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AS 1 DISCLOSURE OF ACCOUNTING POLICIES

Question 1 NB Pg. No.

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

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

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

Solution :

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

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

The change in policy has reduced current profit and value of inventory by ₹ 16,000.

Question 2 (RTP May'21) NB Pg. No.

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

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

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

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

Solution :

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

Notes on Accounts:

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(i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year.

As a result of this change, the year-end inventory has been valued at ₹ 50 crores and the profit for the year has increased by ₹ 20 crores.

(ii) The company has decided to provide ₹10 crores for the permanent diminution in the value of investments which has taken place over the period of past five years.

The provision so made has reduced the profit disclosed in the accounts by ₹10 crores.

Question 3 NB Pg. No.

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

Solution :

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

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

Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, **the treatment, done by the company, of not providing the interest amount from due date to the date of repayment is not correct.**

Question 4 (RTP Nov'20) NB Pg. No.

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

Solution :

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

(i) **Going Concern:** The financial statements are normally prepared on the assumption that an

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enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.

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

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

Question 5 NB Pg. No.

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

Solution :

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

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

Question 6 (MTP Apr'21, Mar'22, Oct '23, RTP May'20, PYQ May '22) NB Pg. No.

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

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

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

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

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

v. There is no single list of accounting policies which are applicable to all circumstance. **(5 Marks)**

Solution :

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

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

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

financial statements and they should be disclosed in one place.

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

v. **True;** As per AS 1, there is no single list of accounting policies which are applicable to all circumstances.

The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

Question 7 NB Pg. No.

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

Solution :

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

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

Question 8 (MTP Apr'22, Apr'23, PYQ Nov'18, Dec'21, RTP May'20, Nov'23) NB Pg. No.

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

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

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

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

(5 Marks)

Solution :

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

In the given case, considering the total value of inventory, the change in the amount of required **provision of non-moving inventory from Rs. 4 lakhs to Rs. 3 lakhs are also not material.**

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The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2019–20 in the following manner:

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

Question 9 (RTP Jan'25) NB Pg. No.

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

The company wants to provide during the year ending 31.3.2024 based on technical evaluation:

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

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

Solution :

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy.

Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the **change in the amount of required provision of non-moving inventory from Rs.3.5 lakhs to Rs.2.5 lakhs is also not material.**

The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2023–24:

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

Question 10 (MTP Apr'19, Aug'18, Oct'22) NB Pg. No.

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

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016–2017 **(5 Marks)**

Solution :

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be

disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably.

Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. **Due to this change, the profit for the year is increased by Rs. 12 crores** than would have been the case if the old policy were to continue.

Question 11 (PYQ May'19) **NB Pg. No.**

What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'. **(5 Marks)**

Solution :

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

Reasons for Accrual Basis of Accounting

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

Question 12 (PYQ – May'23) **NB Pg. No.**

You are required to comment on the following cases as per the provisions of Accounting Standard-1 'Disclosure of Accounting Policies':

1. Bee Limited has not complied with AS-2 "Valuation of inventories" and the same is disclosed in the Notes on Accounts. Management is of the view that the financial statements give a true and fair view as non-compliance with AS-2 is disclosed.
2. Cee Limited sold its Office Building for ₹ 10,00,000 on 1st March, 2023. The buyer has paid the full amount and taken possession of the building. The book value of the Office Building is ₹ 4,00,000. On 31st 2023, documentation and legal formalities are pending. The company has not recorded the disposal and the amount received is shown as an advance.
3. Dee Limited has prepared its accounts on cash basis and the same is not disclosed.
4. Jee Limited disclosed significant accounting policies adopted in the preparation of

financial statements, in the Directors' Report. (5 Marks)

Solution :

1. As per AS-I disclosure of accounting policies is **not a remedy for wrong or inappropriate treatment** in accounting. In the given case the financial statement does not give a true and fair view as they are not in compliance with AS-2.
2. **Considering the substance over form as per AS-I, documentation and legal formalities represent the form of the transaction, although the legal title has not been transferred,** the economic reality and substance are that the rights and beneficial interest in the Office Building have been transferred. Therefore, recording of acquisition/ disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.
3. Accrual is a fundamental accounting assumption. If it is not followed by the company, the **facts should be disclosed under AS-I.** Hence the company should disclose the fact that the cash basis of accounting has been followed in the notes on accounts.
4. The **practice followed by the company is not correct.** It should be disclosed as part of financial statements (The director's report is not part of financial statements).

Question 13 (PYQ Nov'23) NB Pg. No.

Discuss Disclosure requirements in following cases as per AS 1.

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

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

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

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

Solution : (5 Marks)

(i) In this case, accountant of company created a provision for damages of probability of losing a suit by a charge against profits. Unless the probability of losing the suit is more than probability of not losing it, there should not be any creation of provision for such probable losses. So there is **no need to charge such loss against profit and disclosing the same in financial statements.**

(ii) Repairs and maintenance are **revenue expenditure and should not be added to the value of assets,** as these expenses do not increase the capacity of asset. Hence such expenses should be charged to profit & loss statement.

Further the chief accountant also disclosed its policy of adding repairs to value of assets by way of notes to accounts. As per AS 1 disclosure is not a method to correct the wrong treatments. So the contention of chief accountant is wrong.

(iii) Accrual is one of the Fundamental accounting assumptions. If fundamental accounting assumptions are followed properly then **no specific disclosure is required.**

Disclosure is **required only when there is deviation** and the company is **not following** fundamental accounting assumptions. So the company need not disclose this in financial statements.

(iv) As per AS 1, any change in the accounting policies which has a material effect in the current

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period or which is reasonably expected to have a material effect in later periods should be disclosed. Accordingly, the **notes on accounts should properly disclose the change and its effect.**

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

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AS 2 – Inventories

Illustration 1

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

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

What will be the value of closing stock?

Solution

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

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

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

Illustration 2 (MTP April'21, Sep'22, Oct'23) (RTP Nov'19)

X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October, 20X1. Till March, 20X2, 75% of the stocks were sold. The company wants to disclose closing stock at 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.20X2. **(5 Marks)**

Solution

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

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

Illustration 3 (MTP March '21, Apr'22 & April '23)

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

Solution

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

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

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Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315

Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

Illustration 4

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

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

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

Solution

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

Cost per kg. of finished goods:

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

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

Illustration 5

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

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

Solution:

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

a) abnormal amount of wasted materials, labour, or other production costs;
b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
d) selling and distribution costs.

Illustration 6 (MTP Apr'24)

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-20X2 the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was in stock.

The accountant wants to know how this wastage is to be treated in the books.

Explain in the context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss, if any. **(5 Marks)**

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Solution:

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

Amount of Abnormal Loss:

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

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

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

Illustration 7

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

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

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

(iii) 1500 units of finished Product X and total cost incurred ₹ 320 per unit.

Expected selling price of Product X is ₹ 300 per unit.

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

Solution:

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

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.20X1:

	Units	**Cost (₹)**	**NRV / Replacement cost**	**Value = units x cost or NRV whichever is less (₹)**
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000

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

Illustration 8 (RTP May'19, May'21)

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

Solution:

Valuation of unfinished unit

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

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MTP / RTP / Past Exam

Question 1 (RTP May'23)

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

You are required to calculate cost of material per KG;

Allocation of material cost.

Solution:

Calculation of Normal cost per Kg.

	₹
Purchase price (20,000 Kg; x ₹ 110)	22,00,000
Less: Input Tax Credit (20,000 Kg; x ₹ 12)	(2,40,000)
	19,60,000
Add: Freight	1,17,600
A. Total material cost	20,77,600
B. Number of units normally received = 98% of 20,000 Kg.	Kg. 19,600
C. Normal cost per Kg. (A/B)	106

Allocation of material cost

	Kg.	₹ /Kg.	₹
Materials consumed	18,000	106	19,08,000
Cost of inventory	1,500	106	1,59,000
Abnormal loss	100	106	10,600
Total material cost	19,600	106	20,77,600

Note: Abnormal losses are recognized as separate expense.

Question 2 (MTP May '20, April '19, Oct '18) (Past Exam May'19)

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

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

Solution:

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

Amount of Normal Loss and Abnormal Loss:

Material used 12,000 MT @ Rs. 150	= Rs. 18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520MT
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)

Abnormal Loss Rs. 23,437.50

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[150 units @ Rs. 156.25 (Rs.18,00,000/11,520)] Amount of Rs. 23,437.50 will be charged to the Profit and Loss statement.

Question 3 (MTP March '19, March '18) (RTP May'22)

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

Average Basis.

Details of Purchases:

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

Details of issue of Inventory:

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

Net realizable value of inventory as on 31st March, 2017 is Rs. 107.75 per unit. You are required to compute the value of Inventory as per AS 2. **(5 Marks)**

Solution:

Net Realizable Value of Inventory as on 31st March, 2017 = Rs. 107.75 x 20 units = Rs. 2,155

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

01.03.2017 Rs. 108 x 20 units = Rs. 2160

08.3.2017 Rs. 107 x 15 units = Rs. 1605

17.03.2017 Rs. 109 x 30 units = Rs. 3270

25.03.2017 Rs. 107 x 15 units = Rs. 1605

Total 80 units = Rs. 8640

Weighted Average Cost = Rs. 8640/80 units = Rs.108

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

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2017 is, Cost or

Net Realizable value whichever is lower i.e. Rs. 2,155.

Question 4 (MTP Aug '18) (RTP Nov'18 (RTP Nov'20) (PAST EXAM Nov'22)

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

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

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Chemical Y	
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

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

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

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is Rs. 800 per unit. **(5 Marks)**

Solution:

When Net Realizable Value of the Chemical Y is Rs. 800 per unit NRV is greater than the cost of Finished Goods Y i.e. Rs. 660 (Refer W.N.)

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

Value of Closing Stock:

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

Working Note:

Statement showing cost calculation of Raw Material X and Chemical Y

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

Question 5 (MTP Oct '21)

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

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

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

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

Calculate the value of closing stock, when

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

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit. **(5 Marks)**

Solution:

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

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

(ii) When Net Realizable Value of the Finished Good Q is ₹ 340 per unit Since NRV of finished goods Q is less than its cost i.e., ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

Value of Closing Stock:

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

Working Note:

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

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

Question 6 (MTP Oct'22)

U.S.A Ltd. purchased raw material @ ₹ 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

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inventories at the end of the year. However, replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material? **(5 Marks)**

Solution:

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, USA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg; @ ₹ 300 per kg;);

Question 7 (MTP Mar'23) (RTP May'20) (Past Exam July'21)

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

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

Solution: **(5 Marks)**

Calculation of cost for closing inventory

Particulars	**₹**
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead $\frac{75000 \text{ X } 10,200}{15,000}$	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 realizable value is less than cost, closing inventory will be valued at ₹ 20;

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i;e; ₹ 9;50;

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

Question 8 (RTP May '21)

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

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Details of cost for these products are:

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

Product – B: Material cost and wages cost of each unit are Rs. 45 and Rs. 35 respectively and normal selling rate is Rs. 150 each, however due to defect in the manufacturing process 800 units of Product- B were expected to be sold at Rs. 70. You are requested to value closing inventory according to AS 2 after considering the above.

Solution:

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

Product – A

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

Product – B

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

Question 9 (RTP May '18)

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers. You are required to advise the company on the valuation of the inventories in line with the provisions of AS 2.

Solution:

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. The standard states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods are often valued at net realizable value at certain stages of production." Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realizable value and not at net realizable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

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Question 10 (RTP May '22)

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

Solution

AS 2 does not apply to producers of agricultural products but applies to traders in agricultural products.

Hence AS 2 will apply to Rohan Pvt. Ltd. and it will have to value inventory at lower of cost or market value.

Question 11 (RTP Nov'22)

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

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

b) Shirts which had cost ₹ 50,000, their net realizable value at Balance sheet date was ₹ 55,000.

Commission @ 10% on sales is payable to agents.

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

Solution:

Valuation of closing stock

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

Working Notes:

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

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

Question 12 (Past Exam Nov'19, Jan '21 MTP Oct'19, Sep '23)

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

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

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

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

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

Determine how each item of inventory will be valued as on 31.03.2019. Also calculate the value of total Inventory as on 31.03.2019. **(5 Marks)**

Solution

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

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expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product P is ₹ 266 and total cost per unit for production is ₹ 295;

Hence the valuation will be done as under:

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

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

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

2021 Valuation of Total Inventory as on 31.03.2019:

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

Question 13 (PAST EXAM May'19)

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price. **(1 Mark)**

Solution

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

Question 14 (Past Exam May'22)

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

(i) Sales for the month of June 2021 was ₹30,40,000.

(ii) General overheads cost ₹4,00,000.

(iii) Inventory at beginning 10,000 liters @ ₹ 92 per liter.

(iv) Purchases-June 1, 2021, 20,000 liters @ ₹ 90 per liter, June 30, 2021, 10,000 liters @ ₹ 95 per liter.

(v) Closing inventory 13,000 liters.

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

(i) Value of Inventory on 30th June, 2021.

(ii) Amount of cost of goods sold for June,2021.

(iii) Profit/Loss for the month of June,2021. **(5 Marks)**

Solution

	₹
Cost of closing inventory for 13,000 liters as on 30th June 2021	
10,000 liters @ ₹ 95	9,50,000
3,000 liters @ ₹ 90	2,70,000

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Value of inventory (determined at cost in absence of NRV) -	
	12,20,000
Calculation of cost of goods sold	
Opening inventories (10,000 liters @ ₹ 92)	9,20,000
Purchases June – 1 (20,000 liters @ ₹ 90)	18,00,000
June – 30 (10,000 liters @ 95)	9,50,000
	36,70,000
Less: Closing inventories	(12,20,000)
Cost of Goods Sold	24,50,000
Calculation of Profit	30,40,000
Sales (Given) (A)	24,50,000
Cost of Goods Sold	4,00,000
Add: General Overheads	28,50,000
Total Cost (B)	1,90,000
Profit (A-B)	

Question 15 (RTP Nov'23)

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

Keeping this in view:

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

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

Solution:

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

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

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

Therefore, empty bottles are assets for the company.

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

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

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

Question 16 (Past Exam Nov'23)

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

(i) Sonu is a retailer dealing in toys. During the year, he purchased items worth ₹ 1,47,000 and made a total sale ₹ 1,54,000. The average percentage of gross margin is 10% on cost. Opening stock of toys at cost was ₹ 20,000.

(ii) On 21st March, 2023, Mohan purchased 250 chairs at ₹ 300 each. The selling price of the chair is ₹ 400 each. Owing to a manufacturing defect, net realisable value of the whole lot of chair was determined at 70% of their normal selling price. No chairs were sold during the year. **(5 Marks)**

TELEGRAM: CA NOTE HUB

Solution:

(i) Cost of closing inventory is shown below:

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

(ii)

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

Question 17 (RTP Sep'24)

Kirti Ltd. is in the business of manufacturing computers. During the year ended 31st March, 2024, the company manufactured 550 computers. It has the policy of valuing finished stock of goods at a standard cost of ₹ 1.8 lakh per computer. The details of the costs are as under:

	(₹ in lakh)
Raw material consumed	400
Direct Labour	250
Variable production overheads	150
Fixed production overheads (including interest of ₹ 100 lakh)	290

Compute the value cost per computer for the purpose of closing stock.

Solution:

As per para 9 of AS 2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production overheads is based on the normal capacity of the production facilities.

In this, case finished stock has been valued at a standard cost of ₹ 1.8 lakh per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

		(₹ in lakh)
Materials	400	
Direct Labour		250
Variable production overheads		150
Fixed production overheads	290	
Less: Interest	(100)	190
Total cost		990

Number of computers produced = 550 computers (Assumed to be normal production)

Cost per computer ₹ 990 lakh / 550 computers = ₹ 1.80 lakh

TELEGRAM: CA NOTE HUB

MCQ

1. Which item of inventory is under the scope of AS 2 (Revised)?
   a) WIP arising under construction contracts
   b) Raw materials
   c) Shares
   d) Debentures held as stock in trade.
2. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be
   a) sold at or above cost.
   b) sold above cost.
   c) sold less than cost.
   d) sold at market value(where market value is more than cost).
3. All of the following costs are excluded while computing value of inventories except?
   a) Selling and Distribution costs
   b) Allocated fixed production overheads based on normal capacity.
   c) Abnormal wastage
   d) Storage costs (which is necessary part of the production process)
4. Identify the statement(s) which is/are incorrect.
   a) Storage costs which is a necessary part of the production process is included in inventory valuation.
   b) Administration overheads are never included in inventory valuation.
   c) Full amount of variable production overheads incurred are included in inventory valuation.
   d) Administration overheads are always included in inventory valuation.

MCQs

1. (b)
2. (a)
3. (b)
4. (b)

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Solved Example

Example 1

Cost of a partly finished unit at the end of 20X1-X2 is ₹ 150. The unit can be finished next year by a further expenditure of ₹ 100. The finished unit can be sold at ₹ 250, subject to payment of 4% brokerage on selling price. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further. The value of inventory will be determined as below:

	₹
Net selling price	250
Less: Estimated cost of completion	(100)
	150
Less: Brokerage (4% of 250)	(10)
Net Realisable Value	140
Cost of inventory	150
Value of inventory (Lower of cost and net realisable value)	140

Example 2

ABC Ltd. has a plant with the capacity to produce 1 lac unit of a product per annum and the expected fixed overhead is ₹ 18 lacs. Fixed overhead on the basis of normal capacity is ₹ 18 (18 lacs/1 lac).

Case 1: Actual production is 1 lac units. Fixed overhead on the basis of normal capacity and actual overhead will lead to same figure of ₹ 18 lacs. Therefore, it is advisable to include this on normal capacity.

Case 2: Actual production is 90,000 units. Fixed overhead is not going to change with the change in output and will remain constant at ₹ 18 lacs, therefore, overheads on actual basis is ₹ 20 per unit (18 lacs/ 90 thousands). Hence by valuing inventory at ₹ 20 each for fixed overhead purpose, it will be overvalued and the losses of ₹ 1.8 lacs will also be included in closing inventory leading to a higher gross profit then actually earned. Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (90,000 x 18)₹ 16.2 lacs and rest ₹ 1.8 lacs should be transferred to Profit & Loss Account.

Case 3: Actual production is 1.2 lacs units. Fixed overhead is not going to change with the change in output and will remain constant at ₹ 18 lacs, therefore, overheads on actual basis is ₹ 15 (18 lacs/ 1.2 lacs). Hence by valuing inventory at ₹ 18 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At ₹ 18 per unit, total fixed overhead comes to ₹ 21.6 lacs whereas, actual fixed overhead expense is only ₹ 18 lacs. Therefore, it is advisable to include fixed overhead on actual basis (1.2 lacs x 15) ₹ 18 lacs.

Example 3

A trader purchased certain articles for ₹ 85,000. He sold some of articles for ₹ 1,05,000. The average percentage of gross markup is 25% on cost. Opening stock of inventory at cost was ₹ 15,000.

Cost of closing inventory is shown below:

	₹
Sale value of opening stock and purchase (₹ 85,000 + ₹ 15,000) x 1.25	1,25,000
Sales	(1,05,000)
Sale value of unsold stock	20,000
Less: Gross Markup (₹ 20,000 / 1.25) x 0.25	(4,000)
Cost of inventory	16,000

Note: Margin is on sales and mark-up is on cost.

Example 4

TELEGRAM: CA NOTE HUB

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

	Cost	Net Realisable Value	Inventory Value
	₹	₹	₹
Item 1	50,000	45,000	45,000
Item 2	20,000	24,000	20,000
Total	70,000	69,000	65,000

Estimates of NRV should be based on evidence available at the time of estimation.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. AS 2 (Revised) also provides that estimates of net realisable value are to be based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the balance sheet date to the extent that such events confirm the conditions existing at the balance sheet date.

TELEGRAM: CA NOTE HUB

AS 3 – CASH FLOW STATEMENT

Illustration 1

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

(a) Purchase of Machinery.

(b) Proceeds from issuance of equity share capital

(c) Cash Sales.

(d) Proceeds from long-term borrowings.

(e) Cheques collected from Trade receivables.

(f) Cash receipts from Trade receivables.

(g) Trading Commission received.

(h) Purchase of investment.

(i) Redemption of Preference Shares.

(j) Cash Purchases.

(k) Proceeds from sale of investment

(l) Purchase of goodwill.

(m) Cash paid to suppliers.

(n) Interim Dividend paid on equity shares.

(o) Wages and salaries paid.

(p) Proceed from sale of patents.

(q) Interest received on debentures held as investment.

(r) Interest paid on Long-term borrowings.

(s) Office and Administration Expenses paid

(t) Manufacturing Overheads paid.

(u) Dividend received on shares held as investments.

(v) Rent Received on property held as investment.

(w) Selling and distribution expense paid.

(x) Income tax paid

(y) Dividend paid on Preference shares.

(z) Underwritings Commission paid.

(aa) Rent paid.

(bb) Brokerage paid on purchase of investments.

(cc) Bank Overdraft

(dd) Cash Credit

(ee) Short-term Deposits

(ff) Highly liquid Marketable Securities (without risk of change in value)

(gg) Refund of Income Tax received.

Solution

(a) Operating Activities: c, e, f, g, j, m, o, s, t, w, x, aa & gg.

TELEGRAM: CA NOTE HUB

(b) Investing Activities: a, h, k, l, p, q, u, v, bb & ee.

(c) Financing Activities: b, d, i, n, r, y, z, cc & dd.

(d) Cash Equivalent: ff.

Illustration 2

X Ltd. purchased debentures of ₹10 lacs of Y Ltd., which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 20X1?

Solution

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments* . If investment, of ₹10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

However, if investment of ₹10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

Illustration 3

Classify the following activities as per AS 3 Cash Flow Statement:

i. Interest paid by financial enterprise

ii. Tax deducted at source on interest received from subsidiary company

iii. Deposit with Bank for a term of two years

iv. Insurance claim received towards loss of machinery by fire

v. Bad debts written off

Solution

i. Interest paid by financial enterprise

Cash flows from operating activities

ii. TDS on interest received from subsidiary company

Cash flows from investing activities

iii. Deposit with bank for a term of two years

Cash flows from investing activities

iv. Insurance claim received against loss of fixed asset by fire

Extraordinary item to be shown as a separate heading under 'Cash flow from investing activities'

v. Bad debts written off

It is a non-cash item which is adjusted from net profit/loss under indirect method, to arrive at net cash flow from operating activity.

Illustration 4

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 20X1:

Cash Flow (Abstract)

Inflows	₹	Outflows	₹
Opening balance:		Payment for Account Payables	90,000
Cash	10,000	Salaries and wages	25,000
Bank	70,000	Payment of overheads	15,000
Share capital – shares issued	5,00,000	Property, plant and equipment acquired	4,00,000

TELEGRAM: CA NOTE HUB

Collection on account of Trade Receivables	3,50,000	Debentures redeemed	50,000
Sale of Property, plant and equipment	70,000	Bank loan repaid	2,50,000
		Taxation	55,000
		Dividends	1,00,000
		Closing balance:	
		Cash	5,000
		Bank	10,000
	10,00,000		**10,00,000**

Prepare Cash Flow Statement for the year ended 31st March, 20X1in accordance with Accounting Standard 3.

Solution

Cash Flow Statement for the year ended 31.3.20X1

	₹	₹
Cash flow from operating activities		
Cash received on account of trade receivables	3,50,000	
Cash paid on account of trade payables	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(55,000)	
Net cash generated from operating activities		1,65,000
Cash flow from investing activities		
Payment for purchase of Property, plant and equipment	(4,00,000)	
Proceeds from sale of Property, plant and equipment	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	
Dividends paid	(1,00,000)	
Net cash used in financing activities		1,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Illustration 5

Prepare Cash Flow from Investing Activities of M/s. Creative Furnishings Limited for the year ended 31-3-20X1.

Particulars	₹

TELEGRAM: CA NOTE HUB

Plant acquired by the issue of 8% Debentures	1,56,000
Claim received for loss of plant in fire	49,600
Unsecured loans given to subsidiaries	4,85,000
Interest on loan received from subsidiary companies	82,500
Pre-acquisition dividend received on investment made	62,400
Debenture interest paid	1,16,000
Term loan repaid	4,25,000
Interest received on investment	68,000
(TDS of ₹ 8,200 was deducted on the above interest)	
Book value of plant sold (loss incurred ₹ 9,600)	84,000

Solution

Cash Flow Statement from Investing Activities of

M/s Creative Furnishings Limited for the year ended 31-03-20X1

Cash generated from investing activities	**₹**	**₹**
Interest on loan received	82,500	
Pre-acquisition dividend received on investment made	62,400	
Unsecured loans given to subsidiaries	(4,85,000)	
Interest received on investments (gross value)	76,200	
TDS deducted on interest	(8,200)	
Sale of plant	74,400	
Cash used in investing activities (before extra ordinary item)		(1,97,700)
Extraordinary claim received for loss of plant		49,600
Net cash used in investing activities (after extra ordinary item)		(1,48,100)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and, therefore, not considered for preparing cash flow from investing activities.
2. Plant acquired by issue of 8% debentures does not amount to cash outflow, hence also not considered in the above cash flow statement.

Illustration 6

What are the main features of the Cash Flow Statement?

Solution:

According to AS 3 on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either (a) the direct method, or (b) the indirect method. A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.

Illustration 7

Mayuri Ltd. acquired Plant and Machinery for ₹ 25 lakhs. During the same year, it also sold Furniture and Fixtures for ₹ 4 lakhs. Can the company disclose, Net Cash Outflow towards purchase of Fixed Assets ₹ 21 lakhs (i.e., 25 lakhs – 4 lakhs) in the Cash Flow Statement?

TELEGRAM: CA NOTE HUB

Solution:

As per AS 3, Cash Flow Statements, an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except in the case of:

- cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and
- cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

In the given case, since the purchase of Plant and Machinery and disposal of Furniture and Fixtures do not fall in the criteria of exception mentioned above, the same should be presented on a gross basis as an outflow of ₹ 25 lakhs and an inflow of ₹ 4 lakhs. Presentation of net cash outflow of ₹ 21 lakhs is not permitted as per AS 3.

Illustration 8

How would the following cash flows be classified in accordance with AS 3?

- Corporate Income Tax paid amounting to ₹ 70 lakhs during the reporting period.
- Payment of advance tax ₹ 8,75,000 out of which ₹ 75,000 was towards capital gains arising on account of sale of assets during the reporting period.
- Fixed Deposits withdrawn by customers of State Bank of India ₹ 3 crores.

Solution:

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

Corporate Income Tax paid amounting to₹ 70 lakhs during the reporting period.	₹ 70 lakhs: Operating Cash Flows
Payment of advance tax ₹ 8,75,000 out of which ₹ 75,000 was towards capital gains arising on account of sale of assets during the reporting period.	₹ 8,00,000: Operating Cash Flows ₹ 75,000: Investing Cash Flows
Fixed Deposits withdrawn by customers of State Bank of India ₹ 3 crores.	₹ 3 crores: Operating Cash Flows for State Bank of India.

Illustration 9 (RTP Sep'24)

Money Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

i. Loans and Advances given to the following and interest earned on them:
   1) to suppliers
   2) to employees
   3) to its subsidiaries companies

ii. Investment made in subsidiary Smart Ltd. and dividend received

iii. Dividend paid for the year

Discuss in the context of AS 3 Cash Flow Statement.

Solution:

Treatment as per AS 3 'Cash Flow Statement'

i. Loans and advances given and interest earned
   1) to suppliers - Cash flows from operating activities
   2) to employees - Cash flows from operating activities
   3) to its subsidiary companies - Cash flows from investing activities

ii. Investment made in subsidiary company and dividend received - Cash flows from investing activities

TELEGRAM: CA NOTE HUB

iii. Dividend paid for the year - Cash flows from financing activities

Illustration 10

From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-20X2 as per AS 3.

Particulars	Amount (₹)
Balance as per the Bank Statement	25,000
Cheque issued but not presented in the Bank	15,000
Short Term Investment in liquid equity shares of ABC Limited	50,000
Fixed Deposit created on 01-11-20X1 and maturing on 15-04-20X2	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund on 01-03-20X2 (having maturity period of less than 3 months)	1,00,000
Bank Balance in a Foreign Currency Account in India	$ 1,000
(Conversion Rate: On the day of deposit ₹ 69/USD as on 31-03-20X2 ₹ 70/USD)	

Solution:

Computation of Cash and Cash Equivalents as on 31st March, 20X2

	₹
Cash balance with bank (₹ 25,000 less ₹ 15,000)	10,000
Short term investment in highly liquid sovereign debt mutual fund on 1.3.20X2	1,00,000
Bank balance in foreign currency account ($1,000 x ₹ 70)	70,000
	1,80,000

Note: Short term investment in liquid equity shares and fixed deposit will not be considered as cash and cash equivalents.

Illustration 11

Z Ltd. has no Foreign Currency Cash Flow during the reporting period. It held a deposit in a bank in France. The balances as at the beginning of the year and at the end of the year were € 100,000 and € 105,000 respectively. The exchange rate at the beginning of the year was € 1 = ₹ 82, and at the end of the year was € 1 = ₹ 85. The increase in the deposit balance of € 5,000 was on account of interest credited on the last day of the reporting period. The deposit was reported at ₹ 82,00,000 in the opening balance sheet and at ₹ 89,25,000 in the jclosing balance sheet. You are required to show how these transactions would be presented in the Cash Flow Statement as per AS 3.

Solution:

The Statement of Profit and Loss was credited on account of:

Interest Income: € 5,000 x ₹ 85 =₹ 4,25,000

Exchange difference = € 100,000 x (₹ 85 – ₹ 82) = ₹ 3,00,000

In preparing the Cash Flow Statement, the exchange difference of ₹ 3,00,000 should be deducted from the Net Profit before taxes, since it is a non-cash item. However, in order to reconcile the opening balance of the Cash and Cash Equivalents with its closing balance, the Exchange Difference of ₹ 3,00,000 should be added to the opening balance in a Note to the Cash Flow Statement.,

Cash Flows arising from transactions in a Foreign Currency shall be recorded in Z Ltd.'s reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Oct'19, Oct '22) (RTP May 19)

J Ltd. presents you the following information for the year ended 31st March, 2019:

		(Rs. in lacs)
(i)	Net profit before tax provision	36,000
(ii)	Dividend paid	10,202
(iii)	Income-tax paid	5,100
(iv)	Book value of assets sold	222
	Loss on sale of asset	48
(v)	Depreciation debited to P & L account	24,000
(vi)	Capital grant received - amortized to P & L A/c	10
(vii)	Book value of investment sold	33,318
	Profit on sale of investment	120
(viii)	Interest income from investment credited to P & L A/c	3,000
(ix)	Interest expenditure debited to P & L A/c	12,000
(x)	Interest actually paid (Financing activity)	13,042
(xi)	Increase in working capital	67,290
	[Excluding cash and bank balance]	
(xii)	Purchase of Property, Plant & Equipment	22,092
(xiii)	Expenditure on construction work	41,688
(xiv)	Grant received for capital projects	18
(xv)	Long term borrowings from banks	55,866
(xvi)	Provision for Income-tax debited to P & L A/c	6,000
	Cash and bank balance on 1.4.2018	6,000
	Cash and bank balance on 31.3.2019	8,000

You are required to prepare a cash flow statement as per AS-3 (Revised). **(12 Marks)**

Solution:

Cash Flow Statement as per AS 3

		Rs. in lacs
Cash flows from operating activities:		36,000
Net profit before tax provision		
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048

TELEGRAM: CA NOTE HUB

			72,048
Less:	Non cash income		
	Amortization of capital grant received	(10)	
	Profit on sale of investments (non operating income)	(120)	
	Interest income from investments (non operating income)	(3,000)	3,130
Operating profit			68,918
Less: Increase in working capital			(67,290)
Cash from operations			1,628
Less: Income tax paid			(5,100)
Net cash generated from operating activities			(3,472)
Cash flows from investing activities:			
	Sale of assets (222 - 48)	174	
	Sale of investments (33,318+120)	33,438	
	Interest income from investments	3,000	
	Purchase of Property, Plant & Equipment	(22,092)	
	Expenditure on construction work	(41,688)	
	Net cash used in investing activities		(27,168)
Cash flows from financing activities:			
	Grants for capital projects	18	
	Long term borrowings	55,866	
	Interest paid	(13,042)	
Dividend paid		(10,202)	
Net cash from financing activities			32,640
Net increase in cash			2,000
Add: Cash and bank balance as on 1.4.2018			6,000
Cash and bank balance as on 31.3.2019			8,000

Question 2 (RTP Nov 18, Nov'22) (MTP March '23)

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 were summarised as follows:

	2018 (₹)	**2017 (₹)**
Equity share capital	1,20,000	1,00,000
Reserves:		
Profit and Loss Account	9,000	8,000
Current Liabilities:		

TELEGRAM: CA NOTE HUB

Trade Payables	8,000	5,000
Income tax payable	3,000	2,000
Declared Dividends	4,000	2,000
Property, Plant & Equipment (at W.D.V) :	**1,44,000**	**1,17,000**
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	25,000	16,000
Long Term Investments	32,000	28,000
Current Assets:		
Inventory	14,000	8,000
Trade Receivables	8,000	6,000
Cash & Bank	12,000	17,000
	1,44,000	**1,17,000**

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

	₹
Profit before tax	8,000
Income Tax	(3,000)
Profit after tax	5,000
Declared Dividends	(4,000)
Retained Profit	1,000

Further Information is available:

1. Depreciation on Building ₹ 1,000.
2. Depreciation on Furniture & Fixtures for the year ₹ 2,000.
3. Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.
4. Purchase investments for ₹ 6,000.
5. Sold investments for ₹ 10,000, these investments cost ₹ 2,000.
6. You are required to prepare Cash Flow Statement as per AS-3 using indirect method. **(15 Marks)**

Solution:

Harry Ltd.
Cash Flow Statement for the year ended 31st March, 2018

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		

TELEGRAM: CA NOTE HUB

Depreciation (1,000 + 2,000 +5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(2,000)	
Net cash generated from operating activities (A)		(400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	
Dividends paid*	(2,000)	
Net cash from financing activities(C)		18,000
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		12,000

* Dividend declared for the year ended 31st March, 2017 amounting ₹ 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

Working Notes:

1. Calculation of Income taxes paid

	₹	
Income tax expense for the year	3,000	
Add: Income tax liability at the beginning of the year	2,000	
		5,000
Less: Income tax liability at the end of the year	(3,000)	
		2,000

TELEGRAM: CA NOTE HUB

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (₹)	Car (₹)
W.D.V. at 31.3.2018	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	—	2,000
	36,000	32,000
Less: W.D.V. at 31. 3. 2017	(22,000)	(16,000)
Acquisitions during 2016-2018	14,000	16,000

Question 3 (MTP Nov'21, April 23 Sep '23) (Past Exam Nov '20) (RTP May 20)

The following figures have been extracted from the books of Manan Limited for the year ended on 31.3.2022. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs:

(a) Depreciation on Property, Plant & Equipment ₹ 7;50 lakhs;

(b) Discount on issue of Debentures written off ₹ 45,000;

(c) Interest on Debentures paid ₹ 5,25,000;

(d) Book value of investments ₹ 4;50 lakhs (Sale of Investments for ₹ 4,80,000);

(e) Interest received on investments ₹ 90,000;

(ii) Compensation received ₹ 1,35,000 by the company in a suit filed;

(iii) Income tax paid during the year ₹ 15,75,000;

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2021 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹ 10 each at a premium of 20% on 30/3/2022 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2020-21 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2022 for the year 2020-2021 ₹ 7;50 lakhs and interim dividend paid ₹ 2;50 lakhs for the year 2021-2022.

(viii) Land was purchased on 02/4/2021 for ₹ 3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration;

(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 01.04.2021	**As on 31.3.2022**
	₹	₹
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650

TELEGRAM: CA NOTE HUB

Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

(10 Marks)

Solution:

Manan Ltd.

Cash Flow Statement for the year ended 31st March, 2022

	Rs.	Rs.
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments		12,00,000
Operating profit before working capital changes		42,00,000
Adjustments for:		
Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities;		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	36,000	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	

TELEGRAM: CA NOTE HUB

Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2021		3,94,450
Cash and cash equivalents as on 31.3.2022		16,950

Question 4 (RTP May'21)

The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

Extract of Balance Sheet

		Particulars	**Notes**	**2021(Rs;'000)**	**2020(Rs;'000)**
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	Share capital	1	500	200
2		**Non- current liabilities**			
	(a)	Long term loan from bank		---	250
3		**Current liabilities**			
	(a)	Trade Payables		1,000	3,047
		Assets			
1		**Non-current assets**			
	(a)	Property, Plant and Equipment		230	128
2		**Current assets**			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	**Notes**	**2021 (Rs;'000) 2020**	**(Rs;'000)**
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			

TELEGRAM: CA NOTE HUB

	Current tax (paid during year)		243	140

Notes to accounts

		2021 (Rs;'000)	2020 (Rs;'000)
1	**Share Capital**		
	Equity Shares of Rs.10 each, fully paid up	500	200
2	**Other expenses**		
	Overheads	115	110

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting Rs. 80,000 was paid during the year ended 31st March, 2021.

Solution

Supriya Ltd.

Cash Flow Statement for the year ended 31st March, 2021

(Using direct method)

		(Rs; '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads) (115)		
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of Property, Plant and Equipment	(102)	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35

TELEGRAM: CA NOTE HUB

Cash and cash equivalents at end of period		212

Question 5 (RTP Nov 19)

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

Balance Sheets

Particulars	**Note**	**31.03.2019 (₹)**	**31.03.2018 (₹)**
I EQUITY AND LIABILITES			
(1) Shareholder's Funds			
(a) Share Capital	1	3,50,000	3,00,000
(b) Reserves and Surplus	2	82,000	38,000
(2) Non-Current Liabilities			
(3) Current Liabilities			
(a) Trade Payables		65,000	44,000
(b) Other Current Liabilities	3	37,000	27,000
(c) Short term Provisions (provision for tax)	4	32,000	28,000
Total		**5,66,000**	**4,37,000**
II ASSETS			
(1) Non-current Assets			
(a) Tangible Assets		2,66,000	1,90,000
(b) Intangible Assets (Goodwill)		47,000	60,000
Non-Current Investments		35,000	10,000
(2) Current Assets			
(a) Inventories		78,000	85,000
(b) Trade Receivables		1,08,000	75,000
(c) Cash & Cash Equivalents		32,000	17,000
Total		**5,66,000**	**4,37,000**

Note 1: Share Capital

Particulars	**31;03;2019 (₹)**	**31;03;2018 (₹)**
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	1,00,000	1,50,000
Total	3,50,000	3,00,000

Note 2: Reserves and Surplus

Particulars	**31;03;2019 (₹)**	**31;03;2018 (₹)**
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000

TELEGRAM: CA NOTE HUB

Capital Reserve	25,000	
Total	82,000	38,000

Note 3: Current Liabilities

Particulars	**31;03;2019(₹)**	**31;03;2018 (₹)**
Dividend declared	37,000	27,000

Note 4: Tangible Assets

Particulars	**31.03.2019 (₹)**	**31.03.2018 (₹)**
Land & Building	75,000	1,00,000
Machinery	1,91,000	90,000
Total	2,66,000	1,90,000

Additional Information:

(i) 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:

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

		Particulars	₹	₹
1.		**Cash flow from Operating Activities**		
	A.	**Closing balance as per Profit and Loss Account**		27,000
		Less: Opening balance as per Profit and Loss Account		(18,000)
		Add: Dividend declared during the year		37,000
		Add: Interim dividend paid during the year		10,000
		Add: Transfer to reserve		10,000
		Add: Provision for Tax		32,000
	B	**. Net profit before taxation, and extra-ordinary item**		98,000
	C	**. Add: Items to be added**		
		Depreciation	18,000	
		Loss on sale of Plant	3,000	

TELEGRAM: CA NOTE HUB

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

1. Land and Building Account

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

Plant and Machinery Account

Particulars	₹	Particulars	₹
To Balance b/d	90,000	By Depreciation A/c	18,000

TELEGRAM: CA NOTE HUB

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

2. Investments Account

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

Question 6 (RTP May 18)

A company provides you the following information:

(i) Total sales for the year were Rs. 398 crores out of which cash sales amounted to Rs. 262 crores.

(ii) Receipts from credit customers during the year, aggregated Rs. 134 crores.

(iii) Purchases for the year amounted to Rs. 220 crores out of which credit purchase was 80%.

Balance in creditors as on

1.4.2020	₹ 84 crores
31.3.2021	₹ 92 crores

(iv) Suppliers of other consumables and services were paid Rs. 19 crores in cash.

(v) Employees of the enterprises were paid 20 crores in cash.

(vi) Fully paid preference shares of the face value of Rs. 32 crores were redeemed. Equity shares of the face value of Rs. 20 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of Rs. 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) Rs. 26 crores were paid by way of income tax.

(ix) A new machinery costing Rs. 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was Rs. 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of Rs. 15 crores. The balance was paid in cash to the vendor.

(x) Investment costing Rs. 18 cores were sold at a loss of Rs. 2 crores.

(xi) Dividends amounting Rs. 15 crores (including dividend distribution tax of Rs. 2.7 crores) was also paid.

(xii) Debenture interest amounting Rs. 2 crore was paid.

(xiii) On 31st March 2016, Balance with Bank and Cash on hand was Rs. 2 crores.

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method).

Solution:

TELEGRAM: CA NOTE HUB

Cash flow statement (using direct method) for the year ended 31st March, 2017

	(Rs. in crores)	(Rs. in crores)
Cash flow from operating activities		
Cash sales	262	
Cash collected from credit customers 1	34	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(251)	
Cash from operations	145	
Less: Income tax paid	(26)	
Net cash generated from operating activities		119
Cash flow from investing activities		
Net Payment for purchase of Machine (25 – 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities		
Redemption of Preference shares	(32)	
Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net cash used in financing activities		(25)
Net increase in cash and cash equivalents		100
Add: Cash and cash equivalents as on 1.04.2016		2
Cash and cash equivalents as on 31.3.2017		102

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(Rs. in crores)
Opening Balance in creditors Account	84
Add: Purchases (220x .8)	176
Total	260
Less: Closing balance in Creditors Account	92
Cash paid to suppliers of goods	168
Add: Cash purchases (220x .2)	44
Total cash paid for purchases to suppliers (a)	212
Add: Cash paid to suppliers of other consumables and services (b)	19

TELEGRAM: CA NOTE HUB

Add: Payment to employees (c)	20
Total cash paid to suppliers of goods & services and to employees [(a)+(b) + (c)]	251

Question 7 (RTP May '22)

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement for the year ended 31st March, 2021:

	31;03;2021(₹)	31;03;2020 (₹)
Share Capital	14,00,000	11,20,000
General Reserve	5,60,000	3,50,000
Profit and Loss Account	1,40,000	84,000
Debentures	2,80,000 -	
Provision for taxation	1,40,000	98,000
Trade payables	9,80,000	11,48,000
Plant and Machinery	9,80,000	7,00,000
Land and Building	8,40,000	5,60,000
Investments	1,40,000 -	
Trade receivables	7,00,000	9,80,000
Inventories	5,60,000	2,80,000
Cash in hand and at Bank	2,80,000	2,80,000

(i) Depreciation @ 20% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing 70,000 (WDV 28,000) was sold for ₹ 49,000; Purchase of machinery was also made at the year end.

(iii) ₹ 70,000 was paid towards Income tax during the year.

(iv) Land & Building is not subject to any depreciation; Expenses on renovation of building amount ₹ 2,80,000 were incurred during the year. Prepare Cash Flow Statement.

Solution:

Omega Ltd.

Cash Flow Statement for the year ended 31st March, 2021

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account	₹56,000	
Provision for taxation	1,12,000	
Transfer to General Reserve	2,10,000	
Depreciation	1,40,000	
Profit on sale of Plant and Machinery	(21,000)	
Operating Profit before Working Capital changes	4,97,000	
Increase in Inventories	(2,80,000)	

TELEGRAM: CA NOTE HUB

Decrease in Trade receivables	2,80,000	
Decrease in Trade payables	(1,68,000)	
Cash generated from operations	3,29,000	
Income tax paid	(70,000)	
Net Cash from operating activities		2,59,000
Cash Flow from Investing Activities		
Purchase of plant & machinery	(4,48,000)	
Expenses on building	(2,80,000)	
Increase in investments	(1,40,000)	
Sale of old machine	49,000	
Net Cash used in investing activities		(8,19,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	2,80,000	
Proceeds from issue of debentures	2,80,000	
Net cash from financing activities		5,60,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,80,000
Cash and Cash equivalents at the end of the year		2,80,000

Working Notes: Provision for taxation account

	₹		₹
To Cash (Tax Paid)	70,000	By Balance b/d	98,000
To Balance c/d	1,40,000	By Profit and Loss A/c	1,12,000
		(Balancing figure)	
	2,10,000		2,10,000

Plant and Machinery account

	₹		₹
To Balance b/d	7,00,000	By Depreciation	1,40,000
To Profit and Loss A/c (profit on sale of machine)	21,000	By Cash (sale of machine)	49,000
To Cash (Balancing figure)	4,48,000	By Balance c/d	9,80,000
	11,69,000		11,69,000

Question 8 (RTP May 23)

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

TELEGRAM: CA NOTE HUB

Particulars	Note No.	31st March,2021 (₹)	31st March,2020 (₹)
(I) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share capital	1	5,60,000	3,00,000
(b) Reserve and Surplus	2	35,000	25,000
2. Current Liabilities			
(a) Trade payables		1,50,000	60,000
(b) Short-term provisions		8,000	5,000
(Provision for taxation)			
Total		**7,53,000**	**3,90,000**
(II) Assets			
1. Non-current assets			
(a) Property, Plant and Equipment		3,50,000	1,80,000
2. Current assets			
(a) Inventories		1,20,000	50,000
(b) Trade receivables		1,00,000	25,000
(c) Cash and cash equivalents		1,05,000	90,000
(d) Other current assets		78,000	45,000
Total		**7,53,000**	**3,90,000**

Notes to Accounts

Particulars	31st March,2021 (₹)	31st March,2020 (₹)
1. Share capital		
(a) Equity share capital	4,10,000	2,00,000
(b) Preference share capital	1,50,000	1,00,000
	5,60,000	3,00,000
2. Reserve and surplus		
Surplus in statement of profit and loss at the beginning of the year	25,000	
Add: Profit of the year	20,000	
Less: Dividend	(10,000)	
Surplus in statement of profit and loss at the end of the year	**35,000**	**25,000**

Additional Information:

1. Dividend paid during the year ₹ 10,000
2. Depreciation charges during the year ₹ 40,000;

TELEGRAM: CA NOTE HUB

Solution:

Fox Ltd.

Cash Flow Statement for the year ended 31st March 2021

	₹	₹
Cash flows from operating activities		
Net Profit (35,000 less 25,000)	10,000	
Add: Dividend	10,000	
Provision for tax	8,000	
Net profit before taxation and extraordinary items	28,000	
Adjustments for:		
Depreciation	40,000	
Operating profit before working capital changes		68,000
Increase in trade receivables	(75,000)	
Increase in inventories	(70,000)	
Increase in other current assets	(33,000)	
Increase in trade payables	90,000	(88,000)
Cash used in operating activities		(20,000)
Less: Tax paid*		(5,000)
Net cash used in operating activities	(2,10,000)	(25,000)
Cash flows from investing activities		
Purchase of PPE		
Net cash used in investing activities		(2,10,000)
Cash flows from financing activities		
Issue of equity shares for cash	2,10,000	
Issue of preference shares	50,000	
Dividends paid	(10,000)	
Net cash generated from financing activities		2,50,000
Net increase in cash and cash equivalents		15,000
Cash and cash equivalents at beginning of period		90,000
Cash and cash equivalents at end of period		1,05,000

*Provision for tax of last year considered to be paid in the current year.

Working Note:

	₹
Property, plant and equipment acquisitions	

TELEGRAM: CA NOTE HUB

W.D.V. at 31.3.2021	3,50,000
Add back:	
Depreciation for the year	40,000
	3,90,000
Less: W.D.V. at 31.12.2020	1,80,000
Acquisitions during 2020-2021	2,10,000

Question 9 (Past Exam May '19)

The following information was provided by PQR Ltd. for the year ended 31st March, 2019:

1. Gross Profit Ratio was 25% for the year, which amounts to Rs. 3,75,000.
2. Company sold goods for cash only.
3. Opening inventory was lesser than closing inventory by Rs. 25,000.
4. Wages paid during the year Rs. 5,55,000.
5. Office expenses paid during the year Rs. 35,000.
6. Selling expenses paid during the year Rs. 15,000.
7. Dividend paid during the year Rs. 40,000 (including dividend distribution tax).
8. Bank Loan repaid during the year Rs. 2,05,000 (included interest Rs. 5,000)
9. Trade Payables on 31st March, 2018 were Rs. 50,000 and on 31st March, 2019 were Rs. 35,000.
10. Amount paid to Trade payables during the year Rs.6,10,000
11. Income Tax paid during the year amounts to Rs. 55,000 (Provision for taxation as on 31st March, 2019 Rs. 30,000).
12. Investments of Rs. 8,20,000 sold during the year at a profit of Rs. 20,000.
13. Depreciation on furniture amounts to Rs. 40,000.
14. Depreciation on other tangible assets amounts to Rs. 20,000.
15. Plant and Machinery purchased on 15th November, 2018 for Rs. 3,50,000.
16. On 31st March, 2019 Rs. 2,00,000, 7% Debentures were issued at face value in an exchange for a plant.
17. Cash and Cash equivalents on 31st March, 2018 Rs. 2,25,000.

A. Prepare cash flow statement for the year ended 31st March, 2019, using direct method.

B. Calculate cash flow from operating activities, using indirect method. **(10 Marks)**

Solution:

(i) PQR Ltd. Cash Flow Statement for the year ended 31st March, 2019 (Using direct method)		
Particulars	**₹**	**₹**
Cash flows from Operating Activities		
Cash sales (₹ 3,75,000/25%)		15,00,000

TELEGRAM: CA NOTE HUB

Less: Cash payments for trade payables	(6,10,000)	
Wages Paid	(5,55,000)	
Office and selling expenses ₹ (35,000 + 15,000)	(50,000)	(12,15,000)
Cash generated from operations before taxes		2,85,000
Income tax paid		(55,000)
Net cash generated from operating activities (A)		2,30,000
Cash flows from Investing activities		
Sale of investments ₹ (8,20,000 + 20,000)	8,40,000	
Payments for purchase of Plant & machinery	(3,50,000)	
Net cash used in investing activities (B)		4,90,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,05,000)	
Dividend paid (including dividend distribution tax)	(40,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,75,000
Cash and cash equivalents at beginning of the period		2,25,000
Cash and cash equivalents at end of the period		7,00,000

(ii) 'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year before tax and extraordinary items		2,80,000
Add: Non-Cash and Non-Operating Expenses:		
Depreciation		60,000
Interest Paid		5,000
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Investments		(20,000)
Net Profit after Adjustment for Non-Cash Items		3,25,000
Less: Decrease in trade payables	15,000	
Increase in inventory	25,000	(40,000)
Cash generated from operations before taxes		2,85,000

Working Note:

Calculation of net profit earned during the year

	Rs.	**Rs.**
Gross profit		3,75,000
Less: Office expenses, selling expenses	50,000	

TELEGRAM: CA NOTE HUB

Depreciation	60,000	
Interest paid	5,000	(1,15,000)
		2,60,000
Add: Profit on sale of investments		20,000
Net profit before tax		2,80,000

TELEGRAM: CA NOTE HUB

MCQ

1. Crown Ltd. wants to prepare its cash flow statement. It sold equipment of book value of ₹ 60,000 at a gain of ₹ 8,000. The amount to be reported in its cash flow statement under operating activities is
   a. Nil
   b. ₹ 8,000
   c. ₹ 68,000
   d. ₹ 60,000
2. While preparing cash flows statement, an entity (other than a financial institution) should disclose the dividends received from its investment in shares as
   a. operating cash inflow
   b. investing cash inflow
   c. financing cash inflow
   d. cash & cash equivalent
3. XYZ Co. is a financial enterprise. In its cash flow statement, interest paid and dividends received should be
   a. classified as operating cash flows.
   b. classified as financing cash flows.
   c. Not shown in cash flow statement.
   d. classified as investing cash flows.
4. In the cash flow statement, 'cash and cash equivalents' donot include
   a. Bank balances .
   b. Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value.
   c. Cash balances.
   d. Loan from bank.
5. While preparing a Cash Flow Statement using the Indirect method as required under AS 3, which of the following will not be deducted from/added to the Net Profit to arrive at the "Cash flow from Operating activities"?
   a. Interest income
   b. Gain on sale of a fixed asset.
   c. Depreciation.
   d. Gain on sale of inventory

MCQs

1. (a)
2. (b)
3. (a)
4. (d)
5. (d)

TELEGRAM: CA NOTE HUB

AS 4 – CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

Illustration 1

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 20X1 was detected only in May, 20X1. The accounts of the company were not yet approved by the Board of Directors of the company.

Decide whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1.

Solution

As per AS 4

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

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

Illustration 2 (MTP Nov '21, April '23) (RTP Nov 19)

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company. **(5 Marks)**

Solution

AS 4 (Revised) "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 20X1-20X2.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated.

Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the report of the approving authority for financial year 20X1-X2 to enable users of financial statements to make proper evaluations and decisions.

Illustration 3

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss.

Solution

As per AS 4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial

TELEGRAM: CA NOTE HUB

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

Illustration 4

In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements:

The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.

Solution

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 20X1. The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 100 lakhs in April, 20X1

for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

Illustration 5

A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

Solution

AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above-mentioned definition and requirements given in AS 4 (Revised). In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.

Illustration 6 (MTP March 19, April'19) (RTP Nov 18)

While preparing its final accounts for the year ended 31st March, 20X1 a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February, 20X1 a trade receivable for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 20X1 the trade receivable became a bankrupt. Can the company provide for the full loss arising out of insolvency of the trade receivable in the final accounts for the year ended 31st March, 20X1? **(5 Marks)**

Solution

As per Accounting Standard 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date. So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 20X1. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 20X1, then this would have been treated as non-adjusting event and only disclosure required as per AS 4 (Revised), would have been sufficient.

TELEGRAM: CA NOTE HUB

Illustration 7

Y Ltd. has book debts and has a doubt over recoverability of some of the book debts. The amount that cannot be recovered is not quantifiable. Thus, Y Ltd. is of the opinion that provision for doubtful debts should not be created. Y Ltd. Creates provision for certain other expenses on estimated basis.

Whether contention of Y Ltd. is correct?

Solution

As per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date" if it is likely that a contingency will result in a loss to an entity then it should create provision for that contingency on the estimated basis.

Based on the above, the contention that provision for doubtful debt is not be created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books on the basis of estimation.

Illustration 8

A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

Solution:

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognise the gain of ₹ 20 lakhs in its profit and loss account. The building should be derecognized in the financial statements.

Illustration 9

During the year 20X1-20X2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2.

Solution:

As per AS 4 (Revised), adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP May'20, Mar'22) (RTP May'20, May'22, May'24) (Past Exam May'19 July 21)

The financial statements of Alpha Ltd. for the year 2019-2020 were approved by the Board of Directors on 15th July, 2020. The following information was provided:

(i) A suit against the company's advertisement was filed by a party on 20 th April, 2020 claiming damages of Rs. 25 lakhs.

(ii) The terms and conditions for acquisition of business of another company had been decided by March, 2020. But the financial resources were arranged in April, 2020 and amount invested was Rs. 50 lakhs.

(iii) Theft of cash of Rs. 5 lakhs by the cashier on 31st March, 2020, was detected on 16th July, 2020.

(iv) The company started a negotiation with a party to sell an immovable property for Rs. 40 lakhs in March, 2020. The book value of the property is Rs. 30 lakh on 31st March, 2020. However, the deed was registered on 15th April, 2020.

A major fire had damaged the assets in a factory on 5th April, 2020. However, the assets were fully insured. With reference to AS 4, state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date. **(5 Marks)**

Solution:

(i) Non-adjusting event: Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 20 th April after the balance sheet date. As per AS 4, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. Hence, it will have no effect on financial statement and will be a non-adjusting event.

(ii) Adjusting event: In the given case, terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2020. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2020.

(iii) Non-adjusting event: Only those events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure. In the given case, as the theft of cash was detected on 16th July, 2020 ie after approval of financial statements, no adjustment is required.

(iv) Non-adjusting event: Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. In the given case, sale of immovable property was under proposal stage (negotiations only started) on the balance sheet date, and was not finalized. Therefore, adjustment to assets for sale of immovable property is not necessary in the financial statements for the year ended 31st March, 2020. Disclosure may be given in Report of approving Authority.

(v) Non-adjusting event: Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date.

The condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding fire and loss, being completely insured may be given in the report of approving authority.

Question 2 (MTP Oct '21, Oct '23) (RTP May'22)

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

TELEGRAM: CA NOTE HUB

(i) Tee Ltd. has an inventory of 50 stitching machines costing at Rs. 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of Rs. 4,000 per machine.

(ii) A fire has broken out in the company's go down on 15 April 2020. The company has estimated a loss of Rs. 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of Rs. 7,50,000 which is being carried in the books at Rs. 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of Rs. 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020. You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020. **(5 Marks)**

Solution:

Events occurring after the balance sheet date are those significant events, both favourable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event.

(ii) Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to Rs. 4,000 per machine. Total value of inventory in the books will be 50 machines x Rs. 4,000 = Rs. 2,00,000.

(iii) A fire took place after the balance sheet date i.e. during 2020 -2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

(iv) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognized with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(v) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019 -2020 because the violation of the conditions took place in the financial year 2019 -2020 and the company must be aware of it.

Question 3 (MTP Aug'18, Mar'18) (RTP May'19)

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of Rs. 2 per equity share (on 2 crore fully paid up equity shares of Rs. 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

TELEGRAM: CA NOTE HUB

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements. **(5 Marks)**

Solution:

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time.

Hence such dividends are disclosed in the notes to financial statements. No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of Rs. 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016- 17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

Question 4 (MTP Sep'22)

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2022 (accounts were approved on 25th July, 2022):

1) Negotiations with another company for acquisition of its business was started on 21st January, 2022. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2022.

2) The company made a provision for bad debts @ 4% of its total debtors (as per trend followed from the previous years). In the second week of March 2022, a debtor for ₹ 2,50,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In May, 2022 the debtor became bankrupt.

3) During the year 2021-22, Hari Ltd. was sued by a competitor for ₹ 13 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Hari Ltd. provided for a sum of ₹ 8 lakhs in its financial statements for the year ended 31st March, 2022. On 26th May, 2022, the Court decided in favour of the party alleging infringement of the trademark and ordered Hari Ltd. to pay the aggrieved party a sum of ₹ 12 lakhs.

4) Cashier of Hari Ltd. embezzled cash amounting to ₹ 3,00,000 during March, 2022. However the same comes to the notice of Company management during August, 2022.

5) Cheques dated 31st March, 2022 collected in the month of April, 2022. All cheques are presented to the bank in the month of April, 2022 and are also realized in the same month in the normal course after deposit in the bank **(5 Marks)**

Solution:

I. As per AS 4'Contingencies and Events Occurring After the Balance Sheet Date', disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2022 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

II. As per AS 4, adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date. A debtor for ₹ 2,50,000 suffered heavy loss due to earthquake in the second week of March, 2022 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in May, 2022 (after the balance sheet date) is only an additional information related to the

TELEGRAM: CA NOTE HUB

existing condition on the balance sheet date. Accordingly, full provision for bad debts amounting ₹ 2,50,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2022.

III. As per AS 4, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. In the given case, since Hari Ltd. was sued by a competitor for infringement of a trademark during the year 2021- 22 for which the provision was also made by it, the decision of the Court on 26 th May, 2022, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Hari Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

IV. As the embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" and the same will not be adjusted in the financial statements for the year ended 31st March, 2022. This being an extra-ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2023, in a manner, that its impact on current profit or loss can be perceived.

V. Collection of cheques after balance sheet date is not an adjusting event even if the cheques bear the date of 31st March. Recognition of cheques in hand is therefore not consistent with requirements of AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise and no disclosure of such collections in the Directors' Report is necessary.

Question 5 (RTP Nov 21, Past Exam Nov'22)

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

a) A major property was sold (it was included in the balance sheet at Rs. 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of Rs. 26,50,000.

b) On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company.

c) A claim for damage amounting to Rs. 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020. **(5 Marks)**

Solution:

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

a) The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property Rs. 1,50,000 would be considered.

b) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

TELEGRAM: CA NOTE HUB

c) On the basis of evidence provided, the claim against the company will not succeed. Thus, Rs. 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

Question 6 (RTP May '21)

A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 2019-2020. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements were approved on 31st May, 2020. Shall company account for such tax in the year 2019-2020 or shall it account for in the year 2020-2021?

Solution:

To decide whether, the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date.

Here both the conditions are satisfied. Court order is a conclusive evidence which has been received before approval of the financial statements since the liability is related to earlier year. The event will be considered as an adjusting event and accordingly the amount will be adjusted in accounts of 2019-2020.

Question 7 (RTP Nov'22)

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

Solution:

Accounting Treatment of Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate

Question 8

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.2021):

1. Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
2. On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.
3. One building got damaged due to occurrence of fire on 23.05.221. Loss was estimated to be ₹ 81,00,000.

Solution:

(i) If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statements for financial year ended 31 st March, 2021 and declaration of dividend is non-adjusting event.

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes if such events relate to conditions existing at the balance sheet date. In the given

TELEGRAM: CA NOTE HUB

case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus loss amounting ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

(iii) AS 4 states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ₹ 81 lakhs should be disclosed in the report of the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

Question 9 (Past Exam, Nov 18)

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again. State with reasons, whether the loss due to fire is an adjusting or non- adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4.

Solution:

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner: "Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again.

Therefore, the financial statements have been prepared on liquidation basis."

Question 10 (RTP Sep'24)

For five companies whose financial year ended on 31st March, 2023, the financial statements were approved by their approving authority on 15th June, 2023.

During 2023-2024, the following material events took place:

(a) A Ltd. sold a major property which was included in the balance sheet at ₹ 1,00,000 and for which contracts had been exchanged on 15th March, 2023. The sale was completed on 15th May, 2023 at a price of ₹ 2,50,000.

(b) On 30th April, 2023, a 100% subsidiary of B Ltd. declared a dividend of ₹ 3,00,000 in respect of its own shares for the year ended on 31st March, 2023.

(c) On 31st May, 2023, the mail order activities of C Ltd. (a retail trading group) were shut down with closure costs amounting to ₹ 2.5 million.

TELEGRAM: CA NOTE HUB

(d) On 1st July, 2023 the discovery of sand under D Ltd.'s major civil engineering contract site causes the cost of the contract to increase by 25% for .which there would be no corresponding recovery from the customer.

(e) A fire, on 2nd April, 2023, completely destroyed a manufacturing plant of E Ltd. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.

You are required to state with reasons, how each of the above items numbered (a) to (e) should be dealt with in the financial statement of the various companies for the year ended 31st March, 2023.

Solution:

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(a)	A Ltd.	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended on 31.3.2023 and the profit on sale of property ₹ 1,50,000 would be treated as an extraordinary item.
(b)	B Ltd.	The declaration of dividend on 30th April, 2023 of ₹ 3,00,000 would be treated as a non-adjusting event in the financial statements of 2022-2023. This is because, the dividend has been declared after the balance sheet date and no conditions existed on the balance sheet date for such declaration of dividend. Further as per AS 9, right to receive dividend is established when it is declared and not before that.
(c)	C Ltd.	A closure not anticipated at the year-end would be treated as a non-adjusting event. Memorandum disclosure would be required for closure of mail order activities since non disclosure would affect user's understanding of the financial statements.
(d)	D Ltd.	The event took place after the financial statements were approved by the approving authority and is thus outside the purview of AS 4. However, in view of its significance of the transaction, the directors may consider publishing a separate financial statement/additional statement for the attention of the members in general meeting.
(e)	E Ltd.	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

TELEGRAM: CA NOTE HUB

MCQs

1. Cash amounting to ₹ 4 lakhs, stolen by the cashier in the month of March 20X1, was detected in April, 20X1. The financial statements for the year ended 31st March, 20X1 were approved by the Board of Directors on 15th May, 20X1. As per Accounting Standards, this is _____ for the financial statements year ended on 31st March, 20X1.

(a) An Adjusting event.

(b) Non-adjusting event.

(c) Contingency.

(d) Provision

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

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

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

(c) Those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of directors.

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

3. AS 4 does not apply to

(a) Obligation under retirement benefit plans.

(b) Commitments arising from long term lease contracts.

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

(c) Both (a) & (b).

4. A Ltd. sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. For the financial year ended 31st March, 20X1

(a) The company should record the sale.

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

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

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

Answers/Hints:

MCQ

1. (a) 2. (c) 3. (d) 4. (c)

TELEGRAM: CANOTE HUB

Solved Example

A company follows April-March as its financial year. The company recognizes cheques dated 31st March or before, received from customers after the balance sheet date but before approval of financial statement by debiting Cheques in hand A/c and crediting the Debtors A/c. The Cheques in hand are shown in the balance sheet as an item of cash and cash equivalents. All Cheques in hand are presented to bank in the month of April and are also realised in the same month in the normal course after deposit in the bank.

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on 31st March. Thus the collection of cheques after balance sheet date is not an adjusting event. Recognition of cheques in hand is therefore not consistent with the requirements of AS 4 (Revised). Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise, and so no disclosure of such collections in the Directors' Report is necessary.

It should also be noted that, the Framework for Preparation and Presentation of Financial Statement defines assets as resources controlled by an enterprise as a result of past events from which economic benefits are expected to flow to the enterprise. Since the company acquires custody of the cheques after 31st March, it does not have any control over the cheques on 31st March and hence cheques in hand do not qualify to be recognised as asset on 31st March.

TELEGRAM: CA NOTE HUB

AS 5 NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS & CHANGES IN ACCOUNTING POLICIES

NB Pg. No.

Question 1

From the past 5 financial years, an old outstanding balance of ₹50,000 was still appearing as sundry creditor in the current year balance sheet of People Ltd. The company is certain that this amount is not payable due to one or more reasons.

Therefore, it decided to write off the said amount in its current year's books of accounts and recognize it as income. The company treated the amount of ₹ 50,000 written off as a prior period item and made the adjustments accordingly.

The company is of the view that since sundry balances were recognized in the prior period(s), its related written-off amount should be treated as a prior period item.

Solution :

No, the company is not correct in treating the amount written off as a prior period item. As per AS 5, prior period items are income or expenses which arise in a current year due to errors or omissions in the preparation of the financial statements of one or more prior period(s).

Writing off an old outstanding balance in the current year which is appearing in its books of accounts from the past 5 financial years does not mean that there has been an error or omission in the preparation of financial statements of prior period(s). It is just a practice adopted by the company to write off the old outstanding balances of more than 5 years in its current year books of accounts. Therefore, the amount written off is not treated as a prior period item.

Hence, **adjusting the amount ₹50,000 written off as a prior period item** on the basis that sundry balances were recognized in prior period(s) is not in line with AS 5.

Question 2

NB Pg. No.

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.

Solution :

The final bill having been paid in February, 20X8 **should have been accounted for in the annual accounts** of the company for the year ended 31st March, 20X8. However, **it seems that as a result of error or omission in the preparation of the financial statements of prior period** i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore, it **should be treated as 'Prior period item'** as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5. For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

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NB Pg. No.

Question 3

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

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

Solution :

(i) Although the case under **consideration does not relate to extraordinary item, but the nature and amount** of such item may be **relevant to users** of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which **may require separate disclosure of items of income and expense** in accordance with AS 5 **include the write-down** of inventories to net realisable value as well as the **reversal of such write-downs.**

(ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore **wages payable for the half year** from 1.10.20X2 to 31.3.20X3 **cannot be taken as an error or omission** in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that **additional wages is an expense** arising from the **ordinary activities** of the company. Such an expense **does not qualify as an extraordinary item.** However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that **their disclosure is relevant** to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

NB Pg. No.

Question 4

The company finds that the inventory sheets of 31.3.20X1 did not include two pages containing details of inventory worth ₹ 14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 20X2.

Solution :

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

NB Pg. No.

Question 5 (RTP Nov'21, May'20, Sep'24)

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

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

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

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Solution :

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is **not a change in an accounting policy.**

(ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will **not be treated as a change in an accounting policy.**

Question 6

NB Pg. No.

In the current year, A Ltd. changed the depreciation method from the Straight Line Method (SLM) to Written Down Value (WDV) method. When A Ltd. Recomputed depreciation retrospectively as per the new method, deficiency arose in depreciation in respect of past years. Therefore, it reduced the carrying amount of the asset by the amount of deficiency and such change in carrying amount (deficiency amount) has been debited to the statement of profit and loss as an extraordinary expense.

Whether the change in the carrying amount of assets due to the change in depreciation method should be treated as an extraordinary item?

Solution :

No.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. Has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense. A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

Question 7

NB Pg. No.

A company (Z Ltd.) is engaged in the business of providing consultancy services. A few days back, it received a notice from GST department raising a demand of GST on consultancy services provided by it for Rs. 500,000.

Recently Z Ltd. paid the demand. In the books, the payment is recorded as an extraordinary expenditure.

Whether payment of tax demand raised by the taxation authority can be recognised as an extraordinary item?

Solution :

No, payment of tax cannot be recognised as an extraordinary item.

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

an extraordinary item is income or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

In the given case, providing consultancy service is an ordinary activity of Z Ltd.

Thus, GST paid pursuant to the demand raised by GST department is also a part of an ordinary activity of Z Ltd. Recognising such payments as an **extra-ordinary item is contrary to AS 5.**

Question 8 (MTP April 21) NB Pg. No.

S.T.B. Ltd. makes provision for expenses amounting Rs. 7,00,000 as on March 31, 2020, but the actual expenses during the year ending March 31, 2021 comes to Rs. 9,00,000 against provision made during the last year. State with reasons whether difference of Rs. 2,00,000 is to be treated as prior period item as per AS 5. **(5 Marks)**

Solution :

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of Rs. 2 lakhs, is not a prior period item. Therefore, in the given case **expenses amounting Rs. 2,00,000** (i.e. Rs. 9,00,000 – Rs. 7,00,000) recorded in the current year, **should not be regarded as prior period item.**

Question 9 (MTP March'21, April'22) NB Pg. No.

A company created a provision of Rs. 7,50,000 for staff welfare while preparing the financial statements for the year 2020–21. On 31st March 2021, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to Rs. 10,00,000. The accounts were approved by Board of Directors on 15th April, 2021. You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5? **(4 Marks)**

Solution :

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies ", the change in amount of staff welfare provision amounting Rs. 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020–21. As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates.

However, the **effect of such change in accounting estimate** should be classified using the same classification in the **statement of profit and loss, as was used previously, for the estimate.**

Question 10 (MTP May'20, Oct'22, RTP Nov'20, May'20, May 22, PYQ Nov'22) NB Pg. No.

The Accountant of a company has sought your opinion with relevant reasons, whether the following

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will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019-2020, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2020, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

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

(v) During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories.

(5 Marks)

Solution :

(i) In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019–20, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is **change in estimate and is not change in accounting policy. This change will affect only current year.**

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will **not be treated as change in an accounting policy.**

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is **not a change in accounting policy.**

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is **not a change in accounting policy.**

(v) Change in cost formula used in measurement of cost of inventories is a **change in accounting policy.**

Question 11 (RTP Nov 21)

NB Pg. No.

There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (2020–2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021.

Solution :

Due to major theft of stores in the preceding year (2019–2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the **adjustments relating** to both **opening inventory** of the current year and **profit brought forward** from the previous year should be **separately disclosed** in the statement of **profit and loss** together with their nature and amount in a manner that their impact on the current profit or loss can be perceived.

Alternatively, it may be assumed that in the **preceding year, the value of inventory** of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, **only the disclosure** as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

Question 12 (RTP May 18 & Nov 22) NB Pg. No.

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of Rs.10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at Rs. 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of Rs. 2 lakhs was disclosed as net profit from sale of assets.

You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5.

Solution :

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, **disclosing net profits by setting off fire losses against profit from sale of land is not correct.** The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss .

Question 13 (RTP May'23, PYQ Jan 21) NB Pg. No.

State whether the following items are examples of change in Accounting Policy / Change in Accounting Estimates / Extraordinary items / Prior period items / Ordinary Activity:

(i) Actual bad debts turning out to be more than provisions.

(ii) Change from Cost model to Revaluation model for measurement of carrying amount of PPE.

(iii) Government grant receivable as compensation for expenses incurred in previous accounting period.

(iv) Treating operating lease as finance lease.

(v) Capitalization of borrowing cost on working capital.

(vi) Legislative changes having long term retrospective application.

(vii) Change in the method of depreciation from straight line to WDV.

(viii) Government grant becoming refundable.

(ix) Applying 10% depreciation instead of 15% on furniture.

(x) Change in useful life of PPE. **(5 Marks)**

Solution :

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates

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(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalization of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of PPE	Change in Accounting Estimates

Question 14 (PYQ May 19) NB Pg. No.

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

Solution : **(1 Mark)**

False: The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 15 (PYQ May 18, RTP May 19) NB Pg. No.

PQR Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

(i) Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015–16. In March, 2018, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31 st March, 2018.

(ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017–18.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra ordinary item or prior period it em?

Solution : **(5 Marks)**

(i) As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods.

Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived. In the given instance, it is clearly a case of error/omission in preparation of financial

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statements for the year 2015- 16. Hence, **claim received** in the financial year 2017- 18 is a **prior period item** and should be separately disclosed in the statement of Profit and Loss.

(ii) In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company **revised the estimates** based on the changed circumstances and wants to create 8% provision. As per AS 5, the revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

The effect of **such change should be shown in the profit and loss account** for the year ending 31st March, 2018.

Question 16 (PYQ May'22) NB Pg. No.

TQ Cycles Ltd. is in the manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the Government enhanced the minimum wages payable to workers with retrospective effect from the 1st January,2022. Due to this legislative change, the additional wages for the period from January 2022 to March 2022 amounted to ₹ 30 lakhs. The management asked the Finance manager to charge ₹ 30 lakhs as prior period item while finalizing financial statements for the year 2022–23.

Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra-ordinary item in the Profit and loss account for the financial year 2021–22.

Discuss with reference to applicable Accounting Standards. **(5 Marks)**

Solution :

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances which though related to prior periods, are determined in the current period.

It is given that revision of wages took place in April, 2022 with retrospective effect from 1st January, 2022. Therefore, wages payable for the period from 1 01.2022 to 31.3.2022 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. The full amount of wages payable to workers will be treated as an expense of current year and it will be charged to profit & loss account for the year 2022–23 as normal expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. Therefore, finance manager is incorrect in treating increase as extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Therefore, additional wages liability of ₹ 30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31st March, 2023.

Question 17 (PYQ Nov'23) NB Pg. No.

The accountant of Beryl Limited has asked you to identify the following items as – Change in Accounting Policies / Change in Accounting Estimates / Extraordinary Items / Prior period items / Ordinary Activity:

(i) Non-provision for salary already due in earlier year.

(ii) Attachment of the property of the enterprise.

(iii) Introduction of new pension scheme for employees.

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v) Change in Reserve for obsolete inventory.
v) Settlement of litigation case.
vi) Actual Bad debts exceeds the provision.
vii) Legislative changes having long term retrospective application.
viii) Capitalisation of working capital loan interest.
(ix) Change from Cost Molde to Revaluation Model for measurement of carrying amount of PPE.
(x) Government sanctioned grant in current year for expenses incurred in previous accounting year.

(5 Marks)

Solution :

(i) Prior Period item
(ii) Attachment of property of enterprise is an extraordinary item.
(iii) Introduction of new pension scheme for employes is not a change in accounting policy. It is an ordinary activity.
(iv) Change in provision for obsolete inventory is a change in accounting estimate.
(v) Litigation settlement is an ordinary activity but requires separate disclosure
(vi) Change in estimate
(vii) Ordinary activity requiring separate disclosure
(viii) Error
(ix) Change in Accounting policy.
(x) Ordinary activity requiring separate disclosure or extra ordinary item.

Question 18 (RTP Jan'25) NB Pg. No.

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write it back to the Profit and Loss account as a prior period item.

Is the company's proposed accounting treatment correct? Discuss.

Solution :

The balance amount of **maintenance provision** written back to profit and loss account, no longer required due to crash of the helicopters, is **not a prior period** item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The **balance amount left in the provision created** earlier is not as a result of error in the past. So it will **not be considered as prior period item.** Such write back of provision is not an ordinary feature of the business, it **shall be considered as an extra-ordinary item.**

As per paragraph 8 of AS 5, extraordinary items should be disclosed in the Statement of Profit and Loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the Statement of Profit and Loss in a manner that its impact on current profit or loss can be perceived. Hence, the amount so written-back (if material) should be disclosed as an extraordinary item as per AS 5 rather than as prior period items.

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AS 7 – CONSTRUCTION CONTRACTS

Illustration 1

XYZ construction Ltd, a construction company undertakes the construction of an industrial complex. It has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should XYZ Ltd, treat construction of each unit as a separate construction contract according to AS 7?

Solution

As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

a) separate proposals have been submitted for each asset;

b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

c) the costs and revenues of each asset can be identified.

Therefore, XYZ Ltd. is required to treat construction of each unit as a separate construction contract.

Illustration 2

AB contactors enters into a contract on 1st January 20X1 with XY to construct a 5- storied building. Under the contract, AB is required to complete the construction in 3 years (i.e., by 31st December 20X3). The following information is relevant:

Fixed price (agreed) ₹5 crore

Material cost escalation (to the extent of 20% of increase in material cost)

Labour cost escalation (up to 30% of increase in minimum wages)

In case AB is able to complete the construction in less than 2 years and 10 months, it will be entitled for an additional incentive of ₹50 lakh. However, in case the construction is delayed beyond 3 years and 2 months, XY will charge a penalty of ₹20 lakh. At the start of the contract, AB has a reason to believe that construction will be completed in 2 years and 8 months. Assume that the construction was actually completed in 2 years 9 months.

Labour cost was originally estimated to be ₹1.20 crore (based on initial minimum wages). However, the costs have increased by 25% during the construction period.

Material costs have increased by 40% due to short-supply. The total increase in material cost due to the 40% escalation is ₹80 lakh.

You are required to suggest what should be the contract revenue in above case?

Assume that in year 20X2, XY has requested AB to increase the scope of the contract. An additional floor is required to be constructed and there is an increase in contract fee by ₹1 crore.

AB has incurred a cost of ₹20 lakh for getting the local authority approvals which it will be entitled to claim from XY in addition to the increase in the fixed fee.

Also measure the total contract revenue in this case.

Solution

Total Revenue after considering the escalation costs, claims and incentives:

	₹
Fixed Price:	5.00 crore
Incentive for early completion	0.50 crore
Material costs recovery (to the extent of 20%)	0.40 crore
Labour costs recovery (Actual increase is less than 30%)	0.30 crore

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[1.20 crore x 25%]	
Total Contract Revenue	6.20 crore
Add: Variation to the contract	1.00 crore
Add: Claims recoverable from XY	0.20 crore
Total Contract Revenue	7.40 crore

Illustration 3 (Percentage completion method)

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

Solution

Profit & Loss Account

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

Customer's Account

Year	**₹ 000**	**Year**		**₹ 000**	
20X1-X2	To Contract Price	90	20X1-X2	By Bank	79
				By Balance c/d	11
		90			90
20X2-X3	To Balance b/d	11	20X2-X3		
	To Contract Price	110		By Bank	121
		121			121

AS 7 provides that the percentage completion method should not be applied if the outcome of a construction contract cannot be estimated reliably. In such cases:

a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and contract costs should be recognised as an expense in the period in which they are incurred.

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

Illustration 4

PQ & Associates undertakes a construction contract the details of which are provided below:

Total Contract Value	₹40 lakh
Costs incurred to date	₹3 lakh
Estimated future costs of completion	₹30 lakh

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Work completed 10%

The work has started some time ago and there is an uncertainty with respect to the outcome of the contract due to expected changes in regulations. PQ is certain that it would be able to recover the costs incurred to date.

Solution

In the given case, revenue and costs can only be recognised to the extent of the costs incurred and those which are expected to be recovered. Therefore, the profit & loss statement would appear as under:

Contract Revenue	₹3 lakh
Contract Costs	₹3 lakh
Contract Profit	Nil

When the uncertainties that prevented the outcome of the contract being estimated reliably cease to exist, revenue and expenses associated with the construction contract should be recognised by the percentage completion method.

Illustration 5 (Stage of completion for a loss-making contract)

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data for Year 1.

Information for Year 1	₹ 000
Contract price (Fixed)	600
Cost incurred to date	390
Estimated cost to complete	260

Assume that the contract period is 2 years. The contract is 100% completed by Year 2. Actual costs incurred is the same as total estimated costs to complete (Cost incurred to date plus estimated cost to complete).

Solution

Amount INR ₹ 000

	Year (1)	Total up to Yr2 (2)	Year 2 (2) – (1)
A. Cost incurred to date	(390)	(650)	(260)
B. Estimate of cost to completion	(260)	-	-
C. Estimated total cost	(650)	650	650
D. Degree of completion (A/C)	60%	100%	40%
E. Revenue Recognised			
(60% of 600)	360		
(100% of 600)		600	240
Total foreseeable loss (650 – 600)	50		
Less: Loss for current year (E – A)	(30)		
Expected loss to be recognised immediately	(20)		
Reversal of Loss provision in Year 2			20

Profit & Loss A/c (Year 1)

	₹		₹
To Construction costs	390	By Contract Price	360
To Provision for loss	20	By Net Loss	50
	410		410

TELEGRAM: CANOTE HUB

Profit & Loss A/c (Year 2)

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

Illustration 6 (MTP Nov '21)

A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 20X1.

	(₹ in lakhs)
Total Contract Price	1,000
Work Certified for the cost incurred	500
Work yet not Certified for the cost incurred	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 issued by your institute. **(5 Marks)**

Solution

(a)		**(₹in lakhs)**
	Amount of foreseeable loss:	
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognized as expense	100

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(b)		**(₹in lakhs)**
	Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs	
	Work certified	500
	Work not certified	105
		605

This is 55% (605/1,100 x100) of total costs of construction.

(c) Proportion of total contract value recognized as revenue:

55% of ₹ 1,000 lakhs = ₹ 550 lakhs

(d) Gross Amount due from/to customers profits = (Contract costs + Recognized – Recognized Losses) – (Progress payments received + Progress payments to be received)

= (605 + Nil– 100) – (400 + 140) ₹ in lakhs

= [505 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 are given below:

	₹ in lakhs

TELEGRAM: CA NOTE HUB

Contract revenue	550
Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

Method of revenue recognition (use of percentage completion method)

Method of determining state of completion (based on proportionate cost

Illustration 7 (MTP Sep'22) (RTP Nov'19, Nov'22, May '23, Nov '23) (Past Exam May'19)

On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)? **(5 Marks)**

Solution

	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	(85,00,000)
Total foreseeable loss	12,00,000

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

Contract work in progress = $\frac{₹\ 64,99,000 \times 100}{97,00,000}$ = 67%

Proportion of total contract value recognised as turnover: = 67% of ₹ 85,00,000 = ₹ 56,95,000.

The amount of expected loss will be split as under:

Particulars	Workings	Amount
Expected Loss 97,00,000– 85,00,000	12,00,000	
Contract revenue	67% of 85,00,000	56,95,000
Contract cost	Given	64,99,000
Actual loss	56,95,000– 64,99,000	8,04,000
Amount of provision required [As per Para 35]	12,00,000–8,04,000	3,96,000

Illustration 8

It is argued that profit on construction contracts should not be recognized until the contract is completed. Please explain whether you believe that this suggestion would improve the quality of financial reporting for long-term construction contracts.

Solution:

Usually, construction contracts are long term nature i.e., the contracts are entered in one accounting period, however, the work performed will flow into more than one accounting year. If the profit on construction contracts is not recognised over the construction period, then the costs incurred during the

TELEGRAM: CA NOTE HUB

earlier years of the contract would be recognised without any corresponding revenue. This will result in losses for initial years followed high profits in future years.

The current treatment under AS 7 results in matching of revenue and associated costs as they are recognised during the same period. Also, the current accounting incorporates the prudence concept as any foreseeable losses are accounted for immediately.

Therefore, AS 7 results in a fair representation of the underlying financial substance of the transaction.

Illustration 9

A contractor has entered into a contract with a municipal body for construction of a flyover. As per the contract terms, the contractor will receive an additional ₹ 2 Crore as incentive if the construction of the flyover were to be finished within a period of two years from the start of the contract. The contractor wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Explain whether the contractor's view-point is correct?

Solution:

The contractor's view is not entirely correct in considering the variation as a part of contract revenue. There is an argument that he has been able to complete similar contracts within stipulated time. However, each contract needs to be assessed in isolation with respect to the specific challenges associated with the timing and uncertainty in completion.

Accordingly, the contractor needs to validate the assumptions with respect to the specific contract. Only after that assessment is done, the incentive of ₹ 2 crore may be included within the contract revenue.

Illustration 10 (RTP May'20)

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

(Amount ₹ in lakhs)

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

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

**Excludes ₹ 100 lakhs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

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

Solution:

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in ₹ lakhs)

	Up to the reporting date	Recognized in previous years	Recognized in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			

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Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	Year 2	Year 3
Revenue after considering variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

Illustration 11 (MTP Mar 21, Oct 20, April 22, Oct '23)

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

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

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7. **(5 Marks)**

Solution:

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

Cost of Construction	₹	₹
Material used		71,00,000
Labour Charges paid	36,00,000	
Add: Outstanding on 31.03.20X2	2,00,000	38,00,000
Hire Charges of Plant		10,00,000
Other Contract cost incurred		15,00,000
Cost incurred upto 31.03.20X2		1,34,00,000
Add: Estimated future cost		33,50,000
Total Estimated cost of construction		1,67,50,000
Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
Revenue recognized (80% of 1,50,00,000)		1,20,00,000

TELEGRAM: CA NOTE HUB

Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less: Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
Loss to be provided for		**3,50,000**

Illustration 12

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.

During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs.

Contract costs incurred at the end of each year is:

Year 1: ₹ 52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)

Year 3: ₹ 205 crore.

You are required to calculate:

(a) Stage of completion for each year.

(b) Profit to be recognised for each year.

Solution:

(a) Stage of completion = Costs incurred to date / Total estimated costs

Year 1: 52.52 crore / 202 crore = 26%

Year 2: (154.20 crore – 2.50 crore) / 205 crore = 74%

Year 3: 205 crore / 205 crore = 100%

(b) Profit for the year

	Year 1	**Year 2**	**Year 3**
Contract Revenue (1)	57.20 crore	109.30 crore	58.50 crore
	(220 crore x 26%)	(225 crore x 74% - 57.20 crore)	(225 crore x 100% - 109.30 crore – 57.20 crore)
Contract Cost (2)	52.52 crore	99.18 crore	53.30 crore
	(202 crore x 26%)	(205 crore x 74% - 52.52 crore)	(205 crore x 100% - 99.18 crore – 52.52 crore)
Contract Profit (1) – (2)	4.68 crore	10.12 crore	5.20 crore

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Mar'18, Aug'18, Oct'19)

X Ltd. negotiates with Bharat Petroleum Corporation Ltd (BPCL), for construction of "Franchise Retail Petrol Outlet Stations". Based on proposals submitted to different Zonal offices of BPCL, the final approval for one outlet each in Zone A, Zone B, Zone C, Zone D, is awarded to X Ltd. Agreement (in single document) is entered into with BPCL for Rs. 490 lakhs. The agreement lays down values for each of the four outlets (Rs. 88 + 132 + 160 + 110 lakhs) in addition to individual completion time. You are required to examine and comment whether X Ltd., will treat it as a single contract or four separate contracts. **(5 Marks)**

Solution:

As per AS 7 on 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

a) separate proposals have been submitted for each asset;

b) each asset has been subject to separate negotiation and the contractor and customer have been able toaccept or reject that part of the contract relating to each asset; and

c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Office, which can be separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one document of contract. Therefore, four separate contract accounts have to be recorded and maintained in the books of X Ltd. For each contract, principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS 7.

Question 2 (MTP Oct'18)

M/s Highway Constructions undertook the construction of a highway on 01.04.2016. The contract was to be completed in 2 years. The contract price was estimated at Rs.150 crores. Up to 31.03.2017 the company incurred Rs. 120 crores on the construction. The engineers involved in the project estimated that a further Rs. 45 crores would be incurred for completing the work. What amount should be charged to profit and loss statement for the year 2016 -17 as per the provisions of AS 7? **(5 Marks)**

Solution:

Statement showing amount to be charged to Profit and Loss Statement as per AS 7

	Rs. in crores
Cost of construction incurred upto 31.03.2017 Add:	120
Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165 x 100)	72.73%
Revenue recognized (72.73% of 150)	109 (approx)
Total foreseeable loss (165 – 150)	15
Less: Loss for the current year (120 – 109)	11
Loss to be provided for in the P&L statement	4

Question 3 (MTP Oct '21, April '23) (Past Exam May'18, May '23)

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PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

	(Rs. crore)
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress in pipe line	300

Using the given data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2021.

(ii) Arrive at the contract work in progress as at the end of financial year 2020-21.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end. **(5 Marks)**

Solution:

(i)	Calculation of profit/ loss for the year ended 31st March, 2021	(Rs. in crores)
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	Contract work-in-progress i.e. cost incurred to date	(Rs. in crores)
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250) X 100 = 46.15%

Revenue to be recognized till date = 46.15% of Rs. 2,400 crores = Rs. 1,107.60 crores.

(iv) Amount due from / to customers = Contract costs + Recognized profits – Recognized losses – (Progress payments received + Progress payments to be received)

= Rs. [1,500 + Nil – 850 – (1100 + 300)] crores

= Rs. [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = Rs. 750 crores.

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Question 4 (MTP Oct'22, Past Exam July 21) (RTP May'24)

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price - ₹ 85 lakhs

(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused.at the end of the period.

(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)

(iv) Specific Contract Costs = ₹ 5 Lakhs

(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to Sub-Contractors - ₹ 4 Lakhs

(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7 **(5 Marks)**

Solution:

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

Question 5 (RTP Nov '21)

a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.

b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs. 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to

TELEGRAM: CA NOTE HUB

recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss.

Solution:

a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;

(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

b) According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

Question 6 (RTP May'18, Nov'18, Nov'20)

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2019 and is likely to be completed by the next financial year. The contract is for a fixed price of Rs. 12 crore with an escalation clause. You are given the following information for the year ended 31.03.2019:

Cost incurred upto 31.03.2019	Rs. 4 crore
Further cost estimated to complete the contract	Rs. 6 crore

Escalation in cost was by 5%. Hence, the contract price is also increased by 5%.

You are required to ascertain the stage of completion and compute the amount of revenue and profit to be recognized for the year as per AS 7.

Solution:

	Rs. in crore
Cost of construction of bridge incurred upto 31.3.2019	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= (4/10)X100 = 40%

Revenue and Profit to be recognized for the year ended 31st March, 2019 as per AS 7:

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Proportion of total contract value recognized as revenue

= Contract price x percentage of completion

= Rs. 12.60 crore x 40% = Rs. 5.04 crore Profit for the year ended 31st March, 2019 = Rs. 5.04 crore – Rs. 4 crore = 1.04 crore.

Question 7 (RTP May 22)

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹ 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.

Solution:

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Therefore, the foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

Question 8 (Past Exam Nov 20) (MTP Sep '23)

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed. In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000. In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000. In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed. Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year. **(5 Marks)**

Solution:

(a) Year 1	**₹**
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

% of work completed = $\frac{8,60,000}{18,60,000}$ ×100 = 46.24%(Rounded off)

Revenue to be recognized (cumulative) = 20,00,000 x 76.95% = 15,39,000

Less: revenue recognized in Year 1 = (9,24,800)

Revenue to be recognized in Year 2 ₹ 6,14,200

Year 2

TELEGRAM: CA NOTE HUB

Actual expenditure	4,75,000
Future Expenditure	4,00,000
Expenditure incurred in year 1	8,60,000
	17,35,000
% of work completed $= \frac{4,75,000+8,60,000}{17,35,000}$	= 76.95%(Rounded off)
Revenue to be recognized (cumulative)	= 20,00,000 ×76.95%
	= 15,39,000
Less: revenue recognized in Year 1	= (9,24,800)
Revenue to be recognized in Year 1	= Rs. 6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000. Note: Calendar year has been considered as accounting year.

Question 9 (MTP May'22)

Grace Ltd., a firm of contractors provided the following information in respect of a contract for the year ended on 31st March,2022:

Particulars	**(₹ in '000)**
Fixed Price Contract with an escalation clause Work Certified	35,000
Work not Certified (includes ₹ 26,25,000 for materials issued, out of which material	17,500
lying unused at the end of the period is ₹ 1,40,000)	
Estimated further cost to completion	3,815
Progress Payment Received Payment to be Received	17,325
Escalation in cost is by 8% and accordingly the contract price is increased by 8%	14,000
	4,900

From the above information, you are required to:

I. Compute the contract revenue to be recognized.

II. Calculate Profit /Loss for the year ended 31st March,2022 and additional provision for loss to be made, if any, for the year ended 31st March, 2022. **(5 Marks)**

Solution:

Calculation of total estimated cost of construction

		₹ in thousand
Cost of Contract incurred till date		

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Work certified	17,500	
Work not certified (3,815 thousand – 140 thousand)	3,675	21,175
Add: Estimated future cost		17,325
Total estimated cost of construction		38,500
Contract Price (35,000 thousand x 1.08)		37,800

Stage of completion

Percentage of completion till date to total estimated cost of construction = [Cost of work completed till date / total estimated cost of the contract] x 100

= [₹ 21,175 thousand / ₹ 38,500 thousand] x 100= 55%

Revenue to be recognized for the year ended 31stMarch, 2022

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = ₹ 37,800 thousand x 55% = ₹ 20,790 thousand

Loss to be recognized for the year ended 31st March, 2022

Loss for the year ended 31stMarch, 2022 = Cost incurred till date – Revenue to be recognized for the year ended 31st March, 2022

= ₹ 21,175 thousand – ₹ 20,790 thousand = ₹ 385 thousand

Provision for loss to be made at the end of 31stMarch, 2022

		₹ in thousand
Total estimated loss on the contract		
Total estimated cost of the contract	38,500	
Less: Total revised contract price	(37,800)	700
Less: Loss recognized for the year ended 31st March, 2022		(385)
Provision for loss to be made at the end of 31stMarch, 2022		315

Question 10 (RTP Sep'24)

Mehta ltd. has undertaken bridge construction contract wherein, bridge will be constructed in 3 years. The details of the contracts are as follows:

(i) Initial contract revenue ₹ 900 crore

(ii) Initial contract cost ₹ 800 crore

	Years		
	I	II	III
	₹ in crore	₹ in crore	₹ in crore
Estimated contract cost	805		
Increase in contract revenue	-	20	
Estimated additional increase cost	-	15	

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Contract cost incurred upto	161	584	820

At the end of year II, cost incurred includes ₹ 10 crore, for material stored at the sites to be used in year III to complete the project.

State the amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in these three years.

Solution:

Statement showing analysis of the contract details

(₹ in crore)

	Year I	**Year II**	**Year III**
(a) Initial revenue agreed	900	900	900
(b) Increase in contract revenue	-	20	20
(c) Total Contract Value	900	920	920
(d) Contract cost incurred upto the date of reporting	161	574	820
		(excluding ₹ 10* crore of material stored)	
(e) Estimated cost to complete	644	246	-
(f) Total estimated contract	805	820(805+15)	820
(g) Stage of Completion	20%	70%	100%
[(d/f) x 100)]	(161/805 x 100)	(574/820 x 100)	(820/820 x 100)

* Note: 10 crore, for material stored at the sites to be used in its 1st year. i.e. in IInd year it is already included so it will be deducted in II year only.

Statement showing amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in three years

(₹ in crore)

	Upto reporting date	**Recognised in the prior year**	**Recognized in the current year**
Year I			
Revenue (900 x 20/100)	180	-	180
Expenses	161	-	161
Profit	19	-	19
Year II			
Revenue (920 x 70/100)	644	180	464
Expenses (820 x 70/100)	574	161	413
Profit	70	19	51
Year III			
Revenue	920	644	276
Expenses	820	574	246
Profit	100	70	30

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MCQs

The below information relates to Questions 1- – 3:

XY Ltd. agrees to construct a building on behalf of its client GH Ltd. on 1st April 20X1. The expected completion time is 3 years. XY Ltd. incurred a cost of ₹ 30 lakh up to 31st March 20X2. It is expected that additional costs of ₹ 90 lakh. Total contract value is ₹ 112 lakh. As at 31st March 20X2, XY Ltd. has billed GH Ltd. For ₹ 42 lakh as per the agreement. Assume that the work is completed to the extent of 75% by the end of Year 2.

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

(a) ₹ 28 lakh

(b) ₹ 42 lakh

(c) ₹ 30 lakh

(d) ₹ 32 lakh

2. Total expense to be recognised in Year 1 is

(a) ₹ 30 lakh

(b) ₹ 120 lakh

(c) ₹ 38 lakh

(d) ₹ 36 lakh

3. Revenue to be recognised for year 2 is

(a) ₹ 84 lakh

(b) ₹ 42 lakh

(c) ₹ 56 lakh

(d) ₹ 28 lakh

Below information relates to Questions 4 – 5

M/s AV has presented the information for Contract No. XY123:

Total contract value ₹ 370 lakh

Certified work completed ₹ 320 lakh

Costs incurred to date ₹ 360 lakh

Progress Payments received ₹ 300 lakh

Expected future costs to be incurred ₹ 50 lakh

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

(a) ₹ 320 lakh

(b) ₹ 370 lakh

(c) ₹ 360 lakh

(d) ₹ 400 lakh

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

(a) ₹ 360 lakh

(b) ₹ 400 lakh

(c) ₹ 320 lakh

TELEGRAM: CA NOTE HUB

(d) ₹ 360 lakh

6. LP Contractors undertakes a fixed price contract of ₹ 200 lakh. Transactions related to the contract include:

Material purchased: ₹ 80 lakh

Unused material: ₹ 30 lakh

Labour charges: ₹ 60 lakh

Machine used for 3 years for the contract. Original cost of the machine is ₹ 100 lakh. Expected useful life is 15 years.

Estimated future costs to be incurred to complete the contract: ₹ 80 lakh.

Loss on contract to be recognised is:

(a) ₹ 40 lakh

(b) ₹ 10 lakh

(c) ₹ 90 lakh

(d) ₹ 50 lakh

MCQ

1. (a) 2. (d) 3. (c) 4. (a) 5. (d) 6. (b)

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Solved Example

Example 1

Entity XY contracts with AB to construct 2 residential buildings in the same premises. The construction of both buildings will begin simultaneously. Building material, construction work, and other related activities will go on in parallel to provide cost savings to entity XY. This also helps AB achieve a timely completion of the two buildings and negotiate a consolidated price for the two buildings.

The above example suggests that there is a single contract negotiated to construct two buildings that are closely interrelated and interdependent in terms of their ultimate purpose and use. Therefore, this represents a Construction Contract.

Example 2

H, a sole-proprietor, contracts with M/s DM Construction, to dismantle his office premises and construct it from scratch.

In the given case, the construction contract includes both demolition as well as construction of a new building.

Example 3: Cost-Plus contract

The language can be changed as under (Entire Question):

ABC Constructions has a contract to build an office building.

The terms and conditions are as under:

1. ABC's profit is agreed at:
   - 25% on expected contract's cost; For this purpose, the expected cost cannot exceed ₹ 22 crores.
2. The agreed price will be revised depending upon the actual cost incurred.
   - The cost for fixation will be taken actual cost or ₹ 22 crores whichever is less.

Price fixation based on expected cost:

Assume that the costs expected to be incurred by ABC are ₹16 crore. Thus, ABC can charge a profit of ₹ 4 crores (25% on actual cost).

The contract price will be ₹ 20 crores. (₹16 crores plus ₹ 4 crores)

Price fixation based on actual cost incurred – Scenario 1:

However, if cost incurred by ABC is ₹15 crore, in that case, it would be able to charge a profit of:

= 25% on ₹15 crore = 15 x 25% = ₹ 3.75 crore

Thus, Total Value of the contract will stand revised as follows:

= Actual Costs + Profit (25% of costs) = ₹ 15 crore + ₹ 3.75 crore = ₹ 18.75 crores.

Price fixation based on actual cost incurred – Scenario 2:

For any unavoidable reasons, if total cost incurred by ABC is ₹ 25 crore, it can only charge a profit on the expected costs of ₹22 crore as under:

Thus, Total Value of the contract will stand revised as follows:

= Expected Costs + Profit (20% of costs) = ₹ 22 crore + ₹ 4.40 crore = ₹ 26.40 crores.

Analysis of the above scenario:

Cost actually incurred by ABC = ₹ 25 crores.

Actual profit earned by ABC = Total Value of the contract

– Actual costs incurred

= ₹ 26.40 Crores

– ₹ 25 Crores = ₹ 1.40 Crores.

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Example 4

X Ltd. commenced a construction contract on 01/04/X1. The contract price agreed was reimbursable cost plus 10%. The company incurred ₹1,00,000 in 20X1-X2, of which cost of ₹90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹5,000. The other costs to complete the contract could not be estimated reliably. The Profit & Loss A/c extract of X Ltd. for 20X1-X2 is shown below:

Solution

Profit & Loss Account

	₹ 000		**₹ 000**
To Construction Costs	100	By Contract Price (90+9)	99
To Provision for loss	5	Net loss	6
	105		**105**

TELEGRAM: CA NOTE HUB

AS 9 – REVENUE RECOGNITION

Illustration 1

Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item -	₹ 200 lakhs
Delivery charges -	₹ 60 lakhs
GST -	₹ 40 lakhs
Total -	**₹ 300 lakhs**

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

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

Solution

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

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

The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹ 200 lakhs.

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

Illustration 2

AB sells goods to CD on 1st March 20X1. CD is having significant cash flows issues since last few months. However, it is trying to raise funding through bank loan to be able to run its operations in future. On 5th of May 20X1, CD is able to seek the funding and is expected to be able to pay for the goods in future.

At the time of sale, it is difficult for AB to ascertain whether it will be able to collect the amount from CD due to poor financial conditions.

Explain how the recognition of revenue be done by AB?

Solution

In the above case, AB should not recognise any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognisedby AB on 5th of May 20X1. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Illustration 3

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

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

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

Solution

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In the above case, at the time of sale, it was not unreasonable for AB to expect ultimate collection from CD. Therefore, AB should recognise the revenue of ₹ 2 lakhs on 1st of January 20X1 and recognise a receivable for the same amount.

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

Accounting in the books of AB

1st January 20X1

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

15th March 20X1

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

Illustration 4

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

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

Solution

Dividends from investments in shares are not recognized in the statement of profit and loss until a right to receive payment is established. In the given situation, the dividend is proposed on 10th April, 20X1, while it is declared on 15th June, 20X1. Thus, the right to receive the payment of dividend gets established on 15th June, 20X1.

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

Illustration 5 (MTP Mar'24)

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd. **(4 Marks)**

Solution

As per AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

(i) **Interest**: on a time proportion basis taking into account the amount outstanding and the rate applicable. Therefore X Ltd. should recognize interest revenue of ₹ 10 Lakhs

(ii) **Royalties**: on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.

Illustration 6 (RTP Nov'19)

The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2.

Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 20X1-20X2.Advise.

Solution

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Price revision was effected during the current accounting period 20X1-20X2. As a result, the company stands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, only then additional revenue arising out of the said price revision may be recognized in 20X1-20X2.

If the company is not reasonably certain on ultimate collection ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2, it shall postpone recognition of revenue and disclose it in financial statements for year 20X1-20X2 as per AS 1

Illustration 7

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

Solution

AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is certain to be collected. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,50,000 were collected against a claim of ₹ 2,00,000. So this transaction can not be taken as a Prior Period Item.

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

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

Illustration 8

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

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

When should Entity GH recognize revenue in its books?

Solution:

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

Illustration 9 (RTP May'20, Nov'23, May'24) (MT, Nov'21, Oct'22) (Past Exam May'19, May'23)

The following information of Meghna Ltd. is provided:

(i) Goods of ₹ 60,000 were sold on 20-3-20X2 but at the request of the buyer these were delivered on 10-4-20X2.

(ii) On 15-1-20X2 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-20X2.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-20X1.

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The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X2 and no approval or disapproval received for the remaining goods till 31-3- 20X2.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS 9. **(5 Marks)**

Solution:

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

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 20X2.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the ₹ 90,000 upon receipt of approval on 31-02-20X1 and for the balance ₹ 30,000 on 01-03- 20X1 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue.

Thus, revenue should be ₹ 7,41,000.

Illustration 10

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

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

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

Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine

2 was installed between 2 and 5 April 20X1. Details of costs and sales prices are as follows:

	Machine 1	**Machine 2**
Sale Price	3,20,000	3,00,000
Cost of production	1,60,000	1,50,000
Installation fee	Nil	10,000

How should above transactions be recognized by KY Enterprises for the year ended 31st March 20X1?

Solution:

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

Revenue (Machine 1)	₹ 3,20,000
Cost of Goods Sold	₹ 1,60,000

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Profit during the period	₹ 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 20X1. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to ST.

Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 20X1.

Revenue (Machine 2)	₹ 3,00,000
Cost of Goods Sold	₹ 1,50,000
Profit during the period	₹ 1,50,000

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges ₹10,000 needs to be recognized on 5 April 20X1 once the installation process gets completed.

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MTP / RTP / Past Exam

Question 1 (MTP Oct'18, Apr'19)

Ruby Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to Rs. 5 lakhs. The accountant of Ruby Ltd. booked Rs. 5 lakhs as interest income in the year ended 31st March, 2017. Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition". **(5 Marks)**

Solution:

As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of Rs. 5 lakhs should not be recognized in the books for the year ended 31st March, 2017.

Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 5 lakhs as interest amount.

Question 2 (MTP Oct 20, Oct'21, Mar 22, Apr'23, Oct '23)

Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2023 issue of the magazine was sold in the month of February, 2023. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2023 and ₹ 30,000 was received on 10th April, 2023 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2023. **(5 Marks)**

Solution:

Definition: As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2023, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2023. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2023 and ₹ 2,70,000 will be treated as payment received against the sale.

Question 3 (RTP Nov '21)

a) How will you recognize revenue in the following cases:

   1) Installation Fees;

   2) Advertising and insurance agency commissions;

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3) Subscriptions for publications.

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

Solution:

a) **Installation Fees**: In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Subscription for publications: Revenue received or billed should be deferred and recognized either on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

Question 4 (RTP May'19)

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing Rs. 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of Rs. 30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth Rs. 15,00,000 ready for dispatch. Raj Ltd. accounted Rs. 15,00,000 as sales and transferred the balance to Advance received against Sales account. Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9.

Solution:

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

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

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In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller.

Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognize the entire sale of Rs. 30,00,000 (Rs. 5,00,000 x 6) and no part of the same is to be treated as Advance Received against Sales.

Question 5 (RTP May'18)

A manufacturing company has the following stages of production and sale in manufacturing fine paper rolls:

Date	Activity	Cost to Date(Rs.)	Net Realizable Value(Rs.)
15.1.16	Raw Material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and calculate how much would be net profit for year ending 31.3.16 on this product as per AS 9.

Solution:

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit Rs. 1,50,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2016.

Question 6 (RTP May 22)

An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

Solution:

TELEGRAM: CA NOTE HUB

AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

Question 7 (RTP Nov'22)

When revenue will be recognized in the following situation:

(i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

(ii) Where seller concurrently agrees to repurchase the same goods at a later date.

(iii) Where goods are sold to distributors, dealers or others for resale.

(iv) Commissions on service rendered as agent on insurance business.

Solution:

(i) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

(ii) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

(iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognized if significant risks of ownership have passed. However, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

Question 8 (RTP May '23)

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree?

Solution:

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

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Thus, PQR Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

Question 9 (Past Exam Nov'19) (RTP May'22)

Indicate in each case whether revenue can be recognized and when it will be recognized as per As -9.

1) Trade discount and volume rebates received.
2) Whether goods are sold to distributor or others for resale.
3) Whether seller concurrently agrees to repurchase the same goods at a late date.
4) Insurance agency commission for rendering services.
5) On 11-3-2019 cloths worth Rs. 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019. **(5 Marks)**

Solution:

1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.
2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.
3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.
4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.
5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

Question 10 (RTP Sep'24)

When will the revenue be recognized in the case of inter divisional transfers?

Solution:

The Accounting Standard Board of ICAI has come up with an announcement in the earlier years wherein it clarified that the interdivisional transfers/sales are not revenue as per AS 9 "Revenue Recognition". According to it, in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Therefore, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. Hence, no revenue is recognized in the case of inter-divisional transfers.

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MCQs

1. Which of the conditions mentioned below must be met to recognize revenue from the sale of goods?

(i) the entity selling does not retain any continuing influence or control over the goods;

(ii) when the goods are dispatched to the buyer;

(iii) revenue can be measured reliably;

(iv) the supplier is paid for the goods;

(v) it is reasonably certain that the buyer will pay for the goods;

(vi) the buyer has paid for the goods.

(a) (i), (ii) and (v)

(b) (ii), (iii) and (iv)

(c) (i), (iii) and (v)

(d) (i), (iv) and (v)

2. Consignment inventory is an arrangement whereby inventory is held by one party but owned by another party. Which of the following indicates that the inventory in question is a consignment inventory?

(a) Manufacturer cannot require the dealer to return the inventory

(b) Dealer has the right to return the inventory

(c) Manufacture is responsible for the pricing of goods and any changes in the pricing can only be approved by the manufacturer .

(d) Manufacture is responsible for the holding the goods and any changes in the pricing can only be approved by the dealer

3. Which of the following transactions qualify as revenue for M/s AB Enterprises?

(a) Sales of ₹ 20 lakhs made under consignment sales.

(b) Sale of an old machine amounting ₹ 5 lakhs

(c) Services provided to the customer in the normal course of business. Sales recorded is ₹ 50,000.

(d) Sales of ₹ 25 lakhs made under consignment sales

4. The Accounting Club has 100 members who are required to pay an annual membership fee of ₹ 5,000 each. During the current year, all members have paid the fee. However, 5 members have paid an amount of ₹ 10,000 each. Of these, 3 members paid the current year's fee and also the previous year's dues. Remaining 2 members have paid next years' fee of ₹ 5,000 in advance.

Revenue from membership fee for the current year to be recognised will be:

(a) ₹ 5,25,000

(b) ₹ 5,10,000

(c) ₹ 5,00,000

(d) ₹ 5,15,000

5. FlixNet International offers a subscription fee model to allow the paid subscribers an annual viewing of movies, sports events and other content. It allows users to register for free and have access to limited content for one month without any charges. The customer has a right to cancel the subscription within a month's time but is required to pay for 1 year subscription fee after the free period.

XY has subscribed for free viewing on 1st March 20X1. After 1 month, he has agreed to pay the annual membership and has paid ₹ 1,200 on 31st March 20X1 for the subscription that is valid up to 31st of March 20X2.

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Revenue that can be recognized by FlixNet for the year ended 31st March 20X2 is

(a) ₹ 100

(b) ₹ 1,200

(c) Nil

(d) ₹ 1,100

MCQ

1. (a) 2. (c) 3. (c) 4. (c) 5. (b)

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Solved Example

Example 1

Entity XY sells a machine being used at its factory at a price of ₹ 2 lakh. The carrying value of the machine is ₹ 1.80 lakh. The sale of the machine does not increase the revenue of XY but is an example of a capital receipt since transaction does not take place in the normal course of business. Such gain on sale of ₹ 20,000 (₹ 2 lakhs – ₹ 1.80 lakhs) is recognised as a part of profit & loss statement under Gain/(Loss) on disposal of asset.

Example 2

ST Ltd is a real-estate developer and builder. It is into the business of buying and selling properties. In 20X1, ST Ltd purchased a unit of land for ₹ 150 crore. It sold off that land after few months at a price of ₹ 240 crore.

In the above case, the sale of land is a transaction that happens in the ordinary course of business (as he is a real estate developer and builder – properties will be an item of inventory in the financial statements) for ST Ltd. Hence, it should recognise a revenue of ₹ 240 crore when the land is sold.

Example 3

DL Ltd, a pharma company, has been conducting research on new medicine since last 2 years to increase the immunity levels of the people consuming it without any side effects. During the current year, it decides to sell the outcome of the research undertaken so far to another competitor, GH Ltd for ₹ 50 crore. DL has already incurred ₹ 30 crore on the ongoing research. In the above example, the sale of the research findings does not represent an increase in revenue. This is because DL Ltd's business is not to sell these research findings in the ordinary course of business. The amount of ₹ 50 crore will be a part of Other Income in the profit & loss statement.

Example 4

Trip Deal is a website that allows people to book airlines tickets. As a part of the business, it agrees to buys 100 tickets from an airline on a particular date and resells those tickets to customers. However, Trip Deal bears the loss for any unsold tickets.

In the above example, the risks and rewards relating to tickets are borne by Trip Deal. Hence, sales made for the tickets will be fully recognized as part of its revenue. Any unsold tickets will be charged as loss by the entity.

Example 5

XY Ltd sells goods worth ₹ 50 lakh on 20 February 20X1 to AB Ltd. AB Ltd is facing storage capacity constraints at their warehouse. AB Ltd instructs XY Ltd to hold the goods at XY Ltd's warehouse and arrange for delivery on 15 March 20X1. However, all the risks and rewards associated with the sold goods are deemed transferred to AB Ltd.

In the current scenario, delivery of goods sold is delayed at the request of buyer. XY Ltd can recognize revenue for sale of goods to AB Ltd on 20 February 20X1 provided that the goods sold to AB Ltd are held in XY Ltd's warehouse separately and are not clubbed with other inventory.

Example 6

M/s XY sells goods worth ₹ 5 lakh on 30th of March 20X1 to M/s FT under Sale on approval basis. Under the arrangement, FT can return the goods back to XY within next 3 months. XY cannot reasonably determine whether FT will give the acceptance of goods before the expiry of 3 months.

Under these circumstances, XY cannot recognize revenue until the goods are accepted by FT or on completion of 3 months, whichever is earlier.

Example 7

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On 1st January 20X1, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of₹ 6 Lac.

You are required to do the accounting for above transactions in the books of M/s KJ.

Solution

1st Jan 20X1:

Bank A/c	Dr.	₹5 lakhs	
To Loan from M/s TH A/c			₹5 lakhs
(Being borrowing made under the Sale & Repurchase arrangement)			

31st March 20X1

Interest expense A/c	Dr.	₹1 lakhs	
To Loan from M/s TH A/c			₹1 lakhs
(Being interest cost recognised on the borrowing)			

31st March 20X1:

Loan from M/s TH A/c	Dr.	₹6 lakhs	
To Bank A/c			₹6 lakhs
(Being repayment of loan taken from TH)			

Example 8

In the year 20X1-X2, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹ 10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods.

During the year 20X1-X2, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 20X1-X2.

Solution

As per AS 9, consignment risk and rewards are not transferred to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party. Therefore, XYZ can recognize revenue of ₹ 5,50,000 only.

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AS 10 – PROPERTY, PLANT AND EQUIPMENT

Illustration 1 (MTP Oct'19, Oct 20, Mar 22)

(Capitalising the cost of "Remodelling" a Supermarket)

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalised or not.

Solution

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

Illustration 2 (MTP March 18, Oct '18, May 20, Apr'21, Apr'22, Oct '22)

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. Setup costs of ₹ 5,00,000 to install machinery in the new location.
2. Rent of ₹ 15,00,000
3. Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Can these costs be capitalised into the cost of the new building? **(5 Marks)**

Solution

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

Illustration 3 (RTP Nov 20)

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time.

The cost of the site preparation and laying foundations were ₹ 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized.

Solution

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

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Illustration 4 (MTP March '21, Sep '22, Oct '23) (PYP Nov'18)

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure.

Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its pening and related utilities costs. What will be the treatment of such expenditures? **(5 Marks)**

Solution

Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

Illustration 5 (Operating costs incurred in the start-up period)

An amusement park has a 'soft' opening to the public, to trial run its attractions.

Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later.

Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner.

Accordingly, the net operating costs incurred should be capitalised. Comment.

Solution

The net operating costs should not be capitalised but should be recognised in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

Illustration 6 (Consideration received comprising a combination of non-monetary and monetary assets)

Entity A exchanges land with a book value of ₹ 10,00,000 for cash of ₹ 20,00,000 and plant and machinery valued at ₹ 25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

Solution

In the given case, Plant & Machinery is valued at ₹ 25,00,000, which is assumed to be fair value in absence of information. Further, since fair value of land (asset given up) is not given, the transaction will be recorded at fair value of assets acquired of ₹ 45,00,000 (₹ Cash 20,00,000 + ₹ Plant & Machinery 25,00,000). Since land of book value ₹ 10,00,000 is transferred in exchange of assets worth ₹ 45,00,000, a gain of ₹ 35,00,000 will be recognised in the books of Entity A.

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The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	20,00,000	
Plant & Machinery A/c	Dr.	25,00,000	
To Land			10,00,000

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To Profit on Sale of Land (balancing figure) 35,00,000

Illustration 7 (Exchange of assets that lack commercial substance)

Entity A exchanges car X with a book value of ₹ 13,00,000 and a fair value of ₹ 13,25,000 for cash of ₹ 15,000 and car Y which has a fair value of ₹ 13,10,000.

The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

Solution

Since the transaction lacks commercial substance, the entity recognises the assets received at the book value of car X. Therefore, it recognises cash of ₹ 15,000 and car Y as PPE with a carrying value of ₹ 12,85,000.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c Dr. 15,000

Car Y A/c (balancing figure) Dr. 12,85,000

To Car X A/c 13,00,000

Illustration 8

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

Solution

De-recognition of the carrying amount occurs regardless of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

Illustration 9

What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

Solution

It may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/existing inspection component was when the item was acquired or constructed.

Illustration 10 (Revaluation on a class by class basis)

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management want to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

State whether this is acceptable under AS 10 (Revised) or not with reasons?

Solution

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location.AS 10 (Revised) permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

However, all properties within the class of office buildings must be carried at revalued amount.

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Illustration 11

Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

Solution

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

Illustration 12 (MTP April '19)

Entity A purchased an asset on 1st January 20X1 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 20X5, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

Solution

The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (1,00,000/10 years).

On 1st January 20X5, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹ 60,000.

The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.

Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years).

Note: Depreciation is recognised even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

Illustration 13

Entity B constructs a machine for its own use. Construction is completed on 1st November 20X1 but the company does not begin using the machine until 1st March 20X2. Comment.

Solution

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 20X1. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

Illustration 14 (RTP Nov 21)

A property costing ₹ 10,00,000 is bought in 20X1. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 20X1 prices, is:

Case (a) ₹ 10,00,000

Case (b) ₹ 9,00,000.

Calculate the amount of depreciation.

Solution

Case (a)

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

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

Case (b)

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

Annual depreciation (on a straight-line basis) will be ₹ 5,000 [{10,00,000 – 9,00,000} ÷ 20].

Illustration 15 (Determination of appropriate Depreciation Method)

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.

However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

Solution

The straight-line depreciation method should be adopted, because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

Illustration 16 (**MTP Oct 20, Mar 22)**

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

Solution

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

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

Illustration 17

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

Solution:

As per AS 10, Property, Plant and Equipment, the depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

Accordingly, the change in method of depreciation should be accounting for as a change in accounting estimate, prospectively.

Illustration 18

A company has debited the Building Account with the Cost of the Land on which the building stands and has provided depreciation on such total cost. Comment on the accounting treatment.

Solution:

As per AS 10, Property, Plant and Equipment, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. Further,

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Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets.

In the given case, land should not be depreciated unless it has a limited useful life. Accordingly, it is incorrect to debit the cost of land to the Building Account and provide depreciation on the aggregate cost.

Illustration 19

An entity is setting up a manufacturing plant. Construction of the plant is completed in August and the plant is ready for commercial production in November. However, the entity commences production in March. When should be company start charging depreciation.

Solution:

As per AS 10, Property, Plant and Equipment, depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, since the plant is ready for commercial production in November, depreciation shall commence from November. The date of commencement of commercial production is irrelevant for charging depreciation.

Illustration 20

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

Solution:

All the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Illustration 21

An entity gave the following Note in its Financial Statements:

The company chooses not to charge depreciation on Property, Plant and Equipment on account of:

a. Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery.

b. Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

c. The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

d. At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.'

You are required to state the appropriateness of the above accounting policy in line with the relevant Accounting Standards.

Solution:

Depreciation refers to writing off the value of the asset over its useful life.

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Such write-off is necessitated on account of normal wear-and-tear, usage, or obsolescence. Since items of Property, Plant and Equipment are generally used in generating revenue, the pro-rated write-off in value of such item should be recorded in the books against the income earned by such an asset.

Providing depreciation is mandatory, inspite of the fact that repairs are expensed in the Statement of Profit and Loss, or the value of the Property is appreciating. Depreciation is a systematic allocation of cost of the asset against the income generated from the continued use of the asset. Further, the Companies Act, 2013 mandates depreciation to be charged in order to determine the correct profits. Thus, not charging depreciation would result in non-compliance with the Companies Act provisions as well.

The argument laid down by the company and the reasons for the same being invalid are discussed below.

(a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery:

The fact that the company enters into Annual Maintenance Contracts for timely repairs can be regarded as a running cost. Such expense is incurred in order to ensure that the machine continues to run as intended. Thus, it implies that because the machine is being utilized, it will need regular repairs. In other words, continuous use is resulting in normal wear-and-tear which is the reason why depreciation should be charged by the company. By stating that the company incurs Annual Maintenance Expenses, the company is recording only the 'maintenance expenses', but not the wear-and-tear requiring the maintenance in the first place. Hence, this argument put forth by the company is not valid.

(b) Depreciation being a non-cash expense has no impact on cash flows.

Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

When viewed from the prism of depreciation alone, it appears that the fact that depreciation is a non-cash item is correct. However, it must be noted that at the time of procurement of the asset, the company would have paid cash. Depreciation is after all writing off this amount over the life of the asset. Hence the argument that depreciation is a non-cash item is not valid. Depreciation is writing off the cost of the asset (which was already paid for) over the useful life of the asset, and hence is mandatory.

(c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

Certain assets like immovable property do increase in value with the passage of time. However, such assets are 'used for the purposes of business' and are not 'held for sale' or held as investment property.

Accordingly, since the asset is being used for carrying on business, providing depreciation will give a true and fair view of the results of the company, and hence the argument that the value of the property appreciates is not valid.

If the company wants to show the fair market value of the PPE, then it has the option to apply Revaluation model. However, depreciation is mandatory to be charged in Revaluation model also.

(d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.'

The value of any asset, after usage, will reduce. Accordingly, the argument that the 'exact profit or loss on sale of the asset' will be obtained is incorrect. Due to usage of the asset, the value of the asset would be lower than the cost. Charging depreciation would seek to bring the book value approximating to such reduced value. Thereafter, on sale of the asset, the true profit or loss would be available.

Accordingly, this argument is also invalid.

It may be pertinent to note that Accounting Standard 1, Disclosure of Accounting Policies states that Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts. In other words, the company cannot be absolved of the fact that it has not complied with the relevant accounting standards merely by giving a disclosure of incorrect policies or practices being followed.

Thus, the company's stand of disclosing the incorrect policy as a remedy is not correct. The company is suggested to charge depreciation on a systematic basis over the useful life of the asset thereby complying with the Accounting Standards.

Illustration 22

With reference to AS-10 Revised, classify the items under the following heads:

TELEGRAM: CA NOTE HUB

HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

1. Import duties and non-refundable purchase taxes.
2. Initial delivery and handling costs.
3. Initial operating losses, such as those incurred while demand for the output of an item builds up.
4. Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
5. Trade discounts and rebates.
6. Costs of relocating or reorganizing part or all of the operations of an enterprise.
7. Installation and assembly costs.
8. Administration and other general overhead costs.

Solution:

Heads

(i) Purchase price of PPE

(iii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

Items	**Classified under Head**
1 Import duties and non-refundable purchase taxes	(i)
2 Initial delivery and handling costs	(ii)
3 Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4 Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5 Trade discounts and rebates (deducted for computing purchase price)	(i)
6 Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
7 Installation and assembly costs	(ii)
8 Administration and other general overhead costs	(iii)

Illustration 23 (MTP Aug'18, Nov'21, Mar'23, RTP Nov'18, May'19, Nov'23)

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

1. Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2. Initial delivery and handling costs	₹ 2,00,000
3. Cost of site preparation	₹ 6,00,000
4. Consultants used for advice on the acquisition of the plant	₹ 7,00,000
5. Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6. Present Value of Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7. Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10. **(5 Marks)**

TELEGRAM: CA NOTE HUB

Solution:

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

1. Cost of the plant	₹ 25,00,000
2. Initial delivery and handling costs	₹ 2,00,000
3. Cost of site preparation	₹ 6,00,000
4. Consultants' fees	₹ 7,00,000
5. Present Value of Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
	₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Illustration 24

Arka Ltd. purchased machinery for ₹ 3,000 lakhs. Depreciation was charged at 10% on SLM basis for a useful life of 10 years. At the end of Year 4, the machinery was revalued to ₹ 2,700 lakhs and the same was adopted. What will be the carrying amount of the asset at the end of Year 5 and Year 6? Assume no change in the useful life.

Solution:

Particulars	**₹ in lakhs**
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years (₹ 3,000 lakhs x 10% x 4 years)	(1,200.00)
Book Value at the end of Year 4	1,800.00
Add: Revaluation Surplus (balancing figure)	900.00
Revalued Amount as given (= revised depreciable value)	2,700.00
Less: Depreciation for Year 5 (₹ 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 (₹ 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 6	1,800.00

Illustration 25

Skanda Ltd. acquired a machinery for ₹ 2,50,00,000 five years ago. Depreciation was charged at 10% p.a. on SLM basis, useful life being 10 years. =At the beginning of Year 3, the machinery was revalued to ₹ 3,00,00,000 with the surplus on revaluation being credited to Revaluation Reserve. Depreciation was provided on the revalued amount over the balance useful life of 8 years. The machinery was sold in the current year for ₹ 1,12,50,000. Give the accounting treatment for the above in the Company's accounts. What will be the treatment if the machinery fetched only ₹ 42,50,000 now?

Solution:

Particulars	**₹**
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (₹ 2,50,00,000 x 10% x 2 years)	50,00,000
Book Value at the beginning of Year 3	2,00,00,000
Add: Revaluation Surplus (balancing figure)	1,00,00,000
Revalued Amount as given (= revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3-5 (₹ 3,00,00,000 ÷ 8 yrs x 3 yrs)	1,12,50,000

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Carrying Amount at the end of Year 5	**1,87,50,000**

The treatment of Gain / Loss on Disposal / Revaluation is as below:

Particulars	**Disposal Proceeds = ₹ 1,12,50,000**	**Disposal Proceeds = ₹ 42,50,000**
Book Value Less Disposal Proceeds = Loss recognized in Profit or Loss	₹ 1,87,50,000 – ₹ 1,12,50,000 = ₹ 75,00,000 (Loss)	₹ 1,87,50,000 – ₹ 42,50,000 = ₹ 1,45,00,000 (Loss)
Revaluation Surplus directly transferred to Retained Earnings	₹ 1,00,00,000	₹ 1,00,00,000

Illustration 26

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

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

The company identified motors installed in the Plant as a separate component and a cost of ₹ 5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of ₹ 6,00,000 and estimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is ₹ 25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a whole for ₹ 6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

Solution:

1. Cost at Initial Recognition:

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

* Purchase price of Motors = ₹ 5,00,000 out of ₹ 30,00,000 i.e., 1/6 of value of Plant

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Note: Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of ₹ 40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

2. Recognition of Motors Replacement

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM)	3,75,555
5,63,333 ÷ 6 years x 4 years	
Carrying Amount of Motors at the end of Year 4	**1,87,778**

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

3. Revaluation

Particulars	**₹**
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹ 28,16,667 ÷ 10 years x 4 years	11,26,667
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since the same is treated as a separate component: ₹ 25,00,000 – ₹ 6,00,000)	19,00,000
Therefore, Gain on Revaluation credited to Revaluation Reserve	**2,10,000**
Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years	**3,16,667**

4. Derecognition

Particulars	**Motors**	**Plant (excluding Motors)**
Cost / Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5-8	1,20,000 x 4 = 4,80,000	3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / Derecognition	1,20,000	6,33,332
Less: Disposal Proceeds ₹ 6,00,000 allocated in ratio of carrying amount	95,575	5,04,425
Loss to be written off to P/L	**24,425**	**1,28,907**

Notes:

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

(b) The allocation of disposal proceeds of ₹ 6,00,000 for the plant as whole is apportioned based on carrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on the reasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

Illustration 27

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of ₹ 1,000 lakhs, the breakdown of its components is not provided. The estimated useful life of the machinery is 10 years. At the end of Year 6,

TELEGRAM: CA NOTE HUB

the turbine, which is a major component of the machinery, needed replacement, as further usage and maintenance was uneconomical. The remainder of the machine is in good condition and is expected to last for the remaining 4 years. The cost of the new turbine is ₹ 450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.

Solution:

As per AS 10, Property, Plant and Equipment, the derecognition of the carrying amount of components of an item of Property, Plant and Equipment occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

In the given case, the new turbine will produce economic benefits to Bharat Infrastructure Ltd. and the cost is measurable. Since the recognition criteria is fulfilled, the same should be recognised as a separate item of Property, Plant and Equipment. However, since the initial breakup of the components is not available, the cost of the replacement of ₹ 450 lakhs can be used as an indication based on the guidance given above, discounted at 8% for the 6-year period lapsed.

Thus, estimate of cost 6 years back = ₹ 450 lakhs ÷ 1.086 = ₹ 283.58 lakhs Current carrying amount of turbine (to be de-recognised) = Estimated cost ₹ 283.58 lakhs (–) SLM depreciation at 10% (useful life 10 years) for 6 years ₹ 170.15 lakhs= ₹ 113.43 lakhs.

Hence revised carrying amount of the machinery will be as under:

Particulars	₹ in lakhs
Historical Cost [₹ 1,000 lakhs (–) SLM Depreciation at 10% (10 year life) for 6 years]	400.00
Add: Cost of new turbine	450.00
Less: Derecognition of current carrying amount of old turbine	(113.43)
New Carrying Amount of Machinery	**736.57**

Illustration 28

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factor having an area of 5,000 acres at a cost of ₹ 60,000 per acre. Preet Ltd. has incurred ₹ 1.10 crores on demolishing the old Factory Building thereon. A sum of ₹ 63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. Incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹ 8,00,000 for land acquisition and incurred ₹ 1,25,000 on title guarantee insurance. Compute the value of the land acquired.

Solution:

Particulars	**₹**
Purchase Price: 5,000 acres x ₹ 60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7%	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income)	
[₹ 110 lakhs (–) ₹ 60 lakhs (₹ 63 lakhs x 100/105)]	50.00
Cost of Land	**3,269.25**

TELEGRAM: CANOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Oct'18, Aug 18, Oct'19, Oct'20, Mar 22)

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to Rs. 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'. Show the treatment of machine in the books of ABC Ltd **(5 Marks)**

Solution

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

Question 2 (MTP Oct '19) (RTP May'18)

In the year 2018-19, an entity has acquired a new freehold building with a useful life of 50 years for Rs. 75,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	Rs. 10,00,000
Roof	25	Rs. 15,00,000
Lifts	20	Rs. 7,50,000
Fixtures	10	Rs. 2,50,000
Remainder of building	50	Rs. 40,00,000
		Rs. 75,00,000

Calculate depreciation for the year 2018-19 as per componentization method. Also state the treatment, in case Roof requires replacement at the end of its useful life.

Solution:

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum)
	(Rs.)
Land	Nil
Roof	60,000
Lifts	37,500
Fixtures	25,000
Remainder of Building	80,000

TELEGRAM: CA NOTE HUB

	2,02,500

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

Question 3 (RTP May '21)

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

a) Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this period, including expenditure related to construction and remodeling costs (Rs. 18 lakhs), salaries of staff (Rs. 2 lakhs) who will be preparing the store before its opening and related utilities costs (Rs. 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?

b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)?

Solution:

a) Trozen Ltd. should capitalize the costs of construction and remodeling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended. The supermarket cannot be opened without incurring the remodeling expenditure. Therefore, this construction and remodeling expenditure of Rs. 18 lakhs should be considered as part of the cost of the asset. However, the cost of salaries of the staff Rs. 2 lakh and utilities cost Rs. 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by the management and should be expensed.

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

(i) it is probable that future economic benefits associated with the item will flow to the entity; and

(ii) the cost of the item can be measured reliably.

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

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

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project.

TELEGRAM: CA NOTE HUB

From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

Question 4 (RTP May 20)

The following items are given to you:

ITEMS

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

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

HEADS

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

Solution

1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE";
2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carrying amount of an item of PPE.
3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE
4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.
5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

Question 5 (RTP Nov 19)

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs.1,41,870. These activities were supervised by a technician during the entire period, who is employed

TELEGRAM: CA NOTE HUB

for this purpose of Rs.45,000 per month. The technician's services were given by Department B to Department A, which billed the services at Rs.49,500 per month after adding 10% profit margin.

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

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

Solution

Calculation of Cost of Property Plant & Equipment (i.e. Machinery)

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

Question 6 (RTP Nov'22)

RS Ltd. has acquired a heavy plant at a cost of ₹ 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e., the Boiler has become obsolete (which was acquired at price of ₹ 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000. Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year?

Solution

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

Statement showing cost of new boiler and machine after year 2

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

TELEGRAM: CA NOTE HUB

Question 7 (RTP May 23)

Star Limited purchased machinery for ₹ 6,80,000 (inclusive of GST of ₹ 40,000). Input credit is available for entire amount of GST paid. The company incurred the following other expense for installation.

	₹
Cost of preparation of site for installation	21,200
Total Labour charges	56,000
(200 out of the total of 500 men hours worked, were spent on installation of the machinery)	
Spare parts and tools consumed in installation	5,000
Total salary of supervisor	26,000
(Time spent for installation was 25% of the total time worked) Total technical expense	34,000
(1/10 relates to the plant installation) Test run and experimental production expenses	18,000
Consultancy charges to architect for plant set up	11,000
Depreciation on assets used for installation	12,000

The machine was ready for use on 15.01.2021 but was used from 01.02.2021. Due to this delay further expenses of ₹ 8,900 were incurred. Calculate the value at which the plant should be capitalized in the books of Star Limited.

Solution

Calculation of Cost of Plant

Particulars		₹
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour charges	(56,000×200/500) Given	22,400
Spare parts		5,000
Supervisor's Salary	25% of ₹ 26,000	6,500
Technical costs	1/10 of ₹ 34,000	3,400
Test run and experimental production charges	Given	18,000
Architect Fees for set up	Given	11,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		7,79,500
Less: GST credit receivable		(40,000)
Value to be capitalized		7,39,500

Note: Further Expenses of ₹ 8,900 from 15;1;2021 to 1;2;2021 to be charged to profit and loss A/c as plant was ready for production on 15.1.2021.

Question 8 (Past Exam Nov 20) (MTP Sep '23)

TELEGRAM: CA NOTE HUB

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

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only **(5 Marks)**

Solution

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April,2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (50,000/5 years). On 1st April,2019 the asset's net book value is [50,000 – (10,000 x 2)\ i;e; ₹ 30,000; The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

Question 9 (Past Exam May'22)

XYZ Limited provided you the following information for the year ended 31 st March, 2022.

(i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance in the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000. You are required to calculate the revaluation loss as per AS 10 (Revised) and give its treatment in the books of accounts.

(ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash. You are required to explain how the disposal should be accounted for in the financial statements as per AS 10. **(5 Marks)**

Solution

TELEGRAM: CA NOTE HUB

(i) As per AS 10, a decrease in the carrying amount of an asset arising on revaluation should ben charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Calculation of revaluation loss and its accounting treatment

		₹
Carrying value of the asset as on 31st March, 2022	a	2,16,000
Revalued amount of the asset	b	(1,90,000)
Total revaluation loss on asset	c=a-b	26,000
Adjustment of previous revaluation reserve	d	(20,000)
Net revaluation loss to be charged to the Profit and loss account	e=c-d	6,000

(ii) AS 10 states that the carrying amount of an item of property, plant and equipment is derecognized on disposal of the asset. It further states that the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognized. Gains should also not be classified as revenue.

Calculation of loss on disposal of the asset and its accounting treatment

		₹
Original cost of the asset	a	76,000
Accumulated depreciation till date	b	62,000
Carrying value of the asset as on 31st March, 2022	c=a-b	14,000
Cash received on disposal of the asset	d	4,000
Loss on disposal of asset charged to the Profit and loss account	e=c-d	10,000

Question 10 (Past Exam May '23)

In the books of Top maker Limited, carrying amount of Plant and Machinery as on 1stApril, 2022 is ₹ 56,30,000. On scrutiny, it was found that a purchase of Machinery worth ₹ 21,12,000 was included in the purchase of goods on 1stJune, 2022. On 30thJune, 2022 the company disposed a Machine having book value of ₹ 9,60,000 (as on 1stApril, 2022) for ₹ 8,25,000 in part exchange of a new machine costing ₹ 15,65,000. The company charges depreciation @ 10% p.a. on written down value method on Plant and Machinery.

You are required to compute:

(i) Depreciation to be charged to Profit & Loss Account;

(ii) Book value of Plant & Machinery as on 31stMarch, 2023; and

(iii) Profit/Loss on exchange of Plant & Machinery. **(5 Marks)**

Solution

(i) Depreciation to be charged in the Profit & Loss Account

Particulars	**Amount in ₹**
Depreciation on old Machinery	1,40,750
[10% on ₹ 56,30,000 for 3 months (01.04.2022 to 30.06.2022)] Add: Depreciation on	1,76,000

TELEGRAM: CA NOTE HUB

Machinery acquired on 01.06.2022	
(₹21,12,000 X 10% X10/12) Add: Depreciation on Machinery after adjustment of Exchange [10% of ₹ 56,30,000 – 9,60,000 + 15,65,000) for 9 months]	4,67,625
Total Depreciation to be charged in Profit & Loss A/c	**7,84,375**

(ii) Book value of Plant & Machinery as on 31.3.2023

Particulars		**Amount in ₹**
Balance as per books on 01.04.2022		56,30,000
Add: Included in purchases on 01.06.2022	21,12,000	
Add: Purchases on 30.06.2022	15,65,000	36,77,000 93,07,000
Less: Book value of Machine sold on 30.06.2022		(9,60,000) 83,47,000
Less: Depreciation on Machinery in use ₹ (7,84,375 -24,000)		(7,60,375)
Book Value as on 31.03.2023		75,86,625

Note: The computation of depreciation and book value of Plant & Machinery can be presented in the following alternative manner:

Particulars	**Book Value or Cost or Acquisition**	**Period**	**Depreciation**	**Book Value as on 31.03.2023**
Opening Value	46,70,000 (56,30,000 – 9,60,000)	01.04.2022 to 31.03.2023	4,67,000 (46,70,000 x 10%)	42,03,000
Sold	9,60,000	01.04.2022 to 30.06.2022	24,000 (9,60,000 x 10% x 3/12)	
Purchases	21,12,000	01.06.2022 to 31.03.2023	1,76,000 (21,12,000 x 10% x 10/12)	19,36,000
New Machinery	15,65,000	01.07.2022 to 31.03.2023	1,17,375	14,47,625
			(15,65,000 x 10% x 9/12)	
Total			7,84,375	75,86,625

iii) Profit/Loss on Exchange of Machinery

Particulars	**Amount in**
Balance as per books on 01.04.2022	9,60,000
Less: Depreciation for 3 months (₹ 9,60,000 x 10 /100 x 3 / 12)	(24,000)
W.D.V. as on 30.06.2022	9,36,000
Less: Exchange value	(8,25,000)
Loss on Exchange of Machinery	1,11,000

TELEGRAM: CA NOTE HUB

MCQ

1. As per AS 10 (Revised) 'Property, plant and equipment', which of the following costs is not included in the carrying amount of an item of PPE
    a. Costs of site preparation
    b. Costs of relocating
    c. Installation and assembly costs.
    d. initial delivery and handling costs

2. As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property
    a. as per fair value
    b. under discounted cash flow model.
    c. under cost model
    d. under cash flow model

3. A plot of land with carrying amount of ₹ 1,00,000 was revalued to ₹ 1,50,000 at the end of Year 2. Subsequently, due to drop in market values, the land was determined to have a fair value of ₹ 1,30,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?
    a. Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
    b. Initial upward valuation of ₹ 50,000 credited to P/L. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
    c. Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to Revaluation Reserve.
    d. Initial upward valuation of ₹ 50,000 debited to P/L. Subsequent downward revaluation of ₹ 20,000 credited to P/L.

4. A plot of land with carrying amount of ₹ 1,00,000 was revalued to ₹ 90,000 at the end of Year 2. Subsequently, due to increase in market values, the land was determined to have a fair value of ₹ 1,05,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?
    a. Initial downward valuation of ₹ 10,000 debited to Revaluation Reserve. Subsequent upward revaluation of ₹ 15,000 credited to P/L.
    b. Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 15,000 credited to P/L.
    c. Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 10,000 credited to P/L and ₹ 5,000 credited to Revaluation Reserve.
    d. Initial downward valuation of ₹ 10,000 credited to P/L. Subsequent upward revaluation of ₹ 10,000 debited to P/L and ₹ 5,000 debited to Revaluation Reserve.

5. On sale of an asset which was revalued upwards, what would be the treatment of Revaluation Reserve?
    a. The Revaluation Reserve is credited to P/L since the profit on sale of such asset is now realized.
    b. The Revaluation Reserve is credited to Retained Earnings as a movement in reserves without impacting the P/L.

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

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

6. A machinery was purchased having an invoice price ₹ 1,18,000 (including GST ₹ 18,000) on 1 April 20X1. The GST amount is available as input tax credit.

   The rate of depreciation is 10% on SLM basis. The depreciation for 20X2-X3 would be

   a. ₹ 10,000.

   b. ₹ 11,800.

   c. ₹ 9,000.

   d. ₹ 10,500.

MCQs

1. (b) 2. (c) 3. (c) 4. (c) 5. (b) 6. (a)

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AS 18 – RELATED PARTY DISCLOSURES

Illustration 1

Identify the related parties in the following case as per AS 18:

A Ltd. holds 51% of B Ltd.

B Ltd holds 51% of O Ltd.

Z Ltd holds 49% of O Ltd.

Solution

In relation to Reporting enterprise - A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related party

In relation to Reporting enterprise - B Ltd.

- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party

In relation to Reporting enterprise - O Ltd.

- A Ltd. (ultimate holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party (O Ltd being Associate of Z Ltd)

Reporting enterprise - Z Ltd.

- Ltd. (Associate) is a related party

Illustration 2

Consider a scenario wherein:

- A Ltd. has 60% voting right in B Ltd.
- A Ltd. also has 22% voting right in C Ltd.; and
- B Ltd. has 30% voting right in C Ltd.

Whether C Ltd. is to be treated under AS-18 as a party related to A Ltd.?

Solution

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

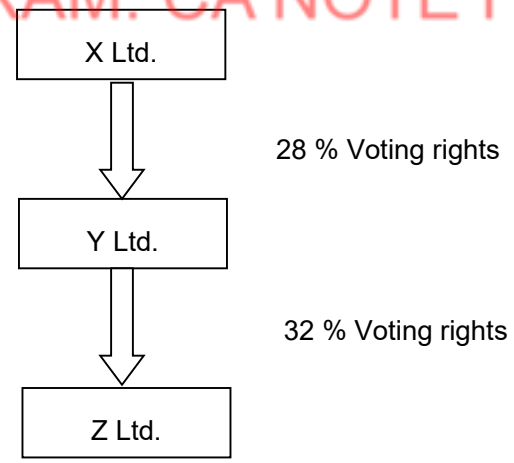
In this case, A Ltd. (together with its subsidiary B Ltd.) controls more than one half of the voting rights of C Ltd.

Illustration 3

Consider a scenario wherein:

- X Ltd. holds 28% voting right in Y Ltd. (and hence Y Ltd. is an associate of X Ltd.)
- Y Ltd. holds 32% voting right in Z Ltd. (and hence Z Ltd. is an associate of Y Ltd.)

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In the above case, since Y Ltd. is an associate of X Ltd. – Y Ltd. is a related party to X Ltd.

Likewise, since Z Ltd. is an associate of Y Ltd. - Z Ltd. is a related party to Y Ltd.

The question is: Whether Z Ltd. is to be treated under AS-18 as a party related to X Ltd.?

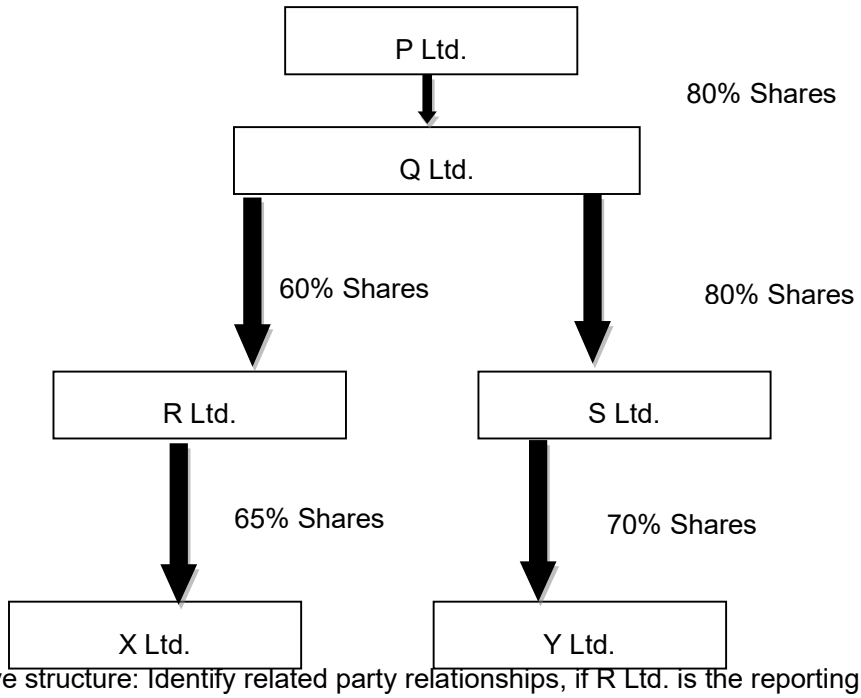
Solution

No – in relation to X Ltd. (the reporting enterprise), Z Ltd. is a not a related party.

This is because as per the requirements of AS-18, 'associate of an associate' is not a related party.

Illustration 4

Consider the following organization structure related to P Ltd.



Given the above structure: Identify related party relationships, if R Ltd. is the reporting enterprise

Solution

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

Party Name	Relationship under AS-18
P Ltd.	• P Ltd. has indirect control on R Ltd. (through Q Ltd.) • Hence R Ltd. is related to P Ltd.
Q Ltd.	• Q Ltd. has direct control of R Ltd. • Hence R Ltd. is related to Q Ltd.

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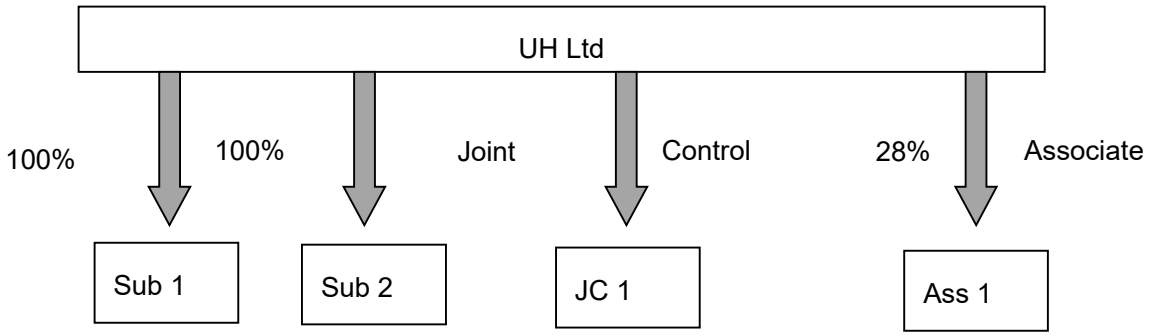
S Ltd.	• R Ltd. and S Ltd. are under common control of Q Ltd. • Hence R Ltd. is related to S Ltd.
X Ltd.	• X Ltd. is controlled by R Ltd. • Hence R Ltd. is related to X Ltd.
Y Ltd.	• Y Ltd. is the sub-subsidiary of Q Ltd. • Both R Ltd. and Y Ltd. are under common control of Q Ltd. • Hence R Ltd. is related to Y Ltd.

Illustration 5

Consider the following organization structure related to UH Ltd. (the ultimate parent company of a Group), wherein UH Ltd. has made the following investments:

- Investment in two of the wholly owned subsidiaries, viz. Sub 1 and Sub 2
- Investment in JC 1, in which UH Ltd. has a joint control
- 20% investment in Ass 1 (and hence, Ass 1 is an associate of UH Ltd.)

Given the above structure: Identify related party relationships for each of the above entities under AS-18



Solution

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

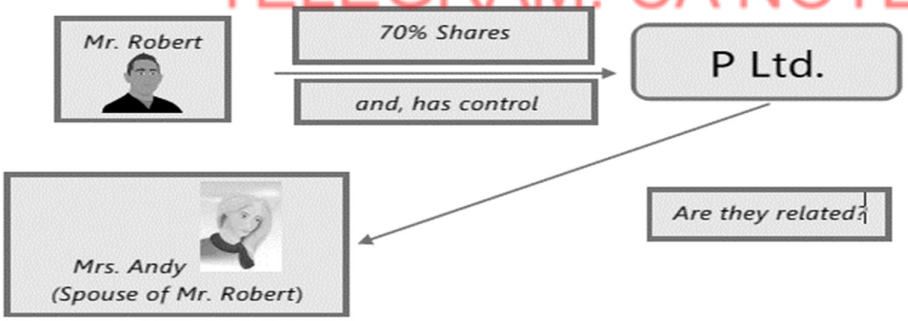
Reporting enterprise	**Related Party as per AS-18**
UH Ltd.	All the four entities (viz. Sub 1, Sub 2, JC 1 and Ass 1)
Sub 1	Only two of the entities in the Group (viz. UH Ltd. and Sub 2)
Sub 2	Only two of the entities in the Group (viz. UH Ltd. and Sub 1)
JC 1	Only UH Ltd.
Ass 1	Only UH Ltd.

Illustration 6

Consider a scenario wherein:

- Mr. Robert holds 70% shares and voting rights in P Ltd

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Determine: Whether Andy (spouse of Mr. Robert) is a related party to P Ltd. Under AS-18?

Solution

Yes

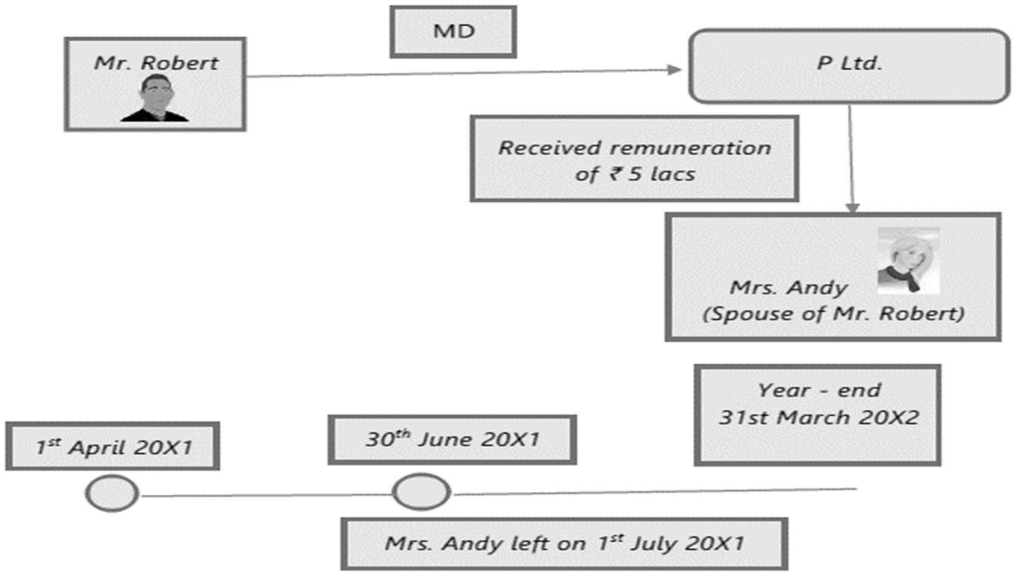
– Andy is a related party to P Ltd., in view of the requirements of AS-18.

It may be recalled that under AS-18 'relatives of individuals owning an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise' are considered as related parties.

Illustration 7

Consider a scenario wherein:

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



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

Solution

Yes

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

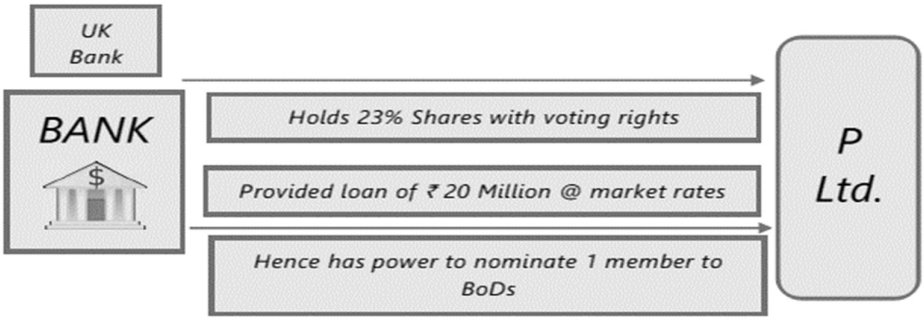
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Hence Andy (being the spouse and relative of the KMP of P Ltd.) needs to be reported as related party at the year-end date (i.e. 31st March 20X2). This is because the remuneration Andy received from P Ltd. (for the period April 20X1 to 30 June 20X1) falls within the reporting year April 20X1 to March 20X2.

Illustration 8

Consider a scenario wherein:

- UK Bank holds 23% equity shares with voting rights in P Ltd.
- The bank has provided a loan of Rs. 20 million to P Ltd. at market interest rate
- As per the terms and conditions of the loan agreement, the bank has appointed one person as its nominee to the board of directors of P Ltd. and any major transaction to be entered into by P Ltd. will require the consent of the Bank Determine: Whether under AS-18 - UK Bank is a related party to P Ltd. (the reporting enterprise)?



Solution

In the instant case, the UK Bank holds 23% shares with voting rights in P Ltd. And hence is deemed to exercise significant influence over P Ltd.

The bank is also a provider of finance to P Ltd. (the reporting enterprise) and as per AS-18, parties like providers of finance are deemed not to be considered as a related party in the course of normal dealings with an enterprise by virtue only of those dealings. However, this exemption will not be available to UK Bank in this case – since it exercises significant influence over P Ltd. (by virtue of holding 23% shares with voting rights in P Ltd.)

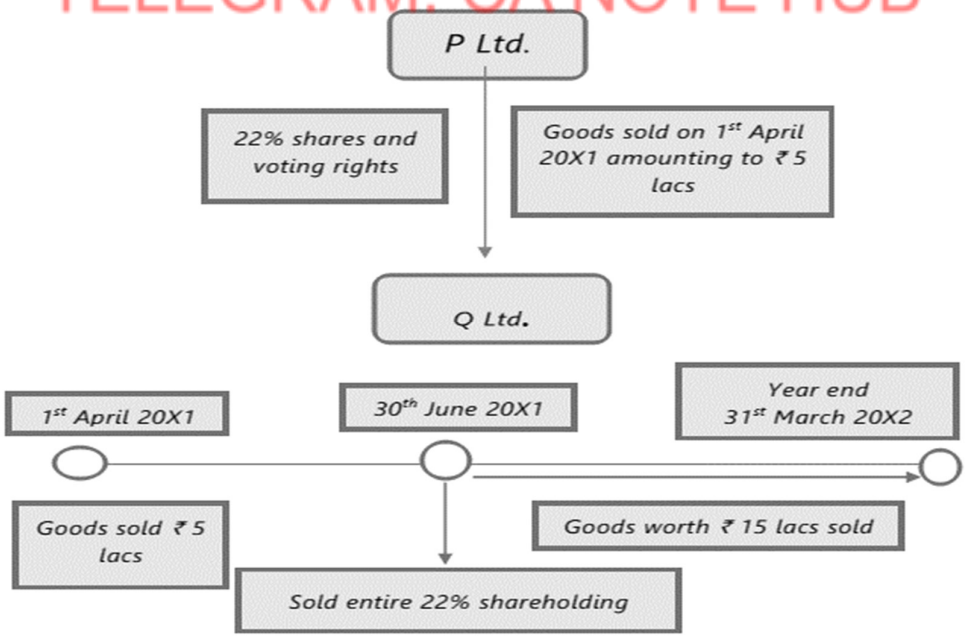
Accordingly, for P Ltd. (the reporting enterprise), the UK Bank is a related party and it will be required to disclose the transactions with UK Bank in its financial statements.

Illustration 9

Consider a scenario wherein:

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

TELEGRAM: CA NOTE HUB



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

Solution

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

Accordingly, only transactions between P Ltd and Q Ltd till 30th June 20X1 (being sale of goods worth Rs. 5 lacs) are required to be reported / disclosed under AS18.

Transactions entered into after 30th June 20X1 are NOT required to be disclosed under AS-18.

Illustration 10 (MTP Mar'23) (RTP Nov'18, May'20, Nov'20)

Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd. during financial year ended 31-3-20X1. The Managing Director of Narmada Ltd. owns 100% shares of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct? **(5 Marks)**

Solution

As per AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Narmada Ltd is wrong.

Illustration 11

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

Solution:

Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

i. The name of the transacting related party;

TELEGRAM: CA NOTE HUB

ii. A description of the relationship between the parties;

iii. A description of the nature of transactions;

iv. Volume of the transactions either as an amount or as an appropriate proportion;

v. Any other elements of the related party transactions necessary for an understanding of the financial statements;

vi. The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;

vii. Amounts written off or written back in the period in respect of debts due from or to related parties.

Illustration 12

ABC Limited is in the business of manufacturing textiles. It has certain commercial contracts with its customers and those customer contracts carry various clauses, imposing restriction on ABC Limited for disclosure of certain information. Accordingly, the company doesn't intend to provide related party disclosure under AS-18 in its ensuing financial statements. Is this correct?

Solution:

As per AS-18 stipulate that related party disclosure requirements under AS18 do not apply in circumstances, where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality, as specifically required in terms of a statute or by any regulator or similar competent authority.

In case, where (1) a statute or (2) a regulator or (3) a similar competent authority governing an enterprise prohibit the enterprise to disclose certain information, which is required to be disclosed as per AS 18, disclosure of such information is not warranted. For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and AS-18 would not override the obligation to preserve the confidentiality of customers' dealings.

However, this exemption is not available in respect of confidentiality provisions in a commercial contract between two enterprises – where confidentiality is not specifically required in terms of (1) a statute or (2) by any regulator or (3) similar competent authority.

Therefore, in the given case AS-18 related party disclosures would have to be made by ABC Limited in its ensuing financial statements.

Illustration 13

Should the related parties be identified as at the reporting date (i.e. balance sheet date) for the purposes of AS-18? In disclosing transactions with related parties, are the transactions of the entire reporting period to be disclosed or only those for the period during which related party relationship exists?

Solution:

As per the definition of related parties in AS-18, the existence of a related party relationship should be identified at all points during the year (and not only at the close of the financial year). However, AS 18 requires disclosure of transactions with these parties only during the existence of the related party relationship.

Illustration 14 (MTP Mar'21, Mar'22) (Past Exam Nov'18, July'21) (RTP May'24)

Mr. Raj, a relative of key management personnel, received remuneration of ₹ 2,50,000 for his services in the company for the period from 1.4.20X1 to 30.6.20X1. On 1.7.20X1, he left the service of the company.

Should the relative be identified as at the closing date i.e. on 31.3.20X2 for the purposes of AS 18?

Solution: **(2.5 Marks)**

According to AS 18 on 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence Mr. Raj, a relative of key

TELEGRAM: CA NOTE HUB

management personnel, should be identified as related party for disclosure in the financial statements for the year ended 31.3.20X2.

Illustration 15 (MTP Mar'21, Mar'22, Oct '23)

X Ltd. sold goods to its associate company during the 1st quarter ended 30.6.20X1. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

Solution:

As per AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.20X1 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist would not be reported.

Illustration 16 (MTP May 20, Sep '22) (Past Exam May 18)

You are required to identify the related parties in the following cases as per AS 18:

M Ltd. holds 61 % shares of S Ltd.

S Ltd. holds 51 % shares of F Ltd.

C Ltd. holds 49% shares of F Ltd.

(Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.) **(2.5 Marks)**

Solution:

Reporting Entity	**Related Party**
M Ltd.	S Ltd. (subsidiary) F Ltd.(subsidiary)
S Ltd.	M Ltd. (holding company) F Ltd. (subsidiary)
F Ltd.	M Ltd. (ultimate holding company) S Ltd. (holding company) C Ltd. (investor/ investing party)
C Ltd.	F Ltd. (associate)

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP April'21, Sep'23) (RTP Nov'22, May'24) Past Exam July'21)

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited? Also explain the required related party disclosure requirements under AS 18? **(5 Marks)**

Solution:

Mr. A will not be considered as a related party of SP Hotels Limited in view of AS 18 which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual". In the given case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

Related Party Disclosures: Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) The name of the transacting related party;

(ii) A description of the relationship between the parties;

(iii) A description of the nature of transactions;

(iv) Volume of the transactions either as an amount or as an appropriate proportion;

a) Any other elements of the related party transactions necessary for an

b) understanding of the financial statements;

c) The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;

d) Amounts written off or written back in the period in respect of debts due from or to related parties.

Question 2

On the basis of provisions of AS 18 'Related Party Disclosures': Identify the related parties in the following cases:

X Limited holds 60% shares of Y Limited Y Limited holds 55% shares of W Limited Z Limited holds 35% shares of W Limited

Solution:

X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor significant influence exists between them.

Question 3 (RTP Nov'21)

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a) Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (reporting enterprise)?

b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would Be Limited be considered a related party for the purpose of financial statements of C Limited?

Solution:

a) Omega Bank Limited would be a related party of B Limited. As per AS 18 "associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venture" are related party relationship. Further, an associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies". Further, it is given in the standard that 1significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power. Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

b) Both B Limited and C Limited are 'associates' of A Limited. Follow-associates cannot be regarded as a related parties only by virtue of the relationship. AS 18 states that "enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are related parties. Further, it is given that "associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture" are also related parties. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.

Question 4 (RTP May 21)

R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 10% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd. You are required to assess the situation from the view point of AS 18 on Related Party Disclosures.

Solution:

AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Definition for Control

Here, control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and Significant Influence is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

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Nature of Relationship

R Ltd. has direct economic interest in T Ltd. to the extent of 10%, and through S Ltd. in which it is the majority shareholders, it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%). These two taken together (10% + 9%) make the total control of 19%.

Conclusion

In the present case, control of R Ltd. in T Ltd. directly and through S Ltd., is only 19%. Significant influence may also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries only 19% of the voting power of the T Ltd. Accordingly, R Ltd. and T Ltd. are not related parties. Hence related party disclosure, as per AS 18, is not required.

Question 5 (RTP May 22)

a) In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier and the company be considered as related parties?

b) Define "Key management personnel" in the context of AS 18.

Solution:

a) The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties. Paragraph 3 of AS 18 states that "enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are considered to be related party relationships. However, the conditions which define the existence of control, as follows, are not satisfied in the given example.

- 'ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise". Paragraph 10 of the standard defines significant influence as "participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies". In the given example, although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions. Therefore, as the conditions specified by the Standard for being classified as a related party are not satisfied in the given example, the company cannot be said to be related to the supplier. This view is supported by paragraph 4 (b) of the Standard which states that "a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence" would not be deemed to be related parties.

b) In context of AS 18, "Key management personnel" are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

Question 6 (Past Exam May'19)

Mr. Subhash Kumar is Managing Director of a Ltd. and also holds 72% capital of B Ltd. Identify the related parties in the following cases as per AS-18

Solution:

TELEGRAM: CA NOTE HUB

Mr. Subhash Kumar is Key management personnel as he has the authority for planning, directing and controlling the activities of A Ltd. He also holds substantial interest in B Ltd. as he holds 72% capital of B Ltd. Thus, Mr. Subhash is related party for both A Ltd. and B Ltd. Moreover, as per the definition of related party relationship described in para 3 of AS 18, enterprises over which Subhash is able to exercise significant influence are also related parties. Thus, a Ltd. and B Ltd. will also be construed as related to each other.

Question 7 (Past Exam May'23)

Answer the following with respect to AS-18:

(i) If the majority of directors of Arjun Ltd. constitute the majority of the Board of another Company Bheem Ltd. in their individual capacity as professionals (and not by virtue of their being Directors in Arjun Ltd.). Are both the companies related?

(ii) Asha Ltd. sells all the manufactured furniture of ₹ 1,00,00,000 to Sasha Ltd, as per agreement. Sasha Ltd. is the only customer to Asha Ltd. In the financial statements, Asha Ltd. wants to present Sasha company as a related party. Comment on the disclosure requirement.

Solution:

(i) In the given case, Arjun Ltd. cannot be said to control the composition of board of directors of Bheem Ltd. as the directors have been appointed in their individual capacity as professionals and not by virtue of their being directors in Arjun Ltd.

Hence, it cannot be concluded that the companies are related merely because the majority of the directors of one company became the majority of the directors of the second in their individual capacity as professionals.

(ii) In the context of AS 18, a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business cannot be construed as Related Party Relationship merely by virtue of the resulting economic dependence. There is an economic dependence between the companies but no one controls or exercise significant influence on the other.

In the given case, Asha Ltd. need not report Sasha Company as its related party in its financial statements.

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MCQs

1. According to AS-18 Related Party Disclosures, which ONE of the following isnot a related party of Skyline Limited?
   a. A shareholder of Skyline Limited owning 30% of the ordinary share capital
   b. An entity providing banking facilities to Skyline Limited in the normal course of business
   c. An associate of Skyline Limited
   d. Key management personnel of Skyline Limited

2. Are the following statements in relation to related parties true or false, according to AS-18 Related Party Disclosures?
   A. A party is related to another entity that it is jointly controlled by.
   B. A party is related to another entity that it controls.

	Statement (A)	Statement (B)
a.	False	False
b.	False	True
c.	True	False
d.	True	True

3. Which of the following is not a related party as envisaged by AS-18 Related Party Disclosures?
   a. A director of the entity
   b. The parent company of the entity
   c. A shareholder of the entity that holds 1% stake in the entity
   d. The spouse of the managing director of the entity

4. According to AS-18 Related Party Disclosures, related party transaction is a transfer of resources or obligations between related parties – provided a price is charged for such transfer.
   a. True
   b. False

5. According to AS-18 Related Party Disclosures, parties are considered to be related, if and only if at the end of the reporting period - one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.
   a. True
   b. False

c. ANSWERS/HINTS

MCQs

1. (b) 2. (d) 3. (c) 4. (b) 5. (b)

TELEGRAM: CA NOTE HUB

AS 11 – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Illustration 1

Classify the following items as monetary or non-monetary item:

Inventories

Trade Receivables

Investment in Equity Shares

Property, Plant and Equipment.

Solution:

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

Illustration 2 (RTP Nov 18, Nov 20)

	Exchange Rate per $
Goods purchased on 1.1.20X1 for US $ 15,000	₹ 75
Exchange rate on 31.3.20X1	₹ 74
Date of actual payment 7.7.20X1	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 20X1 and 31st March, 20X2 as per AS 11.

Solution

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.20X1 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.20X1 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year ended 31st March, 20X1.

On 7.7.20X1, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year ended 31st March, 20X2.

Illustration 3 (MTP Sep '22, Past Exam May '18)

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. prepares financial statement ending on 31/03/20X1. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/20X1 1 US$ = ₹ 48.00

31/03/20X1 1 US$ = ₹ 49.00

31/07/20X1 1 US$ = ₹ 49.50 **(5 Marks)**

Solution

Journal Entries in the Books of Kalim Ltd.

TELEGRAM: CA NOTE HUB

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

Illustration 4 (MTP May'20) (RTP May'18, Nov'19, Nov'21, May'19, May 20) (Past Exam Nov.'18)

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

Solution

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount US$	1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised (30,000/3) x 2 = ₹ 20,000 in the year ended 31st March, 20X1. Rest ₹ 10,000 will be recognised in the following year.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Illustration 5

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.

Solution:

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	₹ 47.18
Less: Contract Rate	(₹ 47.10)
Premium on Contract	₹ 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	₹ 8,000

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Illustration 6 (MTP Oct '22)(RTP May 20)

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to the statement of profit and loss. Comment.

Solution

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

Illustration 7 (Past Exam Nov'19)

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.20X4:

Account Name	**Amount in £**	
	Dr.	**Cr.**
Machinery (purchased on 01.04.20X1)	5,000	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account	6,100	
(Recorded in HO books as ₹ 4,02,000)		
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	2,900	
Head Office Account (Recorded in HO books as ₹ 4,90,000)		7,400
Creditors		4,000

TELEGRAM: CA NOTE HUB

- Closing stock at branch is £ 700 on 31.03.20X4.
- Depreciation @ 10% p.a. is to be charged on Machinery.
- Prepare the trial balance after been converted in Indian Rupees.
- Exchange rates of Pounds on different dates are as follows:

  01.04.20X1– ₹ 61; 01.04.20X3– ₹ 63 & 31.03.20X4 – ₹ 67 **(5 Marks)**

Solution

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

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	₹ (Dr.)	₹ (Cr.)
Machinery	5,000		Transaction date rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	
Wages 1,000 Average Rate	65,000				
Salaries	1,200		Average Rate 78,000		
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

Illustration 8

A Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

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

Solution

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{3{,}000 \text{ lakhs}}{40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars x (42.50 – 40.00) = ₹187.50 lakhs

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(including exchange loss on payment of first instalment)

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

Note: The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has done the correct treatment.

Illustration 9

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 20X1 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/20X1 1 US$ = ₹ 48.00

31/03/20X2 1 US$ = ₹ 51.00

You are required to pass the journal entries in the following cases:

(i) Option under Para 46A is not availed.

(ii) Option under Para 46A is availed.

(iii) The loan was taken to finance the operations of the entity (and not to procure a depreciable asset).

In all cases, assume interest accrued on 31 March 20X2 is paid on the same date.

Solution

Journal Entries in the Books of A Ltd.

(i) Option under Para 46A is not availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1 Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account (P/L)	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000

In this case, since the option under Para 46A is NOT availed, the Exchange Loss of ₹ 30,000 is recognised as an expense in the Statement of Profit and Loss for the year ending 31 March 20X2.

(ii) Option under Para 46A is availed

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1 Apr. 01	Bank Account (10,000 x 48) Dr.	4,80,000	
	To Foreign Loan Account		4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)	25,500	
	To Bank Account		25,500
Mar 31	Foreign Exchange Difference Account Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]		30,000
Mar 31	Property, Plant and Equipment Dr.	30,000	
	To Foreign Exchange Difference Account		30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is capitalized in the cost of Property, Plant and Equipment, which will indirectly get recognized in the Profit & Loss A/c by way of increased depreciation over the remaining useful life of the asset.

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(iii) Option under Para 46A is availed

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1 Apr. 01	Bank Account (10,000 x 48) Dr.	4,80,000	
	To Foreign Loan Account		4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)	25,500	
	To Bank Account		25,500
Mar 31	Foreign Exchange Difference Account Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]		30,000
Mar 31	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA) Dr.	30,000	
	To Foreign Exchange Difference Account		30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is accumulated in the FCMITD A/c, which will be subsequently spread over and debited to P&L A/c over the tenure of the loan.

Illustration 10

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

Solution:

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Illustration 11

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

Solution:

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation.

Illustration 12 (RTP Nov 19) (Past Exam Nov'18, Jan'21) (PYP Nov'18) (MTP Apr'23)

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction.

US $ 1 = ₹61.20 was on 31.3. 20X1. **(5 Marks)**

Solution:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

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However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency

Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	Foreign Currency Rate	₹
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ =₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c		
And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

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MTP / RTP / Past Exam

Question 1 (MTP Oct 20, Oct 21) (RTP Sep'24)

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakhs on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment. **(5 Marks)**

Solution:

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US $ 10 lakhs, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakhs $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh

US $ x (62.00-60.00) = ₹ 80 lakh. So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 Each + 100 lakh) = ₹ 620 lakh.

Question 2 (MTP Nov '21 & April '23)

"Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Property Pant & Equipment. **(5 Marks)**

Solution:

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary

TELEGRAM: CA NOTE HUB

Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 3 (RTP May '22)

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US$) on different dates are as under:

31-12-2020	1 US $ = ₹ 44.00
31-03-2021	1 US $ = ₹ 44.50
30-06-2021	1 US $ = ₹ 44.75

(i) Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.

(ii) If borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US $ = ₹ 44.20 then what entry should be passed?

Solution:

(i) As per AS 11 'The Effect of Changes in Foreign Exchange Rates", a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Moreover, at each balance sheet date, foreign currency monetary items should be reported using the closing rate; Accordingly, on 31;12;2020 borrowings will be recorded at ₹ 1,32,00,000 (i;e;, ₹ 3,00,000 × ₹ 44;00); On 31;3;2021 borrowings (monetary items) will be recorded at ₹ 1,33,50,000 (i;e; $ 3,00,000 × ₹ 44.50).

Journal of Kumar Ltd.

Date	**Particular**		**Dr; (₹)**	**Cr; (₹)**
31-12-2020	Bank A/c	Dr	. 1,32,00,000	
	To Foreign Loan Account			1,32,00,000
31-03-2021	Foreign Exchange A/c Difference Account	Dr	1,50,000	
	To Foreign Loan Account			1,50,000
30-06-2021	Foreign Loan Account A/c	Dr.	1,33,50,000	
	Foreign Exchange Difference Account A/c		75,000	
	To Bank A/c			1,34,25,0000

In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

Date	Particular		Dr; (₹)	Cr; (₹)
28-02-2021	Foreign Loan Account A/c	Dr	. 1,32,00,000	
	Foreign Exchange Difference Account A/c	Dr.	60,000	
	To Bank A/c			1,32,60,000

Working Notes:

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(i) The exchange difference of ₹ 1,50,000 is arising because the transaction has been reported at different rate (₹ 44;50 = 1 US $) from the rate initially recorded (i;e;, ₹ 44 = 1 US $) from the rate initially recorded (i;e;, ₹ 44 = 1 US $)

(ii) The exchange difference of ₹ 75,000 is arising because the transaction has been settled at an exchange rate (₹ 44;75 = 1 US$) different from the rate at which reported in the last financial statements (₹ 44;50 = 1 US$).

(iii) The exchange difference of ₹ 60,000 is arising because the transaction has been settled at a different rate (i;e;, ₹ 44;20 = 1 US $) than the rate at which initially recorded (1 US $ = ₹ 44;00)

Question 4 (RTP Nov'22)

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2022, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2022 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2022, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2022 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar. In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss

Solution:

As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables is a monetary item, hence should be valued at the closing rate i.e, ₹ 48 at 31st March, 2022 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of ₹ 5 (₹ 48-₹ 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2022 and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of ₹ 1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

Question 5 (RTP May 23)

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2020- 21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2021 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Solution:

(i) Interest for the period 2020-21

= US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs

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

= US $ 15 lakhs × ₹ 72 x 9;5% = ₹ 102;60 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹

102;60 lakhs less ₹ 57 lakhs = ₹ 45;60 lakhs;

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost; Thus, total borrowing cost would be ₹ 102;60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of

TELEGRAM: CA NOTE HUB

difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45;60 lakhs; Hence, ₹ 102;60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14;4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates";

Question 6 (Past Exam Nov '22)

Trade Payables of Jared Limited includes amount due to Sterling Limited ₹ 9,75,000 recorded at the prevailing exchange rate on the date of purchase- transaction recorded at US $ 1 = ₹ 75.00. The exchange rate on Balance Sheet date (31st March,2022) was US $ 1 = 79.00 The payment was made on 1st May,2022 when the exchange rate was US $ 1 = ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as per AS 11 in the books of Jared Limited. **(2.5 Marks)**

Solution:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Trade payables	**Foreign Currency Rate**	**Amount ₹**
Initial recognition US $13,000 (9,75,000/75)	1 US $ = ₹ 75	
Exchange Rate on Balance sheet date	1 US $ = ₹ 79	
Exchange Difference Loss US $ 13,000 X (79-75)		52,000
Exchange Rate on Settlement date	1 US $ = ₹ 78;30	
Exchange Difference Profit US $ 13,000x(79- 78.30)		9,100

For the year ended 31st March, 2022 exchange diffefence loss amounting ₹ 52,000 will be charged to statement of Profit & Loss A/c.

However, there is exchange difference gain of ₹ 13,000 x (79-78.30) = 9,100 on 1st May, 2022. Thus, gain of ₹ 9,100 will be credited to statement of Profit & Loss A/c for the year ended 31st March, 2023;

Question 7 (Past Exam May '23)

Trower Limited is an Indian importer. It imports goods from True View Limited situated at London. Trower Limited has a payable of £50,000 to True View Limited as on 31st March, 2023. True View Limited has given Trower Limited the following two options:

(i) Pay immediately with a cash discount of 1% on the payable.

(ii) Pay after 6 months with interest @ 5% p.a. on the payable.

The borrowing rate for Trower Limited in rupees is 15% p.a.

The following are the exchange rates:

Date	₹
31st March,2023	97
30th September, 2023	99

You are required to give your opinion to Trower Limited on which of the above two options to be chosen.

(5 Marks)

Solution:

Option (i) Pay immediately with Cash discount of 1% on the payable

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	₹
Total amount payable as on 31.3.2023 (50,000 x ₹ 97)	48,50,000
Less: Cash discount	(48,500)
	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months	3,60,112
If payment made immediate	51,61,612

Option (ii) Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x ₹ 99)	49,50,000
Interest for 6 months @ 5%	1,23,750
If payment made after 6 months	50,73,750

Thus, Option (iii) is beneficial to Trower Limited as the Rupee outflow will be lower by

₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

Note: The above answer be presented in the alternative manner given as below:

Option (i) Pay immediately with Cash discount of 1% on the payable

	₹
Total amount payable on 31.3.2023	50,000
Less: Cash discount (50,000 x 1 / 100)	(500)
	49,500
	48,01,500
49,500 x ₹ 97	3,60,112
Add: Borrowing cost @ 15% p.a. for 6 months	₹ 51,61,612
If payment made immediate	

Option (ii)

Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable on 31.3.2023	50,000
Interest for 6 months @ 5% (50,000 x 5 / 100 x 6 / 12)	1.250
	51,250
If payment made after 6 months (51,250 x 99)	50,73,750

Thus, Option (ii) is beneficial to Trower Limited as the Rupee outflow will be lower by ₹ (51,61,612 –

50,73,750) = ₹ 87,862 in option (ii).

Question 8 (Past Exam Nov'23)

Karna Ltd., an Indian Company, has the following foreign currency transactions during the financial year 2022-23:

(i) On 1st July, 2022, imported goods from Try Ltd., a German based company, amounting to ₹ 30,96,000.

(ii) On 1st October, 2022, imported plant and machinery from Lucy Ltd., a German based company, for € 18,500. The amount was paid on the date of import itself. (Ignore depreciation).

(iii) On 1st December, 2022, exported good on credit to Cream Ltd., a German based company, amounting to ₹ 50,40,000.

All the above transactions were recorded in the books of account at the prevailing exchange rate on the date of the transactions. Ignore taxes and duty on the above transactions.

Payment due from Cream Ltd. and payment due to Try Ltd. is outstanding as on 31st March, 2023.

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Rate of exchange between reporting currency (₹) and foreign currency (€) on different dates are as under:

On 1st July, 2022	1 € = ₹ 86
On 1st October, 2022	1 € = ₹ 88
On 1st December, 2022	1 € = ₹ 84
On 31st March, 2023	1 € = ₹ 90

You are required, as per AS-11:

(i) To show value at which above items will appear in Balance sheet as on 31st March, 2023;

(ii) To calculate the amount of gain/loss on each of above transactions on account of exchange differences, if any. **(5 Marks)**

Solution:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", Foreign currency monetary items should be reported using the closing rate. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

(i) Items given in the question will appear in the Balance Sheet at the following values:

Trade Payables (30,96,000/86= 36,000 German Currency) x ₹ 90 = ₹ 32,40,000

Plant and Machinery 18,500 German Currency X ₹ 88 = ₹16,28,000

Trade Receivables (50,40,000/84= 60,000 German Currency) x ₹ 90 = ₹ 54,00,000

(ii) Amount of gain / loss on each transaction on account of exchange difference:

Exchange loss on Transaction of import of goods from Try Ltd. = ₹ (1,44,000)

[36,000 German Currency X ₹ 4 (i.e. 90-86)]

Exchange gain on Transaction of export of goods to Cream Ltd = ₹ 3,60,000

[60,000 German Currency X ₹ 6 (i.e. 90-84)]

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MCQ

1. As per AS 11 assets and liabilities of non-integral foreign operations should be converted at _____ rate.

(a) Opening

(b) Average

(c) Closing

(d) Transaction

2. The debit or credit balance of "Foreign Currency Monetary Item Translation Difference Account"

(a) Is shown as "Miscellaneous Expenditure" in the Balance Sheet

(b) Is shown under "Reserves and Surplus" as a separate line item

(c) Is shown as "Other Non-current" in the Balance Sheet

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

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

(a) Average exchange rate

(b) Closing exchange rate

(c) Exchange rate at the date of purchase of asset

(d) Opening exchange rate

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

(a) Branch office serving as an extension of the head office in terms of operations

(b) Independent subsidiary of the parent company

(c) Branch office independent of the head office in terms of operational decisions

(d) None of the above

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

(a) Items of Property, Plant and Equipment

(b) Inventory

(c) Trade Payables, Trade Receivables and Foreign Currency Borrowings

(d) All of the above

Answers/Solution

1. (c) 2. (b) 3. (c) 4. (a) 5. (c)

AS 12 → Accounting for Government Grants

TELEGRAM: CA NOTE HUB

1] Definition of Govt Grant

→ It is assistance by govt, in cash or kind for past or future compliance with certain conditions.

2] Scope

AS 12 does not apply to

— Grant such as tax holiday period, Tax Exemptions

— Govt participation such as Invst by Govt in a Co. as equity shareholder.

3] Recognition of Govt Grants

A govt grant is NOT recognised until there is reasonable assurance that :

a) the enterprise will comply with the conditions attached to the grant (AND)

b) the grant will be received.

4] Accounting Treatment of Govt Grants

- Capital Approach (Capital Grant)
- Income Approach (Revenue Grant)

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Types of Government Grants

- **Non-Monetary Grants** (received in kind)
- **Monetary Grants** (received in Cash)

Non-Monetary Grant

- **Received Asset at concessional rate**
  - (eg: Bldg → Cost 10 cr. provided @ ₹4 cr)
  - ⇓
  - Record at acquisition cost

J.E

Bldg A/c Dr. 4 cr
To CIB 4 cr

↓

Co. will provide depreciation on 4 crores

- **Received Asset free of cost**
  - (eg. Bldg worth ₹10 cr provided for free by Govt)
  - ⇓
  - Record at Nominal value
  - ⇓
  - Immaterial value

J.E

Bldg A/c Dr. ₹1/₹10/₹100
To Govt Grant (Capital Reserve) ₹1/₹10/₹100

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Monetary Grant

- A. Grant Relating to Fixed Assets (PPE)
- B. Grant relating to Revenue Nature
- C. Grant in the nature of Promoter's contribution

Monetary

A. Grant Relating to Fixed Assets (PPE)

- Depreciation Asset
- Non Depreciable Asset

(eg. Co. purchased Bldg worth ₹10 crores. Govt Grant received is ₹6 crores) Life 10yrs

First method

Reduce from the cost of Asset

J.E.

① Purchase
Bldg A/c Dr 10cr
To Bank 10cr

② Grant
CIB A/c Dr 6cr
To Bldg A/c 6cr.

Net value of Bldg on Day ① = 4cr (10cr - 6cr)

③ Deprn
Deprn 0.4cr
To Bldg 0.4cr
} 4cr/10yrs

P/L 0.4cr
To Deprn 0.4cr.

Second Method

Treat the Grant as Deferred Income and recognised the income in proportion to Deprn / Life of Asset

① Purchase
Bldg A/c Dr 10cr
To Bank 10cr

② Grant
CIB A/c Dr 6cr
To Deferred Govt Grant (DGG) 6cr → P/L over 10yrs.

③ Deprn → on 10cr
Deprn 1cr
To Bldg 1cr

P/L 1cr
To Deprn 1cr.

④ Trf of DGG to P/L
DGG A/c Dr 0.6cr
To P/L (other Income) 0.6cr
(6cr/10yrs)

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P/L

Deprn 0.4 cr

P/L

Deprn 1cr. | Other Income 0.6cr. (Govt Grant)

Net Exp 0.4cr

Non-Depreciable Asset

1. Reduce the Grant from cost of Asset

(eg. Land purchased for 10cr. Govt Grant received = 6cr)

1) Purchase

Land A/c Dr 10cr
To CIB 10cr

2) Grant

CIB A/c Dr 6cr
To Land A/c 6cr

Net value of Land = 4cr

⇓

No Deprn as it is Non-Deprn Asset

2. If Co. does not want to reduce Grant from cost of Asset

Grant is unconditional

(No conditions to be fulfilled)

⇓

Treat this like a promoter's contribution

⇓

If CIB A/c Dr 6cr
To Govt Grant 6cr.
(Capital Reserve)

Grant is conditional

(eg. Co. cannot sell the land for next 5yrs)

If Grant
CIB 6cr
To DGG 6cr

DGG 1.2cr
To P/L 1.2cr
(6cr/5yrs)

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B. Grant relating to Revenue Nature.

(Generally these grants are received to reimburse expenses of the company)
eg: Salary Exp, Employee Training exp etc).

Grant received to reimburse expenses of 1yr.

(eg. Salary Exp was 90 lakh p.a.
Grant received was 30 lakhs to reimburse salary of 1st year)

J.E.

First Method

Show Exp & Income separately

J.E.

Sal Exp 90L
To CIB 90L

CIB 30L
To PL (Other Income) 30L

Second Method

Adjust the Grant from Exp.

J.E.

Sal Exp 90L
To CIB 90L

CIB 30L
To Sal Exp 30L

(Grant adjusted from Sal Exp)

PL

Exp 90L	Other Income
	Govt Grant 30L

PL

Exp
Sal 60L (90L-30L)

Grant received to reimbursed expenses of multiple years.

(eg. Sal Exp was ₹90 Lakh p.a.
Grant received was ₹100 lakhs lumpsum to reimburse Sal of 5yrs)

Treat this 100 lakhs as DGrt & trf to PL over 5yrs.

1) Grant
CIB 100L
To DGrt 100L → Trf to PL over 5yrs.

2) Sal Exp 90L
To CIB 90L

3) DGrt 20L
To PL 20L
(100L/5yrs)

PL

Sal 90L	Grant 20L

OR

PL

Sal 70 (90-20)

Grant rec'd for past expenses incurred

Treat this like a promoter's contribution (as no further conditions are to be fulfilled)

J.E.
CIB
To Cap. Reserve

TELEGRAM: CA NOTE HUB

c. Govt Grant in the nature of promoter's contribution

Eg: Grant received to set up Business / Plant / Machinery / in a Backward region / notified area.

↓

Hint that grant is in nature of promoter's contribution

J.E. CIB A/c Dr

To Capital Reserve

Refund of Govt Grant

If Grant received was adjusted against cost of Asset

Refund of Grant will also be adjusted against cost of asset

J.E. Refund

PPE A/c Dr XX

To CIB XX

(After above entry the carrying Amount of asset increases.

∴ Deprn for subsequent years will also increase) i.e. prospectively

No Retrospective effect

If Grant received was transferred to DGG as deferred income

Refund of Grant will be done from DGG upto the balance in DGG, excess if any will adjusted against PIL

(Eg. Grant Day① 100 cr to be trf in PIL over 5 yrs)

Day① DGG → 100cr]

on 1st day of 3rd year the full 100 cr Becomes refundable)

1st Day (3rd yr) DGG Bal = 60 cr.

[100 cr − 20 cr (1 yr) − 20 cr (2 yr) (PIL)]

J.E Refund

1st day (3rd yr) DGG (Reverse) 60 cr

PIL (CBP) (40 cr.)

To CIB 100 cr.

If Grant received was transferred to Cap. Reserve.

Refund will also be adjusted from Capital Reserve

↓

J.E. Capital Reserve

To CIB

Note: Refund of Govt Grant is treated as an Extra-ordinary item as per AS5

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Illus 1

1st Method

Yr 1

Fixed Asset 50L

To Bank 50L

Bank 10L

To Fixed Assets 10L

Net value of Asset 40L, Salvage value = 5L, life 5yrs.

Deprn 7L

To Fixed Assets 7L

$\left\{ \left(\frac{40L - 5L}{5yrs} \right) \right.$

P/L 7L

To Deprn 7L.

Yr 2

Deprn 7L

To Fixed Assets 7L

P/L 7L

To Deprn 7L.

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Illus 2

1st Year

Purchase

PPE 50L

TO Bank 50L

Grant

Bank 10L

TO DGG 10L

Deprn

Deprn 9L

TO PPE 9L

(50L - 5L / 5yrs)

PL 9L

TO Deprn 9L

DGG trf to P/L

DGG A/c DR 2L

TO PL A/C 2L

(10L / 5yrs)

Yr 2

Deprn

Deprn 9L

TO PPE 9L

(50L - 5L / 5yrs)

PL 9L

TO Deprn 9L

DGG trf to P/L

DGG A/c DR 2L

TO PL A/C 2L

(10L / 5yrs)

Illus 3 → Q.B

TELEGRAM: CA NOTE HUB

Illus 4

Case (a) Show separately as Other Income

(1) Bank A/c Dr 90L
To DGG 90L

(2) Sal & Exp 30L
To Bank A/c 30L

(3) DGG 18L
To P/L (Other Income) 18L
(90L / 5yr)

P/L	
Other Income	
Govt Grant	18L
Exp	
Sal & Exp	30L

Case (b) Deduct against salary cost

(1) Bank A/c Dr 90L
To DGG 90L

(2) Sal & Exp 30L
To Bank A/c 30L

(3) DGG A/c Dr 18L
To Sal & Exp 18L

P/L	
Other Income	
Govt Grant	–
Exp	
Sal & Exp	12L
(30L – 18L)	

TELEGRAM: CA NOTE HUB

Illus 8

Journal Entries

Year 1

① Purchase

PPE Dr 20

To Bank A/c 20

② Grant

Bank A/c Dr 8

TO PPE 8

Net value of PPE = 12 lakhs

③ Depn

Deprn Dr 2

TO PPE 2

P/L 2

TO Deprn 2

Yr 2

1st Day Refund

PPE 5

To CIB 5

① Depn

Deprn Dr 3·67

TO PPE 3·67

P/L 3·67

TO Deprn 3·67

TELEGRAM: CA NOTE HUB

WN 1 Calculation of Depn

Cost on Day 1	20L
(-) Grant	(8)
Net cost on Day (1)	12L
less: 4r 1 Depn	(2L) ($\frac{12L - 4L}{4yrs}$) ← Residual value
C.A @ the end of 4r 1	10L
(+) Refund	5L
New C.A (after Refund)	15L
less: 4r 2 Depn	(3.67L) ($\frac{15L - 4L}{3yrs}$) ← remaining life
C.A @ the end of 4r 2	11.33L

Illus 9 (WDV)

		(₹in lakhs)
01.04.16	Cost of Machine Purchased	300
	less: Govt Grant from cost	(60)
	Net cost of Machine	240
	less: Depn 16-17 (WDV @ 10%)	(24)
31.3.17	CA of Machine	216
	less: Depn 17-18 (WDV @ 10%)	(21.6)
31.3.18	CA of Machine	194.4
	less: Depn 18-19 (WDV @ 10%)	(19.44)
31.3.19	CA of Machine	174.96
	less: 2m Depn (1st April to 1st June) ($174.96 \times 10\% \times \frac{2m}{12m}$)	(2.916)
01.06.19	CA of Machine	172.044
	Add: Refund of grant	60
01.06.19	New CA of Machine (after Refund)	232.044

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less: Deprn 10m (1st June 19 to 31st March 20) (232.044 × 10% × 10m/12m) (19.337)

31.3.20 CA of Machine 212.707

J-E-

Year 19-20

01/06/19 Refund

PPE A/c Dr. 60
TO Bank 60

19-20 Deprn

Deprn Dr 22.253
TO PPE 22.253

2m ↓ 2.916 + 10m ↓ 19.337

P/L 22.253
TO Deprn 22.253

Illus 10 Q&B

Case A: If the grant is credited to Fixed Assets

i) Calculation of value of Fixed Asset (after Refund)

Day ① Cost of PPE	40 lakhs	(Residual value - 8 lakhs, life 4 years)
less: Grant recd	(16 lakhs)	
Net cost of PPE	24 lakhs	
less: Deprn Yr 1	(4 lakhs)	(24 - 8/4yrs)
CA @ the end of Yr 1	20 lakhs	
(-) Deprn for Yr 2	(4 lakhs)	
CA @ the end of Yr 2	16 lakhs	

Add: Refund of Grant (1st day of 3rd Yr) 16 lakhs

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CA @ the 1st day of 3rd yr — 32 lakhs
(after Refund)

Depn for yr 3 — (12 lakhs) — $\left(\frac{32-8}{2\text{yrs}}\right)$ ← remaining life

CA @ the end of 3rd yr — 20 lakhs

ii) J-E for Refund

PPE A/c Dr — 16 lakhs
To Bank A/c — 16 lakhs

Case B: If Grant trf to DGG.

i) Calculation of Fixed Asset (after Refund)

↳ Hint: Grant Booked as DGG, PPE ko grant milne se, ya refund se, koi farak nahi padega.

Day ① Cost of PPE — 40 lakhs (life 4yrs, Residual 8L)
Less: Depn yr 1 $\left(\frac{40-8}{4}\right)$ — (8 lakhs)
CA @ the end of yr 1 — 32 lakhs
Less: Depn yr 2 — (8 lakhs)
CA @ the end of yr 2 — 24 lakhs

~~(i) Refund~~

Less: Depn yr 3 — (8 lakhs)

This won't change as refund is not adjusted against PPE ∴ CA did not change ∴ Depn won't change.

Calculation of Balance in DGG

Bank To DGG → Day ① DGG — 16 lakhs.
Trf to PIL over life (4yrs)
Less: yr 1 Trf to PIL (16/4yrs) — (4 lakhs)
12 lakhs
Less: yr 2 Trf to PIL — (4 lakhs)
Bal in DGG @ the end of yr 2 — 8 lakhs

Refund in yr 3 → Refer J-E.

TELEGRAM: CA NOTE HUB

ii) J.E for Refund

DGG A/c Dr 8 lakhs

PL A/c Dr 8 lakhs (BIF)

To Bank A/c 16 lakhs

Illus 11

Ext Srg Bank 90L > Trf to PL over 5 yrs.

To DGG 90L

Total DGG Day 1 90 (90/5 yrs)

less: Trf to PL Yr1 (18)

Yr2 (18)

Yr3 (18)

Bal in DGG @ the end of Yr3 36 lakhs.

Refund (Start of Yr 4) → 90 lakhs Refund

DGG 36 lakhs

PL (BIF) 54 lakhs

To Bank A/c 90 lakhs.

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Ques 1

JE Refund

Dr. 21 lakhs (Given)

PL (BIF) 9 lakhs

To Bank 30 lakhs

There will be no change in the cost of Fixed Asset & Amt of Deprn i.e. Deprn charged will be on the same basis as charged in earlier years.

Ques 8 (CLDR) → Refer Q.B.

Ques 9 (CLDR)

Amount of Depreciation for 2nd yr (22-23)

Case i) (i) If the grant amount is deducted from the value of Plant.

Cost 1st April 21	60 lakhs	(Salvage 10%, life 10 yrs)
(-) Grant received	(20 lakhs)	
Net cost on 1st April 21	40 lakhs	
less: Deprn 21-22	(3 lakhs)	$\left(\frac{40-10}{10 yrs}\right)$
	37 lakhs	
less: Deprn 22-23	(3 lakhs)	

The Amount of Deprn for 22-23 will be 3,00,000

Case (ii) If the grant is treated as deferred income.

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Cost 1st April 21	60 lakhs
Less: Deprn 21-22 $\left(\frac{60-10}{10yrs}\right)$	(5 lakhs)
	55
Less: Deprn 22-23	5 lakhs

DGG on Day 20 lakhs.

The Amount of Deprn for 22-23 will be 5,00,000

Case (iii)

Cost 1st April 21	60 lakhs
(-) Grant received	(20 lakhs)
Net cost on 1st April 21	40 lakhs
less: Deprn 21-22 $\left(\frac{40-10}{10yrs}\right)$	(3 lakhs)
CA on 31/3/22	37 lakhs
Less: Deprn 22-23	(3 lakhs)
CA on 31/3/23	34 lakhs
(+) Refund	4 lakhs

(Salvage 10%, life 10yrs)

Refund is done @ the end of 2nd yr.
So Deprn wont change for 2nd yr.
It will start changing from 3rd yr.

The Amount of Deprn for 22-23 will be 3,00,000

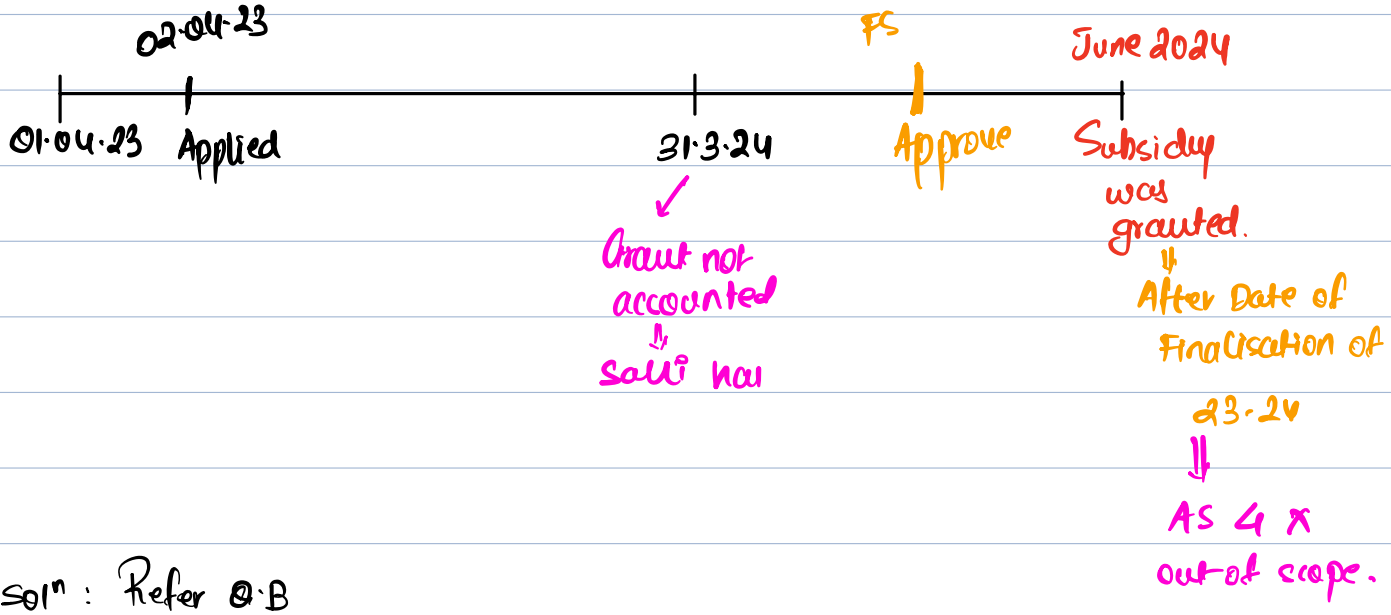
Case iv)

TELEGRAM: CA NOTE HUB

Cost 1st April 21	60 lakhs	Grant	
Less: Deprn 21-22 $\left(\frac{60-10}{10\text{yrs}}\right)$	(5 lakhs)	Bank	20L
	55	TO Cap Res	20L
Less: Depⁿ 22-23	5 lakhs		

The Amount of Deprn for 22-23 will be 5,00,000

Q10



main Soln: Refer Q.B

TELEGRAM: CA NOTE HUB

AS 12 ACCOUNTING FOR GOVERNMENT GRANTS

Illustration 1

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

Solution:

Journal in the books of Z Ltd.

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

Method II:

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

Illustration 2

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

Solution

Journal in the books of Z Ltd.

TELEGRAM: CA NOTE HUB

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

Illustration 3 (RTP Nov '23)

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

Solution

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS 12.

Illustration 4

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

TELEGRAM: CA NOTE HUB

You are required to pass the necessary journal entries in the books of the company for first year if the grant is:

a) Shown separately as Other Income; and

b) Deducted against the Salary costs.

Solution

(a)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	30,00,000	
To Bank Account			30,00,000
(Being Salary expense paid for the year)			
Deferred Income Account	Dr.	18,00,000	
To Other Income Account			18,00,000
(Being Year 1 Grant income recognised in Profit & Loss)			

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

(b)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	12,00,000	
To Bank Account			12,00,000
(Being Salary expense paid (net of grant income) for the year)			
Deferred Income Account	Dr.	18,00,000	
To Salary Expense Account			18,00,000
(Being Year 1 grant adjusted against Salary expense for the year)			

Illustration 5 (RTP Nov'19, Nov'22)

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Solution

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

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

TELEGRAM: CANOTE HUB

treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

Illustration 6 (RTP May 20, MTP Oct'22)

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

(i) ₹ 35 Lakhs received from the Local Authority for providing medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.

(iii) Rs.10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment.

(5 Marks)

Solution

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

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

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

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

Illustration 7

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

Solution

Fixed Assets Account	Dr.	₹ 7,00,000	
To Bank Account	₹		7,00,000

(Being government grant on asset refunded)

Illustration 8

A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non- compliance with certain conditions. Pass journal entries for first two years.

Solution

Journal Entries

TELEGRAM: CA NOTE HUB

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account	Dr.	20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account	Dr.	8	
	To Fixed Asset Account			8
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account	Dr.	2	
	To Depreciation Account			2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
2	Fixed Asset Account	Dr.	5	
	To Bank Account			5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.2)	Dr.	3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation $\left[\frac{12-4}{4}\right]$	2

2. Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\left[\frac{12-4}{4}\right]$	2
	10
Add: Government grant refundable	5
	15
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	3.67

Illustration 9 (MTP Oct'20, Mar'22) (Past Exam May'18, Nov '20)

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

TELEGRAM: CA NOTE HUB

the grant in June 2019 due to non- compliance of certain conditions. How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20. Pass necessary Journal Entries for the year 2019-20.

Solution:

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

Depreciation @10% on the revised book value amounting to ₹ 232;044 lakhs is to be provided prospectively over the residual useful life of the machinery.

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

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account		19.337	
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253
(Being depreciation transferred to Profit and Loss Account amounting to ₹ (2;916 + 19.337= 22.253)			

Illustration 10

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

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

1) the grant is credited to Fixed Assets A/c.

2) the grant is credited to Deferred Grant A/c.

Solution:

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account:

I.

TELEGRAM: CA NOTE HUB

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

II. The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = ₹12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹16 lakhs /4 years) = ₹4 lakhs p.a. x 2 years = ₹8 lakhs were credited to Profit and Loss Account and ₹8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

I

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

II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at

₹24 lakhs (W.N.2) and depreciation will continue to be charged at ₹8 lakhs per annum for the remaining two years.

Working Notes:

1. Balance of Fixed Assets after two years but before refund (under first alternative)

Fixed assets initially recorded in the books = ₹40 lakhs – ₹16 lakhs = ₹24 lakhs

Depreciation p.a. = (₹24 lakhs – ₹8 lakhs)/4 years = ₹4 lakhs per year

Value of fixed assets after two years but before refund of grant

= ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

2. Balance of Fixed Assets after two years but before refund (under second alternative)

Fixed assets initially recorded in the books = ₹40 lakhs

Depreciation p.a. = (₹40 lakhs – ₹8 lakhs)/4 years = ₹8 lakhs per year

Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years) = ₹24 lakhs

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

Illustration 11

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required to refund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income.

Solution

TELEGRAM: CA NOTE HUB

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

Workings:

Total grant received: ₹ 90 Lakhs

Grant recognised as income for first 3 years: ₹ 18 lakhs × 3

= ₹ 54 lakhs

Remaining Deferred Income = ₹ 90 Lakhs – 54 lakhs

= ₹ 36 lakhs

Illustration 12

AS 12 deals with recognition and measurement of government grants. Please elaborate the parameters which are required to be met before an entity can recognise government grants in its books?

Solution:

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

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Illustration 13

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1- 20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

Solution:

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled.

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

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

In the present case, the amount of refund of government grant should be first adjusted against the unamortised deferred income in the books and the excess if any will be debited to profit & loss account of the company as an extraordinary item in the year 20X2-20X3.

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP May 20, March '21, Sep'22, April'23) (RTP May '19)

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2018-19 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2021-22, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2021-22 in profit and loss account? **(5 Marks)**

Solution: 1

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

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2021-22. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 2 (MTP April 19, April 21, April 22, Oct '23)

Ram Ltd. purchased machinery for Rs. 80 lakhs (useful life 4 years and residual value Rs. 8 lakhs). Government grant received was Rs. 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant had been credited to Deferred Grant A/c. **(5 Marks)**

Solution:

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (Rs. 32 lakhs /4 years) = Rs. 8 lakhs x 2 years= Rs. 16 lakhs will be credited to Profit and Loss Account and Rs. 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		Rs.	Rs.
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
To Bank A/c			32 lakhs
(Being Government grant refunded)			

1. **Value of Fixed Assets after two years but before refund of grant**

   Fixed assets initially recorded in the books = Rs. 80 lakhs

   Depreciation for each year = (Rs. 80 lakhs – Rs.8 lakhs)/4 years = Rs. 18 lakhs per year

   Book value of fixed assets after two years = Rs. 80 lakhs – (Rs. 18 lakhs x 2 years) = Rs. 44 lakhs

2. **Value of Fixed Assets after refund of grant**

   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at Rs. 44 lakhs.

3. **Amount of depreciation for remaining two years**

   Depreciation will continue to be charged at Rs. 18 lakhs per annum for the remaining two years.

Question 3 (MTP March '23) (RTP May'18, Nov 21)

TELEGRAM: CA NOTE HUB

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

Particulars	**₹**
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

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

(5 Marks)

Solution:

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants; Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c; The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

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

Question 4 (RTP May '21, May'23)

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

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

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

Solution:

(i) As per the facts of the case, Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions.

However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundablein respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

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

TELEGRAM: CA NOTE HUB

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognized at nominal value in the balance sheet.

- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of Rs. 2 lakhs is deducted from the cost of the machinery.

Machinery will be recognised in the books at Rs. 10 lakhs – Rs. 2 lakhs = Rs. 8 lakhs and depreciation will be charged on it as follows:

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

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

Question 5 (RTP Nov 18)

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017 -18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

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

Solution:

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

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life).

TELEGRAM: CANOTE HUB

Depreciation charged during the year 2017-18 shall be (56+15)/7 years = ₹ 10;14 lakhs presuming the depreciation is charged on SLM.

Question 6 (Past Exam Nov'23)

A Ltd. purchased a Machinery for ₹ 75 Lakhs. Government Grant received towards this Machinery is ₹ 10, Lakhs. Residual Value of Machinery at the end of useful life of 6 Years is ₹ 5 Lakhs.
Asset is shown in Balance Sheet at net of grant.
At the beginning of the 3rd year, an amount becomes refundable to the extent of ₹ 8 Lakhs due to non-compliance of certain conditions of grant.
You are required to give necessary Journal entries for the 1st year and the 3rd year in the books of A Ltd.
Solution: **(5 Marks)**

Journal Entries in the Books of A Ltd.

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

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Machinery	75

TELEGRAM: CA NOTE HUB

Less: Government grant received	(10)
	65
Depreciation $\left[\frac{65-5}{10}\right]$	6

2. Depreciation for Year 3

	₹ in lakhs
Cost of the Machinery	75
Less: Government grant received	(10)
	65
Less: Depreciation for the first two years	20
	45
Add: Government grant refundable	8
	53
Depreciation for the third year $\left[\frac{53-5}{4}\right]$	12

Question 7 (Past Exam May '19)

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve., **(1 Mark)**

Solution:

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

Question 8 (Past Exam May'22)

Suraj Limited provides you the following information:

(i) It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores.

(ii) It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region.

(iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.

(iv) It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.

(v) It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited. **(5 Marks)**

Solution:

(i) As per AS 12 "Accounting for Govt; Grants", two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under the first alternative, the grant of ₹ 10 crores (40% of 25 crores) is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under

TELEGRAM: CA NOTE HUB

second alternative method, grant amounting ₹ 10 crores is treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(ii) In the given case, the grant amounting ₹ 150 lakhs received from the Central Government for setting up a plant in notified backward area may be considered as in the nature of promoters' contribution; Thus, amount of ₹ 150 lakhs should be credited to capital reserve and the plant will be shown at ₹ 300 lakhs;

(iii) ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water in notified area should be credited to capital reserve.

Alternatively, if it is assumed that the project consists of capital asset only, then the amount of ₹ 50 lakhs received from Govt; for setting up a project for supply of arsenic free water should either be deducted from cost of asset of the project concerned in the balance sheet or treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(iv) ₹ 5 lakhs received from the local authority for providing corona vaccine to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss account, either separately or under a general heading 'Other Income';

Alternatively, ₹ 5 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(v) ₹ 500 Lakhs will be reduced from the renovation cost of power plant or will be treated as deferred income irrespective of the expenditure done by the entity out of it as it was specifically received for the purpose major renovation of power plant. However, it may be, later on, decided by the Govt. whether the grant will have to be refunded or not due to non-compliance of conditions attached to the grant.

Question 9 (Past Exam May '23)

On 1st April 2021, Eleanor Limited purchased a manufacturing Plant for ₹ 60 lakhs, which has an estimated useful life of ₹ 10 years with a salvage value of ₹ 10 lakhs. On purchase of the Plant, a grant of ₹ 20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

(i) If the grant amount is deducted from the value of Plant.

(ii) If the grant is treated as deferred income.

(iii) If the grant amount is deducted from the value of Plant, but at the end of the year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions.

(iv) If the grant is treated as the promoter's contribution.

(Assume depreciation on the basis of Straight-Line Method.) **(5 Marks)**

Solution:

Calculation of depreciation as per AS 12 for the financial year 2022-23:

(i) If the grant amount is deducted from the value of Plant, then the amount of deprecation will be ₹ 3,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) / 10 year.

(ii) If the grant is treated as deferred income, then amount of depreciation will be ₹ 5,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000) / 10 year.

(iii) If the grant amount is deducted from the value of plant, but at the end of the year 2022-23 grant is refunded to the extent of ₹ 4 lakh then the amount of depreciation will be ₹ 3,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) /10 year for year 202122 and for the year 2022-23

(iv) Depreciation will be ₹ 3,00,000 calculated as follows, (₹60,00,000 - ₹ 10,00,000 - ₹ 20,00,000– ₹ 3,00,000) / 10 years.

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Note: It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as ₹ 3,44,444 calculated as follows, (₹ 60,00,000 - ₹10,00,000 - ₹ 20,00,000 + 4,00,000– ₹ 3,00,000 / 9 years

(v) If the grant is treated as promoter's contribution, then the amount of depreciation will be ₹ 5,00,000 p.a. (₹ 60,00,000 -10,00,000) /10 year.

NOTE: The answer can be presented in the following alternative manner:

(i) (ii) (iii) (iv)

Date	Particulars	Grant Value deducted from Plant	Grant treated as Deferred Income	Grant Refunded	Grant is treated as Promoter'sContribution
01.04.2021	Cost of Plant	60,00,000	60,00,000	60,00,000	60,00,000
	Less: Salvage	10,00,000	10,00,000	10,00,000	10,00,000
		50,00,000	**50,00,000**	**50,00,000**	**50,00,000**
01.04.2021	Less: Grant	20,00,000	-	20,00,000	-
		30,00,000	50,00,000	30,00,000	50,00,000
	Useful Life (years)	10	10	10	10
31.03.2022	Depreciation FY 2021-22	3,00,000	5,00,000	3,00,000	5,00,000
1.4.2022	Cost of Plant			60,00,000	
	Less: Salvage			10,00,000	
				50,00,000	
	Less: Grant			20,00,000	
	Less:			30,00,000	
	Depreciation FY 2022-23			3,00,000	
				27,00,000	
	Book value at the time of refund of grant i.e. at the end of period			4,00,000	
	Add: Grant Refundable at end of 22-23 Book value available for remining 8 years.			31,00,000	

Note:

It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as:

Cost of Plant	60,00,000
Less: Salvage	10,00,000
	50,00,000
Less: Grant	20,00,000
	30,00,000
Add: Grant Refundable	4,00,000
	34,00,000
Less: Depreciation For 2021-22	3,00,000
	31,00,000
Useful Life (years)	9
Depreciation For 2022-23	**3,44,444**

TELEGRAM: CA NOTE HUB

Question 10 (RTP Sep'24)

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

State

(i) Is this a prior period item?

(ii) How should the subsidy be accounted in the accounting year 2024-2025?

Solution:

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

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

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

(ii) the subsidy will be received.

Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2024 after approval of accounts, non-recognition of grant in 2023-2024 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2023-2024.

(ii) The subsidy should be deducted from the cost of the generator.

The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as 'deferred income' and allocated over the remaining useful life in the proportion in which depreciation is charged.

TELEGRAM: CA NOTE HUB

MCQ

1. To encourage industrial promotion, IDCI offers subsidy worth ₹ 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy should be accounted in the books?

(a) Credit it to capital reserve

(b) Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations

(c) Both (a) and (b) are permitted

(d) Credit it to general reserve

2. Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be

(a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.

(b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.

(c) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.

(d) disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item

3. Which of the following is an acceptable method of accounting presentation for a government grant relating to an asset?

(a) Credit the grant immediately to Income statement

(b) Show the grant as part of Capital Reserve

(c) Reduce the grant from the cost of the asset or show it separately as a deferred income on the Liability side of the Balance Sheet.

(d) Show the grant as part of general Reserve

4. X Ltd. has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd has a policy to recognise the grant as a deduction from the cost of the asset. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of annual depreciation to be charged as an expense in Profit and Loss Statement will be:

(a) ₹ 10 crore

(b) ₹ 6 crore

(c) ₹ 2 crore

(d) ₹ 8 crore

5. X Ltd has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd. has a policy to recognise the grant as deferred income. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of other income to be to be recognised in Profit and Loss Statement will be:

(a) ₹ 10 crore

(b) ₹ 6 crore

(c) ₹ 2 crore

(d) ₹ 8 crore

TELEGRAM: CA NOTE HUB

Answers

1. (a) 2. (c) 3. (c) 4. (b) 5. (c)

TELEGRAM: CANOTE HUB

SOLVED EXAMPLE

Example 1

X Ltd applies for a grant from the local authority towards a social cause. X Ltd. Is required to meet certain conditions to be eligible for the receipt of grant. There is a reasonable assurance that X Ltd will receive the grant in time. However, after having applied for the grant, there is a likelihood that X Ltd may not be able to meet all the conditions attached to the grant.

In such case, X Ltd should not recognise the grant in its books until there is a reasonable assurance that it would be able to meet all conditions attached to the grant

Example 2

X Convent wishes to open a school in locality A. It applies to the State authority for grant of land. The State authority grants the land for construction of the the purposes of the school construction. The market value of the land is ₹ 20 crore whereas However, the authority provides the land at a nominal cost of ₹ 50 lakhs including cost of registration. The State authority requires that free education must be provided to the poor children by way of reserving 20% of the seats in the school for such children. There is a reasonable assurance that X Convent has a reason to believe it can will meet that the above stated condition attached to the grant.

Thus, X Convent needs to would recognise the cost of the land at its acquisition cost of ₹ 50 lakhs. held.

Example 3

The Central Government is planning to generate large employment in rural and backward regions. Thus, it is planning to give grants for the same to entities who will meet the required conditions. F Ltd applied for a grant to the Central Government. The Government will give the grant on the condition that, F Ltd will be required to construct a factory where it would need to employ at least 500 workers for 5 years. Total cost of the construction is expected to be ₹ 50 crore. The amount of the grant is ₹ 30 crore.

F Ltd will be able to recognise the grant only if there is reasonable assurance that it will meet o the condition of employing 500 workers for next 5 years.

Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

AS 13 ACCOUNTING FOR INVESTMENTS

Question1 (Past Exam Nov'22) **NB Pg. No.**

(i) An unquoted long term investment made in the shares of Rachel Limited is carried in the books of Ziva Limited at a cost of ₹ 1,00,000/ The audited financial statements of Rachel Limited received in May,2021 showed that the company had been incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 55,000

(ii) On 1st December, 2021 Ziva Limited had made an investment of ₹ 5,00,000 in 4,000 Equity Shares of Garry Limited at a price of ₹ 125 per share with an intention to hold it for not more than six months. In the first week of March, 2022, Garry Limited suffered heavy loss due to an earthquake; the loss was not covered by an insurance policy. On 31st March,2022, the shares of Garry Ltd/ were traded at a price of ₹ 80 per share on the Stock Exchange.

How would you deal with the above investments in the books of Ziva Limited for the year ended 31st March,2022 as per the provisions of AS 13? **(5 Marks)**

Solution

(i) Investments classified as long -term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

On this basis, the facts of the given case, it would be appropriate to reduce the carrying value of Long-term investments to ₹ 55,000 in the financial statements for the year ended 31st March, 2022.Thus the unquoted investment in the shares of Rachel Ltd. will be valued at ₹ 55,000

The provision for diminution amounting **₹ 45,000** should be made to reduce the carrying amount of the investments.

(ii) Equity Shares in Garry Ltd. will be considered as current investment as intended to hold for not more than six months; As per AS 13, "Accounting for Investments", carrying amount for current investments is the lower of cost and fair value. In respect of current Investments for which as active market exists, market value generally provides the best evidence of fair value.

Since on 31st March,2022, the shares of Garry Limited were trading at a price of ₹ 80 per share on the stock exchange, the equity shares of Garry Ltd. should be carried in the financial statements at realizable value i.e. at **₹ 3,20,000** (4,000 shares @ ₹ 80 per share).The reduction of **₹ 1,80,000** in carrying value of current investment will be charged to the statement of profit and loss for the year ended 31 st March,2022.

Question 2 (RTP Nov'20) **NB Pg. No.**

X Ltd. on 1–1–20X1 had made an investment of ₹ 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31–3–20X1 became ₹ 200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31–3–20X1?

Solution :

X Ltd. invested ₹ 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.20X1 to 31.3.20X1), AS 13 (Revised) lays emphasis on intention of the investor to classify the

investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.20X1 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long term investment.

As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be charged to the profit and loss account.

The Standard further states that long-term investments are usually carried at cost.

However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in the long run.

Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and show the investments at ₹ 100 lakhs, since the downfall in the value of shares is **other than temporary.** The reduction of **₹ 200** lakhs in the carrying value of long term investment will also be charged to the Statement of **profit and loss.**

Question 3 (RTP May'20, Nov'22) **NB Pg. No.**

ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised).

Decide and state on the amount of transfer, based on the following information:

(1) A portion of current investments purchased for ₹ 20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹ 25 lakhs.

(2) Another portion of current investments purchased for ₹ 15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹ 6.5 lakhs.

(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹ 18 lakhs but had been written down to ₹ 12 lakhs to recognise other than temporary decline as per AS 13 (Revised).

Solution :

As per AS 13 (Revised), where investments are reclassified from current to longterm, transfers are made at the lower of cost and fair value at the date of transfer.

(1) In the first case, the market value of the investment is ₹ 25 lakhs, which is higher than its cost i.e. ₹ 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. **₹ 20 lakhs.**

(2) In the second case, the market value of the investment is ₹ 6.5 lakhs, which is lower than its cost i.e. ₹ 15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. **₹ 6.5 lakhs**. The loss of **₹ 8.5 lakhs** should be charged to profit and loss account.

As per AS 13 (Revised), where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(3) In the third case, the book value of the investment is ₹ 12 lakhs, which is lower than its cost i.e. ₹ 18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at **₹ 12 lakhs.**

Question 4 (RTP Nov'18, May'23) (MTP Mar'24) **NB Pg. No.**

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 20X3 at a cost of ₹ 2,50,000. It also earlier purchased Gold of ₹ 4,00,000 and Silver of ₹ 2,00,000 on 1st March, 20X1. Market value as on 31st March, 20X4 of above investments are as follows:

	₹
Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 20X4 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Solution :

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹ 2,50,000) and market value (₹ 2,25,000) as on 31 March 20X4, i.e., ₹ 2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognise a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 20X1) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 20X4, i.e., ₹ 4,00,000 and ₹ 2,00,000 respectively, though their market values have been increased.

Question 5 **NB Pg. No.**

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

Solution :

The disclosure requirements as per AS 13 (Revised) are as follows:

(i) Accounting policies followed for the determination of carrying amount of investments.

(ii) Classification of investment into current and long term.

(iii) The amount included in profit and loss statements for

  a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;

  b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;

  c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises

Question 6 NB Pg. No.

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

Solution :

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments.

A current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. The reduction in carrying amount is charged to the statement of profit and loss.

Question 7 (MTP Oct'20, Mar'22) NB Pg. No.

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? What methodology should be adopted for ascertaining the provision for diminution in the value of investment, if any. Explain in brief **(4 Marks)**

Solution :

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made. The reduction in market value should not be considered, in isolation to determine the decline, other than temporary.

The amount of the provision for diminution in the value of investment may be ascertained considering the factors indicated in AS 13.

Question 8 (Past Exam May'19, Jan'21) (MTP Sep'23, Apr'24, Sept.24) NB Pg. No.

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decide and state the amount of transfer, based on the following information:

1) A portion of long term investments purchased on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 14 lakhs but had been written down by Rs. 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was Rs. 11 lakhs.
2) Another portion of long term investments purchased on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 7 lakhs but had been written down to Rs. 5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was Rs. 4.5 lakhs.
3) A portion of current investments purchased on 15th March, 2018 for Rs. 7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was Rs. 6 lakhs and fair value on 15th June 2018 was Rs. 8.5 lakhs.
4) Another portion of current investments purchased on 7th December, 2017 for Rs. 4 lakhs are to

be re- classified as long term investments. The market value of these investments was :

on 31st March, 2018 Rs. 3.5 lakhs

on 15th June, 2018 Rs. 3.8 lakhs **(5 Marks)**

Solution :

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer; and where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this reclassified current investment should be carried at Rs. 12 lakhs in the books.

(ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs. 5 lakhs in the books.

(iii) In this case, reclassification of current investment into long-term investments will be made at Rs. 7 lakhs as cost is less than its fair value of Rs.8.5 lakhs on the date of transfer.

(iv) In this case, market value (considered as fair value) is Rs. 3.8 lakhs on the date of transfer which is lower than the cost of Rs. 4 lakhs. The reclassification of current investment into long-term investments will be made at Rs. 3.8 lakhs.

Question 9 (MTP May'20) **NB Pg. No.**

The Investment portfolio of XYZ Ltd. as on 31.03.2020 consisted of the following:

			(Rs. in lacs)	
	Current Investments		**Cost**	**Fair Value as on 31.03.2020**
1.	1000 Equity Shares of A Ltd.		5	7
2.	500 Equity Shares of B Ltd.		10	15
3.	1000 Equity Shares of C Ltd.		15	12
		Total	30	34

Give your comments on the following:

(i) The company wants to value the above portfolio at Rs. 30 lakhs being lower of cost or fair market value.

(ii) Company wants to transfer 1000 Equity Shares of C Ltd. from current investments to long term investments on 31.03.2020 at cost of Rs. 15 lakhs. **(5 Marks)**

Solution :

As per AS 13 "Accounting for Investments", Valuation of current investments on overall (or global) basis is not considered appropriate. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly the investments may be carried at the lower of cost and fair value computed category-wise (i.e. equity shares, preference shares, convertible debentures, etc.). However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

(i) Hence the company has to value the current investment at Rs. 27 Lacs (A Ltd. shares at Rs. 5 lacs; B Ltd. shares at Rs; 10 lacs and C Ltd; shares at Rs; 12 lacs); The company's decision to value the portfolio at Rs; 30 lacs are not appropriate.

(ii) Moreover, where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

Hence, the company has to make transfer of 1,000 equity shares of C Ltd. at Rs. 12 lacs (fair value) and not Rs. 15 lacs (cost) as the fair value is less than cost.

Question 10 (MTP Aug'18, Oct'22) (RTP May 19) **NB Pg. No.**

How you will deal with following in the financial statements of the Parish Electronics Ltd. as on 31.3.18 with reference to AS-13? Also Parish Electronics Ltd has current investment (X Ltd's shares) purchased for Rs. 5 lakhs, which the company want to reclassify as long term investment. The market value of these investments as on date of Balance Sheet was Rs. 2.5 lakhs. **(5 Marks)**

Solution :

As per AS 13 'Accounting for Investments', where investments are reclassified from current to long – term, transfers are made at the lower of cost or fair value at the date of transfer.

In the given case, the market value of the investment (X Ltd. shares) is Rs.2.50 lakhs, which is lower than its cost i.e. Rs. 5 lakhs. Therefore, the transfer to long term investments should be made at cost of Rs. 2.50 lakhs. The loss of Rs. 2.50 lakhs should be charged to profit and loss account.

Question 11 (MTP Nov'21) (RTP Nov'19, Nov 21) **NB Pg. No.**

Z Bank has classified its total investment on 31–3–2021 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines/ 'Held to maturity' investments are carried at acquisition cost less amortized amount/ 'Available for sale' investments are carried at marked to market/ 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13? **(5 Marks)**

Solution :

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

Question 12 (RTP May'18 May'21) (MTP Oct'21) **NB Pg. No.**

Paridhi Electronics Ltd. invested in the shares of Dhansukh Ltd. on 1st May 2020 at a cost of Rs. 10,00,000. Three fourth of these investments were current investments and the remaining investments were intended to be held for more than a year. The published accounts of Dhansukh Ltd. received in January, 2021 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than 7,50,000. The reduction in value is apparent to be non-temporary. You are required to explain how you will deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.21 with reference to AS 13? **(4 Marks)**

Solution :

As per AS 13, "Accounting for Investments", carrying amount for current investments is the lower of cost and fair value. But long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value,the investee's assets and results and the expected cash flows from the investment. Paridhi Ltd. made three fourth of Rs. 10,00,000 ie. Rs.7,50,000 as current investment

and remaining Rs. 2,50,000 as long term. The facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares for both categories of shares to bring them to market value. Hence the carrying value of investments will be shown at amount of Rs. 7,50,000 in the financial statements for the year ended 31st March, 2021 and charge the difference of loss of Rs. 2,50,000 to profit and loss account.

Question 13 (RTP May '22) **NB Pg. No.**

JVR Limited has made investment of ₹97 Crores in Equity Shares of QSR Limited in 2016–17. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to re-assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investment for the year ended 31st March, 2021. Discuss whether the connection of JVR Limited to bring down the carrying Amount of investment in QSR Limited is in accordance with Accounting Standards.

Solution :

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments. A current Investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss. A long – term investment is an investment other than a current investment. The investments referred in the question can be classified as long-term investments and long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. The contention of the company to bring down the value of investment may be correct if the decline in value is permanent in nature and the reduction in carrying amount may be charged to the statement of profit and loss. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Question 14 (RTP Sep'24) **NB Pg. No.**

A company is engaged in the business of refining, transportation and marketing of petroleum products. During the financial year ended 31st March, 2024, the company acquired controlling interest from Government of India in another public sector undertaking @ ₹ 1,551 per share as against the book value of ₹ 192.58 per share and market value of ₹ 876 per share as on 18th February, 2024.

Thus, the strategic premium of ₹ 675 per share has been paid considering various tangible and intangible factors.

The above investment in the shares of the acquired company has been considered as long term strategic investment and, therefore, has been accounted for at cost, i.e. at ₹ 1,551 per share in the financial statements. No provision for diminution in value has been made in the books of account.

As per the requirement of Schedule III to the Companies Act, 2013, the aggregate market value of the quoted shares has been properly reflected in the financial statements.

On 28th March, 2024, the acquired shares were quoted at ₹ 880 per share on BSE and the current market price as on 18th July was around ₹ 300.

Considering the tangible and intangible benefits the Management is of the view that there is no permanent diminution in the value of the strategic investment in the acquired company, as the same has been considered as a long-term investment. Therefore, there is no need for provision for diminution in the value of the shares of the acquired company.

Required:

(i) Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without

providing for any diminution in value is correct and in accordance with the provisions of AS 13.

(ii) If any provision for diminution in the value is to be made, whether such provision should be charged to the profit and loss account or whether same can be considered as deferred expenditure and amortised over a period of 5 years. Whether it is open for the company to charge off such diminution in the value in the books of account instead of creating provision.

(iii) Whether the premium paid for strategic benefits for investment described in facts of the case, can be accounted for separately in the books of account keeping in view that AS 13 specifies that long term investments should be recorded at cost and there is no specific provision in the standard in respect of accounting for premium paid for strategic benefits.

Solution :

(i) The accounting treatment 'at cost' under the head 'Long Term Investment' in the separate financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment.

(ii) The provision for diminution in the value of investment should be a charge to the profit and loss statement. As per the requirements of AS 13, the diminution in the value of investment can neither be accounted for as deferred revenue expenditure nor it can be written off in the statement of profit and loss.

(iii) The long-term investments should be carried at cost as per the requirements of AS 13. The amount paid over and above the market price should be treated as cost and cannot be accounted for separately.

Question 15 (Past Exam Nov'19) **NB Pg. No.**

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹ 100 each) of P Ltd., held as Current assets:

1.4.20X1 Opening balance – Nominal value ₹ 1,20,000, Cost ₹ 1,18,000

1.7.20X1 100 Debentures purchased ex-interest at ₹ 98

1.10.20X1 Sold 200 Debentures ex-interest at ₹ 100

1.1.20X2 Purchased 50 Debentures at ₹ 98 ex-interest

1.2.20X2 Sold 200 Debentures ex-interest at ₹99

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction (at ex-interest price). Show Investment account as it would appear in his books. Assume FIFO method. Market value of 8% Debentures of P Limited on 31.3.20X2 is ₹ 99. **(10 Marks)**

Solution :

Investment A/c of Mr. Purohit

for the year ending on 31-3-20X2

(Scrip: 8% Debentures of P Limited)

(Interest Payable on 30th September and 31st March)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
			₹	₹				₹	₹
1.4.20X1	To Balance b/d	1,20,000	-	1,18,000	30.9.20X1	By Bank (1,300 x 100 × 8% x 6/12)	-	5,200	-
1.7.20X1	To Bank (ex-Interest) (W.N.1)	10,000	200	9,898	1.10.20X1	By Bank (W.N.4)	20,000	-	19,800
1.10.20X1	To Profit & Loss A/c (W.N.4)			133	1.2.20X2	By Bank (ex-Interest) (W.N.5)	20,000	533	19,602
1.1.20X2	To Bank (ex-Interest) (W.N.2)	5,000	100	4,949	1.2.20X2	By Profit & Loss A/c (W.N.5)			64
31.3.20X2	To Profit & Loss A/c (Bal. fig.)	-	9,233		31.3.20X2	By Bank (950 x 100 × 8% x 6/12)	-	3,800	-
					31.3.20X2	By Balance c/d (W.N.3)	95,000	-	93,514
		1,35,000	**9,533**	**1,32,980**			**1,35,000**	**9,533**	**1,32,980**

Working Notes:

1. **Purchase of debentures on 1.7.20X1**

   Interest element = 100 × 100 × 8% x 3/12 = ₹ 200

   Investment element = (100 × 98) + [1% (100 × 98)] = **₹ 9,898**

2. **Purchase of debentures on 1.1.20X2**

   Interest element = 50 × 100 × 8% x 3/12 = ₹ 100

   Investment element = {(50 × 98) + [1%(50 × 98)]} = **₹ 4,949**

3. **Valuation of closing balance as on 31.3.20X2:**

   Market value of 950 Debentures at ₹ 99 = **₹ 94,050**

   Cost of 800 Debentures =

   1,18,000 × 80,000 = **78,667**

   1,20,000

100 Debentures cost	=	9,898
50 Debentures cost	=	4,949
		93,514
Value at the end	**=**	**₹ 93,514, i.e., whichever is less**

4. Profit on sale of debentures as on 1.10.20X1

	₹
Sales price of debentures (200 x ₹ 100)	20,000
Less: Brokerage @ 1%	(200)
	19,800
Less: Cost of Debentures 1,18,000 x20,000 1,20,000	(19,667)
Profit on sale	**133**

5. Loss on sale of debentures as on 1.2.20X2

	₹
Sales price of debentures (200 x ₹ 99)	19,800
Less: Brokerage @ 1%	(198)
	19,602
Less: Cost of Debentures 1,18,000 x20,000 1,20,000	(19,666)
Loss on sale	64
Interest element in sale of investment = 200 × 100 × 8% x 4/12	**₹ 533**

Question 16 **NB Pg. No.**

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at ₹ 101 ex-interest price, also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at ₹ 103 ex-interest price, again paying brokerage @ 1 % of ex-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

Solution :

In the books of M/s Bull & Bear

Investment Account

for the period from 1st December 20X2 to 1st March, 20X3

(Scrip: 12% Debentures of M/s. Wye Ltd.)

Date	Particulars	Nominal Value ₹	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
1.12.20X2	To Bank A/c (W.N.1)	10,00,000	20,000	10,20,100	1.03.20X3	By Bank A/c (W.N.2)	10,00,000	50,000	10,19,700
1.3.20X3	To Profit & loss A/c* (b.f.)		30,000		1.3.20X3	By Profit & loss A/c (b.f.)			400
		10,00,000	**50,000**	**10,20,100**			**10,00,000**	**50,000**	**10,20,100**

* This represents income for M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3, i.e., interest for three months- 1st December, 20X2 to 28 February, 20X3).

Working Notes:

1.	**Cost of 12% debentures purchased on 1.12.20X2**	**₹**
	Cost Value (10,000 x₹ 101)	= 10,10,000
	Add: Brokerage (1% of ₹ 10,10,000)	= 10,100
	Total	= **10,20,100**
2.	**Sale proceeds of 12% debentures sold**	**₹**
	Sales Price (10,000 x₹ 103)	= 10,30,000
	Less: Brokerage (1% of ₹ 10,30,000)	= (10,300)
	Total	**= 10,19,700**

Question 17 **NB Pg. No.**

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (nominal value) ₹ 1,20,000, Cost ₹ 1,18,000 (Nominal value of each unit is ₹ 100).

1.3.20X1 Purchased 200 units, ex-interest at ₹ 98.

1.7.20X1 Sold 500 units, ex-interest out of original holding at ₹ 100.

1.10.20X1 Purchased 150 units at ₹ 98, cum interest.

1.11.20X1 Sold 300 units, ex-interest at ₹ 99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.

Solution :

In the Books of Mr. Z

9% Central Government Bonds (Investment) Account

Particulars		Nominal Value ₹	Interest	Principal	Particulars		Nominal Value	Interest	Principal
20X1		₹	₹	₹	20X1		₹	₹	₹
Jan.1	To Balance b/d (W.N.1)	1,20,000	2,700	1,18,000	Mar. 31	By Bank A/c (W.N.3)	-	6,300	-
March 1	To Bank A/c (W.N.2)	20,000	750	19,600	July 1	By Bank A/c (W.N.4)	50,000	1,125	50,000
July 1	To P&L A/c (W.N.5)	-	-	833	Sept. 30	By Bank A/c (W.N.6)	-	4,050	-

Oct. 1	To Bank A/c (150 × 98)	15,000	-	14,700	Nov. 1	By Bank A/c (W.N.7)	30,000	225	29,700
Nov. 1	To P&L A/c (W.N.8)	-	-	200	Dec.31	By Balance c/d (W.N. 9 & W.N.10)	75,000	1,688	73,633
Dec. 31	To P&L A/c (b.f.) (Transfer)		9,938						
		1,55,000	**13,388**	**1,53,333**			**1,55,000**	**13,388**	**1,53,333**

Working Note:

1. **Interest element** in opening balance of bonds = 1,20,000 × 9% x 3/12 = ₹ 2,700
2. **Purchase of bonds on 1. 3.20X1**

   Interest element in purchase of bonds = 200 × 100 × 9% x 5/12 = ₹ 750

   Investment element in purchase of bonds = 200 × 98 = ₹ 19,600
3. **Interest for half-year** ended 31 March = 1,400 × 100 × 9% x 6/12 = ₹ 6,300
4. **Sale of bonds on 1.7.20X1**

   Interest element = 500 × 100 × 9% x 3/12 = ₹ 1,125

   Investment element = 500 × 100 = ₹ 50,000
5. **Profit on sale of bonds on 1.7.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 500 = ₹ 49,167

   Sale proceeds = ₹ 50,000

   Profit element = ₹ 833
6. **Interest for half-year ended 30 September**

   = 900 × 100 × 9% x 6/12 = ₹ 4,050
7. **Sale of bonds on 1.11.20X1**

   Interest element = 300 × 100 × 9% x 1/12 = ₹ 225

   Investment element = 300 × 99 = ₹ 29,700
8. **Profit on sale of bonds on 1.11.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 300 = ₹ 29,500

   Sale proceeds = ₹ 29,700

   Profit element = ₹ 200
9. **Closing value of investment**

Calculation of closing balance:	Nominal value		₹
Bonds in hand remained in hand at 31st December 20X1			

From original holding (1,20,000 – 50,000 – 30,000) =	40,000	$\frac{1,18,000}{1,20,000} \times 40,000$	39,333
Purchased on 1st March	20,000		19,600
Purchased on 1st October	15,000		14,700
	75,000		**73,633**

10. Interest element in closing balance of bonds = 750 × 100 × 9% x 3/12 = ₹ 1,688

Question 18 (MTP April'19, Oct '22) (RTP May'24) **NB Pg. No.**

Gopal holds 2,000, 15% Debentures of ₹ 100 each in Ritu Industries Ltd. as on April 1, 2021 at a cost of ₹ 2,10,000. Interest is payable on June, 30th and December, 31st each year

On May 1, 2021, 1,000 debentures are purchased cum-interest at ₹ 1,07,000

On November 1, 2021, 1,200 debentures are sold ex-interest at ₹ 1,14,600

On November 30, 2021, 800 debentures are purchased ex-interest at ₹ 76,800.

On December 31, 2021, 800 debentures are sold cum-interest for ₹ 1,10,000

You are required to prepare the Investment Account showing value of holdings on March 31, 2022 at cost, using FIFO Method **(10 Marks)**

Solution :

Investment Account of Gopal For the year ended 31.3.2022

(Script: 15% Debentures in Ritu Industries Ltd.)

(Interest payable on 30th June and 31st December)

Date	Particulars	Nominal Value ₹	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
1.04.21	To Balance A/c	2,00,000	7,500	2,10,000	30.06.21	By Bank A/c	-	22,500	
1.05.21	To Bank A/c	1,00,000	5,000	1,02,000	1.11.21	By Bank A/c	1,20,000	6,000	1,14,600
30.11.21	To Bank A/c	80,000	5,000	76,800	1.11.21	By Profit & Loss A/c	-	-	11,400
31.12.21	To Profit & Loss A/c			20,000	31.12.21	By Bank A/c	80,000	6,000	1,04,000
31.03.22	To Profit & Loss A/c		37,250		31.12.21	By Bank A/c	-	13,500	-
	(Bal. fig.)				31.3.22	By Bal. c/d	1,80,000	6,750	1,78,800
		3,80,000	54,750	4,08,800			3,80,000	54,750	4,08,800

Working Notes:

(I) Accrued Interest as on 1st April, 2021 = ₹ 2,00,000 X $\frac{15}{100} \times \frac{3}{12}$ = Rs. 7,500

(II) Accrued Interest as on 1.5.2021= ₹ 1,00,000 X $\frac{15}{100} \times \frac{4}{12}$ = Rs. 5,000

(iii) Cost of Investment for purchase on 1st May = ₹ 1,07,000 – ₹ 5,000 = ₹ 1,02,000

(iv) Interest received as on 30.6.2021 = ₹ 3,00,000 X $\frac{15}{100} \times \frac{6}{12}$ = Rs. 22,500

(v) Accrued Interest on debentures sold on 1.11.2021 = ₹ 1,20,000 X $\frac{15}{100}$ × $\frac{4}{12}$ = Rs. 6,000

(vi) Accrued Interest = ₹ 80,000 × $\frac{15}{100}$ × $\frac{5}{12}$ = Rs. 5,000

(vii) Accrued Interest on sold debentures 31.12.2021 = ₹ 80,000 × $\frac{15}{100}$ × $\frac{6}{12}$ = Rs. 6,000

(viii) Sale Price of Investment on 31st Dec; 2021 = ₹ 1,10,000-₹ 6,000 = ₹ 1,04,000

(iX) Loss on Sale of Debenture on 1.11.2021

Sale Price of debenture	1,14,600
Less: Cost Price of debenture2,10,000 / 2,00,000 x Rs.1,20,000	1,26,000
Loss on sale	11,400

(x) Accrued interest as on 31;12;2021 = ₹ 1,80,000 × $\frac{15}{100}$ × $\frac{6}{12}$ = Rs. 13,500

(xi) Accrued Interest = ₹ 1,80,000 × $\frac{15}{100}$ × $\frac{3}{12}$ = ₹6,750

(xii) Cost of investment as on 31st March = ₹ 1,02,000 + ₹ 76,800 = ₹ 1,78,800

(xiii) Profit on debentures sold on 31st December = ₹ 1,04,000 –(₹ 2,10,000×800/2,000) = ₹ 20,000

Question 19 (RTP May 23) **NB Pg. No.**

Remo Ltd held on 1st April, 2021, 1000 9% Government Securities at ₹ 90,000 (Face Value of Security ₹ 100 each). Three month's interest had accrued on the above date. On 1st May, the company purchased the same Government Securities of the face value of ₹ 80,000 at ₹ 95 cum-interest. On 1st June, ₹ 60,000 face value of the security was sold at ₹ 94 cum-interest. Interest on the security was paid each year on 30th June and 31st December and was credited by the bank on the same date. On 30th September, ₹ 40,000 face value of the Govt. securities were sold at ₹ 97 cum-interest. On 1st December, the company purchased the same security ₹ 10,000 at par ex-interest/ On 1st March, the company sold ₹ 10,000 face value of the government securities at ₹ 95 ex- interest. You are required to draw up the 9% Government Security Account in the books of Remo Limited. FIFO method shall be followed.

Calculation shall be made to the nearest rupee or multiple thereof.

Solution :

In the Books of Remo Ltd.

9% Government Securities (Investment) Account

		Face Value	Interest	Cost	Particulars	Face Value	Interest	Cost	
2021		₹	₹	₹	2021		₹	₹	₹
April 1	To Balance b/d	1,00,000	2,250	90,000	June 1	By Bank A/c	60,000	2,250	54,150
May 1	To Bank A/c	80,000	2,400	73,600	June 30	By Bank A/c	–	5,400	-
June 1	To P&L A/c	-	-	150	Sept. 30	By Bank A/c	40,000	900	37,900

Sept.	30 To P & L A/c	-	-	1,900	Dec. 31	By Bank A/c	–	4,050	–
Dec. 1	To Bank A/c	10,000	375	10,000	Mar.1 2022	By Bank A/c	10,000	150	9,500
Mar. 1 2022	To P&L A/c	-	–	300	Mar. 31 2022	By Balance c/d	80,000	1,800	74,400
Mar. 31, 2022	To P&L A/c (Transfer)	-	9,525	–					
		1,90,000	14,550	1,75,950			1,90,000	14,550	1,75,950

Working Notes:

1. Interest accrued on 1st April 2021 = ₹1,00,000 × 9% x 3/12 = ₹ 2,250
2. Accrued Interest on 800 units as on 01 05;2021 = ₹ 80,000 × 9/100 × 4/12 = ₹ 2,400
3. Cost of Investment for purchase on 01;05;2021 = ₹ 76,000 – ₹ 2,400 = ₹ 73,600
4. Accrued Interest on 600 units as on 01 06;2021 = ₹ 60,000 × 9/100 × 5/12 = ₹ 2,250
5. Profit on Securities sold on 1st June = ₹ 54,150 (56,400 – 2,250)- ₹ 54,000 (60,000 × 90,000/1,00,000) = ₹ 150
6. Interest received on 30 06;2021 = ₹1,20,000 × 9/100 × 6/12 = ₹ 5,400
7. Accrued Interest on 400 units as on 30 09;2021 = ₹ 40,000 × 9/100 × 3/12 = ₹ 900
8. Cost of 400 Govt. Securities sold on 30;09;2021 = 40,000 × 90,000/1,00,000 = ₹ 36,000
9. Profit on securities sold on 30th September = ₹37,900 (38,800–900) – ₹ 36,000 = ₹ 1,900
10. Accrued Interest on 1 12;2021 = ₹ 10,000 × 9/100 × 5/12 = ₹ 375
11. Interest received on 31 12;2021 = ₹ 90,000 × 9/100 × 6/12 = ₹ 4,050
12. Accrued Interest on 100 units as on 01 03;2022 = ₹ 10,000 × 9/100 × 2/12 = ₹ 150
13. Cost of 100 Govt; Securities sold on 01;03;2022 = ₹ 10,000 × 73,600/80,000 = ₹ 9,200
14. Profit on securities sold on 01;03;2022 = ₹ 9,500 – ₹ 9,200 = ₹ 300 15

Calculation of closing balance:	**Units**	**₹**
Securities in hand remained in hand at 31/3/2022		
From original holding (1,00,000 – 60,000 – 40,000)		-
Purchased on 1st May (80,000 – 10,000)	70,000	64,400
Purchased on 1st December	10,000	10,000
	80,000	**74,400**

Question 20 (RTP Nov'23) (MTP March'21, Sep 22) **NB Pg. No.**

On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹ 15 per share (nominal value ₹ 10 each). He provides you the further information:

1. On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at ₹ 16 per share.
2. On 1st August, 20X1, P Ltd. issued one equity bonus share for every six shares held by the shareholders.
3. On 31st October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹ 15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of ₹ 2 per share and subscribed the rest on 5th November, 20X1.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 20 X2. **(6 Marks)**

Solution :

In the books of Rajat
Investment Account
(Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.X1	To Balance b/d	50,000	7,50,000	31.3.X2	By Balance c/d (Bal. fig.)	90,000	12,10,000
20.6.X1	To Bank A/c	10,000	1,60,000				
1.8.X1	To Bonus issue(W.N.1)	10,000	-				
5.11.X1	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	**12,10,000**			**90,000**	**12,10,000**

Working Notes:

(1) Bonus shares $= \frac{(50,000 + 10,000)}{6}$ = 10,000 shares

(2) Right shares $= \frac{(50,000 + 10,000 + 10,000)}{7} \times 3$ = 30,000 shares

(3) Sale of rights = 30,000 shares $\times \frac{1}{3}$ × ₹ 2= ₹ 20,000 to be credited to statement of profit and loss

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

Question 21 **NB Pg. No.**

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹ 15 per share (nominal value ₹ 10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹ 1,00,000. ABC Ltd. announced a bonus and right issue.

1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.
2) Right shares are to be issued to the existing shareholders on 1st September 20X1. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.
3) Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 20X1.XY Ltd.
   (i) Took up half the right issue.
   (ii) Sold the remaining rights for ₹ 8 per share.
   (iii) Sold half of its shareholdings on 1st January 20X2 at ₹ 16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31st March 20X2 assuming the shares are being valued at average cost.

Solution :

In the books of XY Ltd.

Investment in equity shares of ABC Ltd.

for the year ended 31st March, 20X2

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend ₹	Amount ₹
20X1 April 1	To Balance b/d	15,000	-	2,25,000	20X1 Oct. 31	By Bank A/c (W.N. 5)	-	30,000	10,000
June 1	To Bank A/c	5,000	–	1,00,000	20X2 Jan. 1	By Bank A/c (W.N.4)	13,000	-	2,12,355
July 1	To Bonus Issue(W.N. 1)	4,000	-	-	March 31	By Balance c/d (W.N. 6)	13,000	-	1,69,500
Sept.1	To Bank A/c (W.N. 2)	2,000	-	24,000					
20X2 Jan 1	To P & L A/c (W.N. 4)	- –	-	42,855					
"20X2 March 31	To P & L A/c	-	30,000	-					
		26,000	**30,000**	**3,91,855**			**26,000**	**30,000**	**3,91,855**

Working Notes:

1. Calculation of no. of bonus shares issued

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

2. Calculation of right shares subscribed

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

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

Value of right shares subscribed = 2,000 shares @ ₹ 12 per share

= ₹ 24,000

3. Calculation of sale of right entitlement

2,000 shares x ₹ 8 per share = ₹ 16,000

Amount received from sale of rights will be credited to statement of profit and loss.

4. Calculation of profit on sale of shares

Total holding = 15,000 shares original
5,000 shares purchased
4,000 shares bonus
2,000 shares right shares
26,000 shares

50% of the holdings were sold i.e. 13,000 shares (26,000 x1/2) were sold.

Cost of total holdings of 26,000 shares (on average basis)

= ₹ 2,25,000 + ₹ 1,00,000 + ₹ 24,000– ₹ 10,000 = ₹ 3,39,000

Average cost of 13,000 shares would be

$$= \frac{3,39,000}{26,000} \times 13,000 = ₹\ 1,69,500$$

	₹
Sale proceeds of 13,000 shares (13,000 x ₹16.50)	2,14,500
Less: 1% Brokerage	(2,145)
	2,12,355
Less: Cost of 13,000 shares	(1,69,500)
Profit on sale	42,855

5. Dividend received on investment held as on 1st April, 20X1

= 15,000 shares x ₹ 10 × 20%

= ₹ 30,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st June, 20X1

= 5,000 shares x ₹ 10 × 20% = ₹10,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 1st July, 20X1 and dividend pertains to the year ended 31.3.20X1.

6. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

$$13,000 \times \frac{3,39,000}{26,000} = ₹\ 1,69,500$$

Question 22 **NB Pg. No.**

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for ₹ 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.

On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.

On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost. **(8 Marks)**

Solution :

Investment Account in Books of Vijay

(Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.20X1	To Bal b/d	30,000	4,50,000	31.10.20X1	By Bank (dividend on shares acquired on 22.6.20X1)	—	10,000
22.6.20X1	To Bank	5,000	80,000				
10.8.20X1	To Bonus	5,000	–				
30.9.20X1	To Bank (Rights Shares)	10,000	1,50,000				
15.11.20X1	To P&L A/c (Profit on sale of shares)		32,000	15.11.20X1	By Bank (Sale of shares)	20,000	3,00,000
				31.3.20X2	By Bal. c/d	30,000	4,02,000
		50,000	**7,12,000**			**50,000**	**7,12,000**

Working Notes:

(1) Bonus Shares = (30,000 + 5,000) / 7 = 5,000 shares

(2) Right Shares = $\frac{(30,000 + 5,000 + 5,000)}{8} \times 3$ = 15,000 shares

(3) Rights shares sold = 15,000×1/3 = 5,000 shares

(4) Dividend received = 30,000×10×20% = ₹ 60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.20X1

= 5,000×10×20%

= ₹ 10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost

Sales proceeds = ₹ 3,00,000

Average cost = $\frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 20,000$

= ₹ 2,68,000

Profit = ₹ 3,00,000– ₹ 2,68,000= ₹ 32,000.

(7) Cost of shares on 31.3.20X2

$$\frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 30,000$$

= ₹ 4,02,000

(8) Sale of rights amounting ₹ 10,000 (₹ 2 × 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

Question 23 NB Pg. No.

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of ₹ 100 each in TELCO Ltd. @ ₹ 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ₹ 100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ₹ 175 per share and ₹ 90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

Solution :

In the books of Mr. Krishna Murty

Investment Account for the year ended 31st March, 20X2

(Scrip: Equity Shares of TELCO Ltd.)

Date	Particulars	Nominal Value (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Cost (₹)
1.4.20X1	To Bank A/c (W.N.1)	1,00,000	1,23,000	31.3.20X2	By Bank A/c (W.N.2)	50,000	44,100
31.1.20X2	To Bonus shares (W.N.5)	50,000	–	31.3.20X2	By Balance c/d (W.N.4)	1,00,000	82,000
31.3.20X2	To Profit & loss A/c (W.N.3)	–	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

Working Notes:

1. **Cost of equity shares purchased** on 1.4.20X1 = (1,000 x₹ 120) + (2% of ₹ 1,20,000) + (½% of ₹ 1,20,000) = ₹ 1,23,000
2. **Sale proceeds of equity shares** (bonus) sold on 31st March, 20X2= (500 x₹ 90) – (2% of ₹ 45,000) = ₹ 44,100.
3. **Profit on sale of bonus shares on 31st March, 20X2**

   = Sale proceeds – Average cost

   Sale proceeds = ₹ 44,100

   Average cost = ₹ (1,23,000 /1,50,000) x 50,000 = ₹ 41,000

   Profit = ₹ 44,100 – ₹ 41,000 = ₹ 3,100.
4. **Valuation of equity shares on 31st March, 20X2**

   Cost = (₹ 1,23,000/1,50,000) x 1,00,000 = ₹ 82,000

Market Value = 1,000 shares × ₹ 90 = ₹ 90,000

Closing balance has been valued at ₹ 82,000 being lower than the market value.

5. **Bonus shares do not have any cost.**

Question 24 (MTP March '23) **NB Pg. No.**

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of ₹ 15 per share (Nominal value ₹ 10). On 20.6.20X1, he purchased another 5,000 shares of the company at ₹16 per share. The directors of 'X' Ltd. announced a bonus and rights issue.

No dividend was payable on these issues. The terms of the issue are as follows:

Bonus basis 1:6 (Date 16.8.20X1).

Rights basis 3:7 (Date 31.8.20X1) Price ₹ 15 per share.

Due date for payment 30.9.20X1.

Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of ₹ 2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of ₹ 5 per share.

You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account. (10 Marks)

For your exercise, assume that the books are closed on 31.12.20X1and shares are valued at average cost.

Solution :

Books of Sundar

Investment Account

(Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
1.4.20X1	To Bal b/d	25,000	3,75,000	31.10.20X1	By Bank (dividend on shares acquired on 20/6/20X1) (W.N.4)	—	10,000
20.6.20X1	To Bank	5,000	80,000				
16.8.20X1	To Bonus (W.N.1)	5,000	—				
30.9.20X1	To Bank (Rights Shares) (W.N.3)	10,000	1,50,000				
15.11.20X1	To Profit (on sale of shares)		44,444	15.11.20X1	By Bank (Sale of shares)	25,000	3,75,000
				31.12.20X1	By Bal. c/d (W.N.6)	20,000	2,64,444
		45,000	**6,49,444**			**45,000**	**6,49,444**

Profit and Loss Account (An extract)

To Balance c/d	1,04,444	By Profit transferred	44,444
		By Sale of rights (W.N.3)	10,000
		By Dividend (W.N.4)	50,000
	1,04,444		**1,04,444**

Working Notes:

(1) Bonus Shares = $\frac{(25,000+5,000)}{6}$ = 5,000 shares

(2) Right Shares = $\frac{(25,000+5,000+5,000)}{7} \times 3$ = 15,000 shares

(3) Right shares renounced = 15,000×1/3 = 5,000 shares

Sale of right shares = 5,000 × 2 = ₹ 10,000

Right shares subscribed = 15,000 – 5,000 = 10,000 shares

Amount paid for subscription of right shares = 10,000 × 15 = ₹ 1,50,000

(4) Dividend received = 25,000 (shares as on 1st April 20X1) × 10 × 20% = ₹ 50,000

Dividend on shares purchased on 20.6.20X1 = 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c

(5) Profit on sale of 25,000 shares

= Sales proceeds – Average cost

Sales proceeds = ₹ 3,75,000

Average cost = $\frac{(3,75,000+80,000+1,50,000-10,000)}{45,000} \times 25,000$ = ₹ 3,30,556

Profit = ₹ 3,75,000– ₹ 3,30,556= ₹44,444.

(6) Cost of shares on 31.12.20X1

$\frac{(3,75,000+80,000+1,50,000-10,000)}{45,000} \times 20,000$ = ₹ 2,64,444

Question 25 (MTP Oct'19) (RTP Nov 18) (Past Exam Jan'21, Nov '22) **NB Pg. No.**

Akash Ltd. had 4,000 equity share of X Limited, at a book value of Rs. 15 per share (face value of Rs. 10 each) on 1st April 2018. On 1st September 2018, Akash Ltd. acquired 1,000 equity shares of X Limited at a premium of Rs. 4 per share. X Limited announced a bonus and right issue for existing share holders.

The terms of bonus and right issue were –

1. At the rate of two equity shares for every five equity shares held on 30th September, 2018.
2. Right shares are to be issued to the existing shareholders on 1st December, 2018. The company issued two right shares for every seven shares held at 25% premium. No dividend, was payable on these shares. The whole sum being payable by 31st December, 2018.
3. Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.
4. Akash Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for Rs. 8 per share.
5. Dividend for the year ended 31st March 2018, at the rate of 20% was declared by the company

and received by Akash Ltd., on 20th January 2019.

6. On 1st February 2019, Akash Ltd., sold half of its share holdings at a premium of Rs. 4 per share.
7. The market price of share on 31.03.2019 was Rs. 13 per share.

You are required to prepare Investment Account of Akash Ltd. for year ended 31st March, 2019 and determine the value of shares held on that date assuming investment as current investment.

(10 Marks)

Solution :

Investment Account-Equity Shares in X Ltd.

Date		No. of shares	Dividend	Amount	Date		No. of shares	Dividend	Amount
			Rs	Rs				Rs	Rs.
2018					2019				
April 1	To Balance b/d	4,000	-	60,000	Jan. 20	By Bank (dividend)		8,000	2,000
Sept 1	To Bank	1,000	-	14,000	Feb. 1	By Bank	4,000		56,000
Sept. 30	To Bonus Issue	2,000		-	Mar. 31	By Balance c/d	4,000		42,250
Dec.1	To Bank (Right)	1,000	-	12,500					
2019									
Feb. 1	To Profit & Loss A/c			13,750					
Feb. 1	To Profit & Loss A/c (Dividend income)		8,000						
		8,000	**8,000**	**1,00,250**			**8,000**	**8,000**	**1,00,250**
April. 1	To Balance b/d	4,000		42,250					

Working Notes:

	Rs.
(Rs. 60,000 + Rs. 14,000 + Rs. 12,500)	86,500
Less: Dividend on shares purchased on 1st Sept, 2018	(2,000)
Cost of 8,000 shares	84,500
Cost of 4,000 shares (Average cost basis*)	42,250
Sale proceeds (4,000 shares @ 14/-)	56,000
Profit on sale	13,750

1. **Cost of shares sold. Amount paid for 8,000 shares**

   For ascertainment of cost for equity shares sold, average cost basis has been applied.

2. **Value of investment at the end of the year**

Closing balance will be valued based on lower of cost (Rs. 42,250) or net realizable value (Rs.13 x 4,000). Thus investment will be valued at Rs. 42,250.

3. Calculation of sale of right entitlement

1,000 shares x Rs. 8 per share = Rs. 8,000

Amount received from sale of rights will be credited to P & L A/c as per AS 13

4. Dividend received on investment held as on 1st April, 2018

= 4,000 shares x Rs. 10 × 20%

= Rs. 8,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st Sep. 2018

= 1,000 shares x Rs. 10 × 20% = Rs. 2,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30th Sept., 2018 and dividend pertains to the year ended 31.3.2018.

Question 26 (MTP Oct'20, Mar'22) (Past Exam May'18) **NB Pg. No.**

Mr. Vijay entered into the following transactions of purchase and sale of equity shares of JP Power Ltd/ The shares have paid up value of ₹ 10 per share

Date	No. of Shares	Terms
01.01.2019	600	Buy @ ₹ 20 per share
15.03.2019	900	Buy @ ₹ 25 per share
20.05.2019	1000	Buy @ ₹ 23 per share
25.07.2019	2500	Bonus Shares received
20.12.2019	1500	Sale @ ₹ 22 per share
01.02.2020	1000	Sale @ ₹ 24 per share

Addition information:

1) On 15.09.2019 dividend @ ₹ 3 per share was received for the year ended 31.03.2019.

2) On 12.11.2019 company made a right issue of equity shares in the ratio of one share for five shares held on payment of ₹ 20 per share. He subscribed to 60% of the shares and renounced the remaining shares on receipt of ₹ 3 per share.

3) Shares are to be valued on weighted average cost basis.

You are required to prepare Investment Account for the year ended 31.03.2019 and 31.03.2020.

(8 Marks)

Solution :

(a) (i) Investment in Equity shares of JP Power Ltd.

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend ₹	Amount ₹
1.1.19	To Bank A/c	600		12,000	31.3.19	By Balance c/d	1,500		34,500
15.3.19	To Bank A/c	900		22,500					
		1,500		**34,500**			**1,500**		**34,500**

1.4.19	To Balance b/d	1,500		34,500	15.9.19	By Bank dividend		4,500	3,000
20.5.19	To Bank A/c	1,000		23,000	20.12.19	By Bank	1,500		33,000
25.7.19	To Bonus shares	2,500		_	1.2.20	By Bank	1,000		24,000
12.11.19	To Bank A/c	600		12,000	31.3.20	By Balance c/d	3,100		36,812.50
20.12.19	To P& L A/c (profit on sale)			15,187.50					
1.2.20	To P& L A/c (profit on sale)			12,125					
31.3.20	To P & L A/c (dividend)		4,500						
		5,600	4,500	96,812.50			5,600	4,500	96,812.50

Working Notes:

1. **Calculation of Weighted average cost of equity shares**

   600 shares purchased at ₹ 12,000

   900 shares purchased at ₹ 22,500

   1,000 shares purchased at ₹ 23,000

   2,500 shares at nil cost

   600 right shares purchased at ₹ 12,000

   Total cost of 5,600 shares is ₹ 66,500 [₹ 69,500 less ₹ 3,000 (pre-acquisition dividend received on 1,000 shares purchased on 20.5.19].

   Hence, weighted average cost per share will be considered as ₹ 11;875 per share (66,500/5,600);

2. It has been considered that no dividend was received on bonus shares as the dividend pertains to the year ended 31set March, 2019.

3. **Calculation of right shares subscribed by Vijay Right Shares (considering that right shares have been granted on Bonus shares also) = 5,000/5 × 1= 1,000 shares**

   Shares subscribed = 1,000 × 60%= 600 shares

   Value of right shares subscribed = 600 shares @ ₹ 20 per share = ₹ 12,000 Calculation of sale of right renouncement

   No. of right shares sold = 1,000 × 40% = 400 shares

   Sale value of right = 400 shares x ₹ 3 per share = ₹ 1,200

   Note: As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.

4. **Profit on sale of equity shares**

   As on 20.12.19

   Sales price (1,500 shares at ₹ 22) 33,000.00

Less: Cost of shares sold (1,500 x ₹ 11.875)	(17,812.50)
Profit on sale	15,187.50
As on 1. 2.20	
Sales price	(1,000 shares at ₹ 24) 24,000
Less: Cost of shares sold (1,000 x ₹ 11.875)	(11,875)
Profit on sale	12,125

Balance of 3,100 shares as on 31;3;20 will be valued at ₹ 36,812;50 (at rate of ₹ 11.875 per share)

Question 27 (RTP May 20) (MTP Oct '18, Mar'18) **NB Pg. No.**

Meera carried out the following transactions in the shares of Kumar Ltd.:

(1) On 1st April, 2019 she purchased 40,000 equity shares of Rs.1 each fully paid up for Rs.60,000.

(2) On 15th May 2019, Meera sold 8,000 shares for Rs.15,200.

(3) At a meeting on 15th June 2019, the company decided:

(i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2019 and

(ii) To give its members the right to apply for one share for every five shares held on 1st June 2019 at a price of Rs.1.50 per share of which 75 paise is payable on or before 15th July 2019 and the balance, 75 paise per share, on or before 15th September, 2019.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2019.

a) Meera received her bonus shares and took up 4,000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30th September 2019.

b) On 15th March 2020, she received interim dividend from Kumar Ltd. of 15 per cent in respect of the current financial year.

c) On 30th March 2020, she received Rs.28,000 from the sale of 20,000 shares. You are required to record these transactions in the Investment Account in Meera's books for the year ended 31st March 2020 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis. Expenses and tax to be ignored **(8 Marks)**

Solution :

Investment Account (Shares in Kumar Limited) in the books of Meera

Date	Particulars	No. of Shares	Income	Amount	Date	Particulars	No. of Shares	Income	Amount
2019			Rs	Rs	2019			Rs	Rs.
April 1	To Bank (Purchases)	40,000	-	60,000	May 15	By Bank (Sale)	8,000	-	15,200
May 15	To Profit & Loss A/c (W.N.1)	-	-	3,200					
June15	To Bonus Issue	8,000	-	Nil	2020				

July 15	To Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By Bank (Dividend @ 15% on Rs.32,000)		4,800	-
Sept.	To Bank (@ 75 p. paid on 4,000 shares)	–	–	3,000	Mar. 30	By Bank (Sale)	20,000	-	28,000
2020 Mar. 31	To Profit & Loss A/c (W.N.2)			3,455	Mar. 31	By Balance c/d*	24,000	-	29,455
	To Profit & Loss A/c	-	4,800						
		52,000	**4,800**	**72,655**			**52,000**	**4,800**	**72,655**

$\left(\frac{24,000}{44,000} \times 54,000\right)$

Working Notes:

(1) Profit on Sale on 15–5–2019:	**(2)**	**(3)**
Cost of 8,000 shares @ Rs.1.50	Rs.12,000	
Less: Sales price	Rs.15,200	
Profit		Rs.3,200
(4) Cost of 20,000 shares sold:	**(5)**	**(6)**
Cost of 44,000 shares (48,000 + 6,000)		Rs.54,000
Cost of 20,000 shares $\left(\frac{\textbf{Rs.54,000}}{\textbf{44,000 Shares}} \times \textbf{20,000 Shares}\right)$		Rs.24,545
Profit on sale of 20,000 shares (Rs.28,000 – Rs.24,545)		Rs.3,455

Question 28 (Past Exam May'22) **NB Pg. No.**

On 1st April 2021 Ms. Jayshree has 5,000 equity shares of Rama Limited (a listed company) of face value of₹ 10 each. Ms. Jayshree has purchased the above shares at ₹15 per share and paid a brokerage of 2% and stamp duty of 1 %.

On 15th May,2021 Ms. Jayshree purchased another 5,000 shares of Rama Limited at ₹ 18 including brokerage and stamp duty.

On 26th August,2021 Rama Limited issued one bonus equity share for every 1 equity share held by the shareholders.

On 23rd October,2021 Rama Limited announced a Right Issue which entitles the holders to subscribe 1 equity share for every 2 equity shares held at ₹ 20 per share. Shareholders can exercise their rights in full or in part. Ms. Jayshree sold 1/4th of entitlement to Mr. Mike for a consideration of ₹ 10 per share and subscribed the rest on 1st November 2021.

Ms. Jayshree also sold 10,000 shares at ₹ 25 per share on 1st November, 2021. The shares of Rama Limited were quoted at ₹ 11 per share on 31st March,2022.

You are required to prepare Investment A/c for Ms. Jayshree for year ended 31st March 2022.

(5 Marks)

Solution :

In the books of Ms. Jayshree

Investment Account (Equity shares in Rama Ltd.)

Date	Particulars	No. of Shares	Income	Amount	Date	Particulars	No. of Shares
1.4.21	To Balance b/d	5,000	77,250	1.11.21	By Bank A/c	10,000	2,50,000
15.5.21	To Bank A/c	5,000	90,000				
26.8.21	To Bonus issue (W.N.1)	10,000	-	31.3.22	By Balance c/d	17,500	1,92,500
1.11.21	To Bank A/c (right shares) (W.N.4)	7,500	1,50,000	31.3.22	By Profit & Loss A/c (loss on valuation)		9,386
1.11.21	To Profit & Loss A/c		1,34,636				
		27,500	**4,51,886**			**27,500**	**4,51,886**

Working Notes:

1) Profit on sale of shares (average cost basis) on 1;11;21 10,000 shares @ ₹ 25 per share = 2,50,000 Cost of shares sold = [(77,250 + 90,000 + 1,50,000)/27,500 × 10,000] = ₹ 1,15,364 Profit on sale of shares

   = ₹ 1,34,636

2) Value of shares on 31.3.22 [(77,250 + 90,000 + 1,50,000)/27,500 × 17,500]

   = ₹ 2,01,886 or ₹ 1,92,500 (17,500 shares at ₹ 11)

   Shares will be valued at ₹, 1,92,500 as market value is less than cost;

Note: Average cost basis has been considered for valuation of shares at the year end and for calculation of cost of shares sold in the given answer.

Question 29 (PYQ Sept.24) **NB Pg. No.**

On 01.04.2023, Mr. Day has 25,000 shares of Squares Ltd. at a book value of Rs.25 per share (nominal value of Rs.10 each). Further information is as under:

(i) On 31st July 2023, the Directors of Squares Ltd. issued one equity bonus share for every five shares held by the shareholders.

(ii) On 30th September 2023, the Directors of Squares Ltd. announced a right issue which entitled the ·holders to subscribe three shares for every two shares at Rs.20 per share. Shareholders can transfer their rights in full or in part.

Mr. Day sold 1/4th of entitlement to Dhwani for a consideration of Rs.5 per share and subscribed the rest on 5th October, 2023.

You are required to prepare Investment A/c in the books of Mr. Day for the year ending 31.03.2024.

(4 Marks)

Solution :

In the books of Mr. Day Investment Account

(Equity shares in Square Ltd.)

Date	Particulars	No. of shares	Amount (Rs.)	Date	Particulars	No. of shares	Amount (Rs.)
1.4.23	To Balance b/d	25,000	6,25,000	31.3.24	By Balance c/d (Bal. fig.)	63,750	13,00,000
31.7.23	To Bonus issue (W.N.1)	5,000	-				
5.10.23	To Bank A/c (right shares) (W.N.4)	33,750	6,75,000				
		63,750	13,00,000			63,750	13,00,000

Working Notes:

(1) Bonus shares = 25000/5 = 5000 Shares

(2) Right shares = (25000+5000/2) x 3 = 45000 Shares

(3) Sale of rights = 45000 shares x 1/4 x Rs.5 = Rs.56250

Rs.56,250 to be credited to statement of profit and loss

(4) Rights subscribed = 45000 shares x 3/4 x Rs.20 = Rs.675000

Question 30 (RTP Nov'19 Nov'22) (MTP Nov'21) **NB Pg. No.**

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of Rs.100 each of P Ltd. on 1st May 2018 @ Rs.105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st 2018 the company again purchased 2,500 of such debentures @ Rs.102.50 each on cum interest basis. On 1st October, 2018 the company sold 2,000 Debentures @ Rs.103 each. On 31st December, 2018 the company received 10,000 equity shares of Rs.10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018. The market value of the debentures and equity shares as at the close of the year were Rs.106 and Rs.9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis. **(8 Marks)**

Solution :

Books of A Pvt. Ltd.

Investment in 13.5% Convertible Debentures in P Ltd. Account

(Interest payable 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
		₹	₹	₹			₹	₹	₹
2018					2018				
May 1	To Bank	5,00,000	5,625	5,19,375	Sept. 30	By Bank (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					

Dec. 31	To P&L A/c		52,313		Dec. 31	By Equity share	1,10,000		1,12,108
					Dec. 31	By Bank (See note1)		3,713	
					Dec. 31	By Balance c/d	4,40,000	14,850	4,48,434
		7,50,000	**69,188**	**7,66,542**			**7,50,000**	**69,188**	**7,66,542**

Note 1: Rs.3,713 received on 31.12.2018 represents interest on the debentures converted till date of conversion.

Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

Investment in Equity shares in P Ltd. Account

Date	Particulars	Nominal	Amount	Date	Particulars	Nominal	Amount
		₹	₹			₹	₹
2018	To 13.5% Deb.	1,00,000	1,12,108	2018		1,00,000	
Dec 31				Dec.31	By P&L A/c		22,108
				Dec.31	By Bal. c/d		90,000
		1,00,000	**1,12,108**			**1,00,000**	**1,12,108**

Note 1: Cost being higher than Market Value the shares are carried forward at Market Value.

Working Notes:

1. Interest paid on Rs.5,00,000 purchased on May 1st, 2018 for the month of April 2018, as part of purchase price: 5,00,000 × 13.5% x 1/12 = Rs.5,625
2. Interest received on 30th Sept. 2018

   On Rs.5,00,000 = 5,00,000 × 13.5% x ½ = 33,750

   On Rs.2,50,000 = 2,50,000 × 13.5% x ½ = 16,875

   Total Rs. = 50,625
3. Interest paid on Rs.2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018 as part of purchase price:

   2,50,000 × 13.5% x 4/12 = Rs.11,250
4. Loss on Sale of Debentures Cost of acquisition

   (Rs.5,19,375 + Rs.2,45,000) x Rs.2,00,000/Rs.7,50,000 = 2,03,833

   Less: Sale Price (2,000 × 103) = 2,06,000

   Profit on sale = Rs. 2,167
5. Interest on 1,100 Debentures (being those converted) for 3 months i.e., Oct-Dec. 2018

   1,10,000 × 13.5% x 3/12 = Rs.3,713
6. Cost of Debentures converted to Equity Shares

   (Rs.5,19,375 + Rs.2,45,000) x 1,10,000/7,50,000= Rs.1,12,108
7. Cost of Balance Debentures

   (Rs.5,19,375 + Rs.2,45,000) x Rs.4,40,000/Rs.7,50,000 = Rs.4,48,434
8. Interest on Closing Debentures for period Oct.- Dec. 2018 carried forward (accrued interest) Rs.4,40,000 × 13.5% x 3/12 = Rs.14,850

Question 31 : (MTP April'21, April'23, Oct'23, Sept.24, RTP May 19) **NB Pg. No.**

A Ltd. purchased on 1st April, 2023 8% convertible debenture in C Ltd. of face value of Rs. 2,00,000 @ Rs. 108. On 1st July, 2023 A Ltd. purchased another Rs. 1,00,000 debentures @ Rs. 112 cum interest. On 1st October, 2023 Rs. 80,000 debentures were sold @ Rs. 105. On 1st December, 2023, C Ltd. give option for conversion of 8% convertible debentures into equity share of Rs. 10 each. A Ltd. received 5,000 equity shares in C Ltd. in conversion of 25% debentures held on that date. The market price of debenture and equity share in C Ltd. on 31st December, 2023 is Rs. 110 and Rs. 15 respectively. Interest on debenture is payable each year on 31st March, and 30th September. Prepare investment account in the books of A Ltd. on average cost basis for the accounting year ended 31st December, 2023. **(10 Marks)**

Solution :

Investment Account for the year ending on 31st December, 2023

Scrip : 8% Convertible Debentures in C Ltd.

[Interest Payable on 31st March and 30th September]

Date	Particulars	Nominal value Rs.	Interest Rs.	Cost Rs.	Date	Particulars	Nominal Value (Rs.)	Interest (Rs.)	Cost (Rs.)
1.4.23	To Bank A/c	2,00,000	-	2,16,000	30.09.23	By Bank A/c	-	12,000	-
1.7.23	To Bank A/c (W.N.1)	1,00,000	2,000	1,10,000		[Rs.3,00,000 x 8% x (6/12]			
31.12.23	To P & L A/c [Interest]	-	14,033	-	1.10.23	By Bank A/c	80,000		84,000
					1.10.23	By P & L A/c (loss) (W.N.3)			2,933
					1.12.23	By Bank A/c (Accrued interest) (Rs. 55,000 x .08 × 2/12)		733	
					1.12.23	By Equity shares in C Ltd. (W.N. 3 and 4)	55,000		59,767
					31.12.23	By Balance c/d (W.N.5)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

SCRIP: Equity Shares in C LTD.

Date	Particulars	Cost (Rs.)	Date	Particulars	Cost (Rs.)
1.12.23	To 8 % debentures	59,767	31.12.23	By balance c/d	59,767

Working Notes:

(i) Cost of Debenture purchased on 1st July

= Rs. 1,12,000 – Rs. 2,000 (Interest) = Rs.1,10,000

(ii) Cost of Debentures sold on 1st Oct.

= (Rs. 2,16,000 + Rs. 1,10,000) x 80,000/3,00,000 = Rs. 86,933

(iii) Loss on sale of Debentures = Rs. 86,933– Rs.84,000 = Rs. 2,933 Nominal value of debentures converted into equity shares

=Rs. 55,000 [(Rs. 3,00,000 – 80,000) x.25]

Interest received before the conversion of debentures

Interest on 25% of total debentures = 55,000 × 8% x 2/12 = 733

(iv) Cost of Debentures converted = (Rs. 2,16,000 + Rs.1,10,000) x 55,000/3,00,000 = Rs. 59,767

(v) Cost of closing balance of Debentures = (Rs. 2,16,000 + Rs.1,10,000) x 1,65,000 / 3,00,000 = Rs. 1,79,300

(vii) Closing balance of Debentures has been valued at cost.

(viii) 5,000 equity Shares in C Ltd. will be valued at cost of Rs. 59,767 being lower than the market value Rs. 75,000 (Rs. 15 x5,000)

Note: It is assumed that interest on debentures, which are converted into cash, has been received at the time of conversion.

Question 32 NB Pg. No.

Following transactions of Meeta took place during the financial year 2020 -21:

1st April, 2020	Purchased ₹ 4,500 8% bonds of ₹ 100 each at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.
1st May, 2020	Received half year's interest on 8% bonds;
10 July, 2020	Purchased 6,000 equity shares of ₹ 10 each in Kamal Limited for ₹ 44 each through a broker, who charged brokerage @ 2%.
1st October 2020	Sold 1,125 8% bonds at ₹ 81 Ex-interest.
1st November, 2020	Received half year's interest on 8% bonds;
15th January, 2021	Received 18% interim dividend on equity shares of Kamal Limited.
15th March, 2021	Kamal Limited made a rights issue of one equity share for every four Equity shares held at ₹ 5 per share; Meeta exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹ 2.25 per share;

Prepare separate investment account for 8% bonds & equity shares of Kamal Limited in the books of Meeta for year ended on 31st March, 2021. Assume that the average cost method is followed.

(10 Marks)

Solution :

In the books of Meeta

8% Bonds for the year ended 31st March, 2021

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2020	To Bank A/c	2,00,000	-	2,16,000	30.09.23	By Bank A/c	-	12,000	-
1 April,	To Bank A/c	4,500	15,000	3,47,250	1 May 2020	By Bank-Interest	-	18,000	
Oct. 1	To P & L A/c (W.N.1)		-	4,312.50	1 Oct. 2020	By Bank A/c	1,125	3,750	91,125
2021 March 31	To P & L A/c		20,250		1 Nov. 2021	By Bank-Interest		13,500	
					2021 Mar. 31	By Balance c/d (W.N.2)	3,375	–	2,60,437.50
		4,500	35,250	3,51,562.50			4,500	35,250	3,51,562.50

Investment in Equity shares of Kamal Ltd. for the year ended 31 st March, 2021

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2020 July 10	To Bank A/c	6,000	-	2,69,280	2021 Jan 15	By Bank dividend	–	10,800	
2021 March 15	To Bank A/c (W.N. 3)	600	–	3,000	March 31	By Balancec/d bal. fig.)	6,600		2,72,280
March 31	To P & L A/c	–	10,800						
		6,600	10,800	2,72,280			6,600	10,800	2,72,280

Working Notes:

1. **Profit on sale of 8% Bonds**

   Sales price ₹ 91,125

   Less: Cost of bonds sold = 3,47,250/4,500x 1,125 (₹ 86,812.50)

   Profit on sale ₹ 4,312.50

2. **Closing balance as on 31.3.2021 of 8 % Bonds**

   3,47,250/4,500x 3,375= ₹ 2,60,437;50

3. **Calculation of right shares subscribed by Kamal Ltd.**

   Right Shares = 6,000/4 × 1= 1,500 shares

   Shares subscribed by Meeta = 1,500 × 40%= 600 shares

   Value of right shares subscribed = 600 shares @ ₹ 5 per share = ₹ 3,000

4. **Calculation of sale of right entitlement by Kamal Ltd.**

   No. of right shares sold = 1,500 – 600 = 900 rights for 2,025

   Note: As per para 13 of AS 13, sale proceeds of rights are to be credited to P & L A/c.

Question 33 NB Pg. No.

Mr. X acquires 200 shares of a company on cum-right basis for ₹ 70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 107 each. He does not subscribe but sells all the rights for ₹ 12,000. The market value of the shares after their becoming exrights has also gone down to ₹ 60,000. What should be the accounting treatment in this case?

Solution :

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹ 60,000. In this case, out of sale proceeds of ₹ 12,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value and ₹ 2,000 would be credited to the profit and loss account.

Question 34 (RTP May'21) NB Pg. No.

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd Rs. 1,20,000 (face value Rs.100 each). On 5.04.2019 he further purchased 200 cum-right shares for Rs. 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of Rs. 20 each. All the shares held by Shyam had been acquired on cum right basis and the total market price (ex-right) of all these shares after the declaration of rights got reduced by Rs. 3,400. On 10.10.2019 Shyam sold 350 shares for Rs. 140 each. 31.03.2020 The market price of each share is Rs. 125 each. You are required to prepare the Investment account in the books of Mr. Shyam for the year ended 31.03/2020 assuming that the shares are being valued at average cost.

Solution :

In the books of Mr. Shyam

for the year ending on 31–3–2020 (Scrip: Equity Shares of X Limited)

Date	Particulars	Qty	Amount	Date	Particulars	Qty	Amount
1.4.2019	To Balance b/d	1000	1,20,000	8.04.2019	By Bank A/c (W.N.1)		3,400
5.04.2019	To Bank (200x Rs.135)	200	27,000	10.10.2019	By Bank A/c (350x Rs.140)	350	49,000
10.10.2019	To Profit & Loss A/c (W.N.2)		7,117	31.3.2020	By Balance c/d (W.N.3)	850	1,01,717
		1200	1,54,117			1200	1,54,117

Working Notes:

1. **Sale of Rights** Rs. 4,000

The market price of all shares of X Ltd after shares becoming ex-rights has been reduced by Rs. 3,400 In this case out of sale proceeds of Rs.4,000; Rs. 3,400 may be applied to reduce the carrying amount to the market value and Rs. 600 would be credited to the profit and loss account.

2. Profit on sale of 350 shares

		Amount	
Sale price of 350 shares	(350 shares X 140 each)	Rs.	49,000
Less: Cost of 350 shares [(1,20,000+27,000–3,400) X350]/1200		Rs.	41,883
Profit		Rs.	7,117

3. Valuation of 850 shares as on 31.03.2020

Particulars	Amount
Cost price of 850 shares [(1,20,000 +27,000 -3,400) x 850 /1,200]	Rs. 1,01,717
Fair Value as on 31.03.2020 [850 X Rs. 125 each]	Rs. 1,06,250
Cost price or fair value whichever is less	Rs. 1,01,717

Question 35 (Past Exam Dec'21) **NB Pg. No.**

Mr. Mohan has invested some money in various Mutual funds. Following information in this regard is given:

Mutual Funds	Date of purchase	Purchase cost (₹)	Brokerage Cost (₹)	Stamp duty (₹)	Market value as on 31/03/2021 (₹)
A	01.05.2017	50,000	200	20	48,225
B	05.08.2020	25,000	150	25	24,220
C	01.01.2021	75,000	300	75	78,190
D	07.05.2020	70,000	275	50	65,880

You are required to:

1. Classify his investment in accordance with AS-13 (revised).
2. Value of Investment in mutual fund as on 31.03.2021 **(5 Marks)**

Solution :

As per AS 13 "Accounting for Investments", a current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. If there is a decline, other than temporary, in the value of a long-term investment; the carrying amount is reduced to recognize the decline.

Mutual Funds	Classification	Cost (₹)	Market value (₹)	Carrying value (₹)
A	Long-term Investment	50,220	48,225*	50,220
B	Current Investment	25,175	24,220	24,220
C	Current Investment	75,375	78,190	75,375
D	Current Investment	70,325	65,880	65,880
Total				2,15,695

Note: *The reduction in value of Mutual fund A is considered to be temporary. If reduction in Market value is assumed as other than temporary in nature, then the carrying value of ₹48,225 will be considered;

TELEGRAM: CA NOTE HUB

AS 15 – EMPLOYEE BENEFITS

Illustration 1

What are the kinds of employees covered in the revised AS 15 and whether a formal employer employee relationship is necessary or not, for benefits to be covered under the Standard?

Solution

The Standard does not define the term "employee". Paragraph 6 of the Standard states that 'an employee may provide services to an enterprise on a full time, part time, permanent, casual or temporary basis and the term would also include the whole-time directors and other management personnel. The Standard is applicable to all forms of employer employee relationships. There is no requirement for a formal employer employee relationship. Several factors need to be considered to determine the nature of relationship.

Generally, 'outsourcing contracts' may not meet the definition of employer -employee relationship. However, such contracts need to be carefully examined to distinguish between a "contract of service" and a "contract for services". A 'contract for services' implies a contract for rendering services, e.g., professional or technical services which is subject to limited direction and control whereas a 'contract of service' implies a relationship of an employer and employee, and the person is obliged to obey orders in the work to be performed and as to its mode and manner of performance.

Illustration 2

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

Solution

Paragraph 3(c) of the Standard defines employee benefits to include those informal practices that give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. The historical pattern of granting such benefits, the expectation created and the impact on the relationship with employees in the event such benefit is withdrawn should be considered in determining whether the informal practice gives rise to a benefit covered by the Standard. For example, where an employer has a practice of making a lumpsum payment on occasion of a festival or regularly grants advances against informal benefits to employees it would be necessary to provide for such benefits.

Careful judgement should be applied in assessing whether an obligation has arisen particularly in instances where an enterprise's practice is to provide improvements only during the collective bargaining process and not during any informal process. If the employer has not set a pattern of benefits that can be projected reliably to give rise to an obligation there is no requirement to provide for the benefits.

However, if the practice established by an employer was that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of the benefit obligation.

Employee benefits include:

a) Short-term employee benefits (e.g., wages, salaries, paid annual leave and sick leave, profit sharing bonuses etc. (payable within 12 months of the year-end) and non-monetary benefits for current employees.

b) Post-employment benefits (e.g., gratuity, pension, provident fund, postemployment medical care etc.).

c) long-term employee benefits (e.g., long-service leave, long-term disability benefits, bonuses not wholly payable within 12 months of the year end etc.), and

d) termination benefits (e.g. VRS payments)

The Standard lays down recognition and measurement criteria and disclosure requirements for the above four types of employee benefits separately.

Illustration 3

TELEGRAM: CA NOTE HUB

Entity XY is required to pay salary of ₹ 2 crore for the year 20X1-X2. It actually paid a salary of ₹ 1.90 crore up to 31st March 20X2, and balance in April 20X2.

Determine the actual costs to be recognized in the year 20X1-X2 and any amounts to be shown through balance sheet.

Solution

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

Illustration 4

Whether an entitlement to earned leave which can be carried forward to future periods is a short -term employee benefit or a long-term employee benefit.

Solution

Paragraph 7.2 of the Standard defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.

Paragraph 8(b) of the Standard illustrates the term 'Short -term benefits' to include "short term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service".

Paragraph 7.2 of the Standard uses "falls due" as the basis, paragraph 8(b) of the Standard uses "expected to occur" as the basis to illustrate classification of short term compensated absences. A reading of paragraph 8(b) together with paragraph 7.2 would imply that the classification of short -term compensated absences should be only when absences have "fallen due" and are also "expected to occur". In other words, where employees are entitled to earned leave which can be carried forward to future periods, the benefit would be a 'short-term benefit' provided the employee is entitled to either encash or utilise the benefit during the twelve months after the end of the period when the employee became entitled to the leave and is also expected to utilise the leave.

Where there are restrictions on encashment and/or availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long-term benefit. For example, where an employee has 100 days of earned leave which he is entitled to an unlimited carry forward, but the rules of the enterprise allow him to encash/utilise only 30 days during the next twelve months, the benefit would be considered as a 'long-term' benefit. In some situations, where there is no restriction but the absence is not expected to wholly occur in the next twelve months, the benefit should be considered as 'long-term'. For example, where an employee has 400 days carry forward earned leave and the past pattern indicates that the employees are unlikely to avail / encash the entire carry forward during the next twelve months, the benefit would not be 'short-term'.

Whilst it is necessary to consider the earned leave which "falls due", the pattern of actual utilisation/encashment by employees, although reflective of the behavioural pattern of employees, does determine the status of the benefit, i.e., whether 'short-term' or 'long-term'. The value of short-term benefits should be determined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordance with paragraph 129 of the Standard.

The categorisation in 'short-term' or 'long-term' employee benefits should be done on the basis of the overall behavioural pattern of all the employees of the enterprise and not on individual basis.

Illustration 5

In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be carried forward, whether it is required to recognise a provision in respect of carried forward benefits.

Solution

A provision should be recognised for all benefits (conditional or unconditional) which an employee becomes entitledto as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In estimating the cost of such benefit the probability of the employee availing such benefit should be considered.

TELEGRAM: CA NOTE HUB

Illustration 6 (RTP May'24)

Neerav Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs; The average remaining life of the employee is estimated to be 6 years. You are required to advise the company in accordance with AS 15.

Solution:

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Neerav Ltd. cannot spread the actuarial gain of ₹ 6 lakhs over the next 2 years by reducing the annual contributions to ₹ 2 lakhs instead of ₹ 5 lakhs. It has to contribute ₹ 5 lakhs annually for its pension schemes.

Illustration 7

As on 1st April, 20X1 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of ₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 20X2 the fair value of plan assets was₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,47,920. Actuarial losses on the obligations for the year 20X1- 20X2 were ₹ 600.

On 1st April, 20X1, the company made the following estimates, based on its market studies, understanding and prevailing prices.

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

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

Solution

Computation of Expected and Actual Returns on Plan Assets

		₹
Return on ₹ 1,00,000 held for 12 months at 10.25%		10,250
Return on ₹ 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)		1,500
Expected return on plan assets for 20X1-20X2		11,750
Fair value of plan assets as on 31 March, 20X2		1,50,000
Less: Fair value of plan assets as on 1 April,20X1	1,00,000	
Contributions received	49,000	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		20,000

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

Illustration 8

Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement,

TELEGRAM: CA NOTE HUB

because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:

a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.

b) The fair value of plan assets on the date is estimated at ₹ 5,100.

c) The unamortized past service cost is ₹ 180.

d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

Solution

Gain from curtailment is estimated as under:

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

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

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

Illustration 9

An employee Roshan has joined a company XYZ Ltd. in the year 20X1. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring. Thus he will get 5 yearly increment.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

Solution

Calculation of Defined Benefit Obligation (DBO)

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

TELEGRAM: CA NOTE HUB

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

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

Illustration 10

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

Solution:

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

a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

d) termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

TELEGRAM: CA NOTE HUB

Illustration 11

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

The company's contentions in this matter are:

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

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

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

Solution:

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

1. Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).
2. A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
3. Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Illustration 12

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.20X2 calculate the actual return on plan assets:

- Benefits paid	2,00,000
- Employer contribution	2,80,000
- Fair market value of plan assets on 31.03.20X2	11,40,000
- Fair market value of plan assets as on 31.03.20X1	8,00,000

Solution:

	₹
Fair value of plan assets on 31.3.20X1	8,00,000
Add: Employer contribution	2,80,000
Less: Benefits paid	(2,00,000)
(A)	8,80,000
Fair market value of plan assets at 31.3.20X2 (B)	11,40,000
Actual return on plan assets (B-A)	2,60,000

Illustration 13

TELEGRAM: CA NOTE HUB

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was ₹ 3,00,000.

On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	10.25
Realized gains on plan assets (after tax)	3.00
Fund administrative costs	(3.00)
Expected rate of return	10.25

Calculate the expected and actual returns on plan assets as on 31st March, 20X2, as per AS 15.

Solution:

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

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 20X2	22,000

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

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

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (RTP Nov 20)

Luv limited is a private Limited company. As per HR policy of Luv Limited, Grade F employees are eligible for sabbatical leave (Long term compensated absences as per AS 15). Till previous year, there were 15 employees who are eligible for Sabbatical leave and company had duly recorded the liability for long term compensated absences based on the actuarial valuation for eligible employees. During the current period out of total 15 employees, 13 employees have left the organization and only 2 employees are continuing in LUV Limited. Due to budget constraint, CFO has denied to involve actuary and told finance manager to determine the liability based on the recent actuarial report available with them. Finance manager ensured the following:

- There is no material change in interest rate
- There is no change in fair value of plan assets.

Based on that, Finance manager have manually computed an amount of Rs. 5,00,000 (considering last year actuarial report as base) towards long term compensation liability without involving Actuary during the period ended 31.03.2020. Is this treatment is in line with AS 15?

Solution:

As per para 58 of the AS 15, the detailed actuarial valuation of the present value of defined benefit obligations may be made at intervals not exceeding three years. However, with a view that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date, the most recent valuation is reviewed at the balance sheet date and updated to reflect any material transactions and other material changes in circumstances (including changes in interest rates) between the date of valuation and the balance sheet date. The fair value of any plan assets is determined at each balance sheet.

Since AS-15 (Para 58) states that actuarial valuation needs to be done at least once in three years. Since management had done the actuarial valuation in Previous Year, they can go ahead with exemption for this year subject to evaluation and conclusion by management as at balance sheet date that there are no significant changes in the amount of liability compared to previous year. Hence working done by the finance manager is appropriate. It is in line with AS 15, since company had recently done the actuaria l valuation in previous year and there is no material changes in the external environment.

TELEGRAM: CANOTE HUB

TEST YOUR KNOWLEDGE

MCQs

1. Gratuity and Pension would be examples of:

(a) Short-term employee benefits

(b) Long-term employee benefits

(c) Post-employment benefits.

(d) None of the above.

2. Non-accumulating compensating absence is commonly referred to as:

(a) Earned Leave

(b) Sick Leave

(c) Casual leave

(d) All of the above

3. The plans that are established by legislation to cover all enterprises and are operated by Governments include:

(a) Multi-Employer plans

(b) State plans

(c) Insured Benefits

(d) Employee benefit plan

4. Best estimates of the variable to determine the eventual cost of postemployment benefits is referred to as:

(a) Employer's contribution

(b) Actuarial assumptions

(c) Cost to Company

(d) Employee's contribution

5. Actuarial gains / losses should be:

(a) Recognised through reserves

(b) Charged over the expected life of employees

(c) Charged immediately to Profit and Loss Statement

(d) Do not charged to Profit and Loss Statement

Answers - MCQs

1. (c) 2. (c) 3. (b) 4. (b) 5. (c)

TELEGRAM: CA NOTE HUB

AS 16 – BORROWING COSTS

Illustration 1

PRM Ltd. obtained a loan from a bank for ₹ 120 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	Amount (₹ in lakhs)
Construction of a shed	50
Purchase of a machinery	40
Working Capital	20
Advance for purchase of truck	10

Construction of shed was completed in March 20X2. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-20X2 was ₹ 18 lakhs. Show the treatment of interest.

Solution

Qualifying Asset as per AS 16 = ₹ 50 lakhs (construction of a shed)

Borrowing cost to be capitalised = 18 x 50/120 = ₹ 7.5 lakhs

Interest to be debited to Profit or Loss account = ₹ (18 – 7.5) lakhs = ₹ 10.5 lakhs

Illustration 2 (RTP May'24)

X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 20X1 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

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

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

		₹
January	20X1	2,00,000
April	20X1	2,50,000
July	20X1	4,50,000
December	20X1	1,20,000

Building was completed by 31st December 20X1. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.

Solution

(i) Computation of weighted average accumulated expenses

		₹
₹ 2,00,000 x 12 / 12	=	2,00,000
₹ 2,50,000 x 9 / 12	=	1,87,500
₹ 4,50,000 x 6 / 12	=	2,25,000
₹ 1,20,000 x 1 / 12	=	10,000
		6,22,500

(ii) Calculation of weighted average interest rate other than for specific borrowings

TELEGRAM: CA NOTE HUB

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
5,00,000	11%	= 55,000
9,00,000	13%	= 1,17,000
14,00,000		1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000} \times 100\right)$		= 12.285% (approx.)

(iii) Interest on weighted average accumulated expenses

		₹
Specific borrowings (₹ 1,00,000 x 10%)	=	10,000
Non-specific borrowings(₹ 5,22,500*x 12.285%)	=	64,189
Amount of interest to be capitalised	=	74,189

(iv) Total expenses to be capitalized for building

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	Particulars		Dr. (₹)	Cr. (₹)
31.12. 20X1	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalised)			

Illustration 3 (MTP Oct '21)

The company has obtained Institutional Term Loan of ₹ 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to ₹ 406 lakhs, ₹ 58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹ 580 lakhs. **(5 Marks)**

Solution

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

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

The treatment for total interest amount of ₹ 52.20 lakhs can be given as:

Purpose	Nature	Interest to be capitalized	Interest to be charged to P&L account
		₹ in lakhs	₹ in lakhs

TELEGRAM: CA NOTE HUB

Modernisation and renovation of plant and machinery	Qualifying asset	**52.20 x $\frac{406}{580} = 36.54$	
Advance to supplies for additional assets	Qualifying asset	**52.20 x $\frac{58}{580} = 5.22$	52.20 x $\frac{116}{580} = 10.44$
Working Capital	Not a qualifying asset	41.76	10.44

* A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.

** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 20X2.

Illustration 4

Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 20X1-20X2. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹ 50 lakhs. As on 31st March, 20X2, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹ 4 lakhs and add it to the cost of investments. Comment.

Solution

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹ 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. Cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 20X2.

Illustration 5

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

Solution:

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

Illustration 6

H Ltd. incurs borrowing costs for the purpose of construction of a qualifying asset for its own use. The construction gets completed on May 31, 20X1. However, decoration work is under process which is

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expected to be completed by November 20X1 after which H Ltd. will be able to start using the said asset for its own use. H Ltd. wants to capitalize the eligible borrowing costs incurred up to November 20X1.

Solution:

The capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale is completed.

In the given case, H Ltd. should capitalize borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 20X1. The fact that decoration work was being carried out should not be considered as the asset was ready for its intended use on May 31, 20X1.

Illustration 7

ABC Ltd. is in the process of getting an entertainment park constructed. For this purpose, it has taken loan from a bank. The said park consists of several rides and facilities, each of which can be used individually. Three fourth part of the park has been constructed and can be opened up for public, while construction on the remaining part is continuing. Whether the capitalization of borrowing cost should continue for the whole park until construction continues?

Solution:

ABC Ltd. is in process of constructing an entertainment park which consists of several rides and facilities that can operate independently for their intended use. Even though the park as whole is not complete, the individual facilities are ready for their intended use.

The cessation of capitalization depends upon the nature of the qualifying assets, particularly where the qualifying assets consists of various parts. There are qualifying assets where each part is capable of being used while the construction continues on other parts. There are qualifying assets where all parts have to be completed before any earlier completed part can be put to use.

Since in the given scenario, the individual facilities are capable of operating independently and are ready for their intended use, therefore the borrowing costs shall cease to be capitalized for the three-fourth part of the project

Illustration 8 (RTP May 19)

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

(i)	Construction of sealink across two cities:		
	(work was held up totally for a month during the year due to high water levels)	:	₹ 25 crores
(ii)	Purchase of equipments and machineries	:	₹ 3 crores
(iii)	Working capital	:	₹ 2 crores
(iv)	Purchase of vehicles	:	₹ 50,00,000
(v)	Advance for tools/cranes etc.	:	₹ 50,00,000
(vi)	Purchase of technical know-how	:	₹ 1 crores
(vii)	Total interest charged by the bank for the year ending 31st March, 20X2	:	₹ 80,00,000

Show the treatment of interest by Amazing Construction Ltd.

Solution:

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

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

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

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	Qualifying Asset	Interest to be capitalized ₹	Interest to be charged to Profit & Loss A/c ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000x(25/32)]
Purchase of equipment and machineries	No		7,50,000	[80,00,000x(3/32)]
Working capital	No		5,00,000	[80,00,000x(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000x(0.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000x(1/32)]
Total		62,50,000	17,50,000	

*It is assumed that work held up for a month due to high water level is normal during the construction of sealink and capitalization of borrowing cost should not be suspended for necessary temporary delay.

Illustration 9 (MTP March'23) (RTP Nov 20)

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.20X1 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.20X2. Due to surplus fund out of ₹ 150 crores, income of ₹ 3.50 crores were earned and credited to profit and loss account.

Comment on the above treatment of accountant with reference to relevant AS. **(5 Marks)**

Solution:

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

The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Thus, the treatment of accountant of Rainbow Ltd. is incorrect.

Amount of borrowing costs capitalized should be calculated as follows:

Particulars	**₹ in crores**
Actual interest for 20X1-20X2 (11% of ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 20X1-20X2	13.00

Illustration 10 (RTP Nov '22)

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

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

(₹ in lakhs)

	Phase I	**Phase II**	**Phase III**	**Phase IV**

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

During mid of the current year, Phase I and Phase II have become operational.

Find out the total amount to be capitalized and to be expensed during the year.

Solution:

Computation of amount to be capitalized

No.	Particulars	₹
1.	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (₹ 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹ 55,00,000 +₹ 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate	30,00,000
	Loan amount = $\frac{2,21,00,000}{3,30,317}$× 98,00,000	(approx.)
7.	Interest on loan used for Phases III & IV, based on	16,69,683
	proportionate Loan amount =$\frac{30,00,000}{2,21,00,000}$ ×1,23,00,000	(approx.)

Accounting treatment

For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

For Phase III and Phase IV

Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

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MTP / RTP / Past Exam

Question 1 (MTP April 21, April'22) (RTP Nov'18)

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same.

Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16. (**5 Marks)**

Solution:

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case.

However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa. The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset.

The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 2 (MTP Mar'18, Mar'19, Mar'21, Sep'22, Oct '23) (RTP May'21)

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2021-22 for its residential project at 4%. The interest is payable at the end of the Financial Year. At the time of availment of loan exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2022 was ₹ 62 per US $. If Omega Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2022 as per applicable Accounting Standards **(4 Marks)**

Solution:

(i) Interest for the period 2021-22

= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

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

= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

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(iv) Difference between interest on local currency borrowing and foreign currency borrowing

= ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 3 (MTP Oct'18, Aug'18, Oct'19, Oct '22) (RTP May 20)

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01;05;2021, to be utilized as under:

Particulars	Amount (₹ in lakhs)
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2022, construction of the factory building was completed and machinery was installed and ready for it intended use; Total interest on debentures for the financial year ended 31;03;2022 was ₹ 11,00,000. During the year 2021-22, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000; Explain the treatment of interest under Accounting Standard 16 and also explain nature of assets. **(5 Marks)**

Solution:

As per AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred; Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be Capitalized (₹)	Interest to be charged to P&L Account (₹)
i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

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

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Question 4 (MTP Nov'21, April 23)

ABC Limited has started construction of an asset on 1st December, 2021, which continues till 31st March, 2022 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2021 and ₹ 4 lakh in each of the months of January to March 2022. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2022; Interest was paid on the overdraft at 10% until 1st January, 2022 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 **(5 Marks)**

Solution:

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of Outstanding balance	Amount of loan(Rs.)	Rate of interest p.a.	Weighted average amount of Interest (Rs.)
	a	b	c	d=[bXc)X(a/12)]
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		2,26,000

Weighted average cost of borrowings

=(20,00,000 x(12/12))+(4,00,000 x(11/12))+(8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest / Weighted average of general borrowings) x 100] = [(2,26,000 / 24,33,334) x 100] = 9.29% p.a.

Question 5 (RTP May'18, Nov 19, Nov 21)

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31 st March, 2021 amounted to ₹ 25 lakhs. the company wants to treat ₹ 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

Solution:

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 6 (RTP May '22)

a) An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15

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months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?

b) Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress?

Solution:

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

(b) As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete"; The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the cost of the asset.

Question 7 (RTP May 23)

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01;06;2021; Money raised from debentures to be utilized as under:

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

Additional Information:

Interest on debentures for the Financial Year 2021-2022 was paid by the Company.

During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000;

In March, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).

In March 2022, Machinery was installed and ready for its intended use.

Furniture was put to use at the end of March 2022.

Truck is going to be received in April, 2022.

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You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2022 in the Books of Expert Limited.

Solution:

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

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

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory building	Qualifying Asset	9,50,000x40/100 = ₹ 3,80,000	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100 = 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	9,50,000x2/100 =19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100 = 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100 = ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

Question 8 (Past Exam Nov'20) (MTP Sep '23)

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

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

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

In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets. **(5 Marks)**

Solution:

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying

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assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset.

Other borrowing costs should be recognized as an expense in the period in which they are incurred. Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are nonqualifying assets and related borrowing cost will be charged to Profit and Loss statement. Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs;

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

Question 9 (Past Exam May'19)

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

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

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

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

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

1. Calculate the amount of interest to be capitalized.
2. Pass Journal entry for capitalizing the cost & borrowing cost in respect of the factory building **(5 Marks)**

Solution:

(i) Computation of average accumulated expenses

		Rs.
Rs. 3,00,000 x 12 / 12	=	3,00,000
Rs. 2,40,000 x 10 / 12	=	2,00,000
Rs. 4,00,000 x 8 / 12	=	2,66,667
Rs. 3,60,000 x 3 / 12	=	90,000
		8,56,667

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (₹)

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4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	14%	= 42,000
Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000} \times 100\right)$		1,38,000
		= 11.5%

(iii) Amount of interest to be capitalized

Interest on average accumulated expenses:

	Rs.
Specific borrowings (Rs. 2,00,000 x 8%)	= 16,000
Non-specific borrowings (Rs. 6,56,667* x 11.5%)	= 75,517
Amount of interest to be capitalised	= 91,517

(iv) Total expenses to be capitalized for building

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

(v) Journal Entry

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

Question 10 (Past Exam May'22)

Zebra Limited began construction of a new plant on 1st April,2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

	₹
1st April,2021	10,00,000
1st August,2021	24,00,000
1st January,2022	4,00,000

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%;

The construction of the plant completed on 31st March,2022. You are required to:

a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

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b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant. **(5 Marks)**

Solution:

Total expenses to be capitalized for borrowings as per AS 16 "Borrowing Costs":

	₹
Cost of Plant (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalized (W.N.)	3,24,000
	41,24,000

Journal Entry

		₹	₹
31st March, 2022	Plant A/c Dr.	41,24,000	
	To Bank A/c		41,24,000
	[Being amount of cost of plant and borrowing cost thereon capitalized]		

Working Note:

Computation of interest to be capitalized:

	Expenditure			₹
1st April, 2021	10,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021	24,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021		On non-specific borrowings	₹ 14,00,000× $\frac{8}{12}$ x 12%	1,12,000
1st January, 2022	4,00,000	On non-specific borrowings	₹ 4,00,000 × $\frac{8}{13}$×12	12,000
				3,24,000

Alternatively, interest cost to be capitalized can be derived by computing average accumulated expenses in the following manner.

Computation of Average Accumulated Expenses:

1st April, 2021	10,00,000 x 12/12	10,00,000
1st August, 2021	10,00,000 x 12/12	10,00,000
	14,00,000 x 8/12	9,33,333
1st January, 2022	4,00,000 x 3/12	1,00,000
		30,33,333

Computation of interest to be capitalized:

		₹
On specific borrowing	₹ 20,00,000 x 10%	2,00,000
On non-specific borrowing	₹ (30,33,333- 20,00,000) x 12%	1,24,000
		3,24,000

NOTE: Since specific borrowings are earmarked for construction of a particular qualifying asset, it cannot be used for construction of any other qualifying asset except for temporary investment. Therefore, once the

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commencement of capitalization of borrowing cost criteria are met, actual borrowing cost incurred on specific borrowing shall be capitalized irrespective of the fact that amount had been utilized in parts.

Question 11 (Past Exam May '23)

On 1stApril, 2022 Workhouse Limited took a loan from a Financial Institution for ₹ 25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

(i) 8% Debentures ₹ 15,00,000

(ii) 15% Term Loan ₹ 30,00,000

(iii) 10% Other Loans ₹ 18,00,000

The company has utilised the above funds in construction / purchase of the following assets:

(i) Building ₹ 70,00,000

(ii) Furniture ₹ 22,00,000

(iii) Plant & Machinery ₹ 90,00,000

(iv) Factory Shed ₹ 43,00,000

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 1stApril 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets. **(5 Marks)**

Solution:

Interest to be Capitalized (on qualifying asset)

	Particulars	**Computation**	**₹**
i.	On specific Borrowings	25,00,000x12%	3,00,000
ii.	On non-specific borrowings	(W.N.1)	6,67,500
iii.	Amount of interest to beCapitalised	(i+ii)	9,67,500

Interest transferred to P&L (on non-qualifying asset)

	Particulars	Computation	₹
i.	On non-specific Borrowings	(W.N.1)	82,500

Working note:

1. Treatment of interest under AS 16 on non-specific borrowings

	Particulars	**Qualifying asset**	**# Computation**	**Interest-Capitalized**	**Interest charged to P&L A/c**
i.	Building	Yes	45,00,000/2,00,00,000 x 63,00,000 x 11.9048%	1,68,750	-
ii.	Furniture	No	22,00,000/2,00,00,000 x 63,00,000 x 11.9048%	-	82,500
iii.	Plant &	Yes	90,00,000/2,00,00,000 x 63,00,000 x	3,37,500	-

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	Machinery		11.9048%		
iv.	Factory shed	Yes	43,00,000/2,00,00,000 x 63,00,000 x 11.9048%	1,61,250	-
	Total			6,67,500	82,500

NOTE: Alternative manner of presentation for Treatment of interest under AS 16 on non-specific borrowings:

	Particulars Qualifying asset		**Expenses Share in Incurred borrowings** ₹	₹	**Interest-Capitalized** ₹	**Interest charged to P&L A/c** ₹
i.	Building	Yes	45,00,000	7,50,000 x 45/200	1,68,750	-
ii.	Furniture	No	22,00,000	7,50,000 x 22/200	-	82,500
iii.	Plant & Machinery	Yes	90,00,000	7,50,000 x 90 /200	3,37,500	-
iv.	Factory shed	Yes	43,00,000	7,50,000 x 43 / 200	1,61,250	-
	Total		**2,00,00,000**		**6,67,500**	**82,500**

2. Weighted Average interest rate for non-specific borrowings

Particulars	**Amount of loan (a)**	**Rate of interest (b)**	**Amount of interest (c) = (a) x (b)**
Debentures	15,00,000	8%	1,20,000
Term loan	30,00,000	15%	4,50,000
Other loans	18,00,000	10%	1,80,000
	63,00,000		7,50,000
		# Weighted Average Rate of Interest = 7,50,000 / 63,00,000 x 100 = 11.9048%	

Question 12 (Past Exam Nov'23)

Answer the following questions:

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

(i) Loan of ₹ 60,00,000 from Data Bank Ltd. was taken at interest rate of 8% per annum. This loan was fully utilized for construction of the new building.

(ii) Loan of ₹ 20,00,000 from Satya Bank Ltd. Out of this, loan amount of ₹ 6,00,000 was utilized for working capital purpose. Total interest of ₹ 1,92,000 were paid to Satya Bank Ltd. for the financial year 2022-23.

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

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

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

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

Solution: **(5 Marks)**

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

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

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

= ₹(60,00,000 x 8%)x 10/12 - ₹30,000

= ₹4,00,000 - ₹ 30,000

= ₹3,70,000

Loan	Particulars	Nature of assets	(a) Interest to be Capitalized (₹)	(b) Interest to be charged to Profit & Loss Account (₹)
Data bank	Construction of factory building	Qualifying Asset	3,70,000	(4,80,000 - 4,00,000) 80,000
Satya Bank	Construction of factory building	Qualifying Asset	(1,92,000x14/20) x 10/12 = 1,12,000	(1,92,000 x 14/20) x 2/12 = 22,400
Satya Bank	Working Capital	Not a Qualifying Asset	NIL	(1,92,000x6/20) = ₹57,600
	Total ₹		4,82,000	₹1,60,000

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

Question 13 (RTP Sep'24)

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

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

The company pays to its bank interest at a rate of 15% p.a., which is debited on a monthly basis. During the half year, company had ₹ 20 lakh overdraft up to 31st December, surplus cash in January and again overdraft of ₹ 14 lakh from 1.2.2024 and ₹ 30 lakh from 1.3.2024. The company had a strike during December and hence could not continue the work during said period. However, the substantial administrative work related to the project was continued. Onsite work was again commenced on 1st January and all the work were completed on 31st March. Assume that expenditure was incurred on 1st day of each month.

Calculate interest to be capitalized giving reason wherever necessary. Assume overdraft will be less, if there is no capital expenditure.

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Solution:

Loyal Ltd.

Month	Actual Expenditure (₹)	Interest on outstanding amount @ 15% p.a.	Interest capitalized (₹)	Outstanding amount	Cumulative amount (₹)
	1		2	3	
October, 2023	4,00,000	4,00,000*15% *1/12	5,000	4,05,000	4,05,000
November, 2023	7,95,000	(4,05,000 +7,95,000) *15%*1/12	15,000	(4,05,000 + 7,95,000 + 15,000)	12,15,000
December, 2023	-	(12,15,000) *15%*1/12	15,188	12,15,000 + 15,188	12,30,188
January, 2024	50,000		-	12,30,188 + 50,000	12,80,188
February, 2024	2,00,000	14,00,000 *15%*1/12	17,500	12,80,188 + 2,00,000 + 17,500	14,97,688
March, 2024	12,00,000	(14,97,688 + 12,00,000)*15 %*1/12	33,721	14,97,688 + 12,00,000 + 33,721	27,31,409
	26,45,000		86,409		

Note:

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

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MCQ

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

(a) Manufacturing plants and Power generation facilities

(b) Inventories that require substantial period of time

(c) Assets those are ready for sale.

(d) None of the above

2. Which of the following statement is correct:

(a) Entire exchange gain is reduced from the cost of the Qualifying asset.

(b) Entire exchange loss is added to the cost of a Qualifying asset.

(c) No adjustment is done for the exchange loss while computing cost of Qualifying asset.

(d) None of the above

3. Capitalisation rate considers:

(a) Borrowing costs on general borrowings only.

(b) Borrowing costs on general and specific borrowings both.

(c) Borrowing costs on specific borrowings only

(d) None of the above

4. If the amount eligible for capitalisation in case of inventory as per AS 16 is ₹ 12,000 and cost of inventory is ₹ 40,000 and its net realizable value is ₹ 45,000; What amount can be capitalised as a part of inventory cost.

(a) ₹ 12,000.

(b) ₹ 5,000.

(c) ₹ 7,000.

(c) ₹ 10,000.

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

(i) 15th May, 20X1: Loan interest relating to the project starts to be incurred

(ii) 2nd June, 20X1: Technical site planning commences

(iii) 19th June, 20X1: Expenditure on the project started to be incurred

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

Identify the commencement date for capitalisation under AS 16.

(a) 15th May, 20X1.

(b) 19th June, 20X1.

(c) 18th July, 20X1.

(d) 2nd June, 20X1

/SOLUTIONS

MCQs

1. (c) 2. (c) 3. (a) 4. (b) 5. (b)

AS 17 SEGMENT REPORTING

Question 1 (MTP Mar'23) (RTP May'20, May'23) (PYQ Jan'21, May'23) NB Pg. No.

PRM Ltd. obtained a loan from a bank for ₹ 120 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	(190)	10	10	(10)	30	(100)
Segment Revenue	300	620	80	60	80	60	1,200

The Chief accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss. **(5 Marks)**

Solution :

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

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

or

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

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

whichever is greater in absolute amount; or

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

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

On the basis of **turnover** criteria segments **M and N** are reportable segments.

On the basis of the **result** criteria, segments **M, N and R** are reportable segments

(since their results in absolute amount is 10% or more of₹ 200 lakhs).

On the basis of **asset** criteria, **all segments except R** are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported in accordance with Accounting Standard (AS) 17. Hence the opinion of chief accountant is wrong.

Question 2 : (PYQ Jan 21) NB Pg. No.

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

(Rs. in lakhs)

Particulars	P	Q	R	S	T	Total
	(Rs.)	(Rs.)	(Rs.)	(Rs.)	(Rs.)	(Rs.)
Segment Assets	80	30	20	20	10	160
Segment Results	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

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The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'.

Solution :

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

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

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

(1) The combined result of all segments in profit; or

(2) The combined result of all segments in loss, whichever is greater in absolute amount; or

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

Accordingly,

(a) On the basis of revenue from sales criteria, segment P is a reportable segment.

(b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of Rs. 200 Lakhs).

(c) On the basis of asset criteria, all segments except T are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17.

Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

Question 3 (PYQ May'22) NB Pg. No.

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March, 20X2 have been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	Profit (Loss) ₹ in lakhs
A	225
B	25
C	(175)
D	(20)
E	(105)

Solution: **(5 Marks)**

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

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

- The combined result of all segments in profit; i.e. ₹ 250 Lakhs or
- The combined result of all segments in loss; i.e. ₹ 300 Lakhs

Whichever is greater in absolute amount i.e. ₹ 300 Lakhs.

Operating Segment	Absolute amount of Profit or Loss (₹ In lakhs)	Reportable Segment Yes or No
A	225	Yes
B	25	No
C	175	Yes

D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments (since their results in absolute amount is 10% or more of ₹ 300 lakhs i.e. 30 lakhs).

Question 4 NB Pg. No.

Segment	Profit/(Loss) (₹ in crore)
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	1,480

Identify the Reportable segments.

Solution:

In compliance with AS 17, the segment profit/loss of respective segment will be compared with the greater of the following:

i. All segments in profit, i.e., A, B and E – Total profit ₹ 8,280 crores.

ii. All segments in loss, i.e., C and D – Total loss ₹ 6,800 crores.

Greater of the above – ₹ 8,280 crores.

Based on the above, reportable segments will be determined as follows:

Segment	Profit/(Loss)	Absolute Profit/Loss as a % of 8,280	Reportable Segment
A	780	9%	**No**
B	1,500	18%	**Yes**
C	(2,300)	28%	**Yes**
D	(4,500)	54%	**Yes**
E	6,000	72%	**Yes**
Total	1,480		

Question 5 NB Pg. No.

Heavy Goods Ltd. has 6 segments namely L-Q (below).

The total revenues (internal and external), profits or losses and assets are set out below:

(In ₹)

Segment	Inter Segment Sales	External Sales	Profit / loss	Total assets
L	4,200	12,300	3,000	37,500
M	3,500	7,750	1,500	23,250
N	1,000	3,500	(1,500)	15,750
O	0	5,250	(750)	10,500
P	500	5,500	900	10,500
Q	1,200	1,050	600	5,250
	10,400	35,350	3,750	1,02,750

Ak Hai Bhaisaahaab !! TELEGRAM: CA NOTE HUB

Heavy Goods Ltd. needs to determine how many reportable segments it has.

You are required to advice Heavy Goods Ltd. as per the criteria defined in AS 17.

Solution:

Quantitative Threshold Test:

Revenue Test:

Combined total sales of all the segment = ₹ 10,400 + ₹ 35,350 = ₹ 45,750.

10% thresholds = 45,750 × 10% = **4,575.**

Profitability Test:

In the given situation, combined reported profit = ₹ 6,000 and combined reported loss (₹ 2,250). Hence, for 10% thresholds ₹ 6,000 will be considered.

10% thresholds = ₹ 6,000 × 10% = **₹ 600**

Asset Test:

Combined total assets of all the segment = ₹ 1,02,750

10% thresholds = ₹ 1,02,750 × 10% = **₹ 10,275**

Accordingly, quantitative thresholds are calculated below:

Segments	L	M	N	O	P	Q	Reportable segments
% segment sales to total sales	36.66%	24.59%	9.84%	11.48%	13.11%	4.92%	L, M,O,P
% segment profit to total profits	50%	25%	25%	12.5%	15%	10%	L,M,N,O,P,Q
% segment assets to total assets	36.50%	22.63%	15.33%	10.22%	10.22%	5.11%	L,M,N,O,P

Conclusion:

Segments L, M, O and P clearly satisfy the revenue and assets tests and they are separate reportable segments.

Segment N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.

Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.

Hence all segments i.e. L, M, N, O, P and Q are reportable segments.

Question 6 (PYQ Nov'20, Jan'21) (MTP Sep'23) (RTP Nov'23) NB Pg. No.

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions:

(₹ in Lacs)

Division	A	B	C	D	Total
Segment Revenue	100	300	200	400	1,000
Segment Result	45 –	70	80 –	10	45
Segment Assets	39	51	48	12	150

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17.

(5 Marks)

Solution:

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

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

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

- The combined result of all segments in profit; or
- The combined result of all segments in loss, whichever is greater in absolute amount; or Its segment assets are 10% or more of the total assets of all segments.

On the basis of **revenue criteria,** segments **A, B, C and D – all are reportable segments.**

On the basis of the **result criteria,** segments **A, B and C** are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs).

On the basis of **asset criteria,** all segments **except D are reportable segments.**

Since all the segments are covered in at least one of the above criteria, **all segments have to be reported** upon in accordance with Accounting Standard (AS) 17.

Question 7 (PYQ Nov'23) NB Pg. No.

Garnet Limited has 4 operating segments. The total revenue (internal and external) and assets are set out as below:

Segment	Inter Segment Sales	External Sales	Total Assets
Fan	3,200	10,900	23,700
Light	200	1,400	13,200
Lamp	0	1,500	4,200
Printer	1,100	200	3,400
TOTAL	**4,500**	**14,000**	**44,500**

How many reportable segments does Garnet Limited have as per the Revenue and Assets criteria given in AS 17? State Reasons for your answer. **(5 Marks)**

Solution:

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

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

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

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

In the given case **75% of External Revenue** is ₹ 10,500 Lakhs (₹ 14,000 × 75%) and the total External Revenue from Reportable segments is ₹ 12,300 Lakhs. So, **no need to add Reportable segments.**

On the basis of **turnover criteria** segment **Fan is reportable segment** as its sales are more than 1,850 lakhs (10% of ₹ 18,500 lakhs). Moreover, total external revenue attributable to reportable segment is also more than 75% of the total enterprise revenue.

On the basis of **asset criteria, Fan and Light are reportable segments** as their assets are more than 4,450 lakhs (10% of ₹ 44,500 lakhs).

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NB Pg. No.

Question 8

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	₹ ('000)
Forging Shop Division	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	6,135
	10,800
Bright Bar Division	
Sales to Fitting Division	45
Export Sales to Rwanda	300
	345
Fitting Division	
Export Sales to Maldives	270

Particulars	Head Office₹ ('000)	Forging Shop Division₹ ('000)	Bright Bar Division ₹ ('000)	Fitting Division ₹ ('000)
Pre-tax operating result	240	30	(12)	
Head office cost reallocated	72	36	36	
Interest costs	6	8	2	
Fixed assets	75	300	60	180
Net current assets	72	180	60	135
Long-term liabilities	57	30	15	180

Solution :

Diversifiers Ltd.

Segmental Report

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging shop	Bright Bar	Fitting		
Segment Revenue					
Sales:					
Domestic	90	–	–	–	90
Export	6,135	300	270	–	6,705
External Sales	6,225	300	270	–	6,795
Inter-Segment Sales	4,575	45	–	4,620	–
Total Revenue	**10,800**	**345**	**270**	**4,620**	**6,795**
Segment Result (Given)	**240**	**30**	**(12)**		**258**
Head Office Expenses					(144)
Operating Profit					114

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Interest Expense					(16)
Profit Before Tax					**98**
Information in Relation to Assets and Liabilities:					
Fixed Assets	300	60	180	–	540
Net Current Assets	180	60	135	–	375
Segment assets	480	120	315	–	915
Unallocated Corporate Assets (75 + 72)	–	–	–	–	147
Total assets					**1,062**
Segment liabilities	30	15	180	–	225
Unallocated corporate Liabilities					57
Total liabilities					**282**

Sales Revenue by Geographical Market

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	Consolidated Total
External sales	90	6,135	300	270	6,795

Question 9 (MTP Nov'21, April'23) (RTP Nov'19, May'21, May'22, Jan'25) NB Pg. No.

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

Solution :

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence the enterprise can have its own policy for pricing inter-segment transfers and hence inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently.

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

Question 10 NB Pg. No.

M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹ 10.00 crores. Segment X has₹ 2.00 crores, segment Y has ₹ 3.00 crores and segment Z has₹ 5.00 crores. Deferred tax assets included in the assets of each segments are X- ₹ 0.50 crores, Y—₹ 0.40 crores and Z—₹ 0.30 crores. The accountant contends that all the three segments are reportable segments. Comment.

Solution :

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are ₹ 8.8 crores [₹10 crores – (₹0.5 +₹ 0.4+₹ 0.3)]. Segment X holds total assets of ₹ 1.5 crores (₹ 2 crores –₹ 0.5 crores); Segment Y holds ₹ 2.6 crores (₹ 3 crores –₹ 0.4 crores); and Segment Z holds ₹ 4.7 crores (₹ 5 crores –₹ 0.3 crores).

Thus **all the three segments hold more than 10% of the total assets, all segments are reportable segments.**

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NB Pg. No.

Question 11

Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?

Solution :

In case of Microtech Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobile batteries, the risks and returns are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS, the risks and returns are affected by power condition, standard of living, etc.

Therefore, it can be said that Microtech Ltd. has two business segments viz'Automobile batteries' and 'batteries for Invertors and UPS'. Reference: The students are advised to refer the full text of AS 17 "Segment Reporting".

NB Pg. No.

Question 12

Nathan Limited has three segments namely P, Q and R. The assets of the company are ₹ 15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P – ₹ 1 crore, Q – ₹ 0.90 crores and R – ₹ 0.80 crores. The accountant contends all these three segments are reportable segments. **(5 Marks)**

Comment.

Solution:

According to AS 17 "Segment Reporting", segment assets do not include income tax assets.

Therefore, the revised total assets are 12.3 crores [₹15 – (₹ 1 +0.9 + 0.8).

Details of Segment wise assets:

Segment P holds total assets of ₹ 3 crores (₹ 4 crores – ₹ 1 crores);

Segment Q holds ₹ 5.1 crores (₹ 6 crores – ₹ 0.9 crores);

Segment R holds ₹ 4.2 crores (₹ 5 crores – ₹ 0.8 crores).

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments.

Hence, the **contention of the Accountant that all three segments are reportable segments is correct.**

Question 13 NB Pg. No.

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban.

Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.

Solution:

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country".

Accordingly, to identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same

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country.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement...".

Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment.

Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

Question 14 (RTP May 19) NB Pg. No.

PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA and UK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 per cent is sold in USA and the balance is sold in UK.

Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant?

Solution:

As per AS 17, if primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

Therefore, for the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 per cent or more of enterprise revenue threshold.

However, other secondary segment information as per AS 17 should be disclosed in respect of this segment if the thresholds prescribed in the AS 17 are met.

Question 15 (RTP Nov '21) NB Pg. No.

a) Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.

b) Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain.

Solution:

a) As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments. Factors

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that should be considered in determining whether products or services are related include:

a. the nature of the products of services;

b. the nature of the productions processes;

c. the type of class of customers for the products or services;

d. the methods used to distribute the products or provide the services; and

e. if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors. In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

b) As per AS 17, "Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable." It also states that "some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand and impact of such changes, this Statement requires the disclosure of the nature of change and the financial effect of the change, if reasonably determinable".

In view of the above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting. Accordingly, if the change has a material financial effect on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, should be disclosed.

Question 16 (RTP Sep'24) NB Pg. No.

Whether interest expense relating to overdrafts and other operating liabilities identified to a particular segment should be included in the segment expense or not?

Solution:

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

Question 17 (RTP Nov 18) NB Pg. No.

Calculate the segment results of a manufacturing organization from the following information:

Segments	A	B	C	Total
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000

Enterprise revenue				
(allocated in 5 :4 : 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 :4 :2 basis)				77,000
Expenses on transactions with other				
segments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	

Solution:

Computation of segment result:

Segments	**A ₹**	**B ₹**	**C ₹**	**Total ₹**
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue	50,000	40,000	20,000	1,10,000
(allocated in 5 :4 :2 basis)				
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue (1)	**6,60,000**	**4,15,000**	**2.70,000**	**13,45,000**
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses	35,000	28,000	14,000	77,000
(allocated in 5 :4 :2 basis)				
Expenses on transactions with other segments				
Transaction from B	75,000	30,000	1,05,000	
Transaction from C	6,000	40,000	46,000	
Transaction from A	18,000	82,000	1,00,000	
Total segment expenses (2)	**4,16,000**	**2,36,000**	**2,01,000**	**8,53,000**
Segment result (1–2)	**2,44,000**	**1,79,000**	**69,000**	**4,92,000**

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AS 19 – LEASES

Illustration 1 (MTP Nov'21, Oct'22, April'23) (Past Exam May'19)

S. Square Private Limited has taken machinery on finance lease from S.K. Ltd. The information is as under:

Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000

Lease rent = ₹ 6,25,000 p.a. at the end of year

Guaranteed residual value = ₹ 1,25,000

Expected residual value = ₹ 3,75,000

Implicit interest rate = 15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

Calculate the value of the lease liability as per AS-19 and disclose impact of this on Balance sheet and Profit & loss account at the end of year 1 **(5 Marks)**

Solution

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee.

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

Year	Minimum Lease Payment ₹	Implicit interest rate (Discount rate @15%)	Present value ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments ₹ 18,55,850 is less than fair value at the inception of lease i.e. ₹ 20,00,000, therefore, the asset and corresponding lease liability should be recognised at ₹ 18,55,850 as per AS 19.

Illustration 2

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

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

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

Ascertain Unearned Finance Income.

Solution

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

Where:

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

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹ 8,00,000 x 5 years) + ₹ 1,60,000] + ₹ 1,40,000

= ₹ 43,00,000 (a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and

(ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	8,00,000	0.8696	6,95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	1,60,000 (GRV)	0.4972	79,552
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	69,608 (ii)
	43,00,000	(i)+ (ii)	28,30,920 (b)

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

Illustration 3

A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease.

Comment if –

a) Sale price of ₹ 50 lakhs is equal to fair value.

b) Fair value is ₹ 60 lakhs.

c) Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.

d) Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.

e) Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs

f) Fair value is ₹ 35 lakhs and sale price is ₹ 39 lakhs.

Solution

Following will be the treatment in the given cases:

(a) When sales price of ₹ 50 lakhs is equal to fair value, A Ltd. Should immediately recognise the profit of ₹ 10 lakhs (i.e. 50 – 40) in its books.

(b) When fair value is ₹ 60 lakhs then also profit of ₹ 10 lakhs should be immediately recognised by A Ltd.

(c) When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then loss of ₹ 2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment, otherwise defer and amortise the loss.

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(d) When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, profit of ₹ 10 lakhs is to be deferred and amortised over the lease period.

(e) When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, profit of ₹ 6 lakhs (46 - 40) to be immediately recognised in its books and balance profit of ₹ 4 lakhs (50-46) is to be amortised/deferred over lease period.

(f) When fair value is ₹ 35 lakhs & sales price is ₹ 39 lakhs, then the loss of ₹ 5 lakhs (40-35) to be immediately recognised by A Ltd. in its books and profit of ₹ 4 lakhs (39-35) should be amortised/deferred over lease period.

Illustration 4

Explain the types of lease as per AS 19.

Solution:

For the purpose of accounting AS 19, classifies leases into two categories as follows:

1. Finance Lease

2. Operating Lease

Finance Lease:

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.
As per para 8 of the standard, in following situations, the lease transactions are called Finance lease:
1. The lessee will get the ownership of leased asset at the end of the lease term.
2. The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.
3. The lease term covers the major part of the life of asset even if title is not transferred.
4. At the beginning of lease term, present value of minimum lease rental covers the initial fair value.
5. The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

Operating Lease:

It is lease, which does not transfer all the risks and rewards incidental to ownership.

Illustration 5

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

Solution:

As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately.

Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Illustration 6

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

Solution:

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As per para 3 of AS 19 'Leases' the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Illustration 7 (Past Exam May'22)

What are the disclosures requirements for operating leases by the lessee as per AS-19? **(5 Marks)**

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

(a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non- cancelable subleases at the balance sheet date;

(c) lease payments recognized in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognized in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Illustration 8 (RTP Nov 20) (Past Exam Nov'19)

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

1) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.

2) Lessee has option to purchase the asset at lower than fair value at the end of lease term.

3) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.

4) Present Value (PV) of Minimum Lease Payment (MLP) = "X" Fair value of the asset is "Y" And X = Y.

5) Economics life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee. **(5 Marks)**

Solution:

(i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.

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

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(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.

Illustration 9 (Past Exam Dec'21) (MTP May'20, Mar'21)

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹ 1,50,000.

Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. Compute the following:

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years of lease. **(5 Marks)**

Solution:

(i) Annual lease rent

Total lease rent

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

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

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹ 97,500

Annual lease rent = ₹ 97,500 / 3 = ₹ 32,500

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

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

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

Year 1 ₹ 26,000,

Year 2 ₹ 32,500 and

Year 3 ₹ 39,000.

(**iii) Depreciation for three years of lease**

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

Depreciation for year 1 is ₹ 20,000, year 2 = 25,000 and year 3 = 30,000.

Illustration 10 (RTP Nov'18, May'20, Nov'23) (MTP Oct'19, Mar'24)

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000.

The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. The Lessee has guaranteed a residual value of ₹ 22,000 on expiry of the lease to the Lessor. However, Lessor Ltd., estimates that the residual value of the machinery will be only ₹ 15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate value of machinery to be considered by Lessee Ltd. and finance charges in each year. **(5 Marks)**

Solution:

As per para 11 of AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

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Computation of Value of machinery:

Present value of minimum lease payment = ₹ 6,99,054

(See working note below)

Fair value of leased asset = ₹ 7,00,000

Therefore, the recognition will be at the lower of the two i.e. 6,99,054

Working Note - Present value of minimum lease payments:

Annual lease rental × PVIF+ Present value of guaranteed residual value

= ₹ 3,00,000 × (0.869 + 0.756 + 0.657) + ₹ 22,000 × 0.657

= ₹ 6,84,600 + ₹ 14,454 = 6,99,054

Computation of finance charges:

Year	Finance charge	Payment	Reduction in outstanding liability	Outstanding liability
1st Year beginning	–	–	–	6,99,054
End of 1st year	1,04,858	3,00,000	1,95,142	5,03,912
End of 2nd year	75,587	3,00,000	2,24,413	2,79,499
End of 3rd year	41,925	3,00,000	2,58,075	21,424

Illustration 11

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

(i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 years.

(ii) The Fair market value is also ₹ 10,00,000

(iii) The property reverts back to the lessor on termination of the lease.

(iv) The unguaranteed residual value is estimated at ₹ 1,00,000 at the end of the year 2011.

(v) 3 equal annual payments are made at the end of each year.

(vi) Consider IRR = 10%.

The present value off ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513. The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

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

Solution:

Computation of annual lease payment:

Particulars	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of unguaranteed residual value (₹ 1,00,000 x 0.7513)	75,130
Present value of lease payments (₹ 10,00,000 - ₹ 75,130)	9,24,870
Present value of annuity for three years is	2.4868
Annual lease payment [9,24,870/2.4868]	3,71,911.70

Classification of lease:

Parameter 1:

The present value of lease payment i.e., ₹ 9,24,870 which equals 92.48% of the fair market value i.e., ₹ 10,00,000.

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

Parameter 2:

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

Therefore, it constitutes a finance lease.

Computation of Unearned Finance Income:

Particulars	
Total lease payments (₹ 3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	1,215,735
Less: Present value of lease payments and residual value i.e.	
Net Investment (₹ 75,130 + ₹ 9,24,870)	(10,00,000)
Unearned finance income	2,15,735

Illustration 12 (MTP Oct'20, Oct'21) (Past Exam May'18, Jan'21) (RTP Nov 20, May'22)

X Ltd. sold machinery having WDV of ₹ 300 lakhs to Y Ltd. for ₹ 400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease.

Give your comments in the following situations:

(i) Sale price of ₹ 400 lakhs is equal to fair value.

(ii) Fair value is ₹ 450 lakhs.

(iii) Fair value is ₹ 350 lakhs and the sale price is ₹ 250 lakhs.

(iv) Fair value is ₹ 300 lakhs and sale price is ₹ 400 lakhs.

(v) Fair value is ₹ 250 lakhs and sale price is ₹ 290 lakhs. **(5 Marks)**

Solution:

Accounting Treatment:

S. No.	**Particulars**	**Accounting Treatment**
(i)	When sale price of ₹ 400 lakhs is equal to fair value	X Ltd. should immediately recognize the profit of ₹ 100 lakhs (i.e. 400 – 300) in its books.
(ii)	When fair value is ₹ 450 lakhs	Profit of ₹ 100 lakhs should be immediately recognized by X Ltd.
(iii)	When fair value of leased machinery is ₹ 350 lakhs & sales price is ₹ 250 lakhs	Then loss of ₹ 50 lakhs (300 – 250) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payment.
(iv)	When fair value is ₹ 300 lakhs & sales price is ₹ 400 lakhs	Then, profit of ₹ 100 lakhs is to be deferred and amortized over the lease period.
(v)	When fair value is ₹ 250 lakhs & sales price is ₹ 290 lakhs	Then the loss of ₹ 50 lakhs (300-250) to be immediately recognized by X Ltd. in its books and profit of ₹ 40 lakhs (290-250) should be amortized/ deferred over lease period.

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MTP / RTP / Past Exam

Question 1 (MTP Aug'18) (RTP Nov'19, May'21, May'24)

Sun Limited wishes to obtain a machine costing Rs. 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Star Ltd., for a lease rental for Rs. 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sun Limited is not sure about the treatment of these lease rentals and seeks your advise. You are required to explain the necessary accounting treatment in line with AS 19. (use annuity factor at @ 15% for 3 years as 3.36) **(5 Marks)**

Solution:

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

Annuity Factor (Year 1 to Year 5) 3.36 (approx.)

Present Value of minimum lease payments (Rs. 3 lakhs each year) Rs. 10.08 lakhs (approx.)

Thus present value of minimum lease payments is Rs. 10.08 lakhs and the fair value of the machine is Rs. 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease.

Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 2 (MTP April'21, April'22)

You are required to give the necessary journal entry at the inception of lease to record the asset taken on finance lease in books of lessee from the following information:

Lease period = 5 years;

Annual lease rents = Rs. 50,000 at the end of each year.

Guaranteed residual value = Rs. 25,000

Fair Value at the inception (beginning) of lease = Rs. 2,00,000

Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively). **(5 Marks)**

Solution:

Present value of minimum lease payment is computed below:

Year	MLP Rs.	DF (12.6%)	PV Rs.
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = Rs. 1,91,500 Fair value of leased asset = Rs. 2,00,000 As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding iability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease

TELEGRAM: CA NOTE HUB

payments from the standpoint of the lessee. The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

		Rs.	Rs.
Asset A/c	Dr.	1,91,500	
To Lessor (Lease Liability) A/c			1,91,500
(Being recognition of finance lease as asset and liability)			

Question 3 (RTP May'19)(MTP Sep '23)

Aksat International Limited has given a machinery on lease for 36 months, and its useful life is 60 months. Cost & fair market value of the machinery is Rs. 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is Rs. 50,000. IRR of investment is 10% and present value of annuity factor of Rs. 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of Rs. 1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income. **(5 Marks)**

Solution:

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year = Rs. 50,000 x 0.7513= Rs. 37,565

Present value of lease payments = Rs. 5,00,000 – Rs. 37,565= Rs. 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (Rs. 4,62,435/ Rs. 5,00,000) x 100 = 92.487%.

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

Calculation of Unearned Finance Income

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

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

= (Rs. 1,85,956 × 3) + Rs. 50,000

= Rs. 5,57,868 + Rs. 50,000 = Rs. 6,07,868

Unearned finance income

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

= Rs. 6,07,868 – Rs. 5,00,000 = Rs. 1,07,868

Question 4 (RTP May'18, May'23)

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

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

Solution:

I. Computation of annual lease payment to the lessor

	₹

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

II. Computation of Unearned Finance Income

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

Question 5 (RTP Nov '23)

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

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

Solution:

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

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

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

Present value of minimum lease payments ₹ 11,56,960 is more than fair value at the inception of lease i.e. ₹ 11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹ 11,50,000 as per AS 19.

* Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e.

3,50,000 + 70,000 = 4,20,000.

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MCQs

1. A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs (Fair value ₹ 50 lakhs) and same machinery was leased back by B Ltd. to A Ltd. The lease back is in nature of operating lease. The treatment will be

(a) A Ltd. should amortise the profit of ₹ 10 lakhs over lease term.

(b) A Ltd. should recognise the profit of ₹ 10 lakhs immediately.

(c) A Ltd. should defer the profit of ₹ 10 lakhs.

(d) B Ltd. should recognise the profit of ₹ 10 lakhs immediately.

2. In case of an operating lease – identify which statement is correct:

(a) The lessor continues to show the leased asset in its books of accounts.

(b) The lessor de-recognises the asset from its Balance Sheet.

(c) The lessor discontinues to claim depreciation in its books.

(d) The lessee recognises the asset in its Balance Sheet.

3. In case of finance lease, if the asset is returned back to the lessor at the end of the lease term - the lessee always claims depreciation based on which of the following:

(a) Useful life.

(b) Lease term.

(c) Useful life or lease term whichever is less.

(d) Useful life or lease term whichever is higher.

4. AS 19 lays down 5 deterministic conditions to classify the lease as a finance lease. To classify the lease as an operating lease – which statement is correct?

(a) Any 1 condition fails.

(b) Majority of the 5 conditions fail.

(c) All 5 conditions fail.

(d) Any 2 conditions fails.

5. The basis of classification of a lease is:

(a) Control Test.

(b) Risk and reward Test.

(c) Both control test and risk and reward test.

(d) Only reward Test

ANSWERS/SOLUTIONS

MCQs

1. (b) 2. (a) 3. (c) 4. (c) 5. (b)

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SOLVED EXAMPLE

Example 1

Annual lease rents = ₹ 50,000 at the end of each year.

Lease period = 5 years;

Guaranteed residual value = ₹ 25,000

Unguaranteed residual value (UGR) = ₹ 15,000

Fair Value at the inception (beginning) of lease = ₹ 2,00,000

Interest rate implicit on lease is computed below:

Interest rate implicit on lease is a discounting rate at which present value of minimum lease payments and unguaranteed residual value is ₹ 2 lakhs.

PV of minimum lease payments and unguaranteed residual value at guessed rate 10%

Year	MLP + UGR	DF (10%)	PV
	₹		₹
I	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150
5	50,000	0.621	31,050
5	25,000	0.621	15,525
5	15,000	0.621	9,315
			2,14,340

PV of minimum lease payments and unguaranteed residual value at guessed rate 14%

Year	MLP + UGR	DF (14%)	PV
	₹		₹
1	50,000	0.877	43,850
2	50,000	0.769	38,450
3	50,000	0.675	33,750
4	50,000	0.592	29,600
5	50,000	0.519	25,950
5	25,000	0.519	12,975
5	15,000	0.519	7,785
			1,92,360

Interest rate implicit on lease is computed below by interpolation:

Interest rate implicit on lease =10% + $\frac{14\% - 10\%}{2,14,340 - 1,92,360}$(2,14,340 2,00,000) 12.6%

Example 2

Annual lease rents = ₹ 50,000 at the end of each year.

Lease period = 5 years;

TELEGRAM: CANOTE HUB

Guaranteed residual value = ₹ 25,000

Unguaranteed residual value (UGR) = ₹ 15,000

Fair Value at the inception (beginning) of lease = ₹ 2,00,000

Interest rate implicit on lease is =12.6%

Present value of minimum lease payment is computed below:

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

Present value of minimum lease payment = ₹ 1,91,500

Fair value of leased asset = ₹ 2,00,000

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

		₹	₹
Asset A/c	Dr.	1,91,500	
To Lessor (Lease Liability) A/c			1,91,500
(Being recognition of finance lease as asset and liability)			

		₹	₹
Asset A/c	Dr.	1,91,500	
To Lessor (Lease Liability) A/c			1,91,500
(Being recognition of finance lease as asset and liability)			

Example 3

Using data for example 2 and assuming zero residual value, allocation of finance charge over lease period is shown below:

Year	Minimum Lease Payments ₹	Finance Charge (12.6%)₹	Principal ₹	Principal due ₹
0	--	--	--	1,91,500
1	50,000	24,129	25,871	1,65,629
2	50,000	20,869	29,131	1,36,498
3	50,000	17,199	32,801	1,03,697
4	50,000	13,066	36,934	66,763
5	75,000	8,237*	66,763	
	2,75,000	83,500	1,91,500	

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:

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		₹	₹
Finance Charge A/c	Dr.	24,129	
To Lessor			24,129
(Being finance charge due for the year)			
Lessor	Dr.	50,000	
To Bank A/c			50,000
(Being payment of lease rent for the year)			
P & L A/c	Dr.	24,129	
To Finance Charge A/c			24,129
(Being recognition of finance charge as expense for the year)			

Example 4

In example 2, suppose unguaranteed residual value is not determinable and lessee's incremental borrowing rate is 10%.

Since interest rate implicit on lease is discounting rate at which present value of minimum lease payment and present value of unguaranteed residual value equals the fair value, interest rate implicit on lease cannot be determined unless unguaranteed residual value is known. If interest rate implicit on lease is not determinable, the present value of minimum lease payments should be determined using lessee's incremental borrowing rate.

Present value of minimum lease payment using lessee's incremental borrowing rate 10% is computed below:

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

Present value of minimum lease payment = ₹ 2,05,025

Fair value of leased asset = ₹ 2,00,000

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

		₹	₹
Asset A/c	Dr.	2,00,000	
To Lessor (Lease Liability)			2,00,000
(Being recognition of finance lease as asset and liability)			

Since the liability is recognised at fair value ₹ 2 lakh (total principal), we need to ascertain a discounting rate at which present value minimum lease payments equals ₹ 2 lakh. The discounting rate can then be used for allocation of finance charge over lease period.

PV of minimum lease payments at guessed rate 12%.

Year	Minimum Lease	DF (12%)	PV ₹

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	Payments		
1	50,000	0.893	44,650
2	50,000	0.797	39,850
3	50,000	0.712	35,600
4	50,000	0.636	31,800
5	50,000	0.567	28,350
5	25,000	0.567	14,175
			1,94,425

Required discounting rate = 10%+ $\frac{12\% - 10\%}{2{,}05{,}025 - 1{,}94{,}425}$ (2,05,025 2,00,000) 10.95%

Allocation of finance charge over lease period is shown below:

Year	Minimum Lease Payments	Finance Charge (10.95%)	Principal	Principal due
	₹	₹	₹	₹
0	--	--	--	2,00,000
1	50,000	21,900	28,100	1,71,900
2	50,000	18,823	31,177	1,40,723
3	50,000	15,409	34,591	1,06,132
4	50,000	11,621	38,379	67,753
5	75,000	7,247*	67,753	
	2,75,000	75,000	2,00,000	

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:

		₹	₹
Finance Charge A/c	Dr.	21,900	
To Lessor			21,900
(Being finance charge due for the year)			
Lessor	Dr.	50,000	
To Bank A/c			50,000
(Being payment of lease rent for the year)			
P & L A/c	Dr.	21,900	
To Finance Charge			21,900
(Being recognition of finance charge as expense for the year)			

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AS 20 EARNINGS PER SHARE

Question 1

NB Pg. No.

Date	Particulars			Balance
1st January	Balance at beginning of year	1,800	-	1,800
31st May	Issue of shares for cash	600	-	2,400
1st November	Buy Back of shares	-	300	2,100

Calculate Weighted Number of Shares.

Solution

Computation of Weighted Average:

(1,800 × 5/12) + (2,400 × 5/12) + (2,100 × 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as fol-lows:

(1,800 x12/12) + (600 × 7/12) – (300 × 2/12) = **2,100 shares**

Question 2

NB Pg. No.

Date	Particulars	No. of Shares	Face Value	Paid up Value
1st January	Balance at beginning of year	1,800	₹ 10	₹ 10
31st October	Issue of Shares	600	₹ 10	₹ 5

Calculate Weighted Number of Shares.

Solution

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.

Computation of weighted average would be as follows:

(1,800 × 12/12) + (300 × 2/12) = **1,850 shares.**

Question 3 (MTP Apr'21, Apr'22)

NB Pg. No.

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case:

		No. of shares
1st April, 2020	Balance of equity shares	7,20,000
31st August, 2020	Equity shares issued for cash	2,40,000
1st February, 2021	Equity shares bought back	1,20,000
31st March, 2021	Balance of equity shares	8,40,000

(5 Marks)

Solution:

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of

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calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares:

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	= 8,40,000 shares

Question 4 (MTP Oct '21, Mar'22, Mar'23, Oct'23) (PYQ May'18)

NB Pg. No.

On 1st April, 20X1 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 20X1 the remaining ₹ 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 20X2 was ₹ 21,96,000 after considering dividend on preference shares of ₹ 3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 20X2 as per Accounting Standard 20 "Earnings Per Share". **(5 Marks)**

Solution:

$$\text{Basic Earnings per share (EPS)} = \frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

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

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period.

Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
1.4.20X1	6,00,000	5	6,00,000 X 5/10 X 5/12 = 1,25,000
1.9.20X1	5,40,000	10	5,40,000 X 7/12 = 3,15,000
1.9.20X1	60,000	5	60,000 X 5/10 X 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 5

NB Pg. No.

Net profit for the year 20X1	₹ 18,00,000
Net profit for the year 20X2	₹ 60,00,000
No. of equity shares outstanding until 30th September 20X2	20,00,000

Bonus issue 1st October 20X2 was 2 equity shares for each equity share out-standing at 30th September, 20X2

Calculate Basic Earnings Per Share.

TELEGRAM: CA NOTE HUB

Solution

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

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

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

Question 6 (PYQ May'22)

NB Pg. No.

NAT, a listed entity, as on 1st April, 20X1 had the following capital structure:

Particulars	₹
10,00,000 Equity Shares having face value of ₹ 1 each	10,00,000
10,00,000 8% Preference Shares having face value of ₹ 10 each	1,00,00,000

During the year 20X1–20X2, the company had profit after tax of Rs. 90,00,000.

On 1st January, 20X2, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December, 20X1.

On 1st January, 20X2, NAT issued 2,00,000 equity shares of Rs. 1 each at their full market price of Rs. 7.60 per share.

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

Further it has been provided that the basic earnings per share for the year ended 31st March, 20X1 was previously reported at Rs. 62.30.

You are required to:

i. Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March, 20X2 including the comparative figure, in accordance with AS-20 Earnings Per Share.

ii. Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share? **(5 Marks)**

Solution:

(i) **Computation of Basic Earnings per share for the year ended 31st March, 20X2:**

(including the comparative figure)

Working Note – I:

Earnings for the year ended 31st March, 20X1:

= EPS x Number of shares outstanding during 20X0–20X1

= ₹ 62.30 × 10,00,000 equity shares

= ₹ 6,23,00,000

Adjusted/Restated Earnings per share for the year ended 31st March 20X1:

(after taking into consideration bonus issue)

Adjusted/Restated Basic EPS:

= Earnings for the year 20X0–20X1 / (Total outstanding shares +Bonus issue)

= ₹ 6,23,00,000 / (10,00,000+ 5,00,000)

= ₹ 6,23,00,000 / 15,00,000

= ₹ 41.53 per share

Computation of Basic EPS for the year 20X1–20X2:

TELEGRAM: CA NOTE HUB

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 20X2)

=(₹ 90,00,000 – ₹ (1,00,00,000 × 8%)) / (10,00,000 + 5,00,000 + (2,00,000 × 3/12))

= ₹ 82,00,000 / 15,50,000 shares

= ₹ 5.29 per share

(ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources.

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

NB Pg. No.

Question 7 (RTP May '21)

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from wnich date weight is to be considered:

i. Equity Shares issued in exchange of cash,

ii. Equity Shares issued as a result of conversion of a debt instrument,

iii. Equity Shares issued in exchange for the settlement of a liability of the enterprise,

iv. Equity Shares issued for rendering of services to the enterprise,

v. Equity Shares issued in lieu of interest and/or principal of an other financial instrument,

vi. Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

Solution:

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given cases:

i. Date of Cash receivable

ii. Date of conversion

iii. Date on which settlement becomes effective

iv. When the services are rendered

v. Date when interest ceases to accrue

vi. Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles or may entitle its holder to equity shares.

Question 8

NB Pg. No.

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

TELEGRAM: CA NOTE HUB

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was ₹ 21.00.

Compute Basic Earnings Per Share.

Solution

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

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

Theoretical ex-rights fair value per share = **₹ 20.00**

Computation of adjustment factor:

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

Computation of earnings per share:

EPS for the year 20X1 as originally reported: ₹ 11,00,000/5,00,000 shares = **₹ 2.20**

EPS for the year 20X1 restated for rights issue: ₹ 11,00,000/ (5,00,000 shares x 1.05) = **₹ 2.10**

EPS for the year 20X2 including effects of rights issue:

(5,00,000 × 1.05 × 2/12) + (6,00,000 × 10/12) = 5,87,500 shares

EPS = 15,00,000/5,87,500 = **₹ 2.55**

Question 9 (MTP May'20 Sep'22) (RTP Nov'20, May'23, Nov'23) (PYQ Nov'19) NB Pg. No.

X Ltd. supplied the following information. You are required to compute the basic earnings per share:

(Accounting year 1.1.20X1– 31.12.20X1)

Net Profit : Year 20X1	:	₹ 20,00,000
: Year 20X2	:	₹ 30,00,000
No. of shares outstanding prior to Right Issue	:	10,00,000 shares
Right Issue	:	One new share for each four outstanding i.e., 2,50,000 shares.
		Right Issue price – ₹ 20
		Last date of exercise rights– 31.3.20X2.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2	:	₹ 25

(5 Marks)

Solution:

Computation of Basic Earnings Per Share

	Year 20X1	Year 20X2
EPS for the year 20X1 as originally reported		

TELEGRAM: CA NOTE HUB

= (₹ 20,00,000 / 10,00,000 shares)	2.00	
EPS for the year 20X1 restated for rights issue		
= [₹ 20,00,000 / (10,00,000 shares x1.04*)]	1.91 (approx.)	
EPS for the year 20X2 including effects of rights issue		
30,00,000 / (10,00,000 shares 1.04 3/12) (12,50,000 shares 9/12)		2.51 (approx.)
30,00,000 / ₹ 11,97,500 shares		

Working Notes:

1. Computation of theoretical ex-rights fair value per share Fair value of all outstanding shares immediately prior to

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

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

2. Computation of adjustment factor

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

$$= \frac{3,00,00,000}{24 \text{ (Refer Working Note 1)}} = \mathbf{1.04 \text{ (approx.)}}$$

Question 10 (MTP Jan'25) (RTP Sep'24) NB Pg. No.

The following information is available in respect of High-end Ltd. for the accounting year 2022-2023 and 2023-2024:

Net profit for	₹
Year 2022-2023	22,00,000
Year 2023-2024	30,00,000

Number of shares outstanding prior to right issue 10,00,000 shares.

Right issue: One new share for each five shares outstanding i.e. 2,00,000 shares.

: Right issue price ₹ 25

: Last date to exercise right 31st July, 2023.

Fair value of one equity share immediately prior to exercise of rights on 31.07.2023 is ₹ 32.

You are required to compute, as per AS 20:

(i) Basic earnings per share for the year 2022-2023.

(ii) Restated basic earnings per share for the year 2022-20223 for right issue.

TELEGRAM: CA NOTE HUB

(iii) Basic earnings per share for the year 2023–2024.

Solution:

Computation of basic earnings per share

	2022–2023 (₹)	2023–2024 (₹)
EPS for the year 2022–2023 as originally reported = Net profit for the year attributable to equity shareholders / weighted average number of equity shares outstanding during the year = ₹ 22,00,000 / 10,00,000 shares	2.20	
EPS for the year 2022–2023 restated for the right issue = ₹ 22,00,000 / (10,00,000 × 1.04)	2.12	
EPS for the year 2023–2024 (including effect of right issue) = ₹ 30,00,000 / {(10,00,000 × 1.04 × 4/12) + (12,00,000 × 8/12)}		2.62

Working Notes:

1) Computation of theoretical ex-rights fair value per share = (fair value of all outstanding shares immediately prior to exercise of rights + Total value received from exercise of rights) / (number of shares outstanding prior to exercise + number of shares issued on the exercise)

= (₹ 32 × 10,00,000 + ₹ 25 × 2,00,000) / (10,00,000 + 2,00,000)

= ₹ 30.83

2) Computation of adjustment factor

= Fair value per share prior to exercise of rights / Theoretical exright value per share

= ₹ 32/₹ 30.83

= 1.04 (approx.)

Question 11 (PYQ Nov'23) NB Pg. No.

Sapphire Limited earned Net profit of ₹ 39,00,000 and ₹ 59,40,000 for the years 2021–22 & 2022–23 respectively.

The following information were given for 2022–2023:

(i) The company declared Rights issue of two new shares for each five outstanding shares.

(ii) 4,00,000 shares were outstanding prior to Rights issue.

(iii) Rights issue price was ₹ 27.50 and the last date to exercise rights was 1stJuly, 2022.

(iv) Fair value of one equity share immediately prior to exercise of rights on 1st July,2022 was₹ 143.

You are required to Compute Basic Earnings Per Share as per AS-20:

(i) For the year 2021–22, and

(ii) For the year 2022–23 **(5 Marks)**

Solution:

(a) Computation of Basic Earnings Per Share

	Year 2021–22 ₹	Year 2022–23 ₹
EPS for the year 2021–22 as originally reported Net profit of the year attributable to equity shareholders		

Bhaisaahaab ! TELEGRAM: CA NOTE HUB

Weighted average number of equity shares outstanding during the year = (₹ 39,00,000 / 4,00,000 shares)	9.75	
EPS for the year 2021–22 restated for rights issue = [₹ 39,00,000 / (4,00,000 shares X1.3*)] 7.5		
EPS for the year 2022–23 including effects of rights issue $\frac{₹\ 59,40,000}{(4,00,000 \times 1.3 \times 3/12) + (5,60,000 \times 9/12)}$ $\frac{₹\ 59,40,000}{5,50,000}$		10.8 (approx.)

*Refer working note 2.

Working Notes:

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

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

$$= \frac{(143 \times 4,00,000 \text{ shares}) + (27.5 \times 1,60,000 \text{ shares})}{4,00,000 \text{ shares} + 1,60,000 \text{ shares}} = \frac{6,16,00,000}{5,60,000 \text{ shares}} = 110$$

2) Computation of adjustment factor

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

$$= \frac{143}{110 \text{ (Refer Working Note 1)}} = 1.3 \text{ (approx.)}$$

Question 12 (PYQ Dec'21) NB Pg. No.

Net profit for the current year	₹ 1,00,00,000
No. of equity shares outstanding	50,00,000
Basic earnings per share	₹ 2.00
No. of 12% convertible debentures of ₹ 100 each	1,00,000
Each debenture is convertible into 10 equity shares	
Interest expense for the current year	₹ 12,00,000
Tax relating to interest expense (30%)	₹ 3,60,000

Compute Diluted Earnings Per Share. (5 Marks)

Solution

Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = ₹ 1,08,40,000

No. of equity shares resulting from conversion of debentures: 10,00,000 Shares

No. of equity shares used to compute diluted EPS: (50,00,000 + 10,00,000) = 60,00,000 Shares

Diluted earnings per share: (1,08,40,000/60,00,000) = **₹ 1.81**

TELEGRAM: CA NOTE HUB

Question 13 (PYQ Nov'18) NB Pg. No.

No. of equity shares outstanding = 30,00,000

Basic earnings per share ₹ 5.00

No. of 12% convertible debentures of ₹ 100 each; 50,000

Each debenture is convertible into 10 equity shares

Tax Rate 30%

Compute Diluted Earnings per Share.

Working notes should form part of the answer. (5 Marks)

Solution:

Earnings for the year:

= No. of Shares x Basic EPS

= 30,00,000 shares x ₹ 5 per share = ₹ 1,50,00,000

Computation of Adjusted Net Profit:

= Earnings for the year + Interest on debentures net of tax

= 1,50,00,000 + (6,00,000 – 1,80,000) = ₹ 1,54,20,000

Computation of Adjusted Denominator:

No. of equity shares resulting from conversion of debentures:

= 50,000 × 10 shares = 5,00,000 shares

No. of equity shares for diluted EPS = 30,00,000 + 5,00,000

= 35,00,000 shares

Computation of Diluted EPS:

= ₹ 1,54,20,000/35,00,000 shares = ₹ 4.4 per share

Question 14 (MTP Oct'18, Nov'21) (RTP May'20, Nov'22) NB Pg. No.

From the following information, you are required to compute Basic and Diluted Earnings Per Share (EPS) of M/s. XYZ Limited for the year ended 31st March, 2019:

Net Profit for the year after tax: Rs. 75,00,000

Number of Equity Shares of Rs.10 each outstanding: Rs. 10,00,000

1,00,000, 8% Convertible Debentures of Rs. 100 each were issued by the Company at the beginning of the year. 1,10,000 Equity Shares were supposed to be issued on conversion. Consider rate of Income Tax as 30% (5 Marks)

Solution:

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year Rs. 75,00,000 / 10,00,000 = Rs. 7.50 per share

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

TELEGRAM: CA NOTE HUB

Eg 2 (LDR) (Deb issued during the year)

Basic EPS = $\frac{\text{EAFESH}}{\text{WANES}} = \frac{₹10,00,000}{10,00,000 \text{ shares}} = ₹1$ per share.

C.Y.

On 01.07.X1 issue of 10% Conv Deb of ₹7,00,000 (FV ₹100), they are convertible into 10,000 equity shares after 5 years.

Tax Rate = 30%.

Compute Basic & Diluted EPS for X1-X2.

Soln: Basic EPS = ₹1 per share.

Diluted EPS = $\frac{\text{EAFESH (+) Effect of PES}}{\text{WANES (+) Effect of PES}}$ → WN 1 / WN 2

$= \frac{10,36,750}{10,07,500} = 1.03$ → This is more than Basic EPS ∴ it is anti dilutive.

(Here Basic EPS = Diluted EPS = 1)

WN 1

EAFESH	10,00,000
(+) Savings in Int (700000 × 10% × 9m/12m) × 70%	36150
	10,36,750

WN 2

WANES	10,00,000 shares
(+) Effect of PES (10,000 shares × 9m/12m)	7500 shares
	10,07,500 shares

TELEGRAM: CA NOTE HUB

Eg 3 (CDR)

EAFESH = 1,00,00,000
WANES = 50,00,000 shares
} Basic EPS = ₹2

No. of 12% Conv Deb of ₹100 each = 1,00,000 Deb
Each Deb is convertible into 10 equity shares

Interest Exp for current year = ₹9,00,000

Tax Rate = 30%.
Compute Basic & Diluted EPS

Soln: Hidden Adj

Deb Int for 12 months = 12,00,000 → 12m
Int Exp in Qtes = 9,00,000 → ? 9m

This means Conv Deb was there only for 9 months in C.Y.

Diluted EPS = $\frac{\text{EAFESH + Effect of PES}}{\text{WANES + Effect of PES}} = \frac{1,06,30,000}{57,50,000} = ₹1.85$ per share

It is less than Basic EPS
∴ reported.

WN ①

EAFESH	1,00,00,000
(+) Effect of PES (Savings in Int) 900000 (9m) x 70%	630000
	1,06,30,000

WN ② WANES = 50,00,000 shares

(+) Effect of PES (100000 Deb x 10 share) x 9/12 = 750000 shares	
	57,50,000 shares

TELEGRAM: CA NOTE HUB

Adjusted net profit for the current year

	Rs.
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of Rs.8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the Question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

= Rs. 80,60,000/ 11,10,000

= Rs. 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

NB Pg. No.

Question 15 (PYQ Nov'22)

Net profit for the year 20X1	₹ 12,00,000
Weighted average number of equity shares outstanding during the year 20X1	5,00,000 shares
Average fair value of one equity share during the year 20X1	₹ 20.00
Weighted average number of shares under option during the year 20X1	1,00,000 shares
Exercise price for shares under option during the year 20X1	₹ 15.00

Compute Basic and Diluted Earnings Per Share. **(5 Marks)**

Solution

Computation of earnings per share

	Earnings	Shares	Earnings/ Share
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares during year 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at			
fair value (100,000 × 15.00)/20.00	—	(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

TELEGRAM: CA NOTE HUB

Question 16 : (PYQ May 24)

On 1 April 2023, ABC Limited has given the following information: NB Pg. No.

	₹
50,000 equity shares of Rs.100 each (Rs.80 paid up by all shareholders)	40,00,000
2,00,000 8% Preference shares of Rs.10 each	
10,000, 12% Debentures of Rs.100 each	20,00,000
(Each debenture is convertible into 3 equity shares of Rs.100 each)	10,00,000

On 1st July 2023, the remaining Rs.20 was called up and paid by all the shareholders except one shareholder holding 10,000 equity shares. During the year 2023-24 the company had a profit after tax of Rs.3,44,000.

Tax rate is 30%.

You are required to compute Basic and Diluted EPS.

Solution :

Basic Earnings per share (EPS) =

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

$$= \frac{1,84,000}{46,000 \text{ Shares (as per working note)}} = \textbf{Rs.4 per share}$$

Diluted earnings per share

Net profit for the current year	Rs.3,44,000
No. of equity shares outstanding	50,000
Basic earnings per share	Rs.4
No. of 12% convertible debentures of Rs.100 each Each debenture is convertible into 3 equity shares	10,000
Interest expense for the current year	Rs.1,20,000
Tax relating to interest expense (30%)	Rs.36,000
Adjusted net profit for the current year	Rs.(1,84,000 + 1,20,000 – 36,000) = Rs.2,68,000
No. of equity shares resulting from conversion of debentures	30,000
No. of equity shares used to compute diluted earnings per share	46,000 + 30,000 = 76,000
Diluted earnings per share	2,68,000 / 76,000 = Rs.3.53

Working Note:

1. **Net profit attributable to equity share holders = Net profit less preference dividends**

   Total earnings – preference shares dividend

   Rs.3,44,000 – Rs.(8% x 20,00,000)'

   Rs.3,44,000 – Rs.1,60,000

   = Rs.1,84,000

2. **Calculation of weighted average number of equity shares**

   As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity

share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
	₹	₹	₹
01.04.2023	50,000	80	50,000x 80/100x 3/12 = 10,000
01.07.2023	40,000	100	40,000 × 9/12 = 30,000
01.07.2023	10,000	80	10,000x 80/100x 9/12 = 6,000
Total weighted average equity shares			46,000

Question 17 (RTP Jan'25) NB Pg. No.

XYZ Limited has a wholly owned subsidiary BC Limited. The Group prepares consolidated Financial Statements for the year ended 31st March, 2024. XYZ Limited (in its separate financial statements) has incurred a loss of Rs.2 crore during the year, while the consolidated profit for the group during the year is Rs.40 lakh. XYZ Limited has 5,00,000 shares outstanding as at 31st March, 2024.

Further, it has granted options to issue equity shares as at that date. In respect of such options, 1,00,000 shares are considered to be the shares issued for no consideration. There are no changes in income orexpenses that are expected from the issue of equity shares on exercise of these options.

Calculate Basic and Diluted EPS for XYZ Limited for separate financial statements and for the Group.

Solution :

Computation of earnings per share

Particulars	Consolidated financial statements	Standalone financial statements of XYZ Limited
Basic earnings/(loss) per share	Rs.8 [40,00,000/5,00,000]	(Rs. 40) [2,00,00,000/ 5,00,000]
Diluted earnings/ (loss) per share	Rs. 6.66 [40,00,000/ 6,00,000]	(Rs. 40) [2,00,00,000/ 5,00,000]

As per paragraph 39 of AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

In the above case, if the exercise of options was considered for separate financial statements of XYZ Limited, the diluted loss per share would have reduced to Rs.33.33 [2,00,00,000/6,00,000]. As this is antidilutive, the options would not be treated as potentially dilutive equity shares. Accordingly, in the separate financial statements of XYZ Limited, the Diluted EPS would be same as Basic EPS.

Question 18 (RTP May 22) NB Pg. No.

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

You are required to compute Basic and Diluted EPS?

TELEGRAM: CA NOTE HUB

Solution:

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

Question 19 (RTP May 22)

NB Pg. No.

Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS.

Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

Solution:

As per AS 20 "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares".

Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

Question 20 (RTP Nov 21)

NB Pg. No.

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20?

Solution:

The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period"; With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend,

TELEGRAM: CA NOTE HUB

are still attributable to equity shareholders. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

Question 21 (PYQ Nov'23) **NB Pg. No.**

Z Ltd. decides to increase its existing share capital by making right issue to its existing shareholders.

The company is offering 2 new shares for every 5 existing shares held by the shareholders.

The market value of shares is ₹ 420 per share.

Company is offering each share at ₹ 245 per share.

Calculate the value of right and the ex-right market price of a share. **(5 Marks)**

Solution:

Ex-right value of the shares = (Cum-right value of the existing shares + Rights shares X Issue Price) / (Existing Number of shares + No. of right shares)

= (₹420 X 5 Shares + ₹245 X 2 Share) / (5 + 2) Shares

= ₹ 2,590 / 7 shares = **₹370 per share.**

Value of right = Cum-right value of the share – Ex-right value of the share

= ₹420 – ₹370 = **₹50 per share**

Note: In the question, the market value of share is given at ₹ 420 per share. It has been considered that this value is cum right.

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Q22 (LDR) (Jan'25 PYQ)

Question 1

(a) XYZ Limited has provided you the following information as on 31st March,2024:

Particulars	₹
Net profit (After Tax) / EAFESH	₹ 31,20,000
No. of shares outstanding as on 31-3-2024 of ₹ 10 each	8,00,000
Average fair value of one equity share during the year 2023-24	₹ 25
Weighted average on. Of shares under option during the year 2023-24	80,000
Exercise price for shares under option during the year 2023-24	₹ 20
12% Debentures of ₹ 100 each	₹ 30,00,000
(Each debenture is convertible into 4 equity shares)	
Tax rate	30%

The company issued one equity share as bonus for every 5 equity shares outstanding as on 1st October, 2023. It further issued 2,00,000 equity shares of ₹ 10 each as on 1st January, 2024. The Financial Year of the company ends on 31st March each year.

You are required to calculate Basic and Diluted earnings per share as on 31st March, 2024 (round off your answer to 2 decimal places). **(5 Marks)**

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Soln: Q22 (LDR)

No. of shares outstanding on 31/03/24 = 8,00,000 (It includes New Issue & Bonus Shares)

Imp

Working ① Calculation of shares on Day 1, Bonus shares, New Issue.

Total shares on Yr end	800000	
(-) New Issue (Given)	(200000)	
Opn Shares + Bonus	600000	6
(-) Bonus	(100000)	1
Opn Shares	500000	5

i) Basic EPS = $\frac{3120000}{5L \times \frac{12}{12} + 12 \times \frac{12}{12} + 2L \times \frac{3}{12}}$

(5L: Opn shares; 12: Bonus; 2L: new Issue)

$= \frac{3120000}{650000 \text{ shares}} = ₹4.8$ per share.

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	AS 20 Earning Per Share	
	Que	Type
	1	WANES
	2	WANES
	3	WANES
LDR	4	**BASIC**
	5	BASIC+BONUS
LDR	6	**DIVIDEND**
	7	THEORY
	8	BASIC+RIGHT
LDR	9	**BASIC+RIGHT**
	10	BASIC+RIGHT
	11	BASIC+RIGHT
	12	DILUTED+DEB
	13	DILUTED+DEB
LDR	Eg 2	DEB+INT
LDR	Eg 3	DEB+INT
LDR	14	**DILUTED+DEB**
LDR	15	**DILUTED+ESOP**
LDR	16	**DILUTED+DEB**
LDR	17	**CASE+DILUTED**
	18	DISCONTINUING
	19	THEORY
	20	THEORY
	21	RIGHT
LDR	PYQ J25	FULL Q

LDR LIST FROM QB OF AK SIR

Credit- mehul jain

To Participate
30Days_Hard_Challenge
https://t.me/CA_30Days_Blitz

TELEGRAM: CA NOTE HUB

AS 21 – CONSOLIDATED FINANCIAL STATEMENTS

Illustration 1

From the following data, determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹ 2,00,000 in each case:

Case	Subsidiary Company	% shares owned	Cos	Date of acquisition 1.1.20X1		Consolidation Date 31.12.20X1	
				Share Capital	Profit & Loss Account	Share Capital	Profit & Loss Account
		₹	₹	₹	₹	₹	₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

Solution

(1) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c

	Minority % Shares Owned	Minority interest as at the date of acquisition	Minority interest as at the date of consolidation
	[E]	[E] x [A + B]₹	[E] X [C + D] ₹
Case 1 [100-90]	10 %	15,000	17,000
Case 2 [100-85]	15 %	19,500	18,000
Case 3 [100-80]	20 %	14,000	14,000
Case 4 [100-100]	NIL	Nil	Nil

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

(2) Calculation of Goodwill or Capital Reserve

	Shareholding	Cost	Total Equity	Parent's Portion of equity	Goodwill	Capital Reserve
	% [F]	[G]	[A] + [B] =[C]	[F] x [C] =H	₹ [G] – [H]	₹ [H] – [G]
Case 1	90 %	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85 %	1,04,000	1,30,000	1,10,500	— 6,500	
Case 3	80 %	56,000	70,000	56,000	Nil	Nil
Case 4	100 %	1,00,000	90,000	90,000	10,000	—

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(3) The balance in the Profit & Loss Account on the date of acquisition (1.1.20X1) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.20X1 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 1.1.20X1 [L]	P & L as on consolidate on date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added / (deducted) from holding's P & L [O] = [K] x [N]
1	90 %	50,000	70,000	20,000	18,000
2	85 %	30,000	20,000	(10,000)	(8,500)
3	80 %	20,000	20,000	NIL	NIL
4	100 %	40,000	55,000	15,000	15,000

Illustration 2

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st January, 20X1 was ₹ 1,00,000 and the balance in the Profit & Loss Account was ₹ 60,000.

During the year ended 31st December, 20X1, ABC Ltd. earned a profit of ₹ 20,000 and at year end, declared and paid a dividend of ₹ 15,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also please check whether there should be any goodwill/ capital reserve at the date of acquisition.

Solution

Total dividend paid is ₹ 15,000 (assumed to be out of post-acquisition profits), hence dividend received by XYZ will be credited to P & L.

XYZ Ltd.'s share of dividend = ₹ 15,000 X 80% = ₹ 12,000

In the books of XYZ Ltd.

	₹	₹
Bank A/c Dr.	12,000	
To Profit & Loss A/c	12,000	
(Dividend received from ABC Ltd credited to P&L A/c being out of post-acquisition profits – as explained above)		
Goodwill on consolidation (at the date of acquisition):	**₹**	**₹**
Cost of shares		1,40,000
Less: Face value of capital i.e. 80% of capital	80,000	
Add: Share of capital profits [60,000X 80 %]	48,000	(1,28,000)
Goodwill		12,000
Minority interest on:		
- 1st January, 20X1:		
20% of		
₹ 1,60,000 [1,00,000 + 60,000]	32,000	
- 31st December, 20X1:	33,000	
20% of ₹ 1,65,000 [1,00,000 + 60,000 + 20,000 – 15,000]		

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Illustration 3 (MTP Apr'24)

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 20X1 at a cost of ₹ 70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	120
Investments	55
Current Assets	70
Loans & Advances	15
15% Debentures	90
Current Liabilities	50

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment Up by 20%

Investments Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1 (Face value - ₹ 10 per share). Exe Ltd. purchased the shares of Zed Ltd. @ ₹ 20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd. **(7 Marks)**

Solution

Revalued net assets of Zed Ltd. as on 31st March, 20X1

	₹ in lakhs	₹ in lakhs
Property, plant and equipment [120 X 120%]		144.0
Investments [55 X 90%]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5
Less: 15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity / Net Worth		138.5
Exe Ltd.'s share of net assets (70% of 138.5)		96.95
Exe Ltd.'s cost of acquisition of shares of Zed Ltd.		
(₹ 70 lakhs – ₹ 7 lakhs*)		63.00
Capital reserve		33.95

* Total Cost of 70 % Equity of Zed Ltd	₹ 70 lakhs
Purchase Price of each share	₹ 20
Number of shares purchased [70 lakhs /₹ 20]	3.5 lakhs
Dividend @ 20 % i.e. ₹ 2 per share	₹ 7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Illustration 4 (MTP Mar'19, Oct 19) (RTP May'23) (Past Exam May'19, Nov'23)

TELEGRAM: CANOTE HUB

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹ 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5- X6, B Ltd. experienced turnaround and registered an annual profit of ₹ 50,000. In the next two years i.e. 20X6-X7 and 20X7-X8, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation. **(10 Marks)**

Solution

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. In such cases, AS 21 prescribes that the excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Where the minority interest has a binding obligation (say by way of a shareholders' agreement), then the share of losses will be attributed to the minority interest even if it exceeds the minority interest in the equity (i.e., debit balance in minority interest). Since information on the existence of a binding obligation is not given in the question, we solve as if such obligation does not exist, and hence the minority interests will be computed as follows:

Year	**Profit/(Loss)**	**Minority Interest (30%)**	**Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)**	**Minority's Share of losses borne by A Ltd.**		**Cost of Control**
				₹	**Balance**	
At the time of acquisition in 20X1		3,24,000	-			
		-				
		(W.N.)				
20X1-X2	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
Balance		**2,49,000**				
20X2-X3	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		**1,29,000**				
20X3-X4	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		**Nil**	**(3,71,000)**			
20X4-X5	(1,20,000)	(36,000)	(84,000)		2,44,000	
Loss of minority borne by Holding Co.	36,000		(36,000)	36,000	57,000	
Balance		**Nil**	**(1,20,000)**			
20X5-X6	50,000	15,000	35,000			2,44,000
	Profit share of minority	(15,000)	15,000	(15,000)	42,000	

TELEGRAM: CA NOTE HUB

	adjusted against losses of minority absorbed by Holding Co.					
Balance		**Nil**	**50,000**			
20X6-X7	1,00,000	30,000	70,000			
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000	(30,000)	12,000	2,44,000
Balance		**Nil**	**100,000**			
20X7-X8	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		**33,000**	**1,17,000**			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.20X1

		Share of Holding Co.	Minority Interest
	100%	**70%**	**30%**
	(₹)	**(₹)**	**(₹)**
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Illustration 5

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of ₹ 17 per share. The balance of shares of VR Ltd. Are held by a foreign collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:

a) The shares held by the foreign company will be sold to Variety Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were ₹ 30 lakhs, ₹ 40 lakhs and ₹ 65 lakhs.

b) The actual cost of the shares to the foreign company was ₹ 5,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%.

c) The tax payable will be deducted from the proceeds and Variety Ltd. will pay it to the Government.

d) Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after two years.

The above agreement was approved by all concerned for being given effect to on 1.4.20X1. The total assets of VR Ltd. as on 31st March, 20X1 was ₹ 1,00,00,000. It was decided to write down Property, Plant and Equipment by ₹ 1,75,000. Current liabilities of VR Ltd. as on the same date were ₹ 20,00,000. The paid-up share capital of VR Ltd. was ₹ 20,00,000 divided into 2,00,000 equity shares of ₹ 10 each.

Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.

Solution

1. Computation of Purchase Consideration

TELEGRAM: CA NOTE HUB

(a) Yield of VR Ltd.: $\left[\frac{40}{100} \times \frac{30+40+65}{3}\right]$	₹ 18 lakhs
(b) Price per share of VR Ltd.:	
Capitalized Yield: $\left[\frac{18 \text{ lakhs}}{0.15}\right]$	120 lakhs
No. of shares	2 lakhs
Therefore, price per share	₹ 60
(c) Purchase Consideration for 54% shares in VR Ltd.	
2 lakh shares x 54% x ₹ 60 per shares	₹ 64.80 lakhs
(d) Discharge of Purchase Consideration:	
Tax at source (₹ 64.80 lakhs – ₹ 5.40 lakhs) × $\frac{30}{100}$	₹ 17.82 lakhs
50% of purchase consideration (net of tax) in cash	₹ 23.49 lakhs
[₹ (64.80 – 17.82) x 50%]	
Balance – Unsecured Loan	₹ 23.49 lakhs

2. Goodwill / Capital Reserve to Variety Ltd.

	₹ in lakhs	
Total Assets	100.00	
Less: Reduction in Value of Property, Plant and Equipment	(1.75)	
	98.25	
Less: Current Liabilities	(20.00)	
Net Assets of VR Ltd. on Date of Acquisition		78.25
Purchase Consideration: 54% purchased from Foreign Co.	64.80	
Investment: 46% existing stake	15.64	(80.44)
Goodwill on Date of Acquisition		**2.19**

Illustration 6 (RTP May'24)

A Ltd. acquired 60% shares of B Ltd. @ ₹ 20 per share. Following is the extract of Balance Sheet of B Ltd.:

	₹
10,00,000 Equity Shares of ₹ 10 each	1,00,00,000
10% Debentures	10,00,000
Trade Payables	55,00,000
Property, Plant and Equipment	70,00,000
Investments	45,00,000
Current Assets	68,00,000
Loans and Advances	22,00,000

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of ₹ 60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.

Solution

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., preacquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

	₹	₹
Assets		
Property, Plant and Equipment	70,00,000	
Less: Value written off (₹ 70 lakhs x 10%)	(7,00,000)	
	63,00,000	
Investments at Market Value	60,00,000	

TELEGRAM: CA NOTE HUB

Current Assets	68,00,000	
Loans and Advances	22,00,000	2,13,00,000
Less: Liabilities		
Trade Payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x ₹ 20 per share	1,20,00,000	
Less: Pre-acquisition dividend: 6,00,000 shares x ₹ 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		**19,20,000**

Illustration 7

H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹ 4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed an opening balance of ₹ 1,25,000 and profit for the year was ₹ 3,00,000. At the end of the year, it declared a dividend of 40%. Record the entry in the books of H Ltd., in respect of the dividend. Assume the profit is accruing evenly and calendar year as financial year.

Solution

The profits of S Ltd., have to be divided between capital and revenue profits from the point of view of the holding company:

	Capital Profit (Preacquisition)		**Revenue Profit (Post acquisition)**
	₹		**₹**
Balance on 1.1.20X1	1,25,000	—	
Profit for 20X1 (3,00,000 × 7/12)	1,75,000	(3,00,000×5/12)	1,25,000
Total	3,00,000		1,25,000
Proportionate share of H Ltd. (3/5)	1,80,000		75,000

Total dividend declared = ₹ 5,00,000 X 40 % = ₹ 2,00,000

H Ltd.'s share in the dividend = ₹ 2,00,000 X 3/5 = ₹ 1,20,000

There can be two situations as regards the treatment of dividend of ₹ 1,20,000:

(1) The profit for 20X1 has been utilised to pay the dividend.

The share of H Ltd in profit for the first seven months of S Ltd = ₹ 1,05,000

(i.e. ₹ 1,75,000 × 3/5)

Profit for the remaining five months = ₹ 75,000

(i.e.₹ 1,25,000 × 3/5).

The dividend of ₹ 1,20,000 will be adjusted in this ratio of 1,05,000: 75,000 = ₹ 70,000 out of profits up to 31.7.20X1 and ₹ 50,000 out of profits after that date.

The dividend out of profits subsequent to 31.7.20X1 will be revenue income and that out of earlier profits will be capital receipt. Hence the entry will be:

₹ ₹

Bank Dr. 1,20,000

To Investment Account 70,000

To Profit and Loss Account 50,000

(2) Later profits have been utilised first and then pre- acquisition profits.

TELEGRAM: CANOTE HUB

In such a case, the whole of ₹ 75,000 (share of H Ltd. in profits of S Ltd., after 31.7.20X1) would be received and treated as revenue income; the remaining dividend, ₹45,000 (₹1,20,000 less ₹ 75,000) would be capital receipt. The entry would be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			45,000
To Profit & Loss Account			75,000

Note: Point (2) discussed above can arise only if there is definite information about the profits utilized. In practice, such treatment is rare.

Illustration 8

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

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

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

a) Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands bought forward from the previous year.

b) The General Reserve balance is brought forward from the previous year.

c) The directors of both the companies have declared a dividend of 10% on equity share capital for the previous and current year.

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

Solution

Calculation of Pre- and Post-Acquisition Profits:

	Pre-Acquisition Profits (₹)	**Post-Acquisition Profits (₹)**
Profit & Loss Account	10,00,000	7,90,000
General Reserve	8,00,000	NIL
	18,00,000	7,90,000
Less: Share of Minority Interest: (¼)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500

TELEGRAM: CA NOTE HUB

	(Cost of Control)	(Post-acquisition Profits)

Calculation of Minority Interest:

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

Calculation of Goodwill/Capital Reserve

	₹	₹
Cost of Investment in Subsidiary:	46,87,500	
₹ 50,00,000 x 75% x 125% (cost + 25% premium)		
Less: Pre-acquisition dividend	(3,75,000)	43,12,500
Less: Net Worth of B Ltd. on Date of Acquisition (attributable to A Ltd.):		
Paid-up Capital	37,50,000	
Pre-acquisition Reserves	13,50,000	(51,00,000)
Capital Reserve		7,87,500

Illustration 9 (RTP Nov'21)

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

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

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

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

TELEGRAM: CA NOTE HUB

Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

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

a) Before issue of bonus shares;

b) Immediately After issue of bonus shares.

Solution

Shareholding pattern

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

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

(a) Before issue of bonus shares

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

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Face value of investments (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		₹

TELEGRAM: CA NOTE HUB

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

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition)	Revenue Profits (Post-acquisition)	
	(Before and after issue of bonus shares) ₹	Before Bonus Issue ₹	After Bonus Issue ₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.20X1	60,000		
	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 20X1 to 31st March, 20X3 (₹ 4,20,000 – ₹ 60,000)		3,60,000	3,60,000
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

Illustration 10

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March,

20X1 from the following information:

	H Ltd.	S Ltd.
	₹	₹
PPE	5,00,000	3,00,000
Investments		
(20,000 equity shares of S Ltd.)	2,20,000	
Current Assets	1,55,000	1,00,000
Share capital (Fully paid equity shares of ₹ 10 each)	5,00,000	2,50,000
Profit and loss account	2,00,000	1,00,000
Trade Payables	1,75,000	50,000

H Ltd. acquired the shares of S Ltd. on 31st March, 20X1.

Solution

Percentage of holding:

	No. of Shares	Percentage

TELEGRAM: CA NOTE HUB

Holding Co :	20,000	(80%)
Minority shareholders :	5,000	(20%)
TOTAL SHARES :	25,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.

as at 31st March,20X1

		Note No	Amount (₹)
	I EQUITY AND LIABILITIES		
1	**Shareholder's Fund**		
	(a) Share Capital	1	5,00,000
	(b) Reserve and Surplus	2	2,60,000
2	Minority interest	3	
3	Current Liabilities	4	70,000
	(a) Trade payables		
			2,25,000
	Total		**10,55,000**
	II ASSETS		
1.	Non-Current Assets		
	PPE	5	8,00,000
2.	Current Assets	6	2,55,000
	Total		**10,55,000**

Notes to Accounts

	Amounts	(₹)
1	Share capital	
	50,000 Equity Shares @ ₹10 each	5,00,000
2	Reserve and Surplus	
	Capital Reserve (W.N.)	60,000
	Profit and loss account	2,00,000
		2,60,000
3	Minority Interest	
	Paid up value of shares 50,000	
	Add: Share in Profit and loss account 20,000 70,000	
4	Trade payables	
	H Ltd.	1,75,000
	S Ltd.	50,000
		2,25,000
5	PPE	
	H Ltd.	5,00,000
	S Ltd.	3,00,000
		8,00,000
6	Current Assets	
	H Ltd.	1,55,000
	S Ltd.	1,00,000

TELEGRAM: CA NOTE HUB

		2,55,000

Working Note:

Determination of Goodwill/(Capital Reserve)		(₹)
Cost of investment		2,20,000
Less: Paid up value of shares (80% of 2,50,000)	2,00,000	
Share in pre-acquisition profits (80% of 1,00,000)	80,000	
		(2,80,000)
Capital Reserve		**(60,000)**

Illustration 11 (Past Exam Nov'22)

H Ltd. and S Ltd. provide the following information as at 31st March,20X2:

	H Ltd.	**S Ltd.**
	₹	**₹**
PPE	1,00,000	1,30,000
Investments (8,000 equity shares of S Ltd.)	1,26,000	
Current Assets	74,000	70,000
Share capital (Fully paid equity shares of ₹10 each)	1,50,000	1,00,000
Profit and loss account	50,000	40,000
Trade Payables	1,00,000	60,000

Additional information:

H Ltd. acquired the shares of S Ltd. on 1-7-20X1 and Balance of profit and loss account of S Ltd. on 1-4-20X1 was 30,000.

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 20X2. **(15 Marks)**

Solution

Percentage of holding:

	No. of Shares	Percentage
Holding Co. :	8,000	(80%)
Minority shareholders :	2,000	(20%)
TOTAL SHARES :	10,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.

as at 31st March, 20X2

		Note No	Amount (₹)
	I EQUITY AND LIABILITYES		
1	**Shareholder's Fund**		
	(a) Share Capital	1	1,50,000
	(b) Reserve and Surplus	2	56,000
2	Minority interest	3	28,000
3	Current Liabilities		
	(a) Trade payables	4	1,60,000
	Total		**3,94,000**

TELEGRAM: CA NOTE HUB

	II ASSETS		
1	Non-Current Assets:		
	PPE	5	2,30,000
	Intangible Asset	6	20,000
2	Current Assets	7	1,44,000
	Total		**3,94,000**

Notes to Accounts

		Amount (₹)
1	Share capital	
	15,000 Equity Shares @ ₹10 each	1,50,000
2	Reserve and Surplus	
	Profit and loss account (₹ 50,000+ 80% of 9/12 x 10,000)	56,000
3	Minority Interest Share capital (20% of ₹ 1,00,000) 20,000	
	Share in Profit and loss account (₹ 40,000 X 20%) 8,000	28,000
4	Trade payables	
	H Ltd.	1,00,000
	S Ltd.	60,000
		1,60,000
5	PPE	
	H Ltd.	1,00,000
	S Ltd.	1,30,000
		2,30,000
6	Intangible Asset	
	Cost of Investment	1,26,000
	Less: Paid up value of shares (80% of ₹	1,00,000)
	Share in pre-acquisition profits	(80,000)
	80% of [30,000+3/12(40,000-30,000)]	(26,000)
	Goodwill	20,000
7	Current Assets	
	H Ltd.	74,000
	S Ltd.	70,000
		1,44,000

Illustration 12 (MTP Mar'24)

From the Balance Sheets and information given below, prepare Consolidated Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March. Virat Ltd. holds 80% of Equity Shares in Anushka Ltd. since its (Anushka Ltd.'s) incorporation.

Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March, 20X1

Particulars	**Note No.**	**Virat Ltd. (₹)**	**Anushka Ltd. (₹)**
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	6,00,000	4,00,000

TELEGRAM: CA NOTE HUB

(b) Reserves and Surplus	2	1,00,000	1,00,000
(2) Non-current Liabilities			
Long Term Borrowings		2,00,000	1,00,000
(3) Current Liabilities			
(a) Trade Payables		1,00,000	1,00,000
Total		**10,00,000**	**7,00,000**
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment		4,00,000	3,00,000
(b) Non-current investments	3	3,20,000	-
(2) Current Assets			
(a) Inventories		1,60,000	2,00,000
(b) Trade Receivables		80,000	1,40,000
(c) Cash & Cash Equivalents		40,000	60,000
Total		**10,00,000**	**7,00,000**

Notes to Accounts

	Particulars	**(₹)**	**Virat Ltd. (₹)**	**Anushka Ltd.(₹)**
1.	Share capital			
	60,000 equity shares of ₹ 10 each fully paid up		6,00,000	--
	40,000 equity shares of ₹ 10 each fully paid up		--	4,00,000
	Total		6,00,000	4,00,000
2.	Reserves and Surplus			
	General Reserve		1,00,000	1,00,000
	Total		1,00,000	1,00,000
3.	Non-current investments			
	Shares in Anushka Ltd		3,20,000	--

Solution **(14 Marks)**

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 20X1

	Particulars	**Note**	**Amount (₹)**
I	**EQUITY AND LIABILITIES:**		
(1)	**Shareholders' Funds:**		
	(a) Share Capital	1	6,00,000
	(b) Reserve and Surplus	2	1,80,000
(2)	**Minority Interest**	3	1,00,000
(3)	**Non-Current Liabilities:**		
	Long Term Borrowings	4	3,00,000
(4)	Current Liabilities:		
	Trade Payables	5	2,00,000
	Total		**13,80,000**
II	**ASSETS:**		
(1)	**Non-Current Assets**		
	Property, Plant & Equipment	6	7,00,000

TELEGRAM: CA NOTE HUB

(2)	**Current Assets:**		
	(a) Inventories	7	3,60,000
	(b) Trade receivables	8	2,20,000
	(c) Cash and Cash Equivalents	9	1,00,000
	Total		**13,80,000**

Notes to Accounts

	Particulars	**₹**	**₹**
1.	Share capital		
	60,000 equity shares of ₹10 each fully paid up		6,00,000
2.	Reserves and Surplus		
	General Reserve	1,00,000	
	Add: General reserve of Anushka Ltd (80%)	80,000	
	Total		**1,80,000**
3.	Minority interest		
	20% share in Anushka Ltd (WN 3)		1,00,000
4	Long term borrowings		
	Long term borrowings of Virat	2,00,000	
	Add: Long term borrowings of Anushka	1,00,000	
	Total		**3,00,000**
5.	Trade payables		
	Trade payables of Virat	1,00,000	
	Add: Trade payables of Anushka	1,00,000	
	Total		**2,00,000**
6.	Property, Plant and Equipment (PPE)		
	PPE of Virat Ltd	4,00,000	
	Add: PPE of Anushka Ltd	3,00,000	
	Total		**7,00,000**
7.	Inventories		
	Inventories of Virat Ltd	1,60,000	
	Add: Inventories of Anushka Ltd	2,00,000	
	Total		**3,60,000**
8.	Trade receivables		
	Trade receivables of Virat Ltd	80,000	
	Add: Trade receivables of Anushka Ltd	1,40,000	
	Total		**2,20,000**
9	Cash and cash equivalents		
	Cash and cash equivalents of Virat Ltd	40,000	
	Add: Cash and cash equivalents of Anushka Ltd	60,000	
	Total		**1,00,000**

Working Notes:

1. Basic Information

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

2. Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of ₹1,00,000 will be Revenue.

TELEGRAM: CA NOTE HUB

3. Consolidation of Balances

Holding- 80%, Minority - 20%	Total	Minority Interest	Holding Company	
Equity Capital	4,00,000	80,000	3,20,000	-
General Reserves	1,00,000	20,000	Nil (pre-acq)	80,000 (post-acq)
Total		1,00,000	3,20,000	80,000
Cost of Investment			(3,20,000)	-
Goodwill/capital reserve			NIL	
Parent's Balance				1,00,000
Amount for Consolidated Balance Sheet				1,80,000

Illustration 13 (RTP May'22, May'20)

From the following balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 20X1, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of S Ltd. stood at ₹ 25,000 and ₹ 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April, 20X0.

(ii) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 respectively on 1st April, 20X0 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Balance Sheet of H Ltd. and S Ltd. as at 31st March, 20X1

Particulars	Note No.	H Ltd. (₹)	S Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	6,00,000	1,00,000
(b) Reserves and Surplus	2	3,00,000	1,00,000
(2) Current Liabilities			
(a) Trade Payables		1,50,000	57,000
Total		**10,50,000**	**2,57,000**
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	3	4,50,000	1,07,000
(b) Other non- current investments	4	6,00,000	1,50,000
Total		**10,50,000**	**2,57,000**

Notes to Accounts

		₹	H Ltd. (₹)	S Ltd. (₹)
1.	Share capital			
	6,000 equity shares of ₹ 100 each, fully paid up		6,00,000	-
	1,000 equity shares of ₹ 100 each, fully paid up		- -	1,00,000
	Total		6,00,000	1,00,000
2.	Reserves and Surplus			
	General reserves		2,00,000	75,000
	Profit and loss account		1,00,000	25,000

TELEGRAM: CA NOTE HUB

	Total		3,00,000	1,00,000
3.	Property, Plant and Equipment			
	Machinery		3,00,000	90,000
	Furniture		1,50,000	17,000
	Total		4,50,000	1,07,000
4.	Other Non-current investments			
	Non-current Investments		4,40,000	1,50,000
	Shares in S Ltd.			
	(800 shares at ₹200 each)		1,60,000	--
	Total		6,00,000	1,50,000

Solution

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.

as at 31st March, 20X1

	Particulars	**Note No.**	**(₹)**
I.	**Equity and Liabilities**		
	(1) Shareholder's Funds		
	(a) Share Capital	1	6,00,000
	(b) Reserves and Surplus	2	3,44,600
	(2) Minority Interest	3	48,150
	(3) Current Liabilities		
	(a) Trade Payables		2,07,000
	Total		**11,99,750**
II.	**Assets**		
	(1) Non-current assets		
	(a) Property, Plant and Equipment	4	5,97,750
	(b) Intangible assets	5	12,000
	(c) Other non-current investments	6	5,90,000
	Total		**11,99,750**

Notes to Accounts

				₹
1.	**Share capital**			
	6,000 equity shares of ₹ 100 each, fully paid up			6,00,000
	Total			6,00,000
2.	**Reserves and Surplus**			
	Reserves		2,00,000	
	Add: 4/5th share of S Ltd.'s postacquisition reserves (W.N.3)		40,000	2,40,000
	Profit and Loss Account		1,00,000	
	Add: 4/5th share of S Ltd.'s post acquisition profits (W.N.4)		4,600	1,04,600
	Total			3,44,600
3.	**Minority interest in S Ltd. (WN 5)**			48,150
4.	**Property, plant and equipment**			
	Machinery			
	H. Ltd.		3,00,000	
	S Ltd.	1,00,000		
	Add: Appreciation	50,000		

TELEGRAM: CA NOTE HUB

		1,50,000		
	Less: Depreciation (1,50,000 X 10%)*	(15,000)	1,35,000	
	Furniture			
	H. Ltd.		1,50,000	
	S Ltd.	20,000		
	Less: Decrease in value	(5,000)		
		15,000		
	Less: Depreciation (15,000 X 15%)*	(2,250)	12,750	5,97,750
5.	**Intangible assets**			
	Goodwill [WN 6]			12,000
6.	**Other non-current investments**			
	H Ltd.		4,40,000	
	S Ltd.		1,50,000	
	Total			5,90,000

* As an alternative manner of presentation, the solution contains only the 'additional depreciation'.

Working Notes:

1.	Pre-acquisition profits and reserves of S Ltd. ₹	
	Reserves	25,000
	Profit and Loss Account	15,000
		40,000
	H Ltd.'s = 4/5 (or 80%) × 40,000	32,000
	Minority Interest= 1/5 (or 20%) × 40,000	8,000
2.	Profit on revaluation of assets of S Ltd.	
	Profit on Machinery ₹ (1,50,000 – 1,00,000)	50,000
	Less: Loss on Furniture ₹ (20,000 – 15,000)	5,000
	Net Profit on revaluation	45,000
	H Ltd.'s share 4/5 × 45,000	36,000
	Minority Interest 1/5 × 45,000	9,000
3.	Post-acquisition reserves of S Ltd.	
	Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 75,000 – 25,000)	50,000
	H Ltd.'s share 4/5 × 50,000	40,000
	Minority interest 1/5 × 50,000	10,000
4.	Post -acquisition profits of S Ltd.	
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 25,000 – 15,000)	10,000
	Add: Excess depreciation charged on furniture @ 15%	
	On ₹ 5,000 i.e. (20,000 – 15,000)	750
		10,750
	Less: Under depreciation on machinery @ 10%	
	on ₹ 50,000 i.e. (1,50,000 – 1,00,000)	(5,000)
	Adjusted post-acquisition profits	5,750
	H Ltd.'s share 4/5 × 5,750	4,600
	Minority Interest 1/5 × 5,750	1,150
5.	Minority Interest	
	Paid-up value of (1,000 – 800) = 200 shares	
	held by outsiders i.e. 200 × ₹ 100 (or 1,00,000 X 20%)	20,000
	Add: 1/5th share of pre-acquisition profits and reserves	8,000
	1/5th share of profit on revaluation	9,000
	1/5th share of post-acquisition reserves	10,000
	1/5th share of post-acquisition profit	1,150
		48,150

TELEGRAM: CA NOTE HUB

	6. Cost of Control or Goodwill	
	Price paid by H Ltd. for 800 shares (A)	1,60,000
	Intrinsic value of the shares-	
	Paid-up value of 800 shares held by H Ltd. i.e. 800 × ₹ 100 (or 1,00,000 X 80%)	80,000
	Add: 4/5th share of pre-acquisition profits and reserves	32,000
	4/5th share of profit on the revaluation	36,000
	Intrinsic value of shares on the date of acquisition (B)	1,48,000
	Cost of control or Goodwill (A – B)	12,000

Illustration 14 (MTP Oct'20, Mar'22, Oct'23)

a) A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd. Sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd. at the financial year end i.e. 31 March 20X1.

b) A Ltd. holds 75% of the equity capital and voting power in B Ltd. A Ltd. purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd. at the financial year end i.e. 31 March 20X1.

Suggest the accounting treatment for the above mentioned transactions in the consolidated financial statements of A Ltd. giving reference of the relevant guidance/standard. **(5 Marks)**

Solution

As per para 16 and 17 of AS 21, intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealized profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealized losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

Using above mentioned guidance, following adjustments would be required:

a. This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs – ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 20X1, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 20X1.

b. This would be the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

TELEGRAM: CANOTE HUB

Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs – ₹ 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 20X1, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 20X1. In the consolidated balance sheet as of 31 March 20X1, A Ltd.'s share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).

Illustration 15

H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:

H Ltd. S Ltd.

	(₹ in lacs)	**(₹ in lacs)**
Sales and other income	5,000	1,000
Increase in Inventory (closing less opening)	1,000	200
Raw material consumed	800	200
Wages and Salaries	800	150
Production expenses	200	100
Administrative Expenses	200	100
Selling and Distribution Expenses	200	50
Interest	100	50
Depreciation	100	50

Other Information:

H Ltd. sold goods to S Ltd. of ₹ 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative expenses of S Ltd. Include ₹ 5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. prior to 20X1-20X2.

H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.

Prepare a consolidated statement of profit and loss..

Solution

Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd.

for the year ended on 31st March, 20X3

	Particulars	**Note No.**	**₹ in Lacs**
I.	Revenue from operations	1	5,865
II.	**Total Income**		**5,865**
III.	Expenses		
	Cost of material purchased/consumed	2	1,180
	Changes of inventories of finished goods	3	(1,196)
	Employee benefit expense	4	950
	Finance cost	5	150
	Depreciation and amortization expense	6	150
	Other expenses	7	535
	Total expenses		**1,769**
IV.	**Profit before tax (II-III)**		**4,096**

TELEGRAM: CA NOTE HUB

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	Revenue from operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	1,000	
		6,000	
	Less: Inter-company sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Cost of material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct expenses (Production)		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
3.	Changes of inventories of finished goods		
	H Ltd.	1,000	
	S Ltd.	200	
	Less: Unrealized profits ₹ 24 lacs × $\frac{20}{120}$	(4)	1,196
4.	Employee benefits and expenses		
	Wages and salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Finance cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150
6.	Depreciation		
	H Ltd.	100	
	S Ltd.	50	150
7.	Other expenses		
	Administrative expenses		
	H Ltd.	200	
	S Ltd.	100	
	Less: Consultancy fees received by H Ltd. from S Ltd.	(5)	295
	Selling and distribution Expenses:		
	H Ltd.	200	
	S Ltd.	50	
	Less: Commission received by S Ltd. from H Ltd.	(10)	240
			535

Illustration 16

Subsidiary B Ltd. provides the following balance sheet:

Particulars	Note No.	20X0 (₹)	20X1 (₹)
I. Equity and Liabilities			

TELEGRAM: CA NOTE HUB

(1) Shareholder's Funds			
(a) Share Capital	1	5,00,000	5,00,000
(b) Reserves and Surplus	2	2,86,000	7,14,000
(2) Current Liabilities			
(a) Short term borrowings	3	--	1,70,000
(b) Trade Payables		4,90,000	4,94,000
(c) Short-term provisions		4 3,10,000	4,30,000
Total		**15,86,000**	**23,08,000**
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	5	2,72,000	2,24,000
(b) Non-current Investment			4,00,000
(2) Current assets			
(a) Inventories		5,97,000	7,42,000
(b) Trade Receivables		5,94,000	8,91,000
(c) Cash & Cash Equivalents		51,000	3,000
(d) Other current assets		6 72,000	48,000
Total		**15,86,000**	**23,08,000**

		20X0 (₹)	20X1 (₹)
1.	Share capital		
	5,000 equity shares of ₹10 each, fully paid up	5,00,000	5,00,000
2.	Reserves and Surplus		
	General Reserves	2,86,000	7,14,000
3.	Short term borrowings		
	Bank overdraft	--	1,70,000
4.	Short term provisions		
	Provision for taxation	3,10,000	4,30,000
5.	Property, plant and equipment		
	Cost	3,20,000	3,20,000
	Less: Depreciation	(48,000)	(96,000)
	Total	2,72,000	2,24,000
6.	Other current Assets		
	Prepaid expenses	72,000	48,000

Also consider the following information:

a) B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accounting year.

b) A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by ₹12,000 at the end of 20X0 and ₹ 34,000 at the end of 20X1.

c) B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

d) Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 20X0 and₹ 30,000 in 20X1, being part of initial advertising expenditure of ₹ 90,000 in 20X0 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 20X0.

TELEGRAM: CA NOTE HUB

Restate the balance sheet of B Ltd. as at 31st December, 20X1 after considering the above information, for the purpose of consolidation. Would restatement be necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

Solution

As per para 20 and 21 of AS 21, Consolidated financial statements:

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

Adjusted reserves of B Ltd.:

	₹	₹
Reserves as given		7,14,000
Add: Provision for doubtful debts		
{[8,91,000 / 99 X 100]-8,91,000}		9,000
		7,23,000
Less: Reduction in value of Inventory	34,000	
Advertising expenditure to be written off	30,000	(64,000)
Adjusted reserves		6,59,000

Note: No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

Restated Balance Sheet of B Ltd.

as at 31st December, 20X1

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	6,59,000
(2) Current Liabilities		
(a) Short term borrowings	3	1,70,000
(b) Trade Payables		4,94,000
(c) Short-term provision	4	4,30,000
Total		**22,53,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	2,24,000
(b) Non-current Investment		4,00,000
(2) Current assets		

TELEGRAM: CA NOTE HUB

	(a) Inventories	6	7,08,000
	(b) Trade Receivables	7	9,00,000
	(c) Cash & Cash Equivalents		3,000
	(d) Other current assets	8	18,000
	Total		**22,53,000**

Notes to Accounts

		20X1 (₹)
1.	Share capital	
	5,000 equity shares of Rs 10 each, fully paid up	5,00,000
2.	Reserves and Surplus	
	General Reserves (refer to WN)	6,59,000
3.	Short term borrowings	
	Bank overdraft	1,70,000
4.	Short term provisions	
	Provision for taxation	4,30,000
5.	Property, plant and equipment	
	Cost	3,20,000
	Less: Depreciation	(96,000)
	Total	2,24,000
6.	Inventory	
	Actual inventory	7,42,000
	Less: Change in method of valuation	(34,000)
	Total	7,08,000
7.	Trade receivables	
	Actual trade receivables	8,91,000
	Add: Adjustment for provision	9,000
	Total	9,00,000
8.	Other current Assets	
	Prepaid expenses	48,000

Illustration 17 (MTP Oct 20)

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 20X1 for ₹ 2,10,000. The issued capital of Power Ltd., on 1st January, 20X1 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 20X1, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500. What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also compute goodwill/ capital reserve at the date of acquisition.

Solution **(6 Marks)**

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

Goodwill on consolidation (at the date of acquisition):	**₹**	**₹**
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on:		
- 1st January, 20X1:		
20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000

TELEGRAM: CA NOTE HUB

- 31st December, 20X1:		
20% of ₹ 2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		49,500

Illustration 18

King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 20X1 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	240
Investments	110
Current Assets	140
Loans & Advances	30
15% Debentures	180
Current Liabilities	100

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment- up by 20% and Investments- down by 10%.

King Ltd. purchased the shares of Queen Ltd. @ ₹20 per share (Face value - ₹10).

Calculate the amount of goodwill/capital reserve on acquisition of shares of Queen Ltd.

Solution

Revalued net assets of Queen Ltd. as on 31st March, 20X1

	₹ in lakhs	**₹ in lakhs**
PPE [240 X 120%]		288
Investments [110 X 90%]		99
Current Assets		140
Loans and Advances		30
Total Assets after revaluation		557
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		277
King Ltd.'s share of net assets (70% of 277)		193.9
King Ltd.'s cost of acquisition of shares of Queen Ltd.		
(₹140 lakhs)		(140)
Capital reserve		**53.9**

Illustration 19 (MTP Sep'22, Past Exam Nov'19) (RTP Nov'20)

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

Case	Subsidiary Company	% of Share owned	Cost	Date of Acquisition	Consolidation date
				01-01-20X1	**31-12-20X1**

TELEGRAM: CA NOTE HUB

				Share Capital	Profit and Loss A/c	Share Capital	Profit and Loss A/c
				₹	₹	₹	₹
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000

Solution: **(5 Marks)**

Minority Interest = Equity attributable to minorities Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

	Minority % Shares Owned	**Minority interest as at the date of acquisition**	**Minority interest as at the date of consolidation**
	[E]	**[E] x [A + B] ₹**	**[E] X [C + D] ₹**
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750

Illustration 20 (MTP Oct'22, Sept'23) (Past Exam Nov'20)

A Ltd acquired 1,600 ordinary shares of ₹100 each of B Ltd on 1st July, 20X1. On 31st December, 20X1, the balance sheets of the two companies were as given below:

Balance Sheet of A Ltd. and its subsidiary, B Ltd.

as at 31st December, 20X1

	Particulars	**Note No.**	**A Ltd. (₹)**	**B Ltd. (₹)**
I.	**Equity and Liabilities**			
	(1) Shareholder's Funds			
	(a) Share Capital	1	5,00,000	2,00,000
	(b) Reserves and Surplus	2	2,97,200	1,82,000
	(2) Current Liabilities			
	(a) Trade Payables		47,100	17,400
	(b) Short term borrowings	3	80,000	
	Total		**9,24,300**	**3,99,400**
II.	**Assets**			
	(1) Non-current assets			

TELEGRAM: CA NOTE HUB

	(a) Property, Plant and Equipment	4	3,90,000	3,15,000
	(b) Non-current Investments	5	3,40,000	--
	(2) Current assets			
	(a) Inventories		1,20,000	36,400
	(b) Trade receivables		59,800	40,000
	(c) Cash & Cash equivalents	6	14,500	8,000
	Total		**9,24,300**	**3,99,400**

Notes to Accounts

		A Ltd. ₹	B Ltd. ₹
1.	Share Capital		
	5,000 shares of ₹ 100 each, fully paid up	5,00,000	-
	2,000 shares of ₹ 100 each, fully paid up	-	2,00,000
	Total	**5,00,000**	**2,00,000**
2.	Reserves and Surplus		
	General Reserves	2,40,000	1,00,000
	Profit & loss	57,200	82,000
	Total	**2,97,200**	**1,82,000**
3.	Short term borrowings		
	Bank overdraft	80,000	--
4.	Property plant and equipment		
	Land and building	1,50,000	1,80,000
	Plant & Machinery	2,40,000	1,35,000
	Total	**3,90,000**	**3,15,000**
5.	Non-current Investments		
	Investment in B Ltd (at cost)	**3,40,000**	**--**
6.	Cash & Cash equivalents		
	Cash	**14,500**	**8,000**

The Profit & Loss Account of B Ltd. showed a credit balance of ₹30,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 20X1 was considered as worth ₹ 1,80,000 on 1st July, 20X1; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).

Prepare consolidated Balance Sheet as at 31st December, 20X1. **(15 Marks)**

Solution

Consolidated Balance Sheet of A Ltd. and its subsidiary, B Ltd.

as at 31st December, 20X1

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	3,08,800
(2) Minority Interest		83,600
(3) Current Liabilities		
(a) Trade Payables	3	64,500
(b) Short term borrowings	4	80,000

TELEGRAM: CA NOTE HUB

Total		**10,36,900**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	7,41,000
(b) Intangible assets	6	17,200
(2) Current assets		
(a) Inventories	7	1,56,400
(b) Trade receivables	8	99,800
(c) Cash & Cash equivalents	9	22,500
Total		**10,36,900**

Notes to Accounts

				₹
1.	Share Capital			
	5,000 shares of ₹ 100 each			5,00,000
2.	Reserves and Surplus			
	Reserves		2,40,000	
	Profit & loss (Refer to W.N 8)		68,800	
	Total			3,08,800
3.	Trade Payables			
	A Ltd.	47,100		
	Add: B Ltd	17,400		
	Total			64,500
4.	Short term borrowings			
	Bank overdraft			80,000
5.	Property, plant and equipment			
	Land and building- A Ltd	1,50,000		
	Add: Land and building- B Ltd	1,80,000	3,30,000	
	Plant & Machinery (Refer to W.N 7)		4,11,000	
	Total			7,41,000
6.	Intangible assets			
	Goodwill (refer to W.N 6)			17,200
7.	Inventories			
	A Ltd.		1,20,000	
	B Ltd.		36,400	
	Total			1,56,400
8	Trade Receivables			
	A Ltd.	59,800		
	B Ltd.	40,000		
	Total			99,800
9	Cash & Cash equivalents			
	Cash of A Ltd		14,500	
	Add: cash of B Ltd.		8,000	
	Total			22,500

Share holding Pattern

Total Shares of B Ltd	2,000 shares
Shares held by A Ltd	1,600 shares i.e. 80 %
Minority Shareholding	400 shares i.e. 20 %

TELEGRAM: CA NOTE HUB

Working Notes:

1. The dividend @ 10% on 1,600 shares - ₹ 16,000 received by A Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. A Ltd., must pass a rectification entry, viz.

Profit & Loss Account	Dr.	₹ 16,000	
To Investment			₹ 16,000

2. The Plant & Machinery of B Ltd. would stand in the books at ₹ 1,42,500 on 1st July, 20X1, considering only six months' depreciation on ₹ 1,50,000 total depreciation being ₹ 15,000. The value put on the assets being ₹ 1,80,000, there is an appreciation to the extent of ₹ 37,500 (1,80,000 – 1,42,500).

3. Capital profits of B Ltd.

	₹	₹
Reserve on 1st January, 20X1 (Assumed there is no movement in reserves during the year and hence balance as on 1st January 20X1 is same as of 31st December 20X1)		1,00,000
Profit & Loss Account Balance on 1st January, 20X1	30,000	
Less: Dividend paid	(20,000)	10,000
Profit for 20X1:		
Total	₹ 82,000	
Less:	₹10,000	
	₹ 72,000	
Proportionate upto 1st July, 20X1 on time basis (₹ 72,000/2)		36,000
Appreciation in value of Plant & Machinery		37,500
		1,83,500
Less: 20% due to outsiders		(36,700)
Holding company's share		**1,46,800**

4. **Revenue profits of B Ltd.:**

Profit after 1st July, 20X1 [(82,000 – 10,000) x ½]		36,000
Less: Depreciation		
10% depreciation on ₹1,80,000 for 6 months	9,000	
Less: Depreciation already charged for 2nd half		
year on 1,50,000	(7,500)	(1,500)
		34,500
Less: 1/5 due to outsiders		(6,900)
Share of A Ltd.		**27,600**

5. Minority interest:

Par value of 400 shares (2,00,000 X 20%)	40,000
Add: 1/5Capital Profits [WN 3]	36,700
1/5 Revenue Profits [WN 4]	6,900
	83,600

6. Cost of Control:

Amount paid for 1,600 shares	3,40,000	
Less: Dividend out of pre-acquisition profits	(16,000)	3,24,000
Par value of shares	1,60,000	
Capital Profits –share of A Ltd. [WN 3]	1,46,800	(3,06,800)
Cost of Control or Goodwill		**17,200**

7. Value of plant & Machinery:

TELEGRAM: CA NOTE HUB

B Ltd.	1,35,000	2,40,000
Add: Appreciation on 1st July, 20X1 [1,80,000 – (1,50,000 – 7,500)]	37,500	
	1,72,500	
Add: Deprecation for 2nd half charged on pre- revalued value	7,500	
Less: Depreciation on ₹1,80,000 for 6 months	(9,000)	1,71,000
		4,11,000

8. Profit & Loss Account (Consolidated):

A Ltd. as given	57,200	
Less: Dividend transferred to Investment A/c	(16,000)	41,200
Share of A Ltd. in revenue profits of B Ltd.		27,600
(WN 4)		
		68,800

Illustration 21

On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Balance Sheet of H Ltd.

and its subsidiary S Ltd. as at 31st March, 20X1

	Particulars	Note No.	H Ltd. (₹ in Lacs)	S Ltd. (₹ in Lacs)
I.	**Equity and Liabilities**			
	(1) Shareholder's Funds			
	(a) Share Capital	1	12,000	4,800
	(b) Reserves and Surplus	2	5,499	3,000
	(2) Current Liabilities			
	(a) Trade payables	3	1,833	1,014
	(b) Short term provisions	4	855	394
	(c) Other current liabilities		1,200	-
	(Dividend payable)			
	Total		**21,387**	**9,208**
II.	**Assets**			
	(1) Non-current assets			
	Property, Plant and Equipment	5	9,468	5,486
	Non-current Investments		3,000	
	(Shares in S Ltd.)			
	(2) Current assets			
	(a) Inventories		3,949	1,956
	(b) Trade receivables	6	2,960	1,562
	(c) Cash and cash equivalents		1,490	204
	(d) Short term loans and advances	7	520	
	Total		**21,387**	**9,208**

Notes to Accounts

		H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)

TELEGRAM: CA NOTE HUB

1.	**Share Capital**		
	Authorized share capital	15,000	6,000
	Equity shares of ₹ 10 each, fully paid up		
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up	12,000	4,800
2.	**Reserves and surplus**		
	General Reserve	2,784	1,380
	Profit and Loss Account:	2,715	1,620
	Total	5,499	3,000
3.	**Trade Payables**		
	Creditors	1,461	854
	Bills Payable	372	160
		1,833	1,014
4.	**Short term provisions**		
	Provision for Taxation	855	394
5.	**Property, plant and equipment**		
	Land and Buildings	2,718	-
	Plant and Machinery	4,905	4,900
	Furniture and Fittings	1,845	586
	Total	9,468	5,486
6.	**Trade receivables**		
	Debtors	2,600	1,363
	Bills Receivable	360	199
	Total	2,960	1,562
7.	**Short term loans and advances**		
	Sundry Advances	520	--

The following information is also provided to you:

a) H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 20X0 when the balances of General Reserve and Profit and Loss Account of S Ltd. Stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

b) On 1st April, 20X0, S Ltd. declared a dividend @ 20% for the year ended 31st March, 20X0. H Ltd. credited the dividend received by it to its Profit and Loss Account.

c) On 1st January, 20X1, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 20X0.

d) On 31st March, 20X1, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

e) On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

Solution

Consolidated Balance Sheet of H Ltd.

and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	**Note No.**	**(₹in Lacs)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) Minority Interest [W.N.6]		3,120

TELEGRAM: CA NOTE HUB

(3) Current Liabilities		
(a) Trade payables	3	2,802
(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		**27,530**
II. Assets		
(1) Non-current assets		
Property, Plant and Equipment	6	14,954
(2) Current assets		
(a) Inventories	7	5,885
(b) Trade receivables	8	4,477
(c) Short term loans and advances	9	520
(d) Cash and cash equivalents	10	1,694
Total		**27,530**

Notes to Accounts

				(₹ in lacs)	(₹ in lacs)
1.	**Share Capital**				
	Authorized share capital				15,000
	Equity shares of ₹10 each, fully paid up Issued and Subscribed:				
	Equity shares of ₹ 10 each, fully paid up				12,000
	Total				12,000
2.	**Reserves and surplus**				
	Capital Reserve (Note 5)			1,320	
	General Reserve (2,784 + 108)			2,892	
	Profit and Loss Account:				
	H Ltd.		2,715		
	Less: Dividend wrongly credited	360			
	Unrealized Profit	20	(380)		
			2,335		
	Add: Share in S Ltd.'s Revenue profits		612	2,947	
	Total				7,159
3.	**Trade payables**				
	Creditors				
	H Ltd.		1,461		
	S Ltd.		854	2,315	
	Bills Payable				
	H Ltd.		₹ 372		
	S Ltd.		₹ 160		
			₹ 532		
	Less: Mutual owing		₹ (45)	487	2,802
4.	**Short term provisions**				
	Provision for Taxation				
	H Ltd.			855	
	S Ltd.			394	
	Total				1,249
5.	**Other current liabilities**				

TELEGRAM: CA NOTE HUB

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

Share holding pattern of S Ltd.

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

Working Notes:

1. S Ltd.'s General Reserve Account

	₹ in lakhs	**₹ in lakhs**	
To Bonus to equity		By Balance b/d	3,000
shareholders (WN-8)	1,800	By Profit and Loss A/c	180
To Balance c/d	1,380	(Balancing figure)	
	3,180		3,180

2. S Ltd.'s Profit and Loss Account

	₹ in lakhs		**₹ in lakhs**
To General Reserve		By Balance b/d	1,200
[WN 1]	180	By Net Profit for the year*	1,200
To Dividend paid			
(20% on ₹3,000 lakhs)	600	(Balancing figure)	

TELEGRAM: CA NOTE HUB

To Balance c/d	1,620		
	2,400		2,400

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60%	(720)
(General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	-----
Share of Minority Shareholders (40%)	480

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

4. Calculation of Capital Profits

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

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

Minority interest = ₹ 1,800 – ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

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

6. Calculation of Minority Interest

	II₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	720
	3,120

7. Unrealized profit in respect of inventory

₹ 100 lakhs $\times \frac{25}{125}$= ₹ 20 lakhs

8. Computation of bonus to equity shareholders

	₹ In lakhs
Shares as on 31 March 20X1 including bonus share issued on 1 January 20X1	4,800
Or we can say these are $1 + \frac{3}{5}$ or $\frac{8}{5}$	
i.e. Shares before bonus issue should have been $\frac{4,800}{8/5}$	= 3,000
Accordingly, bonus issue would be (4,800-3,000)	1,800

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Apr'19, Mar'18)

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for Rs. 2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was Rs. 2,00,000 and the balance in the Profit & Loss Account was Rs. 1,20,000. During the year ended 31st December, 2016, ABC Ltd. earned a profit of Rs. 40,000 and at year end, declared and paid a dividend of Rs. 60,000. Show by an entry how the dividend should be recorded in the books of XYZ Ltd. What is the amount of minority interest as on 1st January, 2016 and 31st December, 2016? **(5 Marks)**

Solution:

Total dividend paid = Rs. 60,000

Out of post-acquisition profit = Rs. 40,000

Out of pre-acquisition profit = Rs. 20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = Rs. 60,000 X 80% = Rs. 48,000

In the books of XYZ Ltd.

		Rs.	**Rs.**
Bank A/c	Dr.	48,000	
To Profit & Loss A/c			32,000
To Investments in ABC Ltd.			16,000
(Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits – as explained above)			
Goodwill on Consolidation:			**Rs.**
Cost of shares less dividend out of capital profits			2,64,000
Less: Face value of capital i.e. 80% of capital		1,60,000	
Add: Share of capital profits [1,20,000-20,000			
(dividend portion out of pre-acquisition profits)] X 80 %		80,000	2,40,000
Goodwill			24,000
Minority interest on: 1st January, 2016: 20% of			
Rs. 3,20,000 [2,00,000 + 1,20,000]			64,000
31st December, 2016: 20% of Rs. 3,00,000			
[2,00,000 + 1,20,000 + 40,000 – 60,000]			60,000

Question 2 (MTP Mar'18, Aug'18, Oct'18) (RTP May'18)

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

	Hello Ltd. (Rs. In lacs)	**Sun Ltd. (Rs. in lacs)**
Incomes:		
Sales and other income	10,000	2,000

TELEGRAM: CA NOTE HUB

Increase in Inventory	2,000	400
	12,000	**2,400**
Expenses :		
Raw material consumed	1,600	400
Wages and Salaries	1,600	300
Production expenses	400	200
Administrative Expenses	400	200
Selling and Distribution Expenses	400	100
Interest	200	100
Depreciation	200	100
	4,800	**1,400**
Profit before tax	7,200	1,000
Provision for tax	2,400	400
Profit after tax	4,800	600
Dividend paid	2,400	300
Balance of Profit	2,400	300

Other Information:

Hello Ltd. sold goods to Sun Ltd. of Rs. 240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing Rs. 48 lacs. Administrative expenses of Sun Ltd. include Rs. 10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include Rs. 20 lacs paid to Sun Ltd. as commission. Hello Ltd. holds 80% of equity share capital of Rs. 2,000 lacs in Sun Ltd. prior to 2015- 2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017. **(12 Marks)**

Solution:

Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended on 31st March, 2017

	Particulars	**Note No.**	**Rs. in Lacs**
I.	Revenue from operations	1	11,730
II.	Total revenue		11,730
III.	Expenses		
	Cost of Material purchased/Consumed	3	2,360
	Changes of Inventories of finished goods	2	(2,392)
	Employee benefit expense	4	1,900
	Finance cost	6	300
	Depreciation and amortization expense	7	300
	Other expenses	5	1,070
	Total expenses		3,538
IV.	Profit before Tax(II-III)		8,192
V.	Tax Expenses	8	2,800
VI.	Profit After Tax		5,392

TELEGRAM: CA NOTE HUB

	Profit transferred to Consolidated Balance Sheet		
	Profit After Tax		5,392
	Dividend paid		
	Hello Ltd.	2,400	
	Sun Ltd.	300	
	2,700		
	Less: Share of Hello Ltd. in dividend of Sun Ltd.		
	80% of Rs. 300 lacs	(240)	(2,460)
	Profit to be transferred to consolidated balance sheet		2,932

Notes to Accounts

		Rs. in Lacs	Rs. in Lacs
1.	Revenue from Operations		
	Sales and other income		
	Hello Ltd.	10,000	
	Sun Ltd.	2,000	
		12,000	
	Less: Inter-company Sales	(240)	
	Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	
	Commission received by Sun Ltd. from Hello Ltd.	(20)	11,730
2.	Increase in Inventory		
	Hello Ltd.	2,000	
	Sun Ltd.	400	
		2,400	
	Less: Unrealized profits Rs. 48 lacs ×20/120	(8)	2,392
			14,122
3.	Cost of Material purchased/consumed		
	Hello Ltd.	1,600	
	Sun Ltd.	400	
		2,000	
	Less: Purchases by Sun Ltd. from Hello Ltd.	(240)	1,760
	Direct Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	600
			2,360
4.	Employee benefits and expenses		
	Wages and Salaries:		
	Hello Ltd.	1,600	
	Sun Ltd.	300	1,900
5.	Other Expenses		
	Administrative Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	
		600	
	Less: Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	590
	Selling and Distribution Expenses:		
	Hello Ltd.	400	

TELEGRAM: CA NOTE HUB

	Sun Ltd.	100	
		500	
	Less: Commission received from Sun Ltd. from Hello Ltd.	(20)	480
			1,070
6.	Finance Cost		
	Interest:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
7.	Depreciation and Amortization		
	Depreciation:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
8.	Provision for tax		
	Hello Ltd.	2,400	
	Sun Ltd.	400	2,800

Note: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not added to consolidated opening retained earnings (which is also not given).

Question 3 (MTP Apr'21, Mar 22) (RTP Nov'19) (Past Exam May'18)

H Ltd. and its subsidiary S Ltd. Give the following information as on 31st March, 2021:

	H Ltd. (Rs.)	S Ltd. (Rs.)
Share Capital		
Equity Share Capital (fully paid up shares of Rs. 10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Cr. Balance in Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
Non-Current Assets		
Property, Plant and Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ Rs. 20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2020. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at Rs. 50,000 and Rs. 30,000 respectively.

TELEGRAM: CA NOTE HUB

Machinery (book value Rs. 2,00,000) and Furniture (book value Rs. 40,000) of S Ltd. were revalued at Rs. 3,00,000 and Rs. 30,000 respectively on 1st April,2020 for the purpose of fixing the price of its shares (rates of depreciation on W.D.V basis: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include Rs. 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing Rs. 55,000 (cost to H Ltd.) purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet of H Ltd. With its subsidiary as at 31st March, 2021. **(15 Marks)**

Solution:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2021

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		12,00,000
(1,20,000 equity shares of ₹ 10 each)		
(b) Reserves and Surplus	1	8,16,200
(2) Minority Interest (W.N.4)		99,300
(3) Current Liabilities		
(a) Trade Payables	2	4,10,000
Total		**25,25,500**
II. Assets		
(1) Non-current assets		
(i) Property, plant and equipment	3	13,10,500
(ii) Intangible assets	4	24,000
(2) Current assets		
(i) Inventories	5	3,25,000
(ii) Trade Receivables	6	6,70,000
(iii) Cash at Bank	7	1,96,000
Total		**25,25,500**

Notes to Accounts

				₹
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s postacquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
2.	Trade Payables			8,16,200
	H Ltd.		3,22,000	

TELEGRAM: CA NOTE HUB

	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
4.	Intangible assets			13,10,500
	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
6.	Trade Receivables			3,25,000
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	
				7,05,000
	Less: Mutual transaction			(35,000)
7.	Cash and Bank			6,70,000
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2020

	Rs.
Machinery	
Revaluation as on 1.4.2020	3,00,000
Less: Book value as on 1.4.2020	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2020	30,000
Less: Book value as on 1.4.2020	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	**Furniture**
Upward/ (Downward) Revaluation	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	(10,000)	1,500

3. Analysis of reserves and profits of S Ltd. as on 31.03.2021

	Preacquisition profit upto 1.4.2020	**Post-acquisition profits (1.4.2020 – 31.3.2021)**

TELEGRAM: CA NOTE HUB

	(Capital profits)	General Reserve	Profit and loss account
General reserve as on 31.3.2021	50,000	1,05,000	
Profit and loss account as on 31.3.2021	30,000		35,000
Upward Revaluation of machinery as on 1.4.2020	1,00,000		
Downward Revaluation of Furniture as on 1.4.2020	(10,000)		
Short depreciation on machinery			(10,000)
Excess depreciation on furniture			1,500
Total	1,70,000	1,05,000	26,500

4. Minority Interest

	Rs.
Paid-up value of (2,00,000 x 20%)	40,000
Add: 20% share of pre-acquisition profits and reserves	
[(20% of (50,000 + 30,000)]	16,000
20% share of profit on revaluation	18,000
20% share of post-acquisition reserves	21,000
20% share of post-acquisition profit	5,300
	1,00,300
Less: Unrealised Profit on Inventory	
(55,000 x 10/110) x 20%	(1,000)
	99,300

5. Cost of Control or Goodwill

Cost of Investment		3,20,000
Less: Paid-up value of 80% shares	1,60,000	
80% share of pre-acquisition profits and		
reserves (Rs. 64,000 + Rs.72,000)	1,36,000	(2,96,000)
Cost of control or Goodwill		24,000

Question 4 (MTP Oct'21, Oct'23)

A Ltd. had acquired 80% shares of B Ltd. for Rs. 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for Rs. 30 lakhs and net assets of B Ltd. on the date of disposal was Rs. 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd. **(4 Marks)**

Solution:

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	Rs.
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd.	(28,00,000)
	2,00,000

Working Note:

A Ltd.'s share in net assets of B Ltd.

	Rs.
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of Rs. 35 lakhs)	(7,00,000)

TELEGRAM: CANOTE HUB

A Ltd.'s share in the net assets of B Ltd. 28,00,000

Question 5 (MTP Nov'21, Mar'23, Apr'23) (Past Exam Jan'21)

On 31st March, 2023 H Ltd. and its subsidiary S Ltd. give the following information:

	H Ltd.	S Ltd.
	Rs.	Rs.
Shareholders' Fund:		
Equity shares of Rs. 10 each	13,40,000	2,40,000
Reserves and Surplus	4,80,000	1,80,000
Profit & Loss Account	2,40,000	60,000
Secured Loans:		
12% Debentures	1,00,000	-
Current Liabilities:		
Creditors	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Property, Plant & Equipment:		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
Investments:		
Investments in S Ltd.	3,84,000	-
(19,200 shares at Rs. 20 each)		
Current Assets:		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000

The following information is also provided to you:

a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at Rs. 60,000 and Rs. 36,000 respectively.

b) Machinery (Book value Rs. 2,40,000) and Furniture (Book value Rs. 48,000) of S Ltd were revalued at Rs. 3,60,000 and Rs. 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%).

c) On 31st March, 2022, Bills payable of Rs. 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023 **(20 Marks)**

Solution:

TELEGRAM: CA NOTE HUB

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023

		Particulars	Note No.	(Rs.)
I.		Equity and Liabilities		
	1	Shareholder's Funds		
		(a) Share Capital	1	13,40,000
		(b) Reserves and Surplus	2	8,27,040
	2	(Minority Interest		1,15,560
	3	Non- Current Liabilities		
		(a) 12% Debentures		1,00,000
	4	Current Liabilities		
		(a) Trade Payables	3	3,84,800
		(b) Short term Borrowings (Bank)		1,00,000
		Total		**28,67,400**
II.		**Assets**		
	1	Non-current assets		
		(a)		
		(i) Property, Plant and Equipment	4	14,34,600
		(ii) Intangible assets	5	28,800
	2	Current assets		
		(a) Inventory (6,00,000+2,00,000)		8,00,000
		(b) Trade Receivables	6	5,08,000
		(c) Cash and Cash equivalents		96,000
		Total		**28,67,400**

Notes to Accounts

			Rs.
1. Share Capital Equity share capital 1,34,000 shares of Rs. 10 each fully paid up			**13,40,000**
2. Reserves and Surplus Reserves		4,80,000	
Add: 4/5th share of S Ltd.'s postacquisition reserves (W.N.3)		96,000	5,76,000
Profit and Loss Account		2,40,000	
Add: 4/5th share of S Ltd.'s postacquisition profits (W.N.4)		11,040	2,51,040
3. Trade Payables			8,27,040
Creditors			
H Ltd.	2,00,000		
S Ltd.	1,22,000	3,22,000	
Bills Payables			
H Ltd.	60,000		
S Ltd.	14,800	74,800	
		3,96,800	

TELEGRAM: CA NOTE HUB

Less: Mutual Owings		(12,000)	3,84,800
4. Property Plant and Equipment			
Machinery			
H. Ltd.		7,20,000	
S Ltd.	2,40,000		
Add: Appreciation	1,20,000		
	3,60,000		
Less: Depreciation (3,60,000 X 10%)	(36,000)	3,24,000	
Furniture			
H. Ltd.		3,60,000	
S Ltd.	48,000		
Less: Decrease in value	(12,000)		
	36,000		
Less: Depreciation (36,000 X 15%)	5,400	30,600	14,34,600
5. Intangible assets			
Goodwill [WN 6]			28,800
6. Trade receivables			
H Ltd.	3,00,000		
S Ltd.	90,000	3,90,000	
Bills Receivables			
H Ltd.	1,00,000		
S Ltd.	30,000	1,30,000	
		5,20,000	
Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

1. Pre-acquisition profits and reserves of S Ltd.	**Rs.**
Reserves	60,000
Profit and Loss Account	36,000
	96,000
H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
Minority Interest= 1/5 (or 20%) × 96,000	19,200
2. Profit on revaluation of assets of S Ltd.	
Profit on Machinery Rs. (3,60,000 – 2,40,000)	1,20,000
Less: Loss on Furniture Rs.(48,000 –36,000)	(12,000)
Net Profit on revaluation	1,08,000
H Ltd.'s share 4/5 × 1,08,000	86,400
Minority Interest 1/5 × 1,08,000	21,600
3. Post-acquisition reserves of S Ltd.	
Total reserves	1,80,000
Less: Pre- acquisition reserves	(60,000)
Post-acquisition reserves	1,20,000
H Ltd.'s share 4/5 × 1,20,000	96,000
Minority interest 1/5 × 1,20,000	24,000
4. Post -acquisition profits of S Ltd.	
Post-acquisition profits (Profit & loss account balance less preacquisition profits = Rs. 60,000 – 36,000)	24,000
Add: Excess depreciation charged on furniture @ 15%	
on Rs. 12,000 i.e. (48,000 – 36,000)	1,800
Less: Under depreciation on machinery @ 10%	25,800
on Rs. 1,20,000 i.e. (3,60,000 – 2,40,000)	(12,000)

TELEGRAM: CA NOTE HUB

Adjusted post-acquisition profits	13,800
H Ltd.'s share 4/5 × 13,800	11,040
Minority Interest 1/5 × 13,800	2,760
5. Minority Interest	
Paid-up value of (24,000 – 19,200) = 4,800 shares	
held by outsiders i.e. 2,40,000 X 20%	48,000
Add: 1/5th share of pre-acquisition profits and reserves	19,200
1/5th share of profit on revaluation	21,600
1/5th share of post-acquisition reserves	24,000
1/5th share of post-acquisition profit	2,760
6. Cost of Control or Goodwill	1,15,560
Price paid by H Ltd. for 19,200 shares (A) Less: Intrinsic value of the shares	3,84,000
Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%	1,92,000
Add: 4/5th share of pre-acquisition profits and reserves	76,800
4/5th share of profit on the revaluation	86,400
Intrinsic value of shares on the date of acquisition (B)	3,55,200
Cost of control or Goodwill B) (A –	28,800

Question 6 (MTP Apr'19, Sep'22, Oct'23) (Past Exam Nov'19)

Consider the following information of subsidiary MNT Ltd.

	2020-21	**2021-22**
	Amount in ₹	**Amount in ₹**
Share Capital		
Issued and subscribed 7500 Equity Shares of ₹ 100 each	7,50,000	7,50,000
Reserve and Surplus		
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Current Liabilities and Provisions		
Trade Payables	2,90,000	2,46,000
Bank Overdraft		1,70,000
Provision for Taxation	2,62,000	4,30,000
Non-current assets		
Property, Plant and equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment at Cost	5,30,000	
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500

TELEGRAM: CA NOTE HUB

Other Information:

1) MNT Ltd. is a subsidiary of LTC Ltd.

2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2020-21 and increased by ₹ 12,000 at the end of 2021-22. (Inventory of 2020-21 has been sold out during the year 2021-22)

3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25,000 in 2020-21 and ₹ 12,500 in 2021-22 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2020-21, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2020-21. Restate the balance sheet of MNT Ltd. as on 31st March, 2022 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. Uniform.

Solution:

Restated Balance Sheet of MNT Ltd. as at 31st March, 2022

Particulars	Note	No. (₹)
I. **Equity and Liabilities**		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		**23,14,500**
II. **Assets**		
(1) **Non-current assets**		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) **Current assets**		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\frac{3,43,000}{98} \times 100$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		**23,14,500**

Notes to Accounts

			₹
1.	Reserves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	Short term borrowings		
	Bank overdraft		1,70,000
3.	Short-term provision		
	Provision for taxation		4,30,000
	Provision for taxation		4,30,000
4.	Property, Plant and Equipment		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500

TELEGRAM: CA NOTE HUB

5.	Inventories	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	Other current assets		
	Prepaid expenses (After adjusting salespromotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 7 (RTP May'21)

A Ltd. acquired 70% equity shares of B Ltd. @ Rs.20 per share (Face value - Rs.10) on 31st March, 2021 at a cost of Rs. 140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021:

	Rs. in lakhs
Property, plant and equipment	360
Investments	90
Current Assets	140
Loans & Advances	30
15% Debentures	180
Current Liabilities	100

Solution:

Net assets of B Ltd. as on 31st March, 2021

	Rs. in lakhs	Rs. in lakhs
Property, plant and equipment		360
Investments		90
Current Assets		140
Loans and Advances		30
Total Assets		620
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		340
Share of Minority Interest in net assets (30% of 340)		102
A Ltd.'s share in net assets (70% of 340)		238
A Ltd.'s cost of acquisition of shares of B Ltd.		
(Rs.140 lakhs)		(140)
Capital reserve		**98**

Question 8 (RTP Nov 18)

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 are as follows:

Particulars	**Amounts as at 31st March,**

TELEGRAM: CA NOTE HUB

	2017	
	X Ltd. (Rs. in lakhs)	Y Ltd. (Rs. in lakhs)
LIABILITIES		
Share Capital:		
Authorised	20,000	8,000
Issues and subscribed:		
Equity share of Rs. 10 each, fully paid up	15,000	6,000
15% preference shares of Rs. 10 each, fully paid up	4,000	1,000
General Reserves	2,500	1,450
Profit & Loss Account	2,750	1,250
Trade payables	1,646	1,027
	25,896	**10,727**
ASSESTS		
Land & Building	3,550	1,510
Plant & Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd.: 450 Lakh Equity share in		
Y Ltd. purchased on 1st April, 2016	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	1,174	560
	25,896	**10,727**

The following information is also given to you

a) 10% dividend on Equity shares was declared by Y Ltd. on 31st March, 2016 for the year ended 31st March, 2016. X Ltd. credited the dividend received to its Profit & Loss Account.

b) Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2016 was Rs. 650 Lakhs.

c) General Reserve of Y Ltd. stood at same Rs. 1,450 Lakhs as on 1st April, 2016.

d) Y Ltd.'s Plant & machinery showed a balance of Rs. 4,000 Lakh on 1st April 2016. At the time of purchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by Rs. 1,000 Lakh.

e) Included in Trade Payables of Y Ltd. are Rs. 50 Lakh for goods supplied by X Ltd.

f) On 31st March, 2017, Y's ltd. inventory included goods for Rs. 150 lakhs which it had purchased from X Ltd. X Ltd. sold goods to Y Ltd. at cost plus 25%.

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 giving working notes. (Ignoring dividend on preference shares).

Solution:

Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017

TELEGRAM: CA NOTE HUB

	Particulars	Note No.	Rs. in lakhs
I	Equity and Liabilities		
1	Shareholders' Funds		
	(a) Share Capital	1	19,000
	(b) Reserves and Surplus	2	5,620
2.	**Minority interest**	3	3,400
3.	**Current Liabilities**		
	(a) Trade payables	4	2,623
	Total		30,643
II	**Assets**		
1	**Non Current Assets**		
	Property, Plant & Equipment		
	(i) Tangible Assets	5	17,435
2	**Current Assets**		
	(a) Inventories	6	6,632
	(b) Trade Receivables	7	4,842
	(c) Cash and Cash equivalents	8	1,734
			30,643

Notes to Accounts

			Rs. in lakhs
1	**. Share Capital**		
	Issued, Subscribed and Paid up (1,500 lakh Equity Shares of Rs. 10 each fully paid up)		15,000
	400 lakh Preference Shares of Rs. 10 each fully paid up		4,000
2	**. Reserves and Surplus**		19,000
	Credit Balance of Profit & Loss Account	2,750	
	Less: Capital Receipt wrongly credited (Dividend @ 10% on Rs. 4500 Lakh Equity Shares)	450	
		2,300	
	Add: Share in Y Ltd. Revenue Profit (Working Note i)	825	
		3,125	
	Less: Unrealised Profit (Working Note iv)	30	3,095
	Capital Reserve (Working Note iii)	25	
	General Reserve	2,500	2,525
3	**. Minority interest**		5,620
	100 Lakh Preference Shares of Rs. 10 fully paid up	1,000	
	150 Lakh Equity Shares of Rs.10 each fully paid up	1,500	2,500
	Share in Revenue Profits (Working Note i)	275	
	Share in Capital Profit (working Note ii)	625	900
4	**. Trade payables**		3,400

TELEGRAM: CA NOTE HUB

	X Ltd.	1,646	
	Y Ltd.	1,027	
		2,673	
	Less: Mutual owing	50	2,623
5	**. Tangible Assets**		
	Land & Building		
	X Ltd.	3,550	
	Y Ltd	1,510	5,060
	Plant & Machinery		
	X Ltd.	5,275	
	Y Ltd (Working note v)	4,500	9,775
	Furniture & Fixtures		
	X Ltd.	1,945	
	Y Ltd	655	2,600
			17,435
6.	**Inventories**		
	X Ltd.	4,142	
	Y Ltd	2,520	
		6,662	
	Less: Unrealized Profit	(30)	6,632

Working Notes:

i. Calculation of Revenue Profits Y's Ltd Profit & Loss Account

	Rs. in lakh		**Rs. in lakh**
To Equity Dividend		By Balance b/d	650
10 % of 6,000 lakh	600	By Net profit for the year (Bal Fig.)	1,200
To balance c/d	1,250		
	1,850		**1,850**

Depreciation provided on Plant & Machinery	
Balance as on 1st April, 2016	4,000
Less Balance as 31st March 2017	3,600
	400
Hence rate of Depreciation = 400/4000 x 100	10%
Net Profit for the year ended 31st March 2017	1,200
Less: Additional Depreciation	100
Revenue Profit	1,100
X Ltd's share- 1100 x 450/600	825
Y Ltd's share = 1100 x150/600	275

ii. Calculation of Capital Profits

Profit & Loss Balance as on 1st April, 2016	650
Less: Dividend Paid	600
	50
Add: General Reserve as on 1st April, 2016	1,450
Add: Profit on Revaluation of Plant & machinery	1,000
Capital Profit	2,500
X Ltd's Share in Capital Profit = 2,500 x 450/600	1,875
Y Ltd's Share in Capital Profit = 2,500 x 150/600	625

iii. Calculation of Capital Reserve

TELEGRAM: CA NOTE HUB

Paid up value of 450 Lakh equity shares	4,500
Add: Share in Capital Profits	1,875
	6,375
Amount Paid to acquire the 450 Lakh Equity Shares	6,800
Less: Dividend received out of Pre acquisition profits	450
	6,350
Capital Reserve = 6,375-6,350	25

iv. Unrealized Profit

Rs. 150 Lakh x 25/125* = 30 lakh	

v. Plant & Machinery of Y Ltd.

Balance as on 31st March, 2017		3,600
Add: Addition due to revaluation	1,000	
Less: Depreciation on additional Value of Plant & Machinery @ 10 %	100	900
		4,500

* Rs. 150 lakh considered as cost to Y Ltd.

Question 9 (RTP Nov'22)

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Equity Share Capital – Authorised	5,000	3,000
Issued and subscribed in Equity Shares of ₹ 10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account (Cr. Balance)	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
Plant and Machinery	2,541	2,450
Furniture and Fittings	615	298
Investment in the Equity Shares of S Ltd.	1,500	-
Inventory	983	786
Trade receivables	820	778
Cash and Bank Balances	410	102
Sundry Advances (Dr. balances)	260	190

Following Additional Information is available:

a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the following balances stood in the books of S Ltd.:

General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 633 thousand.

b) On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.

TELEGRAM: CANOTE HUB

c) On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of ₹ 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.

d) On 31st March, 2021, the Inventory of S Ltd. included goods purchased for ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

(e) Details of Trade payables and Trade receivables:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Trade payables		
Bills Payable	124	80
Sundry creditors	487	427
	611	**507**
Trade receivables		
Debtors	700	683
Bills Receivables	120	95
	820	**778**

Prepare a consolidated Balance Sheet as on 31st March, 2022.

Solution:

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2022

Particulars	**Note No.**	**(₹ in 000's)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(a) Reserves and Surplus	2	3,063
(2) Minority Interest (W.N.6)		1,560
(3) Current Liabilities		
Trade payables	3	1,118
Short term provisions	4	482
Total		**10,223**
II. Assets		
(1) Non-current assets		
PPE	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade receivables	7	1,598
(c) Cash and cash equivalents	8	512
(d) Short term loans and advances	9	450
Total		**10,223**

Notes to Accounts

		(₹ in 000's)	(₹ in 000's)

TELEGRAM: CA NOTE HUB

1.	Share Capital		
	Authorised share capital		
	5 lakhs equity shares of ₹ 10 each		5,000
	Issued, Subscribed and Paid up		
	4 lakhs equity shares of ₹ 10 each fully paid		4,000
2.	Reserves and surplus		
	Capital Reserve (Note 5)	679.8	
	General Reserve	928	
	Profit and Loss Account:		
	H Ltd. ₹ 1,305		
	Add: Share in S Ltd ₹ 340.20		
	₹ 1,645.20		
	Less: Dividend wrongly credited ₹ (180)		
	₹ 1,465.20		
	Less: Unrealised profit (50 X 1/5) ₹ (10)	1,455.20	3,063
3.	Trade payables		
	H Ltd.	611	
	S Ltd.	507	1,118
4.	Short –term provisions		
	Provision for Taxation H Ltd. ₹ 220		
	S Ltd. ₹ 180	400	
	Other Provisions H Ltd ₹ 65		
	S Ltd. ₹ 17	82	482
5.	PPE		
	Plant and Machinery		
	H Ltd. ₹ 2,541		
	S Ltd. ₹ 2,450	4,991	
	Furniture and fittings		
	H Ltd. ₹ 615		
	S Ltd. ₹ 298	913	5,904
6.	Inventories		
	Inventory		
	H Ltd. ₹ 983		
	S Ltd. ₹786		
		1,769	
	Less: Unrealised profit (₹ 50 x 1/5)	(10)	1,759
	7. Trade receivables		
	H Ltd.	820	
	S Ltd.	778	1,598
	8. Cash and cash equivalents		
	Cash and Bank Balances H Ltd	410	
	S Ltd.	102	512
	9. Short term loans and advances		
	Sundry Advances H Ltd.	260	
	S Ltd.	190	450

Working Notes:

Share holding pattern

Particulars	Number of Shares	% of holding
a. S Ltd.		
(i) Purchased on 01.04.2021	90,000	

TELEGRAM: CA NOTE HUB

(ii) Bonus Issue (90,000/5 x 3)	54,000	
Total	1,44,000	60% (1,44,000 /2,40,000*x100)
b. Minority Interest	96,000	40%

*2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022

1. **S Ltd. General Reserve**

	(₹ in 000)		(₹ in 000)
To Bonus to equity shareholders $\frac{2,400 \times 3}{8}$	900	By Balance b/d	1,500
		By Profit and Loss A/c	
To Balance c/d.	690	(Balancing figure)	90
	1,590		1,590

2. S Ltd.'s Profit and Loss Account

	(₹ in 000)		(₹ in 000)
To General Reserve	90	By Balance b/d	633
To Dividend paid on 14.7.2021 $\frac{1,500 \text{ X } 20}{100}$	300	By Net Profit for the year (Balancing figure)	567*
To Balance c/d	810		
	1,200		1,200

* Out of ₹ 5,67,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

3. Distribution of Revenue Profits

	₹ in '000
Revenue Profit as above	567.00
Share of H Ltd. (60%)	340.20
Share of Minority shareholders (567– 340.20)	226.80

4. Computation of Capital Profits

	₹ in 000	₹ in 000
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		(900)
Profit and Loss Account balance on the date of acquisition	633	600
Less: Dividends paid	(300)	333
		933
Share of H Ltd. (60%)		559.80
Share of Minority shareholders		373.20

5. **Computation of Capital Reserve**

		₹ in '000
60% of share capital of S Ltd.		1,440
Add: Share of H Ltd. in the capital profits as in working note (4)		559.80
Less: Investments in S Ltd.	1,500	1,999.80
Less: Dividends received out of pre- acquisition profits $\frac{₹30 \times 60}{100}$	(180)	(1,320)
		679.80

6. **Calculation of Minority Interest**

	₹ in '000
40% of share capital of S Ltd.	960.00

TELEGRAM: CA NOTE HUB

Add: Share of Revenue Profits (Note 3)	226.80
Share of Capital Profits (Note 4)	373.20
	1,560.00

Question 10

G Ltd.. and its subsidiary K Ltd. give the following information for the year ended 31stMarch, 2023:

Particulars	**G Ltd.**	**K Ltd**
Sales and other Income	3000	750
Increase in Inventory	750	100
Raw material consumed	600	100
Wages and Salaries	600	75
Production expenses	100	50
Administrative expenses	75	50
Selling and Distribution expenses	100	25
Interest	75	30
Depreciation	75	30

The following information is also given:

(i) G sold goods of ₹ 200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventory of K Ltd. at the end of the year)

(ii) G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is ₹ 800 crores on 01.04.2022 (date of acquisition of shares)

(iii) Administrative expenses of K Ltd. include ₹ 5 crore paid to G Ltd. as consultancy fees. Also, selling and distribution expenses of G Ltd. include ₹ 20 crores paid to K Ltd. as commission.

Prepare a consolidated statement of Profit and Loss of G Ltd. with its subsidiary K. Ltd. for the year ended 31st March, 2023.

Solution:

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd. for the year ended on 31st March, 2023

Particulars	**Note No.**	**₹ in Crores**
I. Revenue from operations	1	3,525
II. Total Income		**3,525**
III. Expenses		
Cost of material purchased/consumed	2	650
Changes of inventories of finished goods	3	(842)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225

TELEGRAM: CA NOTE HUB

Total expenses		**918**
IV. Profit before tax (II-III)		**2,607**

Notes to Accounts

		₹ in Crores	₹ in Crores
1.	Revenue from operations Sales and other income G Ltd.	 3,000	
	K Ltd.	750 3,750	
	Less: Inter-company sales	(200)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,525
2.	Cost of material purchased/consumed G Ltd.	 600	
	K Ltd.	100 700	
	Less: Purchases by K Ltd. from G Ltd.	(200)	500
	Direct expenses (Production) G Ltd.	 100	
	K Ltd.	50	150 650
3.	Changes of inventories of finished goods G Ltd.	 750	
	K Ltd.	100 850	
	Less: Unrealized profits ₹ 40 crores × 25/125	(8)	842
4.	Employee benefits and expenses Wages and salaries: G Ltd.	 600	
	K Ltd.	75	675
5.	Finance cost Interest: G Ltd.	 75	
	K Ltd.	30	105
6.	Depreciation G Ltd.	 75	
	K Ltd.	30	105
7.	Other expenses Administrative expenses G Ltd.	 75	
	K Ltd.	50 125	
	Less: Consultancy fees received by G Ltd. from K Ltd.	(5)	120
	Selling and distribution Expenses: G Ltd.	 100	
	K Ltd.	25 125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105
			225

Note: The information (i) given in the question states that G Ltd. sold goods of ₹ 200 crores to K Ltd. at cost plus 25%. In the above solution it has been considered that the amount of ₹ 200 crores is sale value. Alternatively, ₹ 200 crores may be assumed as the cost of the goods sold. In that case, the solution will differ and will be as follows:

Alternative solution:

TELEGRAM: CA NOTE HUB

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd. for the year ended on 31st March, 2023

Particulars	Note No.	₹ in Crores
I. Revenue from operations	1	3,475
II. Total Income		3,475
III. Expenses		
Cost of material purchased/consumed	2	600
Changes of inventories of finished goods	3	(840)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225
Total expenses		870
IV. Profit before tax (II-III)		2,605

Notes to Accounts

		₹ in Crores	₹ in Crores
1.	Revenue from operations Sales and other income G Ltd.	3,000	
	K Ltd.	750 3,750	
	Less: Inter-company sales	(250)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,475
2.	Cost of material purchased/consumed G Ltd.	600	
	K Ltd.	100 700	
	Less: Purchases by K Ltd. from G Ltd.	(250)	450
	Direct expenses (Production) G Ltd.	100	
	K Ltd.	50	150 600
3.	Changes of inventories of finished goods G Ltd.	750	
	K Ltd.	100 850	
	Less: Unrealized profits ₹ 40 crores × 25/100	(10)	840
4.	Employee benefits and expenses Wages and salaries: G Ltd.	600	
	K Ltd.	75	675
5.	Finance cost Interest: G Ltd.	75	
	K Ltd.	30	105
6.	Depreciation G Ltd.	75	

TELEGRAM: CA NOTE HUB

	K Ltd.	30	105
7.	Other expenses Administrative expenses G Ltd.	 75	
	K Ltd.	50 125	
	Less: Consultancy fees received by G Ltd. from K Ltd.	(5)	120
	Selling and distribution Expenses: G Ltd.	 100	
	K Ltd.	25	
		125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105 225

Question 11 (Past Exam May'23)

H Ltd acquired 15000 shares in S Ltd. for 1,55,000 on July 1, 2022. The Balance sheet of the two companies as on 31st March, 2023 were as follows:

	H Ltd.₹	S Ltd.₹
Equity and Liabilities:		
Equity Share Capital	9,00,000	2,50,000
(Fully paid shares of ₹ 10 each)		
General Reserve	1,60,000	40,000
Surplus i.e., Balance in Statement of Profit and Loss	80,000	25,000
Bills payable	40,000	20,000
Trade Creditors	50,000	30,000
Total	12,30,000	3,65,000
Assets		
Machinery	7,00,000	1,50,000
Furniture	1,00,000	70,000
Investment in Equity Shares of S Ltd.	1,55,000	-
Stock-in Trade	1,00,000	50,000
Trade Debtors	60,000	35,000
Bills Receivable	25,000	20,000
Cash at Bank	90,000	40,000
Total	12,30,000	3,65,000

The following additional information is provided to you:

(i) General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March, 2022.

(ii) Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to ₹ 20,000.

(iii) H Ltd. sold goods to S Ltd. costing ₹ 8,000 for ₹ 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.

TELEGRAM: CA NOTE HUB

(iv) Creditors of S Ltd. include ₹ 4000 due to H Ltd. on account of these goods.

(v) Out of Bills payable issued by S Ltd. ₹ 15,000 are those which have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, ₹ 8000 worth of bills receivable in favour of its creditors.

You are required to draw a consolidated Balance Sheet as on 31st March, 2023. **(15 Marks)**

Solution:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	9,00,000
(b) Reserves and Surplus	2	2,73,500
(2) Minority Interest	3	1,26,000
(3) Current Liabilities		
(a) Trade Payables	4	1,29,000
Total		**14,28,500**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	10,20,000
(2) Current assets		
(i) Inventory	6	1,49,500
(ii) Trade Receivables	7	1,29,000
(iii) Cash & cash equivalent	8	1,30,000
Total		**14,28,500**

Notes to Accounts

			₹
1.	Share capital		
	Authorised, issued, subscribed and paid up capital 90,000 equity shares of ₹ 10 each, fully paid up		9,00,000
2.	Reserves and Surplus		
	General Reserves	1,60,000	
	Profit and Loss Account (W.N.5)	88,500	
	Capital Reserve (W.N. 4)	25,000	2,73,500
3.	Minority interest in S Ltd. (WN 3)		1,26,000
4.	Trade payables		
	Bills Payable		
	H Ltd. 40,000		
	S Ltd. 20,000		
	60,000		
	Less: Mutual payables (7,000)	53,000	
	Trade Creditors		
	H Ltd. 50,000		

TELEGRAM: CA NOTE HUB

	S Ltd.	30,000		
		80,000		
	Less: Mutual owing	(4,000)	76,000	1,29,000
5.	Property, plant and equipment			
	Machinery H Ltd.	7,00,000		
	S Ltd.	1,50,000	8,50,000	
	Furniture H Ltd.	1,00,000		
	S Ltd. 70,000		1,70,000	10,20,000
6.	Inventory			
	H Ltd.		1,00,000	
	S Ltd.		50,000	
	Less: Unrealized profit (2,000x 25%)		500	1,49,500
7.	Trade receivables			
	Bills receivable			
	H Ltd.	25,000		
	S Ltd.	20,000		
		45,000		
	Less: Mutual payables	(7,000)	38,000	
	Debtors			
	H Ltd. 60,000			
	S Ltd. 35,000			
	95,000			
	Less: Mutual owing (4,000)		91,000	1,29,000
8.	Cash & cash equivalent Cash at Bank HLtd.		90,000	
	S Ltd.		40,000	1,30,000

Working Notes:

1. Percentage of holding

	No. of Shares	Percentage
Holding Co. :	15,000	(60%)
Minority shareholders :	10,000	(40%)
Total Shares :	25,000	

2. Analysis of Profits

	Pre-acquisition profits and reserves of S Ltd.(₹)	**Postacquisition profits of S Ltd. (₹)**
General Reserve	40,000	---
Opening balance of Profit and Loss	5,000	---
Current Year's profit (in 1:3)	5,000	15,000
	50,000	15,000
H Ltd.'s share (60%)	30,000	9,000
Minority Interest (40%)	20,000	6,000

3. Minority Interest

Paid up value of 10,000 shares @ ₹ 10 each	₹ 1,00,000
Add: Share in pre-acquisition profits and reserve (40%)	₹ 20,000
Add: Share in post-acquisition profits (40%)	₹ 6,000
	1,26,000

4. **Capital Reserve for H Ltd.**

(A) Cost of acquiring 15,000 shares of S Ltd.	₹ 1,55,000
(B) Paid up value of 15,000 shares of S Ltd. @ ₹ 10 each	₹ 1,50,000

TELEGRAM: CA NOTE HUB

Add: Share in pre-acquisition profit and reserves of S Ltd.	₹ 30,000
	₹1,80,000
Capital Reserve (B-A)	₹ 25,000

5. **Consolidated Balance of Profits of H Ltd.**

Balance as per Statement of Profit and Loss	₹ 80,000
Add: Share in post-acquisition profits of S Ltd.	₹ 9,000
Less: Unrealised Profit in unsold stock of S Ltd.	₹(500)
	₹88,500

Question 12 (Past Exam July'21)

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (Rs. In 000)		Y Limited (Rs. In 000)	
	Dr.	**Cr.**	**Dr.**	**Cr.**
Equity Share capital (Share of Rs. 100 each)		2,000		400
7% Preference share capital		-		400
Reserves		600		200
6% Debentures		400		400
Trade Receivables/Trade Payables	160	180	100	120
Profit & Loss A/c balance		40		30
Purchases /Sales	1,000	1,800	1,200	1,900
Wages and Salaries	200		300	
Debenture Interest	24		24	
General Expenses	160		120	
Preference share dividend up to 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
Property, Plant & Equipment	2,200		1,580	
Total	5,027	5,027	3,450	3,450

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

- After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being Rs. 1,20,000, one fourth of such goods were still lying in inventory at the end of the year.
- Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Property, Plant & Equipment.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021. **(10 Marks)**

Solution:

TELEGRAM: CANOTE HUB

Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, 2021

Particulars	Note No.	Rs.
I. Revenue from operations	1	35,80,000
II. Total revenue		35,80,000
III. Expenses		
Cost of Material purchased/Consumed	2	20,80,000
Changes of Inventories of finished goods		-
Employee benefit expense	3	5,00,000
Finance cost	4	48,000
Depreciation and amortization expense	5	4,57,000
Other expenses	6	2,80,000
Total expenses		33,65,000
IV. Profit before Tax (II-III)		2,15,000
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		2,15,000
Preference dividend	7,000	
Preference dividend payable	7,000	(14,000)
		2,01,000
Share in pre-acquisition loss (WN 3)		1,800
Share of Minority interest in losses (WN 1)		1,800
Less: Investment Account- dividend for 3 months (prior to acquisition)		(3,500)
Inventory reserve (WN 2)		(6,000)
Profit to be transferred to consolidated balance sheet		1,95,100

Notes to Accounts

		Rs	. Rs.
1	Revenue from Operations		
	X Ltd.	18,00,000	
	Y Ltd.	19,00,000	
	Total	37,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	35,80,000
2	Cost of Materials Purchased/Consumed		
	X Ltd.	10,00,000	
	Y Ltd.	12,00,000	
	Total	22,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	20,80,000
3	Employee benefit and expenses		
	Wages and salaries		
	H Ltd.	2,00,000	
	S Ltd.	3,00,000	5,00,000

TELEGRAM: CA NOTE HUB

4	Finance cost		
	Interest		
	H Ltd.	24,000	
	S Ltd.	24,000	48,000
5	Depreciation		
	H Ltd.	2,20,000	
	S Ltd.	2,37,000	4,57,000
6	Other expenses		
	H Ltd.	1,60,000	
	S Ltd.	1,20,000	2,80,000

Working Note

1) **Profit of Subsidiary** Rs.

Revenue from Operations		19,00,000
Less: Expenses		
Cost of Material purchased/Consumed	12,00,000	
Changes of Inventories of finished goods -		
Employee benefit expense	3,00,000	
Finance cost	24,000	
Depreciation and amortization expense	2,37,000	
Other expenses	1,20,000	
Total expenses		(18,81,000)
Profit Before Tax		19,000
Less: Preference Dividend	14,000	
Less: Preference Dividend Payable	14,000	(28,000)
Profit available for shareholders		(9,000)
Minority Share (20% of loss Rs. 9,000)		(1,800)

2) **Inventory reserve** = $[\frac{120,000}{4} \times \frac{25}{125}]$ =Rs. 6,000

3) **Pre-acquisition loss** = 80% of 3 month's profit up to 30th June,2020 i.e. 80 % of ¼ of loss Rs. 9,000. Hence, pre-acquisition loss = Rs. 1,800

4) Investment account includes Preference dividend for 3 months prior to acquisition i.e. Rs. 4,00,000 X 50% X 7% X1/4 = Rs. 3,500

Question 13 (MTP May'20) (Past Exam, Nov'18)

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 are given below : **Rs. In Lakhs**

Incomes	**A Ltd.**	**B Ltd.**
Sales and other income	7,500	1,500
Increase in Inventory	1,500	300
Total	9,000	1,800
Expenses		
Raw material consumed	1,200	300
Wages and Salaries	1,200	225
Production expenses	300	150

TELEGRAM: CA NOTE HUB

Administrative expenses	300	150
Selling and distribution expenses	300	75
Interest	150	75
Depreciation	150	75
Total	3,600	1,050
Profit before tax	5,400	750
Provision for tax	1,800	300
Profit after tax	3,600 450	
Dividend paid	1,800	225
Balance of Profit	1,800	225

The following information is also given:

(i) A Ltd sold goods of Rs. 180 Lakhs to B Ltd at cost plus 25%. (1/6 of such goods were still in inventory of B Ltd at the end of the year)

(ii) Administrative expenses of B Ltd include Rs. 8 Lakhs paid to A Ltd as consultancy fees.

(iii) Selling and distribution expenses of A Ltd include Rs. 15 Lakhs paid to B Ltd as commission.

(iv) A Ltd holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2016-17 is Rs. 1,500 Lakhs

Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2018. **(10 Marks)**

Solution:

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.

for the year ended on 31st March, 2018

Particulars	**Note No.**	**Rs.in Lacs**
I. Revenue from operations	1	8,797
II. Total revenue		8,797
III. Expenses		
Cost of Material purchased/Consumed	3	1,770
Changes of Inventories of finished goods expense	2	(1,794)
Employee benefit expense	4	1,425
Finance cost	6	225
Depreciation and amortization e	7	225
Other expenses	5	802
Total expenses		2,653
IV. Profit before Tax(II-III)		6,144
V. Tax Expenses	8	2,100
VI. Profit After Tax		4,044

Notes to Accounts

TELEGRAM: CA NOTE HUB

		Rs. in Lacs	Rs. in Lacs
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealised profits Rs. 180×1/6 x 25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	BLtd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from BLtd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortisation		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225
8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	300	2100

TELEGRAM: CA NOTE HUB

Note: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. Alternative Answer is possible considering is otherwise.

Question 14 (Past Exam May'22)

White Ltd. acquired 2,250 shares of Black Ltd. on 1st October,.2020. The summarized balance sheets of both the companies as on 31st March, 2021 are given below:

	White Ltd. (₹)	Black Ltd. (₹)
(I) Equity and Liabilities		
(1) Shareholder's fund		
Share capital (Equity shares of ₹ 100 each fully paid up)	6,50,000	3,00,000
Reserves and Surplus General Reserve	60,000	30,000
Profit and loss account	1,50,000	90,000
(2) Current Liabilities	1,15,000	75,000
Trade payables Due to White Ltd.	-	30,000
Total	**9,75,000**	**5,25,000**
(II) Assets:		
Non-current assets		
Property, Plant and Equipment	5,80,000	3,51,000
Investments		
Shares in Black Ltd. (2,250 shares)	2,70,000	
Current assets		
Inventories	50,000	1,20,000
Due from Black Ltd.	36,000	
Cash and Cash equivalents	39,000	54,000
Total	**9,75,000**	**5,25,000**

Other information:

(i) During the year, Black Limited fabricated a machine, which is sold to White Ltd. for ₹ 39,000, the transaction being completed on 30th March,2021.

(ii) Cash in transit from Black Ltd. to White Ltd. was ₹ 6,000 on 31st March,2021. Profits during the year 2020-2021 were earned evenly

(iii) The balances of Reserve and Profit and Loss account as on 1st April,2020 were as follows:

	Reserves	Profit and Loss A/c
	₹	₹
White Ltd.	30,000	15,000 Profit
Black Ltd.	30,000	10,000 Loss

You are required to prepare consolidated Balance Sheet of the group as on 31st March,2021 as per the requirement of Schedule III of the Companies Act, 2013.(**PAST EXAM 15 Marks May '22)**

TELEGRAM: CA NOTE HUB

Solution:

Consolidated Balance Sheet of White Ltd. and its Subsidiary Black Ltd.

as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,50,000
(b) Reserves and Surplus	2	2,55,000
(2) Minority Interest	3	1,05,000
(3) Current Liabilities		
(a) Trade Payables	4	1,90,000
Total		**12,00,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	9,31,000
(2) Current assets		
(i) Inventory	6	1,70,000
(ii) Cash & cash equivalent	7	99,000
Total		**12,00,000**

Notes to Accounts

			₹
1.	Share capital		
	6,500 equity shares of ₹ 100 each, fully paid up		6,50,000
	Total		6,50,000
2.	Reserves and Surplus		
	General Reserves		60,000
	Profit and Loss Account	1,50,000	
	Add: 75% share of Black Ltd.'s post-acquisition profits (W.N.1)	37,500	1,87,500
	Capital reserve (W.N. 5)		7,500
	Total		2,55,000
3.	Minority interest in Black Ltd. (WN 4)		1,05,000
4.	Trade payables		
	White Ltd.	1,15,000	
	Black Ltd.	75,000	1,90,000
5.	Property, plant and equipment		
	White Ltd.	5,80,000	
	Black Ltd.	3,51,000	9,31,000
6	Inventory		
	White Ltd.	50,000	
	Black Ltd.	1,20,000	1,70,000

TELEGRAM: CA NOTE HUB

7	Cash & cash equivalent		
	White Ltd.	39,000	
	Black Ltd.	54,000	
	Cash in transit	6,000	99,000

Working Notes:

1. Post-acquisition profits of Black Ltd.		₹
profits earned during the year = ₹ 90,000 + ₹10,000		1,00,000
Pre-acquisition profits (1.4.20 to 30.9.20)		50,000
Post-acquisition profits (1.10.20 to 31.3.21)		50,000
White Ltd.'s share 75% of 50,000		37,500
Minority Interest 25% of 50,000		12,500
2. Pre-acquisition profits and reserves of Black Ltd.		
Reserves as on 1.4.2020		30,000
Profit and Loss Account		
[10,000 (loss as on 1.4.20) +50,000 (6 month Adjusted pre-acquisition profits)]		40,000
		70,000
White Ltd.'s = (75%) × 70,000		52,500
Minority Interest= (25%) × 70,000		17,500
3. Post-acquisition reserves of Black Ltd.		
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 30,000 – 30,000)		nil
4. Minority Interest		
Paid-up value of (3,000 – 2,250) = 750 shares		
held by outsiders i.e. 750 × ₹ 100		75,000
Add: 25% share of pre-acquisition reserves & Profit		17,500
25% share of post-acquisition profit		12,500
5. Capital Reserve		**1,05,000**
Price paid by White Ltd. for 2,250 shares (A)		2,70,000
Intrinsic value of the shares-		
Paid-up value of 2,250 shares held by White Ltd. i.e. 2,250 × ₹100	2,25,000	
Add 75% share of pre-acquisition reserves & profit (70,000 x 75%)	52,500 (B)	2,77,500
Capital reserve (A – B)		**7,500**

Question 15 (RTP Nov'23) (Past Exam Dec'21)

Chand Ltd. and its subsidiary Sitara Ltd. provided the following information for the year ended 31st March, 2023:

Particulars	**Chand Ltd (₹)**	**Sitara Ltd. (₹)**
Equity Share Capital	20,00,000	6,00,000
Finished Goods Inventory as on 01.04.2022	4,20,000	3,01,000
Finished Goods Inventory as on 31.03.2023	8,57,500	3,76,250
Dividend Income	1,68,000	43,750
Other non-operating Income	35,000	10,500
Raw material consumed	13,93,000	4,72,500
Selling and Distribution Expenses	3,32,500	1,57,500
Production Expenses	3,15,000	1,40,000

TELEGRAM: CA NOTE HUB

Loss on sale of investments	26,250	Nil
Sales and other operating income	33,25,000	19,07,500
Wages and Salaries	13,30,000	2,45,000
General and Administrative Expenses	2,80,000	1,22,500
Royalty paid	Nil	5,000
Depreciation	31,500	14,000
Interest expense	17,500	5,250

Other information

- On 1st September 2020 Chand Ltd., acquired 5,000 equity shares of ₹ 100 each fully paid up in Sitara Ltd.
- Sitara Ltd. paid a dividend of 10% for the year ended 31st March 2022. The dividend was correctly accounted for by Chand Ltd.
- Chand Ltd. sold goods of ₹ 1,75,000 to Sitara Ltd. at a profit of 20% on selling price. Inventory of Sitara Ltd. includes goods of ₹ 70,000 received from Chand Ltd.
- Selling and Distribution expenses of Sitara Ltd. include ₹ 21,250 paid to Chand Ltd. as brokerage fees.
- General and Administrative expenses of Chand Ltd. include ₹ 28,000 paid to Sitara Ltd. as consultancy fees.
- Sitara Ltd. used some resources of Chand Ltd., and Sitara Ltd. paid ₹ 5,000 to Chand Ltd. as royalty.

Consultancy fees, Royalty and brokerage received is to be considered as operating revenues.

Prepare Consolidated Statement of Profit and Loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended 31st March, 2023 as per Schedule III to the Companies Act, 2013 **(15 Marks)**

Solution:

Consolidated statement of profit and loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended on 31st March, 2023

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

TELEGRAM: CA NOTE HUB

Notes to Accounts:

			₹	₹
1.	**Revenue from operations**			
	Sales and other operating revenues			
	Chand Ltd.		33,25,000	
	Sitara Ltd.		19,07,500	
			52,32,500	
	Less: Inter-company sales		(1,75,000)	
	Consultancy fees received by Sitara Ltd. from Chand Ltd.		(28,000)	
	Royalty received by Chand Ltd. from Sitara Ltd.		(5,000)	
	Brokage received by Chand Ltd. from Sitara Ltd.		(21,250)	50,03,250
2.	**Other Income**			
	Dividend income:			
	Chand Ltd.	1,68,000		
	Sitara Ltd.	43,750	2,11,750	
	Loss on sale of investments Sitara Ltd.		(26,250)	
	Other Non-operating Income			
	Chand Ltd.	35,000		
	Sitara Ltd.	10,500		
	Less: Dividend realized from Sitara Ltd. (5,00,000 x 10%)	(50,000)	4,500	1,81,000
3.	**Cost of material purchased/consumed**			
	Chand Ltd.	13,93,000		
	Sitara Ltd.	4,72,500		
	Less: Purchases by Sitara Ltd. From Chand Ltd.	18,65,500		
			(1,75,000)	16,90,500
	Direct expenses (Production)			
	Chand Ltd.	3,15,000		
	Sitara Ltd.	1,40,000	4,55,000	21,45,500
4.	**Changes (Increase) in inventories of**			
	finished goods			
	Chand Ltd.	4,37,500		
	Sitara Ltd.	75,250		
			5,12,750	
	Less: Unrealized profits ₹ 7,00,00 × 20/100		(14,000)	4,98,750
5.	**Employee benefits and expenses**			
	Wages and salaries:			
	Chand Ltd.	13,30,000		
	Sitara Ltd.		2,45,000	15,75,000
6	**Finance cost**			
	Interest:			
	Chand Ltd.		17,500	
	Sitara Ltd.		5,250	22,750
7.	**Depreciation**			
	Chand Ltd.		31,500	
	Sitara Ltd.		14,000	45,500
8.	**Other expenses**			
	General & Administrative expenses:			
	Chand Ltd.	2,80,000		
	Sitara Ltd.	1,22,500		
			4,02,500	
	Less: Consultancy fees received by Sitara Ltd. from Chand	(28,000)	3,74,500	

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

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MCQs

1. Minority interest should be presented in the consolidated balance sheet

(a) As a part of liabilities.

(b) As a part of equity of the parent's shareholders.

(c) Separately from liabilities and the equity of the parent's shareholders.

(d) As a part of assets.

2. Minority of the subsidiary is entitled to

(a) Capital profits of the subsidiary company.

(b) Revenue profits of the subsidiary company.

(c) Both capital and revenue profits of the subsidiary company.

(d) Neither capital nor revenue profits of the subsidiary.

3. In consolidation of accounts of holding and subsidiary company _____ is eliminated in full.

(a) Current liabilities of subsidiary company.

(b) Reserves and surplus of both holding and subsidiary company.

(c) Mutual indebtedness.

(d) Nothing.

4. In consolidated balance sheet, the share of the outsiders in the net assets of the subsidiary must be shown as

(a) Minority interest.

(b) Capital reserve.

(c) Current liability.

(d) Current assets.

5. Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of

(a) Current liability.

(b) Revenue profit.

(c) Capital profit.

(d) Current assets.

ANSWERS/SOLUTION

MCQ

1. (c) 2. (c) 3. (c) 4. (a) 5. (a)

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SOLVED EXAMPLE

Example 1

The following information is given as at 31 March 20X1

	P Ltd.	S Ltd.
Non-current Assets:		
PPE	2,000	500
Investment in Subsidiary	1,000	
Net Current Assets	2,000	500
	5,000	**1,000**
Issued Capital	500	1,000
Reserves and Surplus	4,500	
	5,000	1,000

P Ltd. acquired 100% of shares of S Ltd. on 31 March 20X1 for ₹ 1,000.

Since P Ltd. has acquired S Ltd., we will have to determine goodwill / capital reserve. Let us understand why goodwill / capital reserve arises in case of consolidation, and what would be the interpretation of the same.

In the given case, P Ltd. acquired all the shares of S Ltd. by paying ₹ 1,000. This payment (i.e., purchase consideration) would be made by P Ltd. to the shareholder(s) of S Ltd. (hence the transfer of this amount would not appear in the books of S Ltd.).

By paying ₹ 1,000, P Ltd. has acquired 'control' over S Ltd. This acquisition is quite different from the concept of amalgamation done in accordance with AS 14, though the concept of goodwill / capital reserve is similar. Under AS 14, the target company would generally liquidate, and all assets and liabilities would be transferred from the Selling Company to the Purchasing Company. In case of consolidation, P Ltd. is acquiring 'control' i.e., by way of acquiring equity shares in S Ltd.. Thus, S Ltd. continues to exist, and the assets and liabilities of S Ltd. are not transferred to P Ltd., but instead continue to remain with S Ltd. only. However, since in substance, acquisition has taken place (albeit through transfer of control), the purchase consideration of ₹ 1,000 will be compared with the net worth of S Ltd., which is ₹ 1,000. Since amount paid (i.e., purchase consideration) equals the net worth, no goodwill / capital reserve is recognized. In case the amount paid (i.e., purchase consideration) would be higher / lower than the net worth of S Ltd., such difference would be recognized in Goodwill / Capital Reserve respectively.

The calculation of goodwill is presented below:

Tangible Assets	500
Net Current Assets	500
	1,000
Less: Liabilities	NIL
Net Worth of S Ltd.	1,000
Investment in S Ltd. (purchase consideration)	1,000
Goodwill / (Capital Reserve)	NIL

Example 2

Modifying example 1, the following information is given as at 31 March 20X1

	P Ltd.	S Ltd.
Non-current Assets:		
PPE	2,000	500
Investment in Subsidiary	1,000	

TELEGRAM: CA NOTE HUB

Net Current Assets	2,000	500
	5,000	1,000
Issued Capital	500	700#
Reserves and Surplus	4,500	300#
	5,000	1,000

As compared to Example 1 – There is a difference in the break-up of net worth of S Ltd. (Example 1 – Issued capital was 1,000 and Reserves and Surplus was Nil; The Net worth is 1,000).

P Ltd. acquired 100% of shares of S Ltd. on 31 March 20X1 for ₹ 1,000.

Like Example 1 above P Ltd. has acquired 'control' over S Ltd. by paying ₹ 1,000. Accordingly, the purchase consideration of ₹ 1,000 will be compared with the net worth of S Ltd. which is ₹ 1,000. Since amount paid (i.e., purchase consideration) equals the net worth, no goodwill / capital reserve is recognized. In case the amount paid (i.e., purchase consideration) would be higher / lower than the net worth of S Ltd., such difference would be recognized in Goodwill / Capital Reserve respectively.

The calculation of goodwill is presented below:

Tangible Assets	500
Net Current Assets	500
	1,000
Less: Liabilities	NIL
Net Worth of S Ltd.	1,000
Investment in S Ltd. (purchase consideration)	1,000
Goodwill / (Capital Reserve)	NIL

Example 3

Modifying example 2, the following information is given as at 31 March 20X1

	P Ltd.	S Ltd.
Non-current Assets:		
PPE	2,000	500
Investment in Subsidiary	1,200	
Net Current Assets	2,000	500
	5,200	1,000
Issued Capital	700	700
Reserves and Surplus	4,500	300
	5,200	1,000

P Ltd. acquired 100% of shares of S Ltd. on 31 March 20X1 for ₹ 1,200.

Like Examples 1 and 2 above P Ltd. has acquired 'control' over S Ltd. by paying ₹ 1,200. Accordingly, the purchase consideration of ₹ 1,200 will be compared with the net worth of S Ltd. which is ₹ 1,000. Since amount paid (i.e., purchase consideration) exceeds the net worth, such excess of is recognized as goodwill. In case the amount paid (i.e., purchase consideration) would be lower than the net worth of S Ltd., such difference would be credited to Capital Reserve.

The calculation of goodwill is presented below:

Tangible Assets	500
Net Current Assets	500
	1,000

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Less: Liabilities	NIL
Net Worth of S Ltd.	1,000
Investment in S Ltd. (purchase consideration)	1,200
Goodwill / (Capital Reserve)	200

Example 4

Modifying Example 2, the following information is given as at 31 March 20X1:

	P Ltd.	S Ltd.
Non-current Assets:		
Tangible Assets	2,000	500
Investment in Subsidiary	1,000	
Net Current Assets	2,000	500
	5,000	1,000
Issued Capital	500	700
Reserves and Surplus	4,500	300
	5,000	1,000

P Ltd. acquired 80% of shares of S Ltd. on 31 March 20X1 for ₹ 1,000.

In the given case, P Ltd. acquired 80% of the shares of S Ltd. by paying ₹ 1,000. This payment (i.e., purchase consideration) would be made by P Ltd. to the shareholder(s) of S Ltd.

By paying ₹ 1,000, P Ltd. has acquired 'control' over S Ltd. We cannot say that P Ltd. has acquired only '80% control', since its shareholding in S Ltd. will enable it to take all the decisions regarding S Ltd.'s operations and usage of assets and repayment of liabilities. However, the fact remains that 20% stake does NOT belong to S Ltd. It belongs to outsiders, who are called 'Minority Interest' in accordance with AS 21. Accordingly, in this case, the purchase consideration of ₹ 1,000 will be compared with 80% of the net worth of S Ltd. Any excess or deficit would be recorded as goodwill / capital reserve respectively. 20% of the net worth on the date of acquisition would be recorded separately as Minority Interest.

AS 21 defines Minority Interest as that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent. As per Schedule III to the Companies Act, 2013, "Minority Interests" in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.

In the given case, the calculation of goodwill is presented below:

Tangible Assets: 80% being share of parent	400
Net Current Assets: 80% being share of parent	400
	800
Less: Liabilities	NIL
Net Worth of S Ltd.: attributable to the parent's shareholding	800
Investment in S Ltd. (purchase consideration)	1,000

Goodwill / (Capital Reserve) 200

Example 5

H Ltd. acquires 70% of the equity shares of S Ltd. on 1.1.20X1. On that date, paid up capital of S Ltd. was 10,000 equity shares of ₹ 10 each; accumulated reserve balance was ₹ 1,00,000. H Ltd. paid ₹ 1,60,000 to acquire 70% interest in the S Ltd.

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Assets of S Ltd. were revalued on 1.1.20X1 and a revaluation loss of ₹ 20,000 was ascertained. The book value of shares of S Ltd. is calculated as shown below:

	₹
70% of the Equity Share Capital ₹ 1,00,000	70,000
70% of Accumulated Reserve ₹ 1,00,000	70,000
70% of Revaluation Loss ₹ 20,000	(14,000)
	1,26,0001

So, H Ltd. paid a positive differential of ₹ 34,000 i.e. ₹ (1,60,000 – 1,26,000). This differential is called goodwill and is shown in the balance sheet under the head intangibles.

Example 6

A Ltd. acquired 70% interest in B Ltd. on 1.1.20X1. On that date, B Ltd. had paid-up capital of ₹ 1,00,000 consisting of 10,000 equity shares of ₹ 10 each and accumulated balance in reserve and surplus of ₹1,00,000. On that date, assets and liabilities of B Ltd. were also revalued and revaluation profit of ₹ 20,000 was calculated. A Ltd. paid ₹ 1,30,000 to purchase the said interest.

In this case, the book value of Shares of B Ltd. is calculated as shown below:

	₹
70% of the Equity Share Capital ₹1,00,000	70,000
70% of Reserves and Surplus ₹ 1,00,000	70,000
70% of Revaluation Profit ₹ 20,000	14,000
	1,54,000

In this case, a negative differential of ₹ 24,000 arises i.e. (1,54,000 – 1,30,000) which is called and presented as capital reserve.

Example 7

H Ltd. acquired 16,000 equity shares of ₹ 10 each, in S Ltd. on October 1, 20X1 for ₹ 3,06,800. The profit and loss account of S Ltd. showed a balance of ₹10,000 on April 1,20X1. The plant and machinery of S Ltd. which stood in the books at ₹ 1,50,000 on April 1,20X1 was considered worth ₹ 1,80,000 on the date of acquisition.

The information of the two companies as at 31-3-20X2 was as follows:

	H Ltd.(₹)	S Ltd. (₹)
Shares capital (fully paid equity shares of ₹ 10 each)	5,00,000	2,00,000
General reserve	2,40,000	1,00,000
Profit and loss account	57,200	82,000
Current Liabilities	1,69,800	33,000
Land and building	1,80,000	1,90,000
Plant and machinery	2,40,000	1,35,000
Investments	3,06,800	
Current assets	2,40,200	90,000

In this case,

Percentage of holding:

	No. of Shares	Percentage
Holding Co. :	16,000	(80%)

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Minority shareholders :	4,000	(20%)
TOTAL SHARES :	20,000	

Impact of Revaluation of Plant and Machinery will be as -

	₹
Book value of Plant and Machinery as on 01-04-20X1	1,50,000
Depreciation Rate (1,50,000-1,35,000) / 1,50,000 = 15,000/1,50,000 X100	10%
Book value of Plant and Machinery as on 01-10-20X1 after six months depreciation @10% (1,50,000-7,500)	1,42,500
Revalued at	1,80,000
Revaluation profit (1,80,000-1,42,500)	37,500
Share of H Limited in Revaluation Profit (80%)	30,000
Share of Minority in Revaluation profit (20%)	7,500
Additional Depreciation on appreciated value to be charged from post-acquisition profits	
(10% of ₹ 1,50,000 for 6 months) + (10% of ₹ 1,80,000 for 6 months) less ₹ 15,000 (as already charged)	1500
Share of H Limited in additional depreciation that will reduce its share (80%) in post-acquisition profit by	1,200
Share of Minority Interest in additional depreciation	300

Example 8

If shares in X Ltd., are purchased in January 20X2 and in April 20X2, X Ltd., declares a dividend in respect of 20X1, the dividend received by the holder of the shares correctly should not be treated as income but as capital receipt and credited to Investment Account.

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AS 22 – ACCOUNTING FOR TAXES ON INCOME

Illustration 1 (RTP Nov'20, Past Exam May'18, May'19)

Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	= 2,00,000
Depreciation as per income tax records	= 5,00,000
Unamortised preliminary expenses as per tax record	= 30,000

There is adequate evidence of future profit sufficiency. How much net deferred tax asset/liability should be recognised as transition adjustment? Tax rate 50%. **(5 Marks)**

Solution

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 50%
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability			1,35,000	

Illustration 2 (Past Exam Nov'19, Nov'20) (RTP Nov'19, Nov'23)

From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	₹
Accounting Profit	6,00,000
Book Profit as per MAT	3,50,000
Profit as per Income Tax Act	60,000
Tax rate	20%
MAT rate	7.50%

Solution **(5 Marks)**

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

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

Tax as per MAT 3,50,000 x 7.50% = ₹ 26,250

Tax expense= Current Tax +Deferred Tax

₹ 1,20,000 = ₹ 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-20X1

= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-20X1

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000) = ₹ 1,34,250

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Illustration 3

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

Solution

Statement of Profit and Loss

	31.3.20X1	**31.3.20X2**	**31.3.20X3**
	₹	₹	₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year (2,00,000 x 40%)	80,000		
Tax effect of timing differences reversed/adjusted during the year (1,00,000 x 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

Illustration 4

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%.

Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3.

Solution

Calculation of Deferred Tax Asset/Liability in Omega Limited

Year	**Accounting Income**	**Taxable Income**	**Timing Difference**	**Timing Difference (balance)**	**Deferred Tax**	**Deferred Tax Liability (balance)**
20X0- 20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1- 20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2- 20X3	21,00,000	23,00,000	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

Illustration 5 (Past Exam, May'19)

Write short note on Timing differences and Permanent differences as per AS 22. **(5 Marks)**

Solution

In current practices, companies, in general, prepare books of accounts as per Companies Act, 2013 generating Accounting Profit/Loss and Income-tax Act, 1961 generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same. Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is

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not allowable as a deduction for tax purposes. Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation Bonus, etc.

Illustration 6 (MTP Oct 19) (RTP Nov'18)

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference is INR 200 lakhs and INR 400 lakhs respectively which will result in a tax liability in year 1 and 2. From the third year it is expected that the timing difference would reverse each year by INR 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account. **(5 Marks)**

Solution

As per AS 22, 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of 200 lakhs timing difference due to depreciation, difference amounting 80 lakhs (10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for 120 lakhs (200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for 48 lakhs (40% of 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting 160 lakhs (40% of 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be 208 lakhs (48 lakhs + 160 lakhs).

Illustration 7

Ultra Ltd. has provided the following information:

Depreciation as per accounting records =INR 4,00,000

Depreciation as per tax records =INR 10,00,000

Unamortized preliminary expenses as per tax record = INR 30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

Solution

Calculation of difference between taxable income and accounting income

Particulars	**Amount (₹)**
Excess depreciation as per tax ₹ (10,00,000 – 4,00,000)	6,00,000
Less: Expenses unamortized in tax records	(30,000)
Timing difference	5,70,000

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50% x 5,70,000 = 2,85,000

Illustration 8

Saras Ltd. closes its books as on 31st March 20X2. They have accrued ₹ 5,00,000 towards GST Liability for the month of March 20X2 by debiting their Profit and loss statement which is expected to be paid off by 21st April 20X2 . As per the provisions of Section 43B of the Income Tax Act, 1961 – Any expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis will be allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 20X2.

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Solution

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act (Section 43B)	Nil
Timing difference	5,00,000

Tax expense is less than the current tax due to timing difference.

Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

Illustration 9

ABC Company limited had an investment in Venture Capital amounting ₹ 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:

Portfolio Companies	Amount of investment (₹ in Crores)
Oscar Limited	2
Zee Limited	3
Star Limited	4
Sony Limited	1
Total	10

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 8 Crores have been transferred by Venture Capital to ABC Company Limited.

The accounts manager has received the following additional information from venture capital on 31.03.2020:

(1) 8 Crores has been deducted from the cost of investment and carrying amount of investment as at year end is 2 Crores.

(2) Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 4 Crores.

(3) Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

Solution

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	Amount (₹ in Crores)
Sales Consideration	8
Cost of Investment	4
Net gain on Sale	4
Tax @ 20%	0.8

As per AS 22, Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Particulars	Amount (₹ in Crores)	Rationale
Taxable Income	4	As per income tax laws

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Accounting Income	Nil	As the same is deducted from the cost of investment
Timing Difference	4	

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of ₹ 0.8 Crores and company should recognize only current tax liability of ₹ 0.8 Crores.

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MTP / RTP / Past Exam

Question 1 (RTP Nov '21)

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22. ?

Solution:

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

Question 2 (RTP May'21, Past Exam Nov'22)

(a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books Rs. 2,80,000

Depreciation for tax purpose Rs. 1,90,000

The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing Rs. 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.

(iii) The company has made a profit of Rs. 6,40,000 before depreciation and taxes.

(iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22? **(5 Marks)**

Solution:

(a) Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)

		Rs.	
Profit before depreciation and taxes			6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)			(3,10,000)
Profit before taxes	(A)		3,30,000
Less: Tax expense	(B)		
Current tax (W.N.1) (3,30,000 x 40%) Deferred tax (W.N.2)		1,32,000	(1,32,000)
Profit after tax	(A-B)	NIL	1,98,000

Working Notes:

1. Computation of taxable income

	Amount (Rs.)

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Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2. Impact of various items in terms of deferred tax liability / deferred tax asset

S.No.	Transactions	Analysis	Nature of difference	Effect	Amount (Rs.)
(i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000
	Net impact				NIL

(b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Question 3 (RTP May 22)

The following transactions were reported by PQR Ltd. during the year 2020-2021:

	Tax Rate	**30%**
		(Rs. in lakh)
i.	Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	20.00
ii.	Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
iii.	Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

Solution

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

TELEGRAM: CA NOTE HUB

Transactions	Analysis	Nature of difference	Effect	Amount
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	Rs. 20 lakh X 30% = Rs. 6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 4 (RTP May 19)

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advice to the company.

Solution:

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

Question 5 (RTP Nov'22)

Define followings as per AS 22:

(i) Accounting income (loss)

(ii) Taxable income (tax loss)

(iii) Tax expense (tax saving)

Solution:

Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.

Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Question 6 (Past Exam July'21)

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020 -2021:

TELEGRAM: CA NOTE HUB

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs.

There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.

Tax Rate to be taken at 40%. You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021. **(5 Marks)**

Solution:

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs X 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs X 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs X 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs X 40% =28 lakhs

Question 7 (Past Exam Nov'23)

The following particulars are stated in the Balance Sheet of Siddhi Limited as on 31st March,2022:

Particulars	(₹ In lakhs)
Deferred Tax Liabilities (Cr.)	2.50
Deferred Tax Assets (Dr.)	1.35

The following transactions were reported during the year 2022-23:

	₹ in lakhs
(i) Depreciation as per accounting records	15.00
(ii) Depreciation as per income tax records	20.00
(iii) Interest paid to NBFC accounted in books on accrual basis but paid on 30.06.2023	6.00
(iv) Items disallowed for tax purposes in 2021-22 but allowed in 2022- 23	1.05
(v) Donation to Private Trust	40.00
(vi) Tax rate	15%

TELEGRAM: CA NOTE HUB

(vii) There were no additions to fixed assets during the year.	

You are required to calculate the Deferred Tax Asset and Deferred Tax Liability as on 31-03-2023 as per AS-22. **(5 Marks)**

Solution:

Balances of Deferred tax assets and Deferred tax liability as on 31st March, 2023

	₹ (in lakhs)
Deferred tax liability (Cr.) (2.5 +.75)	3.25
Deferred tax asset (Dr.) (1.35 - .158*)	1.192

Working Note:

Impact of various items in terms of deferred tax liability / deferred tax asset

S. No.	**Transactions**	**Nature of difference**	**Effect**	**Amount (₹)**
(i), (ii)	Difference in depreciation	Responding timing difference	Creation of DTL	(20 - 15) x 15% = .75
(iii)	Interest to financial institutions	No timing difference	Not applicable	Not applicable
(iv)	Disallowances, as per IT Act, of earlier years	Timing difference	Reversal of DTA	₹ 1.05 lakh X15% = ₹ .158* lakh
(v)	Donation to private trusts	Permanent difference	Not applicable	Not applicable

*Alternatively, may be rounded off as ₹ .157 lakh or 0.1575.

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MCQs

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

(a) Current tax + deferred tax charged to profit and loss account

(b) Current tax-deferred tax credited to profit and loss account

(c) Either (a) or (b)

(d) Deferred tax charged to profit and loss account

2. G Ltd. has provided the following information:

Depreciation as per accounting records = ₹ 2,00,000

Depreciation as per tax records = ₹ 5,00,000

There is adequate evidence of future profit sufficiency.

How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

(a) Deferred Tax asset = ₹ 2,70,000.

(b) Deferred Tax asset = ₹ 1,35,000.

(c) Deferred Tax Liability = ₹ 2,70,000

(d) Deferred Tax Liability = ₹ 1,35,000.

3. State which of the followings statements are correct:

(1) There are no pre-conditions required to recognize deferred tax liability,

(2) Deferred tax asset under all circumstances can only be created if and only if there is reasonable certainty that future taxable income will arise.

(a) Both are correct.

(b) Only (1) is correct.

(c) Only (2) is correct.

(d) None of the statements are correct.

4. Which of the following statement are incorrect:

(a) Only timing differences result in creation of deferred tax.

(b) Permanent differences do not result in recognition of deferred tax.

(c) The tax rate used for measurement of deferred tax is substantively enacted tax rate.

(d) The entity has to recognize deferred tax liability/asset arising out of timing difference. There are no conditions which are required to evaluated for their recognition.

ANSWERS/SOLUTIONS

MCQs

1. (c) 2. (d) 3. (a) 4. (d)

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TELEGRAM: CA NOTE HUB

AS 23 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

Question 1 (RTP Nov 18, Nov 20) NB Pg. No.

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

Paid up Equity Share Capital	₹ 10,00,000
Securities Premium	₹ 1,00,000
Reserve & Surplus	₹ 5,00,000

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

Solution

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹	₹
Investment in B Ltd. (A)		15,00,000
Equity Shares	10,00,000	
Security Premium	1,00,000	
Reserves & Surplus	5,00,000	
Net Assets	16,00,000	
45% of Net Asset (B)		7,20,000
Goodwill (A-B)		**7,80,000**

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 × 45%)	1,35,000
Less: Dividend paid (1,00,000 × 45%)	(45,000)
Carrying Amount of Investment	**15,90,000**

Question 2 (RTP Jan'25) NB Pg. No.

A Ltd. invested Rs.1,00,000 to acquire 10% stake (Investment I) in B Ltd. and later invested Rs.3,00,000 to acquire additional 20% (Investment II). The net asset value of the B ltd. at the respective investment dates was Rs.7,50,000 and Rs.12,50,000 respectively. Determine whether B Ltd. is an associate of A Ltd. Also, calculate goodwill arising on the acquisition of the associate.

Solution :

As per para 3 of AS 23 an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds,

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directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. In this case, A Ltd. has invested 30 % in B Ltd. so B Ltd. is to be considered as an associate of A Ltd.

The goodwill arising on the acquisition of the associate will be computed as follows:

		Rs.
Investment I	(10 percent of Rs.7,50,000)	1,00,000
Share of net assets		(75,000)
Goodwill (A)		25,000
Investment II		3,00,000
Share of net assets	(20 percent of Rs.12,50,000)	(2,50,000)
Goodwill (B)		50,000
Total goodwill (A + B)		**75,000**

Question 3

NB Pg. No.

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

(i) Separate financial statements of Bright Ltd. as on 31-03-20X2;

(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

(iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

Solution:

(i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2

	₹
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 × 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of 10-month profit of investee as per equity method (30% of ₹ 3,00,000 × 10/12)	75,000
Carrying amount as on 31.3.20X2	**2,60,000**

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(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2 as per AS 23

	₹
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (₹60,000 × 30%)	(18,000)
Carrying amount as on 30.6.20X2	**2,42,000**

Question 4 **NB Pg. No.**

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000
Fixed Assets	5,00,000
Investments	2,00,000
II. Current Assets	3,00,000
	10,00,000

During the year ended 31.3.20X2 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.

(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?

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

Solution:

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

(i) Calculation of Goodwill

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

(ii) A Ltd. Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd. (7×25%)		1.75
Pre-acquisition Dividend received from B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd. (including goodwill)	2.50	
Share of profit for year 20X1 – 20X2	1.75	4.25

Working Notes:

1. Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.

Question 5

NB Pg. No.

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2–20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000.

Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Solution :

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	**5,20,000**

Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April	1 4,80,000	
Add: Goodwill	5,20,000	10,00,000

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Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,00
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 × 40%)	(4,00,000)
Carrying Amount of Investment	**6,00,000**

Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	**6,00,000**

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 × 40%)	(5,00,000)
Carrying Amount of Investment	**1,00,000**

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹ 4,00,000 + ₹ 5,00,000)	(4,20,000)	
Add: Goodwill		**1,00,000**

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 × 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) -refer note below Carrying Amount of Investment	

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

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

TELEGRAM: CA NOTE HUB

Question 6 NB Pg. No.

Hill Ltd. has a share capital of 50,000 shares @ ₹ 100 per share. Sun Ltd. acquired 15% shares in Hill Ltd. on 1.4.2024. It also acquired all the 5,000, 12% convertible debentures of ₹ 100 each of Hill Ltd. These debentures will be converted at par into equity shares of Hill Ltd. after 3 years. State whether, as per AS 23, Hill Ltd. is an Associate of Sun Ltd. or not with reasons?

Solution:

As per para 3 of AS 23 'Accounting for Investments in Associates in Consolidated Financial Statements', an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Standard further explains in para 4 that as regards share ownership, if an investor holds, directly or indirectly through subsidiary (ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary (ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

Further as per an explanation to para 4 of the standard, for the purpose of classification of associate, the potential equity shares of the investee held by the investor will not be taken into account for determining the voting power of the investor. In other words, the voting power should be determined on the basis of the current outstanding securities with voting rights.

As per the information given in the question, Sun Ltd. presently holds indirectly 22.7% shares (with and without voting rights) (Refer W.N.) in Hill Ltd. However, the current outstanding securities with voting rights in Hill Ltd. is only 15% and the remaining holding is on account of potential equity shares. Since potential equity shares do not have voting rights they will not be taken into consideration while determining the significant influence of Sun Ltd. on Hill Ltd. Hence, Hill Ltd. Is not an associate of Sun Ltd.

Working Note:

Calculation of percentage of holding of shares after conversion

	₹
Current holding is 15% i.e. 7,500 shares of ₹ 100 each	7,50,000
Potential equity shares i.e. 5,000 shares of ₹ 100 each	5,00,000
	12,50,000

Total share capital of Hill Ltd. after conversion of debentures into equity shares will be = ₹ 50,00,000 + ₹ 5,00,000 = ₹ 55,00,000

Percentage of holding = ₹ (12,50,000/55,00,000) x 100 = **22.7% approx.**

Question 7 NB Pg. No.

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

Solution:

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates **except in the following cases:**

a. Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

Or;

b. It operates under severe long-term restrictions, which significantly impair its ability to transfer

funds to the investor.

In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

Question 8 NB Pg. No.

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

Solution:

An investor should discontinue the use of the equity method from the date that:

a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13,

Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

TELEGRAM: CA NOTE HUB

AS 24 DISCONTINUING OPERATIONS

NB Pg. No.

Question 1 (RTP Nov 18, Nov 20)

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.

You are required to comment:

i. If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

ii. If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

iii. Would your answer to (ii) above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner? **(5 Marks)**

Solution

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

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

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

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

iii. terminating through abandonment; and

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

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

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

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

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

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

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

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Question 2 (RTP May'18, May'23) (MTP Aug'18, Apr'19) NB Pg. No.

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

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

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

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24? **(5 Marks)**

Solution:

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

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

1) disposing of substantially in its entirety,
2) disposing of piecemeal, or
3) terminating through abandonment; and

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

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

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a **gradual enforcement** of change in product line and **does not represent a separate major line** of business and hence is **not a discontinued operation.** If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

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Question 3 (RTP May 20, May 22, Jan'25) (Past Exam Nov'23) NB Pg. No.

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

(In Exam any 5 was asked)

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

Solution:

i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s);
- The business or geographical segment(s) in which it is reported as per AS 17;
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable,
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Presentation of the required disclosures

The above disclosures should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

a. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto and

b. The amount of the pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

(i) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations.

Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do so in combination with other circumstances, include:

a. Gradual or evolutionary phasing out of a product line or class of service.

b. Discontinuing, even if relatively abruptly, several products within an ongoing line of business.

c. Shifting of some production or marketing activities for a particular line of business from one location to another and

d. Closing of a facility to achieve productivity improvements or other cost savings.

Question 4 NB Pg. No.

What are the initial disclosure requirements of AS 24 for discontinuing operations?

Solution:

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) A description of the discontinuing operation(s)

(b) The business or geographical segment(s) in which it is reported as per AS 17.

(c) The date and nature of the initial disclosure event.

(d) The date or period in which the discontinuance is expected to be completed if known or determinable

(e) The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.

(f) The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.

(g) The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.

(h) The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 5 (RTP Nov'21) NB Pg. No.

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

Solution:

A discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:

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

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

(iii) Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.

c. That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

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NB Pg. No.

Question 6 (RTP Nov'22)

What is the disclosure requirement interim financial reports as per AS 24 for discontinuing operations?

Solution:

Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

a) Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and

b) Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

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AS 25 INTERIM FINANCIAL REPORTING

Question 1 (RTP Nov 18, Nov 20) NB Pg. No.

Sincere Corporation is dealing in seasonal product. Sales pattern of the product quarter-wise is as follows:

1st quarter 30th June	10%
2nd quarter 30th September	10%
3rd quarter 31st December	60%
4th quarter 31st March	20%

Information regarding the 1st quarter ended on 30th June, 20X1 is as follows:

Sales	80 crores
Salary and other expenses	60 crores
Advertisement expenses (routine)	4 crores
Administrative and selling expenses	8 crores

While preparing interim financial report for first quarter Sincere Corporation wants to defer ₹ 10 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, the third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.

Solution

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

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

Question 2 NB Pg. No.

Intelligent Corporation (I–Corp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

Quarter I	II	III	IV
Ending 30th June	30th September	31st December	31st March
15%	15%	50%	25%

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For the First quarter ending 30th June, 20X1, I–Corp. gives you the following information:

	₹ crores
Sales	50
Salary and other expenses	30
Advertisement expenses (routine)	02
Administrative and selling expenses	08

While preparing interim financial report for the first quarter, 'I–Corp.' wants to defer ₹ 21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, third quarter should be debited by higher expenditure, considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

Solution :

Result of the first quarter ended 30th June, 20X1

		(₹ in crores)
Turnover		50
Add: Other Income		Nil
Total		50
Less: Change in inventories	Nil	
Salaries and other cost	30	
Administrative and selling expenses (8 + 2)	10	40
Profit		10

As per AS 25 on Interim Financial Reporting, the income and expense should be recognized when they are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

i. it is appropriate to anticipate that type of cost at the end of the financial year, and

ii. costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to **deferment of ₹ 21 crores is not tenable as expenditures** are uniform throughout all quarters.

Question 3

NB Pg. No.

Accountants of Poornima Ltd. showed a net profit of ₹ 7,20,000 for the third quarter of 20X1 after incorporating the following:

i. Bad debts of ₹ 40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

ii. Extra ordinary loss of ₹ 35,000 incurred during the quarter has been fully recognized in this quarter.

iii. Additional depreciation of ₹ 45,000 resulting from the change in the method of charge of depreciation assuming that ₹ 45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

Solution :

In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹ 40,000 have been incurred during current quarter. Out of this, the company has

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deferred 50% (i.e.) ₹ 20,000 to the next quarter. Therefore, ₹ 20,000 should be deducted from ₹ 7,20,000. The treatment of extra-ordinary loss of ₹ 35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of ₹ 45,000 in the same quarter is in tune with AS 25. Hence no adjustments are required for these two items.

Poornima Ltd should report quarterly income as ₹ 7,00,000 (₹ 7,20,000 – ₹ 20,000).

Question 4

NB Pg. No.

What are the periods for which Interim financial Statements are required to be presented? You are required to answer your question in light of preparation of financial statements for the period ended and as at 31st December, 20X1. The Financial Year is FY 20X1-X2.

Solution :

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

Statement	Current period	Comparative period
Balance sheet	End of current interim period End of immediately preceding financial year	
Statement of profit and loss	Current interim period and cumulatively for the year-to-date	Comparable interim period and year-to-date of immediately preceding financial year
Cash flow statement	Cumulatively for the current financial year-to- date	Comparable year-to-date of immediately preceding financial year

In light of the above, following periods needs to be covered in interim financial statements for the period ended and as at 31st December, 20X1:

Balance Sheet	as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year (As at 31 December 20X1 and 31 March 20X1).
Statements of Profit and Loss	for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. (for 3 months and 9 months i.e., year to date ended 31 December 20X1 and same for 31 December 20X0 being comparative period).
Cash Flow Statement	cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year. (year to date i.e., 1 April 20X1 to 31 December 20X1 and 1 April 20X0 to 31 December 20X0).

Question 5

NB Pg. No.

Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:

i. Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.

ii. 80% of sales promotion expenses ₹ 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quar ter is high.

iii. In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹ 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.

iv. ₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.

v. Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.

vi. Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter.

Solution :

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise's financial year. Therefore, dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per AS 10, Property, Plant and Equipment, if there is change in the depreciation method, such a change should be accounted for as a change in accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, and applied prospectively. Therefore, no adjustment would be required due to change in the method of depreciation.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹ in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹ (4–1) lakhs	3
Excess depreciation charged in the 3rd quarter,	
due to change in the method	-
Extra ordinary gain ₹ (2–1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹ (3–2) lakhs	1
Less: Sales promotion expenses (80% of ₹ 15 lakhs)	9
Gain on sale of investment (occasional gain should not be deferred)	(12)
Adjusted Profit before tax for the third quarter	(5)
	(8)

Question 6

NB Pg. No.

On 30th June, 20X1, Asmitha Ltd. incurred ₹ 2,00,000, net loss from disposal of a business segment. Also, on 31st July, 20X1, the company paid ₹ 60,000 for property taxes assessed for the calendar year 20X1. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 20X1.

Solution :

According to Para 10 of AS 25 "Interim Financial Reporting", if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial

statements. As at 30th September, 20X1, Asmitha Ltd would report the entire amount of ₹ 2,00,000 as loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to interim periods on accrual basis.

Since ₹ 60,000 Property tax payment relates to entire calendar year 20X1, **₹ 30,000 would be reported as an expense for six months** ended on 30th September, 20X1 while out of the **remaining ₹ 30,000, ₹ 15,000** for January, 20X1 to March, 20X1 should be shown as payment of the **outstanding amount of previous year** and another **₹ 15,000** related to quarter October, 20X1 to December, 20X1 **would be reported as prepaid expenses.**

Question 7 NB Pg. No.

An enterprise reports quarterly, estimates an annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expense to be recognized in each quarter.

Solution :

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

	₹
Estimated Annual Income (A)	**10,00,000**
Tax expense:	
30% on ₹ 5,00,000	1,50,000
40% on remaining ₹ 5,00,000	2,00,000
(B)	**3,50,000**

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

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

Question 8 NB Pg. No.

To comply with listing requirements and other statutory obligations, Prateek Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of Rs. 350 lakhs under Income-tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No deferred tax asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of Rs. 350 lakhs and Rs. 150 lakhs respectively for the first two quarters of financial year 2017–2018 and anticipates net earnings of Rs. 400 lakhs in the coming half year ended March 2018 of which Rs. 50 lakhs will be the loss in the quarter ended December, 2017. The tax rate for the company is 30% with

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a 10% surcharge. You are required to calculate the amount of tax expense to be reported for each quarter of financial year 2017–2018.

Solution :

Estimated tax liability on annual income = [Income Rs. 900 lakhs – b/f losses Rs. 315 lakhs (90% of 350)] x 33% = 33% of Rs. 585 lakhs = Rs. 193.05 lakhs

As per para 29(c) of AS 25 Interim Financial Reporting, income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Thus, estimated weighted average annual income tax rate = Rs. 193.05 lakhs divided by Rs. 900 lakhs=**21.45%**

Tax expense to be recognized in each quarter	**Rs. in lakhs**
Quarter I – Rs. 350 lakhs x 21.45%	75.075
Quarter II – Rs. 150 lakhs x 21.45%	32.175
Quarter III – (Rs. 50 lakhs) x 21.45%	(10.725)
Quarter IV – Rs. 450 lakhs x 21.45%	96.525
	193.05

Question 9 **NB Pg. No.**

Adam Ltd; provides you the following information and asks you to calculate the tax expense for each quarter with reference to AS 25, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income 33,00,000 (inclusive of Estimated Capital Gains of Rs; 8,00,000) Estimated Income of Quarter I is Rs; 7,00,000, Quarter II is Rs; 8,00,000, Quarter III (including Estimated Capital Gains of Rs; 8,00,000) is Rs; 12,00,000 and Quarter IV is Rs; 6,00,000;

Tax Rates:	On Capital Gains	12%
	On Other Income: First Rs. 5,00,000	30%
	Balance Income·	40%

Solution :

As per para 29 of AS 25 ₹Interim Financial Reporting₹, income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

		Rs.
Estimated annual income exclusive of estimated capital gain		
(33,00,000 – 8,00,000)	**(A)**	**25,00,000**
Tax expense on other income:		
30% on Rs. 5,00,000		1,50,000
40% on remaining Rs. 20,00,000		8,00,000
(B)		**9,50,000**
Weighted average annual income tax rate = $\frac{B}{A}$ (9,50,000/25,00,000) x 100 = **38%**		

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Tax expense to be recognized in each of the quarterly reports

		Rs.
Quarter I – Rs. 7,00,000 × 38%		2,66,000
Quarter II – Rs. 8,00,000 × 38%		3,04,000
Quarter III – Rs. (12,00,000 – 8,00,000) × 38%		
Rs. 8,00,000 × 12%	1,52,000	
Quarter IV – Rs. 6,00,000 × 38%	96,000	2,48,000
		2,28,000
		10,46,000

Question 10 NB Pg. No.

The accounting year of X Ltd. ends on 30th September, 20X1 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-20X0 to 30-9-20X1, the quarterly income is as under:

1st quarter ending on 31st December, 20X0	₹ 200 crores
2nd quarter ending on 31st March, 20X1	₹ 200 crores
3rd quarter ending on 30th June, 20X1	₹ 200 crores
4th quarter ending on 30th September, 20X1	₹ 200 crores
Total	₹ 800 crores

Average actual tax rate for the financial year ending on 31st March, 20X1 is 20% and for financial year ending 31st March, 20X2 is 30%. Calculate tax expense for each quarter.

Solution :

Calculation of tax expense

1st quarter ending on 31st December,	20X0 200 x20%	₹ 40 lakhs
2nd quarter ending on 31st March,	20X1 200 x20%	₹ 40 lakhs
3rd quarter ending on 30th June,	20X1 200 x30%	₹ 60 lakhs
4th quarter ending on 30th September,	20X1 200 x30%	₹ 60 lakhs

Question 11 NB Pg. No.

Whether quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises meet the definition of 'interim financial report' as per AS 25 and the provisions of AS 25 should be applied on the same?

Solution :

The presentation and disclosure requirements contained in **AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25.** Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise.

The quarterly financial results presented under Clause 41 of the Listing Agreement do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

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Question 12 NB Pg. No.

Whether the impairment loss recognized on property, plant and equipment in first quarter of the financial year can be reversed in the second quarter in that financial year?

Solution :

As per AS 25, the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount. In light of the same, the impairment loss recognized in one quarter can be reversed in the another quarter of the financial year, if favourable indicator exists as per AS 28 and the recoverable amount increased in comparison to earlier period.

Question 13 NB Pg. No.

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

Solution :

Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

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AS 26 – INTANGIBLE ASSETS

Illustration 1

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

Solution

Journal Entry

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

Illustration 2

The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1-20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.

Solution

In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.

Illustration 3

A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

Solution

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

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of ₹ 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 2 crores to the Profit and Loss account of the year is correct.

Illustration 4

What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?

Solution

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An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- identifiability,
- control over a resource and
- expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

b. The cost of the asset can be measured reliably.

Illustration 5

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

Solution

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and
- any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

Illustration 6

What is the criteria for recognition and measurement of Internally generated intangible assets. Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the same applies for internally generated goodwill also?

Solution

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

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The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

Illustration 7

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

Solution

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Illustration 8

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

Solution

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

Illustration 9 (MTP Mar'22, Oct '23) (Past Exam May'18, Nov'23)

Swift Ltd. acquired a patent at a cost of ₹ 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹ 10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000. Find out the amortization cost of the patent for each of the years. **(5 Marks)**

Solution

Swift Limited amortised ₹ 10,00,000 per annum for the first two years i.e. ₹ 20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product.

The amortisation may be found as follows:

TELEGRAM: CA NOTE HUB

	Net cash flows ₹	Amortisation Ratio	Amortisation Amount ₹
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total 2,00,00,000	1.000	80,00,000	

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

Illustration 10 (MTP Mar'19, Apr'24) (RTP May'18, Nov'19, Nov'22)

AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred ₹ 20 lakhs towards Research. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

Solution

As per AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting ₹ 20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

Illustration 11 (MTP May'20, Oct'21, Apr'23)

During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts. **(5 Marks)**

Solution

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design, coding and testing. In this case, ₹ 90,000 would be recorded as an expense (₹ 50,000 for completion of detailed program design and ₹ 40,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹ 1,00,500. Packing cost ₹ 16,500 should be recognized as expenses and charged to P & L A/c.

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Apr'19, Oct'19)

A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of Rs. 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in lakhs)	Net operating cash flow (Rs. in lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method. **(5 Marks)**

Solution

As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used. In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	Net operating Cash in flow (Rs.)	Ratio	Amortize amount (Rs. in lakhs)
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200 0.11 (bal.)	22	
	27,400	1.00	200

Question 2 (MTP Apr'21)

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred Rs. 10 lakh on research during first 5 months of the financial year 2020-21. The development of the process began on 1st September, 2020 and up to 31st March, 2021, a sum of Rs. 8 lakhs were incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of Rs. 2 lakhs per annum for next five years. The cost of capital is 10%. The present value of annuity factor of Rs. 1 for 5 years @ 10% is 3.7908. Decide the treatment of Research and Development Cost of the project as per AS 26. **(5 Marks)**

Solution:

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product Rs. 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2020- 21. Hence, it should be written off as an expense in that year itself.

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Cost of internally generated intangible asset – it is given that development phase expenditure amounting Rs. 8 lakhs incurred up to 31st March, 2021 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	Rs. 2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (Rs. 2 lakhs x 3.7908)	Rs. 7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value Rs. 8 lakhs or present value of future net cash flows Rs. 7.582 lakhs.

Hence, cost of an internally generated intangible asset will be Rs. 7.582 lakhs.

The difference of Rs. 0.418 lakhs (i.e. Rs. 8 lakhs – Rs. 7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21. Amortization - The company can amortise Rs. 7.582 lakhs over a period of five years by charging Rs. 1.516 lakhs per annum from the financial year 2021-2022 onwards.

Question 3 (MTP Mar'21, Apr'22) (RTP Nov'21)

PIL Ltd. is showing an intangible asset at Rs. 72 lakhs as on 31-3-2022. This asset was acquired for Rs. 120 lakhs as on 01-04-2016 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis. You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books. **(4 Marks)**

Solution:

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2022 at Rs. 48 lakhs i.e. Rs. 120 lakhs less Rs. 72 lakhs (Rs. 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of Rs. 24 Lakhs (Rs. 72 lakhs – Rs. 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of Rs. 48 lakhs will be amortized over remaining 4 years by amortizing Rs. 12 lakhs per year.

The necessary journal entry (for rectification) will be Revenue Reserves Dr.	Rs. 24 Lakhs	
To Intangible Assets		Rs. 24 Lakhs
(Adjustment to reserves due to restatement of the carrying amount of intangible asset)		

Question 4 (MTP Oct'22) (RTP May'21, May'24)

Surya Ltd. had the following transactions during the year ended 31 st March, 2021.

(i) It acquired the business of Gomati Limited on a going concern basis for ₹ 25,00,000 on 1st June,2020. The fair value of the Net Assets of Gomati Limited was ₹ 18,75,000. Surya Ltd. believes that due to popularity of the products of Gomati Limited in the market, its goodwill exists.

(ii) On 20th August, 2020, Surya Ltd. incurred cost of ₹ 6,00,000 to register the patent for its product. Surya Ltd. expects the Patent's economic life to be 8 years.

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(iii) On 1st October, 2020, Surya Ltd. has taken a franchise to operate an ice cream parlour from Volga Ltd. for ₹ 4,50,000 and at an Annual Fee of 10 % of Net Revenues (after deducting expenditure). The franchise expires after six years. Net Revenue for the year ended 31st March, 2021 amounted to ₹ 1,50,000.

Surya Ltd. follows an accounting policy to amortize all Intangibles on Straight Line basis (SLM) over the maximum period permitted by the Accounting Standards taking a full year amortization in the year of acquisition.

Goodwill on acquisition of business is to be amortized over 5 years (SLM).

Prepare an extract showing the Intangible Assets section in the Balance Sheet of Surya Ltd. as at 31st March, 2021. **(5 Marks)**

Solution:

Surya Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2021

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	14,00,000

Notes to Accounts (Extract)

		₹	₹
1.	**Intangible assets**		
	Goodwill (Refer to note 1)	5,00,000	
	Patents (Refer to Note 2)	5,25,000	
	Franchise (Refer to Note 3)	3,75,000	14,00,000

Working Notes:

		₹
(1)	**Goodwill on acquisition of business**	
	Cash paid for acquiring the business (purchase consideration)	25,00,000
	Less: Fair value of net assets acquired	(18,75,000)
	Goodwill	6,25,000
	Less: Amortization. over 5 years (as per SLM)	(1,25,000)
	Balance to be shown in the balance sheet	**5,00,000**
(2)	**Patent**	6,00,000
	Less: Amortization (over 8 years as per SLM)	(75,000)
	Balance to be shown in the balance sheet	**5,25,000**
(3)	**Franchise**	4,50,000
	Less: Amortization (over 6 years)	(75,000)
	Balance to be shown in the balance sheet	**3,75,000**

Question 5 (MTP Mar'23, RTP Nov'20)

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya". X Ltd. incurred additional legal fees to stop infringement on

TELEGRAM: CANOTE HUB

both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks? **(5 Marks)**

Solution:

As per para 59 of AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

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

Question 6 (RTP Nov'23, May 20) (Past Exam Nov'20)

A company acquired patent right for Rs.1200 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year Estimated future cash flows	1	2	3	4	5
(Rs. in lakhs)	600	600	600	300	300

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be Rs. 150 lakhs. You are required to determine the amortization pattern under AS 26. **(5 Marks)**

Solution:

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (Rs. in lakhs)	Amortization Ratio	Amortized Amount (Rs. in lakhs)
1	600	.25	300
2	600	.25	300
3	600	.25	300
4	300	.40 (Revised)	120
5	300	.40 (Revised)	120
6	150	.20 (Revised)	60
			1,200

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be Rs. 300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Question 7 (RTP May'22)

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

Solution:

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

Question 8 (RTP May 22)

X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of AS.

Solution:

As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

Question 9 (RTP May'19, May'23) (Past Exam Nov'19)

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

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

2) During the year 2021-22, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

3) A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.

4) A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product. **(5 Marks)**

Solution:

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

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

(ii) The company is required to expense the entire amount of ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 2022 because no benefit will arise in the future.

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

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

Question 10 (Past Exam, Jan'21)

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

(i) Import Duty 10%

(ii) Additional Import Duty 5%

(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses ₹ 1,50,000.

Professional fees for clearance from customs ₹ 50,000. Compute the cost of software to be Capitalized as per relevant AS. **(5 Marks)**

Solution:

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	**170,91,875**

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

Question 11 (Past Exam Nov'20, Dec'21)

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

You are required to work out :

TELEGRAM: CA NOTE HUB

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

2) What is the carrying amount of the intangible asset as on 31st March, 2019?

3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020 ?

4) What is the carrying amount of the intangible asset as on 31st March, 2020? **(5 Marks)**

Solution:

As per AS 26 'Intangible Assets'

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

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

(ii) Carrying value of intangible asset as on 31.03.2019

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

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

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

₹ 46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

(iv) Carrying value of intangible asset as on 31.03.2020

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

TELEGRAM: CA NOTE HUB

MCQs

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

(a) Intangible assets held-for-sale in the ordinary course of business

(b) Assets arising from employee benefits

(c) (a) & (b) both

(d) Research and development activities

2. Intangible asset is recognised if it:

(a) meets the definition of an intangible asset

(b) is probable that future economic benefits will flow

(c) the cost can be measured reliably

(d) meets all of the above parameters

3. Sun Limited has purchased a computer with various additional software.

These are integral part of the computer. Which of the following are true in the context of AS 26:

(a) Recognise Computer and software as tangible asset

(b) Recognise tangible and intangible separately

(c) Recognise computer and software as intangible asset

(d) Does not recognize the software as an asset.

4. Hexa Ltd developed a technology to enhance the battery life of mobile devices. Hexa has capitalised development expenditure of ₹ 5,00,000. Hexa estimates the life of the technology developed to be 3 years but the company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in the second year of the product's life?

(a) ₹ 2,50,000

(b) ₹ 1,75,000

(c) ₹ 1,66,667

(d) ₹ 1,85,000

ANSWERS/SOLUTIONS

MCQs

1. (c) 2. (d) 3. (a) 4. (b)

TELEGRAM: CA NOTE HUB

AS 27 FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

NB Pg. No.

Question 1

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied the materials for ₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture. Mr. C met all other expenses of advertising, labour and other incidental expenses which turnout to be ₹ 9,00,000. On 30.06.20X1 each of the venturer agreed to take away one flat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along with the interest and net proceeds were shared by the partners equally.

You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

Solution:

Draft Consolidated Profit & Loss Account

Particulars	₹	₹	Particulars	₹	₹
To Purchase of Land:			By Sale of Flats:		
Mr. A		60,00,000	Mr. A	40,00,000	
To Registration Fees:			Mr. B	20,00,000	
Mr. A		60,000	Mr. C	10,00,000	70,00,000
To Materials:			By Flats taken by Venturers:		
Mr. B		9,50,000	Mr. A	10,00,000	
To Other Expenses:			Mr. B	10,00,000	
Mr. C		9,00,000	Mr. C	10,00,000	30,00,000
To Bank Interest:					
Mr. A		2,00,000			
To Profits:					
Mr. A	6,30,000				
Mr. B	6,30,000				
Mr. C	6,30,000	18,90,000			
		1,00,00,000			1,00,00,000

In the Books of Mr. A

Joint Venture Account

Particulars	₹	Particulars	₹
To Bank Loan (Purchase of Land)	50,00,000	By Bank (Sale of Flats)	40,00,000
To Bank:(Purchase of Land)	10,00,000	By Land & Building	10,00,000
To Bank (Registration Fees)	60,000	By Bank (Received from Mr. B)	14,20,000
To Bank (Bank Interest)	2,00,000	By Bank (Received from Mr. C)	4,70,000
To Profit on JV	6,30,000		
	68,90,000		68,90,000

TELEGRAM: CA NOTE HUB

In the Books of Mr. B

Joint Venture Account

Particulars	₹	Particulars	₹
To Purchases (Material Supplied)	4,50,000	By Bank (Sale of Flats)	20,00,000
To Bank (Materials)	5,00,000	By Land & Building	10,00,000
To Profit on JV	6,30,000		
To Bank (Paid to Mr. A)	14,20,000		
	30,00,000		30,00,000

In the Books of Mr. C

Joint Venture Account

Particulars	₹	Particulars	₹
To Bank (Misc. Expenses)	9,00,000	By Bank (Sale of Flats)	10,00,000
To Profit on JV	6,30,000	By Land & Building	10,00,000
To Bank (Paid to Mr. A)	4,70,000		
	20,00,000		20,00,000

Question 2 NB Pg. No.

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehicles of ₹ 9,00,000 to be depreciated @ 20% p.a. They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year.

You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

Solution :

Consolidated Balance Sheet

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

Notes to Accounts

			(₹)
1.	Share capital		
	A Ltd.	23,80,000	
	B Ltd.	23,80,000	
	C Ltd.	23,80,000	71,40,000

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2.	Property, Plant and Equipment		
	Land & Building:		
	A Ltd.	3,80,000	
	B Ltd.	3,80,000	
	C Ltd.	3,80,000	11,40,000
	Plant & Machinery:		
	A Ltd.	17,00,000	
	B Ltd.	17,00,000	
	C Ltd.	17,00,000	51,00,000
	Computers:		
	A Ltd.	60,000	
	B Ltd.	60,000	
	C Ltd.	60,000	1,80,000
	Vehicles:		
	A Ltd.	2,40,000	
	B Ltd.	2,40,000	
	C Ltd.	2,40,000	7,20,000

In the Books of A Ltd.

Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

Particulars	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	

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	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of B Ltd.

Extract of draft Profit & Loss Account

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

Particulars	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of C Ltd.

Extract of Draft Profit & Loss Account	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

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Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

Question 3 NB Pg. No.

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd. agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributed equally. A Ltd. invested 49% of total capital but has equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	Dr. (₹)	Cr. (₹)
Purchases	9,00,000	
Other Expenses	3,06,000	
Sales		13,05,000
Property, Plant and Equipment	6,00,000	
Current Assets	2,00,000	
Unsecured Loans		2,00,000
Current Liabilities		1,00,000
Capital		4,01,000

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

Solution :

Consolidated Profit & Loss Account

Particulars	Note No.	₹
Revenue from operations	1	13,05,000
Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000

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Other expenses	3	3,06,000
Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

Particulars	Note No.	₹
I Equity and liabilities		
1. Shareholders' funds:		
Share Capital	5	4,01,000
Reserves and Surplus	6	1,99,000
2. Non-current liabilities		
Long term borrowings	7	2,00,000
3. Current Liabilities	8	1,00,000
		9,00,000
II Assets		
Non-current Assets		
Property, Plant and Equipment	9	6,00,000
Current Assets		
Inventories	10	1,00,000
Other current assets	11	2,00,000
		9,00,000

Notes to Accounts

			₹
1.	Revenue from operations		
	Sales:		
	A Ltd.	7,25,000	
	B Ltd.	5,80,000	13,05,000
2.	Purchases		
	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	Other expenses		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	Closing Inventory		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	Share Capital		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	Reserves and Surplus		
	Profit & Loss Account:		
	A Ltd.	99,500	

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	B Ltd.	99,500	1,99,000
7.	Long Term Borrowings		
	Unsecured Loans:		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	Current Liabilities		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
9.	Property, Plant and Equipment		
	A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000
	10. Inventories		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
	11. Other Current Assets		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

Question 4 NB Pg. No.

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	A Ltd.	B Ltd.	C Ltd.
Share Capital	10,00,000	7,50,000	5,00,000
Reserve & Surplus	18,00,000	16,00,000	12,00,000
Loans	3,00,000	4,00,000	2,00,000
Current Liabilities	4,00,000	2,50,000	1,00,000
Property, Plant and Equipment	30,50,000	26,25,000	19,50,000
Investment in JV	2,50,000	2,50,000	-
Current Assets	2,00,000	1,25,000	50,000

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

Solution :

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		10,00,000
	Reserves and Surplus	1	24,00,000
	2. Non-current liabilities	2	4,00,000
	3. Current Liabilities	3	4,50,000
	TOTAL		**42,50,000**
II	Assets		
	Non-current Assets		
	Property, Plant and Equipment:	4	40,25,000

	Current Assets	5	2,25,000
	TOTAL		**42,50,000**

Notes to Accounts

		₹	₹
1.	**Reserves and Surplus**		
	A Ltd.	18,00,000	
	C Ltd.	6,00,000	24,00,000
2.	Long Term Borrowings Loans:		
	A Ltd.	3,00,000	
	C Ltd.	1,00,000	4,00,000
3.	Current Liabilities:		
	A Ltd.	4,00,000	
	C Ltd.	50,000	4,50,000
4.	Property, Plant and Equipment:		
	A Ltd.	30,50,000	
	C Ltd.	9,75,000	40,25,000
5.	Current Assets:		
	A Ltd.	2,00,000	
	C Ltd.	25,000	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		7,50,000
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	3,00,000
			37,50,000
II	**Assets**		
	1. Non-current Assets		
	Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	1,50,000
			37,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	16,00,000	
	C Ltd.	6,00,000	22,00,000
2.	Long Term Borrowings Loans:		
	A Ltd.	4,00,000	
	C Ltd.	1,00,000	5,00,000

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3.	Current Liabilities:		
	A Ltd.	2,50,000	
	C Ltd.	50,000	3,00,000
4.	Property, Plant and Equipment:		
	A Ltd.	26,25,000	
	C Ltd.	9,75,000	36,00,000
5.	Current Assets:		
	A Ltd.	1,25,000	
	C Ltd.	25,000	1,50,000

Question 5 NB Pg. No.

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

Solution :

Proportionate consolidation method of accounting is to be followed except in the following cases:

a. Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or

b. joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investee is treated as investment according to AS 13.

Question 6 NB Pg. No.

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

Solution :

A venturer should discontinue the use of the proportionate consolidation method from the date that:

a. It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.

b. The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe longterm restrictions that significantly impair its ability to transfer funds to the venturers.

From the date of discontinuing the use of the proportionate consolidation method,

a. If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.

b. If interest is 20% or more but up to 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statement.

c. For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

d. For this purpose, the carrying amount of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost thereafter.

Question 7 NB Pg. No.

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to reassess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years.

Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

Solution :

As per para 26 of AS 27 "Financial Reporting of Interests in Joint Ventures", in a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 'Accounting for Investments'.

As per para 17 of AS 13 "Accounting for Investments", long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1–20X2 i.e., more than a year, it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution in the value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares.

Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

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AS 28 IMPAIRMENT OF ASSETS

Illustration 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property,

Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year Cash	Flow (₹ in lakhs)
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000

Residual value at the end of 20X6 = ₹ 1000 lakhs

Property, Plant and Equipment purchased on 1-1-20XX = ₹ 40,000 lakhs

Useful life = 8 years

Net selling price on 31-12-20X1 = ₹ 20,000 lakhs

Calculate on 31-12-20X1:

a) Carrying amount at the end of 20X1

b) Value in use on 31-12-20X1

c) Recoverable amount on 31-12-20X1

d) Impairment loss to be recognized for the year ended 31-12-20X1

e) Revised carrying amount

f) Depreciation charge for 20X2.

Note: The year 20XX is the immediate preceding year before the year 20X0.

Solution

Calculation of value in use

Year	Cash Flow	Discount as per 15%	Discounted cash flow
20X2	4,000	0.870	3,480
20X3	6,000	0.756	4,536
20X4	6,000	0.658	3,948
20X5	8,000	0.572	4,576
20X6	4,000	0.497	1,988
20X6	(residual) 1,000	0.497	497
			19,025

(a) Calculation of carrying amount:

Original cost = ₹ 40,000 lakhs

Depreciation for 3 years = [(40,000-1000)□3/8] = ₹ 14,625 lakhs

Carrying amount on 31-12-20X1 = [40,000-14,625] = ₹ 25,375 lakhs

(b) Value in use = ₹ 19,025 lakhs

(c) Recoverable amount = higher of value in use and net selling price i.e.

₹ 20,000 lakhs.

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Recoverable amount = ₹ 20,000 lakhs

(d) Impairment Loss = ₹ (25,375-20,000) = ₹ 5,375 lakhs

(e) Revised carrying amount = ₹ (25,375-5,375) = ₹ 20,000 lakhs

(f) Depreciation charge for 20X2 = (20,000-1000)/5 = ₹ 3,800 lakhs

Illustration 2

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the

recoverable amount if net selling price of plant on 31.3.20X1 is ₹ 60 lakhs.

Solution

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53
31.3.20X5	20	0.683	13.66
31.3.20X6	20	0.620	12.40
			118.82
Present value of residual price on 31.3.20X6 = 5 x 0.620			3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.20X1 is ₹ 60 lakhs, the recoverable amount will be higher of ₹ 121.92 lakhs (value in use) and ₹ 60 lakhs (net selling price), hence recoverable amount is ₹ 121.92 lakhs.

Illustration 3 (Past Exam May'18)

G Ltd., acquired a machine on 1st April, 20X0 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation. **(5 Marks)**

Solution

Statement Showing Impairment Loss

	(₹ in crores)

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

Illustration 4 (MTP Mar'24)

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs? **(4 Marks)**

Solution

Treatment of Impairment Loss

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹ 64.50 lakhs (₹ 67.50 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs. Therefore, recoverable amount will be ₹ 64.50 lakhs. Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹ 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

	(₹ in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)

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Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

Illustration 5

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

Solution:

The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss.

- If carrying amount < = Recoverable amount : Asset is not impaired
- If carrying amount > Recoverable amount : Asset is impaired

Impairment Loss = Carrying Amount – Recoverable Amount

Recoverable amount is the higher of net selling price and its value in use

This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

Illustration 6 (RTP May'20, Sep'24)

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognized as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognized as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title.

Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

Solution:

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title.

In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent of each other and that each magazine title is a separate cash-generating unit.

Illustration 7

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

Solution:

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As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where recoverable amount is the higher of an asset's net selling price and its value in use. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (negative ₹ 70,000)]. Thus impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) –recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

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

Illustration 8

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

Solution:

(i) Recoverable amount is higher of value in use ₹ 400 lakhs and net selling price ₹ 375 lakhs.

Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹ 500 lakhs – ₹ 400 lakhs = ₹ 100 lakhs.

(ii) Journal Entries

Particulars	**Dr. Amount (₹ in lakhs)**	**Cr. Amount (₹ in lakhs)**
(i) Impairment loss account Dr.	100	
To Provision for Accumulated Impairment Loss Account		100
(Being the entry for accounting impairment loss)		
(ii) Profit and loss account Dr.	100	
To Impairment loss		100
(Being the entry to transfer impairment loss to profit and loss account)		

(iii) Balance Sheet of Venus Ltd. as on 31.3.20X1

	(₹ in lakhs)
Fixed Asset	
Asset less depreciation	500
Less: Impairment loss	(100)
	400

Illustration 9

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did

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not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed. Discuss the applicability of Impairment loss.

Solution:

As per provisions of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Illustration 10

From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset:

Cost of asset	₹ 56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	₹ 27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹ 12 lakhs
Upward revaluation done in last year	₹ 14 lakhs

Solution:

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	₹
Current carrying amount (including revaluation amount of ₹ 14 lakhs)	27,30,000
Less: Current recoverable amount	(12,00,000)
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization)

charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to ₹ 12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹ 4,00,000.

Illustration 11

A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹ 4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹ 25 lakhs. Estimated

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Net Selling Price as on 31st March, 20X1 was ₹ 30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.

Its value in use has been computed at ₹ 35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?

(ii) How much will be the amount of write off for the financial year ended 31st March, 20X2?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 12 lakhs, how would you answer: to questions (i) and (ii) above?

(iv) If the value in use was zero and the enterprise were required to incur a cost of ₹ 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

Solution:

As per AS 28 "Impairment of Assets", if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss.

An impairment loss on a revalued asset is recognized as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹ 24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 20X2	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹ 60 lakhs – ₹ 24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account	23.50
	(₹ 35.50 lakhs – ₹ 12 lakhs)	
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-)2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss) (₹ 60 lakhs – Nil)	60.00
	Entire book value of plant will be written off and charged to profit and loss account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 20X2

	(₹ in lakhs)
Opening book value as on 1.4.20X1 (₹ 500 lakhs –₹ 415 lakhs)	85
Less: Depreciation for financial year 20X1–20X2	(25)
Closing book value as on 31.3.20X2	60
Estimated net selling price as on 1.4.20X1	30

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Less: Estimated decrease during the year (20% of ₹ 30 lakhs)	(6)
Estimated net selling price as on 31.3.20X2	24
Estimated value in use as on 1.4.20X1	35.0
Less: Estimated decrease during the year (30% of ₹ 35 lakhs)	(10.5)
Estimated value in use as on 31.3.20X2	**24.5**

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MTP / RTP / Past Exam

Question 1 (MTP Oct'18)

Wow Ltd. is developing a new production process. During the financial year ending 31st March, 2018, the total expenditure incurred was Rs. 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2017. Expenditure incurred till this date was Rs.22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2019 was Rs. 80 lakhs.

As at 31st March, 2019, the recoverable amount of know-how embodied in the process is estimated to be Rs. 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

(i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2018 and carrying value of intangible as on that date.

(ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2019.

Ignore depreciation. **(4 Marks)**

Solution:

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2018

1) Carrying value of intangible as on 31.03.2018:

At the end of financial year 31st March 2018, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2017).

2) Expenditure to be charged to Profit and Loss account:

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2018. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2019

1) Expenditure to be charged to Profit and Loss account:

	(Rs. in lakhs)
Carrying Amount as on 31.03.2018	28
Expenditure during 2018 –2019	80
Total book cost	108
Recoverable Amount	(72)
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2019.

2) Carrying value of intangible as on 31.03.2019:

	(Rs.in lakhs)
Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2019	72

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Question 2 (RTP Nov 20)

H Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2018, the Government put restriction on export of goods exported by H Ltd. and due to that restriction H Ltd. impaired its assets. H Ltd. acquired identifiable assets worth of Rs. 4,000 lakh for Rs. 6,000 lakh at the end of the year 2014. The difference is treated as goodwill. The useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 2018, the company recognised the impairment loss by determining the recoverable amount of assets for Rs. 2,720 lakh. In 2020 Government lifted the restriction imposed on the export and due to this favourable change, H Ltd. re-estimate recoverable amount, which was estimated at Rs. 3,420 lakh.

Required:

(i) Calculation and allocation of impairment loss in 2018.

(ii) Reversal of impairment loss and its allocation as per AS 28 in 2020.

Solution:

(i) Calculation and allocation of impairment loss in 2018(Amount in Rs. lakh)

	Goodwill	Identifiable assets	Total
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortization (4 yrs.)	(1,600)	(1,067)	(2,667)
Carrying amount before impairment	400	2,933	3,333
Impairment loss*	(400)	(213)	(613)
Carrying amount after impairment loss	0	2,720	2,720

Notes:

1) As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

   (a) first, to goodwill allocated to the cash-generating unit (if any); and

   (b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit. Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.

2) Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortise over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.

(ii) Carrying amount of the assets at the end of 2020 (Amount in Rs. lakh)

End of 2020	Goodwill	Identifiable assets	Total
Carrying amount in 2020	0	2,225	2,225
Add: Reversal of impairment loss (W.N.2)	-	175	175
Carrying amount after reversal of impairment loss	-	2,400	2,400

Working Note:

1. Calculation of depreciation after impairment till 2020 and reversal of impairment loss in 2020

(Amount in Rs. lakh)

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	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in 2018	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	–	(495)	(495)
Carrying amount	0	2,225	2,225
Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted at the end of the year 2020.

2. Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of 2020

(Amount in Rs. lakh)

End of 2020	Identifiable assets
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N.1)	2,225
Amount of reversal of impairment loss	175

Notes:

1) As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:

   (a) its recoverable amount (if determinable); and

   (b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

   Hence impairment loss reversal is restricted to Rs. 175 lakh only.

2) The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

Question 3 (RTP Nov 18)

M Ltd. has three cash-generating units: A, B and C. Due to adverse changes in the technological environment, M Ltd. conducted impairment tests of each of its cash- generating units. On 31st March, 2018, the carrying amounts of A, B and C are Rs. 100 lakhs, Rs. 150 lakhs and Rs. 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is Rs. 200 lakhs: a headquarter building of Rs. 150 lakhs and a research centre of Rs. 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

Following is the remaining estimated useful life of:

	A	B	C	Head quarter assets

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Remaining estimated useful life	10	20	20	20

The headquarter assets are depreciated on a straight-line basis.

The recoverable amount of each cash generating unit is based on its value in use since net selling price for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	B	C	M Ltd. as a whole
Recoverable amount	199	164	271	720*

*The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.

Calculate and show allocation of impairment loss as per AS 28. Ignore tax effects.

Solution:

1. Identification of Corporate Assets of M Ltd.

Here, the corporate assets are the headquarter building and the research centre.

For corporate building

Since, the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a ₹bottom-up₹ test is necessary.

For research centre

Since the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual CGU under review. Therefore, a ₹top-down₹ test will be applied in addition to the ₹bottom-up₹ test.

2. Allocation of Corporate Assets

Since the estimated remaining useful life of A₹s CGU is 10 years, whereas the estimated remaining useful lives of B and C₹s CGU are 20 years, the carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit on weight basis.

3. Calculation of a weighted allocation of the carrying amount of the headquarter building

(Amount in Rs. lakhs)

On 31st March, 2018	**A**	**B**	**C**	**Total**
Carrying amount **(A)**	100	150	200	450
Useful life	10 years	20 years	20 years	
Weight based on useful life	1	2	2	
Carrying amount after weight	100	300	400	800
Pro-rata allocation of the building	12.5%	37.5%	50%	100%
	(100/800)	(300/800)	(400/800)	
Allocation of the carrying amount of the building (based on pro-rata above) (**B**)	18.75	56.25	75	150
Carrying amount (after allocation of the building)	118.75	206.25	275	600

4. Calculation of Impairment Losses

a. Application of ₹bottom-up₹ test **(Amount in Rs. lakhs)**

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31st March, 2018	A	B	C
Carrying amount (after allocation of the building) (Refer point 3 above)	118.75	206.25	275
Recoverable amount (given in the question)	199	164	271
Impairment loss	0	(42)	(4)

Allocation of the impairment losses for cash-generating units B and C (Amount in Rs. lakhs)

Cash-generating unit	B	C
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

Since the research centre could not be allocated on a reasonable and consistent basis to A, B and C₹s CGU, M Ltd. compares the carrying amount of the smallest CGU to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount, in accordance with the ₹top-down₹ test.

Application of the ₹top-down₹ test (Amount in Rs. lakhs)

31st March, 2018	A	B	C	Building	Research Centre	M Ltd.
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the ₹bottom-up₹ test	–	(30)	(3)	(13)	–	(46)
Carrying amount after the ₹bottom-up₹ test	100	120	197	137	50	604
Recoverable amount						720

Since recoverable amount is more than the carrying amount of M Ltd., no additional impairment loss has been resulted from the application of the top- down test. Only an impairment loss of Rs. 46 lakhs will be recognized as a result of the application of the ₹bottom-up₹ test.

Question 4 (RTP May 18)

M Ltd. produces a single product and owns plants A, B and C. Each plant is located in a different continent. Plant A produces a component that is assembled in either plant B or plant C. The combined capacity of plants B and C is not fully utilised. M Ltd's products are sold world-wide from either plants B or C i.e. plant Bs production can be sold in plant Cs continent if the products can be delivered faster from plant B than from plant C. Utilisation levels of plant B and plant C depend on the allocation of sales between the two sites.

For each of the following cases, what are the cash-generating units for plants A, B and C?

Case 1: There is an active market for plant A's products.

Case 2: There is no active market for plant A's products.

Solution:

(a) Case 1: It is likely that A is a separate cash-generating unit because there is an active market for its products.

Although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B

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and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

In determining the value in use of A and B plus C, M Ltd. adjusts financial budgets/forecasts to reflect its best estimate of future market prices for A₹s products.

Case 2: It is likely that the recoverable amount of each plant cannot be assessed independently because:

a) there is no active market for A's products. Therefore, A's cash inflows depend on sales of the final product by B and C; and

b) although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

As a consequence, it is likely that A, B and C together (i.e., M Ltd. as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

Question 5 (Past Exam Nov'18)

C Ltd. acquired S Ltd. business (a cash generating unit) on 31-3-2016 for ₹ 8,000 Lakhs. The details of acquisition are us under: -

Fair value of identifiable asset	6000 Lakhs
Goodwill	2000 Lakhs

The anticipated useful life of acquired assets is 5 years Goodwill is to be amortised in 4 years C Ltd. uses straight-line method of depreciation with no residual values anticipated. On 31-3-2018, C Ltd. estimated the significant decline in production due to change in Government policies. The net selling price of identifiable asset is not determinable. The cash flow forecast based on recent financial budget for next 7 years after considering change in Govt. policies are as follows. Incremental financing cost is 8% which represent current market assessment of the time value of money.

			₹ in Crore
Year	Cash flow	Year	Cash flow
2019	800	2022	600
2020	800	2023	600
2021	800	2024	500
		2025	400

You are required to calculate:

(i) Value in use

(ii) Impairment loss

(iii) Revised carrying amount on 31-3-2018 **(5 Marks)**

Solution:

(i) Value in Use

Year ended on 31st March	Cash flow (₹ in lakh)	Discounting factor @ 8%	Present Value (₹ in lakh)
2019	800	0.926	740.80
2020	800	0.857	685.60

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2021	800	0.794	635.20
2022	600	0.735	441.00
2023	600	0.681	408.60
2024	500	0.630	315.00
2025	400	0.583	233.20
			3459.40

(ii) Impairment loss

Impairment loss = Carrying amount of the asset - Recoverable Amount

= ₹ 4,600 lakhs - ₹ 3,459.40 lakhs (Refer W.N.)

= ₹ 1,140.60 lakhs

(iii) Revised Carrying Amount on 31.3.2018

As per para 87 of AS 28 'Impairment of Assets', an impairment loss should be allocated to reduce the carrying amount of the assets of CGU in the following order:

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value. **(₹ in lakh)**

	Goodwill	**Identifiable assets**	**Total**
Useful life	4 years	5 years	
Historical cost	2,000	6,000	8,000
Accumulated depreciation/amortization (for 2 years)	(1,000)	(2,400)	(3,400)
Carrying amount before impairment	1,000	3,600	4,600
Impairment loss	(1,000)	(140.60)	(1,140.60)
Revised carrying amount after impairment loss	0	3,459.40	3,459.40

Working Note:

Calculation of Recoverable Amount

Recoverable amount = Higher of Asset's Net Selling Price or Value in Use

Where, Asset's net selling price is not determinable

Recoverable Amount of the asset will be equal to the Value in use ie. ₹ 3,459.40 lakh.

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MCQs

1. If there is indication that an asset may be impaired but the recoverable amount of the asset is more than the carrying amount of the asset, the following are true:
   a) No further action is required and the company can continue the asset in the books at the book value itself.
   b) The entity should review the remaining useful life, scrap value and method of depreciation and amortization for the purposes of AS 10.
   c) The entity can follow either (a) or (b).
   d) The entity should review the scrap value and method of depreciation and amortization for the purposes of AS 10.

2. In case Goodwill appears in the Balance Sheet of an entity, the following is true:
   a) Apply Bottom up test if goodwill cannot be allocated to CGU (cash generating unit) under review.
   b) Apply Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.
   c) Apply both Bottom up test and Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.
   d) Apply either Bottom up test or Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.

3. In case of Corporate assets in the Balance Sheet of an entity, the following is true:
   a) Apply Bottom up test if corporate assets cannot be allocated to CGU (cash generating unit) under review.
   b) Apply Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.
   c) Apply both Bottom up test and Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.
   d) Apply either Bottom up test or Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.

4. In case of reversal of impairment loss, which statement is true:
   a) Goodwill written off can never be reversed.
   b) Goodwill written off can be reversed without any conditions to be met.
   c) Goodwill written off can be reversed only if certain conditions are met.
   d) Goodwill written off can be reversed.

ANSWERS/HINTS

MCQs

1. (b) 2. (c) 3. (c) 4. (c)

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SOLVED EXAMPLE

Example: 1

At the end of 20X0, enterprise M acquired 100% of enterprise Z for ₹ 3,000 lakhs. Z has 3 cash-generating units A, B and C with net fair values of ₹ 1,200 lakhs, ₹ 800 lakhs and₹ 400 lakhs respectively. M recognises goodwill of ₹ 600 lakhs (₹ 3,000 lakhs less ₹ 2,400 lakhs) that relates to Z.

At the end of 20X4, A makes significant losses. Its recoverable amount is estimated to be ₹ 1,350 lakhs. Carrying amounts are detailed below (₹ In Lakh).

End of 20X4	A	B	C	Goodwill	Total
Net carrying amount	1300	1200	800	120	3420

Scenario A - Goodwill Can be Allocated on a Reasonable and Consistent Basis

On the date of acquisition of Z, the net fair values of A, B and C are considered a reasonable basis for a pro-rata allocation of the goodwill to A, B and C.

Allocation of goodwill at the end of 20X4:

	A	B	C	Goodwill
End of 20X0				
Net fair values	1200	800	400	2400
Pro-Rata	50%	33%	17%	100%
End of 20X4				
Net carrying amount	1300	1200	800	3300
Allocation of goodwill	60	40	20	120
(Using pro rate above)				
Net carrying amount (After goodwill)	1360	1240	820	3420

In accordance with the 'bottom-up' test in paragraph 78(a) of AS 28, M compares A's recoverable amount to its carrying amount after the allocation of the carrying amount of goodwill:

End of 20X4 A	(Rs. In Lakh)
Carrying amount after allocation of goodwill	1360
Recoverable amount	1350
Impairment loss	10

M recognises an impairment loss of ₹ 10 lakhs for A. The impairment loss is fully allocated to the goodwill in accordance with paragraph 87 of AS 28.

Scenario B - Goodwill Cannot be Allocated on a Reasonable and Consistent Basis

There is no reasonable way to allocate the goodwill that arose on the acquisition of Z to A, B and C. At the end of 20X4, Z's recoverable amount is estimated to be ₹ 3,400 lakhs.

At the end of 20X4, M first applies the 'bottom-up' test in accordance with paragraph 78(a) of this Statement. It compares A's recoverable amount to its carrying amount excluding the goodwill.

End of 20X4	A (Rs. In Lakh)
Carrying amount	1300
Recoverable amount	1350
Impairment loss	0

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Therefore, no impairment loss is recognised for A as a result of the 'bottom-up' test.

Since the goodwill could not be allocated on a reasonable and consistent basis to A, M also performs a 'top-down' test in accordance with paragraph 78(b) of AS 28. It compares the carrying amount of Z as a whole to its recoverable amount (Z as a whole is the smallest cash-generating unit that includes A and to which goodwill can be allocated on a reasonable and consistent basis).

Application of the 'top-down' test (Amount in ₹ lakhs)

End of 20X4	A	B	C	Goodwill	Total
Carrying amount	1300	1200	800	120	3420
Impairment loss arising from the 'bottom-up' test	0	-	-	-	0
Carrying amount after the 'bottom-up' test	1300	1200	800	120	3420
Recoverable amount	-	-	-	-	3400
Impairment loss arising from 'topdown' test	-	-	-	-	20

Therefore, M recognises an impairment loss of ₹ 20 lakhs that it allocates fully to goodwill in accordance with AS 28.

Example 2

A machine has suffered physical damage but is still working, although not as well as it used to. The net selling price of the machine is less than its carrying amount.

The machine does not generate independent cash inflows from continuing use.

The smallest identifiable group of assets that includes the machine and generates cash inflows from continuing use that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. There coverable amount of the production line shows that the production line taken as a whole is not impaired.

Assumption 1: Budgets/forecasts approved by management reflect no commitment of management to replace the machine.

The recoverable amount of the machine alone cannot be estimated since the machine's value in use:

(a) may differ from its net selling price; and

(b) can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired, therefore, no impairment loss is recognized for the machine. Nevertheless, the enterprise may need to reassess the depreciation period or the depreciation method for the machine. Perhaps, a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are consumed by the enterprise.

Assumption 2: Budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future.

Cash flows from continuing use of the machine until its disposal are estimated to be negligible.

The machine's value in use can be estimated to be close to its net selling price.

Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (the production line). Since the machine's net selling price is less than its carrying amount, an impairment loss is recognised for the machine.

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AS 29 PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS

Question 1 (Past Exam Nov'22) NB Pg. No.

At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

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

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof. **(5 Marks)**

Solution:

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

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made.

For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

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

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Question 2 (MTP April '19) (RTP May'21) NB Pg. No.

EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following:

(i) The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(ii) The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 20X2.

Solution :

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

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

Question 3 NB Pg. No.

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

Solution :

A provision should be recognised only when: (a) An enterprise has a present obligation as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation.

Question 4 (RTP Nov'20) (MTP Mar'19) NB Pg. No.

Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. During 20X1–20X2 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 20X2–20X3 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 20X1–20X2 financial year.

As on balance sheet date (31.3.20X2), the goods were not manufactured, and it was unlikely that Sun Ltd. will be able to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

(5 Marks)

Solution :

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

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the contingency amounting ₹ 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 20X2 and no profit had accrued for the financial year 20X1-20X2. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.

Question 5 NB Pg. No.

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

Solution :

As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused, there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

Question 6 (MTP – Nov'21, April'23) NB Pg. No.

An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. You are required to comment on the validity of the treatment done by the company in line with the provisions of AS 29.

Solution :

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29. The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

Question 7 (MTP Oct'18) NB Pg No.

S Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2016-17, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2016-17 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client

on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by this employee s on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of Rs. 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made". The accountant feels that the company should also book/recognise the income by Rs. 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the Accountant with reference to relevant accounting standards. **(5 Marks)**

Solution :

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

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter -claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of Rs. 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of Rs. 680 lakhs is not as per AS-29 and also the concept of prudence will not be followed if Rs. 680 lakhs is simultaneously recognized as income. Rs. 680 lakhs is not the revenue at present but only reimbursement of claim for which an asset is created. However, the accountant is correct to the extent as that non-recognition of Rs. 680 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Question 8 (MTP Apr'21, Apr'22) (RTP Nov 18, May 19) NB Pg No.

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

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

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

(ii) What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard? (5 Marks)

Solution :

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

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

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

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

(ii) As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

Question 9 (MTP Oct '21 ,March '23 & Oct '23)

NB Pg No.

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2022 and needs your expert advice on the following issue in line with the provisions of AS 29:

(i) The company had committed to supply a consignment worth Rs. 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth Rs. 30 lakhs met with an accident. It was however covered by Insurance.

According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth Rs. 30 lakhs which was in transit.

Solution :

(i)	Loss due to accident		Rs. 30,00,000
	Insurance claim receivable by company = Rs. 30,00,000 x90%	=	Rs. 27,00,000
	Loss to be recognised in the books for 2019–2020		Rs. 3,00,000
	Insurance claim receivable to be recorded in the books		Rs. 27,00,000

Compensation claim by dealer against company to be provided for in the books

= Rs. 30,00,000 × 15% = Rs. 4,50,000

Question 10 (MTP Mar'22, Sep'22, Apr'24) (RTP Nov'19)

NB Pg No.

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

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XYZ Ltd. in line with the provisions of AS 29. **(5 Marks)**

Solution :

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision. It is apparent from the Question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 11 (MTP Oct'22, Jan'25) (Past Exam Nov'19) (RTP May'23) **NB Pg No.**

A Company dealing in software provides after sales warranty for 2 years to its customer. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year: 3% provision

More than 1 year: 4% provision

The company has raised invoices as under

Invoice Date	Amount (₹)
19th January, 2019	1,20,000
29th January, 2020	75,000
15th October, 2020	2,70,000

You are required to calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2020 and 31st March, 2021. Also compute the amount to be debited to Profit and Loss Account for the year ended 31st March, 2021. **(5 Marks)**

Solution :

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

As at 31st March, 2020 = ₹ 1,20,000 x .03 + ₹ 75,000 x .04

= ₹ 3,600 + ₹ 3,000 = ₹ 6,600

As at 31st March, 2021 = ₹ 75,000 x .03 + ₹ 2,70,000 x .04

= ₹ 2,250 + ₹ 10,800 = ₹ 13,050

Amount debited to Profit and Loss Account for year ended 31st March, 2021

	₹
Balance of provision required as on 31.03.2021	13,050
Less: Opening Balance as on 1.4.2020	(6,600)
Amount debited to profit and loss account	6,450

Note: No provision will be made on 31st March, 2021 in respect of sales amounting ₹ 1,20,000 made on 19th January, 2019 as the warranty period of 2 years has already expired.

Question 12 (RTP Nov'21, Sep'24) NB Pg No.

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

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

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

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

Required:

(i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS 29.

(ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet.

Solution :

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

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

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

Question 13 (RTP May 21) NB Pg No.

Explain whether provision is required in the following situations in line with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of

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resources is remote.

Solution :

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognized. Disclosures are required for the provision.

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

Question 14 (RTP Nov 20) NB Pg No.

How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.

Solution :

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

A present obligation that arises from past events but is not recognized because:

(i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Question 15 (RTP May 20) NB Pg No.

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

(i) During 2018–19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019–20, the financial condition of Brew Ltd. deteriorates and on 31st Dec. 2019, it goes into liquidation. (Balance Sheet date 31–3–19).

Solution :

(i) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation

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but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 2019. Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019–20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

Question 16 (RTP May'22, Nov'22) NB Pg No.

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

(i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of Rs. 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.

(ii) Chaos Limited has filed a court case in 2014–2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay Rs. 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(iii) A new regulation has been passed in 2021–22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of Rs. 10,00,000 for the said upgrade.

(iv) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of Rs. 5 crores.

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

Solution :

Principles for recognition of provisions:

As per AS 29, "a provision shall be recognised when:

a) an entity has a present obligation (legal or constructive) as a result of a past event;

b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

(ii) On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case

and also a reliable estimate of the outflow can be made as Rs. 3,00,000, there is a present obligation. Hence, provision should be recognised for Rs. 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

(iv) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows: Probability of warranty cases for the entity where repair/replacement may be required as per past experience

= 1% of Rs. 5,00,00,000 = Rs. 5,00,000

Estimated cost of repair / replacement = Rs. 5,00,000 × 10% = Rs. 50,000.

Question 17 (Past Exam May'22) NB Pg No.

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

I. On 1st April 2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March,2022, the company does not provide any provision for replacement of lining of the furnace.

II. A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalization of the case. There are 70% chances that the penalty may not be levied.

(5 Marks)

Solution :

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

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

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

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

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Question 18 (Past Exam July 21) (MTP Sep'23) NB Pg. No.

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0–1 month	6%
Between 1–2 months	7%
Between 2–3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March. (5 Marks)

Solution :

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(₹ in lacs)
Sales for the year	400

Less: Cost of sales	(320)
Profit	80
Profit mark up on sales (80/400) x 100 = 20%	

Question 19 (RTP Nov'23) (MTP Sep'23) NB Pg. No.

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

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place. **(5 Marks)**

Solution :

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig.

However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff. The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

Question 20 : (MTP Jan'25) NB Pg. No.

"The company has not made provision for warrantee in respect of certain goods considering that the company can claim the warranty cost from the original supplier".

You are required to comment in line with the provisions of AS 29. **(6 Marks)**

Solution :

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

It is apparent from the question that the company had not made provision for warranty in respect of

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TELEGRAM: CA NOTE HUB

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

Question 21 : (RTP Jan'25) NB Pg. No.

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

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

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

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

(i) Whether the Company is required to make provision for the claim from customer K as per applicable AS? If yes, please give the rationale for the same.

(ii) If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2024?

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

Solution :

(i) Yes, QA Ltd. is required to make provision for the claim from customer K as per AS 29 since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of Rs.5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31st March, 2024.

(ii) Statement of Profit and Loss A/c Dr. Rs.5.2 crore

To Current Liability A/c Rs.5.2 crore

(iii) As per para 30 of AS 29, QA Ltd. shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized.

Question 22 : (MTP Oct'18, Aug 18, Oct'19,Oct'20, Mar 22) NB Pg No.

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to Rs. 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to

change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'. Show the treatment of machine in the books of ABC Ltd. **(5 Marks)**

Solution :

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

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CASH FLOW STATEMENTS

Illustration 1

Intelligent Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

(i) Loans and Advances given to the following and interest earned on them:

1) to suppliers
2) to employees
3) to its subsidiaries companies

(ii) Investment made in subsidiary Smart Ltd. and dividend received

(iii) Dividend paid for the year

(iv) TDS on interest income earned on investments made

(v) TDS on interest earned on advance given to suppliers

(vi) Insurance claim received against loss of fixed asset by fire Discuss in the context of AS 3 Cash Flow Statement.

Solution

(i) Loans and advances given and interest earned

(1)	to suppliers	Operating Cash flow
(2)	to employees	Operating Cash flow
(3)	to its subsidiary companies	Investing Cash flow

(ii) Investment made in subsidiary company and dividend received

Investing Cash flow

(iii) Dividend paid for the year

Financing Cash Outflow

(iv) TDS on interest income earned on investments made

Investing Cash Outflow

(v) TDS on interest earned on advance given to suppliers

Operating Cash Outflow

(vi) Insurance claim received of amount loss of fixed asset by fire

Extraordinary item to be shown under a separate heading as 'Cash inflow from investing activities'.

Illustration 2

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

		Particulars	**Notes**	**31.3.20X1** ₹	**31.3.20X2** ₹
		Equity and Liabilities			
		Shareholder's funds			
	(a)	Share capital	1	5,00,000	5,00,000
	(b)	Reserve & surplus	2	50,000	90,000
		Non-current liabilities			
	(a)	Long-term borrowings	3	5,00,000	7,50,000
		Current liabilities			
	(a)	Other current liabilities	4	---	5,000

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		Assets			
		Non-current assets			
	(a)	Intangible assets	5	2,05,000	1,80,000

Notes to accounts

		31.3.20X1 ₹	31.3.20X2 ₹
1	**Share Capital**		
	50,000 Equity Shares of r10 each	5,00,000	5,00,000
2	**Reserve & surplus**		
	Profit & Loss A/c	50,000	90,000
3	**Long-term borrowings**		
	10% Debentures	5,00,000	7,50,000
4	**Other current liabilities**		
	Unpaid interest	---	5,000
5	**Intangible assets**		
	Goodwill	2,05,000	1,80,000

You are required to show the related items in Cash Flow Statement.

Solution

An Extract of Cash Flow Statement for the year ending 31.3.20X2

	₹
Cash flows from operating activities:	
Closing balance as per Profit & Loss A/c	90,000
Less: Opening balance as per Profit & Loss Alc	(50,000)
Add: Goodwill amortisation	25,000
Add: Interest on Debentures (Refer Note 1)	75,000
Net Cash from Operating Activities	1,40,000

Note 1 : Interest has been computed on the closing balance of debentures as on 31.3.20X2 assuming that all the additions/ deletions were made, if any, at the beginning of the year.

Cash flows from financing activities:

Proceeds from debentures (Refer Working Note)	2,50,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,80,000

Working Note:

10% Debentures Account

Particulars	₹	**Particular**	₹
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,50,000
	7,50,000		7,50,000

Illustration 3 (MTP Mar'24)

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

Summary of Cash Account

for the year ended March 31, 20X1

Particulars	₹	**Particulars**	₹

TELEGRAM: CA NOTE HUB

To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Trade payables	1,57,000
To Trade receivables	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000
To Loan from Bank	1,00,000	By Repayment of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000
		By Balance c/d	1,04,000
	5,96,000		5,96,000

Solution **(4 Marks)**

Cash Flow Statement of
for the year ended March 31, 20X1(Direct Method)

Particulars	₹	₹
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

Illustration 4

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

Summary Cash Account

		(₹ '000)
Balance at 1.3.20X1		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		128
		3,246
Payments to suppliers	2,047	
Payments for property, plant & equipment	230	
Payments for overheads	115	
Wages and salaries	69	
Taxation	243	

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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

Hills Ltd.

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

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Illustration 5

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 20X1 with the help of the following information:

1) Company sold goods for cash only.
2) Gross Profit Ratio was 30% for the year, gross profit amounts to ₹ 3,82,500.
3) Opening inventory was lesser than closing inventory by ₹ 35,000.
4) Wages paid during the year ₹ 4,92,500.
5) Office and selling expenses paid during the year ₹ 75,000.
6) Dividend paid during the year ₹ 30,000.

TELEGRAM: CA NOTE HUB

7) Bank loan repaid during the year ₹ 2,15,000 (included interest ₹ 15,000).
8) Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by ₹ 25,000.
9) Amount paid to trade payables during the year ₹ 4,60,000.
10) Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.20X1r 45,000).
11) Investments of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.
12) Depreciation on fixed assets amounts to ₹ 85,000.
13) Plant and machinery purchased on 15th November, 20X0 for ₹ 2,50,000.
14) Cash and Cash Equivalents on 31st March, 20X0r 2,00,000.
15) Cash and Cash Equivalents on 31st March, 20X1r 6,07,500.

Solution

M/s MNT Ltd.

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

Particulars	₹	₹
Cash flows from Operating Activities		
Cash sales (₹ 3,82,500/.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from investing activities		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash used in investing activities (B)		4,70,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,07,500
Cash and cash equivalents at beginning of the period		2,00,000
Cash and cash equivalents at end of the period		6,07,500

Illustration 6

Ryan Ltd provides you the following information at the year-end, March 31, 20X1:

TELEGRAM: CA NOTE HUB

	₹	₹
Sales		6,98,000
Cost of Goods Sold		(5,20,000)
		1,78,000
Operating Expenses		
(including Depreciation Expense of ₹ 37,000)		(1,47,000)
		31,000
Other Income / (Expenses):		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	(3,000)	
		(8,000)
		23,000
Income tax		(7,000)
		16,000

Information available:

	31st March 20X1	31st March 20X0
	₹	₹
Plant	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (Long term)	1,15,000	1,27,000
Inventory	1,44,000	1,10,000
Trade receivables	47,000	55,000
Cash	46,000	15,000
Prepaid expenses	1,000	5,000
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Trade payables	50,000	43,000
Outstanding liabilities	12,000	9,000
Income taxes payable	3,000	5,000

Analysis of selected accounts and transactions during 20X0-X1

1) Purchased investments for ₹ 78,000.
2) Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000.
3) Purchased plant assets for ₹ 1,20,000.
4) Sold plant assets that cost r10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.
5) Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 20X1.
6) Repaid ₹ 50,000 of bonds at face value at maturity.

TELEGRAM: CA NOTE HUB

7) Issued 15,000 shares of ₹ 10 each.

8) Paid cash dividends ₹ 8,000.

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

Solution

Ryan Ltd.
Cash Flow Statement
for the year ending 31st March, 20X1

	₹	₹
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in trade receivables	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in trade payables	7,000	
Increase in outstanding liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash generated from operating activities		47,000
Cash flows from investing activities		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

Note: Significant non-cash adjustments: Issued ₹ 1,00,000 of bonds at face value for acquisition of plant on 31st March, 20X1.

***Working Note:**

	₹
Income taxes paid:	
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000
	12,000

TELEGRAM: CA NOTE HUB

Less: Income tax liability at the end of the year	(3,000)
	9,000

Illustration 7

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

Particulars	Notes	20X1 ₹	20X0 ₹
Equity and Liabilities			
1 Shareholder's funds	1		
(a) Share capital		60,000	50,000
(b) Reserve & surplus	2	5,000	4,000
2 Current liabilities			
a) Trade Payables		4,000	2,500
b) Other current liabilities	3	-	1,000
(c) Short term provision (provision for tax)		1,500	1,000
Total		**70,500**	**58,500**
Assets			
1 Non-current assets	4		
(a) Property, Plant & Equipment		39,500	29,000
2 Current assets			
a) Current investments		2,000	1,000
b) Inventories		17,000	14,000
c) Trade receivables		8,000	6,000
d) Cash & cash equivalents	5	4,000	8,500
		70,500	**58,500**

Notes to accounts

		20X1 r	20X0 r
1	**Share Capital**		
	Equity Shares of r10 each	60,000	50,000
2	**Reserve & surplus**		
	Profit and Loss Account	5,000	4,000
3	**Other current liabilities**		
	Dividend Payable	-	1,000
4	**Property, plant and equipment (at WDV)**		
	Building	10,000	10,000
	Fixtures	17,000	11,000
	Vehicles	12,500	8,000
	Total	39,500	29,000
5	**Cash and cash equivalents**		
	Cash and Bank	4,000	8,500

The profit and loss statement for the year ended 31st March, 20X1 disclosed:

Particulars	₹

TELEGRAM: CA NOTE HUB

Profit before tax	4,500
Tax expense: Current tax	(1,500)
Profit for the year	3,000
Declared dividend	(2,000)
Retained Profit	1,000

Further information is available:

	Fixtures ₹	Vehicles ₹
Depreciation for the year	1,000	2,500
Disposals:		
Proceeds on disposal of vehicles	—	1,700
Written down value	—	(1,000)
Profit on disposal		700

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

Solution

Sun Ltd.
Cash Flow Statement
for the year ended 31st March, 20X1

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid (**W.N.1**)	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of current investments	(1,000)	
Purchase of vehicles (**W.N.3**)	(8,000)	
Purchase of fixtures (**W.N.3**)	(7,000)	
Net cash used in investing activities		(14,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid **(W.N.2)**	(3,000)	
Net cash generated from financing activities		7,000
Net decrease in cash and cash equivalents		(4,500)
Cash and cash equivalents at beginning of period (See Note)		8,500
Cash and cash equivalents at end of period (See Note)		4,000

TELEGRAM: CA NOTE HUB

Note to the Cash Flow Statement		
Cash and Cash Equivalents		
	31.3.20X1	31.3.20X0
Bank and Cash	4,000	8,500
Cash and cash equivalents	4,000	8,500

Working Notes:

			₹
1.	**Income taxes paid**		
	Income tax expense for the year		1,500
	Add: Income tax liability at the beginning of the year		1,000
			2,500
	Less: Income tax liability at the end of the year		(1,500)
			1,000
2.	**Dividend paid**		
	Declared dividend for the year		2,000
	Add: Amount payable at the beginning of the year		1,000
			3,000
	Less: Amount payable at the end of the year		-
			3,000
3.	**Property, plant and equipment acquisitions**		
		Fixtures	Vehicles
		₹	₹
	W.D.V. at 31.3.20X1	17,000	12,500
	Add back:		
	Depreciation for the year	1,000	2,500
	Disposals	—	1,000
		18,000	16,000
	Less: W.D.V. at 31.12.20X0	(11,000)	(8,000)
	Acquisitions during 20X0-20X1	7,000	8,000

Note: Current investments may not be readily convertible to a known amount of cash and may not be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

Illustration 8

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

	(₹ in lakhs)
Net Profit	25,000
Dividend paid	8,535
Provision for Income tax	5,000
Income tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to the Statement of Profit and Loss	20,000
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income received on investments	2,506
Interest expenses of the year	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,081
Purchase of Fixed assets	14,560

TELEGRAM: CA NOTE HUB

Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and bank balance	5,003
Closing cash and bank balance	6,988

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

Solution

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

		(₹ in lakhs)
Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bank balance)	(56,081)	
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flows from investing activities		
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Receipt of grant for capital projects	12	
Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,622)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	27,502
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note:

1. Book value of the assets sold	185	
Less : Loss on sale of assets	(40)	
Proceeds on sale	145	

TELEGRAM: CA NOTE HUB

Illustration 9

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.20X1

	₹'000		₹'000
Balance on 1.4.20X0	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Asset	200
Receipts from Customers	2,800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.3.20X1	150
	3,250		3,250

Solution

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

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash generated from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at the beginning of the year		50
Cash at the end of the year		150

Illustration 10

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

Extract of Balance sheet

		Particulars	**Notes**	**31.3.20X1 (₹ in lakhs)**	**31.3.20X0 (₹ in lakhs)**
		Equity and Liabilities			
1		**Current liabilities**			
	(a)	Trade Payables		250	230
	(b)	Short term Provisions	1	200	180

TELEGRAM: CA NOTE HUB

	(c)	Other current liabilities	2	70	50
		Assets			
1		**Current assets**			
		Inventories		200	180
		Trade Receivables		400	250
		Other current assets	3	195	180

Statement of Profit and Loss of ABC Ltd.

for the year ended 31st March, 20X1

	Particulars	**Notes**	**₹ in lakhs**
I	Revenue from operations		4,150
II	Other income	4	100
III	Total income (I + II)		**4,250**
	Expenses:		
	Purchases of Stock-in-Trade		2,400
	Change in inventories of finished goods		(20)
	Employee benefits expense		800
	Depreciation expense		100
	Finance cost	5	60
	Other expenses		200
IV	**Total expenses**		**3,540**
V	Profit before tax (**III** – **IV**)		710
VI	Tax expense:		
	Current tax		200
VII	Profit for the year from continuing operations		510

Appropriations

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

Notes to accounts:

		20X1 (₹ in lakhs)	**20X0 (₹ in lakhs)**
1	Short term Provisions:		
	Provision for Tax	200	180
2	Other current liabilities:		
	Outstanding wages	50	40
	Outstanding expenses	20	10
	Total	70	50
3	Other current assets:		
	Advance tax	195	180
4	Other income:		
	Interest and dividend	100	
5	Finance cost:		
	Interest	60	

Compute cash flow from operating activities using both direct and indirect method.

TELEGRAM: CA NOTE HUB

Solution

Cash Flows from Operating Activities

	₹ in lakhs	₹ in lakhs
Using Direct Method		
Cash Receipts:		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 − 400	4,000
Cash payments:		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables – Closing Trade payables	2,400 + 230 − 250	2,380
Wages and salaries paid	800 + 40 − 50	790
Cash expenses	200 + 10 – 20	190
Taxes paid – Advance tax		195
(B)		3,555
Cash flow from operating activities (A – B)		445
Using Indirect Method		
Profit before tax		710
Add: Non-cash items : Depreciation		100
Add: Interest : Financing cash inflow		60
Less: Interest and Dividend : Investment cash outflow		(100)
Less: Tax paid		(195)
Working capital adjustments		
Trade receivables	250-400 (150)	
Inventories	180-200 (20)	
Trade payables	250-230 20	
Outstanding wages	50-40 10	
Outstanding expenses	20-10 10	(130)
Cash flow from operating activities		445

Illustration 11

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

1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.
2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.
3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.
4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.
5) Dividend paid during the year amounted to ₹ 11.7 crores.
6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.
7) ₹ 8 crores was paid towards income tax during the year.
8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.
9) The following balances are also provided:

	₹ in crores 1.4.20X0	₹ in crores 31.3.20X1
Debtors	45	50

TELEGRAM: CA NOTE HUB

Creditors	21	23
Bank	6	18.2

Solution

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

Particulars	**₹ in crores**	**₹ in crores**
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors	49	
[45+ (135x40%) - 50]		
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers	(42)	
[21+ (55x80%) – 23]		
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	
Payments for purchase of fixed assets (21 – 10)	(11)	
Net cash generated from investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Significant non-cash items:

a) Debenture-holders received equity shares of ₹ 15 crores on redemption of the debentures.

b) Plant having book value of ₹ 12 crores was given in exchange of an asset costing ₹ 21 crores. The said plant was transferred at a value of ₹ 10 crores only, and ₹ 11 crores was paid for the balance dues towards the plant.

Illustration 12

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

Ledger balances of Mr. Zen as of 20X0 and 20X1

	As on 1.4.20X0 ₹	**As on 1.4.20X1** ₹
Zen's Capital A/c	10,00,000	12,24,000
Trade payables	3,20,000	3,52,000
Mrs. Zen's loan	2,00,000	--
Loan from Bank	3,20,000	4,00,000
Land	6,00,000	8,80,000

TELEGRAM: CA NOTE HUB

Plant and Machinery (net block)	6,40,000	4,40,000
Inventories	2,80,000	2,00,000
Trade receivables	2,40,000	4,00,000
Cash	80,000	56,000

Additional information:

A machine costing ₹ 80,000 (accumulated depreciation there on r24,000) 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

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

		₹
(i) Cash flow from operating activities		
Net Profit (given)		3,60,000
Adjustments for		
Depreciation on Plant & Machinery (W.N.2)	1,44,000	
Loss on Sale of Machinery (W.N.1)	16,000	1,60,000
Operating Profit before working capital changes		5,20,000
Decrease in inventories	80,000	
Increase in trade receivables	(1,60,000)	
Increase in trade payables	32,000	(48,000)
Net cash generated from operating activities		4,72,000
(ii) Cash flow from investing activities		
Sale of Machinery (W.N.1)	40,000	
Purchase of Land (8,80,000 – 6,00,000)	(2,80,000)	
Net cash used in investing activities		(2,40,000)
(iii) Cash flow from financing activities		
Repayment of Mrs. Zen's Loan	(2,00,000)	
Drawings (W.N.3)	(1,36,000)	
Loan from Bank	80,000	
Net cash used in financing activities		(2,56,000)
Net decrease in cash		(24,000)
Opening balance as on 1.4.20X0		80,000
Cash balance as on 31.3.20X1		56,000

Working Notes:

1. Plant & Machinery A/c

	₹		₹
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision for Depreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 64,000)	16,000
		By Balance c/d (4,40,000+3,20,000)	7,60,000
	8,40,000		8,40,000

2. Provision for depreciation on Plant and Machinery A/c

	₹		₹

TELEGRAM: CA NOTE HUB

To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c (Bal. fig.)	1,44,000
	3,44,000		3,44,000

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

	₹
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,000)
Drawings	1,36,000

Note: Students may note that in case there is an increase in the amount of debentures/ loans during the year and the interest is required to be computed, then in such a case, students may choose either to compute interest on the closing balance of the debentures or may compute interest on opening balance for full year (in case of no repayment) and proportionate interest on additions. Suitable note for assumption may be given in the solution for this.

Illustration 13

What is the significance of cash flow statement? Explain in brief.

Solution:

Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.

Illustration 14

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

Solution:

As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Illustration 15 (MTP Oct'18)

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).

(a) Brokerage paid on purchase of investments

(b) Underwriting commission paid

(c) Trading commission received

(d) Proceeds from sale of investment

(e) Purchase of goodwill

(f) Redemption of preference shares

(g) Rent received from property held as investment

TELEGRAM: CA NOTE HUB

(h) Interest paid on long-term borrowings

(i) Marketable securities (having risk of change in value)

(j) Refund of income tax received

Solution:

Classification of activities with reference to AS 3

a.	Brokerage paid on purchased of investments	Investing Activities
b.	Underwriting Commission paid	Financing Activities
c.	Trading Commission received	Operating Activities
d.	Proceeds from sale of investment	Investing Activities
e.	Purchase of goodwill	Investing Activities
f.	Redemption of Preference shares	Financing Activities
g.	Rent received from property held as investment	Investing Activities
h.	Interest paid on long term borrowings	Financing Activities
i.	Marketable securities	Not a Cash equivalent
j.	Refund of Income tax received	Operating activities

Illustration 16 (MTP March '23)

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?

(i) 10% Debentures issued: As on 01-04-20X1 ₹ 1,10,000. As on 31-03-20X2 ₹ 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

(iii) Unpaid Interest on Debentures: As on 01-04-20X1 ₹ 275

As on 31-03-20X2 ₹ 1,175

(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v) 10% Bonds (Investments): As on 01-04-20X1 ₹ 3,50,000

As on 31-03-20X2 ₹ 3,50,000

(vi) Accrued Interest on Investments: As on 31-03-20X2 ₹ 10,500 **(5 Marks)**

Solution:

Classification of activities with reference to AS 3 for the year ended March 31, 20X2

A	Cash Flow from Operating Activities	
	Net Profit as per Profit & Loss A/c	xxxxx
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	Cash Flow from Investing Activities	
	Interest on Investments [35,000-10,500]	24,500
C	Cash Flow from Financing Activities	
	Interest on Debentures paid [11,000 - (1,175 - 275)] - outflow	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) at 5% premium] - outflow	(34,650)

Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.

TELEGRAM: CA NOTE HUB

Illustration 17

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1 :

Particulars			Notes	31st March, 20X1	31st March, 20X0
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		10,00,000	8,00,000
	B	Reserves and Surplus	1	3,00,000	2,10,000
2		**Non-current liabilities**			
		Long term borrowings	2	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		7,00,000	8,20,000
	B	Other current liabilities	3	-	1,00,000
	C	Short term provision		1,00,000	70,000
		(provision for tax)			
		Total		**23,00,000**	**20,00,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and		13,00,000	9,00,000
		Equipment	4		
	B	Non-Current Investments		1,00,000	-
2		**Current assets**			
	A	Inventories		4,00,000	2,00,000
	B	Trade receivables		5,00,000	7,00,000
	C	Cash and Cash equivalents		-	2,00,000
		Total		**23,00,000**	**20,00,000**

Notes to accounts

No.	Particulars	31st March, 20X1	31st March, 20X0
1	**Reserves and Surplus**		
	General reserve	2,00,000	1,50,000
	Profit and Loss account	1,00,000	60,000
	Total	**3,00,000**	**2,10,000**
2	**Long term borrowings**		
	Debentures (issued at end of year)	2,00,000	--
3.	**Other current liabilities**		
	Dividend payable	-	1,00,000
4	**Property, plant and equipment**		
	Plant and machinery	7,00,000	5,00,000
	Land and building	6,00,000	4,00,000
	Net carrying value	**13,00,000**	**9,00,000**

(i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing ₹ 50,000 (WDV ₹ 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.

(iii) ₹ 50,000 was paid towards Income tax during the year.

TELEGRAM: CANOTE HUB

(iv) Construction of the building got completed on 31.03.20X1 and hence no depreciation may be charged on the same.

Prepare Cash flow Statement.

Solution:

Cash Flow Statement of Grow More Ltd. for the year ended 31st March, 20X1

Cash Flow from Operating Activities

		₹
Increase in balance of Profit and Loss Account (1,00,000 – 60,000)	40,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	2,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	(1,20,000)	
Cash generated from operations	1,60,000	
Income tax paid	(50,000)	
Net Cash generated from operating activities		1,10,000

Cash Flow from Investing Activities

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

Cash Flow from Financing activities

Proceeds from issue of shares (10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	(1,00,000)	
Net cash generated from financing activities		3,00,000
Net decrease in cash and cash equivalents		(2,00,000)
Cash and Cash equivalents at the beginning of the year		2,00,000
Cash and Cash equivalents at the end of the year		Nil

Working Notes:

1) Provision for taxation account

	₹		₹
To Cash (Paid)	50,000	By Balance b/d	70,000

TELEGRAM: CA NOTE HUB

To	Balance c/d	1,00,000	By	Profit and Loss A/c (Balancing figure)	80,000
		1,50,000			1,50,000

2) Plant and Machinery account

		₹			₹
To	Balance b/d	5,00,000	By	Depreciation	1,25,000
To	Profit and Loss A/c (profit on sale of machine)	15000			
To	Cash (Balancing figure)	3,45,000	By	Cash (sale of machine)	35,000
			By	Balance c/d	7,00,000
		8,60,000			8,60,000

Illustration 18

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

Particulars			Notes	31st March 20X1₹	31st March 20X0 ₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	6,00,000	7,00,000
	B	Reserves and Surplus	2	4,20,000	3,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		1,15,000	1,10,000
	B	Other current liabilities	4	30,000	80,000
	C	Short term provision (provision for tax)		95,000	60,000
		Total		**14,60,000**	**12,50,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	9,15,000	7,00,000
	B	Non-Current Investments		50,000	80,000
2		**Current assets**			
	A	Inventories		95,000	90,000
	B	Trade receivables		2,50,000	2,25,000
	C	Cash and Cash equivalents		50,000	90,000
	D	Other Current assets		1,00,000	65,000
		Total		**14,60,000**	**12,50,000**

Notes to accounts

No.			31st March, 20X1	31st March, 20X0
1.	**Share capital**			
	Equity share capital		6,00,000	5,00,000
	10% Redeemable Preference share			

TELEGRAM: CA NOTE HUB

	capital		--	2,00,000
	Total		**6,00,000**	**7,00,000**
2	**Reserves and Surplus**			
	Capital redemption reserve		1,00,000	-
	Capital reserve		70,000	-
	General reserve		1,50,000	2,50,000
	Profit and Loss account		1,00,000	50,000
	Total		**4,20,000**	**3,00,000**
3	**Long term borrowings**			
	9% Debentures		2,00,000	--
4.	**Other current liabilities**			
	Dividend payable		-	60,000
	Liabilities for expenses		30,000	20,000
	Total		**30,000**	**80,000**
5	**Property, plant and equipment**			
	Plant and machinery		7,65,000	5,00,000
	Land and building		1,50,000	2,00,000
	Net carrying value		**9,15,000**	**7,00,000**

Additional Information:

(i) A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.

(ii) On 1st April, 20X0 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹1 lakh were issued at par as part consideration for plant of ₹4.5 lakhs acquired.

(iii) Part of the investments (Cost – ₹50,000) was sold for ₹70,000.

(iv) Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.

(v) Interim dividend was declared and paid @ 15% during the current year.

(vi) Income-tax liability for the current year was estimated at ₹1,35,000.

(vii) Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.

Solution:

Cash Flow Statement of Ryan Limited For the year ended 31st March, 20X1

	₹	₹
Cash flow from operating activities		
Net Profit before taxation (W.N.1)	2,75,000	
Adjustment for		
Depreciation (W.N.3)	1,35,000	
Profit on sale of land	(30,000)	
Profit on sale of plant (W.N.3)	(40,000)	
Profit on sale of investments (W.N.4)	(20,000)	
Interest on debentures (2,00,000 X 9%)	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	
Increase in trade receivables	(25,000)	
Increase in Other current assets (W.N.9)	(35,000)	
Increase in Trade payables	5,000	
Increase in liabilities for expenses	10,000	

TELEGRAM: CA NOTE HUB

Cash generated from operations	2,88,000	
Income taxes paid (W.N.8)	(1,00,000)	
Net cash generated from operating activities		1,88,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.2)	1,50,000	
Proceeds from sale of plant (W.N.3)	90,000	
Proceeds from sale of investments (W.N.4)	70,000	
Purchase of plant (W.N.3)	(3,50,000)	
Purchase of investments (W.N.4)	(25,000)	
Pre-acquisition dividend received (W.N.4)	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares (6,00,000 – 5,00,000)	1,00,000	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(1,50,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(1,68,000)
Net decrease in cash and cash equivalents		(40,000)
Cash and cash equivalents at the beginning of the year		90,00
Cash and Cash equivalents at the end of the year		50,000

Significant Non-cash Items:

Debentures amounting to ₹ 1,00,000 have been issued as part consideration for acquisition of plant of ₹ 4,50,000.

Working Notes:

1. Provision for taxation account

	₹
Net profit before taxation	
Retained profit	1,00,000
Less: Balance as on 31.3.20X0	(50,000)
	50,000
Provision for taxation	1,35,000
Dividend	90,000
	2,75,000

2. Land and Building Account

	₹		₹
To Balance b/d	2,00,000	By Cash (Sale)	1,50,000

TELEGRAM: CA NOTE HUB

To	Profit and Loss A/c (Profit on sale)	30,000	By	Balance c/d	1,50,000
To	Capital reserve (Revaluation profit)	70,000			
		3,00,000			3,00,000

3. Plant and Machinery Account

		₹			₹
To	Balance b/d	5,00,000	By	Cash (Sale)	90,000
To	Profit and loss account	40,000	By	Depreciation	1,35,000
To	Debentures	1,00,000	By	Balance c/d	7,65,000
To	Bank	3,50,000			
		9,90,000			9,90,000

4. Investments Account

		₹			₹
To	Balance b/d	80,000	By	Cash (Sale)	70,000
To	Profit and loss account	20,000	By	Dividend	
To	Bank (Balancing figure)	25,000		(Pre- acquisition)	5,000
			By	Balance c/d	50,000
		1,25,000			1,25,000

5. Capital Reserve Account

		₹			₹
To	Balance c/d	70,000	By	Profit on revaluation of land	70,000
		70,000			70,000

6. General Reserve Account

		₹			₹
To	Capital redemption reserve	1,00,000	By	Balance b/d	2,50,000
To	Balance c/d	1,50,000			
		2,50,000			2,50,000

7. Dividend payable Account

		₹			₹
To	Bank (Balancing figure)	1,50,000	By	Balance b/d	60,000
To	Balance c/d	-	By	Profit and loss account	90,000
		1,50,000			1,50,000

8. Provision for Taxation Account

		₹			₹
To	Bank (Balancing figure)	1,00,000	By	Balance b/d	60,000
To	Balance c/d	95,000	By	Profit and loss account	1,35,000
		1,95,000			1,95,000

9. Other Current Assets Account

TELEGRAM: CA NOTE HUB

	₹		₹
To Balance b/d	65,000	By Balance c/d	1,00,000
To Bank (Balancing figure)	35,000		
	1,00,000		1,00,000

Illustration 19

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

			Notes	₹ 31st March 20X0	₹ 31st March 20X1
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	16,00,000	18,80,000
	B	Reserves and Surplus	2	8,40,000	11,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	4,00,000	2,80,000
3		**Current liabilities**			
	A	Other current liabilities	4	6,00,000	5,20,000
	B	Short term provision			
		(provision for tax)		3,60,000	3,40,000
		Total		**38,00,000**	**41,20,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	22,80,000	26,40,000
	B	Non-Current Investments		4,00,000	3,20,000
2		**Current assets**			
	A	Cash and Cash equivalents		10,000	10,000
	B	Other Current assets		11,10,000	11,50,000
		Total		**38,00,000**	**41,20,000**

Notes to accounts

No.	Particulars		31st March, 20X0	31st March, 20X1
1.	**Share capital**			
	Equity share capital		12,00,000	16,00,000
	10% Preference share capital		4,00,000	2,80,000
	Total		**16,00,000**	**18,80,000**
2	**Reserves and Surplus**			
	General reserve		6,00,000	7,60,000
	Profit and Loss account		2,40,000	3,40,000
	Total		**8,40,000**	**11,00,000**
3	**Long term borrowings**			
	9% Debentures		4,00,000	2,80,000
	Total		**4,00,000**	**2,80,000**
4.	**Other current liabilities**			
	Dividend payable		1,20,000	-
	Current Liabilities		4,80,000	5,20,000
	Total		**6,00,000**	**5,20,000**

TELEGRAM: CA NOTE HUB

5.	**Property, plant and equipment**			
	Property, plant and equipment		32,00,000	38,00,000
	Less: Depreciation		(9,20,000)	(11,60,000)
	Net carrying value		**22,80,000**	**26,40,000**

Additional information:

(i) The company sold one property, plant and equipment for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was r80,000.

(ii) The company also decided to write off another item of property, plant and equipment costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

(iii) Depreciation on property, plant and equipment provided ₹ 3,60,000.

(iv) Company sold some investment at a profit of ₹ 40,000.

(v) Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the year end.

(vi) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was ₹ 2,16,000. The inventory on 31.3.20X1 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

Solution:

New Light Ltd.

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

A.	**Cash Flow from operating activities**	₹	₹
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [3,40,000 – (2,40,000 + 24,000)]	76,000	
	Transfer to general reserve	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	5,76,000	
	Adjustments for:		
	Depreciation	3,60,000	
	Loss on sale of property, plant and equipment	20,000	
	Decrease in value of property, plant and equipment	16,000	
	Profit on sale of investment	(40,000)	
	Premium on redemption of preference share capital	6,000	
	Interest on debentures	36,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	9,80,000	
	Increase in current liabilities		
	(₹5,20,000 –₹4,80,000)	40,000	
	Increase in other current assets		
	[₹11,50,000 – (₹ 11,10,000 + ₹24,000)]	(16,000)	
	Cash generated from operations	10,04,000	
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		6,44,000

TELEGRAM: CA NOTE HUB

B.	**Cash Flow from investing activities**		
	Purchase of property, plant and equipment	(8,56,000)	
	(W.N.3)		
	Proceeds from sale of property, plant and equipment (W.N.3)	1,00,000	
	Proceeds from sale of investments (W.N.2)	1,20,000	
	Net Cash used in investing activities		(6,36,000)
C.	**Cash Flow from financing activities**		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital	(1,26,000)	
	(₹1,20,000 + ₹6,000)		
	Redemption of debentures	(1,26,000)	
	(₹ 1,20,000 +₹ 6,000)		
	Dividend paid	(1,20,000)	
	Interest on debentures	(36,000)	
	Net Cash generated from financing activities		(8,000)
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

Working Notes:

1) Revaluation of inventory will increase opening inventory by ₹ 24,000. 2,16,000/90 x 10 = ₹ 24,000

Therefore, opening balance of other current assets would be as follows:

₹ 11,10,000 + ₹ 24,000 = ₹ 11,34,000

Due to under valuation of inventory, the opening balance of profit and loss account be increased by ₹ 24,000.

The opening balance of profit and loss account after revaluation of inventory will be ₹ 2,40,000 + ₹ 24,000 = ₹ 2,64,000

2)

	₹		₹
To Balance b/d	4,00,000	By Bank A/c	1,20,000
To Profit and Loss A/c		(balancing figure being investment sold)	
(Profit on sale of investment)	40,000	By Balance c/d	3,20,000
	4,40,000		4,40,000

3) **Property, Plant and Equipment Account**

	₹		₹	₹
To Balance b/d	32,00,000	By Bank A/c (sale of assets)	1,00,000	
To Bank A/c	8,56,000	By Accumulated depreciation A/c	80,000	
(balancing figure being assets purchased)				

TELEGRAM: CA NOTE HUB

		By Profit and loss A/c (loss on sale of assets)	20,000	2,00,000
		By Accumulated depreciation A/c	40,000	
		By Profit and loss A/c (assets written off)	16,000	56,000
		By Balance c/d		38,00,000
	40,56,000			40,56,000

4) **Accumulated Depreciation Account**

To	Property, plantand equipment A/c	80,000	By	Balance b/d	9,20,000
To	Property, plant and equipment A/c	40,000	By	Profit and loss A/c (depreciation for the year)	3,60,000
To	Balance c/d	11,60,000			
		12,80,000			12,80,000

Illustration 20

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

Particulars			**Notes**	**₹ 31st March 20X0**	**₹ 31st March 20X1**
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		50,00,000	50,00,000
	B	Reserves and Surplus		26,50,000	36,90,000
2		**Non-current liabilities**			
		Long term borrowings	1	-	9,00,000
3		**Current liabilities**			
	A	Short-term borrowings		1,50,000	3,00,000
		(Bank loan)			
	B	Trade payables		8,80,000	8,20,000
	C	Other current liabilities	2	4,80,000	2,70,000
		Total		**91,60,000**	**1,09,80,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and		21,20,000	32,80,000
		Equipment	3		
2		**Current assets**			
	A	Current Investments		11,80,000	15,00,000
	B	Inventory		20,10,000	19,20,000
	C	Trade receivables	4	22,40,000	26,40,000
	D	Cash and Cash equivalents		15,20,000	15,20,000
	E	Other Current assets (Prepaid expenses)		90,000	1,20,000
		Total		**91,60,000**	**1,09,80,000**

TELEGRAM: CA NOTE HUB

Notes to accounts

No.	Particulars		20X0	20X1
1	**Long term borrowings**			
	9% Debentures (issued at the end of year)		-	9,00,000
	Total		**-**	**9,00,000**
2.	**Other current liabilities**			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		**4,80,000**	**2,70,000**
3	**Property, plant and equipment**			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		**21,20,000**	**32,80,000**
4	**Trade receivables**			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000)	(1,90,000)
	Total		**22,40,000**	**26,40,000**

Additional Information:

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

(ii) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

Solution:

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities		₹	₹
Net Profit		10,40,000	
Add: Adjustment For Depreciation (7,90,000 –6,10,000)		1,80,000	
Add: Adjustment for Provision for Doubtful Debts		2,70,000	
(4,20,000 – 1,50,000)			
Operating Profit Before Working Capital Changes		14,90,000	
Add: Decrease in Inventories		90,000	
(20,10,000 – 19,20,000)			
		15,80,000	
Less: Increase in Current Assets			
Trade Receivables			
(30,60,000 – 23,90,000)	6,70,000		
Prepaid Expenses (1,20,000 – 90,000)	30,000		
Decrease in Current Liabilities:			
Trade Payables (₹ 8,80,000 – ₹ 8,20,000)	60,000		
Expenses Outstanding			
(₹ 3,30,000 – ₹ 2,70,000)	60,000	(8,20,000)	
Net Cash generated from Operating Activities			7,60,000
Cash Flows from Investing Activities			
Investment in Current Investments		(3,20,000)	
Purchase of Plant & Machinery			

TELEGRAM: CA NOTE HUB

(₹ 40,70,000 – ₹ 27,30,000)		
	(13,40,000)	
Net Cash Used in Investing Activities		(16,60,000)
Cash Flows from Financing Activities		
Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000)	1,50,000	
Issue of Debentures	9,00,000	
Payment of Dividend	(1,50,000)	
Net Cash Used in Financing Activities		9,00,000
Net Increase in Cash During the Year		-
Add: Cash and Cash Equivalents as on 1.4.20X0		15,20,000
Cash and Cash Equivalents as on 31.3.20X1		15,20,000

Note:

1. Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

TELEGRAM: CANOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Oct'20)

What do you mean by the term "cash and cash equivalent" as per AS 3? From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-2019.

Particulars	Amount (₹)
Cash balance with Bank	10,000
Fixed Deposit created on 01-11-2018 and maturing on15-07-2019	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund made on 01-03-2019 (having maturity period of less than 3 months)	1,00,000
Bank Balance in a Foreign Currency Account in India	$ 1,000
(Conversion Rate: on the day of deposit ₹ 69/USD; ₹ 70/USD as on 31-03-2019)	
Debentures purchased of ₹ 10 lacs of A Ltd., which are redeemable on 31st October, 2019	90,000
Shares of Alpha Ltd. purchased on 1st January, 2019	60,000

Solution: **(5 Marks)**

As per AS 3, Cash and cash equivalents consists of: (i) Cash in hand and deposits repayable on demand with any bank or other financial institutions and (ii) Cash equivalents, which are short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value. A short-term investment is one, which is due for maturity within three months from the date of acquisition. Investments in shares are not normally taken as cash equivalent, because of uncertainties associated with them as to realizable value.

Computation of Cash and Cash Equivalents as on 31st March, 2019

	₹
Cash balance with bank	10,000
Short term investment in highly liquid sovereign debt mutual fund on 1.3.19	1,00,000
Bank balance in foreign currency account ($1,000 x ₹ 70)	70,000
	1,80,000

Note: Fixed deposit, Shares and Debentures will not be considered as cash and cash equivalents.

Question 2 (MTP Oct'21)

From the following information, prepare the Cash Flow from Financing activities as per AS 3 'Cash Flow Statements' as the accountant of XYZ Limited is not able to decide and seeks your advice:

(i) Received ₹ 4,00,000 as redemption of short-term deposit
(ii) Proceeds of ₹ 20,00,000 from issuance of equity share capital
(iii) Received interest of ₹ 70,000 on Govt. bonds.
(iv) An amount of ₹ 13,00,000 incurred for purchase of goodwill
(v) Proceeds of ₹ 5,00,000 from sale of patent.
(vi) Proceeds of ₹ 12,00,000 from long term borrowing.
(vii) Amount paid for redemption of debentures of ₹ 22,00,000
(viii) Underwriting commission of ₹ 40,000 paid on issue of equity share capital
(ix) Interest of ₹ 1,44,000 paid on long-term borrowing. **(5 Marks)**

Solution:

Statement showing Cash Flow from Financing Activities

		₹
Cash inflow from financing activity		
Proceeds from issuance of equity share capital	20,00,000	
Proceeds from long term borrowings	12,00,000	

TELEGRAM: CA NOTE HUB

Total cash inflow from financing activity		32,00,000
Less: Cash outflow from financing activity		
Amount paid for redemption of debentures	22,00,000	
Underwriting commission paid	40,000	
Interest paid on long-term borrowings	1,44,000	(23,84,000)
Net cash inflow from financing activity		8,16,000

Question 3 (MTP Sep'22, Past Exam May'18)

Classify the following activities as
(i) Operating Activities, (ii) Investing activities, (iii) Financial activities and (iv) Cash Equivalents.

1. Cash receipts from Trade Receivables
2. Highly liquid Marketable Securities without risk of change in value
3. Purchase of investment
4. Proceeds from long term borrowings
5. Wages and Salaries paid
6. Bank overdraft
7. Purchase of Goodwill
8. Interim dividend paid on equity shares
9. Short term Deposits
10. Underwriting commission paid **(5 Marks)**

Solution:

a) Operating Activities: Items 1 and 5.
b) Investing Activities: Items 3,7 and 9
c) Financing Activities: Items 4,6,8 and 10
d) Cash Equivalent: 2

Question 4 (Past Exam Nov'19) (MTP Mar'21, Apr'22, Oct'23)

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019

Particulars	**Amount (Rs.)**
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received form associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of Rs. 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred Rs. 9,600)	90,000

Solution: **(5 Marks)**

Cash Flow Statement from Investing Activities of Subham Creative Limited for the year ended 31-03-2019

Cash generated from investing activities	**Rs.**	**Rs.**
Interest on loan received	70,000	
Pre-acquisition dividend received on investment made	52,600	
Unsecured loans given to subsidiaries	(5,00,000)	

TELEGRAM: CA NOTE HUB

Interest received on investments (gross value)	82,000	
TDS deducted on interest	(8,200)	
Sale of Plant & Machinery ₹ (90,000 – 9,600)	80,400	
Cash used in investing activities (before extra-ordinary item)		(2,23,200)
Extraordinary claim received for loss of machinery		55,000
Net cash used in investing activities (after extra-ordinary item)		(1,68,200)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.

   The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

Question 5 (Past Exam July'21)

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3(Revised) from the following cash account summary:

Cash summary Account

Inflows	**₹ ('000)**	**Outflows**	**₹ ('000)**
Opening Balance	945	Payment to suppliers	54,918
Receipts from Customers	74,682	Purchase of Investments	351
Sale of Investments (Cost ₹ 4,05,000)	459	Property, plant and equipment acquired	6,210
Issue of Shares	8,100	Wages and salaries	1,863
Sale of Property, Plant & equipment	3,456	Payment of Overheads	3,105
		Taxation	6,561
		Dividends	2,160
		Repayment of Bank Overdraft	6,750
		Interest paid on Bank Overdraft	1,350
		Closing Balance	4,374
	87,642		**87,642**

Solution: **(5 Marks)**

Gama Limited Cash Flow Statement for the Year Ended 31st March 2021

Particulars	**Amount (₹'000)**	**Amount (₹'000)**
Cash flow from Operating Activities:		
Cash receipts from customers	74,682	
Cash payments to suppliers	(54,918)	
Cash payments for wages & salaries	(1,863)	
Cash payments of overheads	(3,105)	
Cash Generated from Operations	14,796	
Payment of Taxation	(6,561)	
Net Cash from Operating Activities		8,235
Cash Flow from Investing Activities:		
Proceeds from sale of investments	459	
Proceeds from sale of Property, Plant and Equipment	3,456	
Purchase of Investments	(351)	

TELEGRAM: CA NOTE HUB

Purchase of Property, Plant and Equipment	(6,210)	
Net Cash Used in Investing Activities		(2,646)
Cash Flow from Financing Activities:		
Proceeds from issue of shares	8,100	
Payment of Dividend	(2,160)	
Repayment of Bank Overdraft	(6,750)	
Interest paid on Bank Overdraft	(1,350)	
Net Cash Used in Financing Activities		(2,160)
Net Increase in Cash & Cash Equivalent		3,429
Cash and Cash Equivalent in the Beginning of the year		945
Cash and Cash Equivalent in the end of the year		4374

Question 6 (Past Exam, Dec'21)

Following are the extracts from the Balance Sheet of ABC Ltd.

Liabilities	**31.3.2020**	**31.3.2021**
	(₹)	**(₹)**
Equity Share Capital	25,00,0000	35,60,000
10% Preference Share Capital	7,00,000	6,00,000
Securities Premium Account	5,00,000	5,50,000
Profit & Loss A/c	20,00,000	28,00,000

Equity Share Capital for the year ended 31st March, 2021 includes ₹ 60,000 of equity shares issued to Grey Ltd. at par for supply of Machinery of ₹ 60,000; Profit & Loss account on 31st March, 2021 includes ₹ 50,000 of dividend received on Equity shares invested in X Ltd; Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised) **(5 Marks)**

Solution:

The related items given in the question will appear in the Cash Flow Statement of ABC Limited for the year ended 31st March, 2021 as follows:

	₹	**₹**
Cash flows from operating activities		
Closing Balance as per Profit and Loss Account	28,00,000	
Less: Opening Balance as per Profit and Loss Account	(20,00,000)	
	8,00,000	
Less: Dividend received	50,000	
		7,50,000
Cash flows from investing activities		
Dividend received		50,000
Cash flows from financing activities		
Proceeds from issuance of share capital		
Equity shares issued for cash ₹	10,00,000	
Proceeds from securities premium		
(₹ 5,50,000 – 5,00,000) ₹ 50,000	10,50,000	
Less: Redemption of Preference shares (₹ 7,00,000 – ₹ 6,00,000)	(1,00,000)	9,50,000

Note:

1. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the cash flow statement.
2. ABC Ltd. has been considered as a non-financial company in the given answer.

TELEGRAM: CA NOTE HUB

Question 7 (Past Exam May'22)

The following information is provided by Alpha Limited, for the year ended 31st March, 2022:

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 40 lakhs;
(ii) Depreciation on Fixed Assets ₹ 10 lakhs;
(iii) Discount on issue of Debentures written of ₹ 60,000;
(iv) Interest on Debentures paid ₹ 7,00,000;
(v) Book value of investments ₹ 6 lakhs (Sale of Investments for ₹ 6,40,000);
(vi) Interest received on investments ₹ 1,20,000;
(vii) Compensation received ₹ 1,80,000 by the company in a suit filed.
(viii) Income tax paid ₹ 21,00,000
(ix) Current assets and current liabilities in the beginning and at the end of the year were as detailed below:

	As on 31.3.2021 ₹	As on 31.3.2022 ₹
Stock	24,00,000	26,36,000
Sundry Debtors	4,16,000	4,26,200
Cash in hand	3,92,600	70,600
Bills Receivable	1,00,000	80,000
Bills Payable	90,000	80,000
Sundry Creditors	3,32,000	3,42,600
Outstanding Expenses	1,50,000	1,63,600

You are required to prepare Cash Flow Statement from Operating Activities in accordance with AS-3 (revised) using the indirect method for the year ended 31st March,2022. **(5 Marks)**

Solution:

Alpha Ltd. Cash Flow Statement (from Operating Activities) for the year ended 31st March, 2022

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		40,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	10,00,000	
Discount on issue of debentures	60,000	
Interest on debentures paid	7,00,000	
Interest on investments received	(1,20,000)	
Profit on sale of investments	(40,000)	16,00,000
Operating profit before working capital changes		56,00,000
Adjustments for:		
Increase in inventory	(2,36,000)	
Increase in Sundry Debtors	(10,200)	
Decrease in Bills receivables	20,000	
Increase in Sundry Creditors	10,600	
Increase in Bills payables	(10,000)	
Increase in outstanding expenses	13,600	(2,12,000)
Cash generated from operations		53,88,000
Income tax paid		(21,00,000)
Cash flow from ordinary items		32,88,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,80,000
Net cash flow from operating activities		34,68,000

TELEGRAM: CA NOTE HUB

Question 8 (Past Exam Nov'22)

Ridgeway Limited, a Non-Financial company has the following activities:

(i) Dividend paid for the year.
(ii) TDS on interest income earned on investments made.
(iii) Loans and advances given to suppliers and interest earned from them.
(iv) Deposit with bank for a term of two years.
(v) Highly liquid Marketable Securities (without risk of change in value).
(vi) Investments made and dividends earned on them.
(vii) Insurance claims received against loss of stock or loss of profits.
(viii) Loans and advances given to subsidiaries and interest earned from them.
(ix) Issue of Bonus Shares.
(x) Term loan repaid.

You are required to classify the above activities in Cash Flow Statement as per 'AS-3'; **(5 Marks)**

Solution:

No.		Activities
(i)	Dividend paid for the year	Financing
(ii)	TDS on interest income earned on investments made	Investing
(iii)	Loans and advances given to suppliers and interest earned from them	Operating
(iv)	Deposit with bank for a term of two years	Investing
(v)	Highly liquid Marketable Securities (without risk of change in value)	Cash Equivalent
(vi)	Investments made and dividends earned on them	Investing
(vii)	Insurance claims received against loss of stock or loss of profits	Operating
(viii)	Loans and advances given to subsidiaries and interest earned from them	Investing
(ix)	Issue of Bonus Shares	No Cash Inflow/Cash outflow
(x)	Term Loan repaid	Financing

Question 9 (Past Exam May'23)

The summarized Balance Sheets of Flora Limited for the year ended 31st March, 2022 and 31st March, 2023 are as below:

Assts	31/03/2023 (₹)	31/03/2022 (₹)
Goodwill	15,000	28,000
Land	5,75,000	6,00,000
Furniture and Fixtures	48,000	44,000
Vehicles	22,000	28,000
Office Equipment	21,000	-
Long-term Investments	60,000	1,10,000
Stock-in-hand	96,000	88,000
Bills Receivables	18,150	14,500
Trade Receivables	46,000	52,000
Cash and Bank Balances	1,29,850	34,500
Total	10,31,000	9,99,000

Liabilities	31/03/2023 (₹)	31/03/2022 (₹)

TELEGRAM: CA NOTE HUB

Equity Shares Capital	6,80,000	5,00,000
General Reserves	90,000	60,000
Profit and Loss Account	93,000	52,000
Capital Reserve	75,000	-
8% Debentures of ₹ 100 each	-	3,00,000
Loan from Mr. Andrew	-	15,000
Bills Payables	11,000	13,000
Trade Payables	49,000	45,000
Creditors for Equipment	10,500	-
Outstanding Expenses	4,500	3,000
Provision for Taxation	18,000	11,000
Total	10,31,000	9,99,000

Additional Information:

(i) On 1st April, 2022, one of the vehicles was sold for ₹ 3,000. No new purchases were made during the year.

(ii) A part of the total land was sold for ₹ 1,25,000 (Cost ₹ 1,00,000) and the balance land was revalued. Capital reserve consists of profit on revaluation of balance land. No new purchases were made during the year. (iii) Depreciation provided during the year-

- Furniture and Fixtures ₹ 5,000
- Vehicles ₹ 2,200

(iii) Interim dividend of 5,000 was paid during the year.

(iv) Provision for taxation for the year 2022-2023 was ₹ 16,000.

(v) 8% Debentures were redeemed at par after half year interest payment on 30th September, 2022.

(vi) Part of the long-term investments were sold at a profit of 8,000.

(vii)Interest income received during the year on long-term investment was 6,500.

You are required to prepare Cash Flow Statement from Operating Activities for the year ended 31st March, 2023 using indirect method. (All workings should form part of the answer) **(10 Marks)**

Solution:

Cash Flow Statement of Flora Limited from Operating Activities For the year ended 31st March, 2023

	₹	₹
Net profit before taxation (W.N.1)		92,000
Adjustment: Depreciation on Furniture & Fixtures	5,000	
Depreciation on Vehicles	2,200	
Profit on sale of land (₹ 125000 - ₹ 100000)	(25,000)	
Loss on sale (Vehicle)	800	
Profit on sale of long-term investments	(8,000)	
Interest received	(6,500)	
Interest on debentures	12,000	
Goodwill written off	13,000	(6,500)
Operating profit before working capital changes		85,500
Increase in Stock in Hand	(8,000)	
Increase in Bills Receivables	(3,650)	
Decrease in Trade Receivables	6,000	
Decrease in Bills payable	(2,000)	
Increase in Trade Payables	4,000	
Increase in outstanding expenses	1,500	(2,150)

TELEGRAM: CA NOTE HUB

Cash generated from Operations		83,350
Less: Income taxes paid		9,000
Cash flow from Operating activities		74,350

Alternative presentation:

Cash Flow Statement of Flora Limited from Operating Activities For the year ended 31st March, 2023

		₹
Net profit before taxation (W.N. 1)		92,000
Adjustment: Depreciation on Furniture & fixtures	5,000	
Depreciation on Vehicles	2,200	
Profit on sale of land	(25,000)	
Loss on sale (Vehicle)	800	
Profit on sale of long- term investments	(8,000)	
Interest received	(6,500)	
Interest on debentures	12,000	
Goodwill written off	13,000	(6,500)
Operating profit before working capital changes		85,500
Increase in inventory	(8,000)	
Decrease in Trade receivables*	2,350	
Increase in Trade payables**	2,000	
Increase in outstanding expenses	1,500	(2,150)
Cash generated from Operations		83,350
Less: Income taxes paid		9,000
Cash flow from Operating activities		74,350

*[(18,150 +46,000) - (14,500 + 52,000)] ** [(11,000 49,000) - (13,000+45,000)]

Working Notes:

1. Net Profit before Taxation

Increases in Profit and Loss A/c (93,000-52,000)	41,000
Increases in General Reserve (90,000-60,000)	30,000
Interim dividend Paid	5,000
Transfer – provision for Taxation	16,000
Increase in retained earnings (Net Profit before Taxation)	92,000

2. Provision for Taxation Account

	₹		₹
To Bank (Balancing figure)	9,000	By Balance b/d	11,000
To Balance c/d	18,000	By Profit and loss account	16,000
	27,000		27,000

3. Vehicles Account

Particulars	**(₹)**
Opening Balance	28,000
Less: Depreciation	(2,200)
Less: Closing Balance	(22,000)
Book value of vehicle sold	3,800
Less: Sale Value	(3,000)
Loss on sale of Vehicle	800

Question 10 (RTP Nov '23)

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st

TELEGRAM: CA NOTE HUB

March, 2023 (Using direct method):

(i) Total sales for the year were ₹ 796 crores out of which cash sales amounted to ₹ 524 crores.

(ii) Receipts from credit customers during the year, totalled ₹ 268 crores;

(iii) Purchases for the year amounted to ₹ 440 crores out of which credit purchase was 80%;

Balance in creditors as on 1.4.2022 ₹ 168 crores

31.3.2023 ₹ 184 crores

(i) Suppliers of other consumables and services were paid ₹ 38 crores in cash;

(ii) Employees of the enterprises were paid 40 crores in cash.

(iii) Fully paid 9% Preference shares of the face value of ₹ 64 crores were redeemed; Equity shares of the face value of ₹ 40 crores were allotted as fully paid up at premium of 20%;

(iv) 10% Debentures of ₹ 40 crores at a premium of 10% were redeemed; Debenture holders were issued equity shares in lieu of their debentures.

(v) ₹ 52 crores were paid by way of income tax.

(vi) A new machinery costing ₹ 50 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹ 26 crores; Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 30 crores. The balance was paid in cash to the vendor.

(vii) Investment costing ₹ 36 cores were sold at a loss of ₹ 4 crores;

(viii) Dividends totaling ₹ 30 crores was also paid;

(ix) Debenture interest amounting ₹ 4 crore was paid;

(x) Non-cash expenditure incurred during the current year was 1.2 crores.

(xi) Dividends declared during the current year was 15% on equity share capital (ESC = ₹120 crores);

(xii) On 31st March 2022, Balance with Bank and Cash on hand totalled ₹ 4 crores.

Solution:

Cash flow statement (using direct method) for the year ended 31st March, 2023

	(₹ in crores)	**(₹ in crores)**
Cash flow from operating activities		
Cash sales	524	
Cash collected from credit customers	268	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(502)	
Cash from operations	290	
Less: Income tax paid	(52)	
Net cash from operating activities		238
Cash flow from investing activities		
Net Payment for purchase of Machine (50 – 30)	(20)	
Proceeds from sale of investments	32	
Net cash from investing activities		12
Cash flow from financing activities		
Redemption of Preference shares	(64)	
Proceeds from issue of Equity shares	48	
Debenture interest paid	(4)	
Dividend Paid	(30)	

TELEGRAM: CA NOTE HUB

Net cash used in financing activities		(50)
Net increase in cash and cash equivalents		200
Add: Cash and cash equivalents as on 1.04.2022		4
Cash and cash equivalents as on 31.3.2023		204

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(₹ in crores)
Opening Balance in creditors Account	168
Add: Purchases (440x .8)	352
Total	520
Less: Closing balance in Creditors Account	184
Cash paid to suppliers of goods	336
Add: Cash purchases (440x .2)	88
Total cash paid for purchases to suppliers (a)	424
Add: Cash paid to suppliers of other consumables and services (b)	38
Add: Payment to employees (c)	40
Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)]	502

Question 11 (RTP May'24)

From the following particulars calculate cash flows from Operating activities:

Particulars	**₹**
Retained earning	17,000
Depreciation	4,000
Loss on Sale of Machinery	3,000
Provision for tax	7,000
Interim Dividend paid during the year	10,000
Dividend paid during the year	8,000
Premium payable on redeemable Preference Shares	2,000
Profit on sale of investment	10,000
Refund of tax	1,000

Additional Information:

	31.3.22 ₹	**31.3.23 ₹**
Trade Receivable	10,000	12,000
Trade Payable	7,000	15,000
Provision for Tax	4,000	7,000
Prepare Expenses	2,000	1,000
Outstanding Expenses	1,400	1,000

Solution:

Calculation of Cash Flow from Operating Activities

Particulars	**Amount ₹**
Retained earnings	17,000
Add: Depreciation	4,000

TELEGRAM: CA NOTE HUB

Add: Loss on sale of Machinery	3,000
Add: Premium Payable on redeemable Preference Shares	2,000
Add: Dividend paid	8,000
Add: Interim dividend paid during the year	10,000
Add: provision for tax made during the current year	7,000
Less: Refund of tax	(1,000)
Less: Profit on Sale of Investment	(10,000)
Operating Profit before Working Capital Changes	40,000
Add: Decrease in Prepaid Expenses	1,000
Less: Increase in Trade receivable	(2,000)
Add: Increase in Trade Payable	8,000
Less: Decrease in Outstanding Expenses	(400)
Cash generated from (Net of refund) operation	46,600
Less: Income tax paid (4,000 – 1,000)	(3,000)
Net Cash flow operating activities	**43,600**

TELEGRAM: CA NOTE HUB

MCQs

1. While preparing cash flow statement, conversion of debt to equity

(a) Should be shown as a financing activity.

(b) Should be shown as an investing activity.

(c) Should not be shown as it is a non-cash transaction

(d) Should not be shown as operating activity.

2. Which of the following would be considered a 'cash-flow item from an "investing" activity'?

(a) Cash outflow to the government for payment of taxes.

(b) Cash outflow to purchase bonds issued by another company.

(c) Cash outflow to shareholders as dividends

(d) Cash outflow to make payment to trade payables.

3. All of the following would be included in a company's operating activities except:

(a) Income tax payments

(b) Collections from customers or Cash payments to suppliers

(c) Dividend payments

(d) Office and selling expenses.

4. Hari Uttam, a stock broking firm, received ₹ 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?

(a) Operating Activities.

(b) Investing Activities.

(c) Financing Activities.

(d) Non-cash transaction

5. As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as

(a) Operating activity.

(b) Financing activity.

(c) Investing activity.

(d) Non-cash transaction

ANSWERS/ HINTS

MCQ

1. (c) **2.** (b) **3.** (c) **4.** (a) **5.** (c)

TELEGRAM: CA NOTE HUB

Chapter 32 BUY BACK OF SECURITIES

Question 1 NB Pg. No.

M Ltd. furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	₹ (in 000)
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	5,000
	B	Reserves and Surplus	2	6,310
2		Non-current liabilities		
		Long term borrowings	3	400
3		Current liabilities		
	A	Trade Payables		40
		Total		**11,750**
		Assets		
1		Non-current assets		
	A	Property, plant and Equipment	4	2,750
	B	Non-Current Investments (at cost)		5,000
2		Current assets		
	A	Inventories		1,000
	B	Trade receivables		2,000
	C	Cash and Cash equivalents		1,000
		Total		**11,750**

Notes to accounts

No.	Particulars	₹ in ('000)
1	Share Capital	
	Authorized, Issued and Subscribed Capital:	
	3,00,000 Equity shares of ₹ 10 each fully paid up	3,000
	20,000 9% Preference Shares of 100 each	2,000
	Total	5,000
2	Reserves and Surplus	
	Capital reserve	10
	Revenue reserve	4,000
	Securities premium	500
	Profit and Loss account	1,800
	Total	6,310
3	Long term borrowings	
	10% Debentures 400	
4	Property, Plant and Equipment (PPE)	

	PPE: Cost	3,000
	Less: Provision for depreciation	(250)
	Net carrying value	2,750

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs. You are required to pass necessary Journal entries.

Solution

Journal Entries in the books of M Ltd.

₹ in '000

	Particulars		Dr.	Cr.
1.	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buyback of Equity Shares)			
2.	Equity share capital A/c	Dr.	600	
	Premium payable on buy-back	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
3.	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back of equity shares)			
4.	Securities Premium A/c	Dr.	300	300
	To Premium payable on buy-back			
	(Being premium payable on buy-back charged from Securities premium)			
5.	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c			600
	(Being creation of capital redemption reserve to the extent of the equity shares bought back)			

Question 2 (RTP May '23) NB Pg. No.

Anu Ltd. (a non-listed company) furnishes you with the following balance sheet as at 31st March, 20X1:

(in crores ₹)

		Particulars	Notes	₹ (in 000)
1		Equity and Liabilities		
		Shareholders' funds		
	A	Share capital	1	100
	B	Reserves and Surplus	2	300

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TELEGRAM: CA NOTE HUB

2		Current liabilities		
	A	Trade Payables		40
		Total		440
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
2		Current assets		
	A	Trade receivables		140
	B	Cash and Cash equivalents		200
		Total		440

Notes to accounts

No.	Particulars		₹
1	Share Capital		
	Authorized, issued and subscribed share capital:		
	12% Redeemable preference shares of ₹ 100 each, fully paid up		75
	Equity shares of ₹ 10 each, fully paid up		25
	Total		100
2	Reserves and Surplus		
	Capital reserve		15
	Securities premium		25
	Revenue reserves		260
	Total		300
3	Property, Plant and Equipment		
	PPE Cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		NIL
4	Non-Current Investments		
	Non-current investments at cost (Market value ₹ 400 Cr.)		100

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

(i) Pass journal entries to record the above.

(ii) Prepare balance sheet as at 1.4.20X1.

Solution

(i) Journal entries in the books of Anu Ltd.

(in crores ₹)

	Particulars		Dr.	Cr.
1st April, 20X1	12% Preference share capital A/c	Dr.	75	
	To Preference shareholders A/c			75
	(Being preference share capital account transferred to shareholders account)			
	Preference shareholders A/c	Dr.	75	
	To Bank A/c			75
	(Being payment made to shareholders)			
	Shares buy-back A/c	Dr.	25	
	To Bank A/c			25
	(Being 50 lakhs equity shares bought back @ ₹ 50 per share)			
	Equity share capital A/c (50 lakhs x ₹ 10)	Dr.	5	
	Securities premium A/c (50 lakhs x ₹ 40)	Dr.	20	
	To Shares buy-back A/c			25
	(Being cancellation of shares bought back)			
	Revenue Reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5)			80
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

(ii) Balance Sheet of Anu Ltd as at 1.4.20X1

(in crores ₹)

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

TELEGRAM: CA NOTE HUB

Notes to accounts

No	Particulars		₹
1	Share Capital		
	Authorized, issued and subscribed share capital 200 lakhs Equity shares of ₹ 10 each fully paid		20
	Total		20
2	Reserves and Surplus		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3	Property, plant and Equipment		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4	Non-Current Investments		
	Non-current investments at cost		100
	(Market value ₹ 400 Crores)		
5	Cash and Cash Equivalents		
	Cash and Cash Equivalents as on 31.3.20X1		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

Question 3 (RTP May'24)

NB Pg. No.

KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**		
	B	Reserves and Surplus	1	1,200
2		**Non-current liabilities**	2	810
		Long term borrowings		
3		**Current liabilities**	3	750
	A	Trade Payables		
	B	Other Current Liabilities		745
		Total		195
		Assets		3,700
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026

TELEGRAM: CA NOTE HUB

	B	Non-current Investments		74
2		**Current assets**		
	A	Inventories		600
	B	Trade receivables		260
	C	Cash and Cash equivalents		740
		Total		3,700

Notes to accounts

No.	Particulars	₹
1	**Share Capital**	
	Authorized, issued and subscribed capital	
	Equity share capital (fully paid up shares of ₹ 10 each)	1,200
2	**Reserves and Surplus**	
	Securities premium	175
	General reserve	265
	Capital redemption reserve	200
	Profit & loss A/c	170
	Total	810
3	**Long term borrowings**	
	12% Debentures	750
4	**Property, plant and equipment**	
	Land and Building	1,800
	Plant and machinery	226
	Net carrying value	2,026

On 1st April, 20X1, the company announced the buy-back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 75 lakhs.

On 5th April, 20X1, the company achieved the target of buy-back. On 30th April, 20X1 the company issued one fully paid up equity share of ₹ 10 by way of bonus for every four equity shares held by the equity shareholders.

You are required to:

1) Pass necessary journal entries for the above transactions.
2) Prepare Balance Sheet of KG Limited after bonus issue of the shares.

Solution:

In the books of KG Limited

Journal Entries

Date	Particulars		Dr.	Cr.
20X1			**(₹ in lakhs)**	
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	300	

TELEGRAM: CA NOTE HUB

	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450
	(Being the amount due to equity shareholders on buy-back)			
April 5	General reserve A/c	Dr.	265	
	Profit and Loss A/c	Dr.	35	
	To Capital redemption reserve A/c			300
	(Being amount equal to nominal value of buyback shares from free reserves transferred to capital redemption reserve account as per the law)			
April 30	Capital redemption reserve A/c	Dr.	225	
	To Bonus shares A/c (W.N.1)			225
	(Being the utilization of capital redemption reserve to issue bonus shares)			
	Bonus shares A/c	Dr.	225	
	To Equity share capital A/c			225
	(Being issue of one bonus equity share for every four equity shares held)			

Balance Sheet

(After buy-back and issue of bonus shares)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,125
	B	Reserves and Surplus	2	436
2		**Non-current liabilities**		
		Long term borrowings		3 750
3		**Current liabilities**		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,251
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026
2		**Current assets**		
	A	Inventories		600
	B	Trade receivables		260
	C	Cash and Cash equivalents		365
		Total		3,251

TELEGRAM: CA NOTE HUB

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹10 each)		1,125
2	**Reserves and Surplus**		
	General Reserve		
	Less: Transfer to CR	265	
	Capital Redemption Reserve	(265)	-
	Add: Transfer due to buy-back of shares from P/L	200	
	Add; Transfer due to buy-back of shares from General Reserve	35	
	Less: Utilisation for issue of bonus shares	265	
	Securities premium	(225)	275
	Less: Adjustment for premium paid on buyback	175	
	Profit & Loss A/c	(150)	25
	Add: Profit on sale of investment	170	
	Less: Transfer to CRR	1	
	Total	(35)	136
			436
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, Plant and Equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working Notes:

1) Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹ 225 lakhs

2) Cash at bank after issue of bonus shares

Particulars	₹ in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

Note: In the given solution, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

NB Pg. No.

Question 4 (RTP Nov'18)

Dee Limited (a non-listed company) furnishes the following Balance Sheet as at 31st March, 20X1:

(in thousand ₹)

		Particulars	Notes	₹
		Equity and Liabilities		

TELEGRAM: CA NOTE HUB

1		Shareholders' funds		
	A	Share capital	1	2,700
	B	Reserves and Surplus	2	9,700
2		Current liabilities		
	A	Trade Payables		1,400
		Total		13,800
		Assets		
1		Non-current assets		
	A	Property, plant and Equipment		9,300
	B	Non-Current Investments		3,000
2		Current assets		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		800
		Total		13,800

Notes to accounts

No.	Particulars		₹
1	Share Capital		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,500
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy-back)		-----
	Total		2,700
2	Reserves and Surplus		
	Capital reserve		1,000
	Revenue reserve		3,000
	Securities premium		2,200
	Profit and loss account		3,500
	Total		9,700

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

You are required to pass necessary journal entries and prepare the Balance Sheet.

Solution

Journal Entries in the books of Dee Limited

(in thousand ₹)

	Particulars		Dr.	Cr.
(i)	Bank Account	Dr.	2,200	
	Profit and Loss Account	Dr.	800	
	To Investment Account			3,000
	(Being the investments sold at loss for the purpose of buy-back)			

TELEGRAM: CA NOTE HUB

(ii)	Equity Share buy-back Account	Dr.	2,500	
	To Bank Account			2,500
	(Being the payment made on buy-back)			
(iii)	Equity Share Capital Account	Dr.	500	
	Premium Payable on Buy-Back Account	Dr.	2,000	
	To Equity Shares Buy-Back Account			2,500
	(Being the buy-back amount allocated to equity share capital)			
(iv)	Securities premium Account	Dr.	2,000	
	To Premium payable on buy-back Account			2,000
	(Being the premium payable on buy-back adjusted against securities premium account)			
(v)	Revenue reserve Account	Dr.	300	
	To Capital Redemption Reserve Account			300
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)			

Balance Sheet of Dee Limited as at 1st April, 20X1

(After buy-back of shares)

(in thousand ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,200
	B	Reserves and Surplus	2	6,900
2		**Current liabilities**		
	A	Trade Payables		1,400
		Total		10,500
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		9,300
2		**Current assets**		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		500
		Total		10,500

Notes to accounts

No.	Particulars		₹
1	Share Capital		
	Authorized, issued and subscribed capital:		

Ak Hai Bhaisaahaab ! TELEGRAM: CA NOTE HUB

	2,50,000 Equity shares of ₹ 10 each fully paid up		2,000
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buyback)		2,200
	Total		
2	Reserves and Surplus		
	Capital reserve		1,000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	
	Less: Loss on investment	(800)	2,700
	Total		6,900

Question 5

NB Pg. No.

Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March 20X1:

(in lakhs ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	120
	B	Reserves and Surplus	2	118
2		**Non-current liabilities**		
		Long term borrowings	3	4
3		**Current liabilities**		
	A	Trade Payables		70
		Total		312
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50
	B	Non-current Investments		120
2		**Current assets**		
	A	Cash and Cash equivalents		142
		Total		312

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity shares of ₹ 10 each fully paid		100

TELEGRAM: CA NOTE HUB

	9% Redeemable preference shares of ₹ 100 each fully paid		20
	Total		120
2	**Reserves and Surplus**		
	Capital reserves		8
	Revenue reserves		50
	Securities premium		60
	Total		118
3	**Long term borrowings**		
	10% Debentures		4

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share. The payment for the above was made out of huge bank balances.

(iii) Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.

(iv) The company had 1,00,000 equity stock options outstanding on the above mentioned date, to the employees at ₹ 20 when the market price was ₹30 (This was included under current liabilities) On 1.04.20X1 employees exercised their options for 50,000 shares.

(a) Pass the journal entries to record the above.

(b) Prepare Balance Sheet as at 01.04.20X1.

Solution

(₹ in lakhs)

Date	Particulars		Debit	Credit
20X1 1st April	9% Redeemable preference share capital A/c	Dr.	20.00	
	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.		
	To Bank A/c			
	(Being payment made to shareholders)		22.00	
				22.00
	Equity shares buy-back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs equity shares of ₹ 10 each bought back @ ₹ 30 per share)			
	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy-back A/c			90.00
	(Being cancellation of shares bought back)			

TELEGRAM: CA NOTE HUB

	Revenue reserve A/c Dr.	50.00	
	To Capital redemption reserve A/c		50.00
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)		
	10% Debentures A/c Dr.	2.20	
	To Investment (own debentures) A/c		2.00
	To Profit on cancellation of own debentures A/c		0.20
	(Being cancellation of own debentures costing ₹ 2 lakhs, face value being ₹ 2.20 lakhs and the balance being profit on cancellation of debentures)		
	Bank A/c Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c Dr.	5.00	
	To Equity share capital A/c		5.00
	To Securities premium A/c		10.00
	(Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)		
	Securities premium A/c Dr.	2.00	
	To Premium on redemption of preference shares A/c		2.00
	(Being premium on redemption of preference shares adjusted through securities premium)		

Balance Sheet of Extra Ltd. as at 01.04.20X1

(in lakhs ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	75.00
	B	Reserves and Surplus	2	66.20
2		**Non-current liabilities**		
		Long term borrowings	3	1.80
3		**Current liabilities**		
	A	Other Current Liabilities	4	65.00
		Total		208
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50.00
	B	Non-current Investments	5	118.00
2		**Current assets**		
	A	Cash and Cash equivalents	6	40.00
		Total		208

TELEGRAM: CA NOTE HUB

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Equity shares of ₹ 10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance		
	Add: Profit on cancellation of debentures	8.00	
	Revenue reserves	0.20	8.20
	Opening balance		
	Less: Creation of Capital Redemption Reserve	50.00	
	Securities Premium	(50.00)	-
	Opening balance		
	Less: Adjustment for cancellation of equity shares	60.00	
	Less: Adjustment for premium on redemption of preference shares	(60.00)	
	Add: Shares issued against ESOP at premium	(2.00)	
	Capital Redemption Reserve	10.00	8.00
	Total		50.00
			66.20
3	**Long term borrowings**		
	10% Debentures		4.00
	Less: Cancellation of own debentures		(2.20)
	Total		1.80
4.	**Other Current liabilities**		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		(5.00)
	Total		65.00
5.	**Non-current investments**		
	Opening balance		120.00
	Less: Investment in own debentures		(2.00)
	Total		118.00
6.	**Cash and Cash Equivalents**		
	Opening balance		142.00
	Less: Payment to preference shareholders		(22.00)
	Less: Payment to equity shareholders		(90.00)
	Add: Share price received against ESOP		10.00
	Total		40.00

TELEGRAM: CA NOTE HUB

Question 6 (MTP Oct'20, Oct'21, Oct'23, RTP May'20) NB Pg. No.

The following was the summarized balance sheet of Bhoomi Ltd. as on 31st March, 2020:

Equity & liability	Rs (in lakhs)	Assets	Rs (in lakhs)
Authorised Capital:		Property, plant and equipment	1,12,000
Equity shares of Rs 10 each	80,000	Investments	24,000
Issued Capital		Cash at Bank	13,200
Equity Shares of Rs10 each Fully Paid up	64,000		
Trade Receivables	66,000		
10% Redeemable Preference Shares of 10 each, Fully Paid Up	20,000		
Reserves & Surplus:			
Capital Redemption Reserve	8,000		
Securities Premium	6,400		
General Reserve	48,000		
Profit & Loss Account	2,400		
9% Debentures	40,000		
Trade Payables	26,400		
	2,15,200		**2,15,200**

On 1st April,2020 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 25% of its Equity Shares at Rs 20 per Share. In order to make Cash available, the Company sold all the Investments for Rs 25,000 Lakhs and raised a Bank Loan amounting to Rs 16,000 lakh on the Security of the Company's Plant. Give the necessary Journal Entries considering that the buy back is authorized by the articles of company and necessary resolution is passed by the company for this. The amount of Securities premium may be utilized to the maximum extent allowed by law.

(8 Marks)

Solution:

Journal entries In the books of Bhoomi Ltd.

		Dr.	Cr.
		(₹ in lakhs)	
1	Bank A/c Dr.	25,000	
	To Investments A/c		24,000
	To Profit and Loss A/c		1,000
	(Being Investments sold and, profit being credited to Profit and Loss Account)		
2	10% Redeemable Preference Share Capital A/c Dr.	20,000	
	Premium payable on Redemption of Preference Shares A/c Dr.	2,000	
	To Preference Shareholders A/c		**22,000**
	(Being amount payable on redemption of Preference shares, at a Premium of 10%)		
3	Securities Premium A/c Dr.	2,000	

TELEGRAM: CA NOTE HUB

	To Premium payable on Redemption of Preference Shares A/c			2,000
	(Being Securities Premium utilised to provide Premium on Redemption of Preference Shares)			
4	Equity Share Capital A/c	Dr.	16,000	
	Premium payable on Buyback A/c	Dr.	16,000	
	To Equity Share buy back A/c			32,000
	(Being the amount due on buy-back)			
5	Securities Premium A/c (6,400 – 2,000)	Dr.	4,400	
	General Reserve A/c (balancing figure)	Dr.	11,600	
	To Premium payable on Buyback A/c			16,000
	(Being premium on buyback provided first out of Securities Premium and the balance out of General Reserves.)			
6	Bank A/c	Dr.	16,000	
	To Bank Loan A/c			16,000
	(Being Loan taken from Bank to finance Buyback)			
7	Preference Shareholders A/c	Dr.	22,000	
	Equity Shares buy back A/c	Dr.	32,000	
	To Bank A/c			54,000
	(Being payment made to Preference Shareholders and Equity Shareholders)			
8	General Reserve Account	Dr.	36,000	
	To Capital Redemption Reserve Account			36,000
	(Being amount transferred to Capital Redemption Reserve Account to the extent of face value of preference shares redeemed and equity Shares bought back) (20,000 + 16,000)			

Question 7 (MTP Nov'21, Apr'23) NB Pg. No.

SM Limited gives the following information as on 31st March, 2020:

		Rs
Share capital		
(60,000 Equity Shares of Rs 10 Each)		6,00,000
Reserve & Surplus:		
Security premium		70,000
General reserve		63,000
Profit and Loss		1,40,000
Non-current liability:		
9% debentures (secured)		3,00,000
Current Liabilities:		
Term loan		40,000
Creditors		65,000
Provision for taxation		15,000

TELEGRAM: CA NOTE HUB

Property plant and equipment		6,00,000
Non-current investment		1,50,000
Current assets:		
Stock		2,00,000
Debtors		2,60,000
Bank		83,000

The shareholders adopted the resolution on 31st March, 2020 to:

(i) Buy back 25% of the paid up capital @ Rs 15 each.

(ii) Issue 10% debentures of Rs 60,000 at a premium of 10% to finance the buyback of shares.

(iii) Maintain a balance of Rs 20,000 in General Reserve.

(iv) Sell investments worth Rs 1,00,000 for Rs 80,000.

(v) Buy back expenses were Rs 2,000.

You are required to pass necessary journal entries to record the above transactions and prepare Ledger account of Bank. **(8 Marks)**

Solution:

In the books of SM Limited Journal Entries

Particulars		Dr.	Cr.
		Rs	Rs
1. Equity share capital A/c (15,000 x Rs10)	Dr.	1,50,000	
Premium on buyback A/c (15,000 x Rs5)	Dr.	75,000	
To Equity shares buy back or Equity Shareholders A/c (15,000 x Rs15)			2,25,000
(Being the amount due to equity shareholders on buy back)			
2. Equity shares buy back/Equity shareholders A/c	Dr.	2,25,000	
To Bank A/c			2,25,000
(Being the payment made on account of buy back of 15,000 Equity Shares as per the Companies Act)			
3. Bank A/c	Dr.	66,000	
To 10 % Debentures A/c			60,000
To Securities Premium A/c			6,000
(Being 14 % debentures issued to finance buy back)			
4. Buyback Expenses A/c	Dr.	2,000	
To Bank A/c			2,000
(Buyback expenses paid)			
5. Bank A/c	Dr.	80,000	
Profit and Loss A/c (Loss on sale of investment)		20,000	
To Investment A/c			1,00,000
(Being investment sold at loss)			
6. General reserve	Dr.	43,000	
Profit and Loss A/c	Dr.	1,07,000	
To Capital redemption reserve A/c			1,50,000

TELEGRAM: CA NOTE HUB

(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)			
7. Securities Premium	Dr.	75,000	
Profit and Loss A/c	Dr.	2,000	
To Premium on buyback			75,000
To Buyback Expenses A/c			2,000
(Being premium on buyback and buyback expenses charged to securities premium and profit and loss account)			

Bank Account

Particulars	Amount (Rs)	Particulars	Amount (Rs)
To Balance b/d To	83,000	By Equity Shareholders A/c	2,25,000
Investment A/c	80,000	By Expenses on buy back of shares	2,000
To 10% Debentures and Securities premium	66,000	By Balance c/d	2,000
Total	2,29,000	Total	2,29,000

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of Rs 1,50,000 has been credited to CRR while solving the Question.

Question 8 (PYQ Nov'19) (RTP Nov'21) NB Pg. No.

X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2018.

Liabilities	(in ₹)	(in ₹)
Share Capital		
Equity Share Capital of ₹ 20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹ 100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	20,00,000	
Dividend Equalization Fund	5,50,000	43,50,000
Non-Current Liabilities		
12% Debenture		12,50,000
Current Liabilities and Provisions		5,50,000
Total		1,21,50,000
Assets		
Fixed Assets		
Tangible Assets		1,00,75,000

TELEGRAM: CA NOTE HUB

Current Assets	3,00,000	
Investment	2,00,000	
Inventory	15,75,000	20,75,000
Cash and Bank		1,21,50,000
Total		

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

1) Buy back 25% of the paid up capital and i was decided to offer a price of 20% over market price. The prevailing market value of the company's share is Rs. 30 per share.
2) To finance the buy back of share company :
   a. Issue 3000, 14 % debenture of 100 each at a premium of 20%
   b. Issue 2500, 10 % preference share of Rs. 100 each
3) Sell investment worth Rs. 1,00,000 for Rs. 1,50,000.
4) Maintain a balance of Rs. 2,00,000 in Revenue Reserve.
5) Later the company issue three fully paid up equity share of Rs. 20 each by way of bonus share for every 15 equity share held by the equity shareholder.

You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back. **(15 Marks)**

Solution:

In the books of X Limited Journal Entries

Particulars	Dr.	Cr.
	₹	₹
1. Bank A/c Dr.	3,60,000	
To 14 % Debenture A/c		3,00,000
To Securities Premium A/c		60,000
(Being 14 % debentures issued to finance buy back)		
2. Bank A/c Dr.	2,50,000	
To 10% preference share capital A/c		2,50,000
(Being 10% preference share issued to finance buy back)		
3. Bank A/c Dr.	1,50,000	
To Investment A/c		1,00,000
To Profit on sale of investment (Being investment sold on profit)		50,000
4. Equity Share Capital A/c (62,500 x ₹20) Dr.	12,50,000	
Securities premium A/c (62,500 x ₹16) Dr.	10,00,000	
To Equity shares buy back A/c (62,500 x ₹36)		22,50,000
(Being the amount due to equity shareholders on buy back)		
5. Equity shares buy back A/c Dr.	22,50,000	
To Bank A/c		22,50,000
(Being the payment made on account of buy back of 62,500 Equity Shares as per the Companies Act)		
6. Revenue reserve Dr.	3,00,000	
Securities premium Dr.	2,60,000	

TELEGRAM: CA NOTE HUB

Profit and Loss A/c Dr.	4,40,000	
To Capital redemption reserve A/c*		10,00,000
(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law) [12,50,000 less 2,50,000]		
7. Capital Redemption Reserve A/c Dr.	7,50,000	
To Bonus shares A/c (W.N.1)		7,50,000
(Being the utilization of capital redemption reserve to issue 37,500 bonus shares)		
8. Bonus shares A/c Dr.	7,50,000	
To Equity share capital A/c		7,50,000
(Being issue of 3 bonus equity share for every 15equity shares held)		

*Alternatively, entry for combination of different amounts (from Revenue reserve, Securities premium and profit and Loss account.) may be passed for transferring the required amount to CRR.

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other **specified securities** shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other **specified securities**. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of Rs; 10,00,000 (after deducting only pref. share capital) has been credited to CRR while solving the question.

Balance Sheet (After buy back and issue of bonus shares)

I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	57,50,000
(b) Reserves and Surplus	2	27,10,000
(2) Non-Current Liabilities	3	
(a) Long-term borrowings		15,50,000
(3) Current Liabilities		
(a) Trade payables –		
(b) current liabilities & Provisions		5,50,000
Total		**1,05,60,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		1,00,75,000
(2) Current assets		
(a) Investments		2,00,000
(b) Inventory		2,00,000
(c) Cash and cash equivalents (W.N. 2)		85,000
Total		**1,05,60,000**

Notes to Accounts

				₹
1	Share Capital			

TELEGRAM: CA NOTE HUB

	Equity share capital (Fully paid up shares of ₹ 20 each)			
	(2,50,000–62,500+37,500 shares)		45,00,000	
	10% preference shares @ ₹ 100 each (10,00,000 + 2,50,000)		12,50,000	57,50,000
2.	Reserves and Surplus			
	Capital Reserve		1,00,000	
	Revenue reserve		2,00,000	
	Securities premium	12,00,000		
	Add: Premium on debenture	60,000		
	Less: Adjustment for premium paid on buy back	(10,00,000)		
	Less: Transfer to CRR	(2,60,000)	Nil	
	Capital Redemption Reserve			
	Transfer due to buy-back of shares from P&L			
		10,00,000		
	Less: Utilisation for issue of bonus shares	(7,50,000)	2,50,000	
	Profit & Loss A/c	20,00,000		
	Add: Profit on sale of investment	50,000		
	Less: Transfer to CRR	(4,40,000)	16,10,000	
	Dividend equalization reserve		5,50,000	27,10,000
3	Long-term borrowings – 12% Debentures	12,50,000		
	- 14% Debentures	3,00,000		15,50,000

Working Notes:

1. Amount of bonus shares = [(2,50,000 -25%)3/15] x 20 = 37,500 × 20=7,50,000
2. Cash at bank after issue of bonus shares

	Rs.
Cash balance as on 30.3.2018	15,75,000
Add: Issue of debenture	3,60,000
Add: issue of preference shares	2,50,000
Add: Sale of investments	1,50,000
	23,35,000
Less: Payment for buy back of shares (22,50,000)	85,000

Question 9 (PYQ Jan'21) NB Pg. No.

The Directors of Umang Ltd. passed a resolution to buyback 5,00,000 of its fully paid equity shares of ₹ 10 each at ₹ 15 per share. This buyback is in compliance with the provisions of the Companies Act, 2013.

For this purpose, the company

(i) Sold its investments of ₹ 30,00,000 for ₹ 25,00,000.

(ii) Issued 20,000, 12% preference shares of ₹ 100 each at par, the entire amount being payable with application.

TELEGRAM: CA NOTE HUB

(iii) Used ₹ 15,00,000 of its Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back.

(iv) The company has necessary cash balance for the payment to shareholders.

You are required to pass necessary Journal Entries (including narration) regarding buy- back of shares in the books of Umang Ltd. **(5 Marks)**

Solution:

Journal Entries in the books of Umang Ltd.

	Particulars		Dr.	Cr.
1.	Bank A/c	Dr.	25,00,000	
	Profit and Loss A/c	Dr.	5,00,000	
	To Investment A/c			30,00,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	Bank A/c	Dr.	20,00,000	
	To 12% Pref. Share capital A/c			20,00,000
	(Being 12% Pref. Shares issued for ₹ 20,00,000)			
3.	Equity share capital A/c	Dr.	50,00,000	
	Premium payable on buy-back	Dr.	25,00,000	
	To Equity shares buy-back A/c			75,00,000
	Equity shareholders A/c			
	(Being the amount due on buy-back of equity shares)			
4.	Equity shares buy-back A/c/ Equity shareholders A/c	Dr.	75,00,000	
	To Bank A/c			75,00,000
	(Being payment made for buy-back of equity shares)			
5.	Securities Premium A/c General Dr.		15,00,000	
	Reserve A/c	Dr.	10,00,000	
	To Premium payable on buy-back			25,00,000
	(Being premium payable on buy-back charged from Securities premium)			
6.	General Reserve A/c	Dr.	30,00,000	
	To Capital Redemption Reserve A/c			30,00,000
	(Being creation of capital redemption reserve to the extent of the equity shares bought back after deducting fresh pref.shares issued)			

Question 10 (MTP Mar'23, Sep'23) (RTP Nov'20 MTP Sep'23) NB Pg. No.

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 20X1:

Particulars	₹	₹
Equity Share Capital (shares of ₹ 10 each fully paid		30,00,000
Reserves & Surplus		

TELEGRAM: CA NOTE HUB

General Reserve	32,50,000	
Security Premium Account	6,00,000	
Profit & Loss Account	4,30,000	
Revaluation Reserve	6,20,000	49,00,000
Loan Funds		42,00,000

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy-back is ₹ 30 per share. **(10 Marks)**

Solution

Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	21,00,000
(c)	Present equity shareholders fund (₹ in crores)	72,80,000
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000
		(72,80,000–12,95,000)
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	₹
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

   Equation 1 : (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity.

   $(72,80,000 - x) - 21,00,000 = y$ (1)

   Since $51,80,000 - x = y$

   Equation 2: $\left(\frac{\text{Maximum buy -back}}{\text{Offer price for buy -back}} \times \text{Nominal Value}\right)$

   = Nominal value of the shares bought –back to be transferred to CRR

   Equation 2: $\left(\frac{y}{30} \times 10\right) == x$

   $3x = y$ (2)

TELEGRAM: CA NOTE HUB

x = ₹ 12,95,000 crores and y
= ₹ 38,85,000 crores

Question 11 : (PYQ Sept.24) NB Pg. No.

Aerodots Ltd. has the following capital structure as on 31.03.2024 :

Particulars	Amount (Rs. in thousands)
Equity Share Capital (shares of Rs.10 each)	600
Reserves:	
General Reserve	540
Securities Premium	200
Profit & Loss	100
Revaluation Reserve	30
Investment Allowance Reserve (Statutory Reserve)	75
Infrastructure Development Reserve	25
Loan Funds	2000

On 1st April, 2024 the company wants to buy back 14,000 equity shares of Rs.10 each at Rs.30 per Equity share.

You are required to calculate maximum permissible number of equity shares that can be bought back.

Buy Back of shares is duly authorized by its articles and necessary resolution has been passed by the company. **(7 Marks)**

Solution :

Statement determining the maximum number of shares to be bought back

(in thousands)

Particulars	Number of shares
Shares Outstanding Test (W.N.1)	15
Resources Test (W.N.2)	12
Debt Equity Ratio Test (W.N.3)	11
Maximum number of shares that can be bought back [least of the above]	11

Thus, the lowest being 11,000 shares, the company cannot buy back 14,000 shares.

Working Notes:

1. **Shares Outstanding Test**

Particulars	(Shares in thousands)
Number of shares outstanding	60
25% of the shares outstanding	15

TELEGRAM: CA NOTE HUB

2. Resources Test

Particulars	Rs.(in thousands)
Paid up capital	600
Free reserves (540 + 200 +100)	840
Shareholders' funds	1,440
25% of Shareholders fund	360
Buy-back price per share	Rs.30
Number of shares that can be bought back	12,000 shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

Particulars	Rs. in thousands
(a) Loan funds	2,000
(b) Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs.) (a/2)	1,000
(c) Present equity shareholders fund (Rs.)	1,440
(d) Future equity shareholders fund (Rs.) (see W.N.4) (1,440–110)	1,330
(E) Maximum permitted buy-back of Equity (Rs.) [(d) – (b)]	330
(F) Maximum number of shares that can be bought back @ Rs.30 per share	11,000 shares

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

$= (1,440 - x) - 1,000 = y$

$= 440 - x = y(1)$

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

$y/30 \times 10 = x$

Or

$3x = y \quad (2)$

by solving the above two equations we get

x = Rs.110 thousands

y = Rs.330 thousands

Alternatively, Maximum number of shares from debt equity ratio test may be worked out as follows:

Buy-back price + Face value of equity shares = Rs.30 + Rs.10 = Rs.40

Excess of equity fund over the minimum equity to be maintained 1440–1000 = 440 thousands

Number of Shares that can be bought back = 440/40 thousands = 11 thousands.

TELEGRAM: CA NOTE HUB

Question 12

Following is the Balance Sheet of Competent Limited as at 31st March, 20X1: NB Pg. No.

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	12,50,000
	B	Reserves and Surplus	2	18,75,000
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000
3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		76,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets		30,00,000
		Total		76,50,000

Notes to accounts

	No. Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		
2	**Reserves and Surplus**		12,50,000
	Securities premium		2,50,000
	Profit and loss account		1,25.000
	Revenue reserve		15,00,000
	Total		18,75,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

The company wants to buy-back 25,000 equity shares of ₹ 10 each, on 1st April, 20X1 at ₹ 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy-back of shares by company is within the provisions

TELEGRAM: CA NOTE HUB

of the Companies Act, 2013. If yes, pass necessary journal entries towards buy-back of shares and prepare the Balance Sheet after buy-back of shares.

Solution:

Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	(Shares)
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000
25% of Shareholders fund (₹)	7,81,250
Buy-back price per share	₹ 20
Number of shares that can be bought back (shares)	39,062
Actual Number of shares for buy-back	25,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

Particulars	₹
(a) Loan funds (₹) (18,75,000 + 10,00,000 +16,50,000)	45,25,000
(b) Minimum equity to be maintained after buyback in the ratio of 2:1 (₹) (a/2)	22,62,500
(c) Present equity/shareholders fund (₹)	31,25,000
(d) Future equity/shareholders fund (₹) (see W.N.) (31,25,000 – 2,87,500)	28,37,500
(e) Maximum permitted buy-back of Equity (₹) [(d) – (b)]	5,75,000
(f) Maximum number of shares that can be bought back @ ₹ 20 per share	28,750 shares
(g) Actual Buy-Back Proposed	25,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	31,250
Resources Test	39,062
Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

TELEGRAM: CA NOTE HUB

Journal Entries for buy-back of shares

Particulars		Debit (₹)	Credit (₹)
(a) Equity shares buy-back account	Dr.	5,00,000	
To Bank account			5,00,000
(Being buy-back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)			
(b) Equity share capital account	Dr.	2,50,000	
Securities premium account	Dr.	2,50,000	
To Equity shares buy-back account			5,00,000
(Being cancellation of shares bought back)			
(c) Revenue reserve account	Dr.	2,50,000	
To Capital redemption reserve account			2,50,000
(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd.

as at 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	10,00,000
	B	Reserves and Surplus	2	16,25,000
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000
3		Current liabilities		
	A	Other Current Liabilities		16,50,000
		Total		**71,50,000**
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets (30,00,000 –5,00,000)		25,00,000
		Total		**71,50,000**

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		10,00,000
2	**Reserves and Surplus**		
	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	(2,50,000)	12,50,000

TELEGRAM: CA NOTE HUB

	Securities premium	2,50,000	
	Less: Utilization for share buy-back	(2,50,000)	
	Capital Redemption Reserves		-
	Total		2,50,000
3	**Long term borrowings**		16,25,000
	14% Debentures	18,75,000	
	Unsecured Loans	10,00,000	
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

Working Note:

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

(31,25,000 – x) – 22,62,500 = y (1)

(y/20 × 10) = x or 2x = y (2)

by solving the above equation, we get

x = ₹2,87,500

y = ₹ 5,75,000

Question 13 (PYQ Nov'23) NB Pg. No.

The following is the extract of Balance Sheet of Yellow Limited as on 31.03.2023:

	₹
4,00,000 Equity shares of ₹ 10 each	40,00,000
General Reserve	48,00,000
Profit & Loss Account	10,00,000
Securities Premium	18,00,000
Secured Loans	60,00,000
Unsecured Loans	32,00,000
Current Liabilities	28,00,000
	2,36,00,000
Property, Plant and Equipment	90,00,000
Investments	18,00,000
Current Assets	1,28,00,000
	2,36,00,000

The company intends to buy-back 80,000 equity shares of ₹ 10 each at a premium of 150%.

You are required to state whether the company can buy back equity shares.

(5 Marks)

TELEGRAM: CA NOTE HUB

Solution:

Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013

1. **Shares Outstanding Test**

Particulars (Shares)	
Number of shares outstanding	4,00,000
25% of the shares outstanding	1,00,000

2. **Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves**

Particulars	
Paid up capital (₹)	40,00,000
Free reserves (₹) (48,00,000 + 18,00,000 + 10,00,000)	76,00,000
Shareholders' funds (₹)	1,16,00,000
25% of Shareholders fund (₹)	29,00,000
Buy-back price per share	₹ 25
Number of shares that can be bought back (shares)	1,16,000
Actual Number of shares for buy-back	80,000

3. **Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back**

Debt Equity ratio of the company should not exceed 2:1 after such buy-back. In this case, the debt is ₹ 92,00,000 (60,00,000 + 32,00,000)* and equity after such buy back will be ₹ 96,00,000 (1,16,00,000 – 20,00,000). Thus, the debt equity ratio is 0.96:1, which is less than 2:1.

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy 80,000 equity shares @ ₹ 25.

Question 14 NB Pg. No.

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.20X1:

	Particulars	(₹ in crores)	
(1)	Equity Share Capital (Shares of ₹ 10 each fully paid)	-	330
(2)	Reserves and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-
	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
(3)	Loan Funds		1,800

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.20X1 a proposal to buy-back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is ₹ 25 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Development Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,200 crores or ₹ 1,500 crores.

Assuming that the entire buy-back is completed by 09.12.20X1, show the accounting entries in the company's books in each situation.

Solution

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	When loan fund is		
	₹ 1,800 crores	₹ 1,200 crores	₹ 1,500 crores
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy-Back

(applicable only when loan fund is ₹ 1,200 crores)

₹ in crores

	Particulars	Debit	Credit
(a)	Equity share buy-back account Dr.	112.5	
	To Bank account		112.5
	(Being buy-back of 3.75 crores equity shares of ₹ 10 each @ ₹ 30 per share)		
(b)	Equity share capital account Dr.	37.5	
	Securities premium account Dr.	75	
	To Equity share buy-back account		112.5
	(Being cancellation of shares bought back)		
(c)	General reserve account Dr.	37.5	
	To Capital redemption reserve account		37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)		

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in crores)
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	330
Free reserves (₹ in crores)	420
Shareholders' funds (₹ in crores)	750

TELEGRAM: CA NOTE HUB

25% of Shareholders fund (₹ in crores)	₹ 187.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3. **Debt Equity Ratio Test**

	Particulars	When loan fund is		
		₹ 1,800 crores	₹ 1,200 crores	₹ 1,500 crores
(a)	Loan funds (₹ in crores)	1,800	1,200	1,500
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	900	600	750
(c)	Present equity shareholders fund (₹ in crores)	750	750	750
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	N.A.	712.5 (750–37.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	Nil	3.75 (by simultaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.
2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. In the question, it is stated that the company has surplus funds to dispose of therefore, it is presumed that buy-back is out of free reserves or securities premium and hence a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from present equity.

   Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

   Then

   Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buyback of equity

   $(750 - x) - 600 = y$ (1)

   Since $150 - x = y$

   Equation 2: $\left(\frac{\text{Maximum buy -back}}{\text{Offer price for buy -back}} \times \text{Nominal Value}\right)$

   = Nominal value of the shares bought –back to be transferred to CRR

   Equation 2: $\left(\frac{y}{30} \times 10\right) = x$

TELEGRAM: CA NOTE HUB

[here (30 = 25% x 120]

Or 3x = y (2)

by solving the above two equations we get

x = ₹ 37.5 crores

y = ₹ 112.5 crores

NB Pg. No.

Question 15 (PYQ May'22)

Quick Ltd. has the following capital structure as on 31st March,2021:

		₹ in Crores	
(1)	Share Capital:		462
	(Equity Shares of ₹ 10 each, fully paid)		
(2)	Reserves and Surplus:		
	General Reserve	336	
	Securities Premium Account	126	
	Profit and Loss Account	126	
	Statutory Reserve	180	
	Capital Redemption Reserve	87	
	Plant Revaluation Reserve	33	888
(3)	Loan Funds:		
	Secured	2,200	
	Unsecured	320	2,520

On the recommendations of the Board of Directors, on 16th September, 2021, the shareholders of the company have approved a proposal to buy-back of equity shares. The prevailing market value of the company's share is ₹ 20 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 50% over market value. The company had sufficient balance in its bank account for the buy-back of shares. You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,680 Crores or ₹ 2,100 Crores; Assuming that the entire buy-back is completed by 31st December,2021, Pass the necessary accounting entries (narrations not required) in the books of the company in each situation.

(10 Marks)

Solution:

Statement determining the maximum number of shares to be bought back Number of shares

Particulars	When loan fund is		
	₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
Shares Outstanding Test (W.N.1)	11.55	11.55	11.55
Resources Test (W.N.2)	8.75	8.75	8.75
Debt Equity Ratio Test (W.N.3)	Nil	5.25	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	5.25	Nil

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Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 1,680 crores)

₹ in crores

	Particulars	Debit	Credit
(a)	Equity share buy-back account Dr.	157.5	
	To Bank account		157.5
(b)	Equity share capital account (5;25 x ₹ 10) Dr.	52.5	
	Securities premium account (5;25 x ₹ 20) Dr.	105	
	To Equity share buy-back account		157.5
(c)	General reserve account Dr.	52.5	
	To Capital redemption reserve account		52.5

Working Notes:

1. **Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	46.2
25% of the shares outstanding	11.55

2. **Resources Test**

Particulars	
Paid up capital (₹ in crores)	462
Free reserves (₹ in crores) (336+126+126)	588
Shareholders' funds (₹ in crores)	1,050
25% of Shareholders fund (₹ in crores)	₹ 262.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	8.75 crores shares

3. **Debt Equity Ratio Test**

	Particulars	When loan fund is		
		₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
(a)	Loan funds (₹ in crores)	2,520	1,680	2,100
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	1,260	840	1,050
(c)	Present equity shareholders fund (₹ in crores)	1,050	1,050	1,050
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	N.A.	997.5 (1,050–52.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	Nil	157.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	Nil	5.25 (by simultaneous equation)	Nil

Note:

1) Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.

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2) As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method. Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'; Then Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buy-back of equity

(1,050 –x)-840 = y

Since 210 – x = y

$$\text{Equation 2} = \left[\frac{\text{Maximum buy -back}}{\text{Offer price for buy -back}} \times \text{Nominal Value}\right]$$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \frac{y}{30} \times 10$$

Or $3x = y$ (2)

by solving the above two equations we get

x = ₹ 52;5 crores y = ₹ 157;5 crores

3) Statutory reserves, capital redemption reserve and plant revaluation reserves are not free reserves.

4) For calculation of debt -equity ratio both secured and unsecured loans have been considered.

Question 16 (PYQ Dec'21) NB Pg. No.

Mohan Ltd. furnishes the following summarised Balance Sheet on 31st March 2021. (₹ in Lakhs)

	Amount
Equity and Liabilities:	
Shareholders' fund	
Share Capital	
Equity Shares of ₹ 10 each fully paid up 6%	780
Redeemable Preference shares of ₹ 50 each fully Paid up	240
Reserves and Surplus	
Capital Reserves	58
General Reserve	625
Securities Premium	52
Profit & Loss	148
Revaluation Reserve	34
Infrastructure Development Reserve	16
Non-current liabilities	
7% Debentures	268
Unsecured Loans	36
Current Liabilities	395
	2652

TELEGRAM: CA NOTE HUB

Assets:	
Non-current Assets	
Plant and Equipment less depreciation	725
Investment at cost	720
Current Assets	1207
	2652

Other Information:

1) The company redeemed preference shares at a premium of 10% on 1st April,2021.
2) It also offered to buy back the maximum permissible number of equity shares of ₹ 10 each at ₹ 30 per share on 2nd April 2021.
3) The payment for the above was made out of available bank balance, which appeared as a part of the current assets.
4) The company had investment in own debentures costing ₹ 60 lakhs (face value ₹ 75 lakhs). These debentures were cancelled on 2nd April 2021.
5) On 4th April 2021 company issued one fully paid-up equity share of ₹ 10 each by way of bonus for every five equity shares held by the shareholders.

You are required to:

a) Calculate maximum possible number of equity shares that can be bought back as per the Companies Act, 2013 and

b) Record the Journal Entries for the above-mentioned information. **(10 Marks)**

Solution:

(a) (i) Statement determining the maximum number of shares to be bought back

Number of shares (in lakhs)

Particulars	When loan fund is ₹ 304 lakhs'
Shares Outstanding Test (W.N.1)	19.5
Resources Test (W.N.2)	11.175
Debt Equity Ratio Test (W.N.3)	29.725
Maximum number of shares that can be bought back [least of the above]	11.175

Thus, the company can buy 11,17,500 Equity shares at ₹ 30 each.

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in lakh)
Number of shares outstanding	78
25% of the shares outstanding	19.5

2. Resources Test

Particulars	
Paid up capital (₹ in lakh)	780
Free reserves (₹ in lakh) (625+52+148–24–240*)	561
Shareholders' funds (₹ in lakh)	1341
25% of Shareholders fund (₹ in lakh)	335.25

Buy-back price per share	30
Number of shares that can be bought back	11.175
*Amount transferred to CRR is excluded from free reserves.	
Premium on redemption also reduced.	

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	₹ In lakh
(a)	Loan funds (₹)	304
(b)	Minimum equity to be maintained after buyback in the ratio of 2:1 (₹) (a/2)	152
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1043.75 (1341–297.25)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	891.75
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	29.725
	As per the provisions of the Companies Act, 2013, company	Qualifies

Alternatively, when current liabilities are considered as part of loan funds, in that case Debt Equity Ratio

Test will be done as follows:

Particulars	₹ in lakh
(a) Loan funds (₹)	699
(b) Minimum equity to be maintained after buyback in the ratio of 2:1 (₹) (a/2)	349.5
(c) Present equity shareholders fund (₹)	1341
(d) Future equity shareholders fund (₹) (see W.N.4)	1093.125 (1341-247.875)
(e) Maximum permitted buy-back of Equity (₹) [(d) – (b)]	743.625
(f) Maximum number of shares that can be bought back @ ₹ 30 per share	24.7875
As per the provisions of the Companies Act, 2013, company	Qualifies

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy- back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR) – Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (1341 – x) – 152 = y

= 1189 – x =y (1)

Equation 2: Maximum Permitted Buy-Back x Nominal Value Per Share/Offer Price Per Share

y/30 × 10 = x or 3x = y (2)

by solving the above two equations we get x = ₹ 297.25 and y = ₹ 891.75

Alternatively, when current liabilities are considered as part of loan funds, in that case

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted

TELEGRAM: CA NOTE HUB

Buy-Back
= (1341 – x) – 349.5 = y
= 991.5 – x =y (1)

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share
y/30 × 10 = x or 3x = y (2)

by solving the above two equations we get x = 247.875 and y = 743.625

(ii) Journal Entries for Buy Back (₹ in lakhs)

Date	Particulars		Debit	Credit
2021 1st April	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c.	Dr	24	
	To Preference shareholders A/c			264
	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c.	Dr	24	
	To Preference shareholders A/c			264
	(Being premium on redemption of preference shares adjusted through securities premium)			
2nd April	Equity shares buy-back A/c	Dr.	335.25	
	To Bank A/c			335.25
	(Being 11.175 lakhs equity shares of ₹ 10 each bought back @ ₹ 30 per share)			
	Equity share capital A/c	Dr.	111.75	
	Securities Premium A/c.	Dr	52	
	General Reserve or P&L A/c	Dr.	171.50	
	To Equity Shares buy-back A/c			335.25
	(Being cancellation of shares bought back)			
	General reserve A/c.	Dr	351.75	
	To Capital redemption reserve A/c			351.75
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law ie. 240+ 111.75 lakhs)			
2nd April	7% Debentures A/c.	Dr	75	
	To Investment (own debentures) A/c			60
	To Profit on cancellation of own debentures A/c			15

	(Being cancellation of own debentures costing ₹ 60 lakhs, face value being ₹ 75 lakhs and the balance being profit on cancellation of debentures)			
4th April	Capital Redemption Reserve	Dr.	133.65	
	To Bonus Shares A/c			133.65
	(Being issue of one bonus equity share for every five equity shares held)			
	Bonus shares A/c	Dr.	133.65	
	To Equity share capital A/c			133.65
	(Being bonus shares issued)			

Working Note: Bonus Share to be issued =66.825 (78 – 11.175) lakh shares divided by 5 = 13.365 lakh shares.

Note: *Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and complies with the Accounting Standards prescribed for them. Alternative entry considering otherwise is also possible by utilizing securities premium amount.

Question 17 (PYQ May'23) NB Pg. No.

What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as per Companies Act, 2013? Explain in brief. **(5 Marks)**

Solution:

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. For details, refer para 1.1 and 1.2 of the chapter

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AMALGAMATION OF COMPANIES

Illustration 1

S. Ltd. is absorbed by P. Ltd. S ltd. gives the following information on the date of absorption:

	₹
Sundry Assets	13,00,000
Share capital:	
2,000 7% Preference shares of ₹ 100 each (fully paid-up)	2,00,000
5,000 Equity shares of ₹ 100 each (fully paid-up)	5,00,000
Reserves	3,00,000
6% Debentures	2,00,000
Trade payables	1,00,000

Additional information:

P. Ltd. has agreed:

(i) to issue 9% Preference shares of ₹ 100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.

(ii) to issue to the debenture-holders in S Ltd. 8% Mortgage Debentures at ₹ 96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%;

(iii) to pay ₹ 20 per share in cash and to issue six equity shares of ₹ 100 each issued at the market value ₹ 125 in lieu of every five shares held in S. Ltd.; and

(iv) to assume the liability to trade payables.

You are required to calculate the purchase consideration.

Solution

The purchase consideration will be Form

	₹	
Preference shareholders: 2,000 × 3/4 × 100	1,50,000	9% Pref. shares
Equity shareholders: 5,000 × 20	1,00,000	Cash
5,000 × 6/5 × 125	7,50,000	Equity shares
	10,00,000	

Note:

1. According to AS 14, 'consideration' excludes the any amount payable to debenture-holders. The liability in respect of debentures of S Ltd. will be taken by P Ltd., which will then be settled by issuing new 8% debentures.
2. The issue of the equity shares is done at ₹ 125 (market value) as it has been mentioned in the question. The face value shall not be considered for this purpose.

Illustration 2

Following is the balance sheet of A Ltd. as on 31st March, 20X1

		Particulars	**Notes**	**₹ (000)**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	22,50
	B	Reserves and Surplus	2	9,00
2		**Non-current liabilities**		
	A	Long-term borrowings	3	7,00
3		**Current liabilities**		

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	A	Trade Payables		5,00
		Total		**43,50**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	32,50
	B	Non-current investments	5	6,00
2		**Current assets**		
	a	Inventories		2,00
	b	Trade receivables		2,00
	c	Cash and Cash equivalents		1,00
		Total		**43,50**

Notes to accounts

1	**Share Capital**	₹ in ('000)
	Equity share capital	
	1,50,000 Equity Shares of ₹ 10 each 15,00	
	7,500 14% Preference Shares of ₹ 100 each 7,50	
		22,50
2	**Reserves and Surplus**	
	General reserve	9,00
3	**Long-term borrowings**	
	Secured	
	15% Debentures	7,00
4	**Property, plant and Equipment**	
	Land and Building	32,50
5	Non-current investments	
	Investments at cost	6,00

B Ltd agreed to take over the assets and liabilities on the following terms and conditions:

a) Discharge 15% debentures at a premium of 10% by issuing 15% debentures of X Ltd.

b) PPE at 10% above the book value and investments at par value.

c) Current assets at a discount of 10% and Current liabilities at book value.

d) Preference shareholders are discharged at a premium of 10% by issuing 15% preference shares of

e) Issue 3 equity shares of ₹ 10 each for every 2 equity shares in B Ltd. and pay the balance in cash.

Calculate Purchase consideration.

Solution

Calculation of Purchase Consideration (Net Asset value Method)

PARTICULARS	**(₹ in '000's)**
Value of assets taken over:	
Property, Plant and Equipment	35,75
Non-Current Investments	6,00
Current Assets	4,50
Total Assets (A)	46,25
Less: **Liabilities taken over:**	
15% Debentures	7,70
Current Liabilities	5,00
Total Liabilities (B)	12,70
Purchase consideration (A -B)	33,55
Mode of Purchase Consideration	
In the form of 15% Preference shares	8,25
In the form of Equity shares	22,50

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In the form of Cash (Balance)	2,80
Total	33,55

Illustration 3

Let us consider the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ (000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	100,00
	B	Reserves and Surplus	2	12,50
2		**Non-current liabilities**		
	A	Long-term borrowings	3	40,00
3		**Current liabilities**		
	A	Trade Payables		20,00
		Total		172,50
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	105,50
	B	Non-current investments	5	5,00
2		**Current assets**		
	a	Inventories		23,00
	b	Trade receivables		24,00
	c	Cash and Cash equivalents		15,00
		Total		172,50

Notes to accounts

		₹ in ('000)
1	**Share Capital**	
	Equity share capital	
	7,50,000 Equity Shares of ₹ 10 each	75,00
	25,000 14% Preference Shares of ₹ 100 each	25,00
		100,00
2	**Reserves and Surplus**	
	General reserve	12,50
		12,50
3	**Long-term borrowings**	
	Secured	
	14% Debentures	40,00
		40,00
4	**Property, plant and Equipment**	
	Land and Building	50,00
	Plant and machinery	45,00
	Furniture	10,50
		105,50
5	**Non-current investments**	
	Investments at cost	5,00
		5,00

Other Information:

(i) Y Ltd. takes over X Ltd. on 10th April, 20X1.

(ii) Debenture holders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.

(iii) 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value ₹ 100 each).

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(iv) Intrinsic value per share of X Ltd. is ₹ 20 and that of Y Ltd. ₹ 30. Y Ltd. Will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, the entry should be made at par value only. The nominal value of each equity share of Y Ltd. is ₹ 10.

Compute the purchase consideration.

Solution

Computation of Purchase consideration	**(₹ in '000)**	**Form**
For Preference Shareholders of X Ltd.	3,000	30,000
		15% Preference
		shares in Y Ltd.
For equity shareholders of X Ltd.	5,000	5,00,000 Equity
(20/30 × 7,50,000) × ₹ 10		shares of Y Ltd.
of ₹ 10 each		
Total Purchase consideration	8,000	

Note: According to AS 14, amount paid to the debenture holders should not be included in the purchase consideration calculation. Such debentures will be taken over by Y Ltd. and then discharged by them later.

Illustration 4

Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04.20X1. Following is the Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3.20X1:

		Particulars	**Notes**	**Neel**	**Gagan**
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		7,75,000	8,55,000
2		**Current liabilities**		6,23,500	5,57,600
		Total		13,98,500	14,12,600
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	1	12,35,000	12,54,000
2		**Current assets**		1,63,500	1,58,600
		Total		13,98,500	14,12,600

Notes to accounts:

1	**Property, plant and Equipment**			
	Land and Building		7,50,000	6,40,000
	Plant and machinery		4,85,000	6,14,000
			12,35,000	12,54,000

Following is the additional information:

(i) The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:

	Neel	**Gagan**
	₹	**₹**
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

(ii) The purchase consideration is to be discharged as under:

(a) Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years.

(b) Profits for the preceding 2 years are given below:

	Neel	**Gagan**
	₹	**₹**
Ist year	2,62,800	2,75,125
IInd year	2,12,200	2,49,875

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Total	4,75,000	5,25,000

(c) Issue 12% preference shares of ₹ 10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as on 31.3.20X1 after revaluation of assets of Neel Ltd. and Gagan Ltd. respectively.

You are required to compute the

(i) Equity and preference shares issued to Neel Ltd. and Gagan Ltd.,

(ii) Purchase consideration.

Solution

(i) Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.

Profits of	Neel	Gagan
	₹	₹
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

The total profits- ₹ 4,75,000+ ₹ 5,25,000= ₹ 10,00,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profits.

	Neel	Gagan
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. And Gagan Ltd.

	Neel	Gagan
	₹	₹
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued	56,000 shares	
$\left[67{,}200 \times \frac{100}{12}\right]$= 5,60,000@ 10 each		
$\left[73{,}920 \times \frac{100}{12}\right] = 6{,}16{,}000$@ 10 each		61,600 shares

(ii) Total Purchase Consideration

	Neel	Gagan
	₹	₹
Equity shares @ of ₹ 25 each	2,85,000	3,15,000
12% Preference shares @ of ₹ 10 each	5,60,000	6,16,000
Total	8,45,000	9,31,000

Working Note:

Calculation of Net assets as on 31.3.20X1

	Neel	Gagan
	₹	₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	(6,23,500)	(5,57,600)
	8,40,000	9,24,000

Note: Since the income from the preference shares shall be equal to the 8% return on assets, the shares are computed in such way that 12% dividend on them shall be equal to 8% of the return on Net assets.

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Illustration 5

Wye Ltd. acquires the business of Zed Ltd. whose balance sheet as at 31st March, 20X1 is as under:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	12,00,000
	B	Reserves and Surplus	2	1,58,000
2		**Non-current liabilities**		
	A	Long-term borrowings	3	2,00,000
3		**Current liabilities**		
	A	Trade Payables		1,20,000
	B	Other current liabilities		12,000
		(Interest payable on debentures)		
		Total		16,90,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	10,00,000
	B	Intangible assets	5	2,90,000
2		**Current assets**		
	A	Inventories		1,50,000
	B	Trade receivables		1,80,000
	C	Cash and Cash equivalents		70,000
		Total		16,90,000

Notes to accounts:

		₹
1	**Share Capital**	
	Equity Share capital (₹ 100 each)	8,00,000
	6% Preference Share capital (₹ 100 each)	4,00,000
		12,00,000
2	**Reserves and Surplus**	
	Capital reserve	1,00,000
	Profit and loss A/c	50,000
	Workmen compensation reserve	
	(Expected liability ₹ 5,000)	8,000
		1,58,000
3	**Long-term borrowings**	
	6% Debentures	2,00,000
		2,00,000
4	**Property, Plant and Equipment**	
	Land and Building	4,00,000
	Plant and machinery	6,00,000
		10,00,000
5	**Intangible assets**	
	Goodwill	2,40,000
	Patents	50,000
		2,90,000

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts:

(i) ₹ 2,00,000 7% Debentures (₹ 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth ₹ 105.

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(ii) For each preference share in Zed Ltd. ₹ 10 in cash and one 9% preference

(iii) For each equity share in Zed Ltd. ₹ 20 in cash and one equity share in Wye Ltd. of ₹ 100 each having the market value of ₹ 140.

(iv) Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of ₹ 10,000. Actual expenses amounted to ₹ 12,500.

Wye Ltd. valued Land and building at ₹ 5,50,000 Plant and Machinery at ₹ 6,50,000 and patents at ₹ 20,000 of Zed Ltd for the purpose of amalgamation.

Solution

Purchase Consideration

		₹	Form
(i) Preference Shares: ₹ 10 per share	40,000		Cash
Preference shares	4,00,000	4,40,000	Preference shares
(ii) Equity shares: ₹ 20 per share	1,60,000		Cash
8,000 equity shares in			
Wye Ltd. @ ₹ 140	11,20,000	12,80,000	Equity shares
	17,20,000		

Steps to close the Books of the Vendor Company

1. Open Realization Account and transfer all assets at book value.

   Exception: If cash is not taken over by the purchasing company, it should

   Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realization Account.

The journal entry in the above case is:

		₹	₹
Realization A/c	Dr.	16,20,000	
To Sundries —			
Goodwill			2,40,000
Land & Building			4,00,000
Plant & Machinery			6,00,000
Patents			50,000
Inventory			1,50,000
Trade receivables			1,80,000

(Transfer of assets to Realization Account on sale of business to Wye Ltd.)

2. Transfer to the Realization Account the liabilities which the purchasing company is to take over. In case of the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is not required (i.e., the reserve portion) should be treated as profit.

Accordingly, the following entry will be recorded:

		₹	₹
6% Debentures in Wye Ltd.	Dr.	2,00,000	
Workmen's Compensation Reserve	Dr.	5,000	
Trade payables	Dr.	1,20,000	
To Realization A/c			3,25,000
(Transfer of liabilities taken over by Wye Ltd. to Realization A/c)			

For liabilities not take over by the purchasing company, the profit or loss on discharge of such liabilities shall be transferred to Realization Account.

3. Debit purchasing company and credit Realization Account with the purchase consideration.

Wye Ltd.-	Dr.	17,20,000	
To Realization A/c			17,20,000

TELEGRAM: CA NOTE HUB

(Amount receivable from Wye Ltd. for sale of business)			

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company. Thus —

Cash	Dr.	2,00,000	
9% Preference shares in Wye Ltd.	Dr.	4,00,000	
Equity shares in Wye Ltd.	Dr.	11,20,000	
To Wye Ltd.			17,20,000
(Receipt of purchase consideration from the purchase company)			

5. Expenses of liquidation have to be dealt with according to the circumstances of each case.

a) If the vendor company has to bear and pay them:

Realization Account should be debited and Cash Account credited.

b) If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:

(i) It may be ignored in the books of the vendor company.

(ii) If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed:

a) Debit Purchasing company and credit Cash Account when expenses are paid by the vendor company and

b) Debit Cash Account and credit purchasing company (on the expenses being reimbursed).

In the above mentioned case Wye Ltd. has to pay maximum of ₹ 10,000 only whereas, the amount spent is ₹ 12,500. Hence ₹ 2,500 is to be borne by Zed Ltd.; the entries required will be :

		₹	₹
Wye Ltd.	Dr.	10,000	
Realization A/c	Dr.	2,500	
To Cash A/c			12,500
(Liquidation expenses out of which ₹ 10,000 is payable by Wye Ltd.)			
Cash A/c	Dr.	10,000	
To Wye Ltd.			10,000
(Account reimbursed by Wye Ltd. for expense)			

6. Liabilities not assumed by the purchasing company, have to be paid off. On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realization Account. Zed Ltd. shall pass the following entries in this respect:

		₹	₹
Interest Outstanding	Dr.	12,000	
To Debenture holders A/c			12,000
(Amount due to debenture holders for debentures interest)			
Debenture holders	Dr.	12,000	
To Cash A/c			12,000
(Debenture holders paid cash ₹ 12,000 for outstanding interest)			

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realization Account. Thus —

6% Pref. Share Capital A/c	Dr.	4,00,000	
Realization A/c	Dr.	40,000	
To Preference Shareholders A/c			4,40,000

TELEGRAM: CA NOTE HUB

(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)		

Note: In the absence of any indication to the contrary, preference shareholders will be entitled only to the capital contributed by them. But if funds available after paying off creditors are not sufficient to satisfy the claim of preference shareholders fully, they will have to suffer a loss to the extent of the deficit.

8. Pay off preference shareholders by debiting them and crediting whatever is given to them. The entry in the above case is :

	₹	₹
Preference shareholders A/c Dr.	4,40,000	
To Cash A/c		40,000
To 9% Preference shares in Wye Ltd.		4,00,000

(Cash and preference shares in Wye Ltd. given to preference shareholders)

9. Transfer equity share capital and account representing profit or loss (including the balance in Realization Account) to Equity Shareholders Account. This will determine the amount receivable by the equity shareholders. Zed Ltd. Shall pass the following entries in this regard :

		₹	₹
Equity Share Capital A/c	Dr.	8,00,000	
Capital Reserve A/c	Dr.	1,00,000	
Profit and Loss A/c	Dr.	50,000	
Workmen's Compensation Reserve A/c	Dr.	3,000	
Realization A/c	Dr.	3,82,500	
To Equity Shareholders A/c			13,35,500
(Various accounts representing capital and profit transferred to Equity Shareholders Account)			

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them. Hence:

Equity Shareholders A/c	Dr.	13,35,500	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c (W.N.2)			2,15,500

Working Notes

1. Realization Account

	₹		₹
To Sundry Assets	16,20,000	By Sundry Liabilities	3,25,000
To Cash (excess expenses of liquidation)	2,500	By Wye Ltd.	17,20,000
To Preference Shareholders	40,000		
To Equity Shareholders A/c -			
profit transferred	3,82,500		
	20,45,000		20,45,000

2. Cash Account

	₹		₹
To Balance b/d	70,000	By Realization	2,500
To Wye Ltd.	2,00,000	By Wye Ltd.	10,000
(consideration for amalgamation)			
To Wye Ltd.	10,000	By Debenture-holders	12000
(liquidation expenses reimbursed)		By Preference shareholder	40000

TELEGRAM: CA NOTE HUB

		By Equity Shareholder (B/F)	215500
	280000		280000

Continuing with the information given in Illustration 5:

1. Debit Business Purchase Account and Credit Liquidator of the vendor company with the account of the purchase consideration. Thus -

Business Purchase A/c Dr. 17,20,000

To Liquidator of Zed Ltd. 17,20,000

(Amount payable to Zed Ltd. as per agreement dated)

2. (i) Debit assets acquired (except goodwill) at the value placed on them by the purchasing company;

(ii) Credit liabilities taken over at agreed values and credit Business Purchase Account with the amount of purchase consideration; and

(iii) If the credits as per (*ii*) above exceed debits as per (*i*) above, the difference should be debited to Goodwill Account, in the reverse case, the difference should be credited to Capital Reserve.

Note: The amount of Goodwill or Capital Reserve that shall be included will be the amount as has been arrived at only in foregoing manner.

In the above case the entry to be passed shall be:

		₹	₹
Land and Building A/c	Dr.	5,50,000	
Plant and Machinery A/c	Dr.	6,50,000	
Patents A/c	Dr.	20,000	
Inventory A/c	Dr.	1,50,000	
Trade receivables	Dr.	1,80,000	
Goodwill	Dr.	5,05,000	
To			
Provision for Workmen's Compensation A/c			5,000
Trade payables			1,20,000
Debentures in Z Ltd.			2,10,000
Business Purchases Account			17,20,000

(Various assets and liabilities taken over from Zed Ltd.Goodwill ascertained as a balancing figure)

3. On the payment to the vendor company the balance at its credit, the entry to be made by Wye Ltd. shall be:

Liquidator of Zed Ltd. Dr. 17,20,000

To Cash 2,00,000

To 9% Preference Share Capital A/c 4,00,000

To Equity Share Capital A/c 8,00,000

To Securities Premium A/c 3,20,000

(Payment of cash and issue of shares in satisfaction of purchase consideration)

4. Debentures in Z Ltd. A/c Dr. 2,10,000

To 7% Debentures A/c 2,00,000

To Premium on Debentures A/c 10,000

(Debentures issued)

TELEGRAM: CA NOTE HUB

5. If the purchasing company is required to pay the expenses of liquidation of the vendor company, the amount should be debited to the Goodwill or Capital Reserve Account, as the case may be. In the instant case, the entry shall be:

Goodwill Account Dr. 10,000

To Cash Account 10,000

(Amount paid towards liquidation expenses on Zed Ltd.)

Illustration 6

The following Balance Sheets are given as at 31st March, 20X1:

		Particulars	₹ Best Ltd. (in lakhs)	₹ Better Ltd. (in lakhs)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	20	10
		(shares of ₹ 100 each, fully pad)		
	B	Reserves and Surplus	10	8
	2	**Current liabilities**	20	2
		Total	**50**	**20**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	25	15
	B	Non-current investments	5	-
2		**Current assets**	20	5
		Total	**50**	**20**

The following further information is given:

a) Better Limited issued bonus shares on 1st April, 20X1, in the ratio of one share for every two held, out of Reserves and Surplus.

b) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.

c) The value of shares in Best Ltd. was considered to be ₹ 150 and the shares in Better Ltd. were valued at ₹ 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.

d) Liabilities of Better Ltd., included ₹ 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 20X1 after the takeover.

Solution

LEDGER OF BETTER LIMITED

Property, Plant and Equipment (PPE) Account

	₹		₹
To Balance b/d	15,00,000	By Realization A/c (transfer)	15,00,000

Current Assets Account

	₹		₹
To Balance b/d	5,00,000	By Realization A/c (transfer)	5,00,000

TELEGRAM: CA NOTE HUB

Liabilities Account

	₹		₹
To Realization A/c	2,00,000	By Balance b/d	2,00,000

Realization Account

	₹		₹
To PPE A/c	15,00,000	By Liabilities A/c	2,00,000
” Current Assets A/c	5,00,000	” Best Limited	15,00,000
		(Purchase Consideration)	
		” Shareholders’ A/c 3,00,000	
		(Loss on Realization)	
	20,00,000		**20,00,000**

Share Capital Account

	₹		₹
To Sundry shareholders		By Balance b/d	10,00,000
A/c - (transfer)	15,00,000	” Reserves & Surplus A/c	
		(Bonus issue)	5,00,000
	15,00,000		**15,00,000**

Reserves & Surplus Account

	₹		₹
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
” Sundry Shareholders	3,00,000		
	8,00,000		**8,00,000**

Best Ltd.

	₹		₹
To Realization A/c - Purchase		By Shares in Best Ltd	15,00,000
Consideration	15,00,000		
	15,00,000		**15,00,000**

Shares in Best Ltd.

	₹		₹
To Best Ltd.	15,00,000	By Sundry Shareholders A/c	15,00,000

Sundry Shareholders Account

	₹		₹
To Realization A/c	3,00,000	By Share Capital A/c	15,00,000
(Loss)		” Reserves & Surplus A/c	3,00,000
” Share in Best Ltd.	15,00,000		
	18,00,000		**18,00,000**

Journal of Best Ltd.

TELEGRAM: CA NOTE HUB

		Dr.	Cr.
20X1		₹	₹
Apr. 1	Property, Plant and Equipment A/c Dr.	15,00,000	
	Current Assets A/c Dr.	5,00,000	
	To Liabilities A/c		2,00,000
	To Liquidator of Better Ltd.		15,00,000
	To Capital Reserve A/c		3,00,000
	(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of ₹ 15,00,000 as per agreement dated....)		
	Liquidator of Better Ltd. Dr.	15,00,000	
	To Share Capital A/c		10,00,000
	To Securities Premium A/c	5,00,000	
	(Discharge of Purchase consideration by the issue of equity shares of ₹ 10,00,000 at a premium of ₹ 50 per share as per agreement)		
	Trade payables A/c Dr.	1,00,000	
	To Trade receivables A/c		1,00,000
	(Amount due from Better Ltd., and included in its creditors taken over, cancelled against own Trade receivables)		
	Capital Reserve A/c Dr.	10,000	
	To Current Asset (Stock) A/c		10,000
	(Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account. 20% on sale value of ₹50,000 shall be eliminated as unrealized profit)		

Working Note :

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at ₹ 100 per share ₹ 15,00,000

Purchase consideration has been discharged by Best Ltd. by the issue of shares for ₹ 10,00,000 at a premium of ₹ 5,00,000. This gives the value of ₹ 150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
	b	Reserves and Surplus	2	17,90,000
2		**Current liabilities**		21,00,000
		Total		68,90,000
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	3	40,00,000
	b	Non-current investments		5,00,000
2		**Current assets**		23,90,000
		Total		68,90,000

Notes to accounts

		₹
1 Share Capital		
Equity share capital		
Issued & Subscribed		
30,000 shares of ₹ 100 (of the above 10,000 shares have been issued		30,00,000

TELEGRAM: CA NOTE HUB

for consideration other than cash)		
Total		30,00,000
2 Reserves and Surplus		
Capital Reserve (3,00,000 – 10,000)		2,90,000
Securities Premium		5,00,000
Other reserves and surplus		10,00,000
Total		17,90,000
3 Property, Plant and Equipment		
PPE	25,00,000	
Acquired during the year	15,00,000	40,00,000
Total		40,00,000

Illustration 7

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies as at the date of amalgamation was as under:

		Particulars	Notes	₹ K Ltd.	₹ L Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	12,00,000	6,00,000
	B	Reserves and Surplus	2	3,71,375	1,97,175
2		**Non-current liabilities**			
	A	Long-term borrowings	3	2,00,000	2,00,000
3		**Current liabilities**			
	A	Trade Payables		1,00,000	2,10,000
		Total		18,71,375	12,07,175
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	11,30,000	8,20,000
	B	Intangible assets	5	80,000	-
2		**Current assets**			
	A	Inventories		2,25,000	1,40,000
	B	Trade receivables		2,75,000	1,75,000
	C	Cash and Cash equivalents	6	1,61,375	72,175
		Total		18,71,375	12,07,175

Notes to accounts

		K Ltd.	L Ltd.
1	**Share Capital**		
	Equity shares of ₹ 100 each	8,00,000	3,00,000
	7% Preference Shares of ₹ 100 each	4,00,000	3,00,000
		12,00,000	6,00,000
2	**Reserves and Surplus**		
	General reserve	-	1,00,000
	Profit and loss account	3,71,375	97,175
		3,71,375	1,97,175
3	**Long-term borrowings**		
	5% Debentures	2,00,000	-
	Secured loan	-	2,00,000
		2,00,000	2,00,000
4	**Property, plant and Equipment**		
	Land and Building	4,50,000	3,00,000
	Plant and machinery	6,20,000	5,00,000

TELEGRAM: CA NOTE HUB

	Furniture and fittings	60,000	20,000
		11,30,000	8,20,000
5	**Intangible assets**		
	Goodwill	80,000	-
		80,000	-
6	**Cash and Cash Equivalents**		
	Cash at Bank	1,20,000	55,000
	Cash in hand	41,375	17,175
		1,61,375	72,175

The terms of amalgamation are as under:

(A) (1) The assumption of liabilities of both the Companies.

(2) Issue of 5 Preference shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at premium of ₹ 4 per share for each preference share held in both the Companies.

(3) Issue of 6 Equity shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at a premium of ₹ 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.

(4) Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.

(B) (1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively to be raised.

(2) The trade receivables of K Ltd. include ₹ 20,000 due from L Ltd.

(C) The LK Ltd. is to issue 15,000 new equity shares of ₹ 20 each, ₹ 18 paid up at premium of ₹ 4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

Solution

Books of K Ltd.

Realization Account

	₹		₹
To Goodwill	80,000	By 5% Debentures	2,00,000
To Land & Building	4,50,000	By Trade payables	1,00,000
To Plant & Machinery	6,20,000	By LK Ltd.	15,60,000
To Furniture & Fitting	60,000	(Purchase consideration)	
To Trade receivables	2,75,000	By Equity shareholders A/c	51,375
To Stores & inventory	2,25,000	(loss)	
To Cash at Bank	1,20,000		
To Cash in hand	41,375		
To Preference shareholders			
(excess payment)	40,000		
	19,11,375		19,11,375

Equity Shareholders Account

	₹		₹
To Realization A/c (loss)	51,375	By Share capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit & Loss A/c	3,71,375
To Cash	64,000		
	11,71,375		11,71,375

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	4,40,000	By Share capital	4,00,000

TELEGRAM: CA NOTE HUB

		By Realization A/c	40,000
	4,40,000	4,40,000	

LK Ltd. Account

	₹		₹
To Realization A/c	15,60,000	By Equity Shares in LK Ltd.	
		For Equity 10,56,000	
		Pref. 4,40,000	14,96,000
		By Cash	64,000
	15,60,000	15,60,000	

Books of L Ltd.

Realization Account

	₹		₹
To Land & Building	3,00,000	By Trade payables	2,10,000
To Plant & Machinery	5,00,000	By Secured loan	2,00,000
To Furniture & Fittings	20,000	By LK Ltd. (Purchase consideration)	7,90,000
To Trade receivables	1,75,000	By Equity shareholders A/c— Loss	37,175
To Inventory of stores	1,40,000		
To Cash at bank	55,000		
To Cash in hand	17,175		
To Pref. shareholders	30,000		
	12,37,175		12,37,175

Equity Shareholders Account

	₹		₹
To Equity shares in LK Ltd.	3,96,000	By Share Capital	3,00,000
To Realization	37,175	By Profit & Loss A/c	97,175
To Cash	64,000	By Reserve	1,00,000
	4,97,175		4,97,175

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	3,30,000	By Share capital	3,00,000
		By Realization A/c	30,000
	3,30,000		3,30,000

LK Ltd. Account

	₹		₹
To Realization A/c	7,90,000	By Equity shares in LK Ltd	
		For Equity 3,96,000	
		Preference 3,30,000	7,26,000
		By Cash	64,000
	7,90,000		7,90,000

Working Notes:

(i) Purchase consideration

	K Ltd.	L Ltd.
	₹	₹
Payable to preference shareholders:		
Preference shares at ₹ 22 per share	4,40,000	3,30,000
Equity Shares at ₹ 22 per share	10,56,000	3,96,000
Cash [See W.N. (ii)]	64,000	64,000
	15,60,000	7,90,000

TELEGRAM: CA NOTE HUB

(ii) Value of Net Assets

		K Ltd.		L Ltd.
		₹		₹
Goodwill		80,000		
Land & Building		4,50,000		3,00,000
Plant & Machinery		6,20,000		5,00,000
Furniture & Fittings		60,000		20,000
Trade receivables less 2.5%		2,68,125		1,70,625
Inventory less 2%		2,20,500		1,37,200
Cash at Bank		1,20,000		55,000
Cash in hand		41,375		17,175
		18,60,000		12,00,000
Less : Debentures	2,00,000	–		
Trade payables	1,00,000		2,10,000	
Secured Loans –		(3,00,000)	2,00,000	(4,10,000)
		15,60,000		7,90,000
Payable in shares		14,96,000		7,26,000
Payable in cash		64,000		64,000

Illustration 8

Consider the following balance sheets of X Ltd. and Y Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ X Ltd ('000)	₹ Y Ltd. ('000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	72,00	47,00
	B	Reserves and Surplus	2	15,50	10,50
2		**Non-current liabilities**			
	A	Long-term borrowings	3	5,00	3,50
3		**Current liabilities**			
	A	Trade Payables		4,50	3,50
	B	Other current liabilities		2,00	1,50
		Total		99,00	66,00
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	63,25	36,00
	B	Non-current investments	5	7,00	5,00
2		**Current assets**			
	A	Inventories		12,50	9,50
	B	Trade receivables		9,00	10,30
	C	Cash and Cash equivalents		7,25	5,20
		Total		99,00	66,00

Notes to accounts

		X Ltd ('000)	Y Ltd ('000)
1	**Share Capital**		
	Equity share capital (₹ 10 each)	50,00	30,00
	14% Preference Shares capital ₹ 100 each	22,00	17,00
		72,00	47,00

TELEGRAM: CA NOTE HUB

2	**Reserves and Surplus**		
	General reserve	5,00	2,50
	Export profit reserve	3,00	2,00
	Investment allowance reserve	-	1,00
	Profit and loss account	7,50	5,00
		15,50	10,50
3	**Long-term borrowings**		
	13% Debentures of ₹ 100 each	5,00	3,50
		5,00	3,50
4	**Property, Plant and Equipment**		
	Land and Building	25,00	15,50
	Plant and machinery	32,50	17,00
	Furniture	5,75	3,50
		63,25	36,00
5	**Non-current investments**		
	Investments at cost	7,00	5,00
		7,00	5,00

X Ltd. takes over Y Ltd. on 1st April, 20X1. X Ltd. discharges the purchase consideration as below:

(i) Issued 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders of Y Ltd.

(ii) Issued 15% preference shares of ₹ 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the (i) Journal entries and (ii) Balance sheet of X Ltd. after amalgamation on the assumption that:

a) the amalgamation is in the nature of merger.

b) the amalgamation is in the nature of purchase.

Solution

(a) Amalgamation in the nature of merger:

(i) Journal Entries in the Books of X Ltd.

		Dr.	Cr.
		₹	₹
Business Purchase	Dr.	53,70,000	
To Liquidator of Y Ltd.			53,70,000
(Consideration payable for business taken over from Y Ltd)			
Sundry Assets of Y Ltd	Dr.	66,00,000	
General Reserve (Related to X Ltd)		4,20,000	
To Sundry Liabilities of Y Ltd			8,50,000
To Export profit Reserve			2,00,000
To Investment allowance Reserve1,00,000			
To Profit & Loss			5,00,000
To Business Purchase			53,70,000
(Incorporation of various assets and liabilities taken over from Y Ltd. at book values and difference of share capital and purchase consideration being adjusted with free Reserves)			
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000
(Discharge of consideration for Y Ltd.'s business)			
Sundry Liabilities in Y Ltd (13% Debentures in Y Ltd.)	Dr.	3,50,000	

TELEGRAM: CA NOTE HUB

To 13% Debentures		3,50,000
(Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)		

(ii) Balance Sheet of X Ltd.

		Particulars	Notes	₹ in '000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570
	b	Reserves and Surplus	2	1,930
2		**Non-current liabilities**		
	a	Long-term borrowings	3	850
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		16,500
		Assets		
	1	**Non-current assets**		
	a	Property, Plant and Equipment	4	9,925
	b	Non-current investments		1,200
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and cash equivalents		1,245
		Total		16,500

Notes to accounts

			₹ in '000
1 Share Capital			
Equity share capital			
8,50,000 Equity Shares of ₹ 10 each			8,500
Preference share capital			
18,700, 15% Preference Shares of ₹ 100 each			1,870
22,000, 14% Preference Shares of ₹ 100 each			2,200
Total			12,570
2 Reserves and Surplus			
General Reserve of X Ltd.	500		
Add: General reserve of Y Ltd.	250	750	
Less: Adjustment for amalgamation*		(670)	80
Export Profit Reserve of X Ltd.		300	
Add: Export Profit Reserve of Y Ltd.		200	500
Investment Allowance Reserve			100
Profit & Loss A/c of X Ltd.		750	
Add: Profit & Loss A/c of Y Ltd.		500	1,250
Total			1,930
3 Long-term borrowings			
Secured			
8,500 13% Debentures of ₹ 100 each			850
Total			850
4 Property, Plant and Equipment			
Land & Buildings			4,050

TELEGRAM: CA NOTE HUB

Plant & Machinery		4,950
Furniture & Fittings		925
Total		9,925

*The difference between the amount recorded as share capital issued and the amount of share capital of transferor-company should be adjusted in reserves. Thus, Adjustment for amalgamation = ₹ '000 (53,70 – 47,00) = ₹ ('000) 670

(b) Amalgamation in the nature of purchase:

(i) Journal Entries in the Books of X Ltd.

		Dr. ₹	Cr. ₹
Business Purchase	Dr.	53,70,000	
To Liquidator of Y Ltd.			53,70,000
(Consideration payable for business taken over from Y Ltd)			
Sundry Assets of Y Ltd	Dr.	66,00,000	
To Sundry Liabilities of Y Ltd			8,50,000
To Capital Reserve			3,80,000
To Business Purchase			53,70,000
(Incorporation of various assets and liabilities taken over from Y Ltd. at book values and difference of Net assets and purchase consideration being credited to Capital reserve)			
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000
(Discharge of consideration for Y Ltd.'s business)			
13% Debentures in Y Ltd.	Dr.	3,50,000	
To 13% Debentures			3,50,000
(Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)			

Balance Sheet of X Ltd.

		Particulars	Notes	₹ in'000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570
	b	Reserves and Surplus	2	1,930
2		**Non-current liabilities**		
	a	Long-term borrowings	3	850
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		**16,500**
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	9,925
	b	Non-current investments		1,200
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and cash equivalents		1,245
		Total		**16,500**

Notes to accounts

TELEGRAM: CA NOTE HUB

			₹ in'000
1	**Share Capital**		
	Equity share capital		
	8,50,000 Equity Shares of ₹ 10 each		8,500
	Preference share capital		
	18,700, 15% Preference Shares of ₹ 100 each		1,870
	22,000, 14% Preference Shares of ₹ 100 each		2,200
	Total		**12,570**
2	**Reserves and Surplus**		
	Capital Reserve		380
	General Reserve		500
	Amalgamation adjustment reserve		(300)
	Export Profit Reserve		500
	Investment Allowance Reserve		100
	Surplus (Profit & Loss A/c)		750
	Total		**1,930**
3	**Long-term borrowings**		
	Secured		
	8,500 13% Debentures of ₹ 100 each		850
	Total		**850**
4	**Property, Plant and Equipment**		
	Land & Buildings		4,050
	Plant & Machinery		4,950
	Furniture & Fittings		925
	Total		**9,925**

Workings Notes:

Capital Reserve arising on Amalgamation:

(A)	Net Assets taken over:	₹ ('000) ₹	('000)
	Sundry Assets		66,00
	Less: 13% Debentures	3,50	
	Trade payables	3,50	
	Other current liabilities	1,50	(8,50)
			57,50
(B)	Purchase consideration:		
	To Equity Shareholders of Y Ltd.		35,00
	To Preference Shareholders of Y Ltd.		18,70
			53,70
(C)	Capital Reserve (A – B)		3,80

Illustration 9 (RTP May'23) (Past Exam May'19)

The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ P Ltd	₹ Q Ltd
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	8,00,000	4,00,000
	B	Reserves and Surplus		3,00,000	2,00,000
2		**Non-current liabilities**			
	A	Long-term borrowings	2	2,00,000	1,50,000
3		**Current liabilities**			
	A	Trade Payables		2,50,000	1,50,000
		Total		**15,50,000**	**9,00,000**

TELEGRAM: CA NOTE HUB

		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		7,00,000	2,50,000
	B	Non-current investments		80,000	80,000
2		**Current assets**			
	A	Inventories		2,40,000	3,20,000
	B	Trade receivables		4,20,000	2,10,000
	C	Cash and Cash equivalents		1,10,000	40,000
		Total		**15,50,000**	**9,00,000**

Notes to accounts

		P Ltd.	Q Ltd.
1	**Share Capital**		
	Equity shares of ₹ 10 each	6,00,000	3,00,000
	10% Preference Shares of ₹ 100 each	2,00,000	1,00,000
		8,00,000	4,00,000
2	**Long term borrowings**		
	12% Debentures	2,00,000	1,50,000
		2,00,000	1,50,000

Details of Trade receivables and trade payables are as under:

	P Ltd. (₹)	Q Ltd. (₹)
Trade receivables		
Debtors	3,60,000	1,90,000
Bills Receivable	60,000	20,000
	4,20,000	2,10,000
Trade payables		
Sundry Creditors	2,20,000	1,25,000
Bills Payable	30,000	25,000
	2,50,000	1,50,000

Property, plant and equipment of both the companies are to be revalued at 15% above book value. Both the companies are to pay 10% Equity dividend, but Preference dividend having been already paid.

After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in P Ltd.

(iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include ₹ 10,000 due to P Ltd.

(v) Inventory in Trade and Debtors are taken over at 5% lesser than their book value by P Ltd.

Prepare:

a) Journal entries in the books of P Ltd.

b) Statement of consideration payable by P Ltd. **(10 Marks)**

Solution

(a) Journal Entries in the Books of P Ltd.

		Dr. ₹	Cr. ₹
Property, Plant and Equipment	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of PPE at 15% above book value)			

TELEGRAM: CA NOTE HUB

Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	4,90,000	
To Liquidator of Q Ltd.			4,90,000
(Consideration payable for the business taken over from Q Ltd.)			
Property, Plant and Equipment (115% of ₹ 2,50,000)	Dr.	2,87,500	
Inventory (95% of ₹ 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(₹ 40,000 –₹ 30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders of Q Ltd. at a discount of 10%)			
Sundry Creditors of Q Ltd.	Dr.	10,000	
To Sundry Debtors of P Ltd.			10,000
(Cancellation of mutual owing)			
Goodwill Dr.		30,000	
To Bank			30,000
(Being liquidation expenses reimbursed to Q Ltd.)			
Capital Reserve	Dr.	30,000	
To Goodwill			30,000
(Being goodwill set off)			

(b) Statement of Consideration payable by P Ltd. for 30,000 shares (payment method)

Shares to be allotted $\frac{30,000}{6} \times 8$ = 40,000 shares of P Ltd.

Issued 40,000 shares of ₹ 10 each i.e. ₹ 4,00,000 (i)

For 10% preference shares, to be paid at 10% discount

₹ $\frac{1,00,000 \times 90}{100}$ ₹ 90,000 (ii)

TELEGRAM: CANOTE HUB

Consideration amount [(i) + (ii)]	₹ 4,90,000

TELEGRAM: CANOTE HUB

Illustration 10 (MTP Mar'22, Oct'23, Mar'24) (RTP Nov'18)

The financial position of two companies Hari Ltd. and Vayu Ltd. as at 31st March, 20X1 was as under:

		Particulars	Notes	Hari Ltd.	Vayu Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	11,00,000	4,00,000
	B	Reserves and Surplus	2	70,000	70,000
2		**Non-current liabilities**			
	A	Long term provisions	3	50,000	20,000
3		**Current liabilities**			
	A	Trade Payables		1,30,000	80,000
		Total		**13,50,000**	**5,70,000**
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	8,00,000	2,50,000
	B.	Intangible assets	5	50,000	25,000
2		**Current assets**			
	A	Inventories		2,50,000	1,75,000
	B	Trade receivables		2,00,000	1,00,000
	C	Cash and Cash equivalents		50,000	20,000
		Total		**13,50,000**	**5,70,000**

Notes to accounts

	Hari Ltd.	Vayu Ltd.
1 Share Capital		
Equity shares of ₹ 10 each	10,00,000	3,00,000
9% Preference Shares of ₹ 100 each	1,00,000	--
10% Preference Shares of ₹ 100 each	--	1,00,000
	11,00,000	4,00,000
2 Reserves and Surplus		
General reserve	70,000	70,000
	70,000	70,000
3 Long term Provisions		
Retirement gratuity fund	50,000	20,000
	50,000	20,000
4 Property, plant and Equipment		
Land and Building	3,00,000	1,00,000
Plant and machinery	5,00,000	1,50,000
	8,00,000	2,50,000
5 Intangible assets		
Goodwill	50,000	25,000
	50,000	25,000

Hari Ltd. absorbs Vayu Ltd. on the following terms:

a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.

b) Goodwill of Vayu Ltd. is valued at ₹ 50,000, Buildings are valued at ₹,50,000 and the Machinery at ₹ 1,60,000.

c) Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.

d) Equity Shareholders of Vayu Ltd. will be issued necessary Equity Shares @ 5% premium.

Prepare necessary Ledger Accounts to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 20X1. **(16 Marks)**

TELEGRAM: CA NOTE HUB

Solution

In the Books of Vayu Ltd.

Realization Account

	₹		₹
To Sundry Assets	5,70,000	By Retirement Gratuity Fund	20,000
To Preference Shareholders (Premium on Redemption)	10,000	By Trade payables	80,000
To Equity Shareholders		By Hari Ltd. (Purchase Consideration) 5,30,000	
(Profit on Realization)	50,000		
	6,30,000		6,30,000

Equity Shareholders Account

	₹		₹
To Equity Shares of Hari Ltd.	4,20,000	By Share Capital	3,00,000
		By General Reserve	70,00
		By Realization Account (Profit on realization)	50,000
	4,20,000		4,20,000

Preference Shareholders Account

	₹		₹
To 9% Preference Shares of Hari Ltd.	1,10,000	By Preference Share Capital	1,00,000
		By Realization Account (Premium on Redemption of Preference Shares)	10,000
	1,10,000		1,10,000

Hari Ltd. Account

	₹		₹
To Realization Account	5,30,000	By 9% Preference Shares	1,10,000
		By Equity Shares	4,20,000
	5,30,000		5,30,000

In the Books of Hari Ltd.

Journal Entries

		Dr. ₹	Cr. ₹
Business Purchase A/c	Dr.	5,30,000	
To Liquidators of Vayu Ltd. Account			5,30,000
(Being business of Vayu Ltd. taken over)			
Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Inventory Account	Dr.	1,57,500	
Trade receivables Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Retirement Gratuity Fund Account			20,000
To Trade payables Account			80,000
To Provision for Doubtful Debts Account			7,500

TELEGRAM: CA NOTE HUB

To Business Purchase A/c			5,30,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Vayu Ltd. A/c	Dr.	5,30,000	
To 9% Preference Share Capital A/c			1,10,000
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			20,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Hari Ltd. (after absorption)

as at 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	16,10,000
	B	Reserves and Surplus	2	90,000
2		**Non-current liabilities**		
	A	Long-term provisions	3	70,000
3		**Current liabilities**		
	A	Trade Payables		2,10,000
		Total		19,80,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	11,10,000
	B	Intangible assets	5	1,00,000
2		**Current assets**		
	A	Inventories		4,07,500
	B	Trade receivables	6	2,92,500
	C	Cash and cash equivalents		70,000
		Total		19,80,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	1,40,000 Equity Shares of ₹ 10 each fully paid (Out of above 40,000 Equity Shares were issued in consideration other than for cash)	14,00,000
	Preference share capital	
	2,100 9% Preference Shares of ₹ 100 each	
	(Out of above 1,100 Preference Shares were issued in consideration other than for cash)	2,10,000
	Total	16,10,000
2	**Reserves and Surplus**	
	Securities Premium	20,000

TELEGRAM: CA NOTE HUB

	General Reserve	70,000
	Total	90,000
3	**Long-term provisions**	
	Retirement Gratuity fund	70,000
	Total	70,000
4	**Property, Plant and Equipment**	
	Buildings	4,50,000
	Machinery	6,60,000
	Total	11,10,000
5	**Intangible assets**	
	Goodwill	1,00,000
6	**Trade receivables**	3,00,000
	Less: Provision for Doubtful Debts	7,500
		2,92,500

Working Notes:

Purchase Consideration:	**₹**
Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Inventory	1,57,500
Trade receivables	92,500
Cash at Bank	20,000
	6,30,000
Less: Liabilities:	
Retirement Gratuity Fund	(20,000)
Trade payables	(80,000)
Net Assets/ Purchase Consideration	5,30,000
To be satisfied as under:	
10% Preference Shareholders of Vayu Ltd.	1,00,000
Add: 10% Premium	10,000
1,100 9% Preference Shares of Hari Ltd.	1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium	4,20,000
Total	5,30,000

Illustration 11

The following are the Balance Sheets of A Ltd. and B Ltd. as at 31.3.20X1:

		Particulars	**Notes**	**₹ A Ltd (in'000)**	**₹ B Ltd (in'000)**
		Equity and Liabilities			
1		**Shareholders' funds**			

TELEGRAM: CA NOTE HUB

	A	Share capital	1	2,000	1,000
	B	Reserves and Surplus	2	1,000	(800)
2		**Non-current liabilities**			
	A	Long-term borrowings	3	750	450
3		**Current liabilities**			
	A	Trade Payables		300	300
	B	Short term Borrowings –			
		Bank overdraft		--	50
		Total		4,050	1,000
		Assets			
	1	**Non-current assets**			
	A	Property, Plant and Equipment		2,700	850
	B	Non-current investments		700	--
2		**Current assets**			
	A	Trade receivables		400	150
	B	Cash and Cash equivalents		250	--
		(cash at bank)			
		Total		4050	1000

Notes to accounts

1 Share capital	**A Ltd. ('000)**	**B Ltd. ('000)**
Equity shares of ₹ 100 each	2000	1000
	2000	1000
2 Reserves and Surplus		
General reserve	1000	--
Profit and loss A/c (debit balance)	--	(800)
	1000	(800)
3 Long term borrowings		
10% debentures	500	--
Loan from banks	I	450
	750	450

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

(i) Banks agreed to waive off the loan of ₹ 60 thousands of B Ltd.

(ii) B Ltd. will reduce its shares to ₹ 10 per share and then consolidate 10 such shares into one share of ₹ 100 each (new share).

(iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.

(iv) Trade payables of B Ltd. includes ₹ 100 thousands payable to A Ltd.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger.

Solution:

Calculation of purchase consideration

TELEGRAM: CA NOTE HUB

One share of B Ltd. will be issued in exchange of every share of A Ltd. (i.e. 20,000 equity shares of B Ltd. will be issued against 20,000 equity shares of A Ltd.) 20,000 shares

Journal Entries in the books of B Ltd.

Date			(₹ in thousands)	
20X1			Dr.	Cr.
March,31	Loan from bank A/c	Dr.	60	
	To Capital reduction A/c			60
	(Being loan from bank waived off to the extent of ₹ 60 thousand)			
	Equity share capital A/c (₹ 100)	Dr.	1,000	
	To Equity share capital A/c (₹ 10)			100
	To Capital reduction A/c			900
	(Being equity shares of ₹ 100 each reduced to ₹ 10 each)			
	Equity share capital A/c (₹ 10)	Dr.	100	
	To Equity share capital A/c (₹ 100 each)			100
	(Being 10 equity shares of ₹ 10 each consolidated to one share of ₹ 100 each)			
	Capital reduction A/c	Dr.	960	
	To Profit and loss A/c			800
	To Capital reserve A/c			160
	(Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)			
	Property, plant and equipment A/c	Dr.	2,700	
	Investment A/c	Dr	. 700	
	Trade receivables A/c	Dr.	400	
	Cash at bank A/c	Dr.	250	
	To Trade payables A/c			300
	To Loans from bank A/c			250
	To 10% Debentures A/c			500
	To Liquidator of A Ltd. A/c		2,000	
	To Reserves A/c			1,000
	(Being assets, liabilities and reserves taken over under pooling of interest method and amount due to Liquidator)			
	Liquidator of A Ltd. A/c	Dr.	2,000	
	To Equity share capital A/c			2,000
	(Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)			
	Trade payables A/c	Dr.	100	
	To Trade receivables A/c			100
	(Being mutual owing cancelled)			

Balance Sheet of B Ltd. after merger as at 31.3.20X1

		Particulars	Notes	₹ in

TELEGRAM: CA NOTE HUB

				'000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	2,100
	b	Reserves and Surplus	2	1,160
2		**Non-current liabilities**		
	a	Long term borrowings	3	1,140
3		**Current liabilities**		
	a	Trade payables		500
	b	Short term borrowings	4	50
		Total		4,950
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment		3,550
	b	Non-current investments		700
2		**Current assets**		
	a	Trade receivables		450
	b	Cash and cash equivalents		250
		Total		4,950

Notes to accounts

				₹ in '000
1	**Share Capital**			
	21,000, Equity shares of ₹ 100 each fully paid			2,100
	(Out of the above, 20,000 shares have been issued for consideration other than cash)			
2	**Reserves and Surplus**			
	Capital reserve	160		
	General reserve	1,000		
			Total	1,160
3	**Long Term Borrowings**			
	10% Debentures	500		
	Loan from Bank (250+450-60)	640		1,140
4	**Short term borrowings**			
	Bank overdraft			50

Illustration 12 (MTP Apr'21, Mar'22, Past Exam Jan'21)

What are the conditions, which, according to AS 14 on Accounting for Amalgamations, must be satisfied for an amalgamation in the nature of merger? **(4 Marks)**

Solution:

Amalgamation in the nature of merger is an amalgamation where there is a genuine pooling not only of assets and liabilities of the transferor and transferee companies but also of the shareholders' interests and of the businesses of the companies. The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the respective figures of the transferor and transferee companies.

TELEGRAM: CA NOTE HUB

Amalgamation in the nature of merger is an amalgamation, as per para 3(e) of AS-14, which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies. For example, if transferor company is following weighted average method for inventory valuation, the book value of the inventory of the transferor company will be revised by applying the FIFO method (if the transferee company follows FIFO method for inventory valuation).

If any one or more of the above conditions are not satisfied in an amalgamation, such amalgamation is called **amalgamation in the nature of purchase**.

Illustration 13 (MTP Oct'20, Oct'21)

Distinguish between (i) the pooling of interest's method and (ii) the purchase method of recording transactions relating to amalgamation. **(4 Marks)**

Solution:

Pooling of Interest Method

Under pooling of interest's method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies. As a result, the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in the reserves of the financial statements of Transferee company (recorded as deduction from the reserves where the capital issued is more than the capital of the transferor company).

In simple terms, where in case of pooling method- the amount to be adjusted against the reservescan be computed in the following 3 steps-

Step I- Equity Share capital + Preference share capital issued+ any other additional consideration in form of cash and other assets by the Transferee Company.

Step II- Existing Equity share capital + Existing Preference share capital in the books of Transferor Company.

Step III- Step I- Step II= amount to be adjusted from the reserves of Transferee company.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

TELEGRAM: CA NOTE HUB

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized as goodwill in the financial statement of the transferee company. Any short fall should be shown as capital reserve. Goodwill should be amortized over period of five years unless a somewhat longer period can be justified.

In simple terms, where in case of purchase method- the amount to be transferred to capital reserve or to be recorded as Goodwill- can be computed in the following 3 steps-

Step I- Find out the **Net assets** amount using the following formula- Total assets- Outside liabilities (Noncurrent liabilities + Current Liabilities)

Step II- Compute the purchase consideration using any of the methods as given under Purchase consideration computation.

Step III- (a) If Step I- Step II= Positive amount- then it is capital reserve- since the assets received more than the amount paid as purchase consideration to acquire them.

(b) If Step I- Step II= Negative amount- then it is to be recorded as Goodwill (intangible asset) - since the amount paid for acquiring business is more than the Net assets, which is technically due to its goodwill.

Illustration 14

The following are the Balance Sheets of Yes Ltd. and No Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ Yes Ltd (in crores)	₹ No Ltd (in crores)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	12	5
	B	Reserves and Surplus		88	10
2		**Non-current liabilities**			
	A	Long term borrowings	2	--	10
3		**Current liabilities**		33	15
		Total		133	40
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	3	20	6
	B	Non-current investments	4	13	--
2		**Current assets**		100	34
		Total		133	40

Notes of accounts

			Yes Ltd.	No Ltd.
1	**Share Capital**			
	Equity share capital			
	Authorized share capital		25	5
	Issued and subscribed:			
	Equity shares of ₹ 10 each fully paid		12	5
			12	5
2	**Long term borrowings**			
	Unsecured loan from Yes Ltd.		--	10

TELEGRAM: CA NOTE HUB

			--	10
3	**Property, Plant and Equipment**			
	Gross value		70	30
	Depreciation		(50)	(24)
			20	6
4	**Non-current investments**			
	30 lakhs equity shares of ₹ 10 each		3	--
	Long term loan to No Ltd.		10	--
			13	--

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity share of Yes Ltd. issued at a premium of ₹ 2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.

You are asked to pass journal entries in the books of the two companies to give effect to the above if the amalgamation is in the nature of merger.

Solution:

Journal Entries in the books of No Ltd.

(Rupees in crores)

		Dr.	Cr.
Realization Account	Dr.	64.00	
To Property, plant and equipment Account			30.00
To Current Assets Account			34.00
(Being the assets taken over by Yes Ltd. transferred to Realization Account)			
Provision for depreciation Account	Dr.	24.00	
Current Liabilities Account	Dr.	15.00	
Unsecured Loan from Yes Ltd. Account	Dr.	10.00	
To Realization Account			49.00
(Being the transfer of liabilities and provision to Realization Account)			
Yes Ltd.	Dr.	1.2	
To Realization Account			1.2
(Being the amount of consideration due from Yes Ltd. Credited to Realization Account)			
Equity Shareholders Account	Dr.	13.80	
To Realization Account			13.80
(Being the loss on Realization transferred to equity share- holders account)			
Equity Share Capital Account	Dr.	5.00	
Reserves and Surplus Account	Dr.	10.00	
To Equity Shareholders Account			15.00
(Being the amount of share capital, reserves and surplus credited to equity shareholders account)			
Equity shares of Yes Ltd.	Dr.	1.20	
To Yes Ltd.			1.20
(Being the receipt of 10 lakhs equity shares of ₹ 10 each at ₹ 12 per share for allotment to shareholders)			
Equity shareholders Account	Dr.	1.20	

TELEGRAM: CA NOTE HUB

To Equity shares of Yes Ltd.		1.20
(Being the distribution of equity shares received from Yes Ltd. to shareholders)		

Journal Entries in the books of Yes Ltd.

(Rupees in crores)

		Dr.	Cr.
Business Purchase Account	Dr.	1.2	
To Liquidator of No Ltd. Account			1.2
(Being the amount of purchase consideration agreed under approved scheme of amalgamation- W.N. 1)			
Property, plant and equipment	Dr.	6.00	
Current Assets	Dr.	34.00	
To Current Liabilities			15.00
To Unsecured Loan (from Yes Ltd.)			10.00
To Business Purchase Account			1.20
To Reserve & Surplus A/c			10.00
To Profit & loss A/c			3.80
(Being the assets and liabilities taken over and the surplus transferred to Profit and loss account)			
Liquidator of No Ltd.	Dr.	1.20	
To Equity Share Capital Account			1.00
To Securities Premium Account			0.20
(Being the allotment to shareholders of No Ltd. 10 lakhs equity shares of ₹ 10 each at a premium of ₹ 2 per share)			
Unsecured Loan (from Yes Ltd.)	Dr.	10.00	
To Loan to No. Ltd.			10.00
(Being the cancellation of unsecured loan given to No Ltd.)			

Working Note:

Purchase Consideration ₹ in crores

$\frac{50\text{lakhs}}{5}$× ₹ 12 i.e., 10 lakhs equity shares at ₹ 12 per share 1.20

Number of equity shares of ₹ 10 each to be issued $\left[\frac{1.20\text{ crores}}{12}\right]$ = 10 lakhs.

Illustration 15

The following are the Balance Sheets of X Ltd. and Y Ltd :

		Particulars	Notes	₹ X Ltd.	₹ Y Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	1,00,000	50,000
	B	Reserves and Surplus	2	10,000	(10,000)
	2	**Non-current liabilities**			
	A	Long term borrowings	3	--	15,000

TELEGRAM: CA NOTE HUB

3		**Current liabilities**			
	A	Trade Payables		25,000	5,000
		Total		135,000	60,000
		Assets			
	1	**Non-current assets**			
	A	Property, Plant and Equipment		1,20,000	60,000
	B	Non-current investments	4	15,000	--
		Total		135,000	60,000

Notes to accounts

1	**Share Capital X Ltd. Y Ltd.**			
	Equity share capital		1,00,000	50,000
			1,00,000	50,000
2	**Reserves and Surplus**			
	Profit and loss A/c		10,000	--
	Profit and loss A/c (debit balance)		--	(10,000)
			10,000	(10,000)
3	**Long term borrowings**			
	Loan from X Ltd.		--	15,000
4	**Non-current investments**			
	Loan to Y Ltd.		15,000	--
			15,000	--

A new company XY Ltd. is formed to acquire the sundry assets and trade payables of X Ltd. and Y Ltd. and for this purpose, the sundry assets of X Ltd. are revalued at ₹ 1,00,000. The debt due to X Ltd. is also to be discharged in shares of XY Ltd.

Show the Ledger Accounts to close the books of X Ltd.

Solution:

Books of X Ltd.

Realization Account

	₹		₹
To Sundry Assets	1,20,000	By Trade payables	25,000
		By XY Ltd. (Purchase consideration)	75,000
		By Shareholders (Loss on realization)	20,000
	1,20,000		1,20,000

Shareholders Account

	₹		₹
To Realization Account (Loss)	20,000	By Equity Share Capital	1,00,000
To Shares in XY Ltd.	90,000	By Profit and Loss Account	10,000
	1,10,000	1,10,000	

Loan Y Ltd.

	₹		₹
To Balance b/d	15,000	By Shares in XY Ltd.	15,000

TELEGRAM: CA NOTE HUB

Shares in XY Ltd.

	₹		₹
To XY Ltd.	75,000	By Shareholders	90,000
To Loan Y Ltd.	15,000		
	90,000		90,000

XY Ltd.

	₹		₹
To Realization Account	75,000	By Shares in XY Ltd.	75,000

Illustration 16

Super Express Ltd. and Fast Express Ltd. were in competing business. They decided to form a new company named Super Fast Express Ltd. The balance sheets of both the companies were as under:

		Particulars	**Notes**	**Super Express Ltd. ₹**	**Fast Express Ltd.₹**
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	20,00,000	10,00,000
	B	Reserves and Surplus	2	1,00,000	2,60,000
2		**Non-current liabilities**			
	A	Long term provisions	3	1,00,000	--
2		**Current liabilities**			
	A	Trade Payables		60,000	40,000
		Total		22,60,000	13,00,000
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	14,00,000	11,00,000
	B	Intangible assets	5	--	1,00,000
2		**Current assets**			
	A	Inventories		3,00,000	40,000
	B	Trade receivables		2,40,000	40,000
	C	Cash and Cash equivalents	6	3,20,000	20,000
		Total		22,60,000	13,00,000

Notes to accounts

		Super Express Ltd. ₹	**Fast Express Ltd.₹**
1	**Share Capital**		
	Equity shares of ₹ 100 each	20,00,000	10,00,000
2	**Reserves and Surplus**		
	Insurance reserve	1,00,000	--
	Employee profit sharing reserve	--	60,000

TELEGRAM: CA NOTE HUB

	Reserve account	--	1,00,000
	Surplus	--	1,00,000
		1,00,000	2,60,000
3	**Long term provisions**		
	Provident fund	1,00,000	--
	Total	1,00,000	--
4	**Property, Plant and Equipment**		
	Land and Building	10,00,000	6,00,000
	Plant and machinery	4,00,000	5,00,000
		14,00,000	11,00,000
5	**Intangible assets**		
	Goodwill	--	1,00,000
		--	1,00,000
6	**. Cash and Cash Equivalents**		
	Cash at Bank	2,20,000	10,000
	Cash in hand	1,00,000	10,000
		3,20,000	20,000

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of ₹ 100 each in lieu of purchase consideration amounting to ₹ 30,000 (20,000 for Super-Fast Express Ltd and 10,000 for Fast Express Ltd.).

Prepare opening balance sheet of Super Fast Express Ltd. considering pooling method.

Solution:

Balance Sheet of Super Fast Express Ltd.

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
	b	Reserves and Surplus	2	3,60,000
2		**Non-current liabilities**		
	a	Long-term provisions	3	1,00,000
3		**Current liabilities**		
	a	Trade Payables		1,00,000
		Total		35,60,000
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	25,00,000
	b	Intangible assets	5	1,00,000
2		**Current assets**		
		Inventories		3,40,000
		Trade receivables		2,80,000
		Cash and cash equivalents	6	3,40,000

TELEGRAM: CA NOTE HUB

		Total		35,60,000

Notes to Accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	30,000 Equity shares of ₹ 100 each		30,00,000
	Total		30,00,000
2	**Reserves and Surplus**		
	Reserve account		1,00,000
	Surplus		1,00,000
	Insurance reserve		1,00,000
	Employees profit sharing account		60,000
	Total		3,60,000
3	**Long-term provisions**		
	Provident fund		1,00,000
	Total		1,00,000
4	**Property, Plant and Equipment**		
	Buildings		16,00,000
	Machinery		9,00,000
	Total		25,00,000
5	**Intangible assets**		
	Goodwill		1,00,000
	Total		1,00,000
6	**Cash and cash equivalents**		
	Balances with banks		2,30,000
	Cash on hand		1,10,000
	Total		3,40,000

Illustration 17 (MTP Aug'18, Apr'19, May'20, Mar'21, Apr'22)

The following were the Balance Sheets of P Ltd. and V Ltd. as at 31st March, 20X1:

		Particulars	**Notes**	**₹ P Ltd (₹ in Lakhs)**	**₹ V Ltd (₹ in Lakhs)**
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	15,000	6,000
	B	Reserves and Surplus	2	15,370	4,335
2		**Non-current liabilities**			
		Long term borrowings	3	--	1,000
3		**Current liabilities**			
	A	Trade Payables		1,200	463
	B	Short term provisions		1,830	702

TELEGRAM: CA NOTE HUB

		Total		33,400	12,500
		Assets			
1		**Non-current assets**			
		A Property, Plant and Equipment	4	22,304	6,750
2		**Current assets**			
	A	Inventories		7,862	4,041
	B	Trade receivables		2,120	1,100
	C	Cash and Cash equivalents		1,114	609
		Total		33,400	12,500

Notes to accounts

		₹ P Ltd (₹ in Lakhs)	₹ V Ltd (₹ in Lakhs)
1	**Share Capital**	15,000	6,000
2	**Reserves and Surplus**		
	Securities premium	3,000	--
	Foreign project reserve	--	310
	General reserve	9,500	3,200
	Profit and loss account	2,870	825
		15,370	4,335
3	**Long term borrowings**		
	12% debentures	--	1,000
		--	1,000
4	**Property, Plant and Equipment**		
	Land and Building	6,000	--
	Plant and machinery	14,000	5,000
	Furniture and fixtures	2,304	1,750
		22,304	6,750

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.

On 1st April 20X1, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P Ltd. would allot three fully paid equity shares of ₹ 10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Details of trade receivables and trade payables as under:

	P Ltd. (₹ in lakhs)	V Ltd. (₹ in lakhs)
Trade payables		
Bills Payable	120	-
Trade Creditors	1,080	463
	1,200	463
Trade receivables		
Trade debtors	2,120	1,020
Bills Receivable	—	80
	2,120	1,100

Expenses of amalgamation amounting to ₹ 1 lakh were borne by P Ltd.

You are required to: (i) pass journal entries in the books of P Ltd. and (ii) prepare P Ltd.'s Balance Sheet immediately after the merger. **(15 Marks)**

Solution:

TELEGRAM: CANOTE HUB

Books of P Ltd.

Journal Entries

		Dr. (₹ in Lacs)	Cr. (₹ in Lacs)
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd.			9,000
(Being business of V Ltd. taken over for Consideration settled as per agreement)			
Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1750	
Inventory	Dr.	4,041	
Debtors	Dr.	1,020	
Cash at Bank	Dr	609	
Bills Receivable	Dr.	80	
To Foreign Project Reserve			310
To General Reserve (3,200 - 3,000)			200
To Profit and Loss A/c (825)			825
To Liability for 12% Debentures			1,000
To Creditors			463
To Provisions			702
To Business Purchase			9,000
(Being assets & liabilities taken over from V Ltd.)			
Liquidator of V Ltd. A/c	Dr.	9,000	
To Equity Share Capital A/c			9,000
(Purchase consideration discharged in the form of equity shares)			
Goodwill A/c	Dr.	1	
To Bank A/c			1
(Liquidation expenses paid by P Ltd debited to Goodwill A/c)			
Profit and loss A/c	Dr.	1	
To Goodwill A/c			1
(being the Goodwill charged to Profit and loss account)			
Liability for 12% Debentures A/c	Dr.	1,000	
To 13% Debentures A/c			1,000
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	80	
To Bills Receivable A/c			80
(Cancellation of mutual owing on account of bills)			

Balance Sheet of P Ltd. as at 1st April, 20X1 (after merger)

		Particulars	Notes	₹ (in lakhs)

TELEGRAM: CA NOTE HUB

		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	24,000
	B	Reserves and Surplus	2	16,704
2		**Non-current liabilities**		
	A	Long-term borrowings	3	1,000
3		**Current liabilities**		
	A	Trade Payables (1,543 + 40)		1,583
	B	Short-term provisions		2,532
		Total		45,819
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	29,054
2		**Current assets**		
	A	Inventories		11,903
	B	Trade receivables		3,140
	C	Cash and cash equivalents		1,722
		Total		45,819

Notes to accounts

		₹
1.	**Share Capital**	
	Equity share capital	
	Authorized, issued, subscribed and paid up	
	24 crores equity shares of ₹ 10 each	24,000
	(Of the above shares, 9 crores shares have been issued for consideration other than cash)	
	Total	24,000
2.	**Reserves and Surplus**	
	General Reserve	9,700
	Securities Premium	3,000
	Foreign Project Reserve	310
	Profit and Loss Account	3,694
	Total	16,704
3.	**Long-term borrowings**	
	Secured	
	13% Debentures	1,000
4.	**Property, Plant and Equipment**	
	Land & Buildings	6,000
	Plant & Machinery	19,000
	Furniture & Fittings	4,054

TELEGRAM: CA NOTE HUB

	Total	29,054

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = ₹ 6,000 lacs × $\frac{3}{2}$ = ₹ 9,000 lacs.

Illustration 18 (MTP Oct'21, Apr'23) (Past Exam May'23)

Sun and Neptune had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorized share capital of ₹ 4,00,000 divided into 80,000 equity shares of ₹ 5 each. On 31st March, 20X3 the respective information of Sun and Neptune were as follows:

	Sun (₹)	Neptune (₹)
Share capital	3,65,000	3,52,500
Current liabilities	5,97,000	1,80,250
Property, Plant and Equipment	6,35,000	3,65,000
Current assets	3,27,000	1,67,750

Additional Information:

(a) Revalued figures of non-current and Current assets were as follows:

	Sun (₹)	Neptune (₹)
Property, Plant and Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

(b) The debtors and creditors include ₹ 43,350 owed by Sun to Neptune.

The purchase consideration is satisfied by issue of the following shares and debentures.

(i) 60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

	Sun (₹)	Neptune (₹)
20X1 Profit	4,49,576	2,73,900
20X2 (Loss)/Profit	(2,500)	3,42,100
20X3 Profit	3,77,924	3,59,000

(ii) 15% debenture in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31st March, 20X3 after revaluation of assets.

You are required to:

(1) Compute the amount of debentures and shares to be issued to Sun and Neptune.

(2) A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation. **(16 Marks)**

Solution:

(1) Computation of Amount of Debentures and Shares to be issued:

		Sun	Neptune
(i)	Average Net Profit		
	₹ (4,49,576-2,500+3,77,924)/3	= 2,75,000	
	₹ (2,73,900+,3,42,100+3,59,000)/3		= 3,25,000
(ii)	Equity Shares Issued		

TELEGRAM: CA NOTE HUB

	(a) Ratio of distribution		
	Sun: Neptune		
	275 325		
	(b) Number		
	Sun : 27,500		
	Neptune: 32,500		
	60,000		
	(c) Amount		
	27,500 shares of ₹ 5 each =		1,37,500
	32,500 shares of ₹ 5 each =		1,62,500
(iii)	Capital Employed (after revaluation of assets) ₹ ₹		
	Property, plant and equipment	7,10,000	3,90,000
	Current Assets	2,99,500	1,57,750
		10,09,500	5,47,750
	Less: Current Liabilities	(5,97,000)	(1,80,250)
		4,12,500	3,67,500
(iv)	Debentures Issued		
	8% Return on capital employed	33,000 29,400	
	15% Debentures to be issued to provide equivalent income:		
	Sun: 33,000 × $\frac{100}{15}$=	2,20,000	
	Neptune: 29,400 ×$\frac{100}{15}$=		1,96,000

(2) Balance Sheet of Jupiter Ltd.

As at 31st March 20X3 (after amalgamation)

Particulars	**Note No**	**₹**
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		
(a) Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
(1) Non-current assets		
(a) PPE		11,00,000
(2) Current assets		

TELEGRAM: CA NOTE HUB

(a) Other current assets		4, 13,900
Total		15,13,900

Notes to Accounts

		₹
1	Share Capital	
	Authorized	
	80,000 Equity Shares of ₹ 5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of ₹ 5 each	3,00,000
	(all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash)	
2	Reserve and Surplus	
	Capital Reserve	64,000
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	4,16,000

Working Notes:

		Sun ₹	Neptune ₹	Total ₹
(1)	Purchase Consideration			
	Equity Shares Issued	1,37,500	1,62,500	3,00,000
	15% Debentures Issued	2,20,000	1,96,000	4,16,000
		3,57,500	3,58,500	7,16,000
(2)	Capital Reserve			
	(a) Net Assets taken over			
	Property, plant & equipment	7,10,000	3,90,000	11,00,000
	Current Assets	2,99,500	1,14,400*	4,13,900
		10,09,500	5,04,400	15,13,900
	Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
		4,55,850	3,24,150	7,80,000
	(b) Purchase Consideration	3,57,500	3,58,500	7,16,000
	(c) Capital Reserve [(a) - (b)]	98,350		
	(d) Goodwill [(b) - (a)]		34,350	
	(e) Capital Reserve			64,000
	[Final Figure(c) -(d)]			

* 1,57,750–43,350= 1,14,400

** 5,97,000–43,350= 5,53,650

TELEGRAM: CA NOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Oct'19)

The following is the summarized Balance Sheet of 'A' Ltd. as on 31.3.2019:

Liabilities	Rs.	Assets	Rs.
14,000 Equity shares of Rs. 100 each, fully paid-up	14,00,000	Sundry assets	18,00,000
General reserve	10,000		
10% Debentures	2,00,000		
Trade payables	1,40,000		
Bank overdraft	50,000		
	18,00,000		18,00,000

B Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis: Market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is an unrecorded liability of Rs. 25,000. **(5 Marks)**

Solution:

Calculation of Purchase Consideration under Net Assets Method

	Rs.	Rs.
Sundry assets		
18,00,000 × $\frac{75}{100}$ × $\frac{112}{100}$ =	15,12,000	
18,00,000 × $\frac{75}{100}$ × $\frac{112}{100}$=	4,14,000	19,26,000
Less: Liabilities:		
10% Debentures	2,00,000	
Trade payables	1,40,000	
Bank overdraft	50,000	
Unrecorded liability	25,000	(4,15,000)
Purchase consideration		15,11,000

Question 2 (MTP Oct'18, RTP May'19)

P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2016 Their summarized Balance Sheets as on 31.03.2016 were as follows:

(Rs.in '000)

Particulars	P Ltd.	Q Ltd.
Source of Funds:		
Equity share capital (Rs.10 each)	300	280
9% preference share Capital (Rs.100 each)	60	40
Investment allowance Reserve	70	60
Profit and Loss Account	8	12
10 % Debentures	100	60
Trade Payables	50	30
Tax provision	14	8
Total	**602**	**490**
Application of Funds:		
Building	120	100
Plant and Machinery	160	140
Investments	80	50
Trade receivables	90	70

TELEGRAM: CA NOTE HUB

Inventories	72	80
Cash and Bank	80	50
Total	**602**	**490**

From the following information, you are required to prepare the Balance Sheet as on 01.04.2016 of a new company, R Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

(i) 50 % Debenture are to be converted into Equity Shares of the New Company.

(ii) Investments are non - current in nature.

(iii) Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.

(iv) 10 % of trade receivables were doubtful for both the companies. Inventories to be carried at cost.

(v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.

(vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of Rs.10 each of the new company at a premium of Rs. 5 per share.

Give your Answer on the basis that amalgamation is in the nature of purchase. **(15 Marks)**

Solution:

M/s R Ltd. Balance Sheet as at 1.4.2016

Particulars	**Notes**	**Rs. in'000**
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	6,55,980
b Reserves and Surplus	2	2,77,990
2 Non-current liabilities		
a Long-term borrowings	3	80,000
3 Current liabilities		
a Trade Payables	4	80,000
b Short term provision	5	22,000
Total		**11,15,970**
Assets		
1 Non-current assets		
a Fixed assets		
Tangible assets	6	5,60,000
b Non-current investments	7	1,30,000
2 Current assets		
a Inventory	8	1,52,000
b Trade receivables	9	1,44,000
c Cash and cash equivalents	10	1,29,970
Total		**11,15,970**

Note to accounts

	Rs. in'000
1. Share Capital	
Equity share capital	
55,598 Equity shares of Rs.10 each, fully paid up (W.N.2)	5,55,980
Preference share capital	
9% Preference share capital (Share of Rs.100 each) (W.N.2)	1,00,000
	6,55,980
2. Reserves and Surplus	

TELEGRAM: CA NOTE HUB

Securities premium (W.N.2)	2,77,990
Investment allowance reserve	1,30,000
(Rs.70,000+ Rs.60,000)	
Amalgamation adjustment reserve	(1,30,000)
	2,77,990
3. Long-term borrowings	
Secured	
10% Debentures (50% of Rs.1,60,000)	80,000
4. Trade Payables (Rs.50,000+ Rs.30,000)	80,000
5. Short term provisions	
Provision for tax (Rs.14,000+ Rs.8,000)	22,000
6. Tangible assets	
Building (Rs.1,32,000+Rs.1,05,000)	2,37,000
Plant and machinery (Rs.1,76,000+Rs.1,47,000)	3,23,000
	5,60,000
7. Non – current Investments (Rs.80,000+ Rs.50,000)	1,30,000
8. Inventory	
Stock (Rs. 72,000+ Rs. 80,000)	1,52,000
9. Trade receivables	
Trade receivables (90% of (Rs.90,000+ Rs.70,000)	1,44,000
10. Cash and cash equivalents	
Cash and Bank (Rs. 80,000+ Rs. 50,000 – Rs. 30)	1,29,970

Working Notes:

1. Calculation of value of equity shares issued to transferor companies

	P Ltd. (Rs.)	Q Ltd. (Rs.)
Assets taken over:		
Building	1,32,000	1,05,000
Plant and machinery	1,76,000	1,47,000
Investments	80,000	50,000
Inventories	72,000	80,000
Trade receivables	81,000	63,000
Cash & Bank	80,000	50,000
	6,21,000	4,95,000

Less: Liabilities:

10% Debentures	1,00,000		60,000	
Trade payables	50,000		30,000	
Tax Provision	14,000	1,64,000	8,000	98,000
		4,57,000		3,97,000
Less: Preference Share Capital		60,000		40,000
		3,97,000		**3,57,000**

2. Number of shares issued to equity shareholders, debenture holders and preference shareholders

	P Ltd.	Q Ltd.	Total
Equity shares issued @ Rs.15 per			
share (including Rs.5 premium)			
Rs.3,97,000/15	26,466 shares		
Rs.3,57,000/15		23,800 shares	50,266 shares
Equity share capital @ Rs.10	Rs.2,64,660	Rs.2,38,000	Rs.5,02,660
Securities premium @ Rs.5	Rs.1,32,330	Rs.1,19,000	Rs.2,51,330

TELEGRAM: CA NOTE HUB

	Rs.3,96,990	Rs.3,57,000	Rs.7,53,990

50% of Debentures are converted into equity shares @ Rs. 15 per share

1,00,000/2 = 50,000/15	3,332 shares		
60,000/2 = 30,000/15		2,000 shares	5,332 shares
Equity share capital @ Rs.10	Rs.33,320	Rs.20,000	Rs.53,320
Security premium@ Rs.5	Rs.16,660	Rs.49,980	Rs.10,000
	Rs.30,000	Rs.26,660	Rs. 79,980
9% Preference share capital issued	Rs.60,000	Rs.40,000	Rs.1,00,000

Question 3 (MTP Sep'22)

Black Limited and White Limited have been carrying their business independently from 01/04/2022.

Because of synergy in business, they amalgamated on and from 1 st April, 2022 and formed a new company Grey Limited to take over the business of Black Limited and White Limited. The information of Black Limited and White Limited as on 31st March, 2022 are as follows:

	Black Ltd.(₹)	**White Ltd.(₹)**
Share Capital:		
Equity share of ₹ 10 each	15,00,000	14,50,000
10% Preference shares of ₹ 100 each	2,00,000	1,40,000
Revaluation Reserve	1,00,000	2,00,000
General Reserve	1,65,000	85,000
Profit & Loss Account:		
Opening balance (Credit balance)	1,50,000	1,20,000
Profit for the Year	2,00,000	1,30,000
15% Debentures of ₹ 100 each (Secured)	4,00,000	5,00,000
Trade payables	3,10,000	1,20,000
Land and Buildings	3,20,000	7,40,000
Plant and Machinery	18,00,000	14,00,000
Investments	1,00,000	60,000
Inventory	2,20,000	1,50,000
Trade Receivables	4,25,000	2,65,000
Cash at Bank	1,60,000	1,30,000

Additional Information:

(i) The authorized capital of the new company will be ₹ 54,00,000 divided into 2,00,000 equity shares of ₹ 25 each, and 4,000 preference shares of ₹ 100 each.

(ii) Trade payables of Black Limited includes ₹ 15,000 due to White Limited and trade receivables of White Limited shows ₹ 15,000 receivable from Black Limited.

(iii) Land & Buildings and inventory of Black Limited and White Limited are to be revalued as under:

	Black Ltd.(₹)	**White Ltd.(₹)**
Land and Buildings	5,20,000	10,40,000
Inventory	1,80,000	1,25,000

(iv) The purchase consideration is to be discharged as under:

(a) Issue 1,80,000 equity shares of ₹ 25 each fully paid up in proportion of their profitability in the preceding two financial years.

(b) Preference shareholders of two companies are issued equivalent number of 12% preference shares of Grey Limited at a price of ₹ 120 per share (face value ₹ 100).

TELEGRAM: CA NOTE HUB

(c) 15% Debenture holders of Black Limited and White Limited are discharged by Grey Limited issuing such number of its 18% Debentures of ₹ 100 each so as to maintain the same amount of interest.

You are required to prepare the Balance Sheet of Grey Limited after amalgamation. The amalgamation took place in the nature of purchase. **(15 Marks)**

Solution:

Balance Sheet of Grey Ltd. as at 1st April, 2022

Particulars	Note No.	(₹)
I. **Equity and Liabilities**		
(1) Shareholder's Funds		
(a) Share Capital	1	48,40,000
(b) Reserves and Surplus	2	1,85,000
(2) Non-Current Liabilities		
Long-term borrowings	3	7,50,000
(3) Current Liabilities		
Trade payables		4,15,000
Total		**61,90,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	47,60,000
(b) Non-current investments		1,60,000
(2) Current assets		
(a) Inventory		3,05,000
(b) Trade receivables		6,75,000
(c) Cash and bank balances		2,90,000
Total		**61,90,000**

Notes to Accounts:

	(₹)	(₹)
1. Share Capital		
Authorized:		
2,00,000 equity shares of ₹ 25 each		50,00,000
4,000 preference share of ₹ 100 each		4,00,000
Issued, subscribed, and paid up share capital:		
1,80,000 Equity shares of ₹ 25 each	45,00,000	
3,400 Preference shares of ₹ 100 each	3,40,000	
(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		48,40,000
2. Reserves and surplus		
Securities Premium (3,400 x ₹ 20)	68,000	
Capital Reserve	1,17,000	1,85,000
3. Long-term borrowings		
18% Debentures		7,50,000
4. Property, plant and equipment		
Land and Building	15,60,000	
Plant and Machinery	32,00,000	47,60,000

Working Notes:

	(₹)		
	Black Ltd.		**Grey Ltd.**
1. **Computation of Purchase consideration**			

TELEGRAM: CA NOTE HUB

(a) **Preference shares:**			
Shares at ₹ 120 each	2,40,000		1,68,000
(b) **Equity shares:**			
Preceding 2 years profitability			
Year 1	1,50,000		1,20,000
Year 2	2,00,000		1,30,000
	3,50,000		2,50,000
Shares (in ratio 35: 25)			
1,05,000 shares at ₹ 25	26,25,000		
75,000 shares at ₹ 25	_____		18,75,000
Amount of purchase consideration (a + b)	28,65,000		20,43,000
2. **Net Assets Taken Over**			
Assets taken over:			
Land and Building	5,20,000		10,40,000
Plant and Machinery	18,00,000		14,00,000
Investments	1,00,000		60,000
Inventory	1,80,000		1, 25,000
Trade receivables	4,25,000		2,50,000
Cash and bank	1,60,000		1,30,000
	31,85,000		30,05,000
Less: Liabilities taken over:			
Debentures 3,33,333		4,16,667	
Trade payables 2,95,000		1,20,000	
	6,28,333		5,36,667
Net assets taken over	25,56,667		24,68,333
Purchase consideration	28,65,000		20,43,000
Goodwill	3,08,333		
Capital reserve			4,25,333
Net amount of capital reserve			₹ 1,17,000
3.	**Black Limited**		**White Limited**
Existing Debentures	₹ 4,00,000 x 15%		₹ 5,00,000 x 15%
	= ₹ 60,000		= ₹ 75,000
Debentures to be issued in Grey Limited @	₹ 60,000 x 100/18		₹ 75,000x100/18
18% to maintain the same amount of interest	= ₹ 3,33,333		= ₹ 4,16,667

Question 4 (MTP Oct'22)

A Limited and B Limited are carrying on business of same nature. On 31 st March, 2021 the information given by both these companies is as follows:

	A Ltd.(₹)	**B Ltd. (₹)**
Share Capital		
- Equity Shares 10 each (Fully Paid)	12,00,000	7,20,000
- 10% Preference Shares of ₹ 100 each	6,00,000	-
- 8% Preference Shares of ₹ 100 each	-	5,00,000
General Reserve	3,00,000	2,50,000
Investment Allowance Reserve	-	60,000
Security Premium	2,40,000	-
Export Profit Reserve	1,80,000	1,20,000
Profit & Loss Account	2,16,000	1,92,000
9% Debentures (₹ 10 each)	3,00,000	2,00,000

TELEGRAM: CA NOTE HUB

Secured Loan	-	3,60,000
Sundry Creditors	3,12,000	2,04,000
Bills Payable	75,000	1,00,000
Other Current Liabilities	50,000	75,000
Land and Building	10,80,000	8,40,000
Plant and Machinery	6,00,000	5,60,000
Office Equipment	3,45,000	2,10,000
Investments	96,000	3,00,000
Stock in Trade	6,30,000	4,20,000
Sundry Debtors	4,90,000	3,20,000
Bills Receivables	60,000	70,000
Cash at Bank	1,72,000	61,000

A Limited take over B Limited on the above date, both companies agreeing on a scheme of Amalgamation on the following terms:

a) A Limited will issue 80,000 Equity Shares of ₹ 10 each at par to the Equity Shareholders of B Limited.

b) A Limited will issue 10% Preference Shares of ₹ 100 each to discharge the Preference Shareholders of B Limited at 15% premium in such a way that the existing dividend quantum of the preference shareholders of B Limited will not get affected. Accordingly, ₹ 5,00,000 pref. shares are discharged at ₹ 5,75,000 (5,00,000X 115%) by issue of 4,000 preference shares of ₹ 100 each at premium of ₹ 43.75 each.

c) The Debentures of B Limited will be converted into equivalent number of Debentures of A Limited.

d) All the Bills Receivable of A Limited were accepted by B Limited.

e) A contingent liability of B Limited amounting to ₹ 72,000 to be treated as actual liability in trade payables.

f) Expenses of Amalgamation amounted to ₹ 12,000 were borne by A Limited.

You are required to pass opening Journal Entries in the books of A Limited and prepare the opening Balance Sheet of A Limited as on 1st April, 2021 after amalgamation, assuming that the amalgamation is in the nature of Merger**.** **(20 Marks)**

Solution:

Journal Entries in the books of A Ltd.

Particulars		**Debit**	**Credit**
		₹	**₹**
Business purchase A/c (W.N.1)	Dr.	13,75,000	
To Liquidator of B Ltd.			13,75,000
(Being business of B Ltd. taken over)			
Land & Building A/c	Dr.	8,40,000	
Plant and machinery A/c	Dr.	5,60,000	
Office equipment A/c	Dr.	2,10,000	
Investments A/c	Dr.	3,00,000	
Inventory A/c	Dr.	4,20,000	
Debtors A/c	Dr.	3,20,000	
Bills receivables A/c	Dr.	70,000	
Bank A/c	Dr.	61,000	
To General reserve A/c (W.N.2)			95,000
(2,50,000-1,55,000)			
To Export profit reserve A/c			1,20,000
To Investment allowance reserve A/c			60,000

TELEGRAM: CA NOTE HUB

To Profit and loss A/c			1,20,000
To Liability for 9% Debentures A/c (₹ 100 each)			2,00,000
To Secured Loan			3,60,000
To Trade creditors A/c			2,76,000
To Bills payables A/c			1,00,000
To Other current liabilities A/c			75,000
To Business purchase A/c			13,75,000
(Being assets and liabilities taken over)			
Liquidator of B Ltd.	Dr.	13,75,000	
To Equity share capital A/c			8,00,000
To 10% Preference share capital A/c			4,00,000
To Securities premium A/c			1,75,000
(Being purchase consideration discharged)			
General Reserve* A/c	Dr.	12,000	
To Cash at bank			12,000
(Being expenses of amalgamation paid)			
Liability for 9% Debentures in B Ltd. A/c	Dr.	2,00,000	
To 9% Debentures A/c			2,00,000
(Being debentures in B ltd. discharged by issuing own 9% debentures)			
Bills payables A/c	Dr.	60,000	
To Bill receivables A/c			60,000
(Cancellation of mutual owing on account of bills of exchange)			

*Alternatively, profit & loss A/c may be debited in place of general reserve A/c.

Opening Balance Sheet of A Ltd. (after absorption) as at 1st April, 2021

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
	a Share capital	1	30,00,000
	b Reserves and Surplus	2	14,94,000
2	Non-current liabilities		
	a Long-term borrowings	3	8,60,000
3	Current liabilities		
	a Trade Payables	4	7,03,000
	b Other current liabilities	5	1,25,000
	Total		61,82,000
	Assets		
1	Non-current assets		
	a PPE	6	36,35,000
	b Investments	7	3,96,000
2	Current assets		
	a Inventories	8	10,50,000
	b Trade receivables	9	8,80,000
	c Cash and cash equivalents	10	2,21,000
	Total		61,82,000

Notes to accounts

		₹	
1	Share Capital		
	Equity share capital		
	2,00,000 Equity shares of ₹ 10 each		
	(Out of above, 80,000 shares were issued for consideration other than		20,00,000

TELEGRAM: CA NOTE HUB

	cash)		
	Preference share capital		
	10,000 10% Preference shares of ₹ 100 each		
	(Out of above, 4,000 shares were issued for consideration other than cash)		10,00,000
	Total		30,00,000
2	Reserves and Surplus		
	General Reserve		
	Opening balance	3,00,000	
	Add: Adjustment under scheme of amalgamation	95,000	
	Less: Amalgamation expense paid	(12,000)	3,83,000
	Securities premium (2,40,000+1,75,000)		4,15,000
	Export profit reserve		
	Opening balance	1,80,000	
	Add: Adjustment under scheme of amalgamation	1,20,000	3,00,000
	Investment allowance reserve		60,000
	Profit and loss account		
	Opening balance	2,16,000	
	Add: Adjustment under scheme of amalgamation	1,20,000	3,36,000
	Total		14,94,000
3	Long-term borrowings		
	Secured		
	9% Debentures	3,00,000	
	Add: Adjustment under scheme of amalgamation	2,00,000	
	Secured loan	3,60,000	8,60,000
4	Trade payables		
	Creditors: Opening balance	3,12,000	
	Add: Adjustment under scheme of amalgamation	2,76,000	5,88,000
	Bills Payables: Opening balance	75,000	
	Add: Adjustment under scheme of amalgamation	1,00,000	
	Less: Cancellation of mutual owning upon amalgamation	(60,000)	1,15,000
			7,03,000
5	Other current liabilities		
	Opening balance	50,000	
	Add: Adjustment under scheme of amalgamation	75,000	1,25,000
6	PPE		
	Land & Building- Opening balance	10,80,000	
	Add: Adjustment under scheme of amalgamation	8,40,000	19,20,000
	Plant and machinery- Opening balance	6,00,000	
	Add: Adjustment under scheme of amalgamation	5,60,000	11,60,000
	Office equipment- Opening balance	3,45,000	
	Add: Adjustment under scheme of amalgamation	2,10,000	5,55,000
	Total		36,35,000
7	Investments		
	Opening balance	96,000	
	Add: Adjustment under scheme of amalgamation	3,00,000	3,96,000
8	Inventories		
	Opening balance	6,30,000	
	Add: Adjustment under scheme of amalgamation	4,20,000	10,50,000
9	Trade receivables		
	Debtors: Opening balance	4,90,000	

TELEGRAM: CA NOTE HUB

	Add: Adjustment under scheme of amalgamation	3,20,000	8,10,000
	Bills Payables: Opening balance	60,000	
	Add: Adjustment under scheme of amalgamation	70,000	
	Less: Cancellation of mutual owning upon amalgamation	(60,000)	70,000
	Total		8,80,000
10	Cash and cash equivalents		
	Opening balance	1,72,000	
	Add: Adjustment under scheme of amalgamation	61,000	
	Less: Amalgamation expense paid	(12,000)	2,21,000

Working Notes:

1. Calculation of purchase consideration

	₹
Equity shareholders of B Ltd. (80,000 x ₹ 10)	8,00,000
Preference shareholders of B Ltd. (5,00,000 x 115%)	5,75,000
Purchase consideration would be	13,75,000

2. Amount to be adjusted from general reserve

The difference between the amount recorded as share capital issued and the amount of share capital of transferor company should be adjusted in General Reserve.

Thus, General reserve will be adjusted as follows:

	₹
Purchase consideration	13,75,000
Less: Share capital issued (₹ 7,20,000 + ₹ 5,00,000)	(12,20,000)
Amount to be adjusted from general reserve	1,55,000

3. Calculation of balances of Profit & Loss and Sundry Creditors of B Limited to be taken over by A Limited

	P&L (₹)	Creditors (₹)
Balance as per Balance Sheet of B Limited	1,92,000	2,04,000
Less / Add: Contingent Trade Payable treated as Actual Liability	(72,000)	72,000
Taken by A Limited	1,20,000	2,76,000

Question 5 (RTP May 21)

Mohan Ltd. gives you the following information as on 31st March, 2020:

	Rs.
Share capital:	
Equity shares of Rs. 10 each	3,00,000
6,000, 9% cumulative preference shares of Rs. 10 each	60,000
Profit and Loss Account (Dr. balance)	1,70,000
10% Debentures of Rs. 100 each	2,00,000
Interest payable on Debentures	20,000
Trade Payables	1,50,000
Property, Plant and Equipment	3,40,000
Goodwill	10,000
Inventory	80,000
Trade Receivables	1,10,000
Bank Balance	20,000

TELEGRAM: CA NOTE HUB

A new company Ravi Ltd. is formed with authorised share capital of Rs. 4,00,000 divided into 40,000 Equity Shares of Rs. 10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following terms:

(i) (a) Mohan Ltd.'s debentures are paid by similar debentures in new company and for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.

(b) The trade payables are paid by issue of 12,000 equity shares at par in full and final settlement of their claims.

(c) Preference shareholders are to get equal number of equity shares issued at par. Dividend on preference shares is in arrears for three years. Preference shareholders to forgo dividend for two years. For balance dividend, equity shares of equal amount are issued at par.

(d) Equity shareholders are issued one share at par for every three shares held in Mohan Ltd.

(ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%). Goodwill is to be eliminated. The Property, plant and equipment is taken over at Rs. 3,08,400.

(iii) Remaining equity shares of the new company are issued to public at par fully paid up.

(iv) Expenses of Rs. 5,000 to be met from bank balance of Mohan Ltd. This is to be adjusted from the bank balance of Mohan Ltd. before acquisition by Ravi Ltd.

You are required to prepare:

(a) Realization account and Equity Shareholders' account in the books of Mohan Ltd.

(b) Bank Account and Balance Sheet with notes to accounts in the books of Ravi Ltd.

Solution:

In the books of Mohan Ltd.

(i) Realisation Account

	Rs.		Rs.
To Goodwill	10,000	By 10% Debentures	2,00,000
To Property, plant and equipment	3,40,000	By Interest accrued on debentures	20,000
To Inventory	80,000	By Trade payables	1,50,000
To Trade receivables	1,10,000	By Ravi Ltd. (Purchase consideration) (W.N. 1)	1,65,400
To Bank (20,000 - 5,000)	15,000	By Equity shareholders A/c (loss on realization) (Bal. fig.)	25,000
To Preference shareholders A/c (W.N.2)	5,400		
	5,60,400		5,60,400

(ii) Equity shareholders' Account

	Rs.		Rs.
To Profit & loss A/c	1,70,000	By Equity Share capital	3,00,000
To Expenses*	5,000		
To Equity shares in Ravi Ltd.	1,00,000		
To Realization A/c	25,000		
	3,00,000		3,00,000

*Alternatively, expenses may be routed through Realization account.

In the books of Ravi Ltd.

(iii) Bank Account

	Rs.		Rs.

TELEGRAM: CA NOTE HUB

To Business Purchase	15,000	By Balance c/d (Bal. fig.)	1,09,600
To Equity shares application & allotment A/c (W.N. 3)	94,600		
	1,09,600		1,09,600

(iv) Balance Sheet as at 31st March, 2020

Particulars	Note No.	Rs.
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital	1	4,00,000
(2) Non-Current Liabilities		
Long-term borrowings	2	2,00,000
Total		6,00,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		3,08,400
(2) Current assets		
(a) Inventories		72,000
(b) Trade receivables		1,10,000
(c) Cash and cash equivalents		1,09,600
Total		6,00,000

Notes to Accounts

		Rs.
1.	Share Capital	
	Authorised share capital	
	40,000 equity shares of Rs. 10 each	4,00,000
	Issued and Subscribed	
	40,000 shares of Rs. 10 each fully paid up	4,00,000
	(out of the above, 30,540 (W.N.3) shares have been allotted as fully paid-up pursuant to contract without payment being received in cash)	
2.	**Long Term Borrowings**	
	10% Debentures	2,00,000

Working Notes:

1. Calculation of Purchase consideration

	Rs.
Payment to preference shareholders	
6,000 equity shares @ Rs. 10	60,000
For arrears of dividend: (6,000 x Rs. 10) x 9%	5,400
Payment to equity shareholders	
(30,000 shares x 1/3) @ Rs. 10	1,00,000
Total purchase consideration	1,65,400

2. Preference shareholders' Account in books of Mohan Ltd.

	Rs.		Rs.
To Equity Shares in Ravi Ltd.	65,400	By Preference Share capital	60,000
		By Realization A/c (Bal. fig.)	5,400
	65,400		65,400

3. Calculation of number of Equity shares issued to public

	Number of shares	
Authorized equity shares		40,000

TELEGRAM: CA NOTE HUB

Less: Equity shares issued for		
Interest accrued on debentures	2,000	
Trade payables of Mohan Ltd.	12,000	
Preference shareholders of Mohan Ltd.	6,000	
Arrears of preference dividend	540	
Equity shareholders of Mohan Ltd.	10,000	(30,540)
Number of equity shares issued to public at par for cash		9,460

Question 6 (RTP Nov'20) (Past Exam May'18)

X Ltd. and Y Ltd. give the following information of assets, equity and liabilities as on 31st March, 2018:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
Equity and Liabilities		
Equity Shares of Rs. 10 each	30,00,000	9,00,000
9% Preference Shares of Rs. 100 each	3,00,000	-
10% Preference Shares of Rs. 100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	3,90,000	2,40,000
Assets		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	1,50,000	60,000

X Ltd. absorbs Y Ltd. on the following terms:

(i) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.

(ii) Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of preceding three financial years (2016-17 : Rs. 90,000; 2015-16 : Rs. 78,000 and 2014-15: Rs. 72,000). The profits of 2014 -15 included credit of an insurance claim of Rs. 25,000 (fire occurred in 2013-14 and loss by fire Rs. 30,000 was booked in Profit and Loss Account of that year). In the year 2015 -16, there was an embezzlement of cash by an employee amounting to Rs. 10,000.

(iii) Land & Buildings are valued at Rs. 5,00,000 and the Plant & Machinery at Rs. 4,00,000.

(iv) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.

(v) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to Rs. 15,000 and such asset was also taken over by X Ltd.

(vi) The trade payables of Y Ltd. included Rs. 20,000 payable to X Ltd.

(vii) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium.

You are required to:

(i) Prepare Realizations A/c in the books of Y Ltd.

(ii) Show journal entries in the books of X Ltd.

(iii) Prepare the Balance Sheet of X Ltd. after absorption as at 31st March,2018.

Solution:

TELEGRAM: CANOTE HUB

In the Books of Y Ltd.

Realization Account

		Rs.		Rs.
To Sundry Assets:			By Retirement Gratuity Fund	60,000
Goodwill	75,000			
Land & Building	3,00,000		By Trade payables	2,40,000
Plant & Machinery	4,50,000		By X Ltd. (Purchase Consideration)	15,90,000
Inventory	5,25,000			
Trade receivables	3,00,000			
Bank	60,000	17,10,000		
To Preference Shareholders		30,000		
(Premium on Redemption)				
To Equity Shareholders				
(Profit on Realization)		1,50,000		
		18,90,000		18,90,000

In the Books of X Ltd.
Journal Entries

		Dr.	Cr.
		Rs.	Rs.
Business Purchase A/c	Dr.	15,90,000	
To Liquidators of Y Ltd. Account			15,90,000
(Being business of Y Ltd. taken over)			
Goodwill Account	Dr.	1,50,000	
Land & Building Account	Dr.	5,00,000	
Plant & Machinery Account	Dr.	4,00,000	
Inventory Account	Dr.	4,72,500	
Trade receivables Account	Dr.	3,00,000	
Bank Account	Dr.	60,000	
Unrecorded assets Account	Dr.	15,000	
To Retirement Gratuity Fund Account			60,000
To Trade payables Account			2,40,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			15,90,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Y Ltd. A/c	Dr.	15,90,000	
To 9% Preference Share Capital A/c			3,30,000
To Equity Share Capital A/c			12,00,000
To Securities Premium A/c			60,000
(Being Purchase Consideration satisfied as above)			

Balance Sheet of X Ltd. (after absorption) as at 31st March, 2018

Particulars	Notes	Rs.
Equity and Liabilities		
1 Shareholders' funds		
A Share capital	1	48,30,000
B Reserves and Surplus	2	2,70,000
2 Non-current liabilities		
A Long-term provisions	3	2,10,000

TELEGRAM: CA NOTE HUB

3 Current liabilities		
A Trade Payables	4	6,10,000
B Short term provision	5	7,500
Total		**59,27,500**
Assets		
1 Non-current assets		
Property, Plant and Equipment	6	33,00,000
Intangible assets	7	3,00,000
2 Current assets		
A Inventories	8	12,22,500
B Trade receivables	9	8,80,000
C Other current Assets	10	15,000
D Cash and cash equivalents	11	2,10,000
Total		**59,27,500**

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	4,20,000 Equity Shares of Rs. 10 each fully paid (Out of above 1,20,000 Equity Shares were issued at 5% premium in consideration other than for cash)	42,00,000
	Preference share capital	
	6,300 9% Preference Shares of Rs. 100 each (Out of above 3,300 Preference Shares were issued in consideration other than for cash)	6,30,000
	Total	48,30,000
2	Reserves and Surplus	
	Securities Premium	60,000
	General Reserve	2,10,000
	Total	2,70,000
3	Long-term provisions	
	Retirement Gratuity fund	2,10,000
4	Trade payables (3,90,000 + 2,40,000 - 20,000*) * Mutual Owings eliminated.	6,10,000
5	Short term Provisions	
	Provision for Doubtful Debts	7,500
`	Property, Plant and Equipment	
	Land & Buildings	14,00,000
	Plant & Machinery	19,00,000
	Total	33,00,000
7	Intangible assets	
	Goodwill (1,50,000 +1,50,000)	3,00,000
8	Inventories (7,50,000 + 4,72,500)	12,22,500
9	Trade receivables (6,00,000 + 3,00,000 - 20,000)	8,80,000
10	Other current Assets	15,000
11	Cash and cash equivalents (1,50,000 +60,000)	2,10,000

Working Notes:

1. Computation of goodwill	Rs.
Profit of 2016-17	90,000
Profit of 2015-16 adjusted (Rs. 78,000 + 10,000)	88,000
Profit of 2014-15 adjusted (Rs. 72,000 – 25,000	47,000

TELEGRAM: CA NOTE HUB

	2,25,000
Average profit	75,000

2. Goodwill to be valued at 2 times of average profits = Rs. 75,000 x 2 = Rs. 1,50,000

Purchase Consideration:		Rs.
Goodwill		1,50,000
Land & Building		5,00,000
Plant & Machinery		4,00,000
Inventory		4,72,500
Trade receivables		3,00,000
Unrecorded assets		15,000
Cash at Bank		60,000
Less: Liabilities:		
		18,97,500
Retirement Gratuity	60,000	
Trade payables	2,40,000	
Provision for doubtful debts	7,500	(3,07,500)
Net Assets/ Purchase Consideration		15,90,000
To be satisfied as under:		
10% Preference Shareholders of Y Ltd.		3,00,000
Add: 10% Premium		30,000
9% Preference Shares of X Ltd.		3,30,000
Equity Shareholders of Y Ltd. to be satisfied by issue of 1,20,000 equity Shares of X Ltd. at 5% Premium		12,60,000
Total		**15,90,000**

Question 7 (RTP May'20)

P Ltd. and Q Ltd. agreed to amalgamate and form a new company called PQ Ltd. The summarized balance sheets of both the companies on the date of amalgamation stood as below:

Liabilities	**P Ltd. Rs.**	**Q Ltd. Rs.**	**Assets**	**P Ltd. Rs.**	**Q Ltd. Rs.**
Equity Shares	8,20,000	3,20,000	Land & Building	4,50,000	3,40,000
(Rs. 100 each)					
9% Pref. Shares	3,80,000	2,80,000	Furniture & Fittings	1,00,000	50,000
(Rs. 100 each)					
8% Debentures	2,00,000	1,00,000	Plant & Machinery	6,20,000	4,50,000
General Reserve	1,50,000	50,000	Trade receivables	3,25,000	1,50,000
Profit & Loss A/c	3,52,000	2,05,000	Inventory	2,33,000	1,05,000
Unsecured Loan	-	1,75,000	Cash at bank	2,08,000	1,75,000
Trade payables	88,000	1,60,000	Cash in hand	54,000	20,000
	19,90,000	**12,90,000**		**19,90,000**	**12,90,000**

PQ Ltd. took over the assets and liabilities of both the companies at book value after creating provision @ 5% on inventory and trade receivables respectively and depreciating Furniture & Fittings by @ 10%, Plant and Machinery by @ 10%. The trade receivables of P Ltd. include Rs. 25,000 due from Q Ltd. PQ Ltd. will issue:

TELEGRAM: CA NOTE HUB

(i) 5 Preference shares of Rs. 20 each @ Rs. 18 paid up at a premium of Rs. 4 per share for each pref. share held in both the companies.

(ii) 6 Equity shares of Rs. 20 each @ Rs. 18 paid up a premium of Rs. 4 per share for each equity share held in both the companies.

(iii) 6% Debentures to discharge the 8% debentures of both the companies.

(iv) 20,000 new equity shares of Rs. 20 each for cash @ Rs.18 paid up at a premium of Rs.4 per share. PQ Ltd. will pay cash to equity shareholders of both the companies in order to adjust their rights as per the intrinsic value of the shares of both the companies.

You are required to prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books.

Solution:

In the Books of P Ltd. Realization Account

	Rs.		Rs.
To Land & Building	4,50,000	By 8% Debentures	2,00,000
To Plant & Machinery	6,20,000	By Trade Payables	88,000
To Furniture & Fitting	1,00,000	By PQ Ltd.	16,02,100
To Trade receivables	3,25,000	(Purchase consideration)	
To Inventory/Stock	2,33,000	By Equity Shareholders A/c	1,37,900
To Cash at Bank	2,08,000	(loss)	
To Cash in Hand	54,000		
To Preference shareholders	38,000		
(excess payment)			
	20,28,000		**20,28,000**

Equity Shareholders Account

	Rs.		Rs.
To Realization A/c (loss)	1,37,900	By Share capital	8,20,000
To Equity Shares in PQ Ltd.	10,82,400	By Profit & Loss A/c	3,52,000
To Cash	1,01,700	By General Reserve	1,50,000
	13,22,000		**13,22,000**

9% Preference Shareholders Account

To Preference Shares in	4,18,000	By Pref. Share capital	3,80,000
PQ Ltd.		By Realization A/c	38,000
	4,18,000		**4,18,000**

PQ Ltd. Account

To Realization A/c	16,02,100	By Shares in PQ Ltd.		
		For Equity	10,82,400	15,00,400
		For Pref.	4,18,000	
		By Cash		
				1,01,700
	16,02,100			**16,02,100**

8% Debentures holders Account

	Rs.		Rs.
To 6% Debentures	2,00,000	By 8% Debentures	2,00,000

TELEGRAM: CANOTE HUB

Books of Q Ltd.

Realization Account

	Rs.		Rs.
To Land & Building	3,40,000	By 8% Debentures	1,00,000
To Plant & Machinery	4,50,000	By Trade payables	1,60,000
To Furniture & Fittings	50,000	By Unsecured loan	1,75,000
To Trade receivables	1,50,000	By PQ Ltd. (Purchase consideration)	7,92,250
To Inventory	1,05,000	By Equity Shareholders A/c	90,750
To Cash at bank	1,75,000	Loss	
To Cash in hand	20,000		
To Pref. shareholders	28,000		
	13,18,000		13,18,000

Equity Shareholders Account

	Rs.		Rs.
To Equity shares in PQ Ltd.	4,22,400	By Share Capital	3,20,000
To Realization	90,750	By Profit & Loss A/c	2,05,000
To Cash	61,850	By General Reserve	50,000
	5,75,000		**5,75,000**

9% Preference Shareholders Account

	Rs.		Rs.
To Preference Shares in PQ Ltd.	3,08,000	By Share capital	2,80,000
		By Realization A/c	28,000
	3,08,000		**3,08,000**

Q Ltd. Account

	Rs.		Rs.
To Realization A/c	7,92,250	By Equity shares in PQ Ltd.	
		For Equity 4,22,400	
		Preference 3,08,000	7,30,400
		By Cash	61,850
	7,92,250		**7,92,250**

8% Debentures holders Account

	Rs.		Rs.
To 6% Debentures	1,00,000	By 8% Debentures	1,00,000

Working Notes:

(i) Purchase consideration

	P Ltd. Rs.	Q Ltd. Rs.
Payable to preference shareholders:		
Preference shares at Rs. 22 per share	4,18,000	3,08,000
Equity Shares at Rs. 22 per share	10,82,400	4,22,400
Cash [See W.N. (ii)]	1,01,700	61,850
	16,02,100	**7,92,250**

(ii) Value of Net Assets

	P Ltd. Rs.	Q Ltd. Rs.

TELEGRAM: CA NOTE HUB

Land & Building	4,50,000	3,40,000
Plant & Machinery less 10% Depreciation	5,58,000	4,05,000
Furniture & Fittings less 10% Depreciation	90,000	45,000
Trade receivables less 5%	3,08,750	1,42,500
Inventory less 5%	2,21,350	99,750
Cash at Bank	2,08,000	1,75,000
Cash in hand	54,000	20,000
	18,90,100	12,27,250
Less: Debentures	2,00,000	1,00,000
Trade payables	88,000	1,60,000
Secured Loans – (2,88,000)	1,75,000	(4,35,000)
	16,02,100	7,92,250
Payable in shares	15,00,400	7,30,400
Payable in cash*	1,01,700	(61,850)

(iii)

	P	**Q**
Plant & Machinery	6,20,000	4,50,000
Less: Depreciation 10%	62,000	45,000
	5,58,000	4,05,000
Furniture & Fixtures	1,00,000	50,000
Less: Depreciation 10%	10,000	5,000
	90,000	45,000

*This cash is paid to equity shareholders of both the companies for adjustment of their rights as per intrinsic value of both companies.

Question 8 (RTP May'18, Nov'21)

P Ltd. and Q Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of P Ltd. and Q Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in PQ Ltd. The Summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March, 2017 (the date of amalgamation) are given below**:**

Summarized balance sheets as at 31-03-2017

Liabilities	**P Ltd. Rs.**	**Q Ltd. Rs.**	**Assets**	**P Ltd. Rs.**	**Q Ltd. Rs.**
Equity & liabilities:			Assets:		
Shareholders Fund			Non-current Assets:		
a. Share Capital	6,00,000	8,40,000	Property, Plant & Equipment		
b. Reserves	10,20,000	6,00,000	(excluding Goodwill)	7,20,000	10,80,000
Current Liabilities			Current Assets		
Bank Overdraft	-	5,40,000	a. Inventories	3,60,000	6,60,000
Trade payables	2,40,000	5,40,000	b. Trade receivables	4,80,000	7,80,000
c. Cash at Bank	3,00,000	-			
	18,60,000	**25,20,000**		**18,60,000**	**25,20,000**

TELEGRAM: CANOTE HUB

The consideration was to be based on the net assets of the companies as shown in the above Balance Sheets, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March, 2017.

The weights for this purpose for the years 2014-15, 2015-16 and 2016-17 were agreed as 1, 2 and 3 respectively. The profit had been: 2014- 15 Rs. 3,00,000; 2015-16 Rs. 5,25,000 and 2016-17 Rs. 6,30,000.

The shares of PQ Ltd. were to be issued to P Ltd. and Q Ltd. at a premium and in proportion to the agreed net assets value of these companies.

In order to raise working capital, PQ Ltd proceeded to issue 72,000 shares of Rs. 10 each at the same rate of premium as issued for discharging purchase consideration to P Ltd. and Q Ltd.

You are required to :

(i) Calculate the number of shares issued to P Ltd. and Q Ltd; and

(ii) Prepare required journal entries in the books of PQ Ltd.; and

(iii) Prepare the Balance Sheet of PQ Ltd. as per Schedule III after recording the necessary journal entries.

Solution:

(i) Calculation of number of shares issued to P Ltd. and Q Ltd.:

Amount of Share Capital as per balance sheet	**Rs.**
P Ltd.	6,00,000
Q Ltd.	8,40,000
	14,40,000

Share of P Ltd. = Rs. 14,40,000 x [21,60,000/ (21,60,000 + 14,40,000)]

= Rs. 8,64,000 or 86,400 shares

Securities premium = Rs. 21,60,000 – Rs. 8,64,000 = Rs. 12,96,000 Premium

per share = Rs. 12,96,000 / Rs. 86,400 = Rs. 15

Issued 86,400 shares @ Rs. 10 each at a premium of Rs.15 per share Share of Q Ltd.

= Rs. 14,40,000 x [14,40,000/ (21,60,000 + 14,40,000)]

= Rs. 5,76,000 or 57,600 shares

Securities premium = Rs. 14,40,000 – Rs. 5,76,000 = Rs. 8,64,000 Premium

per share = Rs. 8,64,000 / Rs. 57,600 = Rs. 15

Issued 57,600 shares @ Rs. 10 each at a premium of Rs. 15 per share

(ii) Journal Entries in the books of PQ Ltd.

Particulars		**Dr. Amount (Rs.)**	**Cr. Amount (Rs.)**
Business purchase account	Dr.	36,00,000	
To Liquidator of P Ltd. account			21,60,000
To Liquidator of Q Ltd. account			14,40,000
(Being the amount of purchase consideration payable to liquidator of P Ltd. and Q Ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	
Property, Plant & Equipment account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	

TELEGRAM: CA NOTE HUB

Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of P Ltd. taken over)			
Property, Plant & Equipment account	Dr.	10,80,000	
Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Q Ltd. taken over)			
Liquidator of P Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 x Rs. 10)			8,64,000
To Securities premium (86,400 x Rs. 15)			12,96,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Liquidator of Q Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 x Rs. 10)			5,76,000
To Securities premium (57,600 x Rs. 15)			8,64,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Bank A/c		18,00,000	
To Equity share capital account			7,20,000
To Securities premium			10,80,000
(Equity share capital issued to raise working capital)			

(iii) Balance Sheet of PQ Ltd. on 31st March, 2017 after amalgamation

Particulars	Notes	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	21,60,000
b Reserves and Surplus	2	32,40,000
2 Current liabilities		
a Trade payables (2,40,000 + 5,40,000)		7,80,000
Total		61,80,000
Assets		
1 Non-current assets		
a Fixed assets		
2 Tangible assets (7,20,000 + 10,80,000)		18,00,000
Intangible assets (goodwill)	4	5,40,000
Current assets		
a Inventories (3,60,000 + 6,60,000)		10,20,000
b Trade receivables (4,80,000 +7,80,000)		12,60,000
c Cash and cash equivalents	3	15,60,000
Total		61,80,000

Notes to accounts

		Rs.
1	**Share Capital**	
	Issued, subscribed and paid up share capital	
	2,16,000 Equity shares of Rs. 10 each	21,60,000
	(Out of the above 1,44,000 shares issued for non-cash consideration under scheme of	

TELEGRAM: CA NOTE HUB

	amalgamation)	
2	**Reserves and Surplus**	
	Securities premium	32,40,000
	(@ Rs. 15 for 2,16,000 shares)	
3	**Cash and cash equivalents**	
	Cash at Bank	15,60,000
4	**Intangible Assets**	
	Goodwill	5,40,000

Working Notes:

1. **Calculation of goodwill of P Ltd.**

Particulars	**Amount Rs.**	**Weight**	**Weighted amount Rs.**
2014-15	3,00,000	1	3,00,000
2015-16	5,25,000	2	10,50,000
2016-17	6,30,000	3	18,90,000
Total (a+b+c)	14,55,000	6	32,40,000
weighted Average = [Total weighted amount/			
Total of weight][Rs. 32,40,000/6]Goodwill			5,40,000

2. Calculation of Net assets

	P Ltd. Rs.	**Q Ltd. Rs.**
Assets		
Goodwill	5,40,000	
Property, Plant & Equipment	7,20,000	10,80,000
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft	5,40,000	
Trade payables	2,40,000	5,40,000
Net assets or Purchase consideration	21,60,000	14,40,000
New authorized capital		
= Rs. 14,40,000 + Rs. 12,00 000 = Rs. 26,40,000		
Cash and Cash equivalents Rs.		
P Ltd. Balance 3,00,000		
Cash received from Fresh issue (72,000 X Rs.25) 18,00,000		
21,00,000		
Less: Bank Overdraft 5,40,000		
15,60,000*		

*The balance of cash and equivalents has been shown after setting off overdraft amount.

Question 9 (RTP May'22)

The following are the Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

Particulars	**Note No.**	**Aakash Limited (Rs.)**	**Ganga Limited (Rs.)**
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	1	80,00,000	20,00,000

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(b) Reserves and Surplus	2	(3,24,00,000)	56,00,000
(2) Non-Current Liabilities:			
(a) Secured Loans	3	3,20,00,000	1,60,00,000
(b) Unsecured Loans	4	1,72,00,000	-
(3) Current Liabilities:			
(a) Trade Payables		56,00,000	36,00,000
(b) Other Current Liabilities	5	2,04,00,000	56,00,000
Total		**5,08,00,000**	**3,28,00,000**
II. Assets:			
(1) Non-Current Assets:			
Property, Plant & Equipment		68,00,000	1,36,00,000
(2) Current Assets:			
(a) Inventories		3,68,00,000	-
(b) Other Current Assets		72,00,000	1,92,00,000
Total		**5,08,00,000**	**3,28,00,000**

Notes to Accounts:

		Aakash Limited (Rs.)	Ganga Limited (Rs.)
	1. Share Capital		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of Rs.10 each	60,00,000	-
	20,000 Preference Shares of Rs. 100 each	20,00,000	-
	2,00,000 Equity Shares of Rs. 10 each	-	20,00,000
		80,00,000	20,00,000
	2. Reserves and Surplus		
	General Reserve	8,00,000	56,00,000
	Surplus	(3,32,00,000)	-
		(3,24,00,000)	56,00,000
	3. Secured Loans		
	(Secured Loans of Aakash Limited are secured against pledge of Inventories)	3,20,00,000	1,60,00,000
	4. Unsecured Loans	1,72,00,000	-
	5. Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000
	Liability to Employees	60,00,000	36,00,000
		2,04,00,000	56,00,000

Both the companies go into liquidation and a new company 'AakashGanga Limited' is formed to take over their business. The following information is given:

(i) All Current Assets of two companies, except pledged inventory are taken over by Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.

(ii) Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.

(iii) Secured Loans include Rs. 32,00,000 accured interest in case of Ganga Limited.

(iv) 4,00,000 Equity Shares of Rs. 10 each are allotted by AakashGanga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.

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(v) Preference Shareholders in Aakash Limited are issued Equity Shares in AakashGanga Ltd. worth Rs. 4,00,000 in lieu of their present holdings.

(vi) Secured Loan agree to continue the balance amount of their loans to AakashGanga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.

(vii) Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.

(viii) Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.

(ix) Statutory Liabilities are taken over by AakashGanga Limited at full value and Trade Payables are taken over at 80% of the book value.

You are required to prepare the opening Balance Sheet of AakashGanga Limited as at 1.4.2021.

Solution:

Balance sheet of Aakash Ganga Ltd. as at 1st April, 2021

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	1,40,00,000
(2) Non-Current Liabilities		
(a) Long term borrowings	2	2,12,60,000
(3) Current Liabilities		
(a) Trade Payables	3	73,60,000
(b) Other current liabilities	4	1,64,00,000
Total		5,90,20,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	5	2,04,00,000
(b) Intangible assets	6	1,54,20,000
(2) Current assets		
(a) Cash and cash equivalents		40,00,000
(b) Other current assets	7	1,92,00,000
Total		5,90,20,000

Notes to Accounts

			(Rs.)
1.	Share Capital		
	Issued, subscribed & Paid up:		
	14,00,000 equity shares of Rs. 10 each, fully paid up (W.N.4) (of the above 10,00,000 shares have been issued for consideration other than cash)		1,40,00,000
2	. Long Term borrowings		
	Secured Loans		
	Aakash Limited 25,60,000		
	Ganga Limited 1,44,00,000	1,69,60,000	
	Unsecured Loans	43,00,000	
			2,12,60,000
3	. Trade Payables (W.N.1)		
	Aakash Limited	44,80,000	
	Ganga Limited	28,80,000	73,60,000
4.	Other current liabilities		

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	Statutory Liabilities		
	Aakash Limited	1,44,00,000	
	Ganga Limited	20,00,000	1,64,00,000
5.	Property, Plant & Equipment		
	Aakash Limited	68,00,000	
	Ganga Limited	1,36,00,000	2,04,00,000
6	. Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7	. Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

1. Value of total liabilities taken over by Aakash Ganga Ltd. (Rs.)

	Aakash Limited		Ganga Limited	
Current liabilities				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	44,80,000	2,48,80,000	28,80,000	84,80,000
Secured loans				
Given in Balance Sheet	3,20,00,000		1,60,00,000	
Interest waived	-		16,00,000	1,44,00,000
Value of Inventory (80% of Rs. 3,68,00,000)	2,94,40,000	25,60,000		
Unsecured Loans (25% of Rs.1,72,00,000)		43,00,000		-
		3,17,40,000		2,28,80,000

2. Assets taken over by AakashGanga Ltd. (Rs.)

	Aakash Limited	Ganga Limited
	Rs.	Rs.
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets (80% and 70% respectively of book value)	57,60,000	1,34,40,000
	1,25,60,000	2,70,40,000

3. Goodwill / Capital Reserve on amalgamation (Rs.)

Liabilities taken over (W.N. 1)		3,17,40,000	2,28,80,000
Equity shares to be issued to Preference Shareholders		4,00,000	-
	A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N. 2)	B	(1,25,60,000)	(2,70,40,000)
	A-B	1,95,80,000	(41,60,000)
Goodwill Capital Reserve			
Net Goodwill (1,95,80,000- 41,60,000)		1,54,20,000	

4. Equity shares issued by AakashGanga Ltd.

(i)	For Cash		40,00,000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	96,00,000	
(iii)	To Preference shareholders	4,00,000	1,00,00,000

TELEGRAM: CA NOTE HUB

			1,40,00,000
	No. of shares @ Rs. 10		14,00,000

5. Journal Entries in the Books of Z Ltd.

			Rs.	Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs. 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs. 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c Dr.		1,00,000	
	Interest on Debentures payable A/c	Dr.	96,000	
	Bank A/c Dr.		1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being Rs. 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures payable A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being Rs. 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (Rs. 5) A/c		40,000	
	To Reconstruction A/c		60,000	
	(Being Directors' loan claim settled by issuing 8,000 equity shares of Rs. 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of Rs. 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	15,000	

TELEGRAM: CA NOTE HUB

	To Bank A/c		15,000
	(Being payment of reconstruction expenses.)		
(x)	Provision for Tax A/c Dr.	1,00,000	
	To Bank A/c		75,000
	To Reconstruction A/c		25,000
	(Being payment of tax liability in full settlement against provision for tax)		
(xi)	Land and Building A/c Dr.	2,00,000	
	To Reconstruction A/c		2,00,000
	(Being appreciation in value of Land & Building recorded)		
(xii)	Reconstruction A/c Dr.	49,85,000	
	To Goodwill A/c		11,00,000
	To Patent A/c		5,00,000
	To Profit and Loss A/c		14,60,000
	To Plant and Machinery A/c		6,50,000
	To Furniture & Fixture A/c		1,00,000
	To Trade Investment A/c		50,000
	To Inventory A/c		2,50,000
	To Trade Receivables A/c		1,00,000
	To Capital Reserve (bal. fig.)		7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)		

Bank Account

	Rs.		Rs.
To Reconstruction (Y)	1,00,000	By Balance b/d (overdraft)	1,00,000
To Reconstruction(Z)	60,000	By Reconstruction A/c(capital commitment penalty paid)	15,000
To Reconstruction A/c (refund of earlier fees by directors)	1,00,000		
		By Reconstruction A/c (reconstruction expenses paid)	15,000
		By Provision for tax A/c (tax paid)	75,000
		By Balance c/d	55,000
	2,60,000		2,60,000

Reconstruction Account

	Rs.		Rs.
To Bank (penalty)	15,000	By Equity Share Capital A/c	
To Bank (reconstruction expenses)	15,000		25,00,000
To Goodwill	11,00,000	By 9% Pref. Share Capital A/c	10,00,000
To Patent	5,00,000	By Mr. Y (Settlement)	5,78,000
To P & L A/c	14,60,000	By Mr. Z (Settlement)	3,82,000
To P & M	6,50,000	By Trade Payables A/c	1,70,000
To Furniture and Fixtures	1,00,000	By Director's loan	60,000
To Trade investment	50,000	By Bank	1,00,000
To Inventory	2,50,000	By Provision for tax	25,000
To Trade Receivables	1,00,000	By Land and Building	2,00,000
To Capital Reserve (bal. fig.)	7,75,000		
	50,15,000		50,15,000

TELEGRAM: CA NOTE HUB

Question 10 (RTP Nov'22)

The balance sheets of Truth Limited and Myth Limited as at 31.03.2021 is given below. Myth Limited is to be amalgamated with Truth Limited from 1.04.2021. The amalgamation is to be carried out in the nature of purchase

Particulars	Note No.	Truth Ltd. (₹)	Myth Ltd. (₹)
(1) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share Capital	1	10,00,000	4,00,000
(b) Reserves and Surplus	2	11,35,000	4,13,000
2. Non -Current Liabilities	3	-	1,50,000
3. Current Liabilities	4	1,40,000	1,82,000
Total		**22,75,000**	**11,45,000**
(2) Assets			
1. Non -Current Assets			
(a) Property, Plant & Equipment		15,75,000	6,80,000
(b) Investments		1,87,500	1,00,000
2. Current Assets	5	5,12,500	3,65,000
Total		22,75,000	11,45,000

Particulars	Truth Limited (₹)	Myth Limited (₹)
1 Share Capital	10,00,000	4,00,000
Equity shares of ₹ 10 each		
2 Reserves & Surplus		
General Reserve	5,05,000	2,30,000
Profit & Loss A/c	4,45,000	1,58,000
Export Profit Reserve	1,85,000	25,000
3 Non- Current Liabilities	11,35,000	4,13,000
14% Debentures	---	1,50,000
4 Current Liabilities		
Trade Payables	90,000	1,42,000
Other Current Liabilities	50,000	40,000
5 Current Assets	1,40,000	1,82,000
Inventory	2,15,000	85,000
Trade Receivables	2,02,500	1,75,000
Cash and Cash equivalents	95,000	1,05,000
	5,12,500	**3,65,000**

Truth Limited would issue 12% debentures to discharge the claim of the debenture holders of Myth Limited so as to maintain their present annual interest income. Non-trade investment, which constitute 80% of their respective total investments yielded income of 20% to Truth Limited and 15% to Myth Limited. This income is to be deducted from profits while computing average profit for the purpose of calculating goodwill. Profit before tax of both the companies during the last 3 years were as follows:

	Truth Limited (₹)	Myth Limited (₹)
2018-2019	8,20,000	2,55,000
2019-2020	7,45,000	2,15,000
2020-2021	6,04,000	2,14,000

Goodwill is to be calculated on the basis of simple average of three years profit by using Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by

TELEGRAM: CA NOTE HUB

Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the amalgamation.

Solution:

Balance Sheet of Truth Ltd. (after amalgamated with Myth Ltd.) as at 1.4.2021

Particulars	Note No.	(₹)
I. Equity and liabilities		
(1) Shareholder's funds		
(a) Share capital	1	13,13,750
(b) Reserves and surplus	2	20,76,250
(2) Non-current liabilities		
12% Debentures	3	1,75,000
(3) Current liabilities		
(a) Trade payables	4	2,32,000
(b) Other current liabilities	5	90,000
Total		**38,87,000**
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	22,55,000
(b) Intangible assets (Goodwill) [WN 1]		4,67,000
(c) Non-current investments	7	2,87,500
(2) Current assets		
(a) Inventories (2,15,000 + 85,000)		3,00,000
(b) Trade receivables (2,02,500 + 1,75,000)		3,77,500
(c) Cash & cash equivalents (95,000 + 1,05,000)		2,00,000
Total		**38,87,000**

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	1,31,375 Equity Shares of ₹ 10 each [1,00,000 + 31,375]		13,13,750
	(of the above shares, 31,375 shares were issued to the vendors otherwise than for cash)		
2	. Reserves and surplus		
	General Reserve	5,05,000	
	Profit and Loss A/c	4,45,000	
	Securities Premium [31,375 x 30]	9,41,250	
	Export profit reserve 1,85,000		
	Add: Balance of Myth Ltd. 25,000	2,10,000	
	Amalgamation Adjustment Reserve	(25,000)	20,76,250
3.	Long Term Borrowings		
	12% Debentures issued to Myth Ltd.		1,75,000
4.	Trade payables		
	Trade payables	90,000	
	Add: Taken over	1,42,000	2,32,000
5	Other Current Liabilities		
	Truth Ltd.	50,000	
	Myth Ltd.	40,000	90,000
6	. Property, Plant & Equipment		
	Truth Ltd.	15,75,000	
	Myth Ltd.	6,80,000	22,55,000

TELEGRAM: CA NOTE HUB

7.	Investment		2,87,500
	Truth Ltd.	1,87,500.	
	Myth Ltd	1,00,000	

Working Notes:

(1) Valuation of Goodwill

(i) Capital Employed

	Truth Ltd.		Myth Ltd.	
	₹`	₹	`₹`	₹
Assets as per Balance Sheet		22,75,000		11,45,000
Less: Non-trade Investment		(1,50,000)		(80,000)
Less: Liabilities:		21,25,000		10,65,000
14% Debentures	-		1,50,000	
Trade payables	90,000		1,42,000	
Other current liabilities	50,000	(1,40,000)	40,000	(3,32,000)
Capital Employed		19,85,000		7,33,000

(ii) Average Profit before Tax

		Truth Ltd.		Myth Ltd.
2018-2019		8,20,000		2,55,000
2019-2020		7,45,000		2,15,000
2020- 2021		6,04,000		2,14,000
Total profit of 3 years (a)		21,69,000		6,84,000
Simple Average [(a)/3]		7,23,000		2,28,000
Less: Non-trading income*		(30,000)		(12,000)
(iii) Goodwill		6,93,000		2,16,000
Capitalized value of average profit	[(6,93,000 / 18) x 100]	38,50,000	[(2,16,000 / 18) x 100]	12,00,000
Less: Capital Employed [From (i) above]		(19,85,000)		(7,33,000)
Goodwill		18,65,000		4,67,000

* For Truth Ltd. = 1,87,500 x 80% x 20% = 30,000; and

Myth Ltd. = 1,00,000 x 80% x 15% = 12,000

(2) Intrinsic Value per Share

		Truth Ltd.		Myth Ltd.
		₹		₹
Goodwill [W.N. 1]	18,65,000		4,67,000	
Other Assets	22,75,000	41,40,000	11,45,000	16,12,000
Less: Liabilities				
12% Debentures	-		1,75,000**	
Trade payables	90,000		1,42,000	
Provision for Tax	50,000	(1,40,000)	40,000	(3,57,000)
Net Assets		40,00,000		12,55,000
Intrinsic value per share [Net Assets / No. of Shares]		40,00,000 / 1,00,000		12,55,000 / 40,000
		= ₹ 40		= ₹ 31.375

** 1,50,000× $\frac{14\%}{12\%}$ =1,75,000

(3) Purchase Consideration & manner of its discharge

Intrinsic Value of Myth Ltd. [a]	₹ 31.375 per share

TELEGRAM: CA NOTE HUB

No. of shares [b]	40,000 shares
Purchase Consideration c= [a x b]	₹ 12,55,000
Intrinsic Value of Truth Ltd. [d]	₹ 40 per share
No. of shares to be issued [c / d]	31,375 shares

Question 11 (Past Exam July'21)

The summarized Balance Sheets of Black Limited and White Limited as on 31st March, 2020 is as follows:

Particulars	Notes	Black Limited (₹ In 000)	White Limited (₹ In 000)
Equity and Liabilities			
Shareholders' Funds			
(a) Share Capital	1	6,000	3,600
(b) Reserves and Surplus	2	1,080	660
Current Liabilities			
Trade payables		600	360
Total		**7,680**	**4,620**
Assets			
Non-current assets			
Property, Plant and Equipment		3,600	2,400
Current assets			
(a) Inventories		960	720
(b) Trade receivables		1,680	1,080
(c) Cash and Cash Equivalents		1,440	420
Total		**7,680**	**4,620**

Note No.	Particulars	Black Limited (₹ in 000)	White Limited (₹ in 000)
1.	Share Capital		
	Equity Shares of ₹ 100 each	6,000	3,600
	Reserves and Surplus		
2.	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

Black Limited takes over White Limited on 1st July, 2020.

No Balance Sheet of White Limited is available as on that date. It is, however estimated that White Limited earned profit of ₹ 2,40,000 after charging proportionate depreciation @ 10% p.a. on Property Plant and Equipment, during April-June, 2020.

Estimated profit of Black Limited during these 3 months was ₹ 4,80,000 after charging proportionate deprecation @ 10% p.a. on Property Plant and Equipment

Both the companies have declared and paid 10% dividend within this 3 months' period.

Goodwill of White Limited is valued at ₹ 2,40,000 and Property Plant and Equipment are valued at ₹ 1,20,000 above the depreciated book value on the date of takeover.

Purchase consideration is to be satisfied by Black Limited by issuing shares at par. Ignore income tax.

You are required to:

(i) Compute No. of shares to be issued by Black Limited to White Limited against purchase consideration.

TELEGRAM: CA NOTE HUB

(ii) Calculate the balance of Net Current Assets of Black Limited and White Limited as on 1st July, 2020.

(iii) Give balance of Profit or Loss of Black Limited as on 1st July, 2020

(iv) Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover. **(10 Marks)**

Solution:

(i) No. of shares issued by Black Ltd. to White Ltd. against purchase consideration

White Ltd.		**₹**	**₹**
Goodwill			2,40,000
Property, plant and equipment		24,00,000	
Less: Depreciation [24,00,000 10 % 3/12]		(60,000)	
		23,40,000	
Add: Appreciation		1,20,000	24,60,000
Inventory			7,20,000
Trade receivables			10,80,000
Cash and Bank balances		4,20,000	
Add: Profit after depreciation	2,40,000		
Add: Depreciation (non-cash)	60,000	3,00,000	
Less: Dividend [36,00,000 10%]		(3,60,000)	3,60,000
			48,60,000
Less: Trade payables			(3,60,000)
Purchase Consideration			45,00,000
Number of shares to be issued by Black Ltd. @ ₹ 100 each			45,000 shares

(ii) Calculation of Net Current Assets as on 01.07.2020

	₹	**Black Ltd.**	**.**	**White Ltd**
		₹		**₹**
Current assets:				
Inventory		9,60,000		7,20,000
Trade receivables		16,80,000		10,80,000
Cash and Bank	14,40,000		4,20,000	
Less: Dividend	(6,00,000)		(3,60,000)	
Add: Profit after depreciation	4,80,000		2,40,000	
Add: Depreciation being non cash	90,000	14,10,000	60,000	3,60,000
		40,50,000		21,60,000
Less: Trade payables		(6,00,000)		(3,60,000)
		34,50,000		18,00,000

(iii) Profit and Loss Account balance of Black Ltd. as on 1.07.2020

	₹
P & L A/c balance as on 31.03.2020	7,20,000
Less: Dividend paid	(6,00,000)
	1,20,000
Add: Estimated profit for 3 months after charging depreciation	4,80,000
	6,00,000

(iv) Property, plant and equipment as on 01.07.2020

Property, plant and equipment of Black Ltd. as on 31.03.2020		36,00,000
Less: Depreciation for 3 months [36,00,000 x 10% x 3/12]		(90,000)
Property, plant and equipment of White Ltd. Taken over as on 31.03.2020	24,00,000	35,10,000

TELEGRAM: CANOTE HUB

Less: Proportionate depreciation for 3 months on fixed assets	(60,000)	
	23,40,000	
Add: Appreciation above the estimated book value	1,20,000	24,60,000
Total Property, plant and equipment as on 1.7.2020		59,70,000

Question 12 (Past Exam, Jan'21)

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigate competition, a new company Glorious Ltd, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. The summarized Balance Sheet of Galaxy Ltd. and Glory Ltd. as at 31st March, 2020 are as follows:

	Galaxy Ltd.	Glory Ltd.
	₹	₹
(I) Equity & Liabilities		
(1) Shareholders' fund		
Share Capital		
Equity shares of ₹ 10 each	8,40,000	4,55,000
Reserves & Surplus		
General Reserve	4,48,000	40,000
Profit & Loss A/c	1,12,000	72,000
(1) Non-current Liabilities Secured Loan		
6% Debentures	-	3,30,000
(1) Current Liabilities		
Trade Payables	4,20,000	1,83,000
Total	**18,20,000**	**10,80,000**
(II) Assets		
(1) Non-current assets Property,		
Plant & Equipment		
Freehold property, at cost	5,88,000	3,36,000
Plant & Machinery, at cost less depreciation	1,40,000	84,000
Motor vehicles, at cost less depreciation	56,000	-
(2) Current Assets		
Inventories	3,36,000	4,38,000
Trade Receivables	4,62,000	1,18,000
Cash at Bank	2,38,000	1,04,000
Total	**18,20,000**	**10,80,000**

Assets and Liabilities are to be taken at book value, with the following exceptions:

(i) The Debentures of Glory Ltd. are to be discharged, by the issue of 8% Debentures of Glorious Ltd. at a premium of 10%.

(ii) Plant and Machinery of Galaxy Ltd. are to be valued at ₹ 2,52,000.

(iii) Goodwill is to be valued at : Galaxy Ltd. ₹ 4,48,000 Glory Ltd. ₹ 1,68,000

(iv) Liquidator of Glory Ltd. is appointed for collection from trade debtors and payment to trade creditors.

He retained the cash balance and collected ₹ 1,10,000 from debtors and paid ₹ 1,80,000 to trade creditors. Liquidator is entitled to receive 5% commission for collection and 2.5% for payments. The balance cash will be taken over by new company.

You are required to :

1) Compute the number of shares to be issued to the shareholders of Galaxy Ltd. and Glory Ltd, assuming the nominal value of each share in Glorious Ltd. is ₹ 10.

TELEGRAM: CA NOTE HUB

2) Prepare Balance Sheet of Glorious Ltd., as on 1st April, 2020 and also prepare notes to the accounts as per Schedule III of the Companies Act, 2013. **(20 Marks)**

Solution:

(i) Calculation of Purchase consideration (or basis for issue of shares of Glorious Ltd.

	Galaxy Ltd.	Glory Ltd.
Purchase Consideration:	₹	₹
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36,000
Plant and Machinery	2,52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000
Less: Liabilities:		
6% Debentures (3,00,000 x 110%)	- (4,20,000)	(3,30,000)
Trade payables	19,60,000	
Net Assets taken over	1,96,000	7,20,000
To be satisfied by issue of shares of Glorious. Ltd. @ ₹ 10 each		72,000

(ii) Balance Sheet of Glorious Ltd. as at 1st April, 2020

Particulars	Note No	Amount
		₹
EQUITY AND LIABILITIES		
1 Shareholders' funds		
(a) Share capital	1	26,80,000
(b) Reserves and surplus	2	30,000
2 Non-current liabilities		
(a) Long-term borrowings	3	3,00,000
3 Current liabilities		
(a) Trade payables		4,20,000
Total		**34,30,000**
ASSETS		
1 Non-current assets		
(a) i Property, plant and equipment	4	13,16,000
ii Intangible assets	5	6,16,000
2 Current assets		
(a) Inventories	6	7,74,000
(b) Trade receivables		4,62,000
(c) Cash and cash equivalents	7	2,62,000
Total		**34,30,000**

Notes to accounts:

		₹	₹
1	. Share Capital		
	Equity share capital		
	2,68,000 shares of ₹ 10 each		26,80,000
	(All the above shares are issued for consideration other than cash)		
2.	Reserves and surplus		

TELEGRAM: CA NOTE HUB

	Securities Premium		30,000
	(10% premium on debentures of ₹3,00,000)		
3.	Long-term borrowings		3,00,000
	Secured 8% 3,000 Debentures of ₹100 each		
4.	Property Plant and Equipment		
	Freehold property		
	Galaxy Ltd.	5,88,000	
	Glory Ltd.	3,36,000	9,24,000
	Plant and Machinery		
	Galaxy Ltd.	2,52,000	
	Glory Ltd.	84,000	3,36,000
	Motor vehicles - Galaxy Ltd.		56,000
			13,16,000
5	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	4,38,000	7,74,000
7	Cash and cash equivalents		
	Galaxy Ltd.	2,38,000	
	Glory Ltd.(As per working note)	24,000	2,62,000

Question 13 (Past Exam Dec'21) (MTP Sep'23)

Dark Ltd. and Fair Ltd. were amalgamated on and from 1st April, 2021. A new company Bright Ltd. was formed to take over the business of the existing companies. The balance Sheets of Dark Ltd. and Fair Ltd. as at 31st March, 2021 are given below:

(₹ In Lakhs)

Particulars	**Note No.**	**Dark Ltd.**	**Fair Ltd.**
1 Equity and Liabilities			
(1) Shareholders' Funds			
Share Capital	1	1,650	1,425
Reserves and Surplus	2	630	495
(2) Non-Current Liabilities Long Term Borrowings:			
10% Debentures of 100 ₹ each		90	45
(3) Current Liabilities Trade Payables		630	285
Total		**3,000**	**2,250**
II Assets			
(1) Non Current Assets			
(a) Property, Plant and Equipment		1,350	975
(b) Non Current Investments		225	75
(2) Current Assets			
(a) Inventories		525	375
(b) Trade Receivables		450	525
(c) Cash and Cash Equivalents		450	300
Total		**3,000**	**2,250**

Notes to Accounts

	Dark Ltd.	**Fair Ltd.**

TELEGRAM: CA NOTE HUB

	(₹ in Lakh)	(₹ in Lakh)
1 Share Capital		
Equity Shares of ₹ 100 each	1, 200	1,125
14% Preference Shares of ₹ 100 each	450	300
	1,650	1,425
2 Reserves and Surplus		
Revaluation Reserve	225	150
General Reserve	255	225
Investment Allowance Reserve	75	75
Profit and Loss Account	75	45
	630	495

Additional Information:

(i) Bright Limited will issue 5 equity shares for each equity share of Dark Limited and 4 equity shares for each equity share of Fair Limited. The shares are to be issued @ ₹ 35 each having a face value of ₹ 10 per share.

(ii) Preference shareholders of the two companies are issued equivalent number of 16% preference shares of Bright Limited at a price of ₹ 160 per share (face value ₹ 100).

(iii) 10% Debenture holders of Dark Limited and Fair Limited are discharged by Bright Limited, issuing such number of its 16% Debentures of ₹ 100 each so as to maintain the interest.

(iv) Investment allowance reserve is to be maintained for 4 more years.

(v) Liquidation expenses are for Dark Limited ₹ 6,00,000 and for Fair Limited ₹ 3,00,000. It is decided that these expenses would be borne by Bright Limited.

(vi) All the assets and liabilities of Dark Limited and Fair Limited are taken over at book value.

(vii) Authorized equity share capital of Bright Limited is ₹ 15,00,00,000 divided into equity share of ₹ 10 each. After issuing required number of shares to the liquidators of Dark Limited and Fair Limited, Bright Limited issued balance shares to public. The issue was fully subscribed.

You are required to prepare Balance Sheet of Bright Limited as at 1st April, 2021 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase. **(15 Marks)**

Solution:

Balance Sheet of Bright Ltd. as at 1st April, 2021

Particulars	**Note No.**	**(₹ in lakhs)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,250
(b) Reserves and Surplus	2	4,200
(2) Non-Current Liabilities		
Long-term borrowings	3	84.375
(3) Current Liabilities		
Trade payables	4	915
Total		**7449.375**
II. Assets		
(1) Non-current assets		
(a) i. Property, plant and equipment	5	2,325
ii. Intangible assets	6	633.375
(b) Non-current investments	7	300
(2) Current assets		
(a) Inventories	8	900

TELEGRAM: CA NOTE HUB

(b) Trade receivables	9	975
(c) Cash and cash equivalents	10	2316
Total		**7449.375**

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	Authorized Share Capital		
	1,50,00,000 Equity shares of ₹10 each	1500	
	7,50,000 16% Preference Share of 100 each	750	
	Issued: 1,50,00,000 Equity shares of ₹ 10 each	1500	
	(Out of which 1,05,00,000 Shares were Issued for consideration other than cash)		
	7,50,000 16% Preference Shares of 100 each		
	(Issued for consideration other than cash)	750	2,250
2.	Reserves and surplus		
	Securities Premium Account		
	(1,50,00,000 shares ×₹ 25) 3750		
	(7,50,000 shares × ₹ 60) 450	4,200	
	Investment Allowance Reserve	150	
	Amalgamation Adjustment Reserve	(150)	4,200
3.	Long-term borrowings		
	16% Debentures (56,25,000+28,12,500)		
	(W.N. 3)		84.375
4.	Trade payables		
	Dark Ltd.	630	
	Fair Ltd.	285	915
5.	Property, plant & equipment		
	Land and Building	1350	
	Plant and Machinery	975	2,325
6.	Intangible assets		
	Goodwill [W.N. 2] 624.375		
	Add: liquidation exp. (6+3) 9.00		633.375
7.	Non-current Investments		
	Investments (225+75)		300
8.	Inventories		
	Dark Ltd.	525	
	Fair Ltd.	375	900
9	Trade receivables		
	Dark Ltd.	450	
	Fair Ltd.	525	975
10	Cash & cash equivalents		
	Dark Ltd.	450	
	Fair Ltd.	300	
	Liquidation Expenses (6+3)	(9)	
	Shares issued for cash (45 lakh shares x ₹35)	1575	2316

Working Notes:

		(₹ in lakhs)		
		Dark Ltd.		Fair Ltd.

TELEGRAM: CA NOTE HUB

(1)	Computation of Purchase consideration				
	(a) Preference shareholders: $\left(\frac{4,50,00,000}{100}\right)$				
	i.e. 4,50,000 shares × ₹ 160 each $\left(\frac{3,00,00,000}{100}\right)$		720		
	i.e. 3,00,000 shares × ₹ 160 each				480
	(b) Equity shareholders: $\left(\frac{12,00,00,000X\ 5}{100}\right)$		2,100		
	i.e. 60,00,000 shares x ₹ 35 each $\left(\frac{11,25,00,000X4}{100}\right)$				
	i.e. 45,00,000 shares × ₹ 35 each				
	Amount of Purchase Consideration Net		2,820		1,575
	Assets Taken Over				2,055
(2)	Assets taken over:				
	Property Plant & Equity		1,350		975
	Non-Current Investments		225		75
	Inventory		525		375
	Trade receivables		450		525
	Cash and bank		450		300
	Less: Liabilities taken over:		3,000		2,250
	10% Debentures	56.25		28.125	
Trade payables		630	(686.25)	285	(313.125)
Net assets taken over		2,313.75		1936.875	
Purchase consideration			2,820		2055.00
Goodwill			506.25		118.125
Total goodwill					624.375

(3) Issue of Debentures

Debentures	₹ 90,00,000	₹ 45,00,000
Interest 10%	₹ 9,00,000	₹ 4,50,000
	$\left(\frac{9,00,000 \times 100}{16}\right)$) = 56,25,000	$\left(\frac{4,50,000 \times 100}{16}\right)$ = 28,12,500

NOTE: In the above solution ₹ 35 has been considered as the issue price of Equity shares for public issue also. Alternative considering this as ₹ 10 also possible. In that case, the balance of cash and cash equivalents will be ₹ 1,191 lakhs and securities premium will be ₹ 3,075 lakhs in place of the balances given in the balance sheet in the above solution.

Question 14 (Past Exam May'22)

The summarized Balance Sheet of A Ltd. and B Ltd. as at 31st March,2022 are as under:

	A Ltd. (in ₹)	**B Ltd. (in ₹)**
Equity shares of ₹10 each, fully paid up	30,00,000	24,00,000
Securities Premium Account	4,00,000	
General Reserve	6,20,000	5,00,000
Profit and Loss Account	3,60,000	3,20,000
Retirement Gratuity Fund Account	1,00,000	
10% Debentures	20,00,000	
Unsecured Loan (including loan from A Ltd.)	6,00,000	8,20,000
Trade Payables	1,00,000	3,40,000
	71,80,000	**43,80,000**
Land and Buildings	28,00,000	21,00,000
Plant and Machinery	20,00,000	7,60,000
Long term advance to B Ltd.	2,20,000	7,00,000

TELEGRAM: CA NOTE HUB

Inventories	10,40,000	5,20,000
Trade Receivables	8,20,000	3,00,000
Cash and Bank	3,00,000	
	71,80,000	**43,80,000**

B Ltd. is to declare and pay ₹ 1 per equity share as dividend, before the following amalgamation takes place with Z Ltd.

Z Ltd. was incorporated to take over the business of both A Ltd. and B Ltd.

a) The authorized share capital of Z Ltd. is ₹ 60 lakhs divided into ₹ 6 lakhs equity shares of ₹ 10 each.

b) As per Registered Valuer the value of equity shares of A Ltd. is ₹ 18 per share and of B Ltd. is ₹ 12 per share respectively and agreed by respective shareholders of the companies.

c) 10% Debentures of A Ltd. to be issued 12% Debentures of Z Ltd. at par in consideration of their holdings.

d) A contingent liability of A Ltd. of ₹ 2,00,000 is to be treated as actual liability.

e) Liquidation expenses including Registered Valuer fees of A Ltd.₹ 50,000 and B Ltd.₹ 30,000 respectively to be borne by Z Ltd.

f) The shareholders of A Ltd. and B Ltd. is to be paid by issuing sufficient number of fully paid up equity shares of ₹ 10 each at a premium of ₹ 10 per share.

Assuming amalgamation in the nature of purchase, you are required to pass the necessary journal entries (narrations not required) in the books of Z Ltd. and Prepare Balance Sheet of Z Ltd. immediately after amalgamation of both the companies. **(20 Marks)**

Solution:

Journal Entries in the books of Z Ltd.

		₹	₹
Business Purchase A/c	Dr.	54,00,000	
To Liquidator of A Ltd. A/c			54,00,000
Land & Building A/c	Dr.	28,00,000	
Plant & Machinery A/c	Dr.	20,00,000	
Long term advance to B Ltd. A/c	Dr.	2,20,000	
Inventories A/c	Dr.	10,40,000	
Trade Receivables A/c	Dr.	8,20,000	
Cash and Bank A/c	Dr.	3,00,000	
Goodwill A/c	Dr.	12,20,000	
To Retirement Gratuity Fund A/c			1,00,000
To 10% Debentures A/c			20,00,000
To Unsecured Loan A/c			6,00,000
To Trade Payables A/c			1,00,000
To Other liabilities A/c			2,00,000
To Business Purchase A/c			54,00,000
10% Debentures A/c	Dr.	20,00,000	
To 12% Debentures A/c			20,00,000
Liquidator of A Ltd. A/c	Dr.	54,00,000	
To Equity Share Capital A/c			27,00,000
To Securities Premium A/c			27,00,000
Business Purchase A/c	Dr.	28,80,000	
To Liquidator of B Ltd. A/c			28,80,000
Land and Building A/c	Dr.	21,00,000	
Plant & Machinery A/c	Dr.	7,60,000	

TELEGRAM: CA NOTE HUB

Inventories A/c	Dr.	7,00,000	
Trade Receivables A/c	Dr.	5,20,000	
Cash and Bank (less dividend) A/c	Dr.	60,000	
To Unsecured Loan A/c			8,20,000
To Trade Payables A/c			3,40,000
To Business Purchase A/c			28,80,000
To Capital Reserve A/c			1,00,000
Liquidators of B Ltd. A/c	Dr.	28,80,000	
To Equity Share Capital A/c			14,40,000
To Securities Premium A/c			14,40,000
Unsecured Loans A/c	Dr.	2,20,000	
To Long term Advance to B Ltd. A/c			2,20,000
*Capital Reserve A/c	Dr.	1,00,000	
To Cash and Bank A/c (Liquidation expenses)			80,000
To Goodwill A/c			20,000

Note:

1. The journal entries for A Ltd. and B Ltd. have been given separately in the above solution. Alternatively, the entries may be given as combined for both companies.

2. Alternatively, following set of entries may be given in place of the last entry given in the above solution:

Goodwill A/c Dr.	50,000	
To Cash & Bank A/c (Liquidation expenses of A Ltd.)		50,000
Capital Reserve A/c Dr.	30,000	
To Cash and Bank A/c (Liquidation expenses of B Ltd.)		30,000
Capital Reserve A/c Dr.	70,000	
To Goodwill A/c		70,000

Balance Sheet of Z Ltd. as at 31st March, 2022

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	41,40,000
(b) Reserves and Surplus	2	41,40,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	20,00,000
(b) Long term provisions	4	1,00,000
(3) Current Liabilities		
(a) Short-term borrowings1	5	12,00,000
(b) Trade payables	6	4,40,000
(a) Other liability		2,00,000
Total		**1,22,20,000**
II. Assets		
(1) Non-current assets		
(a) i. Property, plant and equipment	7	76,60,000
ii. Intangible assets		12,00,000
(Goodwill 12,20,000-20,000)		
(2) Current assets		
(a) Inventories	8	17,40,000
(b) Trade receivables	9	13,40,000
(c) Cash and cash equivalents	10	2,80,000
Total		**1,22,20,000**

TELEGRAM: CA NOTE HUB

1 Unsecured loans have been considered as short-term borrowings. Alternatively, it may be considered as long-term borrowings and presented accordingly

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	Authorized Share Capital		
	6,00,000 Equity shares of ₹ 10 each		60,00,000
	Issued: 4,14,000 Equity shares of ₹ 10 each (all these shares were Issued for consideration other than cash)		41,40,000
2.	Reserves and surplus		
	Securities Premium Account (4,14,000 shares × ₹ 10)		41,40,000
3.	Long-term borrowings		
	12% Debentures		20,00,000
4	Long term Provisions		
	Retirement gratuity fund		1,00,000
5.	Short-term borrowings		
	Unsecured loans		
	A Ltd. 6,00,000		
	B Ltd. 8,20,000	14,20,000	
	Less: Mutual	(2,20,000)	12,00,000
6.	Trade payables		
	A Ltd.	1,00,000	
	B Ltd.	3,40,000	4,40,000
7.	Property, plant & equipment		
	Land and Building		
	A Ltd.	28,00,000	
	B Ltd.	21,00,000	49,00,000
	Plant and Machinery		
	A Ltd.	20,00,000	
	B Ltd.	7,60,000	27,60,000
8.	Inventories		76,60,000
	A Ltd.	10,40,000	
	B Ltd.	7,00,000	17,40,000
9	Trade receivables		
	A Ltd.	8,20,000	
	B Ltd.	5,20,000	13,40,000
10	Cash & cash equivalents		
	A Ltd.	3,00,000	
	B Ltd. [3,00,000-2,40,000(dividend)]	60,000	
		3,60,000	
	Less: Liquidation Expenses	(80,000)	2,80,000

Working Note:

Calculation of amount of Purchase Consideration

	A Ltd.	**B Ltd.**
Existing shares	3,00,000	2,40,000
Agreed value per share	₹ 18	₹ 12
Purchase consideration	54,00,000	28,80,000
No. of shares to be issued of ₹ 20 each (including ₹ 10 premium)	2,70,000	1,44,000
Face value of shares at ₹ 10	27,00,000	14,40,000

TELEGRAM: CA NOTE HUB

Premium of shares at ₹ 10	27,00,000	14,40,000

Question 15 (MTP Apr'21, Past Exam Nov'18)

On 1st April, 2021, Bimal Ltd. take over the business of Vimal Ltd. and discharged purchase consideration as follows:

a) Issued 50,000 fully paid Equity shares of Rs. 10 each at a premium of Rs. 5 per share to the equity shareholders of Vimal Ltd.

b) Cash payment of Rs. 50,000 was made to equity shareholders of Vimal Ltd.

c) Issued 2,000 fully paid 12% Preference shares of Rs. 100 each at par to discharge the preference shareholders of Vimal Ltd.

d) Debentures of Vimal Ltd. (Rs.1,20,000) will be converted into equal number and amount of 10% debentures of Bimal Ltd.

Calculate the amount of Purchase consideration as per AS 14 and pass Journal Entry relating to discharge of purchase consideration in the books of Bimal Ltd. **(5 Marks)**

Solution:

Particulars	**Rs.**
Equity Shares (50,000 x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Journal entry relating to discharge of consideration in the books of Bimal Ltd.

Liquidation of Vimal Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Discharge of purchase consideration)		

Question 16 (Past Exam Dec'21)

Moon Limited is absorbed by Sun Limited; the consideration, being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9000); the payment of 9% Debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value; the payment of ₹ 18 per share in cash; allotment of two 11% preference shares of ₹ 10/- each and one equity share of ₹ 10/- each at a premium of 30% fully paid for every three shares in Moon Limited respectively. The number of shares of the vendor company is 1,50,000 of ₹ 10/- each fully paid.

Calculate purchase consideration as per AS-14. **(5 Marks)**

Solution:

TELEGRAM: CA NOTE HUB

As per AS 14 "Accounting for Amalgamations", the term consideration has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Purchase consideration will be:

	₹	Form
Equity shareholders: 1,50,000 × ₹ 18	27,00,000	Cash
1,50,000 × 2/3 × ₹ 10	10,00,000	11% Pref. shares
1,50,000 × 1/3 × ₹ 13	6,50,000	Equity shares
	43,50,000	

Note:

1. According to AS 14, 'consideration' excludes the any amount payable to debenture- holders. The liability in respect of debentures of vendor company will be taken by transferee company, which will then be settled by issuing new debentures.

2. Liquidation expenses will also not form part of purchase consideration.

Question 17 (Past Exam Nov'22)

Star Limited agreed to take over Moon Limited on 1st April,2022. The terms and conditions of takeover were as follows:

(i) Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Moon Limited.

(ii) Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.

(iii) 25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Moon Limited.

You are required:

(i) to give the meaning of "consideration for the amalgamation' as per AS-14, and

(ii) Calculate the amount of purchase consideration. **(5 Marks)**

Solution:

Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase consideration	**(₹)**	**Form**
For Preference Shareholders of Moon Ltd. (25,000 × ₹ 70)	17,50,000	25,000 Preference
For equity shareholders of Moon Ltd. (70,000 × ₹ 110)	77,00,000	70,000 Equity shares of Star Ltd.
	1,25,000	Cash
Total Purchase consideration	**95,75,000**	

Question 18 (MTP Nov'21, Mar'23) (RTP Nov'19)

The following information from Balance Sheet of X Ltd. as at 31st March, 2023:

	₹
4,000 Equity shares of ₹ 100 each	4,00,000

TELEGRAM: CA NOTE HUB

10% Debentures	2,00,000
Loans	80,000
Trade payables	1,60,000
General Reserve	40,000
Building	1,70,000
Machinery	3,20,000
Inventory	1,10,000
Trade receivables	1,30,000
Bank	68,000
Patent	65,000
Share issue Expenses	17,000

Y Ltd. agreed to absorb X Ltd. on the following terms and conditions:

1) Y Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

2) Y Ltd. is to take over trade payables at book value.

3) The purchase consideration is to be paid in cash to the extent of ₹ 3,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 62,200. The liquidation expenses amounted to ₹ 8,000. Y Ltd. sold prior to 31st March, 2023 goods costing ₹ 60,000 to X Ltd. for ₹ 80,000. ₹ 50,000 worth of goods are still in Inventory of X Ltd. on 31st March, 2023. Trade payables of X Ltd. include ₹ 20,000 still due to Y Ltd.

Show the necessary Ledger Accounts to close the books of X Ltd. and prepare the Balance Sheet of Y Ltd. as at 1st April, 2023 after the takeover.

Solution:

Books of X Limited Realization Account

	₹		₹
To Building	1,70,000	By Trade payables	1,60,000
To Machinery	3,20,000	By Y Ltd.	6,05,000
To Inventory	1,10,000	By Equity Shareholders (Loss)	38,000
To Trade receivables	1,30,000		
To Patent	65,000		
To Bank (Exp.)	8,000		
	8,03,000		**8,03,000**

Bank Account

To Balance b/d	68,000	By Realization (Exp.)	8,000
To Y Ltd.	3,00,000	By 10% Debentures	2,00,000
		By Loan	80,000
		By Equity shareholders	80,000
	3,68,000		3,68,000

10% Debentures Account

To Bank	2,00,000	By Balance b/d	2,00,000
	2,00,000		2,00,000

Loan Account

To Bank	80,000	By Balance b/d	80,000

TELEGRAM: CA NOTE HUB

	80,000		80,000

Share Issue Expenses Account

To Balance b/d	17,000	By Equity shareholders	17,000
	17,000		17,000

General Reserve Account

To Equity shareholders	40,000	By Balance b/d	40,000
	40,000		40,000

Y Ltd. Account

To Realization A/c	6,05,000	By Bank	3,05,000
		By Equity share in Y Ltd. (2,440 shares at ₹ 125 each)	3,00,000
	6,05,000		6,05,000

Equity Shares in Y Ltd. Account

To Y Ltd.	3,05,000	By Equity shareholders	3,05,000
	3,05,000		3,05,000

Equity Share Holders Account

To Realization	38,000	By Equity share capital	4,00,000
To Share issue Expenses	17,000	By General reserve	40,000
To Equity shares in B Ltd.	3,05,000		
To Bank	80,000		
			4,40,000

Y Ltd
Balance Sheet as on 1st April, 2023 (An extract) *

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
	a Share capital	1	2,44,000
	b Reserves and Surplus	2	53,500
2	Current liabilities		
	a Trade Payables	3	1,40,000
	b Bank overdraft		3,00,000
	Total		**7,37,500**
	Assets		
1	Non-current assets		
	a Property, Plant and Equipment	4	4,41,000
	Intangible assets	5	1,08,000
2	Current assets		
	a Inventories	6	91,500
	b Trade receivables	7	97,000
			7,37,500

Notes to Accounts

			₹
1	Share Capital		

TELEGRAM: CA NOTE HUB

	Equity share capital		
	2,440 Equity shares of ₹ 100 each (Shares have been issued for consideration other than cash)		2,44,000
	Total		2,44,000
2	Reserves and Surplus (an extract)		
	Securities Premium		61,000
	Profit and loss account	…..	
	Less: Unrealised profit	(7,500)	(7,500)
	Total		53,500
3	Trade payables		
	Opening balance	1,60,000	
	Less: Inter-company transaction cancelled upon amalgamation	(20,000)	1,40,000
4	Property, Plant and Equipments		
	Buildings		1,53,000
	Machinery		2,88,000
	Total		4,41,000
5	Intangible assets		
	Goodwill		1,08,000
6	Inventories		
	Opening balance	99,000	
	Less: Cancellation of profit upon amalgamation	(7,500)	91,500
7	Trade receivables		
	Opening balance	1,17,000	
	Less: Intercompany transaction cancelled upon amalgamation	(20,000)	97,000

Working Notes:

1.	Valuation of Goodwill	₹
	Average profit	62,200
	Less: 8% of ₹ 4,40,000	(35,200)
	Super profit 27,000	
	Value of Goodwill = 27,000 x 4	1,08,000
2.	Net Assets for purchase consideration	
	Goodwill as valued in W.N.1	1,08,000
	Building	1,53,000
	Machinery	2,88,000
	Inventory	99,000
	Trade receivables (1,30,000-13,000)	1,17,000
	Total Assets	7,65,000
	Less: Trade payables	(1,60,000)
	Net Assets	6,05,000

Out of this ₹ 3,00,000 is to be paid in cash and remaining i.e., (6,05,000 – 3,00,000) ₹ 3,05,000 in shares of ₹ 125. Thus, the number of shares to be allotted 3,05,000/125 = 2,440 shares.

3.	Unrealised Profit on Inventory	₹
	The Inventory of X Ltd. includes goods worth ₹ 50,000 which was sold by Y Ltd. on profit. Unrealized profit on this Inventory will be [20,000/80,000 x 50,000]	12,500
	As Y Ltd purchased assets of X Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 50,000.	(5,000)
	Amount of unrealized profit	7,500

*In the absence of the particulars of assets and liabilities (other than those of X Ltd.), the complete Balance Sheet of Y Ltd. after takeover cannot be prepared.

TELEGRAM: CA NOTE HUB

Question 19 (Past Exam Nov'23)

Raman Limited and Naman Limited decided to amalgamate and form a new company Rana Limited as on 31st March, 2023 and provided you the following information:

Particulars	As on 31st March,2023		Revalued Figures for Amalgamation	
	Raman Limited (₹)	Naman Limited (₹)	Raman Limited (₹)	Naman Limited (₹)
Equity shares of ₹ 10 each	6,72,000	2,52,000		
10% Preference Shares of ₹ 100 each	3,36,000	1,68,000		
Reserves and Surplus	5,44,240	2,65,480		
Trade Payables	84,000	1,76,000	80,640	1,68,960
Property, Plant and Equipment	7,69,000	4,36,400	10,58,100	5,20,100
Goodwill	1,62,000	-	1,62,000	-
Inventories	1,89,000	1,17,600	2,78,620	2,06,780
Trade Receivables	2,81,000	1,47,000	2,47,140	1,38,180
Cash & Cash Equivalents	2,35,240	1,60,480		

The purchase consideration is to be satisfied as follows:

i. By issue of 4 Preference Shares of ₹ 100 each in Rana Limited @ ₹ 85 paid up and at a premium of ₹ 30 per share for every 3 preference shares held in both the companies.

ii. By issue of 5 Equity shares of ₹ 10 each in Rana Limited @ ₹ 7 paid up and at a premium of ₹ 5 per share for every 3 equity shares held in both the companies.

iii. In addition, necessary cash should be paid to equity shareholders of both the companies as required to adjust the rights of shareholders of both t he companies in accordance with the intrinsic value of the shares of both the companies.

You are required to compute the purchase consideration for both the companies. **(5 Marks)**

Solution:

Purchase consideration

	Raman Ltd. ₹	Naman Ltd. ₹
Payable to preference shareholders:		
Preference shares at ₹ 115 per share	5,15,200	2,57,600
	(3,360× 4/3)	(1,680 x 4/3)
Equity Shares at ₹ 12 per share	13,44,000	5,04,000
	(67,200× 5/3)	(25,200 x 5/3)
Cash [See W.N.]	41,260	94,980
	19,00,460	8,56,580

Working note:

	Raman Ltd. ₹	Naman Ltd. ₹
Goodwill	1,62,000	
PPE	10,58,100	5,20,100
Trade receivables	2,47,140	1,38,180
Inventory	2,78,620	2,06,780

TELEGRAM: CA NOTE HUB

Cash & Cash Equivalent	2,35,240	1,60,480
	19,81,100	10,25,540
Less: Trade payables	(80,640)	(1,68,960)
	19,00,460	8,56,580
Payable in shares	18,59,200	7,61,600
Payable in cash	41,260	94,980

Question 20 (MTP Apr'24)

Following is the information of Anu Ltd. and Banu Ltd. as on 31.03.2023 were as under:

	Anu Ltd. (₹)	Banu Ltd. (₹)
Share Capital:		
50,000 Equity Shares of ₹10 each, Fully Paid	5,00,000	
37,500 Equity Shares of ₹10 each, Fully Paid		3,75,000
General Reserve	3,00,000	-
Profit and Loss Account	62,500	62,500
Trade Payables	2,62,500	1,62,500
5% Debentures	-	1,50,000
Freehold Property	3,75,000	3,00,000
Plant and Machinery	75,000	50,000
Motor Vehicle	37,500	25,000
Trade Receivables	2,50,000	1,00,000
Inventory	2,87,500	2,25,000
Cash at Bank	1,00,000	50,000

Anu Ltd. and Banu Ltd. carry on business of similar nature and they agreed to amalgamate.

A new Company, Anban Ltd. is formed to take over the Assets and Liabilities of Anu Ltd. and Banu Ltd. on the following basis:

Assets and Liabilities are to be taken at Book Value, with the following exceptions:

(a) Goodwill of Anu Ltd. and Banu Ltd. is to be valued at ₹1,75,000 and ₹50,000 respectively.

(b) Plant and Machinery of Anu Ltd. are to be valued at ₹1,25,000.

(c) The Debentures of Banu Ltd. are to be discharged by the issue of 6% Debentures of Anan Ltd. at a premium of 5%.

You are required to:

1) Compute the basis on which shares in Anban Ltd. will be issued to Shareholders of the existing Companies assuming nominal value of each share of Anban Ltd. is ₹10.

2) Draw up a Balance Sheet of Anban Ltd. as on 1st April, 2023, when Amalgamation is completed.

Solution: **(14 Marks)**

Calculation of Net Assets

Particulars	**Anu Ltd. (₹)**	**Banu Ltd. (₹)**
Goodwill	1,75,000	50,000
Freehold property	3,75,000	3,00,000
Plant & Machinery	1,25,000	50,000

TELEGRAM: CA NOTE HUB

Motor vehicle	37,500	25,000
Trade receivable	2,50,000	1,00,000
Inventory	2,87,500	2,25,000
Cash at Bank	1,00,000	50,000
Total	13,50,000	8,00,000
Less : Trade payable	(2,62,500)	(1,62,500)
6% debentures	-	(1,57,500)
Net Assets	10,87,500	4,80,000

Calculation of Purchase Consideration

Sr. No.	Particulars	Computation	Anu Ltd	Banu Ltd
1	Amount payable to Equity Share Holder in the form of			
	1,08,750 Equity shares of ₹10 each	(1,08,750 × 10)	10,87,500	
	48,000 Equity shares of ₹10 each	(48,000 × 10)		4,80,000
	Purchase Consideration		10,87,500	4,80,000

Balance Sheet of Anban Ltd.

as on 1st April, 2023

	Particulars	Note No.	₹
	Equity and Liabilities		
(1)	Shareholders' Funds		
	(a) Share Capital	1	15,67,500
(2)	Non-current Liabilities		
	(a) Long term borrowings	2	1,57,500
(3)	Current Liabilities		
	(a) Trade Payables (2,62,500 + 1,62,500)		4,25,000
	Total		21,50,000
	Assets		
(1)	Non-current Assets		
	(a) Property Plant and Equipment	3	9,12,500
	(b) Intangible assets	4	2,25,000
(2)	Current Assets		
	(a) Inventories (2,87,500 + 2,25,000)		5,12,500
	(b) Trade Receivables (2,50,000 + 1,00,000)		3,50,000
	(c) Cash and cash equivalents (1,00,000 + 50,000)		1,50,000
	Total		21,50,000

Notes to Accounts:

Note No.	Particulars	₹
1	**Share Capital**	

TELEGRAM: CA NOTE HUB

	Equity share capital	
	1,56,750 equity shares of ₹10 each	15,67,500
	(out of above shares are issued for consideration other than cash)	
2	**Long term borrowings**	
	6% Debentures	1,57,500
3	**Property, Plant & Equipment's**	
	Freehold property (3,75,000 + 3,00,000)	6,75,000
	Plant & Machinery (1,25,000 + 50,000)	1,75,000
	Motor Vehicle (37,500+25,000)	62,500
		9,12,500
4	**Intangible assets**	
	Goodwill (1,75,000 + 50,000)	2,25,000

TELEGRAM: CA NOTE HUB

MCQs

1. In case of amalgamation, the entry for elimination of unrealized profit or loss on stock is made
    a. By the vendor company
    b. By the purchasing company
    c. By the third party
    d. By the court
2. If expenses of liquidation of the vendor company are paid by the purchasing company then, in purchasing company's book, the account debited is
    a. Goodwill account.
    b. Liquidation expense account.
    c. Vendor company account.
    d. General reserve.
3. Amalgamation adjustment reserve is opened in the books of the amalgamated company to incorporate
    a. Assets of the amalgamating company.
    b. Non- Statutory reserves of the amalgamating company.
    c. Statutory reserves of the amalgamating company.
    d. General reserve of the amalgamating company.
4. Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as
    a. Other current asset.
    b. Separate line item with a negative sign under the head 'Reserves and Surplus'.
    c. Other non-current assets.
    d. Investment of the company
5. A company into which the vendor company is merged is called
    a. Transferee company.
    b. Transferor company.
    c. Selling company.
    d. Acquiree company.
6. If the purchase consideration is more than net assets (at agreed values) of the transferor company, difference shall be recorded as _____ in the books of the transferee company.
    a. Goodwill.
    b. Capital Reserve.
    c. Profit.
    d. Loss.

ANSWERS/HINTS

1. (b) 2. (a) 3. (c) 4. (b) 5. (a) 6. (a)

Chapter 33 PREPARATION OF FINANCIAL STATEMENTS

Question 1 NB Pg. No.

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemicals Ltd.
Trial Balance as at 31st March, 20X1

Particulars	₹	Particulars	₹
Inventory	6,80,000	Equity Shares	
Furniture	2,00,000	Capital (Shares of ₹ 10 each)	25,00,000
Discount	40,000	11% Debentures	5,00,000
Loan to Directors	80,000	Bank loans	6,45,000
Advertisement	20,000	Trade payables	2,81,000
Bad debts	35,000	Sales	42,68,000
Commission	1,20,000	Rent received	46,000
Materials consumed	23,19,000	Transfer fees	10,000
Plant and Machinery	8,60,000	Profit & Loss account	1,39,000
Rentals	25,000	Depreciation provision:	
Current account	45,000	Machinery	1,46,000
Cash	8,000		
Interest on bank loans	1,16,000		
Preliminary expenses	10,000		
Fixtures	3,00,000		
Wages	9,00,000		
Consumables	84,000		
Freehold land	15,46,000		
Tools & Equipment	2,45,000		
Goodwill	2,65,000		
Trade receivables	4,40,000		
Dealer aids	21,000		
Transit insurance	30,000		
Trade expenses	37,000		
Distribution freight	54,000		
Debenture interest	55,000		
	85,35,000		**85,35,000**

Additional information: Closing Inventory on 31-3-20X1: ₹ 8,23,000.

Solution :

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

TELEGRAM: CA NOTE HUB

	Schedule No. (1)	Rupees as at the end of 31st March 20X1 (2)
Equity and Liabilities		
(1) Shareholders' funds :		
(a) Share Capital	1	25,00,000
(b) Reserves and Surplus	2	7,40,000
(2) Non Current Liabilities		
(a) Long term borrowings	3	11,45,000
(3) Current Liabilities		
(a) Trade payables		2,81,000
Total		**46,66,000**
Assets		
(1) Non current assets		
(a) PPE	4	30,05,000
(b) Intangible assets (goodwill)		2,65,000
(2) Current assets		
(a) Inventories		8,23,000
(b) Trade receivables		4,40,000
(c) Cash and bank balances	5	53,000
(d) Short term loans and advances	6	80,000
Total		**46,66,000**

Haria Chemicals Ltd.

Statement of Profit and Loss for the year ended 31st March, 20X1

	Schedule	Figures	
Revenue from operations		42,68,000	
Other income	7	56,000	
	(A)	**43,24,000**	
Expenses			
Cost of materials consumed		23,19,000	
Change in inventory of finished goods	8	(1,43,000)	
Employee benefit expenses	9	9,00,000	
Finance cost	10	1,71,000	
Other expenses	11	4,76,000	
	(B)	**37,23,000**	
Profit before tax (A – B)			**6,01,000**
Provision for tax			—
Profit for the period			**6,01,000**

TELEGRAM: CA NOTE HUB

Notes to Accounts

	₹
1. Share capital	
Authorised:	
Equity share capital of ₹ 10 each	25,00,000
Issued and Subscribed:	
Equity share capital of ₹ 10 each	25,00,000
2. Reserves and Surplus	
Balance as per last balance sheet	1,39,000
Balance in profit and loss account	6,01,000
–	7,40,000
3. Long term Borrowings	
11% Debentures	5,00,000
Bank loans (assumed long-term)	6,45,000
	11,45,000
4. PPE	

	Gross block	Depreciation	Net Block
Freehold land	15,46,000		15,46,000
Furniture	2,00,000		2,00,000
Fixtures	3,00,000		3,00,000
Plant & Machinery	8,60,000	1,46,000	7,14,000
Tools & Equipment	2,45,000	—	2,45,000
Total	31,51,000	1,46,000	30,05,000

5. Cash and bank balances		
Cash and cash equivalents		
Current account balance		45,000
Cash		8,000
Other bank balances		Nil
		53,000
6. Short-term loans and Advances		
Loan to directors		80,000
7. Other Income		
Rent received		46,000
Transfer fees		10,000
		56,000
8. Changes in inventory of finished goods, WIP & Stock in trade		
Opening inventory	6,80,000	
Closing inventory	(8,23,000)	(1,43,000)
9. Employee benefit expense		
Wages		9,00,000
10. Finance cost		
Interest on bank loans		1,16,000
Debenture interest		55,000
		1,71,000

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TELEGRAM: CA NOTE HUB

11. Other Expenses	
Consumables	84,000
Preliminary expenses	10,000
Bad debts	35,000
Discount	40,000
Rentals	25,000
Commission	1,20,000
Advertisement	20,000
Dealers' aids	21,000
Transit insurance	30,000
Trade expenses	37,000
Distribution freight	54,000
	4,76,000

Question 2

NB Pg. No.

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

	Dr. ₹	Cr. ₹
Authorised Capital-divided into 5,000 6% Preference Shares of ₹100 each and 10,000 equity Shares of ₹100 each		15,00,000
Subscribed Capital –		
5,000 6% Preference Shares of ₹100 each		5,00,000
Equity Capital		8,05,000
Purchases – Wines, Cigarettes, Cigars, etc.	45,800	
– Foodstuffs	36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	
Sales – Wines, Cigarettes, Cigars, etc.		68,400
– Food		57,600
Coal and Firewood	3,290	
Carriage and Cooliage	810	
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	

TELEGRAM: CA NOTE HUB

Inventory on hand, 1st April, 20X1			
Wines, Cigarettes. Cigars, etc.		12,800	
Foodstuffs		5,260	
Cash in hand		2,200	
Cash with Bankers		76,380	
Preliminary and formation expenses		8,000	
2,000 Debentures of ₹100 each (6%)			2,00,000
Profit and Loss Account			41,500
Trade payables			42,000
Trade receivables		19,260	
Investments		2,72,300	
Goodwill at cost		5,00,000	
General Reserve			2,00,000
		19,75,000	19,75,000
Wages and Salaries Outstanding	1,280		
Inventory on 31st March, 20X2			
Wines, Cigarettes and Cigars, etc.	22,500		
Foodstuffs	16,400		

Depreciation : Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.

The Equity capital on 1st April, 20X1 stood at ₹7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹60 paid. The directors made a call of ₹40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹90 per share as fully paid. The Directors declared a dividend of 8% on equity shares on 2nd April, 20X2, transferring any amount that may be required from General Reserve. Ignore Taxation.

Solution :

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

Particulars	Note No	₹
Equity and Liabilities		
1 Shareholders' funds	1	13,00,000
a Share capital	2	2,68,745
b Reserves and Surplus	3	2,00,000
2 Non-current liabilities		
a Long-term borrowings	4	42,000
3 Current liabilities		
a Trade Payables	5	13,280
b Other current liabilities		
Total		**18,24,025**
ASSETS		
1 Non-current assets	6	9,14,985
i PPE		5,00,000
ii Intangible assets (Goodwill)		2,72,300
iii Non-current investments		

2 Current assets	7	38,900
i Inventories		
ii Trade receivables		19,260
iii Cash and bank balances	8	78,580
Total		**18,24,025**

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

	Particulars	Notes	Amount
I.	Revenue from operations	9	1,79,700
II.	Other income	10	6,800
III.	**Total Income (I + II)**		**1,86,500**
IV.	**Expenses:**		
	Cost of materials consumed	11	25,060
	Purchases of Inventory-in-Trade	12	45,800
	Changes in inventories of finished goods work- in-progress and Inventory-in-Trade	13	(9,700)
	Employee benefits expense	14	29,580
	Other operating expenses	15	18,000
	Selling and administrative expenses	16	14,200
	Finance costs	17	12,000
	Depreciation and amortisation expense	18	21,315
	Other expenses (Preliminary expenses written off)		8,000
	Total expenses		**1,64,255**
V.	**Profit (Loss) for the period (III – IV)**		**22,245**

Notes to accounts

			₹
1 Share Capital			
Equity share capital			
Authorised			
10,000 Equity shares of ₹100 each			
Issued & subscribed			10,00,000
8,000 Equity Shares of ₹100 each	(A)		8,00,000
Preference share capital			
Authorised			
5,000 6% Preference shares of ₹ 100 each			
Issued & subscribed			5,00,000
5,000 6% Preference shares of ₹ 100 each	(B)		5,00,000
	Total (A + B)		**13,00,000**
2 Reserves and Surplus			
Capital reserve [100 x (90 – 40)]			5,000
General reserve			2,00,000

TELEGRAM: CA NOTE HUB

Surplus (Profit & Loss A/c)		22,245	
Add: Balance from previous year		41,500	63,745
	Total		**2,68,745**
3 Long-term borrowings			
Secured			
6% Debentures			2,00,000
	Total		**2,00,000**
4 Trade Payables			42,000
5 Other current liabilities			
Wages and Salaries Outstanding		1,280	
Interest on debentures		12,000	13,280
	Total		**13,280**
6 PPE			
Freehold land & Buildings		8,50,000	
Less: Depreciation		(17,000)	8,33,000
Furniture and Fittings		86,300	
Less: Depreciation		(4,315)	81,985
	Total		**9,14,985**
7 Inventories			
Wines, Cigarettes & Cigars, etc.			22,500
Foodstuffs			16,400
	Total		**38,900**
8 Cash and bank balances			
Cash and cash equivalents			
Cash at bank			76,380
Cash in hand			2,200
Other bank balances			Nil
	Total		**78,580**
9 Revenue from operations			
Sale of products			
Wines, Cigarettes, Cigars etc.		68,400	
Food		57,600	1,26,000
Sale of services			
Room Rent		48,000	
Billiards		5,700	53,700
	Total		**1,79,700**
10 Other Income			
Transfer fees		700	
Miscellaneous Receipts		2,800	
Discount received		3,300	
	Total		**6,800**
11 Cost of materials consumed			
Opening Inventory		5,260	

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Add: Purchases during the year		36,200	
Less: Closing Inventory		(16,400)	
	Total		25,060
			25,060
12 Purchases of Inventory-in-Trade			
Wines, Cigarettes etc.			45,800
	Total		**45,800**
13 Changes in inventories of finished goods			
work-in-progress and Inventory-in-Trade			
Wines, Cigarettes etc.			
Opening Inventory		12,800	
Less: Closing Inventory		(22,500)	
	Total		(9,700)
			(9,700)
14 Employee benefits expense			
Wages and Salaries		28,300	
Add: Wages and Salaries Outstanding		1,280	
	Total		29,580
			29,580
15 Other operating expenses			
Rent, Rates and Taxes			8,900
Coal and Firewood			3,290
Laundry			750
Carriage and Cooliage			810
Repairs			4,250
	Total		**18,000**
16 Selling and administrative expenses			
Advertising			8,360
Sundry Expenses			5,840
	Total		**14,200**
17 Finance costs			
Interest on Debentures (2,00,000 × 6%)			12,000
	Total		**12,200**
18 Depreciation and amortisation expense			
Land and Buildings (8,50,000 × 2%)		17,000	
Furniture & Fittings (86,300 × 5%)		4,315	
	Total		21,315
			21,315

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 3 : (RTP Nov'21)

NB Pg. No.

State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

(i) Share application money received in excess of issued share capital.

TELEGRAM: CA NOTE HUB

(ii) Share option outstanding account.
(iii) Unpaid matured debenture and interest accrued thereon.
(iv) Uncalled liability on shares and other partly paid investments.
(v) Calls unpaid.
(vi) Money received against share warrant.

Solution :

(i) Current Liabilities/Other Current Liabilities
(ii) Shareholders' Fund/Reserve & Surplus
(iii) Current liabilities/Other Current Liabilities
(iv) Contingent Liabilities and Commitments
(v) Shareholders' Fund/Share Capital
(vi) Shareholders' Fund/Money received against share warrants

Question 4 : (RTP May'22) (MTP Mar'24) NB Pg. No.

Following is the trial balance of Delta limited as on 31.3.20X2.

(Figures in ₹'000)

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital	500
		(shares of ₹ 10 each)	
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.X1)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-X2)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		**2455**

Additional Information:

(i) The authorized share capital of the company is 80,000 shares of ₹10 each.
(ii) The company revalued the land at ₹9,60,000.
(iii) Equity share capital includes shares of ₹50,000 issued for consideration other than cash.
(iv) Suspense account of ₹10,000 represents cash received from the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹24,000 and the accumulated depreciation thereon being ₹20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.
(v) Depreciation is to be provided on plant and machinery at 10% on cost.
(vi) Balance at bank includes ₹5,000 with ABC Bank Ltd., which is not a Scheduled Bank.

TELEGRAM: CA NOTE HUB

(vii) Make provision for income tax @30%.

(viii) Trade receivables of ₹50,000 are due for more than six months.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous year's figures & taxation. **(14 Marks)**

Solution :

Delta Limited
Balance Sheet as at 31st March 20X2

Particulars	Note No.	(₹ in '000)
A. Equity and Liabilities		
1. Shareholders' funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00
(b) Short- term provision	4	163.80
Total		**1,796.00**
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00
(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		**1,796.00**

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

Particulars	Note No.	(₹ in '000)
I. Revenue from Operations		1200.00
II. Other Income	8	6.00
III. Total Income (I +II)		**1,206.00**
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)		80.00
Other expenses	10	150.00
Total Expenses		**660.00**
V. Profit / (Loss) for the period before tax (III – IV)		
		546.00
VI. Tax expenses @30%		163.80
VII. VII Profit for the period		**382.20**

TELEGRAM: CA NOTE HUB

Notes to Accounts

	Particulars		(₹ in '000)
1	**Share Capital**		
	Equity Share Capital		
	Authorised		
	80,000 Shares of ₹ 10/- each		800
	Issued, Subscribed and Called-up		
	50,000 Shares of ₹ 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495
2	**Reserves and Surplus**		
	Securities Premium		40.00
	Revaluation Reserve ₹ (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account		
	Balance		
	Opening Balance	75.00	
	Add: Profit for the period	382.20	457.20
			807.20
3	**Long-Term Borrowings**		
	10% Debentures		300
4.	**Short – term provision**		
	Provision for tax		163.80
5	**Property, plant & equipment**		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	
		800	
	Less: Depreciation ₹ (150 – 20 +80)	(210)	
	Closing Balance		590
	Total		1,550
6	**Trade receivables**		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	**Cash and Cash Equivalents**		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	

TELEGRAM: CA NOTE HUB

	Cash in hand	2	
8	**Other Income**		30
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less: Book value of machinery (24– 20)	(4)	
			6
9	**Finance Costs**		
	Debenture Interest		30
10	**Other Expenses:**		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	45	150

Question 5 : (MTP Jan'25) NB Pg. No.

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

(Figures in ₹ '000)

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

Additional Information:

(i) The authorised share capital of the company is 40,000 shares of ₹10 each.

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

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

(iv) Suspense account of ₹4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹10,000 and the accumulated depreciation thereon being ₹8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

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

TELEGRAM: CA NOTE HUB

Solution :

Omega Limited
Balance Sheet as at 31st March, 20X2

Particulars	Note No.	(₹ in 000)
Equity and Liabilities		
1. Shareholders' funds		
A Share capital	1	300
B Reserves and Surplus	2	530
2. Non-Current liabilities		
A Long term borrowings	3	200
3. Current liabilities		
A Trade Payables		52
Total		**1082**
Assets		
1. Non-current assets		
A PPE (Property, Plant & Equipment)	4	880
2. Current assets		
A Inventories		86
B Trade receivables		96
C Cash and bank balances		20
Total		**1082**

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

Particulars	Notes	(E in 000)
I. Revenue from operations		700
II. Other Income	5	2
III. Total Income		**702**
IV. Expenses:		
Purchases		320
Finance costs	6	20
Depreciation (10% of 760*)		76
Other expenses	7	120
Total Expenses		**536**
V. Profit (Loss) for the period (III – IV)		**166**

Notes to accounts

			(₹ in 000)
1.	**Share Capital**		
	Equity share capital		
	Authorised		
	40,000 shares of E 10 each		400
	Issued & subscribed & called up		

TELEGRAM: CA NOTE HUB

	30,000 shares of E 10 each			300
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	General reserve			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	220
				530
3.	**Long term borrowing**			
	10% Debentures			200
4.	**PPE**			
	Land			
	Opening balance		220	
	Add: Revaluation adjustment		140	
	Closing balance			360
	Plant and Machinery			
	Opening balance		770	
	Less: Disposed off		(10)	
			760	
	Less: Depreciation (172–8+76)		(240)	
	Closing balance			520
		Total		**880**
5.	**Other Income**			
	Profit on sale of machinery:			
	Sale value of machinery		4	
	Less: Book value of machinery (10–8)		(2)	2
6.	**Finance costs**			
	Debenture interest			20
7.	**Other expenses:**			
	Factory expenses		60	
	Selling expenses		30	
	Administrative expenses		30	120

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 6 : **NB Pg. No.**

On 31st March, 20X1 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 20X1:

TELEGRAM: CA NOTE HUB

Credit Balances:

	₹
Equity shares capital, fully paid shares of ₹10 each	70,00,000
General Reserve	15,49,100
Loan from State Finance Corporation	10,50,000
(Secured by hypothecation of Plant & Machinery Repayable within one year (2,00,000)	
Loans: Unsecured (Long term)	8,47,000
Sundry Creditors for goods &expenses	14,00,000
(Payable within 6 months)	
Profit & Loss Account	7,00,000
Provision for Taxation	8,16,900
	1,33,63,000

Debit Balances:

	₹
Calls in arrear	7,000
Land	14,00,000
Buildings	20,50,000
Plant and Machinery	36,75,000
Furniture& Fixture	3,50,000
Inventories: Finished goods	14,00,000
Raw Materials	3,50,000
Trade Receivables	14,00,000
Advances: Short-term	2,98,900
Cash in hand	2,10,000
Balances with banks	17,29,000
Preliminary Expenses	93,100
Patents & Trademarks	4,00,000
	1,33,63,000

The following additional information is also provided in respect of the above balances:

(i) 4,20,000 fully paid equity shares were allotted as consideration for land & buildings.

(ii) Cost of Building ₹28,00,000

(iii) Cost of Plant & Machinery ₹49,00,000

(iv) Cost of Furniture & Fixture ₹4,37,500

(v) Trade receivables for ₹3,80,000 are due for more than 6 months.

(vi) The amount of Balances with Bank includes ₹18,000 with a bank which is not a scheduled Bank and the deposits of ₹5 lakhs are for a period of 9 months.

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

(viii) Entire amount of Preliminary expenses to be written off, by adjusting from opening balance of General Reserve.

You are not required to give previous year's figures. You are required to prepare the Balance Sheet of the Company as on 31stMarch, 20X1 as required under Schedule III to the Companies Act, 2013.

TELEGRAM: CA NOTE HUB

Solution :

Bose and Sen Ltd.
Balance Sheet as at 31st March, 20X1

Particulars			Notes	Figures at the end of current reporting period (₹)
Equity and Liabilities				
1		**Shareholders' funds**		
	a	Share capital	1	69,93,000
	b	Reserves and Surplus	2	21,56,000
2		**Non-current liabilities**		
	a	Long-term borrowings	3	16,97,000
3		**Current liabilities**		
	a	Trade Payables		14,00,000
	b	Short term borrowings	4	2,00,000
	c	Short-term provisions	5	8,16,900
		Total		1,32,62,900
Assets				
1		**Non-current assets**		
	a	PPE	6	74,75,000
	b	Intangible assets		4,00,000
		(Patents & Trade Marks)		
2		**Current assets**		
	a	Inventories	7	17,50,000
	b	Trade receivables	8	14,00,000
	c	Cash and bank balances	9	19,39,000
	d	Short-term loans and advances		2,98,900
		Total		**1,32,62,900**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up		
	7,00,000 Equity Shares of ₹ 10 each	70,00,000	
	Out of the above 4,20,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(7,000)	69,93,000
	Total		**69,93,000**
2	**Reserves and Surplus**		
	General Reserve	15,49,100	
	Less: Preliminary expenses	(93,100)	14,56,000
	Surplus (Profit & Loss A/c)		7,00,000

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TELEGRAM: CA NOTE HUB

		Total		**21,56,000**
3	**Long-term borrowings**			
	Secured			
	Term Loans			
	Loan from State Finance Corporation (₹ 10,50,000 – ₹ 2,00,000) (Secured by hypothecation of Plant and Machinery)			8,50,000
	Unsecured			
	Bank Loan		2,00,000	
	Loan from related parties		1,00,000	
	Others		5,47,000	8,47,000
		Total		**16,97,000**
4	Short term borrowings			
	Current maturities of long-term debt- loan Instalment repayable within one year			**2,00,000**
5	**Short-term provisions**			
	Provision for taxation			**8,16,900**
6	**Property, plant and equipment**			
	Land			14,00,000
	Buildings		28,00,000	
	Less: Depreciation		(7,50,000) (b.f.)	20,50,000
	Plant & Machinery		49,00,000	
	Less: Depreciation		(12,25,000) (b.f.)	36,75,000
	Furniture & Fittings		4,37,500	
	Less: Depreciation		(87,500) (b.f.)	3,50,000
		Total		**74,75,000**
7	**Inventories**			
	Raw Material			3,50,000
	Finished goods			14,00,000
				17,50,000
8	Trade receivables			
	Debts outstanding for a period exceeding six months			3,80,000
	Other Debts			10,20,000
		Total		**14,00,000**
9	**Cash and bank balances**			
	Cash and cash equivalents			
	Cash at bank with Scheduled Banks		12,11,000	
	with others		18,000	12,29,000
	Cash in hand			2,10,000

	Other bank balances Bank deposits for period of 9 months		5,00,000
	Total		**19,39,000**

Question 7 : **NB Pg. No.**

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

Particulars	₹	Particulars	₹
Buildings	5,80,000	Sales	10,40,000
Machinery	2,00,000	Outstanding Expenses	4,000
Closing Stock	1,80,000	Provision for Doubtful	6,000
Loose Tools	46,000	Debts (1-4-20X1)	
Purchases (finished goods)	4,20,000	Equity Share Capital	4,00,000
Salaries	1,20,000	General Reserve	80,000
Directors' Fees	20,000	Profit and Loss A/c	50,000
Rent	52,000	(1-4-20X1)	
Depreciation	40,000	Creditors	1,84,000
Bad Debts	12,000	Provision for depreciation:	
Investment	2,40,000	On Building 1,00,000	
Interest accrued on investment	4,000	On Machinery 1,10,000	2,10,000
Debenture Interest	56,000	14% Debentures	4,00,000
Advance Tax	1,20,000	Interest on Debentures	28,000
Sundry expenses	36,000	accrued but not due	
Debtors	2,50,000	Interest on Investments	24,000
Bank	60,000	Unclaimed dividend	10,000
	24,36,000		24,36,000

You are required to prepare statement of Profit and Loss for the year ending 31st March, 20X2 and Balance sheet as at that date after taking into consideration the following information:

a) Closing stock is more than opening stock by ₹1,60,000.

b) Provide to doubtful debts @ 4% on Debtors.

c) Make a provision for income tax @30%.

d) Depreciation expense included depreciation of ₹16,000 on Building and that of ₹24,000 on Machinery.

e) The directors declared a dividend @ 25% on 2nd April, 20X2 and transfer to General Reserve @ 10%.

f) Bills Discounted but not yet matured ₹20,000.

Solution :

Ring Ltd.

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

	Particulars	Note No.	(₹ In lacs)
I	**Revenue from operations**		10,40,000

TELEGRAM: CA NOTE HUB

II	**Other income** (interest on investment)		24,000
III	**Total income [I + II]**		**10,64,000**
IV	**Expenses:**		
	Cost of purchase [4,20,000+ 1,60,000]		5,80,000
	Changes in inventories [20,000–1,80,000]		(1,60,000)
	Employee Benefits Expense		1,20,000
	Finance Costs (debenture interest)		56,000
	Depreciation and Amortisation Expenses		40,000
	Other Expenses	8	1,24,000
	Total Expenses		**7,60,000**
V	Profit before Tax (III-IV)		3,04,000
VI	**Tax Expenses @ 30%**		(91,200)
VII	**Profit for the period**		**2,12,800**

Balance Sheet of Ring Ltd. as at 31ST March, 20X2

		Particulars	Note No.	₹
I	**EQUITY AND LIABILITIES**			
	(1)	Shareholders' Funds		
		(a) Share Capital	1	4,00,000
		(b) Reserves and Surplus	2	3,42,800
	(2)	**Non-Current Liabilities**		
		(a) Long-term Borrowings (14% debentures)		4,00,000
	(3)	**Current Liabilities**		
		(a) Trade Payable (Sundry Creditors)		1,84,000
		(b) Other Current Liabilities	3	42,000
		(c) Short-Term Provisions	4	91,200
		Total		**14,60,000**
II	**ASSETS**			
	(1)	Non-Current Assets		
		(a) PPE	5	5,70,000
		(b) Non-current Investments		2,40,000
	(2)	**Current Assets**		
		a) Inventories	6	2,26,000
		b) Trade Receivables	7	2,40,000
		c) Cash and bank balances		60,000
		d) Short Term Loans and Advances		1,20,000
		(Advance Payment of Tax)		
		e) Other Current Assets		4,000
		(Interest accrued on investments)		
		Total		**14,60,000**

Note: There is a Contingent Liability for bills discounted but not yet matured amounting to ₹ 20,000.

TELEGRAM: CA NOTE HUB

Notes to Accounts:

1.	**Share Capital**		
	Authorised Capital		
	10,000 Equity Shares of ₹ 100 each		10,00,000
	Issued Capital		
	4,000 Equity Shares of ₹ 100 each		4,00,000
	Subscribed Capital and fully paid		
	4,000 Equity Shares of ₹ 100 each		4,00,000
2.	**Reserve and Surplus**		
	General Reserve [₹ 80,000 + ₹ 21,280]		1,01,280
	Balance of Statement of Profit & Loss Account	50,000	
	Opening Balance	2,12,800	
	Add: Profit for the period	2,62,800	
	Appropriations		
	Transfer to General Reserve @ 10%	(21,280)	2,41,520
			3,42,800
3.	**Other Current Liabilities**		
	Unclaimed Dividend		10,000
	Outstanding Expenses		4,000
	Interest accrued on Debentures		28,000
			42,000
4.	**Short-Term Provision**		
	Provision for Tax		91,200
5	**Property, plant and equipment**		
	Buildings	5,80,000	
	Less: Provision for Depreciation	1,00,000	4,80,000
	Plant and Equipment	2,00,000	
	Less: Provision for Depreciation	1,10,000	90,000
			5,70,000
6	**Inventories**		
	Closing Stock of Finished Goods	1,80,000	
	Loose Tools	46,000	2,26,000
7	**Trade Receivables** Sundry Debtors	2,50,000	
	Less: Provision for Doubtful Debts	(10,000)	2,40,000
8.	**Other Expenses**		
	Rent		52,000
	Directors' Fees		20,000
	Bad Debts		12,000
	Provision for Doubtful Debts (4% of ₹ 2,50,000 less ₹ 6,000)		4,000
	Sundry Expenses		36,000
			1,24,000

TELEGRAM: CA NOTE HUB

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 8 : (MTP Mar'21, Jan'25) (RTP May'20, RTP May'23) (PYQ Nov'19) NB Pg. No.

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March 20X1 as required by Part I, Schedule III to the Companies Act, 2013.

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory:			
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000
		94,78,500	**94,78,500**

The following additional information is also provided:

(i) 10,000 Equity shares were issued for consideration other than cash.

(ii) Trade receivables of ₹2,60,000 are due for more than 6 months.

(iii) The cost of the Assets were:

Building ₹30,00,000, Plant & Machinery ₹35,00,000 and Furniture ₹3,12,500

(iv) The balance of ₹7,50,000 in the Loan Account with State Finance Corporation is inclusive of ₹37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

(v) Balance at Bank includes ₹10,000 with Omega Bank Ltd., which is not a Scheduled Bank.

(vi) Transfer ₹20,000 to general reserve is proposed by Board of directors.

(vii) Board of directors declared dividend of 5% on the paid up capital on 2nd April, 20X1. **(15 Marks)**

TELEGRAM: CA NOTE HUB

Solution :

Alpha Ltd.

Balance Sheet as at 31st March, 20X1

	Particulars		Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	49,95,000
	b	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	a	Trade Payables		8,00,000
	b	Short-term provisions	5	6,40,000
	c	Short-term borrowings	4	2,00,000
	d	Other Current Liabilities: Interest accrued		
		Total		**94,73,500**
		Assets		
1		Non-current assets		
		PPE	6	56,25,000
2		Current assets		
	a	Inventories	7	12,50,000
	b	Trade receivables	8	10,00,000
	c	Cash and bank balances	9	13,85,000
	d	Short-term loans and advances		2,13,500
		Total		**94,73,500**

Notes to accounts

		₹
1 Share Capital		
Equity share capital		
Issued & subscribed & called up		
50,000 Equity Shares of ₹ 100 each	50,00,000	
(of the above 10,000 shares have been issued for consideration other than cash)		
Less: Calls in arrears	(5,000)	49,95,000
Total		49,95,000
2 Reserves and Surplus		
General Reserve		
Add: current year transfer	10,50,000	
	20,000	10,70,000
Profit & Loss balance		
Profit for the year	4,33,500	
Less: Appropriations:		

TELEGRAM: CA NOTE HUB

Transfer to General reserve		(20,000)	4,13,500
Total			**14,83,500**
3 Long-term borrowings			
Secured Term Loan			
State Financial Corporation Loan (7,50,000–37,500) (Secured by hypothecation of Plant and Machinery)			7,12,500
Unsecured Loan			6,05,000
	Total		**13,17,500**
4 Short term Borrowings			
Loans and advances			2,00,000
5 Short-term provisions			
Provision for taxation			6,40,000
6 Property, plant and equipment			
Land and Building		30,00,000	
Less: Depreciation		(2,50,000) (b.f.)	27,50,000
Plant & Machinery		35,00,000	
Less: Depreciation		(8,75,000) (b.f.)	26,25,000
Furniture & Fittings		3,12,500	
Less: Depreciation		(62,500) (b.f.)	2,50,000
	Total		**56,25,000**
7 Inventories			
Raw Materials			2,50,000
Finished goods			10,00,000
	Total		**12,50,000**
8 Trade receivables			
Outstanding for a period exceeding six months			2,60,000
Other Amounts			7,40,000
	Total		**10,00,000**
9 Cash and bank balances			
Cash and cash equivalents			
Cash at bank			
with Scheduled Banks		12,25,000	
with others (Omega Bank Ltd.)		10,000	12,35,000
Cash in hand			1,50,000
Other bank balances			Nil
	Total		**13,85,000**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X1. Such dividends will be disclosed in notes only.

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Question 9 : NB Pg. No.

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

		Debit	Credit
		₹	₹
Equity Capital (Face value of ₹100)			10,00,000
Calls in Arrears		1,000	
Land		2,00,000	
Building		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Inventory :			
Finished Goods	2,00,000		
Raw Materials	50,000	2,50,000	
Provision for Taxation			68,000
Trade receivables		2,00,000	
Advances		42,700	
Dividend Payable			60,000
Profit and Loss Account			86,700
Cash Balance		30,000	
Cash at Bank		2,47,000	
Loans (Unsecured)			1,21,000
Trade payables (For Goods and Expenses)			2,00,000
		18,95,700	**18,95,700**

The following additional information is also provided :

1. 2,000 equity shares were issued for consideration other than cash.
2. Trade receivables of ₹52,000 are due for more than six months.
3. The cost of assets:

Building	₹4,00,000
Plant and Machinery	₹7,00,000
Furniture	₹62,500

4. The balance of ₹1,50,000 in the loan account with State Finance Corporation is inclusive of ₹7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.
5. Balance at Bank includes ₹2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.
6. The company had contract for the erection of machinery at ₹1,50,000 which is still incomplete.

Solution :

Pioneer Ltd.

Balance Sheet as at 31st March, 20X1

TELEGRAM: CA NOTE HUB

		Particulars		Notes	₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	a	Share capital		1	9,99,000
	b	Reserves and Surplus		2	2,96,700
2		**Non-current liabilities**			
	a	Long-term borrowings		3	2,63,500
3		**Current liabilities**			
	a	Trade Payables			2,00,000
	b	Other current liabilities		4	67,500
	c	Short-term provisions		5	68,000
			Total		**18,94,700**
		Assets			
1		**Non-current assets**			
	a	PPE		6	11,25,000
2		**Current assets**			
	a	Inventories		7	2,50,000
	b	Trade receivables		8	2,00,000
	c	Cash and bank balances		9	2,77,000
	d	Short-term loans and advances			42,700
			Total		**18,94,700**

Notes to accounts

1 Share Capital		
Equity share capital		
Issued & subscribed & called up		
10,000 Equity Shares of ₹ 100 each	10,00,000	
(Of the above 2,000 shares have been issued for consideration other than cash)		
Less: Calls in arrears	(1,000)	9,99,000
Total		**9,99,000**
2 Reserves and Surplus		
General Reserve		2,10,000
Surplus (Profit & Loss A/c)		86,700
Total		**2,96,700**
3 Long-term borrowings		
Secured- Term Loans		
Loan from State Financial Corporation (1,50,000 – 7,500)		1,42,500
(Secured by hypothecation of Plant and Machinery)		
Unsecured loan		1,21,000
Total		**2,63,500**
4 Other current liabilities		
Interest accrued but not due on loans (SFC)		7,500

TELEGRAM: CA NOTE HUB

Dividend Payable			60,000
Total			**67,500**
5 Short-term provisions			
Provision for taxation			68,000
	Total		**68,000**
6 PPE			
Land			2,00,000
Buildings		4,00,000	
Less: Depreciation		(50,000) (b.f.)	3,50,000
Plant & Machinery		7,00,000	
Less: Depreciation		(1,75,000) (b.f.)	5,25,000
Furniture & Fittings		62,500	
Less: Depreciation		(12,500) (b.f.)	50,000
	Total		**11,25,000**
7 Inventories			
Raw Material			50,000
Finished goods			2,00,000
Total			2,50,000
8 Trade receivables			
Debts outstanding for a period exceeding six months			52,000
Other Debts			1,48,000
	Total		**2,00,000**
9 Cash and bank balances			
Cash and cash equivalents			
Cash at bank			
with Scheduled Banks			
with others (Perfect Bank Ltd.)		2,45,000	
Cash in hand		2,000	2,47,000
Other bank balances			30,000
			Nil
	Total		**2,77,000**

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

Question 10 : (MTP May'20, MTP Oct'21)

NB Pg. No.

On 31st March, 20X1, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 20X1.

Particulars	Amount (₹)	
	Debit	**Credit**
Equity Share Capital, fully paid shares of ₹50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	

TELEGRAM: CA NOTE HUB

Plant & Machinery	24,00,000	
Furniture & Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation		26,30,000
(Secured by Hypothecation of Land)		
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	
Trade Payables		8,13,000
Provision for Taxation		3,80,000
Unpaid Dividend		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	1,76,24,000	1,76,24,000

1. The following additional information was also provided in respect of the above balances:
2. 50,000 fully paid equity shares were allotted as consideration for land. The cost of assets were:

Building	₹ 32,00,000
Plant and Machinery	₹ 30,00,000
Furniture and Fixture	₹ 16,50,000

3. Trade Receivables for ₹4,86,000 due for more than 6 months.
4. Balances with banks include ₹56,000, the Naya bank, which is not a scheduled bank.
5. Loan from Public Finance Corporation repayable after 3 years.
6. The balance of ₹26,30,000 in the loan account with Public Finance Corporation is inclusive of ₹ 1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.
7. Other long term loans (unsecured) includes:

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

8. Bills Receivable for ₹1,60,000 maturing on 15th June, 20X1 has been discounted.
9. Short term borrowings includes:

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

10. Transfer of ₹35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.
11. Inventory of finished goods includes loose tools costing ₹5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 20X1 as required

TELEGRAM: CA NOTE HUB

under Part – I of Schedule III of the Companies Act, 2013.

You are not required to give previous year figures. **(15 Marks)**

Solution :

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

Particulars	Notes	Figures at the end of current reporting period (₹)
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	79,85,000
b Reserves and Surplus	2	30,21,000
2 Non-current liabilities		
a Long-term borrowings	3	42,66,000
3 Current liabilities		
a Short-term borrowings	4	9,40,000
b Trade Payables	5	8,13,000
c Other current liabilities	6	2,04,000
d Short-term provisions		3,80,000
Total		1,76,09,000
Assets		
1 Non-current assets		
a PPE	7	92,00,000
2 Current assets		
a Inventories	8	58,00,000
b Trade receivables	9	17,50,000
c Cash and cash equivalents	10	4,84,000
d Short-term loans and advances		3,75,000
Total		1,76,09,000

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up		
	1,60,000 Equity Shares of ₹ 50 each	80,00,000	
	(Out of the above 50,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(15,000)	79,85,000
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss account	35,000	9,76,000
	Securities premium		15,00,000

TELEGRAM: CA NOTE HUB

	Surplus (Profit & Loss A/c)		5,80,000	
	Less: Appropriation to General Reserve (proposed)		(35,000)	5,45,000
				30,21,000
3.	**Long-term borrowings**			
	Secured: Term Loans			
	Loan from Public Finance Corporation [repayable after 3years (₹ 26,30,000 – ₹ 1,34,000 for interest accrued but not due)] (secured by hypothecation of land)			**24,96,000**
	Unsecured			
	Bank Loan (Nixes bank)	9,00,000		
	(₹ 13,80,000 – ₹ 4,80,000 repayable within 1 year)			
	Loan from Directors	8,50,000		
	Others	20,000		17,70,000
		Total		**42,66,000**
4.	**Short-term borrowings**			
	Loan from Naya bank (Secured)		1,16,000	
	Loan from Nixes bank repayable within one year (Current maturity of Long term borrowing)		4,80,000	
	Loan from Directors		48,000	
	Others		2,96,000	9,40,000
5.	**Other current liabilities**			
	Unpaid dividend		70,000	
	Interest accrued but not due on borrowings		1,34,000	2,04,000
	Short-term provisions			
	Provision for taxation			3,80,000
7.	**PPE**			
	Land			25,00,000
	Buildings		32,00,000	
	Less: Depreciation		(2,00,000)	30,00,000
	Plant & Machinery		30,00,000	
	Less: Depreciation		(6,00,000)	24,00,000
	Furniture & Fittings		16,50,000	
	Less: Depreciation		(3,50,000)	13,00,000
		Total		**92,00,000**
8.	**Inventories**			
	Raw Material		13,00,000	
	Finished goods		40,00,000	
	Loose tools		5,00,000	58,00,000
9.	**Trade receivables**			
	Outstanding for a period exceeding six months			4,86,000

TELEGRAM: CA NOTE HUB

	Others		12,64,000
	Total		**17,50,000**
10.	**Cash and cash equivalents**		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		**4,84,000**

Note: There is a contingent liability amounting to ₹ 1,60,000

Question 11 : (Past Exam May'23) **NB Pg. No.**

The following balances are extracted from the books of Travese Limited as on 31st March 2023:

Particulars	Amount (₹)	
	Debit	Credit
7% Debentures		48,45,000
Plant & Machinery (at cost)	37,43,400	
Trade Receivable	35,70,000	
Land	97,37,000	
Debenture Interest	3,39,150	
Bank Interest	13,260	
Sales		47,22,600
Transfer Fees		38,250
Discount received		66,300
Purchases	28,86,600	
Inventories 1.04.2022	4,97,250	
Factory Expenses	2,58,060	
Rates, Taxes and Insurance	65,025	
Repairs	1,49,685	
Sundry Expenses	1,27,500	
Selling Expenses	26,520	
Directors Fees	38,250	
Interest on Investment for the year 2022–2023		55,000
Provision for depreciation		5,96,700
Miscellaneous receipts		1,42,800

Additional information:

(i) Closing inventory on 31.03.2023 is ₹ 4,76,850,

(ii) Miscellaneous receipts represent cash received from the sale of the Plant on 01.04.2022. The cost of the Plant was₹ 1,65,750 and the accumulated depreciation thereon is ₹ 24865.

(iii) The Land is re-valued at 1,08,63,000.

(iv) Depreciation is to be provided on Plant & Machinery at 10% p.a. on cost.

(v) Make a provision for income tax @ 25%.

(vi) The Board of Directors declared a dividend of 10% on Equity shares on 4th April, 2023.

Bhaisaahaab !
TELEGRAM: CA NOTE HUB

You are required to prepare a Statement of Profit and Loss as per Schedule III of the Companies Act, 2013 for the year ended 31.03.2023. (Ignore previous year figures) **(10 Marks)**

Solution :

Statement of Profit and Loss of Travese Limited. for the year ended 31st March, 2023

	Particulars	Notes	Amount
I.	Revenue from operations	1	47,22,600
II.	Other income	2	1,61,465
III	**Total Income (I + II)**		**48,84,065**
IV	Expenses:		
	Purchases of Inventory-in-Trade		28,86,600
	Changes in inventories of finished goods, work-in progress and Inventory-in-Trade	3	20,400
	Finance costs	4	3,52,410
	Depreciation and amortization expenses	5	3,57,765
	Other expenses	6	6,65,040
V	**Total expenses**		**42,82,215**
	Profit (Loss) for the period (III – IV) before tax		**6,01,850**
VI	**Provision for tax**		**(1,50,463)**
V II	**Profit for the period**		**4,51,387**

Notes to accounts

			₹
1.	Revenue from operations		
	Sale		47,22,600
2.	Other Income		
	Transfer fees		38,250
	Discount received		66,300
	Interest on Investment		55,000
	Profit on sale of plant		1,915
	Total		**1,61,465**
3.	Changes in inventories of finished goods, work-InProgress and Inventory-in-Trade Opening Inventory	4,97,250	
	Less: Closing Inventory	(4,76,850)	
	Total		**20,400**
4.	Finance costs		
	Interest on Debentures		3,39,150
	Total		**3,52,410**
5.	Depreciation and Amortization expenses		**3,57,765**
	Depreciation on Plant & Machinery		
	(10% x 37,43,400 – 1,65,750		
6.	Other expenses		
	Factory expense		2,58,060

	Rent, Taxes and Insurance		65,025
	Repairs		1,49,685
	Sundry expenses		1,27,500
	Selling expenses		26,520
	Directors fees		38,250
	Total		**6,65,040**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of financial statements) as per accounting standards. Hence, it is not recognized in the financial statement for the year ending 31st March 2023. Such dividend will be disclosed in notes only.

Question 12 : (MTP Apr'21, Apr'22, Oct'23, Jan'25) (RTP Nov'18) NB Pg. No.

You are required to prepare a Balance Sheet as at 31st March 2020, as per Schedule III of the Companies Act, 2013, from the following information of Mehar Ltd.:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Term Loans (Secured)	40,00,000	Investments (non-current)	9,00,000
Trade payables	45,80,000	Profit for the year	32,00,000
Cash and Bank Balances	38,40,000	Trade receivables	49,00,000
Staff Advances	2,20,000	Miscellaneous Expenses	2,32,000
Other advances (given by Co.)	14,88,000	Loan from other parties	8,00,000
Provision for Taxation	10,20,000	Provision for Doubtful Debts	80,000
Securities Premium	19,00,000	Stores	16,00,000
Loose Tools	2,00,000	Finished Goods	30,00,000
General Reserve	62,00,000	Plant and Machinery (WDV)	2,14,00,000

Additional Information: –

1. Share Capital consists of-
   a) 1,20,000 Equity Shares of Rs. 100 each fully paid up.
   b) 40,000, 10% Redeemable Preference Shares of Rs. 100 each fully paid up.
2. Write off the amount of Miscellaneous Expenses in full, amounting Rs. 2,32,000. **(14 Marks)**

Solution :

Balance Sheet of Mehar Ltd. as at 31st March, 2020

		Note	₹
I	**EQUITY AND LIABILITIES:**		
1)	(a) Share Capital	1	1,60,00,000
	(b) Reserves and Surplus	2	110,68,000
(2)	Non-current Liabilities		
	Long term Borrowings- Terms Loans (Secured)		40,00,000
(3)	Current Liabilities		
	(a) Trade Payables		45,80,000
	(b) Other current liabilities	3	8,00,000
	(c) Short-term Provisions (Provision for taxation)		10,20,000

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TELEGRAM: CA NOTE HUB

	Total		
II	**ASSETS**		**3,74,68,000**
(1)	Non-current Assets		
	(a) Property, Plant and Equipment		
	(b) Non- current Investments	4	214,00,000
(2)	Current Assets:		9,00,000
	(a) Inventories		
	(b) Trade Receivables	5	48,00,000
	(c) Cash and Cash Equivalents	6	48,20,000
	(d) Short-term Loans and Advances		38,40,000
	Total	7	17,08,000
			3,74,68,000

Notes to accounts

				(₹)
1.	Share Capital			
	Authorized, issued, subscribed & called up			
	1,20,000, Equity Shares of ₹ 100 each		1,20,00,000	
	40,000 10% Redeemable Preference Shares of 100 each		40,00,000	**1,60,00,000**
2.	Reserves and Surplus			
	Securities Premium Account		19,00,000	
	General reserve		62,00,000	
	Profit & Loss Balance			
	Opening balance –			
	Profit for the period	32,00,000		
	Less: Miscellaneous Expenditure written off	(2,32,000)	29,68,000	**110,68,000**
3.	Other current liabilities			
	Loan from other parties			**8,00,000**
4.	Property, plant and equipment			**214,00,000**
	Plant and Machinery (WDV)			
5.	Inventories			
	Finished Goods		30,00,000	
	Stores		16,00,000	
	Loose Tools		2,00,000	**48,00,000**
6.	Trade Receivables			
	Trade receivables		49,00,000	
	Less: Provision for Doubtful Debts		(80,000)	**48,20,000**
7.	Short term loans & Advances			
	Staff Advances*		2,20,000	
	Other Advances*		14,88,000	**17,08,000**

*Considered to be short term.

TELEGRAM: CA NOTE HUB

Question 13 : (MTP Nov'21, Apr'23) NB Pg. No.

From the following information, prepare extract of Balance Sheet of A Limited along with notes making necessary compliance of Schedule III to the Companies Act, 2013:

	Amount (₹)
Loan Funds	
(a) Secured Loans	18,12,000
(b) Unsecured Loan – Short term from bank	2,25,000
Other information is as under:	
Secured Loans	
Term Loans from:	
Banks	8,95,000
Others	9,17,000
	18,12,000
Current Maturities of long-term loan from Bank	1,24,000
Current Maturities of long- term loan from Others	85,000

There was no interest accrued / due as at the end of the year. Current maturities of long-term loans amounting ₹ 2,09,000 is included in the value of secured loans of ₹ 18,12,000. **(5 Marks)**

Solution :

Extract of Balance Sheet of A Ltd

Particulars	Note No.	Amount
Non – Current Liabilities		
Long term borrowings	1	16,03,000
Current Liabilities		
Short term borrowings	2	4,34,000

Notes to Accounts

1. Long-Term Borrowings	
Term loans — Secured	
– From banks	8,95,000
– From other parties	9,17,000
	18,12,000
Less: Current maturities of long-term debt (Refer Note 3)	(2,09,000)
	16,03,000
2. Short-Term Borrowings	
(Unsecured loan)	
– from bank	2,25,000
Current maturities of long-term debt	
– From banks	1,24,000
– From others	85,000
	4,34,000

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TELEGRAM: CA NOTE HUB

Question 14 : (RTP May'19) **NB Pg. No.**

Shweta Ltd. has the Authorized Capital of Rs. 15,00,000 consisting of 6,000 6% Preference shares of Rs. 100 each and 90,000 equity Shares of Rs.10 each. The following was the Trial Balance of the Company as on 31st March, 2018:

Particulars	Dr.	Cr.
Investment in Shares at cost	1,50,000	
Purchases	14,71,500	
Selling Expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and Wages	1,56,000	
Cash on Hand	36,000	
Interim Preference dividend for the half year to 30th September	18,000	
Bills Receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on Debentures upto 30th Sep (1st half year)	11,250	
Debtors	1,50,300	
Trade payables		2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of Rs. 45,000	1,05,000	
6% Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on Freehold properties		4,50,000
Income tax paid in advance for the current year	30,000	
Dividends		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft secured by hypothecation of stocks and receivables		4,50,000
Technical knowhow fees at cost paid during the year	4,50,000	
Audit fees	18,000	
Total	**44,72,850**	**44,72,850**

You are required to prepare the Profit and Loss Statement for the year ended 31st March, 2018 and the Balance Sheet as on 31st March, 2018 as per Schedule III of the Companies Act, 2013 after taking into account the following –

1. Closing Stock was valued at Rs. 4,27,500.
2. Purchases include Rs. 15,000 worth of goods and articles distributed among valued customers.
3. Salaries and Wages include Rs. 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".
4. Bills Receivable include Rs. 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of Rs. 6,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Dow
7. Investment in shares is to be treated as non-current investments.

TELEGRAM: CA NOTE HUB

8. Interest on Debentures for the half year ending on 31st March was due on that date.
9. Provide Provision for taxation Rs.12,000.
10. Technical Knowhow Fees is to be written off over a period of 10 years.
11. Salaries and Wages include Rs. 30,000 being Director's Remuneration.
12. Trade receivables include Rs. 18,000 due for more than six months.

Solution :

(a) Statement of Profit and Loss of Shweta Ltd. for the year ended 31st March, 2018

Particulars	Note	Rs.
I Revenue from Operations		20,11,050
II Other income (Divided income)		12,750
III Total Revenue (I &+ II)		**20,23,800**
IV Expenses:		
(a) Purchases (14,71,500 – Advertisement Expenses 15,000)		14,56,500
(b) Changes in Inventories of finished Goods / Work in progress (4,35,600 – 4,27,500)		8,100
(c) Employee Benefits expense	9	1,20,000
(d) Finance costs	10	51,900
(e) Depreciation & Amortization Expenses [10% of (1,05,000 + 6,000)]		11,100
(f) Other Expenses	11	3,47,550
Total Expenses		**19,95,150**
V Profit before exceptional, extraordinary items and tax (III-IV)		**28,650**
VI Exceptional items –		
VII Profit before extra ordinary items and tax (V-IV)		**28,650**
VIII Extraordinary items –		
IX Profit before tax (VII-VIII)		**28,650**
X Tax expense:		
Current Tax		**12,000**
XI Profit/Loss for the period (after tax)		**16,650**

Balance sheet of Shweta Ltd. as on 31st March, 2018

	Particulars as on 31st March	Note	Note
I			
(1)	**Shareholders funds:**		
	(a) Share capital	1	12,00,000
	(b) Reserves and surplus	2	66,150
(2)	**Noncurrent liabilities:**		
	Long term borrowings	3	4,50,000
(3)	**Current liabilities:**		
	(a) Short term borrowings	4	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	5	29,250
	Total		**24,58,950**

TELEGRAM: CA NOTE HUB

II	ASSETS		
(1)	**Non-current Assets**		
	(a) Property, Plant & Equipment		
	(i) Tangible assets		
	(ii) Intangible assets	6	11,49,900
	(b) Noncurrent investments (Shares at cost)	7	4,05,000
	Current Assets:		1,50,000
	(a) Inventories		
	(b) Trade receivables		4,27,500
	(c) Cash and Cash equivalents – Cash on hand	8	2,72,550
	(d) Short term loans and advances –Income tax (paid 30,000 -Provision 12,000)		36,000
	Total		18,000
			24,58,950

Note: There is a Contingent liability for Bills receivable discounted with Bank Rs. 6,000.

Notes to accounts

			(Rs.)
1.	**Share Capital**		
	Authorized		
	90,000 Equity Shares of Rs. 10 each	9,00,000	
	6,000 6% Preference shares of Rs. 100 each	6,00,000	**15,00,000**
	Issued, subscribed & called up		
	60,000, Equity Shares of Rs. 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	**12,00,000**
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2017	85,500	
	Add: Surplus for current year	16,650	1,02,150
	Less: Preference Dividend		36,000
	Balance as on 31st March, 2018		**66,150**
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		**4,50,000**
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		**4,50,000**
5.	**Other Current liabilities**		
	Interest Accrued and due on Borrowings (5% Debentures)	11,250	
	Unpaid Preference Dividends	18,000	**29,250**
6	**Tangible Property, Plant & Equipment**		
	Furniture		
	Furniture at Cost Less depreciation Rs. 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	

TELEGRAM: CA NOTE HUB

	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Accumulated Depreciation Account: Opening Balance-given in Trial Balance	45,000	
	Depreciation for the year:		
	On Opening WDV at 10% i.e. (10% x 1,05,000)	10,500	
	On additional purchase during the year at 10% i.e. (10% x 6,000)	600	
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Fixed Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	**4,05,000**
8.	**Trade Receivables**		
	Sundry Debtors (a) Debt outstanding for more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 -4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Amount as per Trial Balance	1,56,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors₹ Remuneration shown separately	30,000	
	Balance amount		**1,20,000**
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	51,900
11.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director₹s remuneration	30,000	
	Selling expenses	2,37,300	
	Technical knowhow written of (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x50%)	2,250	**3,47,550**

Working Note

Calculation of Sundry Debtors-Other Debts	
Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonored	4,500
	1,54,800
Less: Bad Debts written off – 50% Rs.	4,500

Adjusted Sundry Debtors	(2,250)
Less: Debts due for more than 6 months (as per information given)	1,52,550
Total of other Debtors i.e. Debtors outstanding for less than 6 months	(18,000)
	1,34,550

Question 15 : (RTP May'18, May'21, May'24) (MTP Oct'20, Mar'22) **NB Pg. No.**

Kapil Ltd. has authorized capital of Rs. 50 lakhs divided into 5,00,000 equity shares of Rs. 10 each. Their books show the following balances as on 31st March, 2017:

	Rs.		Rs.
Inventory 1.4.2016	6,65,000	Bank Current Account	20,000
Discounts & Rebates allowed	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Interest (bank overdraft)	1,11,000
Patterns	3,75,000	Calls in Arrear @ Rs. 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of Rs. 10 each)	
Purchases	12,32,500	Bank Overdraft	12,67,000
Wages	13,68,000		
Freehold Land	16,25,000	Trade Payables (for goods)	2,40,500
Plant & Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rent (Cr.)	30,000
Trade Receivables	4,00,500	Transfer fees received	6,500
Advertisement	15,000	Profit & Loss A/c (Cr.)	67,000
Commission & Brokerage	67,500	Repairs to Building	56,500
Business Expenses	56,000	Bad debts	25,500

The inventory (valued at cost or market value, which is lower) as on 31st March, 2017 was Rs. 7,08,000. Outstanding liabilities for wages Rs. 25,000 and business expenses Rs. 36,000. Dividend declared @ 12% on paid-up capital and it was decided to transfer to reserve @ 2.5% of profits. Charge depreciation on closing written down amount of Plant & Machinery @ 5%, Engineering Tools @ 20%; Patterns @ 10%; and Furniture & Fixtures @10%. Provide 25,000 as doubtful debts after writing off Rs.16,000 as bad debts. Provide for income tax @ 30%.

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2017 and Balance Sheet as on that date. **(16 Marks)**

Solution :

Kapil Ltd. Balance Sheet as at 31st March, 2017

		Particulars	Note No.	(Rs.)
I		Equity and Liabilities		
		(a)Share Capital	1	19,90,000
II		(b) Reserves and Surplus (as per amendment)	2	1,08,200
	(2)	Current Liabilities		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	13,28,000
		(c) Short-Term Provisions **(as per amendment)**	4	**3,58,800**

TELEGRAM: CA NOTE HUB

		Total		**40,25,500**
		ASSETS		
	(1)	**Non-Current Assets**		
		(a) Property, Plant & Equipment		
		(i) Tangible Assets	5	29,30,000
	(2)	**Current Assets**		
		(a) Inventories		7,08,000
		(b) Trade Receivables	6	3,59,500
		(c) Cash and Cash Equivalents	7	28,000
		Total		**40,25,500**

Kapil Ltd.

Statement of Profit and Loss for the year ended 31st March, 2017

	Particulars	**Note No.**	**(Rs.)**
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000–7,08,000]		(43,000)
	Employee Benefits Expenses	9	13,93,000
	Finance Costs	10	1,11,000
	Depreciation and Amortization Expenses		1,20,000
	Other Expenses	11	4,40,000
	Total Expenses		**32,53,500**
V	**Profit before Tax (III-IV)**		**4,00,000**
VI	**Tax Expenses @ 30%**		**(1,20,000)**
VII	**Profit for the period**		**2,80,000**

Notes to Accounts:

1. Share Capital

Authorized Capital	
5,00,000 Equity Shares of Rs. 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of Rs. 10 each	**20,00,000**
Subscribed Capital and fully paid	
1,95,000 Equity Shares of Rs.10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of Rs.10 each Rs. 8 paid	40,000
(Call unpaid Rs.10,000)	**19,90,000**

TELEGRAM: CA NOTE HUB

2. Reserves and Surplus

General Reserve		7,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	2,80,000	
Less: Transfer to Reserve @ 2.5%	(7,000)	
Less: Equity Dividend [12% of (20,00,000–10,000)]	(2,38,800)	101200
		108200

3. Other Current Liabilities

Bank Overdraft	12,67,000
Outstanding Expenses [25,000+36,000]	61,000
	13,28,000

4. Short-term Provisions

Provision for Tax	1,20,000
Equity Dividend payable	2,38,800
	3,58,800

5. Tangible Assets

Particulars	Value given (Rs.)	Depreciation rate	Depreciation Charged (Rs.)	Written down value at the end (Rs.)
Land	16,25,000		-	16,25,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Patterns	3,75,000	10%	37,500	3,37,500
Engineering Tools	1,50,000	20%	30,000	1,20,000
	30,50,000		1,20,000	29,30,000

6. Trade Receivables

Trade receivables (4,00,500–16,000)	3,84,500
Less: Provision for doubtful debts	(25,000)
	3,59,500

7. Cash & Cash Equivalent

Cash Balance	8,000
Bank Balance in current A/c	20,000
	28,000

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	30,000
	36,500

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TELEGRAM: CA NOTE HUB

9. Employee benefits expenses

Wages	13,68,000
Add: Outstanding wages	25,000
	13,93,000

10. Finance Cost

Interest on Bank overdraft	**1,11,000**

11. Other Expenses

Carriage Inward	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,000] (Business Expenses)	92,000
Bad Debts [25,500+16,000]	41,500
Provision for Doubtful Debts	25,000
	4,40,000

Working Note

Calculation of dividend:

Particulars	
Dividend distributed by Company	**Rs.**
	2,38,800

Question 16 : (Past Exam July'21)

NB Pg. No.

The following is the Trial Balance of H Ltd., as on 31st March, 2021:

	Dr.	Cr.
Equity Capital (Shares of ₹ 100 each)		8,05,000
5,000, 6% preference shares of ₹ 100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000
Profit & Loss A/c (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2021)	9,50,000	
Bank	2,30,900	

TELEGRAM: CA NOTE HUB

Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	**1,30,29,000**

Additional Information:

(i) The authorized share capital of the company is:

5,000, 6% preference shares of ₹ 100 each 5,00,000

10,000, equity shares of ₹ 100 each 10,00,000

Issued equity capital as on 1st April 2020 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 2020. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid.

(ii) On 31st March 2021, the Directors declared a dividend of 5% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

(iii) The company on the advice of independent value wishes to revalue the land at ₹ 36,00,000.

(iv) Suspense account of ₹ 40,000 represents amount received for the sale of some of the machinery on 1-4-2020. The cost of the machinery was ₹1,00,000 and the accumulated depreciation thereon being ₹ 30,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Amortize 1/5th of Goodwill.

You are required to prepare H Limited Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years₹ figures & taxation. **(20 Marks)**

Solution :

H Ltd Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in ₹
Equity and Liabilities		
I. Shareholders₹ Funds		
a. Share Capital	1	13,00,000
b. Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
a. Long Term Borrowings	3	4,00,000
III. Current Liabilities		
a. Trade Payables	4	10,40,000
b. Other Current Liabilities	5	70,000
Total		**82,01,900**
Assets		
I. Non-Current Assets		
a. Property, Plant and Equipment	6	40,61,000
b. Intangible Assets	7	10,00,000

TELEGRAM: CA NOTE HUB

II. Current Assets		
a. Inventories		9,50,000
b. Trade Receivables		9,60,000
c. Cash and Cash equivalents		2,30,900
Total		**82,01,900**

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

Particulars	Note No	Amount in ₹
I. Revenue from operations		**60,00,000**
Total Revenue		**60,00,000**
II. Expenses		
Purchases (adjusted)		22,32,100
Finance Costs	8	36,000
Depreciation and Amortization	9	3,17,000
Other Expenses	10	32,30,000
Total Expenses		**58,15,100**
III. Profit/(Loss) for the period		**1,84,900**

Notes to Accounts (Amount in ₹)

1	**Share Capital**		
	a. Authorized Capital		
	5,000, 6% Preference shares of ₹ 100/- each		5,00,000
	10,000 Equity Shares of ₹100/- each		10,00,000
	b. Issued & Subscribed Capital		15,00,000
	5,000, 6% Preference shares of ₹100/- each		5,00,000
	8,000, Equity shares of ₹100/- each		8,00,000
	Total		**13,00,000**
2	**Reserves & Surplus**		
	Capital Reserve (100 X (90–40))		5,000
	Revaluation Reserve (36,00,000–24,00,000)		12,00,000
	General Reserve		40,00,000
	Surplus	1,84,900	
	Add: Balance from previous year	72,000	
	Less:		
	Dividends declared	(70,000)	
	Profit/(Loss) carried forward to Balance Sheet		1,86,900
	Total		**53,91,900**
3	**Long-Term Borrowings**		
	Secured		
	9% Debentures		4,00,000

TELEGRAM: CA NOTE HUB

4	**Trade Payables**		**10,40,000**
5	**Other Current Liabilities**		
	Dividend Payable		
	Preference Dividend	30,000	
	Equity Dividend	40,000	
	Total		70,000
6	**Property, Plant and Equipment**		
	Land		
	Opening balance	24,00,000	
	Add: Revaluation Adjustment	12,00,000	
	Closing Balance		36,00,000
	Plant and Machinery		
	Opening Balance	7,70,000	
	Less: Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	
	Closing Balance		4,61,000
	Total		**40,61,000**
7	**Intangible Assets**		
	Goodwill	12,50,000	
	Less: Amortized (1/5the)	(2,50,000)	
	Total		**10,00,000**
8	**Finance Costs**		
	Debenture Interest		36,000
9	**Depreciation and Amortization**		
	Plant and Machinery	67,000	
	Goodwill	2,50,000	
	Total		**3,17,000**
10	**Other Expenses**		
	Factory Expenses	15,00,000	
	Selling Expenses	14,00,000	
	Administrative Expenses	3,00,000	
	Loss on sale of Plant and Machinery		
	Book Value		
	(1,00,000–30,000) 70,000		
	Less: Sale Value (40,000)	30,000	
	Total		**32,30,000**

Note

1. The inventories (31.3.20) amounting ₹ 9,50,000 (given in the trial balance of the Question should have been as closing inventory i.e. as on 31.3.21. In the above Solution', this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on 31.3.21 and in that case, the balance sheet will not tally without using suspense account amounting ₹ 9,50,000.

TELEGRAM: CA NOTE HUB

2. The financial statements given in the above answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the Question. However, practically dividends are declared in the annual general meetings which take place after the reporting date.

Question 17 : (Past Exam Nov'23) NB Pg. No.

The following is the Trial Balance of Falgun Ltd., as on 31st March, 2023:

Particulars	Debit Amt. in (₹)	Credit Amt. in (₹)
Equity Share Capital (Fully paid-up shares of ₹ 100 each)		10,00,000
10% Preference Share Capital of Face Value ₹ 100 each		4,00,000
General Reserve		2,85,000
2,000 10% Debentures of ₹ 100 each		2,00,000
Securities Premium Account		50,000
Land (at Cost)	7,00,000	
Plant and Machinery	14,70,000	
Furniture	4,00,000	
Provision for Depreciation – Plant and Machinery		3,00,000
Provision for Depreciation – Furniture		1,90,000
Trade Receivables	3,10,000	
Trade Payables		72,000
Cash-in-Hand	1,34,000	
Cash-at-Bank	3,05,000	
Bank Over Drafts from Nationalized bank (Long Term)		2,00,000
(Secured by Hypothecation of Stocks)		
6% Secured Loan from State Finance Corporation (repayable after 3 years) (Secured by Hypothecation of Plant and Machinery)		4,50,000
Unclaimed Dividend		23,000
Loan from Director (Short Term)		1,00,000
Adjusted Purchases	2,25,000	
Closing Stock	1,12,000	
Sales		8,46,000
Carriage Inward	17,200	
Miscellaneous Expenses	10,200	
Selling and Distribution Expenses	46,600	
Depreciation	1,80,000	
Salaries	72,000	
Director's Fees	40,000	
Travelling Expenses (include ₹ 50,000/- for foreign tour)	1,30,000	
Profit and Loss Account		40,000
Office Expenses	28,000	
Rent Received		24,000
Total	**41,80,000**	**41,80,000**

TELEGRAM: CA NOTE HUB

Additional Information:

(i) Authorized Capital – divided into –

a. 20,000 equity shares of ₹ 100 each.

b. 10,000 10% preference shares or ₹ 100 each

(ii) Equity shares include, 2,500 equity shares issued for consideration other than cash.

(iii) The company has land professionally valued and decides to include it in the Balance sheet at its valuation of ₹ 8,50,000.

(iv) It is proposed to capitalize part of the undistributed profits by making bonus issue to the shareholders by allocating one equity share of ₹ 100 each for every 5 shares held.

(v) Trade Receivables of ₹ 46,000 are due for more than six• months.

There is no doubtful amount.

(vi) Depreciation expenses include depreciation of ₹ 1,10,000 on Plant and Machinery and that of ₹ 70,000 on Furniture.

(vii) Cash-at-Bank include ₹ 55,000 with Desire Bank Ltd., which is not scheduled Bank.

(viii) Miscellaneous expenses included ₹ 5,000 being audit fees paid to auditors.

(ix) Bill Receivables for ₹ 35,000 maturing on 31st July, 2023 has been discounted.

(x) Balance of secured loan from State Finance Corporation is inclusive of ₹ 36,000 for interest accrued but not due.

(xi) Directors declared final dividend @ 8% on 6th April, 2023, transferring any amount that may be required from General Reserve. Ignore Taxation.

(xii) Interest on debenture for the year is outstanding as on 31st March, 2023. You are required to prepare Balance Sheet as on 31st March, 2023 and Statement of Profit and Loss with Notes to Accounts for the year ending 31st March, 2023 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures. (Ignore taxation).

(All workings should form part of the answer) **(20 Marks)**

Solution :

Statement of Profit and Loss of Falgun Ltd.

for the year ended 31st March, 2023

Particulars	Notes	₹
I. Revenue from operations		8,46,000
II. Other income (Rent income)		24,000
III. Total Income (I + II)		**8,70,000**
IV. Expenses:		
Cost of materials consumed / Cost of purchases	9	2,42,200
Changes in inventories of finished goods, work-in-progress and Inventory-in-Trade		-
Employee benefits expense	10	72,000
Finance costs (Interest on debentures)	11	20,000
Depreciation and amortization expenses	12	1,80,000
Other expenses	13	2,54,800
Total expenses		**7,69,000**
V. Profit (Loss) for the period (III – IV)		**1,01,000**

TELEGRAM: CA NOTE HUB

Balance Sheet of Falgun Ltd. as at 31st March, 2023

Particulars	Note No	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	14,00,000
b Reserves and Surplus	2	6,26,000
2 Non-current liabilities		
a Long-term borrowings	3	8,14,000
3 Current liabilities		
a Short term borrowings	4	1,00,000
b Trade Payables		72,000
c Other current liabilities	5	79,000
d Short term provisions		
Total		**30,91,000**
ASSETS		
1 Non-current assets		
a Property, plant and equipment	6	22,30,000
2 Current assets		
a Inventories		1,12,000
b Trade receivables	7	3,10,000
c Cash and bank equivalents	8	4,39,000
d Short term loans & advances		
Total		**30,91,000**

Note: There is a Contingent Liability for bills discounted but not yet matured amounting ₹ 35,000.

Notes to accounts:

			₹
	Share Capital		
1	Authorised capital:		
	10,000, 10% preference shares of ₹ 100		10,00,000
	20,000 Equity shares of ₹ 100 each		20,00,000
			30,00,000
	Issued and subscribed capital:		
	4,000, 10% preference shares of ₹ 100 each fully paid		4,00,000
	10,000 Equity shares of ₹ 100 each, fully paid		10,00,000
	(of the above 2,500* shares have been issued for consideration other than cash)		**14,00,000**
2	Reserves and Surplus		
	Securities premium	50,000	
	Revaluation reserve	1,50,000	
	General Reserve	2,85,000	**4,85,000**
	Surplus (Profit & Loss balance)		
	Opening balance	40,000	

TELEGRAM: CA NOTE HUB

	Profit for the year	1,01,000	1,41,000
	Total		6,26,000
3.	Long-term borrowings		
	Debentures		
	2,000 10% Debentures of ₹ 100 each	2,00,000	
	Secured: Term Loans		
	6% Loan from State Finance Corporation [repayable after 3years (₹ 4,50,000 – ₹ 36,000 for interest accrued but not due)] (secured by hypothecation of Plant and machinery)	4,14,000	
	Others		
	Bank overdraft from Nationalized bank (secured by hypothecation of stocks)	2,00,000	
	Total		8,14,000
4.	Short-term borrowings		
	Loan from Directors		1,00,000
5	Other current liabilities		
	Unclaimed dividend	23,000	
	Interest on Debentures	20,000	
	Interest accrued but not due on loans (SFC)	36,000	79,000
6	Property, plant and equipment		
	Land	7,00,000	
	Add: Revaluation Adjustment	1,50,000	8,50,000
	Plant & Machinery	14,70,000	
	Less: Provision for depreciation	(3,00,000)	11,70,000
	Furniture	4,00,000	
	Less: Provision for depreciation	(1,90,000)	2,10,000
	Total		22,30,000
7	Trade receivables		
	Debts outstanding for a period exceeding six months		46,000
	Other Debts		2,64,000
			3,10,000
8	Cash and cash equivalents		
	Cash at bank with Scheduled Banks (3,05,000–55,000)	2,50,000	
	with others	55,000	
	Cash in hand	1,34,000	4,39,000
9	Cost of materials consumed/Cost of purchases		
	Adjusted purchases	2,25,000	
	Carriage inward	17,200	2,42,200
10	Employee benefit expense		
	Salaries		72,000
11	Finance cost		
	Debenture interest		20,000
12	Depreciation and amortization expenses		

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TELEGRAM: CA NOTE HUB

	Plant and Machinery	1,10,000	
	Furniture	70,000	
13	Other expenses		1,80,000
	Misc. expenses (10,200–5,000)	5,200	
	Audit fee	5,000	
	Selling & Distribution expenses	46,600	
	Director's fee	40,000	
	Travelling expenses (including foreign tour)	1,30,000	
	Office expenses	28,000	2,54,800

Notes:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2023. Such dividends will be disclosed in notes only.
2. Since Bonus issue is in proposal state, no adjustment has been made in the given answer.

Question 18 : (RTP Nov'19, Nov'22) (MTP Apr'24) NB Pg. No.

The following balance appeared in the books of Oliva Ltd. as on 31–03–2022.

Particulars		₹	Particulars		₹
Inventory 01–04–2021			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		21,000
Purchases of raw material		12,60,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans:		
			Short–term	4,500	
			Long-term	21,000	25,500
			Fixed Deposits (unsecured)		
Salaries and wages		40,200	Short -term	1,500	
General Charges		16,500	Long – term	3,300	4,800
Building		1,01,000	Trade payables		3,27,000
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Investments: Current	4,500				
Non-Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,07,200			24,07,200

From the above balance and the following information, prepare the company's statement of Profit and

Loss for the year ended 31st March, 2022 and company's Balance Sheet as on that date:

TELEGRAM: CA NOTE HUB

1. Inventory on 31st March,2022- Raw material ₹ 25,800 and finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. Current maturity of long-term loan is ₹ 1,000.
7. The Taxation provision of 40% on net profit is considered.

(14 Marks)

Solution :

Oliva Ltd.
Balance Sheet as at 31.03.2022

	Particulars	Note	Amount
(1)	**Equity and Liabilities**		
	(i) Shareholders₹ funds		
	(a) Share Capital		3,15,000
	(b) Reserves and surplus	1	50,430
(2)	Non-current liabilities		
	(a) Long-term borrowings	2	23,300
(3)	Current Liabilities		
	(a) Short -term borrowings	3	7,000
	(b) Trade payables		3,27,000
	(c) Other current liability	4	72,000
	(d) Short term provision	5	19,620
			8,14,350
II	**ASSETS**		
(1)	Non-current assets		
	(a) Property, Plant & equipment	6	2,04,160
	(b) Non-current investments		7,500
(2)	Current assets		
	(a) Current investments		4,500
	(b) Inventories	7	85,800
	(c) Trade receivables		2,38,500
	(d) Cash and cash equivalents		2,71,100
	(e) Short-term loans and advances	8	2,490
	(f) Other current assets	9	300
			8,14,350

Oliva Ltd.

Statement of Profit and loss for the year ended 31.03.2022

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200

TELEGRAM: CA NOTE HUB

III	**Total income (I +II)**		**17,14,200**
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		–
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		–
	Depreciation and amortization expenses		18,240
	Other expenses	13	3,51,510
	Total Expenses		**16,65,150**
V	**Profit before exceptional and extraordinary items and tax**		**49,050**
VI	Exceptional items		–
VII	**Profit before extraordinary items and tax**		**49,050**
VIII	Extraordinary items		–
IX	**Profit before tax**		**49,050**
X	**Tax expense (40% of 49,050)**		**19,620**
XI	**Profit/Loss for the period from continuing operations**		**29,430**

Notes to accounts

No.	Particulars		Amount	Amount
1.	Reserve & Surplus			
	Profit & Loss Account: Balance b/f		21,000	
	Net Profit for the year		29,430	**50,430**
2.	Long term borrowings			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits: Unsecured		3,300	**23,300**
3.	Short term borrowings			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	
	Current maturities of long term borrowings		1,000	**7,000**
4.	Other current liabilities			
	Expenses Payable (67,500 + 4,500)		72,000	**72,000**
5.	Short term provisions			
	Provision for Income tax			**19,620**
6.	Property, plant and equipment			
	Building	1,01,000		
	Less: Depreciation @ 2%	(2,020)	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation @10%	(7,040)	63,360	
	Furniture	10,200		

TELEGRAM: CA NOTE HUB

	Less: Depreciation @10%	(1,020)	9,180	
	Motor vehicles	40,800		
	Less: Depreciation @20%	(8,160)	32,640	**2,04,160**
7	Inventory			
	Raw Material		25,800	
	Finished goods		60,000	**85,800**
8.	Short term Loans & Advances			
	General Charges prepaid			**2,490**
9.	Other Current Assets			
	Interest accrued			**300**
10.	Cost of material consumed			
	Opening inventory of raw Material	30,000		
	Add: Purchases	12,60,000	12,90,000	
	Less: Closing inventory		(25,800)	**12,64,200**
11.	Changes in inventory of Finished Goods & WIP			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		(46,500)	**13,500**
12.	Employee Benefit expenses			
	Salary & Wages (40,200 + 4,500)			**44,700**
13.	Other Expenses:			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	**3,51,510**

Question 19 : (PYQ Sept. 24) NB Pg. No.

The following is the Trial Balance of Shivam Ltd as on 31st March, 2024 :

Particulars	Dr. (Rs.000)	Particulars	Cr. (Rs.000)
Land at Cost	148	Equity Share of Rs.10 each	200
Plant & Machinery at Cost	520	10% Debenture of Rs.100 each	135
Debtors	65	General Reserve	90
Closing Stock	58	Profit & Loss Ale	48
Bank	14	Security Premium	27
Adjusted Purchases	226	Sales	473
Factory Expenses	40	Creditors	35
Administration Expenses	22	Provision for Depreciation	116
Selling Expenses	20	Suspense A/c	3
Debenture Interest	14		
Total	**1,127**	**Total**	**1,127**

Additional Information:

- On 31st March, the Company issued Bonus Shares to the Shareholders on 1 : 2 basis (one equity share issued as bonus for every 2 equity shares held). No entry relating to this has yet been made.
- The Authorized Share Capital of the Company is 35,000 Equity Shares of Rs.10 each.

TELEGRAM: CA NOTE HUB

- The Company, on the advice of an independent valuer, revalued the Land at Rs.2,45,000.
- The Directors declared a Dividend of 10% on 5th April, 2024 and also transferred profit @ 10% to General Reserve.
- Suspense Account of Rs.3,000 represents cash received for the Sale of some Machinery on the 1st day of the financial year 2023–24. Cost of this Machinery was Rs.10,000 and Accumulated Depreciation thereon being Rs.8,000.
- Depreciation is to be provided on Plant & Machinery at 10% on Cost.
- Provision for Income tax is required@ 30%.

You are required to prepare Shivam Ltd.'s Profit and Loss A/c for the year ended 31st March, 2024 and Balance Sheet as at that date as per the provisions of the Companies Act, 2013 after considering the above information. Ignore previous year figures. **(14 Marks)**

Solution :

Shivam Limited

Balance Sheet as at 31st March 2024

Particulars			Note No.	Rs.(in 000)
I.	**Equity and Liabilities**			
1.	**Shareholders' funds**			
	(a)	Share capital	1	300.00
	(b)	Reserves and Surplus	2	232.70
2.	**Non-Current liabilities**			
	(a)	Long term borrowings	**3**	**135.00**
3.	**Current liabilities**			
	(a)	Trade Payables		**35.00**
	(b)	Short-Term Provisions		**30.30**
		Total		**733.0**
II.	**Assets**			
1.	**Non-current assets**			
	(a)	Property, Plant and Equipment and Intangible assets		
		(i) Property, Plant and Equipment	**4**	**596.0**
2.	**Current assets**			
	(a)	Inventories		**58.00**
	(b)	Trade receivables		**65.00**
	(c)	Cash and cash equivalents		**14.0**
		Total		**733.0**

Shivam Limited

Statement of Profit and Loss for the year ended 31st March 2024

	Particulars	Notes	Rs.(in '000)
I.	Revenue from operations		473.00
II.	Other Income	5	1.00
III.	Total Income		474.00

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TELEGRAM: CA NOTE HUB

IV.	Expenses:			
	Purchases			226.00
	Finance costs			14.00
	Depreciation and Amortisation expenses (10% of 510*)			51.00
	Other expenses		6	82.00
	Total Expenses			373.00
V.	Profit before Tax (III-IV)			101.00
	Tax Expense:			
	Current tax			(30.30)
	Profit for the period (after tax)			70.70

*520 (Plant and machinery at cost) – 10 (Cost of plant and machinery sold)

Notes to accounts

					Rs.(in 000)
1.	**Share Capital**				
	Equity share capital				
	Authorised				
	35,000 shares of Rs.10 each				**350.00**
	Issued, subscribed & paid-up				
	20,000 shares of Rs.10 each fully paid up			200.00	
	Add: 10,000 Bonus Shares issued during the year			100.00	**300.00**
2.	**Reserves and Surplus**				
	Securities Premium Account				
	Opening Balance		27.00		
	Less: Utilised for bonus issue		27.00		0.00
	Revaluation reserve (2,45,000 – 1,48,000)				97.00
	General Reserve	90			
	Less: Utilized for bonus issue	(73)	17.00		
	Add: Transfer from Profit & loss @ 10%		7.07		24.07
	Profit & loss Balance				
	Opening balance		48.00		
	Profit for the period		70.70		
	Appropriations				
	Transfer to General Reserve @ 10%		(7.07)		111.63
					232.70
3.	**Long term borrowing**				
	10% Debentures				**135.00**
4	**Property, Plant and Equipment**				
	Land				
	Opening balance			148.00	
	Add: Revaluation adjustment			97.00	
	Closing balance				**245.00**
	Plant and Machinery				

TELEGRAM: CA NOTE HUB

		520.00	
	Opening balance	(10.00)	
	Less: Disposed off	510.00	
		(159.00)	
	Less: Depreciation (1,16,000–8,000+51,000)		351.00
	Closing balance Total		596.00
5	**Other Income**		
	Profit on sale of machinery:		
	Sale value of machinery	3.00	
	Less: Book value of machinery (10,000–8,000)	(2.00)	1.00
6	**Other expenses:**		
	Factory expenses	40.00	
	Selling expenses	20.00	
	Administrative expenses	22.00	82.00

The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March 2024. Such dividends will be disclosed in notes only.

Working note:

Bonus Shares Issue:

- Bonus shares are issued in a 1:2 ratio, so for every 2 equity shares, 1 bonus share is issued.
- Equity Share Capital = Rs.2,00,000 / Rs.10 = 20,000 shares.
- Bonus Shares = 20,000 / 2 = 10,000 shares × Rs.10 = Rs.1,00,000.

Alternatively, since, the amount of interest on 10% 1,35,000 Debentures comes to Rs 13,500 while the Debenture Interest in the trial balance is listed as Rs.14,000, the difference of Rs.500 (Rs.13,500 - Rs.14,000) may be treated as an advance payment.

Question 20 : (MTP Apr'21, Apr'22, Sept.24) (RTP May'21) NB Pg. No.

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

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

(5 Marks)

TELEGRAM: CA NOTE HUB

Solution :

Amount that can be drawn from reserves for 10% dividend		
10% dividend on ₹ 80,00,000		₹ 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilised from reserves		**6,57,500**

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

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

Condition III

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

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

Question 21 (PYQ May 24) NB Pg. No.

Following information are available in respect of Z Limited as on 31 st March, 2024

1.	Equity shares of Rs.100 each	Rs.500 lakhs
2.	General Reserve	Rs.100 lakhs
3.	Loss for the year ending 31st March, 2024	Rs.5 lakhs

Due to absence of profits during the year 2023-24, the management recommends to declare dividend of 10% on equity share capital out of general reserve.

The rates of equity dividend for the last 5 years immediately preceding the year 2023-24 are as follows:

2022-23	2021-22	2020-21	2019-20	2018-19
12%	14%	10%	10%	7%

As an accountant of the company, you are required to suggest whether the recommendation of the management is justified? If, you do not agree, then suggest the rate of dividend. **(4 Marks)**

Solution :

In case of declaration of dividend out of free reserves, there are 3 conditions:

1. Dividend Rate < Average Rate of last 3 years 10% < 12% [(12+14+10)/3]

   Condition is Satisfied

2. Dividend Distributed < 10% of PUSC + Reserve and Surplus 50,00,000 < 59,50,000 [(5,00,00,000 + 1,00,00,000 – 5,00,000) × 10%]

   Condition is Satisfied

3. Reserves after dividend > 15% of PUSC 45,00,000 not > 75,00,000 (5,00,00,000 × 15%)

   Condition is Not Satisfied

TELEGRAM: CA NOTE HUB

4. The closing balance of reserves after payment of dividend and set off of loss = Rs.75,00,000

Therefore, can be utilized = 20,00,000 (1,00,00,000 – 5,00,000 – 75,00,000)

Thus, rate of dividend = (20,00,000/5,00,00,000) = 4%

Alternatively

To judge the recommendation of management, the satisfaction of all three conditions is to be checked:

1. Condition I

The proposed dividend of 10% is less than the average rate of dividend being 12% (i.e.) (12+14+10) /5 =12 %.

Hence, this condition is satisfied.

2. Condition II

Amount to be withdrawn :

10% dividend on Equity share capital	50,00,000
+ Loss of Current year	5,00,000
Amount to be drawn from General Reserve	55,00,000

Maximum amount that can be withdrawn should not exceed 10% of paid-up share capital + free reserves.

= 10% of [Rs.500 lakhs + Rs.100 lakhs] = Rs.60,00,000

As the amount to be withdrawn is within the maximum limit, hence, this condition is also satisfied.

3. Condition III

Balance of reserves after withdrawal (100–55) Rs.45,00,000

15% of paid-up capital Rs.75,00,000

As the balance of reserves should not be less than 15% of its paid-up share capital, but here the balance of reserves after withdrawal is less than 15% of paid-up share capital, hence this condition is not satisfied, hence, 10% dividend cannot be declared.

Maximum withdrawal of Reserve if condition II is satisfied.

Opening balance of Reserves in the beginning = Rs.1,00,00,000 of the year

- Closing balance of reserves being 15% of = Rs.75,00,000 paid-up capital

Reserves available = Rs.25,00,000 Maximum permissible Divisible Profits

Permissible withdrawal as above = Rs. 25,00,000

Less: Current Year's Loss = Rs.5,00,000

Maximum permissible Divisible profit = Rs.20,00,000

Actual permissible rate of Dividend = (Rs.20,00,000 / Rs.5,00,00,000) x 100 = **4%**

Therefore, the recommendation of management is not justified and a dividend only up to a rate of 4% can be declared.

Question 22 (MTP Oct'19) NB Pg. No.

Future Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2019:

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TELEGRAM: CA NOTE HUB

	Amount Rs. in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of Rs. 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013. **(4 Marks)**

Solution :

Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head Surplus. Similarly, the balance of Reserves and Surplus, after adjusting negative balance of surplus, shall be shown under the head Reserves and Surplus even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceed the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of Reserves and Surplus after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus, the treatment done by the company is incorrect.

TELEGRAM: CA NOTE HUB

INTERNAL RECONSTRUCTION

Illustration 1

On 31-12-20X1, B Ltd. had 20,000, ₹ 10 Equity Shares as authorized capital and the shares were all issued on which Z 8 was paid up. In June, 20X2 the company in general meeting decided to sub-divide each share into two shares of ₹ 5 with ₹ 4 paid up. In June, 20X3 the company in general meeting resolved to consolidate 20 shares of ₹ 5, ₹ 4 per share paid up into one share of ₹ 100 each, ₹ 80 paid up.

Pass entries and show how share capital will appear in notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

20X2			**₹**	**₹**
June	Equity Share Capital (₹ 10) A/c	Dr.	1,60,000	1,60,000
	To Equity Share Capital (₹ 5) A/c			
	(Being the sub-division of 20,000 shares of ₹ 10 each with ₹ 8 paid up into 40,000 shares ₹ 5 each with ₹ 4 paid up by resolution in general meeting dated....)			
20X3	Equity Share Capital (₹ 5) A/c	Dr.	1,60,000	
June	To Equity Share Capital (₹ 100) A/c			1,60,000
	(Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shares with ₹ 80 paid up)			

Notes to Balance Sheet

Liabilities:	**₹**
As on 31-12-20X1	
1. Share Capital	
Authorized:	
20,000 Equity Shares of ₹ 10 each	2,00,000
Issued, Subscribed and Paid up:	
20,000 Equity Shares of ₹ 10 each ₹ 8 per share paid up	1,60,000
As on 31-12-20X2	
1. Share Capital	
Authorized:	
40,000 Equity Shares of ₹ 5 each	2,00,000
Issued, Subscribed and Paid up:	
40,000 Equity Shares of ₹ 5 each ₹ 4 per share paid up	1,60,000
As on 31-12-20X3	r
1. Share Capital	
Authorized:	
2,000 Equity Shares of ₹ 100 each	2,00,000
Issued, Subscribed and Paid up:	
2,000 Equity Shares of ₹ 100 each ₹ 80 per share paid up	1,60,000

TELEGRAM: CA NOTE HUB

Note: Some accountants prefer not to make any entry as the amount remains same. Even when an entry is passed it applies only to the called-up portion, and not to uncalled or unissued portion of share capital.

Illustration 2 (MTP Apr'24)

C Ltd. had ₹5,00,000 authorized capital on 31-12-20X1 divided into shares of ₹100 each out of which 4,000 shares were issued and fully paid up. In June 20X2 the Company decided to convert the issued shares into stock. But in June, 20X3 the Company re-converted the stock into shares of ₹10 each, fully paid up.

Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3. **(4 Marks)**

Solution

Journal Entries

			₹	₹
20X2 June	Equity Share Capital A/c	Dr.	4,00,000	4,00,000
	To Equity Stock A/c			
	(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated...)			
20X3 June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Notes to Balance Sheet

	₹
As on 31-12-20X1	
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	5,00,000
Issued and Subscribed	
4,000 Equity Shares of ₹ 100 each fully called up	4,00,000
As on 31-12-20X2	₹
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	5,00,000
Issued and Subscribed	
Equity Stock- 4,000 Equity Shares of ₹ 100 converted into Stock	4,00,000
As on 31-12-20X3	₹
Share Capital	
Authorized	
50,000 Equity Shares of ₹ 10 each	5,00,000
Issued and Subscribed	
40,000 Equity Shares of ₹ 10 each fully called up	4,00,000

Illustration 3 (MTP Apr'24)

TELEGRAM: CA NOTE HUB

The Balance Sheet of A & Co. Ltd. as at 31-3-20X2 is as follows:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	11,50,000
	B	Reserves and Surplus	2	(5,35,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	3,75,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
	B	Short term borrowings - Bank Overdraft		1,95,000
	C	Other current liabilities	4	1,22,500
		Total		16,07,500
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	5	4,75,000
	B	Intangible assets	6	1,67,500
	C	Non-current investments	7	55,000
2		**Current assets**		
	A	Inventories		4,25,000
	B	Trade receivables		4,85,000
		Total		16,07,500

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital:	
	75,000 Equity Shares of ₹ 10 each	7,50,000
	Preference share capital:	
	4,000 6% Cumulative Preference Shares of ₹ 100 each	4,00,000
		11,50,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(5,35,000)
		(5,35,000)
3	**Long-term borrowings**	
	Secured	
	6% Debentures (secured on the freehold property)	3,75,000
		3,75,000
4	**Other current liabilities**	
	Loan from directors	1,00,000
	Interest payable on 6% debentures	22,500

TELEGRAM: CA NOTE HUB

		1,22,500
5	**Property plant and Equipment**	
	Freehold property	4,25,000
	Plant	50,000
		4,75,000
6	**Intangible assets** Goodwill	1,30,000
	Patents	37,500
7	**Non-current investments**	1,67,500
	Investments at cost	55,000
		55,000

The Court approved a Scheme of re-organization to take effect on 1-4-20X2, whereby:

(i) The Preference shares to be written down to ₹ 75 each and Equity Shares to ₹2 each.

(ii) Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹ 2 each to be allotted for the remaining quarter.

(iii) Interest payable on debentures to be paid in cash.

(iv) Debenture-holders agreed to take over freehold property, book value ₹ 1,00,000 at a valuation of ₹ 1,20,000 in part repayment of their holdings and to provide additional cash of ₹1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.

(v) Patents and Goodwill to be written off.

(vi) Inventory to be written off by ₹ 65,000.

(vii) Amount of ₹ 68,500 to be provided for bad debts.

(viii) Remaining freehold property after giving to debenture holders, to be revalued at ₹ 3,87,500.

(ix) Investments be sold for ₹ 1,40,000.

(x) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹ 2 each and as to 5% in cash, and balance 5% being waived.

(xi) There were capital commitments totalling ₹ 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(xii) Ignore taxation and cost of the scheme.

You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the Scheme. **(10 Marks)**

Solution

Journal of A & Co. Ltd.

			Dr. ₹	Cr. ₹
20X2	Equity Share Capital A/c (₹ 10)	Dr.	7,50,000	
April 1	To Capital Reduction A/c			6,00,000
	To Equity Share Capital A/c (₹ 2)			1,50,000
	(Reduction of equity shares of ₹ 10 each to shares of ₹ 2 each as per Reconstruction Scheme dated...)			
"	6% Cum. Preference Share Capital A/c (₹ 100)	Dr.	4,00,000	
	To Capital Reduction A/c			1,00,000
	To Pref. Share Capital A/c (₹ 75)			3,00,000

TELEGRAM: CA NOTE HUB

	(Reduction of preference shares of ₹ 100 each to shares of ₹ 75 each as per reconstruction scheme)		
"	Capital Reduction Account Dr.	24,000	
	To Equity Share Capital Account		24,000
	(Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, ₹ 96,000)		
"	Freehold Property A/c	82,500	
	Dr.		
	To Capital Reduction A/c		82,500
	(Appreciation in the value of property:		
	Book value / Revalued Figure		
	₹ 1,00,000 / ₹ 1,20,000		
	₹ 3,25,000 / ₹ 3,87,500		
	Total ₹ 4,25,000 / ₹ 5,07,500		
	Profit on revaluation: ₹ 82,500)		
"	6% Debentures A/c Dr.	1,20,000	
	To Freehold Property A/c		1,20,000
	(Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)		
"	Interest payable A/c Dr.	22,500	
	To Bank A/c		22,500
	(Debenture interest paid)		
"	Bank A/c Dr.	1,30,000	
	To 8% Debentures A/c		1,30,000
	(8% Debentures issued for cash)		
"	Bank A/c Dr.	1,40,000	
	To Investment A/c		55,000
	To Capital Reduction A/c		85,000
	(Sale of Investment for ₹ 1,40,000 cost being ₹ 55,000; profit credited to Capital Reduction Account)		
"	Directors' Loan A/c Dr.	1,00,000	
	To Equity Share Capital A/c		90,000
	To Bank A/c		5,000
	To Capital Reduction A/c		5,000
	(Directors' loan discharged by issue of equity shares of ₹ 90,000, cash payments of ₹ 5,000 and surrender of ₹ 5,000, vide Scheme of Reconstruction)		
"	Capital Reduction A/c Dr.	8,48,500	
	To Patents		37,500
	To Goodwill		1,30,000
	To Inventory		65,000
	To Provision for Doubtful Debts		68,500

TELEGRAM: CA NOTE HUB

	To Bank		12,500
	To Profit & Loss Account		5,35,000
	(Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)		

Note: Penalty charges for cancellation of the contract amounts to ₹ 12,500 (2,50,000X5%) being paid in cash.

Balance Sheet of A & Co. Ltd. (And Reduced) as at 1st April, 20X2

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,64,000
2		**Non-current liabilities**		
	A	Long-term borrowings	2	3,85,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
		Total		12,49,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	4,37,500
	B	Intangible assets	4	-
2		**Current assets**		
	A	Inventories		3,60,000
	B	Trade receivables	5	4,16,500
	C	Cash and cash equivalents		35,000
		Total		12,49,000

Notes to accounts

1	**Share Capital**		
	Equity share capital		
	1,32,000 Equity shares of ₹ 2 each (of the above		2,64,000
	57,000 shares have been issued for consideration other than cash)		
	Preference share capital		
	4,000 6% Preference shares of ₹ 75 each		3,00,000
	Total		5,64,000
2	**Long-term borrowings**		
	Secured		
	6% Debentures		2,55,000
	8% Debentures		1,30,000
	Total		3,85,000

TELEGRAM: CA NOTE HUB

3	**Property, plant and equipment**		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	(1,20,000)	3,87,500
	Plant		50,000
	Net carrying value		4,37,500
4	**Intangible assets**		
	Goodwill	1,30,000	
	Less: Written off under scheme of Reconstruction	(1,30,000)	
	Net carrying value		NIL
	Patents	37,500	
	Less: Written off under scheme of Reconstruction	(37,500)	-
	Net carrying value	-	NIL
5	**Trade Receivables**	4,85,000	
	Less: Provision for doubtful debts	68,500	
			4,16,500

Illustration 4 (RTP May'23, Past Exam Nov'19)

Given below is the Balance sheet of Rebuilt Ltd. as at 31.3.20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	13,50,000
	B	Reserves and Surplus	2	(4,51,000)
2		**Non-current liabilities**		
	A	Long-term borrowings (Loan)	3	5,73,000
3		**Current liabilities**		
	A	Trade Payables		2,07,000
	B	Other current liabilities		35,000
		Total		17,14,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	6,68,000
	B	Intangible assets	5	3,18,000
2		**Current assets**		
	A	Inventories		4,00,000
	B	Trade receivables		3,28,000
		Total		17,14,000

Notes to accounts

		₹

TELEGRAM: CA NOTE HUB

1	**Share Capital**	
	Equity share capital	7,50,000
	15,000 Equity Shares of ₹ 50 each	
	Preference share capital	
	12,000, 7% Cumulative Preference Shares of ₹ 50 each	
	(Preference dividend is in arrears for five years)	6,00,000
	Total	13,50,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(4,51,000)
		(4,51,000)
3	**Long-term borrowings**	
	Loan	5,73,000
		5,73,000
4	**Property, plant and Equipment**	
	Building at cost less depreciation	4,00,000
	Plant at cost less depreciation	2,68,000
5	**Intangible assets**	6,68,000
	Trademarks and Goodwill at cost	3,18,000
		3,18,000

The Company is not earning profits, short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

a) The equity shareholders have agreed that their ₹50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.

b) The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.

c) Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

d) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (a) above.

e) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the company.

f) The equity share capital cancelled is to be applied:

   (i) to write off the debit balance in the profit and loss A/c; and

   (ii) to write off ₹35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital. **(15 Marks)**

Solution

In the books of Rebuilt Ltd. Journal Entries

TELEGRAM: CA NOTE HUB

	Particulars		Debit (₹)	Credit (₹)
1.	Equity share capital A/c (₹ 50)	Dr.	7,50,000	
	To Equity share capital A/c (₹ 2.50)			37,500
	To Capital reduction A/c			7,12,500
	(Being equity capital reduced to nominal value of ₹ 2.50 each)			
2.	Bank A/c	Dr.	1,12,500	
	To Equity share capital			1,12,500
	(Being 3 right shares against each share was issued and subscribed)			
3.	7% Preference share capital A/c (₹ 50)	Dr.	6,00,000	
	Capital reduction A/c	Dr.	60,000	
	To 5% Preference share capital (₹ 10)			4,80,000
	To equity share capital (₹ 50)			1,80,000
	(Being 7% preference shares of ₹ 50 each converted to 5% preference shares of ! 10 each and also given to them 6 equity shares for every share held)			
4.	Loan A/c	Dr.	1,50,000	
	To 5% Preference share capital A/c			1,20,000
	To Equity share capital A/c			30,000
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c			1,00,000
	(Being shares subscribed by the directors)			
6.	Equity share application money A/c	Dr.	1,00,000	
	To Equity share capital A/c			1,00,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being loan repaid)			
8.	Capital reduction A/c	Dr.	6,52,500	
	To Profit and loss A/c			4,51,000
	To Plant A/c			35,000
	To Trademarks and Goodwill A/c (Bal.fig.)			1,66,500
	(Being losses and assets written off to the extent required)			

Balance sheet of Rebuilt Ltd. (and reduced) as at 31.3.20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	10,60,000
2		**Non-current liabilities**		

TELEGRAM: CA NOTE HUB

	a	Long-term borrowings		2,23,000
3		**Current liabilities**		
	a	Trade Payables		2,07,000
	b	Other current liabilities		35,000
		Total		15,25,000
		Assets		
1		**Non-current assets**		
	a	Property, plant and equipment	2	6,33,000
	b	Intangible assets	3	1,51,500
2		**Current assets**		
	a	Inventories		4,00,000
	b	Trade receivables		3,28,000
	c	Cash and cash equivalents	4	12,500
		Total		15,25,000

Notes to accounts

			₹
1.	**Share Capital**		
	Authorized capital:		
	65,000 Preference shares of ₹ 10 each	6,50,000	
	3,00,000 Equity shares of ₹ 2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:		
	1,80,000 equity shares of ₹ 2.5 each	4,60,000	
	60,000, 5% Preference shares of ₹ 10 each	6,00,000	10,60,000
2.	**Property plant and equipment**		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3.	**Intangible assets**		
	Trademarks and goodwill		1,51,500
4.	**Cash and cash equivalents**		
	Bank (1,12,500+1,00,000-2,00,000)		12,500

Illustration 5

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

	₹
Property, Plant and Equipment	2,50,00,000
Investments (Market-value ₹ 19,00,000)	20,00,000
Current Assets	2,00,00,000
P & L A/c (Dr. balance)	12,00,000
Share Capital: Equity Shares of ₹ 100 each	2,00,00,000
6%, Cumulative Preference Shares of ₹ 100 each	1,00,00,000

TELEGRAM: CA NOTE HUB

5% Debentures of ₹ 100 each	80,00,000
Creditors	1,00,00,000
Provision for taxation	2,00,000

The following scheme of Internal Reconstruction is sanctioned:

(i) All the existing equity shares are reduced to ₹ 40 each.

(ii) All preference shares are reduced to ₹ 60 each.

(iii) The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.

(iv) Property, Plant and Equipment is to be written down by 20%.

(v) Current assets are to be revalued at ₹ 90,00,000.

(vi) Investments are to be brought to their market value.

(vii) One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.

(viii) The taxation liability is to be settled at ₹ 3,00,000.

(ix) It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

Solution

Journal Entries in the books of Vaibhav Ltd.

			₹	₹
(i)	Equity share capital (₹ 100) A/c	Dr.	2,00,00,000	
	To Equity Share Capital (₹ 40) A/c			80,00,000
	To Capital Reduction A/c			1,20,00,000
	(Being conversion of equity share capital of₹ 100 each into ₹40 each as per reconstruction scheme)			
(ii)	6% Cumulative Preference Share capital(₹ 100) A/c	Dr.	1,00,00,000	
	To 6% Cumulative Preference Share Capital(₹ 60)A/c			60,00,000
	To Capital Reduction A/c			40,00,000
	(Being conversion of 6% cumulative preference shares capital of ₹ 100 each into₹ 60 each as per reconstruction scheme)			
(iii)	5% Debentures (₹ 100) A/c	Dr.	80,00,000	
	To 6% Debentures (₹ 70) A/c			56,00,000
	To Capital Reduction A/c			24,00,000
	(Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Sundry Creditors A/c	Dr.	40,00,000	
	To Equity Share Capital (₹ 40) A/c			24,00,000
	To Capital Reduction A/c			16,00,000
	(Being a creditor of ₹ 40,00,000 agreed to surrender his claim by 40% and was allotted60,000 equity shares of ₹ 40 each in full			

TELEGRAM: CA NOTE HUB

	settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	2,00,000	
	Capital Reduction A/c	Dr.	1,00,000	
	To Liability for Taxation A/c			3,00,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
(vi)	Capital Reduction A/c	Dr.	199,00,000	
	To P & L A/c			12,00,000
	To Property, Plant and Equipment A/c			50,00,000
	To Current Assets A/c			110,00,000
	To Investments A/c			1,00,000
	To Capital Reserve A/c (Bal. fig.)			26,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)			
(vii)	Liability for Taxation A/c	Dr.	3,00,000	
	To Current Assets (Bank A/c)			3,00,000
	(Being the payment of tax liability)			

Balance Sheet of Vaibhav Ltd. (and reduced) as at 31st March, 20X1

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	164,00,000
	b	Reserves and Surplus	2	26,00,000
2		**Non-current liabilities**		
		Long-term borrowings	3	56,00,000
3		**Current liabilities**		
		Trade Payables (1,00,00,000 less 40,00,000)		60,00,000
		Total		3,06,00,000
		Assets		
1		**Non-current assets**		
	a	Property, plant and equipment	4	2,00,00,000
	b	Investments	5	19,00,000
2		**Current assets**	6	87,00,000
		Total		3,06,00,000

Notes to accounts

		₹
1. Share Capital		
Equity share capital		

TELEGRAM: CA NOTE HUB

Issued, subscribed and paid up		
2,60,000 equity shares of ₹ 40 each (of the above 60,000 shares have been issued for consideration other than cash)		1,04,00,000
Preference share capital		
Issued, subscribed and paid up		
1,00,000 6% Cumulative Preference shares of₹ 60 each		60,00,000
Total		1,64,00,000
2. Reserves and Surplus		
Capital Reserve		26,00,000
3. Long-term borrowings Secured		
6% Debentures		56,00,000
4. Property, Plant and Equipment		
Carrying value	2,50,00,000	
Adjustment under scheme of reconstruction	(50,00,000)	2,00,00,000
5. Investments		
	20,00,000	
Adjustment under scheme of reconstruction	(1,00,000)	19,00,000
6. Current assets		
	2,00,00,000	
Adjustment under scheme of reconstruction	(1,10,00,000)	
	90,00,000	
Taxation liability paid	(3,00,000)	87,00,000

Working Note:

Capital Reduction Account

To Liability for taxation A/c	1,00,000	By Equity share capital	1,20,00,000
To P & L A/c	12,00,000	By 6% Cumulative preferences	
To Property, plant and equipment	50,00,000	Share capital	40,00,000
To Current assets	1,10,00,000	By 5% Debentures	24,00,000
To Investment	1,00,000	By Sundry creditors	16,00,000
To Capital Reserve (Bal. fig.)	26,00,000		
	2,00,00,000		2,00,00,000

Illustration 6 (MTP Mar'24)

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

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	26,00,000

TELEGRAM: CA NOTE HUB

	B	Reserves and Surplus	2	(4,05,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	12,00,000
3		**Current liabilities**		
	A	Trade Payables		5,92,000
	B	Short term borrowings - Bank overdraft		1,50,000
		Total		41,37,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	11,50,000
	B	Intangible assets	5	70,000
	C	Non-current investment	6	68,000
2		**Current assets**		
	A	Inventory		14,00,000
	B	Trade receivables		14,39,000
	C	Cash and cash equivalents		10,000
		Total		41,37,000

Notes to accounts:

		₹
1	**Share Capital**	
	Equity share capital:	
	2,00,000 Equity Shares of ₹ 10 each	20,00,000
	6,000, 8% Preference shares of ₹ 100 each	6,00,000
		26,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss A/c	(4,05,000)
		(4,05,000)
3	**Long-term borrowings**	
	9% debentures	12,00,000
		12,00,000
4	**Property, Plant and Equipment**	
	Plant and machinery	9,00,000
	Furniture and fixtures	2,50,000
		11,50,000
5	**Intangible assets**	
	Patents and copyrights	70,000
		70,000
6	**Non-current investments**	
	Investments (market value of ₹55,000)	68,000
		68,000

The following scheme of reconstruction was finalized:

TELEGRAM: CANOTE HUB

(i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.

(ii) Debenture holders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.

(iii) Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.

(iv) Investment value to be reduced to market price.

(v) The company would issue 11% Debentures for ₹ 3,00,000 and augment its working capital requirement after settlement of bank overdraft.

Pass necessary Journal Entries in the books of the company. Prepare Capital Reduction account and Balance Sheet of the company after internal reconstruction. **(10 Marks)**

Solution

In the Books of ABC Ltd.

Journal Entries

Particulars		₹	₹
8% Preference share capital A/c	Dr.	6,00,000	
To 11% Debentures A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital and issue of 11% debentures]			
9% Debentures A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment of plant & machinery]			
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving Inventories]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

Capital Reduction Account

	₹		₹

TELEGRAM: CA NOTE HUB

To Investments A/c	13,000	By Preference share capital A/c	1,80,000
To Profit and loss A/c	4,05,000	By 9% Debenture holders A/c	3,00,000
To Capital reserve A/c	1,54,000	By Trade payables A/c	92,000
	5,72,000		5,72,000

Balance Sheet of ABC Ltd. (And Reduced)

As at 31st March 20X1

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000
Total		28,74,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	4	2,50,000
(b) Intangible assets	5	70,000
(c) Non-current investments	6	55,000
(2) Current assets		9,00,000
a) Inventories (₹ 14,00,000 – ₹ 5,00,000)		
b) Trade receivables		14,39,000
c) Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

			₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹ 10 each fully paid-up		20,00,000
2.	**Reserve and Surplus**		
	Capital Reserve		1,54,000
3.	**Long Term Borrowings**		
	11% Debentures (₹ 4,20,000 + ₹ 3,00,000)		7,20,000
4.	**Property, Plant and Equipment**		
	Plant & machinery	9,00,000	
	Less: Adjustment on scheme of reconstruction	9,00,000	-
	Furniture & fixtures		2,50,000
5.	**Intangible assets**		
	Patents & copyrights		70,000

TELEGRAM: CA NOTE HUB

6.	**Non-Current Investments**	3,20,000
	Investments (₹ 68,000 – ₹ 13,000)	55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid

= ₹ 10,000 + ₹ 3,00,000 – ₹ 1,50,000 = ₹ 1,60,000

Illustration 7 (MTP Oct'20, Mar'22)

The Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows :

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	10,00,000
	B	Reserves and surplus	2	(6,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	2,00,000
3		**Current liabilities**		
	A	Trade Payables		72,000
	B	Other current liabilities	4	24,000
	C	Short term provisions	5	24,000
		Total		7,20,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	6	1,00,000
2		**Current assets**		
	A	Inventory		3,20,000
	B	Trade receivables		2,70,000
	C	Cash and cash equivalents		30,000
		Total		7,20,000

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	10,000 Equity Shares of ₹ 100 each		10,00,000
			10,00,000
2	**Reserves and Surplus**		
	Debit balance of Profit and loss Account		(6,00,000)
			(6,00,000)
3	**Long-term borrowings**		

TELEGRAM: CA NOTE HUB

	12% debentures		2,00,000
			2,00,000
4	**Other current liabilities**		
	Interest payable on debentures		24,000
			24,000
5	**Short term provisions**		
	Provision for taxation		24,000
			24,000
6	**Property, Plant and Equipment**		
	Machinery		1,00,000
			1,00,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

a) Each share is sub-divided into ten fully paid up equity shares of ₹10 each.

b) After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.

c) Out of shares surrendered, 10,000 shares of ₹10 each shall be converted into 12% preference shares of ₹10 each, fully paid up.

d) The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹1,00,000 which are converted out of shares surrendered.

e) Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of ₹10 each out of shares surrendered.

f) Balance of profit and loss account to be written off.

g) The shares surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant Balance Sheet

Solution **(8 Marks)**

		Dr. ₹	Cr. ₹
Equity Share Capital (r 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000
To Equity Share Capital (₹ 10) A/c			5,00,000
(Subdivision of 10,000 equity shares of ₹r 100 each into 1,00,000 equity shares of ₹10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			
12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000

TELEGRAM: CA NOTE HUB

(Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c			3,64,000
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)			
Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c			4,000
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			

Balance Sheet of Revise Limited (and reduced) as at...

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities	4	6,000
(a) Other current liabilities		
(b) Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,00,000
(2) Current assets		
a) Inventories		3,20,000
b) Trade receivables		2,70,000
c) Cash and cash equivalents		30,000
Total		7,20,000

Notes to Accounts

		₹
1.	**Share Capital**	
	Equity Share Capital	

TELEGRAM: CA NOTE HUB

	Issued Capital: 53,600 Equity Shares of ₹ 10 each	5,36,000
	Preference Share Capital	
	Preference Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
2.	**Reserve and Surplus**	
	Capital Reserve	4,000
3.	**Long-term borrowings**	
	Unsecured Loans	
	12% Debentures	50,000
4.	**Other current liabilities**	
	Interest payable on debentures	6,000
5.	**Short-term provisions**	
	Provision for Income-tax	24,000
6.	**Property, plant and Equipment**	
	Machinery	1,00,000

Illustration 8 (RTP May'21)

Recover Ltd. decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 20X1 is as follows-

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	1	3,50,000
	B	**Reserves and surplus**	2	(70,000)
2		**Non-current liabilities**		
	A	**Long-term borrowings**	3	50,000
3		**Current liabilities**		
	A	**Trade Payables**		80,000
		Short term Borrowings – Bank		
	B	**overdraft**		90,000
		Other Current Liabilities (Interest		
	C	**payable on Debentures)**		5,000
				5,05,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant Equipment	4	3,35,000
	B	Intangible assets	5	50,000

TELEGRAM: CA NOTE HUB

	C	Non-current investments	6	40,000
2		**Current assets**		
	A	Inventories		30,000
	B	Trade receivables		50,000
				5,05,000

Notes to accounts:

1	**Share Capital**		₹
	Equity share capital:		
	20,000 Equity Shares of ₹ 10 each		2,00,000
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of ₹ 10 each (preference dividend has been in arrears for4 years)		1,50,000
			3,50,000
2	**Reserves and surplus**		
	Profit and loss account (debit balance)		(70,000)
			(70,000)
3	**Long-term borrowings**		
	Secured		
	10% Debentures (secured on the freehold property)		50,000
			50,000
4	**Property, Plant and Equipment**		
	Freehold property		1,20,000
	Leasehold property		85,000
	Plant and machinery		1,30,000
			3,35,000
5	**Intangible assets**		
	Goodwill		50,000
			50,000
6	**Non-current investments**		
	Non-Trade investments at cost		40,000
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

(i) The preference shares were reduced to ₹2.5 per share, and the equity shares to ₹1 per share.

(ii) One new equity share of ₹1 was issued for the arrears of preferred dividend for past 4 years.

(iii) The debenture holders took over the freehold property at an agreed figure of ₹75,000 and paid the balance to the company after deducting the amount due to them.

(iv) Plant and Machinery was written down to ₹1,00,000.

(v) Non-trade Investments were sold for ₹32,000.

(vi) Goodwill and obsolete stock (included in the value of inventories) of ₹10,000 were written off.

TELEGRAM: CA NOTE HUB

(vii)A contingent liability of which no provision had been made was settled at ₹7,000 and of this amount, ₹6,300 was recovered from the insurance.

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

Solution

Journal entries in the books of Recover Ltd

Particulars		Dr. ₹	Cr. ₹
8% Cumulative Preference share capital (₹ 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital(₹2.5) A/c			37,500
To Reconstruction (₹ 7.5) A/c			1,12,500
(Preference shares being reduced to shares of ₹2.5 per share and remaining transferred to reconstruction account as per internal reconstruction scheme)			
Equity share capital A/c (₹10)	Dr.	2,00,000	
To Equity Share capital A/c (₹ 1)			20,000
To Reconstruction A/c (₹ 9)			1,80,000
(Equity shares reduced to ₹ 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
10% Debentures A/c	Dr.	50,000	
Interest payable on debentures A/c	Dr.	5,000	
Bank A/c	Dr.	20,000	
Reconstruction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the reconstruction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Reconstruction A/c	Dr.	8,000	
To Investments A/c			40,000
(Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	

TELEGRAM: CA NOTE HUB

To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Reconstruction A/c	Dr.	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingency payment amount)			
Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c			70,000
(Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in reconstruction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 20X1 (and reduced)

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		**Non-current liabilities**		
	A	Long-term borrowings		-
3		**Current liabilities**		
	A	Trade Payables		80,000
	B	Short term borrowings - Bank Overdraft		90,000
		Total		**3,06,300**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	1,85,000
2		**Current assets**		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	51,300
		Total		**3,06,300**

Notes to accounts:

1.	**Share Capital**	
	Equity share capital	
	68,000 Equity Shares of ₹ 1 each	68,000
	Preference share capital	

TELEGRAM: CANOTE HUB

	15,000 8% Cumulative Preference Shares of ₹ 2.5 each	37,500
		1,05,500
2.	**Reserves and surplus**	
	Capital reserve	30,800
3.	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
		1,85,000
4.	**Cash and cash equivalents**	
	Bank A/c (20,000+32,000-7000+6,300)	51,300

Illustration 9

What are the methods of internal reconstruction generally followed by companies?

Solution:

Methods of Internal reconstruction:

- Sub-division or consolidation of shares into smaller or higher Denomination and Conversion of share into stock or vice-versa
- Variation of shareholders' rights
- Reduction of share capital
- Compromise, arrangements etc.
- Surrender of Shares.

Illustration 10

Parth Ltd, had laid down the following terms upon the sanction of the reconstruction plan by the court-

1) Furniture and Fixtures which stood at the books at ₹ 1,50,000 to be written down to ₹ 95,000. The freehold premises which was valued at ₹ 7,00,000 showed an appreciation of ₹55,000.
2) Plant and machinery showed fall in value of ₹ 89,000, to be recorded in the books. Investment at ₹ 2,00,000 was brought down to the existing market value at ₹ 1,05,000.
3) Debenture holders accepted to receive the following in lieu of their present 9% debentures of ₹ 2,50,000-
    a) 1/5th of the total to be paid in cash to them.
    b) To take over the land and buildings of value ₹ 72,000.
    c) To forgo the remaining unpaid portion as a policy of reconstruction.
4) Write off the profit and loss A/c debit balance at ₹ 70,000 which had been accumulated over the years. In case of any shortfall, the balance of the General reserve of ₹ 1,50,000 can be utilized to write off the losses under reconstruction scheme.

Show the necessary journal entries as part of the reconstruction process considering that balance in general reserve utilized to write off the losses as per reconstruction scheme.

Solution:

Journal entries in the books of Parth Ltd.

	Dr.	Cr.
	₹	₹

TELEGRAM: CA NOTE HUB

Reconstruction A/c	Dr.	2,39,000	
To Furniture and Fixtures A/c			55,000
To Plant and machinery A/c			89,000
To Investment A/c			95,000
(Writing off overvalued assets as per Reconstruction Scheme dated.)			
Freehold premises A/c	Dr.	55,000	
To Reconstruction A/c			55,000
(Being the increase in the premises credited to reconstruction account as per reconstruction scheme)			
9% Debentures A/c	Dr.	2,50,000	
To Bank A/c			50,000
To Land and building A/c			72,000
To Reconstruction A/c			1,28,000
(Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)			
Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c			70,000
(Being the loss written off as per reconstruction scheme)			
General reserve A/c	Dr.	1,26,000	
To Reconstruction A/c			1,26,000
(Being the balance in general reserve utilized to write off the losses as per reconstruction scheme)			

Illustration 11 (MTP May'20, Mar'21, Apr'22, Sep'22)

The following scheme of reconstruction has been approved for Win Limited:

(i) The shareholders to receive in lieu of their present holding at 1,00,000 shares of ₹10 each, the following:

a) New fully paid ₹ 10 Equity shares equal to 3/5th of their holding.

b) 10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.

c) 40,000, 8% Debentures.

(ii) An issue of ₹ 1 lakh 10% first debentures was made and allotted, payment for the same being received in cash forthwith.

(iii) Goodwill which stood at₹ 1,40,000 was completely written off.

(iv) Plant and machinery which stood at ₹ 2,00,000 was written down to ₹ 1,50,000.

(v) Freehold property which stood at ₹ 1,50,000 was written down by ₹ 50,000.

You are required to draw up the necessary Journal entries in the Books of Win Limited for the above reconstruction. Suitable narrations to Journal entries should form part of your answer. **(5 Marks)**

Solution:

Journal Entries

		₹	₹
Equity Share Capital (old) A/c	Dr.	10,00,000	
To Equity Share Capital (₹ 10) A/c			6,00,000

TELEGRAM: CA NOTE HUB

To 10% Preference Share Capital A/c			1,20,000
To 8% Debentures A/c			40,000
To Capital Reduction A/c			2,40,000
(Being new equity shares, 10% Preference Shares, 8% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
Bank A/c	Dr.	1,00,000	
To 10% First Debentures A/c			1,00,000
(Being allotment of 10% first Debentures)			
Capital Reduction A/c	Dr.	2,40,000	
To Goodwill Account			1,40,000
To Plant and Machinery Account			50,000
To Freehold Property Account			50,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery and Freehold property as per the scheme)			

Illustration 12

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the Company as at 31.3.20X1 before reconstruction:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	65,00,000
	B	Reserves and Surplus	2	(20,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	15,00,000
3		**Current liabilities**		
	A	Trade Payables		5,00,000
		Total		65,00,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	45,00,000
	B	Intangible assets	5	20,00,000
2		**Current assets**		Nil
		Total		65,00,000

Notes to accounts

1.	**Share Capital**	
	Equity share capital	
	Authorized share capital	
	1,50,000 Equity shares of ₹ 50 each	75,00,000

TELEGRAM: CA NOTE HUB

	Issued, subscribed and paid up capital	
	50,000 Equity Shares of ₹ 50 each	25,00,000
	1,00,000 Equity shares of ₹ 50 each, ₹ 40 paid up	40,00,000
		65,00,000
2.	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(20,00,000)
3.	**Long-term borrowings**	
	Secured: 12% First debentures	5,00,000
	12% Second debentures	10,00,000
		15,00,000
4.	**Property, Plant and Equipment**	
	Building	10,00,000
	Plant	10,00,000
	Computers	25,00,000
		45,00,000
5.	**Intangible assets**	
	Goodwill	20,00,000
		20,00,000

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X ₹	**Mr. Y** ₹
12% First Debentures	3,00,000	2,00,000
12% Second Debentures	7,00,000	3,00,000
Trade payables	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up ₹ 50 shares	3,00,000	2,00,000
Partly paid up shares (r 40 paid up)	5,00,000	5,00,000

The following Scheme of Reconstruction is approved by all parties interested and also by the Court:

a) Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of ₹ 20 each.

b) Mr. X is to cancel ₹7,00,000 of his total debt (other than share amount) and to pay ₹ 2 lakhs to the company and to receive new 14% First Debentures for the balance amount.

c) Mr. Y is to cancel ₹3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.

d) The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entries to record the same and also show the Balance Sheet of the reconstructed company.

Solution:

Journal Entries in books of Green Limited

TELEGRAM: CA NOTE HUB

		Dr.	Cr.
		₹	₹
Bank Account	Dr.	10,00,000	
To Equity Share Capital Account			10,00,000
(Balance of ₹ 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)			
Equity Share Capital Account (₹ 50)	Dr.	75,00,000	
To Equity Share Capital Account (₹ 20)			30,00,000
To Capital Reduction Account			45,00,000
(Reduction of equity shares of ₹ 50 each to shares of ₹ 20 each as per reconstruction scheme)			
12% First Debentures Account	Dr.	3,00,000	
12% Second Debentures Account	Dr.	7,00,000	
Trade payables Account	Dr.	2,00,000	
To X			12,00,000
(The total amount due to X, transferred to his account)			
Bank Account	Dr.	2,00,000	
To X			2,00,000
(The amount paid by X under the reconstruction scheme)			
12% First Debentures Account	Dr.	2,00,000	
12% Second Debentures Account	Dr.	3,00,000	
Trade payables Account	Dr.	1,00,000	
To Y			6,00,000
(The total amount due to Y, transferred to his account)			
Y	Dr.	6,00,000	
To 14% First Debentures Account			3,00,000
To Capital Reduction Account			3,00,000
(The amount due to Y discharged by issue of 14% first debentures)			
X	Dr.	14,00,000	
To 14% First Debentures Account			7,00,000
To Capital Reduction Account			7,00,000
(The cancellation of ₹ 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)			
Capital Reduction Account	Dr.	55,00,000	
To Goodwill Account			20,00,000
To Profit and Loss Account			20,00,000
To Computers Account			15,00,000
(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss account, and computers— Working Note)			

Balance Sheet of Green Limited (and reduced)

as at 31st March, 20X1

TELEGRAM: CA NOTE HUB

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
2		**Non-current liabilities**		
	a	Long-term borrowings	2	10,00,000
3		**Current liabilities**		
	a	Trade Payables		2,00,000
		Total		42,00,000
		Assets		
1		**Non-current assets**		
	a	Property, plant and equipment	3	30,00,000
2		**Current assets**		
		Cash and cash equivalents		12,00,000
		Total		42,00,000

Notes to accounts

		₹
1.	**Share Capital**	
	Equity share capital	
	Issued, subscribed and paid up	
	1,50,000 equity shares of ₹ 20 each	30,00,000
	Total	30,00,000
2.	**Long-term borrowings**	
	Secured	
	14% First Debentures	10,00,000
	Total	10,00,000
3.	**Property, Plant and Equipment**	
	Building	10,00,000
	Plant	10,00,000
	Computers	10,00,000
	Total	30,00,000

Working Note:

Capital Reduction Account

	₹		₹
To Goodwill A/c	20,00,000	By Equity Share Capital A/c	45,00,000
To P & L A/c	20,00,000	By X	7,00,000
To Computers (Bal. Fig.)	15,00,000	By Y	3,00,000
	55,00,000		55,00,000

TELEGRAM: CA NOTE HUB

Illustration 13 (RTP Nov'21) (Past Exam Nov'18)

The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,50,00,000
	B	Reserves and Surplus	2	(6,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	40,00,000
3		**Current liabilities**		
	A	Trade Payables		50,00,000
	B	Short term provisions	4	1,00,000
		Total		2,35,00,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment		1,25,00,000
	B	Non-current investment	5	10,00,000
2		**Current assets**		1,00,00,000
		Total		2,35,00,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	1,00,000 Equity Shares of ₹100 each	1,00,00,000
	50,000, 12% Cumulative Preference shares of ₹100 each	50,00,000
		1,50,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(6,00,000)
		(6,00,000)
3	**Long-term borrowings**	
	40,000, 10% debentures of r100 each	40,00,000
		40,00,000
4	**Short term provisions**	
	Provision for taxation	1,00,000
		1,00,000
5	**Non-current investments**	
	Investments (market value of ₹9,50,000)	10,00,000
		10,00,000

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to ₹ 40 each.

TELEGRAM: CA NOTE HUB

(ii) All preference shares are reduced to ₹ 60 each.

(iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹100 each and exchange the same for fresh debentures of ₹70 each for every debenture held by them.

(iv) One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.

(v) Property, plant and equipment are to be written down by 30%.

(vi) Current assets are to be revalued at ₹ 45,00,000.

(vii) The taxation liability of the company is settled at ₹ 1,50,000.

(viii) Investments to be brought to their market value.

(ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

Solution: **(10 Marks)**

Journal Entries in the books of Weak Ltd.

			₹	₹
(i)	Equity share capital (₹ 100) A/c	Dr.	1,00,00,000	
	To Equity Share Capital (₹ 40) A/c			40,00,000
	To Capital Reduction A/c			60,00,000
	(Being conversion of equity share capital of ₹ 100 each into ₹ 40 each as per reconstruction scheme)			
(ii)	12% Cumulative Preference Share capital (₹ 100) A/c Dr.	Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (₹ 60) A/c			30,00,000
	To Capital Reduction A/c			20,00,000
	(Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)			
(iii)	10% Debentures A/c	Dr.	40,00,000	
	To 12% Debentures A/c			28,00,000
	To Capital Reduction A/c			12,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Trade payables A/c	Dr.	20,00,000	
	To Equity Share Capital A/c			12,00,000
	To Capital Reduction A/c			8,00,000
	(Being a creditor of ₹ 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	1,00,000	
	Capital Reduction A/c	Dr.	50,000	
	To current assets(bank A/c) A/c			1,50,000
	(Being liability for taxation settled)			

TELEGRAM: CA NOTE HUB

(vi)	Capital Reduction A/c	Dr.	99,00,000	
	To P & L A/c			6,00,000
	To Property, plant and equipment A/c			37,50,000
	To Current Assets A/c			55,00,000
	To Investments A/c			50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, plant and equipment, Current Assets, Investments through capital reduction account)			
(vii)	Capital Reduction A/c	Dr.	50,000	
	To capital Reserve A/c			50,000
	(Being balance in capital reduction account transferred to capital reserve account)			

Balance Sheet of Weak Ltd. (and reduced) as at 31.3.20X1

		Particulars		**Notes**	**₹**
		Equity and Liabilities			
1		**Shareholders' funds**			
	a	Share capital		1	82,00,000
	b	Reserves and Surplus		2	50,000
2		**Non-current liabilities**			
	a	Long-term borrowings		3	28,00,000
3		**Current liabilities**			
	a	Trade Payables			30,00,000
			Total		1,40,50,000
		Assets			
1		**Non-current assets**			
	a	Property, plant and equipment		4	87,50,000
	b	Investments		5	9,50,000
2		**Current assets**		6	43,50,000
			Total		1,40,50,000

Notes to accounts

		₹	**₹**
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	1,30,000 equity shares of ₹ 40 each		52,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	50,000 12% Cumulative Preference shares of ₹ 60 each		30,00,000
	Total		82,00,000

TELEGRAM: CA NOTE HUB

2.	**Reserves and Surplus**		
	Capital Reserve		50,000
3.	**Long-term borrowings**		
	Secured		
	12% Debentures		28,00,000
4.	**Property, plant and Equipment**		
	Total PPE	1,25,00,000	
	Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5.	**Investments**	10,00,000	
	Adjustment under scheme of reconstruction	(50,000)	9,50,000
6.	**Current assets**	45,00,000	
	Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:

Capital Reduction Account

	₹		₹
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative	
To Property, plant		preference share capital	20,00,000
and equipment	37,50,000	By 10% Debentures	12,00,000
To Current assets	55,00,000	By Trade payables	8,00,000
To Investment	50,000		
To Capital Reserve (bal. fig.)	50,000		
	1,00,00,000		1,00,00,000

Illustration 14

The following is the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	36,00,000
	B	Reserves and Surplus	2	(14,40,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	6,00,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
	B	Short term borrowings – Bank overdraft		6,00,000
		Total		36,60,000
		Assets		
1		**Non-current assets**		

TELEGRAM: CA NOTE HUB

	A	Property, plant and equipment	4	30,00,000
	B	Intangible assets	5	90,000
2		**Current assets**		
	a	Inventories		2,60,000
	b	Trade receivables		2,80,000
	C	Cash and cash equivalents		30,000
		Total		36,60,000

Notes to accounts

		₹
1	**Share capital**	
	24,000 Equity Shares of ₹ 100 each	24,00,000
	12,000, 10% Preference Shares of ₹ 100 each	12,00,000
	Total	36,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(14,40,000)
		(14,40,000)
3	**Long-term borrowings**	
	10% debentures	6,00,000
		6,00,000
4.	**Property, plant and Equipment**	
	Land and Building	12,00,000
	Plant and Machinery	18,00,000
		30,00,000
5	**Intangible assets**	
	Goodwill	90,000
		90,000

On the above date, the company adopted the following scheme of reconstruction:

(i) The equity shares are to be reduced to shares of ₹ 40 each fully paid and the preference shares to be reduced to fully paid shares of ₹ 75 each.

(ii) The debenture holders took over Inventories and Trade receivables in full satisfaction of their claims.

(iii) The Land and Building to be appreciated by 30% and Plant and machinery to be depreciated by 30%.

(iv) The debit balance of profit and loss account and intangible assets are to be eliminated.

(v) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above scheme of reconstruction and prepare the reconstructed Balance Sheet.

Solution:

In the books of X Ltd.

Journal Entries

31st March, 20X1			**₹**	**₹**
	Equity Share Capital A/c (₹ 100)	Dr.	24,00,000	

TELEGRAM: CA NOTE HUB

	To Equity Share Capital A/c (₹ 40)			9,60,000
	To Capital Reduction A/c			14,40,000
	(Being 24,000 equity shares of ₹ 100 each reduced to ₹ 40 each fully paid up)			
	10% Preference Share Capital A/c (₹ 100)	Dr.	12,00,000	
	To 10% Preference Share Capital A/c(₹ 75)			9,00,000
	To Capital Reduction A/c			3,00,000
	(Being 12,000 Preference shares of ₹ 100 each reduced to ₹ 75 each fully paid up)			
	10% Debentures A/c	Dr.	6,00,000	
	To Inventories A/c			2,60,000
	To Trade receivables A/c			2,80,000
	To Capital Reduction A/c			60,000
	(Being debenture holders given Inventories and Trade receivables in full settlement of their claims)			
	Land & Building A/c	Dr.	3,60,000	
	To Capital Reduction A/c			3,60,000
	(Being Land & Building appreciated by30%)			
	Capital reduction A/c	Dr.	5,000	
	To Cash A/c			5,000
	(Being expenses of reconstruction paid)			
	Capital Reduction A/c	Dr.	20,70,000	
	To Goodwill A/c			90,000
	To Profit and Loss A/c			14,40,000
	To Plant & Machinery A/c			5,40,000
	(Being various losses written off, assets written down through Capital Reserve A/c)			
	Capital Reduction	Dr.	85,000	
	To Capital Reserve A/c (Bal. Fig.)			85,000
	(Being balance in Capital Reduction A/c transferred to Capital Reserve A/c)			

Balance Sheet (And Reduced) of X Ltd. as at 31st March, 20X1

		Particulars	**Notes No.**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	18,60,000
	b	Reserves and Surplus	2	85,000
2		**Current liabilities**		
	a	Trade Payables		3,00,000
	b	Short term borrowings		6,00,000
		Total		28,45,000

TELEGRAM: CA NOTE HUB

		Assets		
1		**Non-current assets**		
	a	Property, plant and equipment	3	28,20,000
2		**Current assets**		
		Cash and cash equivalents (30,000 -5,000)		25,000
		Total		28,45,000

Notes to accounts

1.	**Share Capital**		**₹**
	Equity share capital		
	24,000 equity shares of ₹ 40 each fully paid up		9,60,000
	Preference share capital		
	12,000, 10% Preference shares of ₹ 75 each fully paid up		9,00,000
	Total		18,60,000
2.	**Reserves and Surplus**		
	Capital Reserve		85,000
3.	**Property, plant and Equipment**		
	Land and Building	15,60,000	
	Plant and Machinery	12,60,000	
	Total		28,20,000

TELEGRAM: CANOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Oct'19, RTP May'18, Nov'19)

M/s Xylem Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses.

The following is the summarized Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital		Land & Building	42,70,000
50,000 shares of Rs. 50		Machinery	8,50,000
each fully paid up	25,00,000	Computers	5,20,000
1,00,000 shares of Rs. 50		Inventories	3,20,000
each Rs. 40 paid up	40,00,000	Trade receivables	10,90,000
Capital Reserve	5,00,000	Cash at Bank	2,68,000
8% Debentures of Rs. 100 each	4,00,000	Profit & Loss Account	29,82,000
12% Debentures of Rs. 100 each	6,00,000		
Trade payables	12,40,000		
Outstanding Expenses	10,60,000		
	1,03,00,000		**1,03,00,000**

Following is the interest of Mr. A and Mr. B in M/s Xylem Limited:

	Mr. A	Mr. B
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	**7,00,000**	**3,00,000**

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of Rs. 40 each.

2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for Rs. 12,50,000.

3) Trade payables are given option of either to accept fully paid equity shares of Rs. 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade payables for Rs. 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.

4) Mr. A agrees to cancel debentures amounting to Rs. 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to Rs. 1,00,000.

5) Mr. B agrees to cancel debentures amounting to Rs. 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

6) Land & Building to be revalued at Rs. 51,84,000, Machinery at Rs. 7,20,000, Computers at Rs. 4,00,000, Inventories at Rs. 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.

7) Outstanding Expenses are fully paid in cash.

8) Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

TELEGRAM: CANOTE HUB

(b) A Liquidator is entitled to receive remuneration at 2% on the assets realized, 3% on the amount distributed to Preferential Creditors and 3% on the payment made to Unsecured Creditors. The assets were realized for Rs. 25,00,000 against which payment was made as follows:

Liquidation expenses	Rs. 25,000
Secured Creditors	Rs. 10,00,000
Preferential Creditors	Rs. 75,000

The amount due to Unsecured Creditors was Rs. 15,00,000. You are asked to calculate the total Remuneration payable to Liquidator. Calculation shall be made to the nearest multiple of a rupee.

Solution: **(15 Marks)**

Journal Entries

		Rs.	Rs.
Bank A/c	Dr	10,00,000	
To Equity share capital A/c			10,00,000
(Being money on final call received)			
Equity share capital (Rs. 50) A/c	Dr	75,00,000	
To Equity share capital (Rs. 40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of Rs. 50 each into Rs. 40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at Rs. 40 each)			
Trade payables A/c	Dr.	12,40,000	
To Equity share capital A/c			7,50,000
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to trade payables in shares or cash to the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To A A/c			7,00,000
(Being cancellation of 8% and 12% debentures of A)			
A A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance Transferred to capital reduction account as per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To A A/c			1,00,000
(Being new debentures subscribed by A)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c	Dr.	2,00,000	
To B A/c			3,00,000
(Being cancellation of 8% and 12% debentures of B)			
B A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and Transferred to capital			

TELEGRAM: CA NOTE HUB

reduction account as per reconstruction scheme)			
Land and Building	Dr		
.(51,84,000 – 42,70,000)		9,14,000	
Inventories	Dr.	30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000
(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Profit and Loss A/c			29,82,000
(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance and downfall in value of other assets)			
Capital Reserve A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being debit balance of capital reduction account adjusted Against capital reserve)			

Balance Sheet of Xylem Ltd. (as reduced) as on 31.3.2019

	Particulars	Notes	Rs.
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	80,00,000
2	**Non-current liabilities**		
a	Long-term borrowings	2	8,50,000
	Total		**88,50,000**
	Assets	3	
1	**Non-current assets**		
a	**Property, Plant and Equipment**		
	Tangible assets		63,04,000
2	**Current assets**		
a	Inventories		3,50,000
b	Trade receivables		9,81,000
c	Cash and cash equivalents		12,15,000
	Total		**88,50,000**

Notes to accounts

			Rs.
1.	**Share Capital**		
	2,00,000 Equity shares of Rs. 40		80,00,000
2.	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3.	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

TELEGRAM: CA NOTE HUB

Working Notes:

1. Cash at Bank Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2,68,000	By Trade payables A/c	3,43,000
To Equity Share capital A/c	10,00,000	By Outstanding expenses, A/c	10,60,000
To Equity Share Capital A/c	12,50,000	By Balance c/d (bal. fig.)	12,15,000
To A A/c	1,00,000		
	26,18,000		26,18,000

2. Capital Reduction Account

Particulars	Rs.	Particulars	Rs.
To Machinery A/c	1,30,000	By Equity Share Capital A/c	15,00,000
To Computers A/c	1,20,000	By Trade payables A/c	1,47,000
To Trade receivables A/c	1,09,000	By A A/c	2,00,000
To Profit and Loss A/c	29,82,000	By B A/c	50,000
		By Land & Building	9,14,000
		By Inventories	30,000
		By Capital Reserve A/c 5,00,000	
	33,41,000		**33,41,000**

(b) Calculation of Total Remuneration payable to Liquidator

		Amount in Rs.
2% on Assets realised	25,00,000 x 2%	50,000
3% on payment made to Preferential creditors	75,000 x 3%	2,250
3% on payment made to Unsecured creditors (Refer W.N)		39,255
Total Remuneration payable to Liquidator		91,505

Working Note:

Liquidator's remuneration on payment to unsecured creditors = Cash available for unsecured creditors after all payments including liquidation expenses, payment to secured creditors, preferential creditors & liquidator's remuneration

= Rs. 25,00,000 – Rs. 25,000 – Rs. 10,00,000 – Rs. 75,000 – Rs. 50,000 – Rs. 2,250 = Rs. 13,47,750.

Liquidator's remuneration on payment to unsecured creditors = 3/103 x Rs. 13,47,750 = Rs. 39,255.

Question 2 (MTP Mar'19)

The shareholders of Lili Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2017 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Lili Ltd.

Summarized Balance Sheet of Lili Ltd. as on 31.3.2017

Liabilities	Rs.	Assets	Rs.
Share Capital		Property, Plant & Equipment	
30,000 Equity shares of Rs. 10 each	3,00,000	Trademarks and Patents	1,10,000
40,000 8% Cumulative Preference		Goodwill at cost	36,100
shares Rs. 10 each	4,00,000	Freehold Land	1,20,000
Reserves and Surplus		Freehold Premises	2,44,000
Securities Premium Account	10,000	Plant and Equipment Investment	3,20,000
Profit and Loss Account	(1,38,400)	Investment (marked to market)	64,000

TELEGRAM: CA NOTE HUB

Secured Borrowings		Current Assets	
9% Debentures (Rs. 100)	1,20,000	Inventories:	
Accrued Interest 5,400	1,25,400	Raw materials and packing materials 60,000	
Current liabilities Trade payables	1,20,000	Finished goods 16,000	76,000
Tax payable	50,000		
Temporary bank overdraft	2,23,100	Trade receivables	1,20,000
	10,90,100		**10,90,100**

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

1) The authorized capital of the Company to be re-fixed at Rs. 10 lakhs (preference capital of Rs. 3 lakhs and equity capital of Rs. 7 lakhs). Both classes of shares are of Rs. 10 each.

2) The preference shares are to be reduced to Rs. 5 each and equity shares reduced by Rs. 3 per share. Post reduction, both classes of shares to be re-consolidated into Rs. 10 shares.

3) Trade Investments are to be liquidated in open market.

4) One fresh equity shares of Rs.10 to be issued for every Rs.40 of preference dividends in arrears (ignore taxation).

5) Expenses for the scheme were Rs. 10,000.

6) The debenture holders took over freehold land at Rs. 2,10,000 and settled the balance after adjusting their dues.

7) Unprovided contingent liabilities were settled at Rs. 54,000 and a pending insurance claim receivable settled at Rs. 12,500.

8) The intangible assets were all to be written off along with Rs. 10,000 worth obsolete packing material and 10% of the receivables.

9) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.

10) The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.

Solution:

(i) In the books of Lili Ltd. Journal Entries

				Dr.	**Cr.**
	2017			**Rs.**	**Rs.**
1.	March 31	Equity Share Capital A/c (Rs.10)	Dr.	3,00,000	
		To Capital Reduction A/c			90,000
		To Equity Share Capital A/c (Rs.7)			2,10,000
		(Being reduction of equity shares of Rs.10 each to shares of Rs. 7 each as per Reconstruction Scheme dated...)			
2		8% Cum. Preference Share Capital A/c (Rs. 10)	Dr.	4,00,000	
		To Capital Reduction A/c			2,00,000
		To Preference Share Capital A/c (Rs. 5)			2,00,000
		(Being reduction of preference shares of Rs.10 each to shares of Rs.5 each as per reconstruction scheme)			
3.		Equity Share Capital A/c (30,000 x Rs.7)	Dr.	2,10,000	
		Preference Share Capital A/c (40,000 x Rs.5)	Dr.	2,00,000	
		To Equity Share Capital A/c (21,000 x Rs. 10)			

TELEGRAM: CA NOTE HUB

				2,10,000
		To Preference Share Capital A/c (20,000 x Rs.10)		2,00,000
		(Being post reduction, both classes of shares reconsolidated into Rs.10 each) s		
4.		Cash Account Dr.	64,000	
		To Trade Investments		64,000
		(Being trade investments liquidated in the open market)		
5.		Capital Reduction Account Dr.	32,000	
		To Equity Share Capital Account		32,000
		(Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of Rs.10 each)		
6.		Capital Reduction Account Dr.	10,000	
		To Cash Account		10,000
		(Being expenses of reconstruction scheme paid in cash)		
7.		9% Debentures Account Dr.	1,20,000	
		Accrued Interest Account Dr.	5,400	
		To Debenture holders Account		1,25,400
		(Being amount due to debenture holders)		
8.		Debenture holders Account Dr.	1,25,400	
		Cash Account (2,10,000 – 1,25,400) Dr.	84,600	
		To Freehold Land		1,20,000
		To Capital Reduction Account (2,10,000 – 1,20,000)		90,000
		(Being Debenture holders took over freehold land at Rs.2,10,000 and settled the balance)		
9.		Capital Reduction Account Dr.	54,000	
		To Cash Account		54,000
		(Being contingent liability of Rs.54,000 paid)		
10		Cash Account Dr.	12,500	
		To Capital Reduction Account		12,500
		(Being pending insurance claim received)		
11		Capital Reduction Account Dr.	1,68,100	
		To Trademarks and Patents		1,10,000
		To Goodwill		36,100
		To Raw materials & Packing materials		10,000
		To Trade receivables		12,000
		(Being intangible assets written off along with raw materials and packing materials worth Rs.10,000 and 10% of trade receivables)		
12		Cash Account Dr.	1,26,000	
		To Equity Share Capital Account		1,26,000
		(Being 12,600 shares issued to existing shareholders)		
13		Bank Overdraft Account Dr.	2,23,100	
		To Cash Account		2,23,100
		(Being cash balance utilized to pay off bank overdraft)		
14		Capital Reduction Account Dr.	1,28,400	
		To Capital reserve Account		1,28,400
		(Being balance of capital reduction account transferred to capital reserve account)		

(ii) Capital Reduction Account

Particulars	Rs.	Particulars	Rs.

TELEGRAM: CANOTE HUB

To Equity share capital	32,000	By Preference share capital	2,00,000
To Cash (contingent liability settled)	54,000	By Equity share capital	90,000
To Trademarks and Patents	1,10,000	By Freehold land	90,000
To Goodwill	36,100	By Cash (insurance claim)	12,500
To Raw material and Packing materials	10,000		
To Trade receivables	12,000		
To Cash account	10,000		
To Capital reserve account	1,28,400		
	3,92,500		**3,92,500**

(iii) Cash Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Investment	64,000	By Capital reduction	
To 9% Debenture holders		(Contingent liability)	54,000
(2,10,000-1,25,400)	84,600	By Expenses	10,000
To Capital reduction (insurance claim)	12,500	By Temporary bank overdraft	
		- From available cash	
		(64,000+84,600+12,500	
		-54,000-10,000)	97,100
To Equity share capital 12,600		- From proceeds of equity share capital	
shares @ Rs. 10 each	1,26,000		
		(2,23,100–97,100) 1,26,000	2,23,100
	2,87,100		**2,87,100**

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft = Rs. 2,23,100 – Rs. 97,100 = Rs. 1,26,000

Question 3 (MTP Mar'18, Apr'21, RTP May'19)

The Balance Sheet of Lion Limited as on 31-03-2018 is given below:

Particulars	**Note No.**	**Amount (₹ in lakh)**
Equity & Liabilities		
Shareholders' Funds		
Shares' Capital	1	1,400
Reserves & Surplus	2	(522)
Non-Current Liabilities		
Long term Borrowings	3	700
Current Liabilities		
Trade Payables	4	102
Other Liabilities	5	24
Total		**1704**
Assets		
Non-Current Assets		
PPE		
Tangible Assets	6	750
Current Assets		
Current Investments	7	200
Inventories	8	300
Trade Receivables	9	450

TELEGRAM: CA NOTE HUB

Cash & Cash Equivalents	10	4
Total		**1704**

Notes to Accounts:

			₹ in Lakhs
(1)	Share Capital		
	Authorised :		
	200 lakh shares of ₹ 10 each		2,000
	8 lakh, 8% Preference Shares of ₹ 100 each		800
			2,800
	Issued, Subscribed and paid up:		
	100 lakh Equity Shares of ₹ 10 each, full paid up		1,000
	4 lakh 8% Preference Shares of ₹ 100 each, fully paid up		400
	Total		1400
(2)	Reserves and Surplus		
	Debit balance of Profit & Loss A/c		(522)
(3)	Long Term Borrowings		
	6% Debentures (Secured by Freehold Property)		400
	Directors' Loan		300
			700
(4)	Trade Payables		
	Trade payables for Goods		102
(5)	Other Current Liabilities		
	Interest Accrued and Due on 6% Debentures		24
(6)	Tangible Assets		
	Freehold Property		550
	Plant & Machinery		200
			750
(7)	Current Investment		
	Investment in Equity Instruments		200
(8)	Inventories		
	Finished Goods		300
(9)	Trade Receivables		
	Trade receivables for Goods		450
(10)	Cash and Cash Equivalents		
	Balance with Bank		4

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

1) Preference Shares are to be written down to Rs. 80 each and Equity Shares to Rs. 2 each.

2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of Rs. 2 each to be allotted.

3) Debenture holders agreed to take one Freehold Property at its book value of Rs. 300 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.

4) Interest accrued and due on Debentures to be paid in cash.

5) Remaining Freehold Property to be valued at Rs. 400 lakh.

6) All investments sold out for Rs. 250 lakh.

TELEGRAM: CA NOTE HUB

7) 70% of Directors' loan to be waived and for the balance, Equity Shares of Rs. 2 each to be allowed.

8) 40% of Trade receivables and 80% of Inventories to be written off.

9) Company's contractual commitments amounting to Rs. 600 lakh have been settled by paying 5% penalty of contract value.

You are required to :

a) Pass Journal Entries for all the transactions related to internal reconstruction;

b) Prepare Reconstruction Account; and

c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction. **(15 Marks)**

Solution:

Journal Entries in the books of Lion Ltd.

Particulars		**Debit (Rs. in lakhs)**	**Credit (Rs. in lakhs)**
8% Preference share capital A/c (Rs. 100 each)	Dr.	400	
To 8% Preference share capital A/c (Rs. 80 each)			320
To Capital Reduction A/c			80
(Being the preference shares of Rs. 100 each reduced to Rs. 80 each as per the approved scheme)			
Equity share capital A/c (Rs. 10 each)	Dr.	1,000	
To Equity share capital A/c (Rs. 2 each)			200
To Capital Reduction A/c			800
(Being the equity shares of Rs. 10 each reduced to Rs. 2 each)			
Capital Reduction A/c	Dr.	32	
To Equity share capital A/c (Rs. 2 each)			32
(Being 1/3rd arrears of preference share dividend of 3 years to be satisfied by issue of 16 lakhs equity shares of Rs. 2 each)			
6% Debentures A/c	Dr.	300	
To Freehold property A/c			300
(Being claim of Debenture holders settled in part by transfer of freehold property)			
Accrued debenture interest A/c	Dr.	24	
To Bank A/c			24
(Being accrued debenture interest paid)			
Freehold property A/c	Dr.	150	
To Capital Reduction A/c			150
(Being appreciation in the value of freehold property)			
Bank A/c	Dr.	250	
To Investments A/c			200
To Capital Reduction A/c			50
(Being investment sold at profit)			
Director's loan A/c	Dr.	300	
To Equity share capital A/c (Rs. 2 each)			90
To Capital Reduction A/c			210
(Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of Rs. 2 each)			
Capital Reduction A/c	Dr.	972	

TELEGRAM: CA NOTE HUB

	To Profit and loss A/c		522
	To Trade receivables A/c (450 x 40%)		180
	To Inventories-in-trade A/c (300x 80%)		240
	To Bank A/c (600 x 5%)		30
(Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written of through Capital Reduction Account)			

(x)

Capital Reduction A/c	286	
To Capital reserve A/c		286
(Being balance transferred to capital reserve account as per the scheme)		

Capital Reduction Account

	Dr. (Rs. in lakhs)		Cr. (Rs. in lakhs)
To Equity Share Capital	32	By Preference Share Capital	80
To Trade receivables	180	By Equity Share Capital	800
To Finished Goods	240	By Freehold Property	150
To Profit & Loss A/c	522	By Bank	50
To Bank A/c	30	By Director's Loan	210
To Capital Reserve	286		
	1,290		**1,290**

Notes to Balance Sheet

		(Rs. in lakhs)	(Rs. in lakhs)
1.	Share Capital		
	Authorized:		
	200 lakhs Equity shares of Rs. 2 each		400
	8 lakhs 8% Preference shares of Rs. 80 each		640
			1,040
	Issued:		
	161 lakhs equity shares of Rs. 2 each		322
	4 lakhs Preference Shares of Rs. 80 each		320
			642
2.	Tangible Assets		
	Freehold Property	550	
	Less: Utilized to pay Debenture holders	(300)	
		250	
	Add: Appreciation	150	400
	Plant and Machinery		200
			600

Question 4 (RTP May'20)

The following is the Balance Sheet of Star Ltd. as on 31st March, 2019: Rs.

				Rs.
A.			**Equity & Liabilities**	

TELEGRAM: CA NOTE HUB

	1.		**Shareholders' Fund:**	
		(a)	**Share Capital:**	
			9,000 7% Preference Shares of Rs. 100 each fully paid	9,00,000
			10,000 Equity Shares of Rs. 100 each fully paid	10,00,000
		(b)	**Reserve & Surplus:**	
			Profit & Loss Account	(2,00,000)
	2.		**Non-current liabilities:**	
			"A" 6% Debentures (Secured on Bombay Works)	3,00,000
			"B" 6% Debentures (Secured on Chennai Works)	3,50,000
	3.		**Current Liabilities and Provisions:**	
		(a)	Workmen's Compensation Fund:	
			Bombay Works	10,000
			Chennai Works	5,000
		(b)	Trade Payables	1,25,000
			Total	24,90,000
B.			**Assets:**	
			Non- current Assets:	
	1.		**PPE**:	
			Bombay Works	9,50,000
			Chennai Works	7,75,000
	2.		**Investment:**	
			Investments for Workman's Compensation Fund	15,000
	3.		**Current Assets:**	
		(a)	Inventories	4,50,000
		(b)	Trade Receivables	2,50,000
		(c)	Cash at Bank	50,000
				24,90,000

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were as follows:

(i) Paid up value of 7% Preference Share to be reduced to Rs. 80, but the rate of dividend being raised to 9%.

(ii) Paid up value of Equity Shares to be reduced to Rs. 10.

(iii) The directors to refund Rs. 50,000 of the fees previously received by them.

(iv) Debenture holders forego their interest of Rs. 26,000 which is included among the trade payables.

(v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.

(vi) "B" 6% Debenture holders agreed to take over the Chennai Works at Rs. 4,25,000 and to accept an allotment of 1,500 equity shares of Rs. 10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai Works) they allotted 9,000 equity shares of Rs. 10 each fully paid at par to Star Ltd.

(vii) The Chennai Worksmen's compensation fund disclosed that there were actual liabilities of Rs. 1,000 only. As a consequence, the investments of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.

(viii) Inventory was to be written off by Rs. 1,90,000 and a provision for doubtful debts is to be made to the extent of Rs. 20,000.

(ix) Chennai works completely written off.

TELEGRAM: CANOTE HUB

(x) Any balance of the Capital Reduction Account is to be applied as two-third to write off the value of Bombay Works and one-third to Capital Reserve.

Pass necessary Journal Entries in the books of Star Ltd. after the scheme has been carried into effect.

Solution:

In the books of Star Ltd. Journal Entries

	Particulars		**Amount**	**Amount**
			Rs.	**Rs.**
(i)	7% Preference share capital (Rs. 100)	Dr.	9,00,000	
	To 9% Preference share capital (Rs. 80)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being preference shares reduced to Rs.80 and also rate of dividend raised from 7% to 9%)			
(ii)	Equity share capital A/c (Rs. 100 each)	Dr.	10,00,000	
	To Equity share capital A/c (Rs. 10 each)			1,00,000
	To Capital reduction A/c			9,00,000
	(Being reduction of nominal value of one share of Rs. 100 each to Rs. 10 each)			
(iii)	Bank A/c	Dr.	50,000	
	To Capital reduction A/c			50,000
	(Being directors refunded the fee amount)			
(iv)	Trade payables A/c (Interest on debentures)	Dr.	26,000	
	To Capital reduction A/c			26,000
	(Being interest forgone by the debenture holders)			
(v)	No entry required			
(vi)	a 'B' 6% Debentures A/c	Dr.	3,50,000	
	To Debentures holders A/c			3,50,000
	(Being amount due to Debentures holders)			
	b Debentures holders A/c	Dr.	4,40,000	
	To Chennai Works A/c			4,25,000
	To Equity share capital A/c			15,000
	(Being Chennai works taken over and equity shares			
	issued to 'B' 6% Debenture holders)			
	c Equity share of Zia ltd. A/c	Dr.	90,000	
	To Debentures holders A/c			90,000
	(Being 9,000 equity shares of Zia Ltd. issued by Debentures holders)			
(vii)	a Chennai Works – Workmen Compensation Fund	Dr.	4,000	
	To Capital reduction A/c			4,000
	(Being difference due to reduced amount of actual liability transferred to capital reduction account)			
	b Bank A/c	Dr.	15,400	
	To Investment for Workmen Compensation Fund			14,000
	To Capital reduction A/c			1,400
	(Being investment for Workmen Compensation Fund sold @ 10% profit)			
	c Trade Payables A/c	Dr.	15,400	
	To Bank A/c			15,400
	(Being part payment made to trade payables)			
(viii)	Capital reduction A/c	Dr.	2,10,000	
	To Provision for Doubtful Debts A/c			20,000
	To Inventory A/c			1,90,000
	(Being assets revalued)			

TELEGRAM: CA NOTE HUB

(ix)	Capital reduction A/c	Dr.	5,50,000	
	To Profit & Loss A/c			2,00,000
	To PPE – Chennai Works			3,50,000
	(Being assets revalued and losses written off)			
(x)	Capital reduction A/c	Dr.	4,01,400	
	To PPE – Bombay Works			2,67,600
	To Capital reserve A/c			1,33,800
	(Being assets revalued and remaining amount transferred to capital reserve account)			

Question 5 (RTP Nov'18, RTP Nov'20, May'22)

The summarized balance sheet of Z Limited as on 31st March, 2017 is as under:

Liabilities	**Amount in Rs.**
Share Capital:	
5,00,000 Equity shares of Rs. 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of Rs. 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account	(14,60,000)
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Total	**81,00,000**
Assets:	
Non-Current Assets:	
Property, Plant & Equipment:	
(a) Tangible Assets:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
(b) Intangible Assets:	
Goodwill	10,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000
Discount on issue of debentures	1,00,000
Total	**81,00,000**

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover Rs.1,00,000 and Rs. 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares to be converted into fully paid equity shares of Rs. 5.00 each.

TELEGRAM: CANOTE HUB

(ii) The Preference shares be reduced to Rs. 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay Rs. 1,00,000 and Rs. 60,000 respectively in cash and to receive new 12% debentures for the balance amount.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of Rs. 3.00 lacs were cancelled on payment of Rs. 15,000 as penalty.

(vii) Directors refunded Rs. 1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid Rs. 15,000.

(ix) The taxation liability of the company was settled for Rs 75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to prepare necessary journal entries for all the above-mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit and Loss account arid Discount on issue of debentures. And also prepare Bank Account and Reconstruction Account

Solution:

Journal Entries in the Books of Z Ltd.

			Dr. Rs.	Cr. Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs. 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs. 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being Rs. 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	

TELEGRAM: CA NOTE HUB

	Trade Payables	Dr.	60,000	
	Interest on debentures outstanding A/c	Dr.	64,000	
	Bank A/c	Dr.	60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being Rs. 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (Rs. 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of Rs. 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c)			
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
(xii)	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Discount on issue of Debentures A/c			1,00,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

	Rs.		Rs.

TELEGRAM: CANOTE HUB

To Reconstruction (Y)	1,00,000	By Balance b/d	1,00,000
To Reconstruction(Z)	60,000	By Reconstruction A/c	15,000
To Reconstruction A/c		(capital commitment penalty paid)	
(refund of earlier fees by directors)	1,00,000	By Reconstruction A/c (reconstruction expenses paid)	15,000
		By Provision for tax A/c(tax paid)	75,000
		By Balance c/d	55,000
	2,60,000		**2,60,000**

Reconstruction Account

	Rs.		**Rs.**
To Bank (penalty)	15,000	By Equity Share	
To Bank (reconstruction expenses)	15,000	Capital A/c	25,00,000
To Goodwill	10,00,000	By 9% Pref. Share	
To Patent	5,00,000	Capital A/c	10,00,000
To P & L A/c	14,60,000	By Mr. Y (Settlement)	5,78,000
To Discount on issue of debentures	1,00,000	By Mr. Z (Settlement)	3,82,000
To P & M	6,50,000	By Trade Payables A/c	1,70,000
To Furniture and Fixtures	1,00,000	By Director's loan	60,000
To Trade investment	50,000	By Bank	1,00,000
To Inventory	2,50,000	By Provision for tax	25,000
To Trade Receivables	1,00,000	By Land and Building	2,00,000
To Capital Reserve (bal. fig.)	7,75,000		
	50,15,000		**50,15,000**

Question 6 (Past Exam July'21)

Sapra Limited has laid down the following terms upon the sanction of the reconstruction scheme by the court.

(i) The shareholders to receive in lieu of their present holding at 7,50,000 shares of ₹ 10 each, the following:

- New fully paid ₹ 10 Equity Shares equal to 3/5th of their holding.
- Fully paid ₹ 10, 6% Preference Shares to the extent of 2/5th of the above new equity shares.
- 7% Debentures of ₹ 250,000.

(ii) Goodwill which stood at ₹ 2,70,000 is to be completely written off.

(iii) Plant & Machinery to be reduced by ₹ 1,00,000, Furniture to be reduced by ₹ 88,000 and Building to be appreciated by ₹ 1,50,000.

(iv) Investment of ₹ 6,00,000 to be brought down to its existing market price of ₹ 1,80,000.

(v) Write off Profit & Loss Account debit balance of ₹ 2,25,000.

In case of any shortfall, the balance of General Reserve of ₹ 42,000 can be utilized to write off the losses under reconstruction scheme.

You are required to show the necessary Journal Entries in the books of Sapra Limited of the above reconstruction scheme considering that balance in General Reserve is utilized to write off the losses.

Solution: **(5 Marks)**

Journal Entries

	₹	**₹**

TELEGRAM: CA NOTE HUB

Equity Share Capital (old) A/c	Dr.	75,00,000	
To Equity Share Capital (₹ 10) A/c			45,00,000
To 6% Preference Share Capital (₹ 10) A/c			18,00,000
To 7% Debentures A/c			2,50,000
To Capital Reduction A/c			9,50,000
(Being new equity shares, 6% Preference Shares, 7% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
Building A/c	Dr.	1,50,000	
Capital Reduction A/c	Dr.	9,53,000	
To Goodwill Account			2,70,000
To Plant and Machinery Account			1,00,000
To Furniture Account			88,000
To Investment A/c			4,20,000
To Profit & Loss A/c			2,25,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery, furniture, investment and Profit & Loss as per the scheme)			
General reserve A/c	Dr.	3,000	
To Capital Reduction A/c			3,000
(Being general reserve utilized to write off the balance in Capital reduction A/c)			

Note: In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used in the above journal entries.

Question 7 (Past Exam Nov'22)

The following is the Balance Sheet of Purple Limited as at 31st March, 2022:

Particulars	**Notes**	**Amount in ₹**
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	15,00,000
(b) Reserves & Surplus	2	(3,00,000)
(2) Current Liabilities		
(a) Trade Payables		2,20,000
(b) Short Term Borrowings – Bank Overdraft 2,00,000		
Total		**16,20,000**
II. Assets		
(1) Non-Current Assets		
(a) Property, Plant and Equipment	3	10,20,000
(b) Intangible Assets	4	1,20,600
(2) Current Assets		
(a) Inventories		1,70,000
(b) Trade Receivables		3,01,800
(c) Cash and cash equivalents		7,600
Total		**16,20,000**

Notes to Accounts

	₹	₹
(1) Share Capital		
90,000 Equity Shares of ₹ 10 each fully paid	9,00,000	

TELEGRAM: CA NOTE HUB

6% Preference Share Capital	6,00,000	15,00,000
(2) Reserves & Surplus		
Profit & Loss account		(3,00,000)
(3) Property, Plant and Equipment		
Land and Building	5,40,000	
Plant and Machinery	4,80,000	10,20,000
(4) Intangible Assets		
Goodwill	84,600	
Patents	36,000	1,20,600

Dividends on preference shares are in arrears for 3 years.

On the above date, the company adopted the following scheme of reconstruction:

(i) The preference shares are converted from 6% to 8% but revalued in a manner in which the total return on them remains unaffected.

(ii) The value of equity shares is brought down to ₹ 8 per share;

(iii) The arrears of dividend on preference shares are cancelled.

(iv) The debit balance of Goodwill account is written off entirely.

(v) Land and Building and Plant and Machinery are revalued at 85% and 80% of their respective book values.

(vi) Book debts amounting to ₹ 14,400 are to be treated as bad and hence to be written off;

(vii) The company expects to earn a profit at the rate of ₹ 90,000 per annum from the current year which would be utilized entirely for reducing the debit balance of Profit and loss accounts for 3 years. The remaining balance of the said account would be written off at the time of capital reduction process.

(viii) The balance of total capital reduction is to be utilized in writing down Patents.

(ix) A secured loan of ₹ 4,80,000 bearing interest at 12% per annum is to be obtained by mortgaging tangible fixed assets for repayment of bank overdraft and for providing additional funds for working capital.

You are required to give journal entries incorporating the above scheme of reconstruction, capital reduction account and prepare the reconstructed Balance Sheet. **(20 Marks)**

Solution:

	Particulars	**Debit**	**Credit**
		(₹)	**(₹)**
1.	6% Preference share capital A/c Dr.	6,00,000	
	To 8% Preference share capital A/c		4,50,000
	To Capital reduction A/c		1,50,000
	(Being 6% preference shares converted to 8% preference shares so that return to pref. shareholders remains unaffected)		
2.	Equity share capital A/c (₹ 10) Dr.	9,00,000	
	To Equity share capital A/c (₹ 8)		7,20,000
	To Capital reduction A/c		1,80,000
	(Being equity capital reduced to nominal value of ₹ 8 each)		
3.	Capital Reduction A/c Dr.	3,30,000	
	To Goodwill A/c		84,600
	To Land and Building A/c		81,000
	To Plant and Machinery A/c		96,000
	To Trade Receivables A/c (Book debts)		14,400
	To Patents A/c (Bal. fig.)		24,000

TELEGRAM: CA NOTE HUB

	To Profit and loss A/c		30,000
	(Being losses and assets written off to the extent required)		
4.	Bank A/c Dr.	4,80,000	
	To Bank Loan A/c		4,80,000
	(Being Loan taken)		
5.	Bank overdraft A/c Dr.	2,00,000	
	To Bank A/c		2,00,000
	(Being Bank overdraft repaid)		

Capital Reduction Account

Particulars	₹	Particulars	₹
To Goodwill A/c	84,600	By Equity Share Capital A/c	1,80,000
To Land & Building A/c	81,000	By 6% Preference Share Capital A/c	1,50,000
To Plant and Machinery, A/c	96,000		
To Trade receivables (Book Debts) A/c	14,400		
To Profit & Loss A/c	30,000		
To Patents A/c (Bal. fig.)	24,000		
	3,30,000		3,30,000

Balance Sheet of Purple Ltd. (and reduced) as at 31.3.2022

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
	a Share capital	1	11,70,000
	b Reserves and surplus	2	(2,70,000)
2	Current liabilities		
	a Short term borrowings (Secured Bank Loan)		4,80,000
	b Trade Payables		2,20,000
	Total		16,00,000
	Assets		
1	Non-current assets		
	a Property, plant and equipment	3	8,43,000
	b Intangible assets	4	12,000
2	Current Assets		
	a Inventory		1,70,000
	b Trade receivables	5	2,87,400
	c Cash and cash equivalents (7,600+4,80,000-2,00,000)		2,87,600
	Total		16,00,000

Notes to Accounts:

			₹
1.	Share Capital		
	Authorized		
	Issued, subscribed and paid up:		
	90,000 equity shares of ₹ 8 each fully paid	7,20,000	
	8% Preference share capital*	4,50,000	11,70,000
2.	Reserves and Surplus		
	Profit and Loss Account (Dr. balance)	(2,70,000)	

TELEGRAM: CA NOTE HUB

3.	Property plant and equipment		
	Land and Building	4,59,000	
	Plant and Machinery	3,84,000	8,43,000
4.	Intangible assets		
	Patent ₹ (36,000 - 24,000)		12,000
5.	Trade Receivables		
	Sundry Debtors	3,01,800	
	Less: Bad debts	(14,400)	2,87,400

Note: *Face value of preference share is not given in the question (pre and post reconstruction) and hence any suitable value of preference share may be assumed.

Working Notes:

1. Calculation of new Preference Shares

Rate of return : 6% on Preference Shares

Dividend :	(6/100) x ₹ 6,00,000	= ₹ 36,000
Rate of return :	8% on Preference Shares	
Dividend :	(8/100) x X =	₹ 36,000
	X = (36,000/8) x 100 =	₹ 4,50,000
New Preference Share Capital	=	₹ 4,50,000
Old Preference Share Capital	=	₹ 6,00,000
(6,00,000 – 4,50,000)	=	₹ 1,50,000 Amount taken to Capital Reduction A/c.

2. Since the company expects to earn a profit of ₹ 90,000 p;a; consecutively for three years and it shall be used to write-off debit balance of P & L account, hence ₹ 2,70,000 being loss shall be shown in the Balance Sheet under Reserve & Surplus head and ₹ 30,000 shall be written- off from Capital Reduction A/c.

3. Calculation of Amount written off on Land & Building and Plant & Machinery

Land & Building	= (85/100) x 5,40,000	= ₹ 4,59,000
Plant & Machinery	= (80/100) x 4,80,000	= ₹ 3,84,000
Reduced by:		
Land & Building	= (5,40,000 - 4,59,000)	= ₹ 81,000
Plant & Machinery	= (4,80,000 - 3,84,000)	= ₹ 96,000

Question 8 (Past Exam May'23)

X Ltd. had ₹ 1,00,000 equity share capital divided into 1,000 shares of ₹ 100 each out of which ₹ 80 per share was called up and paid up. It has 1,500 cumulative preference shares of ₹ 100 each fully paid up. Intangible assets include Goodwill of ₹ 80,000 and patents of ₹ 27,800. Preference dividends are in arrears of ₹ 33,000.

You are required to show the entries (Ignore dates) under each of the following conditions:

(i) If X Ltd. resolves to subdivide the equity shares into 10,000 equity shares of ₹ 10 each of which ₹ 8 per share is called up and paid up.

(ii) If X Ltd. resolves to convert its 1,000 equity shares of ₹ 100 each (assume fully - paid) into ₹ 1,00,000 worth of stock.

(iii) The preference shares are to be converted into 11% unsecured debentures of ₹ 100 each (including arrears of dividends).

(iv) Patents and Goodwill to be written-off. **(5 Marks)**

TELEGRAM: CA NOTE HUB

Solution:

Journal Entries in the books of X Ltd.

			₹	₹
(i)	Equity Share Capital (₹ 100) A/c	Dr.	80,000	
	To Equity Share Capital (₹ 10) A/c			80,000
	(Being the sub-division of 1,000 shares of ₹ 100 each with ₹ 80 paid up into 10,000 shares ₹ 10 each with ₹ 8 paid up by resolution in general meeting dated....)			
(ii)	Equity Share Capital (₹ 100) A/c	Dr	1,00,000	
	To Equity Stock A/c			1,00,000
	Being conversion of 1,000 fully paid Equity Shares of ₹ 100 into ₹ 1,00,000 Equity Stock as per resolution in general meeting dated)			
(iii)	Cumulative Preference Share Capital A/c	Dr.	1,50,000	
	Capital Reduction (Reconstruction) A/c	Dr	33,000	
	To 11% Debentures (Unsecured)			1,83,000
	(Being 1,500 cumulative preference shares of ₹ 100 each fully paid up converted into 11% debentures of ₹ 100 each (including arrears of dividends amounting ₹ 33,000)			
(iv)	Capital Reduction (Reconstruction) A/c		1,07,800	
	To Goodwill			80,000
	To Patents (Writing off patents, goodwill)			27,800

Question 9 (RTP Nov'23)

Following information from Balance Sheet of Ruby Limited as on 31st March, 2023.

	Amount ₹
Authorised and Issued equity share capital:	
60,000 shares of ₹ 100 each fully paid	60,00,000
40,000 7% cumulative preference shares of ₹ 100 each fully paid	40,00,000
General Reserve	12,00,000
Loan from Director	8,80,000
Trade Payables	49,20,000
Outstanding expenses	6,40,000
Bank loan	6,00,000
Patent	8,00,000
Plant & machinery	60,00,000
Building	11,00,000
Trade receivables	47,00,000
Inventory	32,60,000
Cash	2,40,000
Bank Balance	4,60,000
Profit and Loss account	16,80,000

Note: The arrears of preference dividend amount to ₹ 5,60,000;

The company had suffered losses since last 3 years due to bad market conditions and hope for a better position in the future.

The following scheme of reconstruction has been agreed upon and duly approved by all concerned:

TELEGRAM: CA NOTE HUB

1) Equity shares to be converted into 6,00,000 shares of ₹ 10 each;
2) Equity shareholders to surrender to the company 80 percent of their holdings.
3) Preference shareholders agree to forgo their right on arrears of dividends in consideration of which 7% preference shares are to be converted into 8% preference shares.
4) Trade payables agree to reduce their claim by one fourth in consideration of their getting shares of ₹ 10,00,000 out of the surrendered equity shares;
5) Directors agree to forego the amounts due on account of loan.
6) Surrendered shares not otherwise utilized to be cancelled.
7) Assets to be reduced as under:

	₹
Patent to	Nil
Plant & Machinery by	8,00,000
Inventory by	6,80,000

8) Trade receivables to the extent of ₹ 34,00,000 are considered good;
9) Revalued figures for building is accepted at ₹ 14,00,000;
10) Bank loan is paid.
11) Any surplus after meeting the losses should be utilized in writing down the value of the plant further.
12) Expenses of reconstruction amounted to ₹ 1,20,000;
13) Further 80,000 equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid up.

You are required to pass the Journal Entries for giving effect to the above arrangement and also to draw up the resultant Balance Sheet of the Company.

Solution:

Books of Ruby Ltd.
Journal Entries

Particulars		**Debit (₹)**	**Credit (₹)**
Equity Share Capital (₹ 100 each) a/c	Dr	60,00,000	
To Equity share capital (₹ 10 each) A/c			60,00,000
(Sub division of equity share into ₹ 10 each)			
Equity Share Capital (₹ 10) A/c	Dr.	48,00,000	
To Share surrendered A/c			48,00,000
(Surrender of 80% of share holding by equity share			
holders)			
7% Cumulative preference share capital A/c	Dr.	40,00,000	
To 8% cumulative preference share capital A/c			40,00,000
(Conversion of 7% Cumulative Preference share capital into 8% Cumulative Preference share capital. They also forgo their right to arrears of dividends)			
Shares Surrendered A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Surrendered share issued against trade payables under reconstruction scheme)			
Bank loan A/c	Dr.	6,00,000	
Expenses of reconstruction A/c	Dr.	1,20,000	
To Bank A/c			7,20,000
(Bank loan and reconstruction expenses paid)			
Share surrendered A/c	Dr.	38,00,000	

TELEGRAM: CA NOTE HUB

To Capital Reduction A/c			38,00,000
(Cancellation of unissued surrendered shares) (48,00,000-10,00,000)			
Loan from Director A/c	Dr.	8,80,000	
Trade Payables A/c	Dr.	12,30,000	
Building A/c	Dr.	3,00,000	
To Capital reduction A/c			24,10,000
(Amount sacrificed by directors and trade payables and appreciation in value of building)			
Capital reduction A/c	Dr.	62,10,000	
To Patent A/c			8,00,000
To Trade receivables A/c			13,00,000
To Inventory A/c			6,80,000
To Profit and Loss A/c			16,80,000
To Expenses on Reconstruction A/c			1,20,000
To Plant A/c (bal. fig) (8,00,000+8,30,000)			16,30,000
(Various assets and expenses written off)			
Bank A/c	Dr.	8,00,000	
To Share application money A/c			8,00,000
(Application money received on full and final payment)			
Share application money A/c	Dr.	8,00,000	
To Share capital A/c			8,00,000
(Being 80,000 equity shares of ₹ 10 each issued and fully paid up)			

Note: Cancellation of preference dividend need not be journalised. On cancellation, it ceases to be contingent liability and hence no further disclosure required.

Balance Sheet of Ruby Ltd. (and Reduced) as at 31st March, 2023

Particulars	**Note**	**Amount (₹)**
I. EQUITY AND LIABILITIES		
1. Shareholders' funds		
a. Share capital	1	70,00 000
b. General reserve		12,00 000
2. Current liabilities		
a. Trade payables (49,20,000-12,30,000)		36,90,000
b. Other current liabilities (outstanding expenses)		6,40,000
Total		**125,30,000**
II. ASSETS		
1. Non-current assets		
i. Property, Plant and Equipments	2	57,70,000
ii. Intangible assets	3	
2. Current assets		
a. Inventories (32,60,000- 6,80,000)		25,80,000
b. Trade receivables (47,00,000 - 13,00,000)		34,00,000
c. Cash and cash equivalents	4	7,80,000
Total		**125,30,000**

Notes to the financial statements

(1) Share capital

Particulars	Amount (₹)
a. Authorised	60,00,000
• 6,00,000 equity shares of ₹ 10 each	40,00,000
• 40,000 8% cumulative preference shares of ₹ 100 each	

TELEGRAM: CA NOTE HUB

b. Issued, subscribed and fully paid up	30,00,000
• 3,00,000 equity shares of ₹ 10 each (of the above, 1,00,000 shares were issued as fully paid up for consideration other than cash under the scheme of reconstruction)	40,00,000
• 40,000 8% cumulative preference shares of ₹ 100 each	
Total	**70,00,000**

(2) Property, Plant and Equipments

Particulars	**₹**
Plant (60,00,000-16,30,000)	43,70,000
Building (11,00,000 + 3,00,000)	14,00,000
Total	57,70,000

(3) Intangible assets

Particulars	**₹**
Patent (8,00,000-8,00,000)	-

(4) Cash and cash equivalents

Particulars	**₹**
a. Balance with bank (4,60,000-6,00,000-1,20,000+8,00,000)	5,40,000
b. Cash on hand	2,40,000
Total	**7,80,000**

Question 10 (RTP May'24)

As a part of the reconstruction scheme of Getting better Ltd, the following terms were agreed upon-

1) The shareholders to receive in lieu of their present holdings (viz. 10,000 shares of ₹ 50 each), the following-
   a. 15,000 Fully paid equity shares of ₹ 10 each;
   b. 12% fully paid preference shares to the extent of 2/5 of total equity shares;
   c. To pay them ₹ 50,000 and transfer the remaining to the reconstruction account.
2) 8% Preference share capital - ₹ 3,00,000

   To write down the value of preference shares to ₹ 50 (original face value ₹ 100).
3) 14% debentures of the nominal value of ₹ 2,00,000 along with accrued interest ₹ 56,000 was waived off for three fourths of the total amount, and the remaining being paid in cash.

Show the necessary journal entries in the books of Getting better company based on the above scheme.

Solution:

Journal entries in the books of Getting better Co.

Date	**Particulars**		**Dr.**	**Cr.**
			₹	**₹**
	Share capital A/c (₹50)	Dr.	5,00,000	
	To Share capital A/c (₹10)			1,50,000
	To 12% Preference share capital A/c			2,00,000
	To Bank A/c			50,000
	To Reconstruction A/c			1,00,000
	(Being 15,000 equity shares of ₹ 10 and 12% preference shares issued, paid in cash and remaining forgone as a part of Reconstruction Scheme dated...)			

TELEGRAM: CA NOTE HUB

Preference Share capital A/c (₹ 100) Dr.		3,00,000	
To Preference share capital A/c (₹ 50)			1,50,000
To Reconstruction A/c			1,50,000
(Being the preference share capital reduced and forfeited as per reconstruction scheme)			
14% Debenture A/c	Dr.	2,00,000	
Interest accrued on Debentures A/c	Dr.	56,000	
To Bank A/c			64,000
To Reconstruction A/c			1,92,000
(Being the debenture holders paid their interest and amount foregone as per reconstruction scheme)			
Reconstruction A/c	Dr.	4,42,000	
To Capital Reserve A/c			4,42,000
(Being the balance in reconstruction ac transferred to capital reserve as per reconstruction scheme)			

Question 11 (Past Exam Nov'23)

Following is the Balance Sheet of Tourma Limited as at 31st March,2023:

Particulars	Notes	₹ in lakhs
Equity and Liabilities		
1. Shareholders' funds		
A. Share Capital	1	24.00
B. Reserves and Surplus	2	(9.10)
2. Non-current liabilities		
A. Long-term borrowings	3	3.20
3. Current liabilities		
A. Trade Payables		1.15
B. Short Term Borrowings – Bank Overdraft		1.40
C. Other current liabilities	4	0.32
D. Short term provisions	5	0.42
Total		21.39
Assets		
1. Non-current assets		
A. Property, Plant and Equipment	6	7.80
B. Intangible Assets	7	1.70
C. Non-Current Investments	8	1.80
2. Current Assets		
A. Inventory		5.12
B. Trade receivables		4.32
C. Cash and cash equivalents		0.65

TELEGRAM: CA NOTE HUB

Total		21.39

Notes to Accounts:

		₹ in lakhs
1 Share Capital		
Equity share capital		
16,000 Equity Shares of ₹ 100 each		16.00
8,000 6% Preference Shares of ₹ 100 each		8.00
		24.00
2 Reserves and Surplus		
Debit balance of Profit and loss Account		(9.10)
		(9.10)
3 Long-term borrowings		
3,200 10% Debentures		3.20
		3.20
4 Other current liabilities		
Interest payable on debentures		0.32
		0.32
5 Short term provisions		
Provision for taxation		0.42
		0.42
6 Property, Plant and Equipment		
Plant & Machinery		5.00
Furniture & Fixture		2.80
		7.80
7 Intangible Assets		
Patents & Copyrights		1.70
		1.70
8 Non-current Investments		
Investments (Market Value ₹ 1,10,000)		1.80
		1.80

As on 1st April,2023, the following scheme of reconstruction was finalized for which necessary resolution was passed and approvals were obtained from appropriate authorities. Accordingly, it was decided that:

i. Each equity share is to be sub-divided into ten fully paid-up equity shares of ₹ 10 each. After sub-division, each shareholder shall surrender to the company 40 % of his holding, for the purpose of reissue to trade payables as necessary.

ii. Preference shareholders would give up 30% of their capital and 12% Debentures (face value ₹ 100 each) shall be issued to them for balance holdings.

iii. The company would issue additional 12% Debentures (face value ₹ 100 each) for ₹ 4,00,000 for meeting its working capital requirement and final settlement of Bank Overdraft at 90% of the amount.

iv. Existing debenture holders would accept Furniture & Fixture in full settlement of their dues.

TELEGRAM: CA NOTE HUB

v. Trade payables claim shall be reduced to 70%, it is to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.

vi. The shares surrendered and not re-issued shall be cancelled.

vii. The taxation liability is to be settled at 50,000.

viii. Investments value to be reduced to market price.

ix. Balance of profit and loss account is to be written off.

x. The value of inventories is to be increased by ₹ 32,000 and provision for Doubtful Debts is to be created at 5% of Trade Receivables.

You are required to:

i. Pass necessary journal entries in the books of account of Tourma Limited.

ii. Prepare Reconstruction Account, and

iii. Prepare Balance Sheet of the company after internal reconstruction. **(20 Marks)**

Solution:

Journal Entries in the books of Tourma Ltd.

		Dr. ₹ In lakhs	C r. ₹ In lakhs
Equity Share Capital (₹ 100) A/c	Dr.	16.00	
To Share Surrender A/c			6.40
To Equity Share Capital (₹ 10) A/c 9.60			
(Subdivision of 16,000 equity shares of ₹ 100 each into 1,60,000 equity shares of ₹ 10 each and surrender of 64,000 of such subdivided shares as per capital reduction scheme)			
Preference Share Capital (₹ 100) A/c	Dr.	8.00	
To 12% Debentures A/c			5.60
To Reconstruction (₹ 100) A/c			2.40
(12% Debenture issued to Preference Shareholders and 30% of the capital foregone by them)			
Bank A/c	Dr.	4.00	
To 12% Debentures (₹ 100) A/c			4.00
(Being 12% debentures issued)			
Bank Overdraft A/c	Dr.	1.40	
To Bank A/c			1.26
To Reconstruction A/c			0.14
(Being bank overdraft amount paid)			
10% Debentures A/c	Dr.	3.20	
Interest payable A/c	Dr.	0.32	
To Debenture holders A/c			3.52
(Being Interest payable on the 10% debentures credited to debenture holders A/c)			
10% Debentures A/c	Dr.	3.52	
To Furniture & fixtures A/c			2.80
To Reconstruction A/c			0.72
Trade payables A/c	Dr.	1.15	

TELEGRAM: CA NOTE HUB

To Reconstruction A/c			1.15
(Transferred claims of the trade payables to reconstruction account, 70% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c		6.40	
To Equity Share Capital A/c			0.805
To Reconstruction A/c			5.595
(Issued equity shares to discharge the claims of the trade payables respectively as per scheme and the balance in share surrender account is being transferred to reconstruction account)			
Provision for Taxation A/c	Dr.	0.42	
Reconstruction A/c	Dr.	0.08	
To Liability for taxation A/c			0.50
(Being conversion of the provision for taxation into liability for taxation.)			
Liability for taxation A/c		0.50	
To Cash/Bank A/c			0.50
(Being taxation liability settled)			
Reconstruction A/c	Dr.	0.70	
To Investment A/c			0.70
(Being investments' value reduce to market price)			
Inventory A/c	Dr.	0.32	
To Reconstruction A/c Dr.			0.104
To Provision for doubtful debts (4,32,000 x 5%)			0.216
(Being inventory revalued and provision for doubtful debts created)			
Reconstruction A/c	Dr.	9.329	
To Profit and Loss A/c			9.10
To Capital Reserve A/c			0.229
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			

Balance Sheet of Tourma Limited (and reduced) as at...

Particulars	Note No.	₹ In lakhs
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	10.405
(b) Reserves and Surplus	2	0.229
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	9.60
(3) Current Liabilities		
Total		20.234
II. Assets		

TELEGRAM: CA NOTE HUB

(1) Non-current assets		
(a) Property, plant and equipment	4	5.00
(b) Intangible assets	5	1.70
(c) Non-current investments	6	1.10
(2) Current assets		
(a) Inventories	7	5.44
(b) Trade receivables	8	4.104
(c) Cash and cash equivalents (W.N)		2.89
Total		20.234

Notes to Accounts

		₹ In lakhs
1. Share Capital		
Equity Share Capital		
Issued Capital: 10.405 Equity Shares of ₹ 10 each	10.405	
(9.6 + 0.805)		
(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)		
2. Reserve and Surplus		
Capital Reserve		0.229
3. Long-term borrowings		
Unsecured Loans		
12% Debentures (5.60 + 4)		9.60
4. Property, plant and Equipment		
Plant & Machinery		5.00
5 Intangible assets		
Patents & copyrights		1.70
6. Non-Current Investments		
Investments		1.10
7. Inventory	5.12	
Add: Appreciation under scheme of Reconstruction	0.32	5.44
8 Trade Receivables	4.32	
Less: Provision for doubtful debts	0.216	4.104

TELEGRAM: CA NOTE HUB

MCQs

1. When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called
    a. Internal reconstruction with liquidation
    b. Internal reconstruction without liquidation of the company
    c. External reconstruction
    d. None of the above.
2. The accumulated losses under scheme of internal reconstruction are written off against
    a. Capital Reduction account
    b. Share Capital account
    c. Shareholders' account
    d. Reserve and surplus.
3. A process of reconstruction, which is carried out without liquidating the company and forming a new one is called
    a. Internal reconstruction.
    b. External reconstruction.
    c. Amalgamation in the nature of merger.
    d. Amalgamation in the nature of purchase.
4. Reconstruction is a process by which affairs of a company are reorganized by
    a. Revaluation of assets and Reassessment of liabilities.
    b. Writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
    c. Both (a) and (b).
    d. None of the above.
5. For reduction of the share capital, the permission has to be sought from
    a. Court.
    b. Controller.
    c. State government.
    d. Shareholders.
6. In case of internal reconstruction
    a. Only one company is liquidated.
    b. Two or more companies are liquidated.
    c. No company is liquidated.

Two companies amalgamated.

ANSWERS/HINTS

MCQs

1.	(b)	**2.**	(a)	**3.**	(a)	**4.**	(c)	**5.**	(a)	**6.**	(c)

TELEGRAM: CA NOTE HUB

ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES

Illustration 1 (a)

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost to their branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

	₹		₹
Opening balance (1-1-20X1) Imprest Cash	2,000	Bad Debts	1,000
Sundry Debtors	25,000	Discount to Customers	2,000
Stock: Transferred from H.O.	24,000	Remittances to H.O.	
Direct Purchases	16,000	(received by H.O.)	1,65,000
Cash Sales	45,000	Remittances to H.O.	
Credit Sales	1,30,000	(not received by H.O. so far)	5,000
Direct Purchases	45,000	Branch Exp. directly paid by H.O.	30,000
Returns from Customers	3,000	Closing Balance (31-12-20X1)	
Goods sent to branch from H.O.	60,000	Stock: Direct Purchase	10,000
Transfer from H.O. for Petty Cash expenses	4,000	Transfer from H.O.	15,000
		Debtors	?
		Imprest Cash	?
		Petty Cash expenses	4,000

Solution

In the Books of Buckingham Bros, Bombay

Nagpur Branch Account

Particulars	₹	Particulars		₹
To Opening Branch Assets-		By Bank – Remittances received from branch		
Stock (24,000+16,000)	40,000	Cash Sales	45,000	
Debtors	25,000	Cash from Debtors *	1,20,000	
		Cash in transit *	5,000	1,70,000
Imprest Cash	2,000	By Closing Branch Assets		
To Goods sent to Branch A/c	60,000	Stock (15,000 +10,000)		25,000
To Creditors (Direct	45,000	Debtors (W.N. 1)		24,000

TELEGRAM: CA NOTE HUB

Purchases)		Imprest Cash (W.N. 2)		2,000
To Bank (Sundry exp.)	30,000			
To Bank (Petty cash exp.)	4,000			
To Net Profit transferred to General Profit & Loss A/c	15,000			
	2,21,000			2,21,000

Working Notes:

1. Memorandum Debtors A/c

Particulars	₹	Particulars	₹
To Bal b/d	25,000	By Sales Return	3,000
To Sales	130,000	By Bad Debts	1,000
		By Discount	2,000
		By Cash *	125,000
		By Bal c/d	24,000
	155,000		155,000

2. Memorandum Petty Cash

Particulars	₹	Particulars	₹
To Bal b/d	2,000	By Expenses (met by Branch)	4,000
To Transfer from H.O.	4,000	By Bal c/d	2,000
	6,000		6,000

* Collection from Debtors = Total Remittances (1,65,000+5,000) – Cash Sales (45,000) = ₹ 1,25,000

Illustration 1 (b)

From the information given in the illustration 1(a), prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

Solution

Buckingham Bros. Bombay

Nagpur Branch-Trading and Profit and Loss Account

for the year ending 31st December, 20X1

Particulars	₹	Particulars	₹	₹
To Opening Stock	40,000	By Sales		
To Goods transferred	60,000	Cash	45,000	
from Head Office		Credit sales	1,30,000	
To Purchases	45,000		1,75,000	
To Gross Profit c/d	52,000	Less: Returns	(3,000)	1,72,000
		By Closing Stock		25,000
	1,97,000			**1,97,000**
To Expenses	30,000	By Gross Profit b/d		52,000
To Discounts	2,000			

TELEGRAM: CA NOTE HUB

To Bad Debts	1,000			
To Petty Cash Expenses	4,000			
To Net Profit transferred to General P&L A/c	15,000			
	52,000			**52,000**

The students may note that Gross Profit and Net Profit earned by the branch are ascertainable in this method and also evaluating the performance of the branch is very much easier in this method than in the 'Debtors method'.

Solving Illustration by all three methods

Given below is a simple problem, the solution whereto has been prepared in all the three methods so as to show the distinguishing features of these methods.

Illustration 2

The Bombay Traders invoiced goods to its Delhi branch at cost. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the Branch. All the cash collected by the branch was banked on the same day to the credit of the Head Office. The following is a summary of the transactions entered into at the branch during the year ended December 31, 20X1.

	₹		₹
Balances as on 1.1.20X1:			
Stock	7,000	Bad Debts	600
Debtors	12,600	Goods returned by customers	500
Petty Cash,	200	Salaries & Wages	6,200
Goods sent from H.O.	26,000	Rent & Rates	1,200
Goods returned to H.O.	1,000	Sundry Expenses	800
Cash Sales	17,500	Cash received from Sundry	
Credit Sales	28,400	Debtors	28,500
Allowances to customers	200	Balances as on 31.12.20X1:	
Discount to customers	1,400	Stock	6,500
		Debtors	9,800
		Petty Cash	100

Prepare: (a) Branch Account (Debtors Method), (b) Branch Stock Account, Branch v

Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting v

the Stock and Debtors Method and (c) Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.

Solution

(a) Debtors Method

Delhi Branch Account

20X1		₹	₹	20X1		₹	₹
Jan. 1	To Opening branch assets:			Dec 31	24 Bank		
	Stock	7,000			Cash Sales	17,500	
	Debtors	12,600					
	Petty cash	200	19,800		Cash from sundry		

TELEGRAM: CA NOTE HUB

					Debtors	28,500	46,000
Dec.	To Goods sent				By Goods sent to		
31	to Branch A/c		26,000		Branch A/c –		
	To Bank:				Returns to		1,000
					H.O.		
	Salaries & Wages	6,200			By Closing branch assets		
	Rent & Rates	1,200			Stock	6,500	
	Sundry Exp.	800	8,200		Debtors	9,800	
					Petty Cash	100	16,400
	To Net profit ts/f to		9,400				
	General P&L A/c						
			63,400				63,400
Jan. 1,	To Balance b/d		16,400				
20X2							

(b) Stock and Debtors Method

Branch Stock Account

20X1		₹	20X1			₹
Jan. 1	To Balance b/d - Opening Stock	7,000	Dec. 31	By Sales:		
Dec. 31	To Goods Sent to Branch A/c	26,000		Cash	17,500	
	To Branch P&L A/c	19,900		Credit	28,400	
				Less: Return	(500)	45,400
				By Goods sent to Branch A/c - Return		1,000
				By Balance c/d - Closing Stock		6,500
		52,900				52,900
20X2 Jan. 1	To Balance b/d - Opening Stock	6,500				

Delhi Branch Debtors Account

20X1		₹	20X1		₹
Jan. 1	To Balance b/d	12,600	Dec. 31	By Cash	28,500
Dec. 31	To Sales	28,400		By Returns	500
				By Allowances	200

TELEGRAM: CA NOTE HUB

				By Discounts	1,400
				By Bad debts	600
				By Balance c/d	9,800
		41,000			41,000
20X2 Jan. 1	To Balance b/d	9,800			

Delhi Branch Expenses Account

20X1		₹	20X1		₹
Dec. 31	To Salaries & Wages	6,200	Dec. 31	By Branch P&L A/c	10,500
	To Rent & Rates	1,200			
	To Sundry Expenses	800			
	To Petty Cash expenses (200-100)	100			
	To Allowance to customers	200			
	To Discount	1,400			
	To Bad Debts	600			
		10,500			10,500

Delhi Branch Profit & Loss Account

20X1			₹	20X1			₹
Dec. 31	To	Branch Exp. A/c	10,500	Dec. 31	By Gross b/d	Profit	19,900
	To	Net Profit ts/f to General P & L A/c	9,400				
			19,900				19,900

(c) Branch Trading and Profit and Loss Account

	₹	₹		₹	₹
To Stock		7,000	By Sales:		
To Goods sent			Cash	17,500	
from H.O.	26,000		Credit 28,400		
Less: Returns	(1,000)	25,000	Less:		
to H.O.			returns (500)	27,900	45,400
To Gross profit c/d		19,900	By Closing Stock		6,500
		51,900			51,900
To Salaries & Wages		6,200	By Gross Profit b/d		19,900
To Rent & Rates		1,200			
To Sundry Exp.		800			
To Petty Cash Exp.		100			
To Allowances to		200			

TELEGRAM: CA NOTE HUB

Customers					
To Discounts		1,400			
To Bad Debts		600			
To Net Profit		9,400			
		19,900			19,900

Illustration 3 (a) (MTP Apr'24)

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December, 20X1:

		₹
Cost of goods sent to Branch at cost		2,00,000
Goods received by Branch till 31-12-20X1 at invoice price		2,20,000
Credit Sales for the year @ invoice price		1,65,000
Cash Sales for the year @ invoice price		59,000
Cash Remitted to head office		2,22,500
Expenses paid by H.O. 12,000		
Bad Debts written off		
Balances as on	1-1-20X1	31,-12-20X1
	₹	₹
Stock	25,000(Cost)	28,000(invoice price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,5000

Show necessary ledger accounts in the books of the head office and determine the Profit or Loss of the Branch for the year ended 31st December, 20X1. **(6 Marks)**

Solution

Books of Harrison

Branch Stock Account

	₹		₹
To Balance b/d – Op Stock	30,000	By Branch Debtors (Sales)	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Cash	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	
(Balancing Figure –		Goods in Transit	
Excess of Sale over Invoice		(₹ 2,40,000 – ₹ 2,20,000)	20,000
Price)			
		Closing Stock at	28,000
		Branch	
	2,72,000		2,72,000

Branch Debtors Account

TELEGRAM: CA NOTE HUB

	₹		₹
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock A/c (Sales)	1,65,000	By Branch Cash (bal.fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Branch Cash Account

	₹		₹
To Balance b/d	5,000	By Bank Remittance to H.O.	2,22,500
To Branch Stock	59,000	By Branch Expenses	10,000
To Branch Debtors	1,71,000	[met by Branch (Bal. fig.)]	
		By Balance c/d	2,500
	2,35,000		2,35,000

Branch Adjustment Account

	₹		₹
		By Stock Reserve opening (25,000 × 20%)	5,000
To Branch P &L - Gross Profit (Bal. fig.)	39,000	By Goods sent to Branch A/c	40,000
To Stock Reserve (on closing stock (48,000 ×1/6)	8,000	By Branch Stock A/c	2,000
	47,000		47,000

Branch Expenses

	₹		₹
To Cash (H.O)	12,000		
To Branch Cash	10,000	By Branch P&L A/c	22,000
	22,000		22,000

Branch Profit and Loss Account

	₹		₹
To Branch Expenses	22,000	By Gross Profit (from Branch Adjustment A/c)	39,000
To Branch Debtors (bad debts)	750		
To Net Profit	16,250		
	39,000		39,000

Goods Sent to Branch Account

	₹		₹
To Branch Adjustment A/c	40,000	By Branch to Stock A/c	2,40,000

TELEGRAM: CA NOTE HUB

To Purchase A/c - Transfer	2,00,000		
	2,40,000		2,40,000

Illustration 3 (b)

Take figures from Illustration 3 (a) and prepare branch account following debtors' method.

Solution

Books of Harrison

New Delhi Branch Account

	₹		₹
To Balance B/d			
Stock	30,000	By Stock Reserve	5,000
Debtors	32,750		
Cash	5,000		
To Goods Sent to Branch A/c	2,40,000	By Goods Sent to Branch	40,000
(2,00,000 + 20%)		A/c	
To Cash (Exp. paid by H.O.)	12,000	By Cash – Remittance from branch	2,22,500
To Net Profit ts/f to H.O.	16,250	By Balance c/d	26,000
Profit & Loss A/c		Debtors	
(Balancing Figure)			
To Stock reserve	8,000	Stock (including Transit	48,000
(48,000X20/120)		– W.N 2)	
		Cash	2,500
	3,44,000		3,44,000

Working Note:

Closing Stock = Stock at branch + Stock in Transit (Goods sent by HO – Goods Received by Branch) = ₹ 28,000 + (r 2,40,000 - ₹ 2,20,000) = ₹ 48,000.

Illustration 4

Sell Well who carried on a retail business opened a branch X on January 1st, 20X1 where all sales were on credit basis. All goods required by the branch were supplied from the Head Office and were invoiced to the branch at 10% above cost.

The following were the transactions:

	Jan. 20X1	Feb. 20X1	March 20X1
	₹	₹	₹
Goods sent to Branch (Purchase Price)	40,000	50,000	60,000
Sales as shown by the branch monthly report	38,000	42,000	55,000
Cash received from Debtors and remitted to H.O.	20,000	51,000	35,000
Returns to H.O. (Invoice price to Branch)	1,200	600	2,400

The stock of goods held by the branch on March 31, 20X1 amounted to ₹ 53,400 at invoice to branch.

TELEGRAM: CA NOTE HUB

Record these transactions in the Head Office books, showing balances as on 31st March, 20X1 and the branch gross profit for the three months ended on that date.

All workings should form part of your solution.

Solution

Books of Sell Well

Branch Account

	₹			₹
To Goods sent to Branch A/c (1,50,000+10%)	1,65,000	By Goods sent to Branch-Loading		15,000
To Goods sent to Branch A/c (4,200 X 10/110)	382	By Goods sent to Branch-returns		4,200
		By Bank		1,06,000
		By Balance c/d - Closing Branch Assets		
To Stock Reserve (53,400 X 10/110)	4,855	Stock	53,400	
To Net Profit (Bal fig) ts/f to General P&L A/c	37,363	Debtors (Sales-Collection)	29,000	82,400
	2,07,600			2,07,600

Working Note:

Memorandum Branch Debtors Account

	₹		₹
To Balance b/d	---	By Cash/Bank	1,06,000
To Sales	1,35,000	By Balance c/d	29,000
	1,35,000		1,35,000

Goods Sent to Branch Account

	₹		₹
To Branch A/c – Loading	15,000	By Branch A/c	1,65,000
To Branch A/c – Returns	4,200	By Branch A/c – Loading	382
To Purchases A/c	1,46,182	on returns	
	1,65,382		1,65,382

Illustration 5 (MTP Mar'24)

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 20X2 from the following:

1) Goods are invoiced to the branch at cost plus 20%.
2) The sale price is cost plus 50%.
3) Other information:

TELEGRAM: CA NOTE HUB

	₹
Stock as on 01.04.20X1(invoice price)	2,20,000
Goods sent during the year (invoice price)	11,00,000
Sales during the year	12,00,000
Expenses incurred at the branch	45,000

Ascertain

(i) the profit earned by the branch during the year.

(ii) branch stock reserve in respect of unrealized profit. **(6 Marks)**

Solution

(i) Calculation of profit earned by the branch

In the books of Jammu Branch

Trading Account and Profit and Loss Account

Particulars	**Amount**	**Particulars**	**Amount**
	₹		₹
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit (Bal fig)	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit = ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

	₹	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	**₹**	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less: Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Illustration 6

Hindustan Industries Mumbai has a branch in Cochin to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch Expenses are paid direct from head office, and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit. Branch does not maintain any books of account, but sends weekly returns to the Head Office:

	₹

TELEGRAM: CA NOTE HUB

Goods received from Head Office at invoice price	6,00,000
Returns to Head Office at invoice price	12,000
Stock at Cochin as on 1st Jan., 20X1	60,000
Sales in the year - Cash	2,00,000
Credit	3,60,000
Sundry Debtors at Cochin as on 1st Jan. 20X1	72,000
Cash received from Debtors	3,20,000
Discount allowed to Debtors	6,000
Bad debts in the year	4,000
Sales returns at Cochin Branch	8,000
Rent, Rates, Taxes at Branch	18,000
Salaries, Wages, Bonus at Branch	60,000
Office Expenses	6,000
Stock at Branch on 31st Dec. 20X1 at invoice price	1,20,000

Prepare Branch accounts in books of head office by Stock and debtors method.

Solution

Books of Hindustan Industries, Mumbai

Cochin Branch Stock Account

	₹		₹
To Balance b/d – Op Stock	60,000	By Bank A/c – Cash Sales	2,00,000
To Branch Debtors A/c –	8,000	By Branch Debtors A/c -	3,60,000
Sales Return		Credit Sales	
To Goods sent to Branch	6,00,000	By Goods sent to Branch	12,000
A/c		(Returns to H.O.)	
To Branch Adjustment A/c (Excess of Selling Price over Invoice Price)	24,000	By Balance c/d - Closing stock	1,20,000
	6,92,000		6,92,000

Cochin Branch Stock Adjustment Account

	₹		₹
To Goods sent to Branch A/c	2,400	By Balance b/d	12,000
		(1/5 of ₹ 60,000)	
(1/5 of ₹ 12,000) (on returns)			
To Branch P & L A/c (Profit on sale) – Bal fig	1,29,600	By Goods sent to Branch A/c (1/5 of ₹ 6,00,000)	1,20,000
To Balance c/d (1/5 of ₹ 1,20,000)	24,000	By Branch Stock	24,000
	1,56,000		1,56,000

Goods Sent to Branch Account

	₹		₹
To Cochin Branch Stock	1,20,000	By Cochin Branch Stock	6,00,000

TELEGRAM: CA NOTE HUB

Adjustment A/c		A/c	
To Cochin Branch Stock	12,000	By Cochin Branch Stock	2,400
A/c (Returns)		Adj. A/c	
To Purchases A/c	4,70,400		
	6,02,400		6,02,400

Branch Debtors Account

	₹		₹
To Balance b/d	72,000	By Bank	3,20,000
To Branch Stock		By Branch P&L A/c	6,000
		Discount	
A/c	3,60,000	By Branch P&L A/c - Bad	4,000
		Debts	
		By Branch Stock - Sales	8,000
		Returns	
		By Balance c/d	94,000
	4,32,000		4,32,000

Branch Expenses Account

	₹		₹
To Bank A/c (Rent, Rates		By Branch Profit & Loss	
& Taxes)	18,000	A/c (Transfer)	84,000
To Bank A/c (Salaries & Wages)	60,000		
To Bank A/c (office exp.)	6,000		
	84,000		84,000

Branch Profit & Loss Account for the year ending 31st Dec. 20X1

	₹		₹
To Branch Expenses A/c	84,000	By Branch Stock Adj. A/c	1,29,600
To Branch Debtors A/c	6,000		
To Branch Debtors A/c	4,000		
To Net Profit transferred to Profit & Loss A/c	35,600		
	1,29,600		1,29,600

Illustration 7 (RTP May'22)

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He dispatches 25 tins of Oil @ ₹ 1,000 per tin and 15 tins of Ghee @ ₹ 1,500 per tin on 1st of every month. The branch incurs some expenditure which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

TELEGRAM: CA NOTE HUB

		Delhi	Lucknow
		₹	₹
Purchases	Ghee	14,75,000	-
	Oil	29,32,000	-
Direct expenses		3,83,275	-
Expenses paid by H.O.		-	14,250
Sales	Ghee	18,46,350	3,42,750
	Oil	27,41,250	3,15,730
Collection during the year (including Cash Sales)		-	6,47,330
Remittance by Branch to Head Office		-	6,13,250

	(Delhi)	
Balance as on:	1-1-20X1	31-12-20X1
Stock: Ghee	1,50,000	3,12,500
Oil	3,50,000	4,17,250
Debtors	7,32,750	-
Cash on Hand	70,520	55,250
Furniture & Fittings	21,500	19,350
Plant/Machinery	3,07,250	7,73,500

	(Lucknow)	
Balance as on:	1-1-20X1	31-12-20X1
Stock: Ghee	17,000	13,250
Oil	27,000	44,750
Debtors	75,750	?
Cash on Hand	7,540	12,350
Furniture & Fittings	6,250	5,625
Plant/Machinery	-	

Addition to Plant/Machinery on 1-1-20X1 ₹ 6,02,750.

Rate of Depreciation: Furniture / Fittings @ 10% and Plant / Machinery @ 15% (already adjusted in the above figures).

The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of ₹ 2,000 p.m. General expenses incurred by H.O. ₹ 24,000.

Prepare Branch Account in the head office books and also prepare the Arnold's Trading and Profit and Loss A/c (excluding branch transactions).

Solution

In the books of Arnold

Lucknow Branch Account

	₹		₹

TELEGRAM: CA NOTE HUB

To Balance b/d		By Bank (Remittance)	6,13,250
-Opening Branch Assets		By Closing Branch Assets	
Opening stock:		Closing stock:	
Ghee	17,000	Ghee	13,250
Oil	27,000	Oil	44,750
Debtors	75,750	Debtors (W.N. 1)	86,900
Cash on hand	7,540	Cash on hand (W.N. 2)	12,350
Furniture & fittings	6,250	Furniture & fittings	5,625
To Goods sent to Branch A/c			
Ghee (15 x 1500 x 12)	2,70,000		
Oil (25 x 1000 x 12)	3,00,000		
To Bank (Expenses paid)	14,250		
To Branch Manager Commission (₹ 58,335 × 1/11)	5,303		
To Net Profit transferred to General P & L A/c	53,032		
	7,76,125		7,76,125

Arnold

Trading and Profit and Loss account for the year ended 31st December, 20X1 (Excluding branch transactions)

		₹		₹
To Opening Stock:			By Sales:	
Ghee		1,50,000	Ghee	18,46,350
Oil		3,50,000	Oil	27,41,250
To Purchases:			By Closing Stock:	
Ghee	14,75,000		Ghee	3,12,500
Less: Goods sent			Oil	4,17,250
to Branch	(2,70,000)	12,05,000		
Oil	29,32,000			
Less: Goods sent		26,32,000		
to Branch	(3,00,000)			
To Direct Expenses		3,83,275		
To Gross Profit c/d		5,97,075		
		53,17,350		53,17,350
To Manager's Salary		24,000	By Gross Profit b/d	5,97,075
To General Expenses		24,000	By Branch Profit transferred	53,032
To Depreciation:				
Furniture @10%	2,150			
Plant & Machinery				
@ 15% (W.N.3)	1,36,500	1,38,650		

TELEGRAM: CA NOTE HUB

To General Manager's Commission @ 10% (i.e., 4,63,457 × 1/11)	42,132		
To Net profit	4,21,325		
	6,50,107		6,50,107

Working Notes:

1. Memorandum Branch Debtors Account

	₹		₹
To Balance b/d	75,750	By Cash Collections (including Cash Sales)	6,47,330
To Sales (including Cash Sales)		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		7,34,230

2. Memorandum Branch Cash Account

	₹		₹
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350
	6,54,870		6,54,870

3. Depreciation on Plant & Machinery 3,07,250 x 15% + 6,02,750 x 15% = ₹1,36,500

Illustration 8

M/s Rahul operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.20X2:

	₹
Stock at the outlet 1.4.20X1	30,000
Goods invoiced to the outlet during the year	3,24,000
Gross profit made by the outlet	60,000
Goods lost by fire	?
Expenses of the outlet for the year	20,000
Stock at the outlet 31.3.20X2	36,000

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.20X2:

a) Outlet Stock Account.

TELEGRAM: CA NOTE HUB

b) Outlet Profit & Loss Account.

c) Stock Reserve Account.

Solution

Outlet Stock Account

	₹		₹
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent outlet to	3,24,000	By Goods lost by fire (b.f.)	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

	₹		₹
To Expenses	20,000	By Gross Profit b/d	60,000
To Goods lost by fire (W.N.2)	18,000		
To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

	₹		₹
To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d (Stock Res. required)	7,200	By HO P&L A/c (W.N. 3)	7,200
	13,200		13,200

Working Notes:

₹

1) Wholesale Price 100+25 = 125

Retail Price 125 + 20% = 150

Gross Profit at the outlet

Wholesale Price – Retail Price (150 – 125) 25

Retail sales value = 60,000 x $\frac{150}{25}$ = ₹ 3,60,000

2) Goods lost by fire

Opening Stock + Goods Sent + Gross Profit – Sales – Closing Stock

30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = ₹18,000

3) Stock Reserve

Opening Stock = 30,000 x $\frac{25}{125}$ = ₹6,000

Closing Stock = 36,000 x $\frac{25}{125}$ = ₹7,200

Illustration 9 (Past Exam Jan'21)

Give Journal Entries in the books of an independent Branch to rectify or adjust the following:

TELEGRAM: CANOTE HUB

(i) Branch paid ₹ 5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.

(ii) Asset Purchased by branch for ₹ 25,000, but the Asset account was retained in H.O Books.

(iii) A remittance of ₹ 8,000 sent by the branch has not been received by H.O.

(iv) H.O collected ₹ 25,000 directly from the customer of Branch but fails to give the intimation to branch.

(v) Remittance of funds by H.O to branch ₹ 5,000 not entered in branch books. **(5 Marks)**

Solution

Journal Entries in Books of Branch

	Particulars		Dr. Amount	Cr. Amount
(i)	Head office account	Dr.	5,000	
	To Salaries account			5,000
	(Being the rectification of salary paid on behalf of H.O.)			
(ii)	Head office account	Dr.	25,000	
	To Bank / Liability A/c			25,000
	(Being Asset purchased by branch but Asset account retained at head office books)			
(iii)	No Entry in Branch Books			
(iv)	Head office account	Dr.	25,000	
	To Debtors account			25,000
	(Being the amount of branch debtors collected by H.O.)			
(v)	Bank A/c	Dr.	5,000	
	To Head Office			5,000
	(Remittance of Funds by H.O. to Branch)			

Illustration 10

The following Trial balances as at 31st December, 20X1 have been extracted from the books of Major Ltd. and its branch at a stage where the only adjustments requiring to be made prior to the preparation of a Balance Sheet for the undertaking as a whole are to be done.

	Head Office		Branch	
	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹
Share Capital		1,50,000		
Fixed Assets	75,125		18,901	
Current Assets	1,21,809		23,715	(Note 3)
Current Liabilities		34,567		9,721
Stock Reserve, 1st Jan., 20X1 (Note 2)		693		
Revenue Account		43,210		10,250
Branch Account	31,536			
Head Office Account				22,645

TELEGRAM: CA NOTE HUB

	2,28,470	2,28,470	42,616	42,616

You are required to record the following in the appropriate ledger accounts in both sets of books.

Note:

1. Goods transferred from Head Office to the Branch are invoiced at cost plus 10% and both Revenue Accounts have been prepared on the basis of the prices charged.
2. Relating to the Head Office goods held by the Branch on 1st January, 20X1.
3. Includes goods received from Head Office at invoice price ₹ 4,565.
4. Goods invoiced by Head Office to Branch at ₹ 3,641 were in transit at 31st December, 20X1, as was also a remittance of ₹ 3,500 from the Branch.
5. At 31st December, 20X1, the following transactions were reflected in the Head Office books but unrecorded in the Branch books.

The purchase price of lorry, ₹ 2,500, which reached the Branch on December 25th; a sum received on December 30, 20X1 from one of the Branch debtors, ₹ 750.

Solution

H.O. Books

Branch Account

20X1		₹	20X1		₹
Dec. 31	To Balance b/d	31,536	Dec. 31	By Cash in transit	3,500
				By Balance c/d	28,036
		31,536			31,536

Cash in transit Account

20X1		₹	20X1		₹
Dec. 31	To Branch A/c	3,500	Dec. 31	By Balance c/d	3,500

Stock Reserve Account

20X1		₹	20X1		₹
Dec. 31	To Balance c/d (4,565+3,641) x 10/110	746	Jan. 1	By Balance b/d	693
				By Revenue A/c (b.f.)	53
		746			746

Revenue Account

20X1		₹	20X1		₹
Dec. 31	To Stock Reserve	53	Dec. 31	By Balance b/d	43,210
	To Balance c/d	43,157			
		43,210			43,210

Branch Books

TELEGRAM: CA NOTE HUB

Head Office Account

20X1		₹	20X1		₹
Dec. 31	To Current Assets	750	Dec. 31	By Balance b/d	22,645
				By Goods in transit	3,641
	To Balance c/d	28,036		By Motor Vehicle	2,500
		28,786			28,786

Goods in Transit Account

20X1		₹	20X1		₹
Dec. 31	To Head Office	3,641	Dec. 31	By Balance c/d	3,641

Motor Vehicle Account

20X1		₹	20X1		₹
Dec. 31	To Head Office	2,500	Dec. 31	By Balance c/d	2,500

Sundry Current Assets A/c

20X1		₹	20X1		₹
Dec. 31	To Balance b/d	23,715	Dec. 31	By H.O. (Remittance by Debtor)	750
				By Balance c/d	22,965
		23,715			23,715

Illustration 11

KP manufactures a range of goods which it sells to wholesale customers only from its head office. In addition, the H.O. transfers goods to a newly opened branch at factory cost plus 15%. The branch then sells these goods to the general public on only cash basis.

The selling price to wholesale customers is designed to give a factory profit which amounts to 30% of the sales value. The selling price to the general public is designed to give a gross margin (i.e., selling price less cost of goods from H.O.) of 30% of the sales value.

KP operates from rented premises and leases all other types of fixed assets. The rent and hire charges for these are included in the overhead costs shown in the trial balances.

From the information given below, you are required to prepare for the year ended 31st Dec., 20X1 in columnar form.

a) A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

b) Balance Sheet as on 31st Dec., 20X1 for the entire business.

	H.O.		Branch	
	₹	₹	₹	₹
Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1-20X1				

TELEGRAM: CA NOTE HUB

Raw materials	1,800			
Finished goods	13,000		9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen Salaries	22,500		6,200	
Other administrative & selling overheads	12,500		2,300	
Inter-unit accounts	5,000			2,000
Capital		50,000		
Sundry Creditors		13,000		
Provision for unrealized profit in stock		1,200		
Sales		2,00,000		65,200
Goods sent to Branch		46,000		
Goods received from H.O.			44,500	
	3,10,200	3,10,200	67,200	67,200

Note:

1) On 28th Dec., 20X1 the branch remitted ₹ 1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also, on the same date, the H.O. dispatched goods to the branch invoiced at ₹ 1,500 and these too have not yet been entered into the branch books. It is the company's policy to adjust items in transit in the books of the recipient.
2) The stock of raw materials held at the H.O. on 31st Dec., 20X1 was valued at ₹ 2,300.
3) You are advised that:
   - there were no stock losses incurred at the H.O. or at the branch.
   - it is KP's practice to value finished goods stock at the H.O. at factory cost.
   - there were no opening or closing stock of work-in-progress.
4) Branch employees are entitled to a bonus of ₹ 156 under a bilateral agreement.

Solution

In the books of KP

Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

	H.O. ₹	Branch ₹	Total ₹		H.O. ₹	Branch ₹	Total ₹
To Opening stock of finished goods	13,000	9,200	22,200	By Sales	2,00,000	65,200	2,65,200
To Material consumed (W.N.1)	34,500	-	34,500				
To Wages	1,08,500	-	1,08,500	By Goods Sent	46,000	-	-
To Factory	39,000	-	39,000	to Branch			

TELEGRAM: CA NOTE HUB

Overheads							
To Goods from H.O.		46,000		By Closing stock including transit (W.N.2)	15,000	9,560 (Bal Fig)	24,560
To Gross Profit c/d (W.N.3) (Bal Fig)	66,000	19,560	85,560				
	2,61,000	74,760	2,89,760		2,61,000	74,760	2,89,760
To Admn. Salaries	13,900	4,000	17,900	By Gross Profit b/d	66,000	19,560	85,560
To Salesmen Salaries	22,500	6,200	28,700				
To Other Admn. & selling Overheads	12,500	2,300	14,800				
To Stock Reserve (W.N.4)	47	-	47				
To Bonus to Staff	-	156	156				
To Net Profit	17,053	6,904	23,957				
	66,000	19,560	85,560		66,000	19,560	85,560

Balance Sheet as on 31st Dec., 20X1

		₹	H.O. ₹	Branch ₹	Total ₹		H.O. ₹	Branch ₹	Total ₹
Capital			50,000	-	50,000	Fixed Assets	-	-	-
Profit:	H.O.	17,053				Current Assets:			
	Branch	6,904	23,957		23,957	Raw material	2,300		2,300
Trade Creditors			13,000		13,000	Finished Goods	15,000	9,560	23,313*
Bonus Payable				156	156	(Less Stock Res.)			
H.O. Account*				10,404		Debtors	37,000	-	37,000
Stock Reserve (W.N.4)			1,247			Cash (including transit item)	23,500	1,000	24,500
						Branch A/c	10,404**		
			88,204	10,560	87,113		88,204	10,560	87,113

TELEGRAM: CANOTE HUB

*9,560 × 100/115 i.e., (8,313 + 15,000) = ₹ 23,313 or (15,000 + 9,560) – 1,247 (Stock reserve) ** (5,000 + 6,904) – 1500 = ₹ 10,404.

Working Notes:

1) Material consumed

   Opening raw material + Raw Material Purchased – Closing raw material

   = 1,800 + 35,000 - 2,300 = 34,500

2) Closing stock at head office

   a) Calculation of total factor cost = Material consumed + Wages + Factory overhead

      = 34,500 + 1,08,500 + 39,000 = 1,82,000

   b) Cost (factory cost) of goods sold = Sales – Gross profit

      = 2,00,000 – 2,00,000 x 30% = 1,40,000

   c) Stock transferred to branch = 46,000 x 100/115 = 40,000

   d) Closing stock = 13,000 (Opening Stock) + 1,82,000 – 1,40,000 – 40,000 = 15,000

3) Gross profit of Branch = Sales x Gross profit ratio

   = 65,200 x 30% = 19,560

4) Closing stock reserve = 9,560 x 15/115 = 1,247

   Charge to profit and loss = 1,247 – 1,200 (existing) = 47

Illustration 12 (Past Exam July'21) (MTP Sep'23)

AFFIX of Kolkata has a branch at Delhi to which the goods are supplied from Kolkata but the cost thereof is not recorded in the Head Office books. On 31st March, 20X1 the Branch Balance Sheet was as follows:

Liabilities	**₹**	**Assets**	**₹**
Creditors Balance	40,000	Debtors Balance	2,00,000
Head Office	1,68,000	Building Extension A/c closed by transfer to H.O. A/c	—
		Cash at Bank	8,000
	2,08,000		2,08,000

During the six months ending on 30-9-20X1, the following transactions took place at Delhi.

	₹		**₹**
Sales	2,40,000	Manager's Salary	4,800
Purchases	48,000	Collections from Debtors	1,60,000
Wages paid	20,000	Discounts allowed	8,000
Salaries (inclusive of advance		Discount earned	1,200v
of ₹ 2,000)	6,400	Cash paid to Creditors	60,000
General Expenses	1,600	Building Account	4,000
		(further payment)	
Fire Insurance (paid for one year)	3,200	Cash in Hand	1,600
Remittance to H.O.	38,400	Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-20X1. Also give journal entries in the Delhi books. **(10 Marks)**

Solution

TELEGRAM: CANOTE HUB

Journal Entries

20X1 30 Sept.		Dr. ₹	Cr. ₹
Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance Account)			
Prepared Insurance A/c (3,200 x 6/12)	Dr.	1,600	
To Fire Insurance A/c			1,600
(Six months premium transferred to the Prepaid Insurance A/c)			
Head Office Account	Dr.	88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c (6,400 – 2,000)			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c (3,200 x 6/12)			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
Sales Accounts	Dr.	2,40,000	
Discount Earned A/c	Dr.	1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			
Head Office Account	Dr.	4,000	
To Building Account			4,000
(Transfer of amounts spent on building extension to H.O. A/c)			

Head Office Account

20X1		₹	20X1		₹
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries (Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 20X1

Liabilities	₹	Assets	₹
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600

TELEGRAM: CA NOTE HUB

		Building Extension A/c transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

	₹		₹
To Balance b/d	8,000	By Wages	20,000
To Collection from Debtors	1,60,000	By Salaries	6,400
		By Insurance	3,200
		By General Exp.	1,600
		By H.O. A/c	38,400
		By Manager's Salary	4,800
		By Creditors	60,000
		By Building A/c	4,000
		By Balance c/d	
		By Cash in Hand 1,600	
		By Cash at Bank 28,000	29,600
	1,68,000		1,68,000

Debtors Account

	₹		₹
To Balance b/d	2,00,000	By Cash Collection	1,60,000
To Sales	2,40,000	By Discount (allowed)	8,000
		By Balance c/d	2,72,000
	4,40,000		4,40,000
To Balance b/d	2,72,000		

Creditors Account

	₹		₹
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000
		By Balance b/d	26,800

Illustration 13

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December, 20X1.

TELEGRAM: CANOTE HUB

Head Office Trial Balance

	₹	₹
Share Capital (Authorised: 10,000 Equity Shares of ₹ 100 each):		
Issued: 8,000 Equity Shares		8,00,000
Profit & Loss Account - 1-1-20X1		25,310
General Reserve		1,00,000
Fixed Assets	5,30,000	
Stock	2,22,470	
Debtors and Creditors	50,500	21,900
Profit for 20X1		52,200
Cash Balance	62,730	
Branch Current Account	1,33,710	
	9,99,410	9,99,410

Branch Trial Balance

	₹	₹
Fixed Assets	95,000	
Profit for 20X1		31,700
Stock	50,460	
Debtors and Creditors	19,100	10,400
Cash Balance	6,550	
Head Office Current Account		1,29,010
	1,71,110	1,71,110

The difference between the balances of the Current Account in the two sets of books is accounted for as follows:

a) Cash remitted by the Branch on 31st December, 20X1, but received by the Head Office on 1st January 20X2 - ₹ 3,000.

b) Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not credited to Head Office in the Branch books as the Branch Manager declined to admit any liability (not covered by insurance) - ₹1,700.

Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal.

Solution

The Branch Current Account in the Head Office Books and Head Office Current Account in the Branch Books do not show the same balances. Therefore, in order to reconcile them, the following journal entries will be passed in the Head Office books:

Journal Entries

		Dr.	Cr.
20X1		₹	₹
Dec., 31	Cash in Transit A/c Dr.	3,000	
	To Branch Current A/c		3,000
	(Cash sent by the Branch on 31st Dec., 20X1 but received at		

TELEGRAM: CA NOTE HUB

	H.O. on 1st Jan., 20X2)		
	Loss by theft A/c Dr.	1,700	
	To Branch Current A/c		1,700
	(Stock lost in transit from H.O. to Branch)		

In order to incorporate, in the H.O. books, the given Branch trial balance which has been drawn up after preparing the Branch Profit & Loss Account, the following journal entries will be necessary:

Journal Entries

20X1			₹	₹
Dec. 31	Branch Current Account	Dr.	31,700	
	To Profit & Loss Account			31,700
	(Branch Profit for the year)			
	Branch Fixed Assets	Dr.	95,000	
	Branch Stock	Dr.	50,460	
	Branch Debtors	Dr.	19,100	
	Branch Cash	Dr.	6,550	
	To Branch Current Account			1,71,110
	(Branch assets brought into H.O. Books)			
	Branch Current A/c	Dr.	10,400	
	To Branch Creditors			10,400
	(Branch creditors brought into H.O. Books)			

Branch Current Account

	₹		₹
To Balance b/d	1,33,710	By Cash in transit	3,000
To Profit & Loss A/c	31,700	By Loss of theft	1,700
To Branch Creditors	10,400	By Sundry Branch Assets	1,71,110
	1,75,810		1,75,810

Profit and Loss Account for 20X1

	₹		₹
To Loss by Theft	1,700	By Balance b/d	25,310
To Balance c/d	1,07,510	By Year's Profit: H.O.	52,200
		Branch	31,700
	1,09,210		1,09,210

Illustration 14

Messrs Ramchand & Co., Hyderabad has a branch in Delhi. The Delhi Branch deals not only in the goods from Head Office but also buys some auxiliary goods and deals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the year and open them afresh on the basis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office.

TELEGRAM: CA NOTE HUB

The goods from the Head Office are invoiced at selling prices to give a profit of 20 per cent on the sale price. The goods sent from the branch to Head Office are at cost. From the following prepare Branch Trading and Profit & Loss Account and Branch fixed Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-20X1

Debit	₹	Credit	₹
Head office opening balance on 1-1-20X1	15,000	Sales	1,00,000
Goods from H.O.	50,000	Goods to H.O.	3,000
Purchases	20,000	Head Office Current A/c	15,000
Opening Stock		Sundry Creditors	3,000
(H.O. supplies goods at invoice prices)	4,000		
Opening Stock of other goods	500		
Salaries	7,000		
Rent	3,000		
Office expenditure	2,000		
Cash on Hand	500		
Cash at Bank	4,000		
Sundry Debtors	15,000		
	1,21,000		1,21,000

The Branch balances as on 1st January, 20X1, were as under: Furniture ₹ 5,000; Sundry Debtors ₹ 9,500; Cash ₹ 1,000, Creditors ₹ 30,000. The closing stock at branch of the head office goods at invoice price is ₹ 3,000 and that of purchased goods at cost is ₹ 1,000. Depreciation is to be provided at 10 per cent on branch assets.

Solution

Delhi Branch Trading and Profit & Loss Account

for the year ended 31st Dec., 20X1

		₹			₹
To Opening Stock:			By Sales		1,00,000
Head office Goods (4,000 x 80%)	3,200		By Goods from Branch		3,000
Others	500	3,700	By Closing Stock: Head Office goods (3,000 x 80%)	2,400	
To Goods to Branch (50,000 x 80%)		40,000	Others	1,000	3,400
To Purchases		20,000			
To Gross Profit c/d		42,700			
		1,06,400			1,06,400
To Salaries		7,000	By Gross profit b/d		42,700

TELEGRAM: CA NOTE HUB

To Rent		3,000			
To Office Expenses		2,000			
To Dep. on Furniture @10%		500			
To Net profit		30,200			
		42,700			42,700

Branch (Fixed) Assets Account (In Head Office Books)

20X1		₹	20X1		₹
Jan. 1	To Balance b/d	5,000	Dec. 31	By Delhi Branch A/c (Depreciation)	500
				By Balance c/d	4,500
		5,000			5,000
20X2					
Jan. 1	To Balance b/d	4,500			

Note: Furniture A/c is maintained in Head office books; it is not a part of either opening or closing balance.

Illustration 15 (MTP April '19)

On 31st December, 20X2 the following balances appeared in the books of Chennai Branch of an English firm having its HO office in New York:

	Amount in ₹	Amount in ₹
Stock on 1st Jan., 20X2	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account	-	5,99,150
	36,31,400	36,31,400

Stock on 31st December, 20X2 was ₹ 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 20X2 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 20X1 was ₹ 52 and on 31st

December, 20X2 was ₹ 51. The average rate for the year was ₹ 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch assuming integral foreign operation. **(10 Marks)**

Solution

In the books of English Firm (Head Office in New York)

Chennai Branch Profit and Loss Account

TELEGRAM: CA NOTE HUB

for the year ended 31st December, 20X2

	$		$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Chennai Branch

as on 31st December, 20X2

Liabilities	$	$	**Assets**	$
Head Office A/c	13,400		Furniture	1,750
Add: Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Calculation of Exchange Translation Loss

Chennai Branch Trial Balance (converted in $)

as on 31st December, 20X2

	Dr. ₹	**Cr.** ₹	**Conversion Rate**	**Dr.** ($)	**Cr.** ($)
Stock on 1st Jan., 20X2	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

TELEGRAM: CA NOTE HUB

Illustration 16

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operation of S & M Ltd.

At the end of 31st March, 20X2, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

	Bombay (₹ thousands)		Sydney (Austr dollars thousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.20X1)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available:

(1) Stock as at 31.3.20X2:

Bombay ₹ 1,50,000 Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees;

Use the following rates of exchange :

Opening rate A $ = ₹ 20

Closing rate A $ = ₹ 24

Average rate A $ = ₹ 22

For Fixed Assets A $ = ₹ 18

Solution

Sydney Branch Trial Balance (in Rupees)

As on 31st March, 20X2

TELEGRAM: CA NOTE HUB

(₹ '000)

Conversion	Rate per A$	Dr.	Cr.
Plant & Machinery (cost)	₹18	36,00	
Plant & Machinery Dep. Reserve	₹ 18		23,40
Debtors / Creditors	₹ 24	14,40	7,20
Stock (1.4.20X1)	₹ 20	4,00	
Cash & Bank Balances	₹ 24	2,40	
Purchase / Sales	₹ 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	₹ 22	9,90	
Rent	₹ 22	2,64	
Office expenses	₹ 22	3,96	
Commission Receipts	₹ 22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Illustration 17 (MTP Oct '22, Past Exam May'19)

M/s Carlin has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch is an integral foreign operation of Carlin & Co.

Mumbai branch furnishes you with its trial balance as on 31st March, 20X2 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 20X1	300	–
Purchases and sales	800	1,200
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Wages and salaries	560	–
Rent, rates and taxes	360	–
Sundry charges	160	–
Computers	240	
Bank balance	420	–
New York office a/c	–	1,620
	3,360	3,360

Additional information:

a) Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.

b) Unsold stock of Mumbai branch was worth ₹ 4,20,000 on 31st March, 20X2.

TELEGRAM: CA NOTE HUB

c) The rates of exchange may be taken as follows:

- on 1.4.20X1 @ ₹ 40 per US $
- on 31.3.20X2 @ ₹ 42 per US $
- average exchange rate for the year @ ₹ 41 per US $
- conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 20X2 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.20X2 in New York books and there were no items pending reconciliation.

(8 to 12 Marks)

Solution

M/s Carlin

Mumbai Branch Trial Balance in (US $)

as on 31st March, 20X2

	Conversion	Dr.	Cr.
	rate per US $ (₹)	US $	US $
Stock on 1.4.X1	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

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

	US $		US $
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock (4,20,000/42)	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on computers	3,600.00		

TELEGRAM: CA NOTE HUB

(US $ 6,000 × 0.6)			
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch

as on 31st March, 20X2

Liabilities		**US $**	**Assets**	**US $**	**US $**
New York Office A/c	39,609.18		Computers	6,000.00	
Less: Net Loss	(17,685.38)	21,923.80	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		2,857.14
		34,780.95			34,780.95

Illustration 18

Why goods are marked on invoice price by the head office while sending goods to the branch?

Solution:

Goods are marked on invoice price to achieve the following objectives:

(i) To keep secret from the branch manager, the cost price of the goods and profit made, so that the branch manager may not start a rival and competitive business with the concern; and

(ii) To have effective control on stock i.e. stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.

(iii) To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

Illustration 19

Differentiate Branch Accounts with Departmental accounts.

Solution:

Branch accounts may be maintained either at branch or at head office and no allocation problem arises since the expenses in respect of each branch can be identified However, Departmental accounts are maintained at one place only. Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case. For details, refer Para 2 of the Chapter to know the differences.

Illustration 20

Goods worth ₹ 50,000 sent by head office but the branch has received till the closing date goods for worth ₹ 40,000 only. Give journal entry in the books of H.O. and branch for goods in transit.

Solution:

Journal entry in the books of Head Office

No entry

Journal entry in the books of Branch

		₹	₹

TELEGRAM: CA NOTE HUB

Goods-in-transit account	Dr.	10,000	10,000
To Head Office account			
(Being goods sent by head office is still in transit)			

Illustration 21

Alphs having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account. On 31.3.20X1, it was found that the goods dispatched by head office for ₹ 2,00,000 was received by the branch only to the extent of ₹ 1,50,000. The balance goods are in transit. What is the accounting entry to be passed by the branch for recording the goods in transit, in its books?

Solution:

Nagpur branch must include the inventory in its books as goods in transit. The following journal entry must be made by the branch:

Goods in transit A/c	Dr.	50,000	
To Head office A/c			50,000
[Being Goods sent by Head office is still in transit on the closing date]			

Illustration 22

Show adjustment journal entry in the books of head office at the end of April, 20X1 for incorporation of inter-branch transactions assuming that only head office maintains different branch accounts in its books.

A. Delhi branch:

1) Received goods from Mumbai – ₹ 35,000 and ₹ 15,000 from Kolkata.
2) Sent goods to Chennai – ₹ 25,000, Kolkata – ₹ 20,000.
3) Bill Receivable received – ₹ 20,000 from Chennai.
4) Acceptances sent to Mumbai – ₹ 25,000, Kolkata – ₹ 10,000.

B. Mumbai Branch (apart from the above) :

5) Received goods from Kolkata – ₹ 15,000, Delhi – ₹ 20,000.
6) Cash sent to Delhi – ₹ 15,000, Kolkata – ₹ 7,000.

C. Chennai Branch (apart from the above) :

7) Received goods from Kolkata – ₹ 30,000.
8) Acceptances and Cash sent to Kolkata – ₹ 20,000 and r10,000 respectively.

D. Kolkata Branch (apart from the above) :

9) Sent goods to Chennai – ₹ 35,000.
10) Paid cash to Chennai – r15,000.
11) Acceptances sent to Chennai – r15,000.

Solution:

Journal entry in the books of Head Office

Date	Particulars		Dr.	Cr.
			₹	₹
30th April,	Mumbai Branch Account	Dr.	3,000	
20X1	Chennai Branch Account	Dr.	70,000	
	To Delhi Branch Account			15,000
	To Kolkata Branch Account			58,000

TELEGRAM: CA NOTE HUB

	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 20X1)		

Working Note:

Inter – Branch transactions

	Delhi	Mumbai	Chennai	Kolkata
	₹	₹	₹	₹
A. Delhi Branch	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
1. Received goods				
2. Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
3. Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
4. Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)
B. Mumbai Branch	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)
5. Received goods	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
6. Sent cash				
C. Chennai Branch				
7. Received goods			30,000 (Dr.)	30,000 (Cr.)
8. Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D. Kolkata Branch				
9. Sent goods			35,000 (Dr.)	35,000 (Cr.)
10. Sent cash			15,000 (Dr.)	15,000 (Cr.)
11. Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
	15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Illustration 23

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

Solution:

Books of Branch A

Journal Entries

	Particulars	Dr. Amount ₹	Cr. Amount ₹
(i)	Expenses account Dr.	3,500	

TELEGRAM: CA NOTE HUB

	To Head office account		3,500
	(Being the allocated expenditure by the head office recorded in branch books)		
(ii)	Depreciation account Dr.	1,500	
	To Head office account		1,500
	(Being the depreciation provided)		
(iii)	Head office account Dr.	2,000	
	To Salaries account		2,000
	(Being the rectification of salary paid on behalf of H.O.)		
(iv)	Head office account Dr.	10,000	
	To Debtors account		10,000
	(Being the adjustment of collection from branch debtors)		
(v)	No entry in branch books		
(vi)	Head Office account Dr.	3,000	
	To Cash account		3,000
	(Being the expenditure on account of Branch B, recorded in books)		

Note: Entry (vi) Inter branch transactions are routed through Head Office.

Illustration 24 (RTP Nov '23)

Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding ₹ 10,000 necessary for meeting immediate requirements of cash. On 31st March, 20X1 the assets at the branch were as follows:

	₹ ('000)
Cash in Hand	10
Trade Debtors	384
Stock, at Invoice Price	1,080
Furniture and Fittings	500

During the accounting year ended 31st March, 20X2 the invoice price of goods dispatched by the head office to the branch amounted to₹ 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at ₹ 72,000. Other transactions at the branch during the year were as follows:

	₹ '000)
Cash Sales	9,700
Credit Sales	3,140
Cash collected by Branch from Credit Customers	2,842
Cash Discount allowed to Debtors	58
Returns by Customers	102
Bad Debts written off	37
Expenses paid by Branch	842

On 1st January, 20X2 the branch purchased new furniture for ₹ 1 lakh for which payment was made by head office through a cheque.

TELEGRAM: CANOTE HUB

On 31st March, 20X2 branch expenses amounting to ₹ 6,000 were outstanding and cash in hand was again ₹ 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 20X2.

Solution:

In the Head Office Books

Branch Account

for the year ended 31st March, 20X2

	₹ '000		₹'000
To Balance b/d		By Balance b/d	
Cash in hand	10	Stock reserve ₹ 1,080 × 1/6	180
Trade debtors	384	By Goods sent to branch A/c (Returns to H.O.)	72
Stock	1,080	By Goods sent to branch A/c	2,188
Furniture and fittings	500	(Loading on net goods sent to branch – $\left(13{,}128 \times \frac{1}{6}\right)$	
To Goods sent to branch A/c	13,200		
To Bank A/c (Payment for furniture)	100	By Bank A/c (Remittance from branch to H.O.) (W.N.5)	11,700
To Balance c/d Stock reserve $\left(1470 \times \frac{1}{6}\right)$	245	By Balance c/d Cash in hand	10
To Net profit transferred to General P/L account	1,096	Trade debtors (W.N.3)	485
		Stock (W.N.1)	1,470
To Balance c/d - Outstanding expenses	6	Furniture and fittings (W.N.4)	516
	16,621		16,621

Working Notes:

1. Invoice price and cost

Let cost be	100
So, invoice price	120
Loading	20
Loading: Invoice price= 20 : 120	= 1 : 6

2. Memorandum Branch Stock Account

	₹ '000		₹ '000
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. Memorandum Branch Debtors Account

TELEGRAM: CA NOTE HUB

	₹ '000		₹ '000
To Balance b/d	384	By Branch cash	2,842
To Branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses (Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. Memorandum Branch Furniture and Fittings Account

	₹ '000		₹ '000
To Balance b/d	500	By Depreciation [(500x16%) + (100 x 16% x 3/12)]	84
To Bank	100	By Balance c/d	516
	600		600

Note: Since the new furniture was purchased on 1st Jan 20X2 depreciation will be for 3 months.

5. Memorandum Branch Cash Account

	₹ '000		₹ '000
To Balance b/d	10	By Branch expenses	842
To Branch stock	9,700	By Remittances to H.O. (b.f)	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

Illustration 25 (MTP Mar'23) (RTP May'19, May'20)

On 31st March, 20X2 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Debit Balances	**₹ in lacs**
Furniture and Equipment	18
Depreciation on furniture	2
Salaries	25
Rent	10
Advertising	6
Telephone, Postage and Stationery	3
Sundry Office Expenses	1
Stock on 1st April, 20X1	60
Goods Received from	288
Head Office Debtors	20
Cash at bank and in hand	8

TELEGRAM: CA NOTE HUB

Carriage Inwards	7
	448
Credit Balances	
Outstanding Expenses	3
Goods Returned to Head Office	5
Sales	360
Head Office	80
	448

Additional Information:

Stock on 31st March, 20X2 was valued at ₹ 62 lacs. On 29th March, 20X2 the Head Office dispatched goods costing ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 20X2. Hence, the figure of goods received from Head Office does not include these goods. Also, the head office has charged the branch ₹ 1 lac for centralized services for which the branch has not passed the entry.

You are required to:

(i) Pass Journal Entries in the books of the Branch to make the necessary adjustments

(ii) Prepare Final Accounts of the Branch including Balance Sheet, and

(iii) Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance. **(12 Marks)**

Solution:

(i) Books of Branch

Journal Entries

		(₹ in lacs)	
		Dr.	**Cr.**
Goods in Transit A/c	Dr.	10	10
To Head Office A/c			
(Goods dispatched by head office but not received by branch before 1st April, 20X2)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 20X2

	₹ in lacs		**₹ in lacs**
To Opening Stock	60	By Sales	360
To Goods received from		By Closing Stock including transit	72
Head Office 288+10			
Less: Returns (5)	293		
To Carriage Inwards	7		

TELEGRAM: CA NOTE HUB

To Gross Profit c/d	72		
	432		432
To Salaries	25	By Gross Profit b/d	72
To Depreciation on Furniture	2		
To Rent	10		
To Advertising	6		
To Telephone, Postage & Stationery	3		
To Sundry Office Expenses	1		
To Head Office Expenses (centralised services)	1		
To Net Profit Transferred to Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 20X2

Liabilities	**₹ in lacs**		**Assets**	**₹ in lacs**	
Head Office	80		Furniture & Equipment	20	
Add: Goods in transit	10		Less: Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24	115	Goods in Transit		10
Outstanding Expenses		3	Debtors		20
			Cash at bank and in hand		8
		118			118

(iii) Books of Head Office

Journal Entries

		₹ Dr.	**₹ Dr.**
Branch Trading Account	Dr.	365	
To Branch Account			365
(The total of the following items in branch trial balance debited to branch trading account:			
	₹ in lacs		
Opening Stock	60		
Goods received from Head Office	288		
Goods purchased but not received	10		
Carriage Inwards	7)		

TELEGRAM: CA NOTE HUB

Branch Account		Dr.	437	
To Branch Trading Account				437
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows:				
	₹ in lacs			
Sales	360			
Closing Stock	62			
Goods in transit	10			
Goods returned to Head Office	5)			
Branch Trading Account		Dr.	72	
To Branch Profit and Loss Account				72
(Gross profit earned by branch credited to Branch Profit and Loss Account)				
Branch Profit and Loss Account		Dr.	48	
To Branch Account				48
(Total of the following branch expenses debited to Branch Profit & Loss Account:				
	₹ in lacs			
Salaries	25			
Rent	10			
Advertising	6			
Telephone, Postage & Stationery	3			
Sundry Office Expenses	1			
Head Office Expenses	1			
Depreciation on furniture	2			
Branch Profit & Loss Account		Dr.	24	
To Profit and Loss Account				24
(Net profit at branch credited to general Profit & Loss A/c)				
Branch Furniture & Equipment		Dr.	18	
Branch Stock	Dr.		62	
Branch Debtors		Dr.	20	
Branch Cash at Bank and in Hand	Dr.		8	
Goods in Transit		Dr.	10	
To Branch				118
(Incorporation of different assets at the branch in H.O. books)				
Branch		Dr.	3	
To Branch Outstanding Expenses				3
(Incorporation of Branch Outstanding Expenses in H.O. books)				

Illustration 26

M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit.

TELEGRAM: CA NOTE HUB

Branch Expenses are paid direct from head office and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit under Stock and Debtors Method'.

Branch does not maintain any books of account, but sends weekly returns to the Head Office.

	₹
Goods received from Head Office at invoice price	45,00,000
Returns to Heads Office at invoice price	90,000
Stock at Bangalore as on 1st January, 20X1	4,50,000
Sales during the year - Cash	15,00,000
- Credit	27,00,000
Sundry Debtors at Bangalore as on 1st January, 20X1	5,40,000
Cash received from Debtors	24,00,000
Discount allowed to Debtors	45,000
Bad Debts in the year	30,000
Sales returns at Bangalore Branch	60,000
Rent, Rates and Taxes at Branch	1,35,000
Salaries, Wages and Bonus at Branch	4,50,000
Office Expenses	45,000
Stock at Branch on 31st December, 20X1 at invoice price	9,00,000

Solution:

Bangalore Branch Stock Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	4,50,000	By Goods sent to branch A/c (Returns)	90,000
Goods sent to branch A/c	45,00,000	By Bank A/c (Cash sales)	15,00,000
To Branch debtors A/c (Returns)	60,000	By Branch debtors A/c (credit sales)	27,00,000
To Branch adjustment A/c (Surplus over invoice price)*	1,80,000	By Balance c/d	9,00,000
	51,90,000		51,90,000

*Alternatively, this may directly be transferred to Branch P&L A/c without routing it through Branch Adjustment Account.

Bangalore Branch Adjustment Account

Particulars	Amount ₹)	Particulars	Amount (₹)
To Stock reserve - 20% of ₹ 9,00,000 (closing stock)	1,80,000	By Stock reserve - 20% of ₹ 4,50,000 (Opening stock)	90,000
To Branch profit & loss A/c	9,72,000	By Goods sent to branch A/c –	8,82,000

TELEGRAM: CA NOTE HUB

(Gross profit)		20% of ₹ 44,10,000 (45,00,000 – 90,000)	
		By Branch stock A/c	1,80,000
	11,52,000		11,52,000

Branch Profit & Loss Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Branch expenses A/c	6,30,000	By Branch adjustment A/c	9,72,000
To Branch debtors A/c (Discount)	45,000	(Gross Profit)	
To Branch Debtors A/c (Bad debts)	30,000		
To Net profit (transferred to Profit & Loss A/c)	2,67,000		
	9,72,000		9,72,000

Branch Expenses Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bank A/c (Rent, rates & taxes)	1,35,000	By Branch profit and loss A/c (Transfer)	6,30,000
To Bank A/c (Salaries, wages& bonus)	4,50,000		
To Bank A/c (Office expenses)	45,000		
	6,30,000		6,30,000

Branch Debtors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	5,40,000	By Bank A/c	24,00,000
To Branch stock A/c	27,00,000	By Branch profit and loss A/c (Bad debts and discount)	75,000
		By Branch stock A/c (Sales returns)	60,000
		By Balance c/d (bal. fig.)	7,05,000
	32,40,000		32,40,000

Goods sent to Branch Account

TELEGRAM: CA NOTE HUB

Particulars	Amount (₹)	Particulars	Amount (₹)
To Branch stock A/c	90,000	By Branch stock A/c	45,00,000
To Branch adjustment A/c	8,82,000		
To Purchases A/c	35,28,000		
	45,00,000		45,00,000

Illustration 27

Beta, having head office at Mumbai has a branch at Nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 20X1:

	Head Office (₹)	Branch (₹)
Opening stock	2,25,000	
Purchases	25,50,000	
Goods sent to branch (Cost to H.0. plus 80%)	9,54,000	
Sales	27,81,000	9,50,000
Office expenses	90,000	8,500
Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 20X1.

Solution:

Trading and Profit and Loss A/c

For the year ended 31st March 20X1

	Head office ₹	Branch ₹		Head office ₹	Branch ₹
To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000
To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	_
To Goods received from head office	-	9,54,000	By Closing stock (W.N.1 & 2)	7,00,000	99,000
To Gross profit c/d	16,60,000	95,000			
	44,35,000	10,49,000		44,35,000	10,49,000
To Office expenses	90,000	8,500	By Gross profit b/d	16,60,000	95,000
To Selling expenses	72,000	6,300			
To Staff salaries	65,000	12,000			
To Branch	44,000	_			
Stock					
Reserve					

TELEGRAM: CA NOTE HUB

(W.N.3)					
To Net Profit	13,89,000	68,200			
	16,60,000	95,000		16,60,000	95,000

Working Notes:

(1)	**Calculation of closing stock of head office:**	**₹**
	Opening Stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold [37,35,000 x 100/180]	(20,75,000)
		7,00,000
(2)	Calculation of closing stock of branch:	₹
	Goods received from head office [At invoice value]	9,54,000
	Less: Invoice value of goods sold [9,50,000 x 180/200]	(8,55,000)
		99,000
(3)	Calculation of unrealized profit in branch stock:	
	Branch stock ₹ 99,000	
	Profit included 80% of cost	
	Hence, unrealized profit would be = ₹ 99,000 x 80/180	₹ 44,000

Illustration 28

Pass necessary Journal entries in the books of an independent Branch of a business entity to rectify or adjust the following:

(i) Income of ₹ 2,800 allocated to the Branch by Head Office but not recorded in the Branch books.

(ii) Branch paid ₹ 3,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.

(iii) Branch incurred travelling expenses of ₹ 5,000 on behalf of other Branches, this was not recorded in the books of Branch.

(iv) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.

(v) Head Office allocates ₹ 75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.

(vi) Head Office collected ₹ 30,000 directly from a Branch Customer. The intimation of the fact has been received by the Branch only now, not recorded till now.

(vii) Goods dispatched by the Head office amounting to ₹ 10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

Solution:

Books of Branch

Journal Entries

Sr. No	Particulars		Amount ₹ Dr.	in ₹ Cr.
(i)	Head Office Account	Dr.	2,800	
	To Income Account			2,800

TELEGRAM: CA NOTE HUB

	(Being the income allocated by the Head office not recorded earlier, now recorded)			
(ii)	Head Office Account	Dr.	3,000	
	To Salaries Account			3,000
	(Being rectification of salary paid on behalf of Head Office)			
(iii)	Head Office Account	Dr.	5,000	
	To Cash Account			5,000
	(Being expenditure incurred on account of other branch, now recorded in books)			
(iv)	No entry in Branch Books is required.			
(v)	Expenses Account	Dr.	75,000	
	To Head Office Account			75,000
	(Being allocated expenses of Head Office recorded)			
(vi)	Head Office Account	Dr.	30,000	
	To Debtors Account			30,000
	(Being adjustment entry for collection from Branch Debtors directly by Head Office)			
(vii)	Goods -in- transit Account	Dr.	10,000	
	To Head Office Account			10,000
	(Being goods sent by Head Office still in-transit)			

Illustration 29

The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 20X1:

	$	$
Head office A/c	-	22,800
Sales	-	84,000
Debtors and creditors	4,800	3,400v
Machinery	24,000	_
Cash at bank	1,200	_
Stock, 1 January, 20X1	11,200	_
Goods from H.O.	64,000	_
Expenses	5,000	_
	1,10,200	1,10,200

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

	₹		₹
To Balance b/d	8,10,000	By Cash	28,76,000
To Goods sent to branch	29,26,000	By Balance c/d	8,60,000
	37,36,000		37,36,000

TELEGRAM: CANOTE HUB

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired in past, when $ 1.00 = ₹ 40.

Rates of exchange were:			
1st January, 20X1	$ 1.00	=	₹ 46
31st December, 20X1	$ 1.00	=	₹ 48
Average	$ 1.00	=	₹ 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Solution:

(i) In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars)

for the year ended 31st December, 20X1

Particulars	$	Particulars	$
To Opening stock	11,200	By Sales	84,000
To Goods from H.O.	64,000	By Closing stock (W.N.2)	8,000
To Gross profit c/d	16,800		
	92,000		92,000
To Expenses	5,000	By Gross profit b/d	16,800
To Depreciation (24,000 x10%)	2,400		
To Manager's commission (W.N.1)	470		
To Net profit c/d	8,930		
	16,800		16,800

(ii) (a) Converted Branch Trial Balance (into Indian Currency)

Particulars	Rate per $	Dr. (₹)	Cr. (₹)
Machinery	40	9,60,000	-
Stock January 1, 20X1	46	5,15,200	-
Goods from head office	Actual	29,26,000	-
Sales	47	-	39,48,000
Expenses	47	2,35,000	-
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	-
Head office A/c	Actual	-	8,60,000
Difference in exchange rate (b.f.)		47,000	-
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		₹

TELEGRAM: CA NOTE HUB

			3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 20X1

	₹		₹
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from head office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		43,32,000
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on ₹ 9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		8,90,800

(c) Branch Account

	₹			₹
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	Less: Depreciation	(96,000)	
To Creditors	1,63,200			8,64,000
To Outstanding commission	22,560	By Closing stock		3,84,000
		By Debtors		2,30,400
		By Cash at bank		57,600
	15,36,000			15,36,000

Working Notes:

1. Calculation of manager's commission @ 5% on profit

i.e. 5% of $[16,800 – (5,000 + 2,400)]

Or 5% × $9,400 = $ 470

Manager's commission in Rupees = $ 470 x ₹ 48 = ₹ 22,560

2. Calculation of closing stock

	$
Opening stock	11,200
Add: Goods from head office	64,000
	75,200

TELEGRAM: CA NOTE HUB

Less: Cost of goods sold (at invoice price) i.e. $\frac{100}{125} \times 84,000$	(67,200)
Closing stock	8,000
Closing stock in Rupees = $8,000 x ₹ 48 = ₹ 3,84,000.	

Note: Manager is entitled to commission on profits earned at the end of the year.

TELEGRAM: CANOTE HUB

MTP / RTP / Past Exam

Question 1 (MTP Oct'19, RTP Nov'22)

M & S Co. of Lucknow has a branch in Canberra, Australia (as an integral foreign operation of M & S Co.). At the end of 31st March 2019, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

	Lucknow office (Rs. In thousand)		Canberra Branch (Aust. Dollars in thousand)	
	Dr.	**Cr.**	**Dr.**	**Cr.**
Capital		2,000		
Reserves & Surplus		1,000		
Land	500			
Buildings (Cost)	1,000			
Buildings Dep. Reserves		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery Dep.				
Reserves		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1- 4-2018	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salary	75		45	
Rent			12	
Office Expenses	25		18	
Commission Receipts		256		100
Branch/HO Current Account	120			7
	4,880	**4,880**	**390**	**390**

The following information is also available:

(i) Stock as at 31st March, 2019

Lucknow Rs. 1,50,000

Canberra A$ 3125 (all stock is out of purchases made at Abroad)

(ii) Head Office always sent goods to the Branch at cost plus 25%

(iii) Provision is to be made for doubtful debts at 5%

TELEGRAM: CA NOTE HUB

(iv) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down value.

You are required to:

(1) Convert the Branch Trial Balance into rupees by using the following exchange rates:

Opening rate	1 A $ = Rs. 50
Closing rate	1 A $ = Rs. 53
Average rate	1 A $ = Rs. 51.00
For Property, Plant & Equipment	1 A $ = Rs. 46.00

(2) Prepare Trading and Profit and Loss Account for the year ended 31st March 2019 showing to the extent possible H.O. results and Branch results separately. **(12 Marks)**

Solution:

M & S Co. Ltd. Canberra, Australia Branch Trial Balance As on 31st Mar 2019

			($ 'thousands)	(Rs. 'thousands)	
	Dr.	**Cr.**	**Conversion**	**Dr.**	**Cr.**
			rate per $		
Plant & Machinery (cost)	200		Rs. 46	9,200	
Plant & Machinery Dep. Reserve		130	Rs. 46		5,980
Trade receivable/payable	60	30	Rs. 53	3,180	1,590
Stock (1.4.2018)	20		Rs. 50	1,000	
Cash & Bank Balances	10		Rs. 53	530	
Purchase / Sales	20	123	Rs. 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		Rs. 51	2,295	
Rent	12		Rs. 51	612	
Office expenses	18		Rs. 51	918	
Commission Receipts		100	Rs. 51		5,100
H.O. Current A/c 7			Actual		120
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				208	
	390	**390**		**19,063**	**19,063**
Closing stock	3.125		53	165.625	

Trading and Profit & Loss Account for the year ended 31st March, 2019 (Rs.'000)

	H.O.	**Branch**	**Total**		**H.O.**	**Branch**	**Total**
To Opening Stock	100	1,000.000	1,100.000	By Sales	520	6,273.000	6,793.000

TELEGRAM: CANOTE HUB

To Purchases	240	1,020.000	1,260.000	By Goods sent to Branch	100	-	100.000
To Goods received from Head Office	-	100.000	100.000	By Closing Stock	150	165.625	315.625
To Wages & Salaries	75	2,295.000	2,370.000				
To Gross profit c/d	355	2,023.625	2,378.625				
	770	6,438.625	7,208.625		770	6,438.625	7,208.625
To Rent	-	612.000	612.000	By Gross profit b/d	355	2,023.625	2,378.625
To Office expenses	25	918.000	943.000	By Commission receipts	256	5,100.000	5,356.000
To Provision for doubtful debts@ 5%	14	159.000	173.000				
To Depreciation	460	644.000	1,104.000				
To (W. N.) Balance c/d	112	4,790.625	4,902.625				
	611	**7,123.625**	**7,734.625**		**611**	**7,123.625**	**7,734.625**
To Managing Partner's Salary			30.000	By Balance b/d			4,902.625
To Exchange Loss			208.000	By Branch stock reserve			4,000
To Balance c/d			4,668.625				
			4,906.625				**4,906.625**

Working Note:

Calculation of Depreciation

	H. O	**Branch**
	Rs. '000	**Rs. '000**
Building. Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,500	9,200
Less: Dep. Reserve	(600)	(5,980)
	1,900	3,220
Depreciation @ 20% (B)	380	644
Total Depreciation (A+B)	460	644

TELEGRAM: CA NOTE HUB

Note: As the closing stock of Branch does not consist any stock transferred from M& S Co., there is no need to create closing stock reserve. But the opening branch stock reserve has to be reversed in the P&L A/c.

Question 2 (MTP Mar'19, Mar'18)

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars, you are required to prepare branch account in the books of Head Office.

	Rs.		Rs.
Stock on 1st April 2017 (invoice price)	30,000	Discount allowed to debtors	160
Sundry Debtors on 1st April, 201 7	18,000	Expenses paid by head office:	
Cash in hand as on 1st April, 2017	-	Rent	1,800
Office furniture on 1st April, 2017	3,000	Salary	3,200
Goods invoiced from the head		Stationery & Printing	800
office (invoice price)	1,60,000		
Goods returned to Head Office	2,000	Petty expenses paid by the branch	600
(invoice price)			
Goods returned by debtors	960	Depreciation to be provided on branch	
Cash received from debtors	60,000	furniture at 10% p. a.	
Cash Sales	1,00,000	Stock on 31st March, 2018	
Credit sales	60,000	(at invoice price)	28,000

Solution: **(8 Marks)**

In the books of Head Office – Kolkata Branch Account (at invoice)

	Rs.		Rs.
To Balance b/d		By Stock reserve (opening)	6,000
Stock	30,000	By Remittances:	
Debtors	18,000	Cash Sales	1,00,000
Furniture	3,000	Cash from Debtors	60,000
To Goods sent to	1,60,000	Less: Petty expenses (600)	1,59,400
branch		By Goods sent to branch (loading)	32,000
To Goods returned by branch (loading)	400	By Goods returned by branch (Return to H.O.)	2,000
To Bank (expenses paid by H.O.)		By Balance c/d	
Rent 1,800		Stock	28,000
Salary 3,200		Debtors	16,880

TELEGRAM: CA NOTE HUB

Stationary & printing 800	5,800	Furniture (3,000-300)	2,700
To Stock reserve (closing)	5,600		
To Profit transferred to			
General Profit & Loss A/c	24,180		
	2,46,980		2,46,980

Working Note:

Debtors Account

	Rs.		Rs.
To Balance c/d	18,000	By Cash account	60,000
To Sales account (credit)	60,000	By Sales return account	960
		By Discount allowed account	160
		By Balance c/d	16,880
	78,000		78,000

Note: In the absence of opening cash balance, remittance to Head Office has been made after payment of petty expenses.

Question 3 (MTP May'20, Oct'21)

From the following details of Western Branch Office of M/s. XYZ Corp. for the year ending 31st March, 2020, ascertain branch stock reserve in respect of unrealized profit in opening stock and closing stock:

(i) Goods are sent to the branch at invoice price and branch also maintains stock at the same price.

(ii) Sale price is cost plus 40%.

(iii) Invoice price is cost plus 15%.

(iv) Other information from accounts of branch:

Opening Stock as on 01-04-2019 3,45,000

Goods sent during the year by Head Office to Branch	16,10,000
Sales during the year	21,00,000
Expenses incurred at the branch	45,000

Solution: **(4 Marks)**

Branch Stock Reserve in respect of unrealized profit on opening stock = Rs. 3,45,000 x (15/115) = Rs. 45,000 on closing stock = Rs. 2,30,000 x (15/115) = Rs. 30,000

Working Note:	**Rs.**
Cost Price	100
Invoice Price	115
Sale Price	140
Calculation of closing stock at invoice price	Rs.
Opening stock at invoice price	3,45,000

TELEGRAM: CA NOTE HUB

Goods received during the year at invoice price	16,10,000
	19,55,000
Less: Cost of goods sold at invoice price [21,00,000 X (115/140)]	(17,25,000)
Closing stock	2,30,000

Question 4 (MTP Oct'20, Mar'22)

L Ltd. has its head office at Mumbai and two branches at Pune and Goa. The branches purchase goods independently. Pune branch makes a profit of one third on cost and Goa branch makes a profit of 20% on sales. Goods are also supplied by one branch to another at the respective sales price. From the following particulars, prepare the Trading and Profit and Loss Account of Pune branch and find out the profit or loss made by it considering the reserve for unrealised profits:

Particulars	**Pune Branch ₹**	**Goa Branch ₹**
Opening Stock	40,000	30,000
Purchases (Including Inter Branch transfers)	2,00,000	2,50,000
Sales	2,80,000	2,95,625
Chargeable Expenses	15,000	27,500
Closing Stock	30,000	43,500
Office and Administration Expenses	13,250	7,000
Selling and Distribution Expenses	15,000	10,000

Information:

(i) Opening stock at Pune Branch includes goods of ₹ 10,000 (invoice price) taken from Goa Branch,

(ii) Opening stock at Goa Branch includes goods of invoice price ₹ 17,000 taken from Pune Branch,

(iii) The Pune Branch sales includes transfer of goods to Goa Branch at selling price ₹ 20,000

(iv) The sales of Goa Branch include transfer of goods to Pune Branch at selling price ₹ 15,000.

(v) Closing stock at Pune Branch includes goods received from Goa Branch (invoice price ₹ 5,000.

(vi) Closing stock at Goa Branch includes goods of ₹ 4,000 (invoice price) **(6 Marks)**

Solution:

Pune Branch Trading and Profit and Loss Account

Particulars	**₹**	**Particulars**	**₹**
To Opening Stock (including ₹10,000 from Goa Branch)	40,000	By Sales (including ₹20,000 to Goa Branch)	2,80,000
To Purchases	2,00,000	By Closing Stock (including ₹5,000 from Goa Branch)	30,000
To Chargeable Expenses	15,000		
To Gross Profit c/d (before making adjustment for unrealised profit)	55,000		
	3,10,000		3,10,000

TELEGRAM: CA NOTE HUB

To Stock Reserve (for unrealized profit in Closing Stock lying at Goa Branch) (₹4,000 x 25/100)	1,000	By Gross Profit b/d	55,000
To Office & Adm. Expenses	13,250	By Stock Reserve (for unrealised profit in Opening Stock lying at Goa Branch) (₹ 17,000 x 25/100)	4,250
To Selling & Distribution Expenses	15,000		
To Net Profit	30,000		
	59,250		59,250

Question 5 (MTP Apr'21, Apr'22)

DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 31st March, 2021, the branch furnishes the following trial balance in U.K. Pound:

Particulars	**£**	**£**
	Dr.	**Cr.**
Property, Plant & Equipment (Acquired on 1st April, 2017)	24,000	
Stock as on 1st April, 2020	11,200	
Goods from head Office	64,000	
Expenses	4,800	
Debtors	4,800	
Creditors		3,200
Cash at bank	1,200	
Head Office Account		22,800
Purchases	12,000	
Sales		96,000
	1,22,000	**1,22,000**

In head office books, the branch account stood as shown below:

London Branch A/c

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Balance b/d	20,10,000	By Bank A/c	52,16,000
To Goods sent to branch	49,26,000	By Balance c/d	17,20,000
	69,36,000		**69,36,000**

The following further information is given:

(a) Property, Plant & Equipment are to be depreciated @ 10% p.a. on WDV.

(b) On 31st March, 2021:

Expenses outstanding	-	£ 400
Prepaid expenses	-	£ 200

TELEGRAM: CA NOTE HUB

Closing stock	-	£ 8,000

(c) Rate of Exchange:

1st April, 2017	- Rs. 70 to £ 1
1st April, 2020	- Rs. 76 to £ 1
31st March, 2021	- Rs. 77 to £ 1
Average	- Rs. 75 to £ 1

You are required to prepare: (1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees; and (2) Trading and profit and loss account for the year ended 31st March, 2021 of London branch as would appear in the books of Delhi head office of DM.

Solution: **(8 Marks)**

Trial Balance of London Branch as on 31st March, 2021

Particulars	**U.K. Pound**	**Rate Per U.K. Pound**	**Dr. (Rs.)**	**Cr. (Rs.)**
Property, Plant & Equipment	24,000	70	16,80,000	
Stock (as on 1st April, 2020)	11,200	76	8,51,200	
Goods from Head Office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 – 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding Expenses	400	77		30,800
Prepaid expenses	200	77	15,400	
Cash at Bank	1,200	77	92,400	
Head office Account		-		17,20,000
Difference in Exchange				12,400
			92,09,600	92,09,600

Closing stock will be (8,000 × 77) = Rs. 6,16,000 Trading and Profit & Loss A/c for the year ended 31st March, 2021

Particulars	**Amount**	**Particulars**	**Amount**
	(Rs.)		**(Rs.)**
To Opening Stock	8,51,200	By Sales	72,00,000
To Purchases	9,00,000	By Closing Stock	6,16,000
To Goods from H.O.	49,26,000		78,16,000
To Gross Profit	11,38,800		
	78,16,000	By **Gross Profit**	11,38,800

TELEGRAM: CA NOTE HUB

To Expenses	3,75,000	By Profit due to Exchange difference	12,400
To Depreciation	1,68,000		
To Net Profit	6,08,200		
	11,51,200		11,51,200

Working Note:

Since London Branch is an integral foreign operation. Hence, (1) Property, Plant & Equipment (cost and depreciation) are translated using the exchange rate at the date of purchase of the assets. (2) Exchange difference arising on translation of the financial statement is charged to Profit and Loss Account.

Question 6 (MTP Nov'21, Apr'23)

Pass necessary Journal entries in the books of an independent Branch of a Company, wherever required, to rectify or adjust the following:

(i) Branch incurred travelling expenses of ₹ 4,000 on behalf of other Branches, but not recorded in the books of Branch.

(ii) Goods dispatched by the Head office amounting to ₹ 8,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

(iii) Provision for doubtful debts, whose accounts are kept by the Head Office, not provided earlier for ₹ 2,000.

(iv) Branch paid ₹ 2,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account. **(4 Marks)**

Solution:

Journal Entries in Books of Branch

				Amount in ₹
			Dr.	Cr.
(i)	Head Office Account	Dr.	4,000	
	To Cash Account			4,000
	(Being expenditure incurred on account of other branch, now recorded in books)			
(ii)	Goods –in- transit Account	Dr.	8,000	
	To Head Office Account			8,000
	(Being goods sent by Head Office still intransit)			
(iii)	Provision for Doubtful Debts A/c		2,000	
	To Head Office Account			2,000
	(Being the provision for doubtful debts not provided earlier, now provided for)			
(iv)	Head Office Account		2,000	
	To Salaries Account			2,000
	(Being rectification of salary paid on behalf of Head Office)			

TELEGRAM: CA NOTE HUB

Question 7 (MTP Mar'21 Oct'23)

Moon Star has a branch at Virginia (USA). The Branch is a non-integral foreign operation of the Moon Star.

The trial balance of the Branch as at 31st March, 2022 is as follows:

Particulars	**US $**	
	Dr.	Cr.
Office equipments	48,000	
Furniture and Fixtures	3,200	
Stock (April 1, 2021)	22,400	
Purchases 96,000		
Sales	---	1,66,400
Goods sent from H.O	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rates & Taxes	800	
Insurance	400	
Trade Expenses	400	
Head Office Account -	--	45,600
Sundry Debtors	9,600	
Sundry Creditors	---	6,800
Cash at Bank	2,000	
Cash in Hand	400	
	2,18,800	**2,18,800**

The following further information is given:

1) Salaries outstanding $ 400.
2) Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.
3) The Head Office sent goods to Branch for ₹15,80,000.
4) The Head Office shows an amount of ₹ 20,50,000 due from Branch.
5) Stock on 31st March, 2022 -$21,500.
6) There were no transit items either at the start or at the end of the year.
7) On April 1, 2020 when the fixed assets were purchased the rate of exchange was
8) ₹ 43 to one $. On April 1, 2021, the rate was 47 per $. On March 31, 2022 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare Trial balance incorporating adjustments given converting dollars into rupees and Trading, Profit and Loss Account for the year ended 31st March, 2022 of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet. **(8 to 12 Marks)**

TELEGRAM: CA NOTE HUB

Solution:

In the books of Moon Star Trial Balance (in Rupees) of Virginia (USA) Branch as on 31st March, 2022

	Dr.	Cr.	Conversion	Dr.	Cr.
	US $	US $	rate	₹	₹
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2021)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange difference (bal. fig.) transferred to foreign currency translation reserve account					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Trading and Profit and Loss Account of Virginia Branch for the year ended 31st March, 2022

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US $ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	15,92,200		

TELEGRAM: CA NOTE HUB

	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		15,92,200

Question 8 (RTP Nov'21, Past Exam Nov'20, Nov'23)

Lal & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (₹)
Goods received from Head office at Invoice Price	4,20,000
Goods returned to Head office at Invoice Price	30,000
Cash sales for the year 2019-20	92,500
Credit Sales for the year 2019-20	3,12,500
Stock at Branch as on 01-04-2019 at Invoice price	36,000
Sundry Debtors at Patna branch as on 01-04-2019	48,000
Cash received from Debtors	2,19,000
Discount allowed to Debtors	3,750
Goods returned by customer at Patna Branch	7,000
Bad debts written off	2,750
Amount recovered from Bad debts previously written off as Bad	500
Rent, Rates & taxes at Branch	12,000
Salaries & wages at Branch	36,000
Office Expenses (at Branch)	4,600
Stock at Branch as on 31-03-2020 at cost price	62,500

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit. **(10 Marks)**

Solution:

Branch Stock Account

TELEGRAM: CA NOTE HUB

		₹			₹	₹	₹
1.4.19	To Balance b/d (opening stock)	36,000	31.3.20	By Sales:			
31.3.20	To Goods Sent to Branch A/c	4,20,000		Cash		92,500	
				Credit	3,12,500		
	To Branch P&L	47,000		Less: Return	(7,000)	3,05,500	3,98,000
				By Goods sent to branch – returns			30,000
				By Balance c/d (closing stock)			75,000
		5,03,000					5,03,000
1.4.20	To Balance b/d	75,000					

Branch Debtors Account

			₹		₹
1.4.19	To Balance b/d	48,000	31.3.20	By Cash	2,19,000
31.3.20	To Sales	3,12,500		By Returns	7,000
				By Discounts	3,750
				By Bad debts	2,750
				By Balance c/d	1,28,000
		3,60,500			3,60,500
1.4.20	To Balance b/d	1,28,000			

Branch Expenses Account

		₹			₹
31.3.20	To Salaries & Wages	36,000	31.3.20	By Branch P&L A/c	59,100
	To Rent, Rates & Taxes	12,000			
	To Office Expenses	4,600			
	To Discounts	3,750			
	To Bad Debts	2,750			
		59,100			59,100

Branch Profit & Loss Account for year ended 31.3.20

		₹			₹
31.3.20	To Branch Expenses A/c	59,100	31.3.20	By Branch stock	47,000

TELEGRAM: CA NOTE HUB

	To Net Profit transferred to General P & L A/c	46,900		By Branch Stock Adjustment account	58,500
				By Bad debts recovered	500
		1,06,000			106,000

Branch Stock Adjustment Account for year ended 31.3.20

		₹			₹
31.3.20	To Goods sent to branch (30,000x1/6) –returns	5,000	31.3.20	By Balance b/d (36,000x1/6)	6,000
	To Branch P & L A/c	58,500		By Goods sent to branch (4,20,000x1/6)	70,000
	To Balance c/d (75,000x1/6)	12,500			
		76,000			76,000

Question 9 (RTP May 18, May'21)

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31 st March, 2020.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated before charging his commission but subject to a deduction from such commission equal to 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch from head office. The following details for the year ended 31st March, 2020 are given as follows:

	Rs.		Rs.
Opening Stock (at cost)	74,736	Chargeable expenses	49,120
Goods sent to branch (at cost)	2,89,680	Closing Stock (Selling Price)	1,23,328
Sales	3,61,280		
Manager's commission paid on account	2,400		

From the above details, you are required to calculate the commission due to manager for the year ended 31st March, 2020.

Solution:

In the books of Alpha Ltd.

Step 1: Calculation of Deficiency Branch stock account (at invoice price)

Particulars	Rs.	Particulars	Rs.
To Opening Stock (Rs. 74,736 + 1/3 of Rs. 74,736)	99,648	By Sales	3,61,280
To Goods sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Deficiency at sale price [Balancing figure]	1,280

TELEGRAM: CA NOTE HUB

	4,85,888		4,85,888

Step 2: Calculation of Net Profit before Commission

Branch account

Particulars	Rs.	Particulars	Rs.
To Opening Stock [Rs.74,736 + 1/3 of Rs. 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
To Expenses	49,120	By Stock Reserve A/c	24,912
To Stock Reserve A/c [Rs. 1,23,328 x 25/100]	30,832	By Goods sent to Branch A/c	96,560
To Net Profit – subject to manager's commission	40,240		
	6,06,080		6,06,080

Step 3: Calculation of Commission still due to manager

		Rs.
A	Calculation at 10% profit before charging his commission [Rs. 40,240 x 10/100]	4,024
B	Less: 25% of cost of deficiency in stock [25% of (75% of Rs. 1,280)]	(240)
C	Commission for the year [A-B]	3,784
D	Less: Paid on account	(2,400)
E	Balance due (C-D)	1,384

Question 10 (RTP Nov'19, Sep'24)

From the following particulars relating to Pune branch for the year ending December 31, 2018, prepare Branch Account in the books of Head office.

		₹
Stock at Branch on January 1, 2018		10,000
Branch Debtors on January 1, 2018		4,000
Branch Debtors on Dec. 31, 2018		4,900
Petty cash at branch on January 1, 2018		500
Furniture at branch on January 1, 2018		2,000
Prepaid fire insurance premium on January 1, 2018		150
Salaries outstanding at branch on January 1, 2018		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000

TELEGRAM: CA NOTE HUB

Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash 1	1,000	
Annual Insurance up to March 31, 2019	600	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2018		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs.1,200 were destroyed due to fire and a sum of Rs.1,000 was received from the Insurance Company

Solution:

Pune Branch Account

Particulars		**₹**	**Particulars**	**₹**	**₹**
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash paid by debtors directly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received from Insurance Company	1,000	1,68,000
To Bank (expenses)			By Goods sent to branch	1,000	
Rent	2,000		(return of goods by		
Salaries	2,400		the branch to H.O.)		
Petty Cash	1,000		By Closing Balances:		
Insurance	600	6,000	Stock		5,000
To Net Profit		78,950	Petty Cash		650
			Debtors		4,900

TELEGRAM: CA NOTE HUB

			Furniture (2,000 – 10% depreciation)		1,800
			Prepaid insurance (1/4 x Rs.600)		150
		1,81,600			**1,81,600**

Working Note:

Calculation of petty cash balance at the end:	₹
Opening balance	500
Add: Cash received form the Head Office	1,000
Total Cash with branch	1,500
Less: Spent by the branch	850
Closing balance	650

Question 11 (RTP Nov'18)

Pass necessary Journal entries in the books of an independent Branch of M/s TPL Sons, wherever required, to rectify or adjust the following transactions:

(i) Branch paid ₹ 5,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.

(ii) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.

(iii) Branch assets accounts retained at head office, depreciation charged for the year ₹ 15,000 not recorded by Branch.

(iv) Head Office expenses ₹ 75,000 allocated to the Branch, but not yet been recorded by the Branch.

(v) Head Office collected ₹ 60,000 directly from a Branch Customer. The intimation of the fact has not been received by the Branch.

(vi) Goods dispatched by the Head office amounting to ₹ 50,000, but not received by the Branch till date of reconciliation.

(vii) Branch incurred advertisement expenses of ₹ 10,000 on behalf of other Branches, but not recorded in the books of Branch.

(viii) Head office made payment of ₹ 16,000 for purchase of goods by branch, but not recorded in branch books.

Solution:

Books of Branch Journal Entries

			Amounts₹	
			Dr.	Cr.
(i)	Head Office Account	Dr.	5,000	
	To Salaries Account (Being rectification of salary paid on behalf of Head Office)			5,000

TELEGRAM: CA NOTE HUB

(ii)	No entry in Branch Books is required.			
(iii)	Depreciation A/c	Dr.	15,000	
	To Head Office Account (Being depreciation of assets accounted for)			15,000
(iv)	Expenses Account	Dr.	75,000	
	To Head Office Account (Being allocated expenses of Head Office recorded)			75,000
(v)	Head Office Account	Dr.	60,000	
	To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)			60,000
(vi)	Goods in-transit Account	Dr.	50,000	
	To Head Office Accoun (Being goods sent by Head Office still in-transit)			50,000
(vii)	Head Office Account	Dr.	10,000	
	To expenses Account (Being expenditure incurred, wrongly recorded in books)			10,000
(viii)	Purchases account A/c	Dr.	16,000	
	To Head Office Account (Being purchases booked)			16,000

Question 12 (RTP May'23)

PQR has a branch at Houston (USA). Business of the Branch is carried out substantially independent by way of accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. The trial balance of the Branch as at 31st March, 2022 is as follows:

	US$	
Particulars	**Debit**	**Credit**
Office equipment (Cost)	56,400	
Opening Accumulated Depreciation (Office equipment)		5,400
Furniture and Fixtures (Cost)	36,000	
Opening Accumulated Depreciation		6,840
(Furniture and Fixtures)		
Opening Stock as on 1st April, 2021	24,500	
Purchases	96,500	
Sales		1,76,250
Salaries	4,250	
Carriage inward	256	

TELEGRAM: CA NOTE HUB

Rent, Rates & Taxes	956	
Trade receivables	12,560	
Trade payables		8,650
Cash at bank	2,540	
Cash in hand	500	
Head office Account	_____	37,322
Total	**2,34,462**	**2,34,462**

Following further information are given:

(i) Salaries outstanding as on 31st March, 2022 is US$ 600.

(ii) Depreciate office equipment and furniture & fixtures @ 10% at written down value.

(iii) Closing stock as on 31st March, 2022 is US $, 24,650.

(iv) You are informed that the Head office is showing receivable from the Branch as ₹ 23,75,614 as on 31st March, 2022. No transaction in respect of the Branch is pending in Head office.

(v) Office equipment (cost) includes one office equipment of US $ 2,400 purchased on 1/04/2021.

(vi) One furniture of carrying value of US $ 450 as on 01/04/2021 (cost: US $ 500 and Accumulated depreciation: US $ 50) has been sold for US $ 405 on 31/03/2022 to Mr. M at no profit no loss. Mr. M has not paid the amount till the finalization of branch account. No entry has been passed for this sale of furniture in the above trial balance.

(vii) The rate of exchange on different dates are:

Date	**1 US $ is equivalent to**
1st April, 2021	₹ 64
31st December, 2021	₹ 70
31st March, 2022	₹ 75
Average for the year	₹ 72

You are required to prepare the trial Balance after incorporating adjustments given and converting US $ into rupees.

Solution:

In the books of PQR

Trial Balance (in Rupees) of Houston (USA) Branch – Non-Integral foreign operation as on 31st March, 2022

	Dr.	**Cr.**	**Conversion**	**Dr.**	**Cr.**
	US $	**US $**	**rate**	**₹**	**₹**
Office Equipment	56,400		75	42,30,000	
Depreciation on Office Equipment (Accumulated)		10,500	75		7,87,500
(5,400+5,100)					
Depreciation	8,016		75	6,01,200	
Furniture and fixtures (36,000-500)	35,500		75	26,62,500	

TELEGRAM: CA NOTE HUB

Depreciation on furniture and fixtures (Accumulated)		9,661	75		7,24,575
(6,840-50-45 +2,916)					
Stock (1st April, 2021)	24,500		64	15,68,000	
Purchases	96,500		72	69,48,000	
Sales		1,76,250	72		126,90,000
Carriage inward	256		72	18,432	
Salaries (4,250+600)	4,850		72	3,49,200	
Rent, rates and taxes	956		72	68,832	
Salaries payable		600	75		45,000
Head Office A/c		37,322			23,75,614
					(given)
Trade receivables	12,560		75	9,42,000	
Trade payables		8,650	75		6,48,750
Cash at bank	2,540		75	1,90,500	
Cash in hand	500		75	37,500	
Mr. M	405		75	30,375	
(Receivable for sale of furniture)					
Exchange gain (bal. fig.)					3,75,100
	2,42,983	**2,42,983**		**176,46,539**	**176,46,539**

Closing stock 24,650 US$ x ₹ 75 =₹18,48,750.

Question 13 (Past Exam May'18)

Ayan Ltd. invoices goods to its branch at cost plus 33 % . From the following particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office.

	Rs.
Stock at commencement at Branch at invoice Price	3,60,000
Stock at close at Branch at Invoice Price	2,88,000
Goods sent to Branch during the year at invoice price (including goods invoiced at Rs. 48,000 to Branch on 31.03.2018 but not received by Branch before close of the year).	24,00,000
Return of goods to head office (invoice Price)	1,20,000
Credit Sales at Branch	1,20,000
Invoice value of goods pilfered	24,000
Normal loss at Branch due to wastage and deterioration of stock (at invoice price)	36,000
Cash Sales at Branch	21,60,000

TELEGRAM: CA NOTE HUB

Ayan closes its books on 31st March, 2018.

Solution:

In the books of Head Office Branch Stock Account

Particular	Rs.	Particular	Rs.
To Balance b/d	3,60,000	By Bank A/c (cash Sales)	21,60,000
To Goods sent to Branch A/c	24,00,000	By Branch Debtors A/c (Credit Sales)	1,20,000
To Branch Adjustment	36,000	By Goods sent to Branch A/c (Returns to H.O.)	1,20,000
A/c balancing fig. (Surplus)***		By Branch Adjustment A/c* (Rs.24,000 x 25/100)	6,000
		By Branch P&L A/c* (Cost of Abnormal Loss)	18,000
		By Branch Adjustment A/c** (invoice price of normal loss	36,000
		By Balance c/d:	
		In hand	2,88,000
		In transit	48,000
	27,96,000		**27,96,000**

*Alternative, combined posting for the amount of Rs.24,000 may be passed through Goods preferred account.

** Alternatively, it may first be transferred to normal Loss account which may ultimately be closed by transfer to Branch Adjustment account. The final amount of net profit will however remain same.

*** It has been considered that the surplus may be due to sale of goods by branch at price higher than invoice price.

Branch Stock Adjustment Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c	6,000	By Stock Reserve A/c	90,000
(Loading on Abnormal Loss)		(Rs. 3,60,000x25/100)	
To Branch Stock A/c	36,000	By Goods Sent to Branch A/c	5,70,000
(Normal Loss)		(Rs.24,00,000 - Rs.1,20,000) x 25/100	
To Stock Reserve A/c	84,000	By Branch Stock A/c (Surplus)	36,000
(Rs.3,36,000x25/100)			
To Gross Profit t/f to P & LA/c	5,70,000		
	6,96,000		**6,96,000**

Branch Profit and Loss Account

Particulars	Rs.	Particulars	Rs.

TELEGRAM: CANOTE HUB

To Branch Stock A/c	18,000	By Branch Adjustment A/c	5,70,000
(Cost of Abnormal Loss)		(Gross Profit)	
To Net Profit t/f to General P&LA/c	5,52,000		
	5,70,000		**5,70,000**

Question 14 (Past Exam, Dec'21)

Delta Ltd. Has a branch at Kanpur. Goods are invoiced from head office to Branch at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office. Prepare necessary Ledger accounts in the books of Delta Ltd. Under Stock and Debtors system to show profit earned at the branch for the year ending 31 st March, 2021.

Following information related to Branch is given:

Stock on 1st April, 2020 (Invoice price)	31,200	Goods returned by Debtors	3,000
Debtors on 1st April, 2020	17,400	Surplus in stock (Invoice price)	600
Goods invoiced at cost	72,000	Expenses at Branch	13,400
Sales at Branch: Cash sales	20,000	Discount allowed to Debtors	700
Credit sales	68,200	Debtors on 31st March, 2021	14,300

Solution: **(10 Marks)**

Books of Delta Ltd. Kanpur Branch Stock Account

	₹		₹
To Balance b/d – Opening Stock	31,200	By Bank A/c – Cash Sales	20,000
To Branch Debtors A/c – Sales Return	3,000	By Branch Debtors A/c - Credit Sales	68,200
To Goods sent to Branch A/c (72,000 +50% of 72,000)	1,08,000	By Balance c/d - Closing stock	54,600
To Surplus in stock	600		
	1,42,800		1,42,800

Kanpur Branch Stock Adjustment Account

	₹		₹
To Branch Profit and Loss Account	28,400	By Balance b/d (1/3 of ₹ 31,200)	10,400
To Balance c/d (1/3 of 54,600)	18,200	By Goods sent to Branch A/c (1/3 of ₹ 1,08,000)	36,000
		By Surplus in stock	200
	46,600		46,600

Goods Sent to Branch Account

	₹		₹

TELEGRAM: CANOTE HUB

To Kanpur Branch Stock Adjustment A/c	36,000	By Kanpur Branch Stock A/c	1,08,000
To Purchases A/c	72,000		
	1,08,000		1,08,000

Branch Debtors Account

	₹		₹
To Balance b/d	17,400	By Bank (Bal fig.)	67,600
To Branch Stock A/c	68,200	By Branch Expenses A/c (Discount allowed)	700
		By Branch Stock - Sales Returns	3,000
		By Balance c/d	14,300
	85,600		85,600

Branch Expenses Account

	₹		₹
To Bank A/c (expenses)	13,400	By Branch Profit & Loss A/c(Transfer)	14,100
To Branch Debtors A/c (Discount allowed)*	700		
	14,100		14,100

Branch Profit & Loss Account for the year ending 31st March 2021

	₹		₹
To Branch Expenses A/c	14,100	By Branch Adjustment A/c	28,400
To Net Profit	14,700	By surplus in stock (Cost)	400
	28,800		28,800

Note: * Discount allowed to debtors may be shown in Branch Profit and Loss account directly instead of transferring it through Branch Expenses account.

Question 15 (Past Exam May'22)

Walkaway Footwears has its head office at Nagpur and Branch at Patna. It invoiced goods to its branch at 20% less than the list price which is cost plus 100%, with instruction that cash sales were to be made at invoice price and credit sales at catalogue price (i.e. list price).

The following information was available at the branch for the year ended 31st March,2022.

	(Figures in₹)
Stock on 1st April,2021 (invoice price)	12,000
Debtors on 1st April, 2021	10,000

TELEGRAM: CA NOTE HUB

Goods received from head office (invoice price)	1,32,000
Sales:	
Cash	46,000
Credit 1,00,000	1,46,000
Cash received. from debtors	85,000
Expenses at branch	17,500
Debtors on 31st March, 2022	25,000
Stock on 31st March,2022 (invoice price)	17,600
Remittances to head office	1,20,000

You are required to prepare Branch Stock Account, Branch Adjustment Account, Branch Profit & Loss Account and Branch Debtors Account for the year ended 31st March,2022. **(10 Marks)**

Solution:

(a) In the books of walkaway footwears

Patna Branch Stock Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
1.1.21	To Balance b/d Goods sent to	12,000	31.12.21	By Bank A/c (Cash sales)	46,000
31.12.21	To branch A/c	1,32,000		By Branch debtors A/c (credit sales)	1,00,000
	To Branch adjustment A/c (Surplus over invoice price)	20,000	31.12.21	By Shortage in stock A/c	400
				By Balance c/d	17,600
		1,64,000			1,64,000

Patna Branch Adjustment Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
31.12.21	To Stock reserve - ₹17,600x 60/160(closing stock)	6,600	31.12.21	By Stock reserve – ₹12,000x 60/160 (Opening stock)	4,500
	To Shortage (400x 60/160)	150		By Goods sent to branch A/c	49,500
	To Branch profit & loss A/c (Gross profit)	67,250		By Branch stock A /c (₹1,32,000x 60/160)	20,000
		74,000			74,000

Branch Profit & Loss Account

Particulars	Amount (₹)	Particulars	Amount (₹)

TELEGRAM: CA NOTE HUB

To Branch expenses A/c	17,500	By Branch adjustment A/c (Gross Profit)	67,250
To Shortage in stock A/c	250		
To Net profit (transferred to Profit & Loss A/c)	49,500		
	67,250		67,250

Branch Debtors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
1.1.21 To Balance b/d	10,000	31.12.21 By Bank A/c	85,000
31.12.21 To Branch stock A/c	1,00,000	By Balance c/d (bal. fig.)	25,000
	1,10,000		1,10,000

Question 16 (Past Exam Nov'22)

Modern Stores of Delhi operates a branch at Nagpur. The Head office affects all purchases and the branch is charged at cost plus 60%. All the cash received by Nagpur Branch is remitted to Delhi. The Branch expenses are met by the Branch out of an Imprest Account which is reimbursed by the Delhi Head Office every month. The Branch maintains a Sales Ledger and certain essential subsidiary records, but otherwise all branch transactions are recorded at Delhi.

The following branch transactions took place during the year ended 31st March, 2022:

	₹
Goods received from Delhi at Selling Price	1,50,000
Cash Sales	69,000
Goods returned to Delhi at Selling Price	3,000
Credit Sales (Net of returns)	63,000
Authorized Reduction in Selling Price of Goods Sold	1,500
Cash Received from Debtors	48,000
Debtors written off as irrecoverable	2,000
Cash Discount allowed to Debtors	1,500

- On 1st April, 2021 the Stock in trade at the Branch at Selling Price amounted to ₹ 60,000 and the Debtors were ₹ 40,000.
- A consignment of goods sent to the Branch on 27th March,2022 with a Selling Price of ₹ 1,800 was not received until 5th April,2022 and had not been accounted for in stock.
- The Closing Stock at Selling Price was ₹ 72,900.
- The expenses relating to the Branch for the year ended 31 st March,2022 amounted to 18,000.

You are required to prepare the Branch Stock Account, Branch Debtors Account, Branch Adjustment Account and Branch Profit and Loss Account maintained at Delhi under Stock and Debtors method. Any stock unaccounted for is to be regarded as normal wastage. **(10 Marks)**

TELEGRAM: CA NOTE HUB

Solution:

Books of Modern Store Delhi Nagpur Branch Stock A/c

Particulars	₹	Particulars	₹
To Opening stock	60,000	By Bank A/c (Cash Sales)	69,000
To Goods sent to branch A/c	1,50,000	By Branch Debtors A/c (Credit sales)	63,000
To Goods sent to branch A/c	1,800	By Goods sent to branch A/c (Return)	3,000
		By Branch adjustment A/c (Reduction in selling price)	1,500
		By Branch adjustment A/c (Normal Loss)	600
		By Closing stock (including stock in transit of ₹ 1,800)	74,700
	2,11,800		2,11,800

Branch Debtors A/c

Particulars	₹	Particulars	₹
To Bal. b/d	40,000	By Cash/Bank A/c	48,000
To Branch Stock (Sales)	63,000	By Branch P&L A/c (Bad debts)	2,000
		By Branch P&L A/c (Discount)	1,500
		By Bal. c/d	51,500
	103,000		103,000

Branch Adjustment A/c

Particulars	₹	Particulars	₹
To Branch Stock Account (Reduction in selling price)	1,500	By Stock reserve A/c (60,000 X 60/160)	22,500
To Branch Stock Account (Normal loss*)	600	By Goods sent to branch A/c (Loading) (1,51,800 X 60/160)	56,925
To Goods sent to branch A/c (loading on returns) (3,000 X 60/160)	1,125		
To Branch P&L A/c	48,187		
To Stock reserve A/c (74,700 X 60/160)	28,013**		
	79,425		79,425

Note: * Alternatively, the loading of ₹ 225 on normal loss may be charged to Branch Adjustment A/c and cost ₹375 thereof may be charged to Branch P&L A/c.

** rounded off. Alternatively may be rounded off as ₹ 28,012.

TELEGRAM: CA NOTE HUB

Branch P&L A/c

Particulars	₹	Particulars	₹
To Branch expenses A/c	18,000	By Branch Adjustment A/c	48,187
To Bad debts A/c	2,000		
To Discount A/c	1,500		
To Net Profit	26,687		
	48,187		**48,187**

TELEGRAM: CA NOTE HUB

MCQs

1. If goods are invoiced to branches at cost, trading results of branch can be ascertained by
    a. Debtors method.
    b. Stock and debtors method.
    c. Either (a) or (b).
    d. Both (a) and (b).
2. Under branch trading and profit loss account method
    a. H.O prepares profit and loss account.
    b. Each branch is treated separate entity.
    c. Both (a) and (b).
    d. Either (a) or (b).
3. Goods may be invoiced to branch at
    a. Cost or Selling price.
    b. Wholesale price.
    c. Both (a) and (b).
    d. Either (a) or (b).
4. Under debtors method, opening balance of debtors is
    a. Debited to branch account.
    b. Credited to branch account.
    c. Debited to H.O account.
    d. Credited to H.O account.
5. Cost of goods returned by branch will have the following effect
    a. Goods sent to branch account will be debited.
    b. Branch stock account will be credited.
    c. Both (a) and (b).
    d. Either (a) or (b).

MCQs

1.	(c)	**2.**	(c)	**3.**	(c)	**4.**	(a)	**5.**	(c)

TELEGRAM: CANOTE HUB

SOLVED EXAMPLE

Example 1

XP Ltd opened a branch at Delhi and sent goods costing ₹50,000 to Delhi branch. Delhi Branch sold entire goods on credit at ₹ 62,000. No other transaction occurred at the branch. Prepare branch account in Head Office Books and find out the profit.

Solution

We know that branch earned net profit of ₹12,000, now see how same can be find out by branch account.

Branch Account

Particulars	Amount ₹	Particulars		Amount ₹
To Opening branch assets	Nil	By Closing branch assets		
To Goods sent to branch	50,000	Stock	Nil	
To Net Profit	12,000	Debtor	62,000	62,000
	62,000			62,000

Example 2

XP Ltd opened a new branch at Delhi. XP Ltd sent goods costing ₹ 50,000 to Delhi branch. Delhi branch sold entire goods in cash at ₹ 70,000. Branch paid expenses of ₹ 8,000. No other transaction occurred at the branch. Prepare branch account in HO Books and find out the profit.

Solution

We know that branch earned net profit of ₹12,000 (i.e. Gross Profit ₹ 20,000 less expenses of ₹ 8,000), Let's see how same can be find out by branch account:

Branch Account

Particulars	Amount	Particulars		Amount
To Opening branch assets	Nil	By Closing branch assets		
		Stock	Nil	
To Goods sent to branch	50,000	Debtor	Nil	
To Net Profit transferred to	12,000	Cash	62,000	62,000
General P&L A/c		(70,000 - 8,000)		
	62,000			62,000

Example 3

Prepare branch account and find out profit earned by branch if transactions are as under:

Goods sent to branch	₹	50,000
Furniture sent to branch	₹	10,000 (at the beginning of year)
Credit sales at branch	₹	62,000
Bad Debts	₹	1,000
Other information:		
Closing stock at branch	₹	10,000
Closing Debtor	₹	61,000
Furniture (after depreciation@20%)	₹	8,000

Solution

Branch Account

TELEGRAM: CA NOTE HUB

Particulars	Amount	Particulars		Amount
To Opening branch assets-				
(Furniture)	10,000	By Closing branch assets-		
To Goods sent to branch	50,000	Stock	10,000	
To Net Profit transferred to General P&L A/c	19,000	Debtor	61,000	
		Furniture	8,000	79,000
	79,000			79,000

CA NOTE HUB

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