 2 and the cancellation were made on the same date. On 31st December Year 1, balance in the DRR of the Company was Rs.25,000 and investments made for the purpose of redemption were Rs.20,000.

The purchase details are:

- 1st March Year 2 – Rs.25,000 nominal value purchased for Rs.24,725 ex-interest.
- 1st September Year 2– Rs.20,000 nominal value purchased for Rs.20,125 cum-interest.

You are required to draw up the following accounts up to the date of cancellation:

- (i) Debentures Account and
- (ii) Own Debenture (Investment) Account.

Ignore Taxation.

Solution: Illustration 4

5% Debentures A/c (20X2)

Date	Particulars	Amount	Date	Particulars	Amount
Mar 1	To Own Debenture Investment	24,725	Jan 1	By Balance b/d	1,50,000
	To Gain on Cancellation (25,000 – 24,725)	275			
Sep 1	To Own Debenture Investment	19,708			
	To Gain on Cancellation (WN)	292			
Sep 1	To Balance c/d	1,05,000			
		1,50,000			1,50,000

Own Debenture Investment A/c (20X2)

Date	Particulars	Face Value	Interest	Cost	Date	Particulars	Face Value	Interest	Cost
1/3	To Bank	25,000	521	24,725	1/3	By 5% Debentures A/c	25,000	-	24,725
1/9	To Bank (WN)	20,000	417	19,708	1/9	By 5% Debenture A/c	20,000	-	19,708
					1/9	By P&L		938	
		45,000	938	44,433			45,000	938	44,433

Working Note

Date	Face Value (Nominal Value)	Amount Paid	Interest	Ex- Interest
1/03/21	25,000	25,246	521 (25,000 × 5% × 5/12)	24,725
Gain on Cancellation				275
1/9/X2	20,000	20,125	417 (20,000 × 5% × 5/12)	19,708
Gain on Cancellation				292

Illustration – 5 : Deleted

Illustration – 6

The Summarized Balance Sheet of BEE Co. Ltd. as on 31st March, 20X1 is as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
<u>Share Capital:</u>		Freehold property	1,15,000
Authorized:			
30,000 Equity Shares of Rs. 10 each	3,00,000		
		Stock	1,35,000
		Trade receivables	75,000
<u>Issued and Subscribed:</u>		Cash	30,000
20,000 Equity Shares of Rs. 10 each	2,00,000		
fully paid		Balance at Bank	2,00,000
Profit and Loss Account	1,20,000		
12% Debentures	1,20,000		
Trade payables	1,15,000		
	5,55,000		5,55,000

At the Annual General Meeting, it was resolved:

1. To give existing shareholders the option to purchase one Rs. 10 shares at Rs. 15 for every four shares (held prior to the bonus distribution), this option being taken up by all shareholders.
2. To issue one bonus share for every five shares held.
3. To repay the debentures at a premium of 3%.

Give the necessary journal entries and the company's Balance Sheet after these transactions are completed.

Solution: Illustration 6

Working Notes:

1) Rights Issue

Number of Rights shares to be issued- $(20,000 \text{ shares} / 4) \times 1 = 5,000 \text{ shares} @ ₹15$ (Face Value @ ₹10 + ₹5 towards premium)

2) No. of Bonus Shares

Number of Bonus shares to be issued- $(25,000 \text{ shares} / 5) \times 1 = 5,000 \text{ bonus shares}$

Journal of BEE Co. Ltd

Particulars		Dr. (₹)	Cr. (₹)
Bank A/c	Dr.	75,000	
To Equity Shareholders A/c			75,000
(Being amount collected from equity shareholders @ ₹15 per share for 5,000 right shares)			
Equity Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c			50,000

To Securities Premium A/c (Being right shares issued to the shareholders @₹15. ₹10 accounted as Share Capital and ₹5 accounted as securities Premium)			25,000
Securities Premium A/c Profit & Loss A/c To Bonus to Shareholder's A/c (Being amount transferred for issue of Bonus Share)	Dr. Dr.	25,000 25,000	50,000
Bonus to Shareholders A/c To Equity Share Capital A/c (Being 5000 Bonus Shares issued @1 share for every 5 shares held)	Dr.	50,000	50,000
Profit and Loss A/c To Debenture Redemption Reserve (Being DRR created at 10% of debentures redeemed)	Dr.	12,000	12,000
Debenture Redemption Reserve Investment A/c To Bank A/c (Being DRR Investment created 15% x 1,20,000 as per the provisions)	Dr.	18,000	18,000
12% Debentures A/c Premium on Redemption of Debentures A/c To Debenture Holders a/c (Being amount payable to Debenture holders)	Dr. Dr.	1,20,000 3,600	1,23,600
Debenture holders a/c To Bank A/c (Being Amount repaid to debenture holders)	Dr.	1,23,600	1,23,600
DRR A/c To General Reserve A/c (Being DRR balance transferred to General Reserve after redemption of debentures)	Dr.	12,000	12,000
Bank A/c To DRR Investment (Being DRR investment Realised at par)	Dr.	18,000	18,000

Balance Sheet of BEE Co. Ltd. As on (after completion of transactions)

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	91,400
(2) Current Liabilities		
(a) Trade payables		1,15,000
Total		5,06,400

II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		
(i) Tangible Assets	3	1,15,000
(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and bank balances	4	1,81,400
Total		5,06,400

Notes to Accounts

1	Share Capital 30,000 shares of ₹10 each fully paid (5,000 shares of ₹10 each, fully paid issued as bonus shares out of securities premium and P&L Account)		3,00,000
2	Reserve and Surplus Profit & Loss Account Less: Utilisation for issue of bonus shares Less: DRR created Less: Premium on Redemption General Reserve	1,20,000 (25,000) (12,000) <u>(3,600)</u> 79,400 <u>12,000</u>	91,400
3	Tangible assets Freehold property		1,15,000
4	Cash and bank balances Cash at bank (2,00,000 + 75,000 – 1,23,600) Cash in hand	1,51,400 <u>30,000</u>	1,81,400

Notes:

Closing Balances after Transaction

Account	Opening	Additions	Deletions	Closing Balance
Cash & Bank	2,00,000	75,000 18,000	18,000 1,23,600	1,51,400
Equity Share Capital	1,20,000	50,000 + 50,000		3,00,000
Securities Premium	0	25,000	25,000	0
Profit & Loss	1,20,000		25,000 12,000 3,600	79,400
DRR	30,000	12,000	12,000	0
DRR Investment		18,000	18,000	0
12% Debentures	1,20,000		1,20,000	0
General Reserve	-	12,000	-	12,000

Illustration – 7

The summarised Balance Sheet of Convertible Limited, as on 30th June, 20X1, stood as follows:

Particulars	Amount (Rs.)
Liabilities:	
Share Capital: 5,00,000 equity shares of Rs. 10 each fully paid	50,00,000
General Reserve	75,00,000
Profit And loss A/c	10,00,000
Debenture Redemption Reserve	25,00,000
13.5% Convertible Debentures, 1,00,000 Debentures of Rs. 100 each	1,00,00,000
Other loans	65,00,000
Current Liabilities and Provisions	1,25,00,000
	4,50,00,000

The Debentures are due for redemption on 1st July, 20X1. The terms of issue of debentures provided that they were redeemable at a premium of 5% and conferred option to the debenture holders to convert 20% of their holdings into equity shares at a predetermined price of Rs.15.75 per share and the payment in cash.

Assuming that:

1. except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercised the option for maximum conversion.
2. the investments were realised at par on sale; and
3. all the transactions are put through, without any lag, on 1st July, 20X1.

Redraft the balance sheet of the company as on 1st July, 20X1 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the necessary cash payment.

Solution: Illustration 7

Working Notes :

1) Calculation of number of shares to be allotted:

Total number of debentures	1,00,000
Less: Number of debentures for which debenture holders did not opt for conversion	(25,000)
	75,000
20% of 75,000 opt for conversion as in the form equity shares (Redemption)	15,000
Redemption value of 15,000 debentures (15,000×105)	₹15,75,000
Therefore No. of equity shares to be issued (15,75,000/15.75)	1,00,000 equity shares

2) Computation of cash to be Paid

Total number of debentures	1,00,000
Less: Converted to Equity	15,000
To be Paid (Cash/Bank) in Number of Deb. holders	85,000
Total amount to be Paid (85,000 × 105)	₹89,25,000

Convertible Limited Balance Sheet as on July 1,20X1

Particulars	Note No	₹ in Lakhs
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	60
(b) Reserves and Surplus	2	110.75
(2) Non - Current Liabilities		
(a) Long-term borrowings	3	65
(3) Current Liabilities		
(a) Short-term provisions		125
Total		360.75
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		
(i) Tangible Assets		160
(2) Current assets		
(a) Cash and bank balances	4	0.75
(b) Other current assets		200
Total		360.75

[Text Wrapping Break]Notes to Accounts

(In Lakhs)

1	Share Capital		60
	Authorised, issued and Subscribed (5,00,000 + 1,00,000) 6,00,000 @₹10 (Refer WN (1))		
2	Reserve and Surplus		
	General Reserve	75	
	Add: Transfer from DRR	25	100
	Profit & Loss	10	
	Less: Premium on Redemption	(5)	5
	Securities Premium		5.75
			110.75
3	Long Term Borrowings		
	Secured Loans		65
4	Cash and bank balances	75	
	Add: DRR Investment	15	
		90	
	Less: Debenture Holder Payment	(89.25)	0.75

UNIT 7 - UNDERWRITING OF SHARES

Illustration – 1

A company issued 1,50,000 shares of Rs.10 each at a premium of Rs.10.

The entire issue was underwritten as follows:

X - 90,000 shares (firm underwriting 12,000 shares)

Y - 37,500 shares (firm underwriting 4500 shares)

Z - 22,500 shares (firm underwriting 15,000 shares)

Total subscription received by the company (excluding firm underwriting and marked applications) were 22,500 shares

The marked application (excluding firm underwriting) were as follows :

X – 15,000 shares

Y – 30,000 shares

Z – 75000 shares

Commission payable to underwriters is at 5% of the issue price.

The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of the firm underwriting is to be given to individual underwriters.

- I. Determine the liability of each underwriter (number of shares);
- II. Compute the amounts payable or due from underwriters; and

Pass journal entries in the books of the company relating to underwriting

(Source ICAI)

Illustration 2

A joint stock company resolved to issue 10 lakh equity shares of Rs.10 each at a premium of Rs1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively.

Their firm underwriting was as follows :

X 30,000 shares,

Y 20,000 shares and

Z 10,000 shares.

The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares,

Y 57,500 shares and

Z 10,500 shares.

Unmarked applications totaled 7,00,000 shares. Accounts with the underwriters were promptly settled.

You are required to:

- i. Prepare a statement calculating underwriters' liability for shares other than shares underwritten firm
- ii. Pass journal entries for all the transactions including cash transactions.

Illustration 3

Newton Limited incorporated on 1st January, 20X1 issued a prospectus inviting applications for 20,000 equity shares of ₹ 10 each. The whole issue was fully underwritten by A, B and C as follows:

A	B	C
10,000 shares	6,000 shares	4,000 shares

Applications were received for 16,000 shares, of which marked applications were as follows:

A	B	C
8,000 shares	2,850 shares	4,150 shares

You are required to find out the liabilities of individual underwriters.

(Source ICAI)

Illustration 4

Gemini Ltd. came up with public issue of 30,00,000 Equity shares of ₹10 each at ₹ 15 per share. A, B and C took underwriting of the issue in 3 : 2 : 1 ratio.

Applications were received for 27,00,000 shares. The marked applications were received as under:

A	B	C
8,00,000 shares	7,00,000 shares	6,00,000 shares

Commission payable to underwriters is at 5% on the face value of shares.

- Compute the liability of each underwriter as regards the number of shares to be taken up.
- Pass journal entries in the books of Gemini Ltd. to record the transactions relating to underwriters.

Illustration 5

Rosy Ltd. made a public issue of 4,00,000 equity shares of ₹10 each, ₹ 2 payable on application. The entire issue was underwritten by five underwriters as follows: A: 25%, B: 25%, C: 25%, D: 10% and E: 15%. Under the underwriting terms, a commission of 2% was payable on the amount underwritten. Further, the underwriter was at liberty to apply, during the tenure of public issue, for any number of shares in which case he was entitled to a brokerage equal to 0.5% of the par value of shares so applied for.

Applications received were to be analysed on the basis of rubber stamp of the underwriter, who was to be given credit for the number of applications received bearing his rubber stamp. Applications received which did not bear any rubber stamp were considered as "direct applications" to be credited to all the underwriters in the ratio of their respective underwriting commitment. If, any such credit being given a "surplus" was to result in respect of any underwriter, as compared to his commitment, such surplus was to be distributed amongst the remaining underwriters in the ratio of their respective underwriting commitments.

As a result of the issue the following applications were received:

Bearing rubber stamp of	A	1,02,000 shares
Bearing rubber stamp of	B	95,000 shares
Bearing rubber stamp of	C	60,000 shares
Bearing rubber stamp of	D	32,000 shares
Bearing rubber stamp of	E	51,000 shares
Not bearing any stamp		10,000 shares
	Total	3,50,000 shares

Included in the number of applications mentioned against D in the above table was an application made by D himself for 10,000 shares. The underwriters were informed of the amounts due to or from them, the amounts were duly received or paid.

Show, with the aid of necessary workings, the entries to record the amount so received or paid.

Illustration 6

Libra Ltd. came up with an issue of 20,00,000 equity shares of ₹10 each at par. 5,00,000 shares were issued to the promoters and the balance offered to the public. The issue was underwritten by three underwriters Anand, Vijay and Ashok - equally with firm underwriting of 50,000 shares each. The total subscription received were 12,97,000 shares including the marked forms which were :

Anand	Vijay	Ashok
4,25,000	4,50,000	3,50,000

The underwriters had applied for the number of shares covered by firm underwriting. The amounts payable on application and allotment were ₹2.50 and ₹ 2.00 respectively. The agreed commission was 5%.

Pass summary journal entries for —

1. allotment of shares to the underwriters;
2. commission due to each of them; and
3. net cash paid and or received.

Note: Unmarked applications are to be credited to underwriters equally. Benefit of firm underwriting is given to individual underwriter.

CHAPTER 2 – PREPARATION OF FINANCIAL STATEMENTS

Illustrations

Illustration 1

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

(Figures in Rs.'000)

Particulars	Debit Rs.	Particulars	Credit Rs.
Land at cost	220	Equity Capital (Shares of Rs. 10 each)	300
Plant & Machinery at cost	770	10% Debentures	200
Trade Receivables	96	General Reserve	130
Inventories (31.3.X2)	86	Profit & Loss A/c	72
Bank	20	Securities Premium	40
Adjusted Purchases	320	Sales	700
Factory Expenses	60	Trade Payables	52
Administration Expenses	30	Provision for Depreciation	172
Selling Expenses	30	Suspense Account	4
Debenture Interest	20		
Interim Dividend Paid	18		
	1670		1670

Additional Information:

- The authorised share capital of the company is 40,000 shares of Rs. 10 each.
- The company on the advice of independent valuer wish to revalue the land at Rs. 3,60,000.
- Declared final dividend @ 10%.
- Suspense account of Rs. 4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was Rs. 10,000 and the accumulated depreciation thereon being Rs. 8,000.
- Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

Solution: Illustration 1

Balance Sheet as at 31st March, 20X2

Particulars		Note No.	(₹ in 000)
Equity and Liabilities			
1. Shareholders' funds			
A	Share capital	1	300
B	Reserves and Surplus	2	500
2. Non-Current liabilities			
A	Long term borrowings	3	200
3. Current liabilities			
A	Trade Payables		52
B	Other Current Liabilities	4	<u>30</u>
	Total		1082
Assets			
1. Non-current assets			
A	PPE (Property, Plant & Equipment)	5	880
2. Current assets			
A	Inventories		86
B	Trade receivables		96
C	Cash and bank balances	6	<u>20</u>
	Total		1082

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

Particulars		Notes	(₹ in 000)
I.	Revenue from operations		700
II	Other Income (WN)	7	2
III	Total Revenue (I + II)		<u>702</u>
IV	Expenses:		
	Purchases of stock – in – Trade* (WN)		320
	Changes in inventories		(86)
	Finance Cost	8	20
	Depreciation on Plant and Machinery	9	76
	Other Expenses	10	<u>120</u>
	Total Expenses		<u>536</u>
V.	Profit (Loss) for the period (III – IV)		166

Notes to accounts

			(₹ in 000)
1. Share Capital			
	Equity share capital		

	Authorised:			
	40,000 shares of ₹10 each			<u>400</u>
	Issued & subscribed & called up			
	30,000 shares of ₹10 each			<u>300</u>
2.	Reserves and Surplus			
	Securities Premium Account			40
	General reserve			130
	Revaluation reserve	(360 – 220)		140
	Profit & loss (Surplus)			
	Opening balance	72		
	Add: Profit for the period	166	238	
	Less: Interim Dividend		(18)	
	Final Dividend		(30)	<u>190</u>
				<u>500</u>
3.	Long term borrowing			
	10% Debentures			200
4.	Other Current Liabilities			
	Dividend Payable			30
5.	PPE (Tangible Assets)			
	Land			
	Opening balance		220	
	Add: Upward Revaluation		<u>140</u>	
	Closing balance			360
	Plant and Machinery			
	Cost (Working Note)		760	
	Less: Accumulated Depreciation		(240)	<u>520</u>
	Total			<u>880</u>
6.	Cash and Cash Equivalence			
	Balance with Bank			20
7.	Other Income			
	Gain on Sale of Plant & Machinery (WN)			2
8.	Finance Cost			
	Debenture Interest			20
9.	Depreciation on Plant and Machinery			76
10.	Other Expenses			
	Factory expenses	60		
	Selling expenses	30		
	Administrative expenses	<u>30</u>		<u>120</u>

Note: It is Assumed that Final Dividend is declared prior to 31st March.

If it is assumed that Dividend is declared is declared after the Financial year, then Final Dividend is not required to be provided for.

Working Note:

1)

Plant and Machinery Account (At Cost)

Particulars	(₹ in 000)	Particulars	(₹ in 000)
To Balance b/d	770	By Asset Disposal A/c	10
		By Balance C/d	760
	770		770

Accumulated Depreciation A/c

Particulars	(₹ in 000)	Particulars	(₹ in 000)
To Asset Disposal A/c	8	By Balance b/d	172
To Balance C/d	240	By Depreciation	76
	248		248

Asset Disposal A/c

Particulars	(₹ in 000)	Particulars	(₹ in 000)
To Plant and Machinery	10	By Accumulated Depreciation	8
To Gain on Sale of P&M	2	By Suspense	4
	12		12

2)

Adjusted Purchases	320
Closing Stock*	86
Purchases (Gross)	406

Assumed there is no stock at beginning

Illustration - 2

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

Particulars	Debit	Credit
Authorized Capital - divided into 5,000 6% Preference Shares of Rs.100 each and 10,000 equity shares of Rs.100 each		15,00,000
Subscribed Capital - 5,000 6% Preference Shares of Rs.100 each Equity Capital		5,00,000 8,05,000

Purchases – Wines, Cigarettes, Cigars etc	45,800	
- Foodstuffs	36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	
Sales – Wines, Cigarettes, Cigars, etc.		68,400
- Food		57,600
Coal and Firewood	3,290	
Carriage and Cooliage	810	
Sundry Expenses	5,840	
Advertising	8,360	
Repairs	4,250	
Rent of Rooms		48,000
Billiard		5,700
Miscellaneous Receipts		2,800
Discount received		3,300
Transfer fees		700
Freehold Land and Building	8,50,000	
Furniture and Fittings	86,300	
Stock on hand, 1st April, 2011:		
Wines, Cigarettes, Cigars etc.	12,800	
Foodstuffs	5,260	
Cash in hand	2,200	
Cash with Bankers	76,380	
Preliminary and formation expenses	8,000	
2,000 Debentures of Rs.100 each (6%)		2,00,000
Profit and Loss Account		41,500
Sundry Creditors		42,000
Sundry Debtors	19,260	
Investments	2,72,300	
Goodwill at cost	5,00,000	
General Reserve		2,00,000
	19,75,000	19,75,000
Wages and Salaries Outstanding	1,280	
Stock on 31st March, 2012:		
Wines Cigarettes and Cigars, etc.	22,500	
Foodstuffs	16,400	

- Depreciation : Furniture and Fittings @ 5% p.a.: Land & Buildings @ 2% p.a.
- The equity capital on 1st April 2011 stood at Rs.7,20,000 that is 6,000 shares fully paid and 2,000 shares Rs.60 paid.
- The directors made a call of Rs.40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ Rs.90 per share as fully paid.
- The directors propose a dividend of 8% on equity shares, transferring any amount that may be required from General Reserve.
- Ignore Taxation

Solution: Illustration 2

Balance Sheet of International Hotels Ltd. as at 31st March, 20X2

Particulars		Note No.	₹
Equity and Liabilities			
1.	Shareholders' funds		
	i Share capital	1	13,00,000
	ii Reserves and Surplus	2	1,74,745
2.	Non-Current liabilities		
	i Long term borrowings	3	2,00,000
3.	Other Current liabilities		
	i Trade Payables		42,000
	ii Other Current Liabilities	4	1,07,280
	Total		18,24,025
Assets			
1.	Non-current assets		
	i PPE (Property, Plant & Equipment)	5	9,14,985
	ii Intangible Assets	6	5,00,000
	iii Non-current investments		2,72,300
2.	Current assets		
	i Inventories	7	38,900
	ii Trade receivables		19,260
	iii Cash and Cash Equivalents	8	<u>78,580</u>
	Total		18,24,025

	Particulars	Notes	Amount
I.	Revenue from operations	9	1,83,200
II.	Other income (Discount received)	10	3,300
III.	Total Revenue (I + II)		1,86,500
IV.	Expenses:		

	Cost of materials consumed	11	25,060
	Purchases of Stock-in-Trade	12	45,800
	Changes in inventories	13	(9,700)
	Employee benefits expense	14	29,580
	Finance costs	15	12,000
	Depreciation and Amortization expense	5	21,315
	Other Expenses	16	40,200
	Total Expenses		1,64,255
V.	Profit Before Tax (III - IV)		22,245

Statement of Profit and Loss of International Hotels Ltd. for the year ended 31st March, 20X2

Notes to accounts

			(₹)
1. Share Capital			
Share capital			
Authorised:			
5,000 6% preference of ₹100			5,00,000
10,000 shares of ₹100 each			<u>10,00,000</u>
			<u>15,00,000</u>
Issued, subscribed & fully paid up			
5,000 6% preference of ₹100			5,00,000
8,000 shares of ₹100 each			<u>8,00,000</u>
			13,00,000
2. Reserves and Surplus			
Capital Reserve (100 x (90 – 40))			5,000
Securities Premium Account			
General reserve			
Opening Balance		2,00,000	
Less: Transferred to P&L		(30,255)	1,69,745
Profit & loss (Surplus)			
Opening balance	41,500		
Add: Profit for the period	22,245		
Add: Balance from General Reserve	30,255	94,000	
Less: Dividend declared		(94,000)	--

	Total		1,74,745
3. Long term borrowing			
6% Debentures			2,00,000
4. Other Current Liabilities			
Dividend Payable	1,280		
Interest Payable	12,000		
Dividend Payable	94,000		1,07,280
	Total		
6. Intangible Assets			
Goodwill			5,00,000
7. Inventories			
Wines, Cigarettes & Cigars, etc (Finished Goods)	22,500		
Foodstuffs (Raw Material)	16,400		
	Total		38,900
8. Cash and Cash Equivalents			
Cash in hand	2,200		
Cash at bank	76,380		
	Total		78,580
9. Revenue from operations			
Sale of products			
- Wines, Cigarettes, Cigars etc.	68,400		
- Food	<u>57,600</u>		1,26,000
Sale of services			
- Room Rent	48,000		
- Billiards	5,700		
- Transfer fees	700		
- Miscellaneous Receipts	<u>2,800</u>		57,200
	Total		1,83,200
10. Other Income			
- Discount			3,300
11. Cost of Material Consumed			
Opening Inventory	5,260		
Add: Purchases during the year	36,200		
Less: Closing Inventory	(16,400)		
	Total		25,060
12. Purchases of Inventory-in-Trade			

	Wines, Cigarettes etc.		45,800
13.	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade		
	Opening Inventory	12,800	
	Less: Closing Inventory	(22,500)	(9,700)
14.	Employee benefits expense		
	Wages and Salaries	28,300	
	Add: Wages and Salaries Outstanding	1,280	29,580
15.	Finance costs		
	Interest on Debentures (2,00,000 x 6%)		12,000
16.	Other Expenses:		
	- Rent Rates and Taxes	8,900	
	- Laundry	750	
	- Coal and Firewood	3,290	
	- Carriage and Cooliage	810	
	- Sundry Expenses	5,840	
	- Advertising	8,360	
	- Repairs	4,250	
	- Preliminary Expenses	<u>8,000</u>	40,200

Note – 5: PPE (Property, Plant & Equipment)

	Assets	01/04/X1	Depreciation	31/03/X2
1.	Land and Building (2% of 8,50,000)	8,50,000	17,000	8,33,000
2.	Furniture and Fixtures. (5% of 86,300)	86,300	4,315	81,985
			21,315	9,14,985
			P&L	B/S

Working Note:

1) Equity Share Capital

Opening Paid up 6,000 @ ₹100	₹6,00,000
2,000 @ ₹60	₹1,20,000
Called up (20 × 2) 2,000 @ 40	
Amount Received 1,900 @ 40	<u>₹76,000</u>
	₹7,96,000

Reissue of forfeited Shares @₹90 (100 × 90)	<u>₹9,000</u>
	₹8,05,000

2) Dividend Payable

- Pref shares 6% of 50 Lakh = ₹30,000
- Equity Shares 8% of 8 Lakh = ₹64,000

			(₹)
1. Share Capital			
Share capital			
Authorised, subscribed & Called up			
10,000 shares of ₹100 each (Out of above, 2,000 shares have been issued for consideration other than cash)	10,00,000		
Less: Calls in arrears	<u>(1,000)</u>		9,99,000
2. Reserves and Surplus			
General Reserve	2,10,000		
Profit & loss (Surplus)	<u>86,700</u>		2,96,700
3. Long term borrowing			
Secured			2,00,000
Term Loans			
Loan from State Financial Corporation (1,50,000 – 7,500) (Secured by hypothecation of Plant and Machinery)			1,42,500
4. Other Current Liabilities			
Interest Accrued (not due)	7,500		
Dividend Payable	<u>60,000</u>		67,500
5. Short-term provisions			
Provision for taxation			68,000
Goodwill			5,00,000
7. Inventories			
Raw Material	50,000		
Finished Goods	<u>2,00,000</u>		2,50,000
8. Trade receivables			
Amount Receivable more than 6 months	52,000		
Others (Bal. fig)	<u>1,48,000</u>		2,00,000
9. Cash and cash Equivalents			
Cash at Bank	2,47,000		
Cash in hand	<u>30,000</u>		2,77,000
- Rent Rates and Taxes	8,900		

	- Laundry	750	
	- Coal and Firewood	3,290	
	- Carriage and Cooliage	810	
	- Sundry Expenses	5,840	
	- Advertising	8,360	
	- Repairs	4,250	
	- Preliminary Expenses	<u>8,000</u>	40,200

= ₹94,000

Amount Available in P&L (₹63,745)

Shortfall = ₹30,255

Illustration - 3

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary –

		Assets (Rs.)	Liabilities (Rs.)
Equity Capital (Face value of Rs.100)			10,00,000
Calls in Arrears		1,000	
Land		2,00,000	
Building		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Inventory:			
Finished Goods	2,00,000		
Raw Materials	<u>50,000</u>	2,50,000	
Provision for Taxation			68,000
Trade receivables		2,00,000	
Advances		42,700	
Dividend Payable			60,000
Profit and Loss Account			86,700

Cash Balance		30,000	
Cash at Bank		2,47,000	
Loans (Unsecured)			1,21,000
Trade payables (For Goods and Expenses)			2,00,000
		18,95,700	18,95,700

The following additional information is also provided:

- 2,000 equity shares were issued for consideration other than cash.
- Trade receivables of Rs.52,000 are due for more than six months.
- The cost of assets:

Building	Rs.4,00,000
Plant and Machinery	Rs.7,00,000
Furniture	Rs.62,500
- The balance of Rs.1,50,000 in the loan account with State Finance Corporation is inclusive of Rs.7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.
- Balance at Bank includes Rs.2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.
- The company had contract for the erection of machinery at Rs.1,50,000 which is still incomplete.
- **Solution:** Illustration 3
- **Pioneer Ltd. - Balance Sheet as at 31st March, 20X1**

Particulars		Note No.	₹
Equity and Liabilities			
1. Shareholders' funds			
i	Share capital	1	9,99,000
ii	Reserves and Surplus	2	2,96,700
2. Non-Current liabilities			
i	Long term borrowings	3	2,63,500
3. Other Current liabilities			
i	Trade Payables		2,00,000
ii	Other Current Liabilities	4	1,07,280
iii	Short-term provisions	5	68,000
	Total		18,94,700
Assets			
1. Non-current assets			
i	PPE (Property, Plant & Equipment)	6	11,25,000
2. Current assets			

i	Inventories	7	2,50,000
ii	Trade receivables	8	2,00,000
iii	Cash and Cash Equivalents	9	2,77,000
iv.	Short-term Loans And advances		<u>42,700</u>
	Total		18,94,700

- **Notes to accounts**
- **Note – 6: PPE (Property, Plant & Equipment)**

	Assets	Cost	Accumulated Depreciation	WDV
1.	Building	4,00,000	50,000	3,50,000
2.	Plant and Machinery	7,00,000	1,75,000	5,25,000
3.	Furniture	62,500	12,500	50,000
4.	Land	2,00,000	--	2,00,000
		13,62,500	2,37,500	11,25,000

- **Note:** Estimated amount of contract remaining to be executed on capital account and not provided for ₹1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Illustration – 4

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilised from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	(Rs.)
17,500 9% Preference shares of Rs. 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs. 10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	25,00,000
Capital Reserves as on 1.4.20X1	3,00,000
Revaluation Reserves as on 1.4.20X1	3,50,000
Net profit for the year ended 31st March, 20X2	3,00,000
Average rate of dividend during the last five year has been 12%.	

Solution: Illustration 4

Condition I. Maximum Rate = 12% (Avg. of 3years)

Dividend Payable	
Preference shares = $17,50,000 \times 9\%$	1,57,500
Equity Shares = $80,00,000 \times 10\%$	8,00,000
Total Dividend	9,57,500
Surplus in P/L	3,00,000

Amount to be Withdrawn	6,57,500
------------------------	----------

Condition II.

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed **10% of paid up capital plus free reserves** ie. ₹12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III

The balance of reserves after withdrawal

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

Since all the three conditions are satisfied, the company can withdraw **₹6,57,500** from accumulated reserves (as per Declaration and Payment of Dividend Rules, 2014.)

Illustration 5

The following extract of Balance Sheet of X Ltd. was obtained:

Balance Sheet (**Extract**) as on 31st March, 20X1

Liabilities	Rs.
Authorised capital:	
20,000, 14% preference shares of Rs.100	20,00,000
2,00,000 Equity shares of Rs.100 each	<u>2,00,00,000</u>
	<u>2,20,00,000</u>
Issued and subscribed capital:	
15,000, 14% preference shares of Rs.100 each fully paid	15,00,000
1,20,000 Equity shares of Rs.100 each, Rs.80 paid-up	96,00,000
Share suspense account	20,00,000
Reserves and surplus:	
Capital reserves (Rs. 1,50,000 is revaluation reserve)	1,95,000
Securities premium	50,000
Secured loans:	
15% Debentures	65,00,000
Unsecured loans:	
Public deposits	3,70,000
Cash credit loan from SBI (short term)	4,65,000
Current Liabilities:	
Trade Payables	<u>3,45,000</u>
Assets:	Rs.
Investment in shares, debentures, etc.	75,00,000
Profit and Loss account (Debit balance)	15,25,000

Share suspense account represents application money received on shares, the allotment of which is not yet made.

You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if X Ltd. is an investment company?

Solution: Illustration 5

	Where X Ltd. Is a noninvestment company	Where X Ltd. is an investment company
Paid-up share capital —		
15,000, 14% Preference shares	15,00,000	15,00,00
1,20,000 Equity shares	96,00,000	96,00,000
Capital reserves (1,95,000 – 1,50,000)	45,000	45,000
Securities premium	50,000	50,000
15% Debentures	65,00,00	65,00,00
Public Deposits	<u>3,70,000</u>	<u>3,70,000</u>
	<u>1,80,65,000</u>	<u>1,80,65,000</u>
Less: Profit and Loss account (Dr. balance)	15,25,00	15,25,00
Investments	75,00,000	-
	<u>90,25,000</u>	<u>15,25,000</u>
Effective capital	90,40,000	1,65,40,000

Illustration - 6

The following is the Draft Profit & Loss A/c of Mudra Ltd., the year ended 31st March, 20X1:

	Rs.		Rs.
To Administrative, Selling and distribution expenses	8,22,542	By Balance b/d	5,72,350
To Directors fees	1,34,780	By Balance from Trading A/c	40,25,365
To Interest on debentures	31,240	By Subsidies received from Govt.	2,73,925
To Managerial Remuneration	2,85,350		
To Depreciation on fixed Assets	522,543		
To Provision for Tax	12,42,500		
To General Reserve	4,00,000		
To Investment Revaluation Reserve	12,500		

To Balance c/d	14,20,185		
	48,71,640		48,71,640

Depreciation on fixed assets as per Schedule II of the Companies Act, 2013 was Rs.5,75,345. You are required to calculate the maximum limits of the managerial remuneration as per the Companies Act, 2013.

Solution: Illustration 6

Calculation of net profit u/s 198 of the Companies Act, 2013

Particulars	₹
Gross Profit (Balance from Trading A/c)	40,25,365
Add: Subsidies received from Government	2,73,925
	42,99,290
Less: Administrative, selling and distribution expenses	8,22,542
Director's fees	1,34,780
Interest on debentures	31,240
Depreciation on fixed assets as per Schedule II	5,75,345
Profit u/s 198	27,35,383

Maximum Managerial remuneration under Companies Act, 2013= 11% of ₹27,35,383= ₹3,00,892

Illustration 7

Kumar Ltd., a non-investment company has been incurring losses for the past few years. The company provides the following information for the current year:

	(Rs. In lakhs)
Paid up equity share capital	120
Paid up Preference share capital	20
Reserves (including Revaluation reserve Rs.10 lakhs)	150
Securities premium	40
Long term loans	40
Deposits repayable after one year	20
Application money pending allotment	720
Accumulated losses not written off	20
Investments	180

Kumar Ltd. has only one whole-time director, Mr. X. You are required to calculate the amount of maximum remuneration that can be paid to him as per provisions of Part II of Schedule XIII, if no special resolution is passed at the general meeting of the company in respect of payment of remuneration for a period not exceeding three years.

Solution: Illustration 7

Calculation of effective capital

	(₹ in lakhs)
Paid up equity share capital	120
Reserve excluding Revaluation reserve (150- 10)	140
Securities premium	40
Long term loans	40
Deposits repayable after one year	20
Less: Accumulated losses not written off	(20)
Investments	(180)
Effective capital for the purpose of managerial remuneration	180

Since Kumar Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of **effective capital of the company (< 5 Crores)**, therefore maximum remuneration payable to the Managing Director should be @ ₹60,00,000 per annum.

Illustration 8

Following is the trial balance of Delta limited as on 31.3.2021.

(Figures in Rs. '000)

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital (shares of Rs. 10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.20)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-21)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		

Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information :

- (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.

Solution: Illustration 8

Delta Limited
Balance Sheet as at 31st March 2021

Particulars		Note No.	(₹ in '000)
Equity and Liabilities			
1.	Shareholders' funds		
i	Share capital	1	495.00
ii	Reserves and Surplus	2	807.20
2.	Non-Current liabilities		
i	Long term borrowings	3	300.00
3.	Other Current liabilities		
i	Trade Payables		30.00
ii	Short-term provisions	4	163.80
	Total		1,796.00
Assets			
1.	Non-current assets		
i	PPE (Property, Plant & Equipment)	5	1,550.00
2.	Current assets		
i	Inventories		96

ii	Trade receivables	6	120
iii	Cash and Cash Equivalents	7	30
	Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 2021

	Particulars	Notes	(₹ in '000)
I.	Revenue from operations	8	1,200
II.	Other income (Discount received)	9	6
III.	Total Revenue (I + II)		1,206
IV.	Expenses:		
	Purchases (Adjusted)		400
	Finance costs	10	30
	Depreciation	5	80
	Other Expenses	11	150
	Total Expenses		660
V.	Profit Before Tax (III - IV)		546
VI.	Tax expenses @30%		<u>163.80</u>
VII.	Profit for the period		<u>382.20</u>

Notes to Accounts

			(₹)
1. Share Capital			
	Share capital		
	80,000 Shares of ₹10 each subscribed & Called up		800
	50,000 shares of ₹10 each (Out of above, 5,000 shares have been issued for consideration other than cash)	500	
	Less: Calls in arrears	<u>(5)</u>	495
2. Reserves and Surplus			
	General Reserve		150.00
	Securities Premium		40.00
	Profit & loss (Surplus)		
	Opening Balance	75.00	
	Add: Profit for the period	<u>382.20</u>	<u>457.20</u>
			807.20
3. Long term borrowing			
	10% Debentures		300
4. Short - term provision			
	Provision for tax		163.80

5. Property, plant & equipment		
Land at cost	800	
Add: Revaluation	<u>160</u>	960
Plant and Machinery (at cost)		
Opening Balance	824	
Less: Cost of P&M sold	<u>(24)</u>	
Closing Balance (at cost)	800	
Less: Depreciation (Accumulated)		
Opening Balance	150	
Less: Disposed Off	<u>(20)</u>	
Add: Current year Depreciation (10% on 800)	<u>80</u>	
	<u>210</u>	1,550.00
6. Trade receivables		
Debits outstanding for a period exceeding six months	50	
Other debts	<u>70</u>	120
7. Cash and cash Equivalents		
- Cash at Bank scheduled banks	23	
- With others (ABC Bank Limited)	5	
Cash in hand	<u>2</u>	30
8. Revenue from Operations		
Sales		1,200
9. Other Income		
Gain on sale of Fixed asset ₹(10,000 – (24,000 – 20,000))		6
10. Finance Costs		
Debenture Interest		30
11. Other Expenses		
Factory Expenses	80	
Admin Expenses	45	
Selling Expenses	<u>25</u>	150

Illustration 9

The following balances appeared in the books of Oliva Ltd. as on 31-03-2022.

Particulars		₹	Particulars		₹
-------------	--	---	-------------	--	---

Inventory 01-04-2013			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		45,000
Purchases		12,15,000	Share Capital Loans:		3,15,000
Manufacturing Expenses		2,70,000	Short-term	4,500	
Salaries and wages			Long-term	21,000	25,500
General Charges		40,200	Unclaimed Dividend		3,000
		16,500	Deposits:		
Dividend for 2012-13		27,000	Short -Term Long -term	1,500	
Building		1,01,000	Trade payables	3,300	4,800
Plant and					3,27,000
Machinery Furniture		70,400			
Motor Vehicles		10,200			
Stores and Spare Parts		40,800			
Consumed					
Investments: Current		45,000			
Non Current Trade					
receivables Cash in Bank					
	4,500	12,000			
	7,500	2,38,500			
		2,71,100			
		24,34,200			
					24,34,200

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 2014 and Company's Balance Sheet as on that date:

- Inventory on 31st March, 2014 Raw material ₹ 25,800 & finished goods ₹ 60,000.
- Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
- Interest accrued on Securities ₹ 300.
- General Charges prepaid ₹ 2,490.
- Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
- Current maturity of long term loan is ₹ 1,000.
- The Taxation provision of 40% on net profit is considered.

Solution: Illustration 9

Oliva Company Ltd.
Balance Sheet for the year ended 31.03.2019

Particulars		Note No.	₹
Equity and Liabilities			
1.	Shareholders' funds		
i	Share capital		3,15,000
ii	Reserves and Surplus	1	50,430
2.	Non-Current liabilities		
i	Long term borrowings	2	23,300
3.	Current liabilities		
i	Short -term borrowings	3	6,000
ii.	Trade Payables		3,27,000
iii	Other current liability	4	73,000
iv.	Short-term provisions	5	<u>19,620</u>
	Total		8,14,350
Assets			
1.	Non-current assets		
i	PPE (Property, Plant & Equipment)	6	2,04,160
ii	Non-current investments		7,500
2.	Current assets		
i	Current investments		4,500
ii	Inventories	7	85,800
iii	Trade receivables		2,38,500
iv	Cash and cash equivalents		2,71,100
v	Short-term loans and advances	8	2,490
vi	Other current assets	9	<u>300</u>
	Total		8,14,350

Oliva Company Ltd.
Statement of Profit and loss for the year ended 31.03.2019

	Particulars	Notes	(₹ in '000)
I.	Revenue from operations		17,10,000
II.	Other income (3,900 +300)		<u>4,200</u>
III.	Total Revenue (I + II)		17,14,200
IV.	Expenses:		
	Cost of materials consumed	10	12,64,200
	Changes in inventories of finished goods, work-inprogress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		18,240
	Other Expenses	13	<u>3,51,510</u>
	Total Expenses		16,65,150
V.	Profit Before Tax (III - IV)		49,050
VI.	Tax expense (40% of 49,050)		<u>19,620</u>
VII.	Profit for the period from continuing operations		<u>29,430</u>

Notes to accounts

	Reserves and Surplus		
	Profit & loss (Surplus)	48,000	
	Add: Profit for the period	29,430	
	Less: Interim Dividend including DDT	<u>(27,000)</u>	50,430
2.	Long term borrowing		
	Secured loans (21,000 less current maturities 1,000)	20,000	
	Fixed Deposits: Unsecured	<u>3,300</u>	23,300
3.	Short - term borrowings		
	Secured loans	4,500	
	Fixed Deposits -Unsecured	<u>1,500</u>	6,000
4.	Other current liabilities		
	Expenses Payable (67,500 + 4,500)	72,000	
	Current maturities of longterm borrowings	<u>1,000</u>	73,000
5.	Short term provisions		

ii

	Provision for Income tax		19,620
6.	Property, plant & equipment		
	Building	1,01,000	
	Less: Depreciation @ 2%	<u>(2,020)</u>	98,980
	Plant & Machinery	70,400	
	Less: Depreciation @10%	<u>(7,040)</u>	63,360
	Furniture	10,200	
	Less: Depreciation @10%	<u>(1,020)</u>	9,180
	Motor vehicles	40,800	
	Less: Depreciation @20%	<u>(8,160)</u>	32,640
	Total		2,04,160
7.	Inventory:		
	Raw Material	25,800	
	Finished goods	<u>60,000</u>	85,800
8.	Short term Loans & Advances		
	General Charges prepaid		<u>2,490</u>
9.	Other Current Assets:		
	Interest accrued		300
10.	Cost of material consumed		
	Opening inventory of raw Material & Stores	30,000	
	Add: Purchases	12,15,000	
	Stores & Spare parts consumed	<u>(45,000)</u>	
		<u>12,90,000</u>	
	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

Computation of Effective Capital

	₹
Paid up equity share capital	
15,000, 14% Preference shares	15,00,000
1,20,000 Equity shares	96,00,000
Reserve excluding Revaluation reserve	45,000
Securities premium	50,000

15% Debentures	<u>65,00,000</u>
	1,76,95,000
Less: Profit and Loss account (Dr. balance)	15,25,000
Investments	<u>75,00,000</u>
Effective capital	86,70,000

Illustration 10

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.

Solution: Illustration 10

Calculation of effective capital

Particulars	Non-Investment	Investment
Preference Share capital	30,00,000	30,00,000
Equity Shares capital	1,92,00,000	1,92,00,000
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 @ ₹60,00,000 per annum.

CHAPTER 3 - CASH FLOW STATEMENT

Illustrations

Illustration 1 (Direct Method – CF from operating activity – III-1)

From the following information, calculate cash flow from operating activities:

Summary of Cash Account for the year ended March 31, 20X1			
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Trade payables	1,57,000
To Trade receivables	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000
To Loan from Bank	1,00,000	By Repay of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000
		By Balance c/d	1,04,000
	5,96,000		5,96,000

Solution: Illustration 1 (Direct Method – CF from operating activity – III-1)

Particulars	₹
I. Cash flow from operating Activities:	
• Cash received from Sales	1,40,000
• Cash received from Debtors	1,75,000
• Commission Received	50,000
• Purchases	(1,20,000)
• Payment to creditors	(1,57,000)
• Office & Selling Expenses	(75,000)
Cash Generated from Operations	13,000
Less: Income Tax	(30,000)
Net Cash used in Operations	(17,000)

Illustration 2 (CF from Investing Activities – III – 2 : Example)

In a year the company has made sales of Rs.10,000. From the extracts given, prepare ledger accounts to arrive at money paid by or paid to debtors and creditors respectively.

Profit and Loss Account.

Debit	(Rs.)	Credit	(Rs.)
To Purchases Cash – 2000 Credit 5000	7,000	By Sales Cash – 6000 Credit - 4000	10,000
To Bad Debt	200		

Particulars	Year 1 (Rs.)	Year 2 (Rs.)
Debtors – closing	1,000	1,200
Trade payables - closing	500	600

Solution

Debtors A/c

Debit	(Rs.)	Credit	(Rs.)
To Bal b/d	1,000	By Bank (Bal. fig)	3,600
To Sales	4000	By Bad Debts	200
		By bal C/d	1,200
	5,000		5,000

Cash flow from sales = Cash Sales + Receipts from Debtors = 6,000 + 3,600 = 9,600

Trade Payables A/c

Debit	(Rs.)	Credit	(Rs.)
To Bank (bal Fig)	4,900	By bal b/d	500
To Bal c/d	600	By Purchases	5,000
	5,500		5,500

Cash paid to Suppliers = Cash Purchases+ Payments to Creditors= 2,000 + 4,900 = 6,900

Illustration 3 (CF from Financing Activities- III – 3)

Following are the extracts of Balance Sheet of Ajay Ltd.:

Liabilities	31.3.20X1 (Rs.)	31.3.20X2 (Rs.)	Assets	31.3.20X1 (Rs.)	31.3.20X2 (Rs.)
Share Capital	5,00,000	5,00,000	Goodwill	1,15,000	90,000
15% Debentures	5,00,000	7,50,000			
Unpaid Interest	--	5,000	Discount on issue of Debentures	90,000	1,15,000
Profit & Loss A/c	50,000	90,000			

You are required to present the cashflow from financing activity, if Discount on issue of Debentures amounting to Rs. 10,000 has been written off during the year.

Solution: Illustration 3 (CF from Financing Activities- III – 3)

Particulars	₹
I. Cash flow from Financing Activities:	
• Proceeds From Issue of debentures	2,15,000
• Interest Paid on Debentures	(1,07,500)
Cashflow From Financing Activity	1,07,500

Workings:

15% Debenture A/c

	₹		₹
		By Balance b/d	5,00,000
		By Discount on Issue of Debentures	35,000
To Balance c/d	7,50,000	By Bank (Bal. Fig)	2,15,000
	7,50,000		7,50,000

Discount on Issue of debentures

	₹		₹
To Balance C/d	90,000	By P&L	10,000
To 15% Debentures	35,000	By Balance c/d	1,15,000
	1,25,000		1,25,000

Interest Payable, assumed issued as beginning of the year i.e. $7,50,000 \times 15\% = 1,12,500$

Therefore, Interest Paid = $1,12,500 - 5000 = 1,07,500$

Illustration 4

The following summary cash account has been extracted from the company's accounting records:

Particulars	Amount (Rs. '000)	Amount (Rs. '000)
Balance at 1.3.20X1		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		128
		3,246
Payments to suppliers	2,047	
Payments for fixed assets	230	
Payments for overheads	115	
Wages and salaries	69	
Taxation	243	
Dividends	80	
Repayments of bank loan	250	(3,034)
Balance at 31.3.20X2		212

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

The company does not have any cash equivalents.

Solution 4

Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)

Particulars		₹ ('000)
I. Cash flow from operating Activities:		
• Cash receipts from customers	2,783	
• Cash payments to suppliers	(2,047)	
• Payment for overheads	(115)	
• Wages/ Salaries	(69)	
Cash generated from operations	552	
Less: Income tax paid	(243)	

Net cash from operating activities		309
II. Cash flows from investing activities		
• Sale of fixed assets	128	
• Payments for purchase of fixed assets	(230)	
Net cash used in investing activities		(102)
III. Cash flows from financing activities:		
• Proceeds from issuance of share capital	300	
• Dividend paid	(80)	
• Bank loan repaid	(250)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Illustration 5

Given below is the Statement of Profit and Loss of ABC Ltd. and the relevant Balance Sheet information:

Statement of Profit and Loss of ABC Ltd. for the year ended 31st December 2013

Particulars	Rs.in lakhs
<u>Revenue</u>	
Sales	4150
Interest and dividend	100
Stock adjustment	20
Total Revenue(A)	4270
<u>Expenditure</u>	
Purchases	2400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total Expenditure (B)	3560
Profit before tax(A-B)	710
Tax Provision	(200)
Profit after tax	510
Balance of Profit and Loss account brought forward	50
Profit available for distribution	560
Appropriations:	
Transfer to general reserve	200
Proposed dividend	300
Dividend Distribution Tax	30
Total Appropriations	530
Balance	30

Relevant Balance Sheet Information:

Particulars	Closing Balance Rs. in lakhs	Opening Balance Rs. in lakhs
Trade receivables	400	250
Inventories	200	180
Trade payables	250	230
Outstanding Wages	50	40
Outstanding expenses	20	10
Advance Tax	195	180
Tax Provision-Assessed tax liability	200	180

Compute cash flow from operating activities using

1. Direct method and
2. Indirect method

Solution: Illustration 5

Cash Flow from Operating Activities (Direct Method)

Particulars	₹ in lakhs
Cash collection from Trade receivables	4,000
Cash payment to Trade payables	(2,380)
Cash Paid towards wages	(790)
Cash expenses (200 + 10 - 20)	(190)
Cash generated from operations before Taxes	640
Less: Taxes paid - Advance tax	(195)
Cash generated from operations	445

Indirect Method

Particulars	₹ in lakhs
Net Profit Before Taxation	710
Add: Non - Cash items:	
• Depreciation	100
Add/Less: Items under other Heads	
• Less: interest and Dividend (investment cash inflow)	(100)
• Add: Interest expense (Financing cash outflow)	60
Operating Profit Before Working Capital Changes	770
Changes in working Capital:	
Increase in Inventories (180 - 200)	(20)
Increase in Trade receivables (250 - 400)	(150)
Increase in Trade payables (250 - 230)	20
Increase in outstanding Expense (20 - 10)	10
Increase in Outstanding wages (50 - 40)	10
Cash flow from operating activities before taxes	640
Less: Taxes Paid	(195)
Cash generated from operations	445

Workings:**Trade Receivable**

	₹		₹
To Balance b/d	250	By Bank (Bal. fig)	4,000
To Sales	4,150	By Balance c/d	400
	4,400		4,400

Trade Payables

	₹		₹
To Bank (Bal. fig)	2380	By Balance b/d	230
To Balance c/d	250	By Purchases	2,400
	2,630		2,630

Wages Payable

	₹		₹
To Bank (Bal. fig)	790	By Balance b/d	40
To Balance c/d	50	By Wages	800
	840		840

Provision for Tax

	₹		₹
To Advance Tax	180	By P/L	200
To Balance b/d	200	By Balance c/d	180
	380		380

Advance Tax

	₹		₹
To Balance b/d	180	By Provision for Tax	180
To Bank (Bal fig)	195	By Balance c/d	195
	375		375

Illustration 6

Prepare Cash Flow Statement of M/s MNT Ltd. for the year ended 31st March, Year 1 with the help of the following information:

1. Company sold goods for cash only
2. Gross Profit Ratio was 30% for the year, gross profit amounts to Rs.3,82,500.
3. Opening inventory was less than closing inventory by Rs.35,000
4. Wages paid during the year Rs.4,92,500
5. Office & selling expenses paid during the year Rs.75,000
6. Dividend paid during the year Rs. 30,000 (including dividend distribution tax)
7. Bank loan repaid during the year Rs.2,15,000 (including interest Rs.15,000)
8. Trade payables on 31st March, Year 0 exceed the balance on 31st March Year 1 by Rs.25,000
9. Amount paid to trade payables during the year Rs.4,60,000
10. Tax paid during the year amounts to Rs.65,000 (Provision for taxation as on 31st March of Year 1 Rs.45,000)
11. Investments of Rs.7,00,000 sold during the year at a profit of Rs.20,000
12. Depreciation on fixed assets amounts to Rs.85,000

13. Plant and Machinery purchased on 15th November of Year 0 for Rs.2,50,000
14. Cash and Cash equivalents on 31st March of Year 0 - Rs.2,00,000
15. Cash and Cash equivalents on 31st March of Year 1 – Rs.6,07,500

Solution: Illustration 6

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	₹	₹
I. Cash flow from Operating Activities:		
Cash Collected from Customer (Working Note 1)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Less: Taxes Paid		(65,000)
Net cash generated from operating activities		1,82,500
II. Investing Activities:		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash generated from investing activities		4,70,000
III. Cash flows from financing activities:		
Dividend paid (including dividend distribution tax)	(30,000)	
Bank loan repayment	(2,00,000)	
Interest on loan	(15,000)	
Net cash used in financing activities		(2,45,000)
Net increase in cash		4,07,500
Cash and cash equivalents at beginning of the period		2,00,000
Cash and cash equivalents at end of the period		6,07,500

Working Notes:

1. Sales

GP Ratio = 30%

=> Gross Profit / Sales = 30%

=> Sales = ₹3,82,500 / 30% = 12,75,000

Illustration 7

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.2014 from the following information:

- (1) Sales for the year amounted to Rs.135 crores out of which 60% was cash sales.
- (2) Purchases for the year amounted to Rs. 55 crores out of which credit purchase was 80%.
- (3) Administrative and selling expenses amounted to Rs.18 crores and salary paid amounted to Rs. 22 crores.
- (4) The Company redeemed debentures of Rs. 20 crores at a premium of 10%. Debenture holders were issued equity shares of Rs. 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was Rs1.5 crores.
- (5) Dividend paid during the year amounted to Rs. 11.7 crores (including Dividend distribution tax) was also paid.
- (6) Investment costing Rs.12 crores were sold at a profit of Rs. 2.4 crores.
- (7) Rs. 8 crores were paid towards income tax during the year.

(8) A new plant costing Rs. 21 crores were purchased in part exchange of an old plant. The book value of the old plant was Rs.12 crores but the vendor took over the old plant at a value of Rs.10 crores only. The balance was paid in cash to the vendor.

(9) The following balances are also provided:

	Rs. in crores 1.4.X0	Rs. in crores 31.3.X1
Debtors	45	50
Creditors	21	23
Bank	6	-

Solution: Illustration 7

Gamma Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	₹ in crores	₹ in crores
I. Cash flow from Operating Activities:		
• Cash sales (WN 1)	81	
• Cash collected from Debtors (WN 1)	49	
• Cash purchases (20% of 55)	(11)	
• Cash payments to suppliers (WN 2)	(42)	
• Cash paid towards Admin. & Selling	(18)	
• Cash paid to employees	(22)	
Cash generated from operations before Tax	37	
Less: Income Tax Paid	(8)	
Net cash generated from operating activities		29
II. Cashflow from investing activities:		
• Sale of investments (12+2.40)	14.4	
• Payments for purchase of fixed assets (21 - 10)	(11)	
Net cash generated from investing activities		3.4
Cash flows from financing activities		
• Redemption of debentures (22-15)	(7)	
• Interest paid on debentures	(1.5)	
• Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash and cash equivalents		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Working Note:

1. Cash collected from Sales

Total Sales = 135

Cash sales = 60% of 135 = 81 Crores

Credit Sales = 54

Debtors A/c (Amount collected)

(crores)

	₹		₹
To Balance b/d	45	By Bank (bal. fig)	49
To Sales	54	By Balance c/d	50
	99		99

2.**Creditors A/c**

	₹		₹
To Bank (bal. fig)	42	By Balance b/d	21
To Balance c/d	23	By Purchases (55x80%)	44
	65		65

3. Cash paid to Debt holders

Face value of debentures = 20 Crores

Add: Premium (10% of 20) = 2 Crores

Total amount Payable = 22 Crores

Less: Equity Shares issued = (15)

Cash paid = 7 Crores

Illustration 8

From the following Balance Sheets of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.20X1:

Balance Sheets of Mr. Zen

Liabilities	1.4.20X0	1.4.20X1
Zen's Capital A/c	10,00,000	12,24,000
Trade payables	3,20,000	3,52,000
Mrs. Zen's loan	2,00,000	--
Loan from Bank	3,20,000	4,00,000
	18,40,000	19,76,000
Assets	1.4.20X0	1.4.20X1
Land	6,00,000	4,40,000
Plant and Machinery	6,40,000	8,80,000
Inventories	2,80,000	2,00,000
Trade receivables	2,40,000	4,00,000
Cash	80,000	56,000
	18,40,000	19,76,000

Additional information:

A machine costing Rs.80,000/- (accumulated depreciation there on 24,000/-) was sold for 40,000/-. The provision for depreciation on 1.4.20X0 was 2,00,000/- and 31.3.20X1 was 3,20,000/- The net profit for the year ended on 31.3.20X1 was 3,60,000/-.

Solution: Illustration 8

Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.20X1

Particulars	₹
(i) Cash flow from operating activities	
Net Profit (given)	3,60,000
Add: Non-Cash Depreciation	1,44,000
Add: Investment Related – Loss on sale of Plant & Machinery	16,000
Operating Profit before working capital changes	5,20,000
Adjustments working Capital	

Add: Decrease in inventory	80,000
Less: Increase in trade receivables	(1,60,000)
Add: Increase in trade payables	32,000
Net cash generated from operating activities	4,72,000
(ii) Cash flow from investing activities	
• Cash Paid to purchase of P&M	(4,40,000)
• Sale of Machinery (W.N.1)	40,000
• Cash received on Sale of land	1,60,000
Net cash used in investing activities	(2,40,000)
(iii) Cash flow from financing activities	
• Loan availed from bank	80,000
• Repayment of Mrs. Zen's Loan	(2,00,000)
• Drawings (W.N.2)	(1,36,000)
Net cash used in financing activities	(2,56,000)
Net decrease in cash	(24,000)
Opening balance as on 1.4.20X0	80,000
Cash balance as on 31.3.20X1	56,000

Working Notes:

1.Fixed Assets

	20X0	20X1
WDV	6,40,000	8,80,000
Depreciation (Accumulated)	2,00,000	3,20,000
Cost (Gross Block)	8,40,000	12,00,000

Plant & Machinery A/c

	₹		₹
To Balance b/d	8,40,000	By Asset Disposal	80,000
To Bank (Purchase of P/M)	4,40,000		
(Bal.fig)		By Balance C/d	12,00,000
	12,80,000		12,80,000

Provision for depreciation on Plant and Machinery A/c

	₹		₹
To asset Disposal	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Depreciation (Bal.fig)	1,44,000
	3,44,000		3,44,000

Asset Disposal A/C

	₹		₹
To Plant & Machinery	80,000	By Provision for Deprecia.	24,000
		By Bank	40,000
		By P/L (Loss on sale)	16,000
	80,000		80,000

2.To find out Mr. Zen's drawings:

Capital a/c

	₹		₹
To Bank (Drawings) Bal. fig.	1,36,000	By Bal b/d	10,00,000
To Balance c/d	12,24,000	By P/L	3,60,000
	13,60,000		13,60,000

Illustration 9

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 20X1:

	(Rs. In lakhs)
Net Profit	25,000
Dividend (including dividend tax) paid	8,535
Provision for Income tax	5,000
Income tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to Profit & Loss Account	20,000
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income on investments	2,506
Interest expenses of the year	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,081
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988

Prepare the Cash Flow Statement for the year 20X1 in accordance with AS 3.

Solution: Illustration 9

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

	(₹ in lakhs)
I. Cash flows from operating activities	
Net profit (before taxation) (25,000 + 5,000)	30,000
Add: Depreciation (Non – Cash)	20,000
Loss on sale of assets (Net)	40
Less: Profit on sale of investments	(100)
Less: Interest income on investments	(2,506)
Add: Interest expenses	10,000
Operating profit before working capital changes	57,434

Increase in working capital (Excluding cash and bank balance)	(56,081)
Cash generated from operations before Taxes	1,353
Income taxes paid	(4,248)
Net cash used in operating activities	(2,895)
II. Cash flows from investing activities	
• Sale of assets (185 – 40)	145
• Sale of investments (27,765 + 100)	27,865
• Interest income on investments *	2,506
• Purchase of fixed assets	(14,560)
• Investment in joint venture	(3,850)
• Purchase of fixed assets	(14,560)
• Expenditure on construction work-in progress	(34,740)
• Net cash used in investing activities	(22,634)
Cash flows from financing activities	
• Proceeds from calls in arrear	2
• Receipts of grant for capital projects	12
• Proceeds from long-term borrowings	25,980
• Proceed from short-term borrowings	20,575
• Interest paid	(10,520)
• Dividend (including dividend tax) paid	(8,535)
Net cash generated from financing activities	27,514
Net increase in cash and cash equivalents	1,985
Cash and cash equivalents at the beginning of the period	5,003
Cash and cash equivalents at the end of the period	6,988

* Assumed interest income fully received

Illustration 10

The following data were provided by the accounting records of Ryan Ltd. at year-end, March 31, 20X1:
Income Statement

	(Rs.)	(Rs.) Rs.
Sales		6,98,000
Cost of Goods Sold		<u>(5,20,000)</u>
Gross Margin		1,78,000
Operating Expenses		
(including Depreciation Expense of Rs.37,000/-)		<u>(1,47,000)</u>
		31,000
Other Income / (Expenses)		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	<u>(3,000)</u>	
		<u>(8,000)</u>
		23,000

Income tax		(7,000)
		<u>16,000</u>

Comparative Balance Sheets

	31st March 20X1	31st March 20X0
Assets		
Plant Assets	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (Long term)	1,15,000	1,27,000
Current Assets:		
Inventory	1,44,000	1,10,000
Accounts receivable	47,000	55,000
Cash	46,000	15,000
Prepaid expenses	<u>1,000</u>	<u>5,000</u>
	<u>9,65,000</u>	<u>7,49,000</u>
Liabilities		
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Current liabilities:		
Accounts payable	50,000	43,000
Accrued liabilities	12,000	9,000
Income taxes payable	3,000	5,000
	<u>9,65,000</u>	<u>7,49,000</u>

Analysis of selected accounts and transactions during 20X0-X1

1. Purchased investments for Rs.78,000/-.
2. Sold investments for Rs.1,02,000/-. These investments cost Rs.90,000/-.
3. Purchased plant assets for Rs.1,20,000/-.
4. Sold plant assets that cost Rs.10,000/- with accumulated depreciation of Rs. 2,000/- for Rs.5,000/-.
5. Issued Rs.1,00,000/- of bonds at face value in an exchange for plant assets on 31st March, 20X1.
6. Repaid Rs.50,000/- of bonds at face value at maturity.
7. Issued 15,000 shares of Rs. 10/- each.
8. Paid cash dividends Rs. 8,000/-.

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

Solution: Illustration 10

Cash Flow Statement of Ryan Limited

Particulars	₹	₹
I. Cash flows from operating activities		
Net profit before taxation	23,000	
Add: Depreciation	37,000	
Add: Interest expense	23,000	
Less: Interest income	(6,000)	

Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Operating profit before working capital changes		68,000
Adjustments for Working Capital changes:		
Less: change in Inventory - Increase	(34,000)	
Add: Decrease in Receivable	8,000	
Add: Decrease in prepaid expenses	4,000	
Add: Increase in accounts payable	7,000	
Add: Increase in accrued liabilities	3,000	
Operating Cash flow before taxes	56,000	
Income taxes paid	(9,000)	
Net cash generated from operating activities		47,000
II. Cash flows from investing activities		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of Investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
III. Cash flows from financing activities		
Proceeds from issuance of share capital (465-315)	1,50,000	
Dividends paid	(8,000)	
Repayment of bonds (2,45,000 + 1,00,000 – 2,95,000)	(50,000)	
Interest paid	(23,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

Working Notes:

1. Income Tax Paid

Income Tax Paid

	₹		₹
To Bank (Bal. fig)	9,000	By Bal b/d	5,000
To Balance c/d	3,000	By P/L (Current year Provision)	7,000
	12,000		12,000

2.

Plant Assets

	₹		₹
To Balance b/d	5,05,000	By Asset Disposal	10,000
To Bonds	1,00,000	By Depreciation	7,15,000
To Bank (Bal. fig)	1,20,000		
	7,25,000		7,25,000

Accumulated Depreciation

	₹		₹
To Asset Disposal (Bank)	2,000	By Bal b/d	68,000
To Balance c/d	1,03,000	By Depreciation	37,000
	1,05,000		1,05,000

Asset Disposal

	₹		₹
To Plant Assets	10,000	By Accumulated Depreciation	2,000
		By Bank	5,000
		By P/L (Loss)	3,000
	10,000		10,000

3.

Investment (at Cost)

	₹		₹
To Balance b/d	1,27,000	By Bank	1,02,000
To P/L	12,000	(90,000 + 12,000)	
To Bank (Bal. fig)	78,000	By Balance c/d	1,15,000
	2,17,000		2,17,000

4. Dividend Paid

Reserves and Surplus

	₹		₹
To Dividend Paid (Bank)	8,000	By Bal b/d	1,32,000
Bal.fi			
To Balance c/d	1,48,000	By P/L (Profits for the year)	16,000
	1,48,000		1,48,000

Illustration 11

From the following Balance Sheet and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

Liabilities	31 st March, 20X1	31 st March, 20X0	Assets	31 st March, 20X1	31 st March, 20X0
Equity Share Capital	6,00,000	5,00,000	Land and Building	1,50,000	2,00,000
10% Redeemable Preference Share Capital	•	2,00,000	Plant and Machinery	7,65,000	5,00,000
Capital Redemption Reserve	1,00,000	-	Investments	50,000	80,000
Capital Reserve	1,00,000	•	Inventory	95,000	90,000
General Reserve	1,00,000	2,50,000	Trade receivables	2,50,000	2,25,000

Profit & Loss Account	70,000	50,000	Cash and Bank	65,000	90,000
9% Debentures	2,00,000	-	Voluntary Separation Payments	1,25,000	65,000
Trade payables	1,15,000	1,10,000			
Liability for Expenses	30,000	20,000			
Provision for Taxation	95,000	60,000			
Dividend Payable	90,000	60,000			
	15,00,000	12,50,000		15,00,000	12,50,000

Additional Information:

- A piece of land has been sold out for Rs.1,50,000 (Cost – Rs.1,20,000) and the balance land was revalued. 4960Capital Reserve consisted of profit on sale and profit on revaluation.
- On 1st April, 20X0 a plant was sold for Rs.90,000 (Original Cost – Rs.70,000 and W.D.V. – Rs.50,000) and Debentures worth Rs.1 lakh was issued at par as part consideration for plant of Rs.4.5 lakhs acquired.
- Part of the investments (Cost – Rs.50,000) was sold for Rs.70,000.
- Pre-acquisition dividend received Rs.5,000 was adjusted against cost of investment.
- Directors have declared 15% dividend for the current year.
- Voluntary separation cost of Rs.50,000 was adjusted against General Reserve.
- Income-tax liability for the current year was estimated at Rs.1,35,000.
- Depreciation @ 15% has been written off from Plant account but no depreciation has been charged on Land and Building.

Solution: Illustration 11

Particulars	₹	₹
I. Cash flows from operating activities		
Net Profit after taxation (W.N.1)	1,10,000	
Add: Provision for taxation	1,35,000	
Net Profit before taxation		2,45,000
Add/Less		
• Depreciation	1,35,000	
• Gain on Sale of Plant	(40,000)	
• Gain on Sale of Investment (70,000 – 50,000)	(20,000)	
• Interest on Debentures (9% of Debentures)	18,000	93,000
Operating Profit Before working Capital Changes		3,38,000
Increase in Inventories	(5,000)	
Increase in trade receivables	(25,000)	
Increase in trade payables	5,000	
Increase in liabilities for expenses	10,000	(15,000)
Cash generated from operations		3,23,000
Less: Taxes Paid		(1,00,000)
		2,23,000

Voluntary Separation payment		(1,10,000)
Net cash generated from operating activities		1,13,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.11)	1,50,000	
Proceeds from sale of plant (W.N.8)	90,000	
Purchase of plant (W.N.7)	(3,50,000)	
Proceeds from sale of investments (W.N.12)	70,000	
Pre-acquisition dividend received	5,000	
Purchase of investments (W.N.12)	(25,000)	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares (6,00,000 – 5,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Payment of Interest	(18,000)	
Dividends paid	(60,000)	
Net cash used in financing activities		(78,000)
Net decrease in cash and cash equivalents		(25,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		65,000

Working Notes:

1. Net Profit

Profit and Loss Account

	₹		₹
To Dividend Payable (15% of 6,00,000)	90,000	By Balance b/d	50,000
To balance c/d	70,000	By Profit for 20X1 (Balancing Fig.)	1,10,000
	1,60,000		1,60,000

2. General Reserve A/c

	₹		₹
To Voluntary separation cost	50,000	By Balance b/d	2,50,000
To CRR	1,00,000		
To balance c/d	1,00,000		
	2,50,000		2,50,000

3. Capital Redemption Reserve A/c

	₹		₹
		By Balance b/d	-
To balance c/d	1,00,000	By General Reserve	1,00,000
	1,00,000		1,00,000

4. Capital Reserve

	₹		₹
		By Balance b/d	-
To balance c/d	1,00,000		
	1,00,000		1,00,000

5. Voluntary Separation Cost A/c

	₹		₹
To Balance b/d	65,000	By General Reserve	50,000
To Bank (Balancing Fig.)	70,000	By Balance c/d	1,25,000
	1,75,000		1,75,000

6. Redemption of Preference shares

	₹
Face value redeemed	2,00,000
Face value of fresh issue	(1,00,000)
Balance (Transferred from free reserve to CRR)	1,00,000

7. Plant and Machinery

	₹		₹
To Balance b/d	5,00,000	By Disposal of Plant	50,000
To Debentures	1,00,000	By Depreciation (15% of 9,00,000)	1,35,000
To Bank	3,50,000	By Bal c/d	7,65,000
	9,50,000		9,50,000

8. Disposal of Plant

	₹		₹
To Plant and Machinery	50,000	By Bank	90,000
To Profit on Sale	40,000		
	90,000		90,000

9. Provision for Taxation

	₹		₹
To Bank a/c (Bal. Fig)	1,00,000	By Balance b/d	60,000
To Balance c/d	95,000	By Profit and Loss	1,35,000
	1,95,000		1,95,000

10 Land and Building A/c

	₹		₹
To Balance b/d	2,00,000	By Disposal of land	1,20,000
To Capital Reserve	70,000	By Balance c/d	1,50,000
	2,70,000		2,70,000

11. Disposal of Land

	₹		₹
To Land and Building	1,20,000	By Bank	1,50,000
To Capital Reserve	30,000		
	1,50,000		1,50,000

12. Investment a/c

	₹		₹
To Balance b/d	80,000	By Bank	70,000
		By Bank (Pre acquisition dividend)	5,000
To P&L (Gain on Sale)	20,000	By Balance c/d	50,000
To Bank (Bal. fig) - Purchases	25,000		
	1,25,000		1,25,000

Illustration 12

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2019.

	Particulars	Note	31.03.2019 (Rs.)	31.03.2018 (Rs.)
I	EQUITY AND LIABILITIES			
	(1) Shareholder's Funds	1	3,50,000	3,00,000
	(a) Share Capital			
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities		65,000	44,000
	(a) Trade Payables	3	37,000	27,000
	(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		32,000	17,000
	(c) Cash & Cash Equivalents			
	Total		5,66,000	4,37,000

Note 1 : Share capital

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	1,00,000	1,50,000
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	25,000	

Total	82,000	38,000
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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	1,91,000	90,000
Total	2,66,000	1,90,000

Additional Information:

- (i) Rs. 18,000 depreciation for the year has been written off on plant and machinery and no depreciation has been charged on Land and Building.
- (ii) A piece of land has been sold out for Rs. 50,000 and the balance has been revalued, profit on such sale and revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.
- (iii) A plant was sold for Rs. 12,000 WDV being Rs. 15,000 on the date of sale (after charging depreciation).
- (iv) Dividend received amounted to Rs. 2,100 which included pre-acquisition dividend of Rs. 600.
- (v) An interim dividend of Rs. 10,000 including Dividend Distribution Tax has been paid.
- (vi) Non-current investments given in the balance sheet represents investment in shares of other companies.
- (vii) Amount of provision for tax existing on 31.3.2018 was paid during the year 2018-19.

Solution: Illustration 12

Cash flow Statement for the year ending 31st March, 2019

	₹	₹
I. Cash Flow from Operating Activities		
Closing balance as per Profit and Loss Account		27,000
Less: Opening balance as per Profit and Loss Account		(18,000)
Add: Dividend declared during the year		37,000
Add: Interim dividend paid during the year		10,000
Add: Transfer to reserve		10,000
Add: Provision for Tax		32,000
Net profit before taxation		98,000
Add: Items to be added		
Depreciation	18,000	
Loss on sale of Plant	3,000	
Goodwill written off	13,000	34,000
Less: Dividend Income		(1,500)

Operating profit before working capital changes		1,30,500
Add: Decrease in Current Assets and Increase in Current Liabilities		
Decrease in Inventories	7,000	
Increase in Trade Payables	21,000	28,000
Less: Increase in Trade Receivables		(33,000)
Cash generated from operations		1,25,500
Less: Income taxes paid		(28,000)
Net Cash from operating activities		97,500
II. Cash Flows from investing activities:		
Purchase of Plant	(1,34,000)	
Sale of Land	50,000	
Sale of plant	12,000	
Purchase of investments	(25,600)	
Dividend Received	2,100	
Net cash used in investing activities		(95,500)
III. Cash Flows from Financing Activities:		
Proceeds from issue of equity share capital	1,00,000	
Redemption of preference shares	(50,000)	
Interim Dividend (inclusive of DDT) paid	(10,000)	
Final dividend (inclusive of DDT) paid	(27,000)	
Net cash from financing activities		13,000
Net increase in cash and cash equivalents		15,000
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		32,000

Working Notes:

1.

Land and Building Account

	₹		₹
To Balance b/d	1,00,000	By Bank (Sale)	50,000
To Capital Reserve (Profit on sale/revaluation)	25,000		
	1,25,000		1,25,000

2.

Plant and Machinery Account

	₹		₹
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss on sale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

3.

Investments Account

	₹		₹
To Balance b/d	10,000	By Bank A/c (Div. received	600
To Bank A/c (Purchase)	25,600	By Balance c/d	35,000
	35,600		35,600

CHAPTER 4 – ACCOUNTING OF BANKING, ELECTRICITY & INSURANCE COMPANIES

UNIT 1 - BANKING COMPANIES

1. Illustrations

1. Illustration

A commercial bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk-adjusted asset and risk weighted assets ratio:

Capital Funds:	Rs. Lakh
Equity Share Capital	4,80,00
Statutory Reserve	2,80,00
Capital Reserve (of which ₹ 280 lakhs were due to revaluation of assets and the balance due to sale)	12,10
Assets:	
Cash Balance with RBI	4,80
Balances with other Bank	12,50
Claims on Banks	28,50
Other Investments	782,50
Loans and Advances:	
i. Guaranteed by government	128,20
ii. Guaranteed by public sector undertakings of Government of India	702,10
iii. Others	52,02,50
Premises, furniture and fixtures	182,00
Other Assets	201,20
Off-Balance Sheet Items:	
Acceptances, endorsements and letters of credit	37,02,50

Solution 1

A) Calculation of Tier-1 & Tier- II Capital

Particulars	Tier – I (₹ in lakhs)	Tier – II (₹ in lakhs)
Equity share capital	48,000	-
Statutory Reserves	28,000	-
Capital Reserves (1,210 – 280)	930	-
Revaluation Reserve (45% of 280)	-	126
Total	76,930	126

B) Calculation of Risk Adjusted Assets

Particulars	Amount (₹ in lakhs)	Risk (%)	Risk (₹)
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			(₹ in lakhs)
Cash Balance with RBI	480	0	0
Balance with other Banks	12,50	20	250
Claims on Banks	28,50	20	570
Other Investments	7,82,50	100	7,82,50
Loans and Advances Guaranteed by Govt.	1,28,20	0	0
Loans and Advances Guaranteed by Public Sector	7,02,10	0	0
Loans and Advances Others	52,02,50	100	52,02,50
Premises, Furniture & Fixtures	1,82,00	100	1,82,00
Other Assets	2,01,20	100	2,01,20
			63,76,40
Off- B/s Items : Acceptances, endorsements and LoC	37,02,50	100	250
Total			1,00,78,90

2. Illustration

The outstanding amount (funded as well as unfunded) as on 31st March 2011 was ₹10,000. The realizable value of security of the same was ₹8,000. Period for which the advance has remained in 'doubtful' category as on 31st March 2011 was: 2.5 years.

Compute the total provision required for year ended 31st March 2011 and 31st March 2012 as per relevant banking provisions.

Solution 2

	Asset Classification		Provisions on secured portion		Provisions on unsecured portion	Total (₹)
		%	Amount	%	Amount	
	Doubtful 1 to 3 years	40	3,200	100	2,000	5,200
	Doubtful more than 3 years	100	8,000	100	2,000	10,000

3. Illustration

From the following information, find out the amount of provisions to be shown in the Profit and Loss Account of AG bank.

Assets		₹In lakhs
Standard		5,000
Sub-standard		4,000
Doubtful	: for one year	800
	: for three years	600
	: for more than three years	200

Loss Assets		1,000
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Solution 3

Assets	Amount in Lakhs	% Provision	Provision in Lakhs
Standard	50,00	0.4	20
Substandard (Assumed to be secured exposure)	40,00	15	600
Doubtful for one year (D1) (Assumed to be secured)	8,00	25	200
Doubtful for three year (D2) (Assumed to be secured)	6,00	40	240
Doubtful for more than three years (D3) (Assumed to be secured)	2,00	100	200
Loss	10,00	100	1,000
Total Provision required			2,260

Exam Tip: if the question silent about secured and unsecured portion of the loan of Doubtful Debts, then assume it to be secured.

4. Illustration

From the following information of AY Limited, compute the provisions to be made in the Profit and Loss account:

	₹ In lakhs
Assets	
Standard	20,000
Sub-standard	16,000
Doubtful	
For one year (secured)	6,000
For two years and three years (secured)	4,000
For more than three years (secured by mortgage of plant and machinery ₹600 lakhs)	2,000
Loss Assets	1,500

Solution 4

Calculation of amount of provision to be made in the Profit and loss A/c

Classification of Assets	Amount in Advances	% age of Provision	Amount of Provision
	(₹ in lakhs)		(₹ in lakhs)
Standard assets	20,000	0.4	80
Sub-standard assets	16,000	15	2,400
Doubtful assets :			
• For one year (secured)	6,000	40	1,600

• For two year (secured)	4,000	100	1,400
• For more than three years	1,400	100	600
(unsecured) D3	600	100	1,500
(secured)			
Non- recoverable assets (Loss assets)	1,500	100	1,500
Total provision required			9,080

5. Illustration

From the following information, compute the amount of provision as per applicable banking provisions:

Outstanding Balance	₹ 4 lakhs
ECGC Cover	50%
Period for which the advance has remained doubtful	More than 3 years remained doubtful (as on March 31, 2011)
Value of security held	₹1.50 lakhs

Solution 5

(A)

Sr.no	Particulars	Amount (₹ in lakhs)	% of Provision	Amount (₹ in lakhs)
1	Advance balance	4.00		
2	Less: secured (D – III)	(1.50)	100	1.50
3	Unsecured (1) – (2)	2.50		
4	ECGC guarantee 50% of (3)	(1.25)	0	-
5	Unsecured portion for (D – III)	1.25	100	1.25
Total Provision required				2.75

(B)

Sr.no	Particulars	Amount (₹ in lakhs)	% of Provision	Amount (₹ in lakhs)
1	Advance balance	4.00		
2	Less: secured (D – III)	(1.20)	100	1.20
3	Unsecured (1) – (2)	2.80		
4	ECGC guarantee 50% of (3)	(1.40)	0	-
5	Unsecured portion for (D – III)	1.40	100	1.40
Total Provision required				2.60

6. Illustration

In KR Bank, the doubtful assets (more than 3 years) as on 31.3.2011 is ₹ 1,000 lakhs. The value of security (including DICGC 100% cover of ₹100 lakhs) is ascertained at ₹500 lakhs. How much provision must be made in the books of the Bank towards doubtful assets?

Solution 6

Sr.no	Particulars	Amount (₹ in lakhs)	% of Provision	Amount of provision (₹ in lakhs)
1	Advance balance	1,000		
2	Less: secured (D – III)	(400)	100	400
3	Unsecured (1) – (2)	600		
4	ECGC guarantee 50% of (3)	(100)	0	-
5	Unsecured portion for provision (D – III)	500	100	500
Total Provision required				900

7. Illustration

A loan outstanding of ₹50,00,000 has DICGC cover. The loan guaranteed by ICGC is assigned a risk weight of 50%. What is the value of Risk-adjusted asset?

Solution 7

Particulars	(₹)
Loan outstanding	50,00,000
Guaranteed by DICGC – Risk weight	50%
Value of risk adjusted asset ₹ 50,00,000 x 50%	25,00,000

8. Illustration

The following is an extract from Trial Balance of overseas Bank as at 31st March, 2011:

	₹	₹
Bills discounted	12,64,000	
Rebate on bills discounted not due on March 31st, 20X0		22,160
Discount received		1,05,708

An analysis of the bills discounted is as follows:

	Amount ₹	Due Date 2011	Rate of Discount (%)
(i)	1,40,000	June 5	14
(ii)	4,36,000	June 12	14
(iii)	2,82,000	June 25	14
(iv)	4,06,000	July 6	16

Calculate Rebate on Bills Discounted as on 31-3-2011 and show necessary journal entries.

Solution 8

An Analysis of the bills discounted is as follows

Amount	Days	Discount	Amount
1,40,000	30 + 31 + 5 = 66	14%	3,544
4,36,000	30 + 31 + 12 = 73	14%	12,208

2,82,000	30 + 31 + 25 = 86	14%	9,302
4,06,000	30 + 31 + 30 + 6 = 97	16%	17,263
		Total	42,317

The amount of discount to be credited to the Profit and loss A/c will be

Particulars	Amount
Discount received during the year ended 31.3.2011	1,05,708
Less: Closing Rebate	(42,317)
Add: Opening Rebate	22,160
Discount amount of P&L	85,551

Rebate on Bills discounted A/c (Liability A/c)

Particulars	₹	Particulars	₹
To Discount on bills A/c	22,160	By balance b/d	22,160
To balance c/d	42,317	By Discount on bills A/c	42,317

Discount on Bills A/c (Liability A/c)

Particulars	₹	Particulars	₹
To Rebate on bills A/c	42,317	By Discount on bills	22,160
To P & L A/c	85,551	By Bank A/c	1,05,708

Journal entries

Date	Particulars	Dr ₹	Cr ₹
1)	Rebate on bills discounted A/c Dr To Discount on Bills A/c (Being the transfer of Rebate on Bills Discounted on 31-03-2010 to Discount on Bills Account)	22,160	22,160
2)	Bank A/c Dr To Discount on Bills A/c (Being discount received during the year)	1,05,708	1,05,708
3)	Discount on Bills A/c Dr To Rebate on Bills Discounted A/c (Being the transfer of rebate on bills discounted required on 31-3-2010 from discount on Bills Discount)	42,317	42,317
4)	Discount on Bills A/c Dr To Profit and Loss A/c (Being the amount of discount on bills transferred to P&L A/c)	85,551	85,551

9. Illustration

On 31st March, 2011, Uncertain Bank had a balance of ₹ 9 crores in "rebate on bills discounted" account. During the year ended 31st March, 2012, Uncertain Bank discounted bills of exchange of ₹4,000 crores charging interest at 18% per annum the average period of discount being for 73 days. Of these, bills of exchange of ₹600 crores were due for realisation from the acceptors/customers after 31st March, 2012, the average period outstanding after 31st March, 2012 being 36.5 days.

Uncertain Bank asks you to pass journal entries and show the ledger accounts pertaining to:

- discounting of bills of exchange and
- rebate on bills discounted.

Solution 9

Rebate A/c

Particulars	₹(Crores)	Particulars	₹(Crores)
To Discount A/c	9.00	By Balance b/d	9.00
To Balance c/d	10.8	By Discount A/c	10.8
	19.8		19.8

Discount A/c

Particulars	₹ (Crores)	Particulars	₹(Crores)
To Rebate A/c	10.8	By Rebate A/c	9.00
To P & L A/c	142.2	By Clients A/c	144
	153.00		153.00

Journal entries

Date	Particulars	Dr ₹ (Crores)	Cr ₹ (Crores)
1)	Rebate on bills discounted A/c Dr To Discount on Bills A/c (Being the transfer of opening balance in Rebate on Bills Discounted to Discount on Bills Account)	9.00	9.00
2)	Client / Bank A/c Dr To Discount on Bills A/c (Being income received)	144	144
3)	Discount on Bills A/c Dr To Rebate on Bills Discounted A/c (Being Provision made)	10.80	10.80
4)	Discount on Bills A/c Dr To Profit and Loss A/c (Being the amount of income for the year from discounting of bill exchange transferred to P & L A/c)	142.20	142.20

10. Illustration

The following information is available in the books of X Bank Limited as on 31st March, 2012:

	₹
Bills discounted	1,37,05,000
Rebate on Bills discounted (as on 1.4.2011)	2,21,600
Discount received	10,56,650

Details of bills discounted are as follows:

Value of bill (₹)	Due date	Rate of Discount

18,25,000	5.6.2012	12%
50,00,000	12.6.2012	12%
28,20,000	25.6.2012	14%
40,60,000	6.7.2012	16%

Calculate the rebate on bills discounted as on 31.3.2012 and give necessary journal entries.

Solution 10

Journal entries

Date	Particulars	Dr ₹	Cr ₹
1)	Rebate on bills discounted A/c Dr To Discount on Bills A/c (Being the transfer of opening balance in Rebate on Bills Discounted to Discount on Bills Account)	2,21,600	2,21,600
2)	Customer A/c Dr To Discount on Bills A/c (Being income for the current year recognised)	10,56,650	10,56,650
3)	Discount on Bills A/c Dr To Rebate on Bills Discounted A/c (Being provision made on 31 st march ,2012)	10.80	10.80
4)	Discount on Bills A/c Dr To Profit and Loss A/c (Being transfer of discount on bills ,of the year, to profit and loss A/c)	142.20	142.20

11. Illustration

On 1-4-2011 Bills for collection were Rs.7, 00,000. During 2011-2012 bills received for collection amounted to Rs.64, 50,000, bills collected were Rs.47, 00,000 and bills dishonoured and returned were Rs.5, 50,500. Prepare Bills for Collection (Assets) A/c and bills for Collection (Liability) A/C.

Solution 11

Bills for Collection Asset A/c

Particulars	₹(lakhs)	Particulars	₹(lakhs)
To Balance b/d	7.00	By Bills for collection liability A/c	47.00
To Bills for collection liability A/c	64.50	By Bills for collection liability A/c	5.50
		By Balance c/d	19.00
	71.50		71.50

Bills for Collection Liability A/c

Particulars	₹(lakhs)	Particulars	₹(lakhs)
To Bills for collection asset A/c	47.00	To Balance b/d	7.00
To Bills for collection asset A/c	5.50	To Bills for collection asset A/c	64.50
To Balance b/d	19.00		
	71.50		71.50

12. Illustration

Following facts have been taken out from the records of Adarsha Bank in respect of the year ending March 31, 2012:

- On 1-4-2011 Bills for collection were Rs.7, 00,000. During 2011-2012 bills received for collection amounted to Rs.64, 50,000, bills collected were Rs.47, 00,000 and bills dishonoured and returned were Rs.5, 50,500. Prepare Bills for Collection (Assets) A/c and bills for Collection (Liability) A/C.
- On 1-4-2011, Acceptance, Endorsement, etc. not yet satisfied amounted to Rs.14, 50,000. During the year under question, Acceptances, Endorsements, Guarantees etc., amounted to Rs.44, 00,000. Bank honoured acceptances to the extent of Rs.25, 00,000 and client paid off Rs.10, 00,000 against the guaranteed liability. Clients failed to pay Rs.1, 00,000 which the Bank had to pay. Prepare the "Acceptances, Endorsements and other Obligations A/c" as it would appear in the General ledger.
- It is found from the books, that a loan of Rs. 6, 00,000 was advanced on 30- 9-2011 @ 10 per cent p.a. interest payable half yearly; but the loan was outstanding as on 31-3-2012 without any payment recorded in the meantime, either towards principal or towards interest. The security for the loan was 10,000 fully paid shares of Rs. 100 each (the market value was Rs. 98 as per the Stock Exchange information as on 30th Sept., 2011). But due to fluctuations, the price fell to Rs.40 per share in January, 2012. On 31-3-2012, the price as per Stock Exchange rate was Rs.82 per share. State how you would classify the loan as secured/unsecured in the Balance Sheet of the Company.

Solution 12

Acceptances, Endorsements and other obligations A/c

Particulars	₹	Particulars	₹
To Constituents Ledger A/c	25.00	By Balance b/d	14.5
To Constituents Ledger A/c	10.00	By Constituents Ledger	44.0
To Constituents Ledger A/c	1.0		
To Balance b/d	22.50		
	58.5		58.5

13. Illustration

From the following information, prepare a Balance Sheet of ADT International Bank as on 31st March, 2011 giving the relevant schedules and also specify at least four important Principal Accounting Policies:

Rs. In lakhs

Particulars	Dr	Cr
Share Capital		198.00
19,80,000 Shares of Rs. 10 each		
Statutory Reserve		231.00
Net Profit before Appropriation		150.00
Profit and Loss Account		412.00
Fixed Deposit Account		517.00
Savings Deposit Account		450.00
Current Accounts	28.00	520.12
Bills Payable		0.10
Cash credits	812.10	

Borrowings from other Banks		110.00
Cash in Hand	160.15	
Cash with RBI	37.88	
Cash with other Banks	155.87	
Money at Call	210.12	
Gold	55.23	
Government Securities	110.17	
Premises	155.70	
Furniture	70.12	
Term Loan	792.88	
Total	2,588.22	2,588.22

Additional Information:

Bills for collection	18,10,000
Acceptances and endorsements	14,12,000
Claims against the Bank not acknowledged as debt	55,000
Depreciation charges—Premises	1,10,000
Furniture	78,000

50% of the Term Loans are secured by Government guarantees. 10% of cash credit is unsecured

Solution 13

Balance sheet of ADT International Bank As on 31st March, 2011

Capital and liabilities	Schedule No.	As on 31.3.11
Share Capital	1	198.00
Reserves and Surplus	2	793.00
Deposits	3	1487.00
Borrowings	4	110.00
Other liabilities and provisions	5	0.10
Total		2588.22
Assets		
Cash and balances with RBI	6	219.63
Balances with banks & money at call and short notice	7	344.39
Investments	8	165.40
Advances	9	1632.98
Fixed Assets	10	225.82
Other Assets	11	-
Total		2588.22
Contingent liabilities	12	14.67
Bills for collection		18.10

Schedule 1 – Capital

(Rs. Lakhs)

Authorised Capital	-
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Issued, Subscribed and paid up Capital	
19,80,000 shares of Rs. 10 each	198.00

Schedule 2 – Reserves & Surplus

(Rs. Lakhs)		
1) Statutory Reserve		
Opening balance	231.00	
Less : Current year appropriation	<u>37.50</u>	
Closing balance		268.50
2) Profit and Loss	[WN: 1]	524.50
		793.00

Schedule 3 – Deposits

(i)	Demand deposits from others	520.12
(ii)	Savings bank deposits	450.00
(iii)	Fixed deposits	517.00
		1487.12

Schedule 4 - Borrowings

Borrowings in India – Other Banks	110.00
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Schedule 5 - Borrowings

Bills payable	0.10
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Schedule 6 – Cash and balances with RBI

(i)	Cash in hand	160.15
(ii)	Balances with RBI in current account [WN: 2]	59.48
		219.63

Schedule 7 – Balances with banks and money at call and short notice

1.	In India	
	(i) Balances with banks	134.27
	(a) In current accounts (WN: 3)	
	(ii) Money at call and short notices	210.12
		344.39

Schedule 8 – Investments

(i)	Investments in India in	
	(i) Government securities	110.17
	(ii) Others – Gold	55.23
		165.40

Schedule 9 - Advances

(A)	Nature	
	- Cash, Credit Overdraft - Current A/c (W.Cap) [812.10 + 28] - Term Loans	840.10 792.88 1632.98
(B)	Security	
	- Secured by tangible asset (Bal.fig) - Secured by Bank/Govt guarantee (792.88x50%) - Others (812.10 x 10%)	1155.33 396.44 81.21
		1632.98

Schedule 10 – Fixed assets

	Premises:	
	Cost	156.80
	Less: Depreciation	(1.10)
	1)	155.70
	Other Fixed Assets	
	Furniture:	
	Cost	70.90
	Less: Depreciation	(0.78)
	2)	70.12
	(1) + (2)	225.82

Working notes:

1) Balance in Profit and Loss A/c

Profit and Loss Account (Opening balance)	412
Add: Net profit before appropriation (Profit for the year) 150	
Less: Transfer to statutory reserves (25% of 150.00)	112.5
<u>(37.5)</u>	
Closing P & L	524.50

2)

Cash Reserve Ratio

⇒ ≥ 4% of deposits should be maintained as balance with RBI

A) 4% of 1487.12 → 59.48

B) Current balance → (37.88)

21.60

- ⇒ Balance with other bank → 155.87
Less: Tr. to RBI current A/c → 21.60
Revised Bal with other banks = 134.27

3)

Statutory Liquidity Ratio

➤ Cash on hand	160.15
➤ Bal. with other bank	134.27
➤ Money at call & short notice	210.12
➤ Gold	55.23
➤ Unencumbered government securities	110.17
	669.94

- ⇒ 18% Deposits 1487.12 → 267.68
⇒ Minimum liquid assets for SLR compliances → 267.68
⇒ Actual Liquid assets → 669.94

→ SLR Norms Satisfied

14. Illustration

From the following information, prepare Profit and Loss A/c of KC Bank for the year ended 31st March, 2011

Items	Rs in '000
Interest on cash credit	18,20
Interest on overdraft	7,50
Interest on term loans	15,40
Income on investments	8,40
Interest on balance with RBI	1,50
Commission on remittances and transfer	75
Commission on letters of credit	1,18
Commission on government business	82
Profit on sale of land and building	27
Loss on exchange transactions	52
Interest paid on deposit	27,20
Auditors' fees and allowances	1,20
Directors' fees and allowances	2,50
Advertisements	1,80
Salaries, allowances and bonus to employees	12,40
Payment to Provident Fund	2,80
Printing and stationery	1,40
Repairs and maintenance	50
Postage, telegrams, telephones	80

Other Information

- (i) Interest on NPA's is as follows

Rs. In '000

	Earned	Collected
Cash Credit	8,20	4,00
Over Draft	4,50	1,00
Term Loans	7,50	2,50

- (ii) Classification of NPAs

	Rs. in '000s
Standard	30,00
Sub-Standard	11,20
Doubtful assets not covered by security	2,00
Doubtful assets covered by security for 1 year	50
Loss Assets	2,00

- (iii) Investments Rs 27, 50,000. Bank should not keep more than 25% of investment as 'held-for-maturity' investment. The market value of rest 75% investment is Rs. 19,75,000 as on 31-3-2011

Solution 14 KC Bank

P & L Account for the year ended 31-03-13

(₹ '000)

	Particulars	Sch No.	Year ended 31-03-13
I	Income		
	Interest Earned	13	38,30
	Other Income	14	2,50
	Total		40,80
II	Expenditure		
	Interest Expended	15	27,20
	Operating Expenses	16	23,40
	Provisions and contingencies		6,80
	Total		57,40
	Profit and Loss		
	Net Profit / Loss for the year		(16,60)
	Profit / loss (B/f)		0
	Total		(16,60)
	Appropriation		0

Schedule -13: Interest Earned

	Particulars	₹ '000	(2012-13)
I	Interest/ discount on advances/bills		

	- Interest on cash credit (18,20-8,20+400) - Interest on overdraft (7,50- 4,50 + 2,50) - Interest on term loans (15,40 – 7,50 + 2,50)	14,00 4,00 10,40	28,40
II	Income on term loans		8,40
III	Interest on Balance with RBI		1,50
	Total		38,30

Schedule -14: Other Income

	Particulars	₹ '000 (2012-13)	
I	Commission, Exchange and Brokerage - Commission on remittance and transfer - Commission on letter of credit - Commission on Govt. business	75 1,18 <u>82</u>	2,75
II			27
III	Profit on sale of Land & Building Loss on Exchange Transaction		(52)
	Total		2,50

Schedule -15: Interest expended

	Particulars	₹ '000
	Interest on Deposits	27,20

Schedule -16: Operating expenses

	Particulars	₹ '000 (2012-13)	
I	Payment and provision for employees - Salaries, allowances and bonus - Provident Fund Contribution	12,40 <u>2,80</u>	15,20
II	Printing and Stationery		1,40
III	Advertisement and publicity		1,80
IV	Director's fees, allowances and expenses		2,50
V	Auditors fees and expenses		1,20
VI	Postages, telegrams, telephones etc.,		80
VII	Repair and maintenance		50
	Total		23,40

Working Note:
Provision and contingencies

	Provision for NPA	₹ '000	
	Standard	3,000 x 0.40%	12
	Sub-standard	1,120 x 15%	1,68
	Doubtful not covered by security	200 x 100%	2,00
	Doubtful covered by security for 1 year	50 x 25%	12.5
	Loss assets	200 x 100%	2,00
			592.50
	Depreciation on current investments		
	Cost (75% of 27,50)	2,062.50	
	Less: Market value	<u>(1,975.00)</u>	87.50
	Total		680.00

- Note:
- 1) Sub-standard assets is assumed to be fully secured
 - 2) Investment which are **"held to maturity"** are generally carried **at cost**. Investment which are **"held for trading"** or **"available for sale"** will be valued at **lower of cost or MV**.

UNIT 2 - INSURANCE COMPANIES

Illustration - 1

Indian insurance company limited furnishes you with the following information:

- (i) On 31.12.20X1 it had reserve for unexpired risk to the tune of Rs. 40 crores.
- (ii) It comprised of Rs 15 crores in respect of marine insurance business; Rs 20 crores in respect of fire insurance business and Rs 5 crores in respect of miscellaneous insurance business.
- (iii) It is the practice of Indian Insurance Co. Ltd. to create reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.
- (iv) During 20X2, the following business was conducted:

(Rs. Crores)

	Marine	Fire	Miscellaneous
Premia collected from:			
(a) Insureds in respect of policies issued	18	43	12
(b) Other insurance companies in respect of risks undertaken	7	5	4
Premia paid/payable to other insurance companies on business ceded	6.7	4.3	7

Indian Insurance Co. Ltd. asks you to:

- (a) Pass journal entries relating to "Unexpired risks reserve".
- (b) Show in columnar form "Unexpired risks reserve" a/c for 20X2.

[Source - ICAI]

Illustration 2

Janani Assurance Co. Ltd. received ₹5,90,000 as premium on new policies and ₹ 1,20,000 as renewal premium. The company received ₹90,000 towards reinsurance accepted and paid ₹70,000 towards reinsurance ceded. How much will be credited to Revenue Account towards premium?

Illustration 3

From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 20X2:

	Direct business	Re- insurance
Claim paid during the year	46,70,000	7,00,000
Claim Payable — 1st April, 2012 31st March 2012	7,63,000 8,12,000	87,000 53,000
Claims received		2,30,000
Claims Receivable — 1st April 2012 31st March 2012	– –	65,000 1,13,000
Expenses of Management (includes Rs.35,000 Surveyor's fee and Rs.45,000 Legal expenses for settlement of claims)	2,30,000	–

Illustration 4

From the following information of Reliable Marine Insurance Ltd. for the year ending 31st March 2012 find out the

- Net premium earned
- Net claims incurred

(Rs)

	Direct business	Re-insurance
Premium:		
Received	88,00,000	7,52,000
Receivable -1.04.2011	4,39,000	36,000
Receivable -31.03.2012	3,77,000	32,000
Paid:		
Payable- 1.04.2011		27,000
Payable – 31.03.2012		18,000
Claims:		
Paid	69,00,000	5,54,000
Payable – 1.04.2011	89,000	15,000
Payable - 31.03.2012	95,000	12,000
Received		2,01,000
Receivable –1.04.2011		40,000
Receivable - 31.03.2012		38,000

Illustration 5

Prepare Revenue Account in proper form for the year ended 31st March 2011 from the following particulars related to Goma General Insurance Co. for the year 2011-2012

	Direct Business	Re-Insurance
Premiums:		
Amount received	30,00,000	2,40,000
Receivable at the beginning	1,80,000	24,000
Receivable at the end	2,40,000	36,000
Amount paid	–	3,60,000
Payable at the beginning		30,000
Payable at the end		42,000
Claims:		
Amount paid	18,00,000	1,80,000
Payable at the beginning	60,000	12,000
Payable at the end	1,20,000	18,000
Amount recovered		1,20,000
Receivable at the beginning	–	18,000
Receivable at the end	–	12,000
Commission:	72,000	10,800
Amount paid	–	14,400
Amount received		

Additional information:

- i. Interest, dividend and rent received 30,000
- Income-tax in respect of above 6,000
- Management expenses including Rs.12,000 related to
- Legal expenses regarding claims 132,000

(ii) Provision for income tax existing at the beginning of the year was Rs. 1,95,000 the income – tax actually paid during the year Rs.1,68,000 and the provision necessary at the yearend Rs. 2,07,000

The net premium income of the company during the year 2010-2011 was Rs. 24,00,000 on which reserves for unexpired risk @ 50% and additional reserve @ 7 ½ % was created. This year the balance to be created forward to be carried forward is 50% of net premium on reserves for unexpired risk and 5% on additional reserves.

1. Illustration

Entity XYZ is a large manufacturer of plastic products for the local market. On 1st April, 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency Rs. appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ went into losses. As at 31st March, 20X7, entity XYZ's equity was Rs. 1,000. During the second quarter of financial year ended 31 March 20X7, the management restructured entity's operations. That restructuring helped reduce losses for the third and fourth quarters to Rs. 400 and Rs. 380, respectively. During the year ended 31st March, 20X7, entity XYZ reported a loss of Rs. 4,000. In January 20X7, the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15th March, 20X7, the government announced that it would reintroduce limited plastic import tariffs at 10 percent in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term.

Management of the entity XYZ undertook a going concern assessment at 31st March, 20X7. Management projects / forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31st March, 20X7 annual financial statements?

Hint: XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. But entity XYZ is a going concern.

Solution:

Entity XYZ, a plastic product manufacturer, faced financial distress due to the removal of import tariffs and currency appreciation, leading to a **₹4,000 crore loss for the year ended 31st March 20X7**. Despite restructuring, net equity stood at ₹1,000 crores. The government later announced a **10% import tariff effective from 20X8**, which management believed would help restore profitability.

As per **Ind AS 1**, financial statements must be prepared on a **going concern basis** unless liquidation or closure is imminent. If **material uncertainties** exist that cast doubt on an entity's ability to continue, they must be disclosed. The assessment must cover at least **12 months from the reporting date**.

Disclosure in Financial Statements: XYZ's financials should state that the **going concern assumption is based on expected tariff benefits and stable exchange rates**. However, if these assumptions do not materialize, **XYZ's liabilities could exceed its assets in the next financial year**, and this uncertainty must be transparently disclosed

Extracts from the notes to entity XYZ's 31st March, 20X7 financial statements

Note 1: Basis of preparation

On the basis of management's assessment at 31st March 20X7, the financial statements have been prepared on the going concern basis. However, management's assessment assumes that the government will reintroduce limited plastic import tariffs and that the currency exchange rate will remain constant. On

15th March 20X7, the government announced that limited import tariffs will be imposed in 20X8. However, the government emphasised that the tariff would not be as protective as the 40 percent tariff in effect before 20X7.

Management projects / forecasts that a 10 percent tariff on all plastic products would result in entity XYZ returning to profitability. As at 31st March, 20X7 entity XYZ had net assets of 1,000. If import tariffs are not imposed and currency exchange rates remain unchanged, entity XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. On the basis of their assessment of these factors, management believes that entity XYZ is a going concern.

2. Illustration

In 20X8 entity 'Superb' was acquired by entity 'Happy Go Luck'. To align its reporting date with that of its parent, Superb changed the end of its annual reporting period from 31st January to 31st March. Consequently, entity Superb's reporting period for the year ended 31st March, 20X8 is 14 months.

On the basis of these facts, what disclosure would be appropriate?

Hint: Comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.

Solution:

Entity Superb, acquired by Happy Go Luck in 20X8, changed its reporting date from **31st January to 31st March**, making the current reporting period **14 months** while the prior period is **12 months**.

As per **Ind AS 1**, when an entity changes its reporting period, it must:

- **Disclose the reason for the change.**
- **State that comparative figures are not entirely comparable.**

Note 1

Basis of preparation and accounting policies

Reporting period

To align the entity's reporting period with that of its parent (Happy Go Luck), the entity changed the end of its reporting period from 31st January to 31st March. Amounts presented for the period ended 31st March, 20X8 are for 14 months. Comparative figures are for a 12 months period. Consequently, comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.

3. Illustration

An entity produces whisky from barley, water, and yeast in a 24-month distillation process. At the end of the reporting period the entity has one month's supply of barley and yeast raw materials, 800 barrels of partly distilled whisky and 200 barrels of distilled whisky. Determine whether they are current assets.

Hint: Current Assets

Solution:

An entity producing whisky undergoes a **24-month distillation process** and holds raw materials, work-in-progress, and finished goods.

As per **Ind AS 1**, inventory is a **current asset** if it is **part of the entity's normal operating cycle**, regardless of whether the cycle extends beyond **12 months**. Since whisky production is part of the entity's cycle, all inventories, including **raw materials, work-in-progress, and finished whisky**, are classified as **current assets**.

4. Illustration

An entity owns a machine with which it manufactures goods for sale. It also owns the building in which it carries out its commercial activities. Determine whether they are current assets.

Hint: Non-Current Assets

Solution:

The machine and the building are non-current assets because:

- they are not cash or cash equivalents;
- they are not expected to be realised or consumed in the entity's normal operating cycle;
- they are not held for the purpose of trading; and
- they are not expected to be realised within twelve months of the end of the reporting period.

5. Illustration

On 31 December 20X2, an entity replaced a machine in its production line. The replaced machine was sold to a competitor for Rs,3,00,000. Payment is due 15 months after the end of the reporting period. Determine the nature of payment due.

Hint: Receivable is a non-current asset

Solution:

An entity sold a replaced machine for ₹3,00,000, with **payment due 15 months after the reporting date**.

As per **Ind AS 1**, an asset is **non-current** if it is:

- **Not cash or cash equivalent.**
- **Not expected to be realized within 12 months.**
- **Not held for trading purposes.**

Since the receivable is **due beyond 12 months**, it is classified as a **non-current asset**. If payment were due **within 12 months**, it would be a **current asset**.

6. Illustration

On 1st April, 20X2, XYZ Ltd invested Rs.15,00,000 surplus funds in corporate bonds that bear interest at 8 percent per year. Interest is payable on the corporate bonds on 1st April, of each year. The principal is repayable in three annual instalments of Rs.5,00,000 starting from 1st April, 20X3. Determine if it is a current liability?

Hint: Rs.5,00,000 (repayable on 31/3/20X3)– Current assets & remaining Rs.10 lakhs non-current assets

Solution:

XYZ Ltd invested ₹15,00,000 in corporate bonds at **8% interest**, payable annually. The **principal is repayable in three installments of ₹5,00,000 each**, starting from **1st April 20X3**.

As per **Ind AS 1**, the ₹5,00,000 installment due within 12 months is classified as a **current asset**, while the **remaining ₹10,00,000** is a **non-current asset**. Similarly, ₹1,20,000 **accrued interest** is classified as a **current asset**, as it is expected to be received within 12 months.

7. Illustration

On 1st April, 20X3, Charming Ltd issued 100,000 Rs. 10 bonds for Rs. 1,000,000. On 1st April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at Rs. 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?

Hint: Rs.9,00,000 non-current liability & Rs.1,80,000 current liabilities

Solution:

Charming Ltd issued **100,000 bonds of ₹10 each** (total ₹10,00,000) on **1st April, 20X3**, with **8% annual interest** payable each year. The company is obligated to **redeem 10,000 bonds annually** from **1st April, 20X4**.

As per **Ind AS 1**, in the financial statements for **31st March, 20X4**:

- **₹80,000 accrued interest** and **₹1,00,000 current portion of bonds** (due on **1st April, 20X4**) are classified as **current liabilities**.
- The **remaining ₹9,00,000 bonds** due after **12 months** are classified as **non-current liabilities**.

8. Illustration

X Ltd provides you the following information:

- Raw material stock holding period: 3 months
- Work-in-progress holding period: 1 month
- Finished goods holding period: 5 months
- Debtor's collection period : 5 months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

Hint: Trade payables – Current Liabilities

Solution:

X Ltd has an **operating cycle of 14 months** and settles trade payables within **12.5 months**.

As per **Ind AS 1**, trade payables are classified as **current liabilities** if they are settled **within the entity's normal operating cycle**, even if it exceeds **12 months**. Since X Ltd's payables are due **within the cycle**, they are **classified as current liabilities**.

9. Illustration

Entity A has two different businesses, real estate and manufacturing of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

Hint: Classification should be based the normal operating cycle that is relevant to that particular asset / liability.

Solution:

Entity A has two businesses:

1. **Real estate (operating cycle: 3–4 years)**
2. **Passenger vehicle manufacturing (operating cycle: 15 months)**

As per **Ind AS 1**, an **asset/liability should be classified based on the operating cycle of the specific business it relates to**. Since the operating cycles are different for each business, classification should be done separately for each segment, and **disclosures should be made accordingly**.

It is advisable to disclose the normal operating cycles relevant to different types of businesses for better understanding.

10. Illustration

An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

- (a) Electricity Deposit
- (b) Tender Deposit/Earnest Money Deposit [EMD]
- (c) GST Deposit paid under dispute or GST payment under dispute.

Hint: (a) Non-Current (b) EMD based on terms of deposit (c) GST Deposit depends on facts of case

Solution:

- (a) **Electricity Deposit** - At all points of time, the deposit is recoverable on demand, when the connection is not required. However, practically, such electric connection is required as long as the entity exists. Hence, from a commercial reality perspective, an entity does not expect to realise the asset within twelve months from the end of the reporting period. Hence, electricity deposit should be classified as a non-current asset.
- (b) **Tender Deposit/Earnest Money Deposit [EMD]** - Generally, tender deposit / EMD are paid for participation in various bids. They normally become recoverable if the entity does not win the bid. Bid dates are known at the time of tendering the deposit. But until the date of the actual bid, one is not in a position to know if the entity is winning the bid or otherwise.
Accordingly, depending on the terms of the deposit if entity expects to realise the deposit within a period of twelve months, it should be classified as current otherwise non-current.
- (c) **GST Deposit paid under dispute or GST payment under dispute** - Classification of GST deposit paid to the Government authorities in the event of any legal dispute, which is under protest would depend on the facts of the case and the expectation of the entity to realise the same within a period of twelve months. In the case the entity expects these to be realised within 12 months, it should classify such amounts paid as current otherwise these should be classified as non-current.

11. Illustration

Paragraph 69(a) of Ind AS 1 states "An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle". An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payment upfront and credits the amount so received to "Income Received in Advance". How should this "Income Received in Advance" be classified, i.e., current or non-current?

Hint: Current Liability

Solution:

An entity develops **custom tools** for customers with an **operating cycle of 2 years**. The entity receives **upfront payments**, recorded as **Income Received in Advance**.

As per **Ind AS 1**, trade payables and other operating liabilities **are classified as current liabilities even if settled beyond 12 months**, provided they are part of **working capital**. Since **Income Received in Advance is part of the working capital cycle**, it is classified as a **current liability**.

12. Illustration

An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.

- (a) How should such loan be classified in the balance sheet of the entity?
- (b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?
- (c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?
- (d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?

Hint: (a) Non-Current (b) Current (c) Current Liability (d) Current

Solution:

- (a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as non-current.
- (b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.
- (c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.
- (d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

13. Illustration

In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 20X2, failing which the loan becomes payable on demand. As on March 24, 20X2, the entity has not been able to get the promoter's contribution. On March 25, 20X2, the entity approached the bank and obtained a grace period up to June 30, 20X2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 20X2.

- (a) As on March 31, 20X2, how should the entity classify the loan?
- (b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 20X2, the entity approached the bank and got the

compliance date extended up to June 30, 20X2 for getting promoter's contribution. In this case will the loan classification as on March 31, 20X2 be different from (a) above?

Hint: (a) Current (b) Non-Current

Solution:

- (a) "An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March 20X2, the loan will be classified as current.
- (b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March 20X2, the loan will retain its classification as non-current.

14. Illustration

OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd. How should the loan be classified in the financial statements of OMN Ltd? Will it be any different for MN Ltd?

Hint: Current

Solution:

The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.

However, OMN Ltd would classify the loan as a current asset if both the parties intend that it will be repaid within 12 months of the reporting period.

MN Ltd would classify the loan as current because it does not have the right to defer repayment for more than 12 months, regardless of the intentions of both the parties.

The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.

15. Illustration

An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.

- (a) Will the inventory and the trade receivables be current in nature?
- (b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different?

Hint: (a) Current if realisable within normal operating cycle (b) No

Solution:

Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same or intends to sell or consume it in its normal operating cycle.

- (a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.
- (b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.

16. Illustration

Company A has taken a long term loan from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both the companies agreed that the payment will not be demanded immediately as a consequence of breach of material provision.

Advise on the classification of the liability as current / non-current.

Hint: Liability to be classified as current as at March 31, 20X2.

Solution:

- (a) Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

In the given case, Company B (the lender) agreed for not to demand payment but only after the reporting date and the financial statements were approved for issuance. The financial statements were approved for issuance in the month of June 20X2 and both companies agreed for not to demand payment in the month of July 20X2 although negotiation started in the month of May 20X2 but could not agree before June 20X2 when financial statements were approved for issuance.

Hence, the liability should be classified as current in the financial statement as at 31st March, 20X2.

17. Illustration

Entity A has undertaken various transactions in the financial year ended March 31, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1.

Remeasurement of defined benefit plans	2,57,000
Current service cost	1,75,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000
Income tax expense	35,000
Share based payments cost	3,35,000

Hint: Items impacting (a) P&L – Service cost, translation gains/losses on forex, income tax, share based payments cost (b) OCI – Remeasurement, changes in surplus, translation gains / losses from foreign operations, gains / losses from investments.

Solution:

Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1 ()

Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Income tax expense	35,000
Share based payments cost	3,35,000

Items impacting the other comprehensive income for the year ended 31st March, 20X1 ()

Remeasurement of defined benefit plans	2,57,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000

18. Illustration

XYZ Limited (the 'Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended March 31, 20X1, the accounts department is not sure about the treatment/presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.
(ii)	Is it mandatory to add the word "standalone" before each of the components of financial statements?
(iii)	The Company is Indian Company and preparing and presenting its financial statements in Rs. Is it necessary to write in the financial statements that the financial statements has been presented in Rs.
(iv)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

Evaluate the above matters with respect to preparation and presentation of general-purpose financial statement.

Hint: (i) Yes (ii) No (iii) Yes (iv) No

Solution:

- (i) Yes, an entity whose financial statements comply with Ind AS shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with Ind AS unless they comply with all the requirements of Ind AS. (Refer Para 16 of Ind AS 1)
- (ii) No, but need to disclose in the financial statement that these are individual financial statements of the Company. (Refer Para 51(b) of Ind AS 1)
- (iii) Yes, Para 51(d) of Ind AS 1 inter alia states that an entity shall display the presentation currency, as defined in Ind AS 21 prominently, and repeat it when necessary for the information presented to be understandable.
- (iv) No, as per Para 38 of Ind AS 1, except when Ind AS permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

19. Illustration

A Company presents financial results for three years (i.e one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purpose. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. It will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

- (i) Can management present the third statement of profit and loss as additional comparative in the general-purpose financial statements?
- (ii) If management present third statement of profit and loss in the general-purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?
- (iii) Can management present third statement of profit and loss only as additional comparative in the general-purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

Hint: (i) Yes (ii) Yes (iii) Yes

Solution:

- (i) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.
- (ii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS.
- (iii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

20. Illustration

A Company while preparing the financial statements for Financial Year (FY) 20X1-20X2, erroneously booked excess revenue of Rs. 10 Crore. The total revenue reported in FY 20X1-20X2 was Rs. 80 Crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in FY 20X1-20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative.

With regard to the above background, answer the following:

- (i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?
- (ii) The Company wants to correct the error during FY 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?

Hint: (i) No (ii) No

Solution:

- (i) No, as per Para 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:
 - (a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
 - (b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.
- (ii) No, management need to correct the previous year figures to correct the error but need not to furnish third balance sheet at the beginning of preceding period. (Refer Para 40A of Ind AS 1)

21. Illustration

XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e, March 31, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2.

S. No.	Items/transactions
(1)	The Company has some trade receivables which are due after 15 months from the date of balance sheet. So the Company expects that the payment will be received within the period of operating cycle.
(2)	The Company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the Company does not expect that it will be able to pay these payable within the operating cycle because the nature of business is such that generally projects gets delayed and payments from customers also gets delayed.
(3)	The Company was awarded a contract of Rs. 100 Crore on March 31, 20X2. As per the terms of the contract, the Company made a security deposit of 5% of the contract value with the customer, of Rs. 5 crore on March 31, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.

(4)	The Company has also given certain contracts to third parties and have received security deposits from them of Rs. 2 Crore on March 31, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract.
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Considering the above items/transactions answer the following:

- (i) The Company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?
 - (ii) The Company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?
 - (iii) Can the security deposit of Rs. 5 Crore made by the Company with the customers be presented as current?
 - (iv) Can the security deposit of Rs. 2 Crore taken by the Company from contractors be presented as non-current?
- Hint: (i) Yes (ii) No (iii) No (iv) No*

Solution:

- (i) Yes, but additionally the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date.
- (ii) No, the Company cannot disclose these payables as non-current and the Company also need to disclose amounts that are payable within a period of 12 months and after 12 months from the reporting date.
- (iii) No, because the amount will be received after the operating cycle of the Company.
- (iv) No, because the amount may be required to be paid before completion of the contract in case the contract is cancelled.

22. Illustration

Is offsetting permitted under the following circumstances?

- (a) Expenses incurred by a holding company on behalf of subsidiary, which is reimbursed by the subsidiary - whether in the separate books of the holding company, the expenditure and related reimbursement of expenses can be offset?
- (b) Whether profit on sale of an asset against loss on sale of another asset can be offset?
- (c) When services are rendered in a transaction with an entity and services are received from the same entity in two different arrangements, can the receivable and payable be offset?

Hint: (a) Yes, if in substance is in nature of reimbursement (b) Yes unless material (c) Yes if entity has legal right

Solution:

- (a) Offsetting is permitted only when the offsetting reflects the substance of the transaction.

In this case, the agreement/arrangement, if any, between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be presented net. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.

- (b) Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transactions. Accordingly, gains or losses arising on disposal of various items of property, plant and equipment shall be presented on net basis. However, gains or losses should be presented separately if they are material.

- (c) Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously.

In accordance with the above, the receivable and payable should be offset against each other and net amount is presented in the balance sheet if the entity has a legal right to set off and the entity intends to do so. Otherwise, the receivable and payable should be reported separately.

23. Illustration

As per the statutory requirements, exceptional items are required to be disclosed whereas Ind AS 1 requires separate disclosures of material items and how these are to be presented in the financial statements. Does that imply that 'exceptional' means 'material'? Give examples. How should these be presented in the financial statements?

Solution

Exceptional items are not specifically defined under **Indian Accounting Standards (Ind AS)**. However, as per **paragraph 97 of Ind AS 1**, when items of income or expense are **material**, their nature and amount must be disclosed separately in the financial statements.

Materiality under **Ind AS 1** is assessed based on whether omitting, misstating, or obscuring information could influence the **economic decisions of primary users**. It considers both **size (quantitative aspect)** and **nature (qualitative aspect)** of the item.

While all **exceptional items** are **material**, not all **material items** qualify as **exceptional**. Exceptional items are those that not only meet the **test of materiality** but also possess **unusual size, nature, or incidence**, requiring separate disclosure to explain the entity's performance.

Examples of Exceptional Items (If Material & Unusual in Incidence):

1. **Write-downs** of inventories to **net realizable value** or impairments of **property, plant, and equipment (PPE)**, and subsequent **reversals**.
2. **Restructuring costs** and reversals of provisions related to restructuring.
3. **Disposal of PPE or investments**.
4. **Discontinued operations**.
5. **Litigation settlements** with significant financial impact.
6. **Other reversals of provisions**, if substantial.

Presentation in Financial Statements:

- **Ind AS 1 does not mandate a specific format** for presenting exceptional items.
- Entities must **separately disclose such items in the Statement of Profit & Loss** under the relevant category, ensuring clarity for users.
- The **notes to financial statements** should explain the **nature, amount, and reason** for classification as an exceptional item.

Thus, **exceptional items are material, but not all material items are exceptional**. The distinction lies in their **nature, size, and impact on financial performance**, ensuring that users of financial statements receive **transparent and relevant information**.

1. Illustration (RTP Nov 20) [Fixed Overhead]

A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:

- Material = Rs. 200 per unit;
- Labour = Rs. 100 per unit;
- Variable manufacturing overhead = Rs. 100 per unit;
- Fixed factory production overhead = Rs. 1,00,00,000;
- Fixed factory selling overhead = Rs. 50,00,000;
- Variable factory selling overhead = Rs. 150 per unit.

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead?

Solution:

Calculation of Inventory value per unit as per Ind AS 2:

Particulars	Value per unit(₹)
Raw material	200
Labour	100
Variable manufacturing overhead	100
Fixed production overhead (1,00,00,000/1,00,000)*	100
Total	500

Fixed manufacturing overheads are absorbed based on normal capacity i.e. 1,00,000 units. The rate is not revised if actual production is lower than normal capacity.

Fixed manufacturing overhead on 50,000 units (50,000 x 100.= 50,00,000), will be absorbed as inventory value. The remaining fixed manufacturing overhead ₹50,00,000 (1,00,00,000 - 50,00,000) will be charged to P&L.

Note: Selling costs are excluded from the cost of inventories and recognised as expense in the period in which they are incurred.

2. Illustration (ICAI SM, Past exam) [Joint & By-Product] [IMP]

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

Item	Unit	Amount	Output	Closing Stock 31-03-X1
Raw material	14,500	1,50,000	MP 1-5,000 units	250
Wages	-	90,000	MP II - 4,000 units	100
Fixed overhead	-	65,000	BP- 2,000 units	
Variable overhead	-	50,000		

Average market price of MP1 and MP2 is Rs. 60 per unit and Rs. 50 per unit respectively, by-product is sold @ Rs. 20 per unit. There is a profit of Rs. 5,000 on sale of by-product after incurring separate processing charges of Rs. 8,000 and packing charges of Rs. 2,000, Rs. 5,000 was realised from sale of scrap.

Required: Calculate the value of closing stock of MP1 and MP2 as on 31-03-20X1.

Solution:**1) Calculation of NRV of By-product BP :**

Selling price of by-product	2,000 units x 20 per unit	40,000
Less: Separate processing charges of by-product BP		(8,000)
Packing charges		(2,000)
Net realizable value of by-product BP		30,000

2) Calculation of cost of conversion for allocation between joint products MP1 and MP2:

Raw material		1,50,000
Wages		90,000
Fixed overhead		65,000
Variable overhead		50,000
Less: NRV of by-product BP	30,000	
Sale value of scrap	<u>5,000</u>	(35,000)
Joint cost to be allocated between MP1 and MP2		3,20,000

The net realisable value of by product and scrap is reduced from joint cost.

3) Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2:

Joint costs are allocated on the basis of relative sales value.

	<u>MP I</u>	<u>MP 2</u>
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a x b)	3,00,000	2,00,000
Ratio of allocation (based on sales)	3	2
Joint cost of ₹ 3,20,000 allocated in the ratio of 3:2 (c)	1,92,000	1,28,000
Cost per unit [c/a]	38.4	32

4) Determination of value of closing stock of MP1 and MP2:

Particulars	MP I	MP 2
Closing stock in units	250 units	100 units
Cost per unit	38.4	32
Value of closing stock	9,600	3,200

3. Illustration [FIFO & Weighted Average]

The following information relates to 20X1-20X2

Date	Particular	Unit	Cost p.u.	Total Cost
April	Inventory	200	10	2,000
May	Purchases	50	11	550
September	Purchases	400	12	4,800
February	Purchases	<u>350</u>	14	<u>4,900</u>
	Total	<u>1,000</u>		<u>12,250</u>
June	Sales	<u>150</u>		
October	Sales	<u>300</u>		
November	Sales	<u>150</u>		

Physical inventory at 31.03.20X2 400 units. Calculate ending inventory value and cost of sales using:

1. FIFO
2. Weighted Average

Solution:

For valuing inventory under FIFO method, we consider latest inventory purchases.

FIFO inventory 31.03.20X2	350 @14 =	4,900
	50 @ 12 =	<u>600</u>
		<u>5,500</u>
Cost of Sales	12,250 - 5,500 =	6,750
Weighted average cost is determined by dividing the total cost by total quantity purchased.		
Weighted average cost per item	12,250/1000 =	12.25
Weighted average inventory at 31.03.20X2	400 x 12.25 =	4,900
Cost of sales 20X1-20X2	12,250-4,900 =	7,350

The above solution is given assuming periodic inventory system.

Under Perpetual inventory system – FIFO

Date	Particulars	In/out Qtry	In/Out rate	Value	Closing	Rate	Closing stock
April	Inventory	200		2,000	200	10	2,000
May	Purchase	50	11	550	200	10	2,000
					50	11	550
					250		2,550
June (Sale)	Sales	(150)	10	(1,500)	50	10	500
					50	11	550
					100		1,050
September	Purchase	400	12	4,800	50	10	500
					50	11	550
					400	12	4,800
					500		5,850
October (Sale)	Sales	(300)		-	200	12	2,400

November (Sale)	Sales	(150)		-	50	12	600
February	Purchase	350	14	4,900	50	12	600
					350	14	4,900
					400		5,500

Weighted Average – Closing weighted rate is updated after every purchase

Date	Particulars	In /Out Qty	In/Out Rate	In /Out Value	Closing	Rate	Closing stock
April	Inventory	200	10	2000	200	10.00	2000
May	Purchase	50	11	550	250	10.20	2550
June (Sale)	Sales	-150	10.2	1530	100	10.20	1,020.00
September	Purchase	400	12	4800	500	11.64	5,820.00
October (Sale)	Sales	-300	11.64	3492	200	11.64	2,328.00
November (Sale)	Sales	-150	11.64	1746	50	11.64	582.00
February	Purchase	350	14	4900	400	13.71	5,482.00

4. Illustration (RTP May 2018) [NRV]

On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was Rs. 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were authorised by Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is Rs. 11 million and estimated selling expenses are same Rs. 0.5 million.

What will be the value inventory at the following dates:

- 31st March 20X1
- 31st March 20X2.

Solution:

As per Ind AS 2 'Inventories', inventory is measured at lower of 'cost' or 'net realisable value'. Further, as per Ind AS 10: 'Events after Balance Sheet Date', decline in net realisable value below cost provides additional evidence of events occurring at the balance sheet date and hence shall be considered as 'adjusting events'.

- a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be ₹10 million and net realisable value would be ₹7.5 million (**i.e. Expected selling price ₹8 million- estimated selling expenses ₹0.5 million**).

Accordingly, inventory shall be measured at ₹7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of ₹2.5 million would be recorded in income statement of that year.

It is assumed that the price as on 15th April 20X1 provides additional evidence of conditions existing on balance sheet date.

However, if it is assumed that the price as on 15th April 20X1 does not provide additional evidence of conditions existing on balance sheet date, the value of inventory would be lower of Cost (₹10 million) and NRV (₹12 million - ₹0.5 million = 11.5 Million) i.e at ₹10 million only.

- b) A new assessment is made of net realizable value in each subsequent period. If there is an increase in the net realizable value (NRV) of inventory due to improved economic conditions, any previous write-downs should be reversed. This ensures the inventory is recorded at the lower of cost or the revised NRV.

As of 31 March 20X2, the inventory will be valued at cost or NRV, whichever is lower.

- **Cost:** ₹1 million
- **NRV:** ₹10.5 million (calculated as the expected selling price of ₹11 million minus estimated selling expenses of ₹0.5 million).

Since the NRV (₹10.5 million) is higher than the cost (₹1 million), the inventory will now be recorded at ₹1 million (the cost). The inventory write-down of ₹2.5 million recorded in the previous year will be reversed accordingly.

5. Illustration (RTP May 20) [Overhead]

The following is relevant information for an entity:

- Full capacity is 10,000 labour hours in a year.
- Normal capacity is 7,500 labour hours in a year.
- Actual labour hours for current period are 6,500 hours.
- Total fixed production overhead is Rs. 1,500.
- Total variable production overhead is Rs. 2,600.
- Total opening inventory is 2,500 units.
- Total units produced in a year are 6,500 units.
- Total units sold in a year are 6,700 units.
- The cost of inventories is assigned by using FIFO cost formula.

How overhead costs are to be allocated to cost of goods sold and closing inventory?

Solution:

Hours taken to produce 1 unit = 6,500 hours / 6,500 units = 1 hour per unit.

Fixed production overhead absorption rate:

$$\begin{aligned} &= \text{Fixed production overhead} / \text{labour hours for normal capacity} \\ &= ₹1,500 / 7,500 \\ &= ₹0.2 \text{ per hour} \end{aligned}$$

Management should allocate fixed overhead costs to units produced at a rate of ₹0.2 per hour.

Therefore, fixed production overhead allocated to 6,500 units produced during the year (one unit per hour) = 6,500 units x 1 hour x ₹0.2 = ₹1,300.

The remaining fixed overhead incurred during the year of ₹200 (₹1500 – ₹1300) that remains unallocated is recognised as an expense.

Variable production overhead absorption rate:

= Variable production overhead/actual hours for current period

= ₹2,600 / 6,500 hours = ₹0.4 per hour

Management should allocate variable overhead costs to units produced at a rate of ₹0.4 per hour.

Closing inventory = Opening inventory + Units produced during year – Units sold during year =
2,500 + 6,500 – 6,700 = 2,300 units.

= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)

= 2,300 units x 1 hour x (₹0.2 + ₹0.4) = ₹1,380

The remaining ₹2,720 [(₹1,500 + ₹2,600) – ₹1,380] is recognised as an expense in the income statement as follows:

Particulars	₹
Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x ₹0.6	2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	200
Total	2,720

6. Illustration (ICAI SM) [Replacement Cost]

UA Ltd. purchased raw material @ Rs. 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is Rs. 300 per kg. How will you value the inventory of raw material?

Solution:

- As per Ind AS 2 "Inventories", raw materials 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 or above cost**.
- 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.
- Therefore, in this case, UA Ltd. will value the inventory of raw material at ₹30,00,000 (10,000 kg. @ ₹300 per kg.).

Note from faculty – Do not blindly apply replacement value / lower of cost or replacement value. Also note that inventory cannot be valued above cost.

7. Illustration (ICAI SM, Past Exam) [Customer default]

Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-20X3 are as follows:

- Solar power panel (WIP) Rs. 85 lakhs
- Solar power panel (finished products) Rs. 55 lakhs
- Sundry Debtor (solar power panel) Rs. 65 lakhs

The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of Rs. 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

Solution:

- (i) From the fact given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per Ind AS 2 'Inventories', inventories are assets:
 - a. held for sale in the ordinary course of business;
 - b. in the process of production for such sale; or
 - c. in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- (ii) Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.
- (iii) As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory.
- (iv) The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in Ind AS 2 i.e. lower of Cost or NRV.
- (v) Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods accordingly.
- (vi) Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per Ind AS 2 for ₹140 lakhs [i.e solar power panel (WIP) ₹85 lakhs + solar power panel (finished products) ₹55 lakhs].
- (vii) Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.
- (viii) As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 20X2-20X3, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ₹65 lakhs shall be made in the books against the debtor's amount.

8. Illustration (ICAI SM, Past exam) [Empty bottles]

Night Ltd. sells beer to customers; some of the customers consumes the beer in the bars run by Night Limited. While leaving the bars, the consumers leaves the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling tenders.

(i) Decide whether the stock of empty bottle is an asset of the company;

(ii) If so, whether the stock of empty bottles existing as on the date of

Balance Sheet is to be considered as inventories of the company & valued as per Ind AS-2 or to be treated as scrap and shown at realized value with corresponding credit to 'Other Income'?

Solution:

Assets are resources controlled by enterprise which provide future economic benefit. Night Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

As per IND AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Stock of empty bottles existing on the Balance Sheet date is the inventory and Night Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence stock of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with Ind AS 2.

9. Illustration (ICAI SM) [Imports]

ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was Rs.1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this. Import duties (basic custom duties) of Rs.60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of Rs.5,000 to have the components taken to its warehouse. Calculate the cost of inventory.

Solution:

Particulars	₹
Purchase price (1,000 x 1,200 x 95%)	11,40,000
Import duties (1,000 x 60)	60,000
Delivery cost	5,000
Cost of inventory	12,05,000

Note: The intention to take settlement discount is irrelevant

10. Illustration (ICAI SM) [Costs included/excluded]

ABC Ltd. manufactures control units for air conditioning systems. Each control unit requires the following:

- 1 component X at a cost of Rs.1,205 each
- 1 component Y at a cost of Rs.800 each
- Sundry raw materials at a cost of Rs.150 each

The company faces the following monthly expenses:

- Factory rent Rs.16,500
- Energy cost Rs.7,500
- Selling and administrative costs Rs.10,000

Each unit takes two hours to assemble. Production workers are paid Rs.300 per hour. Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours. Determine the cost of inventory.

Solution:

The cost of a single control unit :	₹
Materials:	
Component X	1,205
Component Y	800
Sundry raw materials	150
	2,155
Labour (2 hours x 300)	600
Production overhead $[(16,500 + 7,500)/1,000 \text{ hours}] \times 2 \text{ hours}$	48
	2,803

Note: The selling and administrative costs are not part of the cost of inventory.

11. Illustration (ICAI SM) [Damage and NRV]

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of Rs.50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was Rs.40 per pack.

Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of Rs.15 per pack for repairing and reapplying glue to the envelopes. Calculate the net realizable value.

Solution:

Calculating the net realizable value:

- The estimated selling price is ₹40 per unit.
- The cost of repair to bring the goods to sellable condition is ₹15.00 per unit.

Net realizable value per unit = Estimated selling price per unit - Cost of repair to bring the goods to sellable condition.

$$= ₹40.00 - ₹15.00$$

$$= ₹25.$$

The net realizable value is \$25 per unit.

Calculating inventory write-down (loss) amount:

- The closing inventory cost is ₹50 per unit.
- The net realizable value is ₹25 per unit.

Inventory write-down (loss) = Inventory cost per unit - Net realizable value per unit

$$= ₹50 - ₹25$$

$$= ₹25.$$

The inventory write-down (loss) amount is ₹25.00 per unit.

12. Illustration (ICAI SM) [Firm contract]

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of Rs.10 per unit. The current market price is Rs.8 per unit at which these units can be sold.

Company P has a firm sales contract with Company Q to sell 60 units at Rs.11 per unit, which cannot be settled net.

Estimated incremental selling cost is Rs. 1 per unit. Determine the Net Realisable Value (NRV) of the inventory of Company P.

Solution:

If the company has a firm contract to sell, it can consider contract price to determine NRV. While performing NRV test, the NRV of 60 units that will be sold to Company Q is ₹ 10 per unit (i.e. 11-1).

NRV of the remaining 40 units is ₹ 7 per unit (i.e. 8-1).

Therefore, Company P will write down those remaining 40 units by ₹120 (i.e. 40x3).

Total cost of inventory would be:

Goods to be sold to Company Q	60 units x ₹ 10	₹600
Remaining goods	40 unit x ₹ 7	₹280
		₹880

13. Illustration (ICAI SM) [Item by Item]

In Year 2, A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

	Cost	Estimated Sales Price	Selling costs
Inventory Item A1	8,000	7,800	500
Inventory Item A2	14,000	18,000	200
Inventory Item B1	16,000	17,000	200
Inventory Item C1	6,000	7,500	150

Determine the value of closing inventory in the financial statements of a business.

Solution:

The value of closing inventory in the financial statements:

Item of inventory	Cost	NRV (Estimated Sales price- Selling costs)	Measurement base (lower of cost or NRV)	Value
A1	8,000	(7,800 – 500) 7,300	NRV	7,300
A2	14,000	(18,000 – 200) 17,800	Cost	14,000
B1	16,000	(17,000 – 200) 16,800	Cost	16,000
C1	6,000	(7,500 – 150) 7,350	Cost	6,000
Value of Inventory				43,300

14. Illustration (ICAI SM) [Deferred Payment]

A dealer has purchased 1,000 cars costing Rs.2,80,000 each on deferred payment basis as 25,000 per month per car to be paid in 12 equal instalments.

At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

Solution:

If inventory is acquired on deferred credit terms, the cost of inventory would be the cash price. The excess amount paid is considered as interest expense

	₹
Deferred payment price (25,000 x 12)	3,00,000
Less: Cash price	2,80,000
Interest expense	20,000

		₹
Cost of inventory	20 cars x 2,80,000	56,00,000
Finance cost	1,000 cars x 20,000	2,00,00,000
Cost of goods sold	980 cars x 2,80,000	27,44,00,000

15. Illustration (ICAI SM, Past exam) [Valuation when OS is given]

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	1,200	

The expected production for the year was 15,000 kg of finished product.

Due to fall in the 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.

Solution:

Calculation of cost for closing inventory:

Particulars	₹
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)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

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

Therefore, value of closing inventory:

Finished Goods (1,200 x 20)	₹ 24,000
Raw Materials (900 x 9.50)	₹ 8,550
	₹ 32,550

16. Illustration (ICAI SM) [Retail method]

Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

(a) One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department.

The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.

(b) Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the factory which has made handbags for the last fifty years. Normally, Mars manufactures 100,000 handbags a year in their handbag division which uses 15% of the space and overheads of the head office factory. The division employs ten people and is seen as being an efficient division within the overall company.

In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

Solution

(a) According to Ind AS 2, inventories should be measured at the lower of cost and net realizable value (NRV). However, in this case, the company cannot reliably determine the cost of each product due to a non-functional inventory system.

The retail method can be used for measuring inventories of the beauty products. The cost of the inventory is determined by taking the selling price of the cosmetics and reducing it by the gross margin of 65% to arrive at the cost.

(b) The handbags can be measured using standard cost especially if the results approximate cost. Given that the company has the information reliably on hand in relation to direct materials, direct labour, direct expenses and overheads, it would be the best method to use to arrive at the cost of inventories.

17. Illustration (ICAI SM) [Inclusions/Exclusions]

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

- (a) Cost of purchases (based on vendors' invoices) Rs. 5,00,000
- (b) Trade discounts on purchases Rs. 10,000
- (c) Import duties Rs. 200
- (d) Freight and insurance on purchases Rs. 250

- (e) Other handling costs relating to imports Rs. 100
- (f) Salaries of accounting department Rs. 15,000
- (g) Brokerage commission payable to indenting agents for arranging imports Rs. 300
- (h) Sales commission payable to sales agents Rs. 150
- (i) After-sales warranty costs Rs. 600

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

Solution

Expense	Inventory Amount
Cost of purchases (based on vendors invoices)	500000
Trade discounts on purchases	-10000
Import duties	200
Freight and insurance on purchases	250
Other handling costs relating to imports	100
Salaries of accounting department	0
Brokerage commission payable to indenting agents for arranging imports	300
Sales commission payable to sales agents	0
After-sales warranty costs	0
	490850

Salaries of accounting department is excluded as it is an administrative cost not directly attributable to inventory. Sales commission and after sales warranty costs are excluded from cost of inventory.

18. Illustration (ICAI SM) [Customised product]

On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts. On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for Rs. 5,50,000, including Rs. 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of Rs. 5,55,000 (including Rs. 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer. Design costs included:

cost of external designer = Rs. 7,000; and
labour = Rs. 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

materials, net of Rs. 3,000 recovered from the sale of the scrapped output = Rs. 21,000
labour = Rs. 11,000
depreciation of plant used to perform the modifications = Rs. 5,000

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

consumable stores =Rs. 55,000
labour = Rs. 65,000
depreciation of plant used to manufacture the customised corporate gifts=Rs. 15,000

The customised corporate gifts were ready for sale on 1st March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

Solution

Particulars	Amount (Rs.)	Remarks
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (Rs. 5,50,000) less refundable purchase taxes (Rs. 50,000)]
Loan-raising fee	—	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs		Recognized as an expense in profit or loss
Total cost of inventories	<u>6,82,000</u>	

19. Illustration (ICAI SM) [Imports]

A retailer company imported goods at a cost of Rs. 1,30,000 including Rs. 20,000 non-refundable import duties and Rs. 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred Rs. 5,000 to transport the goods to its retail outlet and a further Rs. 2,000 in delivering the goods to its customer. Further selling costs of Rs. 3,000 were incurred in selling the goods.

State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory.

Solution

Value of inventory

Particulars	Amount (Rs.)
Purchase Price (1,30,000 – 20,000 – 10,000)	1,00,000
Non-refundable import duties	20,000
Transport cost	<u>5,000</u>
Total	<u>1,25,000</u>

Ind AS 2 excludes selling costs from the cost of inventory. Selling costs are incurred to make the sale, while distribution costs are incurred to deliver the goods to the buyer. Since neither of these costs contributes to bringing the goods to their current location and condition, they are excluded from inventory costs.

Therefore, both selling and distribution costs (e.g., ₹2,000 for delivery and ₹3,000 for other selling costs) are not included in the cost of inventories

20. Illustration (ICAI SM) [Retail Method]

An entity has following details regarding cost and retail price of the goods purchased and unsold at the beginning of the year:

	Cost (Rs.)	Retail Price (Rs.)
Opening inventory	6,250	8,000
Purchases	19,500	34,000
Inventory on hand		(23,000)
Sales for the period		19,000

Applying the retail method, compute the following:

- Percentage of cost price over retail price;
 - Cost of closing inventory;
 - Value of cost of sales (at cost); and
 - Profit earned during the year on sale of inventory
- Ignore the impact of mark-ups or mark-downs on the selling price.

Solution

S. No.	Particulars		Rs.
	Cost price of goods	6,250 + 19,500	25,750
	Retail price of goods	8,000 + 34,000	42,000
(a)	Cost percentage of retail price	25,750 / 42,000	61%
(b)	Closing inventory (at cost)	23,000 x 61%	14,030
(c)	Cost of sales for the period	[(6,250 + 19,500) - 14,030]	11,720
	Sales for the period		19,000
(d)	Profit earned on sale of goods during the year	19,000 - 11,720	7,280

21. Illustration (ICAI SM) [Journal Entries]

A Ltd. began operations in the year 20X1-20X2. In 20X1-20X2, it incurred the following expenditures on purchasing the raw materials for its product:

- Purchase price of the raw materials = Rs. 30,000;
- Import duty and other non-refundable purchase taxes = Rs. 8,000;
- Refundable purchase taxes = Rs. 1,000;
- Freight costs for bringing the goods from the supplier to the factory's storeroom for raw materials = Rs. 3,000;
- Costs of unloading the materials into the storeroom for raw materials = Rs. 20; and Packaging = Rs. 2,000.

On 31st March, 20X2, A Ltd. received Rs. 530 volume rebate from a supplier for purchasing more than Rs. 15,000 from the supplier during the year.

A Ltd. incurred the following additional costs in the production run:

- Salary of the machine workers in the factory = Rs. 5,000;
- Salary of factory supervisor = Rs. 3,000;
- Depreciation of the factory building and equipment used for production process = Rs. 600;
- Consumables used in the production process = Rs. 200;

- v. Depreciation of vehicle used to transport the goods from the storeroom for raw materials to the machine floor = Rs. 400;
- vi. Factory electricity usage = Rs. 300;
- vii. Factory rental = Rs. 1,000; and
- viii. Depreciation of the entity's vehicle used by the factory supervisor is Rs. 200.

During 20X1-20X2, A Ltd. incurred the following administrative expenses:

- 1. Depreciation of the administration building = Rs. 500;
- 2. Depreciation and maintenance of vehicles used by the administrative staff = Rs. 150; and
- 3. Salaries of the administrative personnel = Rs. 3,050.

Of the administrative expenses, 20% is attributable to administering the factory.

Remaining expenses are attributable, in equal proportion, to the sales and other non-production operations (eg financing, tax and corporate secretarial functions).

In 20X1-20X2, A Ltd. incurred the following selling expenses:

- a) Advertising costs = Rs. 300;
- b) Depreciation and maintenance of vehicles used by the sales staff = Rs. 100; and
- c) Salaries of the administrative personnel = Rs. 6,000.

Pass necessary journal entries to record the cost of inventory in the books of A Ltd.

Solution

Particulars		Rs.	Rs.
Inventory A/c (W.N.1)	Dr.	42,490	
To Cash/Bank A/c			42,490
(To recognise the cost of raw materials purchased)			
Inventory A/c (W.N.2)	Dr.	11,240	
To Cash/Bank A/c (cost of direct labour)			5,000
To Property, plant and equipment (accumulated depreciation-factory equipment)			600
To Property, plant and equipment (accumulated depreciation-raw-materials delivery vehicle)			400
To Cash/Bank A/c (cost of electricity used)			300
To Property, plant and equipment (accumulated depreciation-factory supervisor's vehicle)			200
To Cash/Bank A/c (factory management's salaries)			3,000
To Cash/Bank A/c (factory rental)			1,000
To Cash/Bank A/c (administrative salaries attributable to the factory)			610
To Property, plant and equipment (attributable portion of accumulated depreciation- administration building)			100
To Property, plant and equipment (attributable portion of accumulated depreciation- administration vehicles)			30
(To recognise the costs of conversion)			

Inventory A/c (W.N.2)	Dr.	200	200
To Inventory A/c (consumable stores)			
(To recognise the costs of consumable stores inventory consumed)			

Working Notes:

1. Computation of costs of purchase

Description	Rs.
Purchase price	30,000
Import duty and other non-refundable purchase taxes	8,000
Freight costs for bringing the goods to the factory storeroom	3,000
Cost of unloading the raw materials into the storeroom	20
Packaging	2,000
Less: Trade discounts, rebates and subsidies	<u>(530)</u>
Cost of purchase	<u>42,490</u>

Note: Refundable taxes do not form part of the cost of inventories.

2. Computation of costs of conversion

Description	Rs.
Direct labour	5,000
Fixed production overheads	
Depreciation and maintenance of factory equipment	600
Depreciation of vehicle used for transporting the goods	400
Depreciation of vehicle used by factory supervisor	200
Factory electricity usage	300
Factory management	3,000
Factory rental	1,000
Other costs of administering the factory	
20% of depreciation of administration building	100
20% of depreciation of administration vehicles	30
20% of administrative staff costs	610
Variable production overheads	
Indirect material—consumables	<u>200</u>
Cost of conversion	<u>11,440</u>

B Limited has valued its stock held for distribution as free items on claim by customers (on offers) at zero. The customers have a right to claim the free item within 14 days from the date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer.

The majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

Out of it, a few items under this category were found damaged. The replacement cost of such items would be Rs. 2,50,000.

Determine whether the entity has to book loss of inventory or provide for replacement cost of the goods that need to be given as free items to customers as per the principles of Ind AS.

Solution

Ind AS 2 governs inventory valuation. The stock of free items is valued at zero by B Limited since these items are distributed as part of promotional offers. As per Ind AS 2, inventory should be carried at the lower of cost or net realizable value. **In this case, the free items do not generate direct revenue, so valuing them at zero is acceptable.**

The claim for free items is subject to conditions:

- Claim within 14 days of the invoice date.
- Online registration within 3 days of the invoice date.

These conditions make the claim contingent on customer actions. Until these actions occur, no obligation arises for B Limited.

As per Ind AS 37, a provision is recognized when:

- a. There is a present obligation (legal or constructive) from a past event.
- b. It is probable that an outflow of resources will be required to settle the obligation.
- c. The amount can be reliably estimated.

In this case:

The sale occurred in the reporting year, **creating an obligation to fulfill the offer** if customers meet the claim conditions.

If it is probable that customers will register and claim the free items, a provision for ₹2,50,000 should be recognized in the financial statements for the reporting year.

If the time for claims expires without customer action, the provision can be reversed in the next financial year.

The question of booking loss of inventory does not arise since the inventory is anyways valued at nil.

1. Illustration

ABC Ltd. prepared interim financial report for the quarter ending 30th June, 20X1. The interim financial report was approved for issue by the Board of Directors on 15th July, 20X1. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period shall be adjusted in the interim financial report ending 30th June, 20X1? (SM)

[Ans: Yes, they should be adjusted. Reporting period implies any term for which reporting is done by preparing financial statements]

Solution:

Events occurring between the end of the reporting period and the date of approval of financial statements are classified as:

1. **Adjusting events** – Those that provide evidence of conditions that existed at the end of the reporting period.
2. **Non-adjusting events** – Those that indicate conditions arising after the reporting period.

Reporting Period Consideration:

Ind AS 10 does not explicitly define "reporting period," but since Ind AS 34 requires interim financial reports to comply with all Ind ASs, any financial statement period, including interim periods, is treated as a reporting period for Ind AS 10 application.

Analysis of the Given Case

- **ABC Ltd. prepared its interim financial report for the quarter ending 30th June, 20X1.**
- **The Board of Directors approved the report on 15th July, 20X1.**
- Any events occurring **between 1st July and 15th July, 20X1** that provide evidence of conditions existing as of 30th June, 20X1 should be **considered for adjustment** in the interim financial report.

Conclusion

Yes, such **adjusting events** must be incorporated in the **interim financial report ending 30th June, 20X1** to ensure compliance with Ind AS 10 and Ind AS 34.

2. Illustration

The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 20X1-20X2 for issue on 15th June, 20X2. The management of ABC Ltd. discovered a major fraud and decided to reopen the books of account. The financial statements were subsequently approved by the Board of Directors on 30th June, 20X2. What is the date of approval for issue as per Ind AS 10 in the given case? (SM)

[Ans: 30th June, 20X2]

Solution:

As per Ind AS 10, the date of approval for issue is the date on which the financial statements are formally approved by the **Board of Directors** in case of a company or by the corresponding approving authority in case of any other entity.

Analysis of the Given Case

- **ABC Ltd. initially approved the financial statements for issue on 15th June, 20X2.**
- Subsequently, a **major fraud was discovered**, and the company decided to **reopen the books of account** for necessary adjustments.
- After incorporating the required changes, the **financial statements were again approved on 30th June, 20X2.**

Conclusion

Since the financial statements were reopened for further adjustments, the **final date of approval for issue** should be considered as **30th June, 20X2**, as this is the date on which the financial statements were ultimately approved by the Board of Directors.

3. Illustration

A case is going on between ABC Ltd., and GST department on claiming some exemption for the year 20X1-20X2. The court has issued the order on 15th April, 20X2 and rejected the claim of the company. Accordingly, the company is liable to pay the additional tax. The financial statements of the company for the year 20X1-20X2 have been approved on 15th May, 20X2. Should the company account for such tax in the year 20X1-20X2 or should it account for the same in the year 20X2-20X3? (SM)

[Ans: 20X1-20X2]

Solution:

An **event after the reporting period** is classified as:

1. **Adjusting event** – If it provides evidence of a condition existing at the end of the reporting period.
2. **Non-adjusting event** – If it indicates conditions arising after the reporting period.

Analysis of the Given Case

- **ABC Ltd. was involved in a dispute with the GST department** over an exemption claim for the year **20X1-20X2**.
- The **court issued an order on 15th April, 20X2**, rejecting the company's claim and making it liable to pay additional tax.
- The **financial statements were approved on 15th May, 20X2**.

The **court order confirms a liability that existed at the end of 20X1-20X2**, though the confirmation occurred after the reporting period. Since this order provides **evidence of conditions existing as of 31st March, 20X2**, it qualifies as an **adjusting event** under Ind AS 10.

Conclusion

The company should **account for the additional tax in the financial statements for 20X1-20X2**, as it is an adjusting event. The liability must be recognized in the same period rather than in **20X2-20X3**.

4. Illustration

While preparing its financial statements for the year ended 31st March, 20X1, XYZ Ltd. made a general provision for bad debts @ 5% of its debtors. In the last week of February, 20X1 a debtor for Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. Considering the event of earthquake, XYZ Ltd. made a provision @ 50% of the amount receivable from that debtor apart from the general provision of 5% on remaining debtors. In April, 20X1 the debtor became bankrupt. Can XYZ Ltd. provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 20X1? Would answer be different if earthquake

had taken place after 31st March, 20X1, and therefore, XYZ Ltd. did not make any specific provision in context that debtor and made only general provision for bad debts @ 5% on total debtors?

Solution

Financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events). Non-adjusting events are disclosed if they are material but are not recognized in the financial statements.

Case 1: Earthquake Occurred Before 31st March, 20X1

- The debtor suffered heavy losses due to an **earthquake in February 20X1** (before the reporting date).
- XYZ Ltd. **already made a 50% provision** considering the risk.
- In **April 20X1**, the debtor became bankrupt.

Since the **earthquake took place before the year-end**, this provides evidence that the debtor's financial difficulties existed at the reporting date. **Bankruptcy in April 20X1 is merely a confirmation** of the financial condition that already existed.

Conclusion: XYZ Ltd. should **adjust** its financial statements for the full amount of ₹2 lakhs as a bad debt provision in the financial statements for 31st March, 20X1.

Case 2: Earthquake Occurred After 31st March, 20X1

- No specific provision was made for the debtor before year-end, only a **general provision of 5%** was created.
- The **earthquake occurred after the reporting date** and the debtor **was declared bankrupt later**.

Since the earthquake and resulting financial distress **did not exist as of 31st March, 20X1**, the bankruptcy **is a non-adjusting event**.

Conclusion: The company **should not adjust** the financial statements but **should disclose** the event if it is material. The financial statements should include:

1. **Nature of the event** (earthquake and bankruptcy).
2. **Estimated financial impact**, or a statement that such an estimate cannot be made.

5. Illustration

A company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of Rs. 4,00,000 each. On 30th April, 20X2, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to

Rs. 3,00,000 each. The financial statements of the company for the year 20X1-20X2 are not yet approved. Should the company value its stock at Rs. 4,00,000 each or should it value at Rs. 3,00,000 each? Ignore estimated costs necessary to make the sale. (SM)

[Ans: Rs. 3,00,000 – Events after reporting period provide evidence about net realisable value of cars at end of reporting period]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events).

- **Ind AS 2 (Inventories)** requires inventory to be valued at the **lower of cost and net realizable value (NRV)**.

Analysis of the Given Case

- The company had **100 finished cars** in inventory as of **31st March, 20X2**, with a cost of **₹4,00,000 each**.
- On **30th April, 20X2**, due to new government regulations, the **selling price dropped to ₹3,00,000 each**, and demand reduced drastically.
- The **financial statements are not yet approved**, meaning this event must be considered.
- Since the **regulatory changes were expected** and impacted the **NRV of cars as of 31st March, 20X2**, this is an **adjusting event** under Ind AS 10.

Conclusion

The inventory should be valued at **₹3,00,000 per car** instead of ₹4,00,000, as the decline in value provides evidence of conditions that **existed at the reporting date**.

6. Illustration

ABC Ltd. has purchased a new machinery during the year 20X1-20X2. The asset was finally installed and made ready for use on 15th March, 20X2. However, the company involved in installation and training, which was also the supplier, has not yet submitted the final bills for the same.

The supplier company sent the bills on 10th April, 20X2, when the financial statements were not yet approved. Should the company adjust the amount of capitalisation in the year 20X1-20X2 or in the year 20X2-20X3? (SM)

[Ans: In year 20X1-20X2]

Solution:

- **Ind AS 16 (Property, Plant and Equipment)** states that the cost of an asset includes **all directly attributable costs** necessary to bring the asset to its intended use, including **installation and training costs**.
- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events after the reporting period **if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events).

Analysis of the Given Case

- ABC Ltd. **purchased new machinery** in **20X1-20X2**.
- The asset was **installed and made ready for use on 15th March, 20X2**.
- The **supplier (who provided installation and training)** had not yet submitted final bills as of 31st March, 20X2.
- The **bills were received on 10th April, 20X2**, before the financial statements were approved.

Since **installation and training costs are an integral part of the asset's cost**, the final billing received after the reporting period **confirms an obligation that already existed as of 31st March, 20X2**. This makes it an **adjusting event** under Ind AS 10.

Conclusion

The company should **adjust the cost of the asset in the financial statements for the year 20X1-20X2**, as the cost was incurred in that period, even though the invoice was received later.

7. Illustration

Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 20X1- 20X2, 20X2-20X3, 20X3-20X4 and 20X4-20X5. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 20X5, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 20X5. The financial statements for the F.Y. 20X4-20X5 have been approved by Board of Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis? (SM)

[Ans: It may not be appropriate – entity's operations are expected to come to end by 31st Dec 20X5]

Solution:

- **Ind AS 1 (Presentation of Financial Statements)** requires financial statements to be prepared on a **going concern basis**, unless management **intends to liquidate the entity or cease operations** or **has no realistic alternative but to do so**.
- **Ind AS 10 (Events After the Reporting Period)** states that deterioration in financial position after the reporting period may **impact the going concern assumption**, requiring a **fundamental change in the basis of accounting** rather than just an adjustment.

Analysis of the Given Case

- **XYZ Ltd. was formed specifically to publish telephone directories** and secured a **5-year contract for Pune circle**, which **expires on 31st December, 20X5**.
- The company **tried to expand by bidding for tenders in other cities** (Nagpur, Nashik, Mumbai, Hyderabad) but **failed to secure any new contracts**.
- The **results of tenders were announced on 23rd April, 20X5**, confirming that **XYZ Ltd. has no business beyond 31st December, 20X5**.
- The **financial statements for 20X4-20X5 were approved on 10th July, 20X5**, meaning this information was available before approval.

Since **XYZ Ltd.'s only business is publication of Pune directories**, and it **has no secured contracts beyond December 20X5**, it is highly uncertain whether the company can continue as a **going concern** beyond that date.

Conclusion

It **may not be appropriate** to prepare the financial statements for 20X4-20X5 on a **going concern basis**, as the entity's operations are expected to cease by 31st December, 20X5. The company should **assess whether it has any realistic possibility of securing future contracts**; otherwise, an alternative basis of accounting (such as liquidation basis) may be required.

8. Illustration

In the plant of PQR Ltd., there was a fire on 10th May, 20X1 in which the entire plant was damaged and the loss of Rs. 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of Rs. 27,00,000 is expected. The financial statements for the year ending 31st March, 20X1 were approved by the Board of Directors on 12th June, 20X1. Show how should it be disclosed? (SM)

[Ans: It's non-adjusting event; disclosures regarding material non-adjusting event should be made; company needs to determine whether it is appropriate to prepare the financial statements on going concern basis]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** classifies events as:
 1. **Adjusting events** – Events that provide evidence of conditions existing at the end of the reporting period.

2. **Non-adjusting events** – Events that arise after the reporting period and do not provide evidence of conditions that existed at the reporting date.
- **Ind AS 10 also requires disclosure of material non-adjusting events** if their non-disclosure could influence the economic decisions of users.

Analysis of the Given Case

- A fire occurred on 10th May, 20X1, destroying the entire plant of PQR Ltd., causing an estimated loss of ₹40,00,000.
- The insurance claim filed is expected to recover ₹27,00,000.
- The financial statements for the year ending 31st March, 20X1, were approved on 12th June, 20X1.
- Since the fire occurred after the reporting date, it does not relate to conditions existing as of 31st March, 20X1. Thus, it is a non-adjusting event under Ind AS 10.

Disclosure and Going Concern Consideration

1. **Disclosure Requirement**
 - The nature of the event (fire incident).
 - Estimated financial impact (₹40,00,000 loss and ₹27,00,000 insurance claim).
2. **Going Concern Consideration**
 - If PQR Ltd. has only one plant, the fire could significantly impact operations.
 - Management must assess whether the company can continue operations.
 - If the going concern assumption is no longer appropriate, financial statements must be prepared on an alternative basis (e.g., liquidation basis).

9. Illustration

ABC Ltd., has announced its interim results for Quarter 1, ending 30th June, 20X2 on 5th July, 20X2. However, till that time the AGM for the year 20X1-20X2 was not held. The financial statements for 20X1-20X2 were approved by the board of directors on 15th July, 20X2. What will be the 'after the reporting period' as per the definition given in Ind AS 10? (SM)

[Ans: Period between 31st Mar, 20X2 and 15th Jul, 20X2]

Solution:

Ind AS 10 defines '**Events after the reporting period**' as events occurring between the **end of the reporting period and the date when the financial statements are approved by the Board of Directors** (for companies) or the corresponding approving authority (for other entities).

Analysis of the Given Case

- ABC Ltd. announced its interim results for Q1 (ending 30th June, 20X2) on 5th July, 20X2.
- However, the AGM for the year 20X1-20X2 was not held before this date.
- The financial statements for 20X1-20X2 were finally approved by the Board of Directors on 15th July, 20X2.

As per Ind AS 10, the **after the reporting period** for the financial year 20X1-20X2 will be **from 31st March, 20X2 to 15th July, 20X2**, as this is the period between the financial year-end and the date of approval of financial statements by the Board.

Conclusion

The '**after the reporting period**' as per Ind AS 10 in this case is **the period between 31st March, 20X2, and 15th July, 20X2**.

10. Illustration

ABC Ltd. is in a legal suit with the GST department. The company gets a court order in its favour on 15th April, 20X2, which resulted into reducing the tax liability as on 31st March, 20X2. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The management has not considered the effect of the transaction as the event is favourable to the company. The company's view is that favourable events after the reporting period should not be considered as it would hamper the realisation concept of accounting. Comment on the company's views in the light of Ind AS 10. (SM)

[Ans: Company's view is incorrect. Even favourable events need to be considered]

Solution:

Ind AS 10 states that events occurring after the reporting period should be classified as:

1. **Adjusting events** – If they provide evidence of conditions that existed at the end of the reporting period, whether favourable or unfavourable.
2. **Non-adjusting events** – If they indicate conditions arising after the reporting period.

Analysis of the Given Case

- ABC Ltd. was in a legal suit with the GST department regarding a tax liability.
- On 15th April, 20X2, the court ruled in favour of ABC Ltd., reducing its tax liability as of 31st March, 20X2.
- The financial statements were approved on 15th May, 20X2.
- The management did not consider this event, assuming that favourable events should not be considered under Ind AS 10.

Since the court ruling provides evidence of a condition (tax liability) that existed as of 31st March, 20X2, it is an **adjusting event** under Ind AS 10. The company's argument that favourable events should not be considered is incorrect, as Ind AS 10 applies equally to both favourable and unfavourable events.

11. Illustration

ABC Ltd. is trading in laptops. On 31st March, 20X2, the company has 50 laptops which were purchased at Rs. 45,000 each. The company has considered the same price for calculation of closing inventory valuation. On 15th April, 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to Rs. 35,000 each. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The company does not want to value the stock at Rs. 35,000 less estimated costs necessary to make the sale as the event of reduction in selling price took place after 31st March, 20X2 and the reduced prices were not applicable as on 31st March, 20X2. Comment on the company's views. (SM)

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events).
- **Ind AS 2 (Inventories)** requires inventory to be measured at the **lower of cost and net realizable value (NRV)**. A reduction in **NRV after the reporting period** due to market conditions may indicate a condition that existed at the reporting date.

Analysis of the Given Case

- ABC Ltd. had 50 laptops in inventory as of 31st March, 20X2, valued at ₹45,000 each.
- On 15th April, 20X2, an advanced version was launched, causing the price of existing laptops to crash to ₹35,000 each.
- The financial statements were approved on 15th May, 20X2.
- The company argues that since the price drop occurred after 31st March, 20X2, it should not reduce the inventory value.

- The **drop in price was caused by a new product launch**, which was **likely anticipated by the market before the reporting date**.
- As per **Ind AS 2**, if **NRV is lower than cost**, inventory should be written down to **NRV**.
- Since the **price reduction provides evidence of a lower NRV at the reporting date**, it qualifies as an **adjusting event** under **Ind AS 10**.

12. Illustration

XY Ltd had taken a large-sized civil construction contract, for a public sector undertaking, valued at Rs. 200 Crores. Execution of the project started during 20X1-20X2, and continued in the next financial year also. During the course of execution of the work on 29th May, 20X2, the company found while raising the foundation work that it had met a rocky surface and cost of contract would go up by an extra Rs. 50 crore, which would not be recoverable from the Contractee as per the terms of the contract. The Company's financial year ended on 31st March, 20X2, and the financial statements were considered and approved by the Board of Directors on 15th June, 20X2. How will you treat the above in the financial statements for the year ended 31st March, 20X2? (SM)

[Ans: Cost of project and profit should be accounted considering extra Rs. 50 crore of cost]

Solution:

Ind AS 10 requires adjusting events after the reporting period to be incorporated into the financial statements if they provide **evidence of conditions that existed at the end of the reporting period**.

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Analysis of the Given Case

- **XY Ltd. was executing a large construction contract worth ₹200 crores**, which began in **20X1-20X2** and continued in the next financial year.
- On **29th May, 20X2**, during **foundation work**, a **rocky surface was discovered**, leading to an **unavoidable extra cost of ₹50 crores** that **cannot be recovered** under the contract terms.
- The **financial statements for 31st March, 20X2, were approved on 15th June, 20X2**.
- Although the rocky surface **was discovered after the reporting period**, it **already existed as of 31st March, 20X2**, meaning this condition was present before year-end.

Conclusion

Since the **rocky surface existed at the reporting date**, the **increased cost of ₹50 crores should be accounted for** in the **financial statements for the year ended 31st March, 20X2**. This qualifies as an **adjusting event** under Ind AS 10, and **both project cost and profit calculations should reflect the additional cost**.

13. Illustration

A Ltd. was required to pay penalty for a breach in the performance of a contract. A Ltd. believed that the penalty was payable at a lower amount than the amount demanded by the other party. A Ltd. created provision for the penalty but also approached the arbitrator with a submission that the case may be dismissed with costs. A Ltd. prepared the financial statements for the year 20X1-20X2, which were approved in July 20X2. The arbitrator, in June 20X2, awarded the case in favour of A Ltd. As a result of the award of the arbitrator, the provision earlier made by A Ltd. was required to be reduced. The arbitrator also decided that cost of the case should be borne by the other party. Now, whether A Ltd. is required to remeasure its provision and what would be the accounting treatment of the cost that will be recovered by A Ltd., which has already been charged to the Statement of Profit and Loss as an expense for the year 20X1-20X2? (SM)

[Ans: Required to remeasure provision; Recovery of cost should be recognised in financial year 20X2-20X3]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the reporting date** (adjusting events).
- **Ind AS 37 (Provisions, Contingent Liabilities, and Contingent Assets)** states that:
 - Provisions should be **remeasured if new evidence affects the estimate**.
 - Contingent assets should be recognized **only when their realization becomes virtually certain**.

Analysis of the Given Case

- **A Ltd. was required to pay a penalty** for a contract breach and created a provision, but **it disputed the penalty** and approached the **arbitrator before 31st March, 20X2**.
- In **June 20X2**, the **arbitrator ruled in favour of A Ltd.**, reducing the penalty and awarding cost recovery from the other party.
- The **financial statements were approved in July 20X2**.

Since the **arbitration case was filed before the reporting period ended**, the **ruling confirms a condition that existed as of 31st March, 20X2**. This makes it an **adjusting event**, requiring A Ltd. to **remeasure the provision** in the financial statements for **20X1-20X2**.

- Regarding **cost recovery**, as per Ind AS 37, a **contingent asset should only be recognized when realization becomes virtually certain**.
- The **right to recover the cost became certain in June 20X2**, which falls in **financial year 20X2-20X3**.
- Hence, **the recovery of cost should be recognized in 20X2-20X3**, not in **20X1-20X2**.

14. Illustration

A company manufacturing and supplying process control equipment is entitled to duty drawback if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2, the company has exceeded the specified limit of turnover by the end of the reporting period but the application for duty drawback is filed on 20th April, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition.

Duty drawback has been credited by the Department on 28th June, 20X2 and financial statements have been approved by the Board of Directors of the company on 26th July, 20X2. Whether duty drawback credit should be treated as an adjusting event? (SM)

[Ans: No, it is not an adjusting event. Duty draw back credit which was contingent asset for F.Y. 20X1-20X2 should be recognised as asset and related income should be recognised in reporting period in which change occurs. i.e., F.Y. 20X2-20X3.]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **only if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events).
- **Ind AS 37 (Provisions, Contingent Liabilities, and Contingent Assets)** states that:
 - A **contingent asset** is recognized **only when its realization becomes virtually certain**.
 - If realization is only **probable**, it should be disclosed but not recognized.

Analysis of the Given Case

- The company **exceeded the specified turnover** by the end of **20X1-20X2**, making it **eligible for duty drawback**.
- However, the **application was filed late** (on **20th April, 20X2**), and the **Department had discretionary power** to approve or reject the claim.

- The **duty drawback** was credited on 28th June, 20X2, making realization **virtually certain** in 20X2-20X3.
- The **financial statements** were approved on 26th July, 20X2.

Since the duty drawback was **discretionary** and **not certain at the end of 20X1-20X2**, it qualifies as a **contingent asset**. **Contingent assets should only be recognized when realization becomes virtually certain**, which happened in **June 20X2**.

Conclusion

The **duty drawback credit** is **NOT an adjusting event** for **20X1-20X2**, as its realization was not certain at the reporting date. It should be recognized as an **asset and related income in 20X2-20X3**, when it became **virtually certain**.

15. Illustration

XYZ Ltd. sells goods to its customer with a promise to give discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods of Rs. 5 lakhs to ABC Ltd. between 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2.

State whether discount will be adjusted from the sales at the end of the reporting period. (SM)

[Ans: Yes. Condition that sales have been made exists at end of the reporting period, Receipt of payment within 15 days' time confirms that discount is to be provided on those sales]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the reporting date** (adjusting events).
- **Ind AS 115 (Revenue from Contracts with Customers)** states that if the **consideration includes a variable component**, an entity should **estimate the amount of consideration it expects to receive** based on the likelihood of fulfilling the variable condition.

Analysis of the Given Case

- **XYZ Ltd. sold goods worth ₹5,00,000 to ABC Ltd. between 17th March, 20X2, and 31st March, 20X2 with a 5% discount if payment is made within 15 days.**
- **ABC Ltd. made the payment by 15th April, 20X2, satisfying the condition for the discount.**
- **The financial statements were approved on 31st May, 20X2.**

Since **the sale was made before 31st March, 20X2, and the payment condition was met before the approval of financial statements**, this event **confirms a condition that existed at the reporting date**. This makes it an **adjusting event** under **Ind AS 10**, and the discount **must be recognized as a reduction in revenue for 20X1-20X2**.

Conclusion

The **sales revenue must be adjusted** for the **5% discount (₹25,000)** in the **financial statements for 20X1-20X2**, as this is an **adjusting event** under **Ind AS 10** and **Ind AS 115**.

16. Illustration

Whether the fraud related to 20X1-20X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-20X4 is an adjusting event? (SM)

[Ans: Yes. Condition was existing which has been confirmed by detection of same]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events).
- **Ind AS 8 (Accounting Policies, Changes in Accounting Estimates, and Errors)** requires **correction of prior period errors** if an error or fraud is discovered that **affects previously issued financial statements**.
- A fraud related to financial year 20X1-20X2 was discovered after the reporting period of 20X3-20X4 but before the approval of financial statements for 20X3-20X4.
- Since the fraud took place before the end of 20X1-20X2, this means the financial statements of that period were incorrect due to an existing condition that has now been confirmed.
- **Ind AS 10 explicitly states** that the **discovery of fraud or error after the reporting period that proves the financial statements were incorrect is an adjusting event**.
- As per **Ind AS 8**, since this is a **prior period error**, it should be **retrospectively corrected** in the financial statements.

17. Illustration

X Ltd. was having investment in form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 20X2. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 20X1-20X2? (SM)

[Ans: Yes – Value of investments in financial statements should be adjusted for fraudulent error in the computation]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the end of the reporting period** (adjusting events).
- **Ind AS 8 (Accounting Policies, Changes in Accounting Estimates, and Errors)** requires correction of **errors that cause financial statements to be incorrect**, including fraudulent misstatements.

Analysis of the Given Case

- **X Ltd. had investments in equity shares as of 31st March, 20X2.**
- After the reporting period but **before approval of financial statements**, it was discovered that the **value of investments was fraudulently inflated due to a computation error**.
- Since the **fraud led to an incorrect valuation** of investments in **20X1-20X2 financial statements**, and **this error existed at the reporting date**, it qualifies as an **adjusting event** under Ind AS 10.

Conclusion

Yes, the value of investments should be adjusted in the financial statements for **20X1-20X2**, as the fraudulent computation error **existed at the reporting date** and its detection confirms a misstatement.

18. Illustration

ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of Rs. 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of Rs. 28,00,000 and the company has expected that the demand would be settled at Rs. 15,00,000 only. Show how the above event

will have a bearing on the financial statements for the year 20X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly. (SM)
[Ans: It is an adjusting event. Company should make a provision in the financial statements for the year 20X1-20X2.]

Solution:

- **Ind AS 10 (Events After the Reporting Period)** states that financial statements should be adjusted for events occurring after the reporting period **if they provide evidence of conditions that existed at the reporting date** (adjusting events).
- **Ind AS 37 (Provisions, Contingent Liabilities, and Contingent Assets)** requires recognition of a provision when:
 1. There is a **present obligation** as a result of a past event.
 2. A **reliable estimate** of the obligation can be made.
 3. It is **probable** that an outflow of economic benefits will be required to settle the obligation.

Analysis of the Given Case

- **ABC Ltd. received a demand notice on 15th June, 20X2, for an additional excise duty of ₹28,00,000 on transactions related to financial year 20X1-20X2.**
- **The financial statements for 20X1-20X2 were approved on 10th August, 20X2.**
- **The company has appealed against the demand in July, 20X2, expecting a settlement at ₹15,00,000.**
- Since the **excise duty pertains to goods manufactured in 20X1-20X2**, this indicates that the **obligation existed at the reporting date (31st March, 20X2).**
- The **demand notice received in June, 20X2, provides evidence of a condition that already existed at the reporting date, making it an adjusting event under Ind AS 10.**

Conclusion

This is an adjusting event, as the demand for excise duty relates to transactions in **20X1-20X2** and the condition **existed at the reporting date.**

As per **Ind AS 37**, a **provision of ₹15,00,000** (best estimate of the liability) **should be recognized in the financial statements for 20X1-20X2.**

19. Illustration

H Ltd. constructed a warehouse at a cost of Rs. 10 lakhs in 2015. It first became available for use by H Ltd. on 1st January 2016. On 29th January 2020, H Ltd. discovered that its warehouse was damaged. During early February 2020, an investigation revealed that the damage was due to a structural fault in the construction of the warehouse. The fault became apparent when the warehouse building leaked severely after heavy rainfall in the week ended 27th January 2020. The discovery of the fault is an indication of impairment. So, H Ltd. was required to estimate the recoverable amount of its warehouse at 31st December 2019. This estimate was Rs. 6,00,000. Furthermore, H Ltd. reassessed the useful life of its warehouse at 20 years from the date that it was ready for use. Before discovering the fault, H Ltd. had depreciated the warehouse on the straight-line method to a nil residual value over its estimated 30-year useful life.

Seepage of rain water through the crack in the warehouse caused damage to inventory worth about Rs. 1,00,000 (cost price) and became un-saleable. The entire damaged inventory was on hand as at 31st December, 2019. H Ltd. has not insured against any of the losses.

It accounts for all its property, plant and equipment under the cost model. H Ltd.'s annual financial statements for the year ended 31st December, 2019 were approved for issue by the Board of Directors on 28th February, 2020.

You are required to :

- (i) Prepare accounting entries to record the effects of the events after the end of the reporting period in the accounting records of H Ltd. for the year ended 31st December, 2019. Kindly ignore tax impact;

(ii) Discuss disclosure requirement in above case as per relevant Ind AS; and

Will your answer be different if there was no structural fault and damage to the warehouse had been caused by an event that occurred after 31 st December, 2019?

1. Warehouse Damage & Impairment

- The **structural fault existed before 31st December 2019**, but it became evident in **January 2020** after heavy rainfall.
- Since the **fault existed at the reporting date**, it qualifies as an **adjusting event** under Ind AS 10.
- H Ltd. must **recognize an impairment loss of ₹2,47,059** in the financial statements for **2019**.

2. Inventory Damage

- The **rainwater seepage damaged inventory worth ₹1,00,000** in early **2020**.
- The inventory was in **good condition at 31st December 2019**, so the damage is a **non-adjusting event**.
- The company **should not adjust** the inventory valuation in 2019 but must **disclose the event and estimated loss** in the financial statements.

(i) Journal Entries for 31st December 2019

1. Depreciation Adjustment Due to Change in Useful Life

Depreciation Expense A/c Dr. ₹19,608

To Warehouse (Accumulated Depreciation) A/c ₹19,608

(Being additional depreciation due to reassessment of useful life)

2. Recognition of Impairment Loss

Impairment Loss A/c Dr. ₹2,47,059

To Warehouse (Accumulated Depreciation) A/c ₹2,47,059

(Being impairment loss recognized due to structural fault in warehouse)

(ii) Disclosure Requirements as per Ind AS 10

(a) Warehouse Damage (Adjusting Event)

- Recognized impairment loss of **₹2,47,059** in the financial statements.
- Disclosed in **notes to accounts**, explaining that the **structural fault existed at year-end but was confirmed later**.

(b) Inventory Damage (Non-Adjusting Event)

- No adjustment in **2019 financials**.
- **Disclose the nature of the event and estimated financial impact (₹1,00,000)** in the notes to financial statements.

(iii) Alternative Scenario – No Structural Fault

- If the **damage was caused by an event occurring after 31st December 2019** (e.g., an external accident or natural disaster) and **not due to a pre-existing fault**, then:
 - **No impairment loss would be recognized in 2019**.
 - The event would be a **non-adjusting event**, requiring only **disclosure** in the notes to accounts.

Workings

1. Calculation of Additional Depreciation for 2019

Particulars	Amount (₹)
Original cost of warehouse	₹10,00,000
Original depreciation per year (SLM, 30 years)	$₹10,00,000 \div 30 = ₹33,333$
Carrying value at the end of 2018	$₹10,00,000 - (₹33,333 \times 3 \text{ years}) = ₹9,00,000$
Revised remaining useful life (after reassessment)	$20 \text{ years} - 3 \text{ years} = 17 \text{ years}$
Revised depreciation per year	$₹9,00,000 \div 17 = ₹52,941$
Additional depreciation for 2019	$₹52,941 - ₹33,333 = ₹19,608$

2. Calculation of Impairment Loss for 2019

Particulars	Amount (₹)
Carrying value at end of 2018	₹9,00,000
Less: Revised depreciation for 2019	₹52,941
Carrying value after depreciation (31st Dec 2019)	₹8,47,059
Recoverable amount	₹6,00,000
Impairment loss (Carrying value – Recoverable amount)	$₹8,47,059 - ₹6,00,000 = ₹2,47,059$

20. Illustration

The company has made sales of ₹ 60,00,000 to a customer SS LLP on 31st December 20X2. The normal credit is for one month. However, sometimes, it goes upto 2 months. The company expects to receive the payment by 28th February 20X3. However, no payment has been received till 31st March 20X3. On 15th April 20X3, the sales department of the company became aware that the customer is passing through financial crisis and has major cash flow problems.

The company has agreed to allow the customer to settle the debt by 31st March 20X4, by which time the customer is confident that the cashflow problem will be resolved. The company expects that an annual interest of 9% (i.e. effective interest rate) can be received against any money lent out, yet it allowed the customer an interest-free payment period.

Determine the amount to be shown as 'trade receivable' from SS LLP in the books of the company as on 31st March 20X3.

Solution

- **₹60,00,000 was due from SS LLP as of 31st December, 20X2**, and was expected to be received by **28th February, 20X3**.
- No payment was received till **31st March, 20X3**.
- On **15th April, 20X3**, it was confirmed that the **customer had financial difficulties before the reporting date**, making this an **adjusting event**.
- The company agreed to extend the **payment period to 31st March, 20X4, interest-free**, despite a normal **9% effective interest rate**.

- Since the payment is deferred for **one additional year**, the trade receivable must be **re-measured at present value** using the discount factor of **9%**.

(i) Calculation of Present Value of Trade Receivable (31st March, 20X3)

Trade Receivable = ₹60,00,000(1.09) ₹55,04,587

Thus, the **adjusted trade receivable balance on 31st March, 20X3** is **₹55,04,587**, and the **impairment loss** to be recognized in **profit and loss** is:

₹60,00,000 – ₹55,04,587 = ₹4,95,413

(ii) Accounting Entries for 31st March, 20X3

1. Recognizing Impairment Loss

Impairment Loss A/c Dr. ₹4,95,413

 To Trade Receivables A/c ₹4,95,413

(Being impairment loss recognized on trade receivables due to credit impairment)

(iii) Accounting for Interest Income in 20X3-20X4

As per Ind AS 109, in the **next financial year (20X3-20X4)**, **interest income** should be recognized based on the adjusted present value:

₹55,04,587 × 9% = ₹4,95,413

2. Recognizing Interest Income in 20X3-20X4

Trade Receivables A/c Dr. ₹4,95,413

 To Interest Income A/c ₹4,95,413

(Being interest income recognized on trade receivable re-measured at present value)

1. Illustration

Mr. Rajan is working for Infotech Ltd. Consider the following particulars:

Annual salary of Mr. Rajan = ₹ 30,00,000

Total working days in 20X0-X1 = 300 days

Leaves allowed in 20X0-X1 as per policy = 10 days

Leaves utilized by Mr. Rajan in 20X0-X1 = 8 days

The unutilized leaves are settled by way of payment and accordingly, carry forward of such leaves to the subsequent period is not allowed.

Compute the total employee benefit expense for Infotech Ltd. in respect of 20X0-X1.

Solution:

Mr. Rajan is an employee of Infotech Ltd. The company follows a policy where **unused leaves are encashed** at the end of the financial year. According to **Ind AS 19 (Employee Benefits)**, such payments are classified as **short-term compensated absences**, requiring recognition as an **expense in the period in which the employee renders service**.

Computation of Employee Benefit Expense:

Particulars	Amount (INR)
Annual Salary	30,00,000
Total Working Days	300
Per Day Salary (30,00,000 / 300)	10,000
Unutilized Leave (10 - 8)	2 Days
Additional Expense for Unutilized Leave (2 x 10,000)	20,000
Total Employee Benefit Expense for 20X0-X1	30,20,000

Thus, the total **employee benefit expense** recognized for the year **20X0-X1** will be **INR 30,20,000**.

2. Illustration

Mr. Niranjana is working for Infotech Ltd. Consider the following particulars:

	20X0-X1	20X1-X2
Annual salary	30,00,000	30,00,000
Working days	300 days	300 days
Leave allowed	10 days	10 days
Leave taken	7 days	13 days
Leave unutilized carried forward to next year	3 days	NIL

Scenario I

Based on past experience, Infotech Ltd. assumes that Mr. Niranjana will avail the unutilized leaves of 3 days of 20X0-20X1 in 20X1-20X2.

Infotech Ltd. contends that it will record Rs. 30,00,000 as employee benefits expense in each of the years 20X0-20X1 and 20X1-20X2, stating that the leaves will, in any case, be utilized by 20X1-20X2.

Comment on the accounting treatment proposed to be followed by Infotech Ltd. Also pass journal entries for both the years.

Scenario II

Based on past experience, Infotech Ltd. assumes that Mr. Niranjana will avail the unutilized leaves of 2 days of 20X0-20X1 subsequently. However, in 20X1-20X2, Mr. Niranjana availed in actual all 3 days of brought forward leave.

Compute the expense to be recognised in 20X0-20X1 and 20X1-20X2. Also pass journal entries for both the years.

Answer:

Scenario - I

Infotech Ltd. assumes that unutilized leaves from **20X0-X1 (3 days)** will be used in **20X1-X2**. Under **Ind AS 19**, **expense should be recognized in the period in which the benefit accrues**, rather than when the leave is taken.

The expenditure to be recognized will be as under:

	Year 20X0- 20X1	Year 20X1- 20X2
Annual Salary	₹.30,00,000	₹.30,00,000
No. of working days (A)	300 days	300 days
Salary cost per day (A ÷ B)	₹.10,000 per day	₹. 10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to be recognised:		
In 20X0-20X1: 30,00,000 + [10,000 per day x 3 days (leaves unutilized expected to be utilized subsequently)]	₹. 30,30,000	
In 20X1-20X2: 30,00,000 – [10,000 per day– 3 days (excess leave utilized in 20X1-20X2)]		₹. 29,70,000

Journal Entry for 20X0-20X1

Employee Benefits Expense Account	Dr.	30,30,000	
To Bank Account			30,00,000
To Provision for Leave Encashment			30,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,70,000	
Provision for Leave Encashment Account	Dr.	30,000	
To Bank Account			30,00,000

Scenario-II

The expenditure to be recognized will be as under:

Particulars	Year 20X0- 20X1	Year 20X1- 20X2
Annual salary (A)	₹. 30,00,000	₹. 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	₹. 10,000 per day	₹. 10,000 per day
Expense to be recognised:	₹ 30,20,000	
In 20X0-20X1: ₹ 30,00,000 + [₹ 10,000 per day x 2 days (leaves unutilized expected to be utilized subsequently)]		
In 20X1-20X2: ₹ 30,00,000 – [₹ 10,000 per day x 3 days (excess leave utilized in 20X1- 20X2)] + ₹ 10,000 (additional expense due to change in accounting estimate)		₹ 29,80,000

The additional ₹. 10,000 booked as an expense in 20X1-20X2 represents a change in accounting estimate (i.e. as against the entity's estimation that 2 days of unutilized leave would be utilized subsequently, actually 3 days were utilized subsequently), for which a prospective effect needs to be given, in line with Para 36 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Journal Entry for 20X0-20X1

Employee Benefits Expense Account	30,20,000	
Dr.		
To Bank Account		30,00,000
To Provision for Leave Encashment		30,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,80,000	
Provision for Leave Encashment Account	Dr.	20,000	
To Bank Account			30,00,000

3. Illustration

Sundaram Ltd. has a headcount of 100 employees in 20X0-20X1. As per the employee policy, the employees are entitled to:

- 30 casual leaves out of which 10 casual leaves may be carried forward to the next year; and
- 10 sick leaves out of which 2 sick leaves may be carried forward as paid leave.

At 31st March, 20X1, the average unused entitlement is 5 days per employee for casual leaves and 1 day per employee for sick leave. On an average, it is found that the number of such employees who would be claiming casual leaves would be 30 and 10 employees who would claim sick leaves.

Compute the liability to be recognised in respect of sick leaves and casual leaves by the entity at the end of the financial year 20X0-20X1.

Answer:

Type of leave (A)	Leave Entitlement (B)	Leaves c/f permissible (C)	Average leaves Unutilized (D)	No. of Employees (E)	Liability (F = D x E)
Casual Leave	30 days	10 days	5 days	30	150 days salary
Sick Leave	10 days	2 days	1 day	10	10 days salary

The entity will recognise liability in the books equal to 150 (30 x 5) days of paid casual leaves and 10 (10 x 1) days of paid sick leaves.

4. Illustration

An entity has 100 employees, who are each entitled to ten working days of paid sick leave for each year. Unused sick leave may be carried forward for one financial year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis).

At 31 March 20X1, the average unused entitlement is two days per employee. Based on past experience, the management expects that only 20% of the employees will use 1 day from their carried forward leave. Salary per day is Rs. 2,500.

Compute the expenses in respect of the short-term compensated absences, if they are assumed to be

- (a) vested short-term compensated absences, and
- (b) non-vested short-term compensated absences.

Solution:

Vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 2 Days x ₹ 2,500 = ₹ 5,00,000

Non-vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 20% x 1 Day x ₹ 2,500 = ₹ 50,000

5. Illustration

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates observed during past 10 years represents 6% per annum. Acer Ltd. provides the following benefits to all its employees:

Paid vacation - 10 days per year regardless of date of hiring. Compensation for paid vacation is 100% of employee's salary and unused vacation can be carried forward for 1 year.

As of 31st March, 20X1, unused vacation carried forward was 3 days per employee, average salary was Rs. 15,000 per day and accrued expense for unused vacation in 20X0-20X1 was Rs. 65,00,000. During 20X1-20X2, employees took 9 days of vacation in average. Salary increase in 20X1-20X2 was 10%.

How would Acer Ltd. recognize liabilities and expenses for these benefits as of 31st March, 20X2?. Pass the journal entry to show the accounting treatment.

Answer:

Paid Vacation:

Step 1: Calculation of Unused Vacation in man-days as on 31st March, 20X2:

A. No. of Employees in service for the whole year (94%):

Particulars	Man-days
Unused vacation as on 31 st March, 20X1	3 days per employee
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	4 days per employee
Total Unused vacation as on 31st March, 20X2 - (A) (350 employees x 94% x 4 days per employee)	1,316 man-days

B. Newcomers (6%):

Particulars	Man-days
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	1 day per employee
Total Unused vacation as on 31st March, 20X2 - (B) (350 employees x 6% x 1 day per employee)	21 man-days
Total unused vacation as on 31st March, 20X2 (A + B)	1,337 man-days

Step 2: Calculation of average salary per day:

Particulars	₹
Average salary per day as on 31st March, 20X1	15,000
Salary increase in 20X1-20X2	10%
Average salary per day as on 31st March, 20X2	16,500

Step 3: Calculation of provision for unused paid vacation:

Particulars	₹
Calculation of provision for unused paid vacation 20X1-20X2: (1,337 man-days x ₹ 16,500)	2,20,60,500
Provision for unused paid vacation 20X0-20X1	65,00,000

Step 4: Accounting treatment

Provision for 20X1-20X2

Employee Benefits Expenses A/c	Dr.	2,20,60,500	
To Provision for Leave Encashment			2,20,60,500

Settlement of Liability of 20X0-20X1

Provision for Leave Encashment A/c	Dr.	65,00,000	
To Cash / Bank			65,00,000

6. Illustration

An entity has 100 employees, who are each entitled to five working days of paid sick leaves for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is

taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (LIFO basis).

At 31st March, 20X1, the average unused entitlement is two days per employee. The entity expects, on the basis of experience that is expected to continue, that 92 employees will take no more than five days of paid sick leaves in 20X1-20X2 and that the remaining eight employees will take an average of six and a half days each.

The entity expects that it will pay an additional twelve days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 20X1 (one and a half days each, for eight employees).

Would the entity require to recognize any liability in respect of leaves?

Solution:

At **31st March 20X1**, the average unused entitlement is **2 days per employee**.

Management estimates that:

- **92 employees will take 5 days or less.** [They will not use previous years balance)
- **8 employees will take an average of 6.5 days.** [5 days used from current year and 1.5 days from previous year]

Since the additional leave taken due to carried forward balance is **1.5 days per employee for 8 employees**, the entity must recognize **12 days of additional sick pay** as a liability.

Liability to be recognized=12 days of sick pay.

7. Illustration

Laxmi Mills is a profit-making entity and has reported profit of Rs.200 crore in the financial year 20X1-20X2.

According to its profit-sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation.

Under this plan, an entity is under an obligation to pay if the employees complete a specified period with the organisation. Laxmi Mills has estimated that due to staff turnover in the organisation, the estimated pay-out would be around 4.5%.

Compute the liability and expense of the company under this plan.

Solution:

The company shall recognize a liability and an expense of an amount of ₹ 9 crores for the financial year 20X1-20X2 (i.e. 4.5% of ₹ 200 crores).

8. Illustration

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates as observed during past 10 years represents 6% per annum. Acer provides the following benefits to all its employees:

Annual bonus - during past 10 years.

Acer paid bonus to all employees who were in service during the entire financial year. Bonus was paid in June following the financial year-end. Amount of bonus for 20X1-20X2 paid in June 20X2 represented Rs. 1,25,000 per employee. Acer Ltd. used to increase amount of bonus based on official inflation rate which is 8.5% for 20X2-20X3, although there was no legal obligation to increase the bonus by such inflation rate.

How would Acer Ltd. recognize liabilities and expenses for these employee benefits as on 31st March, 20X3? Pass the journal entry to show the accounting treatment.

Solution:

Particulars	₹
Bonus paid for 20X1-20X2	1,25,000 per employee
Bonus for 20X2-20X3 - increased by inflation of 8.5%[1,25,000 x (100% + 8.5%)]	1,35,625 per employee
No. of employees in staff during the whole year [350 x (100-6%)]	329 employees
Provision for Bonus for 20X2-20X3	4,46,20,625

Accounting Treatment:**Provision for Bonus for 20X2-20X3**

Employee Benefits Expenses A/c Dr.	4,46,20,625	
To Provision for Bonus 20X2-20X3		4,46,20,625

Note:

It is given that the company is under no legal obligation to increase the bonus by the official inflation rate. However, the company has been increasing the bonus by the inflation rate over the past years. This has given rise to a constructive obligation for Acer Ltd. Informal practices, such as these, give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. Accordingly, provision is made for the amount considering the inflation rate.

9. Illustration

A company pays each employee a lump-sum one-time benefit upon retirement. This benefit is computed based on the employee's years in service in the company and the final salary prior to retirement. To cover its liabilities from this remuneration, the company contributes 3% of annual gross salaries to the fund. Would this obligation represent a defined contribution plan or a defined benefit plan and why?

Solution:

This obligation represent defined benefit plan.

Reason:

A company pays each employee a **lump-sum one-time benefit upon retirement**, which is based on:

- The **employee's years of service**.
- The **final salary prior to retirement**.

To fund this benefit, the company **contributes 3% of annual gross salaries** to a fund.

This is a **Defined Benefit Plan**, because:

- The benefit amount is predetermined based on service and salary.
- The company bears the risk **if fund assets are insufficient** to cover employee remuneration.

10. Illustration

In accordance with applicable legislation, company contributes 12% and employees 12% of annual gross salaries to the provident and pension fund. Upon retirement, the employees will get the accumulated balance that is calculated based on employee's years of service and his average salary for past 15 years before retirement. The pension will be paid out of the state fund assets and the company has no further obligation except to make contributions. Would this obligation represent a defined contribution plan or a defined benefit plan?

Solution:

A company contributes **12% of salaries** (with an additional **12% from employees**) to a **provident and pension fund**.

Upon **retirement**, employees receive a pension based on:

- **Years of service**.
- **Average salary for the last 15 years**.

The **pension is paid out of state fund assets**, and the **company has no further obligation** beyond contributions.

This is a **Defined Contribution Plan**, because:

- The company's **liability is limited** to fixed contributions.
- The **state fund bears the actuarial and investment risk**.

11. Illustration

Acer Ltd. provides lump-sum remuneration upon retirement to its employees. Remuneration is paid out of the fund to which Acer Ltd. contributes 12% of annual gross salaries. Contributions are made twice a year i.e., in November of the related financial year and in June after the financial year- end. Total annual gross salaries for 20X0-X1 amounted to Rs. 50 crores. Contribution made by Acer Ltd. in November 20X0 was Rs. 2.8 crores. Remuneration depends on the number of employee's service and amount of cash in the fund at retirement date (Acer Ltd. has no further obligations except for contributions).

How should this transaction appear in the financial statements of Acer Ltd. as of 31 March 20X1?

Solution:

1. Calculation of accrual for contributions in 20X0-20X1:

	₹
Annual gross salaries in 20X0-20X1	50.00 crores
Amount of total contributions for 20X0-20X1 (12%):	6.00 crores
Contributions already made in November 20X0	2.80 crores
Accrual (6 crores - 2.8 crores)	3.20 crores

2. Accounting treatment

Employee Benefits Expenses Account	Dr.	6.00 crores	
To Bank Account			2.80 crores
To Contribution Payable			3.20 crores

The contribution of ₹ 6 crores will be debited to the statement profit and loss. The contribution payable of ₹ 3.20 crores will appear as a liability as at 31st March, 20X1.

12. Illustration

In 2017-18, Diana Ltd. has 3,000 employees in the company.

As per the company policy, the employees are given 30 days of Privilege Leave (PL), 12 days of Sick Leave (SL) and 12 days of Casual Leave. Out of the total PL and SL, 10 PL and 5 SL can be carried forward to next year. On the basis of past trends, it has been noted that 1,000 employees will take 5 days of PL and 2 days of SL and 2,000 employees will avail 10 as PL and 5 as SL in the next year.

Also, the company has been incurring profits since incorporation. It has been decided in 2017-18 to distribute profits to its employees @ 8% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Diana Ltd. is to be around 7%. The profits earned during 2017-18 is Rs. 12,000 lakh.

Diana Ltd. also has a post-employment benefit plan available which is in the nature of defined contribution plan where contribution to this fund amounts to Rs. 500 lakh which will fall due within 12 months from the end of accounting period. The company has paid Rs. 120 lakh to its employees in 2017-18. What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Diana Ltd. as per the provisions of relevant Ind AS? [May 19 (N), 5 marks]

Solution:

(i) **For short term compensating expenses:**

Diana. Ltd. will recognise a liability in its books to the extent of 5 days of PL for 1,000 employees and 10 days of PL for remaining 2,000 employees and 2 days of SL for 1,000 employees and 5 days of SL for remaining 2,000 employees in its books as an unused entitlement that has accumulated in 2017-2018.

(ii) For profit sharing plan:

Diana. Ltd. will recognise ₹ 840 lakh (12,000 x 7%) as a liability and expense it in books of accounts.

(iii) For defined contribution plan:

When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:

- Under Ind AS 19, the amount of ₹ 380 lakh (500-120) may be recognised as a liability (accrued expense), after deducting contribution already paid. However, if the contribution already paid would have exceeded the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense); and
- Also, ₹ 380 lakh will be recognised as an expense in this case study which will be disclosed as an expense in the statement of profit and loss.

13. Illustration

A company has an employee benefit plan which involves a lump sum payment to employee on termination of service and that is equal to 1 per cent of final salary for each year of service. Consider the salary in year 1 is Rs. 10,000 and is assumed to increase at 7 per cent (compound) each year.

Taking a discount rate at 10 per cent per year, you are required to show

- benefits attributed (year on year) and
 - the obligation in respect of this benefit (year on year)
- for an employee who is expected to leave at the end of year 5.

Solution:

Salary at Year 1		10,000
Annual Increment		7%
Salary at Year 5	10000×1.07^5	13,108
Benefit payable 1% for every year		131
Total benefit payable		655

Benefits attributed year on year

Years	Benefit	Cumulative	PVF 10%	PV
1 (End)	131	131	0.6830	89.47
2	131	262	0.7513	98.42
3	131	393	0.8264	108.26
4	131	524	0.9091	119.09
5 (End)	131	655	1	131.00

Computation of interest cost and obligation

Years	Opening	Int @ 10%	Service Cost	Closing
1 (End)	0	0.00	89.47	89.47
2	89.47	8.95	98.42	196.84

3	196.84	19.68	108.26	324.79
4	324.79	32.48	119.09	476.36
5 (End)	476.36	47.64	131.00	655.00

14. Illustration

AKJ Ltd is a listed company engaged in the business of manufacturing of electronic equipment. The company has various branch offices spread out across India and has 1,000 employees.

As per the statutory requirements, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years -

- (a) on his superannuation, or
- (b) on his retirement or resignation, or
- (c) on his death or disablement due to accident or disease.

The completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.

The amount payable is determined by a formula linked to number of years of service and last drawn salary. The amount payable to an employee shall not exceed Rs.10,00,000.

How should the amount of employee benefit, if any, be attributed to each year of service?

Solution:

AKJ Ltd., a listed company, must account for gratuity as a **defined benefit plan** under **Ind AS 19 (Employee Benefits)**. The gratuity liability arises upon an employee's **superannuation, resignation, retirement, or death/disablement**, provided they have completed **five years of continuous service**, except in cases of death or disablement. The amount payable is linked to **years of service and last drawn salary**, with a statutory cap of **₹ 10,00,000 per employee**.

As per **Ind AS 19**, the **Projected Unit Credit (PUC) method** should be used to determine the gratuity liability. Employees who are unlikely to meet the **minimum five-year service condition** are excluded. Other employees are categorized based on their **expected tenure**, considering **mortality rates, resignation trends, and disability probabilities**. The gratuity amount is calculated using the prescribed formula, factoring in **salary increments and promotions**. For employees expected to receive **₹ 10,00,000 or less**, the gratuity cost is **spread evenly over their service period**. However, for employees where the **gratuity exceeds ₹ 10,00,000**, the allocation is limited to the period until the cap is reached. Beyond this, no further cost is recognized.

15. Illustration

OPQ Ltd is a listed company having its corporate office at Nagpur. The company has a branch office at Chennai. The company has been operating in Indian market for the last 10 years. The company operates a pension plan that provides a pension of 2.5% of the final salary for each year of service. The benefits become vested after seven years of service.

On 1st April, 20X8, the company increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1. On the date of the improvement, the present value of the additional benefits for service from 1st April, 20X1 to 1 April 20X8 was as follows:

- Employees with more than seven years' service on 1 January 20X8 – Rs. 2,75,000
- Employees with less than 7 years of service – Rs. 2,21,000 (average 4 years to go)

What would be the accounting treatment in this case?

Solution:

OPQ Ltd. operates a **defined benefit pension plan**, initially providing **2.5% of the final salary per service year**, with benefits vesting after **seven years of service**. On **1st April 20X8**, the pension rate was retrospectively increased to **3% per year of service**, effective **from 1st April 20X1**. As per **Ind AS 19**, past service cost arises when an amendment to a defined benefit plan affects prior periods. If benefits are **already vested**, the past service cost is **recognized**

immediately in profit and loss. If they are **not yet vested**, it is amortized over the remaining vesting period.

The company recognizes a **total liability of ₹ 4,96,000**, consisting of **₹ 2,75,000 for vested employees** and **₹ 2,21,000 for employees with an average of four years left for vesting** since these benefits is for the period of service already completed.

16. Illustration

RKA Private Ltd is an old company established in 19XX. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of Rs.11,000 crores and planning to get listed in the next year.

The company has a large employee base. The company provided a defined benefit plan to its employees. Following is the information relating to the balances of the fund's assets and liabilities as on 1st April X1 and 31st March X2 (Rs. Lacs)

Particulars	1 st April	31 st March
Present Value of benefit obligation	1,400	1,580
Fair Value of plans assets	1,140	1,275

For the financial year ended 31st March, 20X2, service cost was Rs. 55 lacs. The company made a contribution of an amount of Rs. 111 lacs to the plan. No benefits were paid during the year.

Consider a discount rate of 8%.

You are required to -

- Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.
- Give the journal entries in respect of amount(s) to be recognized.

Solution:

- Extract of the Balance Sheet of RKA Private Ltd as at 31st March, 20X2:

Closing net defined liability [(1,580 – 1,275) lacs] = ₹. 305 lacs

Extract of the Statement of Profit or Loss of RKA Private Ltd for the year ended 31st March, 20X2

Particulars	₹ in lacs
Service cost	55
Net interest (Refer W.N.1)	21
Profit or loss	96
Other comprehensive income:	
Remeasurements (Refer W.N.2)	80
Total	156

- Journal entries in the books of RKA Private Ltd

	₹ in lacs	₹ in lacs
Profit & Loss Dr	76	
Other comprehensive income Dr	80	
To Cash (Contribution)		111
To Net defined benefit liability (Refer WN 3)		45

Working Notes:

- Computation of Net interest taken to the Statement of Profit or Loss
 = Discount rate x Opening net defined benefit liability
 = 8% x (1,400 – 1,140) lacs
 = 8% x 260 lacs
 = ₹ 21 lacs (Rounded off to nearest lacs)
- Computation of Remeasurements

Defined Benefit Obligation Account

Particulars	₹	Particulars	₹
To Balance c/d (given)	1,580	By Balance b/d (given)	1,400
		By Current Service Cost	55

		By Interest on Opening Liability (1,400 x 8%)	112
		By Actuarial loss (bal. figure)	13
	1580		1580

Plan Assets Account

Particulars	₹	Particulars	₹
To Balance b/d (given)	1,140	By Balance c/d	1,275
To Bank Account (contribution for the year)	111		
To Surplus / Actual Return	24		
	1,275		1,275

Net interest on opening balance of plan asset = ₹ 91 lacs (i.e. ₹ 1,140 lacs x 8%)
(Rounded off to nearest lacs)

Hence there is a decrease in plan assets due to remeasurement for which computation is as follows:

= Actual Return – Net interest on opening plan asset

= ₹ 24 lacs – ₹ 91 lacs = ₹ 67 lacs.

Net remeasurement would be computed as follows:

Actuarial loss on liability + Loss on return = 13 lacs + 67 lacs = 80 lacs.

3. Computation of increase/ decrease in net defined benefit liability:

Particulars	₹ in lacs
Opening net liability (₹ 1,400 lacs – ₹ 1,140 lacs)	260
Closing net liability (₹ 1,580 lacs – ₹ 1,275 lacs)	305
Increase in liability	45

Alternate working note

Particulars	Obligation	Plan Assets	Net
Opening balance 1st April	1,400.00	1,140.00	260.00
Add: Interest cost/ Exp. Return @ 8%	112.00	91.20	20.80
Add: Service Cost		55.00	
Add: Contribution			111.00
Expected closing bal on 31st Mar	1,567.00	1,342.20	
Actual Closing bal on 31st Mar	1,580.00	1,275.00	305.00
Actuarial Gains/(Losses)		(13.00)	
Loss on Remeasurement of PA		(67.20)	
Total Loss to be debited to OCI			(80.20)

17. Illustration

SA Pvt Ltd is engaged in the business of retail having 100 retail outlets across Northern and Southern India. The company's head office is located at Chennai.

SA Pvt Ltd is a subsidiary of SAG Ltd. SAG Ltd is listed on the National Stock Exchange in India.

Following information is available for SA Pvt Ltd:

Plan Assets

On 1st April, 20X1, the fair value of plan assets was ₹ 10,000.

Contribution to the plan assets done on 31st March, 20X2 – ₹ 3,000

Amount paid on 31st March, 20X2 – ₹ 300

On 31st March, 20X2, the fair value of plan assets was ₹ 14,700

Actual return on plan assets – ₹ 2,000

Defined Benefit Obligation

On 1st April, 20X1, present value of the defined benefit obligation was ₹ 12,000.

On 31st March, 20X2, present value of the defined benefit obligation was ₹ 15,500.

Actuarial losses on the obligation for the year ended 31st March, 20X2 were ₹ 100.

Current Service Cost – ₹ 2,500

Benefit paid – ₹ 300

Discount rate used to calculate defined benefit liability - 10%.

As per Ind AS 19, please suggest if there is any amount based on the above-mentioned information that would be taken to other comprehensive income (with workings). Also compute net interest on the net defined benefit liability (asset).

Solution:

As per Ind AS 19, net remeasurement of ₹. 900 would be recognized in other comprehensive income.

Computation of Net remeasurement:

= Remeasurement – Actuarial loss

= 1000 (Refer WN - 1) – 100 (Given in the question) = 900

Computation of net interest expense

Particulars	₹
Defined benefit liability as at 1st April 20X1 (A) (Given in the question)	12,000
Fair value of plan asset as at 1st April 20X1 (B) (Given in the question)	(10,000)
Net defined benefit liability (A - B)	2,000
Net interest expense (as it is net liability) (Refer note given below)	200

Note:

Net interest expense would be computed on net defined benefit liability using discount rate of 10% given in the question-

= Net defined benefit liability x Discount rate

= 2,000 x 10% = ₹. 200.

Working Note:

Computation of amount of remeasurement

Particulars	₹
Actual return on plan asset for the year ended 31st March 20X2 (C) (Given in the question)	2,000
Less: Interest income on 10,000 held for 12 months at 10% (D)	(1,000)
Remeasurement (E = C - D)	1,000

18. Illustration

A Ltd. prepares its financial statements to 31st March each year. It operates a defined benefit retirement benefits plan on behalf of current and former employees. A Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 20X1, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was ₹ 5,20,00,000. On 1st April, 20X1, the annual market yield on government bonds was 5%. During the year ended 31st March, 20X2, A Ltd. made contributions of ₹ 70,00,000 into the plan and the plan paid out benefits of ₹ 42,00,000 to retired members. Both these payments were made on 31st March, 20X2.

The actuaries advised that the current service cost for the year ended 31st March, 20X2 was ₹ 62,00,000. On 28th February, 20X2, the rules of the plan were amended with retrospective

effect. These amendments meant that the present value of the defined benefit obligation was increased by ₹ 15,00,000 from that date.

During the year ended 31st March, 20X2, A Ltd. was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 80,00,000. Before 31st March, 20X2, A Ltd. made payments of ₹ 75,00,000 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were ₹ 5,60,00,000.

Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 20X2 as per Ind AS. Finance cost is to be computed on the opening balances.

Solution:

During the year, A Ltd. incurred a current service cost of ₹ 62,00,000, which is recognized as an expense in the **profit and loss statement**. Additionally, the company amended the plan retrospectively on **28th February 20X2**, leading to a **past service cost of ₹ 15,00,000**, which is also recognized in **profit and loss**. The redundancy program reduced the **DBO by ₹ 80,00,000**, with **settlement payments of ₹ 75,00,000** made out of the plan's assets. The net gain on settlement was ₹ 5,00,000, which is recorded in **profit and loss**.

The **finance cost** for the year is based on the opening net liability of ₹ 80,00,000, at a discount rate of **5%**, resulting in ₹ 4,00,000 being charged to **profit and loss**. The company contributed ₹ 70,00,000 to the plan during the year, and **benefits paid to retired employees amounted to ₹ 42,00,000**.

On **31st March 20X2**, the **DBO increased to ₹ 6,80,00,000**, while the **fair value of plan assets rose to ₹ 5,60,00,000**, leading to a closing **net liability of ₹ 1,20,00,000**. The difference between the expected and actual values results in a **remeasurement loss of ₹ 34,00,000**, which is recognized in **other comprehensive income (OCI)**.

For the year ended 31st March, 20X2, the remeasurement loss will be 3,400,000 (Refer W. N.).

Working Note:

Remeasurement of gain or loss

	₹ in '000
Liability at the start of the year (60,000 – 52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400
Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400
Liability at the end of the year (68,000 – 56,000)	12,000

19. Illustration

On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March, 20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31 March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000.

Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?

Solution:

Reconciliation of Plan assets and Defined benefit obligation

	Plan Assets (₹)	Defined benefit Obligation (₹)
Fair value/present value as at 1st April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost	-	5,10,000
Contributions received	4,25,000	-
Benefits paid	(2,55,000)	(2,55,000)
Return on plan assets (gain) (assets) (balancing figure)	68,000	-
Actuarial Loss (balancing figure)	-	2,33,750
Closing balance as at 31 st March, 20X2	23,80,000	27,20,000

	₹
In the Statement of Profit and loss, the following will be recognised:	
Current service cost	5,10,000
Net interest on net defined liability (₹ 1,06,250 – ₹ 1,02,000)	4,250
Defined benefit re-measurements recognised in Other Comprehensive Income:	
Loss on defined benefit obligation	(2,33,750)
Gain on plan assets	68,000
	(1,65,750)
In the Balance sheet, the following will be recognised:	
Net defined benefit liability (₹ 27,20,000 – ₹ 23,80,000)	3,40,000

20. Illustration

- At 1 April, 20X0, the fair value of the Plan Assets was ₹ 10,00,000. The Plan paid benefits of ₹ 1,90,000 and received contributions of ₹ 4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be ₹ 15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to ₹ 14,79,200 on the same date. Actuarial losses on defined benefit obligation were ₹ 6,000. Compounding happens half-yearly. The normal interest rate for 6 months period is 10%, while the effective interest rate for 12 months period is based on the following data:
At 1 April, 20X0, the company made the following estimates based on market prices at that date:

Particulars	%
Interest and Dividend Income, after tax payable by the fund	9.25
Add: Realized and Unrealized Gains on Plan Assets (after tax)	2.00
Less: Administration Costs	(1.00)
Expected Rate of Return	10.25

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other

Comprehensive Income' in this case.	(RTP may 20)
Solution:	

Computation of Expected Return on Plan Assets	
Particulars	₹
Return on ₹ 10,00,000 for 20X0-20X1 at 10.25%	1,02,500
Add: Return on ₹ 3,00,000 for 6 months at 10% Normal Rate = [3,00,000	
(Inflow ₹ 4,90,000 less Payments ₹ 1,90,000) x 10% x 6/12)]	15,000
Expected Return on Plan Assets	1,17,500
Computation of Actual Return on Plan Assets	
Particulars	₹
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)
Less: Contributions received during the year 20X0-20X1	(4,90,000)
Add: Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	2,00,000
Computation of Net Actuarial Gain	
Particulars	₹
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	76,500

21. Illustration

From the following particulars, compute the net defined benefit liability and expense to be recognized in Profit and Loss account. (₹ in lakhs)

Particulars	Defined benefit obligation		Plan Assets	
	31st Dec. 20X2	31st Dec. 20X1	31st Dec. 20X2	31st Dec. 20X1
Balance at the beginning of the year	63.25	47.08	21.80	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)

Solution

Computation of defined benefit liability and expenses to be charged to Statement of Profit and Loss:

	Defined benefit obligation (₹ in lakhs)		Plan Assets (₹ in lakhs)	
	31 st Dec 20X2	31 st Dec 20X1	31 st Dec 20X2	31 st Dec 20X1

Balance at the beginning of year	63.25	47.08	21.80*	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	<u>2.12</u>	<u>(0.35)</u>
Balance at the end of year	<u>75.07</u>	<u>63.25</u>	<u>33.39</u>	<u>21.81*</u>

*Difference is due to approximation.

In the BALANCE SHEET, the following will be recognised:

Net defined liability to be recognised for the period ending 31 st December, 20X1:
= ₹ 41.44 lakhs (₹ 63.25 lakhs - ₹ 21.81 lakhs)

Net defined liability to be recognised for the period ending 31 st December, 20X2:
= ₹ 41.68 lakhs (₹ 75.07 lakhs - ₹ 33.39 lakhs)

In the STATEMENT OF PROFIT AND LOSS, the following will be recognised:

	Defined benefit obligation(₹ in lakhs)		Plan Assets(₹ in lakhs)	
	31 st Dec., 20X2	31 st Dec., 20X1	31 st Dec., 20X2	31 st Dec., 20X1
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Investment income	-	-	(1.47)	(1.12)
Total	<u>10.11</u>	<u>8.53</u>	<u>(1.47)</u>	<u>(1.12)</u>

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 20X1

= ₹ 7.41 lakhs (₹ 8.53 lakhs - ₹ 1.12 lakhs)

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 20X2 = ₹

8.64 lakhs (₹ 10.11 lakhs - ₹ 1.47 lakhs).

22. Homework Question

Arunachalam Ltd. operates a Defined Retirement Benefits Plan for its current and former employees. Given the large size of the company, it engaged a firm of Actuaries for advice on the Contribution Levels and overall Liabilities of the Plan to pay benefits. Following details are given:

- On 1st April, 20X1, the actuarial valuation of the present value of the defined benefit obligation was ₹ 15 crores. On the same date, the fair value of the assets of the Defined Benefit Plan was ₹ 13 crores. On 1st April, 20X1, the annual market yield based on Government Bonds was 5%.
- During the year ended 31st March, 20X2, Arunachalam made contributions of ₹ 1.75 crore into the Plan and the Plan paid out benefits of ₹ 1.05 crore to retired members. Assume that both these payments were made on 31st March, 20X2.
- The Actuarial Firm estimated that the current service cost for the year ended 31st March, 20X2 would be ₹ 1.55 crores. On 28th February, 20X2, the rules of the Plan were amended with retrospective effect which led to an increase in the present value of the defined benefit obligation by ₹ 37.5 lakhs from that date.

- (d) During the year ended 31st March, 20X2, Arunachalam was in negotiation with employee representatives regarding planned redundancies. These negotiations were completed shortly before the year end and the redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 2 crores. Before 31st March, 20X2, Arunachalam made payments of ₹ 1.875 crores to the employees affected by the redundancies in compensation for a curtailment of their benefits. These payments were made out of the assets of the Retirement Benefits Plan.
- (e) On 31st March, 20X2, the present value of the defined benefit obligation was ₹ 17 crores and the fair value of the assets of the Defined Benefit Plan was ₹ 14 crores.

Discuss how the above will be accounted in the books of Arunachalam Ltd. for the year 20X1-20X2. Also give the extracts of financial statements affected due to above transactions.

1. Illustration

ABC Ltd. issues 9% preference shares of fair value of Rs. 10 each on 1.4.20X1. Total value of the issue is Rs. 10,00,000. The shares are issued for a period of 5 years and would be redeemed at the end of 5th year. The shares are to be redeemed at Rs. 11 each. At the end of the year 3, i.e. on 31.3.20X4, company finds that it has earned good returns than expected over last three years and can make the redemption of preference shares early. To compensate the shareholders for two years of dividend which they need to forego, company decided to redeem the shares at Rs. 12 each instead of original agreement of Rs. 11. Comment on the impact of early conversion of preference shares at a premium on earnings for the year 20X3- 20X4 attributable to ordinary equity holders of ABC Ltd. for basic EPS. Ignore the EIR impact in the solution and answer on the basis of Ind AS 33 only.

Solution:

In the given scenario, ABC Ltd. had originally planned to redeem its **9% preference shares at Rs. 11 per share** after **5 years**. However, due to better-than-expected financial performance, the company decided to **redeem the shares earlier (after 3 years) at Rs. 12 per share** instead of the originally agreed **Rs. 11 per share**.

This results in an **additional payout of Rs. 1 per share**, amounting to **Rs. 1,00,000** (1,00,000 shares × Rs. 1 excess payment).

As per **Ind AS 33 - Earnings Per Share**, any **premium paid on the redemption of preference shares** beyond the original contractual terms is treated as a **return to preference shareholders**. This amount is **deducted from the earnings for the year 20X3-20X4** while computing the **Basic EPS**.

2. Illustration

An entity has following preference shares in issue at the end of 20X4:

- 5% redeemable, non-cumulative preference shares: These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – Rs. 100,000.
- Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 20X0, with a cumulative dividend rate from 20X5 of 10%: The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 20X5. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, Rs. 18,000. These shares are classified as equity – Rs. 200,000.
- 8% non-redeemable, non-cumulative preference shares: At the beginning of the year, the entity had Rs. 100,000 8% preference shares outstanding but, at 30 June 20X4, it repurchased Rs. 50,000 of these at a discount of Rs. 1,000 – Rs. 50,000.
- 7% cumulative, convertible preference shares (converted in the year): These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of Rs. 300 – Nil.

The profit after tax for the year 20X4 is Rs. 150,000.

Determine the adjustments for the purpose of calculating EPS.

Solution:

Profit after tax			150000

Less: Amortisation of increasing rate pref. shares	-18,000.00	
Add: Discount on redemption of preference shares	1,000.00	
Less : Excess fv on conversion	-30,000.00	-47,000.00
	Earnings for EPS	1,03,000

3. Illustration

On 31 March, 20X2, the issued share capital of a company consisted of Rs. 100,000,000 in ordinary shares of Rs. 25 each and Rs. 500,000 in 10% cumulative non-redeemable preference shares (classified as equity) of Re 1 each. On 1 October, 20X2, the company issued 1,000,000 ordinary shares fully paid by way of capitalisation of reserves in the proportion 1:4 for the year ended 31 March, 20X3.

Profit for 20X1-20X2 and 20X2-20X3 is Rs. 450,000 and Rs. 550,000 respectively. Calculate the basic EPS for 20X1-20X2 and 20X2-20X3..

Solution:

Calculation of Basic Earnings per share as on 31st March 20X2 reported in FS of 20X1-X2			
Net Profit	450000		
Less: Cumulative Pref. Dividends	50000		
Earnings available to ordinary equity holders	4,00,000.00		A
No of Eq. Shares outstanding	40,00,000		B
EPS	0.10		A/B
Calculation of Basic EPS as on 31st March 20X3 and 20X2 for FS of 20X2-X3			
	20X2-X3	20X1-X2	
Net Profit	5,50,000	4,50,000.00	
Less: Cumulative pref. dividend	50,000	50,000	
Earnings available to ordinary equity holders	5,00,000	4,00,000	
Weighted Avg. No of equity shares o/s	50,00,000	50,00,000	
EPS	0.1	0.08	
EPS reported in 20X1-X2 x Adj factor		0.08	
W.N 1			
No of shares outstanding			
			Weighted Average
No of Shares before bonus issue	40,00,000	12/12	
Bonus issue 1 for 4	10,00,000	12/12	
Total no of share o/s	50,00,000		

Adjustment factor	Bonus issue		
No of shares before bonus		4	
No of shares after bonus		5	
	Bonus Adj factor	4/5	
		0.80	

4. Illustration

1st January 1,000,000 shares in issue
 28th February Issued 200,000 shares at fair value
 31st August Bonus issue 1 shares for 3 shares held
 30th November Issued 250,000 shares at fair value.

Calculate the number of shares which would be used in basic EPS calculation if the reporting date is 31st December.

Solution:

Date	Transaction	No of Shares	No of Months	Weight	weighted Avg	
01-Jan	Opening Bal	1000000	12	12/12	10,00,000.00	
01-Jan	Bonus on opening bal	3,33,333.33	12	12/12	3,33,333.33	
28-Feb	Fresh issue	2,00,000.00	10	10/12	1,66,666.67	
28-Feb	Bonus issue	66,666.67	10	10/12	55,555.56	
30-Nov	Fresh issue	2,50,000	1	1/12	20,833.33	
				WAVES	15,76,388.89	
Bonus issue 1:3						
Adjusting Bonus issue with opening balance						
01-Jan	Opening bal	10,00,000 $\times 12/12 \times 4/3$			13,33,333	
28-Feb	Issue	200000 $\times 10/12$ $\times 4/3$			2,22,222	
30-Nov	Issue	250000 $\times 1/12$			20,833.33	
					15,76,389	
Alternate working						
01-Jan	Opening bal	10,00,000	2/12	$10,00,000 \times 2/12 \times 4/3$		2,22,222.22
28-Feb	Issue	12,00,000	6/12	$1200000 \times 6/12 \times 4/3$		8,00,000.00
31-Aug	Bonus issue	1600000	3/12	$16,00,000 \times 3/12$		4,00,000.00
30-Nov	Fresh issue	1850000	1/12	$18,50,000 \times 1/12$		1,54,166.67
						15,76,388.89

5. Illustration

At 31 December 20X1, the issued share capital of a company consisted of 1.8 million ordinary shares of Rs. 10 each, fully paid. The profits for the year ended 31 December 20X1 and 20X2 amounted to Rs. 630,000 and Rs. 875,000 respectively. On 31 March 20X2, the company made a rights issue on a 1 for 4 basis at Rs. 30. The market price of the shares immediately before the rights issue was Rs. 60.

Calculate EPS..

Solution:

Step 1

Theoretical Ex-rights price		$\frac{N \times \text{CMP} + 1 \times \text{Rights issue price}}{N+1}$			
		$\frac{4 \times 60 + 1 \times 30}{4+1}$			
		54.00			
Step 2 - Right Adjustment factor		$\frac{\text{MP before Rights}}{\text{TERP}}$		60/54	
				10/9	
		1.111111			
EPS		20X2	20X1		
Net profit		8,75,000	630000		
WANES outstanding		2187500	1800000		
WANES outstanding after bonus element			2000000		
EPS as computed in 20X1			0.35	As computed in 20X1	
EPS for reporting in 20X2		0.40	0.315		
Restated EPS for 20X1			EPS as computed / RAF		
			0.315		
WN 1					
WANES outstanding			RAF		
	Shares	No of months	Adjusment	Weighted Average	
Opening Balance	1800000	3	1.11	$18,00,000 \times \frac{3}{12} \times \frac{10}{9}$	5,00,000.00
			(10/9)		
After rights issue	2250000	9.00	1	$22,50,000 \times \frac{9}{12}$	16,87,500.00
Rights issue	4,50,000.00				21,87,500.00

6. Illustration

ABC Ltd

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1 January 20X1

Shares in issue 1,000,000

31 March 20X1

(a) Rights issue 1 for 5 at Rs. 90

(b) Fair value of shares Rs. 100 (cum-rights price)

Calculate the number of shares for use in the EPS calculation for the calendar year..

Solution:

Step 1 - Calculate TERP		$\frac{5 \times 100 + 1 \times 90}{5+1}$		
		(5+1)		
		98.333333		
Cum - Rights price		100		
Step 2				
Right Adjustment Factor		$\frac{\text{Cum-Rights Price}}{\text{TERP}}$	$\frac{100}{98.3333}$	1.016949497
		TERP	98.3333	
Date	Transaction	No of Shares	Adjustment	WANES
1-Jan-X1	Opening bal	1000000	1.0169495	2,54,237.37
31-Mar-X1	Rights issue	1200000	1	9,00,000.00
				11,54,237.37

7. Illustration

Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax.

Entity A's results for 20X2 showed a profit before tax of Rs. 80,000 and a profit after tax of Rs. 64,000 (for simplicity, a tax rate of 20% is assumed in this question).

Calculate Earnings for the purpose of diluted EPS..

Solution:

Earnings available to equity holders	64,000		
Add: Savings in interest (net of tax)	800	+1000	Profit before tax
[25,000 x 1 x 4% (1-20%)]		-200	
Less: Bonus payable to mgmt.	-10.00	[1% of 1,000]	
Add: Tax savings on bonus	2.00		
Earnings available after conversion	64,792.00		

8. Illustration

ABC Ltd. has 1,000,000 Rs. 1 ordinary shares and 1,000 Rs. 100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period.

ABC Ltd.'s share price is Rs. 4.50 per share and earnings for the period are Rs. 500,000. The tax rate applicable to the entity is 21%.

Calculate basic EPS, earnings per incremental share for the convertible bonds and diluted EPS.

Solution:

	Basic	Increase	Diluted
Earnings available to equity shareholders	5,00,000	7900	5,07,900
No of equity shares	10,00,000	20000	10,20,000
Basic EPS (Rs. Per share)	0.50	0.395	0.4979412
Increase in earnings on conversion of bonds			
Savings in interest	10,000.00	1000 x 100 x 10%	
Tax impact on interest saved (21%)	2,100.00		
Net increase in earnings	7,900.00		
No of potential equity shares	20,000.00		
Incremental earnings per share	0.395		

9. Illustration

At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of Rs. 1 each. On 1 October 20X1, the entity issued Rs. 1,250,000 of 8% convertible loan stock for cash at par. Each Rs. 100 nominal value of the loan stock may be converted, at any time during the years ended 20X6 to 20X9, into the number of ordinary shares set out below:

30 June 20X6: 135 ordinary shares;

30 June 20X7: 130 ordinary shares;

30 June 20X8: 125 ordinary shares; and

30 June 20X9: 120 ordinary shares.

If the loan stocks are not converted by 20X9, they would be redeemed at par.

It is assumed that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options' fair value reported in 20X2 and 20X3 amounted to losses of Rs. 2,500 and Rs. 2,650 respectively. It is assumed that there are no tax consequences arising from these losses.

The profit before interest, fair value movements and taxation for the year ended 30 June 20X2 and 20X3 amounted to Rs. 825,000 and Rs. 895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%.

Calculate Basic and Diluted EPS.

Solution:

Nominal value of loan stock	12,50,000	
Conversion (most favourable)		
135 share per Rs. 100 nominal value		
No of potential equity shares /ordinary shares		
	1250000 / 100 x135	
	16,87,500.00	
Particulars	30-Jun-X3	30-Jun-X2
Profit before interest, FV and Tax	8,95,000.00	8,25,000.00
Less: Interest on loan	1,00,000.00	75,000.00
Less: FV losses (MTM)	2,650.00	2,500.00
Profits before tax	7,92,350	7,47,500

Less: Tax @ 33%		2,62,350	2,47,500.00
(Profit before int, FV - Interest) x 33%			
Profit after tax (Earnings avbl to ord. share)		5,30,000.00	5,00,000.00
WANES		15,00,000.00	15,00,000.00
	Basic EPS	0.3533	0.3333
Check for dilution			
Incremental Earnings			
1. Interest saved (net of tax)		67,000.00	50,250.00
2. FV MTM losses		2,650.00	2,500.00
	Increase in earnings	69,650.00	52,750.00
	Potential equity	16,87,500.00	12,73,125.00
	Incremental EPS	0.04	0.04
Diluted EPS			
Earnings available after conversion			
Profit after tax		5,30,000.00	5,00,000.00
Add: Interest saved (net of tax)		67,000.00	50,250.00
Add: FV MTM losses		2,650.00	2,500.00
	Earnings available	5,99,650.00	5,52,750.00
WANES			
	WANES for basic	15,00,000.00	15,00,000.00
Add: Potential equity shares [Weighted avg]		16,87,500.00	12,65,625.00
			[1687500 x 9/12]
	WANES	31,87,500.00	27,65,625.00
	Diluted EPS	0.19	0.20

10. Illustration

At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of Rs. 25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at Rs. 70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax, attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to Rs. 500,000 and Rs. 600,000 respectively (wholly relating to continuing operations).

Average market price of share:

Year ended 31 December 20X7 = Rs. 120

Year ended 31 December 20X8 = Rs. 160

Calculate basic and diluted EPS.

Solution:

Particulars	20X7	20X8
Profit attributable to ord. equity holders	5,00,000	600000
No of ordinary shares o/s	40,00,000	40,00,000

EPS (Basic)		0.13	0.15
Weighted Average share price		120.00	160.00
Exercise price		70.00	70
No of options		6,30,000.00	6,30,000.00
Total consideration receivable		4,41,00,000	4,41,00,000
No of shares at full value (avg price)		3,67,500.00	2,75,625.00
Bonus element (dilutive shares)		2,62,500	3,54,375
No of shares for diluted EPS		42,62,500.00	43,54,375.00
Diluted EPS		0.12	0.14

11. Illustration

Ordinary shares outstanding during 20X1 - 1,000,000 (there were no options, warrants or convertible instruments outstanding during the period)

An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

- 5,000 additional ordinary shares for each new retail site opened during 20X1
- 1,000 additional ordinary shares for each Rs. 1,000 of consolidated profit more than Rs. 2,000,000 for the year ended 31 December 20X1

Retail sites opened during the year:

- one on 1 May 20X1
- one on 1 September 20X1

Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:

- Rs. 1,100,000 as of 31 March 20X1
- Rs. 2,300,000 as of 30 June 20X1
- Rs. 1,900,000 as of 30 September 20X1 (including Rs. 450,000 loss from a discontinued operation)
- Rs. 2,900,000 as of 31 December 20X1

Calculate basic and diluted EPS.

Solution:

Particulars	Mar-31	Jun-30	Sep-30	Dec-31	20X1
Profits available to ordinary shareholder	11,00,000	2300000	19,00,000	2900000	
- From Continuing operations	11,00,000	12,00,000	50,000	10,00,000	33,50,000
- From discontinued operations			-4,50,000		-4,50,000
- On overall basis	11,00,000	12,00,000	-4,00,000	10,00,000.00	29,00,000
No of ordinary shares o/s	10,00,000	10,03,333.33	10,06,666.67	10,10,000.00	10,05,000
Basic EPS - Continuing ops	1.10	1.20	0.05	0.99	3.33
Basic EPS - Overall basis	1.10	1.20	-0.40	0.99	2.89

Diluted EPS - Continuing ops	Not Reported	0.92	0.04950495	0.52	1.75
Diluted EPS - Overall			-0.3960396	0.52	1.52
No of Ordinary shares + Potential Ordinary		13,05,000.00	10,10,000.00	19,10,000.00	1910000
Jun-30					
Weighted Average No of Shares		Weight	Weighted Avg		
Shares outstanding	10,00,000.00	3/3	10,00,000.00		
Shares issuable for site contingency	5,000.00	2/3	3,333.33		
			10,03,333.33		
Potential ordinary shares - Site	5,000	3/3	5,000.00		
Original shares outstanding	10,00,000	3/3	10,00,000.00		
Potential Ordinary shares - Profit	3,00,000	3/3	3,00,000.00		
			13,05,000.00		
Sep-30					
Shares outstanding	10,00,000.00	3/3	10,00,000.00		
Shares for site contingency - Q2	5,000.00	3/3	5,000.00		
Shares for site contingency - Q3	5,000.00	1/3	1,666.67		
			10,06,666.67		
Potential ordinary shares - Site	10,000.00	3/3	10,000.00		
Potential Ordinary shares - Profit	0.00		0.00		
Shares outstanding	10,00,000.00		10,00,000.00		
			10,10,000.00		
Dec-31					
Ordinary shares o/s	10,00,000.00	3/3	10,00,000.00		
Contingently issuable	10,000.00	3/3	10,000.00		
Contingently issueable - Profits					
(Determined at last day towards end of reporting period, the impact is negligible)					
			10,10,000.00		
Potential equity					
Ordinary shares o/s	10,00,000.00				
Contingently issuable	10,000.00				
Contingently issueable - Profits	9,00,000.00				

		19,10,000.00				
For full year			Weight			
Outstanding shares (opening)	10,00,000.00	12/12	10,00,000.00			
Shares contingent upon site	5,000.00	8/12	3,333.33			
Shares contingent upon site	5,000.00	4/12	1,666.67			
			10,05,000.00			

12. Illustration

Assume the following facts for Company XY:

- Income from continuing operations: 30,00,000
- Loss from discontinued operations: (36,00,000)
- Net loss: (6,00,000)
- Weighted average Number of shares outstanding – 10,00,000
- Incremental common shares outstanding relating to stock options – 2,00,000

Calculate Basic and Diluted EPS

Assume, if in above case, Loss from continued operations is Rs. 10,00,000 and income from discontinued operations is Rs. 36,00,000 calculate the diluted EPS..

Solution:

Particulars	Continuing	Discontinued	Total
Profit/(Loss)	30,00,000	-36,00,000	-6,00,000
No of shares outstanding for Basic EPS	10,00,000	10,00,000	10,00,000
Basic EPS	3.00	-3.60	-0.6
Diluted Earnings per share			
Since, the entity has profits from continuing operations, the effect of additional shares would be dilutive			
Weighted avg no of shares (adjusted)	12,00,000.00	12,00,000.00	12,00,000.00
Diluted EPS	2.50	-3.00	-0.50
Particulars	Continuing	Discontinued	Total
Profit/(Loss)	-10,00,000	36,00,000	26,00,000
No of shares outstanding for Basic EPS	10,00,000	10,00,000	10,00,000
Basic EPS	-1.00	3.60	2.6
Diluted Earnings per share			

Adjusted no of shares considering options	12,00,000.00		
EPS	-0.83		
Since the entity has loss from continued operation, addition of shares would reduce the loss per share			
Hence, the potential equity is anti dilutive.			

13. Illustration

An entity issues 2,000 convertible bonds at the beginning of Year1. The bonds have a three-year term and are issued at par with a face value of Rs. 1,000 per bond, giving total proceeds Rs. 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is Rs. 3. Income tax is ignored.

Calculate basic and diluted EPS when Profit attributable to ordinary equity holders of the parent entity Year 1 Rs. 1,000,000

Ordinary shares outstanding 1,200,000
Convertible bonds outstanding 2,000

Solution:

Particulars					
No of Bonds		2,000			
No of shares per bond		250			
Face value of bonds		1,000.00			
Coupon Rate		6%			
Year	Cash flow		PVF	PV	
1	1,20,000.00	Interest	0.9174	1,10,091	
2	1,20,000.00	Interest	0.8417	1,01,001	
3	1,20,000.00	Interest	0.7722	92,664	
				303,756	Liability comp
				16,96,244	Equity Comp
Liability Component					
Year	Op bal	Int @ 9%	Payment	Closing bal	
1	3,03,756.00	27,338	120000	2,11,094.04	
2	2,11,094.04	18,998	120000	1,10,092.50	
3	1,10,092.50	9,908	120000	0.83	
Basic EPS					
Profit available to ordinary shareholders		10,00,000.00			
No of shares		12,00,000			
	Basic EPS	0.83			

Diluted Earnings per share					
Profit available to ordinary shareholders	10,27,338	[10,00,000 + 27,338]			
No of Ordinary shares	17,00,000				
	Diluted EPS	0.60			

14. Illustration

1 January Shares in issue 1,000,000

5% Convertible bonds Rs. 100,000

(Terms of conversion 120 ordinary shares for Rs. 100)

On 31 March Holders of Rs. 25,000 bonds converted to ordinary shares.

Profit for the year ended 31 December Rs. 200,000

Tax rate 30%.

Calculate basic and diluted EPS.

Ignore the need to split the convertible bonds into liability and equity elements.

Solution:

Particulars			
Profit available to ordinary equity		2,00,000	
Weighted Avg number of shares		10,22,500.00	
	Basic EPS	0.1956	
Date	No of shares	Weight	Weighted avg
1/1/X1	10,00,000.00	12/12	10,00,000.00
31/3/X1	30,000.00	9/12	22,500.00
[25,000 / 100 x 120]			10,22,500.00
Diluted Earnings Per share			
Potential Equity	90000	12/12	90,000.00
[75000 / 100 x 120]			
Converted bonds to equity			
	30000	3/12	7,500.00
	No of shares (adj)		11,20,000
Profit available to equity			2,00,000.00
Add: Interest on 75,000 bonds after tax			2,625.00
Add: Interest on 25,000 bonds for 3 months			218.75
			2,02,843.75
	Diluted EPS		0.1811

15. Illustration

An entity has two classes of shares in issue:

- 5,000 non-convertible preference shares
- 10,000 ordinary shares

The preference shares are entitled to a fixed dividend of Rs. 5 per share before any dividends are paid on the ordinary shares.

Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above Rs. 2 at a rate of 50% of any additional dividend payable on an ordinary share.

The entity's profit for the year is Rs. 100,000, and dividends of Rs. 2 per share are declared on the ordinary shares.

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Solution:

Profit for the period	1,00,000			
Less: Preference dividend 5 x 5000	25,000			
Balance profit	75,000.00		7.50	
Less: Dividend on ordinary shares	20,000.00			
Balance profit (for participation)	55,000.00	Undistributed		
Assume additional dividend on ordinary shares to be 'x' per share				
Dividend on preference shares (participating) will be 0.5x per share				
Additional dividend on ordinary shares	10,000x			
Additional dividend on preference shares	5000 x 0.5x	2500x		
10,000x + 2500 x = 55,000				
12,500x = 55000				
x = 55000/12500	4.40	per share		
Preference dividend (participating)	2.20	per share		
Profits	Distributed	Undistributed	Total	
Ordinary Shares	2	4.40	6.40	64000
Preference shares	5.00	2.20	7.20	36000
				100000
EPS	6.40			

16. Illustration

Profit attributable to equity holders of the parent entity Rs. 100,000

Ordinary shares outstanding 10,000

Non-convertible preference shares 6,000

Non-cumulative annual dividend on preference shares (before any dividend is paid on ordinary shares) Rs. 5.50 per share

After ordinary shares have been paid a dividend of Rs. 2.10 per share, the preference shares participate in any additional dividends on a 20:80 ratio with ordinary shares.

Solution:

Profit for the period	1,00,000			
Less: Preference dividend 5.5×6000	33,000			
Balance profit	67,000.00			
Less: Dividend on ordinary shares	21,000.00			
Balance profit (for participation)	46,000.00			
The dividend per share on preference share is 1x				
The dividend per share on ordinary shares is 4x				
Additional dividend on ordinary shares	$4x \times 10000$	$40,000x$		
Additional dividend on preference shares	$x \times 6000$	$6000x$		
$40,000x + 6,000x = 46,000$				
$x = 1$				
Dividend per share (additional) - pref	1.00			
Dividend per share (additional) - ord	4			
Profits	Distributed	Undistributed	Total	
Ordinary Shares	2.10	4.00	6.10	61000
Preference shares	5.50	1.00	6.50	39000
				100000
EPS	6.10			

17. Illustration

	20X0	20X1	20X2
Profit attributable to ordinary equity holders of the parent entity	Rs. 1,100	Rs. 1,500	Rs. 1,800

Shares outstanding before rights issue	500 shares
Rights issue	One new share for each five outstanding shares
Exercise price	Rs. 5.00
Date of rights issue	1 January 20X1
Last date to exercise rights	1 March 20X1
Market price of one ordinary share immediately before exercise on 1 st March 20X1:	Rs. 11.00
Reporting date	31 December

Compute the EPS.

Solution:

Step 1 - TERP		$\frac{5 \times 11 + 1 \times 5}{6}$			
		6			
	TERP	10			
	Right adjustment Factor	11/10			
		1.10			
Particulars		20X0	20X1	20X2	
Profit attributable to ordinary shareholders		1,100.00	1,500.00	1,800.00	
No of shares outstanding		500.00	591.67	600.00	
EPS (as reported)		2.20	2.54	3.00	
EPS (Restated)		2.00			
Weighted Avg No of shares o/s					
Date		No	Weight	RAF	Weighted Avg
1/Jan/X1		500.00	2/12	1.1	91.67
1/Mar/X1		600.00	10/12	1.00	500
					591.67

18. Illustration

Parent:	
Profit attributable to ordinary equity holders of the parent entity	Rs. 12,000 (excluding any earnings of, or dividends paid by, the subsidiary)
Ordinary shares outstanding	10,000
Instruments of subsidiary owned by the parent	800 ordinary shares 30 warrants exercisable to purchase ordinary shares of subsidiary 300 convertible preference shares
Subsidiary:	
Profit	Rs. 5,400
Ordinary shares outstanding	1,000
Warrants	150, exercisable to purchase ordinary shares of the subsidiary
Exercise price	Rs. 10
Average market price of one ordinary share	Rs. 20
Convertible preference shares	400, each convertible into one ordinary share
Dividends on preference shares	Rs. 1 per share
No inter-company eliminations or adjustments were necessary except for dividends.	
Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32.	

Solution:

Subsidiary		-			
Profit available to equity holders					
Profit for the year		5,400.00			
Less: Preference dividends		400.00			
Profits available to equity holders		5,000.00			
No of shares		1,000.00			
Earnings per share (Basic)		5.00			
Diluted EPS					
Profit available to ordinary share holders		5,000			
Add: Dividend on preference shares		400	Holding - 300	NCI - 100	
	Profits available to ordinary equity	5,400			
Weighted avg. no of shares					
Ordinary shares o/s		1,000.00			
Convertible pref. shares		400			
Warrants [W.N]		75.00			
		1,475.00			
	Diluted EPS	3.66			
Total consideration		1,500			
Average market price		20.00			
No of shares at full price		75.00			
Potential dilutive shares		75.00			
Consolidated Financial Statement					
Profit of parent entity		12,000.00			
			Parent	NCI	
Profit of subsidiary		5,400.00			
Less: Preference dividend		400.00	300.00	100.00	
Balance profits available to equity		5,000.00	4,000.00	1,000.00	
			4,300.00		
Total profits available to owners of parent		16,300.00			
No of shares outstanding		10,000.00			
EPS - Basic		1.63			
Diluted Earnings per share					
Profit of subsidiary		5,400.00			
Share of parent		4,082.03			

		O/s	Converted pref	Warrant	Total
Total No of equity shares		1,000.00	400.00	75	1,475.00
Held by parent		800.00	300.00	15	1,115.00
					75.59%
Total profit attributable		16,082.03			
No of shares o/s		10,000.00			
Earnings per share - dilutive		1.61			
Profit available to owners of parent		12,000.00			
Earnings attributable to ordinary shares		2,928.00			
Earnings attributable to warrants		54.90			
Earnings attributable to preference shares		1,098.00			
		16,080.90			

19. Illustration

CAB Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 20X3 and the extract of the same is as follows:

Particulars	Attributable to CAB Limited	Non-controlling interest	Total (Rs. in '000)
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	5,000	Nil	5,000
Total Comprehensive Income	44,000	3,000	47,000

The long-term finance of the company comprises of the following:

- 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 20X2 at full market value
- 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 20X3. The dividend on these preference shares is discretionary.
- Rs. 18 crores of 6% convertible debentures issued on 1st April, 20X1 and repayable on 31st March, 20X5 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 10 crores ordinary shares in the company. On 1st April, 20X1, the prevailing market interest rate for four-year convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of Rs. 1 payable in four years is 0.74 and the cumulative present value of Rs. 1 payable at the end of years one to four is 3.31.

In the year ended 31st March, 20X3, CAB Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

Compute the following:

- the finance cost of convertible debentures and its closing balance as on 31st March, 20X3 to be presented in the consolidated financial statements.
- the basic and diluted earnings per share for the year ended 31st March, 20X3.
- Assume that income tax is applicable to CAB Limited and its subsidiaries at 25%.

Solution:

		<u>All amounts</u> <u>in '000</u>			
--	--	--------------------------------------	--	--	--

PV of debentures (liability) considering discount of 8%					
			PVF/PVAF	PV	
Redemption value	1,80,000.00		0.74	1,33,200.00	
Interest payments	10,800.00		3.31	35,748.00	
		Liability Component		1,68,948.00	
		Total proceeds		1,80,000.00	
		Equity component		11,052.00	
Calculation of interest expense and closing balance of liability					
Date	Op bal	Int @ 8%	payment	Closing bal	
1/Apr/X1	1,68,948.00	13,515.84	10,800.00	1,71,663.84	31/3/X2
1/Apr/X2	1,71,663.84	13,733.11	10,800.00	1,74,596.95	31/3/X3
Basic earnings per share					
Profit attributable to owners of parent		39,000.00			
Less: Preference dividends (0.05 per share)		4,000			
	Earnings available to equity holders	35,000.00			
Weighted avg no of shares					
Date	No of shares	Weight	Weighted avg		
1/Apr/X2	200000	3/12	50,000.00		
1/Jul/X2	250000	9/12	1,87,500.00		
			2,37,500.00		
	Basic EPS		0.1474		
Diluted earnings per share					
Profit available for ordinary share holders		35,000.00			
Add: Interest savings (net of tax)		10,299.83	[13,733.11 x 75%]		
Profit for computing diluted earnings		45,299.83			
Weighted average no of shares		3,37,500.00			
	Diluted EPS	0.1342			

20. Illustration

Following information pertains to an entity for the year ending 31st March 20X1:

Net profit for the year	₹ 12,00,000
Weighted average number of equity shares outstanding during the year	5,00,000 shares
Average market price per share during the year	₹ 20
Weighted average number of shares under option during the year	1,00,000 shares
Exercise price per share under option during the year	₹ 15

Calculate basic and diluted earnings per share.

Solution:

Calculation of earnings per share			
	Earnings	Shares	Per share
Profit attributable to ordinary equity holders of the parent entity for year 20X1	Rs 1,200,000		
Weighted average shares outstanding during year 20X1		500,000	
Basic earnings per share			Rs 2.40
Weighted average number of shares under option		100,000	
Weighted average number of shares that would have been issued at average market price: $(100,000 \times \text{Rs } 15.00) + \text{Rs } 20.00$	Refer Note	(75,000)	
Diluted earnings per share	Rs 1,200,000	525,000	Rs 2.29

21. Illustration

Company S is a subsidiary of Company P. Following facts are in respect of Company S:

- Company S has 10,000 ordinary shares and 1,000 options outstanding, of which Company P owns 9,000 shares and 500 options, respectively.
- The options have an exercise price of ₹ 40.
- The average market price of Company S's ordinary share was ₹ 50 in 20X1.
- In 20X1, Company S's profit was ₹ 30,000.

Following facts are in respect of Company P:

- Company P has 5,000 ordinary shares outstanding.
- In 20X1, Company P's profit (excluding any distributed and undistributed earnings of subsidiaries) was ₹ 7,000.
- The options outstanding are dilutive at P's level.

Determine the diluted EPS of Company P for the year 20X1. Ignore income tax. (RTP Nov 22)

Solution:

To determine the diluted EPS of Company P, the diluted EPS of Company S has to be calculated first.

Calculation of Company S's diluted EPS:

Particulars	Amount (₹)
Company S's earnings for the period	30,000
Weighted average ordinary shares	10,000
Incremental shares (refer W.N.)	200
Company S's diluted EPS	$30,000 / (10,000 + 200) = 2.94$

Calculation of Company P's diluted EPS:

Particulars	Amount (₹)
Company P's earnings for the period	7,000
Company P's share of Company S's earnings attributable to ordinary shares	26,460 $[(9,000 / 10,000) \times (2.94 \times 10,000)]$
Company P's share of Company S's earnings attributable to options	294 $[(500 / 1,000) \times (2.94 \times 200)]$
Company P's weighted average ordinary shares outstanding	5,000
Company P's diluted EPS	$(7,000 + 26,460 + 294) / 5,000 = 6.75$

Working Note: Computation of Incremental shares related to weighted average options outstanding:

All options are dilutive because their exercise price is below the average market price of Company S's ordinary shares for the period.

The incremental shares are calculated as follows:

Particulars	Amount (₹)
Shares issued on assumed exercise of options	1,000
Less: Shares that would be issued at average market Price $[(40 \times 1,000)/50]$	(800)
Incremental shares	200

22. Illustration (Self practice)

Company P has both ordinary shares and equity-classified preference shares in issue. The reconciliation of the number of shares during Year 1 is set out below:

Number of shares

Dates in Year 1	Transaction	Ordinary shares	Treasury shares	Preference shares
1st April	Balance	30,00,000	(5,00,000)	5,00,000
15th April	Bonus issue - 5% (no corresponding changes in resources)	1,50,000	(25,000)	-
1st May	Repurchase of shares for cash	-	(2,00,000)	-
1st November	Shares issued for cash	4,00,000	-	-
31st March	Balance	35,50,000	(7,25,000)	5,00,000

Additional Information for Year 1:

- Company P's net profit for the year is ₹ 46,00,000.
- On 15th February, non-cumulative preference dividends of ₹ 1.20 per share were declared and paid on 15th March.
- Preference shares do not participate in additional dividends with ordinary shares.
- Dividends on non-cumulative preference shares are deductible for tax purposes. The applicable income tax rate is 30%.
- The financial year of Company P ends on 31st March.

Determine the Basic EPS of Company P for Year 1. (Use the number of months or part of months, rather than the number of days in the calculation of EPS.) (RTP May 23)

Solution:

Step 1: Determination of Numerator for Basic EPS Calculation

The first step in the basic EPS calculation is to determine the profit or loss that is attributable to ordinary shareholders of Company P for the period.

Non-cumulative dividends paid on equity-classified preference shares are not deducted in arriving at net profit or loss for the period, but they are not returns to ordinary shareholders. Accordingly, these dividends are deducted from net profit or loss for the period in arriving at the numerator.

Particulars	Amount (₹)
Net Profit	46,00,000
Preference Dividends (5,00,000 shares × 1.2)	(6,00,000)
Related Tax (₹ 6,00,000 × 30%)	1,80,000
Profit or Loss Attributable to P's Ordinary Shareholders	41,80,000

Thus, the **numerator** for the Basic EPS calculation is ₹ 41,80,000.

Step 2: Determination of Denominator for Basic EPS Calculation

The second step in the basic EPS calculation is to determine the weighted-average number of ordinary shares outstanding for the reporting period.

Number of Shares	Time Weighting	Weight	Weighted Average Number of Shares
1st April – Opening balance (30,00,000 – 5,00,000)	25,00,000	1	-
15th April – Bonus issue (1,50,000 – 25,000)	1,25,000	-	-
1st April to 30th April	26,25,000	1/12	2,18,750
1st May – Repurchase of shares	(2,00,000)	-	-
1st May to 31st October	24,25,000	6/12	12,12,500
1st November – New shares issued	4,00,000	-	-
1st November to 31st March	28,25,000	5/12	11,77,083
Total Weighted Average Number of Shares for the Year	26,08,333		

Thus, the **denominator** for the Basic EPS calculation is **26,08,333 shares**.

Step 3: Calculation of Basic EPS

Basic EPS = $41,80,000 / 26,08,333 = ₹1.60$ per share

1. Illustration

X Ltd. is engaged in the manufacture of fertilisers. Effluents discharged in the manufacturing process have polluted the river near the manufacturing plant. The residents of the nearby locality launched a massive agitation against the pollution. X Ltd. agreed to their demands to reduce the water pollution by installing the necessary Effluent Treatment Plant. However, during the year no steps are taken to install the plant. No legislation requiring the company to reduce its pollution is in existence.

Sol:

Relevant Provisions

A **constructive obligation** arises when a company, through its past actions, policies, or statements, creates a reasonable expectation that it will fulfill certain responsibilities. If stakeholders believe the company will follow through on its commitments, a **valid expectation is created**, requiring the recognition of a provision.

Analysis

X Ltd. publicly committed to installing an **Effluent Treatment Plant** after protests from local residents. Even though there is **no legal requirement** to do so, its public promise has created a **constructive obligation**. Since the company has not acted on its commitment, there is an **unfulfilled obligation** that must be recognized.

Final Answer

X Ltd. **must recognize a provision** for the cost of installing the treatment plant as a constructive obligation has been created.

2. Illustration

ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2.

Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.

Sol:

Relevant Provisions

A provision is recognized when:

1. A **present obligation** exists due to a past event.
2. It is **probable** that economic outflows will occur.
3. The obligation amount can be **reliably estimated**.

If the event triggering the liability has **not yet occurred**, no provision should be made.

Analysis

ABC Ltd. has a contract with a **delivery deadline in June 20X2** and penalties for non-compliance. As of **31st March 20X1**, the company expects to miss the deadline but has **not yet breached the contract**. Since the **penalty will only apply after the delivery failure**, no present obligation exists at the reporting date.

Final Answer

ABC Ltd. **should not recognize a provision** as no present obligation exists as of **31st March 20X1**.

3. Illustration

The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Sol:

Relevant Provisions

Provisions are recognized **only if a past event** has created a present obligation. Future expenses, even if expected, do not qualify unless they are legally or constructively required.

Analysis

A financial services company is **required to retrain employees** due to regulatory changes, but as of the reporting date, **no retraining has been conducted**. Since the company **has not yet incurred any costs**, and training remains a **future activity**, there is **no present obligation**.

Final Answer

The company **should not recognize a provision** for retraining costs. Instead, the expenses should be recorded as and when they occur.

4. Illustration

Under new legislation, an entity is required to fit smoke filters to its factories by September 30, 20X1. The entity has not fitted the smoke filters till March 31, 20X2. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answer:

Relevant Provisions

A provision should 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.

A **legal obligation** exists when a company is bound by law to fulfill a responsibility. If a company fails to meet legal requirements by the deadline, it must recognize a provision for the expected penalties.

Analysis

A company is required to **install smoke filters by 30th September 20X1**, but it **fails to do so by 31st March 20X2**. At **31st March 20X1**, no provision was needed as the deadline had not passed. However, by **31st March 20X2**, the company is **in violation of the law**, making it **liable for penalties**.

Final Answer

The company **must recognize a provision** for the expected fines or penalties but **should not recognize a provision for the installation cost**.

5. Illustration

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answers:

- A provision should 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.

Future maintenance or replacement costs do not qualify as provisions unless they are legally required or unavoidable. Instead, such costs should be accounted for through **depreciation**.

Analysis

A furnace lining must be **replaced every five years**, and as of the reporting date, it has been used for **three years**. However, since the company **controls the timing of the replacement**, and there is **no external obligation**, a provision is **not required**.

Final Answer

The company **should not recognize a provision** but should account for the cost through **depreciation over five years**.

6. Illustration

An airline is required by law to overhaul its aircraft once every three years. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answers:

- A provision should 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.

A company must recognize a provision **only if an unavoidable obligation exists**. If the company can **avoid the cost by discontinuing operations**, no provision is required.

Analysis

An airline must **overhaul its aircraft every three years**, but this obligation exists **only if it continues to use the aircraft**. If the company **sells the aircraft**, it can avoid the cost. Since the obligation depends on **future business decisions**, a provision **should not be recognized**.

Final Answer

The company **should not recognize a provision** for maintenance. Instead, it should account for the cost through **depreciation**.

7. Illustration

X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct?

Answer:

Relevant Provisions (Ind AS 37)

A **provision should be recognized** when:

1. There is a **present obligation (legal or constructive)** due to a past event.
2. It is **probable** that an **outflow of economic benefits** will be required to settle the obligation.
3. A **reliable estimate** can be made of the obligation.

An expense that will arise due to **future activities** is **not a liability** at the reporting date. Only **existing obligations** must be recognized. Future maintenance costs should not be treated as a provision unless they arise due to past events.

Analysis

X Shipping Ltd. is required by law to **overhaul its fleet every three years**. To manage costs, the company is **accumulating a provision over time** based on **hours sailed**, adjusting it when the expenditure is incurred. However, this approach does not comply with Ind AS 37. The cost of overhauling does **not arise from a past event**, and the company **could avoid** the overhaul by **selling the ships**, meaning there is **no present obligation**. The company is attempting to match expenses with revenue, but financial statements must **only recognize obligations that exist at the reporting date**, not anticipated future costs.

Conclusion

The accounting policy of X Shipping Ltd. is **incorrect** under Ind AS 37. Instead of accumulating provisions, the company should **use the component approach under Ind AS 16** (Property, Plant, and Equipment), where the overhaul cost is **capitalized and depreciated over time**.

8. Illustration

An entity in the oil industry (having 31st March year-end) causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years. At March 31st 20x1, it is virtually certain that a draft law requiring a clean-up of land already contaminated will be

enacted shortly after the year-end. It is assumed that a reliable estimate can be made of any outflows expected. Is the provision to be recognised?

Answer:

Relevant Provisions (Ind AS 37)

A **provision should be recognized** when:

1. A **present obligation** exists due to a **past event**.
2. An **outflow of economic benefits** is **probable**.
3. A **reliable estimate** of the obligation can be made.

A law that is **not yet enacted** does **not** create a present obligation unless it is **virtually certain** to be enacted.

Analysis

The entity has been **polluting land** in a country where there is **no current law** requiring cleanup. However, by **31st March 20X1**, it is **virtually certain** that a law requiring **cleanup of past contamination** will be enacted. Since the company has **already contaminated the land**, the **event has already occurred**, and the **future legislation will enforce a legal obligation**. Additionally, a **reliable estimate** of cleanup costs can be made.

Conclusion

A **provision must be recognized** as of **31st March 20X1** for the **best estimate of the cleanup costs**. The contamination is a **past event**, and the draft law makes it **virtually certain** that the company will have to clean up.

9. Illustration

An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. 90% of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10% arise through the extraction of oil. At the end of the reporting period, the rig has been constructed but no oil has been extracted. It is assumed that a reliable estimate can be made of any outflows expected.

Answers:

Relevant Provisions (Ind AS 37)

A **provision should be recognized** when:

1. A **legal or constructive obligation** exists due to a **past event**.
2. An **outflow of resources** to settle the obligation is **probable**.
3. A **reliable estimate** of the cost can be made.

Analysis

The entity operates an **offshore oilfield**, and its licensing agreement requires it to **remove the oil rig** at the end of production.

- **90% of the eventual cost** relates to **removing the rig and restoring damage caused by construction**.
- **10% of the costs** will arise due to **damage from oil extraction**.

Since the rig has **already been constructed**, the company **already has a legal obligation** to remove it, meaning a **provision should be recognized**. However, costs related to **future oil extraction** should **not be recognized yet**, as they will arise in the future.

Conclusion

A **provision must be recognized for 90% of the costs** related to the **removal of the oil rig** and **restoration of construction damage**. The **remaining 10% should be recognized as a liability** when **oil extraction occurs**.

10. Illustration

After a wedding in 20X1-20X2, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of approval of the financial statements for the year to 31 March 20X2 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 March 20X3, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answer:

Recognition of provision:

Relevant Provisions (Ind AS 37)

A **provision is recognized** only if:

1. There is a **present obligation** from a **past event**.
2. An **outflow of resources** is **probable**.
3. A **reliable estimate** can be made.

If the outcome is **uncertain**, a **contingent liability should be disclosed** instead of a provision.

Analysis

- **31st March 20X2:** Legal proceedings have started, but the **company disputes liability**. The company's lawyers believe it is **probable that the company will not be found liable**, meaning there is **no present obligation**. The case should be treated as a **contingent liability** and disclosed in the financial statements.
- **31st March 20X3:** The legal team now believes it is **probable** that the company **will be found liable**. This means there is now a **present obligation**, and a **provision must be recognized**.

Conclusion

At **31st March 20X2**, **no provision is required**; instead, the case should be disclosed as a **contingent liability**. By **31st March 20X3**, a **provision must be recognized** for the **best estimate of settlement costs**, as it is now **probable** that the company will lose the case.

11. Illustration

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of ₹ 1 million would result. If major defects were detected in all products sold, repair costs of ₹ 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor

defects and 5% of the goods sold will have major defects. In accordance with the standard, an entity assesses the probability of an outflow for the warranty obligations as a whole.

Answers:

Particulars	Probability	Repair cost (in Millions)	Expected Cost (in Millions)
No defects	75%	0	0
Minor defects	20%	1	0.2
Major defects	5%	4	0.2
Total expected cost			0.4

12. Illustration

An entity faces a single legal claim, with a 40 per cent likelihood of success with no cost and a 60 percent likelihood of failure with a cost of ₹ 1 million. Should entity use expected value method or most likely outcome method?

Answer:

- Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability.
- In this case, most likely outcome is likelihood of failure (60%) with a cost of ₹. 1 Million
- Therefore, A provision of ₹. 1 Million will be recognised.

13. Illustration

X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. cannot cancel this obligation or transfer to third party. X Solar Power Ltd. has estimated the total cost of dismantling at ₹ 50,00,000, the present value of which is ₹ 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. account for the obligation?

Answer:

Particulars	₹
Cost of dismantling	50,00,000
PV cost of dismantling (a)	30,00,000
Risk involved (b)	5%
Risk adjustment (c=a * b)	1,50,000
Provision to be recognised (a+c)	31,50,000

14. Illustration

ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ₹ 10,00,000 cash on 31st March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate. Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed.

Sol:

(a) Computation of Present Value as on 31.03.20x1:

- Discounting factor of 5% for 2nd year as on 31st March 20X1 = $(\frac{1}{1.05})^2 = 0.907$
- The present value of the provision as on 31st March 20X1 is = ₹. 10,00,000 x 0.907 = ₹. 9,07,000
- The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.

15. Illustration

At the end of 20X1, an entity is demonstrably committed to the closure of some facilities, having drawn up a detailed plan and made appropriate announcements. The expected impact of the plan is as follows:

	20X2	20X3
--	------	------

Committed closure costs	₹ 10,00,000	
Gain from sale of property		₹ 2,00,000

Sol:

In this case, the entity has made a **detailed plan and public announcement** regarding the closure of certain facilities, which creates a **valid expectation** and results in a **constructive obligation**. The committed closure cost is ₹10,00,000, which must be recognized as a **provision at the reporting date**. The expected gain from the sale of the property (₹2,00,000) should **not be offset against the provision** but accounted for separately under **Ind AS 16** (Property, Plant, and Equipment).

Conclusion

The entity must recognize a **provision of ₹10,00,000** at the reporting date, while the gain on the sale of the property is accounted for separately as per Ind AS 16.

16. Illustration

X Beauty Solutions Ltd. is selling cosmetic products under its brand name 'B', but it is getting its product manufactured from Y Ltd. It has an understanding (enforceable agreement) with Y Ltd. that if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 20X1-20X2, a claim of ₹ 30,00,000 becomes payable to customers by X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. account for the claim that becomes payable?

Sol:

For **reimbursements**, an entity must recognize an asset **only if recovery is virtually certain** under an **enforceable agreement**. However, the reimbursement right must be recorded separately from the provision.

Analysis

X Beauty Solutions Ltd. has an **agreement with Y Ltd.** that 30% of any customer damage claim will be reimbursed. During the year, a **claim of ₹30,00,000** is payable to customers, out of which **₹9,00,000 (30%) will be reimbursed**. Since the agreement is **legally enforceable**, the reimbursement right must be **recognized as a separate asset** and **not netted off** against the liability.

Conclusion

A **provision of ₹30,00,000** must be recognized for the claim, while a **reimbursement asset of ₹9,00,000** should be recorded separately. The net expense in the **statement of profit and loss** will be **₹21,00,000** after offsetting the reimbursement.

17. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. The gas will be used to generate electricity, which will be sold at a profit. Is this an onerous contract?

Sol:

An **onerous contract** is a contract where the **unavoidable costs** of fulfilling the contract **exceed the expected economic benefits**. When an onerous contract is identified, the entity must recognize a **provision for the least net cost of exiting the contract**, which is:

1. **The cost of fulfilling the contract**, or
2. **The compensation for non-fulfillment**, whichever is lower.

Analysis

The entity has a contract to **purchase gas at 23p per unit** for a total cost of **₹2,30,000**, while the **market price has dropped to 16p per unit** (total price **₹1,60,000**).

- Since the gas will be **used to generate electricity at a profit**, the contract is **not onerous**, as the economic benefits will still exceed the costs.

Conclusion

Since electricity will be sold at a **profit**, no provision is required as the contract is **not onerous**.

18. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. What if electricity sold at a loss?

Sol:

Here, the entity is now **selling electricity at a loss**, meaning the contract is **onerous** because the **costs exceed economic benefits**.

- Before recognizing a provision, the entity must **assess if assets used for electricity generation are impaired** under **Ind AS 36**.
- If the assets are already impaired and a loss still exists, a **provision for the onerous contract** must be recognized.

Conclusion

If electricity is sold at a **loss**, a provision should be recognized for the **least cost of fulfilling or exiting the contract**.

19. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. Assume the entity sells the gas under contract, which it no longer needs, to a third party for 18p per unit. The entity determines that it would have to pay ₹ 55,000 to exit the purchase contract. What is the provision to be made?

Solution:

The entity **sells the gas** to a third party at **18p per unit** for **₹1,80,000** but has a **purchase obligation at 23p per unit** (total **₹2,30,000**). The entity also has the option to **exit the contract** by paying a **₹55,000** penalty.

- **Loss on fulfilling the contract:** ₹2,30,000 - ₹1,80,000 = **₹50,000**
- **Cost of contract termination (penalty):** ₹55,000

Since the **lower cost is ₹50,000**, this amount must be **recognized as a provision**.

Conclusion

The entity should recognize an **onerous contract provision of ₹50,000**, as it represents the least cost of fulfilling the contract.

20. Illustration

X Sugars Ltd. has entered into a sale contract of ₹ 3,00,00,000 with Y Chocolates Ltd. for the supply of sugar during 20X1-20X2. As per the contract the delivery is to be made within 2 months from the date of contract.

In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of ₹ 30,00,000 to Y Chocolates Ltd.

During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment.

It is, however covered by an insurance policy.

According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy.

The cost of goods lost was ₹ 2,50,00,000.

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of ₹ 30,00,000 since the goods were not delivered on time.

What provision or disclosure would X Ltd. need to make at year end?

Sol:

X Sugars Ltd. had a **sale contract of ₹3,00,00,000** but lost the goods in transit. The goods were **insured**, and the insurance company **agreed to pay 85% of the claim** (after deducting 15% as per policy terms). However, the company still has to **pay a penalty of ₹30,00,000** to Y Chocolates Ltd. for non-delivery.

- **Cost of goods lost:** ₹2,50,00,000
- **Insurance reimbursement (85% of claim):** ₹2,12,50,000
- **Penalty payable to Y Chocolates Ltd.:** ₹30,00,000

Conclusion

- The company can disclose the insurance reimbursement for ₹2,12,50,000 since informal confirmation has been received. If the informal confirmation is considered to be virtually certain, the reimbursement can be recognised in financial statements.
- The company also needs to recognise the penalty payable to Y chocolates for ₹30,00,000

21. Illustration

The annual reporting period of ABC Ltd. ends on March 31. As per the legislation of the State government, a levy is imposed on ABC Limited in full when it generates revenue in financial year 2016-17. The levy imposed by the government is calculated by reference to revenue generated by ABC Ltd. in previous financial year. ABC Ltd. had generated revenue of ₹ 200 crores in financial year 2015-16. For financial year 2016-17, it starts to generate revenue on April 5, 2016.

ABC Ltd. paid the levy on July 10, 2016. What is the obligatory event that gives rise to recognition of a liability to pay a levy in the present case?

What are the principles for recognising the levy in the annual financial statements and interim financial report?

Sol:

Appendix C to Ind AS 37 inter alia states that, a levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (i.e. laws and/or regulations), other than:

- (a) those outflows of resources that are within the scope of other Standards (such as income taxes that are within the scope of Ind AS 12, Income Taxes); and

(b) fines or other penalties that are imposed for breaches of the legislation

According to paragraph 10 of Ind AS 37, an obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation.

ABC Ltd. is subject to a **government levy** when it **generates revenue in 2016-17**, but the levy is **calculated based on revenue of 2015-16**. Since the **obligating event** is the **first generation of revenue in 2016-17**, the levy liability must be **recognized in full on April 5, 2016**.

- The **previous year's revenue** is only used for **calculation purposes**, not for recognition of liability.
- The **date of levy payment (July 10, 2016)** does not impact the liability recognition.

Conclusion

ABC Ltd. **must recognize the liability in full on April 5, 2016**, when it **first generates revenue in 2016-17**.

With regard to interim financial report, an entity shall apply the same recognition principles in the interim financial report that it applies in the annual financial statements.

In the given case, ABC Ltd. has a present obligation to pay the levy on April 5, 2016. In the first interim financial report for the quarter ending June 30, 2016, the liability should be recognised in full since the liability is recognised in full on April 5, 2016.

22. Illustration

X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0-20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ₹ 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

Sol:

X Ltd. has a **pending tax dispute** with a demand of **₹1,00,00,000**. The legal opinion suggests a **50% chance of winning the case** based on conflicting judgments.

- If an **outflow of resources is probable**, a **provision should be recognized**.
- If the outflow is **possible but not probable**, the amount should be **disclosed as a contingent liability**.

Since the **chance of winning is uncertain**, but an outflow is still **probable**, a **provision should be made**.

Conclusion

X Ltd. **must recognize a provision of ₹1,00,00,000**, as it is more likely than not that the obligation exists at the reporting date.

23. Illustration

Entity A is a dealer in washing machines. Entity A offers to its customers a scheme whereby it states that after a period of 3 years, the entity offers to buy back the washing machine at a fixed price which is expected to be less than the fair value of the machine at the end of three years. The credit emanating therefrom will be required to be used by the customer for buying a new washing machine, i.e., new washing machine will be sold at a discounted price. Past experience indicates that customers generally opt for this scheme. At the time of sale of the first washing machine should entity A recognise any provision in this regard?

Sol:

Entity A **offers a buyback scheme** where customers can return their washing machine after 3 years at a **fixed price** (below fair value) to purchase a new machine.

Since:

1. The scheme creates a **valid expectation** among customers.
2. Past experience shows that customers **opt for the scheme**.
3. The discount is **reliably estimable**.

A **provision for the expected buyback discount should be recognized** at the time of **sale of the first machine**.

Conclusion

Entity A **must recognize a provision** for the estimated cost of fulfilling the **discounted sale obligation** from the buyback offer.

24. Illustration

U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 20X2 as per the notified Ind AS. The financial statements are due to be approved for issue on 15th May 20X2. Following are a few transactions that have taken place in some of its subsidiaries during the year:

G Ltd. is a wholly-owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 20X2, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 20X2. They made a public announcement of their decision on 15th February 20X2.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 20X2. U Ltd. would collect any amounts still owed by G Ltd.'s customers after 31st May 20X2. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

- On the date of public announcement, it is estimated by G Ltd. that it would have to pay ₹ 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ₹ 60 lakhs. The actual termination payments

totalling to ₹ 520 lakhs were made in full on 15th May 20X2. As per latest estimates made on 15th May 20X2, the total relocation cost is ₹ 63 lakhs.

- G Ltd. had taken a property on operating lease, which was expiring on 31st March 20X6. The present value of the future lease rentals (using an appropriate discount rate) is ₹ 430 lakhs. On 15th May 20X2, G Ltd. made a payment to the lessor of ₹ 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March 20X2 was ₹ 400 lakhs. G Ltd. made further operating losses totalling ₹ 60 lakhs till 30th April 20X2.

What are the provisions that the Company is required to make as per Ind AS 37?

Sol:

Relevant Provisions (Ind AS 37)

A **provision for restructuring** is recognized when:

1. The company has a **detailed, formal plan** for restructuring.
2. The company has created a **valid expectation** by communicating the plan to those affected.
3. The restructuring costs **exclude future operating losses** and **only cover direct costs**.

Analysis

U Ltd. is **closing its subsidiary G Ltd.** and made a **public announcement on 15th February 20X2**, creating a **constructive obligation**. The estimated costs include:

- **Termination payments:** ₹520 lakhs (actual)
- **Relocation costs:** ₹63 lakhs (future cost, not included in provision)
- **Operating lease penalty:** ₹410 lakhs (onerous contract)

Since the **termination payments** and **lease settlement** relate to the restructuring plan, they should be **provisioned immediately**. However, **relocation costs** are **future business costs** and should not be included.

Conclusion

A provision of **₹930 lakhs (₹520 lakhs + ₹410 lakhs)** should be **recognized for restructuring**, while **relocation costs should be accounted for separately**.

25. Illustration

A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

Sol:

Relevant Provisions (Ind AS 37)

A **contingent asset** should **only be recognized** when it becomes **virtually certain** to be received. Otherwise, it should be **disclosed, not recognized**.

Analysis

The company exceeded the **turnover threshold** and is **eligible for a duty drawback**. However, the **claim was filed late**, and approval is at the **discretion of the department**. Since approval was received **only after the financial year-end**, the claim was **not virtually certain at the reporting date** and should be **classified as a contingent asset**.

Conclusion

As of **31st March 20X2**, the duty drawback should be **disclosed as a contingent asset**, but recognition should occur only in **20X2-20X3**, once realization is **virtually certain**.

26. Illustration

Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non- performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required?

Sol:

Relevant Provisions (Ind AS 37)

An **onerous contract** is one where the **cost of fulfilling it exceeds economic benefits**. A provision must be made for the **least net cost of exiting**.

Analysis

XYZ Ltd. has a contract to **supply 1,000 televisions for ₹2 million**, but the **cost has risen to ₹2.5 million**. The company can either:

1. **Fulfill the contract and incur ₹0.5 million in losses**, or
2. **Cancel the contract and pay a ₹0.25 million penalty**.

Since the **penalty cost is lower**, the company would chose that and hence, the provision should be recognized for **₹0.25 million**.

Conclusion

XYZ Ltd. **must recognize a provision of ₹0.25 million** as the **minimum cost of fulfilling or exiting the contract**.

27. Illustration

Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ₹ 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is ₹ 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ₹ 2 million will be made. Phase 2

costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

Sol:

Year	Cash flow	PVF (10%)	PV
20x2-20x3	20,00,000	0.909	18,18,000
20x5-20x6	35,00,000	0.683	23,90,500
Provision required at 31 March 20X2			42,08,500

The provision is calculated using the pre-tax costs and a pre-tax cost of capital. The fact that the eventual payment will attract tax relief will be reflected in the recognition of a deferred tax asset for the deductible temporary difference (assuming that the recognition criteria for deferred tax assets are met.)

28. Illustration

Sun Limited has entered into a binding agreement with Moon Limited to buy a custom-made machine for ₹ 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry.

Sol:

An **executory contract** is a contract in which **neither party has performed their obligations** or **both parties have partially performed their obligations to an equal extent**. Ind AS 37 applies to **executory contracts only if they are onerous**.

A contract is **onerous** when the **unavoidable costs** of fulfilling the contract **exceed the expected economic benefits**. In such cases, a **provision must be recognized** for the least net cost of fulfilling or exiting the contract.

Analysis

Sun Ltd. entered into a **binding agreement** with Moon Ltd. to purchase a **custom-made machine** for ₹4,00,000. However, before delivery, Sun Ltd. changed its production method, rendering the machine **useless**. Since the **machine has not been delivered yet**, the contract remains **executory**.

- Sun Ltd. **cannot cancel the contract** and must **accept delivery**.
- The machine **must be scrapped immediately** upon receipt, with **zero scrap value**.
- This means that the company **incurs a full loss of ₹4,00,000** without any future benefit.

Since the **cost of fulfilling the contract exceeds the economic benefits (which are nil)**, the contract qualifies as **onerous**, and a **provision of ₹4,00,000 must be recognized**.

Conclusion

Sun Ltd. must **recognize an onerous contract provision** of ₹4,00,000 for the **full purchase cost** of the machine. The accounting entry is:

		₹	₹
Onerous Contract Provision Expense A/c	Dr.	4,00,000	
To Provision for Onerous Contract Liability A/c			4,00,000
(Being asset to be received due to binding agreement recognized)			
Profit and Loss Account	Dr.	4,00,000	

To Onerous Contract Provision Expense A/c			4,00,000
(Being loss due to onerous contract recognized and asset derecognised)			

29. Illustration

Vishnu Company has at its financial year ended 31st March, 2017, fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors.

The directors have estimated the possible outcomes as below:

Result	Probability	Amount of loss
For first ten cases		
Win	0.6	
Loss-low damages	0.3	90,000
Loss-High damages	0.1	1,60,000
For remaining five cases		
Win	0.5	
Loss-low damages	0.3	60,000
Loss-High damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Sol:

- Calculation of expected loss in first ten cases:

Amount of loss	Probability	Expected loss (in ₹)
0	0.6	0
90,000	0.3	27,000
1,60,000	0.1	16,000
Total		43,000

Expected loss for 10 cases = $43,000 \times 10 = 4,30,000$

- Calculation of expected loss in remaining five cases:

Amount of loss	Probability	Expected loss (in ₹)
0	0.5	0
60,000	0.3	18,000
95,000	0.2	19,000
Total		37,000

Expected loss for 5 cases = $37,000 \times 5 = 1,85,000$

- Total contingent liability to be disclosed is ₹. 6,15,000.

30. Illustration

XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typically sold at a gross margin of 40%. XYZ Ltd. has made a provision of ₹ 30,000 during the year ended 31st March, 20X2, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1% of equipment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. evaluate whether any additional warranty provision is required on equipment sold in the past as at

31st March, 20X2? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider?

Solution

Ind AS 37 states that a **provision for warranty should be recognized** when:

1. **A present obligation exists** due to past sales.
2. **It is probable** that an outflow of economic resources will be required to settle the warranty claims.
3. **A reliable estimate** of the warranty obligation can be made.

The provision should be based on **historical data, expected failure rates, and refund policies**. If the warranty period extends beyond one year, **discounting should be applied**.

Analysis

XYZ Ltd. provides a **six-month warranty** with a **refund policy** for faulty equipment, meaning customers receive **a full refund** for defective products. The company **scraps returned goods**, meaning **no recovery from suppliers** is expected.

Given that **sales occur evenly throughout the year**, equipment sold in the **last six months of the year** is still **under warranty at year-end**.

- The company has already **recognized ₹30,000** as a warranty provision, which is **1% of its annual gross margin**.
- The **actual exposure** is higher, as the provision should be based on **the total sales price** rather than the gross margin.
- The provision should be adjusted for the **remaining equipment under warranty**.

Computation of Additional Warranty Provision

Particulars	% of Sales	Amount (₹)	Product under Warranty at 31st March 20X2 (₹)	% Expected to be Returned	Required Provision (₹)
Gross Margin	40%	30,00,000	-	-	-
Selling Price	100%	75,00,000	37,50,000 (6 months)	1%	37,500

Thus, the **required provision** is **₹37,500**, but XYZ Ltd. has already recognized **₹30,000**, so the **additional provision required is ₹7,500**.

Since the provision is expected to be **utilized within six months**, **no discounting is required**.

If the Warranty Period is 2 Years

In the case of a **2-year warranty**, the company must account for:

- **Time value of money** (discounting is required).
- **Extended coverage period**, increasing the probability of claims.

Revised Warranty Provision Calculation for 2-Year Warranty

Particulars	% of Sales	Amount (₹)	Product under Warranty at 31st March 20X2 (₹)	% Expected to be Returned	Required Provision (₹)
Gross	40%	30,00,000	-	-	-

Particulars	% of Sales	Amount (₹)	Product under Warranty at 31st March 20X2 (₹)	% Expected to be Returned	Required Provision (₹)
Margin Selling Price	100%	75,00,000	75,00,000	1%	75,000

Since the **provision required is ₹75,000** and **₹30,000 has already been recognized**, an **additional provision of ₹45,000** must be made.

Additionally, **discounting must be applied** as per **Para 45 and 47 of Ind AS 37**, using a **pre-tax discount rate** that reflects **current market assessments**.

Conclusion

- For a **6-month warranty**, XYZ Ltd. should **increase the provision by ₹7,500**.
- For a **2-year warranty**, XYZ Ltd. should **increase the provision by ₹45,000 and apply discounting** to reflect the time value of money.

31. Illustration

HVCL manufactures heavy equipment for construction industry. An order for supply of 90 equipment was received from ABIL. The unit price of the equipment was agreed at ₹ 190 lakhs each. 64 equipment was supplied during the year 20X1-20X2 and balance quantity remaining to be supplied as on 31.3.20X2. HVCL has 5 equipment in its inventory as on 31.3.20X2. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as on 31.3.20X2.

The management of HVCL contends that costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision. Hence, the same have not been included in the computation of unavoidable cost.

The management of HVCL has submitted the details of costs that have been considered for creation of provision towards onerous contract:

- **Material cost** - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.
- **Labour cost/ Factory Overheads** - includes salaries and other expenses of direct production department, and also expenses allocated from indirect departments to direct department.
- **Material Overheads** - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.

Accordingly, provision has been made considering the above costs only. The value of provision created for 21 remaining equipment to be produced is as per the working shown below:

Particulars	Value (₹ in lakh)
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
(ii) Selling price	<u>(190.00)</u>
(iii) Differential cost per equipment	<u>9.00</u>
(iv) Differential cost of ₹ 9 Lakh per equipment for 21 equipment	189.00

Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37?

Solution

Provisions (Ind AS 37)

As per **Ind AS 37**, an **onerous contract** is a contract in which the **unavoidable costs of fulfilling the obligations exceed the economic benefits** expected to be received. The unavoidable cost of a contract is the **least net cost of exiting from the contract**, which is the **lower of**:

- The **cost of fulfilling the contract**, or
- Any **compensation or penalties arising from failure to fulfill the contract**.

As per Ind AS 37, the **cost of fulfilling a contract** includes:

1. **Incremental costs directly related to fulfilling the contract**, such as:
 - Direct labour
 - Direct materials
2. **Allocation of other directly attributable costs**, such as:
 - Depreciation on assets used for contract execution
 - Overheads that are linked directly to production

Costs that are **not directly linked to fulfilling the contract**, such as **administrative expenses, finance charges, research & development (R&D) costs, and sales overheads**, should not be included in the computation of an onerous contract provision.

Analysis

HVCL received an order from ABIL for **90 equipment** at a **unit price of ₹ 190 lakhs each**. Out of these, **64 units were supplied**, leaving **21 equipment pending production** as of **31st March 20X2**. The company considered the contract as **onerous** and has included **only relevant costs** (materials, direct labour, and material overheads) while creating the provision.

Computation of Onerous Contract Provision

Particulars	Amount (₹ in lakh)
Cost of production per unit (Material, Direct Labour & Overheads)	199.00
Selling price per unit	(190.00)
Loss per unit	9.00
Total loss for 21 pending units (9.00 × 21)	189.00

HVCL **excluded** the following **period costs**, which are **not directly related to the contract**:

- **Administrative overheads**
- **Finance costs**
- **R&D costs**
- **Sales overheads**
- **Headquarter expenses**

Conclusion

HVCL's **accounting treatment is correct** as per **Ind AS 37** because:

- **Only directly attributable costs** related to fulfilling the contract are included.

- **Period costs** (administrative, finance, R&D, etc.) are correctly **excluded**, as they are not directly incremental to the contract.
- The **provision of ₹ 189 lakhs** is based on the **net unavoidable loss** for the remaining 21 units.

Thus, HVCL has **correctly applied the provisions of Ind AS 37** in **recognizing and measuring** the provision for **onerous contracts**.