GROUP 1

PAPER - 1 ACCOUNTING

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Intermediate course paper 1: Accounting (100M)		
Sections	**weightage**	**Content area**
	90% -110%	
I	**20% -25%**	**1. Process of formulation of Accounting standards including Ind Ass (IFRS converged standards) and IFRSs: convergence vs adoption: objective and concepts of carve outs.**
		2. Frame work for preparation and presentation of financial statements (as per Accounting Standards)
		3. Application of Accounting Standards:
		a. AS 1 Disclosure of Accounting Policies
		b. AS 2 Valuation of Inventories
		c. AS 3 Cash flow statements
		d. AS 10 Property, plant and Equipment
		e. As 11 The Effects of changes in foreign Exchange rates
		f. As 12 Accounting for Government Grants
		g. AS 13 Accounting for Investments
		h. As 16 Borrowing Costs
II	**20% -25%**	**4.Accounting for Special Transaction:**
		i) Investment
		ii) Insurance claims for loss stock and loss of profit
		iii) Hire – purchase and installment Sale Transactions
III	**20% -25%**	**5. Special type of Accounting**
		i) Departmental Accounting
		ii) Accounting for branches including foreign branches
		iii) Accounts from Incomplete records
IV	**30% -35%**	**6. Company Accounts**
		i) Preparation of financial statements – statement of profit and loss, balance sheet and cash flow statement
		ii) Managerial Remuneration
		iii) Profit (Loss) pre & post incorporation
		iv) Accounting for bonus issue and right issue
		v) Redemption of preference shares
		vi) Redemption of debentures

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1.FUNDAMENTALS & INTRODUCTION OF ACCOUNTING

1. MEANING OF ACCOUNTING:

Accounting is the art of Recording, Classifying, Summarizing the transactions and events which have financial Character, Analyzing and Interpreting the result there of.

2. TRANSACTIONS & EVENTS:

a) Transaction refers to any exchange of goods and services on cash or credit basis by the business with outside parties.

Conclusion: Transaction is a Cause.

b) An Event may be described as anything that occurs as a result of something. I.e Event is the Final outcome of Transaction. Conclusion: Event is an effect.

Example: Suppose Alpha Ltd. is a supplier of cycles, which costs Rs. 4200 per cycle. Beta Ltd. purchases 20 cycles from Alpha Ltd. @ Rs. 5000 per cycle. The purchasing and selling that took place between the two business entities is a transaction, while the reduction in stock and profit earned is an event.

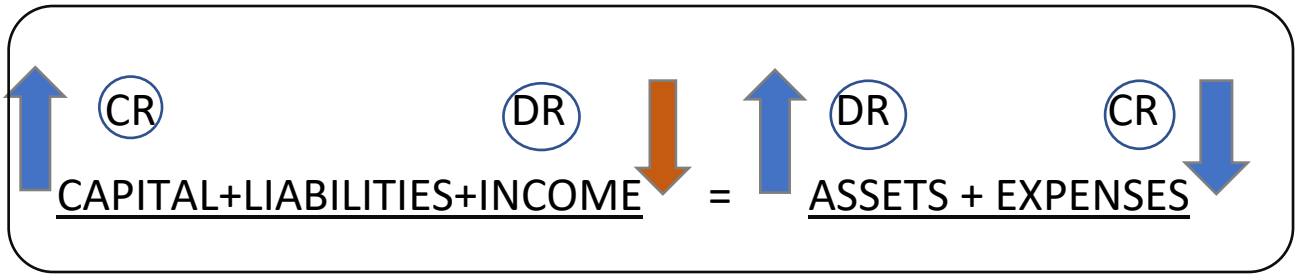
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3. RECORDING:

Business transactions having financial character are recorded in the book of "JOURNAL". This book is further divided into several Subsidiary books.

a) HOW TO RECORD?

Ans: Based on Accounting Equation



4. CLASSIFYING:

The book containing classified information called as "Ledger". It involves grouping of transactions of one nature at one place so as to put information in compact and usable form.

5. SUMMARISING:

Preperation of Trial balance and Fianancial Statements come under this process.

6. ANALYSING:

It is concerened with establishment of relationship between the items of profit & Loss Account and Balance sheet for decission making purpose. It also provides the basis for Interpretation.

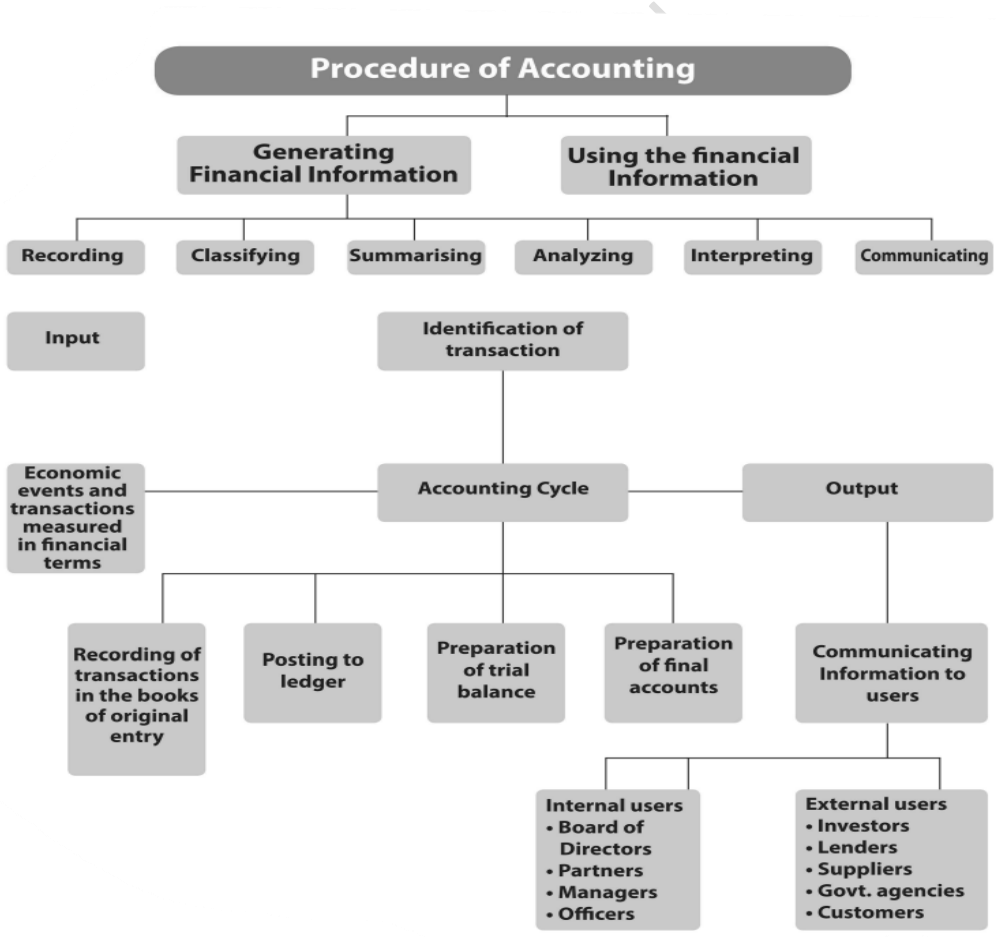
EX: Ratio analysis, Horizontal analysis, Verticla analysis etc.

7. INTERPRETING:

It is concerned with explaining the meaning and significance of the relationship as established by the analysis of Accounting data.Based on Interpretaions, end users will take appropriate decissions.

8. COMMUNICATING:

It is concerned with the transmission of summarised, analysed and interpreted information to the end users to enable them to take rational decissions.This involves distribtion of Various Accounting reports, Ratios, Graphs, Diagrams, Fundflow statement etc.



9. WHAT IS GAAP?

Generally Accepted Accounting principles are basic accounting principles and Guidelines which provide the framework for detailed & comprehensive accounting, Accounting standards and other industry specific accounting practices.

GAAP is a combination of authoritative standards (set by policy boards) and the commonly accepted ways of recording and reporting accounting information. At international level, such authoritative standards are known as International Financial Reporting Standards (IFRS) at many

places and in India we have authoritative standards named as Accounting Standards (ASs) and Indian Accounting Standard (Ind AS).

COMMON SET OF ACCEPTED ACCOUNTING PRINCIPLES:

(a) Business entity Assumption

(b) Monetary unit Assumption

(c) Going concern Assumption

(d) Consistency concept

(e) Accrual Concept

(f) Historical cost concept

(g) Matching concept

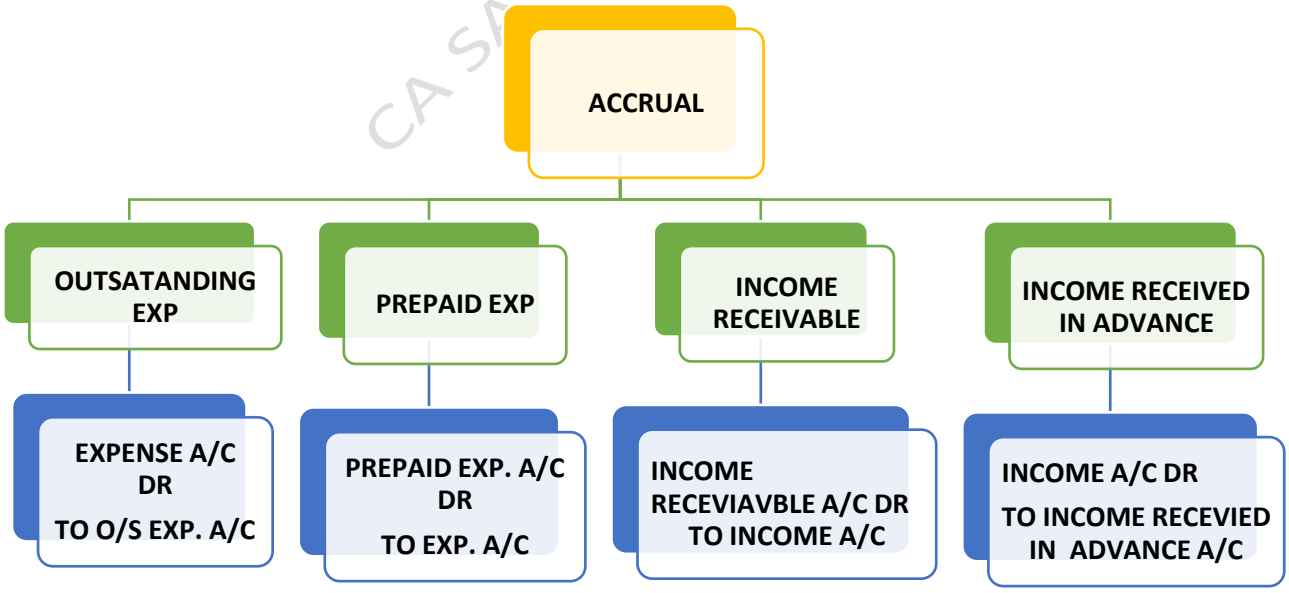
(h) Conservatism principle

(i) Materiality

10. ACCRUAL CONCEPT:

This principle requires all revenue and expenditure to be recorded in the period it is actually incurred and not when cash or cash equivalent has been received/paid.

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11. WHAT IS THEDIFFERENCE BETWEEN ACCRUED & DUE-ACCRUED BUT NOT DUE?

WIill be discussed in class room

12. MEANING OF ADJUSTMENTS GIVEN BELOW TRIAL BALANCE:

If any item which is given below trial balance means which is not accounted so far. That means such item impact should consider now into books of Accounts.

EX:

a) Closing stock given below trial balance for 100000. This means, So far closing stock not recorded into books of accounts. Now you can pass adj entry as closing stock a/c debit and Trading A/c as credit.

b) Closing stock given in trial balance for 100000. This means, Closing stock was previously considered in books of ccounts by making Closing stock debit and purchases credit.Now purchases mentioned in trial balance was after reduction with closing stock.

13. DIFFERENCE BETWEEN RESERVE AND PROVISION:

PARTICULARS	RESERVE	PROVISION
Meaning	The portion of profit kept aside for unforseen obligations of a business.	Portion of money from the business set aside for meeting known liabilities or expenses.
Charge or Appropriation	Appropriation of profits	Charge againist profits
Dividend payment	Useful	Not useful
Presentation in financials	Shown in Reserves & Surplus Under Share holders fund.	Either Reduced from Asset or shown under Liabilities.

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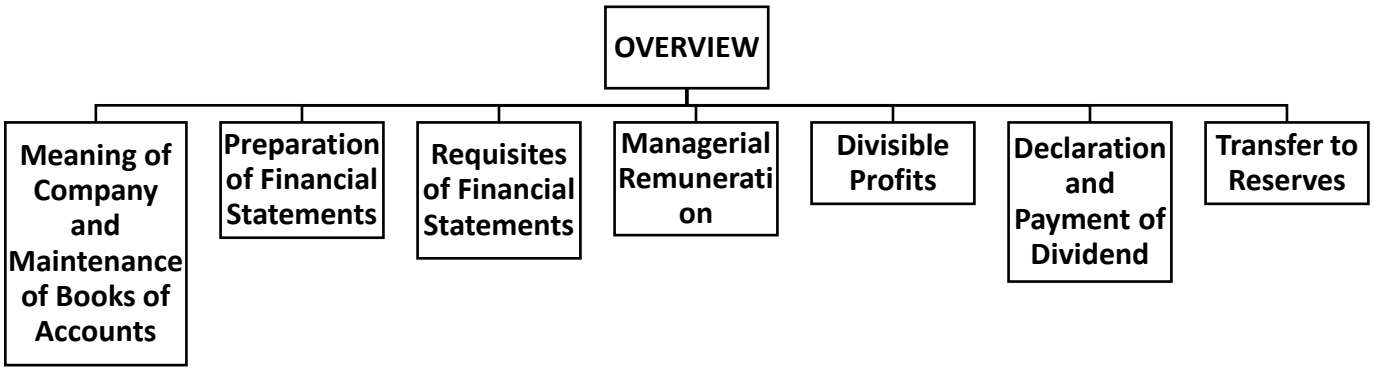
14. SOME IMPORTANT DIFFRENCES BETWEEN VARIOUS TYPES OF ENTITIES:

Basis	Sole proprietorship	Partnership	HUF	Co. operative Society	Joint Stock Company
Registration	Not Required	Optinal	Not Required	Compulsory	Compulsory
Formation	No Legal Formalities	Less Legal Formalities	Less Leagal Formalities	Greater Legal Formalities	Greater Legal Formalities
Members	Only Owner	Minimum -2 Maximum -100	Minimum -2 Maximum – No limt	Minimum -2 Maximum - No limited	Minimum Private -2 Public -7 Maximum Private -50

					Public – no Limit
Capital	Limited	Comparatively More than sole Proprietor ship	Ancestral Property	limited	Large Financial Resources
Liability	Unlimited	Unlimited	Unlimited-Karta ,Limited-Other Members	Limited	Limited
Management	Owner	Partner	Karta	Managing Committee	Board of Directors
Continuity	Unstable	Unstable	Stable	Stable	Stable

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2.FINANCIAL STATEMENTS OF COMPANIES



1. **MEANING OF COMPANY:**

   As per Section 2(20) of the Companies Act, 2013, "Company" means a company incorporated under the Companies Act, 2013 or under any previous company law (e.g., the Companies Act, 1956).

2. **DIFFERENT TYPES OF COMPANIES**:

   a) company limited by guarantee

   b) Company limited by shares

   c) Foreign company

   d) Government company

   e) One Person Company

   f) Private company

   g) Public Company

   h) Small company

   i) Unlimited company

   j) Holding company

   k) Subsidiary company

   (Detailed discussion will be there in company law-paper 2 of CA INTER)

3. **MAINTAINCE OF BOOKS OF ACCOUNTS:**

   a) As per Section 128 of the Companies Act, 2013, Every company should prepare and keep at its registered office books of account and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of the affairs of the company.

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b) In accordance with Section 92 of the Companies Act, 2013, every company should prepare an annual return in the form prescribed by the Companies Act, 2013 signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice.

c) The annual return should be filed with the Registrar within 60 days from the day on which each of the annual general meeting (AGM) is held or where no AGM is held in any year, within 60 days from the date on which AGM should have been held along with a statement showing the reasons why AGM was not held.

d) Under Section 129 of the Companies Act, 2013, at the annual general meeting of a company, the Board of Directors of the company should lay financial statements before the company.

Financial Statements as per Section 2(40) of the Companies Act, 2013, inter-alia include

i) a balance sheet as at the end of the financial year;

ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

iii) cash flow statement for the financial year;

iv) a statement of changes in equity, if applicable and

v) any explanatory note annexed to, or forming part of, any document referred to in (i) to (iv) above

e) Periodic Financial Statements:

i. Prepare the financial results of the company on such periodical basis and in such form as may be prescribed;

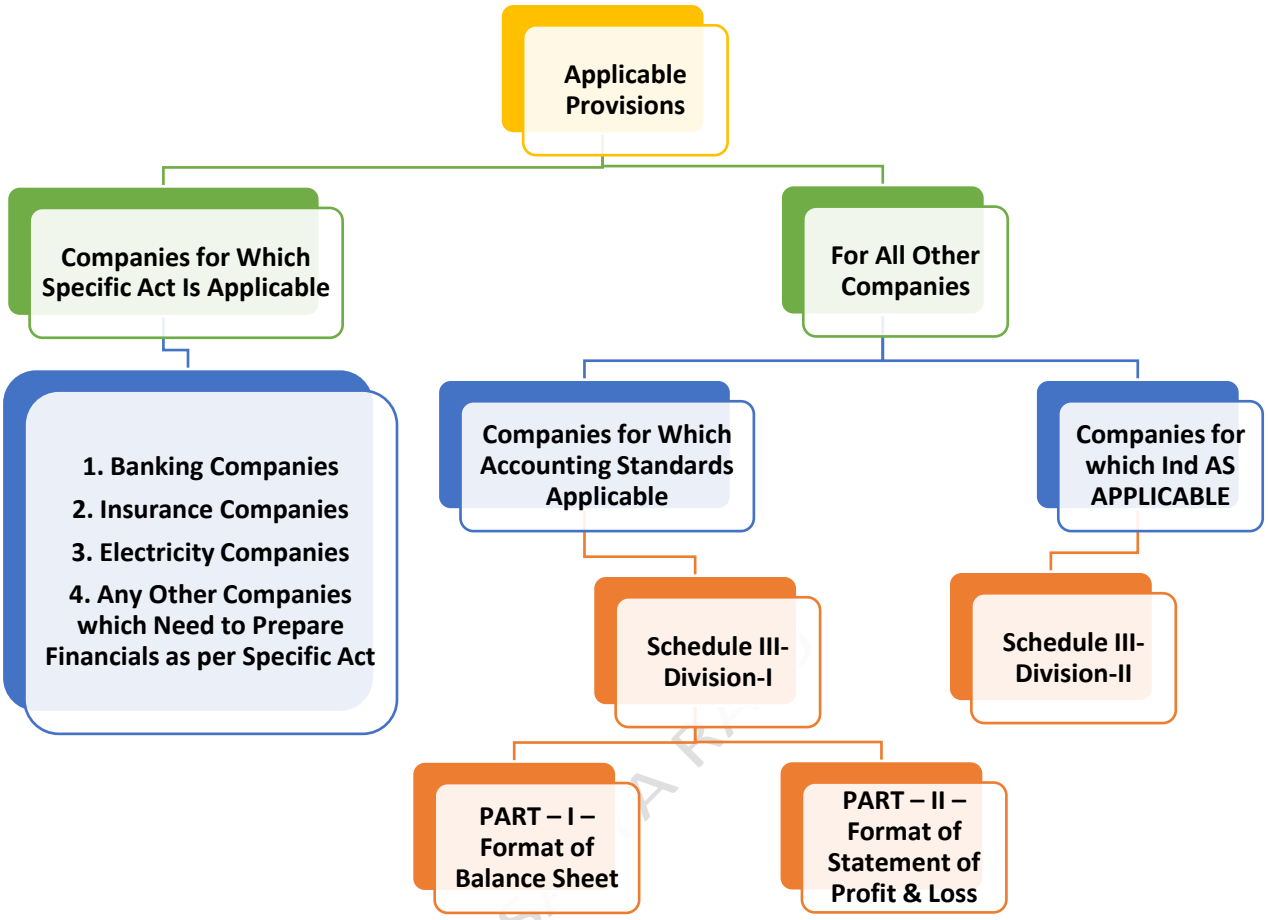
ii. Obtain approval of the Board of Directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and

iii. File a copy with the Registrar within a period of thirty days of completion of the relevant period with such fees as may be prescribed.

4. REQUISITIES OF FINANCIAL STATEMENTS:

Financial statements should give a true and fair view of the state of affairs of the company as at the end of the financial year.

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PART I-BALANCE SHEET

Name of the company…….

Balance sheet as at……

			Particulars	Notes No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
			1	2	3	4
1	a b c		**EQUITY AND LIABILITIES:** Shareholder's funds Share capital Reserves and Surplus Money received against share warrants			
2			**Share application money pending allotment**			
3	a b c		**Non-current liabilities** Long term borrowings Deferred tax liabilities (Net) Other long -term liabilities			

	d		Long term provisions			
4			**Current liabilities**			
	a		Short term borrowings			
	b		Trade Payable			
	c		Other current liabilities			
	d		Short - term provisions			
			TOTAL			
1			**ASSETS:**			
			Non-current assets			
	a		Property, Plant & Equipment and Intangible Assets			
		i	Property, Plant & Equipment			
		ii	Intangible assets			
		iii	Capital Work - in progress			
		iv	Intangible assets under development			
	b		Non-current investments			
	c		Deferred tax assets (Net)			
	d		Long term loans and advances			
	e		Other non-current assets			
2			**Current Assets**			
	a		Current Investments			
	b		Inventories			
	c		Trade receivables			
	d		Cash and cash equivalents			
	e		Short - term loans and advances			
	f		Other current assets			
			TOTAL			

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DEFINITION OF CURRENT ASSET:

An asset shall be classified as current when it satisfies any of the following

CRITERIA:

a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;

b) it is held primarily for the purpose of being traded;

c) it is expected to be realized within twelve months after the reporting date; or

d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

DEFINITION OF CURRENT LIABILITY:

A liability shall be classified as current when it satisfies any of the following

CRITERIA:

a) It is expected to be settled in the company's normal operating cycle;

b) It is held primarily for the purpose of being traded;

c) It is due to be settled within twelve months after the reporting date; or

d) The company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

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NOTES TO ACCOUNTS:

1) SHARE CAPITAL:

For each class of share capital (different classes of preference shares to be treated separately):

a) The number and amount of shares authorized;
b) The number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
c) Par value per share;
d) A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
e) The rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
f) Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
g) Shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held;
h) Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
i) For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
  (i) Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
  (ii) Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
  (iii) Aggregate number and class of shares bought back.

j) Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.

k) Calls unpaid (showing aggregate value of calls unpaid by directors and officers)

l) Forfeited shares (amount originally paid up).

m) A company shall disclose Shareholding of Promoters* as below:

Shares held by promoters at the end of the year				% Change during the year***
S. No	Promoter name	No. of Shares**	% of total shares**	
Total				

*Promoter here means promoter as defined in the Companies Act, 2013.

** Details shall be given separately for each class of shares

*** Percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.

1) <u>RESERVES AND SURPLUS</u>

a) Reserves and Surplus shall be classified as:

i) Capital Reserves;

ii) Capital Redemption Reserve;

iii) Securities Premium;

iv) Debenture Redemption Reserve;

v) Revaluation Reserve;

vi) Share Options Outstanding Account;

vii) Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof);

viii) Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc.

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

b) A reserve specifically represented by earmarked investments shall be termed as a 'fund'.

c) Debit balance of statement of profit and loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

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2) LONG-TERM BORROWINGS

a) Long-term borrowings shall be classified as:

i) Bonds/debentures.

ii) Term loans

1) From banks.

2) From other parties

iii) Deferred payment liabilities.

iv) Deposits.

v) Loans and advances from related parties.

vi) Long term maturities of finance lease obligations

vii) Other loans and advances (specify nature).

b) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

3) OTHER LONG- TERM LIABILITIES

Other Long-term Liabilities shall be classified as:

a) Trade payables

b) Others

4) LONG-TERM PROVISIONS

The amounts shall be classified as:

a) Provision for employee benefits

b) Others (specify nature).

5) SHORT-TERM BORROWINGS

a) Short-term borrowings shall be classified as:

i) Loans repayable on demand

(1) From banks

(2) From other parties

ii) Loans and advances from related parties.

iii) Deposits.

iv) Other loans and advances (specify nature).

b) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

c) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed

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d) Current maturities of long -term borrowings shall be disclosed separately.

6) <u>OTHER CURRENT LIABILITIES</u>

The amounts shall be classified as

a) Current maturities of finance lease obligations;

b) Interest accrued but not due on borrowings;

c) Interest accrued and due on borrowings;

d) Income received in advance;

e) Unpaid dividends

f) Application money received for allotment of securities and due for refund and interest accrued thereon.

g) Unpaid matured deposits and interest accrued thereon

h) Unpaid matured debentures and interest accrued thereon

i) Other payables (specify nature);

7) <u>SHORT-TERM PROVISIONS:</u>

The amounts shall be classified as:

a) Provision for employee benefits.

b) Others (specify nature).

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8) <u>Property, Plant and Equipment</u>

a) Classification shall be given as:

i) Land.

ii) Buildings.

iii) Plant and Equipment.

iv) Furniture and Fixtures.

v) Vehicles.

vi) Office equipment.

vii) Others (specify nature).

b) Assets under lease shall be separately specified under each class of asset.

c) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment) and other

adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.

9) <u>INTANGIBLE ASSETS:</u>

a) Classification shall be given as:

i) Goodwill.

ii) Brands /trademarks.

iii) Computer software.

iv) Mastheads and publishing titles.

v) Mining rights.

vi) Copyrights, and patents and other intellectual property rights, services and operating rights.

vii) Recipes, formulae, models, designs and prototypes.

viii) Licenses and franchise.

ix) Others (specify nature).

b) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of intangible assets) and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

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10) <u>NON-CURRENT INVESTMENTS:</u>

a) Non-current investments shall be classified as trade investments and other investments and further classified as:

i) Investment property;

ii) Investments in Equity Instruments;

iii) Investments in preference shares

iv) Investments in Government or trust securities;

v) Investments in debentures or bonds;

vi) Investments in Mutual Funds;

vii) Investments in partnership firms

viii) Other non-current investments (specify nature) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof.

b) The following shall also be disclosed:

i) Aggregate amount of quoted investments and market value thereof;

ii) Aggregate amount of unquoted investments;

iii) Aggregate provision for diminution in value of investments.

11) <u>LONG-TERM LOANS AND ADVANCES:</u>

a) Long-term loans and advances shall be classified as:

i) Capital Advances;

ii) Loans and advances to related parties (giving details thereof);

iii) Other loans and advances (specify nature).

b) The above shall also be separately sub-classified as:

i) Secured, considered good;

ii) Unsecured, considered good;

iii) Doubtful

12) <u>OTHER NON-CURRENT ASSETS</u>

Other non-current assets shall be classified as:

a) Long Term Trade Receivables (including trade receivables on deferred credit terms);

i) Security Deposits;

ii) (Others (specify nature);

b) Long term Trade Receivables, shall be sub-classified as:

i) Secured, considered good;

ii) Unsecured considered good

iii) Doubtful

c) For trade receivables outstanding, ageing schedule shall be given.

13) <u>CURRENT INVESTMENTS</u>

a) Current investments shall be classified as:

i) Investments in Equity Instruments;

ii) Investment in Preference Shares

iii) Investments in government or trust securities;

iv) Investments in debentures or bonds;

v) Investments in Mutual Funds;

vi) Investments in partnership firms

vii) Other investments (specify nature)

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14) INVENTORIES

a) Inventories shall be classified as:

i) Raw materials;

ii) Work-in-progress;

iii) Finished goods;

iv) Stock-in-trade (in respect of goods acquired for trading);

v) Stores and spares;

vi) Loose tools;

vii) Others (specify nature).

b) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

c) Mode of valuation shall be stated.

15) TRADE RECEIVABLES:

a) For trade receivables outstanding, Ageing schedules shall be given

b) Trade receivables shall be sub-classified as:

i) Secured, considered good;

ii) Unsecured considered good;

iii) Doubtful.

c) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

d) For trade receivables outstanding, the following ageing schedules shall be given.

16) CASH AND CASH EQUIVALENTS

a) Cash and cash equivalents shall be classified as:

i) Balances with banks;

ii) Cheques, drafts on hand;

iii) Cash on hand;

iv) Others (specify nature).

17) SHORT-TERM LOANS AND ADVANCES

a) Short-term loans and advances shall be classified as:

i) Loans and advances to related parties (giving details thereof);

ii) Others (specify nature).

b) The above shall also be sub-classified as:

i) Secured, considered good;

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ii) Unsecured, considered good;

iii) Doubtful.

c) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

18) <u>OTHER CURRENT ASSETS (SPECIFY NATURE</u>).

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

19) <u>CONTINGENT LIABILITIES AND COMMITMENTS (TO THE EXTENT NOT PROVIDED FOR)</u>

a) Contingent liabilities shall be classified as:

i) Claims against the company not acknowledged as debt;

ii) Guarantees;

iii) Other money for which the company is contingently liable

b) Commitments shall be classified as:

i) Estimated amount of contracts remaining to be executed on capital account and not provided for;

ii) Uncalled liability on shares and other investments partly paid

iii) Other commitments (specify nature)

c) <u>Additional Regulatory Information</u>

i) Title deeds of Immovable Property not held in name of the Company

ii) Where the Company has borrowings from banks or financial institutions on the basis of security of current assets

20) <u>Following Ratios to be disclosed</u> :-

i) Current Ratio

ii) Debt-Equity Ratio,

iii) Debt Service Coverage Ratio,

iv) Return on Equity Ratio,

v) Inventory turnover ratio,

vi) Trade Receivables turnover ratio,

iii) Trade payables turnover ratio,

iv) Net capital turnover ratio,

v) Net profit ratio,

vi) Return on Capital employed,

vii) Return on investment

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viii) Utilisation of Borrowed funds and share premium:

PART-II-STATEMENT OF PROFIT AND LOSS

Name of the company……..

P & l statement for the year ended……..

Particulars		Note No.	Figures for the current reporting period	Figures for the previous reporting period
I	Revenue from operations		xxx	xxx
II	Other Income		xxx	xxx
III	Total Revenue (I + II)		xxx	xxx
IV	Expenses:			
	Cost of materials consumed		xxx	xxx
	Purchases of Stock in Trade		xxx	xxx
	Changes in inventories of finished goods		xxx	xxx
	Changes in Work in progress and stock-in-Trade			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expenses			
	Other expenses			
	Total Expenses			
V	Profit before exceptional and extraordinary items and tax (III -IV)		xxx	xxx
VI	Exceptional items		xxx	xxx
VII	Profit before extraordinary items and tax (V - VI)		xxx	xxx
VIII	Extraordinary items		xxx	xxx
IX	Profits before tax (VII - VIII)		xxx	xxx
X	Tax Expense:			
	(1) Current tax		xxx	xxx
	(2) Deferred tax		xxx	xxx
XI	Profit (Loss) for the period (IX - X)		xxx	xxx
XII	Earnings per equity share:			
	(1) Basic		xxx	xxx
	(2) Diluted		xxx	xxx

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1) The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of Clause (40) of Section 2 in like manner as they apply to a statement of profit and loss.

2) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from

i) Sale of products;

ii) Sale of services;

a) " Grants or donations received (relevant in case of section 8 companies only)";

b) Other operating revenues;

Less:

i) Excise duty

c) In respect of a finance company, revenue from operations shall include revenue from

i) Interest; and

ii) Other financial services

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

3) Other income

Other income shall be classified as:

a) Interest Income (in case of a company other than a finance company);

b) Dividend Income;

c) Net gain/loss on sale of investments

4) Finance Costs

Finance costs shall be classified as:

a) Interest expense;

b) Other borrowing costs;

c) Applicable net gain/loss on foreign currency transactions and translation.

5) Employee benefit expenses

a) salaries and wages,
b) contribution to provident and other funds,
c) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP),
d) staff welfare expenses

6) Any item of income or expenditure which exceeds one per cent of the revenue from operations or 1,00,000, whichever is higher;
7) In case of companies covered u/s 135, amount of expenditure incurred on corporate social responsibility activities.
8) Details of items of exceptional and extraordinary nature;
9) Prior period items etc

CA SATYA RAJU

MANAGERIAL REMUNERATION

(SCHEDULE V+SECTION 197)

COMPANY IS HAVING ADEQUATE PROFIT

The total managerial remuneration payable by a public company to its directors, including managing Director and Whole-time director, and its manager in respect of any financial year shall not exceed 11% of the net profits of that Company for that financial year.

a) the remuneration payable to any one managing director, or whole time director or manager shall not exceed 5% of the net profits of the Company and if there is more than one such director remuneration shall not exceed 10% of the net profits to all such directors and manager taken together

b) The remuneration payable to directors who are neither managing nor whole-time directors shall not exceed,—

i) One per cent. of the net profits of the company, if there is a managing or whole-time director or manager;

ii) Three per cent. of the net profits in any other case

CA SATYA RAJU

HOW TO CALCULATE PROFITS UNDER SEC.198:

Section 198 lays down how the net profit of the company will be ascertained for the purpose of calculating managerial remuneration.

As per Section 198 of the Companies Act, 2013,

1) In making the computation aforesaid, credit should be given for the bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

2) In making the computation of the net profits, credit should not be given for the following sums, namely:—

a) Profits, by way of premium on shares or debentures of the company, which are issued or sold by the company

b) Profits on sales by the company of forfeited shares

c) Profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof

d) Profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets: Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit should be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written-down value

e) Any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value

3) In making the computation aforesaid, the following sums should be deducted, namely:—

a) All the usual working charges

b) Directors' remuneration

c) Bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis

d) Any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits

e) Any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf

f) Interest on debentures issued by the company

g) Interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets

h) Interest on unsecured loans and advances

i) Expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature

j) Outgoings inclusive of contributions made under section 181 of the Act

k) Depreciation to the extent specified in section 123 of the Act

l) The excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained

m) Any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract

CA SATYA RAJU

n) Any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m)

o) Debts considered bad and written off or adjusted during the year of account

4) In making the computation aforesaid, the following sums should not be deducted, namely:—

a) Income-tax and super-tax payable by the company under the Incometax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of sub-section (4)

b) Any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4)

c) Loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value

d) Any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value

CA SATYA RAJU

IMPORTANT POINTS:

1) A public company can pay its managerial personnel remuneration in excess of 11% without prior approval of the Central Government. A special resolution approved by the shareholders will be sufficient.

2) Board of directors sitting fee was no it included in above limits.

3) Above limits applicable to Public companies only.There is no restriction in case of private limited companies.

COMPANY HAS INADEQUATE PROFITS OR NO PROFITS

Where in any financial year during the tenure of a Managerial person or other Directors, a Company has no profits or its profits are inadequate, it may, pay remuneration to the managerial person or other Director, not exceeding, the limits under (A) and (B) given below-

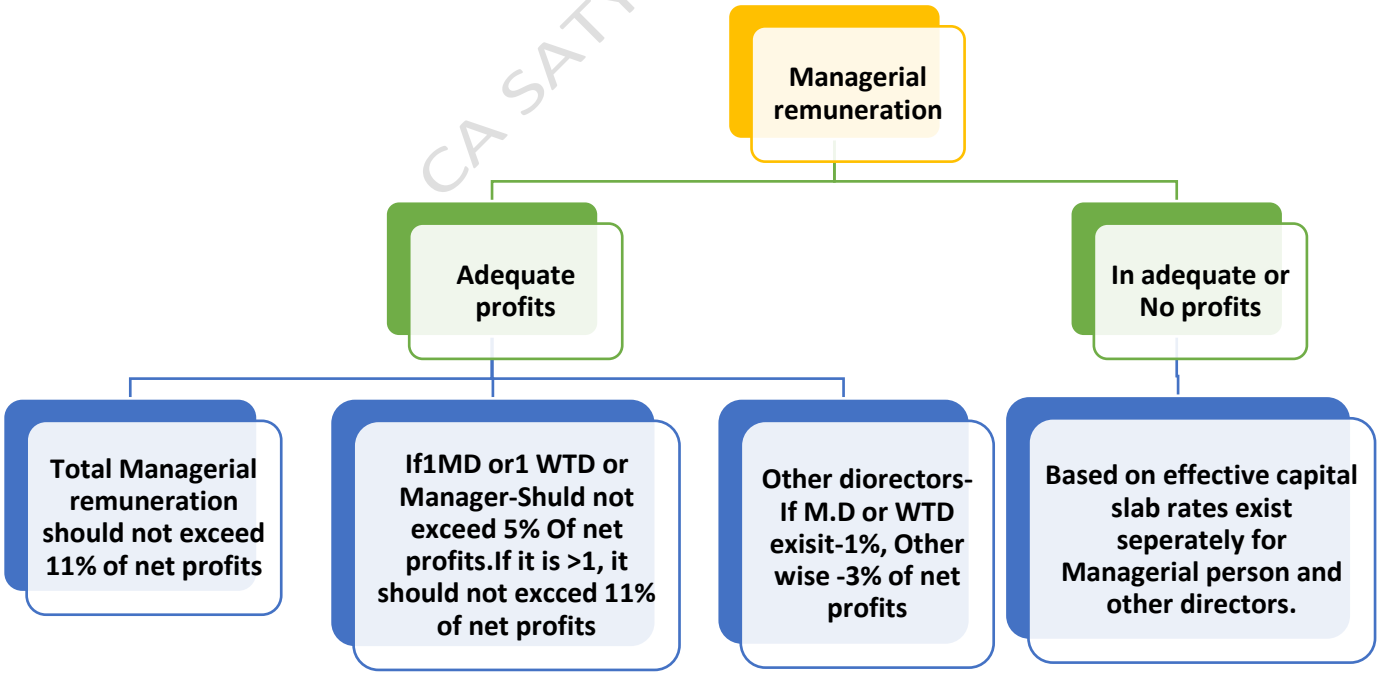
S.NO	EFFECTIVE CAPITAL	(A)Manager or MD & WTD	(B)Other directors
i.	Negative or less than 5 crores	60 lakhs	12 lakhs
ii.	5 crores and above but less than 100 crores.	84 lakhs	17 lakhs
iii.	100 crores and above but less than 250 crores.	120 lakhs	24 lakhs

iv.	250 crores and above.	120 lakhs plus 0.01% of the effective capital in excess of Rs.250 crores:	24 Lakhs plus 0.01% of the effective capital in excess of Rs.250 crores.

HOW TO CALCULATE EFFECTIVE CAPITAL?

Paid-up share capital (excluding share application money or advances against shares)	**XXX**
Add: Share premium	**XXX**
Reserves and surplus (excluding revaluation reserve)	**XXX**
Long-term loans and deposits repayable after one year	**XXX**
Less: Investments (Other than investments held by an investment company)	**(XXX)**
Accumulated losses	**(XXX)**
Preliminary expenses not written off	**(XXX)**
Effective Capital	**XXX**

CA SATYA RAJU



DIVISIBLE PROFIT:

1) Amount of profits which is available for distribution to the shareholders as dividend.

2) Term Dividend includes Interim dividend also.

3) Under Section 123 (1) of the Companies Act, 2013, no dividend should be declared or paid by a company for any financial year except-

a) Out of the profits of the company for that financial year arrived at after providing for depreciation in accordance with the provisions of section 123(2), or

b) Out of the profits for any previous financial years arrived at after providing for depreciation in accordance with the provisions of that sub section and remaining undistributed; or

c) Out of both the above;

d) Out of the moneys provided by the Central Government or any State Government for the payment of dividend by the Company in pursuance of any guarantee given by that government Provided that no dividend should be declared or paid by a company from its reserves other than free reserves.

4) Dividend can be declared and paid by a company only out of the profits or free reserves (other than moneys provided by Central or State Govt.) as the payment of dividend from any other source will amount to payment of dividend from capital units.

5) Company may declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserves, in the event of inadequacy or absence of profits in any year, subject to the fulfilment of the following conditions as per Declaration and payment of Dividend Rules, 2014.

Companies (Declaration and Payment of Dividend) Rules, 2014:

1) The rate of dividend declared should not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: provided that this sub-rule should not apply to a company, which has not declared any dividend in each of the three preceding financial years.

2) The total amount to be drawn from such accumulated profits should not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

3) The amount so drawn should first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

4) The balance of reserves after such withdrawal should not fall below 15% of its paid- up share capital as appearing in the latest audited financial statement.

5) No company should declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

CA SATYA RAJU

Transfer to Reserves:

1) The Board of Directors are free and can appropriate a part of the profits to the credit of a reserve or reserves as per section 123 (1) of the Companies Act, 2013.

2) Appropriation of a part of profit is sometimes made under law.

a) For example, under the Banking Regulation Act, a fixed percentage of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed.

b) Transfer of a part of profit to a reserve is also necessary where the company has undertaken, at the time of raising of loan, that before any part of its profit is distributed, a specified percentage of the profit every year should be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount should remain invested in a specified manner.

CA SATYA RAJU

PROBLEMS FOR DISCUSSION

A) PROBLEMS BASED ON SCHEDULE III

PROBLEM 1:

In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes toaccounts that during financial year, 24,000 equity shares of Rs. 10 each were issued as fully paid bonusshares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment. **(SM)**

PROBLEM 2:

The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III. **(SM)**

CA SATYA RAJU

PROBLEM 3:

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on31st March, 20X1:

PARTICULARS	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 underthe 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.

(SM)

PROBLEM 4:

Sumedha Ltd. took a loan from bank for Rs. 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20X1 of Rs. 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III. **(SM)**

PROBLEM 5:

State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

i) Share application money received in excess of issued share capital.

ii) Share option outstanding account.

iii) Unpaid matured debenture and interest accrued thereon.

iv) Uncalled liability on shares and other partly paid investments.

v) Calls unpaid. **(RTP-NOV-2021 2(b))**

CA SATYA RAJU

PROBLEM 6:

The following is the Trial Balance of H Ltd., as on 31st March 2021. **(20M)**

	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	
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:

a) The authorized share capital of the company is:

5000, 6% preference shares of ₹ 100 each 5,00,000

10000, equity shares of ₹ 100 each 10,00,000

Issued equity capital as on 1st April 2020 stood at ₹ 720,000, 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.

b) 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.

c) The company on the advice of independent valuer wishes to revalue the land at ₹ 36,00,000.

d) 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 ₹ 100,000 and the accumulated depreciation thereon being ₹ 30,000.

e) Depreciation is to be provided on plant and machinery at 10% on cost.

f) Amortize 1/5th of Goodwill.

You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous year's figures & taxation. **(JULY 2021 Q.P-4)**

CA SATYA RAJU

PROBLEM 7:

Om Ltd. has the Authorised Capital of Rs. 15,00,000 consisting of 6,000 6% Redeemable Preference shares of Rs. 100 each and 90,000 equity Shares of Rs.10 each. The following was the Trial Balance of the Company as on 31st March, 2021:

Particulars	Dr.	Cr.
Investment in shares at cost (non-current investment)	1,50,000	
Purchases	14,71,500	
Selling expenses	2,37,300	
Inventory as at the beginning of the year	4,36,600	
Salaries and wages (included Rs. 30,000 being Director's Remuneration)	1,56,000	
Cash on hand	84,000	

Bills receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on debentures up to 30th Sep (1st half year)	11,250	
Sundry Debtors and Sundry Creditors	1,50,300	2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of Rs. 45,000	1,05,000	
6% Redeemable Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on freehold properties		4,50,000
Dividends received		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft (secured by hypothecation of stocks and receivables)		4,50,000
Technical knowhow fees (cost paid during the year)	4,50,000	
Audit fees	18,000	
Total	**44,72,850**	**44,72,850**

CA SATYA RAJU

Other Information:

1) Closing Stock was valued at Rs. 4,27,500.

2) Purchases include Rs. 15,000 worth of goods and articles distributed among valued customers.

3) Salaries and Wages include Rs. 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".

4) Bills Receivable include Rs. 4,500 being dishonored bills. 50% of which had been considered irrecoverable.

5) Bills Receivable of Rs. 6,000 maturing after 31st March were discounted.

6) Depreciation on Furniture to be charged at 10% on Written Down Value.

7) Interest on Debentures for the half year ending on 31st March was due on that date.

8) Technical Knowhow Fees is to be written off over a period of 10 years.

9) Trade receivables include Rs. 18,000 due for more than six months.

You are required to prepare the Balance Sheet as at 31st March, 2021 and Statement of Profit and Loss for the year ended 31st March, 2021 as per Schedule III to the Companies Act, 2013 after taking into account the above information. Ignore taxation. **(NOV 2021 RTP- 1)**

PROBLEM 8:

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:

Particulars	Debit Rs.	Credit Rs.
Equity Capital (Face value of Rs. 100)		10,00,000
Calls in Arrears	1,000	
Land	2,00,000	
Building	3,50,000	
Plant and Machinery	5,25,000	
Furniture	50,000	
General Reserve		2,10,000
Loan from State Financial Corporation	1,50,000	
Inventory:		
Finished Goods 2,00,000		
Raw Materials 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**

CA SATYA RAJU

The following additional information is also provided:

(1) 2,000 equity shares were issued for consideration other than cash.

(2) Trade receivables of Rs. 52,000 are due for more than six months.

(3) The cost of assets:

Building	Rs. 4,00,000
Plant and Machinery	Rs. 7,00,000
Furniture	Rs. 62,500

(4) The balance of Rs. 1,50,000 in the loan account with State Finance Corporation is inclusive of Rs. 7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.

(5) Balance at Bank includes Rs. 2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(6) The company had contract for the erection of machinery at Rs. 1,50,000 which is still incomplete. **(ANS: BALANCE SHEET TOTAL- RS.18,94,700) (SM)**

CA SATYA RAJU

PROBLEMS BASED ON OTHER ISSUES

PROBLEM 9:

Mudra Ltd. gives the following information the year ended 31st March, 20X1:

Particulars	Rs.
Gross profit	40,25,365
Subsidies received from Govt.	2,73,925
Administrative, Selling and distribution expenses	8,22,542
Directors' fees	1,34,780
Interest on debentures	31,240
Managerial remuneration	2,85,350
Depreciation on Property, plant and equipment (PPE)	5,22,543
Provision for Taxation	12,42,500
Transfer to General Reserve	4,00,000
Transfer to Investment Revaluation Reserve	12,500

Depreciation on PPE as per Schedule II of the Companies Act, 2013 was Rs. 5,75,345. You are required to calculate the maximum limits of the managerial remuneration as per Companies Act, 2013. **(ANS: PROFIT U/S 198-RS.27,35,383) (SM)**

PROBLEM 10:

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

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

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

CA SATYA RAJU

Share suspense account represents application money received on shares, the allotment of which isnot yet made.

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

(ANS: EFFECTIVE CAPITAL WHERE X LTD. IS A NON-INVESTMENT COMPANY-RS.90,40,000) (SM)

PROBLEM 11:

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:

Particulars	Rs.
17,500 9% Preference shares of Rs. 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs. 10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	25,00,000
Capital Reserves as on 1.4.20X1	3,00,000
Revaluation Reserves as on 1.4.20X1	3,50,000
Net profit for the year ended 31st March, 20X2	3,00,000

Average rate of dividend during the last three years has been 12%

(ANS: AMOUNT WHICH CAN BE UTILISED FROM RESERVES-RS. 6,57,500) (SM)

CASATYA RAJU

TEST YOUR KNOWLEDGE

THEORY QUESTIONS:

State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

1) Share application money received in excess of issued share capital.

2) Share option outstanding account.

3) Unpaid matured debenture and interest accrued thereon.

4) Uncalled liability on shares and other partly paid investments.

5) Calls unpaid.

6) Money received against share warrant.

ANSWER:

1) Current Liabilities/ Other Current Liabilities

2) Shareholders' Fund / Reserve & Surplus

3) Current liabilities/Other Current Liabilities

4) Contingent Liabilities and Commitments

5) Shareholders' Fund / Share Capital

6) (Shareholders' Fund / Money received against share warrants

MCQs

1) Trade payables as per Schedule III will include:

(a) Dues payable in respect to statutory obligation

(b) Interest accrued on trade payables

(c) Bills payables.

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

(a) Reserves and Surplus.

(b) Current Liabilities.

(c) Share Capital.

3) "Fixed assets held for sale" will be classified in the company's balance sheet as

(a) Current asset

(b) Non-current asset

(c) Capital work- in- progress

4) Current maturities of long term debt will come under

(a) Current Liabilities.

(b) Short term borrowings.

(c) Long term borrowings.

5) If there is increase in managerial remuneration, exceeding the overall ceiling as given in section 198 of the Companies Act, then sanction of which authority is required?

(a) Registrar of the company.

(b) Central Government.

(c) Board of Directors of the company.

6) Declaration of dividends for current year is made after providing for

(a) Depreciation of past years only.

(b) Depreciation on assets for the current year and arrears of depreciation of past years (if any).

(c) Depreciation on current year only and by forgoing arrears of depreciation of past years.

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7) For companies having profits, the overall maximum limit for managerial remuneration as per Section 198 of the Companies Act, 2013 is

(a) 11% of net profit.

(b) 10% of net profit.

(c) 5% of net profit.

8) For the purpose of managerial remuneration, paid up share capital used for calculation of effective capital means

(a) Paid up share capital excluding share application money and advances against shares.

(b) Paid up share capital excluding share application money but including advances against shares.

(c) Paid up share capital including both share application money and advances against shares.

9) Which of the following is not a current liability as per Schedule III?

(a) Bank overdraft

(b) Net deferred tax liability

(c) Dividend declared.

CA SATYA RAJU

10) As per the Schedule III, separate disclosure is required for an item of income or expenditure which exceeds:

(a) % of Revenue from operations or Rs. 1,00,000 whichever is lower

(b) 1% of Revenue or Rs. 5,000

(c) 1% of Revenue from operations or Rs. 1,00,000 whichever is higher.

11) Few friends created a start-up and formed private company for production and marketing of product. At the end of financial year, their company is not required to prepare:

(a) Cash flow statement

(b) Balance Sheet and Profit & Loss Account

(c) Notes to Accounts.

12) The following is not included while computing “Effective capital":

(a) Paid up share capital.

(b) Long term loans repayable after one year.

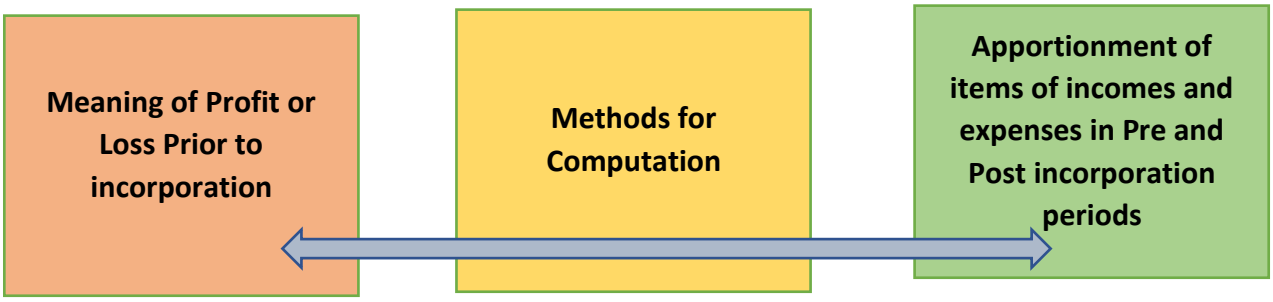
(c) Revaluation reserves.

MCQ's KEY:

1. c	2. a	3. a	4. b	5. b	6. b
7. a	8. a	9. b	10. c	11. a	12. c

CA SATYA RAJU

3. PROFIT OR LOSS PRE AND POST INCORPORATION



CA SATYA RAJU

MEANING:

When a running business is taken over by the promoters of a company, as at a date prior to the date of incorporation of company, the amount of profit or loss of such a business for the period prior to the date the company came into existence is referred to as pre-incorporation profits or losses. Such profits or losses, though belonging to the company or payable by it, are of capital nature; it is necessary to disclose them separately from trading profits or losses.

ACCOUNTING TREATMENT:

1) If there is a loss,

- **a)** It is transferred to a special account described as "Loss Prior to Incorporation" and show as an "asset" in the Balance Sheet,
- **b)** Alternatively, it may be debited to the Goodwill Account.

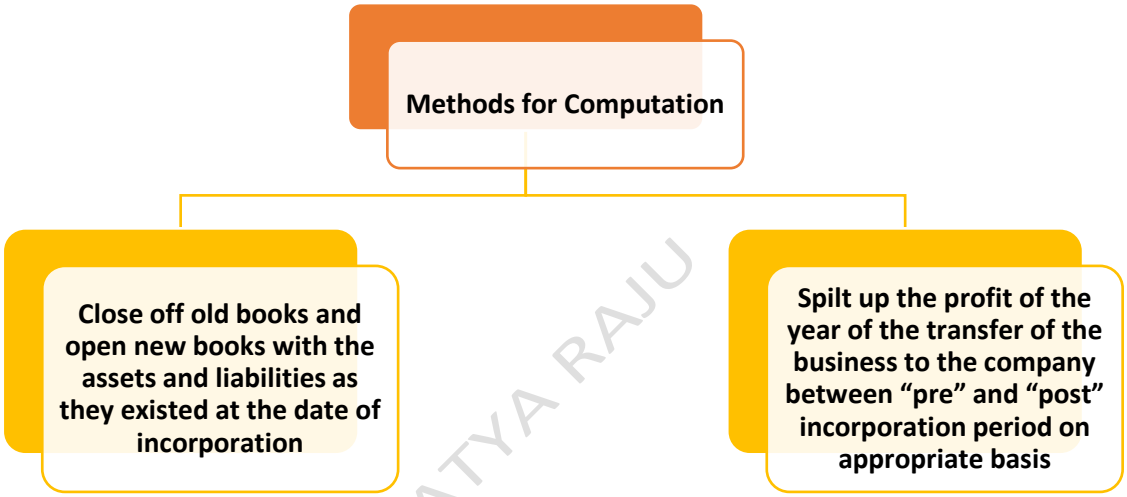
2) On the other hand, if there is profit

It is credited to Capital Reserve Account or to the Goodwill Account, if any goodwill has been adjusted as an asset. The profit will not be available for distribution as a dividend among the members of the company.

S.No.	Pre –incorporation Profits	Pre – incorporation Losses
1.	It is transferred to **Capital Reserve Account (**i.e. capitalised).	It is treated as a part of **business Acquisition cost (**Goodwill).

2.	It can be used for: • writing off Goodwill on acquisition • writing off Preliminary Expenses	It can be used for: • addition to Goodwill on acquisition • writing off Capital Profit

METHODS OF COMPUTATION:



CA SATYA RAJU

BASIS OF APPORRTIONMENT:

Items	Basis of Apportionment between pre and Post incorporation period
Gross Profit or Gross Loss	Sales Ratio-On the basis of turnover in the respective periods (first preference) **Or** On the basis of cost of goods sold in the respective periods in the absence of any information regarding turnover (second preference) **Or** Time Ratio-On the basis of time in the respective periods in the absence of any information regarding turnover and cost of goods sold (third preference)
Variable expenses linked with Turnover [e.g. Carriage / Cartage outward, Selling and distribution expenses, Commission to selling agents/travelling agents, advertisement expenses, Bad debts, Brokerage, Sales Promotion]	Sales Ratio
Fixed Common charges [e.g., Salaries, Office and Administration Expenses, Rent, Rates and Taxes, Printing and Stationery, Telephone, Telegram and Postage, Depreciation, Miscellaneous Expenses] Expenses exclusively	Time Ratio

Expenses exclusively relating to pre-Incorporation period [e.g. Interest on Vendor's Capital]	Charge to Pre-incorporation period (but if the purchase consideration is not paid on taking over of business, interest for the subsequent period is charged to post incorporation period)
Expenses exclusively relating to post-incorporation period [e.g. Formation expenses, interest on debentures, director's fees, Directors' remuneration, Preliminary Expenses, Share issue Expenses, Underwriting commission, Discount on issue of securities. Audit Fees **(i)** For Company's Audit under the Companies Act. **(ii)**For Tax Audit under section 44AB of the Income tax Act, 1961	Charge to Post-incorporation period Charge to post – incorporation period On the basis of turnover in the respective periods
Interest on purchase consideration to vendor: **(i)** For the period from the date of acquisition of business to date of incorporation. **(ii)** From the date of incorporation	 Charge to Pre – incorporation period Charge to Post – incorporation period

CA SATYA RAJU

PROBLEMS FOR DISCUSSION

PROBLEM 1:

S.Ltd. was incorporated on 30th November 2020 to take over the running business of proprietor ship firm of Mr.S. the various expenses debited to the profit and loss Account for the year 2020-21 included:

(i) Director fee

(ii) Preliminary expenses written off

(iii) Salaries and general expenses

(iv) Statutory Audit fees

(v) Tax audit fees u/s 44AB of the income tax Act, 961

(vi) Commission to traveling agents

(vii) Sale promotion expenses

(viii) Advertisement expenses

(ix) Rent expenses

(x) Bad debts

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You are required to determine the basis of apportionment above expenses between pre incorporation and post incorporation periods.

(JULY 2021 Q.P-6(D))

PROBLEM 2:

Rama Udyog Limited was incorporated on August 1, 20X1. It had acquired a running business of Rama & Co. with effect from April 1, 20X1. During the year 20X1-X2, the total sales were Rs. 36,00,000. The sales per month in the first half year were half of what they were in the later half year.

The net profit of the company, Rs. 2,00,000 was worked out after charging the following expenses:

(i) Depreciation Rs. 1,23,000,

(ii) Directors' fees Rs. 50,000,

(iii) Preliminary expenses Rs. 12,000,

(iv) Office expenses Rs. 78,000,

(v) Selling expenses Rs. 72,000 and

(vi) Interest to vendors up to August 31, 20X1 Rs. 5,000.

Please ascertain pre-incorporation and post-incorporation profit for the year ended 31st March, 20X2.

(SM, ILLUSTRATION 1)

PROBLEM 3:

Lotus Ltd. was incorporated on 1st July, 20X1 to acquire a running business of Feel goods with effect from 1st April, 20X1. During the year 20X1-20X2, the total sales were Rs. 48,00,000 of which Rs. 9,60,000 were for the first six months. The Gross profit of the company Rs. 7,81,600. The expenses charged to the Profit & Loss Statement included:

(i) Director's fees Rs. 60,000

(ii) Bad debts Rs. 14,400

(iii) Advertising Rs. 48,000 (under a contract amounting to Rs. 4,000 per month)

(iv) Salaries and General Expenses Rs. 2,56,000

(v) Preliminary Expenses written off Rs. 20,000

(vi) Donation to a political party given by the company Rs. 20,000.

Prepare a statement showing pre-incorporation and post-incorporation profit for the year ended 31st March, 20X2. **(SM, ILLUSTRATION 2)**

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PROBLEM 4:

The promoters of Glorious Ltd. took over on behalf of the company a running business with effect from 1st April, 20X1. The company got incorporated on 1st August, 20X1. The annual accounts were made up to 31st March, 20X2 which revealed that the sales for the whole year totaled Rs. 1,600 lakhs out of which sales till 31st July, 20X1 were for Rs. 400 lakhs. Gross profit ratio was 25%.

The expenses from 1st April 20X1, till 31st March, 20X2 were as follows:

Particulars	(Rs. in lakhs)
Salaries	69
Rent, rates and Insurance	24
Sundry office expenses	66
Traveler's. commission	16
Discount allowed	12
Bad debts	4
Director Rs. Fee	25
Tax audit fee	9
Depreciation on Machinery	12

Debenture interest	11

Prepare a statement showing the calculation of Profits for the pre-incorporation and post incorporation periods. **(SM, ILLUSTRATION 3)**

PROBLEM 5:

The partners of Maitri Agencies decided to convert the partnership into a private limited company called MA (P) Ltd. with effect from 1st January, 20X2. The consideration was agreed at Rs. 1,17,00,000 based on the firm's Balance Sheet as at 31st December, 20X1. However, due to some procedural difficulties, the company could be incorporated only on 1st April, 20X2. Meanwhile the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% per annum. The same books of account were continued by the company which closed its account for the first time on 31st March, 20X3 and gives the following information:

Particulars	Rs.
Sales	2,34,00,000
Cost of goods sold	1,63,80,000
Expenses:	
Salaries	11,70,000
Depreciation	1,80,000
Advertisement	7,02,000
Discounts	11,70,000
Managing Director's remuneration	90,000
Miscellaneous office expenses	1,20,000
Office-cum-show room rent	7,20,000
Interest	9,51,000

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The company's only borrowing was a loan of Rs. 50,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.

The company was able to double the average monthly sales of the firm, from 1st April, 20X2 but the salaries tripled from that date. It had to occupy additional space from 1st July, 20X2 for which rent was Rs. 30,000 per month.

Prepare statement of apportioning cost and revenue between pre-incorporation and post-incorporation periods and calculation of profits/losses for such periods. **(SM, ILLUSTRATION 5)**

PROBLEM 6:

ABC Ltd. took over a running business with effect from 1st April, 20X1. The company was incorporated on 1ST August, 20X1. The following information for the year ended 31.3.20X2 is given:

PARTICULARS	Rs.
Gross profit	3,20,000
Expenses:	
Salaries	48,000
Stationery	4,800
Travelling expenses	16,800
Advertisement	16,000
Miscellaneous trade expenses	37,800
Rent (office buildings)	26,400
Electricity charges	4,200
Director's fee	11,200
Bad debts	3,200
Commission to selling agents	16,000
Tax Audit fee	6,000
Debenture interest	3,000
Interest paid to vendor	4,200
Selling expenses	25,200
Depreciation on fixed assets	9,600
Net profit	**87,600**

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Additional information:

(a) Total sales for the year, which amounted to Rs. 19,20,000 arose evenly up to the date of 30.9.20X1. Thereafter they recorded an increase of two-third during the rest of the year.

(b) Rent of office building was paid @ Rs. 2,000 per month up to September, 20X1 and thereafter it was increased by Rs. 400 per month.

(c) Travelling expenses include Rs. 4,800 towards sales promotion.

(d) Depreciation include Rs. 600 for assets acquired in the post incorporation period.

(e) Purchase consideration was discharged by the company on 30th September, 20X1 by issuing equity shares of Rs. 10 each.

Prepare Statement showing calculation of profits and allocation of expenses between pre and post incorporation periods. **(SM, ILLUSTRATION 6)**

PROBLEM 7:

ABC Ltd. was incorporated on 1.5.20X1 to take over the business of DEF and Co. from 1.1.20X1. The following information as given by ABC Ltd. for the year ending 31.12.20X1 is provided to you:

Particulars	Rs.
Gross Profit	10,64,000
Interest on Investments earned	36,000
Expenses:	
Rent and Taxes	90,000
Salaries including manager's salary of **RS.**85,000	3,31,000
Carriage Outwards	14,000
Printing and Stationery	18,000
Interest on Debentures	25,000
Sales Commission	30,800
Bad Debts (related to sales)	91,000
Underwriting Commission	26,000
Preliminary Expenses	28,000
Audit Fees	45,000
Loss on Sale of Investments	11,200
Net Profit	**3,90,000**

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Prepare a Statement showing allocation of expenses and calculations of pre-incorporation and post-incorporation profits after considering the following information:

(i) G.P. ratio was constant throughout the year.

(ii) Sales for January and October were 1½ times the average monthly sales while sales for Decemberwere twice the average monthly sales.

(iii) Bad Debts are shown after adjusting a recovery of Rs. 7,000 of Bad Debt for a sale made in

July,20X0.

(iv) Manager's salary was increased by Rs. 2,000 p.m. from 1.5.20X1.

(v) All investments were sold in April, 20X1.

(vi) The entire audit fees relates to the company. **(SM, ILLUSTRATION 7)**

PROBLEM 8:

The partners Kamal and Vimal decided to convert their existing partnership business into a Private Limited Company called M/s. KV Trading Private Ltd. with effect from 1-7-20X2.

The same books of accounts were continued by the company which closed its account for first term on 31-3-20X3.

The information for the year ended 31-3-20X3 is given below:

Particulars	(Rs.) in lakhs	(Rs.) in lakhs
Turnover		240.00
Interest on investments		6.00
		246.00
Less: Cost of goods sold	102.00	
Advertisement	3.00	
Sales Commission	6.00	
Salary	18.00	
Managing director's remuneration	6.00	
Interest on Debentures	2.00	
Rent	5.50	
Bad Debts	1.00	
Underwriting Commission	2.00	
Audit fees	2.00	
Loss on sale of investment	1.00	
Depreciation	4.00	152.50
		93.50

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The following additional information was provided:

(i) The average monthly sales doubled from 1-7-20X2. GP ratio was constant.

(ii) All investments were sold on 31-5-20X2.

(iii) Average monthly salary doubled from 1-10-20X2.

(iv) The company occupied additional space from 1-7-20X2 for which rent of Rs. 20,000 per month was incurred.

(v) Bad debts recovered amounting to Rs. 50,000 for a sale made in 20X0, has been deducted frombad debts mentioned above.

(vi) Audit fees pertains to the company.

Prepare a statement apportioning the expenses between pre and post incorporation periods and calculate the Profit/Loss for such periods. **(SM, PRATICAL QUESTION 2)**

PROBLEM 9:

New Limited was incorporated on 01.08.2020 to take-over the business of a partnership firm w.e.f. 01.04.2020. It provides you the following information for the year ended 31.03.2021:

PARTICULARS	AMOUNT
Gross profit	9,00,000
Expenses:	
Salaries	1,80,000
Rent, Rates & Taxes	1,20,000
Depreciation	37,500
Commission on Sales	31,500
Interest on Debentures	48,000
Director's Fees	18,000
Advertisement	54,000
Net Profit for the Year	4,11,000

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(i) New Limited initiated an advertising campaign which resulted increase in monthly average sales by 25% post incorporation.

(ii) The Gross profit ratio post incorporation increased to 30% from 25%.

You are required to apportion the profit for the year between pre-incorporation and post-incorporation periods. **(RTP-NOV 2021-PROBLEM-4)**

TEST YOUR KNOWLEDGE

THEORETICAL QUESTIONS:

1. Define Pre–incorporation profit/loss in brief.

SOLUTION:

When a running business is taken over by the promoters of a company, as at a date prior to the date of incorporation of company, the amount of profit or loss of such a business for the period prior to the date the company came into existence is referred to as pre-incorporation profits or losses.

MCQs:

1. Profit prior to incorporation is transferred to

(a) General reserve.

(b) Capital reserve.

(c) Profit and loss account.

2. The profit earned by the company from the date of purchase to the date of incorporation is

(a) Pre- incorporation profit.

(b) Post- incorporation profit.

(c) Notional profit.

3. Loss prior to incorporation is debited to which account?

(a) Goodwill account

(b) Loss prior to incorporation account

(c) Either (a) or (b)

4. Profit prior to incorporation is

(a) Available for distribution as dividend among the members of the company.

(b) Not available for distribution as dividend among the members of the company.

(c) Depends upon the Memorandum of Association.

5. Profit or loss prior to incorporation is of

(a) Revenue nature.

(b) Capital nature.

(c) Nominal nature.

6. Which of the following expenditure is allocated on the basis of time?

(a) Insurance.

(b) Bad debts.

(c) Discount allowed.

7. Which of the following is allocated on the basis of turnover?

(a) Salaries.

(b) Depreciation.

(c) Gross profit.

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8. Preliminary expenses on the formation of the company are charged against

(a) Pre-incorporation profit.

(b) Post- incorporation profit.

(c) Not calculated because of bifurcation of profit into pre and post.

9. Which of the following expense is not allocated on time basis?

(a) Rent

(b) Salaries

(c) Discounts.

10. Pre incorporation profits cannot be used for

(a) Paying up partly paid up shares

(b) Issue of bonus shares

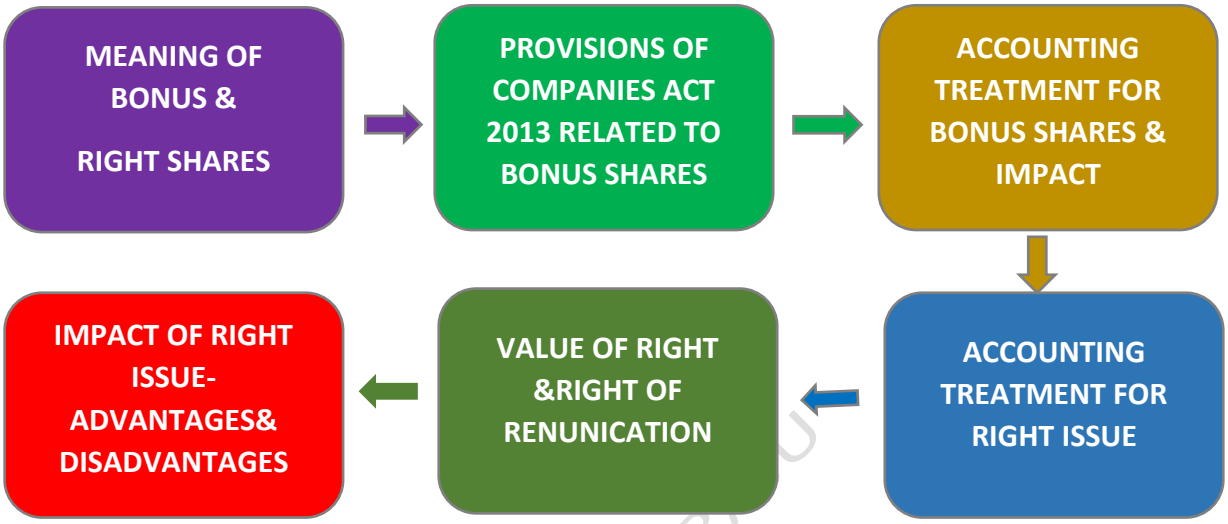
(c) Distribution of dividends

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1) B	**2)** A	**3)** C	**4)** B	**5)** B
6) A	**7)** C	**8)** B	**9)** C	**10)** C

4.ACCOUNTING FOR BONUS AND RIGHTS ISSUE

OVERVIEW



MEANING:

BONUS SHARES	Bonus issue means an issue of additional shares to existing shareholders free of cost in proportion to their existing holding.
RIGHT ISSUE	Rights issue is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price.

PROVISIONS OF THE COMPANIES ACT, 2013:

1. As per Section 63(1) of the Companies Act 2013, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—
   a. its free reserves;
   b. the securities premium account; or
   c. the capital redemption reserve account:

   Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

2. As per Section 63(2) of the Companies Act, 2013, at the time of issue of Bonus shares following provisions should be complied.
   a. it is authorised by its articles;
   b. it has, on the recommendation of the Board, been authorised in the general meeting of the company;
   c. it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

d. it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

e. the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.

f. it complies with such other conditions as may be prescribed.

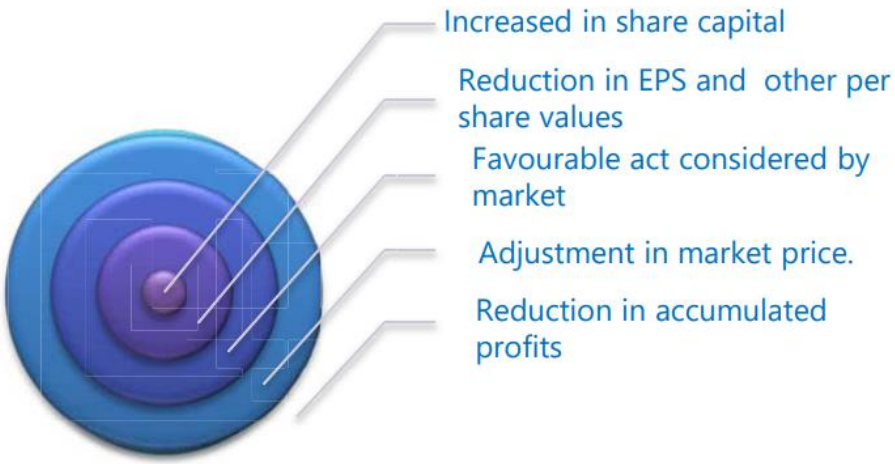
3. As per section 63(2), Bonus shares cannot be issued unless partly paid-up shares are made fully paid-up. As per schedule-1 of companies Act, 2013, Free reserves may be used for paying up amounts unpaid on shares held by existing shareholders (though securities premium account and capital redemption reserve cannot be used). So, Bonus shares can be issued by converting partly paid-up shares into fully paid-up shares also.

4. ACCOUNTING TREATMENT:

1.Upon the sanction of an issue of bonus shares Capital Redemption Reserve Account Dr. Securities Premium Account Dr. General Reserve Account Dr. Profit & Loss Account Dr. To Bonus to Shareholders Account.	**1.Upon the sanction of bonus by converting partly paid shares into fully paid shares** General Reserve Account Dr. Profit & Loss Account Dr. To Bonus to Shareholders Account
2.Upon issue of bonus shares Bonus to Shareholders Account Dr. To Share Capital Account.	**2.On making the final call due** Share Final Call Account Dr. To Share Capital Account.
	3. On adjustment of final call Bonus to Shareholders Account Dr. To Share Final Call Account

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IMPACT OF BONUS ISSUE:



ACCOUNTING FOR RIGHT ISSUE:

1. The accounting treatment of rights share is the same as that of issue of ordinary shares and the following journal entry will be made:

   Bank A/c Dr.

   To Equity shares capital A/c

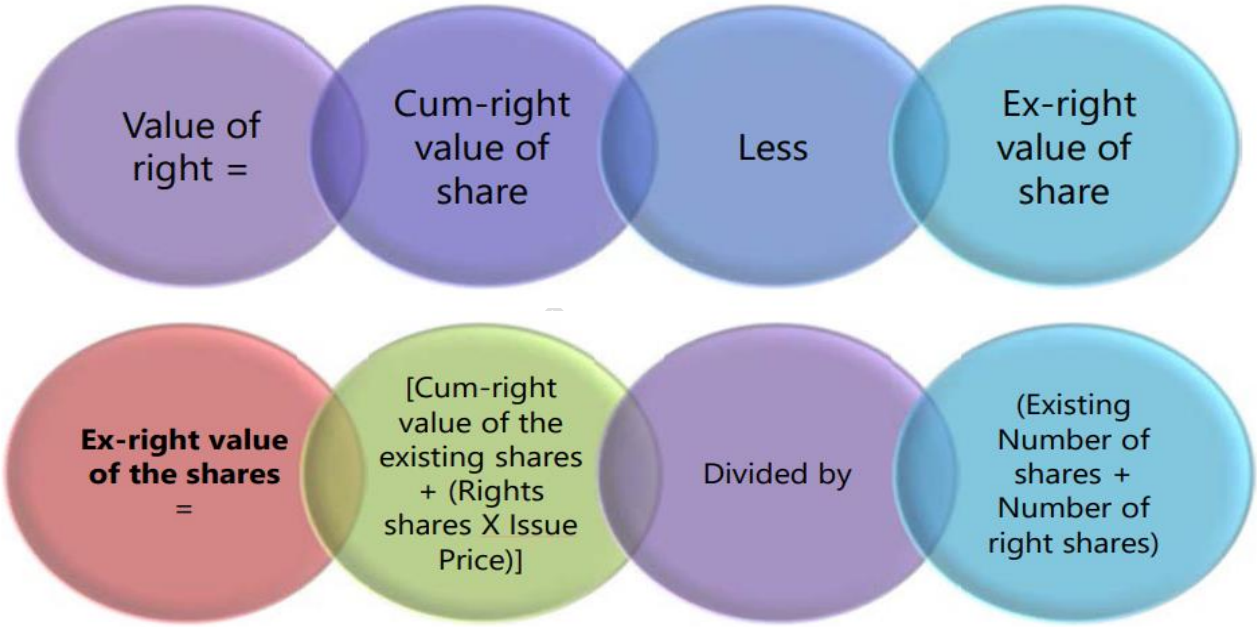
2. In case rights shares are being offered at a premium, the premium amount is credited to the securities premium account. The accounting entry is

   Bank A/c Dr.

   To Equity Share Capital A/c

   To Securities Premium A/c

VALUE OF RIGHT:



RIGHT OF RENUNICATION/RIGHT'S RENOUNCEMENT:

1. Right of renunciation refers to the right of the shareholder to surrender his right to buy the securities and transfer such right to any other person.

2. Shareholders that have received right shares have three choices of what to do with the rights.
   i) They can act on the rights and buy more shares as per the particulars of the rights issue;
   ii) they can sell them in the market; or
   iii) they can pass on taking advantage of their rights (i.e., reject the right offer).

ADVANTAGES AND DISADVANTAGES OF RIGHT ISSUE:

A) Advantages of right Issue

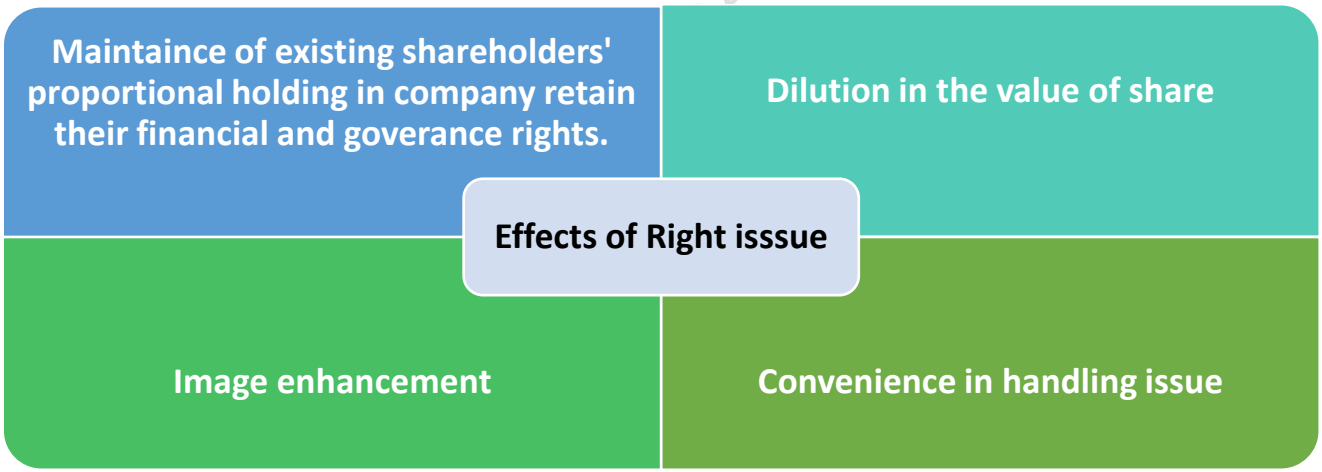
1. Right issue enables the existing shareholders to maintain their proportional holding in the company and retain their financial and governance rights. It works as a deterrent to the management, which may like to issue shares to known persons with a view to have a better control over the company's affairs.

2. In well-functioning capital markets, the right issue necessarily leads to dilution in the value of share. However, the existing shareholders are not affected by it because getting new shares at a discounted value from their cum-right value will compensate decrease in the value of shares. The cum-right value is maintained otherwise also, if the existing shareholders renounce their right in favour of a third party.
3. Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue.
4. Right issue has an image enhancement effect, as public and shareholders view it positively.
5. The chance of success of a right issue is better than that of a general public issue and is logistically much easier to handle.

B) Disadvantages of right issue

1. The right issue invariably leads to dilution in the market value of the share of the company.
2. The attractive price of the right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

EFFECTS OF RIGHT ISSUE



PROBLEMS FOR DISCUSSION

PROBLEM 1:

Alpha Company announced bonus issue to its shareholders in the ratio of 2:3 ie. 2 shares for every 3shares held. Shareholder X has 6,000 shares before announcement of bonus issue. How much shares would he have after bonus issue? **(SM, EXAMPLE-1)**

ROBLEM 2:

Following items appear in the trial balance of Bharat Ltd. (a listed company) as on 31st March, 2011:

Particulars	Rs.
40,000 Equity Shares of Rs 10 each	4,00,000
Securities Premium (collected in cash)	30,000
Capital Redemption Reserve	55,000
General Reserve	1,05,000
Surplus; Profit and Loss Account (Cr. Balance)	50,000

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

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PROBLEM 3:

Pass Journal Entries in the following circumstances:

i) A Limited company with subscribed capital of Rs. 5,00,000 consisting of 50,000 Equity shares of Rs. 10 each; called up capital Rs. 7.50 per share. A bonus of Rs. 1,25,000 declared out of General Reserve to be applied in making the existing shares fully paid up.

ii) A Limited company having fully paid- up capital of Rs. 50,00,000 consisting of Equity shares of Rs. 10 each, had General Reserve of Rs. 9,00,000. It was resolved to capitalize Rs. 5,00,000 out of General Reserve by issuing 50,000 fully paid bonus shares of Rs. 10 each, each shareholder to get one such share for every ten shares held by him in the company. **(SM, ILLUSTRATION 2)**

PROBLEM 4:

Following is the extract of the Balance Sheet of Solid Ltd. as at 31st March, 2015:

Particulars	Rs.
Authorised capital	
10,000 12% Preference shares of Rs.10 each	1,00,000
1,00,000 Equity shares of Rs.10 each	10,00,000

	11,00,000
Issued and subscribed capital:	
8,000 12% Preference shares of Rs.10 each fully paid	80,000
90,000 Equity shares of Rs.10 each Rs.8 paid up	7,20,000
Reserves and Surplus:	
(a) General Reserve	1,60,000
(b) Revaluation reserve	35,000
(c) Securities Premium (collected in cash)	20,000
(d) Profit and Loss Account	2,05,000
Secured loan:	
12% Debentures @ Rs.100 each	5,00,000

On 1st April, 2015 the Company has made final call @ Rs. 2 each on 90,000 equity shares. The call money was received by 20th April, 2015. Thereafter the company decided to capitalise its reserves byway of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue assuming that the company has passed necessary resolution at its general body meeting for increasing the authorised capital.

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(ANS.: SHARE CAPITAL AFTER BONUS ISSUE: RS.12,05,000) (SM, ILLUSTRATION 3)

PROBLEM 5:

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

Authorised capital:	**Rs.**
15,000 12% Preference shares of Rs. 10 each	1,50,000
1,50,000 Equity shares of Rs. 10 each	15,00,000
	16,50,000
Issued and Subscribed capital:	
12,000 12% Preference shares of Rs. 10 each fully paid	1,20,000
1,35,000 Equity shares of Rs. 10 each, Rs. 8 paid up	10,80,000
Reserves and surplus:	

General Reserve	1,80,000
Capital Redemption Reserve	60,000
Securities premium (collected in cash)	37,500
Profit and Loss Account	3,00,000

On 1st April, 20X1, the Company has made final call @ Rs. 2 each on 1,35,000 equity shares. The call money was received by 20th April, 20X1. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 20X1 after bonus issue**.** **(SM, ILLUSTRATION 4)**

PROBLEM 6:

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

	Rs.
Authorised capital:	
30,000 12% Preference shares of Rs. 10 each	3,00,000
3,00,000 Equity shares of Rs. 10 each	30,00,000
	33,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of Rs. 10 each fully paid	2,40,000
2,70,000 Equity shares of Rs. 10 each, Rs. 8 paid up	21,60,000
Reserves and surplus:	
General Reserve	3,60,000
Capital Redemption Reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and Loss Account	6,00,000

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On 1st April, 20X1, the Company has made final call @ Rs 2 each on 2,70,000 equity shares. The call money was received by 20th April, 20X1. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Show necessary journal entries inthe books of the company and prepare the extract of the balance sheet as on 30th April, 20X1 after bonus issue. **(SM, PRATICAL Q.NO.3)**

PROBLEM 7:

A company offers new shares of Rs. 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is Rs. 150. Calculate the value of a right. What should be the ex-right market price of a share? **(SM, ILLUSTRATION 5)**

PROBLEM 8:

(a) Beta Ltd. having share capital of 20,000 equity shares of Rs.10 each decides to issue rights share at the ratio of 1 for every 8 shares held at par value. Assuming all the shareholders accepted the rights issue and all money was duly received, pass journal entry in the books of the company.

(b) Omega Ltd. offers new shares of Rs. 100 each at 25% premium to existing shareholders on the basis one for five shares. The cum-right market price of a share is Rs. 200. You are required to calculate the (i) Ex-right value of a share; (ii) Value of a right share? **(RTP-MAY 2021-PROBLEM 6)**

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PROBLEM 9:

Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March 20X1:

	Rs.
Authorised capital:	
50,000 12% Preference shares of Rs. 10 each	5,00,000
5,00,000 Equity shares of Rs. 10 each	50,00,000
	55,00,000
Issued and Subscribed capital:	
50,000 12% Preference shares of Rs. 10 each fully paid	5,00,000
4,00,000 Equity shares of Rs. 10 each, Rs. 8 paid up	32,00,000
Reserves and surplus:	
General Reserve	1,60,000
Capital Redemption Reserve	2,40,000
Securities premium (collected in cash)	2,75,000
Revaluation Reserve	1,00,000
Profit and Loss Account	16,00,000

On 1st April, 20X1, the Company has made final call @ RRs. 2 each on 4,00,000 equity shares. The call money was received by 25th April, 20X1. Thereafter, on 1st May 20X1 the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held, it decided that there should be minimum reduction in free reserves.

On 1st June 20X1, the Company issued Rights shares at the rate of two shares for every five shares held on that date at issue price of Rs. 12 per share. All the rights shares were accepted by the existing shareholders and the money was duly received by 20th June 20X1.

Show necessary journal entries in the books of the company for bonus issue and rights issue.

(SM, PRACTICE PROBLEM-6)

TEST YOUR KNOWLEDGE

THEORETICAL QUESTIONS:

1. What is meant by Bonus issue? Explain its related provisions as per the Companies Act, 2013.

ANSWER:

Bonus Issue means an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increase the dividend pay-out. For details, refer para 1.2.

2. Explain the financial effects of a further issue of equity shares on the market value of the share.

ANSWER:

The financial position of a business is contained in the balance sheet. Further issue of shares increases the amount of share capital as well as the liquid resources (Bank). The amount of share capital issued is the product of further number of shares issued multiplied by issue price. The issue price may be higher than the face value (issue at a premium).

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3. What are the advantages and disadvantages of a rights issue?

ANSWER:

Rights issue is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. For advantages and disadvantages of right issue, refer para 2.2.

4. What is meant by renunciation of rights shares by existing shareholder?

ANSWER:

In a situation where existing shareholder does not intend to subscribe to the rights issue of a company, he may give up his right in favour of another person for a consideration. Such giving up of rights is called renunciation of rights.

MCQs:

1) Which of the following cannot be used for issue of bonus shares as per the Companies Act?

(a) Securities premium account

(b) Revaluation reserve

(c) Capital redemption reserve

2) Which of the following statements is true with regard to declaring and issuing of Bonus Shares?

(a) Assets are transferred from the company to the shareholders.

(b) A Bonus issue results in decrease in reserves and surplus.

(c) A Bonus issue is same as declaration of dividends.

3) Which of the following statement is true in case of bonus issue?

(a) Convertible debenture holders will get bonus shares in same proportion as to the existing shareholders.

(b) Bonus shares may be issued to convertible debenture holders at the time of conversion of such debentures into shares.

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

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4) Bonus issue is also known as

(a) Scrip issue.

(b) Capitalisation issue.

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

5) The bonus issue is not made unless

(a) Partly paid shares are made fully paid up.

(b) It is provided in its articles of association

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

6) Bonus issue has the following effect

(a) Market price gets adjusted on issue of bonus shares.

(b) Effective Earnings per share, Book Value and other per share values stand increased.

(c) Markets generally take the action as an unfavourable act.

7) ABC Co. Ltd resolved to issue bonus shares. Which of the following is not a pre-requisite for issuance of bonus shares?

(a) Authorization in Articles of Association.

(b) Timely Payment of statutory dues of employees such as PF, Gratuity etc.

(c) Sufficient balance in bank account of company.

8) In case of further issue of shares, the right to renounce the shares in favour of a third party

(a) Must include a right exercisable by the person concerned to renounce the shares;

(b) Should include a right exercisable by the person concerned to renounce the shares;

(c) Is deemed to include a right exercisable by the person concerned to renounce the shares (subject to the provisions under the articles of the company).

9) A company's share's face value is Rs. 10, book value is Rs. 20, Right issue price is Rs. 30 and Market price is Rs. 40, while recording the issue of right share, the securities premium will be credited with

(a) Rs. 10

(b) Rs. 20

(c) Rs. 30

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10) A. Right shares enable existing shareholders to maintain their proportional holding in the company.

B. Right share issue does not cause dilution in the market value of the share.

Which of the option is correct?

(a) A-Correct; B Correct

(b) A – Incorrect; B Correct

(c) A - Correct; B – Incorrect

11) Right shares are normally offered at a price _____the cum-right value of the share, causing dilution in its value post-right issue

(a) More than.

(b) Less than.

(c) Equal

12) Rights issue of shares results in _____ of market value of per share in comparison to market price before rights issue.

(a) Increase.

(b) Decrease.

(c) No change.

13) Ex-Rights price can be calculated by which of these formulas?

(a) (Cum rights value of the existing shares + Rights share issue proceeds)/ (existing number of shares + No. of right shares).

(b) (Cum rights value of the existing shares + Rights share issue proceeds) X (existing number of shares + No. of right shares).

(c) (Cum rights value of the existing shares - Rights share issue proceeds)/ (existing number of shares – No. of right shares).

14) Issued share capital including issue of rights shares and bonus shares should be _____ Authorised capital.

(a) More than.

(b) Less than.

(c) Less than or equal to.

15) Earnings per share _____ after a bonus issue

(a) Increases.

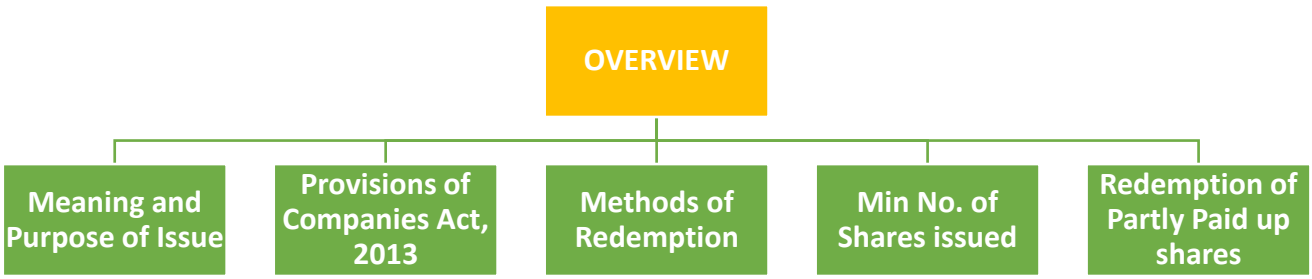
(b) Decreases.

(c) Remains constant.

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1) B	**2)** B	**3)** C	**4)** C	**5)** C
6) A	**7)** C	**8)** C	**9)** B	**10)** C
11) B	**12)** B	**13)** A	**14)** C	**15)** B

5.REDEMPTION OF PREFERENCE SHARES



1) MEANING:

Redemption is the process of repaying an obligation, at prearranged amounts and timings. It is a contract giving the right to redeem preference shares within or at the end of a given time period at an agreed price.

2) PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES:

1. It is a proper way of raising finance in a dull primary market.
2. A company may face difficulty in raising share capital, as its shares are not traded on the stock exchange. Potential investors, hesitate in putting money into shares that cannot easily be sold, may be encouraged to invest if the shares are redeemable by the company.
3. The preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.
4. No dividend is required to be paid, if there is loss or no profit, whereas, interest is payable on debentures or loans even in case of loss.

3) PROVISIONS OF COMPANIES ACT, 2013 – SECTION 55:

a) A company limited by shares if so, authorised by its articles, may issue preference shares which at the option of the company, are liable to be redeemed within a period, normally not exceeding 20 years from the date of their issue.

b) Shares can be redeemed out of divisible or distributable profit, (i.e., out of the profit of the company which would be available for dividend) or out of proceeds of fresh issue of shares made for the purpose of redemption.

c) Shares can be redeemed only if they are fully paid.

d) Treatment for premium on Redemption

(i). In case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

(ii). Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for

out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(iii). In case of other companies (not falling under above), the premium, if any payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

EXPLANATION: Section 52 of the Companies Act, 2013 provides that the securities premium account may be applied by the company;

a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities.

b) To write off preliminary expenses of the company

c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company

d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.

e) For the purchase of its own shares or other securities.

Note:

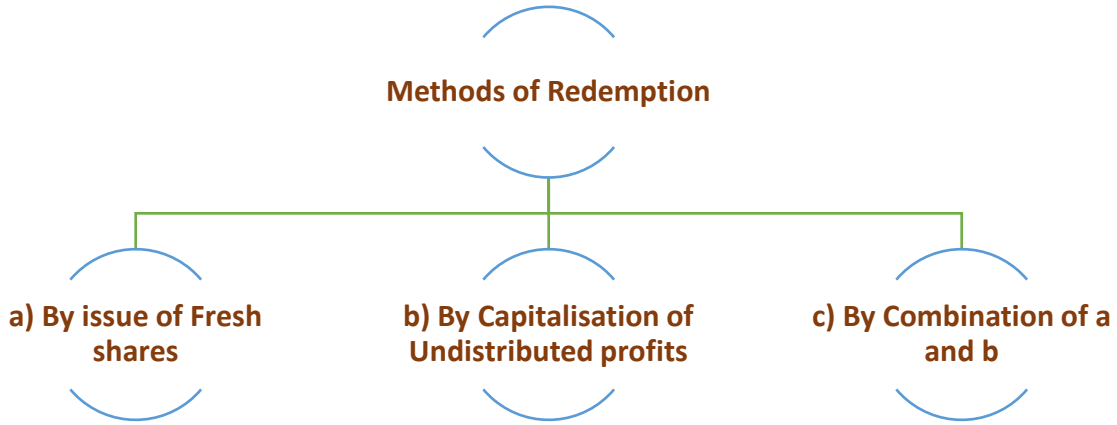
1) It may be noted that certain class of Companies whose financial statements comply with the Accounting Standards as prescribed under Section 133 of the Companies Act, 2013, can't apply the securities premium account for the purposes (b) and (d) mentioned above.

2) All the questions in this chapter have been solved on the basis that the companies referred in the questions are governed by Section 133 of the Companies Act, 2013 and comply with the Accounting Standards prescribed for them. Accordingly the balance in securities premium account has not been utilized for the purpose of premium payable on redemption of preference shares.

e) Where any such shares are proposed to be redeemed out of the profits of the company, there shall, out of the divisible profits, i.e., the profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed.

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METHODS OF REDEMPTION OF FULLY PAID-UP SHARES:



1) REDEMPTION OF PREFERENCE SHARES BY FRESH ISSUE OF SHARES:

a) One of the methods for redemption of preference shares is to use the proceeds of a fresh issue of shares. A company can issue new shares (equity shares or preference shares) and the proceeds from such new shares can be used for redemption of preference shares.

b) The proceeds from issue of debentures cannot be utilised for the purpose.

c) The proceeds of a fresh issue of shares will not include the amount of securities premium for the purpose of redemption of preference shares.

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JOURNAL ENTRIES:

1) When new shares are issued at par

Bank Account Dr.

To Share Capital Account

(Being the issue of …….shares of Rs…….each for the purpose of redemption of preference shares, as per Board's Resolution No…… dated…….)

2) When new shares are issued at a premium

Bank Account Dr.

To Share Capital Account

To Securities Premium Account

(Being the issue of ……..shares of Rs…….each at a premium of Rs…….each for the purpose of redemption of preference shares as per Board's Resolution No….. dated……)

3) When preference shares are redeemed at par

Redeemable Preference Share Capital Account Dr.

To Preference Shareholders Account

4) When preference shares are redeemed at a premium

Redeemable Preference Share Capital Account Dr.

Premium on Redemption of Preference Shares Account Dr.

To Preference Shareholders Account

5) When payment is made to preference shareholders

Preference Shareholders Account Dr.

To Bank Account

6) For adjustment of premium on redemption

Profit and Loss Account Dr.

To Premium on Redemption of Preference Shares Account

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REDEMPTION OF PREFERENCE SHARES BY CAPITALISATION OF UNDISTRIBUTED DIVISIBLE PROFITS:

Another method for redemption of preference shares, as per the Companies Act, is to use the distributable profits in place of issuing new shares. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve Account by debiting the distributable profit. In other words, some of the distributable profits are kept aside to ensure that it can never be distributed to shareholders as dividend.

JOURNAL ENTRIES:

1. For transferring nominal amount of shares redeemed to **Capital Redemption Reserve Account**.		
General Reserve Account Dr. Profit and Loss Account Dr. Or any other Divisible Profits Dr. To Capital Redemption Reserve Account (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act).		
2. **When shares are redeemed at par**		
Redeemable Preference Share Capital Account Dr. To Preference Shareholders Account (Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)		
3. **When shares are redeemed at a premium**		

Redeemable Preference Share Capital Account Dr. Premium on Redemptions of Preference Shares Account Dr. To Preference Shareholders Account (Being the amount payable on redemption transferred to Preference Shareholders Account)		
4. **When payment is made to preference shareholders**		
Preference Shareholders Account Dr. To Bank Account (Being the payment to preference shareholders as per terms)		
5. **For adjustment of premium of redemption**		
Divisible Profit Account Dr. To Premium on Redemption of Preference Shares Account (Being the premium on redemption adjusted against Profit and Loss Account)		

REDEMPTION OF PREFERENCE SHARES BY COMBINATION OF FRESH ISSUE AND CAPITALISATION OF UNDISTRIBUTED DIVISIBLE PROFITS:

A company can redeem the preference shares partly from the proceeds from new issue and partly out of profits.

Formula:

(i) Amount to be Transferred to Capital Redemption Reserve	
	Rs.
Face value of shares redeemed	xxx
Less: Proceeds from new issue	xxx
	xxx
(ii) Proceeds to be collected from New Issue	
	Rs.
Face value of shares redeemed	xxx
Less: Profits available for distribution as dividend	xxx
	xxx

MINIMUM FRESH ISSUE OF SHARES

Minimum Fresh Issue of Shares to comply the provisions of section 55	Minimum Fresh Issue to Provide Funds for Redemption
Minimum Number of Shares = Minimum proceeds to comply with Section 55/ Proceeds of one share.	Besides, ensuring compliance with Section 55, the fresh issue of shares is made to provide funds for making payment to preference shareholders.
Minimum proceeds to comply with Section 55 =Nominal value of preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.	Minimum number of shares = (Amount payable to preference shareholders–Funds available for redemption)/Issue price

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Maximum amount of reserve and surplus available for redemption = Free reserves & surplus as per Balance sheet- Adjustment for premium on redemption payable out of profits- Amount retained in Free reserves as per BOD information.	
Proceeds of one share mean the par value of a share issued, if it is issued at par or premium. However, in case of issue of share at a discount, it refers to the discounted value.	
NOTE: Minimum number of shares calculated as above, needs to be adjusted for share fractions. Thus, minimum number of shares as per above includes a fraction, it must be approximated to the next higher figure to ensure that provisions of Section 55 are not violated. Secondly, if the examination problem states that the proceeds/number of shares should be a multiple of say, 10 or 50 or 100, then again the next higher multiple should be considered.	

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REDEMPTION OF PARTLY CALLED-UP PREFERENCE SHARES:

One of the conditions of redemption is that only fully paid- up preference shares can be redeemed by a company. Hence:

1. If the problem states that it is decided to redeem preference shares which are partly called up, then it is assumed that the final call on these shares is demanded and received before proceeding with redemption of these shares.
2. If information about both fully paid and partly paid preference shares is provided, then, it is presumed that only fully paid shares are to be redeemed and partly paid shares are left intact.

REDEMPTION OF FULLY CALLED BUT PARTLY PAID-UP PREFERENCE SHARES:

a) WHEN THE AMOUNT OF CALLS-IN-ARREARS IS RECEIVED BY THE COMPANY:

If the amount of unpaid calls is received by the Company before redemption, the entry passed is as under:

Bank A/c Dr.

To Calls-in-Arrears A/c

After receipt of calls in arrears, the shares become fully paid up and then, company can proceed with redemption in the normal course.

b) IN CASE OF FORFEITED SHARES:

If in spite of receiving a proper notice from the company, the shareholders fail to pay the unpaid calls, the Board of Directors may decide to forfeit the shares and cancel these shares instead of reissuing the forfeited shares because redemption of these shares is due immediately or in near future. In this case, the journal entry for forfeiture is passed as usual, which will be as follows:

(Called up share capital only relating to the shares to be forfeited)

Preference Share Capital A/c Dr

To Calls- In Arrears A/c

To Shares Forfeited A/c *

(*Amount actually collected on shares forfeited. This will be equal to the balancing amount)

NOTE: But it should be noted, in this case, that the number of shares to be redeemed will be reduced by the number of shares so forfeited.

PROBLEMS FOR DISCUSSION

PROBLEMS BASED ON REDEMPTION OF PREFERENCE SHARES THROUGH FRESH ISSUE

PROBLEM 1:

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of Rs. 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company. (**SM, ILLUSTRATION 1**)

PROBLEM 2:

C Ltd. had 10,000, 10% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of Rs. 10 each at a premium of Rs. 2 per share as fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company. **(SM, ILLUSTRATION 2)**

PROBLEMS BASED ON REDEMPTION OF PREFERENCE SHARES BY CAPITALISATION OF UNDISTRIBUTED DIVISIBLE PROFITS

PROBLEM 3:

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 20X1.

Share capital: 40,000 Equity shares of Rs. 10 each fully paid – Rs. 4,00,000; 1,000 10% Redeemable preference shares of Rs. 100 each fully paid – Rs. 1,00,000.

Reserve & Surplus: Capital reserve – Rs. 50,000; Securities premium – Rs. 50,000; General reserve – Rs. 75,000; Profit and Loss Account – Rs. 35,000

On 1st January 20X2, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

(**SM, ILLUSTRATION 6**)

PROBLEMS BASED ON REDEMPTION OF PREFERENCE SHARES BY COMBINATION OF FRESH ISSUE AND CAPITALISATION OF UNDISTRIBUTED DIVISIBLE PROFITS

PROBLEM 4:

C Limited had 3,000, 12% Redeemable Preference Shares of Rs.100 each, fully paid up. The companyhad to redeem these shares at a premium of 10%.
It was decided by the company to issue the following:
(i) 25,000 Equity Shares of Rs.10 each at par,
(ii) 1,000 14% Debentures of Rs.100 each.
The issue was fully subscribed and all amounts were received in full. The payment was duly made.The company had sufficient profits. Show Journal Entries in the books of the company.

(**SM, ILLUSTRATION 7**)

PROBLEM 5:

The capital structure of a company consists of 20,000 Equity Shares of Rs. 10 each fully paid up and 1,000 8% Redeemable Preference Shares of Rs. 100 each fully paid up (issued on 1.4.20X1).

Undistributed reserve and surplus stood as: General Reserve Rs. 80,000; Profit and Loss Account Rs. 20,000; Investment Allowance Reserve out of which Rs. 5,000, (not free for distribution as dividend) Rs. 10,000; Securities Premium Rs. 2,000, Cash at bank amounted to Rs. 98,000. Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilising the undistributed reserve and surplus, subject to the conditions that a sum of Rs. 20,000 shall be retained in general reserve and which should not be utilised.

Pass Journal Entries to give effect to the above arrangements and also show how the relevant items will appear in the Balance Sheet of the company after the redemption carried out.

(**SM, ILLUSTRATION 8**)

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PROBLEMS BASED ON REDEMPTION OF PARTLY CALLED-UP PREFERENCE SHARES

PROBLEM 6:

The Balance Sheet of XYZ Ltd. as at 31st December, 20X1 inter alia includes the following information:

PARTICULARS	AMOUNT
50,000, 8% Preference Shares of Rs.100 each, Rs.70 paid up	35,00,000
1,00,000 Equity Shares of Rs.100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000
Bank	15,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 20X2 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of Rs. 100 each at Rs. 110 per share, Rs. 20 being payable on application, Rs. 35 (including premium) on allotment and the balance on 1st January, 20X3. The issue was fully subscribed and allotment made on 1st March, 20X2. The money due on allotment were duly received by 31st March,

20X2. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 20X2 with the corresponding figures as on 31st December, 20X1.

(**SM, ILLUSTRATION 9**)

PROBLEM 7:

With the help of the details in above problem and further assuming that the Preference Shareholders holding 2,000 shares fail to make the payment for the Final Call made under Section 55, you are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 20X2 with the corresponding figures as on 31st December, 20X1 assuming that the shares in default are forfeited after giving proper notices. (**SM, ILLUSTRATION 10**)

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PROBLEM 8:

The Board of Directors of a Company decided to issue minimum number of equity shares of Rs. 9 to redeem Rs. 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is Rs. 3,00,000. Calculate the number of shares to be issued by the company to ensure that the provisions of Section 55 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of Rs. 50 only. (**SM, ILLUSTRATION 4**)

PROBLEM 9:

X Ltd. gives you the following information as at 31st March, 20X3:

	Particulars	Rs.
	EQUITY AND LIABILITIES	
1.	**Shareholders' funds**	
	a Share capital	2,90,000
	b Reserves and Surplus	48,000
2.	**Current liabilities**	
	Trade Payables	56,500
	ASSETS	
1.	**Property, Plant and Equipment**	3,45,000
2.	**Non-current investments**	18,500
3.	**Current Assets**	
	Cash and cash equivalents (bank)	31,000

The share capital of the company consists of ` 50 each equity shares of ` 2,25,000 and ` 100 each Preference shares of `65,000(issued on 1.4.20X1). Reserves and Surplus comprises Profit and Loss Account only.

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

(a) to sell all the investments for Rs. 15,000.

(b) to finance part of redemption from company funds, subject to, leaving a bank balance of Rs. 12,000.

(c) to issue minimum equity share of Rs. 50 each share to raise the balance of funds required.

You are required to pass:

The necessary Journal Entries to record the above transactions and prepare the balance sheet as on completion of the above transactions. **(SM, ILLUSTRATION.5)**

PROBLEM 10:

Trinity Ltd. gives you the following information as at 31.3.20X1:

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	Rs.
Property, Plant and Equipment:	
Gross Block	3,00,000
Less: Depreciation	1,00,000
	2,00,000
Investments	1,00,000
Inventory	45,000
Trade receivables	25,000
Cash and Bank Balances	50,000
Share Capital:	
Authorised :	
10,000 10% Redeemable Preference Shares of Rs. 10 each	1,00,000
90,000 Equity Shares of Rs.10 each	9,00,000
Issued, Subscribed and Paid-up Capital:	
10,000 10% Redeemable Preference Shares of Rs. 10 each	1,00,000
10,000 Equity Shares of Rs. 10 each	1,00,000
Reserves and Surplus:	
General Reserve	1,20,000
Securities Premium	70,000
Profit and Loss A/c	18,500
Current Liabilities and Provisions	11,500

For the year ended 31.3.20X2, the company made a net profit of Rs.35,000 after providing Rs.20,000 depreciation.

The following additional information is available with regard to company's operation:

1. The preference dividend for the year ended 31.3.20X2 was paid.

2. Except cash and bank balances, other current assets and current liabilities as on 31.3.20X2, was the same as on 31.3.20X1.

3. The company redeemed the preference shares at a premium of 10%.

4. The company issued bonus shares in the ratio of one share for every equity share held as on 31.3.20X2.

5. To meet the cash requirements of redemption, the company sold investments.

6. Investments were sold at 90% of cost on 31.3.20X2.

You are required to prepare necessary journal entries to record redemption and issue of bonus shares.

(SM, PRATICAL PROBLEM NO.3)

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TEST YOUR KNOWLEDGE

THEORETICAL QUESTIONS:

1. What is the purpose of issuing redeemable preference shares?

ANSWER:

A company may issue redeemable preference shares to raise finance in a dull primary market. Preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use. For details, refer para 2 of the chapter.

2. What are the provisions of the Companies Act, 2013 related with redemption of preference shares? Explain in brief.

ANSWER:

Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to redemption and, thus, the interest of outsiders is not affected. For details, refer para 3 of the chapter.

MCQ's:

1. Securities premium cannot be used to _____.

(a) Issue bonus shares

(b) Redeem preference shares

(c) Write-off preliminary expenses

2. S Ltd. issued 2,000, 10% Preference shares of Rs. 100 each at par on 1.4.20X1, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of Rs. 100 each at a premium of 20% per share. At the time of redemption of Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account =?

(a) Rs. 50,000

(b) Rs. 40,000

(c) Rs. 2,00,000

3. Which of the following cannot be used for the purpose of creation of capital redemption reserve account?

(a) Profit and loss account (credit balance)

(b) General reserve account

(c) Unclaimed dividend account

4. According to Section 52 of the Companies Act, 2013, the amount in the Securities Premium A/c cannot be used for the purpose of

(a) Issue of fully paid bonus shares

(b) Writing off losses of the company

(c) For purchase of own securities

5. Which of the following can be utilized for redemption of preference shares?

(a) The proceeds of fresh issue of equity shares

(b) The proceeds of issue of debentures

(c) The proceeds of issue of fixed deposit

6. Which of the following statements is True?

(a) Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

(b) Capital profit realized in cash cannot be used for payment of dividend

(c) Reserves created by revaluation of fixed assets are not permitted to be capitalized

7. Which of the following accounts can be used for transfer to capital redemption reserve account?

(a) General reserve account

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(b) Forfeited shares account

(c) Profit prior to incorporation

8. Preference shares amounting to Rs. 2,00,000 (already issued on 1.4.20X1) are redeemed at a premium of 5%, by issue of shares amounting to Rs. 1,00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve = ?

(a) Rs. 1,05,000

(b) Rs. 1,00,000

(c) Rs. 2,00,000

9. A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of

(a) Purchase of its own shares or other securities

(b) To write off discount allowed on any of securities or debentures of the company

(c) To provide for premium on the redemption of Redeemable Preference shares of the Company.

10. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to _____ account by debiting the distributable profit.

(a) Capital replacement Reserve.

(b) Capital Redemption Reserve.

(c) Capital Reserve.

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MCQs KEY:

1) B	**2) A**	**3) C**	**4) B**	**5) A**
6) A	**7) A**	**8) B**	**9) C**	**10) B**

6.INTRODUCTION & APPLICABILITY OF ACCOUNTING STANDARDS

MEANING OF ACCOUNTING STANDARDS:

Accounting Standards (ASs) are written policy documents issued by the Government with the support of other regulatory bodies like Ministry of Corporate Affairs (MCA) issuing Accounting Standards for corporates in consultation with National Financial Reporting Authority (NFRA) covering the following aspects of accounting transaction or events in the financial statements:

- **Recognition** of events and transactions in the financial statements
- **Measurement** of these transactions and events;
- **Presentation** of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader; and
- **Disclosures** relating to these transactions and events to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

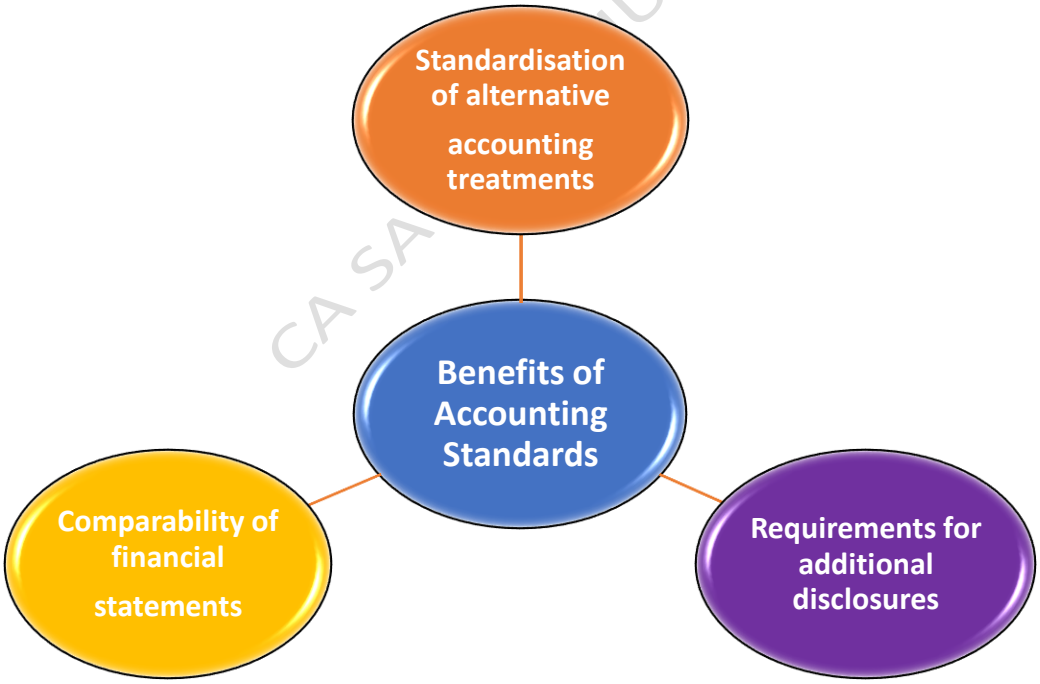
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WHY ACCOUNTING STANDARDS?

1) **Standardisation of alternative accounting treatments**: Accounting Standards reduce or eliminate, to a reasonable extent, any confusing variations in the accounting treatment and presentation of economic events while preparing financial statements.
2) **Requirements for additional disclosures:** There are certain areas where information is not statutorily required to be disclosed. However, accounting standards may call for appropriate disclosures of accounting policies followed and other required information in the financial statements which would be helpful for readers to understand the accounting treatment done for various items in those financial statements.
3) **Comparability of financial statements**: In addition to improving credibility of accounting data, standardisation of accounting procedures improves comparability of financial statements, both intra-enterprise and inter-enterprise.
   a) The intra-enterprise comparison involves comparison of financial statements of same enterprise over a number of years. The intra-enterprise comparison is possible if the enterprise uses same accounting policies every year in drawing up its financial statements.

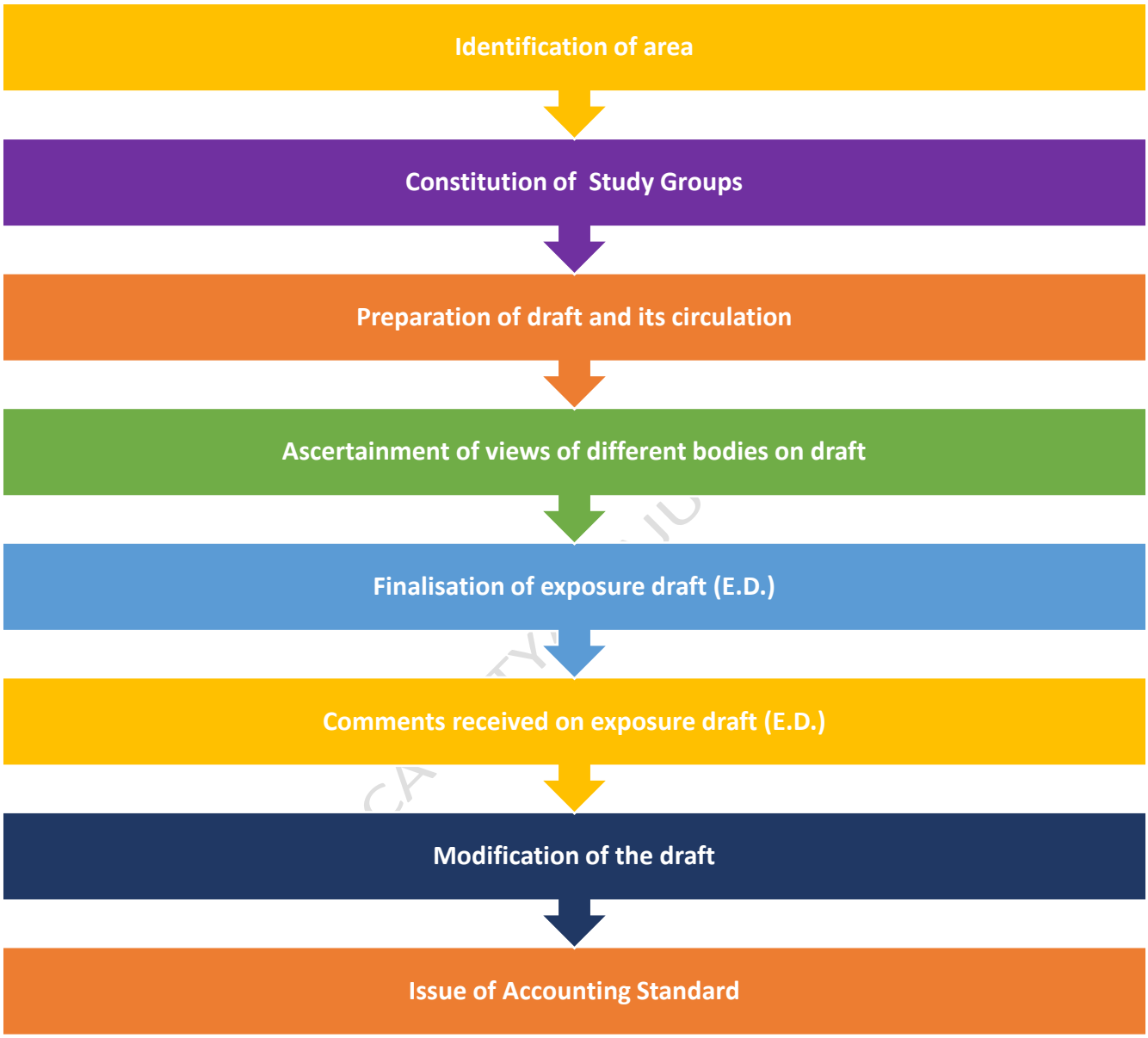
b) The inter-enterprise comparison involves comparison of financial statements of different enterprises for same accounting period. This is possible only when comparable enterprises use similar accounting policies in preparation of respective financial statements.

4) Reduction of scope for creative accounting: The creative accounting refers to twisting of accounting policies to produce financial statements favourable to a particular interest group. It is possible to overstate profits and assets by capitalising revenue expenditure or to understate them by writing off a capital expenditure against revenue of current accounting period. Such practices can be curbed only by framing Standards.



IMPORTNANT NOTE: Accounting Standards have to be read in line with the legal requirements, i.e., in case of any conflict, Statute would prevail over Accounting Standards. Because Accounting Standards are principle based, application of Accounting Standards becomes judgemental in case of complex business transactions.

STANDARDS SETTING PROCESS:



HOW MANY ACCOUNTING STANDARDS?

The Institute of Chartered Accountants of India has, so far, issued 29 Accounting Standards. However, AS 6 on 'Depreciation Accounting' has been withdrawn on revision of AS 10 'Property, Plant and Equipment and AS 8 on 'Accounting for Research and Development' has been withdrawn consequent to the issuance of AS 26 on 'Intangible Assets'. Thus effectively, there are 27 Accounting Standards at present.

The following is the list of Accounting Standards with their respective date of applicability:

AS NO.	AS Title	Date of applicability
1	Disclosure of Accounting Policies	01/04/1993
2	Valuation of Inventories (Revised)	01/04/1999
3	Cash Flow Statement	01/04/2001
4	Contingencies and Events Occurring after the Balance Sheet Date (Revised)	01/04/1998
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	01/04/1996
7	Construction Contracts	01/04/2002
9	Revenue Recognition	01/04/1993
10	Property, Plant and Equipment (Revised)	01/04/2016
11	The Effects of Changes in Foreign Exchange Rates (Revised)	01/04/2004
12	Accounting for Government Grants	01/04/1994
13	Accounting for Investments (Revised)	01/04/1995
14	Accounting for Amalgamations (Revised)	01/04/1995
15	Employee Benefits	01/04/2006
16	Borrowing Costs	01/04/2000
17	Segment Reporting	01/04/2001
18	Related Party Disclosures	01/04/2001
19	Leases	01/04/2001
20	Earnings Per Share	01/04/2001
21	Consolidated Financial Statements (Revised)	01/04/2001
22	Accounting for Taxes on Income	01/04/2006
23	Accounting for Investments in Associates in Consolidated Financial Statements	01/04/2002
24	Discontinuing Operations	01/04/2004
25	Interim Financial Reporting	01/04/2002
26	Intangible Assets	01/04/2003
27	Financial Reporting of Interests in Joint Ventures	01/04/2002

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28	Impairment of Assets	01/04/2008
29	Provisions, Contingent Liabilities and Contingent Assets (Revised)	01/04/2004

APPLICABILITY OF ACCOUNTING STANDARDS:

1. Enterprises to which the accounting standards apply?

Accounting Standards apply in respect of any enterprise engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes. Accounting Standards, however, do not apply to enterprises solely carrying on the activities, which are not of commercial, industrial or business nature.

Ex: an activity of collecting donations and giving them to flood affected people.

2. Implication of mandatory status:

A) The mandatory status of an accounting standard implies that, in discharging their attest functions, the members of the Institute are required to examine whether the financial statements are prepared in compliance with the applicable accounting standards.

B) Section 129 (1) of the Companies Act, 2013 requires companies to present their financial statements in accordance with the accounting standards notified under Section 133 of the Companies Act, 2013. Also, the auditor is required by Section 143(3)(e) to report whether, in his opinion, the financial statements of the company audited, comply with the accounting standards referred to in Section 133 of the Companies Act, 2013. Where the financial statements of a company do not comply with the accounting standards, the company should disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviations as per Section 129(5) of the Companies Act, 2013.

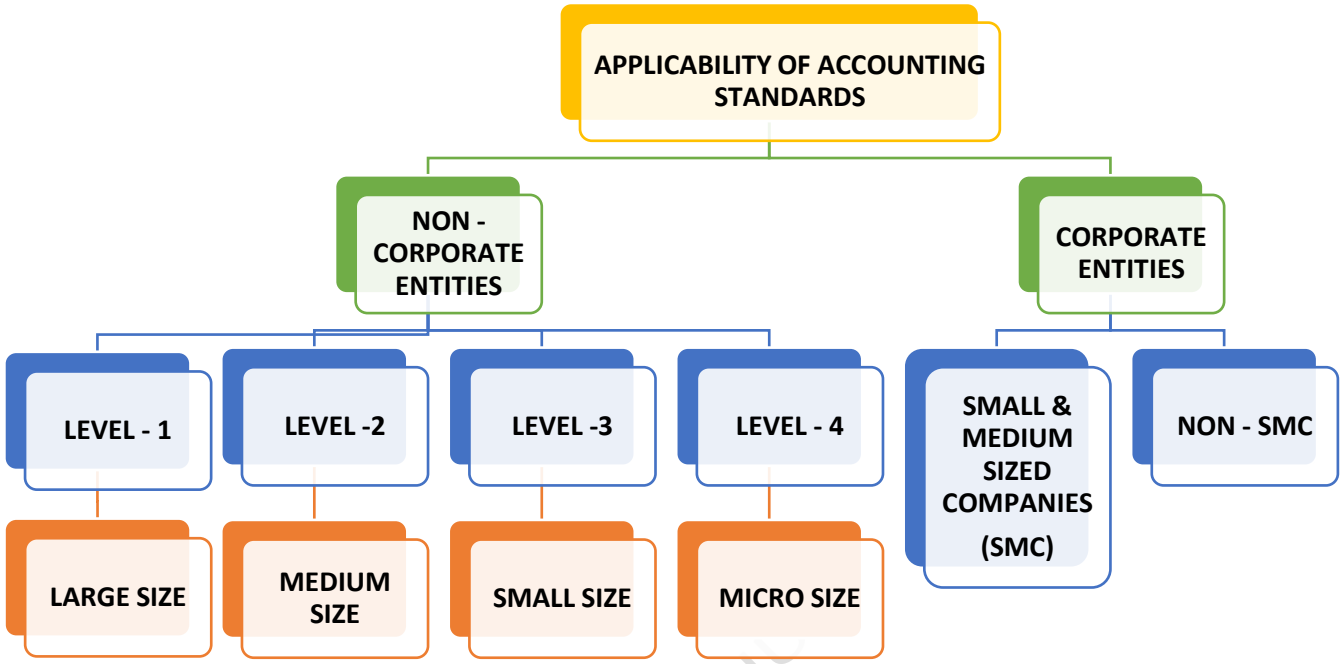
3. Financial items to which the accounting standards apply:

A) The Accounting Standards are intended to apply only to items, which are material. An item is considered material, if its omission or misstatement is likely to affect economic decision of the user.

B) Materiality is not necessarily a function of size; it is the information content i.e. the financial item which is important.

EX: A penalty of Rs. 50,000 paid for breach of law by a company can seem to be a relatively small amount for a company incurring crores of rupees in a year, yet is a material item because of the information it conveys. The materiality should, therefore, be judged on a case-to-case basis. If an item is material, it should be shown separately instead of clubbing it with other items. Therefore, it is not appropriate to club the penalties paid with legal charges.

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1. Criteria for classification of Non-company Entities:

A) Level I Entities

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

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

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

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

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

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

B) Level II Entities

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

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

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

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

C) Level III Entities

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

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

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

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

D) Level IV Entities

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

2. Level I entities are required to comply in full with all the Accounting Standards. Certain exemptions/relaxations have been provided to Level II, Level III and Level IV Non-company entities.

PARTICULARS	LEVEL II	LEVEL III	LEVEL IV
FULLY EXEMPTED	AS-3, AS-17, AS-20, AS-21, AS-23, AS-25, AS-27	AS-3, AS-17, AS-20, AS-21, AS-23, AS-25, AS-27, AS-18, AS-24	AS-3, AS-17, AS-20, AS-21, AS-23, AS-25, AS-27, AS-18, AS-24, AS-14, AS-28
PARTIALLY EXEMPTED	AS-15, AS-19, AS-28, AS-29	AS-15, AS-19, AS-28, AS-29, AS-10, AS-11	AS-15, AS-19, AS-28, AS-29, AS-10, AS-11, AS-13, AS-22, AS-26

3. Criteria for classification of Companies under the Companies (Accounting Standards) Rules, 2021:

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

(i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(ii) which is not a bank, financial institution or an insurance company;

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

(iv) which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and

(v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation: a company should qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

B) Non-SMCs: Companies not falling within the definition of SMC are considered as Non-SMCs.

4. Non-SMC entities are required to comply in full with all the Accounting Standards. Certain exemptions/relaxations have been provided to SMCs.

A) Accounting Standards not applicable to SMCs in their entirety:

(i) AS 3 Cash Flow Statements
(ii) AS 17 Segment Reporting
(iii) AS 21, Consolidated Financial Statements
(iv) AS 23, Accounting for Investments in Associates in Consolidated Financial Statements
(v) AS 27, Financial Reporting of Interests in Joint Ventures
(vi) AS 25, Interim Financial Reporting

B) Accounting Standards in respect of which relaxations from certain requirements have been given to SMCs:

(i) Accounting Standard (AS) 15, Employee Benefits.
(ii) AS 19, Leases
(iii) AS 20, Earnings Per Share
(iv) AS 28, Impairment of Assets
(v) AS 29, Provisions, Contingent Liabilities and Contingent Assets.

NOTE:

Where an entity has been covered in Level I/non-SMC and subsequently, ceases to be so covered and gets covered in Level II or Level III or Level IV/SMC, the entity will not qualify for exemption/relaxation available to that Level, until the entity ceases to be covered in Level I/non-SMC for two consecutive years. Same logic apply to other levels also.

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NEED FOR CONVERGENCE TOWARDS GLOBAL STANDARDS:

1. Multi -national corporations in search of money, to sustain on-going activities has necessitated raising of capital from all parts of the world. Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply and this in turn will require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin. Therefore, translation and reinstatements are of utmost importance in a world that is rapidly globalising in all ways.

2. International analysts and investors would like to compare financial statements based on similar ASs, and this has led to the growing need for an internationally accepted set of ASs for cross-border filings.

3. The harmonization of financial reporting around the world will help to raise confidence of investors, generally, in the information they are using to make their decisions and assess their risks.

4. A strong need was felt by legislation to bring about uniformity, rationalisation, comparability, transparency and adaptability in financial statements. Having a multiplicity of types of ASs around the world is against the public interest.

INTERNATIONAL ACCOUNTING STANDARD AUTHORITIES:

1. With a view of achieving the objective of setting global standards, the London based group namely the International Accounting Standards Committee (IASC), responsible for developing International Accounting Standards (IAS), was established in June, 1973. It is presently known as International Accounting Standards Board (IASB). The IASC comprises the professional accountancy bodies of over 75 countries (including the ICAI).

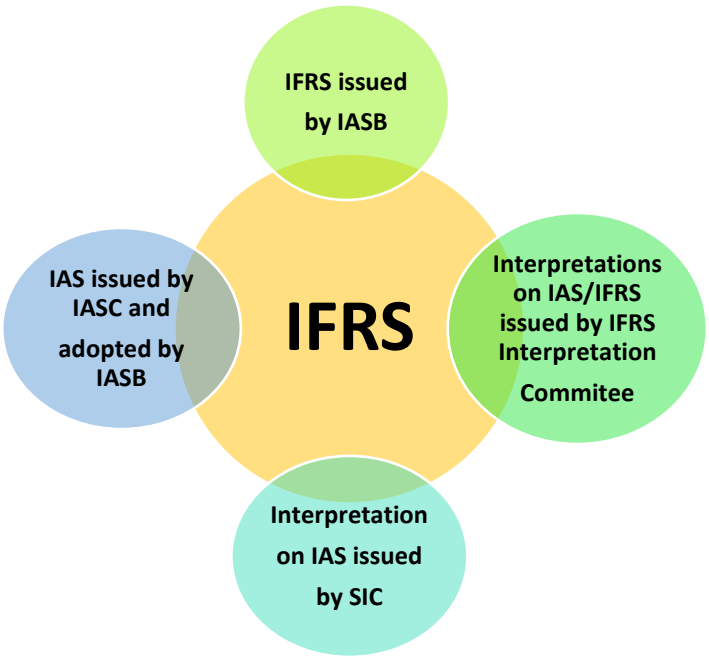
2. Between 1997 and 1999, the IASC restructured their organisation, which resulted in formation of IASB. The standards issued by IASC Board till 31.03.2001 are known as IASs and the standards issued by IASB since 01.04.2001 are known as IFRSs.

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INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AS GLOBAL STANDARDS:

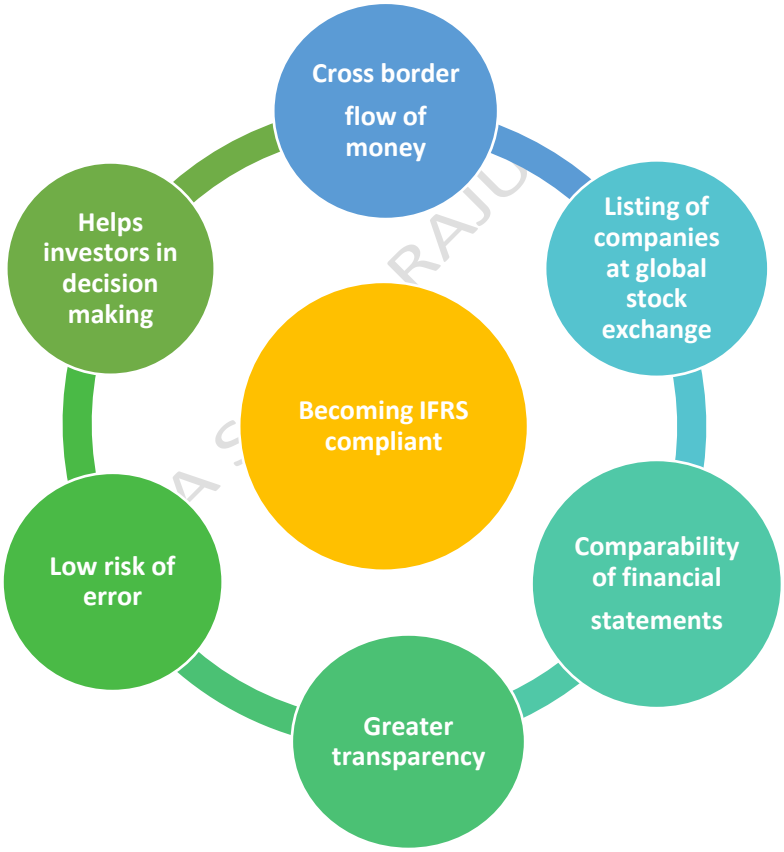
The term International Financial Reporting Standards (IFRS) comprises

1) IFRS issued by IASB;
2) IAS issued by IASC;
3) Interpretations issued by the Standard Interpretations Committee (SIC) and the IFRS Interpretations Committee of the IASB.



BECOMING IFRS COMPLIANT:

Any country can become IFRS compliant either by adoption process or by convergence process. Adoption would mean that the country sets a specific timetable when specific entities would be required to use IFRS as issued by the IASB. Convergence means that the country will develop high quality, compatible accounting standards and there would be alignment of the standards of different standard setters with a certain rate of compromise, by adopting the requirements of the standards either fully or partially.



WHAT ARE IND AS?

1) The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. Ind AS are IFRS converged standards issued by the Central Government of India under the supervision and control of ASB of ICAI and in consultation with NFRA.
2) Ind AS are named and numbered in the same way as the corresponding IAS. However, for Ind AS corresponding to IFRS, one need to add 100 to the IFRS number. For example IFRS 1 corresponding Ind AS number is 101.

3) Accordingly, while formulating Ind AS, efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. Such changes related to

A. Various terminology related changes have been made to make it consistent with the terminology used in law, e.g., 'statement of profit and loss' in place of 'statement of comprehensive income' and 'balance sheet' in place of 'statement of financial position'.

B. Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS, have been made to maintain consistency and comparability of the financial statements to be prepared by following Ind AS. However, these changes will not result into carve outs.

C. Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.

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

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Formulation of Ind AS

Departures

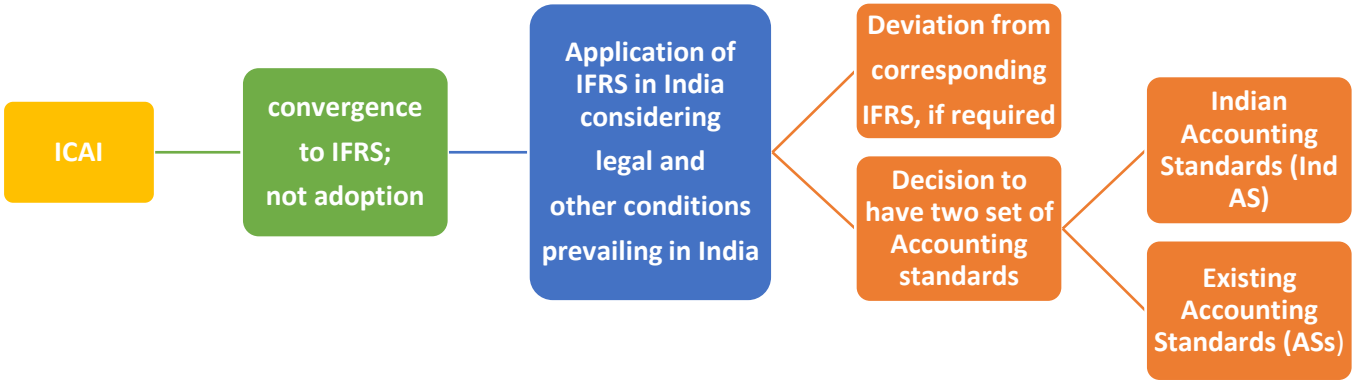
Resulting into Carve-outs

Not resulting into carve-outs

Deviation from the accounting principles stated in IFRS

Removal of options in accounting principles and practices in Ind AS visa-vis IFRS

INDIAN SCENARIO WITH RESPECT TO STANDARDS:



ROADMAP FOR IMPLEMENTATION OF INDIAN ACCOUNTING STANDARDS (IND AS):

1) **For Companies other than Banks, NBFCs and Insurance Companies:**

Phase I:

A. 1st April 2015 or thereafter (with Comparatives): Voluntary Basis for any company (other than Banks, NBFCs and Insurance companies) and its holding, subsidiary, Joint venture (JV) or Associate Company.

B. 1st April 2016: Mandatory Basis

I. Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth of INR 500 crore or more;

II. Unlisted Companies having net worth of INR 500 crore or more;

III. Parent, Subsidiary, Associate and JV of above.

Phase II: 1st April 2017: Mandatory Basis:

A. All companies which are listed/or in process of listing on Stock Exchanges in India or outside India not covered in Phase I (other than companies listed on SME Exchanges);

B. Unlisted companies having net worth of INR 250 crore or more but less than INR 500 crore;

C. Parent, Subsidiary, Associate and JV of above.

Special Points:

A. Companies listed on SME exchange are not required to apply Ind AS. Such companies shall continue to apply existing ASs unless they choose otherwise.

B. Once Ind AS are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements i.e. there is no looking back once the Ind AS are adopted by companies.

C. Companies not covered by the above roadmap shall continue to apply Accounting Standards notified in Companies (Accounting Standards) Rules, 2006

2) For Scheduled Commercial Banks (Excluding RRBs), Non-Banking Financial Companies (NBFCs) Insurers/Insurance Companies:

Scheduled Commercial banks (excluding RRBs):

A. Scheduled Commercial Banks (SCBs) excluding Regional Rural Banks (RRBs) were initially required to implement Ind AS from 1 April 2018. However, RBI (Reserve Bank of India) vide a press release dated 5 April 2018, deferred the implementation of Ind AS by one year i.e. to be effective from 1 April 2019 instead of 1 April 2018.

B. Further, the RBI through a notification dated 22 March 2019, deferred the Ind AS implementation till further notice. This was because the amendments recommended by the RBI are still under consideration of the Government of India, therefore, RBI took a decision to defer the applicability of Ind AS till further notice.

C. Urban Cooperative banks (UCBs) and Regional Rural banks (RRBs) are not required to apply Ind AS.

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Non-Banking Financial Companies (NBFCs)

Phase I: From 1st April, 2018 (with comparatives)

A. NBFCs (whether listed or unlisted) having net worth INR 500 crores or more

B. Holding, Subsidiary, JV and Associate companies of above NBFC other than those already covered under corporate roadmap shall also apply from said date

Phase II: From 1st April, 2019 (with comparatives)

A. NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth less than INR 500 crores

B. NBFCs that are unlisted having net worth INR 250 crores or more but less than INR 500 crores

C. Holding, Subsidiary, JV and Associate companies of above companies other than those already covered under corporate roadmap shall also apply Ind AS from the said date.

Special points

1) Applicable to both Consolidated and Individual Financial Statements

2) NBFC having net worth below INR 250 crores and not covered under the above provisions shall continue to apply ASs specified in Annexure to Companies (Accounting Standards) Rules, 2006.

3) Adoption of Ind AS is allowed only when required as per the roadmap. Voluntary adoption of Ind AS is not allowed.

Insurers/Insurance companies:

IRDAI, vide circular dated 21 January 2020, has deferred implementation of Ind AS in the insurance sector till further notice.

CHAPTER OVER VIEW



PROBLEMS FOR DISCUSSION

PROBLEM1 : M/s Omega & Co. (a partnership firm), had a turnover of Rs. 1.25 crores (excluding other income) and borrowings of Rs. 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.20X1. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI. **(SM-EXAMPLE 1)**

PROBLME2: XYZ Ltd., with a turnover of Rs. 50 crores during previous year and borrowings of RS.1 crore during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.20X1. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.

(SM-PARCTICAL PROBLEM 1)

PROBLEM3: A company was classified as Non-SMC in 20X1-X2. In 20X2-X3, it has been classified as SMC. The management desires to avail the exemptions or relaxations available for SMCs in 20X2-X3. However, the accountant of the company does not agree with the same. Comment.

(SM-PARCTICAL PROBLEM 2)

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TEST YOUR KNOWLEDGE

Theoretical Questions

1. What are the issues, with which Accounting Standards deal?

2. List the criteria to be applied for rating a non-corporate entity as Level-I entity and Level II entity for the purpose of compliance of Accounting Standards in India.

3. List the criteria to be applied for rating a non-corporate entity as Level IV entity for the purpose of compliance of Accounting Standards in India.

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

5. Briefly explain the process of issuance of Indian Accounting Standards.

6. Explain the significance of emergence of IFRS as Global Standards.

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

MCQs

1. Non-corporate entities which are not Level I entities whose turnover (excluding other income) exceeds rupees _____ but does not exceed rupees two-fifty crores in the immediately preceding accounting year are classified as Level II entities.

(a) five crores.

(b) two crores.

(c) fifty crores.

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2. The following Accounting Standard is not applicable to Non-corporate Entities falling in Level II in its entirety

(a) AS 10.

(b) AS 17.

(c) AS 2.

3. All non-corporate entities engaged in commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees 250 crores in the immediately preceding accounting year, are classified as

(a) Level II entities.

(b) Level I entities.

(c) Level III entities.

4. All non-corporate entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crores but does not exceed rupees ten crores at any time during the immediately preceding accounting year.

(a) Level II entities.

(b) Level IV entities.

(c) Level III entities.

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

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

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

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

6. Accounting Standards for non-corporate entities in India are issued by

(a) Central Govt.

(b) State Govt.

(c) Institute of Chartered Accountants of India.

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7. Accounting Standards

(a) Harmonise accounting policies and eliminate the non-comparability of financial statements.

(b) Improve the reliability of financial statements.

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

8. It is essential to standardize the accounting principles and policies in order to ensure

(a) Transparency.

(b) Consistency.

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

9. Which committee is responsible for approval of accounting standards and their modification for the purpose of applicability to companies?

(a) NFRA.

(b) MCA.

(c) Central Government Advisory Committee.

10. Global Standards facilitate

(a) Cross border flow of money.

(b) Comparability of financial statements.

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

11. Additional guidance given in Ind AS over and above what is given in IFRS are called

(a) Carve-outs.

(b) Carve-ins.

(c) Carve clarifications.

12. IASB stands for

(a) International Accounting Standards Bureau

(b) International Advisory Standards Board

(c) International Accounting Standard Board.

13. IFRS stands for

(a) International Financial Reporting System

(b) International Finance Reporting Standard

(c) International Financial Reporting Standard.

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14. Phase I of Ind AS was applicable to:

(a) All listed companies in India or outside India

(b) Companies with turnover INR 500 crores or more

(c) Companies with net worth INR 500 crores or more.

7.FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

1. **PURPOSE OF THE FRAMEWORK:**
   - **a.** The framework sets out the concepts underlying the preparation and presentation of general-purpose financial statements prepared by enterprises for external users.
   - **b.** ASB of ICAI issued a framework in July, 2000 which provides the fundamental basis for development of new standards as also for review of existing standards.
   - **c.** Nothing in the framework overrides any specific Accounting Standard. In case of conflict between an Accounting Standard and the framework, the requirements of the Accounting Standard will prevail over those of the framework.

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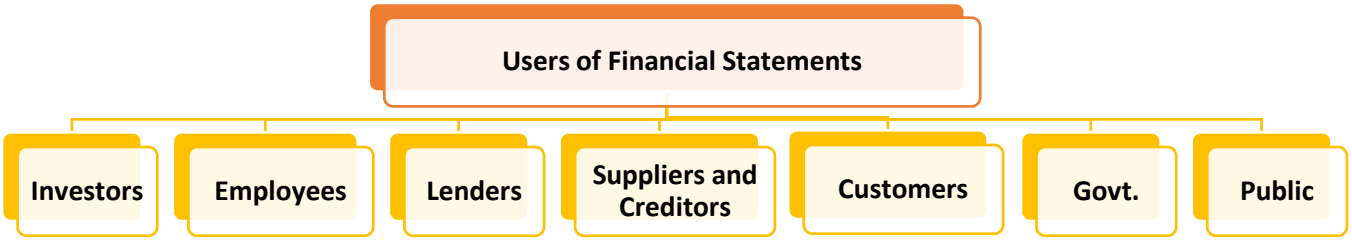
2. **PRINCIPAL AREAS COVERED BY FRAMEWORK:**
   - **a.** Components of financial statements;
   - **b.** Objectives & users of financial statements;
   - **c.** Assumptions underlying financial statements;
   - **d.** Qualitative characteristics of financial statements;
   - **e.** Elements of financial statements;
   - **f.** Criteria for recognition of elements in financial statements;
   - **g.** Principles for measurement of financial elements;
   - **h.** Concepts of Capital and Capital Maintenance.

3. **COMPONENTS OF FINANCIAL STATEMENTS:** A complete set of financial statements normally consists of a Balance Sheet, a Statement of Profit and Loss and a Cash Flow Statement together with notes, other statements and explanatory materials that form an integral part of the financial statements.

4. OBJECTIVES AND USERS OF FINANCIAL STATEMENTS:

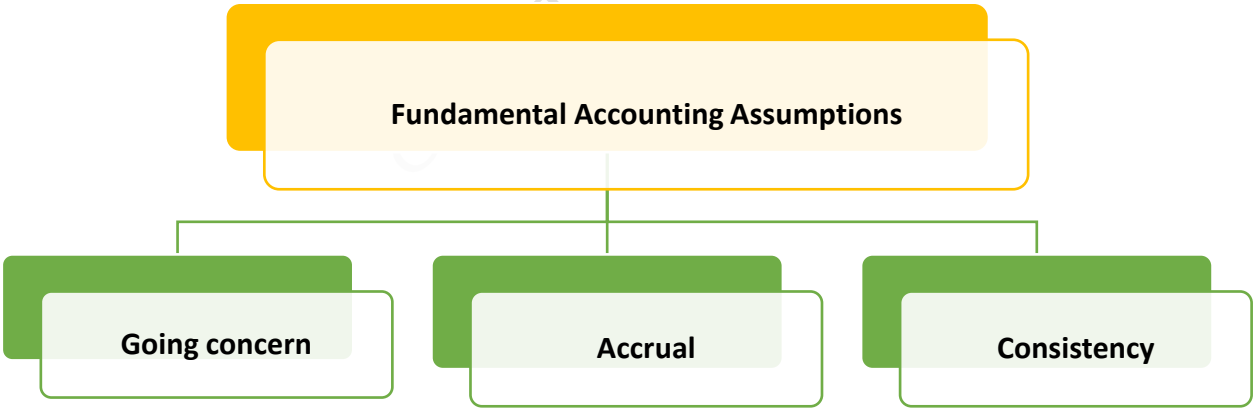
a. The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions

b. The framework identifies seven broad groups of users of financial statements



5. FUNDAMENTAL ACCOUNTING ASSUMPTIONS:

As per the framework, there are three fundamental accounting assumptions



a) These are assumptions, i.e., the users of financial statements believe that the same has been considered while preparing the financial statements. That is why, as long as financial statements are prepared in accordance with these assumptions, no separate disclosure in financial statements would be necessary.

b) If nothing has been written about the fundamental accounting assumption in the financial statements, then it is assumed that they have already been followed in their preparation of financial statements. However, if any of the above-mentioned fundamental accounting assumption is not followed then this fact should be specifically disclosed.

c) **Going Concern:** Financial statements are normally prepared on the assumption that an enterprise will continue in operation in the foreseeable future and neither there is an intention, nor there is a need to materially curtail the scale of operations. If any financial statement is prepared on a different basis, e.g. when assets of an enterprise are stated at net realisable values in its financial statements, the basis used should be disclosed.

d) **Accrual Basis:** According to AS 1, 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. Further Section 128(1) of the Companies Act, 2013 makes it mandatory for companies to maintain accounts on accrual basis only. It is not necessary to expressly state that accrual basis of accounting has been followed in preparation of a financial statement. In case, any income/ expense is recognised on cash basis, the fact should be stated.

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e) **Consistency:** It is assumed that accounting policies are consistent from one period to another. The consistency improves comparability of financial statements through time. According to Accounting Standards, an accounting policy can be changed if the change is required

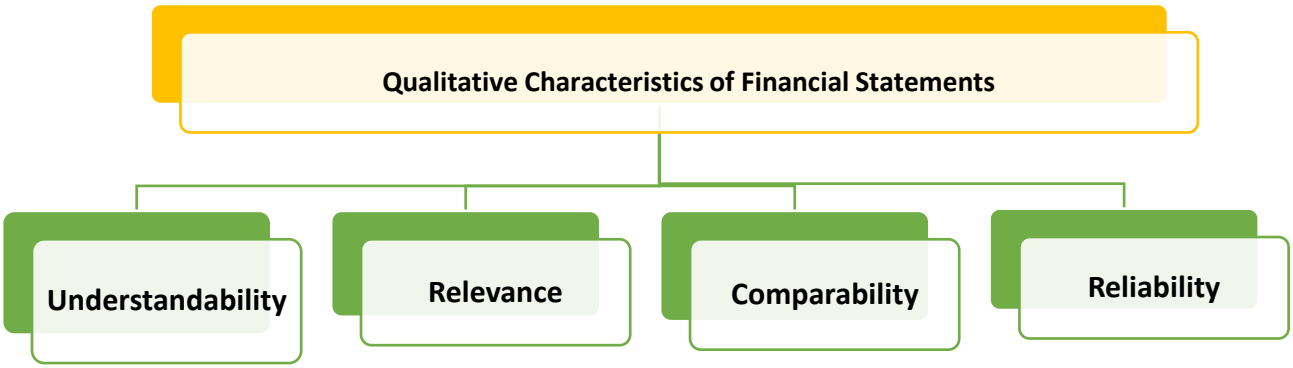
(i) by a statute or

(ii) by an Accounting Standard or

(iii) for more appropriate presentation of financial statements.

6. QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS:

a) The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. The framework suggests that the financial statements should observe and maintain the following four qualitative characteristics as far as possible within limits of reasonable cost/ benefit.



b) **Understandability:** The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities and accounting.

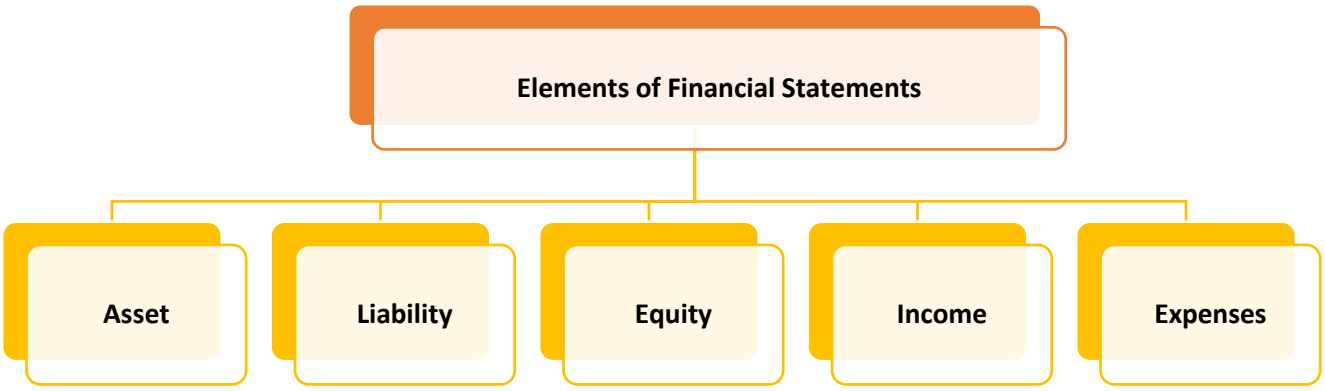
c) **Relevance:** The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user taken on the basis of the financial information.

d) **Reliability:** To be useful, the information must be reliable; that is to say, they must be free from material error and bias.

e) **Comparability:** Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison.

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7. ELEMENTS OF FINANCIAL STATEMENTS:



a) **Asset:** An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.

b) **Liability:** A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.

c) **Equity**: Equity is defined as residual interest in the assets of an enterprise after deducting all its liabilities.

d) **Income:** Income is increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants.

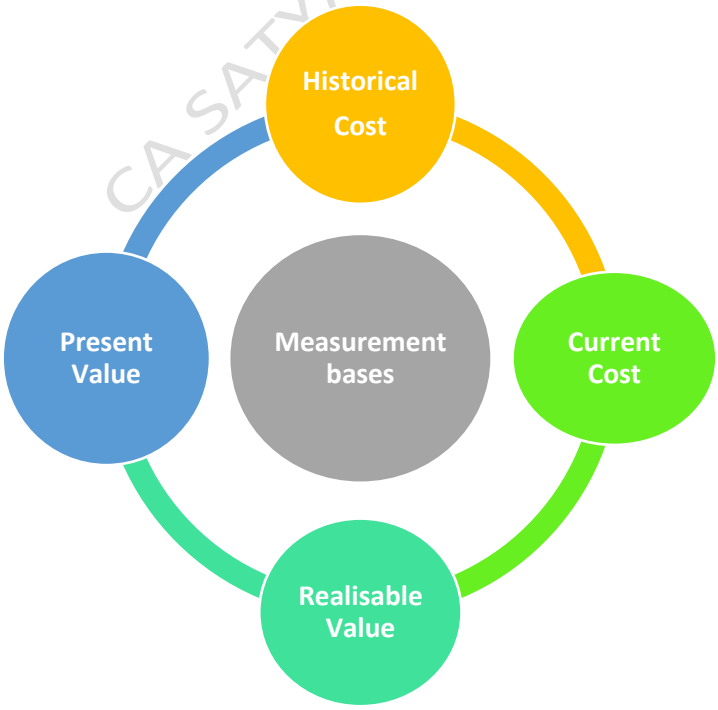
e) **Expense:** An expense is decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants.

8. MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS:

a) Measurement is the process of determining money value at which an element can be recognised in the balance sheet or statement of profit and loss.

b) The framework recognises four alternative measurement bases.

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i. **Historical Cost:** Historical cost means acquisition price.

ii. **Current Cost:** Assets are carried at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

iii. **Realisable (Settlement) Value:** For assets, this is the amount of cash or cash equivalents currently realisable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount of cash or cash equivalents expected to be paid on settlement of liability in the normal course of business.

iv. **Present Value:** Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

9. **CAPITAL MAINTENANCE:** It is important for any business to maintain its net assets in such a way, as to ensure continued operations at least at the same level year after year. In other words, dividends should not exceed profit after appropriate provisions for replacement of assets (Depreciation) consumed in operations.

Financial capital maintenance at historical cost	Opening and closing assets are stated at historical costs
Financial capital maintenance at current purchasing power	Restatement at closing prices using average price indices
Physical capital maintenance at Current cost	Restatement at closing prices using specific price indices

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PROBLEMS FOR DISCUSSION

PROBLEM1 :

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

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

Additional information:

a. The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.X2 was Rs. 60,000.

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

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

d. Expenses (including interest on 10% Loan of Rs. 3,500 for the year) amounted to Rs. 14,900.

e. Deferred cost is amortised equally over 4 years.

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

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

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

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

You are required to prepare Profit and Loss Accounts and Balance Sheets of the trader in both cases (i) assuming going concern (ii) not assuming going concern. **(SM ILLUSTRATION-1)**

PROBLEM2:

(a) A trader purchased article A on credit in period 1 for ` 50,000.
(b) He also purchased article B in period 1 for ` 2,000 cash.
(c) The trader sold article A in period 1 for ` 60,000 in cash.
(d) He also sold article B in period 1 for ` 2,500 on credit.

Prepare Profit and Loss Account of the trader by two basis of accounting (i)Cash basis (ii) Accrual basis **(SM Examle-1)**

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PROBLEM 3:

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

(1) Earned 10% dividend on 2,000 equity shares held of ` 100 each

(2) Paid ` 50,000 to creditors for settlement of ` 70,000

(3) Rent of the premises is outstanding ` 10,000

(4) Mr. A withdrew ` 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction. **(SM Practice problem-2)**

PROBLEM 4:

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

TEST YOUR KNOWLEDGE

Theoretical Questions

1. What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?
2. "One of the characteristics of financial statements is neutrality"- Do you agree with this statement?

MCQs

1. The 'going concern' concept assumes that

   (a) The business can continue in operational existence for the foreseeable future.

   (b) The business cannot continue in operational existence for the foreseeable future.

   (c) The business is continuing to be profitable.

2. Two principal qualitative characteristics of financial statements are

   (a) Understandability and materiality

   (b) Relevance and reliability

   (c) Relevance and materiality

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3. All of the following are components of financial statements except

   (a) Balance sheet

   (b) Statement of Profit and loss

   (c) Human responsibility report

4. An accounting policy can be changed if the change is required

   (a) By statute or accounting standard

   (b) For more appropriate presentation of financial statements

   (c) Both (a) and (b)

5. Value of equity may change due to

   (a) Contribution from or Distribution to equity participants

(b) Income earned/expenses incurred

(c) Both (a) and (b)

6. An item that meets the definition of an element of financial statements should be recognised in the financial statements if:

(a) It is probable that any future economic benefit associated with the item will flow to the enterprise

(b) Item has a cost or value that can be measured with reliability

(c) Both (a) and (b)

7. A machine was acquired in exchange of an old machine and Rs. 20,000 paid in cash. The carrying amount of old machine was Rs. 2,00,000 whereas its fair value was Rs. 1,50,000 on the date of exchange. The historical cost of the new machine will be taken as

(a) Rs. 2,00,000

(b) Rs. 1,70,000

(c) Rs. 2,20,000

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8. Which of the assumption is not considered as fundamental accounting assumption?

(a) Going Concern

(b) Accrual

(c) Reliability.

9. Liabilities are recorded at the undiscounted amount of cash expected to be paid on settlement of liability in the normal course of business under:

(a) Present value.

(b) Realizable value.

(c) Current cost.

8.AS-2-VALUATION OF INVENTORY

OBJECTIVE:

1. AS 2,'Valuation of Inventories' which provides guidance for determining the value at which inventories, are carried in the financial statements until related revenues are recognised.
2. It also provides guidance on the cost formulas that are used to assign costs to inventories and any write-down thereof to net realisable value.

DEFINITION OF INVENTORIES:

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

NOTE:

1. Inventories include Maintenance supplies, consumables and loose tools awaiting use in the production process.

2. Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant and Equipment. Such items are accounted for in accordance with Accounting Standard (AS) 10, Property, Plant and Equipment.

SCOPE:

This Standard should be applied in accounting for inventories other than:

(a) work in progress arising under construction contracts, including directly related service contracts (see Accounting Standard (AS) 7, Construction Contracts);

(b) work in progress arising in the ordinary course of business of service providers;

(c) shares, debentures and other financial instruments held as stock-in-trade; and

(d) Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well established practices in those industries.

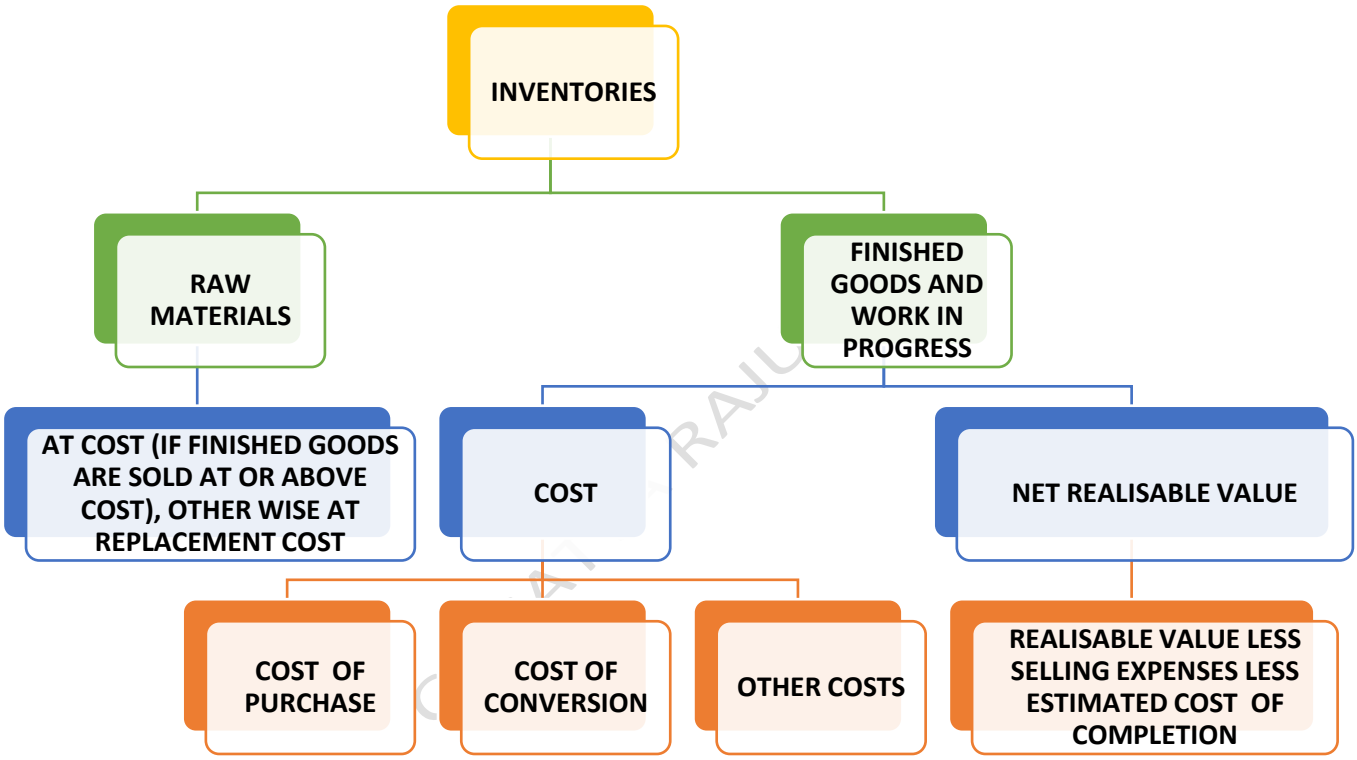
MEASUREMENT OF INVENTORIES:

1. Inventories should be valued at the lower of cost and net realisable value.

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 sold at

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



COST OF INVENTORIES:

The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

COST OF PURCHASE:

The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

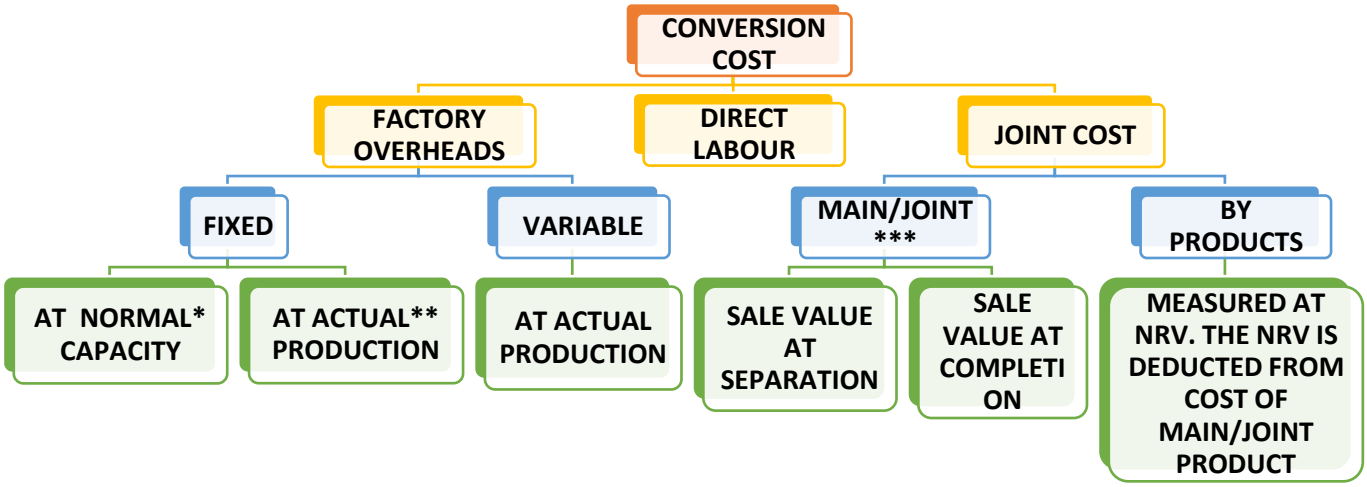
COST OF CONVERSION:

1. The costs of conversion include costs directly related to production, i.e Direct labour, Direct expenses and overheads (both variable and fixed) that are incurred in converting raw material to finished goods.

2. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.
3. Variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities. The fixed production overheads should be absorbed systematically to units of production on the basis of normal capacity, provided actual production is equal to or less than Normal capacity. Otherwise, Actual production of units is used for absorption.
4. Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.
5. **JOINT OR BY PRODUCTS:**
   - **a)** when joint products are produced or when there is a main product and a by-product, the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis.
   - **b)** The allocation may be based, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.
   - **c)** Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product.

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*When actual production is almost equal or lower than normal capacity.

** When actual production is higher than normal capacity.

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OTHER COSTS:

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

EX: the costs of designing products for specific customers in the cost of inventories, Amortisation of intangibles for ascertaining inventory costs. I.e patents right of production or copyright for a publisher should be taken as part of inventory costs.

Exclusions from the Cost of Inventories:

1. Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location. Interests and other borrowing costs however are taken as part of inventory costs, where the inventory necessarily takes substantial period of time for getting ready for intended sale. Example of such inventory is wine.
2. Abnormal amounts of wasted materials, labour, or other production costs;
3. Storage costs, unless those cost are necessary in the production process prior to a further production stage;
4. Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
5. Selling and distribution costs.

Cost Formulas:

1. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been purchased or produced.
2. In all other cases, the cost of inventory should be determined by the First-In First-Out (FIFO), or Weighted Average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

Techniques for the Measurement of Cost:

1. Instead of actual, the standard costs may be taken as cost of inventory provided standards fairly approximate the actual. Such standards (for finished or partly finished units) should be set in the light of normal levels of material consumption, labour efficiency and capacity utilisation. The standards so set should be regularly reviewed and if necessary, be revised to reflect current conditions.
2. In retail business, where a large number of rapidly changing items are traded, the actual costs of items may be difficult to determine. The units dealt by a retailer however, are usually sold for similar gross margins and a retail method to determine cost in such retail trades makes use of the fact. By this method, cost of inventory is determined by reducing sale value of unsold stock by appropriate average percentage of gross margin.

NET REALISABLE VALUE:

1. 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.
2. Estimates of net realisable value are 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.

Comparison of Cost and Net Realisable Value:

1. The comparison between cost and net realisable value should be made on itemby-item basis.
2. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area.

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Disclosure

The financial statements should disclose:

a. The accounting policies adopted in measuring inventories, including the cost formula used; and

b. The total carrying amount of inventories and its classification appropriate to the enterprise.

(i) Raw materials and components

(ii) Work-in-progress

(iii) Finished goods

(iv) Stock-in-trade (in respect of goods acquired for trading)

(v) Stores and spares

(vi) Loose tools

(vii) Others (specify nature)

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PROBLMES FOR DISCUSSSION

PROBLEM 1

X Co. Limited purchased goods at the cost of Rs. 40 lakhs in October, 20X1. Till March, 20X2, 75% of the stocks were sold. The company wants to disclose closing stock at Rs. 10 lakhs. The expected sale value is Rs. 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.

PROBLEM 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 Rs. 18 lacs. Calculate fixed overhead per unit to be recovered for inventory valuation in below cases?

Case 1: Actual production is 1 lac units.

Case 2: Actual production is 90,000 units.

Case 3: Actual production is 1.2 lacs units. **(Example 2-SM)**

PROBLEM 3

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

PARTICULRS	Rs. 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 Rs. 20 lakhs. 4,000kgs of finished goods are in stock at the year end.

PROBLEM 4

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 Rs. 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?

PROBLEM 5

A trader purchased certain articles for RS.85,000. He sold some of articles for RS.1,05,000. The average percentage of gross margin is 25% on cost. Opening stock of inventory at cost was Rs. 15,000. Calculate the cost of closing inventory? **(Example 3-SM)**

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PROBLEM 6

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 (Rs. In lakhs)	Net Realisable value (Rs. In lakhs)
A	40	28
B	32	32
C	16	24

What will be the value of closing stock? **(Illustration 1-SM)**

PROBLEM 7

The inventory of Rich Ltd. as on 31st March, 2020 comprises of Product – A: 200 units and Product – B: 800 units. Details of cost for these products are: Product – A: Material cost, wages cost and overhead cost of each unit are Rs. 40, Rs. 30 and Rs. 20 respectively, Each unit is sold at Rs. 110, selling expenses amounts to 10% of selling costs. Product – B: Material cost and wages cost of each unit are Rs. 45 and Rs. 35 respectively and normal selling rate is Rs. 150 each, however due to defect in the manufacturing process 800 units of Product-B were expected to be sold at Rs. 70. You are requested to value closing inventory according to AS 2 after considering the above. **(RTP-MAY2021-16(B))**

PROBLEM 8

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

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was Rs. 20 per kg and the replacement cost for the raw material was Rs. 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date. **(RTP-MAY 2020-17(A))**

PROBLEM 9

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

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

Additional Information:

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

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

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is Rs. 600 per unit. **(RTP-NOV 2020-16(B))**

Problem 10

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.

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

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

(iii) 1500 units of finished Product X and total cost incurred Rs. 320 per unit. Expected selling price of Product X is Rs. 300 per unit.

Determine how each item of inventory will be valued as on 31-3-20X1. Also calculate the value of total inventory as on 31-3-20X1. **(SM-PRACTICALPROBLEM-4)**

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TEST YOUR KNOWLEDGE

Theory Questions

1. "In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred". Provide examples of such costs as per AS 2 (Revised) 'Valuation of Inventories'

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, Debentures held as stock in trade.

9.CASH FLOW STATEMENT (ALONG WITH AS-3)

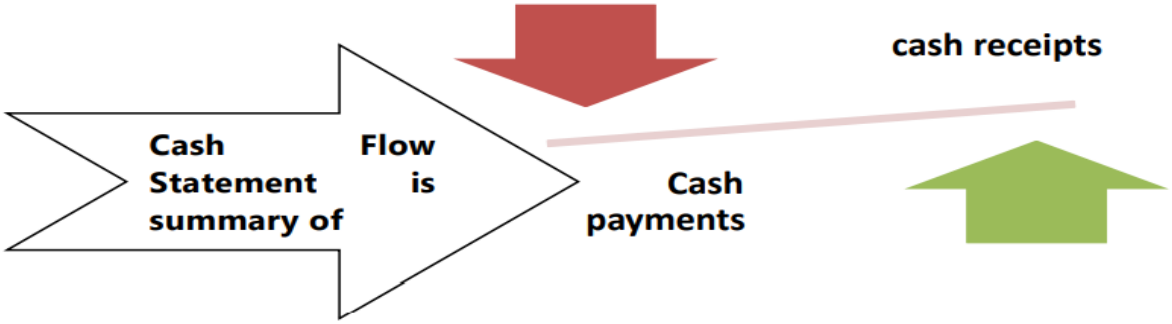
OVERVIEW:



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Introduction:

1.



2. Cash flow statements are prepared to explain the cash movements between two points of time.

Objective:

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. It helps the users of Accounts:

♦ To identify the historical changes in the flow of cash & cash equivalents.

♦ To determine the future requirement of cash & cash equivalents.

♦ To assess the ability to generate cash & cash equivalents.

♦ To estimate the further requirement of generating cash & cash equivalents.

♦ To compare the operational efficiency of different enterprises.

♦ To study the insolvency and liquidity position of an enterprise.

Definitions:

Cash comprises cash on hand and demand deposits with banks.

Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. A short-term investment is one, which is due for maturity within three months from the date of acquisition.

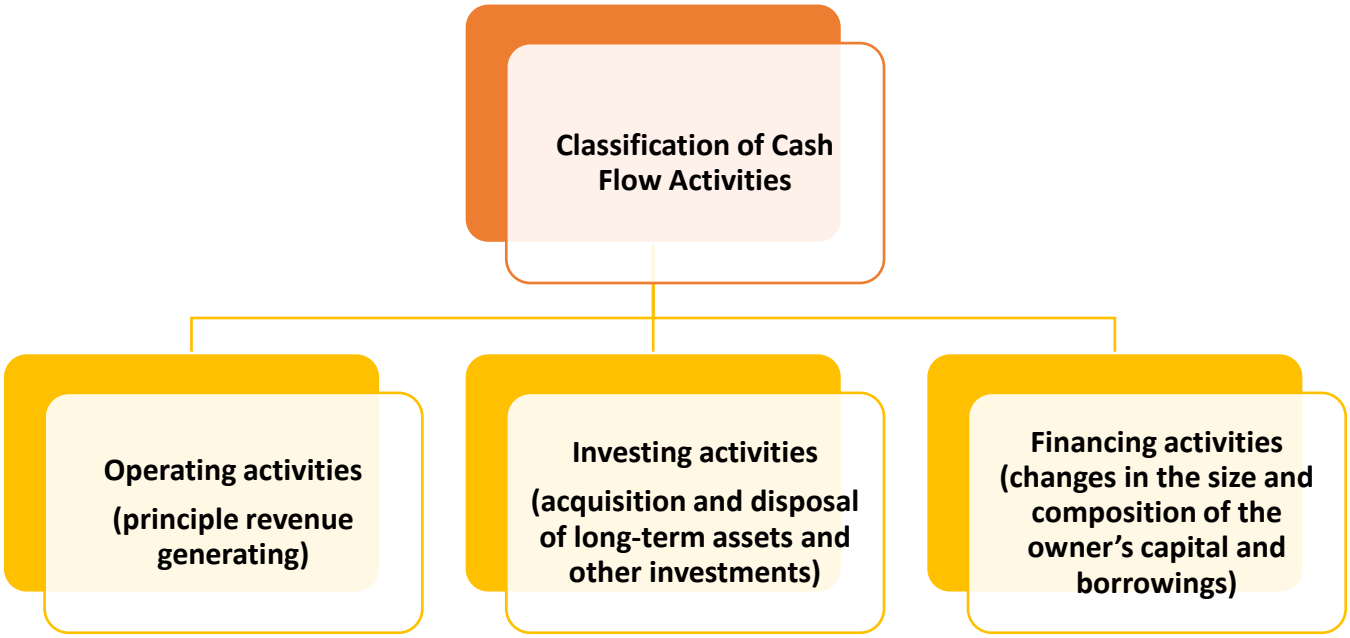
Cash flows are inflows and outflows of cash and cash equivalents.

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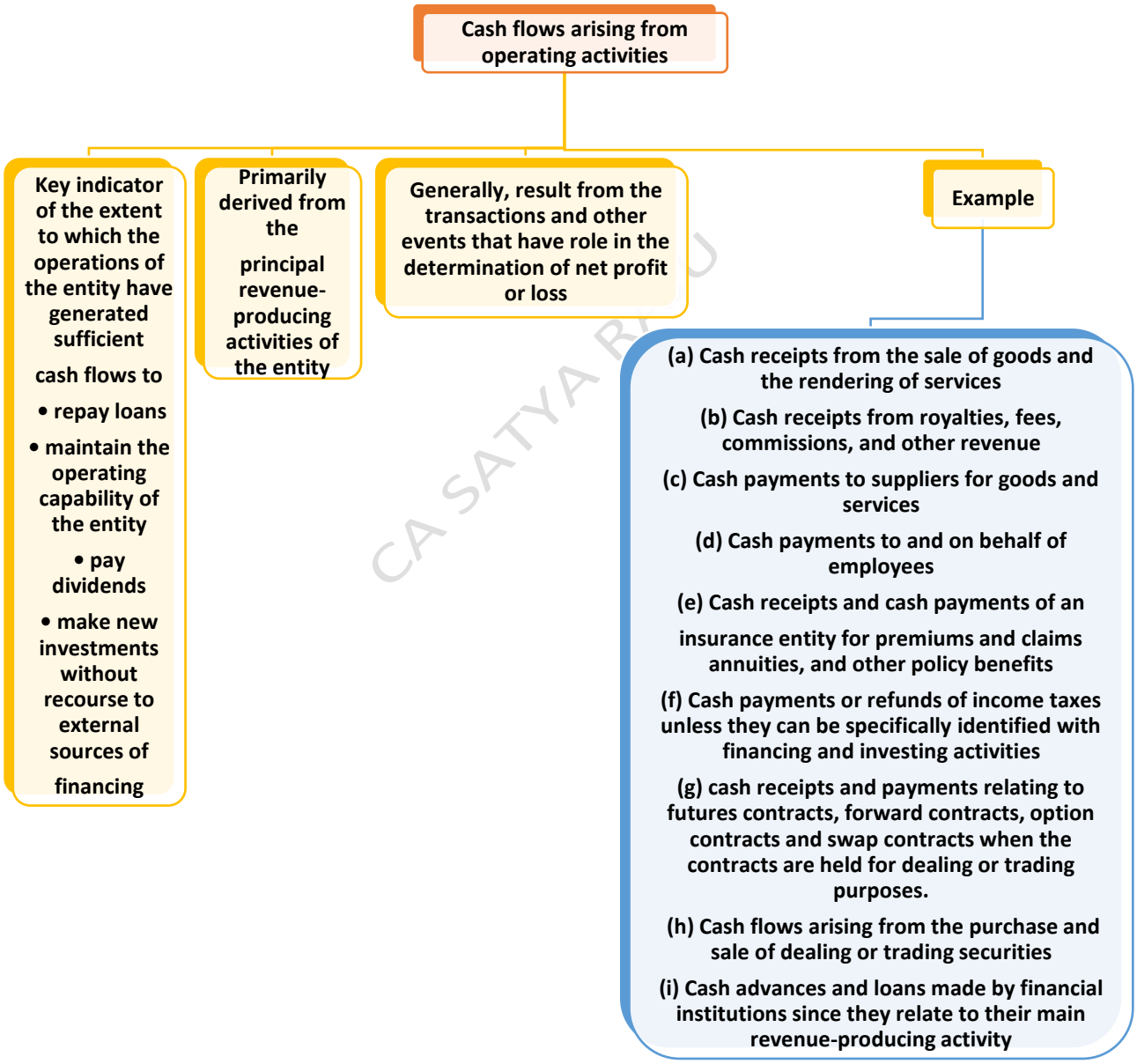
SCOPE:

1. As per section 129-Financial statements, with respect to one person company, small company, dormant company and private company (if such a private company is a start-up), may not include the cash flow statement.
2. This Standard is mandatory for the enterprises, which fall in the category of level I, at the end of the relevant accounting period.

CLASSIFICATION OF CASH FLOW ACTIVITIES:

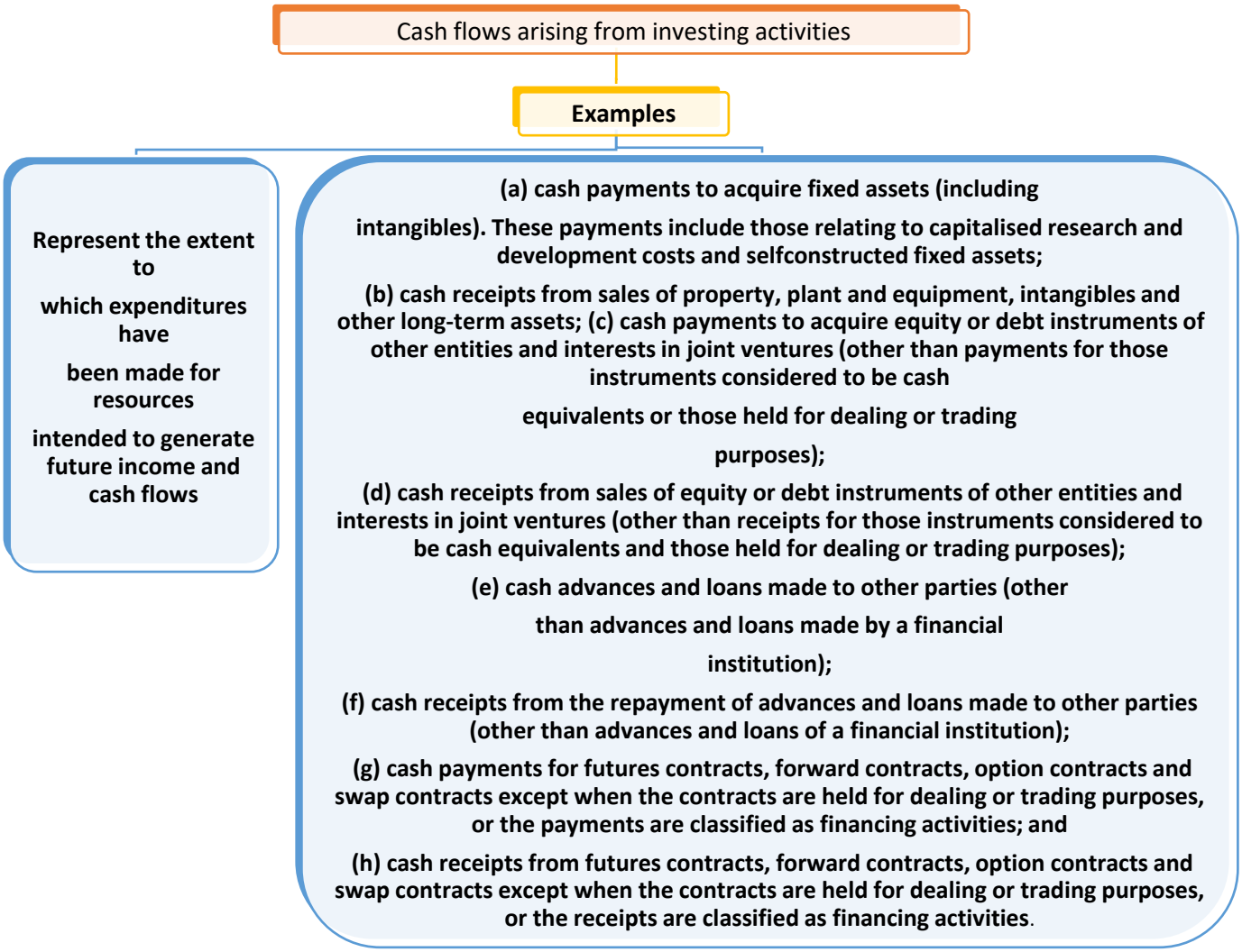


Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

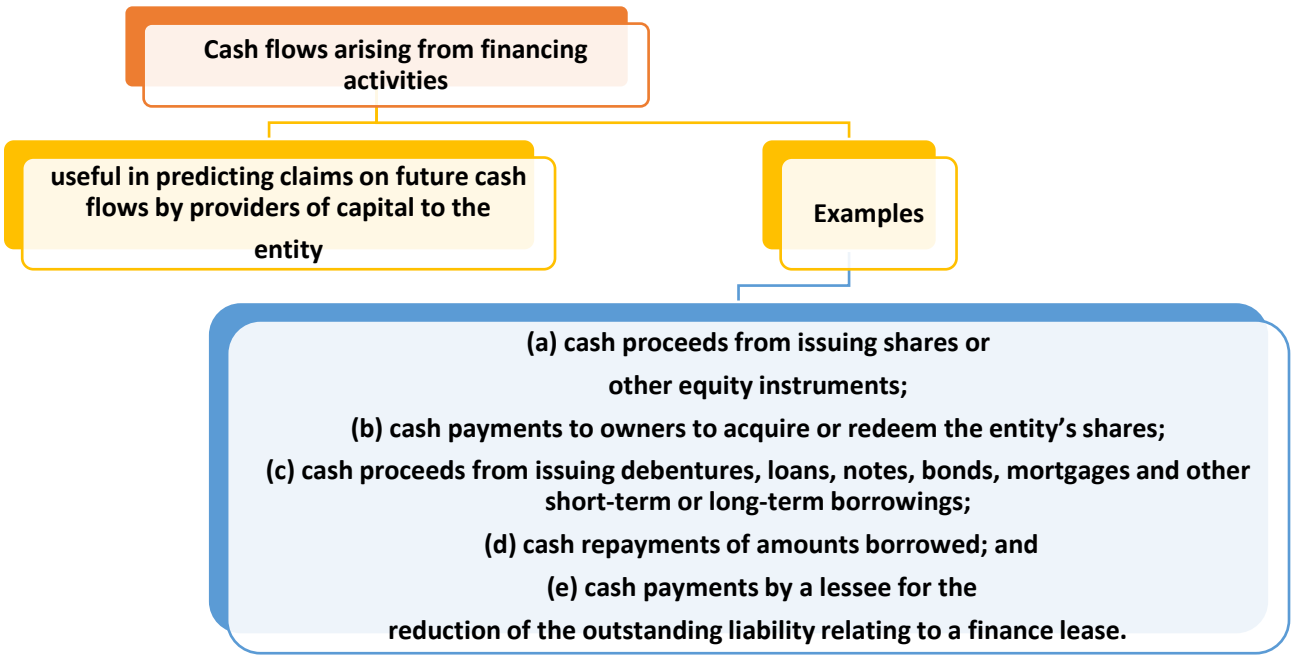


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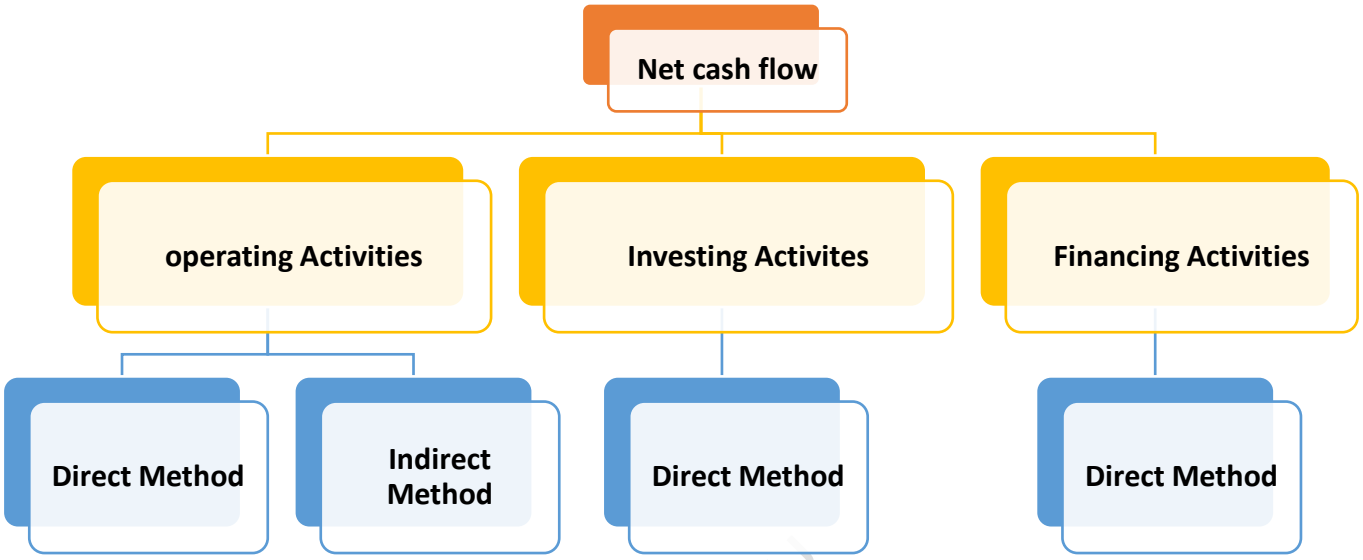
Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.



Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.



METHODS OF CASH FLOW STATEMENT:



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Reporting Cash Flows from Operating Activities:

1. In 'Direct method' we take the gross receipts from sales, trade receivables and other operating inflows subtracted by gross payments for purchases, creditors and other expenses ignoring all non-cash items like depreciation, provisions.
2. In 'Indirect method' we start from the net profit or loss figure, eliminate the effect of any non-cash items, investing items and financing items from such profit figure i.e. all such expenses like depreciation, provisions, interest paid, loss on sale of assets etc. are added and interest received etc. are deducted. Adjustment for changes in working capital items are also made ignoring cash and cash equivalent to reach to the figure of net cash flow.

FORMAT OF CASH FLOW STATEMENT:

Cash Flow Statement of X Ltd. for the year ended March 31, 20X1 (Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	xxx	
Cash received from Trade receivables	xxx	
Cash received from sale of services	xxx	xxx
Less: Payment for Cash Purchases	**xxx**	

Payment to Trade payables	xxx	
Payment to Trade expenses e.g. power, rent, electricity	xxx	
Payment for wages & salaries	xxx	
Payment for Income Tax	xxx	xxx
Adjustment for Extraordinary Items		xxx
Net Cash Flow from Operating Activities		xxx

Cash Flow Statement of X Ltd. for the year ended March 31, 20X1 (Indirect Method)

Particulars	**Rs.**	**Rs.**
Operating Activities:		
Closing balance of Profit & Loss Account	xxx	
Less: Opening balance of Profit & Loss Account	xxx	
Balance of P&L Account related to Current year after appropriations	xxx	
Reversal of the effects of Profit & Loss Appropriation Account	**xxx**	
Add: Provision for Income Tax	xxx	
Effects of Extraordinary Items	xxx	
Net Profit Before Tax and Extraordinary Items	xxx	
Reversal of the effects of non-cash and non-operating items	xxx	
Effects for changes in Working Capital except cash & cash equivalent	xxx	
Cash generated from operations before tax & Extraordinary Activities	xxx	
Less : Payment of Income Tax	xxx	xxx
Adjustment for Extraordinary Items		xxx
Net Cash Flow from Operating Activities		xxx

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Some Important cash flow activities treatment:

Loans/Advances given and Interests earned

1. Loans and advances given and interests earned on them in the ordinary course of business are operating cash flows for financial enterprises.
2. Loans and advances given and interests earned on them are investing cash flows for non-financial enterprises.
3. Loans and advances given to subsidiaries and interests earned on them are investing cash flows for all enterprises.
4. Loans and advances given to employees and interests earned on them are operating cash flows for all enterprises.
5. Advance payments to suppliers and interests earned on them are operating cash flows for all enterprises.
6. Interests earned from customers for late payments are operating cash flows for non-financial enterprises.

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Loans/Advances taken and interests paid

1. Loans and advances taken and interests paid on them in the ordinary course of business are operating cash flows for financial enterprises.
2. Loans and advances taken and interests paid on them are financing cash flows for non-financial enterprises.
3. Loans and advances taken from subsidiaries and interests paid on them are financing cash flows for all enterprises.
4. Advance taken from customers and interests paid on them are operating cash flows for non-financial enterprises.
5. Interests paid to suppliers for late payments are operating cash flows for all enterprises.
6. Interests taken as part of inventory costs in accordance with AS 16 are operating cash flows.

Investments made and dividends earned

1. Investments made and dividends earned on them in the ordinary course of business are operating cash flows for financial enterprises.
2. Investments made and dividends earned on them are investing cash flows for non-financial enterprises.

3. Investments in subsidiaries and dividends earned on them are investing cash flows for all enterprises.

Dividends Paid are financing cash outflows for all enterprises.

Income Tax

1. Tax paid on operating income is operating cash outflows for all enterprises
2. Tax deducted at source against income are operating cash outflows if concerned incomes are operating incomes and investing cash outflows if the concerned incomes are investment incomes, e.g. interest earned.
3. Tax deducted at source against expenses are operating cash inflows if concerned expenses are operating expenses and financing cash inflows if the concerned expenses are financing expenses, e.g. interests paid.

Insurance claims received

a. Insurance claims received against loss of stock or loss of profits are extraordinary operating cash inflows for all enterprises.
b. Insurance claims received against loss of fixed assets are extraordinary investing cash inflows for all enterprises.

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Non-Cash transactions

Investing and financing transactions that do not require the use of cash or cash equivalents, should be excluded from a cash flow statement.

e.g.

a. Issue of bonus shares,
b. The acquisition of an enterprise by means of issue of shares; and
c. The conversion of debt to equity.

Extraordinary Items AS 3 requires separate disclosure of extraordinary cash flows, classifying them as cash flows from operating, investing or financing activities, as may be appropriate.

Acquisitions and Disposals of Subsidiaries and Other Business Units:

The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.

Reporting Cash Flows on a Net Basis:

Generally, enterprises should report separately major classes of gross cash receipts and gross cash payments arising from operating, investing and financing activities. But, the following activities may be reported on net basis.

a. cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise;

Examples:

i) The acceptance and repayment of demand deposits by a bank;

ii) Funds held for customers by an investment enterprise; and

iii) Rents collected on behalf of, and paid over to, the owners of properties.

b. cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples:

i) Principal amounts relating to credit card customers;and

ii) The purchase and sale of investments by an investment entity;

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Foreign Currency Cash Flows:

1. The foreign currency monetary assets (e.g. balance with bank, debtors etc.) and liabilities (e.g. creditors) are initially recognised by translating them into reporting currency by the rate of exchange transaction date. On the balance sheet date, these are restated using the rate of exchange on the balance sheet date. The difference in values is exchange gain/loss. The exchange gains and losses are recognised in the statement of profit and loss.

2. The exchange gains/losses in respect of cash and cash equivalents in foreign currency (e.g. balance in foreign currency bank account) are recognised by the principle aforesaid, and these balances are restated in the balance sheet in reporting currency at rate of exchange on balance sheet date. The change in cash or cash equivalents due to exchange gains and losses are however not cash flows. This being so, the net increases/decreases in cash or cash equivalents in the cash flow statements are stated exclusive of exchange gains and losses. The resultant difference between cash and cash equivalents as per the cash flow statement and that recognised in the balance sheet is reconciled in the note on cash flow statement.

NOTE: If any cash flow occurred in between cash & cash equivalent components, It should be ignored in cash flow statement.

PROBLEMS FOR DISCUSSION

PROBLEM1

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.

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(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**.** **(ILLUSTARATION-1-SM)**

PROBLEM 2

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

(ILLUSTARATION-3-SM)

PROBLEM 3:

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 (**ILLUSTARATION-1-SM-MAIN CHAPTER)**

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PROBLEM 4

X Ltd. purchased debentures of Rs. 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? **(ILLUSTARATION-2-SM)**

PROBLEM 5

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

Summary Cash Account **(Rs. In '000)**

Particulars	Amount (Rs.)	Amount (Rs.)
Balance at 1.4.2014		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		128
		3,246
Payments to suppliers	2,047	
Payments for fixed assets	230	
Payments for overheads	115	
Wages and salaries	69	
Taxation	243	
Dividends	80	
Repayments of bank loan	250	**(3034)**
Balance at 31.3.2015		**212**

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Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 2015 in accordance with AS-3 (Revised).

The company does not have any cash equivalents. **(Illustration-4-Main Chapter)**

Problem 6

Prepare cash flow from investing activities as per AS 3 of M/S Subham creative Limited for the 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 earth quake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received from associate company	70,000
Pre-acquistion 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.8200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd. On 1st December, 2018 which are redeemable with in 3 months	3,00,000
Book value of plant & Machinery sold(loss incurred Rs.9,600)	90,000

(Nov 2019 Question Paper-1(A))

Problem7

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

		Particulars	**Notes**	**31.3.20X1 (Rs. in lakhs)**	**31.3.20X0 (Rs. in lakhs)**
		Equity and Liabilities			
1		**Current liabilities**			
	(a)	Trade Payables		250	230
	(b)	Short term Provisions	1	200	180
	(c)	Other current liabilities	2	70	50
		Assets			
1		**Current assets**			
	(a)	Inventories		200	180
	(b)	Trade Receivables		400	250
	(c)	Other current assets	3	195	180

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Statement of Profit and Loss of ABC Ltd. for the year ended 31st March, 20X1

	Particulars	**Notes**	**Rs. in lakhs**
	Revenue from operations		4,150
	Other income	4	100
	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
	Total expenses		3,540
	Profit before tax (**III – IV**)		710
	Tax expense: Current tax		200
	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:

		20X0-20X1 (Rs. **in lakhs)**	**2009-20X0 (**Rs. **in lakhs)**
1	Short term Provisions: Provision for Tax	 200	 180
2	Other current liabilities: Outstanding wages Outstanding expenses Total	 50 20 70	 40 10 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.

(ILLUSTRATION-10-MAIN CHAPTER)

PROBLEM 8

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 Rs. 3,82,500.
3. Opening inventory was lesser than closing inventory by Rs. 35,000.
4. Wages paid during the year Rs. 4,92,500.
5. Office and selling expenses paid during the year Rs. 75,000.
6. Dividend paid during the year Rs. 30,000.
7. Bank loan repaid during the year Rs. 2,15,000 (included interest Rs. 15,000).
8. Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by Rs. 25,000.
9. Amount paid to trade payables during the year Rs. 4,60,000.
10. Tax paid during the year amounts to Rs. 65,000 (Provision for taxation as on 31.03.20X1Rs. 45,000).
11. Investments of Rs. 7,00,000 sold during the year at a profit of Rs. 20,000.

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12. Depreciation on fixed assets amounts to Rs. 85,000.

13. Plant and machinery purchased on 15th November, 20X0 for Rs. 2,50,000.

14. Cash and Cash Equivalents on 31st March, 20X0Rs. 2,00,000.

15. Cash and Cash Equivalents on 31st March, 20X1Rs. 6,07,500. **(Illustration-5-Main Chapter)**

PROBLEM 9

Ryan Ltd provides you the following information at the year-end, March 31, 20X1:

	Rs.	Rs.
Sales		6,98,000
Cost of Goods Sold		(5,20,000)
		1,78,000
Operating Expenses (including Depreciation Expense of Rs. 37,000)		1,47,000
		31,000
Other Income / (Expenses):		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	(3,000)	(8,000)
Income tax		(7,000)
		16,000

Information available:

	31st March 20X1 Rs.	***31st March 20X0 Rs.***
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

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

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

(ILLUSTRATION-6-MAIN CHAPTER)

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PROBLEM 10

The balance sheets of Sun Ltd. for the years ended 31st March 20X1and 20X0 were summarised as:

	20X1 (Rs.)	**20X0 (Rs.)**
Equity Share Capital	60,000	50,000
Reserves:		
Profit and Loss Account	5,000	4,000
Current Liabilities:		
Trade payables	4,000	2,500
Taxation	1,500	1,000
Other current liabilities (Dividend payable)	-	1,000
	70,500	**58,500**
Fixed Assets (at W.D.V.)		
Premises	10,000	10,000
Fixtures	17,000	11,000

Vehicles	12,500	8,000
Current Assets:		
Short-term investments	2,000	1,000
Inventory	17,000	14,000
Trade receivables	8,000	6,000
Bank and Cash	4,000	8,500
	70,500	**58,500**

The profit and loss account for the year ended 31st March, 20X1 disclosed

	Rs.
Profit before tax	4,500
Taxation	(1,500)
Profit after tax	3,000
Declared dividends	(2,000)
Retained profit	1,000

Further information is available

Particulars	Fixtures (Rs.)	Vehicles (Rs.)
Depreciation for year	1,000	2,500
Disposals:		
Proceeds on disposal	—	1,700
Written down value	—	(1,000)
Profit on disposal		700

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

(ILLUSTRATION-7-MAIN CHAPTER)

Problem 11

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 Rs. 1,10,000 As on 31-03-20X2 Rs. 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 Rs. 275 as on 31-03-20X2 Rs. 1,175

(iv) Debtors of Rs. 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 Rs. 3,50,000 , As on 31-03-20X2 Rs. 3,50,000

(vi) Accrued Interest on Investments: As on 31-03-20X2 Rs. 10,500

(PRACTICAL QUESTION-2-SM)

PROBLEM 12

From the following Balance Sheet and information, prepare Cash Flow Statement of Rani Ltd. for the year ended 31st March, 2011.

Name of the Company: Rani Ltd

Balance Sheet as at : 31st March, 2011 and 31st March, 2010

			Particulars	Notes No.	Figures as at the end of current reporting period 31-03-11	Figures as at the end of the previous reporting period 31.03.10
			1	**2**	**3**	**4**
			EQUITY AND LIABILITIES:			
1			Shareholder's 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:**			
	A		Long term borrowings (9 % debentures)	**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**
1			**ASSETS:**			
			Non-current assets			

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	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:

Particulars	**31st March, 20X1**	**31st March, 20X0**
1.Share capital- Equity share capital	6,00,000	5,00,000
10% Redeemable Preference share capital	-	2,00,000
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
3.Long term borrowings		
9% Debentures	2,00,000	-
4.Other current liabilities		
Dividend payable	-	60,000
Liabilities for expenses	30,000	20,000
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**

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(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. **(PRACTICAL QUESTION-4-SM)**

PROBLEM 13

Following information was extracted from the books of S Ltd. For the year ended 31st March 2020. **(12M)**

i) Net profit before taking into account income tax and after taking into account the following items was ₹ 30 Lakhs.

- Depreciation on property, Plant & Equipment ₹ 7,00,000
- Discount on issue of debentures written off ₹ 45,000
- Interest on debentures paid ₹ 4,35,000
- Investment of Book value ₹ 3,50,000 sold for ₹ 3,75,000
- Interest received on Investments ₹ 70,000

ii) Income tax paid during the year ₹ 12,80,000

iii) Company issued 60,000 equity Shares of ₹ 10 each at a premium of 20% on 10th April 2019.

iv) 20,000, 9% Preference Shares of ₹ 100 each were redeemed on 31st March 2020 at a premium of 5%

v) Dividend paid during the year amounted to ₹ 11 Lakhs (including dividend distribution tax)

vi) A new Plant Costing ₹ 7 Lakhs was purchased in part exchange of an old plant on 1st January 2020. The book value of the old plant was ₹ 8 Lakhs, but the vendor took over the old plant at a value of ₹ 6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March 2020.

vii) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31-03-2020 was ₹ 14,76,000. The inventory on 31-03-2019 was correctly valued at ₹ 13,50,000.

viii) Current Assets and Current Liabilities in the beginning and at the end of year 2019 – 2020 were as:

Particulars	As on 1st April 2019 (₹)	As on 31st March 2020 (₹)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash & Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

CA SATYA RAJU

You are required to prepare a Cash Flow Statement for the year ended 31st March 2020 as per AS 3 (revised) using the indirect method. **(JAN 2021 QUESTION PAPER-4(B))**

TEST YOUR KNOWLEDGE

Theoretical Questions

1. What is the significance of cash flow statement? Explain in brief.
2. Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

MCQs

1. Which of the following would be considered a 'cash-flow item from an "investing" activity'?
   (a) Cash outflow to the government for taxes.
   (b) Cash outflow to purchase bonds issued by another company.
   (c) Cash outflow to shareholders as dividends.

2. 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.

3. Hari Uttam, a stock broking firm, received Rs. 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?
   (a) Operating Activities.
   (b) Investing Activities.
   (c) Financing Activities.

4. 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.

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5. Which of the following activities would generally be regarded as a financing activity in preparing a cash flow statement?

(a) Dividend distribution.

(b) Proceeds from the sale of shares of other companies.

(c) Loans made by the financial enterprise to other businesses entities.

6. All of the following are examples of cash flows arising from investing activities except

(a) Cash payments to acquire fixed assets.

(b) Cash receipts from disposal of fixed assets.

(c) Cash payments to suppliers for goods and services.

7. Cash repayments of amounts borrowed will be disclosed in the cash flow statement as

(a) An operating activity.

(b) A financing activity

(c) An investing activity.

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8. In the cash flow statement, 'cash and cash equivalents' include

(a) Bank balances and Cash balances.

(b) Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value.

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

9. While preparing a Cash Flow Statement using the Indirect method as required under AS 3, which of the following will be deducted from the Net Profit to arrive at the "Cash flow from Operating activities"?

(a) Interest income

(b) Gain on sale of a Fixed asset..

(c) Both (a) and (b)

10. XYZ Co. Ltd is a financial Institute and has given loans and advances to its subsidiary and earned interest of Rs. 5 lacs on that loan. Interest earned by XYZ Co. Ltd is shown as

(a) Operating Cash Flow.

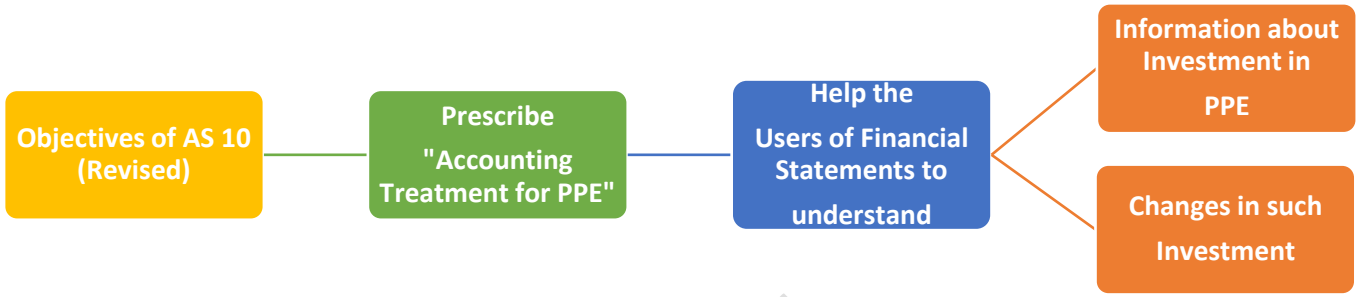
(b) Investing Cash Flow.

(c) Financing Cash Flow.

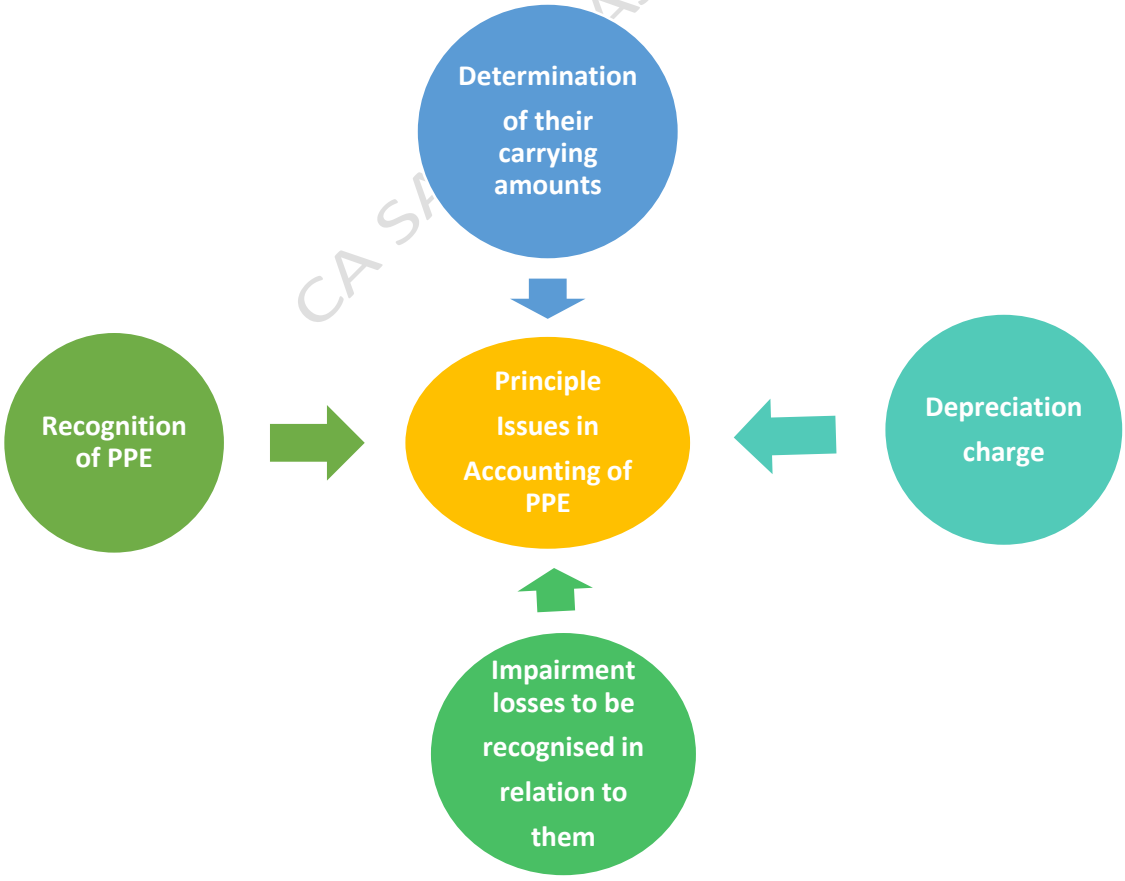
10.AS 10: PROPERTY, PLANT AND EQUIPMENT

OBJECTIVE:

The objective of this Standard is to prescribe accounting treatment for Property, Plant and Equipment (PPE).



The principal issues in Accounting for PPE are:

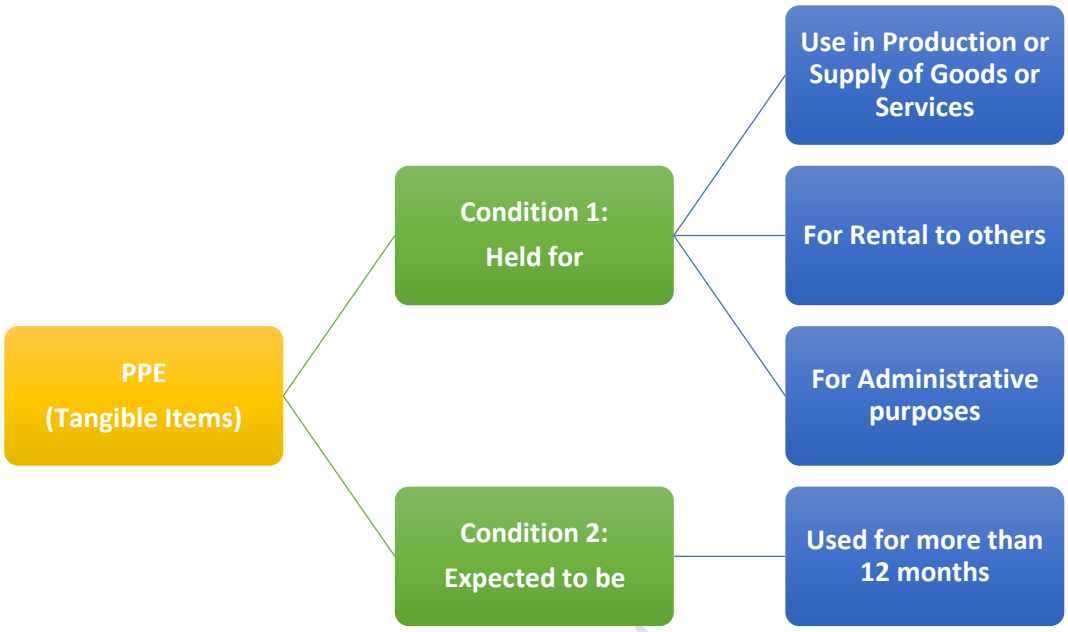


DEFNITIONS:

1.Property, plant and equipment are tangible items that:

(a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) Are expected to be used during more than a period of twelve months.



CLARIFICATIONS ON DEFINITION OF PPE:

1. "Administrative purposes": The term 'Administrative purposes' has been used in wider sense to include all business purposes. Thus, PPE would include assets used for:
   - Selling and distribution
   - Finance and accounting
   - Personnel and other functions of an Enterprise.
2. Items of PPE may also be acquired for safety or environmental reasons.
   a. The acquisition of such PPE, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an enterprise to obtain the future economic benefits from its other assets.
   b. Such items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.

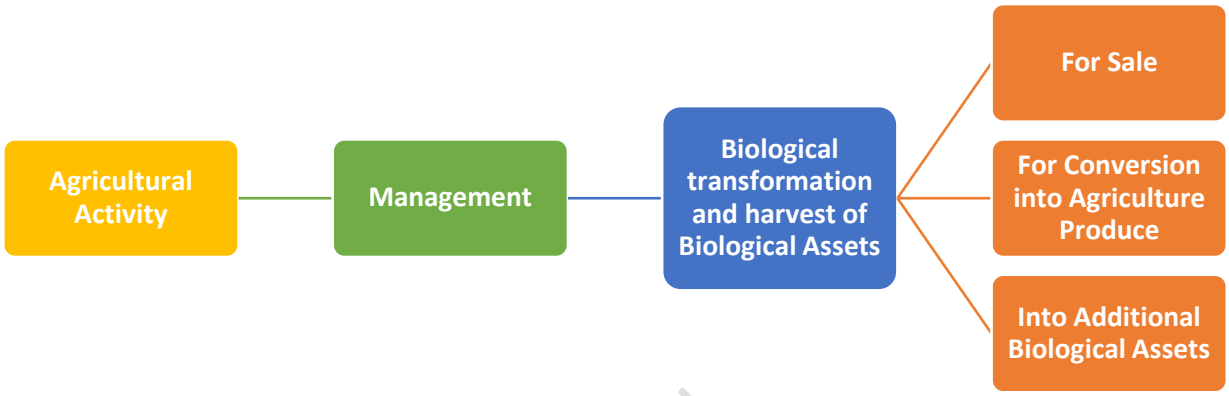
      Example: A chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals.

2.

a. **Biological Asset is a living animal* or plant.**

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b. **Agricultural Activity** is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.



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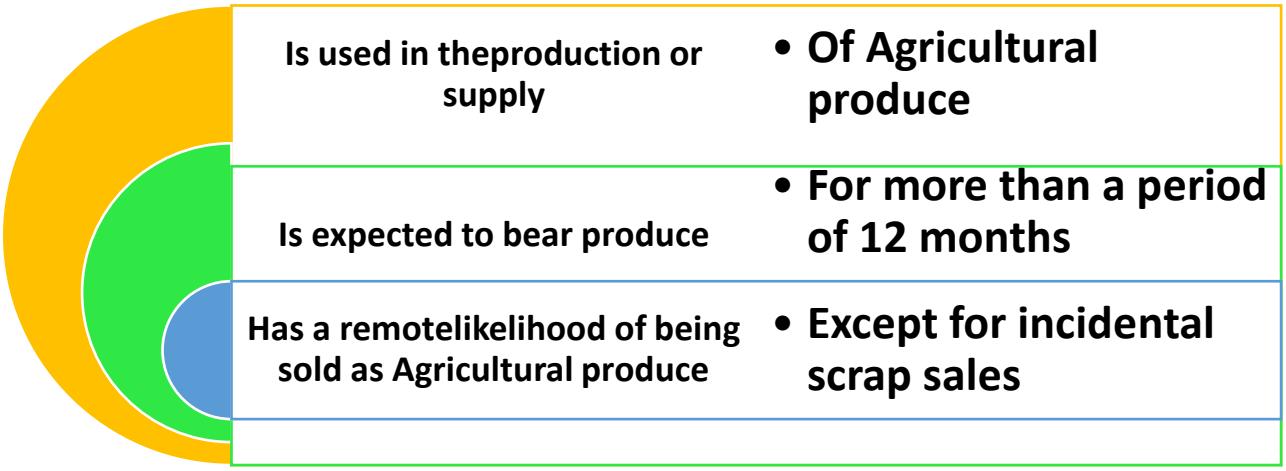
c. **Agricultural Produce** is the harvested product of biological assets of the enterprise.

d. **Bearer plant** is a plant that

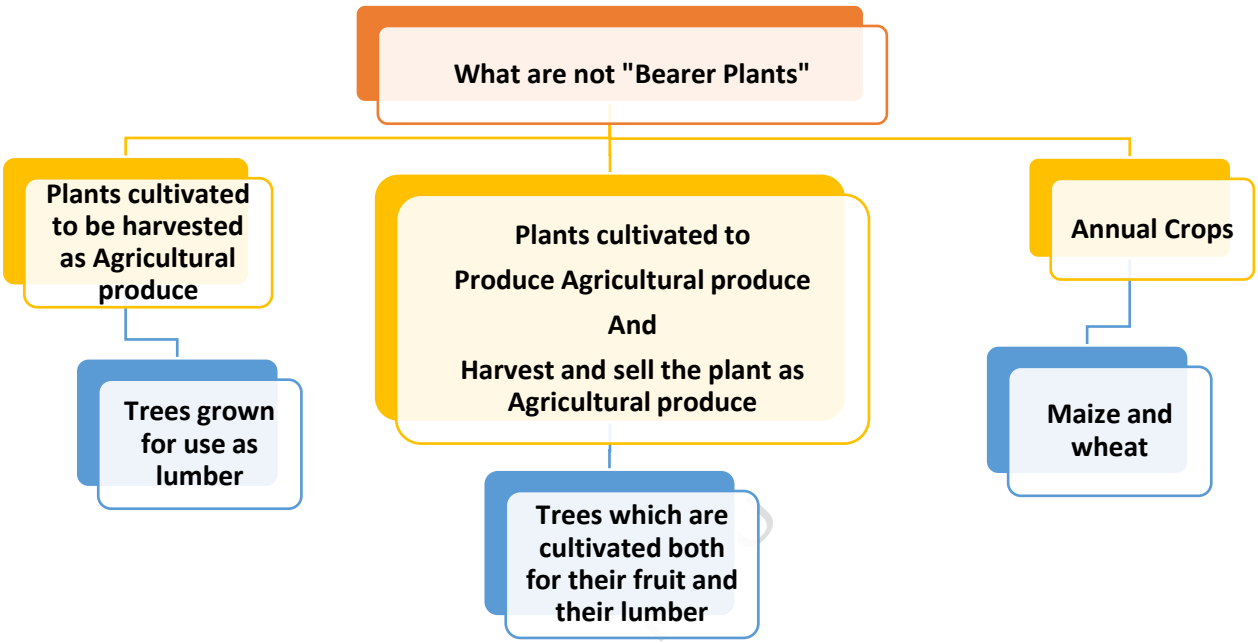
(i) is used in the production or supply of agricultural produce;

(ii) is expected to bear produce for more than a period of twelve months; and

(iii)has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.



The following are not bearer plants:



SCOPE:

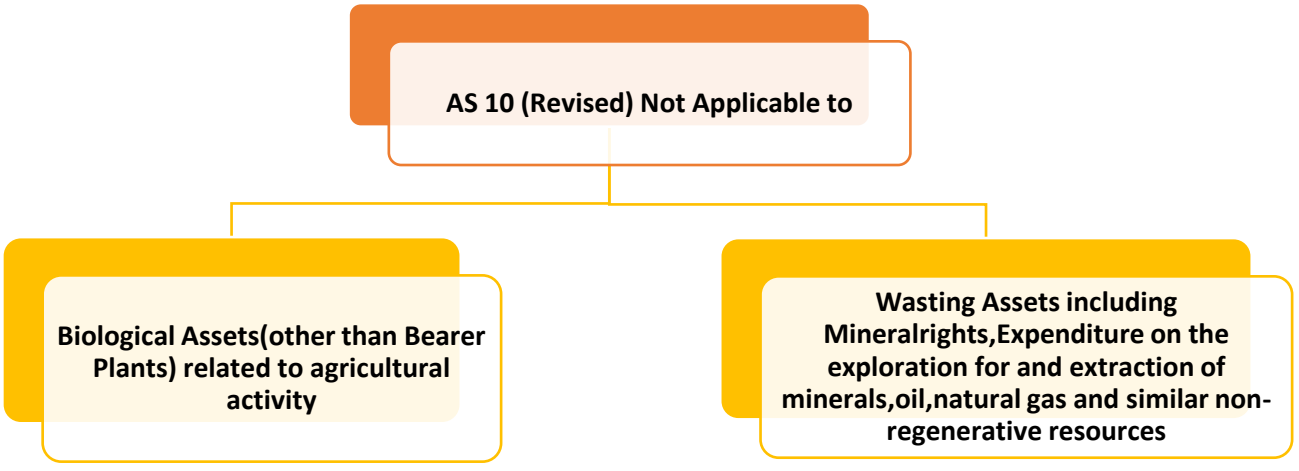
1. This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

Example

a. AS 19, Leases, requires an enterprise to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard only.

b. Investment property, as defined in AS 13, Accounting for Investments, should be accounted for only in accordance with the cost model prescribed in this standard.

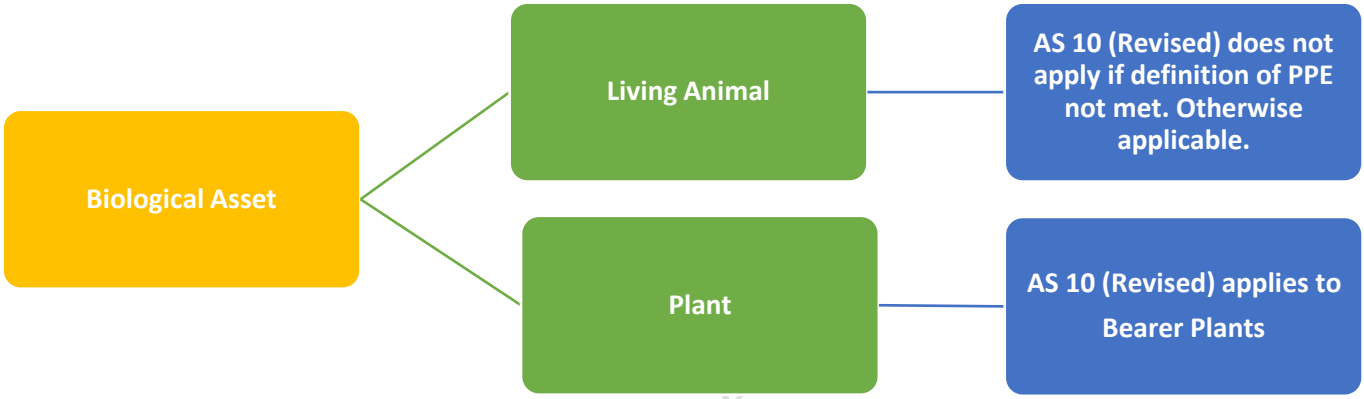
2. This Standard does not apply to:



Notes:

1. AS 10 applies to Bearer Plants but it does not apply to the produce on Bearer Plants.

2*. An Accounting Standard on "Agriculture" is under formulation, which will, inter alia, cover accounting for livestock. Till the time, the Accounting Standard on "Agriculture" is issued, accounting for livestock meeting the definition of PPE, will be covered as per AS 10.



Recognition Criteria for PPE:

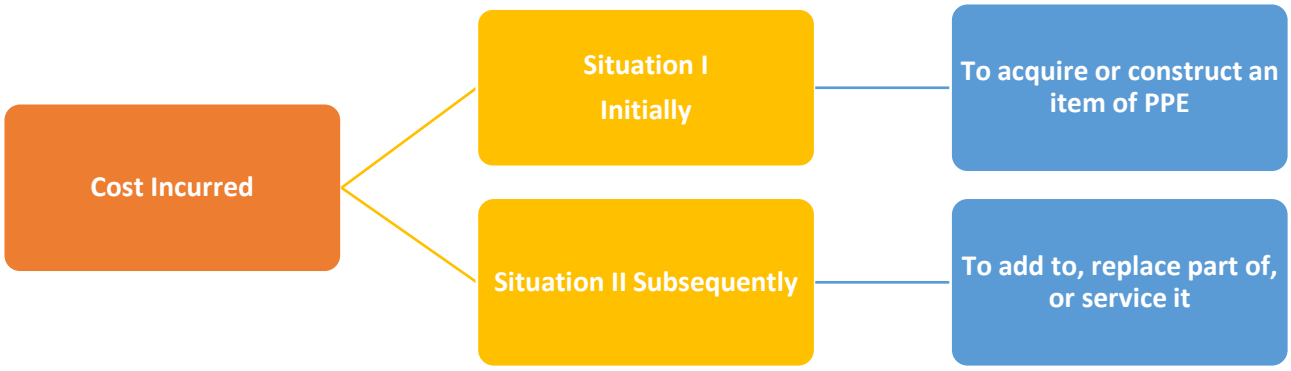
The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the enterprise; and

(b) the cost of the item can be measured reliably.

When do we apply the above criteria for Recognition?

ANS: An enterprise evaluates under this recognition principle all its costs on PPE at the time they are incurred.



NOTES:

1. Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.
2. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value.
3. An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.

TREATMENT OF SUBSEQUENT COSTS:

A) Cost of day-to-day servicing

(i) **Meaning:** Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'Repairs and Maintenance' of the item of PPE.

(ii) **Accounting Treatment**: An enterprise does not recognise in the carrying amount of an item of PPE the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the Statement of Profit and Loss as incurred.

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B) Replacement of Parts of PPE

1. Parts of some items of PPE may require replacement at regular intervals.

EXAMPLES:

(i) A furnace may require relining after a specified number of hours of use.

(ii) Aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe.

(iii) Major parts of conveyor system, such as, conveyor belts, wire ropes, etc., may require replacement several times during the life of the conveyor system.

(iv) Replacing the interior walls of a building, or to make a non-recurring replacement.

2. **Accounting Treatment:** An enterprise recognises in the carrying amount of an item of PPE the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the de-recognition provisions.

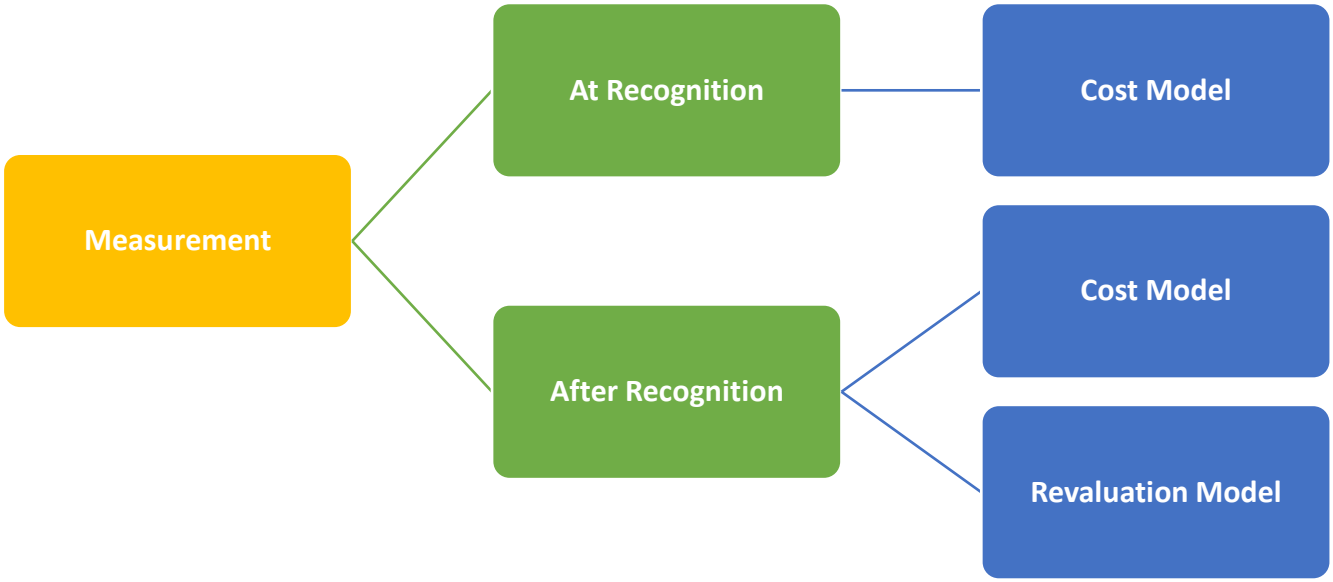
C) Regular Major Inspections - Accounting Treatment

1. A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced.
2. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (apart from physical parts) is derecognised in accordance with the de-recognition provisions.

NOTE: Derecognition of the carrying amount as stated above 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 when the item was acquired or constructed.

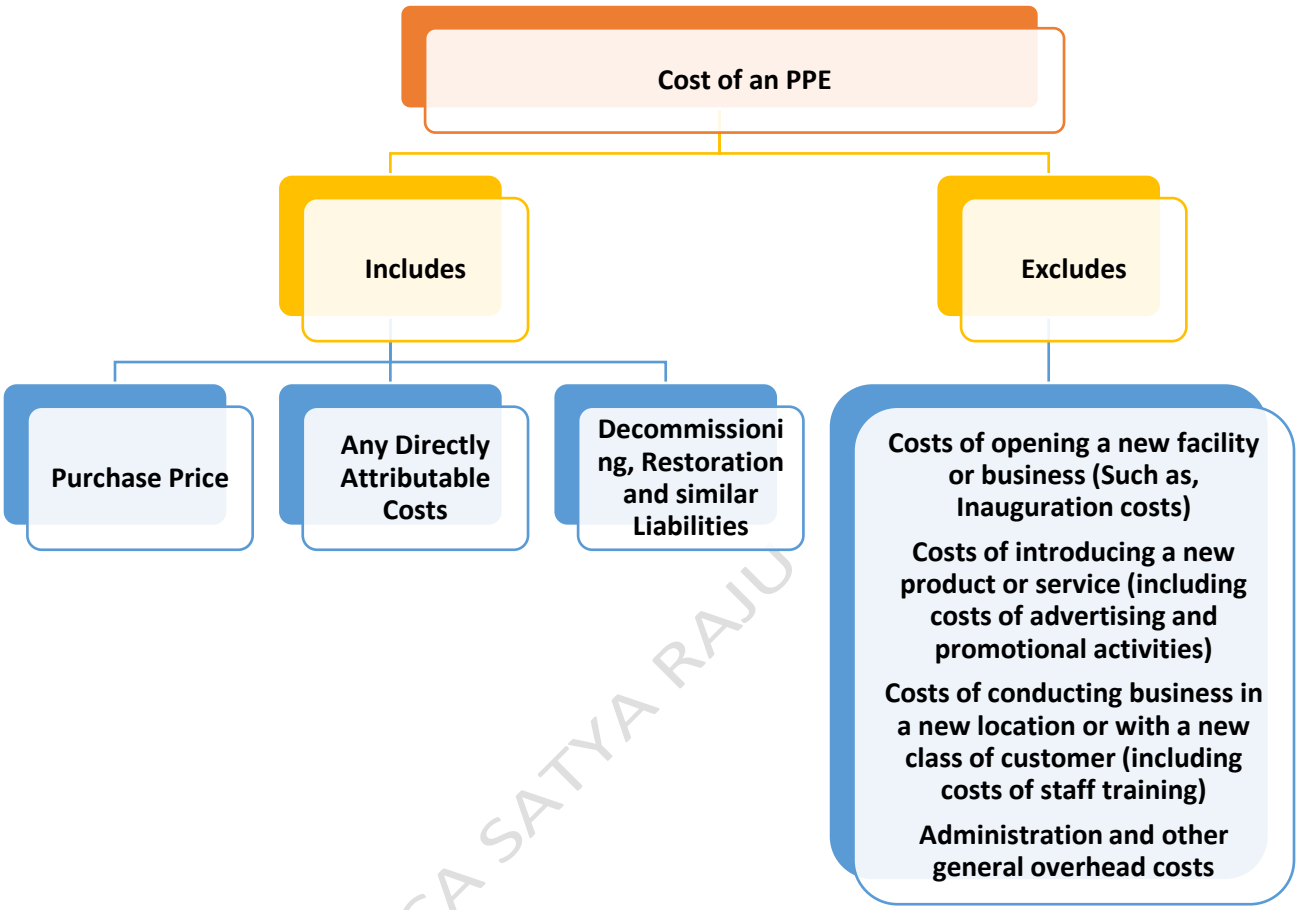
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Measurement of PPE:



Measurement at Recognition An item of PPE that qualifies for recognition as an asset should be measured at its cost.

Cost of an item of PPE comprises:



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1. **Purchase Price**:

   • It includes import duties and non –refundable purchase taxes.

   • It requires deduction of Trade discounts and rebates

2. **Directly Attributable Costs:**

   a) 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.

   Examples of directly attributable costs are:

   i) Costs of employee benefits (as defined in AS 15) arising directly from the construction or acquisition of the item of PPE

   ii) Costs of site preparation

   iii) Initial delivery and handling costs

   iv) Installation and assembly costs

   v) 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)

   vi) Professional fees

b) **Recognition of costs in the carrying amount of an item of PPE ceases** when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.

The following costs are not included in the carrying amount of an item of PPE:

i) 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.

ii) Initial operating losses, such as those incurred while demand for the output of an item builds up and

iii) Costs of relocating or reorganising part or all of the operations of an enterprise.

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

Example: Income may be earned through using a building site as a car park until construction starts because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in the Statement of Profit and Loss and included in their respective classifications of income and expense.

3. **Decommissioning, Restoration and similar Liabilities**:

Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Exception: An enterprise applies AS 2 (Revised) "Valuation of Inventories", to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period.

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COST OF A SELF-CONSTRUCTED ASSET:

1. Cost of a self-constructed asset is determined using the same principles as for an acquired asset.
2. If an enterprise makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale. Therefore, any internal profits are eliminated in arriving at such costs.
3. Cost of abnormal amounts of wasted material, labour, or other resources incurred in self constructing an asset is not included in the cost of the asset.
4. AS 16 on Borrowing Costs, establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of PPE.

MEASURMENT OF COST:

1. Cost of an item of PPE is the cash price equivalent at the recognition date.
2. If payment is deferred beyond normal credit terms:

   Total payment minus Cash price equivalent

   • is recognised as an interest expense over the period of credit

   • unless such interest is capitalised in accordance with AS 16

3. PPE acquired in Exchange for a Non-monetary Asset or Assets or A combination of Monetary and Non-monetary Assets:

   Cost of such an item of PPE is measured at fair value unless:

   (a) Exchange transaction lacks commercial substance; Or

   (b) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

Note:

1. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.

2. An enterprise determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
   a. The configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

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b. The enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;

4. **PPE purchased for a Consolidated Price**:

Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

5. **PPE held by a lessee under a Finance Lease**:

The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19 (Leases).

6. **Government Grant related to PPE:**

The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).

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Measurement after Recognition:

An enterprise should choose

• Either Cost model,

• Or Revaluation model

as its accounting policy and should apply that policy to an entire class of PPE.

Class of PPE: A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise.

Examples of separate classes:

(a) Land

(b) Land and Buildings

(c) Machinery

(d) Ships

(e) Aircraft

(f) Motor Vehicles

(g) Furniture and Fixtures

(h) Office Equipment

(j) Bearer plants

Cost Model

After recognition as an asset, an item of PPE should be carried at:

Cost- Any Accumulated Depreciation- Any Accumulated Impairment losses

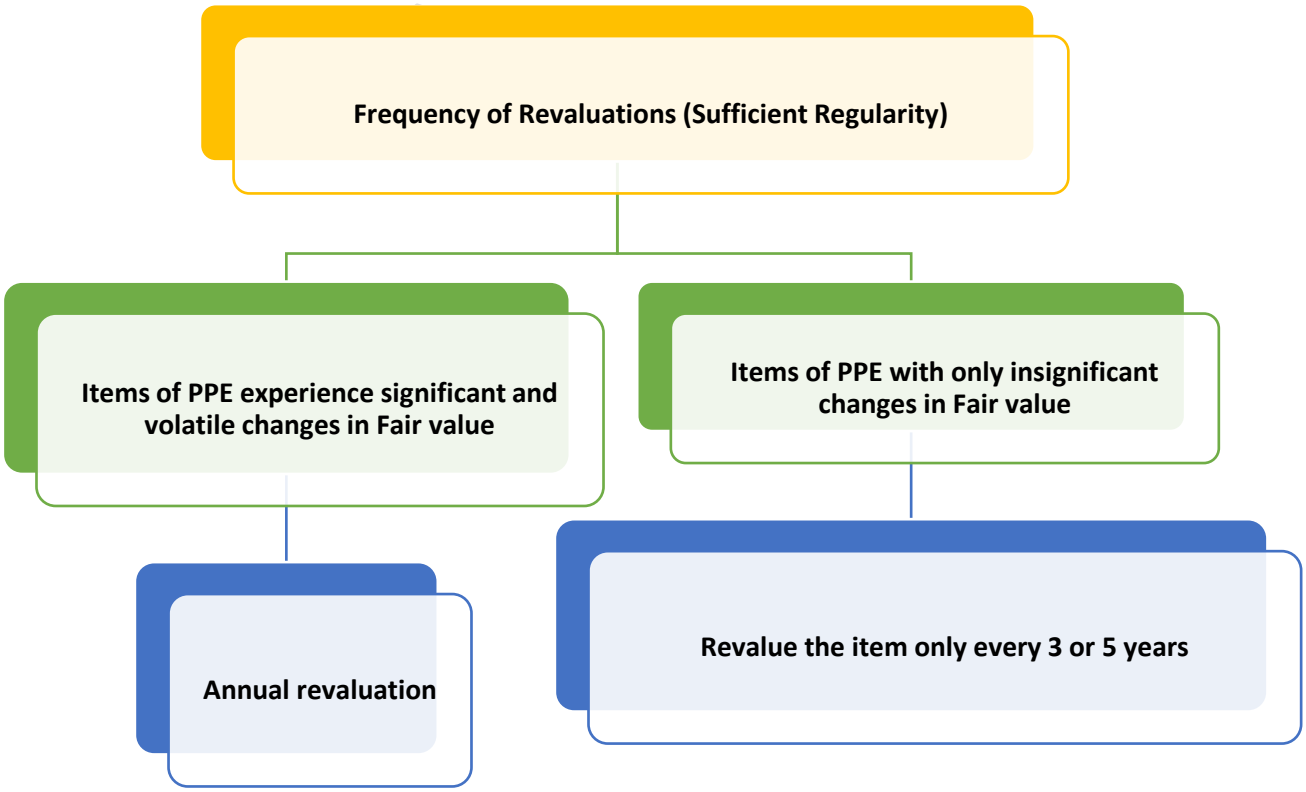
Revaluation Model

After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount.

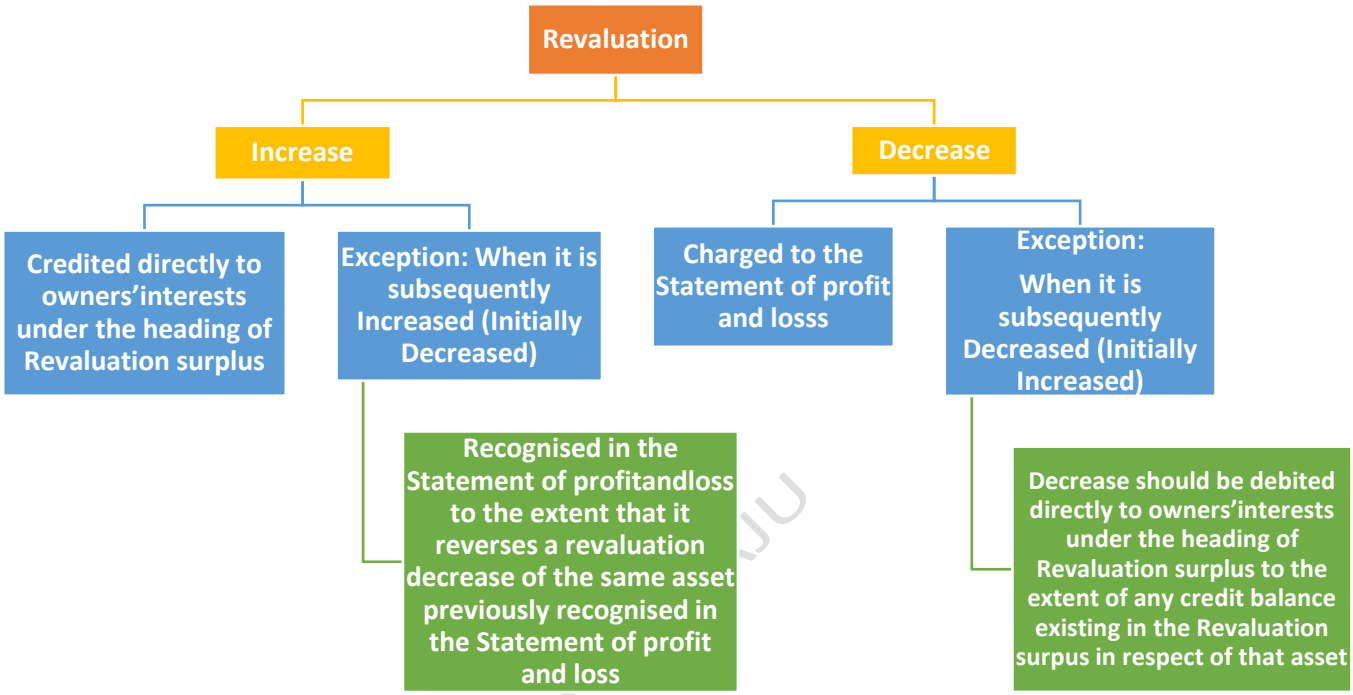
PARTICULARS	AMOUNT
Fair value at the date of the revaluation	XXXX
Less: Any subsequent accumulated depreciation	(XXXX)
Less: Any subsequent accumulated impairment losses	(XXXX)
Carrying value	XXXX

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NOTES:

1. If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.
2. 

Accounting Treatment of Revaluations:



Treatment of Revaluation Surplus:

1. The revaluation surplus included in owners' interests in respect of an item of PPE may be transferred to the Revenue Reserves when the asset is derecognised. i.e whole surplus is transferred:

   When the asset is:

   • Retired; Or

   • Disposed of

2. Some of the surplus may be transferred as the asset is used by an enterprise:

   In such a case, the amount of the surplus transferred would be: Depreciation (based on Revalued Carrying amount) – Depreciation (based on Original Cost)

Depreciation: is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Component Method of Depreciation: Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.

Accounting Treatment

Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.

Examples on Exception

1. AS 2 (Revised): Depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories as per AS 2 (Revised).
2. AS 26: Depreciation of PPE used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26 on Intangible Assets.

Review of Residual Value and Useful Life of an Asset:

Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

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Commencement of period for charging Depreciation:

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 the management.

Cessesation of Depreciation

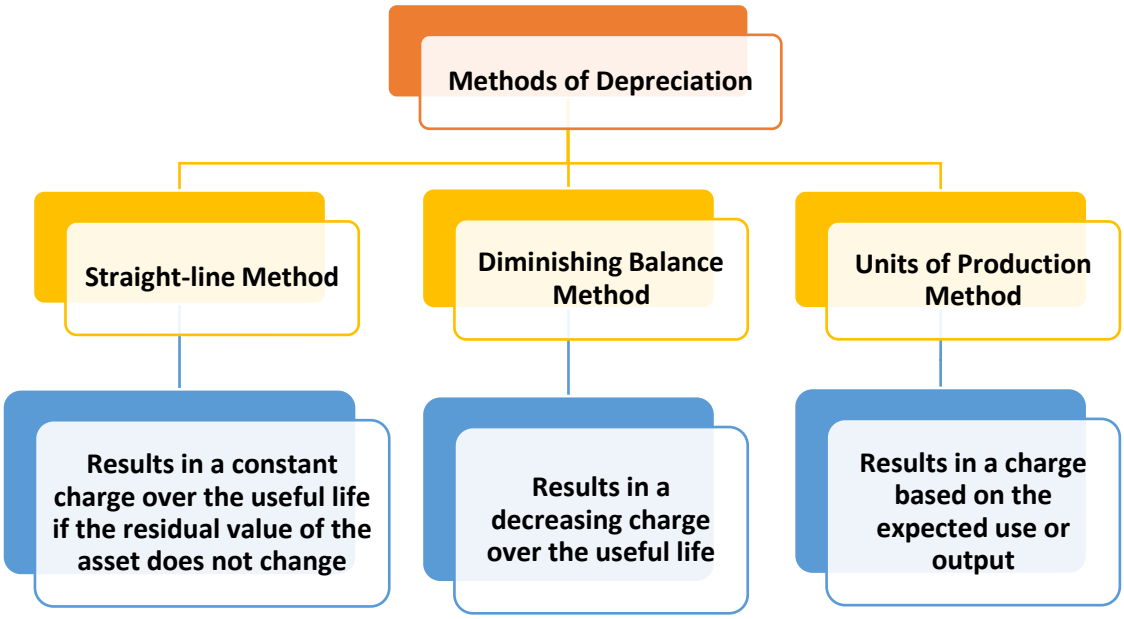
I. Depreciation ceases when asset's residual value exceeds it's carrying amount.

II. Depreciation of an asset ceases at the earlier of:

- The date that the asset is retired from active use and is held for disposal, and
- The date that the asset is derecognised

Depreciation Method:

1. The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
2. The method selected is applied consistently from period to period unless:
   - There is a change in the expected pattern of consumption of those future economic benefits; Or
   - That the method is changed in accordance with the statute to best reflect the way the asset is consumed.



Review of Depreciation Method:

1. 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.
2. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

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Retirements

Items of PPE retired from active use and held for disposal should be stated at the lower of:

• Carrying Amount, and

• Net Realisable Value

Note: Any write-down in this regard should be recognised immediately in the Statement of Profit and Loss

De-recognition:

The carrying amount of an item of PPE should be derecognised:

• On disposal

- By sale
- By entering into a finance lease, or
- By donation, Or

• When no future economic benefits are expected from its use or disposal

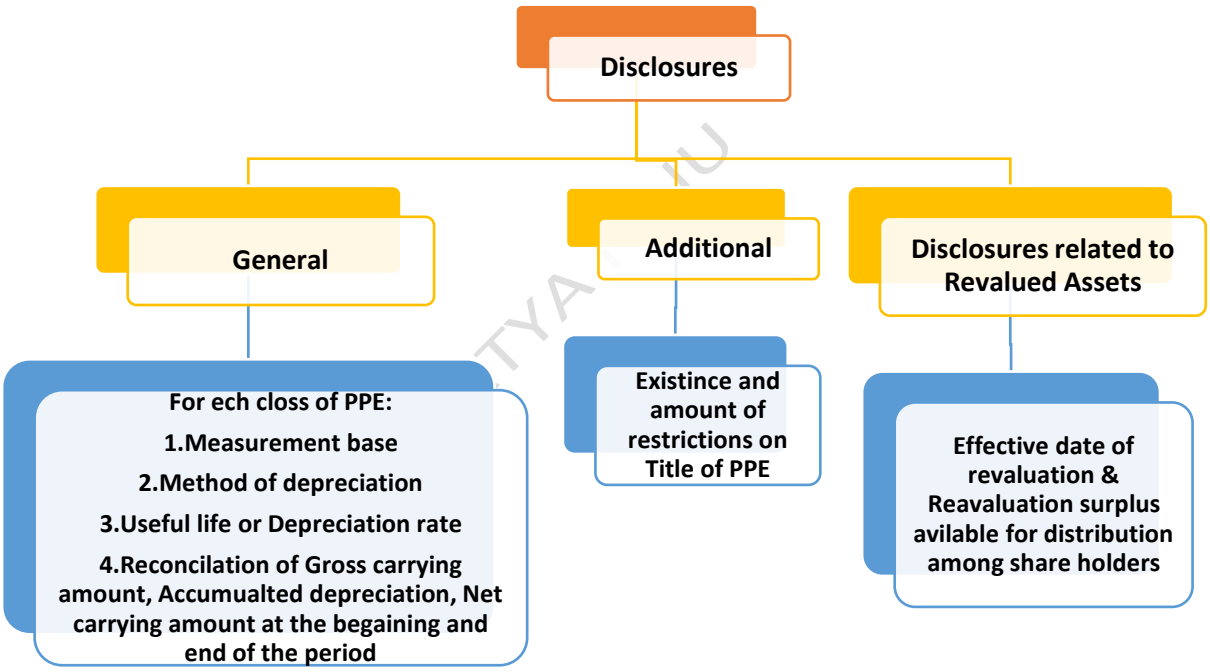
Accounting Treatment

Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss.

Gain or loss arising from de-recognition of an item of PPE = Net disposal proceeds (if any) - Carrying Amount of the item

Note: Gains should not be classified as revenue, as defined in AS 9 'Revenue Recognition'.

Disclosure:



PROBLEMS FOR DISCUSSION

PROBLEM 1

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.

(SM –ILLUSTRATION -1)

PROBLEM 2

What happens if the cost of the previous part/inspection / was not identified in the transaction in which the item was acquired or constructed? **(SM –ILLUSTRATION -2)**

PROBLEM 3

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? **(SM –ILLUSTRATION -3)**

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PROBLEM 4

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. Setup costs of Rs. 5,00,000 to install machinery in the new location.
2. Rent of Rs. 15,00,000
3. Removal costs of Rs. 3,00,000 to transport the machinery from the old location to the temporary location.

Can these costs be capitalised into the cost of the new building? **(SM –ILLUSTRATION -4)**

PROBLEM 5

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs. 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs. 45,000 per month. The machine was purchased at Rs. 1,58,00,000

and Rs. 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of Rs. 30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized.

(SM –ILLUSTRATION -5)

PROBLEM 6

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures? **(SM –ILLUSTRATION -6)**

PROBLEM 7

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.

(SM –ILLUSTRATION -7)

PROBLEM 8

Entity A exchanges land with a book value of Rs. 10,00,000 for cash of Rs. 20,00,000 and plant and machinery valued at Rs. 25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

(SM –ILLUSTRATION -8)

PROBLEM 9

Entity A exchanges car X with a book value of Rs. 13,00,000 and a fair value of Rs. 13,25,000 for cash of Rs. 15,000 and car Y which has a fair value of Rs. 13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received? **(SM –ILLUSTRATION -9)**

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PROBLEM 10

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?

(SM –ILLUSTRATION -10)

PROBLEM 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?

(SM –ILLUSTRATION -11)

PROBLEM 12

Entity A purchased an asset on 1st January 20X1 for Rs. 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 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 depreciaion on Straight Line basis. **(SM –ILLUSTRATION -12)**

PROBLEM 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 on from which date Entity B need to commence depreciation?

(SM –ILLUSTRATION -13)

PROBLEM 14

A property costing Rs. 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) Rs. 10,00,000

Case (b) Rs. 9,00,000.

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Calculate the amount of depreciation. **(SM –ILLUSTRATION -14)**

PROBLEM 15

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. **(SM –ILLUSTRATION -15)**

PROBLEM 16

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

(SM –ILLUSTRATION -16)

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PROBLEM 17

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)	Rs. 25,00,000
2.	Initial delivery and handling costs	Rs. 2,00,000
3.	Cost of site preparation	Rs. 6,00,000
4.	Consultants used for advice on the acquisition of the plant	Rs. 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	Rs. 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
7.	Operating losses before commercial production	Rs. 4,00,000

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

(PRACTICAL QUESTION 6 – SM)

PROBLEM 18

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)? **(RTP-MAY 2021 -17(B))**

11.ACCOUNTING FOR GOVERNMENT GRANTS

INTRODUCTION:

AS 12 deals with accounting for government grants such as subsidies, cash incentives, duty drawbacks, etc. and specifies that the government grants should not be recognised until there is reasonable assurance that the enterprise will comply with the conditions attached to them.

DEFINITION OF GOVERNMENT GRANT:

Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise. For eg:- Receipt of cash on the sale of packaged drinking water to railways by 'Bisleri'.

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SCOPE:

This Standard does not deal with:

1. Government assistance other than in the form of government grants.
   EX: Income tax holidays, investment tax credits, accelerated depreciation etc.
2. Government participation in the ownership of the enterprise.

Recognition of Government Grants:

A government grant is not recognised until there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

NOTE: Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Accounting Treatment of Government Grants:

Two broad approaches may be followed for the accounting treatment of government grants:

- the 'capital approach', under which a grant is treated as part of shareholders' funds, and
- the 'income approach', under which a grant is taken to income over one or more periods.

It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant.

Grants related to Promoters' contribution:

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. Those grants are accounted on the basis of capital approach and treated as Capital reserve.

Non-monetary Government Grants:

Government grants may take the form of non-monetary assets, such as land or other resources like building, plant & machinery, 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.

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Grants related to specific fixed assets:

Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets.

a) **Treatment related to Depreciable fixed assets**

Method I:

- The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.
- The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.
- Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

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.

b) **Treatment related to Non-Depreciable fixed assets**

- Grants related to non-depreciable assets are credited to capital reserve.

- If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to p&l over the same period over which the cost of meeting such obligations is charged to p&l.

Grants Related to Revenue:

Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.

Refund of Government Grants:

- Government grants sometimes become refundable because certain conditions are not fulfilled and are treated as an extraordinary item (AS 5).
- Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfilment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve
- The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.
- 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.

Disclosure

i) The accounting policy adopted for government grants, including the methods of presentation in the financial statements;

ii) The nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

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PROBLEMS FOR DISCUSSION

PROBLEM 1

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset. **(SM –ILLUSTRATION 1)**

PROBLEM 2

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income. **(SM –ILLUSTRATION 2)**

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PROBLEM 3

Santosh Ltd. has received a grant of Rs.8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed Rs.2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct. **(SM –ILLUSTRATION 3)**

PROBLEM 4

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 Rs.50 crore in capital assets received Rs. 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.

(SM –ILLUSTRATION 4)

PROBLEM 5

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

(i) Rs. 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) Rs. 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.

(SM –ILLUSTRATION 5)

PROBLEM 6

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs (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 Rs. 7,00,000. Pass the journal entry for refund of the grant as per the first method. **(SM –ILLUSTRATION 6)**

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PROBLEM 7

A fixed asset is purchased for Rs. 20 lakhs. Government grant received towards it is Rs. 8 lakhs. Residual Value is Rs. 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of Rs. 5 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years. **(SM –ILLUSTRATION 7)**

PROBLEM 8

On 1.4.20X1, ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of machinery costing Rs. 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20X4 due to non-fulfilment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4? **(SM –ILLUSTRATION 8)**

PROBLEM 9

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

Show the Journal Entry to be passed at the time of refund of grant in the 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. **(SM –ILLUSTRATION 9)**

PROBLEM 10

Supriya Ltd. received a grant of Rs. 2,500 lakhs during the accounting year 20X1-20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its 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

(SM –PRATICAL Q.NO.8)

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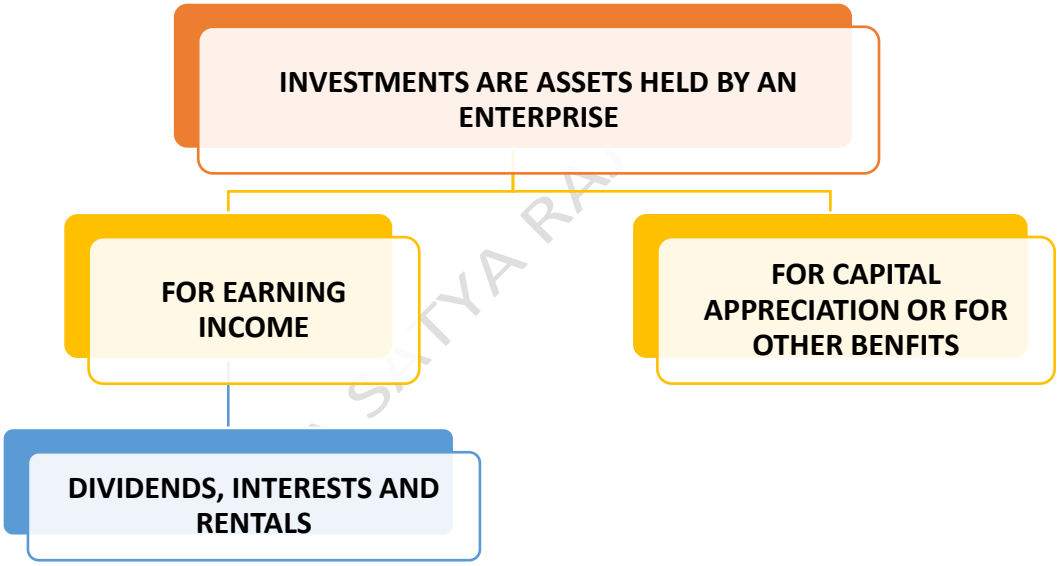
12.INVESTMENT ACCOUNTS+AS-13

OBJECTIVE:

AS-13 deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.

DEFINITIONS:

1. **Investments** are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade (inventory) are not 'investments'



2. **Fair value** is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.
3. **Market value** is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

SCOPE:

This Standard does not deal with:

1. The basis for recognition of interest, dividends and rentals earned on investments which are covered by AS9.
2. Operating or finance leases
3. Investments on retirement benefit plans and life insurance enterprises

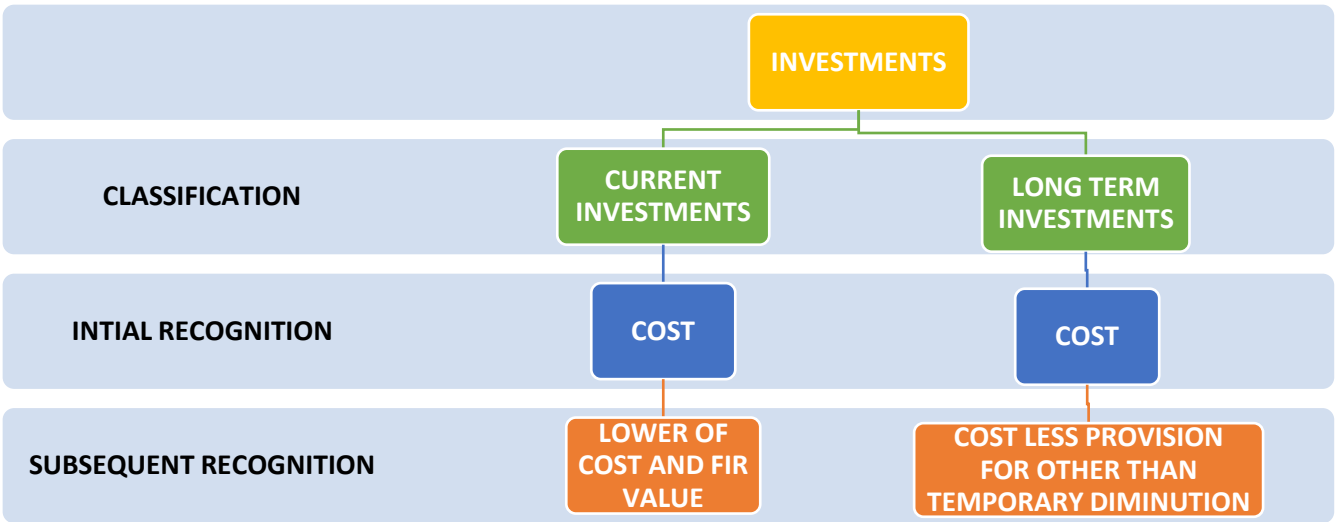
4. Mutual funds, venture capital funds and/ or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 2013.

CLASSIFICATION OF INVESTMENTS:

1. 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 intention to hold for not more than one year is to be judged at the time of purchase of investment.
2. **Long term investment** is an investment other than a current investment.

MEASURMENT:

1. **At the time of Initial Recognition,** both current and long- term investments measured at Cost price only.
2. **At the time of subsequent Recognition,**
   - **a)** The carrying amount for current investments is the lower of cost and fair value.
     - **i)** Any reduction to fair value is debited to profit and loss account
     - **ii)** However, if fair value of investment is increased subsequently, the increase in value of current investment up to the cost of investment is credited to the profit and loss account (and excess portion, if any, is ignored).
   - **b)** Long term investments are usually carried at cost.
     - **(i)** If there is a permanent decline in the value of a long- term investment; the carrying amount is reduced to recognise the decline.
     - **(ii)** The reduction in carrying amount is charged to the statement of profit and loss.
     - **(iii)** 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.



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COST OF INVESTMENTS:

Type of acquisition	Cost of investments
Cash/bank	Cash price including charges such as brokerages, fees and duties
Issue of shares/other securities	Fair value of securities issued
In exchange for another asset	Fair value of asset given up or fair value of investment acquired, which ever is more clearly evident

Investment Properties:

1. An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.
2. An investment property is accounted for in accordance with cost model as prescribed in AS 10 , 'Property, Plant and Equipment'.
3. The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

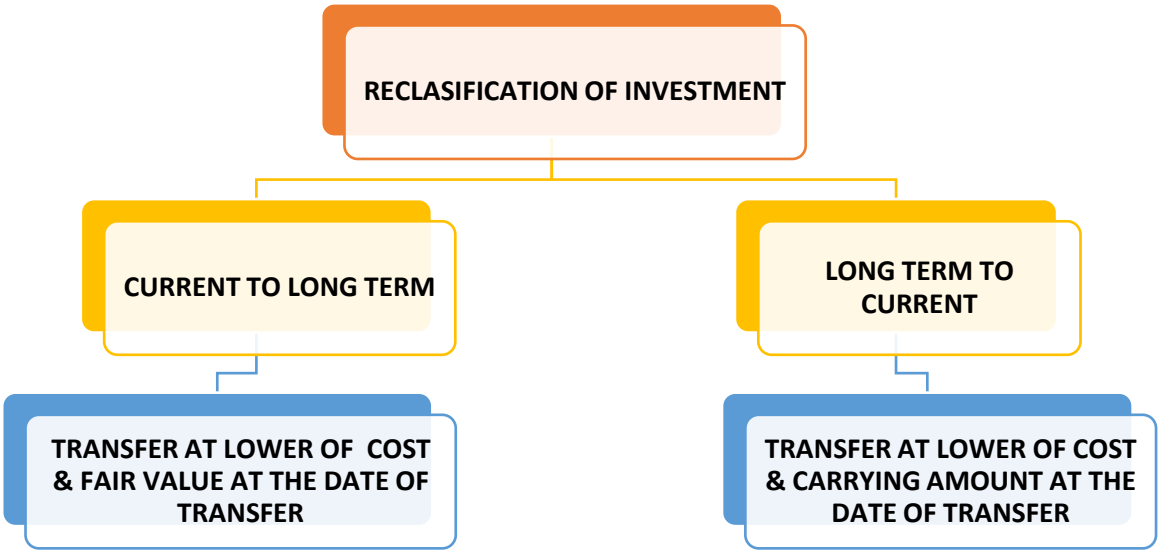
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Disposal of Investments:

On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement.

Reclassification of Investments:

1. 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.
2. 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.



Valuation of investments:

1. 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.

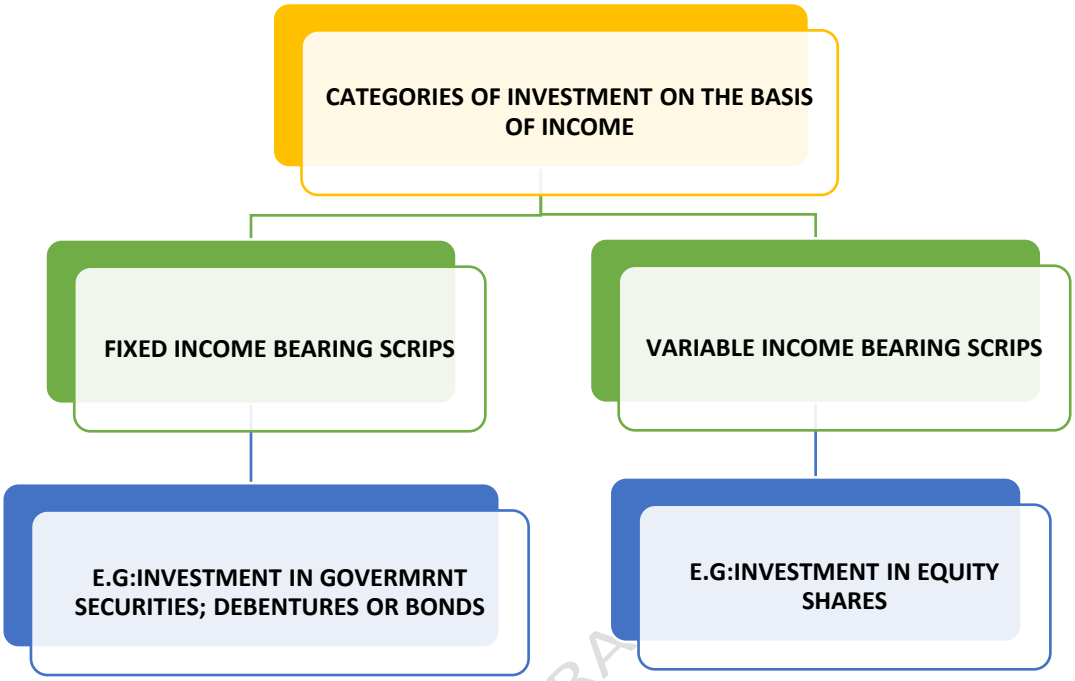
2. Long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis.

Disclosure:

1. The accounting policies followed for valuation of investments.
2. The amounts included in profit and loss statement for
   a. Interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments.
   b. Profits and losses on disposal of current investments
   c. Profits and losses on disposal of long-term investments
3. The aggregate amount of quoted and unquoted investments

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CLASSIFICATION OF INVESTMENTS ON THE BASIS OF INCOME:



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Fixed income Bearing Securities:

1. These refer to securities having fixed return of income. Investment in Government securities or debentures comes under this category.
2. Transaction for fixed income bearing securities may occur on following basis:
   A. Ex-interest basis
   B. Cum- interest basis
3. In case the transaction is on 'Ex-interest' basis, the amount of interest accrued to the date of transaction has to be paid in addition to the price of security.

   The following entries are made in the books of Purchaser:

Investment account	**DR.**	(With the price settled on ex- interest basis)*
Interest accrued account	**DR.**	(Accrued interest till the date of transaction)**
TO Bank A/C		(With total amount paid)

*THE AMOUNT WILL APPAER IN COST COLUMN OF "INVESTMENT A/C"

**THIS AMOUNT WILL APPEAR IN INCOME /INTEREST COLUMN OF "INVESTEMNTA/C"

4. In case the transaction is on cum-interest basis, a part of purchase price is related to the interest accrued from the date of the last interest paid to the date of transaction. Hence, in this case, the cost of investment has to be calculated by subtracting the amount of accrued interest from the Purchase Price.

   The following entries are made in the books of Purchaser:

Investment account	**DR.**	(With the price settled on cum- interest less interest accrued)*
Interest accrued account	**DR.**	(Accrued interest till the date of transaction)**
TO BANK A/C		(With total amount paid)

*THE AMOUNT WILL APPAER IN COST COLUMN OF "INVESTMENT A/C"

**THIS AMOUNT WILL APPEAR IN INCOME /INTEREST COLUMN OF "INVESTEMNTA/C"

5. When the interest amount is actually received, it is entered in the Income Column credit side. The net effect of these entries will be that the amount credited to the income will be only the interest arising between the date of purchase and the one on which it next falls due.

Note:

a) Interest amount is always calculated with respect to nominal value (par value/ nominal value).

b) In case the quotation does not specify whether it is ex-interest or cum-interest, the same will be treated as ex-interest quotation as per the general practice.

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Variable Income Bearing Securities:

1. These refer to securities having variable return of income. Investment in equity shares comes under this category.

2. The following points should be noted with respect to investment in equity shares:

i. Dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established;

ii. The amount of dividend accruing between the date of last dividend payment and the date of purchase cannot be immediately ascertained.

In the following way the information is incorporated in the books of investor at the time of purchase.

Investment A/c	DR	(With the entire purchase price)*
To Bank A/c		(With total amount paid)

*THE AMOUNT WILL APPAER IN CAPITAL COLUMN OF "INVESTMENT A/C"

The adjustment with respect to dividend is made when the dividend is actually received as under:

Bank a/c	DR.	(With total dividend recevied)
TO Investment A/C		With the amount of dividend for the period for which the investor did not hold the share)*
TO Dividend A/C		(With the amount of dividend for the post acquistion period)**

*THE AMOUNT WILL APPAER IN CAPITAL COLUMN OF "INVESTMENT A/C"

**THIS AMOUNT WILL APPEAR IN INCOME /INTEREST COLUMN OF "INVESTEMNTA/C"

3. The important point with respect to investment in equity shares is that the amount of dividends for the period, for which the shares were not held by the investor, should not be treated as revenue receipt but they should be treated as capital receipt, i.e., when dividends on equity shares are declared from pre-acquisition profits, the amount of such dividend received by the investor is entered on the credit side in the capital column, so as to reduce the acquisition cost.

4.

   a. When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding.

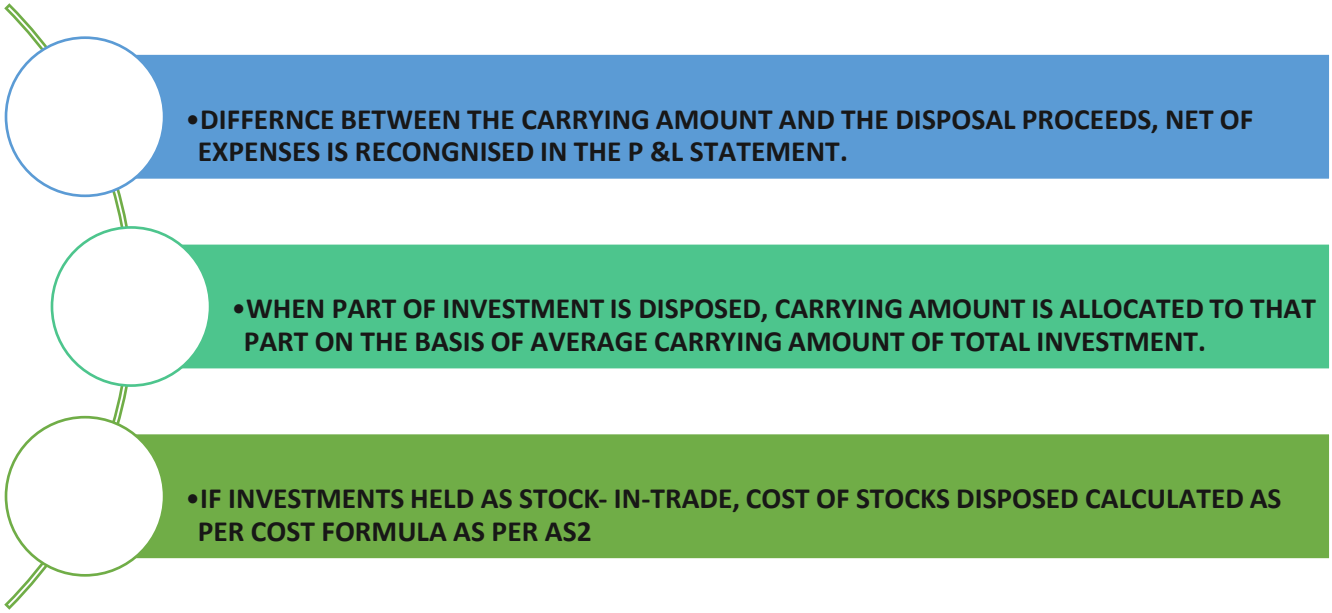
   b. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the statement of profit and loss.

   c. 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.

5. Where an investment is acquired by way of issue of bonus shares, no amount is entered in the capital column of investment account since the investor has not paid anything.

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DISPOSAL OF INVESTMENTS:



(i) Fixed Income Bearing Securities:

A) In case the transaction is on 'Cum-interest basis', the amount of accrued interest from the date of last payment to the date of sale is credited in the income column and only the sale

proceeds, net of accrued interest (from the date of last payment to the date of sale), is credited in the capital column of investment account.

B) In case the transaction is on 'Ex-interest' basis, entire sale proceeds is credited in the capital column and the amount of accrued interest from the date of last payment to the date of sale, separately received from the buyer will be taken to the credit side of the income column of investment account.

PARTICULARS	VALUE IN CAPITAL COLUMN OF INVESTMENT	
	PURCHASE	**SALE**
TRANSACTION ON EX-INTEREST BASIS	Purchase price of investment i.e. No impact of interest accrued up to the date of transaction	Entire sale proceeds from investments, i.e no impact of accrued interest (from the date of last payment to the date of sale)
TRANSACTION ON CUM-INTEREST BASIS	Purchase price of investment less accrued interest up to the date of transaction	Sale proceeds, net of accrued interest (from the date of last payment to the date of sale)

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(ii) <u>Variable Income Bearing Securities</u>:

In case of these securities, the entire amount of sale proceeds should be credited in the capital column of investment account, unless the amount of accrued dividend can be specifically established.

PROBLEMS BASED ON AS-13

PROBLEM 1

An unquoted long- term investment is carried in the books at a cost of Rs. 2 lakhs. The published accounts of the unlisted company received in May, 20X1 showed that the company was incurring cash losses with declining market share and the long- term investment may not fetch more than Rs. 20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 20X1? **(Illustration 1-SM)**

PROBLEM 2

X Ltd. on 1-1-20X1 had made an investment of Rs. 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 Rs. 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

(Illustration 2-SM)

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PROBLEM 3

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 20X3 at a cost of Rs. 2,50,000. It also earlier purchased Gold of Rs. 4,00,000 and Silver of Rs. 2,00,000 on 1st March, 20X1. Market value as on 31st March, 20X4 of above investments are as follows: Rs.

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"? **(Illustration 3-SM)**

PROBLEM 4

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:

(i) A portion of current investments purchased for Rs. 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 Rs. 25 lakhs.

(ii) Another portion of current investments purchased for Rs. 15 lakhs, to be reclassified as long - term investments. The market value of these investments as on the date of balance sheet was Rs. 6.5 lakhs.

(iii) Certain long- term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was Rs. 18 lakhs but had been written down to Rs. 12 lakhs to recognise other than temporary decline as per AS 13 (Revised).

PROBLEMS BASED ON MAIN CHAPTER

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PROBLEM 5

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.
Opening balance (nominal value) Rs. 1,20,000, Cost Rs. 1,18,000 (Nominal value of each unit is Rs. 100).

1.3.20X1	Purchased 200 units, ex-interest at Rs. 98.
1.7.20X1	Sold 500 units, ex-interest out of original holding at Rs. 100.
1.10.20X1	Purchased 150 units at Rs. 98, cum interest.
1.11.20X1	Sold 300 units, ex-interest at Rs. 99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.

(Practical question-3-SM)

PROBLEM 6

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of Rs. 100 each in TELCO Ltd. @ Rs. 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per Rs. 100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at Rs. 175 per share and Rs. 90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.
Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

(ILLUSTRATION-2)

PROBLEM 7

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of Rs. 15 per share (Nominal value Rs. 10). On 20.6.20X1, he purchased another 5,000 shares of the company at Rs.16 per share. The directors of 'X' Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of the issue are as follows:

Bonus basis 1:6 (Date 16.8.20X1).

Rights basis 3:7 (Date 31.8.20X1) Price Rs. 15 per share.

Due date for payment 30.9.20X1

Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of Rs. 2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of Rs. 5 per share.

You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1and shares are valued at average cost. **(ILLUSTRATION 6-SM)**

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PROBLEM 8

A Limited purchased 5,000 equity shares (nominal value Rs. 100 each) of Allianz Limited for Rs. 105 each on 1st April, 20X1. The shares were quoted cum dividend. On 15th May, 20X1, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 20X1. On 30th June, 20X1 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 20X1 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share. A Limited subscribed to half of the rights issue and the balance was sold at Rs. 5 per right entitlement. The company declared interim dividend of 1% on 30th November, 20X1. Right shares were not entitled to dividend. The company sold 3,000 shares on 31st December, 20X1 at Rs. 95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares.

You are required to prepare Investment Account in books of A Ltd for the year ended 31st March, 20X2. **(ILLUSTRATION 8-SM)**

PROBLEM 9

The following transactions of Nidhi took place during the year ended 31st March 20X2:

1st April	Purchased Rs.12,00,000, 8% bonds of Rs.100 each at Rs.80.50 cum- interest. Interest is payable on 1st November and 1st May.

12th April	Purchased 1,00,000 equity shares of Rs.10 each in X Ltd. For Rs.4,00,000
1st May	Received half –year interest on 8% bonds
15th May	X Ltd. Made a bonus issue of three equity shares for every two held. Nidhi sold 1,25,000 bonus shares for Rs.20 each
1st Oct.	Sold Rs.3,00,000, 8% bonds at Rs.81 ex- interest
1st November	Received half – year bond interest
1st December	Received 18% interim dividend on equity shares(including bonus shares) in X Ltd.

Prepare the relevant investment account in the books of Nidhi for the year ended 31st March, 20X2.

PROBLEM 10

Mr. X acquires 200 shares of a company on cum-right basis for Rs. 70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at Rs. 107 each. He does not subscribe but sells all the rights for Rs. 12,000. The market value of the shares after their becoming ex-rights has also gone down to Rs. 60,000. What should be the accounting treatment in this case? **(PRACTICAL QUESTION-1-SM)**

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PROBLEM 11

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of Rs. 4,50,000 (Face Value Rs. 10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for Rs. 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.

On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of Rs. 15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of Rs. 2 per share.

On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.

On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of Rs. 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost.

(PRACTICAL QUESTION-5-SM)

TEST YOUR KNOWLEDGE

Theoretical Questions

1. How will you classify the investments as per AS 13? Explain in Brief.
2. Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? Explain in brief.

MCQs

Choose the most appropriate option as the answer:

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

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

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

4. A Ltd. acquired 2,000 equity shares of Omega Ltd. on cum-right basis at Rs. 75 per share. Subsequently, omega Ltd. made a right issue of 1:1 at Rs. 60 per share, which was subscribed for by A. Total cost of investments at the yearend will be
   (a) 2,70,000.
   (b) 1,50,000.
   (c) 1,20,000.

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5. Cost of investment includes

(a) Purchase costs.

(b) Brokerage and Stamp duty paid.

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

6. A current investment is an investment

(a) That is readily realisable.

(b) That is intended to be held for not more than one year from the date on which such investment is made.

(c) Both (a) and (b)

7. All the following are fixed income bearing securities except

(a) Debentures.

(b) Equity shares.

(c) Govt. Bonds.

8. If there is 'other than temporary' decline in the value of a long term investment then

(a) Carrying amount is reduced to recognise the decline.

(b) The reduction in carrying amount is charged to profit and loss account.

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

9. If investment is acquired by issue of shares, the acquisition cost of investment is

(a) Amount paid for acquisition.

(b) Fair value of securities issued.

(c) Market price of securities.

10. When long-term investments are reclassified as current investments, current investments are valued at

(a) Cost.

(b) Carrying amount.

(c) Lower of Cost and Carrying amount.

11. Violet Ltd. held shares in Omega Co. from 01.04.20X1 onwards as investment which such investment is made. which such investment is made. for long term purpose. Now it wants to reclassify investment of cost of Rs. 50,000 out of these shares as current investments having

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carrying value of Rs. 45000. The fair value on date of transfer is Rs. 48,000. These reclassified shares would be valued on date of transfer at

(a) Rs. 50000

(b) Rs. 48000

(c) Rs. 45000.

12. Mr. X acquires 200 shares of a company on cum-right basis for Rs. 60,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at Rs. 105 each. He does not subscribe but sells the rights for Rs. 5,000. The market value of the shares after their becoming ex-rights has also gone down. It would be appropriate to

(a) Credit Rs. 5,000 to Profit and Loss account.

(b) Reduce the carrying amount of investment by Rs. 5,000.

(c) Add Rs. 5,000 to the carrying amount of investment**.**

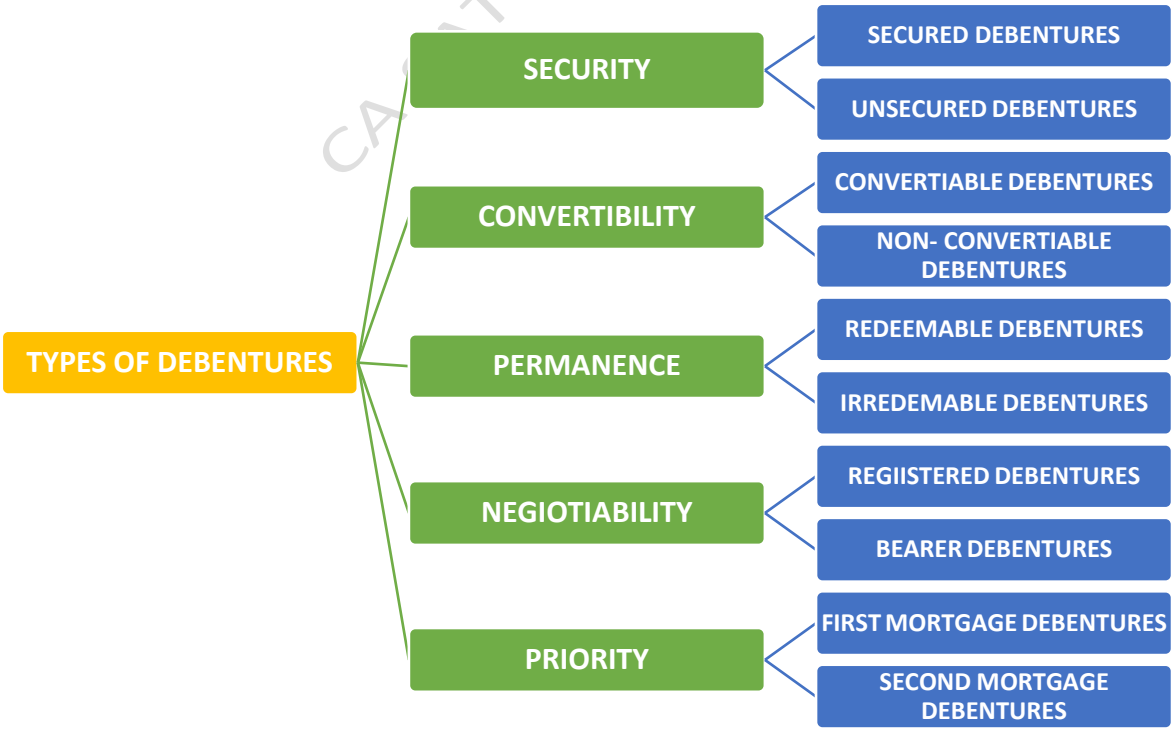
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13.REDEMPTION OF DEBENTURES



MEANING: A debenture is an instrument issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

TYPES OF DEBENTURES:



Provisions under the Companies Act, 2013:

1) Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.

2) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,

(i) Companies engaged in setting up of infrastructure projects;

(ii) Infrastructure Finance Companies

(iii) Infrastructure Debt Fund Non-Banking Financial Companies

(iv) Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

3) A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company for any other purpose except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

4) As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, companies should comply below provisions with respect to Debenture redemption reserve and Debenture redemption reserve investment.

a)

S.No.	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	**All India Financial Institutions** (**AIFIs**) regulated by Reserve Bank of India **and Banking Companies for both public** as well as **privately placed debentures**	**No DRR** is required
2	**Other Financial Institutions (FIs)** within the meaning of clause (72) of section 2 of the Companies Act, 2013	**DRR** will be **as applicable to NBFCs** registered with RBI (**as per (3) below**)
3	**For listed companies** (other than AIFIs and Banking Companies as specified in Sr. No. 1 above):	
a)	All **listed NBFCs** (registered with RBI under section 45-IA of the RBI Act,) and **listed**	**No DRR** is required

	HFCs (Housing Finance Companies registered with National Housing Bank) **for both public** as well as **privately placed debentures**	
b)	**Other listed companies for both public** as well as **privately placed debentures**	**No DRR** is required
4	**For unlisted companies** (other than AIFIs and Banking Companies as specified in Sr. No. 1 above	
a)	All **unlisted NBFCs** (registered with RBI under section 45-IA of the RBI (Amendment) Act, 1997) and **unlisted HFCs** (Housing Finance Companies registered with National Housing Bank) **for privately placed debentures**	**No DRR** is required
b)	**Other unlisted companies**	**DRR** shall be **10% of** the **value of** the **outstanding debentures** issued

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NOTE: In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debentures only.

b)

(i) All listed NBFCs

(ii) All listed HFCs

(iii) All other listed companies (other than AIFIs, Banking Companies and Other FIs); and

(iv) All unlisted companies which are not NBFCs and HFCs

shall on or before the 30th day of April in each year, in respect of debentures issued, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of that year.

JOURNAL ENTRIES:

1) Accounting treatment for Debenture Redemption Fund: (Sinking Fund)

a) After allotment of debentures

i) For setting aside the fixed amount of profit for redemption

Profit and Loss A/c Dr.

To Debenture Redemption Reserve A/c

ii) For investing the amount set aside for redemption

Debenture Redemption Reserve Investment A/c Dr.

To Bank A/c

iii) For receipt of interest on Debenture Redemption Reserve Investments

Bank A/c Dr.

To Interest on Debenture Redemption Reserve Investment A/c

iv) For transfer of interest on Debenture Redemption Reserve Investments (DRRI)

Interest on Debenture Redemption Reserve Investment A/c Dr.

To Profit and loss A/c*

* Considering the fact that interest is received each year through cash/bank account and it is not re-invested. Hence interest on DRR investment is not credited to DRR A/c but taken to P&L A/c. (in accordance with AS 5)

b) <u>At the time of redemption of debentures:</u>

i) For encashment of Debenture Redemption Reserve Investments

Bank A/c Dr.

To Debenture Redemption Reserve Investment A/c

ii) For amount due to debenture holders on redemption

Debentures A/c Dr.

To Debenture holders A/c

iii) For payment to debenture holders

Debenture holders A/c Dr.

To Bank A/c

iv) After redemption of debentures, DRR should be transferred to general reserve

DRR A/c Dr.

To General Reserve

<u>Notes:</u>

a) Debentures sometimes are redeemable at a premium. In such a case, <u>premium on redemption of debentures shall have to be set off with P&L account</u>.

<u>When premium on redemption is due:</u>

Premium on Redemption of Debentures A/c Dr.

To Debenture Holders A/c

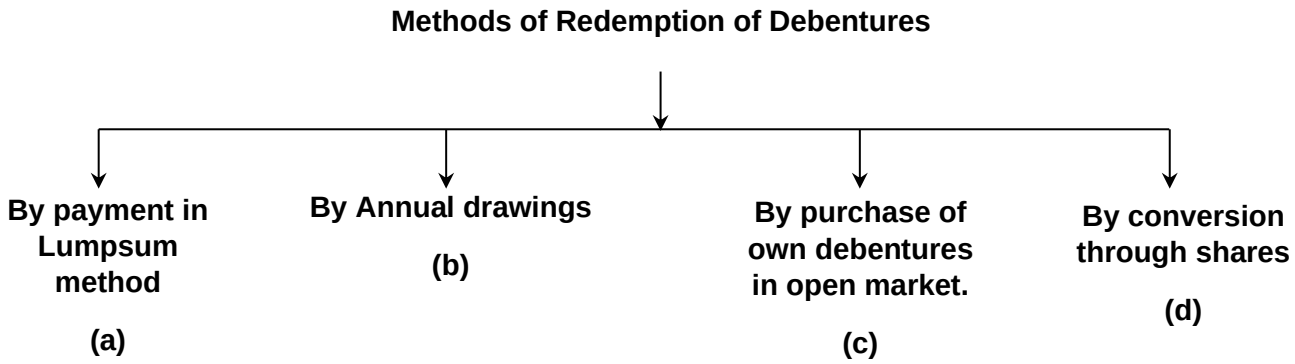
<u>For cancellation of such premium:</u>

Profit & Loss account Dr.

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To Premium on Redemption of Debentures A/c

METHODS OF REDEMPTION OF DEBENTURES:



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a) BY PAYMENT IN LUMPSUM

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period.

b) BY PAYMENT IN INSTALMENTS:

Under payment in instalments method, the payment of specified portion of debenture is made in instalments at specified intervals.

c) PURCHASE OF DEBENTURES IN OPEN MARKET:

Debentures sometimes are purchased in open market. In such a case Own Debenture Account is debited and bank is credited.

Suppose a company has issued 8% debentures for Rs. 10,00,000, interest being payable on 31st March and 30th September every year. The company purchases Rs. 50,000 debentures at Rs. 96 on 1st August 20X1. This means that the company will have to pay Rs. 48,000 as principal plus Rs. 1,333 as interest for 4 months.

Entry

		Rs.	Rs.
Own Debentures (50,000 x 96/ 100)	Dr.	48,000	
Interest Account (50,000 x 8% x 4/12)	Dr.	1,333	

To Bank			49,333

It should be noted that even though Rs. 50,000 debentures have been purchased for Rs. 48,000 there is no profit. On purchase of the debentures, profit does not arise; only on sale and in this case on cancellation of debentures, profit could arise.

These debentures may be cancelled on same date. The journal entries to be passed will be the following:

		Rs.	**Rs.**
8% Debentures A/c	Dr.	50,000	
To Own Debentures A/c			48,000
To Profit on cancellation of debentures			2,000
(Cancellation of Rs. 50,000 Debentures)			

d) <u>Redemption through conversion of shares</u>:

Under Section 71 (1) of the Companies Act, 2013, a company may issue <u>debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption</u>. Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, <u>should be approved by a special resolution</u> passed at a duly convened general meeting.

1.Debentures A/C Dr

To Debenture holders A/C

2.Debenture holders A/C Dr

TO Equity share capital A/C

TO Securities premium A/C (If shares issued with premium)

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PROBLEMS FOR DISCUSSION

PROBLEM1:

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 20X1: 6% Mortgage 10,000 debentures of Rs. 100 each; Debenture Redemption Reserve (for redemption of debentures) Rs.50,000; Investments in deposits with a scheduled bank, free from any charge or lien Rs. 1,50,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is Rs. 9,00,000.

The Interest on debentures had been paid up to December 31, 20X1.

On February 28, 20X2, the investments were realised at par and the debentures were paid off at 101, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions). Ignore taxation.

(SM, ILLUSTRATION 2)

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PROBLEM 2:

The following balances appeared in the books of Paradise Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-20X1:

(i) 12 % Debentures Rs. 7,50,000

(ii) Balance of DRR Rs. 25,000

(iii) DRR Investment 1,12,500 represented by 10% Rs. 1,125 Secured Bonds of the Government of India of Rs. 100 each.

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

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

(1) Debentures Account

(2) DRR Account

(3) DRR Investment Account

(4) Bank Account

(5) Debenture Holders Account. **(SM, ILLUSTRATION 4)**

PROBLEM 3:

Sencom Limited (listed company) issued Rs. 1,50,000 5% Debentures on 30th September 20X0 on which interest is payable half yearly on 31st March and 30th September. The company has power

topurchase debentures in the open market for cancellation thereof. The following purchases were made during the year ended 31st December, 20X2 and the cancellation were made on the same date. On 31 December 20X0, investments made for the purpose of redemption were Rs. 22,500.
1st March 20X2 - Rs. 25,000 nominal value purchased for Rs. 24,725 ex-interest, 1st September 20X2 - Rs. 20,000 nominal- value purchased for Rs. 20,125 cum-interest.You are required to draw up the following accounts up to the date of cancellation:
(i) Debentures Account; and
(ii) Own Debenture (Investment) Account.
Ignore taxation. **(SM, ILLUSTRATION 3)**

PROBLEM 4:

On January 1, Rama Ltd. (listed company), had 500 Debentures of Rs. 100 each outstanding in its books carrying interest at 6% per annum. In accordance with the regulatory requirements, the directors of the company acquired debentures from the open market for immediate cancellation as follows:

March 1 Rs. 5,000 at face value Rs. 98.00 (cum interest)
Aug. 1 Rs. 10,000 at face value Rs. 100.25 (cum interest)
Dec. 15 Rs. 2,500 at face value Rs. 98.50 (ex-interest)

Debenture interest is payable half-yearly, on 30th June and 31st Dec.
Show ledger accounts of Debentures and Debenture interest for the full year by splitting into first and second half years, ignoring income-tax. **(SM, ILLUSTRATION 1)**

PROBLEM 5:

XYZ Ltd. has issued 1,000, 12% convertible debentures of Rs. 100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of Rs. 10 each at a price of Rs. 20 per share and balance in cash. Debenture holders amounting Rs. 20,000 opted to get their debentures converted into equity shares as per terms of the issue. You are required to calculate the number of shares issued and cash paid for redemption of Rs. 20,000 debenture holders. **(RTP-NOV 2020-8)**

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PROBLEM 6:

The Balance Sheet of Convertible Limited (unlisted company other than AIFI, Banking company, NBFC and HFC), as at 31st March, 20X1, stood as follows:

Particulars	Note No	Rs.
Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	**1**	50,00,000
(b) Reserves and Surplus	**2**	1,10,00,000
(2) Non-current liabilities		
(a) Long term borrowings	**3**	1,65,00,000
(3) Current Liabilities		
(a) Other current liabilities		1,25,00,000
Total		**4,50,00,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	**4**	1,60,00,000
(b) Non-current investment		15,00,000
(2) Current assets		
(a) Cash and cash equivalents		75,00,000
(b) Other current assets		2,00,00,000
		4,50,00,000

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Notes to Accounts:

			Rs.
1.	**Share Capital**		
	5,00,000 shares of Rs. 10 each fully paid		50,00,000
2.	**Reserve and Surplus**		
	General Reserve	90,00,000	
	Profit & Loss Account	10,00,000	
	Debenture redemption reserve	10,00,000	1,10,00,000

3.	**Long term borrowings**		
	13.5% convertible Debentures (1,00,000 debentures of Rs. 100 each)		1,00,00,000
	Other loans		65,00,000
			1,65,00,000
4.	**Non-current investments**		
	Debenture redemption reserve investments		15,00,000

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

Assuming that:

(i) Except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercisedthe option for maximum conversion.

(ii) the investments were realised at par on sale; and

(iii) All the transactions are put through, without any lag, on 1st July, 20X1.

Redraft the balance sheet of the company as on 1st July, 20X1 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the necessary cash payment. **(SM, ILLUSTRATION 6)**

PROBLEM 7:

Jeet Limited (listed company) recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued - 1,00,000; face value and issue price- Rs. 100 per debenture.

(b) Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue i.e 31.10.2020.

(c) Date of closure of subscription lists - 1.5.2020, date of allotment- 1.6.2020, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of

conversion- 60 (Face Value 10).

(d) Underwriting Commission- 2%.

(e) Number of debentures applied for - 75,000.

(f) Interest payable on debentures half-yearly on 30th September and 31st March.

(g) Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2021 (including cash and bank entries). **(RTP-NOV 2021-8)**

TEST YOUR KNOWLEDGE

THEORETICAL QUESTIONS:

Question 1

What is meant by redemption of debentures? Explain.

Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period.

Redeemable debentures may be **redeemed**:

- After a **fixed number** of years; or
- Any time after a **certain number of years** has elapsed since their issue; or
- On giving a **specified notice**; or
- By **annual drawing**.

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Question 2

Write short note on Debenture Redemption Reserve?

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

MCQ:

1) Which of the following statements is true?

(a) A debenture holder is an owner of the company.

(b) A debenture holder can get his money back only on the liquidation of the company.

(c) A debenture issued at a discount can be redeemed at a premium.

2) Which of the following statements is false?

(a) Debentures can be redeemed by payment in lump sum at the end of a specified period.

(b) Debentures cannot be redeemed during the life time of the company.

(c) Debentures can be redeemed by payments in annual instalments.

3) For debentures issued by unlisted companies (other than AIFIs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:

(a) 25% of the value of debentures issued through public issue.

(b) 10% of the value of debentures issued through public issue.

(c) 5% of the value of debentures issued through public issue.

4) At the time of cancellation of own debentures, the account credited will be

(a) Debentures account.

(b) Own debentures account.

(c) Bank account.

5) A company has issued 6% debentures for Rs. 10,00,000, interest being payable on 31st March and 30th September. The company purchases Rs. 10,000 debentures at Rs. 96 (ex-interest) on 1st August 20X1. These debentures were cancelled on same date. The amount of Profit/loss on cancellation of debentures will be

(a) Profit of Rs. 600.

(b) Profit of Rs. 400.

(c) Loss of Rs. 400

1. C	**2. B**	**3. B**	**4. B**	**5. B**

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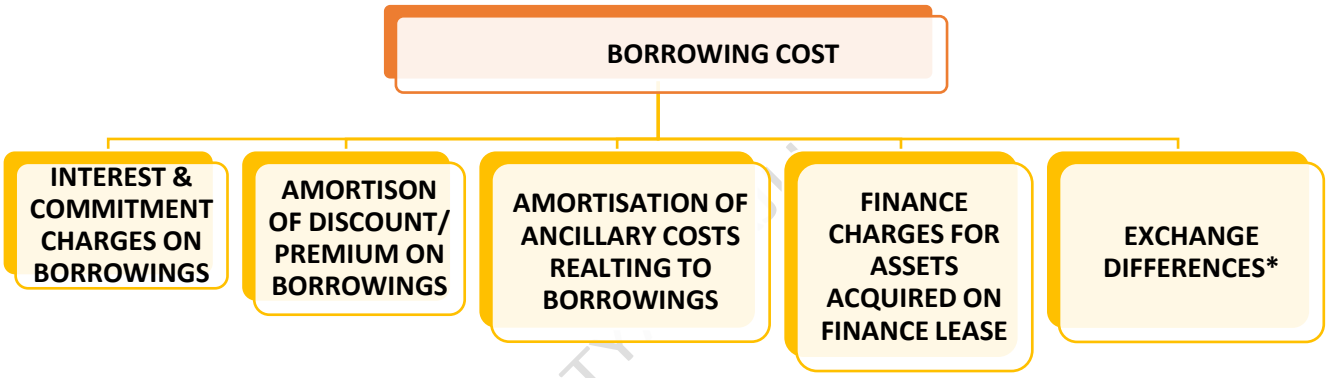
14.AS-16-BORROWING COST

Objective

The objective of this Standard is to prescribe the accounting treatment for borrowing costs.

Definitions:

1 Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds



***To that extent regarded as adjustment to Borrowing cost**

1. **Exchange Differences on Foreign Currency Borrowings:**
   - **a)** Exchange differences arising from foreign currency borrowing is considered as borrowing costs when those exchange differences which arise on the amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings.
   - **b)** The amount of exchange difference not exceeding the difference between interest on local currency borrowings and interest on foreign currency borrowings is considered as borrowings cost to be accounted for under this Standard and the remaining exchange difference, if any, is accounted for under AS 11, 'The Effect of Changes in Foreign Exchange Rates.
   - **c)** For this purpose, the interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

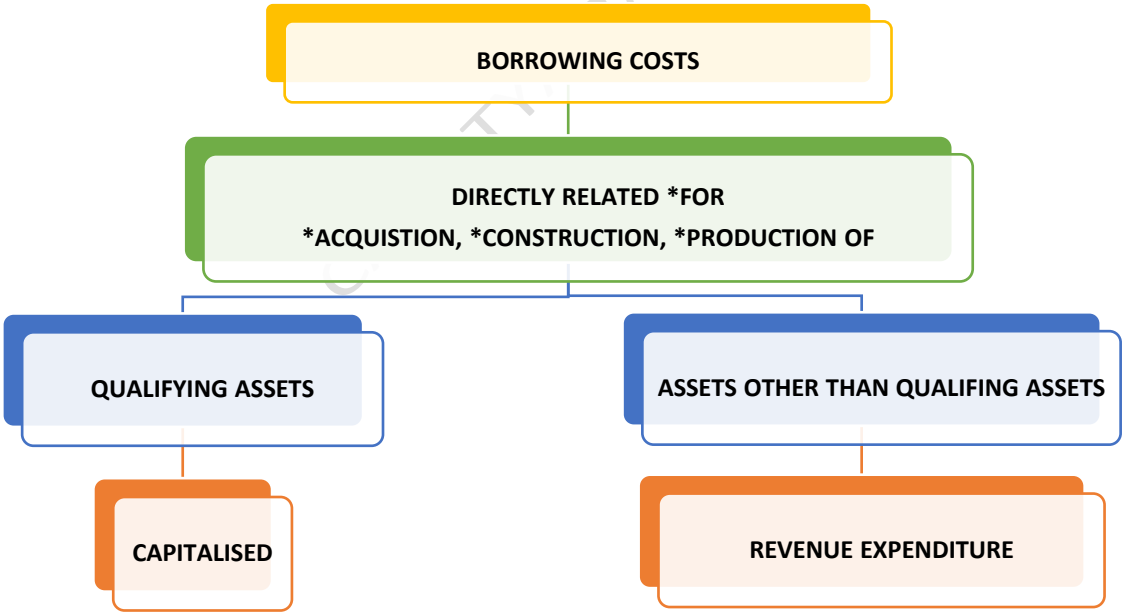
2. **Qualifying asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Examples of qualifying assets are manufacturing plants, power generation facilities, investment properties and inventories that require a substantial period of time to bring them to a saleable condition.

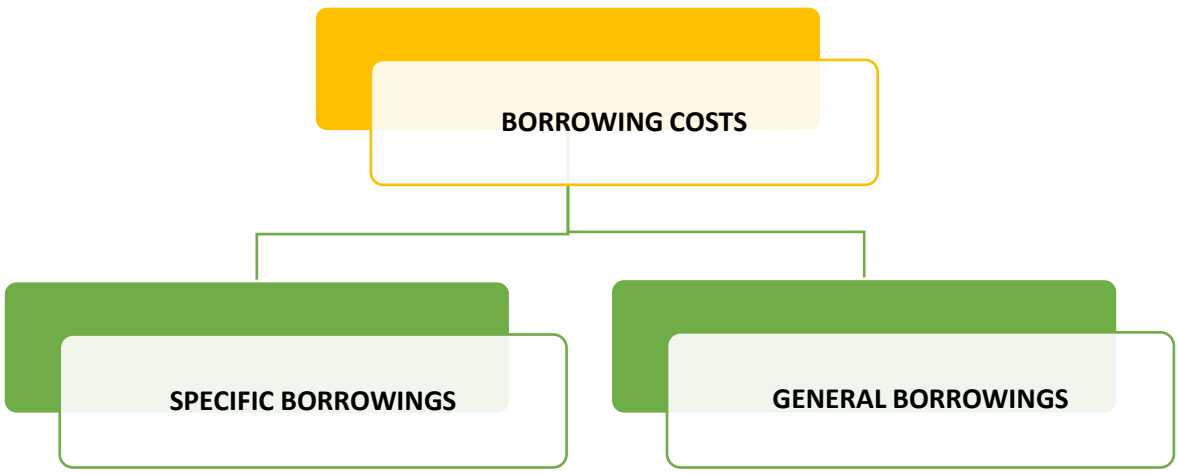
Clarification: substantial period of time primarily depends on the facts and circumstances of each case. It further states that, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.

Scope: This Standard does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability.

Recognition: 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.



TYPES OF BORROWING COST:



Specific borrowings:

1. When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.
2. 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 that period less any income on the temporary investment of those borrowings.

General borrowings:

1. Funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset.

2. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

3. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

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Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount:

When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Accounting Standards. Ie AS-28.

Commencement of Capitalisation:

The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:

1. Expenditure for the acquisition, construction or production of a qualifying asset is being incurred,

2. Borrowing costs are being incurred&

3. Activities that are necessary to prepare the asset for its intended use or sale are in progress.

Suspension of Capitalisation:

1. Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.

2. **EXCEPTIONS:**
   a. Capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out.
   b. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

   Example:
   i. capitalisation continues during the extended period needed for inventories to mature.
   ii. The extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalisation:

1. Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
2. 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.
3. 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.

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Disclosure:

The financial statements should disclose:

1. The accounting policy adopted for borrowing costs; and
2. The amount of borrowing costs capitalised during the period

PROBLEMS FOR DISCUSSION

PROBLEM 1:

PRM Ltd. obtained a loan from a bank for Rs. 50 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	**Amount (**Rs. **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 Rs. 18 lakhs. Show the treatment of interest. **(SM –ILLUSTRATION -1)**

PROBLEM 2:

X Ltd. began construction of a new building on 1st January, 20X1. It obtained Rs. 1 lakh special loan to finance the construction of the building on 1st January, 20X1 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

AMOUNT	**RATE OF INTEREST**
Rs.5,00,000	11%
Rs. 9,00,000	13%

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

		Rs.
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. **(SM –ILLUSTRATION -2)**

PROBLEM 3:

The company has obtained Institutional Term Loan of Rs. 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to Rs. 406 lakhs, Rs. 58 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of Rs. 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of Rs. 580 lakhs. **(SM –ILLUSTRATION -3)**

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PROBLEM 4:

Take Ltd. has borrowed Rs. 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 Rs. 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 Rs. 4 lakhs and add it to the cost of investments. Comment.

(SM –ILLUSTRATION -4)

PROBLEM 5:

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

(i) Construction of sea link across two cities:	
(work was held up totally for a month during the year due to high water levels	Rs. 25 crores
(ii) Purchase of equipment and machineries	Rs. 3 crores
(iii) Working capital	Rs. 2 crores
(iv) Purchase of vehicles	Rs. 50,00,000
(v) Advance for tools/cranes etc.	Rs. 50,00,000
(vi) Purchase of technical know-how	Rs. 1 crore
(vii)Total interest charged by the bank for the year ending 31st March, 20X2	Rs. 80,00,000

Show the treatment of interest by Amazing Construction Ltd. **(SM PRACTICAL PROBLEM-12)**

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PROBLEM 6:

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 Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31 st March, 2021 amounted to Rs. 25 lakhs. the company wants to treat Rs. 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. **(RTP-NOV-2021-20)**

PROBLEM 7:

Vital Limited borrowed an amount of `150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized ` 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund out of `150 crores, an income of ` 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard. **(RTP-NOV-2020-20)**

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15.AS-1 DISCLOSURE OF ACCOUNTING POLICIES

INTRODUCTION:

1. Irrespective of extent of standardization, diversity in accounting policies is unavoidable for two reasons.

A) First, accounting standards cannot and do not cover all possible areas of accounting and enterprises have the freedom of adopting any reasonable accounting policy in areas not covered by a standard.

B) Second, since enterprises operate in diverse situations, it is impossible to develop a single set of policies applicable to all enterprises for all time.

2. The accounting standards therefore permit more than one policy even in areas covered by it. The qualitative characteristic of comparability of financial statements therefore suffers due to diversity of accounting policies. For these reasons, accounting standard 1 requires enterprises to disclose significant accounting policies actually adopted by them in preparation of their financial statements. Such disclosures allow the users of financial statements to take the differences in accounting policies into consideration and to make necessary adjustments in their analysis of such statements.
3. The standard also requires disclosure of changes in accounting policies such that the users can compare financial statements of same enterprise for different accounting periods.

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DEFINITION OF ACCOUNTING POLICIES:

Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

Areas in which Different Accounting Policies are Encountered:

(a) Valuation of inventories

(b) Treatment of expenditure during construction

(c) Conversion or translation of foreign currency items

(d) Treatment of contingent liabilities

(f) Valuation of investments

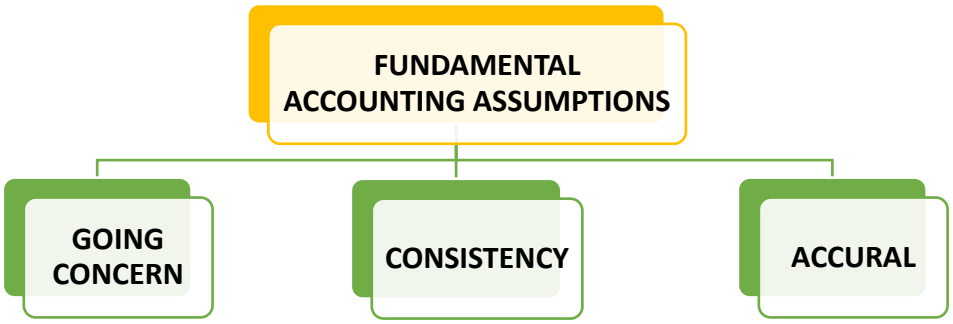
(g) Treatment of retirement benefits

(h) Recognition of profit on long-term contracts

(i) Valuation of PPE

(j)Methods of Cash flow statement to represent operating activities

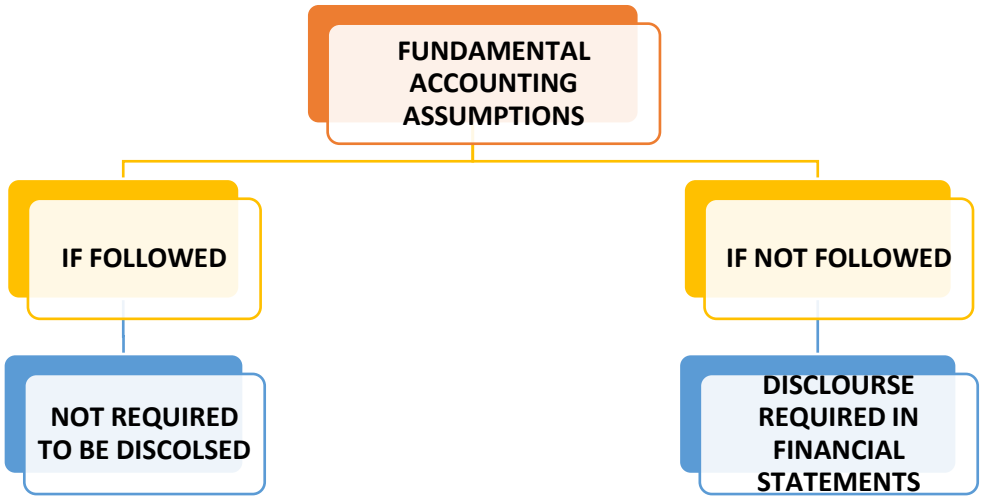
Fundamental Accounting Assumptions:



a) These are assumptions, i.e., the users of financial statements believe that the same has been considered while preparing the financial statements. That is why, as long as financial statements are prepared in accordance with these assumptions, no separate disclosure in financial statements would be necessary.

b) If nothing has been written about the fundamental accounting assumption in the financial statements, then it is assumed that they have already been followed in their preparation of financial statements. However, if any of the above-mentioned fundamental accounting assumption is not followed then this fact should be specifically disclosed.

c) **Going Concern:** Financial statements are normally prepared on the assumption that an enterprise will continue in operation in the foreseeable future and neither there is an intention, nor there is a need to materially curtail the scale of operations. If any financial statement is prepared on a different basis, e.g. when assets of an enterprise are stated at net realisable values in its financial statements, the basis used should be disclosed.



d) **Accrual Basis:** According to AS 1, 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. Further Section 128(1) of the Companies Act,

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2013 makes it mandatory for companies to maintain accounts on accrual basis only. It is not necessary to expressly state that accrual basis of accounting has been followed in preparation of a financial statement. In case, any income/ expense is recognised on cash basis, the fact should be stated.

e) Consistency: It is assumed that accounting policies are consistent from one period to another. The consistency improves comparability of financial statements through time. According to Accounting Standards, an accounting policy can be changed if the change is required

(i) by a statute or

(ii) by an Accounting Standard or

(iii) for more appropriate presentation of financial statements.

Considerations in the Selection of Accounting Policies:

1) The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent 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 on that date.

2) For this purpose, the major considerations governing the selection and application of accounting policies are:

a) Prudence

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.

EXAMPLE:

1. The most common example of exercise of prudence in selection of accounting policy is the policy of valuing inventory at lower of cost and net realisable value.
2. Suppose a company is facing a damage suit. No provision for damages should be recognised by a charge against profit, unless the probability of losing the suit is more than the probability of not losing it.

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b) Substance over Form

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

EXAMPLE:

1. In case of Hire purchase, Hire purchaser have right to record asset in his books of accounts as per substance of the transaction even though, he does not have any legal ownership right.
2. In case of Finance lease, as per AS-19 Lessee have right to record asset in his books of accounts even though, he does not have any legal ownership right.

c) Materiality

Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements. Materiality is not necessarily a function of size; it is the information content i.e. the financial item which is important.

EXAMPLE:

A penalty of Rs. 50,000 paid for breach of law by a company can seem to be a relatively small amount for a company incurring crores of rupees in a year, yet is a material item because of the information it conveys. The materiality should, therefore, be judged on a case-to-case basis. If an item is material, it should be shown separately instead of clubbing it with other items. Therefore, it is not appropriate to club the penalties paid with legal charges.

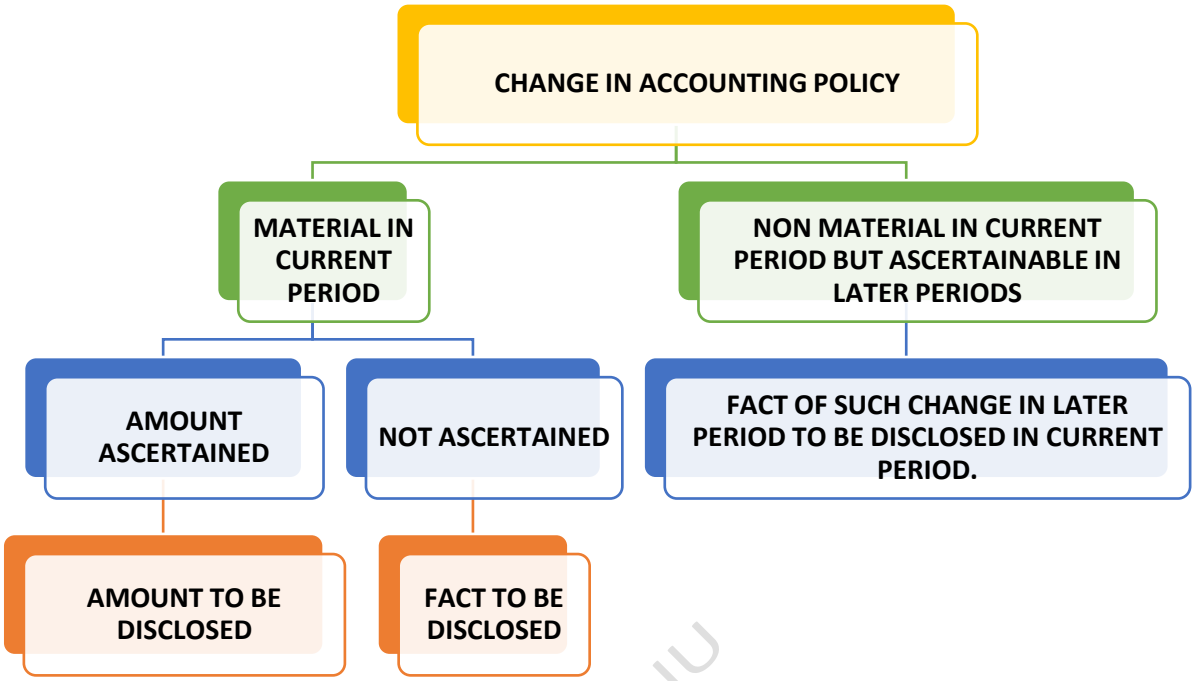
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Manner of disclosure:

1) All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed in one place.

2) 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 a later period should be disclosed.

3) 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.



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PROBLEMS FOR DISCUSSION

PROBLEM 1

In the books of M/s Prashant Ltd., closing inventory as on 31.03.20X2 amounts to Rs. 1,63,000 (on the basis of FIFO method). The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to Rs. 1,95,000. Discuss disclosure requirement of change in accounting policy as per AS-1. **(Illustration-1-SM)**

Problem2

Jagannath Ltd. had made a rights issue of shares in 20X2. 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, 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 Rs. 10 crores. The board in consultation with the managing director, decided on the following:

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

(ii) 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.

(iii) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being Rs. 10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 20X1-20X2. **(Illustration 2-SM)**

PROBLEM3

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

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in the profit and loss accounts. State whether the treatment done by the Company is correct or not.
(Illustration 3-SM)

PROBLEM 4:

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. (**MAY 2020 RTP-16(b))**

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PROBLEM 5:

ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2019.

The company wants to provide during the year ending 31.3.2020 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?
(RTP MAY 2020- 16(a))

PROBLEM 6:

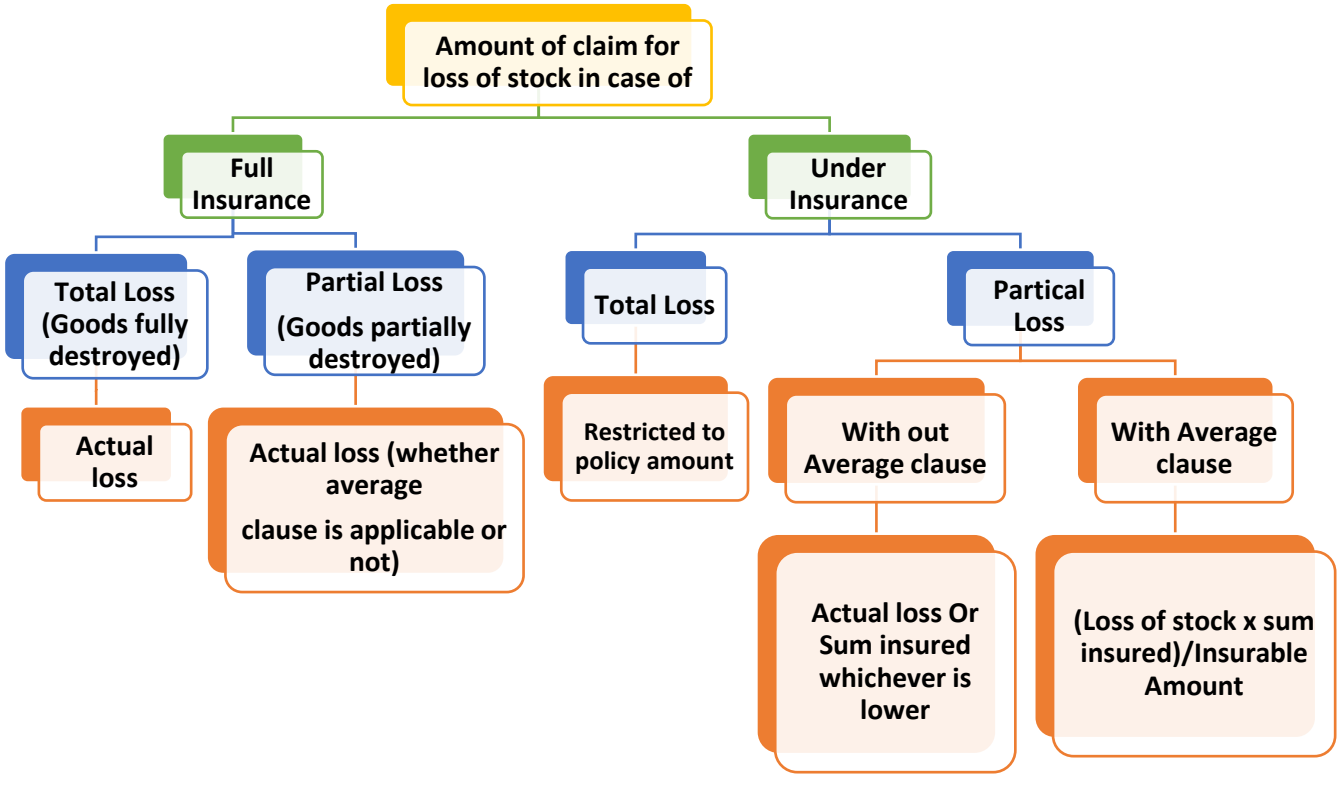
A Ltd. has sold its building for ` 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ` 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment? **(PRACTICAL QUESTION 1 – SM-ADVANCED ACCOUNTING)**

16.INSURANCE CLAIMS FOR LOSS OF STOCK AND LOSS OF PROFITS

INTRODUCTION:

1. General Insurance being a contract of indemnity, the claim for loss is restricted to the actual loss of assets.
2. Business enterprises get insured against the loss of stock on the happening of certain events such as fire, flood, theft, earthquake etc.
3. Sometimes an enterprise also gets itself insured against consequential loss of profit due to decreased turnover, increased expenses etc. f loss consequential to the loss of stock is also insured, the policy is known as loss of profit or consequential loss policy.
4. Insurance claim can be studied under two parts as under:-
   - Claim for loss of stock
   - Claim for loss of profit

CLAIM FOR LOSS OF STOCK:



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1. **Total Loss:**
   - **a)** If the goods are totally destroyed, the amount of claim is equal to the actual loss, provided the goods are fully insured.
   - **b)** However, in case of under insurance (i.e. insurable value of stock insured is more than the sum insured), the amount of claim is restricted to the policy amount.
2. **Partial Loss:**
   - **a)** If the goods are partially destroyed, the amount of claim is equal to the actual loss provided the goods are fully insured.
   - **b)** However, in case of under insurance, the amount of claim will depend upon the nature of insurance policy as follows:
     - i. **Without Average clause**: Claim is equal to the lower of actual loss or the sum insured.
     - ii. **With Average Clause**: Amount of claim for loss of stock is proportionately reduced, considering the ratio of policy amount (i.e. insured amount) to the value of stock as on the date of fire (i.e. insurable amount) as shown below:
       Amount of claim = Loss of stock X sum insured/insurable amount(Total Cost)

NOTE: One should note that the average clause applies only where the insured value is less than the total cost and not when goods are fully insured.

(i) Where the stock records are maintained and such records are not destroyed by fire, the value of the stock as at the date of the fire can be easily arrived at.

(ii) Where either the stock records are not available or where they are destroyed by the fire, the value of stock at the date of the fire has to be estimated. The usual method of arriving at this value is to build up a Trading Account as from the date of last accounting year. After allowing for the usual gross profit, the figure of closing stock on the date of the fire can be ascertained as the balancing item.

(iii) Where books of account are destroyed, the task of building up the Trading Account becomes difficult. In that case information is obtained from the customers and suppliers have to be circularised to ascertain the amount of sales and purchases.

CLACULATION OF LOSS OF STOCK:

PARTICULARS	AMOUNT
STOCK AS ON DATE OF FIRE	XXX
LESS: SALVAGED STAOCK	XXX
ADD: FIRE FIGHTING EXPENSES	XXX
TOTAL LOSS OF STOCK	XXX

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(iv) CLAIM FOR LOSS OF PROFIT:

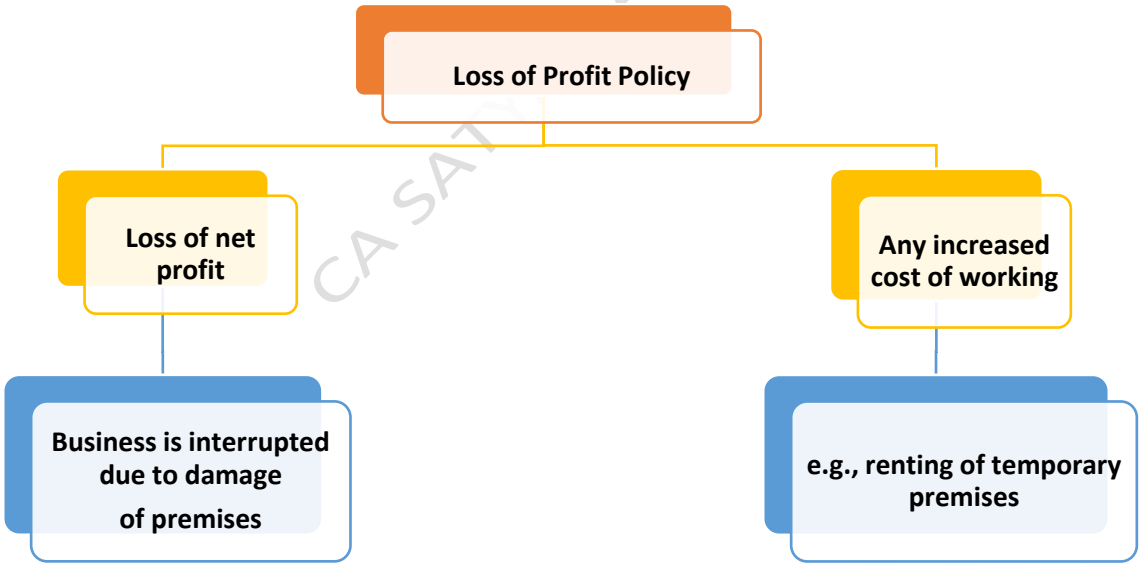
a) When a fire occurs, apart from the direct loss on account of stock or other assets destroyed, there is also a consequential loss because, for some time, the business is disorganized or has to be discontinued, and during that period, the standing expenses of the business like rent, salaries etc. continue.

b) Moreover, there is loss of profits which the business would have earned during the period. This loss can be insured against by a "Loss of Profit" or "Consequential Loss" policy; there must be a separate policy in respect of the consequential loss but claim will be admitted in respect of the policy only when the claim on account of fire is also admitted under other policies.

c) The Loss of Profit Policy normally covers the following items:

i. Loss of net profit

ii. Any increased cost of working.



IMPORTANT TERMS

Claim for Loss of Profit	The Loss of Profit Policy normally covers the following items: (1) Loss of net profit, and (2) Any increased cost of working
Gross Profit	Net profit +Insured Standing charges **OR** Insured Standing charges – [Net Trading Loss (If any) X Insured Standing charges/All standing charges of business]

Net Profit	The net trading profit (exclusive of all capital receipts and accretion and all outlay properly chargeable to capital) resulting from the business of the Insured at the premises after due provision has been made for all standing and other charges including depreciation.
Insurable Standing Charges	Interest on Debentures, Mortgage Loans and Bank Overdrafts, Rent, Rates and Taxes (other than taxes which form part of net profit) Salaries of Permanent Staff and Wages to Skilled Employees, Boarding and Lodging of resident Directors and/or Manager, Directors' Fees, Unspecified Standing Charges.
Rate of Gross Profit	The rate of Gross Profit earned on turnover during the financial year immediately before the date of damage plus / minus adjustment for current year changes in price level.
Annual Turnover	The turnover during the twelve months immediately preceding to the date of damage.
Standard Turnover	The turnover of the period in corresponding previous year from the year in which damage occurred, that corresponds with the Indemnity Period.
Indemnity Period	The period beginning with the occurrence of the damage and ending not later than twelve months. Thus, it is a period during which business is disturbed due to fire and it is not greater than 12 months.
Adjusted Annual Turnover	Annual Turnover adjusted with (+/-) Trend
Actual Turnover	Turnover during dislocation / indemnity period
Adjusted Standard Turnover	Standard Turnover (+/-) Trend (if any) which would be sales in the indemnity period had there been no fire.
Fire Fighting Expenses	Expenses incurred to avoid the damages to the business due to fire. For Example: Fire Brigade Expenses / Water Tankers' Charges
Trend	It is an indication of Sales pattern of an organization over a specific time period. It will help in estimation of future expected sales.

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COMPUTATION OF CLAIM IN CASE OF LOSS OF PROFITS:

STEP1: CALCULATION OF RATE OF GROSS PROFIT

GP Rate applicable for the year =	GP Rate of last Financial Year +/- Adjustment for changes in purchase and sale prices in the year of fire.

STEP2: CALCULATION OF SHORT SLAES

PARTICULARS	AMOUNT
Standard turnover	**XXXX**
+/-Increase/decrease in trend	**XXXX**
Adjusted standard turnover	**XXXX**
- Actual turnover	**XXXX**
SHORT SLAES	**XXXX**

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STEP3: CALCULATION OF GP% ON SHORT SLAES

G.P on short sales =	Short sales *GP %

STEP4: CALCULATION OF G.P ON ADJUSTED ANNUAL TURNOVER (G.P ON AAT)

PARTICULARS	AMOUNT
Annual turnover	XXXX
+/- Increase/decrease in trend	XXXX
Adjusted annual turnover	XXXX
G.P ON AAT=	**AAT * G.P %**

STEP5: CALCULATION OF CLAIM RELATED TO INCREASED COST OF WORKING

Least of the following:

a) Actual amount incurred i.e. increased cost of working

b) b) Increased Cost of Working X $\frac{\text{GP on Adjusted Annual Turnover}}{\text{(GP on Adjusted Annual Turnover) + Uninsured Standing Charges}}$

c) GP on the additional sales generated because of increased cost of working.

STEP6: CALCULATION OF GROSS CLAIM

PARTICULARS	**AMOUNT**
G.P on short sales as per step 3	XXXX
+ Claim on increased cost of working	XXXX
- Savings in Insured standing charges	XXXX
Gross claim	**XXXX**

Average Clause:

Average clause is applicable if Insurance policies provide that if the sum insured in respect of loss of profit is less than the sum produced by applying the rate of gross profit to the adjusted annual turn over.Then go to step 7,Other wise

Gross claim=Net claim

If, Average clause is applicable then

STEP7: CALCULATION OF NET CLAIM

$$\text{NET CLAIM} = \frac{\text{GROSS CLAIM x POLICY AMOUNT}}{\text{G.P ON AAT}}$$

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PROBLEMS FOR DISCUSSION

PROBLEM 1:

From the following information, ascertain the value of stock as on 31st March, 20X2:

	Rs.
Stock as on 01-04-20X1	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100
Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

At the time of valuing stock as on 31st March, 20X1, a sum of Rs. 3,500 was written off on a particular item, which was originally purchased for Rs. 10,000 and was sold during the year for Rs. 9,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales. **(ANS: Value of Stock as on 31st March, 20X2-Rs.12,500) (SM)**

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PROBLEM 2

Mr. A prepares accounts on 30th September each year, but on 31st December, 20X1 fire destroyed the greater part of his stock. Following information was collected from his book:

	Rs.
Stock as on 1.10.20X1	29,700
Purchases from 1.10.20X1 to 31.12.20X1	75,000
Wages from 1.10.20X1 to 31.12.20X1	33,000
Sales from 1.10.20X1 to 31.12.20X1	1,40,000

The rate of gross profit is 33.33% on cost. Stock to the value of Rs. 3,000 was salvaged. Insurance policy was for Rs. 25,000 and claim was subject to average clause.

Additional information:

i Stock at the beginning was calculated at 10% less than cost.

ii A plant was installed by firm's own worker. He was paid Rs. 500, which was included in wages.

iii Purchases include the purchase of the plant for Rs. 5,000

You are required to calculate the claim for the loss of stock. **(ANS: Claim-Rs.22,541) (SM)**

PROBLEM 3:

On 20th October, 20X1, the godown and business premises of Aman Ltd. were affected by fire.

Fromthe salvaged accounting records, the following information is available:

	Rs.
Stock of goods @ 10% lower than cost as on 31st March, 20X1	2,16,000
Purchases less returns (1.4.20X1 to 20.10.20X1)	2,80,000
Sales less returns (1.4.20X1 to 20.10.20X1)	6,20,000

Additional information:

(1) Sales upto 20th October, 20X1 includes Rs. 80,000 for which goods had not been dispatched.

(2) Purchases upto 20th October, 20X1 did not include Rs. 40,000 for which purchase invoices hadnot been received from suppliers, though goods have been received in Godown.

(3) Past records show the gross profit rate of 25%.

(4) The value of goods salvaged from fire Rs. 31,000.

(5) Aman Ltd. has insured their stock for Rs. 1,00,000.

Compute the amount of claim to be lodged to the insurance company.

(ANS: CLAIM-RS.80,000) (SM)

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PROBLEM 4:

On 1st April, 20X2 the stock of Shri Ramesh was destroyed by fire but sufficient records were saved from which following particulars were ascertained:

	Rs.
Stock at cost-1st January, 20X1	73,500
Stock at cost-31st December, 20X1	79,600
Purchases-year ended 31st December,20X1	3,98,000
Sales-year ended 31st December, 20X1	4,87,000
Purchases-1-1-201X2 to 31-3-20X2	1,62,000
Sales-1-1-20X2 to 31-3-20X2	2,31,200

In valuing the stock for the Balance Sheet at 31st December, 20X1 Rs. 2,300 had been written off on certain stock which was a poor selling line having the cost Rs. 6,900. A portion of these goods were sold in March, 20X2 at loss of Rs. 250 on original cost of Rs. 3450. The remainder of this stock was now estimated to be worth its original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout the year.

The value of stock salvaged was Rs. 5,800. The policy was for Rs. 50,000 and was subject to the average clause. Work out the amount of the claim of loss by fire.

(ANS: TRADING ACCOUNT FOR 20X1- PROFIT:RS.97,400) (SM)

PROBLEM 5:

On 30th March, 20X2 fire occurred in the premises of M/s Suraj Brothers. The concern had taken an insurance policy of Rs. 60,000 which was subject to the average clause. From the books of accounts, the following particulars are available relating to the period 1st January 20X2 to 30th March 20X2.

(1) Stock as per Balance Sheet at 31st December, 20X1, Rs. 95,600.

(2) Purchases (including purchase of machinery costing Rs. 30,000) Rs. 1,70,000

(3) Wages (including wages Rs. 3,000 for installation of machinery) Rs. 50,000.

(4) Sales (including goods sold on approval basis amounting to Rs. 49,500) Rs. 2,75,000. No approval has been received in respect of 2/3rd of the goods sold on approval.

(5) The average rate of gross profit is 20% of sales.

(6) The value of the salvaged goods was Rs. 12,300.

You are required to compute the amount of the claim to be lodged to the insurance

(ANS: LOSS OF STOCK-Rs.50,300) (SM)

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PROBLEM 6:

From the following information, compute the amount of claim under loss of profit policy:

(i) Sum insured Rs. 2,00,000

(ii) Turnover, last financial year ended Dec. 31, 20X1 Rs. 12,00,000.

(iii) Gross Profit, i.e., Net profit plus insured standing charges, Rs. 2,00,000 giving a grossprofit rate of 20%.

(iv) Net profit plus all standing charges, Rs. 2,50,000 i.e., 50,000 of the standing charges arenot insured.

(v) Fire occurs on 31st March, 20X2, and affects business for 6 months.

(vi) Turnover for 12 months ended 31st March, 20X2, Rs. 11,70,000.

(viii) Turnover: 1-4-20X1 to 30-9-20X1 5,00,000

(ix)1-4-20X2 to 30-9-20X2 3,00,000

(x) Reduction in turnover 2,00,000

(xi) Sales amounting Rs. 1,60,000 generated in period 1.4.20X2 to 30.9.20X2 by incurring additional expenses of Rs. 30,000.

(xii) Saving in insured standing charges in the indemnity period Rs. 10,000.

(ANS: SHORT SALES:RS.11,70,000) (SM)

PROBLEM 7:

A fire occurred on 1st February, 20X2, in the premises of Pioneer Ltd., a retail store and business was partially disorganized upto 30th June, 20X2. The company was insured under a loss of profits forRs. 1,25,000 with a six months period indemnity.

From the following information, compute the amount of claim under the loss of profit policy assuming entire sales during interrupted period was due to additional expenses.

	Rs.
Actual turnover from 1st February to 30th June, 20X2	80,000
Turnover from 1st February to 30th June, 20X1	2,00,000
Turnover from 1st February, 20X1 to 31st January, 20X2	4,50,000
Net Profit for last financial year	70,000
Insured standing charges for last financial year	56,000
Total standing charges for last financial year	64,000
Turnover for the last financial year	4,20,000

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The company incurred additional expenses amounting to Rs. 6,700 which reduced the loss in turnover. There was also a saving during the indemnity period of Rs. 2,450 in the insured standing charges as aresult of the fire.

There had been a considerable increase in trade since the date of the last annual accounts and it hasbeen agreed that an adjustment of 15% be made in respect of the upward trend in turnover.

(ANS: SHORT SALES-RS. 1,50,000) (SM)

PROBLEM 8:

Sony Ltd.'s. Trading and profit and loss account for the year ended 31 st December, 20X1 were a follows:

Trading and Profit and Loss Account for the year ended 31.12.20X1

	Rs.		**Rs.**
To Opening stock	20,000	By Sales	10,00,000
To Purchases	6,50,000	By Closing stock	90,000
To Manufacturing expenses	1,70,000		
To Gross profit	2,50,000		
	10,90,000		**10,90,000**
To Administrative expenses	80,000	By Gross profit	2,50,000

To Selling expenses	20,000		
To Finance charges	1,00,000		
To Net profit	50,000		
	2,50,000		**2,50,000**

The company had taken out a fire policy for Rs. 3,00,000 and a loss of profits policy for Rs. 1,00,000 having an indemnity period of 6 months. A fire occurred on 1.4.20X2 at the premises and the entire stock were gutted with nil salvage value. The net quarter sales i.e. 1.4.20X2 to 30.6.20X2 was severely affected. The following are the other information:

Sales during the period	1.1.X2 to 31.3.X2	2,50,000
Purchases during the period	1.1.X2 to 31.3.X2	3,00,000
Manufacturing expenses	1.1.X2 to 31.3.X2	70,000
Sales during the period	1.4.X2 to 30.6.X2	87,500
Standing charges insured		50,000
Actual expense incurred after fire		60,000

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The general trend of the industry shows an increase of sales by 15% and decrease in GP by 5% due to increased cost.

Ascertain the claim for stock and loss of profit. **(ANS: SHORT SALES –RS. 2,12,500) (SM)**

PROBLEM 9:

On account of a fire on 15th June, 20X2 in the business house of a company, the working remained disturbed upto 15th December 20X2 as a result of which it was not possible to affect any sales. The company had taken out an insurance policy with an average clause against consequential losses for Rs. 1,40,000 and a period of 7 months has been agreed upon as indemnity period. An increase of 25% was marked in the current year's sales as compared to the last year. The company incurred an additional expenditure of Rs. 12,000 to make sales possible and made a saving of Rs. 2,000 in the insured standing charges. Compute the amount of claim admissible for the loss of profit**.**

	Rs.
Actual sales from 15th June, 20X2 to 15th Dec, 20X2	70,000
Sales from 15th June 20X1 to 15th Dec 20X1	2,40,000

Net profit for last financial year	80,000
Insured standing charges for the last financial year	70,000
Total standing charges for the last financial year	1,20,000
Turnover for the last financial year	6,00,000
Turnover for one year : 16th June 20X1 to 15th June 20X2	5,60,000

(SM -PRACTICAL QUESTION-7)

TEST YOUR KNOWLEDGE

Theoretical Questions

1. Explain the significance of 'Average Clause' in a fire insurance policy.

2. Define the following terms:
(i) Indemnity Period; (ii) Standard Turnover

MCQs

1. Goods costing Rs. 1,00,000 were insured for Rs. 50,000. Out of these goods, ¾ are destroyed by fire. The amount of claim with average clause will be

(a) Rs. 37,500.

(b) Rs. 50,000.

(c) Rs. 75,000.

2. Fire insurance claim will be limited to the

(a) actual loss suffered even though the insured value of the goods may be higher.

(b) proportion of the loss as the insured value bears to the total cost.

(c) both (a) and (b)).

3. The Loss of Profit Policy normally covers the following items:

(a) Loss of net profit and Standing charges.

(b) Any increased cost of working *e.g.,* renting of temporary premises.

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

4. A plant worth Rs. 40,000 has been insured for Rs. 30,000, the loss on account of fire is Rs. 25,000. The insurance company will bear the loss to the extent of

(a) Rs. 18,750.

(b) Rs. 25,000.

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(c) Rs. 30,000.

5. If the policy is without average clause, a claim for loss of profit will be

(a) Sum insured.

(b) Higher of actual loss and sum insured.

(c) Lower of actual loss and sum insured

6. Standard turnover is

(a) Turnover during the last 12 months immediately before damage.

(b) Turnover during that period in 12 months immediately before damage which corresponds with indemnity period.

(c) Turnover during the last accounting period immediately before damage.

7. Gross profit can be calculated as

(a) Net profit + Insured standing charges.

(b) Net profit - Insured standing charges.

(c) Net profit + standing charges.

8. The cost of salvaged stock must be

(a) Credited to trading account.

(b) Debited to salvaged stock account.

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

9. Amount of indemnity payable is

(a) Gross Profit lost – Claim for increased cost of working Capital – Saving in Insured standing Charges.

(b) Gross Profit lost– Claim for increased cost of working Capital + Saving in Insured standing Charges.

(c) Gross Profit Lost +Claim for increased cost of working Capital – Saving in Insured standing Charges.

10. Short Sales for the purposes of Loss of Profit Policy shall be:

(a) Adjusted Annual Turnover – Annual Turnover

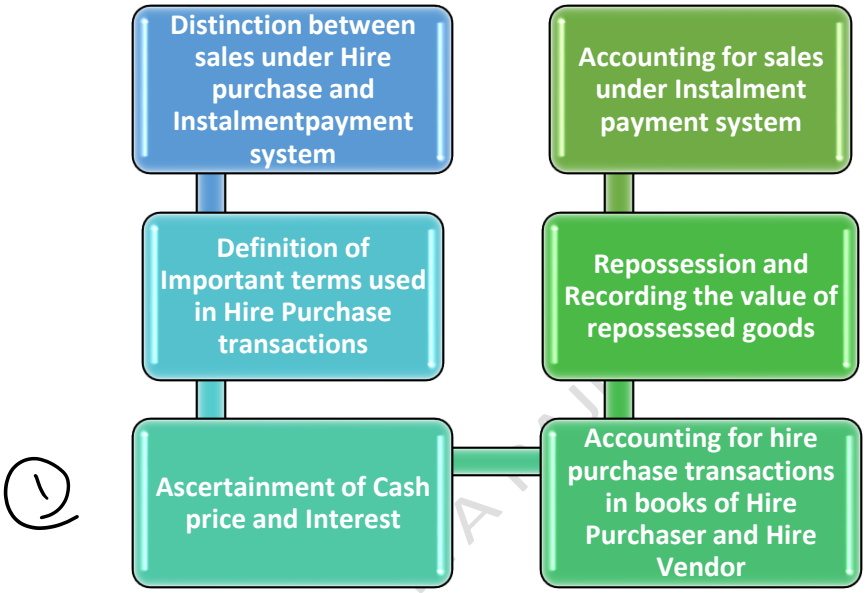
(b) Adjusted Annual Turnover – Adjusted Standard Turnover

(c) Adjusted Standard Turnover – Actual Turnover

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17.HIRE-PURCHASE AND INSTALLMENT SLAE TRANSACTIONS

OVERVIEW:



MEANING OF HIRE-PURCHASE:

Hire purchase is an agreement entered between two parties, Hire purchaser and Hire vendor, where the Hire Purchaser gets possession of the goods at the outset and can use it, while paying for it in instalments over a specified period of time. However, the ownership of the goods remains with the Hire Vendor until the hire purchaser has paid all the instalments. In case he fails to pay any of the instalments (even the last one) the hire vendor has the right to take back his goods without compensating the Hire purchaser.

SPECIAL FEATURES OF HIRE PURCHASE AGREEMENT:

1. Possession: The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.
2. Instalments: The goods are delivered by the hire vendor on the condition that a hire purchaser should pay the amount in periodical instalments.
3. Down Payment: The hire purchaser generally makes a down payment, i.e., an amount on signing the agreement.
4. Constituents of Hire purchase instalments: Each instalment consists of two elements- finance charge (interest on unpaid amount) and capital payment.

5. Ownership: The property in goods is to pass to the hire purchaser on the payment of the last instalment and exercising the option conferred upon him under the agreement.
6. Repossession: In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

TERMS USED IN HIRE PURCHASE AGREEMENTS:

1. **Hire Vendor**: Hire vendor is a person who delivers the goods along with its possession to the hire purchaser under a hire purchase agreement.
2. **Hire Purchaser**: Hire purchaser is a person who obtains the goods and rights to use the same from hire vendor under a hire purchase agreement.
3. **Cash Price**: Cash price is the amount to be paid by the buyer on outright purchase in cash.
4. **Down Payment**: Down payment is the initial payment made to the hire vendor by the hire purchaser at the time of entering into a hire purchase agreement.
5. **Hire Purchase Instalment**: Hire purchase instalment is the amount which the hire purchaser has to pay after a regular interval up to certain period as specified in the agreement to obtain the ownership of the asset purchased (on payment of the last instalment) under a hire purchase agreement. It comprises of principal amount and the interest on the unpaid amount.
6. **Hire purchase price**: It means the total sum payable by the hire purchaser to obtain the ownership of the asset purchased under hire purchase agreement. It comprises of cash price and interest on outstanding balances.

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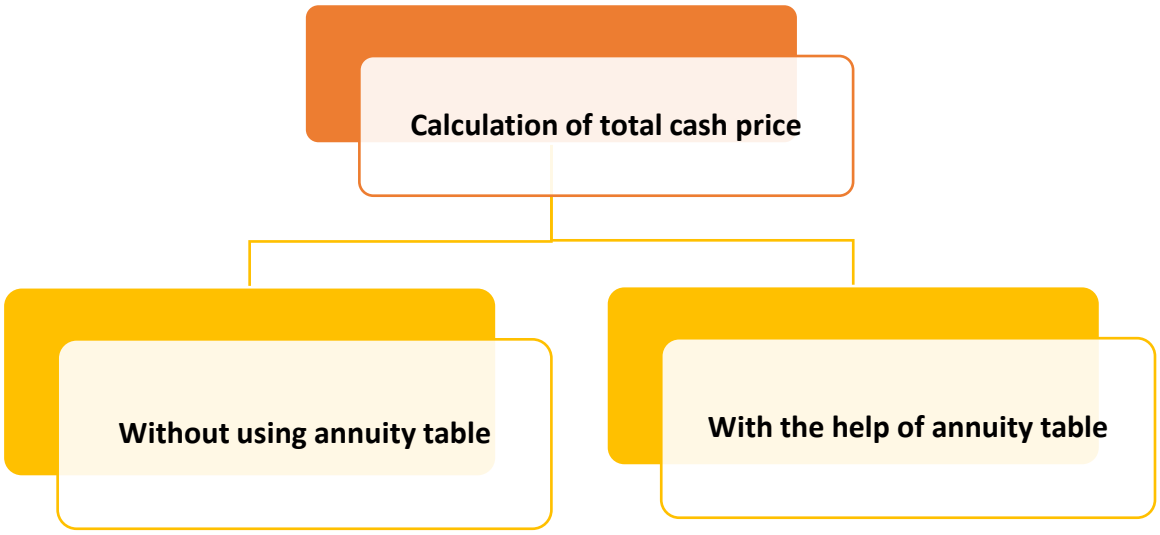
Differences between Hire Purchase and Instalment System:

1	Governing Act	It is governed by Hire Purchase Act, 1972.	It is governed by the Sale of Goods Act, 1930.
2	Nature of Contract	It is an agreement of hiring.	It is an agreement of sale.
3	Passing of Title (ownership)	The title to goods passes on last payment.	The title to goods passes immediately as in the case of usual sale.
4	Right to Return goods	The hirer may return goods without further payment except for accrued instalments.	Unless seller defaults, goods are not returnable.
5	Seller's right to repossess	The seller may take possession of the goods if hirer is in default.	The seller can sue for price if the buyer is in default. He

			cannot take possession of the goods.
6	Right of Disposal	Hirer cannot hire out sell, pledge or assign entitling transferee to retain possession as against the hire vendor.	The buyer may dispose off the goods and give good title to the bona fide purchaser.
7	Responsibility for Risk of Loss.	The hirer is not responsible for risk of loss of goods if he has taken reasonable precaution because the ownership has not yet transferred.	The buyer is responsible for risk of loss of goods because of the ownership has transferred.
8	Name of Parties involved	The parties involved are called Hire purchaser and Hire vendor.	The parties involved are called buyer and seller.
9	Component other than cash price.	Component other than Cash Price included in instalment is called Hire charges.	Component other than Cash Price included in Instalment is called Interest.

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ASCERTAINMENT OF CASH PRICE:



Calculation of Cash Price without using Annuity Table:

Step 1: Calculate the ratio between interest and the amount due with the help of the following formula:

$$\textbf{Ratio of interest and amount due} = \textbf{Rate of interest} \div (100 + \textbf{Rate of interest})$$

Step 2: Calculate the interest included in the last instalment by applying the following formula: Interest = Total amount due at the time of instalment x Ratio of interest and amount due (as calculated in step 1)

Step 3: Subtract the interest (as calculated in step 2) from this instalment to get the amount of outstanding cash price at the time of last instalment.

Step 4: Add the cash price calculated in Step 3 to the amount of instalment due at the end of the third year.

Step 5: Calculate the interest on the entire sum (cash price included in the 4th instalment + amount of 3rd instalment). Deduct this interest from the total amount due at the end of 3rd year to get the outstanding cash price at the time of 3rd instalment.

Step 6: Add the cash price calculated in step 5 to the amount of instalment due at the end of 2nd year.

Step 7: Calculate the interest on the entire sum so obtained in Step 6. Deduct this interest from the total amount due at the end of 2nd year to get the outstanding cash price at the time of 2nd instalment.

Step 8: Add the cash price calculated in Step 7 to the amount of instalment due at the end of 1st year.

Step 9: Calculate the interest on the entire sum so obtained in Step 8. Deduct this interest from the total amount due at the end of 1st year to get the outstanding cash price at the time of 1st instalment.

Step 10: Add the cash price calculated in Step 9 to the amount of down payment, if any. The sum so obtained will be the cash price.

Calculation of Cash Price with the help of Annuity Table:

Cash price = Down payment + Present value of instalments

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ASCERTAINMENT OF INTEREST:

1. When the cash price, rate of interest and the amount of instalments are given;

Total amount of interest is to be ascertained first. It is the difference between the hire purchase price (down payment + total instalments) and the cash price. To calculate the amount of interest involved in each instalment the following steps are followed:

Step 1: Deduct down payment from the cash price. Calculate the interest at the given rate on the remaining balance. This represents the amount of interest included in the first instalment.

Step 2: Deduct the interest of Step 1 from the amount of first instalment. The resultant figure is the cash price included in the first instalment.

Step 3: Deduct the cash price of the 1st instalment (Step 2) from the balance due after down payment. It represents the amount outstanding after the 1st instalment is paid.

Step 4: Calculate the interest at the given rate on the balance outstanding after the 1st instalment. Deduct this interest from the amount of the 2nd instalment to get the cash price included in the 2nd instalment.

Step 5: Deduct the cash price of the 2nd instalment (Step 4) from the balance due after the 1st instalment. It represents the amount outstanding after the 2nd instalment is paid.

Repeat the above steps till the last instalment is paid.

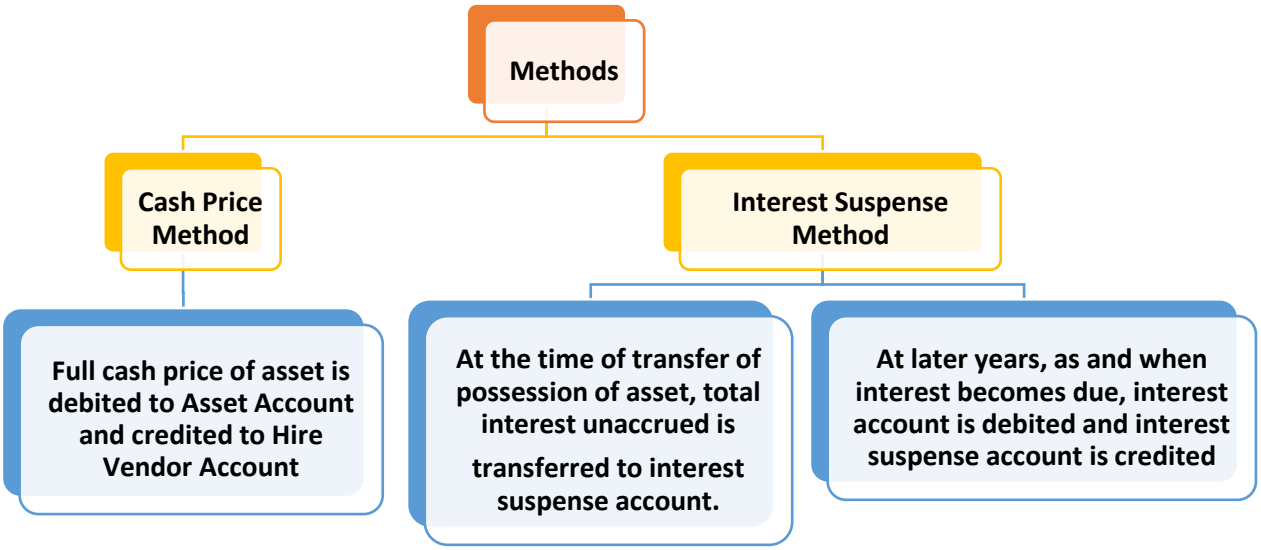
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2. When the cash price and the amount of instalments are given, but the rate of interest is not given:

When the rate of interest is not given, but the cash price and the amount of instalments are given, we have to find interest rate implicit in the transaction. The determination of the discount rate can involve trial and error and interpolation between interest rates.

ACCOUNTING FOR HIRE PURCHASE TRANSACTION:

In the Books of Hire Purchaser



Cash price method

To have proper accounting record, one should know:

(1) Date of purchase of the asset;

(2) Cash price of the asset;

(3) Hire purchase price of the asset;

(4) The amount of down payment;

(5) Number and amount of each instalment;

(6) Rate of interest;

(7) Method and rate of depreciation;

(8) Date of payment of every instalment; and

(9) Date of closing the books of account.

Journal entries:

1.	At the time of entering into the agreement	Dr. [Full cash price]
	Asset Account	
	To Hire Vendor Account	
2.	At the time of entering into the agreement	Dr. [Down payment]
	Asset Account	
	To Hire Vendor Account	
3.	When an instalment becomes due	Dr. [Interest on outstanding balance]
	Interest Account	
	To Hire Vendor Account	
4.	When an instalment is paid	Dr. [Amount of instalment]
	Hire Vendor Account	
	To Bank Account	
5.	When depreciation is charged on the asset	Dr. [Calculated on cash price]
	Depreciation Account	
	To Asset Account	

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6.	For closing interest and depreciation account	Dr.
	Profit and Loss Account	
	To Interest Account	

Disclosure in the balance sheet

Assets

Fixed Assets:

Asset (at cash price)	xxxx
Less: Depreciation	xxxx
	xxxx

Liabilities

Hire Purchase Creditors:

Balance in hire vendor's A/c	xxxx
Interest accrued not yet due	xxxxx

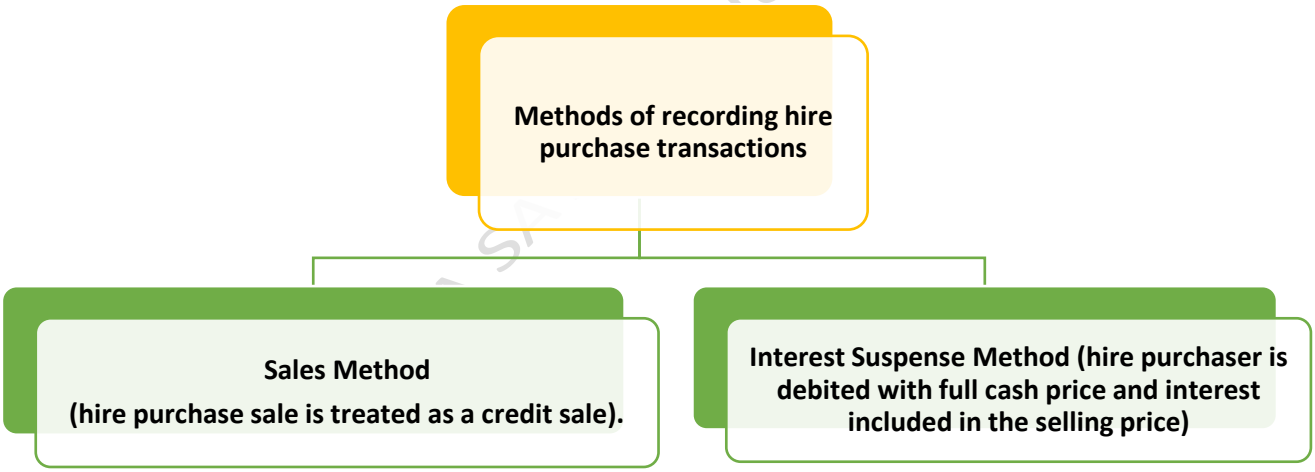
Interest suspense method

1.	*When the asset is acquired on hire purchase*	Dr. [Full cash price]
	Asset Account	
	To Hire Vendor Account	
2.	*For total interest payment*	Dr. [Total interest]
	H.P. Interest Suspense Account	
	To Hire Vendor Account	
3.	*When down payment is made*	Dr. [Down payment]
	Hire Vendor Account	
	To Bank Account	
4.	For Interest of the relevant period	Dr. [Interest of the relevant period]
	Interest Account	
	To H.P. Interest Suspense Account	
5.	When an instalment is paid	Dr.
	Hire Vendor Account	

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	To Bank Account	
6.	*When depreciation is charged on the asset*	Dr. [Calculated on cash price]
	Depreciation Account	
	To Asset Account	
7.	*For closing interest and depreciation account*	Dr.
	Profit and Loss Account	
	To Interest Account	
	To Depreciation Account	

In the books of the Hire Vendor



Sales Method: A business that sells relatively large items on hire purchase may adopt this method. Under this method, hire purchase sale is treated as a credit sale. The only exception is that the vendor agrees to accept payments in instalments and for that he charges interest.

Journal Entries in the books of Hire Vendor

It is worth noting that (i) The entire profit on sale under hire purchase agreement is credited to the Profit and Loss account of the year in which the sale has taken place; and (ii) Interest pertaining to each accounting period is credited to the Profit and Loss Account of the respective year.

Interest Suspense Method

1.	When goods are sold and delivered under hire purchase	Dr. [Full cash price]
	Hire Purchaser Account	

	To H.P. Sales Account	
2.	When the down payment is received	Dr. [Down payment]
	Bank Account	
	To Hire Purchaser Account	
3.	When an instalment becomes due	Dr. [Amount of instalment]
	Hire Purchaser Account	
	To Interest Account	
4.	When the amount of instalment is received	Dr. [Amount of instalment]
	Bank Account	
	To Hire Purchaser Account	
5.	For closing interest Account	Dr.
	Interest Account	
	To Profit and Loss Account	
6.	For closing Hire Purchase Sales Account	Dr.
	H.P. Sales Account	
	To Trading Account	

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The disclosure in balance sheet of the respective parties will be:

Balance Sheet of Hire Purchaser

Assets

Fixed assets:

Asset on Hire purchase

Less: Depreciation

Liabilities

Amount payable to Vendor

Less: Balance in Interest Suspense A/c

Balance Sheet of Vendor

Assets

Current assets:

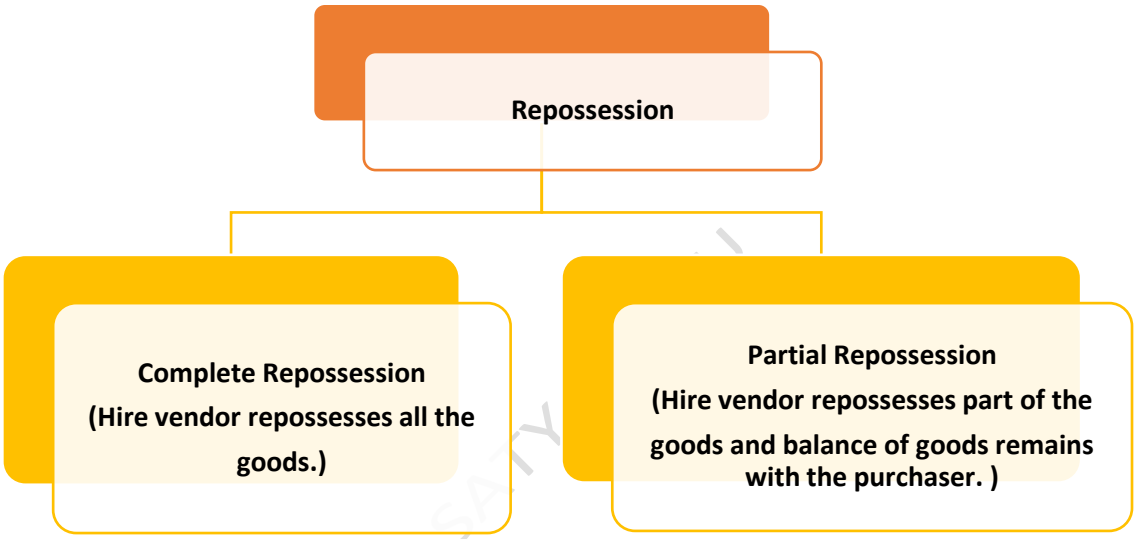
Hire purchase debtors

Less: Balance in Interest suspense A/c

Liabilities

REPOSSESSION:

In a hire purchase agreement, the hire purchaser has to pay up to the last instalment to obtain the ownership of goods. If the hire purchaser fails to pay any one or more of the instalments, the hire vendor has the right to take the asset back in its actual form without any refund of the earlier payments to the hire purchaser. This act of recovery of possession of the asset is termed as repossession.



Complete Repossession:

If hire vendor take back the whole of the asset on failure of one or more instalments by hire purchaser it is termed as complete Repossession.

1. The hire vendor closes Hire Purchaser's Account by transferring balance of Hire Purchaser Account to Goods Repossessed Account.
2. The hire purchaser closes the Hire Vendor's Account by transferring the balance of Hire Vendor Account to Hire Purchase Asset and then finding the profit and loss on repossession in Asset Account.
3. After repossession, the vendor may incur expenses on repossessed stock and may sell the same in due course of time.

Particulars	Books of hire purchaser	Books of hire vendor
Purchase/Sales	Asset A/c …Dr. To Hire Vendor A/c	Hire Purchaser A/c …Dr. To Sales A/c
Instalment	Hire Vendor A/c …Dr. To Cash A/c	Cash A/c …Dr. To Hire Purchaser A/c

Interest	Interest A/c …Dr. To Hire Vendor	Hire Purchaser A/c …Dr. To Interest A/c
Repossession	Hire Vendor A/c …Dr. To Asset A/c	Goods Repossessed A/c …Dr. To Hire Purchaser

Partial Repossession

In case of a partial repossession, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser.

1. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.
2. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.
3. The hire vendor debits the Goods Repossessed Account and credit the Hire Purchaser Account with the value as agreed upon on the repossession. Similarly, the hire purchaser debits the Hire Vendor Account and credits the Assets Account with the same amount.
4. If the repossessed value is less than the book value of the asset which is repossessed, the difference is charged to the Profit and Loss Account of the hire purchaser as 'loss on surrender'. For the remaining portion of the asset lying with the hire purchaser, the (Hire Purchaser) applies the usual rate of depreciation and shows the Asset Account at its usual written-down value.

INSTALMENT PAYMENT SYSTEM: In instalment payment system, the ownership of the goods is passed immediately to the buyer on the signing the agreement. The accounting entries under instalment payment system are similar to those passed under the hire-purchase system.

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PROBLEMS FOR DISCUSSION

PROBLEM 1

A acquired on 1st January, 20X1 a machine under a Hire-Purchase agreement which provides for 5 half-yearly instalments of Rs. 6,000 each, the first instalment being due on 1st July, 20X1. Assuming that the applicable rate of interest is 10 per cent per annum, calculate the cash value of the machine. All working should form part of the answer. **(SM – ILLUSTRATION 2)**

PROBLEM 2

On 1st April, 20X1 a manufacturing company buys on Hire-purchase system a machinery for Rs. 90,000, payable by three equal annual instalments combining principal and interest, the rate of interest was 5% per annum. Calculate the amount of cash price and interest. Assume that the present value of an annuity of one rupee for three years at 5% interest is Rs. 2.723. **(SM – ILLUSTRATION 3)**

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PROBLEM 3

Om Ltd. purchased a machine on hire purchase basis from Kumar Machinery Co. Ltd. on the following terms:

(a) Cash price Rs. 80,000

(b) Down payment at the time of signing the agreement on 1.1.20X1 Rs. 21,622.

(c) 5 annual instalments of Rs. 15,400, the first to commence at the end of twelve months from the date of down payment.

(d) Rate of interest is 10% p.a.

You are required to calculate the total interest and interest included in cash instalment.

(SM – ILLUSTRATION 4)

PROBLEM 4

Happy Valley Florists Ltd. acquired a delivery van on hire purchase on 01.04.20X1 from Ganesh Enterprises. The terms were as follows:

Particulars	Amount (Rs.)
Hire Purchase Price	180,000
Down Payment	30,000
1st instalment payable after 1 year	50,000
2nd instalment after 2 years	50,000
3rd instalment after 3 years	30,000

4th instalment after 4 years	20,000

Cash price of van Rs. 150,000 You are required to calculate Total Interest and Interest included in each instalment.

(SM – ILLUSTRATION 5)

PROBLEM 5

On January 1, 20X1 HP M/s acquired a Pick-up Van on hire purchase from FM M/s.The terms of the contract were as follows:

(a) The cash price of the van was Rs. 1,00,000.

(b) Rs. 40,000 were to be paid on signing of the contract.

(c) The balance was to be paid in annual instalments of Rs. 20,000 plus interest.

(d) Interest chargeable on the outstanding balance was 6% p.a.

(e) Depreciation at 10% p.a. is to be written-off using the straight-line method.

You are required to:

(a) Give Journal Entries and show the relevant accounts in the books of HP M/s from January 1, 20X1 to December 31, 20X3; and

(b) Show the relevant items in the Balance Sheet of the purchaser as on December 31, 20X1 to 20X3.

(SM – ILLUSTRATION 6)

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PROBLEM 6

Continuing with the information given in illustration 6, assume that the hire purchaser adopted the interest suspense method for recording his hire purchase transactions. On this basis, prepare H.P. Interest Suspense Account, Interest Account and FM M/s Accounts and Balance Sheets in the books of hire purchaser. **(SM – ILLUSTRATION 7)**

PROBLEM 7

X Ltd. purchased 3 Milk vans from Super Motors costing Rs. 75,000 each on hire purchase system. Payment was to be made: Rs. 45,000 down and the remainder in 3 equal instalments together with interest @ 9%. X Ltd. writes off depreciation @ 20% on the diminishing balance. It paid the instalment at the end of the 1st year but could not pay the next. Super Motor agreed to leave one Milk van with the purchaser, adjusting the value of the other two Milk vans against the amount due. The Milk vans were valued on the basis of 30% depreciation annually on written down value basis. Also, X Ltd. settled the seller's dues.

You are required to give necessary journal entries and Milk vans Account and Super Motors Account in the books of X Ltd for the first two years. **(SM – ILLUSTRATION 8)**

PROBLEM 8

A firm acquired two tractors under hire purchase agreements from HP Co., details of which were as follows:

Date of Purchase	**Tractor A** **1st April, 20X1(**Rs.)	**Tractor B** **1st Oct., 20X1(**Rs.**)**
Cash price	14,000	19,000

Both agreements provided for payment to be made in twenty-four monthly instalments (of Rs. 600 each for Tractor A and Rs. 800 each for Tractor B), commencing on the last day of the month following purchase, all instalments being paid on due dates.

On 30th June, 20X2, Tractor B was completely destroyed by fire. In full settlement, on 10th July, 20X2 an insurance company paid Rs. 15,000 under a comprehensive policy. Any balance on the hire purchase company's account in respect of these transactions was to be written off.

The firm prepared accounts annually to 31st December and provided depreciation on tractors on a straight-line basis at a rate of 20 per cent per annum rounded off to nearest ten rupees, apportioned as from the date of purchase and up to the date of disposal.

You are required to record these transactions in the following accounts, carrying down the balances on 31st December, 20X1 and 31st December, 20X2:

(a) Tractors on hire purchase.

(b) Provision for depreciation of tractors.

(c) Disposal of tractors. **(SM – ILLUSTRATION 9)**

PROBLEM 9

A machinery is sold on hire purchase. The terms of payment is four annual instalments of Rs. 6,000 at the end of each year commencing from the date of agreement. Interest is charged @ 20% and is included in the annual payment of Rs. 6,000.

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Show Machinery Account and Hire Vendor Account in the books of the purchaser who defaulted in the payment of the third yearly payment whereupon the vendor re-possessed the machinery. The purchaser provides depreciation on the machinery @ 10% per annum on WDV basis. All workings should form part of your answers. **(SM – ILLUSTRATION 10)**

PROBLEM 10

X Transport Ltd. purchased from Delhi Motors 3 Tempos costing Rs. 50,000 each on the hire purchase system on 1-1-20X1. Payment was to be made Rs. 30,000 down and the remainder in 3 equal annual instalments payable on 31-12-20X1, 31-12-20X2 and 31-12-20X3 together with interest @ 9%. X Transport Ltd. write off depreciation at the rate of 20% on the diminishing balance. It paid the instalment due at the end of the first year i.e. 31-12-20X1 but could not pay the next on 31-12-20X2. Delhi Motors agreed to leave one Tempo with the purchaser on 1-1-20X3 adjusting the value of the other 2 Tempos against the amount due on 31-12-20X2 (date of repossession). The Tempos were valued based on 30% depreciation annually. Show the necessary accounts in the books of X Transport Ltd. for the years 20X1, 20X2 and 20X3.

(SM – ILLUSTRATION 11)

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PROBLEM 11

X purchased three cars from Y on hire purchase basis, the cash price of each car being Rs. 2,00,000. The hire purchaser charged depreciation @ 20% on diminishing balance method. Two cars were seized by on hire vendor when second instalment was not paid at the end of the second year. The hire vendor valued the two cars at cash price less 30% depreciation charged under diminishing balance method. The hire vendor spent Rs. 10,000 on repairs of the cars and then sold them for a total amount of Rs. 1,70,000.

You are required to compute:

(i) Agreed value of two cars taken back by the hire vendor and book value of car left with the hire purchaser and

(ii) Profit or loss to hire purchaser on two cars taken back by the hire vendor

(NOV 2020-RTP -11)

TEST YOUR KNOWLEDGE

Theoretical Questions

1. What is meant by Hire purchase transactions? What are the specific features of hire purchase transactions?
2. What are the differences between Hire Purchase and Instalment System?
3. Describe in brief the methods of recording Hire purchase transactions in the books of Hire vendor.
4. Describe in brief the methods of recording Hire purchase transactions in the books of Hire purchaser.
5. What is meant by Repossession. What is the treatment in the books of Hire Purchaser?

MCQs

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1. The amount paid at the time of entering the hire-purchase transaction for the goods purchased is known as

(a) Cash price
(b) Down payment
(c) First instalment

2. Total interest on hire purchased goods is the difference between

(a) Hire purchase price and cash price
(b) Hire purchase price and down payment
(c) Cash price and first instalment

3. Depreciation on hire purchased asset is claimed by

(a) Hire vendor
(b) Hire purchaser
(c) Either the hire vendor or the hire purchaser as per the agreement between them

4. Under instalment payment system, ownership of goods

(a) is transferred at the time of payment of last instalment
(b) is not transferred
(c) is transferred at the time of signing the contract.

5. The hire purchaser records the asset at its

(a) Hire purchase price
(b) Amount paid to the vendor till date
(c) Cash price

6. The ownership of goods purchased under hire purchase is transferred only when

(a) Down payment is paid
(b) Outstanding balance is paid in full.
(c) Cash price and first instalment is paid

7. Hire purchase price is
(a) Cash price
(b) Interest on unpaid instalments.
(c) Both (a) and (b).

8. Which method of recording Hire purchase transactions is not used in Hire vendor's books?

(a) Sales method
(b) Interest suspense method.
(c) Cash price method.

9. The balance of the Interest Suspense Account is shown in the Balance Sheet of vendor as

(a) Addition to Hire Purchase Debtors.
(b) Deduction from balance of Hire Purchase Debtors.
(c) Deduction from balance of Hire Purchase Creditors.

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18.DEPARTMENTAL ACCOUNTING

INTRODUCTION:

If a business consists of several departments, for carrying on separate functions, its management is usually interested in finding out the working results of each department to ascertain their relative efficiencies. This can be made possible only if departmental accounts are prepared. Departmental accounts are of great help and assistance to the managements as they provide necessary information for controlling the business more intelligently and effectively.

ADVANTAGES OF DEPARTMENTAL ACCOUNTING:

1. **Evaluation of performance**: The performance of each department can be evaluated separately on the basis of trading results.

2. **Growth potential of each department**: The growth potential of a department as compared to others can be evaluated.

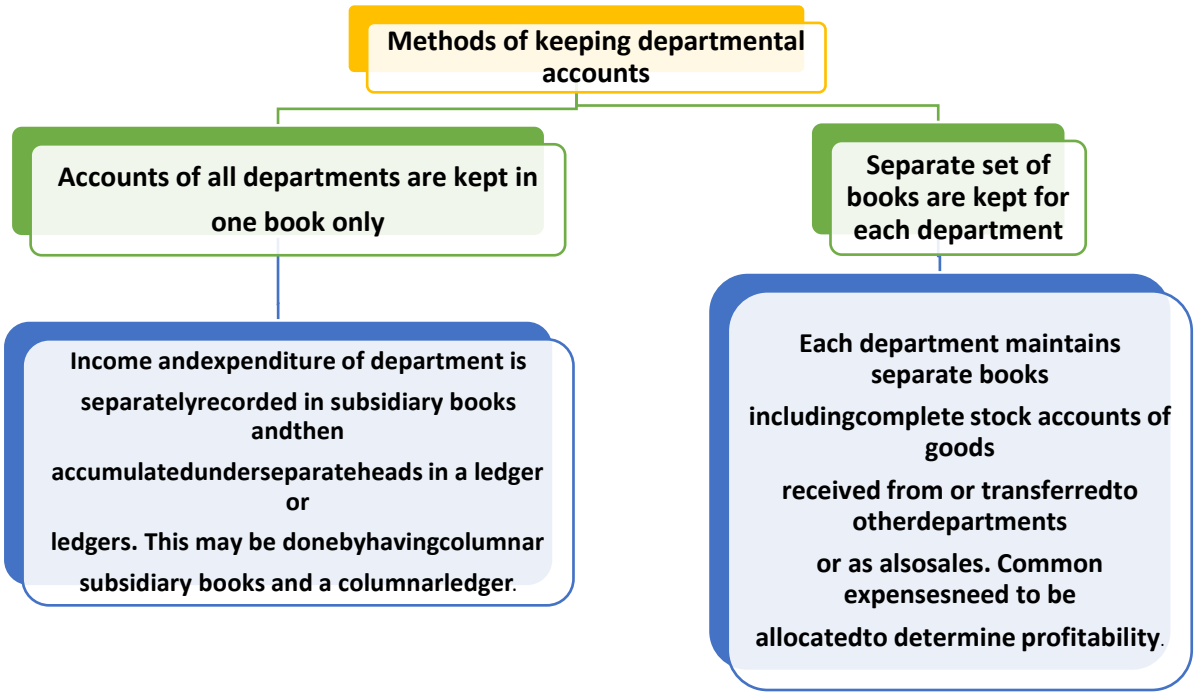
3. **Justification of capital outlay**: It helps the management to determine the justification of capital outlay in each department.

4. **Judgement of efficiency**: It helps to calculate stock turnover ratio of each department separately, and thus the efficiency of each department can be revealed.

5. **Planning and control:** Availability of separate cost and profit figures for each department facilitates better control. Thus, effective planning and control can be achieved on the basis of departmental accounting information.

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METHODS OF DEPARTMENTAL ACCOUNTING:



BASIS OF ALLOCATION OF COMMON EXPENDITURE AMONG DIFFERENT DEPARTMENTS:

1. Expenses should be allocated among different departments on a rational basis while preparing departmental accounts.
2. **Individual Identifiable Expenses**: Expenses incurred specially for a particular department are charged directly thereto, e.g., insurance charges of stock held by the department.
3. **Common Expenses**: Common expenses, the benefit of which is shared by all the departments and which are capable of precise allocation are distributed among the departments concerned on some equitable basis considered suitable in the circumstances of the case.

4.

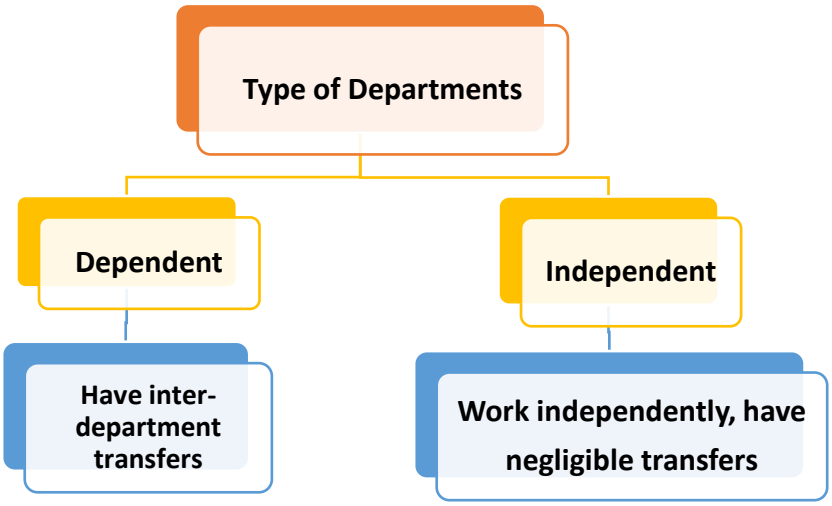
Allocation of Expenses

	Expenses	Basis
1	Rent, rates and taxes, repairs and maintenance, insurance of building	Floor area occupied by each department (if given) otherwise on time basis
2	Lighting and Heating expenses (e.g., energy expenses)	Consumption of energy by each department
3	Selling expenses, *e.g.,* discount, bad debts, selling commission, freight outward, travelling sales manager's salary and other costs	Sales of each department
4	Carriage inward/ Discount received	Purchases of each department
5	Wages/Salaries	Time devoted to each department
6	Depreciation, insurance, repairs and maintenance of capital assets	Value of assets of each department otherwise on time basis
7	Administrative and other expenses, *e.g.,* salaries of managers, directors, common advertisement expenses, etc.	Time basis or equally among all departments
8	Labour welfare expenses	Number of employees in each department
9	ESI contributions	Wages and salaries of each department

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Note: There are certain expenses and income, most being of financial nature, which cannot be apportioned on a suitable basis; therefore, they are recognised in the combined Profit and Loss Account, for example, interest on loan, profit/loss on sale of investment, etc.

TYPES OF DEPARTMENTS:



INTER-DEPARTMENTAL TRANSFERS:

1. Whenever goods are transferred from one department to another, their cost should be separately recorded and charged to the Transferee department and credited to Transferor department.
2. Goods and services may be charged by one department to another usually on either of the following three bases:
   - **(i)** Cost,
   - **(ii)** Current market price,
   - **(iii)** Cost plus agreed percentage of profit.
3. When profit is added in the inter-departmental transfers the loading included in the unsold inventory at the end of the year is to be excluded n the form of stock reserve.
4. Unrealised profit included in unsold stock at the end of accounting period is eliminated by creating an appropriate stock reserve by debiting the combined Profit and Loss Account.
5. The amount of stock reserve will be calculated as:

$$\frac{\text{Transfer price of unsold stock} \times \text{Profit included in transfer price}}{\text{Transfer price}}$$

6. **Journal Entry**

   a) At the end of the accounting year, the following journal entry will be passed for elimination of unrealised profit (creation of stock reserve):

Profit and Loss Account Dr.
To Stock Reserve
(Being a provision made for unrealised profit included in closing stock)

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b) In the beginning of the next accounting year, the aforesaid journal entry will be reversed as under:

Stock Reserve Dr.

To Profit and Loss Account

(Being provision for unrealised profit reversed.)

7. Disclosure in Balance Sheet

Current assets	**xxx**
Stock	**xxx**
Less: Stock reserve	(xxx)
	Xxx

MEMORANDUM STOCK AND MEMORANDUM MARK UP ACCOUNT METHOD:

This method is generally used to have an appropriate control on stock movement of various departments. Please note that the departments prepare only memorandum accounts and hence these are just control accounts. Under this method every department maintains:

1. **Memorandum Stock Account** which records all stock movements: opening balance, purchases, stock transfers, shortages and sales. It is prepared at selling price (i.e. even the purchases and opening / closing balances are adjusted by adding the mark-up), and
2. **Memorandum Mark-up Account** which is prepared for loading or markup on cost (selling price – cost price) in the memorandum stock account.

Accounting adjustments

1. Opening stock is recorded on the debit side of the Memorandum Stock A/c at selling price (Cost + Mark-up) and the respective Mark-Up is noted on the credit side of the Mark-Up Account. Accordingly, any Mark-down (lowering of cost) will have reverse impact.
2. Similarly, any purchases (debit) or stock transfers (debit or credit) are also recorded at selling price itself in the Memorandum Stock Account and its corresponding mark-up is recorded in the Memorandum Mark-up A/c. 3. Any sales are credited to the Memorandum Stock A/c and they are anyways at selling price and hence no loading is required and no mark-up is required to be noted in the Mark-up A/c accordingly.
3. Any theft or shortage or loss of stock is also credited to the Memorandum Stock A/c at its cost-plus mark-up i.e. at selling price and the corresponding mark-up is debited to the Memorandum Mark-up Account.
4. Management may decide to make an ad-hoc amount of mark up on any of the stock and accordingly the adjustment has to be recorded in both the memorandum accounts. Similarly, if

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the selling price of any goods is reduced below its normal selling price, the reduction 'marked down' is adjusted both in the Stock Account and the Departmental Mark-up Account.

5. At the end of the period, mark-up on the closing stock (which shall be the balancing figure of Memorandum Stock A/c) is also recorded in the Memorandum Mark-up A/c. Accordingly, the balance remaining in the Mark-up A/c should reflect profit or loss for the period (which can also be verified by calculating the mark-up % on sales)

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PROBLEMS FOR DISCUSSION

Problem 1

Goods are transferred from Department P to Department Q at a price 50% above cost. If closing stock of Department Q is Rs. 27,000, compute the amount of stock reserve. **(SM ILLUSTRATION 1)**

Problem 2

Z Ltd. has three departments and submits the following information for the year ending on 31st March, 20X1:

	A	B	C	TOTAL Rs.
Purchases (units)	6,000	12,000	14,400	
Purchases (Amount)				6,00,000
Sales (Units)	6,120	11,520	14,976	
Selling Price (per unit) Rs.	40	45	50,360	
Closing Stock (Units)	600	960		

You are required to prepare departmental trading account of Z Ltd., assuming that the rate of profit on sales is uniform in each case. **(SM ILLUSTRATION 2)**

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Problem 3

M/s Omega is a departmental store having three departments X, Y and Z. The information regarding three departments for the year ended 31st March, 20X1 are given below:

	X	Y	Z
	Rs.	Rs.	Rs.
Opening Stock	36,000	24,000	20,000
Purchases	1,32,000	88,000	44,000
Debtors at end	15,000	10,000	10,000
Sales	1,80,000	1,35,000	90,000
Closing stock	45,000	17,500	21,000
Value of furniture in each department	20,000	20,000	10,000
Floor space occupied by each department (in sq. ft.)	3,000	2,500	2,000

Number of employees in each Department	25	20	15
Electricity consumed by each department (in units)	300	200	100

The balances of other revenue items in the books for the year are given below:

	Amount Rs.
Carriage inwards	3,000
Carriage outwards	2,700
Salaries	48,000
Advertisement	2,700
Discount allowed	2,250
Discount received	1,800
Rent, Rates and Taxes	7,500
Depreciation on furniture	1,000
Electricity expenses	3,000
Labour welfare expenses	2,400

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You are required to prepare Departmental Trading and Profit and Loss Account for the year ended 31st March, 20X1 after providing provision for Bad Debts at 5%. **(SM ILLUSTRATION 3)**

Problem 4

M/s X has two departments, A and B. From the following particulars prepare the consolidated Trading Account and Departmental Trading Account for the year ending 31st December, 20X1:

	A	**B**
Opening Stock [consisting of purchased goods -at cost]	20,000	12,000
Purchases	92,000	68,000
Sales	1,40,000	1,12,000
Wages	12,000	8,000
Carriage	2,000	2,000
Closing Stock:		
(i) Purchased goods	4,500	6,000

(ii) Finished goods	24,000	14,000
Purchased goods transferred:		
by B to A	10,000	
by A to B		8,000
Finished goods transferred:		
by A to B	35,000	
by B to A		40,000
Return of finished goods:		
by A to B	10,000	
by B to A		7,000

You are informed that purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 20% of the finished stock (closing) at each department represented finished goods received from the other department. **(SM ILLUSTRATION 4)**

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Problem 5

Department P sells goods to Department S at a profit of 25% on cost and to Department Q at a profit of 15% on cost. Department S sells goods to P and Q at a profit of 20% and 30% on sales respectively. Department Q sells goods to P and S at 20% and 10% profit on cost respectively.

Departmental Managers are entitled to 10% commission on net profit subject to unrealised profit on departmental sales being eliminated. Departmental profits after charging Manager's commission, but before adjustment of unrealised profits are as below:

	Rs.
Department P	90,000
Department S	60,000
Department Q	45,000

Stock lying at different Departments at the end of the year are as below:

	Figures in Rs.		
	DEPARTMENTS		
	P	**S**	**Q**
Transfer from P	-	18,000	14,000
Transfer from S	48,000	-	38,000
Transfer from Q	12,000	8,000	-

Find out correct Departmental Profits after charging Managers' Commission. **(SM ILLUSTRATION 5)**

Problem 6

M/s. Suman Enterprises has two Departments, Finished Leather and Shoes. Shoes are made by the Firm itself out of leather supplied by Leather Department at its usual selling price. From the following figures, prepare Departmental Trading and Profit & Loss Account for the year ended 31st March, 20X3:

	Finished Leather Department (Rs.)	**Shoes Department (Rs.)**
Opening Stock (As on 01.04.20X2)	30,20,000	4,30,000
Purchases	1,50,00,000	2,60,000
Sales	1,80,00,000	45,20,000
Transfer to Shoes Department	30,00,000	-
Manufacturing Expenses	-	5,00,000
Selling Expenses	1,50,000	60,000
Rent and Warehousing	5,00,000	3,00,000
Stock on 31.03.20X3	12,20,000	5,00,000

The following further information are available for necessary consideration:
(i)The stock in Shoes Department may be considered as consisting of 75% ofLeather and 25% of other expenses.
(ii)The Finished Leather Department earned a Gross Profit @ 15% in 20X1-X2.
(iii)General expenses of the business as a whole amount to Rs. 8,50,000. **(SM ILLUSTRATION 6)**

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Problem 7

Gram Udyog, a retail store, has two departments, 'Khadi and Silks' for each of which stock account and memorandum 'mark up' accounts are kept. All the goods supplied to each department are debited to the stock account at cost plus a 'mark up', which together make-up the selling-price of the goods and the sale proceeds of the goods are credited in the account. The amount of 'mark-up' is credited to the Departmental Mark up Account. If the selling price of any goods is reduced below its normal selling price, the reduction 'marked down' is adjusted both in the Stock Account and the Departmental 'Mark up' Account. The rate of 'Mark up' for Khadi Department is 33-1/3% of the cost and for Silks Department it is 50% of the cost.

The following figures have been taken from the books for the year ended December 31, 20X1:

	Khadi Deptt.	**Silks Deptt.**
	Rs.	**Rs.**
Stock as on January 1st at cost	10,500	18,600
Purchases	75,900	93,400
Sales	95,600	1,25,000

(1)The stock of Khadi on January 1, 20X1 included goods the selling price of whichhad been marked down by Rs. 1,260. These goods were sold during the year atthe reduced prices.

(2)Certain stock of the value of Rs. 6,900 purchased for the Khadi Department were later in the year transferred to the Silks department and sold for Rs. 10,350. As aresult, though cost of the goods is included in the Khadi Department the sale proceeds have been credited to the Silks Department.

(3)During the year 20X1 to promote sales the goods were marked down as follows:

	Cost	**Marked down**
	Rs.	**Rs.**
Khadi	5,600	360
Silk	10,000	2,000

All the goods that were marked down were sold except those with Silks of the value worth Rs. 5,000 (that were marked down by Rs. 1,000).

(4)At the time of stock-taking on December 31, 20X1 it was discovered that Khadi cloth of the cost of Rs. 390 was missing and it was decided that the amount be written off.

You are required to prepare for both the departments for the year 20X1.

(a)The Memorandum Stock Account;

(b)The Memorandum Mark up Account;

(c)Extract of Profit and Loss Account. **(SM ILLUSTRATION 7)**

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TEST YOUR KNOWLEDGE

Theoretical Questions

1. Explain the significance of having departmental accounts for a business entity.
2. How will you allocate the following expenses among different departments?
   a) Rent, rates and taxes, repairs and maintenance, insurance of building.
   b) Lighting and Heating expenses (e.g. energy expenses)
   c) Selling expenses.

MCQs

1. Departmental accounting helps in

(a)Evaluation of trading results of each department separately.

(b)Effective planning and control on each department.

(c)Both (a) and (b)

2. Selling commission expense is apportioned among departments in theproportion of

(a)Average stock carried by each department.

(b)Number of units sold by each department.

(c)Sales of each department.

3. If Department A transfers goods to Department B at a price of 50% abovecost, what will be the amount of stock reserve on unsold stock worth Rs.9,000of Department B?

(a)3,000.

(b)4,500.

(c)1,500.

4. Goods and services may be charged by one department to another on

(a)Market price.

(b)Cost plus agreed percentage of profit.

(c)Both (a) and (b)

5. Administrative expenses are apportioned among various departments onbasis of

(a)Time spent by employees in each department.

(b)Value of assets of each department.

(c)Sales of each department.

6. Depreciation on assets is apportioned among various departments on basis of

(a) Value of assets of each department.

(b) Purchases of each department.

(c) Sales of each department.

7. Expense of rent is apportioned among various departments on basis of

(a) Sales of each department.

(b) Floor area occupied by each department.

(c) Either (a) or (b).

8. When profit is added in inter-departmental transfers, unrealised profit included in the closing stock at the year end (before preparing final accounts) is eliminated by

(a) Creating an appropriate stock reserve.

(b) Debiting the combined profit and loss account.

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

9. If an organisation is interested in determining the separate departmental net profit, then

(a) Accounts of all departments are kept in one book only.

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(b) Separate set of books are kept for each department.

(c) Departments transfer goods to each other for further processing.

10. M/s XYZ is a departmental Store having 2 departments A and B. M/s XYZ paid Rs. 4,00,000/- towards interest on loan (loan taken for the business). Please advise the basis of allocation of interest expenses between the departments.

(a) Allocated on basis of Sales of each department.

(b) Allocated on basis of value of assets of each department.

(c) Not allocated to individual department, recognized in the combined Profit and Loss account.

11. Which of the following is not the one of the basis generally used by departments to make the inter-departmental transfer of goods:

(a) Cost

(b) Cost plus % of profit

(c) Variable Cost

12. Which of the following expenses may not be proportioned amongst the departments using any suitable basis:

(a) Carriage Inward

(b) Profit on Sale of Investments

(c) Labour welfare expenses

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19.ACCOUNTING FOR BRANCHES+AS-11

MEANING OF BRANCH:

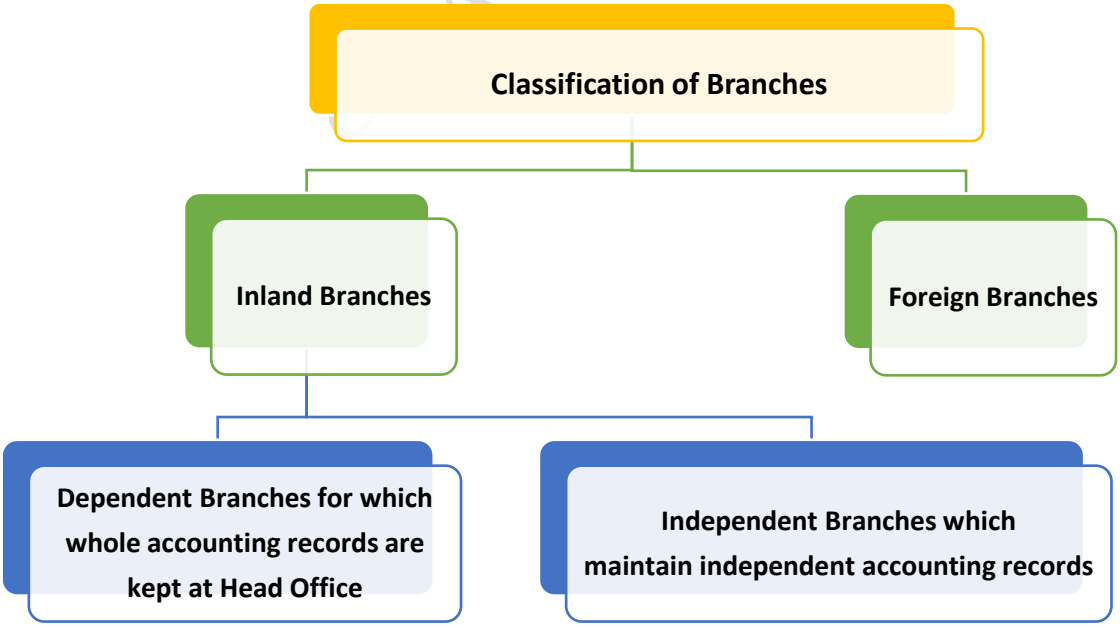
A branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office; for there can be no branch without a head office - the principal place of business.

Difference between branch and department

Branch: Establishment at location different from Head Office to carry either same or substantially same activity as carried on by Head Office

Department: Division of a large organization dealing with a various kind of activity at the same location.

CLASSIFICATION OF BRANCHES:



DEPENDENT BRANCHES

1. When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it, the branch is described as Dependent branch.
2. Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch.

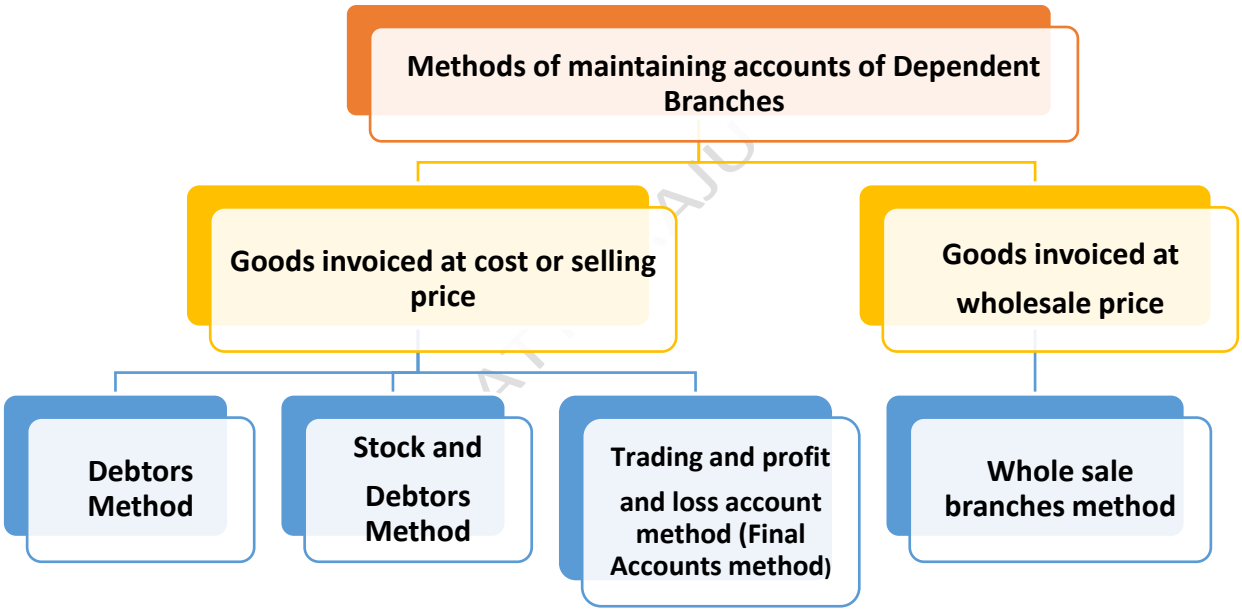
EXAMPLES

(a) A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office;

(b) A branch established at a commercial centre for the sale of goods supplied by the head office, and under its direction all collections are made by the H.O.; and

(c) A branch for the retail sale of goods, supplied by the head office.

METHODS OF MAINTAING ACCOUNTS OF DEPENDENT BRANCHES:



Debtors method:

1. This method of accounting is suitable for small sized branches. Under this method, separate branch account is maintained for each branch by Head office, to compute profit or loss made by each branch.
2. Head office will record those transactions which entered in between Head office and branch only. It will not record transactions entered in between branch and outsiders.
3. By consolidating all branches profit/loss along with head office profit/loss, we will get entire entity profit/loss.

   • The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as any direct purchases made by branch (for which Head Office makes the payment), expenses of the branch paid by the head office, e.g., salaries, rent, insurance, etc., are also debited to it.

   • Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited.

   • At the end of the year, the value of unsold stock, the total of customers' balances outstanding and that of petty cash are brought into the branch account on the credit side.

• Accordingly, the branch account will reveal profit or loss; Debit 'balance' will be the loss suffered by the working of the branch and vice versa.

Proforma Branch Account

To Balance b/d	By Bank A/c (Cash remitted)
Cash	By Return to H.O.
Stock	
Debtors	By Balance c/d
Petty Cash	Cash
Fixed Assets	Stock
Prepaid Expenses	Debtors
	Petty Cash
	Fixed Assets
	Prepaid Expenses
To Goods sent to Branch	
To Bank A/c	
Salaries	
Rent	
Sundry Expenses	
To Profit & Loss A/c—Profit (if credit side is larger)	By Profit and Loss A/c—Loss (if debit side is larger)

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7 step approach:

Step1: Opening balance of Assets and Liabilities

Step 2: Closing balance of Assets and Liabilities

Step 3: Goods sent to branch

Step4: Goods remitted by branch.

Step5: Goods sent to branch.

Step6: Cash remitted by branch.

Step 7: Formalities- Opening stock reserve, closing stock reserve, Loading on net GSB.

Stock and Debtors method:

If it is desired to exercise a more detailed control over the working of a branch, the accounts of the branch are maintained under Stock and Debtors Method. According to this method, the following accounts are maintained by the Head Office:

Account	Purpose
1. Branch Stock Account (or Branch Trading Account)	Ascertainment of shortage or surplus
2. Branch Debtors Account	Ascertainment of closing balance of debtors
3. Branch Expenses Account	Ascertainment of total expenses incurred
4. Goods sent to Branch Account 5. Branch Cash / Bank Account 6. Branch Fixed Asset Account	Ascertainment of cost of goods sent to branch Know about cash flow at branch (eg: where branch is allowed to incur expenses locally) Control over branch Fixed Assets
7. Branch Profit and Loss Account	Calculation of net profit or loss

Journal entries:

	Transaction	Account debited	Account credited
(a)	Cost of goods sent to the Branch	Branch Stock A/c	Goods sent to Branch A/c
(b)	Remittances for expenses	Branch Cash A/c	Cash A/c
(c)	Any asset (*e.g.* furniture) provided by H.O.	Branch Asset (Furniture) A/c	Asset A/c
(d)	Cost of goods returned by the branch	Goods sent to Branch A/c	Branch Stock A/c
(e)	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
(f)	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(g)	Return of goods by debtors	Branch Stock A/c	Branch Debtors A/c
(h)	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
(i)	Discount & allowance to debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
(j)	Remittances to H.O.	Cash A/c	Branch Cash A/c
(k) (	Branch Expenses directly paid by H.O.	Branch Expenses A/c	Cash A/c
(i)	Expenses met by Branch	Branch Expenses A/c	Branch Cash A/c

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Closing Stock: Credit the Branch Stock Account with the value of closing stock at cost. It will be carried down as opening balance (debit) for the next accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.

Other Steps:

(a) Transfer Balance of Branch Stock Account to the Branch Profit and Loss Account.

(b) Transfer Balance of Branch Expenses Account to the debit of Branch Profit & Loss Account.

(c) The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit & Loss Account.

(d) The credit balance in the Goods sent to Branch Account is afterwards transferred to the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

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When goods are invoiced at selling price

1. Under stock & debtors method, when goods are invoiced at selling price, one additional account i.e. 'Branch Adjustment account' is also prepared in addition to all the accounts which are maintained on cost basis.

Journal Entries:

Transaction	Accounts debited	Accounts credited
(a) Sale price of the goods sent from H.O. to the Branch	Branch Stock A/c (at selling price)	(i) Goods sent to Branches A/c with cost of the goods sent. (ii)Branch AdjustmentA/c (with the loading *i.e.*,Difference between the selling and cost price).
(b) Return of goods by the Branch to H.O.	(i)Goods sent to Branch A/c (with the cost of goods returned) .(ii)Branch Adjustment A/c (with the loading) Branch Cash/Bank A/c	Branch Stock A/c
(c) Cash sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(d) Credit Sales at the Branch	Branch Stock A/c	Branch Stock A/c

(e) goods returned to branch by customers	Goods Lost in Transit A/c or Goods Stolen A/c (with cost of the goods)	Branch Debtors A/c (at selling price)
(f) Goods lost in transit or Stolen	Branch AdjustmentA/c (with the loading)	Branch Stock A/c

(ii) **Closing Stock:**

The balance in the Branch Stock Account at the close of the year normally should be equal to the unsold stock at the Branch valued at sale price. But quite often the value of stock actually held at the branch is either more or less than the balance of the Branch Stock Account. The discrepancy in the amount of balance in the Branch Stock Account is due to Physical loss of stock due to natural causes (Total Drs> Total Crs) or pilferage or theft etc. or Goods having been sold either above the established selling price. (Total Drs< Total Crs)[Treated as G.p and transferred to branch P&l]

The adjusting entry in such a case would be:

PARTICULARS		Dr. Rs.	Rs.
Goods Lost A/C	Dr.	80	
Branch adjustment A/C	Dr.	20	
To Branch Stock A/C			100

Elimination of unrealized profit in the closing stock:

The balance in the Branch Stock account would be at the sale price; therefore, it would be necessary to eliminate the element of profit included in such closing stock. This is done by creating a reserve against unrealized profit, by debiting the Branch Adjustment Account and crediting Stock Reserve Account with an amount equal to the difference in the cost and selling price of unsold stock.

Branch Trading and Profit and Loss Account (Final Accounts Method)

In this method, Trading and Profit and Loss accounts are prepared considering each branch as a separate entity. The main advantage of this method is that, it is easy to prepare and understand. It also gives complete information of all transactions which are ignored in the other methods. It should be noted that Branch Trading and Profit and Loss account is merely a memorandum account and therefore, the entries made there in do not have double entry effect.

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Goods invoiced at wholesale price to retail branches:

1. Under this method, the Head Office (particularly, the manufacturing concern) supplies goods to its retail branches at wholesale price which is cost plus wholesale profit. Manufacturer would always be able to sell the goods on wholesale terms thereby Manufacturer profit = Wholesale price - Cost.
2. Profit of branch = Sale proceeds at shop - wholesale price of the goods sold. To know such profit earned by each branch, Manufacturer will prepare Branch stock, Branch profit & loss a/c.
3. Branch Stock Account or the Trading Account is debited with:
   (a) the value of opening stock at the Branch; and
   (b) price of goods sent during the year at wholesale price.
   It is credited by:
   (a) sales effected at the shop; and
   (b) closing stock of goods valued at wholesale price.
4. The value of goods lost due to accident, theft etc. also is credited to the Branch Stock Account or Trading Account calculated at the wholesale price. At this stage, the Branch Stock or Trading Account will reveal the amount of gross profit (or loss). It is transferred to the Branch Profit and Loss Account. On further being debited with the expenses incurred at the shop and the wholesale price of goods lost, the Branch Profit and Loss Account will disclose the net profit (or loss) at the shop.
5. Since the closing stock at the branch has to be valued at wholesale price, it would be necessary to create a stock reserve equal to the difference between its wholesale price and its cost (to the head office) by debiting the amount in the Head Office Profit and Loss Account. This Stock Reserve is carried forward to the next year and then transferred to the credit of the (Head Office) Profit and Loss Account.

ACCOUNTING FOR INDEPENDENT BRANCHES:

When the size of the business is big, it is desirable that the branch maintains complete records of its transactions. These branches are called independent branches and each independent branch maintains comprehensive account books for recording their transactions; therefore, a separate trial

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balance of each branch can be prepared. The head office maintains one ledger account for each such branch, wherein all transactions between the head office and the branches are recorded.

Salient features of accounting system of an independent branch:

1. Branch maintains its entire books of account under double entry system.
2. Branch opens in its books a Head Office account to record all transactions that take place between Head Office and branch. The Head Office maintains a Branch account to record these transactions.
3. Branch prepares its Trial Balance, Trading and profit and loss Account at the end of the accounting period and sends copies of these statements to Head Office for incorporation.
4. After receiving the final statements from branch, Head Office reconciles between the two – Branch account in Head Office books and Head Office account in Branch books.
5. Head office passes necessary journal entries to incorporate branch trial balance in its books.

NOTE: The Head Office Account in branch books and Branch Account in head office books is maintained respectively.

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	Transactions	**Head office books**		**Branch books**	
(i)	Dispatch of goods to branch by H.O.	Branch A/c To Good sent to Branch A/c	Dr.	Goods received from H.O. A/c To Head Office A/c	Dr.
(ii)	When goods are returned by the Branch to H.O.	Goods sent to Branch A/c To Branch A/c	Dr.	Head Office A/c To Goods received from H.O. A/c	D r.
(iii)	Branch Expenses are paid by the Branch	No Entry		Expenses A/c To Bank or Cash A/c	Dr
(iv)	Branch Expenses paid by H.O.	Branch A/c To Bank or cash	Dr	Expenses A/c To Head Office A/c	Dr
(v)	Outside purchases made by the Branch	No Entry		Purchases A/c To Bank (or) Creditors A/c	Dr
(vi)	Sales effected by the Branch	No Entry	Dr	Cash or Debtors A/c To Sales	Dr
(vii)	Collection from Debtors of the Branch recd. by H.O.	Cash or Bank A/c To Branch A/c	Dr	Head office A/c To Sundry Debtors A/c	Dr

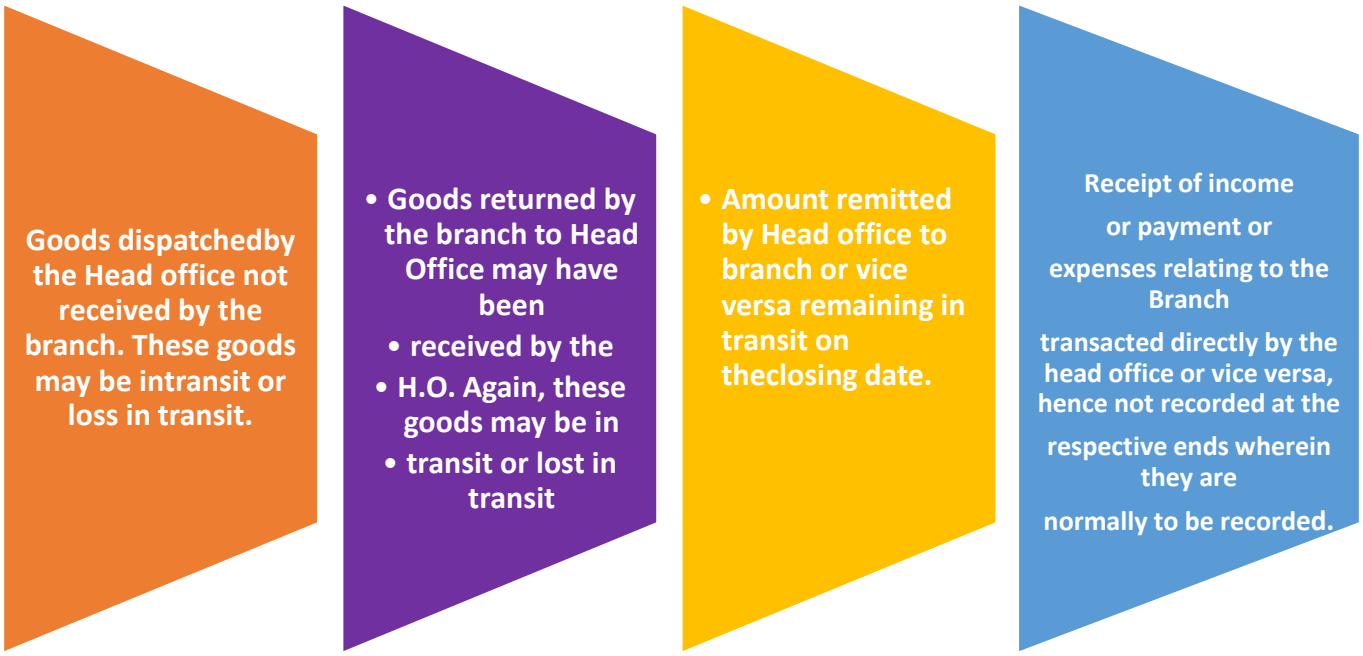
(viii)	Payment by H.O. for purchase made by Branch	Branch A/c To Bank	Dr	Purchases (or) Sundry Creditors A/c To Head Office	Dr
(ix)	Purchase of Asset by Branch	No Entry	Dr	Sundry Assets	Dr
(x)	Asset purchased by the Branch but Asset A/c retained at H.O. books	Branch Asset A/c To Branch A/c	Dr	Head office To Bank A/c	Dr
(xi)	Depreciation on (*x*) above	Branch A/c To Branch Asset	Dr	Depreciation A/c To Head Office	Dr

RECONCILIATION OF BRANCH AND HEAD OFFICE ACCOUNTS:

If the branch and the head office accounts, converse of each other, do not tally, these must be reconciled before the preparation of the final accounts of the concern as a whole.

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Reasons for Disagreement



The technique of reconciliation has been illustrated through the example given below:

	Head office		Branch	
	Dr.	**Cr.**	**Dr.**	**Cr.**

Goods sent to Branch		1,50,000	-	
Goods recd. from H.O. A/c		-	1,40,000	
Branch A/c	1,12,000			
Head office A/c	-	-	-	78,500

On analysis of Branch A/c in Head office books and Head office A/c in branch books, you find:

- Goods valued Rs.10,000 sent by head office has not been received by branch, hence not recorded in the branch books.
- Rs. 15,000 remitted by the branch has not been received, hence not recorded in the head office books. • Direct collection of Rs. 10,500 from a customer of the branch by Head office not informed to the branch, hence not recorded by the branch.
- A sum of Rs. 14,500 paid by branch to the suppliers of head office not recorded at Head office.
- Head office expenditure allocation to the branch Rs.12,000 not recorded in the branch.
- Rs. 7,500 being FD interest of head office received by the branch on oral instructions from H.O., not recorded in the head office books.

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Important Points to be noted:

(i) the balance of Head Office A/c in Branch books and Branch A/c in Head Office books have tallied.

(ii) Adjustment are made only at the point: Where the recording has been omitted, and Other than the point where action has already been effected.

Inter-Branch Transactions

Inter-branch transactions (i.e. transaction between two branches) are usually adjusted as if they were entered into only with the head office.

Fixed Assets

Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry by head office:

Branch Account Dr.

To Branch Asset Account

The branch will pass the following entry:

Depreciation Account Dr.

To Head Office Account

Head office Expenses charged to Branch:

In H.O books the amount is debited to the branch (being receivable from branch) and is credited to appropriate expense head such as Salaries Accounts, General Charges Account, Entertainment Account etc the amount is debited to the branch (being receivable from branch) and is credited to appropriate expense head such as Salaries Accounts, General Charges Account, Entertainment Account etc

INCORPORATION OF BRANCH BALANCE IN HEAD OFFICE BOOKS

The method that will be adopted for incorporating the trading result of the branch with that of the head office would depend on whether it is desired to prepare

(a) Standalone P&L & Balance Sheet for each Branch, or

(b) Consolidated statement of Branch & H.O.

Method I: Separate P&L & Balance Sheet for each Branch

Amount of P&L is shown by Branch & is transfer to H.O. in Branch books & converse entry is passed in H.O. Books as:

Branch A/c Dr.

To Profit & Loss A/c

In such a case, not only P&L but also separate Balance Sheet for Branch & H.O. is to be prepared. The Branch Balance Sheet would show the amount advanced by H.O. to it as "Capital." In H.O. Books such amount would be shown as "Advance to Branch"

Method II: Prepare a consolidated Profit & Loss Account and Balance Sheet

1. Individual balances of all the revenue accounts would be separately transferred to the Head Office Account by debit or credit in the branch books and the converse entries would be passed in the head office books.
2. In case it is also desired that consolidated balance sheet of the branch and the head office should be prepared, it will also be necessary to transfer the balance of assets and liabilities of the branch to the head office.
3. The adjusting entries that would be passed in this respect in the books of branch are shown below:

a) Head Office Account Dr.

To Asset (individual) Account

(b) (Individual) Liability Account Dr.

To Head Office Account

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Converse entries are passed in the head office books.

4. It is obvious that after afore-mentioned entries have been passed, the Branch Account in the Head Office books and Head Office Account in the branch books will be closed and it will be necessary to restart them at the beginning of the next year.

At the beginning of the following year,

Asset Account (In Detail) Dr.

To Liability Accounts (In Detail)

To H.O. Account (The difference between assets and liabilities)

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PROBLEMS FOR DISCUSSION

Problem 1

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 thetransactions entered into at the branch during the year ended December 31, 2012.

Particulars	Rs.	Particulars	Rs.
Stock January 1, 2012	7,000	Bad Debts	600
Debtors, January 1, 2012	12,600	Goods returned by customers	500
Petty Cash, January 1, 2012	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 Debtors	28,500
Credit Sales	28,400	Stock, Dec. 31st, 2012	6,500
Allowances to customers	200	Debtors, Dec. 31st, 2012	9,800
Discount to customers	1,400	Petty Cash, Dec. 31st, 2012	100

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Prepare: (a) Branch Account (Debtors Method), (b) Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and (c) Memorandum Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account. **(SM)**

PROBLEM 2:

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, 2012.

Particulars	Rs.
Cost of goods sent to Branch	2,00,000
Goods received by Branch till 31-12-2012 at invoice price	2,20,000

Credit Sales for the year	1,65,000
Cash Sales for the year	59,000
Cash Remitted to head office	2,22,500
Expenses paid by H.O.	12,000
Bad Debts written off	750

Balance as on:

Particulars	**1-1-2012 (Rs.)**	**31-12-2012 (Rs.)**
Stock	25,000 (Cost)	28,000 (Invoice price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,500

Show necessary ledger accounts in the books of the head office and determine the Profit and Loss ofthe Branch for the year ended 31st December, 2012 under stock & debtors method.

(SM)

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PROBLEM 3:

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 2012 from the following:

a) Goods are invoiced to the branch at cost plus 20%.

b) The sale price is cost plus 50%.

c) Other information's:

Stock as on 01.04.2011(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

a) The profit earned by the branch during the year

b) Branch stock reserve in respect of unrealized profit. **(SM)**

PROBLEM 4:

Arnold of Delhi trades in Ghee and oil. It has a branch at Lucknow. He dispatches 25 tins of oil @ Rs.1,000 per tin and 15 tins of Ghee @ Rs.1,500 per tin on 1st of every month. The Branch incurs some expenditure which is met out of its collections this is in addition to expenditure directly paid by H.O. Following are the other details:

Particulars	Delhi	Lucknow
Purchases:		
Ghee	14,75,000	---
Oil	29,32,000	---
Direct exp. paid by H.O.	3,83,275	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 H.O.	---	6,13,250

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Particulars	Delhi		Lucknow	
	1.1.12	31.12.12	1.1.12	31.12.12
Stock:				
Ghee	1,50,000	3,12,500	17,000	13,250
Oil	3,50,000	4,17,250	27,000	44,750
Debtors	7,32,750	---	75,750	?
Cash on hand	70,520	55,250	7,540	12,350
Furniture & Fittings	21,500	19,350	6,250	5,625
Plant & Machinery	3,07,250	7,73,500	---	---

1) Additions to Plant & Machinery on 1.1.12 Rs.6,02,750.

2) Rate of Depreciation: Furniture & Fittings @ 10%, Plant & Machinery @ 15% (already adjusted inthe above figures).

3) The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of Rs.2,000 p.m. General expenses incurred by H.O. Rs.24,000.

Prepare Branch A/c in the H.O. books and also prepare the Arnold's Trading and P&L A/c (excludingbranch transactions).

PROBLEM 5:

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 31.03.2012:

Particulars	Rs.
Stock at the outlet 1.4.2011	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 31.3.2012	36,000

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You are required to prepare the following accounts in the books of Rahul Ltd. for the year ended 31.03.2012: Outlet Stock A/c, Outlet Profit & Loss A/c and Stock Reserve A/c.

PROBLEM 6 Give Reconciliation entries in the books of Head office and branch based on below information.

Particulars	Head Office		Branch Office	
	Dr.	Cr.	Dr.	Cr
Goods send to Branch		1,50,000	-	
Goods recd. from H.O. A/c		-	1,40,000	
Branch A/c	1,12,000			
Head office A/c		-	-	78,500

On analysis of Branch A/c in Head office books and Head office A/c in branch books, you find:

a) Rs.15,000 remitted by the branch has not been received, hence not recorded in the head office

books.

b) Direct collection of Rs.10,500 from a customer of the branch by Head office not informed to the branch, hence not recorded by the branch.

c) A sum of Rs.14,500 paid by branch to the suppliers of head office not recorded at Head office.

d) Head office expenditure allocation to the branch Rs.12,000 not recorded in the branch.
Rs.7,500 being FD interest of head office received by the branch on oral instructions from H.O.,not recorded in the head office books

PROBLEM 7

Give Journal Entries in the books of an independent Branch to rectify or adjust the following:

(i) Branch paid Rs. 5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.

(ii) Asset Purchased by branch for Rs. 25,000, but the Asset account was retained in H.O Books.

(iii) A remittance of Rs.8,000 sent by the branch has not been received by H.O.

(iv) H.O collected Rs. 25,000 directly from the customer of Branch but fails to give the intimation to branch.

(v) Remittance of funds by H.O to branch Rs. 5,000 not entered in branch books. SM

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PROBLEM 8

The following Trial balances as at 31st December, 20X1 have been extracted from the books of Major Ltd. and its branch at a stage where the only adjustments requiring to be made prior to the preparation of a Balance Sheet for the undertaking as a whole are to be done.

	Head Office		**Branch**	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
Share Capital		1,50,000		
Fixed Assets	75,125		18,901	
Current Assets	1,21,809		23,715	
Current Liabilities		34,567		(Note 3)
Stock Reserve, 1st Jan., 20X1 (Note 2)		693		9,721

Revenue Account		43,210		10,250
Branch Account	31,536			
Head Office Account				22,645
	2,28,470	2,28,470	42,616	42,616

You are required to record the following in the appropriate ledger accounts in both sets of books.

Note:

1. Goods transferred from Head Office to the Branch are invoiced at cost plus 10% and both Revenue Accounts have been prepared on the basis of the prices charged.
2. Relating to the Head Office goods held by the Branch on 1st January, 20X1.
3. Includes goods received from Head Office at invoice price Rs. 4,565.
4. Goods invoiced by Head Office to Branch at Rs. 3,641 were in transit at 31st December, 20X1, as was also a remittance of Rs. 3,500 from the Branch.
5. At 31st December, 20X1, the following transactions were reflected in the Head Office books but unrecorded in the Branch books.

The purchase price of lorry, Rs. 2,500, which reached the Branch on December 25th; a sum received on December 30, 20X1 from one of the Branch debtors, Rs. 750. **(ILLUSTRATION 10 SM)**

PROBLEM 9

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 – Rs. 35,000 and Rs. 15,000 from Kolkata.

(2) Sent goods to Chennai – Rs. 25,000, Kolkata – Rs. 20,000.

(3) Bill Receivable received – Rs. 20,000 from Chennai.

(4) Acceptances sent to Mumbai – Rs. 25,000, Kolkata – Rs. 10,000.

B. Mumbai Branch (apart from the above) :

(5) Received goods from Kolkata – Rs. 15,000, Delhi – Rs. 20,000.

(6) Cash sent to Delhi – Rs. 15,000, Kolkata – Rs. 7,000.

C. Chennai Branch (apart from the above) :

(7) Received goods from Kolkata – Rs. 30,000.

(8) Acceptances and Cash sent to Kolkata – Rs. 20,000 and Rs.10,000 respectively.

D. Kolkata Branch (apart from the above) :

(9) Sent goods to Chennai – Rs. 35,000.

(10) Paid cash to Chennai – Rs.15,000.

(11) Acceptances sent to Chennai – Rs.15,000. **(PRACTICAL QUESTION 3 – SM)**

PROBLEM 10:

AFFIX Ltd. of Calcutta has a branch at Delhi which the goods are supplied from Calcutta but the cost there of is not recorded in the Head office books. On 31st March, 1997 the branch Balance sheet wasas follows:

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Liabilities	Rs.	Assets	Rs.
Creditors Balance	40,000	Debtors Balance	2,00,000
Head Office	1,68,000	Building Extension A/c closed by transfer to H.O. A/c	-
		Cash at Bank	8,000
	2,08,000		**2,08,000**

Particulars	Rs.	Particulars	Rs.
Sales	2,40,000	Manager's Salary	4,800
Purchases	48,000	Collections from Debtors	1,60,000
Wages paid	20,000	Discount allowed	8,000
Salaries (inclusive of advance of Rs.2,000)	6,400	Discount earned	1,200
General Expenses	1,600	Cash paid to Creditors	60,000
Fire Insurance (paid for one year)	3,200	Building Account (further payment)	4,000
Remittance to H.O.	38,400	Cash in Hand	1,600
		Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-1997.

Also give journal entries in the Delhi books.

PROBLEM 11:

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December, 20X1.

Head Office Trial Balance

	Rs.	Rs.
Share Capital (Authorised: 10,000 Equity Shares of Rs.100 each):		
Issued: 8,000 Equity Shares		8,00,000
Profit & Loss Account - 1-1-20X1		25,310
General reserve		1,00,000
Fixed Assets	5,30,000	
Stock	2,22,470	
Debtors and Creditors	50,500	21,900
Profit for 20X1		52,200
Cash Balance	62,730	
Branch Current Account	1,33,710	
	9,99,410	**9,99,410**

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Branch Trial Balance

	Rs.	Rs.
Fixed Assets	95,000	
Profit for 20X1		31,700
Stock	50,460	
Debtors and Creditors	19,100	10,400
Cash Balance	6,550	
Head Office Current Account		1,29,010
	1,71,110	**1,71,110**

The difference between the balances of the Current Account in the two sets of books is accounted for asfollows:

a) Cash remitted by the Branch on 31st December, 20X1, but received by the Head Office on 1st January 20X2 - Rs.3,000.

b) Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not creditedto Head Office in the Branch books as the Branch Manager declined to admit any liability (not covered by insurance) - Rs.1,700.

Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal. **(SM)**

PROBLEM 12:

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% ofthe 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.

The company 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., 2012 incolumnar form.

a) A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

b) A Balance Sheet as on 31st Dec., 2012 for the entire business.

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Particulars	H.O.		Branch	
	Rs.	Rs.	Rs.	Rs.
Raw material purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1- 2012				
Raw material	1,800			
Finished goods	13,000		9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen's 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**

Notes:

a) On 28th Dec., 2012 the branch remitted Rs.1,500 to the H.O. and this has not yet been recorded inthe H.O. books. Also on the same date, the H.O. dispatched goods to the branch invoiced at Rs.1,500 and these too have not yet been entered into the branch books. It is the company's policy

to adjust items in transit in the books of the recipient.

b) The stock of raw materials held at the H.O. on 31st Dec.,2012 was valued at Rs.2,300.

c) You are advised that:

i) There were no stock losses incurred at the H.O. or at the branch.

ii) It is the company's practice to value finished goods stock at the H.O. at factory cost.

iii) There was no opening or closing stock of work- in-progress.

d) Branch employees are entitled to a bonus of Rs.156 under a bilateral agreement. **(SM)**

CA SATYA RAJU

AS 11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Objective:

1. An enterprise may carry on activities involving foreign exchange in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

2. The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

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Scope:

This Standard should be applied:

1. In accounting for transactions in foreign currencies.
2. In translating the financial statements of foreign operations.
3. This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.

This Standard does not:

- **a.** Specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, the Standard requires disclosure of the reasons for using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.
- **b.** Deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation, which are addressed in AS 3 'Cash flow statement'.
- **c.** Deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- **d.** Deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

DEFINITIONS:

a. **Foreign currency transaction** is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:
   - **i.** Buys or sells goods or services whose price is denominated in a foreign currency.
   - **ii.** Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency.
   - **iii.** Becomes a party to an unperformed forward exchange contract or
   - **iv.** Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

b. **Monetary items** are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. For example, cash, receivables and payables.

c. **Non-monetary items** are assets and liabilities other than monetary items. For example, fixed assets, inventories and investments in equity shares.

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Initial Recognition:

1. 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.
2. A rate that approximates the actual rate at the date of the transaction may be used. Example- average rate. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Reporting at each balance sheet date: The treatment of foreign currency items at the balance sheet date depends on whether the item is:

- monetary or non-monetary; and
- carried at historical cost or fair value (for non-monetary items).

a. Foreign currency monetary items should be reported using the closing rate.

b. 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; and

c. non-monetary items which are carried at fair value other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

d. The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.

NOTE: The carrying amount of an item is determined in accordance with the relevant Accounting Standards. For example, certain assets may be measured at fair value or other similar valuation (e.g., net realisable value) or at historical cost.

Recognition of Exchange Differences:

1. 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, should be recognised as income or as expenses in the period in which they arise.

2. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period.

3. when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

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EXCEPTION-PARAGRAPH 46A:

1. At the option of any company, 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, 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 the "Foreign Currency Monetary Item Translation Difference (FCMITD) Account" in the enterprise's financial statements and amortised over the balance period of such long term assets or liability, by recognition as income or expense in each of such periods.

2. Such option is irrevocable and should be applied to all such foreign currency monetary items.

3. Presentation of Foreign Currency Monetary Item Translation Difference Account: Where the balance in FCMITDA represents foreign currency translation loss, it does not meet the above definition of 'asset' as it is neither a resource nor any future economic benefit would flow to the entity therefrom. Accordingly, such balance cannot be reflected as an asset. Accordingly, the

Council decided that debit or credit balance in FCMITDA should be shown on the "Equity and Liabilities" side of the balance sheet under the head 'Reserves and Surplus' as a separate line item.

Forward Exchange Contract:

1. The risks associated with changes in exchange rates may be mitigated by entering into forward exchange contracts. Any premium or discount arising at the inception of a forward exchange contract is accounted for separately from the exchange differences on the forward exchange contract. (In case of Hedging)

2. The risks associated with changes in exchange rates may be mitigated by entering into forward exchange contracts. Any premium or discount arising at the inception of a forward exchange contract is accounted for separately from the exchange differences on the forward exchange contract.

3. Exchange difference on a forward exchange contract is the difference between (a) the foreign currency amount of the contract translated at the exchange rate at the reporting date, or the settlement date where the transaction is settled during the reporting period, and (b) the same foreign currency amount translated at the latter of the date of inception of the forward exchange contract and the last reporting date.

4. 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.

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ACCOUNTING FOR FOREIGN BRANCHES:

Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise.

For the purpose of accounting, AS 11 , the foreign branches may be classified into two types:

- Integral Foreign Operation;
- Non- Integral Foreign Operation.

1.Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting

enterprise's operations. For example, sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.

2**. Non-Integral Foreign Operation (NFO)** is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency.

The following are the indicators of Non- Integral Foreign Operation-

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation, the activities of foreign operation are carried independently without much dependence on reporting enterprise.
- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words, it raises finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency, not in the reporting currency.
- Day-to-day cash flow of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day-to-day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

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TECHNIQUES FOR FOREIGN CURRENCY TRANSLATION:

1. All transactions of IFO be translated at the rate prevailing on the date of transaction.
2. **Translation at the balance sheet date**-
   - **a.** Monetary items at closing rate;
   - **b.** Non-monetary items: 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 tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.
   - **c.** 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.
   - **d.** Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.

Non-Integral Foreign Operation

Accounts of non-integral foreign operation are translated using the following principles:

- Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary – apply closing exchange rate.
- Items of income and expenses – At actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.
- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".

Items	Integral Foreign Operations	Non Integral Foreign Operations
Monetary Items (Cash, Bank Balance, Debtor, Creditor, Loans, Bills receivable, Bills Payable)	Closing rate	Closing rate
Non-Monetary Items (Fixed Assets)	Rate on date of purchase	Closing rate
Inventory	Generally, closing rate (but if rate on the date of purchase of inventory is available, then that rate)	Closing rate
Profit and Loss items (revenue items)	Average rate (but if rate on the date of transaction is available, then that rate)	Average rate (but if rate on the date of transaction is available, then that rate)
Exchange Difference	Charge to P&L account.	Accumulated in Foreign Currency Translation reserve.

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CHANGE IN CLASSIFICATION:

Integral to Non-Integral

(i) Translation procedure applicable to non-integral shall be followed from the date of change.

(ii) Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.

Non-Integral to Integral

(i) Translation procedure as applicable to integral should be applied from the date of change.

(ii) Translated amount of non-monetary items at the date of change is treated as historical cost.

(iii) Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

PROBLEMS FOR DISCUSSION ON AS-11 & FOREGIN BRANCHES

PROBLEM 13:

Classify the following items as monetary or non-monetary item:

Inventories

Trade Receivables Investment in Equity shares

Property, Plant and Equipment. **(SM)**

PROBLEM 14:

	Exchange Rate per $
Goods purchased on 1.1.20X1 for US $ 15,000	Rs.75
Exchange rate on 31.3.20X1	Rs.74
Date of actual payment 7.7.20X1	Rs.73

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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. **(SM)**

PROBLEM 15:

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. prepares financial statement ending on 31/03/20X1. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/20X1 1 US$ = Rs. 48.00

31/03/20X1 1 US$ = Rs. 49.00

31/07/20X1 1 US$ = Rs. 49.50 **(SM)**

PROBLEM 16:

A Ltd. purchased fixed assets costing Rs. 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = Rs. 40.00 and Rs. 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for. **(SM)**

PROBLEM 17:

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = Rs.47.10 when exchange rate was US$ 1 = Rs. 47.02. On 31st December when he closed his books exchange rate was US$ 1 = Rs. 47.15. On 31st January, he decided to sell the contract at Rs. 47.18 per dollar. Show how the profits from contract will be recognised in the books. **(SM)**

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PROBLEM 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 @ Rs. 49.15 per dollar. Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.? **(SM)**

PROBLEM 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 Rs.	**Amount in Rs.**
Stock on 1st Jan., 20X2	2,34,000	-
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	-
New York Account	-	5,99,150

	36,31,000	36,31,400

Stock on 31st December, 20X2 was Rs. 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 20X2 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 20X1 was Rs. 52 and on 31st December, 20X2 was Rs. 51. The average rate for the year was Rs. 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch assuming integral foreign operation. **(Illustration 15 OF MAIN CHAPTER BRANCH ACCOUNTS- SM)**

PROBLEM 20

The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 20X1:

	$	**$**
Head office A/c	_	22,800
Sales	_	84,000
Debtors and creditors	4,800	3,400
Machinery	24,000	_
Cash at bank	1,200	_
Stock, 1 January, 20X1	11,200	_
Goods from H.O.	64,000	_
Expenses	5,000	_

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In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

		Rs.			**Rs.**
To	Balance b/d	8,10,000	By	Cash	28,76,000
To	Goods sent to branch	29,26,000	By	Balance c/d	8,60,000
		37,36,000			**37,36,000**

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%.

Machinery was acquired in past, when $ 1.00 = Rs. 40.

Rates of exchange were:

1st January, 20X1	$ 1.00	=	Rs. 46
31st December, 20X1	$ 1.00	=	Rs.48

Average	$ 1.00	=	Rs. 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

(PRACTICAL QUESTION 10 OF MAIN CHAPTER BRANCH ACCOUNTS-SM)

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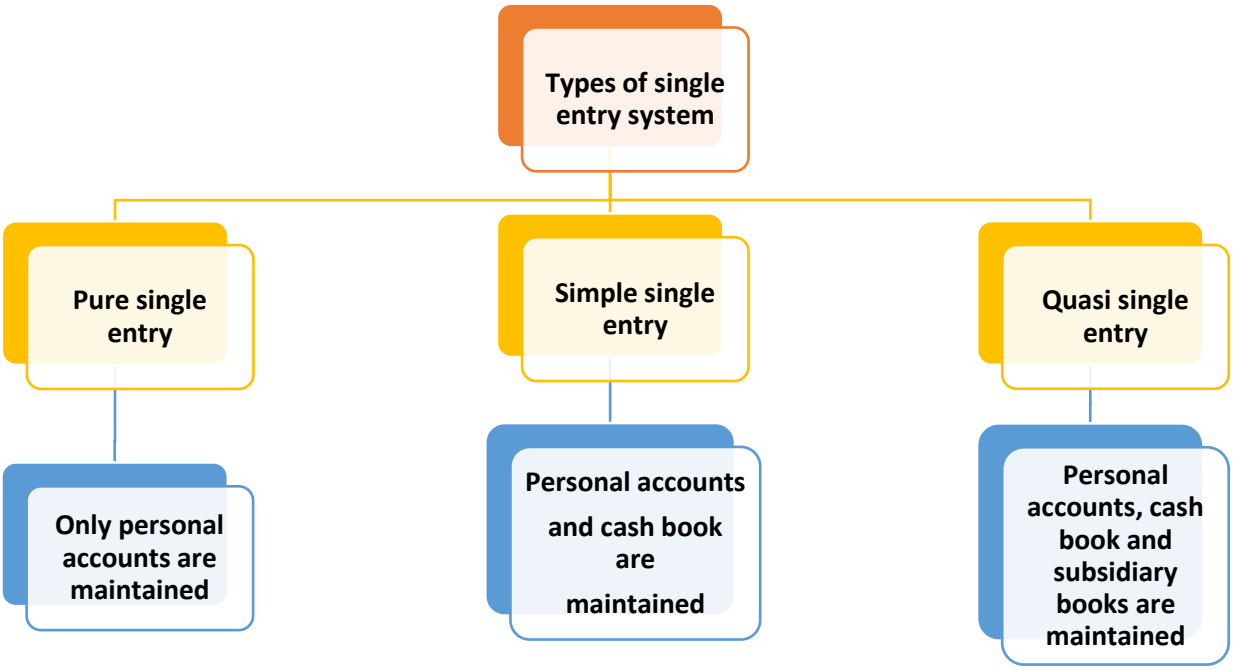
20.ACCOUNTS FROM INCOMPLETE RECORDS

OVERVIEW:

- Definition of Single Entry System and its features
- Types of Single entry system
- Determination of profit by comparing capitals at different points of time
- Statement of Affairs and its comparison with Balance sheet
- Technique of obtaining complete information for Preparation of financial statements

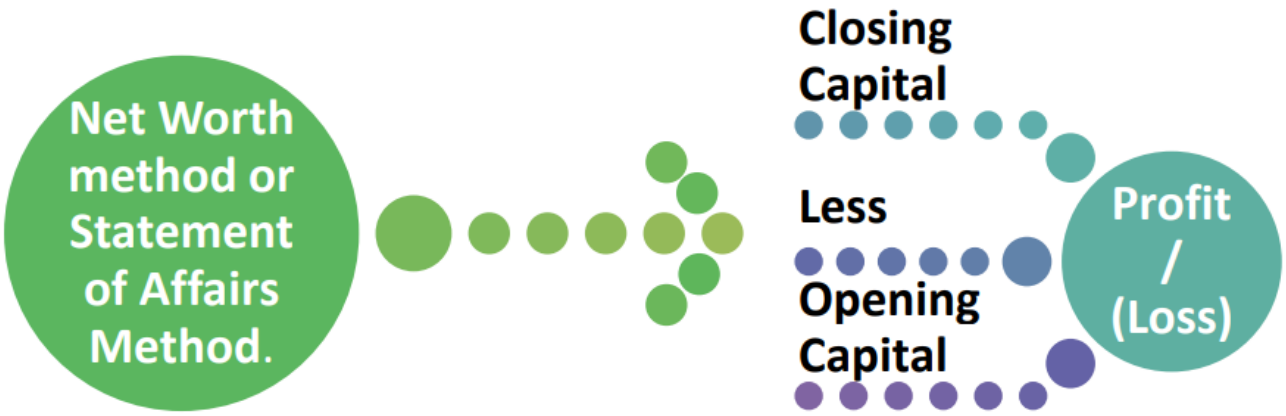
INTRODUCTION: Very often small sole proprietorship and partnership businesses do not maintain double entry book keeping system. They keep a record of the cash transactions and credit transactions only. But at the end of the accounting period, they will want to know the performance and financial position of their businesses. This chapter discusses how to complete the accounts from available incomplete records and addresses the problems faced in a single entry system.

TYPES OF SINGLE ENTRY SYSTEM:



ASCERTAINMENT OF PROFIT BY CAPITAL COMPARISON:

If detailed information regarding revenue and expenses is not known, it becomes difficult to prepare profit and loss account. Instead by collecting information about assets and liabilities, it is easier to prepare statement of affairs at two different points of time. So, while preparing accounts from incomplete records, if sufficient information is not available, it is better to follow the method of capital comparison to arrive at the profit/loss for the current year.



CALCULATION OF PROFIT/LOSS UNDER CAPITAL COMPARISION METHOD:

PARTICULARS	AMOUNT
Capital at the end (a)	**XXXX**
Add: Drawings	**XXXX**
Less: Fresh capital introduced	**(XXXX)**
Capital at the beginning (b)	**XXXX**
Profit (a-b)	**XXXX**

Difference between Statement of Affairs and Balance Sheet

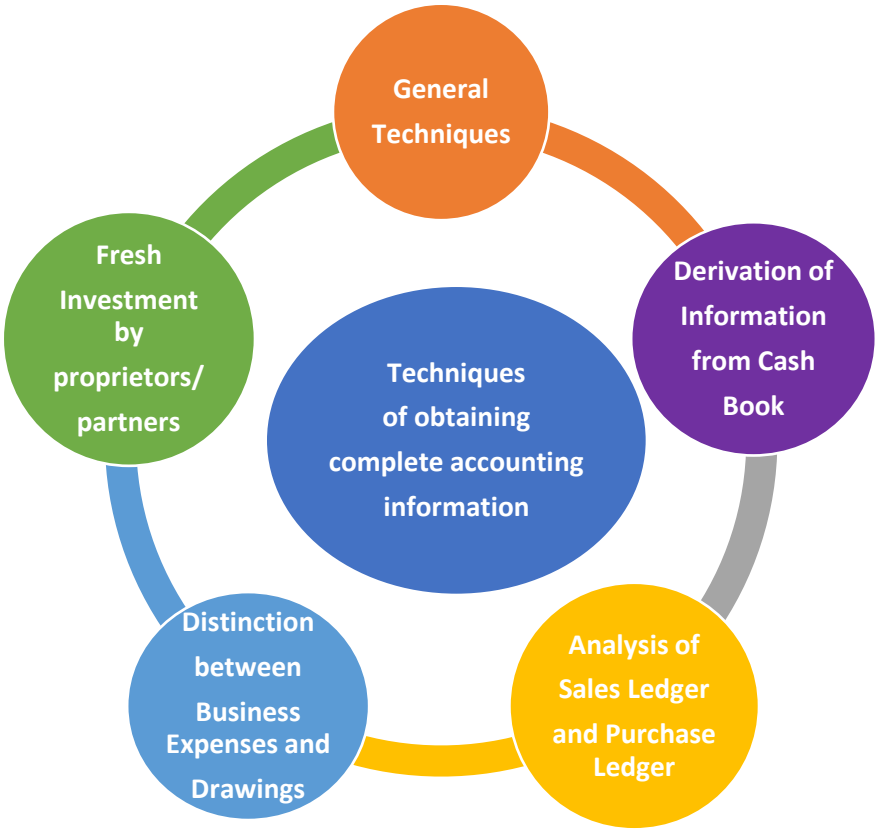
Basis	Statement of affairs	Balance sheet
Source	It is prepared on the basis of transactions partly recorded under the double entry book keeping and partly under the single entry. Most of the assets are recorded based on the estimates, assumptions, information gathered from memory rather from the records.	It is based on transactions recorded strictly on the basis of double entry book keeping; each item in the balance sheet can be verified from the relevant subsidiary books, ledger and documentary evidences.
Capital	In this statement, capital is merely a balancing figure being excess of assets over	Capital is derived from the capital account in the ledger and therefore

	liabilities. Hence assets need not be equal to liabilities.	the total of assets side will always be equal to the total of liabilities side.
Omission	Since this statement is prepared from incomplete records, it is very difficult, to identify and record those assets and liabilities, if omitted from the books.	There is no possibility of omission of any item of asset and liability since all items are properly recorded. Moreover, it is easy to locate the missing items since the balance sheet will not agree.
Basis of Valuation	The valuation of assets is generally done in an arbitrary manner; therefore no method of valuation is disclosed.	The valuation of assets is done on scientific basis, fixed assets are shown at the original costs less depreciation till date.. Any change in the method of valuation is properly disclosed.
Objective	The objective of preparing this statement is to identify the capital figures in the beginning and at the end of the accounting period respectively.	The objective of preparing the balance sheet is to ascertain the financial position on a particular date.

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Technique of obtaining complete information for Preparation of financial statements: (CONVERSION METHOD)

Where the accounts of a business are incomplete, it is advisable to convert them first to the double entry system and then to draw up the Profit and Loss Account and the Balance Sheet, instead of determining the amount of profit/loss by preparing the statement of affairs.



From exam point of view

In the examination we would be given:

1. Opening and closing assets and liabilities
2. Cash transactions
3. Other information

From this we have to prepare

1. Trading Account
2. Profit and loss account
3. Balance Sheet

How to proceed

STEP I: Prepare format of

1. Trading Account for the year
2. Profit and loss account for the year
3. Balance Sheet at the end of the year

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And various other accounts as working notes as follows

1. Opening Balance Sheet
2. Cash Book (with two separated Cash and Bank column if possible)
3. Total Debtors Account
4. Bills Receivable Account (if required)
5. Total creditors Account
6. Bills payable Account (if required)
7. Any particular fixed asset (if required)
8. Any other account as required

STEP II

1. Do the posting of opening balances in the opening balance sheet and as opening balance in concerned account
2. Do the posting of all the transactions on the basis of double entry.
3. Take in to account all the information given

4. Close all the accounts one by one logically, finding out missing figures and posting them to second account concerned. e.g. you can find cash collected from debtors from cash account, then post it to debtors account and find closing debtors etc.
5. Complete the trading account, profit and Loss account and then balance sheet.



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SOME IMPORTANT POINTS

1. Single entry problem is just like su do ku, one must be able to find out missing figures logically and sequentially.

2. **The main items of drawings are** (illustrative):
   a. Rent of premises commonly used for residential as well as business purposes.
   b. Common electricity and telephone bills.
   c. Life insurance premiums of proprietor/partners paid from business cash.
   d. Household expenses met from business cash.
   e. Private loan paid to friends and relatives out of business cash.
   f. Personal gifts made to any friends and relatives out of business cash.
   g. Goods or services taken from the business for personal consumption.
   h. Cash withdrawals to meet family expenses.
   i. Amount collected from debtors directly used for meeting personal expenses.

So it is necessary to scan the summary of cash transactions, business resources and their utilization to assess the nature of drawings and its amount.

3. **Fresh Investment by proprietors / partners**
   a. Money collected and put in the business on maturity of Life Insurance Policy of the proprietors.
   b. Interest and dividend of personal investment of the proprietors collected and put in the business.

c. Income from non-business property collected and put in the business.

d. Payments made to creditors out of personal cash.

PROBLEMS FOR DISCUSSION

PROBLEM 1:

Assets and Liabilities of Mr. X as on 31-12-2015 and 31-12-2016 are as follows:

	31-12-2015 (Rs.)	**31-12-2016 (Rs.)**
Assets		
Building	1,00,000	?
Furniture	50,000	?
Inventory	1,20,000	2,70,000
Sundry debtors	40,000	90,000
Cash at bank	70,000	85,000
Cash in hand	1,200	3,200
Liabilities		
Loans	1,00,000	80,000
Sundry creditors	40,000	70,000

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a. Decided to depreciate building by 2.5% and furniture by 10%. One Life Insurance Policy of the Proprietor was matured during the period and the amount Rs. 40,000 is retained in the business. Proprietor took @ Rs. 2,000 p.m. for meeting family expenses. Prepare Statement of Affairs. Find outprofit of Mr.X.

b. Find out profit of Mr. X for the year ended 31-03-20X2.

(SM)

PROBLEM 2:

The income tax officer, assuming the income of Shri Moti for the financial year 2013-2014 and 2014-2015 feels that Shri Moti has not disclosed the full income. He gives you the following particulars of assets and liabilities of Shri Moti on 1st April 2013 and 1st April, 2015.

1.4.2013	**Assets**	Cash in hand	25,500
		Stock	56,000
		Sundry debtors	41,500
		Land and building	1,90,000
		Wife's jewellery	75,000
	Liabilities	Owing to Moti's brother	40,000
		Sundry creditors	35,000
1.4.2015	**Assets**	Cash in hand	16,000
		Stock	91,500

		Sundry debtors	52,500
		Land and building	1,90,000
		Motor car	1,25,000
		Wife's jewellery	1,25,000
		Loan to Moti's brother	20,000
	Liabilities	Sundry creditors	55,000

During the two years the domestic expenditure was Rs.4,000 p.m. The declared income of the financial years were Rs.1,05,000 for 2013-2014 and Rs.1,23,000 for 2014-2015 respectively.

State whether the income-tax officer's contention is correct. Explain by giving your workings.

(ANS.: SUPPRESSED INCOME: RS. 1,20,000) (SM)

PROBLEM 3:

The following information relates to the business of Mr. Shiv Kumar, who requests you to prepare a Trading and Profit & Loss Account for the year ended 31st March, 2011 and a Balance Sheet as on thatdate:

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a)	Particulars	Balance as on 31st March, 2010 (Rs.)	Balance as on 31st March, 2011 (Rs.)
	Building	3,20,000	3,60,000
	Furniture	60,000	68,000
	Motorcar	80,000	80,000
	Stocks	-	40,000
	Bills payable	28,000	16,000
	Cash and Bank balances	1,80,000	1,04,000
	Sundry Debtors	1,60,000	?
	Bills receivable	32,000	28,000
	Sundry Creditors	1,20,000	?

b) Cash transactions during the year included the following besides certain other items:

Particulars	Rs.	Particulars	Rs.
Sale of old papers and miscellaneous income	20,000	Cash purchases	48,000
Miscellaneous Trade expenses (Including salaries etc.)	80,000	Payment to creditors	1,84,000
Collection from debtors	2,00,000	Cash sales	80,000

c)Other information:

i) Bills receivable drawn during the year amount to Rs.20,000 and Bills payable accepted Rs.16,000.

ii) Some items of old furniture, whose written down value on 31st March, 2010 was Rs.20,000 was sold on 30th September, 2010 for Rs.8,000. Depreciation is to be provided on Building andFurniture @ 10% p.a. and on Motorcar @ 20% p.a. Depreciation on sale

of furniture to be provided for 6 months and for additions to Building for whole year.

iii) Of the Debtors, a sum of Rs.8,000 should be written off as Bad Debt and a reserve for doubtfuldebts is to be provided @ 2%.

iv) Of the Debtors, a sum of Rs.8,000 should be written off as Bad Debt and a reserve for doubtfuldebts is to be provided @ 2%.

v) Mr. Shiv Kumar has been maintaining a steady gross profit rate of 30% on turnover.

vi) Outstanding salary on 31st March, 2010 was Rs.8,000 and on 31st March, 2011 was Rs.10,000.On 31st March, 2010, Profit and Loss Account had a credit balance of Rs.40,000.

vii) 20% of total sales and total purchases are to be treated as for cash.

viii) Additions in Furniture Account took place in the beginning of the year and there was no opening provision for doubtful debts.

(SM)

PROBLEM 4:

Adamjee keeps his books on single entry basis. The analysis of the cash book for the year ended on31st December, 2016 is given below:

Receipts	Rs.	Payments	Rs.
Bank balance as on 1st Jan, 2016	2,800	Payments to sundry creditors	35,000
		Salaries	6,500
Received from sundry debtors	48,000	General expenses	2,500
Cash sales	11,000	Rent and taxes	1,500
Capital brought during the year	6,000	Drawings	3,600
Interest on investments	200	Cash purchases	12,000
		Balance at bank on 31st Dec, 2016	6,400
		Cash in hand on 31st Dec,2016	500
	68,000		**68,000**

Particulars of other assets and liabilities are as follows:

	1st January, 2016	31st December, 2016
Sundry debtors	14,500	17,600
Sundry creditors	5,800	7,900
Machinery	7,500	7,500
Furniture	1,200	1,200
Inventory	3,900	5,700
Investments	5,000	5,000

Prepare final accounts for the year ending 31st December, 2016 after providing depreciation at 10percent on machinery and furniture and Rs.800 against doubtful debts.

(SM)

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PROBLEM 5:

Mr. Anup runs a wholesale business where in all purchases and sales are made on credit. Hefurnishes the following closing balances:

	31st March 20X1	31st March 20X2
Sundry debtors	70,000	92,000
Bills receivable	15,000	6,000
Bills payable	12,000	14,000
Sundry creditors	40,000	56,000
Inventory	1,10,000	1,90,000
Bank	90,000	87,000
Cash	5,200	5,300

Summary of cash transactions during the year 20X1- 20X2:

a. Deposited to bank after payment of shop expenses @ Rs. 600 p.m., salary @ Rs. 9,200 p.m. andpersonal expenses @ Rs. 1,400 p.m. Rs. 7,62,750.

b. Cash Withdrawn from bank Rs. 1,21,000.

c. Cash payment to suppliers Rs. 77,200 for supplies and Rs. 25,000 for furniture.

d. Cheques collected from customers but dishonoured Rs. 5,700.

e. Bills accepted by customers Rs. 40,000.

f. Bills endorsed Rs. 10,000.

g. Bills discounted Rs. 20,000, discount Rs. 750.

h. Bills matured and duly collected Rs. 16,000.

i. Bills accepted Rs. 24,000.

j. Paid suppliers by cheque Rs. 3,20,000.

k. Received Rs. 20,000 on maturity of one LIC policy of the proprietor by cheque.

l. Rent received Rs. 14,000 by cheque for the premises owned by proprietor.

m. A building was purchased on 30-11-20X1 for opening a branch for Rs. 3,50,000 and some expenses were incurred on this building, details of which are not maintained.

n. Electricity and telephone bills paid by cash Rs. 18,700, due Rs. 2,200.

Other transactions:

i. Claim against the firm for damage Rs. 1,55,000 is under legal dispute. Legal expenses Rs. 17,000.The firm anticipates defeat in the suit.

ii. Goods returned to suppliers Rs. 4,200.

iii. Goods returned by customers Rs. 1,200.

iv. Discount offered by suppliers Rs. 2,700.

v. Discount offered to the customers Rs. 2,400.

vi. The business is carried on at the rented premises for an annual rent of Rs. 20,000 which

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isoutstanding at the year end.

Prepare Trading and Profit & Loss Account of Mr. Anup for the year ended 31st March 20X2 andBalance Sheet as on that date. **(SM)**

PROBLEM 6:

Ms. Rashmi furnishes you with the following information relating to her business:

a) Assets and liabilities as on:

Particulars	1.1.2014 (Rs.)	31.12.2014 (Rs.)
Furniture (W.D.V)	12,000	12,700
Inventory at cost	16,000	14,000
Sundry Debtors	32,000	?
Sundry Creditors	22,000	30,000
Prepaid expenses	1,200	1,400
Unpaid expenses	4,000	3,600
Cash in hand and at bank	2,400	1,250

b) Receipts and payments during 2014:

Collections from debtors, after allowing discount of Rs. 3,000 amounted to Rs. 1,17,000.

Collections on discounting of bills of exchange, after deduction of discount of Rs. 250 by the bank, totaled to Rs. 12,250.

Creditors of Rs. 80,000 were paid Rs. 78,400 in full settlement of their dues.

Payment for freight inwards Rs. 6,000.

AmountwithdrawnforpersonaluseRs.14,000.

Payment for office furniture Rs. 2,000.

Investment carrying annual interest of 4% was purchased at Rs. 192 (face value Rs. 200) on 1st July, 2014 and payment made there for.

Expenses including salaries paid Rs. 29,000.Miscellaneous receipts Rs. 1,000.

c) Bills of exchange drawn on and accepted by customers during the year amounted to Rs.20,000. Of these, bills of exchange of Rs. 4,000 were endorsed in favour of creditors. An endorsed bill of exchange of Rs. 800 was dishonoured.

d) Goods costing Rs. 1,800 were used as advertising materials.

e) Goods are invariably sold to show a gross profit of 33-1/3% on sales.

f) Difference in cash book, if any, is to be treated as further drawing or introduction of capital by Ms.Rashmi.

g) Provide at 2.5% for doubtful debts on closing debtors.

Rashmi asks you to prepare Trading and Profit and Loss account for the year ended 31st December,2014 and the balance sheet as on that date.
(**SM**)

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PROBLEM 7:

Mr. A runs a business of readymade garments. He closes the books of accounts on 31st March. The Balance Sheet as on 31st March, 2011 was as follows:

Liabilities	Rs.	Assets	Rs.
A's capital a/c	4,04,000	Furniture	40,000
Creditors	82,000	Stock	2,80,000
		Debtors	1,00,000
		Cash in hand	28,000
		Cash at bank	38,000
	4,86,000		**4,86,000**

You are furnished with the following information:

a) His sales, for the year ended 31st March, 2012 were 20% higher than the sales of previous year,out of which 20% sales was cash sales.

Total sales during the year 2010-11 were Rs. 5,00,000.

b) Payments for all the purchases were made by cheques only.

c) Goods were sold for cash and credit both. Credit customers pay be cheques only.

d) Depreciation on furniture is to be charged 10% p.a.

e) Mr. A sent to the bank the collection of the month at the last date of the each month after payingsalary of Rs. 2,000 to the clerk, office expenses Rs. 1,200 and personal expenses Rs.500.

Analysis of bank pass book for the year ending 31st March 2012 disclosed the following:

Particulars	Rs.
Payment to creditors	3,00,000
Payment of rent up to 31st March, 2012	16,000
Cash deposited into the bank during the year	80,000

The following are the balances on 31st March, 2012:

Particulars	Rs.
Stock	1,60,000
Debtors	1,20,000
Creditors for goods	1,46,000

On the evening of 31st March 2012, the cashier absconded with the available cash in the cash book. You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2012 andBalance Sheet as on that date. All the workings should form part of the answer. **(SM)**

PROBLEM 8:

M/s Rohan & Sons runs a business of Electrical goods on wholesale basis. The books of accounts are closed on 31st March every year. The Balance Sheet as on 31 st March, 2019 is as follows :

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Liabilities		Assets	
Capital Trade Creditors Profit & Loss A/c	12,50,000 1,90,000 1,45,000	Fixed Assets Closing stock Trade Debtors Cash & Bank	6 50,000 3,75,000 3,65,000 1,95,000
	15,85,000		15,85,000

The management estimates the purchase & sales for the year ended 31st March,2020 as under

Particulars	Upto 31.01.2020	February 2020	February 2020
Purchases	16,20,000	1,40,000	1,25,000
Sales	20,75,000	2,10,000	1,75,000

All Sales and Purchases are on credit basis. It was decided to invest ` 1,50,000 in purchase of Fixed assets, which are depreciated @ 10% on book value. A Fixed Asset of book value as on 01.04.2019, ` 60,000 was sold for ` 56,000 on 31st March, 2020.

The time lag for payment to Trade Creditors for purchases is one month and receipt from Trade debtors for sales, is two months. The business earns a gross profit of 25% on turnover. The expenses against gross profit amounts to 15% of the turnover. The amount of depreciation is not included in these expenses.

Prepare Trading & profit & Loss Account for the year ending 31st March, 2020 and draft a Balance Sheet as at 31st March, 2020 assuming that creditors are all Trade creditors for purchases and debtors are all Trade debtors for sales and there is no other current asset and liability apart from stock and cash and bank balances.

Also, prepare Cash & Bank account and Fixed Assets account for the year ending 31 st March, 2020.

[Nov 2020-2(b)]

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NOTES

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