COMPILATION
OF
SUGGESTED ANSWERS
TO
QUESTIONS

SET AT THE

INSTITUTE'S EXAMINATIONS
(MAY, 2004 – NOVEMBER, 2013)

INTERMEDIATE (IPC) COURSE

PAPER – 5

ADVANCED ACCOUNTING

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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NEW DELHI

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Paper – 5: Advanced Accounting

Statement showing Topic-wise distribution of Examination Questions along with Marks

Topics		Term of Examination																	
		Nov. 2009		May, 2010		Nov. 2010		May, 2011		Nov. 2011		May 2012		Nov. 2012		May, 2013		Nov. 2013,	
		Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M
1	Conceptual framework for presentation and preparation of financial statements									7(e)	4					7(e)	4		
2	Problems based on Accounting Standards	1(i) 1(ii) 1(iii) 1(iv) 1(vi) 1(vii) 1(ix) 6(b) 6(c)	2 2 2 2 2 2 2 5 5 24	1(ii) 1(iii) 1(iv) 1(x) 6(c)	2 2 2 2 4 12	1(iii) 1(iv) 7(b) 7(c) 7(e)	5 5 4 4 4 22	1(a) 6(a) 7(b) 7(d)	5 8 4 4 21	1(a) 1(b) 7(a) 7(b) 7(d)	5 5 4 4 4 22	1(a) 1(b) 1(d) 7(b) 7(c) 7(d) 7(e)	5 5 5 4 4 4 4 31	1(c) 3(b) 7(a) 7(b) 7(c) 7(e)	5 4 4 4 4 4 25	1 7(a) 7(b)	20 4 4 28	1(a) 1(b) 1(c) 7(a) 7(b) 7(d)	5 5 5 4 4 4 27
3	Advanced issues in Partnership Accounts																		
Unit 1	Dissolution of firms	6(a)	6	1(v)	2	2	16			2	16	2	16			7(d)	4		
Unit 2	Amalgamation, conversion and sale of partnership firm			2	16			2	16					2	16	2	16	2	16
4	Company Accounts																	1(d)	5
Unit 1	ESOP and Buy-back of shares	1(v) 5(b)	2 8 10			3	16	1(d)	5	7(c)	4	3(a) 7(a)	8 4 12	3(a) 7(d)	12 4 16	3(b)	4		

Unit 2	Underwriting of shares and debentures			6(a)	4			1(b)	5					1(b)	5	3(a)	12		
Unit 3	Redemption of Debentures	1(x) 3	2 16 18	1 (i)	2	1 (i)	5	7 (a)	4	1 (c)	5	3(b)	8	6(a)	8			3	16
Unit 4	Amalgamation and Reconstruction	2	16	3	16	5	16	3	16	3	16	4	16	4	16	4	16		
Unit 5	Liquidation of Companies			5 (b)	8	7 (d)	4	4 (a)	8	6 (a)	8							4	16
5	Financial Statements of Insurance Companies			1(vi) 4(b)	2 8 10	4(b)	8	6(b)	8	6(b)	8			5(b)	8	5(a)	8	7(e)	4
6	Financial Statements of Banking Companies	5(a)	8	1(viii) 5(a) 6(b)	2 8 4 14	1(ii) 6(a)	5 8 13	5	16	5 (b)	8	1(c) 5(a)	5 8 13	1(a) 5(a)	5 8 13	5(b)	8	6(b)	4
7	Financial Statements of Electricity Companies			6 (d)	4	6 (b)	8			4	16	5(b)	8					5	16
8	Departmental Accounts	1(viii)	2			4 (a)	8	1(c)	5	5(a)	8			6(b)	8	7(c)	4	6(a)	12
9	Accounting for Branches including Foreign Branch Accounts	4	16	1(vii) 1(ix) 4(a)	2 2 8 12	7(a)	4	4(b) 7(e)	8 4 12	1(d)	5	6	16	1(d)	5	6	16	7(c)	4

Note: 'Q' represents question numbers as they appeared in the question paper of respective examination. 'M' represents the marks which each question carried in that respective examination.

The question papers of all the past attempts of IPCC can be accessed from the BOS Knowledge Portal at the Students' Page on the Institute's website www.icai.org.

The given Matrix contains analysis of questions pertaining to Intermediate (IPC) Examinations.

CONTENTS

1
Framework for the Presentation & Preparation of Financial Statements

Question 1

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein? *(4 Marks, May, 2007 and November, 2008)(PCC)*

Answer

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 qualitative characteristics as far as possible within limits of reasonable cost/ benefit.

1. *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. It is not right to think that more disclosures are always better. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.
2. *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. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user.
3. *Reliability*: To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless:
   (a) Transactions and events reported are faithfully represented.
   (b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'.
   (c) The reporting of transactions and events are neutral, i.e. free from bias.

(d) Prudence is exercised in reporting uncertain outcome of transactions or events.

4. *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. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

5. *True and Fair View*: Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

Question 2

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement? (2 Marks, May, 2008) (PCC)

Answer

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, they influence the making of a decision or judgment in order to achieve a pre-determined result or outcome. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.

Question 3

What are the qualitative characteristics that improve the usefulness of information provided in the financial statements? (4 Marks, November, 2011) (IPCC)

Answer

The following qualitative characteristics will help in improving the usefulness of the information provided in the financial statements:

1. <u>Understandability</u>: Information in financial statements should be presented in a manner that the users with reasonable knowledge of business and economic activities and accounting, may readily understand it. All relevant information should be given therein.

2. <u>Relevance</u>: The relevance of a piece of information should be judged by its materiality i.e. whether its omission or misstatement can influence economic decisions of users or not. No relevant information should be withheld on the grounds of complexity.

3. <u>Reliability</u>: The information are said to be reliable when transactions and events reported are represented faithfully and also when they are reported in terms of their substance and economic reality. Prudence concept is also used whenever required.

4. <u>Comparability</u>: The financial statements should permit both inter-firm and intra firm

comparison. One essential feature or requirement of comparability is disclosure of financial effect of change in accounting policies.

Question 4

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein? (4 Marks, May 2013) (IPCC)

Answer

The qualitative characteristics of financial statements which improve the usefulness of information provided in financial statements are as follows:

1. **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.
2. **Relevance:** The financial statements should contain relevant information only which influences the economic decisions of the users.
3. **Reliability:** To be useful, the information must be reliable; that is to say, they must be free from material error and bias.
4. **Comparability:** The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
5. **True and Fair view:** Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise.

2
Accounting Standards

Question 1

(a) *On 20.4.2003 JLC Ltd. obtained a loan from the Bank for ₹ 50 lakhs to be utilised as under:*

	₹
Construction of a shed	*20 lakhs*
Purchase of machinery	*15 lakhs*
Working capital	*10 lakhs*
Advance for purchase of truck	*5 lakhs*

In March, 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2004 was ₹ 9 lakhs. Show the treatment of interest under AS 16.

(b) *A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2003-2004.*

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2004. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

(4 Marks each, November 2004)(PE-II)

Answer

(a) As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time (usually 12 months or more) to get ready for its intended use or sale. If an asset is ready for its intended use or sale at the time of its acquisition then it is not treated as a qualifying asst for the purposes of AS 16.

Treatment of interest as per AS 16

	Particulars	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
(1)	Construction of a shed	Qualifying asset	$\left(₹\ 9\,\text{lakhs} \times \dfrac{₹\ 20\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 3.60 lakhs	
(2)	Purchase of machinery	Not a qualifying asset*		$\left(₹\ 9\,\text{lakhs} \times \dfrac{₹\ 15\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 2.70 lakhs.
(3)	Working capital	Not qualifying asset		$\left(₹\ 9\,\text{lakhs} \times \dfrac{₹\ 10\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 1.80 lakhs
(4)	Advance for purchase of truck	Not a qualifying asset		$\left(₹\ 9\,\text{lakhs} \times \dfrac{₹\ 5\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 0.90 lakhs
	Total		₹3.60 lakhs	₹ 5.40 lakhs

(b) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2003-2004. Subsequently in 2004 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

* On the basis that machinery is ready for its intended use at the time of its acquisition/purchase.

Question 2

(a) *A major fire has damaged assets in a factory of X Co. Ltd. on 8.4.2004, 8 days after the year end closing of accounts. The loss is estimated to be ₹ 16 crores (after estimating the recoverable amount of ₹ 24 crores from the Insurance Company).*

If the company had no insurance cover, the loss due to fire would be ₹ 40 crores.

Explain, how the loss should be treated in the Final accounts of the year ended 31.3.2004.

(b) *A Company had deferred research and development cost of ₹ 150 lakhs. Sales expected in the subsequent years are as under:*

Years	*Sales (₹ in lakhs)*
I	*400*
II	*300*
III	*200*
IV	*100*

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

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

(c) In April, 2004 a Limited Company issued 1,20,000 equity shares of ₹ 100 each. ₹ 50 per share was called up on that date which was paid by all shareholders. The remaining ₹ 50 was called up on 1.9.2004. All shareholders paid the sum in September, 2004, except one shareholder having 24,000 shares. The net profit for the year ended 31.3.2005 is ₹ 2,64,000 after dividend on preference shares and dividend distribution tax of ₹ 64,000.

Compute basic EPS for the year ended 31.3.2005 as per Accounting Standard 20.

(d) On 1.4.2001 ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of a machinery costing ₹ 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 2004 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd.?

(4 $\times$ 4 = 16 Marks, May 2005) (PE-II)

Answer

(a) The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.3.2004. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March, 2004. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the Balance Sheet. In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

(b) (i) Based on sales, research and development cost to be allocated as follows:

Year	*Research and Development cost allocation*
	(₹ in lakhs)
I	$\frac{400}{1,000} \times 150 = 60$
II	$\frac{300}{1,000} \times 150 = 45$
III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining ₹ 45 lakhs [150 – (60 + 45)] as an expense immediately.

Note: As per para 41 of AS 26 on Intangible Assets, expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. It has been assumed in the above solution that the entire cost of ₹ 150 lakhs is development cost. Therefore, the expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all the conditions specified in para 44 of AS 26. An intangible asset should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Hence the remaining unamortised amount of ₹ 45,00,000 has been written off as an expense at the end of third year.

(c) Basic earnings per share (EPS) = $\dfrac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$

$$= \frac{₹\ 2,64,000}{88,000 \text{ shares (as calculated in working note)}} = ₹3$$

Working Note:

Calculation of weighted average number of equity shares

	Number of shares	*Nominal value of shares*	*Amount paid*
1st April, 2004	1,20,000	100	50
1st September, 2004	96,000	100	100
	24,000	100	50

As per para 19 of AS 20 on Earnings per share, Partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividends to the extent of amount paid, weighted average number of shares will be calculated as:

Shares

$1,20,000 \times \frac{1}{2} \times \frac{5}{12}$ = 25,000

$96,000 \times \frac{7}{12}$ = 56,000

$24,000 \times \frac{1}{2} \times \frac{7}{12}$ = 7,000

88,000 shares

(d) According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. The accounting treatment in both the alternatives can be given as follows:

Alternative 1:

		₹ (in lakhs)
1st April, 2001	Acquisition cost of machinery (₹ 1,500 – 300)	1,200.00
31st March, 2002	*Less*: Depreciation @ 20%	240.00

	Book value	960.00
31st March, 2003	*Less*: Depreciation @ 20%	192.00
	Book value	768.00
31st March, 2004	*Less*: Depreciation @ 20%	153.60
1st April, 2004	Book value	614.40
May, 2004	*Add*: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset i.e. years ended 31st March, 2005 and 31st March, 2006.

Alternative 2:

ABC Ltd. can also debit the refund amount of ₹ 300 lakhs in capital reserve of the company.

Question 3

(a) *ABC Ltd. could not recover ₹ 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.*

The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of ₹ 10 lakhs in the books of account for the year ended 31st March, 2005?

(b) *X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2004. The wage revision is with retrospective effect from 1.4.2000. The arrear wages upto 31.3.2004 amounts to ₹ 80 lakhs. Arrear wages for the period from 1.4.2004 to 30.06.2004 (being the date of agreement) amounts to ₹ 7 lakhs.*

Decide whether a separate disclosure of arrear wages is required.

(c) *An intangible asset appears in Balance Sheet of A Co. Ltd. at ₹ 16 lakhs as on 31.3.2004. The asset was acquired for ₹ 40 lakhs in April, 1991. The Company has been amortising the asset value on straight line basis. The policy is to amortise for 20 years.*

Do you advise the Company to amortise the entire asset value in the books of the company as on 31.3.2004?

(d) *How refund of revenue grant received from the Government is disclosed in the Financial Statements?* *(4 × 4 = 16 Marks, November 2005) (PE-II)*

Answer

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

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of ₹ 10 lakhs according to para 8 of AS 4.

(b) It is given that revision of wages took place in June, 2004 with retrospective effect from 1.4.2000. The arrear wages payable for the period from 1.4.2000 to 30.6.2004 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 87 lakhs (from 1.4.2000 to 30.6.2004) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised),' Net Profit or loss for the Period, Prior Period Items and Changes in the Accounting Policies', when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

However, wages payable for the current year (from 1.4.2004 to 30.6.2004) amounting ₹ 7 lakhs is not a prior period item, hence need not be disclosed separately. This may be shown as current year wages.

(c) AS 26 'Intangible Assets', came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature. Para 67 of the standard provides that if there is persuasive evidence that the life of the intangible asset is 20 years, then no adjustment is required at 1.4.2003. However, para 63 of the standard states that if it cannot be demonstrated that the life of the intangible asset is greater than 10 years, then AS 26 would require the asset to be amortised over not more than 10 years. Since, in the given case, the amortisation period determined by applying para 63 has already expired as on 1.4.2003, the carrying amount of ₹ 16 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1.4.2003.

(d) The amount refundable in respect of a grant related to revenue should be 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 should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or 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 should be provided prospectively over the residual useful life of the asset.

Question 4

AB Ltd. launched a project for producing product X in October, 2004. The Company incurred ₹ 20 lakhs towards Research and Development expenses upto 31st March, 2006. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard. (4 Marks, May 2006) (PE-II)

Answer

As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting ₹ 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2006.

Question 5

(a) *What are the costs that are to be included in Research and Development costs as per AS 8.*

(b) *What are the conditions that are to be satisfied for 'Amalgamation in the nature of Merger'?*

(c) *X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at ₹ 10 lacs to another company for ₹ 15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4. (4 Marks each, November 2006) (PE-II)*

Answer

(a) According to paras 41 and 43 of AS 26*, "No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

* AS 8 stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. Therefore the above answer has been given as per AS 26.

Examples of research costs are:

- ♦ Costs of activities aimed at obtaining new knowledge;
- ♦ Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- ♦ Costs of the search for alternatives for materials, devices, products, processes, systems or services; and
- ♦ Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

According to paras 45 and 46 of AS 26, "In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

Examples of development activities/costs are:

- ♦ Costs of the design, construction and testing of pre-production or pre-use prototypes and models;
- ♦ Costs of the design of tools, jigs, moulds and dies involving new technology;
- ♦ Costs of the design, construction ad operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- ♦ Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

(b) As per AS 14 "Accounting for Amalgamations", amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(c) According to para 13 of AS 4 "Contingences and Events occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In this case the sale of immovable property was carried out before the closure of the books of Accounts. This is clearly an event occurring after the balance sheet date. Agreement to sell was effected before the balance sheet date and the registration was done after the balance sheet date. So the adjustment for the sale of immovable property is necessary in the books of account for the year ended 31st March, 2006.

Question 6

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2007 was detected only in May, 2007. The accounts of the company were not yet approved by the Board of Directors of the company. Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2007. Decide. (2 Marks, May, 2007) (PCC)

Answer

As per paragraph 13 of AS 4 (revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes. If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 2007.

Question 7

How Government grant relating to specific fixed asset is treated in the books as per AS-12?

(4 Marks, May, 2007) (PCC)

Answer

In accordance with AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account.

Question 8

From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

	₹ in crores
Profit before V.R.S. payments but after depreciation	*75.00*
Depreciation	*10.00*
VRS payments	*32.10*
Provision for taxation	*10.00*
Fringe benefit tax	*5.00*
Paid up share capital (shares of ₹10 each fully paid)	*93.00*

(4 Marks, November, 2007) (PCC)

Answer

		₹ in crores
Profit after depreciation but before VRS Payment		75.00
Less: Depreciation – No. adjustment required	-	
VRS payments	32.10	
Provision for taxation	10.00	
Fringe benefit tax	5.00	47.10
Net Profit		27.90
No. of shares		9.30 crores

$$\text{EPS} = \frac{\text{Net profit}}{\text{No. of shares}}$$

$$= \frac{27.90}{9.30}$$

= ₹3 per share.

Question 9

What is meant by accounting estimate? Give two examples for accounting estimate.

(2 Marks, November, 2007) (PCC)

Answer

As a result of the uncertainties in business activities, many financial statement items cannot be measured with precision but can only be estimated. These are called accounting estimates. Therefore, the management makes various estimates and assumptions of assets, liabilities, incomes and expenses as on the date of preparation of financial statements. This process of estimation involves judgments based on the latest information available.

Examples of estimation in some fields are:

(i) Estimation of useful life of depreciable assets.

(ii) Estimation of provision to be made for bad and doubtful debts.

Question 10

(i) How would you record a non-monetary grant received from the Government as per AS 12?

(ii) An industry borrowed ₹ 40,00,000 for purchase of machinery on 1.6.2007. Interest on loan is 9% per annum. The machinery was put to use from 1.1.2008. Pass journal entry for the year ended 31.3.2008 to record the borrowing cost of loan as per AS 16.

(2 Marks each, May, 2008) (PCC)

Answer

(i) According to para 7.1 of AS 12 'Accounting for Government Grants', Government grants may take the form of non-monetary assets such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary grants given free of cost are recorded at a nominal value.

(ii)

		₹
Interest upto 31.3.2008 (40,00,000 × 9% × $\frac{10}{12}$ months)	=	3,00,000
Less: Interest relating to pre-operative period 3,00,000 × $\frac{7}{10}$	=	2,10,000
Amount to be charged to P&L A/c	=	90,000
Pre-operative interest to be capitalized	=	2,10,000

Journal Entry

		₹	₹
Machinery A/c	Dr.	2,10,000	
To Loan A/c			2,10,000
(Being interest on loan for pre-operative period capitalized)			
Interest on loan A/c	Dr.	90,000	

To Loan A/c (Being the interest on loan for the post-operative period)		90,000
Profit and Loss A/c Dr. To Interest on loan A/c (Being interest on loan transferred to P&L A/c)	90,000	 90,000

Question 11

When can an item qualify to be a prior period item as per AS 5? (4 Marks, May, 2008) (PCC)

Answer

According to para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', prior period items refers to those income or expenses, which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period e.g., arrears payable to workers in current period as a result of revision of wages with retrospective effect.

Question 12

The company finds that the stock sheets of 31.3.2007 did not include two pages containing details of inventory worth ₹20 lakhs. State, how will you deal with this matter in the accounts of A Ltd., for the year ended 31st March, 2008 with reference to AS 5.

(2 Marks, November, 2008) (PCC)

Answer

As per para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', omission of two pages containing details of inventory worth ₹20 lakhs in 31.3.2007 is a prior period item. As per para 19 of the standard, prior period items are normally included in the determination of net profit or loss for the current period. Accordingly, ₹20 lakhs must be added to opening stock of 1.4.2007. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

Question 13

	Exchange Rate per $
Goods purchased on 1.1.2007 of US $ 10,000	*₹45*
Exchange rate on 31.3.2007	*₹44*
Date of actual payment 7.7.2007	*₹43*

Ascertain the loss/gain for financial years 2006-07 and 2007-08, also give their treatment as per AS 11. (4 Marks, November, 2008) (PCC)

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2007 and corresponding creditor would be recorded at ₹4,50,000 (i.e. $10,000 × ₹ 45)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2007 will be reported at ₹4,40,000 (i.e. $10,000 × ₹ 44) and exchange profit of ₹10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2006-07.

On 7.7.2007, trade payables of $10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2007-08.

Question 14

Enumerate two points which the financial statements should disclose in respect of Borrowing Costs as per AS 16. *(2 Marks, June, 2009) (PCC)*

Answer

As per AS 16, the Financial Statements should disclose the following:

(a) The accounting policy adopted for borrowing costs and

(b) The amount of borrowing costs capitalized during the period.

Question 15

(a) Explain the provisions of AS -5 regarding accounting treatment of prior period items.

(b) From the following information relating to X Ltd., calculate Diluted Earnings Per Share as per AS 20:

Net Profit for the current year	*₹ 2,00,00,000*
Number of equity shares outstanding	*40,00,000*
Basic earnings per share	*₹ 5.00*
Number of 11% convertible debentures of ₹100 each	*50,000*
Each debenture is convertible into 8 equity shares.	
Interest expense for the current year	*₹ 5,50,000*
Tax saving relating to interest expense (30%)	*₹ 1,65,000*

(4 Marks each, June, 2009) (PCC)

Answer

(a) As per AS 5, prior period items are income or expenses, which arise, in the current period as a result of errors or omission in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period. Example: arrears payable to workers in current period as a result of retrospective revision of wages.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in manner that their impact on current profit or loss can be perceived.

As per para 19 of AS 5, prior period items are normally included in determination of net profit or loss for the current profit, they can be added (or deducted as the case may be) from the current profit. An alternative approach is to show such items in the statement of profit or loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

(b) Adjusted Net profit for the current year

= 2,00,00,000+5,50,000 – 1,65,000 = ₹ 2,03,85,000

Number of equity shares resulting from conversion of debentures

= 50,000 × 8 = 4,00,000 equity shares

Total number of equity shares resulting from conversion of debentures

= 40,00,000 + 4,00,000 = 44,00,000 shares

Diluted Earnings per share = $\frac{₹\ 2,03,85,000}{44,00,000}$ = ₹4.63 (Approximately)

Question 16

(i) An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company?

(ii) ABC Ltd. developed know-how by incurring expenditure of ₹ 20 lakhs, The know-how was used by the company from 1.4.2002. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.2009. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.2009. (2 Marks each, November, 2009) (PCC)

Answer

(i) Para 8.3 of AS 4 "Contingencies and Events Occuring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to para 8.6 of the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the Report of the Directors for the financial year 2008-2009.

(ii) Journal Entry

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

Question 17

(i) *Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2006. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2006-07.*

In March, 2008, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2008.

(ii) *Briefly indicate the items which are included in the expressions "Borrowing Cost" as per AS 16.*

(iii) *Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2007 payable after 4 months. The company entered into a forward contract for 4 months @ ₹ 48.85 per dollar. On 31st December, 2007, the exchange rate was ₹ 47.50 per dollar.*

How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2008.

(iv) *A company created a provision of ₹ 75,000 for staff welfare while preparing the financial statements for the year 2007-08. On 31st March, in a meeting with staff welfare*

* As per para 63 of AS 26 "Intangible Assets", there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

association, it was decided to increase the amount of provision for staff welfare to ₹ 1,00,000. The accounts were approved by Board of Directors on 15th April, 2008.

Explain the treatment of such revision in financial statements for the year ended 31st March, 2008.

(v) *A company entered into an agreement to sell its immovable property to another company for 35 lakhs. The property was shown in the Balance Sheet at ₹7 lakhs. The agreement to sell was concluded on 15th February, 2008 and sale deed was registered on 30th April, 2008. The financial statements for the year 2007-08 were approved by the board on 12th May,2008.*

You are required to state, how this transaction would be dealt with in the financial statements for the year ended 31st March, 2008.

(vi) *X Ltd. received a revenue grant of ₹ 10 crores during 2006-07 from Government for welfare activities to be carried on by the company for its employees. The grant prescribed the conditions for utilization.*

However during the year 2008-09, it was found that the prescribed conditions were not fulfilled and the grant should be refunded to the Government.

State how this matter will have to be dealt with in the financial statements of X Ltd. for the year ended 2008-09. (2 Marks each, November, 2009 & May, 2011) (IPCC)

Answer

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

In the given situation, it is clearly a case of error in preparation of financial statements for the financial year 2006-07. Hence claim received in the financial year 2007-08 is a prior period item and should be separately disclosed in the statement of profit and loss for the year ended 31st March, 2008.

(ii) Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing cost may include:

(a) Interest and commitment charges on bank borrowings and other short term and long term borrowings.

(b) Amortisation of discounts or premiums relating to borrowings.

(c) Amortisation of ancillary costs incurred in connection with the arrangement of borrowings.

(d) Finance charges in respect of assets required under finance leases or under other similar arrangements; and

(e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

(iii) Calculation of profit or loss to be recognised in the books of Sterling Limited

Forward contract rate	₹ 48.85
Less: Spot rate	(₹ 47.50)
Loss	₹ 1.35
Forward Contract Amount	$20,000
Total loss on entering into forward contract = ($20,000 × ₹ 1.35)	₹ 27,000
Contract period	4 months
Loss for the period 1st January, 2008 to 31st March, 2008 i.e. 3 months falling in the year 2007-2008 will be ₹27,000 $\times \frac{3}{4}$ =	₹ 20,250

Balance loss of ₹6,750 (i.e. ₹ 27,000 – ₹ 20,250) for the month of April, 2008 will be recognised in the financial year 2008-2009.

(iv) As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹ 25,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2007-08.

As per the provisions of the standard, normally, all items of income and expense which are recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

(v) According to para 13 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2009 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2009, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2009.

(vi) As per para 11 of AS 12 "Government Grants", a grant that became refundable should be treated as an extra-ordinary item as per Accounting Standard 5 "Net Profit or Loss for the

Period, Prior Period Items and Changes in Accounting Policies". 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. Therefore, refund of grant of ₹ 10 crores should be shown in the profit and loss account of the company as an extra-ordinary item during the financial year 2008-09.

Question 18

(i) *Axe Limited began construction of a new plant on 1st April, 2008 and obtained a special loan of ₹ 4,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.*

The expenditure that were made on the project of plant were as follows:

	₹
1st April, 2008	*5,00,000*
1st August, 2008	*12,00,000*
1st January, 2009	*2,00,000*

The company's other outstanding non-specific loan was ₹ 23,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2009. You are required to:

(a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

(ii) Compute Basic Earnings per share from the following information:

Date	*Particulars*	*No. of shares*
1st April, 2008	*Balance at the beginning of the year*	*1,500*
1st August, 2008	*Issue of shares for cash*	*600*
31st March, 2009	*Buy back of shares*	*500*

Net profit for the year ended 31st March, 2009 was ₹ 2,75,000.

(5 Marks each, November, 2009) (IPCC)

Answer

(i) Total expenses to be capitalised for borrowings as per AS 16 "Borrowing Costs"

	₹
Cost of Plant (5,00,000 + 12,00,000 + 2,00,000)	19,00,000
Add: Amount of interest to be capitalised (W.N.2)	1,54,000
	20,54,000

Journal Entry

		₹	₹
31st March, 2009	Plant A/c Dr.	20,54,000	
	To Bank A/c		20,54,000
	[Being amount of cost of plant and borrowing cost thereon capitalised]		

Working Notes:

1. Computation of average accumulated expenses

		₹
1st April, 2008	₹ 5,00,000 $\times \frac{12}{12}$	5,00,000
1st August, 2008	₹ 12,00,000 $\times \frac{8}{12}$	8,00,000
1st January, 2009	₹ 2,00,000 $\times \frac{3}{12}$	50,000
		13,50,000

2. Amount of interest capitalised

	₹
On specific borrowing (₹ 4,00,000 x 10%)	40,000
On non-specific borrowings (₹ 13,50,000 – ₹ 4,00,000) × 12%	1,14,000
Amount of interest to be capitalised	1,54,000

(ii) Computation of weighted average number of shares outstanding during the period

Date	*No. of equity shares*	*Period outstanding*	*Weights (months)*	*Weighted average number of shares*
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1st April, 2008	1,500 (Opening)	12 months	12/12	1,500
1st August, 2008	600 (Additional issue)	8 months	8/12	400
31st March, 2009	500 (Buy back)	0 months	0/12	-
Total				1,900

$$\text{Basic Earnings Per Share} = \frac{\text{Net Profit or Loss for the period attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding during the period}}$$

$$= \frac{₹\ 2,75,000}{1,900\ \text{shares}} = ₹\ 144.74$$

Question 19

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

(ii) *A Company follows April to March as its financial year. The Company recognizes cheques dated 31st March or before, received from customers after balance sheet date, but before approval of financial statement by debiting 'Cheques in hand account' and crediting 'Debtors account'. The 'cheques in hand' is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company?*

(iii) *Closing stock for the year ending on 31.3.2010 is ₹ 50,000 which includes stock damaged in a fire in 2008-09. On 31.3.2009, the estimated net realisable value of the damaged stock was ₹ 12,000. The revised estimate of net realisable value of damaged goods amounting ₹ 4,000 has been included in closing stock of ₹ 50,000 as on 31.3.2010.*

Find the value of closing stock to be shown in Profit and Loss account for the year 2009-10. *(2 Marks each, May, 2010) (IPCC)*

Answer

(i) As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the grants is incorrect as per AS 12.

(ii) Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date". Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

(iii) The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

Thus, the value of closing stock for the year 2009-10 will be as follows:

	₹
Closing Stock (including damaged goods)	50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	46,000

Question 20

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

(i) *Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹10,00,000 and has an expected useful life of 5 years.*

(ii) *The Fair market value is also ₹10,00,000.*

(iii) *The property reverts back to the lessor on termination of the lease.*

(iv) *The unguaranteed residual value is estimated at ₹1,00,000 at the end of the year 2011.*

(v) *3 equal annual payments are made at the end of each year.*

Consider IRR = 10%.

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

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

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

(4 Marks, May, 2010) (IPCC)

Answer

(a) Computation of annual lease payment to the lessor

	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10% (₹1,00,000 × 0.7513)	75,130
Fair value to be recovered from lease payments (₹10,00,000 – ₹75,130)	9,24,870
Present value of annuity for three years is 2.4868	
Annual lease payment = ₹ 9,24,870/ 2.4868	3,71,911.70

The present value of lease payment i.e., ₹ 9,24,870 equals 92.48% of the fair market value i.e., 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(b) Computation of Unearned Finance Income

	₹
Total lease payments (₹3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	1,215,735
Less: Present value of investment (lease payments and residual value) (₹75,130 + ₹9,24,870)	(10,00,000)
Unearned finance income	2,15,735

Question 21

While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad debts @ 4% of its total debtors (as per trend follows from the previous *years). In the first week of March 2010, a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2010 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010.*

(5 Marks, November, 2010 & November, 2011) (IPCC)

Answer

As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹ 3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the balance sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹ 3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2010.

Question 22

(a) *Ram Ltd. had 12,00,000 equity shares on April 1, 2009. The company earned a profit of ₹ 30,00,000 during the year 2009-10. The average fair value per share during 2009-10 was ₹ 25. The company has given share option to its employees of 2,00,000 equity shares at option price of ₹ 15. Calculate basic E.P.S. and diluted E.P.S.*

(b) *On 1st April, 2009, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilized as under:*

(i)	*Construction of sealink across two cities:*		
	(work was held up totally for a month during the year due to high water levels)	*:*	*₹ 25 crores*
(ii)	*Purchase of equipments and machineries*	*:*	*₹ 3 crores*
(iii)	*Working capital*	*:*	*₹ 2 crores*
(iv)	*Purchase of vehicles*	*:*	*₹ 50,00,000*
(v)	*Advance for tools/cranes etc.*	*:*	*₹ 50,00,000*
(vi)	*Purchase of technical know-how*	*:*	*₹ 1 crores*
(vii)	*Total interest charged by the bank for the year ending 31st March, 2010*	*:*	*₹ 80,00,000*

Show the treatment of interest by Amazing Construction Ltd.

(c) *M Ltd. launched a project for producing product A in Nov. 2008. The company incurred ₹ 30 lakhs towards Research and Development expenses upto 31st March, 2010. Due to* *unfavourable market conditions the management feels that it is not possible to manufacture and sell the product in the market for next so many years.*

The management hence wants to defer the expenditure write off to future years.

Advise the company as per the applicable Accounting Standard.

(4 Marks each, November, 2010) (IPCC)

Answer

(a) Computation of Earnings Per Share

	Earnings ₹	Shares	Earnings per share ₹
Net Profit for the year 2009-10	30,00,000		
Weighted average number of shares outstanding during the year 2009-10		12,00,000	
Basic Earning Per Share $= \frac{30,00,000}{12,00,000}$			2.50
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value (As indicated in Working Note) $\left[2,00,000 \times \frac{15}{25}\right]$		(1,20,000)	
Diluted Earnings Per Share $\left[\frac{30,00,000}{12,80,000}\right]$	<u>30,00,000</u>	<u>12,80,000</u>	2.34

Working Note:

The earnings have not been increased as the total number of shares has been increased only by the number of shares (80,000) deemed for the purpose of the computation to have been issued for no consideration.

(b) According to para 3 of AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

As per para 6 of the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

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

	Qualifying Asset	*Interest to be capitalized* ₹	*Interest to be charged to Profit & Loss A/c* ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000*(25/32)]
Purchase of equipments and machineries	No		7,50,000	[80,00,000*(3/32)]
Working capital	No		5,00,000	[80,00,000*(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000*(.5/32)]
Advance for tools, cranes etc.	No.		1,25,000	[80,00,000*(.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000*(1/32)]
Total		62,50,000	17,50,000	

(c) As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of AS 26. Therefore, the management can not defer the expenditure write off to future years and the company is required to expense the entire amount of ₹ 30 lakhs in the Profit and Loss account of the year ended 31st March, 2010.

Question 23

The following information is available for Raja Ltd. for the accounting year 2009-10 and 2010-11:

Net profit for	₹
Year 2009-10	*25,00,000*
Year 2010-11	*40,00,000*

No. of shares outstanding prior to right issue 12,00,000 shares.

Right issue : One new share for each three outstanding i.e. 4,00,000 shares

: Right issue price ₹ 22

: Last date to exercise rights 30-6-2010

Fair value of one equity share immediately prior to exercise of rights on 30-6-2010 = ₹ 28.

You are required to compute the basic earnings per share for the years 2009-10 and 2010-11. *

(5 Marks, May, 2011) (IPCC)

* The requirement of the question was missing in the question paper and has been added later.

Answer

Computation of basic earnings per share (EPS)

	Year 2009-10 *(₹)*	*Year 2010-11* *(₹)*
EPS for the year 2009-10 as originally reported $= \dfrac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ $= \dfrac{₹\ 25{,}00{,}000}{12{,}00{,}000 \text{ shares}}$	2.08	
EPS for the year 2009-10 restated for rights issue $= \dfrac{₹\ 25{,}00{,}000}{(12{,}00{,}000 \text{ shares} \times 1.06)}$ *	1.97 (approx.)	
EPS for the year 2010-11 including effects of right issue $= \dfrac{40{,}00{,}000}{\left(12{,}00{,}000 \times 1.06 \times \dfrac{3}{12}\right) + \left(16{,}00{,}000 \times \dfrac{9}{12}\right)}$		2.64 (approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(₹\ 28 \times 12{,}00{,}000 \text{ shares}) + (₹\ 22 \times 4{,}00{,}000 \text{ shares})}{12{,}00{,}000 \text{ shares} + 4{,}00{,}000 \text{ shares}} = ₹\ 26.50$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-right value per share}}$$

$$= \frac{₹\ 28}{₹\ 26.5} = 1.06 \text{ (approx.)}$$

* The number of equity shares to be used in calculating basic earnings per share for periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the adjustment factor. The adjustment factor has been calculated in Working Note 2.

Question 24

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. The Lessee has guaranteed a residual value of ₹ 22,000 on expiry of the lease to the Lessor. However Lessor Ltd., estimates that the residual value of the machinery will be only ₹ 15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively. Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year. *(8 Marks, May, 2011) (IPCC)*

Answer

As per para 11 of AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognision should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is ₹ 7,00,000 and the net present value of minimum lease payments is ₹ 6,99,054*. As the present value of the machine is less than the fair value of the machine, the machine will be recorded at value of ₹ 6,99,054.

Calculation of finance charges for each year

Year	*Finance charge*	*Payment*	*Reduction in outstanding liability*	*Outstanding liability*
	₹	₹	₹	₹
1st year beginning	-	-	-	6,99,054
End of 1st year	1,04,858	3,00,000	1,95,142	5,03,912
End of 2nd year	75,587	3,00,000	2,24,413	2,79,499
End of 3rd year	41,925	3,00,000	2,58,075	21,424**

* Present value of minimum lease payments:

Annual lease rental x PV factor + Present value of guaranteed residual value

= ₹ 3,00,000 x (0.869 + 0.756 + 0.657) + ₹ 22,000 x (0.657)

= ₹ 6,84,600 + ₹ 14,454 = ₹ 6,99,054.

** The difference between this figure and guaranteed residual value (₹ 22,000) is due to approximation in computing the interest rate implicit in the lease.

Question 25

A company signed an agreement with the employees' union on 01-09-2010 for revision of wages with retrospective effect from 01-04-2009. This would cost the company an additional liability of ₹ 10 lakhs per annum. Is a disclosure necessary for the amount paid in 2010-11.

(4 Marks, May, 2011) (IPCC)

Answer

It is given that revision of wages took place on 1st September, 2010 with retrospective effect from 1.4.2009. The arrear of wages payable for the period 01.4.2009 to 31.3.2010, cannot be taken as an error or omission in the preparation of financial statement and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 20 lakhs should be included in current years' wages.It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extra- ordinary item. However, as per AS 5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Therefore, necessary disclosure should be made for the additional liability amounting ₹ 20 lakhs.

Question 26

(a) *On 25th April, 2010, Neel Limited obtained a loan from the bank for ₹ 70 lakhs to be utilized as under:*

	₹ in lakhs
Construction of factory shed	*28*
Purchase of machinery	*21*
Working capital	*14*
Advance for purchase of truck	*7*

In March, 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31st March, 2011 was ₹ 12 lakhs. Show the treatment of interest under Accounting Standard 16.

(5 Marks, May, 2010 & November, 2011) (IPCC)

(b) *An equipment having expected useful life of 5 years, is leased for 3 years. Both the cost and the fair value of the equipment are ₹ 6,00,000. The amount will be paid in 3 equal instalments and at the termination of lease, lessor will get back the equipment. The unguaranteed residual value at the end of 3rd year is ₹ 60,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 3rd year* *at 10% IRR is 2.4868. The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513. State with reason whether the lease constitutes finance lease and also compute the unearned finance income. (5 Marks, November, 2011) (IPCC)*

Answer

(a) Treatment of Interest as per AS 16

S. No.	*Particulars*	*Nature*	*Interest amount to be capitalized*	*Interest amount to be charged to Profit & Loss account*
1	Construction of factory shed	Qualifying asset	$₹ 12 \text{ lakhs} \times \frac{₹ 28 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 4.80 lakhs	
2	Purchase of machinery	Not a qualifying asset		$₹ 12 \text{ lakhs} \times \frac{₹ 21 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 3.60 lakhs
3	Working capital	Not a qualifying asset		$₹ 12 \text{ lakhs} \times \frac{₹ 14 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 2.40 lakhs
4	Advance for purchase of truck	Not a qualifying asset		$₹ 12 \text{ lakhs} \times \frac{₹ 7 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 1.20 lakhs
	Total		₹ 4.80 lakhs	₹ 7.20 lakhs

Note:

1. It is assumed that construction of factory shed was completed at the end of March, 2011. Accordingly, interest for the full year has been capitalized.
2. It is assumed that machinery was ready to use at the time of purchase only and on this basis it has been treated as non-qualifying asset.

(b) (i) Determination of Nature of Lease

It is assumed that the fair value of the leased equipments is equal to the present value of minimum lease payments.

Present value of residual value at the end of 3rd year = ₹ 60,000 x 0.7513

= ₹ 45,078

Present value of lease payments = ₹ 6,00,000 – ₹ 45,078

= ₹ 5,54,922

The percentage of present value of lease payments to fair value of the equipment is

(₹ 5,54,922 / ₹ 6,00,000) x 100 = 92.487%.

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

Annual lease payment = ₹ 5,54,922 / 2.4868 =₹ 2,23,147 (approx)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

= (₹ 2,23,147 × 3) + ₹ 60,000 = ₹ 6,69,441 + ₹ 60,000 = ₹ 7,29,441

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

= ₹ 7,29,441 – ₹ 6,00,000 = ₹ 1,29,441

Question 27

(a) *Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was ₹ 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was ₹ 49 per US Dollar.*

The Chief Accountant of the company passed an entry on 31st March, 2011 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

(b) *Explain the treatment of refund of Government Grants as per Accounting Standard 12.*

(4 Marks each, November, 2011) (IPCC)

Answer

(a) As per para 9 of AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2011, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.

Also, as per para 11 of the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 x ₹ 49 = ₹ 4,41,000) at 31st March, 2011, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of ₹ 5 (49 – 44) per US dollar i.e. ₹ 45,000 (USD 9,000 x ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2011 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

(b) Para 11 of AS 12, "Accounting for Government Grants", explains treatment of government grants in following situations:

(i) When government grant is related to revenue

(a) *When deferred credit account has a balance:* The amount of government grant refundable will be adjusted against unamortized deferred credit balance remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit the amount is immediately charged to profit and loss account.

(b) *Where no deferred credit account balance exists:* The amount of government grant refundable will be charged to profit and Loss account.

(ii) When government grant is related to specific fixed assets

(a) *Where at the time of receipt, the amount of government grant reduced the cost of asset:* The amount of government grant refundable will increase the book value of the asset.

(b) *Where at the time of receipt, the amount of government grant was credited to "Deferred Grant Account":* The amount of government grant refundable will reduce the capital reserve or unamortized balance of deferred grant account as appropriate.

(iii) When government grant is in the nature of Promoter's contribution

The amount of government grant refundable in part or in full on non-fulfilment of specific conditions, the relevant amount recoverable by the government will be reduced from capital reserve.

A government grant that becomes refundable is treated as an extra-ordinary item.

Question 28

(a) *A Company had deferred research and development cost ₹ 450 Lakhs. Sales expected in the subsequent years are as under:*

Years	*Sales (₹ in Lakhs)*
1	*1200*
2	*900*

3	*600*
4	*300*

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of ₹ 450 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the company ?

(b) *ABC Limited purchased a machinery for ₹ 25,00,000 which has estimated useful life of 10 years with the salvage value of ₹ 5,00,000. On purchase of the assets Central Government pays a grant for ₹ 5,00,000. Pass the journal entries with narrations in the books of the company for the first year, treating grant as deferred income.*

(5 Marks each, May 2012) (IPCC)

Answer

(a) (i) Based on sales, research and development cost (assumed that entire cost of ₹ 450 lakhs is development cost) is allocated as follows:

Year	*Research and Development cost allocation*
	(₹ in lakhs)
1st	$\frac{450}{3,000} \times 1200 = 180$
2nd	$\frac{450}{3,000} \times 900 = 135$
3rd	$\frac{450}{3,000} \times 600 = 90$
4th	$\frac{450}{3,000} \times 300 = 45$

(ii) If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining ₹ 135 lakhs [450 – (180 + 135)] as an expense immediately.

(b) Journal Entries in the books of ABC Ltd.

Year	Particulars		Dr. (₹)	Cr. (₹)
1st	Machinery Account	Dr.	25,00,000	
	To Bank Account			25,00,000
	(Being machinery purchased)			

	Bank Account Dr.	5,00,000	
	To Deferred Government Grant Account		5,00,000
	(Being grant received from the government treated as deferred income)		
	Depreciation Account (25,00,000 – 5,00,000)/10 Dr.	2,00,000	
	To Machinery Account		2,00,000
	(Being depreciation charged on Straight line method)		
	Profit & Loss Account Dr.	2,00,000	
	To Depreciation Account		2,00,000
	(Being depreciation transferred to P/L Account)		
	Deferred Government Grant Account (5,00,000/10) Dr.	50,000	
	To Profit & Loss Account		50,000
	(Being proportionate government grant taken to P/L Account)		

Question 29

(i) *Explain the concept of 'Weighted average number of equity shares outstanding during the period".*

State how would you compute, based on AS-20 the weighted average number of equity shares in the following cases:

		No. of Shares
1st April, 2011	*Balance of Equity Shares*	*4,80,000*
31st August, 2011	*Equity shares issued for cash*	*3,60,000*
1st February, 2012	*Equity shares bought back*	*1,80,000*
31st March, 2012	*Balance of equity shares*	*6,60,000*

(ii) *Compute adjusted earning per share and basic earning per share based on the following information:*

Net profit 2010-11	*₹ 11,40,000*
Net profit 2011-12	*₹ 22,50,000*
No. of equity shares outstanding	*₹ 5,00,000*

Until 31st December,2011

Bonus issue on 1st January, 2012

1 equity share for each equity share

outstanding as at 31st December, 2011 *(5 Marks, May 2012) (IPCC)*

Answer

(i) (a) As per para no. 16 of AS 20, the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. Therefore, For the purpose of calculating basic or diluted earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

(b) Weighted average number of equity shares

Period		Weighted shares
1st April, 2011 to 31st August, 2011	4,80,000 shares x 5/12	2,00,000 shares
1st September, 2011 to 31st January, 2012	8,40,000 shares x 5/12	3,50,000 shares
1st February, 2012 to 31st March, 2012	6,60,000 shares x 2/12	1,10,000 shares
		6,60,000 shares

(ii) Earnings per share

Basic EPS 2010-11 = ₹ 11,40,000/5,00,000 shares = ₹ 2.28

Basic EPS 2011-12 = ₹ 22,50,000/10,00,000 shares = ₹ 2.25

Adjusted EPS 2010-11 = ₹ 11,40,000/10,00,000 shares = ₹ 1.14

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2010-11, the earliest period reported.

Question 30

(a) *Tiger Motor Car Limited signed an agreement with its employees union for revision of wages on 01.07.2011. The revision of wages is with retrospective effect from 01.04.2008. The arrear wages up to 31.3.2011 amounts to ₹ 40,00,000 and that for the period from 01.04.2011 to 01.07.2011 amount to ₹ 3,50,000. In view of the provisions of AS 5 "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies", decide whether a separate disclosure of arrear wages is required while preparing financial statements for the year ending 31.3.2012.*

(b) *An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.*

(c) *X Ltd. sold JCB Machine having WDV of ₹ 50 Lakhs to Y Ltd for ₹ 60 Lakhs and the same JCB was leased back by Y Ltd to X Ltd. The lease is operating lease*

Comment according to relevant Accounting Standard if

(i) Sale price of ₹ 60 Lakhs is equal to fair value

(ii) Fair Value is ₹ 50 Lakhs and sale price is ₹45 Lakhs.

(iii) *Fair value is ₹ 55 Lakhs and sale price is ₹ 62 lakhs*

(iv) *Fair value is ₹ 45 Lakhs and sale price is ₹ 48 Lakhs.*

(d) *Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 2012 . However same comes to the notice of Company management during April, 2012 only. financial statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012 ?*

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Boar Directors of the company ? (4 Marks each, May 2012) (IPCC)

Answer

(a) It is given that revision of wages took place in July, 2011 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2011 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 40,00,000 (from 1.4.2008 to 31.3.2011) should be included in current year's wages. It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per para no. 12 of AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. However, wages payable for the current year (from 1.4.2011 to 1.7.2011) amounting ₹ 3,50,000 is not a prior period item hence need not be disclosed separately. This may be shown as current year wages.

(b) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts.

Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime.

A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

(c) According to AS 19, following will be the treatment in the given situations:

(i) When sales price of ₹ 60 lakhs is equal to fair value, X Ltd. should immediately recognize the profit of ₹10 lakhs (i.e. 60 – 50) in its books.

(ii) When fair value of leased JCB machine is ₹ 50 lakhs & sales price is ₹ 45 lakhs, then loss of ₹ 5 lakhs (50 – 45) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payments.

(iii) When fair value is ₹ 55 lakhs & sales price is ₹ 62 lakhs, profit of ₹ 5 lakhs (55 - 50) to be immediately recognized by X Ltd. in its books and balance profit of ₹ 7 lakhs (62-55) is to be amortised/deferred over lease period.

(iv) When fair value is ₹ 45 lakhs & sales price is ₹ 48 lakhs, then the loss of ₹ 5 lakhs (50-45) to be immediately recognized by X Ltd. in its books and profit of ₹ 3 lakhs (48-45) should be amortised/deferred over lease period.

(d) As per para no. 13 of AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Though the theft, by the cashier ₹ 6,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2012 for recognition of the loss amounting ₹ 6,00,000.

If embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5. This being extra ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2013. The nature and the amount of prior period items should be separately disclosed on the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 31

A company acquired for its internal use a software costing ₹10 lakhs on 28.01.2012 from the USA for US $ 1,00,000. The exchange rate on that date was ₹52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:*

(i) Import Duty : 20% ,

* The first sentence of this question should be read as "a company acquired for its internal use a software on 28.01.2012 from the USA for US $ 1,00,000."

(ii) *Purchase Tax : 10 %*

(iii) *Entry Tax : 5 % (Recoverable later from tax department)*

(iv) *Installation expenses : ₹25,000*

(v) *Profession fees for Clearance from Customs : ₹20,000*

Compute the cost of Software to be capitalized. *(5 Marks, November 2012) (IPCC)*

Answer

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

Purchase cost of the software	$ 1,00,000
Less: Trade discount @ 5%	($ 5,000)
	$ 95,000
Cost in ₹ (US $ 95,000 x ₹ 52)	49,40,000
Add: Import duty on cost @ 20% (₹)	9,88,000
	59,28,000
Purchase tax @ 10% (₹)	5,92,800
Installation expenses (₹)	25,000
Profession fee for clearance from customs (₹)	20,000
Cost of the software to be capitalised (₹)	65,65,800

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

Question 32

Define the term Finance Lease. State any three situations when a lease would be classified as finance lease. *(4 Marks, November 2012) (IPCC)*

Answer

As per AS 19, a finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Classification of lease into a finance lease or an operating lease depends on the substance of the transaction rather than its form. Some of the situations which would normally lead to a lease being classified as a finance lease are:

(a) the lessor transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

Question 33

(a) *Annual lease rent = ₹ 40,000 at the end of each year*

Lease period = 5 years

Guaranteed residual value = ₹ 14,000

Fair value at the inception (beginning) of lease = ₹ 1,50,000

Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.

Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

(b) *A new Plant X was acquired in exchange of old Plant B and on payment of ₹ 20,000. The carrying amount of the old Plant B was ₹ 1,75,000 (Historical cost less depreciation). The fair value of the Plant B on the date of exchange was ₹ 1,50,000.*

Suggest the accounting entry in the books of the enterprise.

(c) *A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company? (4 Marks each, November 2012) (IPCC)*

Answer

(a) In books of Lessee

Journal entry

		₹	₹
Asset A/c To Lessor (Being recognition of finance lease as asset and liability)	Dr.	1,49,888	 1,49,888

Working Note:

Year	*Lease Payments* ₹	*DF (12.6%)*	*PV* ₹
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.622	24,880

5	40,000	0.552	22,080
5	14,000	0.552	7,728
			1,49,888

(b) When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. Accordingly, the value of Plant X will be

	₹
Exchange value of Plant B	1,50,000
Add: Additional cash paid	20,000
	1,70,000

Accounting entries for acquisition of Plant X will be:

Journal Entries

			₹	₹
1	Plant X A/c	Dr.	1,70,000	
	To Plant B A/c			1,50,000
	To Bank A/c			20,000
	(Being new plant X acquired in exchange of Plant B on additional payment of ₹ 20,000)			
2	Profit and Loss A/c	Dr.	25,000	
	To Plant B A/c			25,000
	(Being loss on exchange of old Plant B transferred to Profit and Loss Account)			

	₹
Net book value of Plant B	1,75,000
Add: Additional cash paid	20,000
	1,95,000

Journal Entry

		₹	₹
Plant X A/c	Dr.	1,95,000	
To Plant B A/c			1,75,000
To Bank A/c			20,000
(Being New plant X was acquired in the exchange of plant B on additional payment of ₹ 20,000)			

(c) As per para 14 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

If these conditions are not met, no provision should be recognised.

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

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Question 34

Give two examples on each of the following items:

(i) Change in Accounting Estimate

(ii) Extra Ordinary Items

(iii) Prior Period Items. *(4 Marks, November 2012) (IPCC)*

Answer

(i) Changes in Accounting Estimates examples:

a. Estimation of provision for doubtful debts on sundry debtors.

b. Estimation of useful life of fixed assets.

(ii) Extraordinary items examples:

a. Loss due to earthquakes / fire / strike

b. Attachment of property of the enterprise

(iii) Prior period items examples:

a. Applying incorrect rate of depreciation in one or more prior periods.

b. Omission to account for income or expenditure in one or more prior periods.

Question 35

(a) *Net profit for the year 2012 : ₹ 24,00,000*

Weighted average number of equity shares outstanding during the year 2012: 10,00,000

Average Fair value of one equity share during the year 2012 : ₹25.00

Weighted average number of shares under option during the year 2012: 2,00,000

Exercise price for shares under option during the year 2012 : ₹20.00

Compute Basic and diluted earnings per share.

(b) *Closing Stock for the year ending on 31st March, 2013 is ₹1,50,000 which includes stock damaged in a fire in 2011-12. On 31st March, 2012, the estimated net realizable value of the damaged stock was ₹ 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 2012-13 is ₹4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 2012-13, using provisions of Accounting Standard 5.*

(c) *An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:*

Less than 1 year : 2% provision

More than 1 year : 3% provision

The company has raised invoices as under:

Invoice Date	*Amount (₹)*
19th January, 2011	*40,000*
29th January, 2012	*25,000*
15th October, 2012	*90,000*

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013.

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

Year	*Estimated Future Cash Flows (₹ in lakhs)*
1	*200*
2	*200*
3	*200*
4	*100*
5	*100*

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

(4 x 5 = 20 Marks, May 2013) (IPCC)

Answer

(a) Computation of earnings per share

	Earnings (₹)	*Shares*	*Earnings per share*
Net profit for the year 2012	24,00,000		
Weighted average number of shares outstanding during the year 2012		10,00,000	
Basic earnings per share			₹ 2.40
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value: (2,00,000 x 20.00)/25.00	-*	(1,60,000)	
Diluted earnings per share	24,00,000	10,40,000	₹ 2.31

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of computation to have been issued for no consideration.

(b) The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per para 25 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. It is presumed that the loss by fire in the year ended 31.3.2012, i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item. Therefore, in the year 2012-13, revision in accounting estimate should also be classified as extra-ordinary item in the profit and loss account and closing stock should be shown excluding the value of damaged stock.

Value of closing stock for the year 2012-13 will be as follows:

	₹
Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

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

As at 31st March, 2012 = ₹ 40,000 x .02 + ₹ 25,000 x .03

= ₹ 800 + ₹ 750

= ₹ 1,550

As at 31st March, 2013 = ₹ 25,000 x .02 + ₹ 90,000 x .03

= ₹ 500 + ₹ 2,700 = ₹ 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2013

	₹
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on 1.4.2012	(1,550)
Amount debited to profit and loss account	1,650

Note: No provision will be made on 31st March, 2013 in respect of sales amounting ₹ 40,000 made on 19th January, 2011 as the warranty period of 2 years has already expired.

(d) Amortization of cost of patent as per AS 26

Year	*Estimated future cash flow (₹ in lakhs)*	*Amortization Ratio*	*Amortized Amount (₹ in lakhs)*
1	200	.25	100
2	200	.25	100
3	200	.25	100
4	100	.40 (Revised)	40
5	100	.40 (Revised)	40
6	50	.20 (Revised)	20
			400

In the first three years, the patent cost will be amortised in the ratio of estimated future cash flows i.e. (200: 200: 200: 100: 100).

The unamortized amount of the patent after third year will be ₹ 100 (400-300) which will be amortised in the ratio of revised estimated future cash flows (100:100:50) in the fourth, fifth and sixth year.

Question 36

(a) *Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade*

Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) *Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.*

(ii) *Cheques sent by the stockists through courier on or before 31st March, 2013.*

(b) *Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non-monetary item:*

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Fixed Assets. *(4 Marks each, May 2013) (IPCC)*

Answer

(a) (i) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31st March, 2013 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2013) are presented in the bank in the month of April, 2013 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(ii) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2013, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2013 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

(b) As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 37

Answer the following questions:

(a) *State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013:*

(i) *An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹ 20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on15th April, 2013.*

(ii) *The negotiation with another company for acquisition of its business was started on 2nd February, 2013. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2013.*

(b) *Cost of a machine acquired on 01.04.2009 was ₹ 5,00,000. The machine is expected to realize ₹ 50,000 at the end of its working life of 10 years. Straight-line depreciation of ₹ 45,000 per year has been charged upto 2011-2012. For and from 2012-13, the company switched over to 15% p.a. reducing balance method of depreciation in respect of the machine. The new rate of depreciation is based on revised useful life of 15 years. The new rate shall apply with retrospective effect from 01.04.2009. State how would you deal with the above in the annual accounts of the Company for the year ended 31st March, 2013 in the light of AS 5.*

(c) *Beekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2012 payable in foreign currency (US$) on 05.04.2013. Exchange rate of 1 US$ = ₹ 50.00 and ₹ 54.98 as on 01.04.2012 and 31.03.2013 respectively.*

The company also obtained a soft loan of US$ 1 lakh on 01.04.2012 payable in three *annual equal instalments. First instalment was due on 01.05.2013.*

You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2013. (5 Marks each, November 2013) (IPCC)

Answer

(a) (i) According to AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2013 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2013, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013.

(ii) AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2013.

Applying provisions of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

(b) WDV of asset at the end of year 2011-12= ₹ 5,00,000 – ₹ 45,000 x 3 = ₹ 3,65,000

WDV of asset at the end of year 2011-12 (by reducing balance method)

= ₹ 5,00,000 $(1 - 0.15)^3$ = ₹ 3,07,062.50

Depreciation to be charged in year 2012-13

= (₹ 3,65,000 – ₹ 3,07,062.50) + 15% of ₹ 3,07,062.50

₹ 57,937.50 + ₹ 46,059.38 = ₹ 1,03,997 (approx.)

As per AS 5 'Net profit or loss for the period, Prior Period Items and Changes in Accounting Policies' the revision of remaining useful life is change in accounting estimate, and adoption of reducing balance method of depreciation instead of the straight-line method is change in accounting policy. Since it is difficult to segregate impact of these two changes, the entire amount of difference between depreciation at old rate and depreciation charged in 2012-13 (₹ 1,03,997- ₹ 45,000 = ₹ 58,997) is regarded as an effect of change in accounting estimate as per provisions of the standard. The effect of this change in accounting estimate should be properly disclosed in the financial statements of the company for the year ended 31st March, 2013.

(c) As per AS 11 (Revised) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as an expense in the period in which they arise. However, Ministry of Corporate Affairs has recently amended AS 11 through a notification. As per the notification, exchange difference arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to requisition of depreciable capital asset, can be added to or deducted from cost of asset. The MCA has given an option for the enterprises to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March, 2020. Thus the company can capitalize the exchange differences arising due to long term loans linked with the acquisition of fixed assets.

Transaction 1: Calculation of exchange difference on fixed assets

Foreign Exchange Liability = $\frac{5,000}{50}$ = US \$ 100 lakhs

Exchange Difference = US \$ 100 lakhs x (₹ 54.98 – ₹ 50) = ₹ 498 lakhs.

Loss due to exchange difference amounting ₹ 498 lakhs will be capitalised and added in the carrying value of fixed assets. Depreciation on the unamortised amount will be provided in the remaining years

Transaction 2: Soft loan exchange difference (US \$ 1 lakh i.e ₹ 50 lakhs)

Value of loan 31.3.13 → US \$ 1 lakh x 54.98 = ₹ 54,98,000

AS 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) and should be written off over the useful life of such long-term liability, by recognition as income or expenses in each of such periods.

Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2013 = US$1.00 lakh X ₹ (54.98 – 50) = ₹ 4.98 lakh.

Loan account is to be increased to 54.98 lakh and FCMITD account is to be debited by 4.98 lakh. Since loan is repayable in 3 equal annual instalments, ₹ 4.98 lakh/3 = ₹ 1.66 lakh is to be charged in Profit and Loss Account for the year ended 31st March, 2013 and balance in FCMITD A/c ₹ (4.98 lakh – 1.66 lakh) = ₹ 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance Sheet as a negative figure under the head 'Reserve and Surplus' as a separate line item.

Note: The above answer is given on the basis that the company has availed the option under para 46A of AS 11

Question 38

(a) *Classify the following into either operating or finance lease:*

(i) *Lessee has option to purchase the asset at lower than fair value, at the end of lease term;*

(ii) *Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of the lease term;*

(iii) *Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee;*

(iv) *Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".*

(b) *Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹ 10 lakh on research during first 5 months of the financial year 2012-13. The development of the process began on 1st September, 2012 and upto 31st March, 2013, a sum of ₹ 8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria.*

From 1st April, 2013, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹ 2 lakh per annum for next five years.

The cost of capital is 10%. The present value of annuity factor of ₹ 1 for 5 years @ 10% is 3.7908.

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

(c) *Raj & Co. has taken a loan of US$ 20,000 at the beginning of the financial year for a specific project at an interest rate of 6% per annum, payable annually. On the day of taking loan, the exchange rate between currencies was ₹ 48 per 1 US$. The exchange rate at the closing of the financial year was ₹ 50 per 1 US$. The corresponding amount could have been borrowed by the company in Indian Rupee at an interest rate of 11 % per annum. Determine the treatment of borrowing cost in the books of accounts.*

(4 Marks each, November 2013) (IPCC)

Answer

(a) (i) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(b) Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2012-13. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹ 8 lakhs incurred upto 31st March, 2013 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	₹ 2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 2 lakhs x 3.7908)	₹ 7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 8 lakhs or present value of future net cash flows ₹ 7.582 lakhs.

Hence, cost of an internally generated intangible asset will be ₹ 7.582 lakhs.

The difference of ₹ 0.418 lakhs (i.e. ₹ 8 lakhs – ₹ 7.582 lakhs) will be amortized by Plymouth for the financial year 2012-13.

Amortisation - The company can amortise ₹ 7.582 lakhs over a period of five years by charging ₹ 1.516 lakhs per annum from the financial year 2013-2014 onwards.

(c) The following computations would be made to determine the amount of borrowing costs for the purpose of AS 16 ' Borrowing Costs':

Interest for the period = US $ 20,000 × ₹ 50 per US $ × 6% = ₹ 60,000.

Increase in the liability towards the principal amount

= US$ 20,000 × ₹ (50-48) = ₹ 40,000.(A)

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

= US $ 20,000 × 48 × 11% = ₹ 1,05,600

Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 1,05,600 – ₹ 60,000 = ₹ 45,600 (B)

In the above case, ₹ 40,000 (A) is less than ₹ 45,600 (B), therefore the entire exchange difference of ₹ 40,000 would be considered as borrowing costs. The total borrowing cost would be ₹ 1,00,000 (₹ 60,000+ ₹ 40,000)

3

Advanced Issues in Partnership Accounts

Unit 1: Dissolution of firms

Question 1

'X' and 'Y' carrying on business in partnership sharing Profit and Losses equally, wished to dissolve the firm and sell the business to 'X' Limited Company on 31-3-2006, when the firm's position was as follows:

Liabilities	*₹*	*Assets*	*₹*
X's Capital	*1,50,000*	*Land and Building*	*1,00,000*
Y's Capital	*1,00,000*	*Furniture*	*40,000*
Sundry Creditors	*60,000*	*Stock*	*1,00,000*
		Debtors	*66,000*
		Cash	*4,000*
	3,10,000		*3,10,000*

The arrangement with X Limited Company was as follows:

(i) Land and Building was purchased at 20% more than the book value.

(ii) Furniture and stock were purchased at book values less 15%.

(iii) The goodwill of the firm was valued at ₹ 40,000.

(iv) The firm's debtors, cash and creditors were not to be taken over, but the company agreed to collect the book debts of the firm and discharge the creditors of the firm as an agent, for which services, the company was to be paid 5% on all collections from the firm's debtors and 3% on cash paid to firm's creditors.

(v) The purchase price was to be discharged by the company in fully paid equity shares of ₹ 10 each at a premium of ₹ 2 per share.

The company collected all the amounts from debtors. The creditors were paid off less by ₹ 1,000 allowed by them as discount. The company paid the balance due to the vendors in cash.

Prepare the Realisation account, the Capital accounts of the partners and the Cash account in the books of partnership firm. (16 Marks, November 2006)(PE-II)

Answer

Realisation Account

		₹				₹
To	Land & Building	1,00,000	By	Sundry Creditors		60,000
To	Furniture	40,000	By	X Ltd. Co. - Purchase consideration – (W.N.1)		2,79,000
To	Stock	1,00,000	By	X Ltd. Company – Sundry Debtors	66,000	
To	Debtors	66,000		*Less*: Commission 5% on 66,000	3,300	62,700
To	X Ltd. Co. - Sundry Creditors	59,000				
To	X Ltd. Co. – Commission 3% on 59,000	1,770				
To	Profits transferred to A's Capital A/c 17,465 B's Capital A/c 17,465	34,930				
		4,01,700				4,01,700

Capital Accounts

		A	*B*			*A*	*B*
		₹	₹			₹	₹
To	Shares in X Ltd. Co.–(W.N.2)	1,63,980	1,15,020	By	Balance b/d	1,50,000	1,00,000
To	Cash – Final Payment	3,485	2,445	By	Realisation a/c - Profit	17,465	17,465
		1,67,465	1,17,465			1,67,465	1,17,465

Cash Account

		₹			₹
To	Balance b/d	4,000	By	A's Capital A/c- Final payment	3,485
To	X Ltd. Co. (Amount realized from Debtors less amount paid to creditors) –(W.N.3)	1,930	By	B's Capital A/c- Final Payment	2,445
		5,930			5,930

Working Notes:

1 Calculation of Purchase consideration:

	₹
Land & Building	1,20,000
Furniture	34,000
Stock	85,000
Goodwill	40,000
	2,79,000

2. The shares received from the company have been distributed between the two partners A & B in the ratio of their final claims i.e., 1,67,465: 1,17,465*.

No. of shares received from the company = $\frac{2,79,000}{12} = 23,250$

A gets $\frac{23,250 \times 1,67,465}{2,84,930} = 13,665$ shares valued at 13,665 x 12 = ₹ 1,63,980. B gets the remaining 9,585 shares, valued at ₹ 1,15,020 (9,585 × 12)

3. Calculation of net amount received from X Ltd on account of amount realized from debtors less amount paid to creditors.

		₹
	Amount realized from Debtors	66,000
Less:	Commission for realization from debtors (5% on 66,000)	3,300
		62,700
Less:	Amount paid to creditors	59,000
		3,700
Less:	Commission for cash paid to creditors (3% on 59,000)	1,770
Net amount received		1,930

Question 2

X, Y and Z are partners. X became insolvent on 15.4.2007. The Capital account balance of partner Y is on the debit side. Partner Y is solvent. Should partner Y bear the loss arising on account of the insolvency of partner X? (2 Marks, May, 2007) (PCC)

* In the above situation, shares received from X Ltd. Company have been distributed between two partners A and B in the ratio of their final claims. Alternatively, shares received from X Ltd. can be distributed among the partners in their profit sharing ratio i.e. ₹ 2,79,000 x ½ = ₹ 1,39,500 each. In that case, firm will pay cash amounting ₹ 27,965 to A and will receive cash ₹ 22,035 from B.

Answer

If some partner is having debit balance in his capital account and is not insolvent, then he cannot be called upon to bear the loss on account of the insolvency of the other partner.

Hence, Y need not bear the loss due to insolvency of partner X.

Question 3

Explain Garner v/s Murray rule applicable in the case of partnership firms. State, when is this rule not applicable. *(2 Marks, May, 2008) (PCC)*

Answer

In the case of dissolution of a partnership firm due to insolvency, Garner vs Murray rule is applicable at the time of any partner becoming insolvent. It requires –

1. That the solvent partners should bear the loss arising due to insolvency of a partner in their capital ratio after making adjustments for past accumulated reserves, profits or losses, drawings, interest on drawings/capitals, remuneration to partners etc., to the date of dissolution but before making adjustment for profit or loss on realization in case of fluctuating capital. In case of fixed capital no such adjustments are required.
2. That the solvent partners should bring in cash equal to their respective shares of the loss on realization.

This rule is not applicable when:

1. Only one partner is solvent.
2. All partners are insolvent.
3. The partnership deed provides for a specific method to be followed in case of insolvency of a partner, and then the conditions given in the deed would prevail.

Question 4

P, Q and R are partners sharing profits and losses in the ratio of 2 : 2 : 1. Their Balance Sheet as on 31st March, 2009 is as follows:

Liabilities		₹	*Assets*	₹
Capital Accounts:			*Plant & Machinery*	*1,08,000*
P	*1,20,000*		*Fixtures*	*24,000*
Q	*48,000*		*Stock*	*60,000*
R	*24,000*	*1,92,000*	*Sundry debtors*	*48,000*
Reserve fund		*60,000*	*Cash*	*60,000*
Creditors		*48,000*		
		3,00,000		*3,00,000*

They decided to dissolve the firm. The following are the amounts realized from the assets:

	₹
Plant and Machinery	*1,02,000*
Fixtures	*18,000*
Stock	*84,000*
Sundry debtors	*44,400*

Creditors allowed a discount of 5% and realization expenses amounted to ₹ 1,500. A bill for ₹ 4,200 due for sales tax was received during the course of realization and this was also paid.

You are required to prepare:

(a) Realization account

(b) Partners' capital accounts

(c) Cash account. *(6 Marks, November, 2009) (IPCC)*

Answer

Realisation Account

Particulars	*Amount*	*Particulars*		*Amount*
	₹			₹
To Debtors A/c	48,000	By Creditors A/c		48,000
To Stock A/c	60,000	By Cash A/c (assets realised):		
To Fixtures A/c	24,000	Plant & Machinery	1,02,000	
To Plant and machinery A/c	1,08,000	Fixtures	18,000	
To Cash A/c (Creditors)	45,600	Stock	84,000	
To Cash A/c(Sales Tax)	4,200	Debtors	44,400	2,48,400
To Cash A/c (realisation expenses)	1,500			
To Profit on realisation				
P 2,040				
Q 2,040				
R 1,020	5,100			
	2,96,400			2,96,400

Partners' Capital Accounts

Particulars	*P*	*Q*	*R*	*Particulars*	*P*	*Q*	*R*
	₹	₹	₹		₹	₹	₹
To Cash A/c (Bal. fig.)	1,46,040	74,040	37,020	By Balance b/d	1,20,000	48,000	24,000

				By Reserve fund	24,000	24,000	12,000
				By Realisation A/c (Profit)	2,040	2,040	1,020
	1,46,040	74,040	37,020		1,46,040	74,040	37,020

Cash Account

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Balance b/d	60,000	By Realisation A/c (Creditors)	45,600
To Realisation A/c (assets realised)	2,48,400	By Realisation A/c (Expenses)	1,500
		By Realisation A/c (Sales tax)	4,200
		By Partners' Capital Accounts	
		P	1,46,040
		Q	74,040
		R	37,020
	3,08,400		3,08,400

Question 5

What is Piecemeal Payments method under partnership dissolution? Briefly explain the two methods followed for determining the order in which the payments are made?

(2 Marks, May, 2010) (IPCC)

Answer

Generally, the assets sold upon dissolution of partnership are realised only in small instalments over a period of time. In such circumstances the choice is either to distribute whatever is collected or to wait till whole amount is collected. Usually, the first course is adopted. In order to ensure that the distributed cash amongst the partners is in proportion to their interest in the partnership concern either of the two methods described below may be followed for determining the order in which the payment should be made:

(1) *Maximum Loss Method:* Each instalment realised is considered to be the final payment i.e. outstanding assets and claims are considered worthless and partners' accounts are adjusted on that basis each time when a deposit is made following either Garner Vs. Murray rule or the profit sharing ratio rule.

(ii) *Highest Relative Capital Method:* According to this method, the partner who has the higher relative capital, that is, whose capital is greater in proportion to his profit sharing ratio is first paid off. This method is also called as proportionate capital method.

Question 6

A, B, C and D are sharing profits and losses in the ratio 5 : 5 : 4 : 2. Frauds committed by C during the year were found out and it was decided to dissolve the partnership on 31st March, 2012 when their Balance Sheet was as under :

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital		Building	1,20,000
A	90,000	Stock	85,500
B	90,000	Investments	29,000
C	-	Debtors	42,000
D	35,000	Cash	14,500
General reserve	24,000	C	15,000
Trade creditors	47,000		
Bills payable	20,000		
	3,06,000		3,06,000

Following information is given to you:

(i) *A cheque for ₹ 4,300 received from debtor was not recorded in the books and was misappropriated by C.*

(ii) *Investments costing ₹ 5,400 were sold by C at ₹ 7,900 and the funds transferred to his personal account. This sale was omitted from the firm's books.*

(iii) *A creditor agreed to take over investments of the book value of ₹ 5,400 at ₹ 8,400. The rest of the creditors were paid off at a discount of 2%.*

(iv) *The other assets realized as follows:*

Building	105% of book value
Stock	₹ 78,000
Investments	The rest of investments were sold at a profit of ₹ 4,800
Debtors	The rest of the debtors were realized at a discount of 12%

(v) *The bills payable were settled at a discount of ₹ 400.*

(vi) *The expenses of dissolution amounted to ₹ 4,900*

(vii) *It was found out that realization from C's private assets would only be ₹ 4,000.*

Prepare the necessary Ledger Accounts. (16 Marks, November, 2010) (IPCC)

Answer

Realisation account

Particulars	₹	*Particulars*		₹
To Building	1,20,000	By Trade creditors		47,000
To Stock	85,500	By Bills payable		20,000
To Investment	29,000	By Cash		
To Debtors	42,000	Building	1,26,000	
To Cash-creditors paid (W. N. 1)	37,828	Stock	78,000	
To Cash-expenses	4,900	Investments (W.N.2)	23,000	
To Cash-bills payable (20,000-400)	19,600	Debtors (W.N. 3)	33,176	2,60,176
To Partners' Capital A/cs		By Debtors-unrecorded		4,300
A 171		By Investments-unrecorded		7,900
B 171				
C 137				
D 69	548			
	3,39,376			3,39,376

Cash account

Particulars		*Amount* ₹	*Particulars*	*Amount* ₹
To Balance b/d		14,500	By Realisation-creditors paid	37,828
To Realisation - assets realised			By Realisation-bills payable	19,600
Building	1,26,000		By Realisation-expenses	4,900
Stock	78,000		By Capital account	
Investments	23,000		A	90,528
Debtors	33,176	2,60,176	B	90,528
To C's capital A/c		4,000	D	35,292
		2,78,676		2,78,676

Partners' Capital Accounts

Particulars	*A*	*B*	*C*	*D*	*Particulars*	*A*	*B*	*C*	*D*
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d			15,000		By Balance b/d	90,000	90,000	-	35,000
To Debtors-misappropriation			4,300		By General reserve	7,500	7,500	6,000	3,000
To Investment-misappropriation			7,900		By Realisation profit	171	171	137	69
To C's capital A/c (W.N. 4)	7,143	7,143		2,777	By Cash A/c			4,000	
To Cash A/c	90,528	90,528		35,292	By A's capital A/c			7,143	
					By B's capital A/c			7,143	
					By D's capital A/c			2,777	
	97,671	97,671	27,200	38,069		97,671	97,671	27,200	38,069

Working Notes:

1. Amount paid to creditors

	₹
Book value	47,000
Less: Creditors taking over investments	(8,400)
	38,600
Less: Discount @ 2%	(772)
	37,828

2. Amount received from sale of investments

	₹
Book value	29,000
Less: Misappropriated by C	(5,400)
	23,600
Less: Taken over by a creditor	(5,400)
	18,200
Add: Profit on sale of investments	4,800
	23,000

3. Amount received from debtors

	₹
Book value	42,000
Less: Unrecorded receipt	(4,300)
	37,700
Less: Discount @ 12%	(4,524)
	33,176

4. Deficiency of C

	₹
Balance of capital as on 31st March, 2012	15,000
Debtors-misappropriation	4,300
Investment-misappropriation	7,900
	27,200
Less: Realisation Profit	(137)
General reserve	(6,000)
Contribution from private assets	(4,000)
Net deficiency of capital	17,063

This deficiency of ₹ 17,063 in C's capital account will be shared by other partners A, B and D in their capital ratio of 90 : 90 : 35.

Accordingly,

A's share of deficiency =[17,063 x (90/215)] = ₹ 7,143

B's share of deficiency =[17,063 x (90/215)] = ₹ 7,143

D's share of deficiency =[17,063 x (35/215)] = ₹ 2,777

Question 7

P, Q, R and S had been carrying on business in partnership sharing profits & losses in the ratio of 4:3:2:1. They decided to dissolve the partnership on the basis of following Balance Sheet as on 30th April, 2011:

Liabilities		*Amount (₹)*	*Assets*		*Amount (₹)*
Capital Accounts			*Land & building*		*2,46,000*
P	*1,68,000*		*Furniture & fixtures*		*65,000*
Q	*1,08,000*	*2,76,000*	*Stock*		*1,00,000*
General reserve		*95,000*	*Debtors*		*72,500*
Capital reserve		*25,000*	*Cash in hand*		*15,500*
Sundry creditors		*36,000*	*Capital overdrawn:*		
Mortgage loan		*1,10,000*	*R*	*25,000*	
			S	*18,000*	*43,000*
		5,42,000			*5,42,000*

(i)	*The assets were realized as under:*	*₹*
	Land & building	*2,30,000*
	Furniture & fixtures	*42,000*
	Stock	*72,000*
	Debtors	*65,000*

(ii) Expenses of dissolution amounted to ₹ 7,800.

(iii) Further creditors of ₹ 18,000 had to be met.

(iv) R became insolvent and nothing was realized from his private estate.

Applying the principles laid down in Garner Vs. Murray, prepare the Realisation Account, Partners' Capital Accounts and Cash Account. *(16 Marks, November, 2011) (IPCC)*

Answer

Realisation Account

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Land and building	2,46,000	By Sundry creditors	36,000
To Furniture and fixtures	65,000	By Mortgage loan	1,10,000
To Stock	1,00,000	By Cash account -	
To Debtors	72,500	Land and building	2,30,000
To Cash A/c (expenses on dissolution)	7,800	Furniture & fixtures	42,000
To Cash A/c (creditors ₹ 36,000 + ₹ 18,000)	54,000	Stock	72,000
To Cash A/c (Mortgage loan)	1,10,000	Debtors	65,000
		By Partners' capital accounts (Loss 4:3:2:1)	1,00,300
		P = 40,120	
		Q = 30,090	
		R = 20,060	
		S = 10,030	
	6,55,300		6,55,300

Partners' Capital Accounts

Particulars	*P*	*Q*	*R*	*S*	*Particulars*	*P*	*Q*	*R*	*S*
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d	-	-	25,000	18,000	By Balance b/d	1,68,000	1,08,000		
To Realization A/c (Loss)	40,120	30,090	20,060	10,030	By General Reserve	38,000	28,500	19,000	9,500
To R's Capital A/c (Deficiency)	12,636	8,424	-	-	By Capital Reserve	10,000	7,500	5,000	2,500
To Cash A/c	2,03,364	1,35,576	-	-	By Cash A/c (realization loss)	40,120	30,090	-	10,030
					By P's Capital A/c			12,636	
					By Q's Capital A/c			8,424	
					By Cash A/c				6,000
	2,56,120	1,74,090	45,060	28,030		2,56,120	1,74,090	45,060	28,030

Note: P, Q and S brought cash to make good, their share of the loss on realization.

Cash Account

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Balance b/d	15,500	By Realization A/c:	
To Realization A/c:		Expenses on dissolution	7,800
Land and building	2,30,000	Creditors (36,000+18,000)	54,000
Furniture & fixtures	42,000	Mortgage loan	1,10,000
Stock	72,000		
Debtors	65,000		
To P, Q, S's capital A/cs (40,120+30,090+10,030)	80,240	By P's capital A/c	2,03,364
To S's capital A/c	6,000	By Q's capital A/c	1,35,576
	5,10,740		5,10,740

Working Note:

As per Garner Vs. Murray rule, solvent partners have to bear the loss due to insolvency of a partner in their capital ratio.

Calculation of Capital Ratio of Solvent Partners

	P (₹)	*Q (₹)*	*S (₹)*
Opening capital	1,68,000	1,08,000	(18,000)
Add: General reserve	38,000	28,500	9,500
Capital reserve	10,000	7,500	2,500
	2,16,000	1,44,000	(6,000)

Though S is a solvent partner yet he cannot be called upon to bear loss on account of insolvency of R because his capital account has a debit balance.

Therefore, capital ratio of P & Q = 216 : 144 = 3 : 2

Deficiency of R = ₹ {(25,000 + 20,060) – (19,000 + 5,000)} = ₹ 45,060 – ₹ 24,000 = ₹ 21,060.

Deficiency of R will be shared by P & Q in the capital ratio of 3 : 2 i.e.

P = ₹ 21,060 X 3/5 = ₹ 12,636

Q = ₹ 21,060 X 2/5 = ₹ 8,424

Question 8

Ajay Enterprises, a Partnership firm in which A, B and C are three partners sharing profits and losses in the ratio of 4 : 3 : 3. The balance sheet of the firm as on 31st December, 2011 is as below:

Liabilities	₹	Assets	₹
A' s Capital	15,000	Factory Building	24,160
B' s Capital	7,500	Plant & Machinery	16,275
C' s Capital	15,000	Debtors	5,400
B' s Loan A/c	4,500	Stock	12,390
Sundry creditors	16,500	Cash at Bank	275
	58,500		58,500

On balance sheet date all the three partners have decided to dissolve their partnership. Since the realization of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remunerations 1% of the value of the assets realized other than cash at Bank and 10% of the amount distributed to the partners.

Assets were realized piece-meal as under:

	₹
First instalment	18,650
Second instalment	17,320
Third instalment	10,000
Last instalment	7,000
Dissolution expenses were provided for estimated amount of	3,000
The creditors were settled finally for	15,900

Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative capital method'. *(16 Marks, May 2012) (IPCC)*

Answer

Statement showing distribution of cash amongst the partners by Highest Relative Capital method

		Creditors	B's Loan	Capitals		
	(₹)	(₹)	(₹)	A (₹)	B (₹)	C (₹)
Balance due		16,500	4,500	15,000	7,500	15,000
On receipt of 1st instalment	18,650					

amount						
Add: Cash at bank	275					
	18,925					
Less: Dissolution expenses provided for	(3,000)					
	15,925					
Less: C's remuneration of 1% on assets realized (18,650 x 1%)	(187)					
	15,738					
Less: Payment made to creditors	(15,738)	(15,738)				
Balance due	Nil	762				
On realization of 2nd instalment	17,320					
Less: C's remuneration of 1% on assets realized (17,320 x 1%)	(173)					
	17,147					
Less: Payment made to creditors (settled for the total ₹ 15,900)	(162)	(162)				
Transferred to P& L A/c		600				
	16,985	Nil				
Less: Payment for B's loan A/c	(4,500)		(4,500)			
Amount available for distribution to partners	12,485		nil			
Less: C's remuneration of 10% of the amount distributed to partners (12,485 x 10/110)	(1,135)					
Balance distributed to partners on the basis of HRCM	11,350					
Less: Paid to C (See W.N.)	(3,750)					(3,750)
	7,600					11,250

Less: Paid to A and C in 4:3 (See W.N.)	(7,600)			(4,343)	-	(3,257)
Balance due	nil			10,657	7,500	7,993
On realization of 3rd instalment	10,000					
Less: C's remuneration of 1% on assets realized (10,000 x 1%)	(100)					
	9,900					
Less: C's remuneration of 10% of the amount distributed to partners (9,900 x 10/110)	(900)					
	9,000					
Less: Paid to A and C in 4:3 upto ₹ 8,750 (i.e. ₹ 7,600 paid on receipt of second instalment and balance of ₹ 1,150 to be paid now) (See W.N.)	(1,150)			(657)		(493)
	7,850			10,000	7,500	7,500
Less: Now, paid to A, B and C in 4:3:3	(7,850)			(3,140)	(2,355)	(2,355)
Balance due	nil			6,860	5,145	5,145
On realization of 4th and last instalment	7,000					
Less: C's remuneration of 1% on assets realized (7,000 x 1%)	(70)					
	6,930					
Less: C's remuneration of 10% of the amount distributed to partners (6,930 x 10/110)	(630)					
	6,300					
Less: Paid to A, B and C in 4:3:3	(6,300)			(2,520)	(1,890)	(1,890)
Loss suffered by partners				4,340	3,255	3,255

Working Note:

Calculation of amount paid to partners on the basis of Highest Relative Capital Method

		A ₹	B ₹	C ₹
Balance of Capital Accounts	(A)	15,000	7,500	15,000
Profit sharing ratio		4	3	3
Capital - Profit sharing ratio		3,750	2,500	5,000
Capital in profit sharing				
ratio taking B's Capital as base	(B)	10,000	7,500	7,500
Excess of A's Capital and C's Capital (A-B) =	(C)	5,000	nil	7,500
Again repeating the process for A and C				
Profit sharing ratio		4		3
Capital - Profit sharing ratio		1,250		2,500
Capital in profit sharing				
ratio taking A's Capital as base	(D)	5,000		3,750
Excess Capital to be paid first	(C-D)=(E)	nil		3,750

Therefore, first ₹ 3,750 will be paid to C. Then A and C will receive in proportion of 4:3 upto ₹ 8,750 to bring the capital of all partners A, B and C in proportion to their profit sharing ratio. Thereafter, balance available will be paid to all partners viz A, B and C in their profit sharing ratio of 4:3:3.

Question 9

Explain Garner V/S Murrary rule applicable in the case of partnership firms. State, when is this rule not applicable. *(4 Marks, May 2013) (IPCC)*

Answer

Garner vs. Murray rule

When a partner is unable to pay his debt due to the firm, he is said to be insolvent and the share of loss is to be borne by other solvent partners in accordance with the decision held in the English case of Garner vs. Murray. According to this decision, normal loss on realisation of assets is to be brought in cash by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in their capital ratio. In order to calculate the capital ratio, no adjustment will be made in case of fixed capitals. However, in case of fluctuating capitals, ratio should be calculated on the basis of adjusted capital before considering profit or loss on realization at the time of dissolution.

Non-Applicability of Garner vs Murray rule:

1. When the solvent partner has a debit balance in the capital account.

   Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.

2. When the firm has only two partners.
3. When there is an agreement between the partners to share the deficiency in capital account of insolvent partner.
4. When all the partners of the firm are insolvent.

Unit 2: Amalgamation Conversion & Sale of Partnership Firms

Question 1

Riu, Inu and Sinu were running Partnership business sharing Profits and Losses in 2 :2 : 1 ratio. Their Balance Sheet as on 31st March, 2003 stood as follows:

Balance Sheet as on 31st March, 2003

(Figures in ₹'000)

Liabilities	Amount	Amount	Assets	Amount	Amount
	₹	₹		₹	₹
Fixed Capital:			Fixed Assets		400.00
Riu	300.00		Investments		50.00
Inu	200.00		Current Assets:		
Sinu	100.00	600.00	Stock	100.00	
Current Accounts:			Debtors	275.00	
Riu	60.00		Cash & Bank	125.00	500.00
Sinu	40.00	100.00			
Unsecured Loans		100.00			
Current Liabilities		150.00			
		950.00			950.00

On 01.04.2003, they agreed to form a new company RIS (P) Ltd. with Inu and Sinu each taking up 200 shares of ₹ 10 each, which shall take over the firm as a going concern including Goodwill, but excluding Cash and Bank Balances. The following are also agreed upon:

(a) *Goodwill will be valued at 3 year's purchase of super profits.*

(b) *The actual profit for the purpose of Goodwill valuation will be ₹ 2,00,000.*

(c) *The normal rate of return will be 18% per annum on Fixed Capital.*

(d) *All other Assets and Liabilities will be taken over at Book values.*

(e) *The Purchase Consideration will be payable partly in Shares of ₹ 10 each and partly in cash. Payment in cash being to meet the requirement to discharge Riu, who has agreed to retire.*

(f) *Inu and Sinu are to acquire interest in the new company at the ratio 3 : 2.*

(g) *Realisation expenses amounted to ₹ 51,000.*

You are required to prepare Realisation Account, Cash and Bank Account, RIS (P) Limited Account and Capital Account of Partners. *(16 Marks, May 2004) (PE-II)*

Answer

Realisation Account

			₹			₹
To	Sundry Assets			By	Unsecured Loans	1,00,000
	Fixed Assets	4,00,000		By	Current Liabilities	1,50,000
	Investments	50,000		By	RIS(P) Ltd. (WN – 2)	8,51,000
	Stock	1,00,000		By	Capital Accounts:	
	Debtors	2,75,000	8,25,000		Riu	20,400
To	Goodwill (WN –1)		2,76,000		Inu	20,400
To	Bank A/c (Realisation Expenses)		51,000		Sinu	10,200
			11,52,000			11,52,000

Cash and Bank Account

		₹			₹
To	Balance b/d	1,25,000	By	Realisation A/c – Expenses	51,000
To	R.I.S (P) Ltd. (Balancing figure)	3,76,000	By	Riu's Capital A/c	4,50,000
		5,01,000			5,01,000

RIS (P) Ltd.

		₹			₹
To	Realisation A/c	8,51,000	By	Cash A/c	3,76,000
			By	Equity Shares in RIS (P) Ltd. A/c (Balancing figure)	4,75,000
		8,51,000			8,51,000

Partners' Capital Accounts

		Riu	Inu	Sinu			Riu	Inu	Sinu
		₹	₹	₹			₹	₹	₹
To	Realisation A/c	20,400	20,400	10,200	By	Balance b/d	3,00,000	2,00,000	1,00,000
To	Cash A/c	4,50,000	–	–	By	Current A/c	60,000	–	40,000
To	Sinu's A/c	–	5,000	–	By	Goodwill A/c	1,10,400	1,10,400	55,200
	(Capital Adjustment)				By	Inu's A/c	–	–	5,000

To	Equity Shares in RIS(P) Ltd.	–	2,85,000	1,90,000		(Capital Adjustment)			
		4,70,400	3,10,400	2,00,200			4,70,400	3,10,400	2,00,200

Working Notes:

(1) Calculation of Goodwill

	₹
Actual profits	2,00,000
Less: Normal Rate of Return @ 18%	
of fixed capital worth ₹ 6,00,000	1,08,000
Super Profits	92,000
Goodwill valued at 3 years' purchase	2,76,000

(2) Calculation of Purchase Consideration

	₹
Total value of assets as per Balance Sheet	9,50,000
Less: Cash and Bank Balances	1,25,000
	8,25,000
Add: Goodwill	2,76,000
	11,01,000
Less: Liabilities taken over	
Unsecured Loan	1,00,000
Current Liabilities	1,50,000
Purchase Consideration	8,51,000

(3) Sharing of Shares in New Company received as Purchase Consideration

Equity shares of RIS (P) Ltd. have been given to Inu and Sinu in the ratio 3 : 2.

Question 2

Firm X & Co. consists of partners A and B sharing Profits and Losses in the ratio of 3 : 2. The firm Y & Co. consists of partners B and C sharing Profits and Losses in the ratio of 5 : 3.

On 31st March, 2006 it was decided to amalgamate both the firms and form a new firm XY & Co., wherein A, B and C would be partners sharing Profits and Losses in the ratio of 4:5:1.

Balance Sheet as at 31.3.2006

Liabilities	*X & Co.,*	*Y & Co.*	*Assets*	*X & Co.*	*Y & Co.*
	₹	₹		₹	₹
Capital:			*Cash in hand/bank*	*40,000*	*30,000*
A	*1,50,000*	---	*Debtors*	*60,000*	*80,000*
B	*1,00,000*	*75,000*	*Stock*	*50,000*	*20,000*
C	---	*50,000*	*Vehicles*	---	*90,000*
Reserve	*50,000*	*40,000*	*Machinery*	*1,20,000*	---
Creditors	*1,20,000*	*55,000*	*Building*	*1,50,000*	---
	4,20,000	*2,20,000*		*4,20,000*	*2,20,000*

The following were the terms of amalgamation:

(i) Goodwill of X & Co., was valued at ₹ 75,000. Goodwill of Y & Co. was valued at ₹ 40,000. Goodwill account not to be opened in the books of the new firm but adjusted through the Capital accounts of the partners.

(ii) Building, Machinery and Vehicles are to be taken over at ₹ 2,00,000, ₹ 1,00,000 and ₹ 74,000 respectively.

(iii) Provision for doubtful debts at ₹ 5,000 in respect of X & Co. and ₹ 4,000 in respect of Y & Co. are to be provided.

You are required to:

(i) Show, how the Goodwill value is adjusted amongst the partners.

(ii) Prepare the Balance Sheet of XY & Co. as at 31.3.2006 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency to be kept in the respective Partners' Current account. (16 Marks, May 2006) (PE-II)

Answer

(i) Adjustment for raising and writing off of goodwill

	Raised in old profit sharing ratio		*Total*	*Written off in new ratio*	*Difference*
	X & Co.	*Y & Co.*			
	3:2 ₹	*5:3* ₹	₹	₹	₹
A.	45,000	---	45,000 Cr.	46,000 Dr.	1,000 Dr.
B.	30,000	25,000	55,000 Cr.	57,500 Dr.	2,500 Dr.
C	-	15,000	15,000 Cr.	11,500 Dr.	3,500 Cr.
	75,000	40,000	1,15,000	1,15,000	Nil

(ii) Balance Sheet of X Y & Co. (New firm) as on 31.3.2006

Liabilities	₹	*Assets*	₹
Capital Accounts:		Vehicle	74,000
A	1,72,000	Machinery	1,00,000
B	2,15,000	Building	2,00,000
C	43,000	Stock	70,000
Current Accounts:		Debtors	1,31,000
A	22,000	Cash & Bank	70,000
C	18,000		
Creditors	1,75,000		
	6,45,000		6,45,000

Working Notes:

1. Balance of Capital Accounts at the time of amalgamation of firms

X & Co. Profit and loss sharing ratio 3:2	*A's Capital* ₹	*B's Capital* ₹
Balance as per Balance Sheet	1,50,000	1,00,000
Add: Reserves	30,000	20,000
Revaluation profit (Building)	30,000	20,000
Less: Revaluation loss (Machinery)	(12,000)	(8,000)
Provision for doubtful debt.	(3,000)	(2,000)
	1,95,000	1,30,000
Y & Co. Profit and loss sharing ratio 5:3	*B's Capital* ₹	*C's Capital* ₹
Balance as per Balance sheet	75,000	50,000
Add: Reserves	25,000	15,000
Less: Revaluation (vehicle)	(10,000)	(6,000)
Provision for doubtful debts	(2,500)	(1,500)
	87,500	57,500

2. Balance of Capital Accounts in the balance sheet of the new firm as on 31.3.2006

	A ₹	*B* ₹	*C* ₹
Balance b/d: X & Co.	1,95,000	1,30,000	--
Y & Co.	-	87,500	57,500
	1,95,000	2,17,500	57,500

Adjustment for goodwill	(1,000)	(2,500)	3,500
	1,94,000	2,15,000	61,000
Total capital ₹ 4,30,000 (B's capital* i.e. ₹ 2,15,000 x 2) to be contributed in 4:5:1 ratio.	1,72,000	2,15,000	43,000
Transfer to Current Account	22,000	---	18,000

Question 3

'S' and 'T' were carrying on business as equal partner. Their Balance Sheet as on 31st March, 2008 stood as follows:

Liabilities		*₹*	*Assets*	*₹*
Capital accounts:			*Stock*	*2,70,000*
S	*6,40,000*		*Debtors*	*3,65,000*
T	*6,60,000*	*13,00,000*	*Furniture*	*75,000*
Creditors		*3,27,500*	*Joint life policy*	*47,500*
Bank overdraft		*1,50,000*	*Plant*	*1,72,500*
Bills payable		*62,500*	*Building*	*9,10,000*
		18,40,000		*18,40,000*

The operations of the business were carried on till 30th September, 2008. S and T both withdrew in equal amounts half the amount of profits made during the current period of 6 months after 10% per annum had been written off on building and plant and 5% per annum written off on furniture. During the current period of 6 months, creditors were reduced by ₹50,000, Bills payable by ₹11,500 and Bank overdraft by ₹75,000. The Joint Life policy was surrendered for ₹ 47,500 on 30th September, 2008. Stock was valued at ₹ 3,17,000 and debtors at ₹ 3,25,000 on 30th September, 2008. The other items remained the same as on 31st March, 2008.

On 30th September, 2008 the firm sold its business to ST Ltd. The value of goodwill was estimated at ₹ 5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 2008. The ST Ltd. paid the purchase consideration in equity shares of ₹ 10 each. You are required to prepare a Realization Account and Capital accounts of the partners. *(8 Marks, November, 2008) (PCC)*

Answer

Realisation Account

Particulars	*₹*	*Particulars*	*₹*
To Sundry assets:		By Creditors	2,77,500

* B's Capital ₹ 21,500 being one-half of the total capital of the firm.

	Stock		3,17,000	By	Bills payables	51,000
	Debtors		3,25,000	By	Bank overdraft	75,000
	Plant		1,63,875	By	Shares in ST Ltd. (W.N. 3)	18,80,000
	Building		8,64,500			
	Furniture		73,125			
To	Profit:					
	S	2,70,000				
	T	2,70,000	5,40,000			
			22,83,500			22,83,500

Partners' Capital Accounts

Date	*Particulars*	*S*	*T*	*Date*	*Particulars*	*S*	*T*
2008				2008			
April 1	To Cash – Drawings (W.N. 2)	20,000	20,000	April 1	By Balance b/d	6,40,000	6,60,000
Sept. 30	To Shares in ST Ltd.	9,30,000	9,50,000	Sept. 30	By Profit (W.N.2)	40,000	40,000
					By Realisation A/c (Profit)	2,70,000	2,70,000
		9,50,000	9,70,000			9,50,000	9,70,000

Working Notes:

(1) Ascertainment of total capital:

Balance Sheet
as at 30th September, 2008

Liabilities	₹	*Assets*		₹
Sundry creditors	2,77,500	Building	9,10,000	
Bills payable	51,000	*Less:* Depreciation	45,500	8,64,500
Bank overdraft	75,000	Plant	1,72,500	
Total capital (bal. fig.)	13,40,000	*Less:* Depreciation	8,625	1,63,875
		Furniture	75,000	
		Less: Depreciation	1,875	73,125
		Stock		3,17,000
		Debtors		3,25,000
	17,43,500			17,43,500

(2)

Profit earned during six months to 30 September, 2008		₹
Total capital (of S and T) on 30th September, 2008 (W.N.1)		13,40,000
Capital on 1st April, 2008		
S	6,40,000	
T	6,60,000	13,00,000
Net increase (after drawings)		40,000

Since drawings are half of profits therefore, actual profit earned is ₹ 40,000 x 2 = ₹ 80,000 (shared equally by partners S and T).

Half of the profits, has been withdrawn by both the partners equally i.e. drawings ₹ 40,000 (₹ 80,000 x ½) withdrawn by S and T in 1:1 (i.e. ₹ 20,000 each).

(3)

Purchase consideration:	₹
Total assets (W.N.1)	17,43,500
Add: Goodwill	5,40,000
	22,83,500
Less: Liabilities (2,77,500 + 51,000 + 75,000)	4,03,500
Purchase consideration	18,80,000

Note: The above solution is given on the basis that reduction in bank overdraft is after surrender of Joint life policy.

Question 4

XYZ & Co. is a partnership firm consisting of Mr. X, Mr. Y and Mr. Z who share profits and losses in the ratio of 2:2:1 and ABC Ltd. is a company doing similar business.

Following is the Balance Sheet of the firm and that of the company as at 31.3.2009:

Liabilities	*XYZ & Co.* ₹	*ABC Ltd.* ₹		*XYZ & Co.* ₹	*ABC Ltd.* ₹
Equity share capital:			*Plant & machinery*	*5,00,000*	*16,00,000*
Equity shares of ₹ 10 each		*20,00,000*	*Furniture & fixture*	*50,000*	*2,25,000*
Partners capital:			*Stock in trade*	*2,00,000*	*8,50,000*
X	*2,00,000*		*Sundry debtors*	*2,00,000*	*8,25,000*
Y	*3,00,000*		*Cash at bank*	*10,000*	*4,00,000*
Z	*1,00,000*		*Cash in hand*	*40,000*	*1,00,000*
General reserve	*1,00,000*	*7,00,000*			
Sundry creditors	*3,00,000*	*13,00,000*			
	10,00,000	*40,00,000*		*10,00,000*	*40,00,000*

It was decided that the firm XYZ & Co. be dissolved and all the assets (except cash in hand and cash at bank) and all the liabilities of the firm be taken over by ABC Ltd. by issuing 50,000 shares of ₹ 10 each at a premium of ₹ 2 per share.

Partners of XYZ & Co. agreed to divide the shares issued by ABC Ltd. in the profit sharing ratio and bring necessary cash for settlement of their capital.

The creditors of XYZ & Co. includes ₹ 1,00,000 payable to ABC Ltd. An unrecorded liability of ₹ 25,000 of XYZ & Co. must also be taken over by ABC Ltd.

Prepare:

(i) Realisation account, Partners' capital accounts and Cash in hand/Bank account in the books of XYZ & Co.

(ii) Pass journal entries in the books of ABC Ltd. for acquisition of XYZ & Co. and draw the Balance Sheet after the takeover. (16 Marks, November, 2009) (PCC)

Answer

(i) In the books of XYZ & Co.

Realisation Account

		₹			₹
To	Plant & Machinery	5,00,000	By	Sundry Creditors	3,00,000
To	Furniture & Fixture	50,000	By	ABC Ltd. (Refer W.N.)	6,00,000
To	Stock in trade	2,00,000	By	Partners' Capital Accounts (loss):	
To	Sundry Debtors	2,00,000		X's Capital A/c	20,000
				Y's Capital A/c	20,000
				Z's Capital A/c	10,000
		9,50,000			9,50,000

Partners' Capital Accounts

		X ₹	Y ₹	Z ₹			X ₹	Y ₹	Z ₹
To	Realisation A/c	20,000	20,000	10,000	By	Balance b/d	2,00,000	3,00,000	1,00,000
To	Shares in ABC Ltd.	2,40,000	2,40,000	1,20,000	By	General Reserve	40,000	40,000	20,000
To	Cash A/c	-	80,000	-	By	Cash A/c	20,000	-	10,000
		2,60,000	3,40,000	1,30,000			2,60,000	3,40,000	1,30,000

Cash and Bank Account

		Cash ₹	Bank ₹			Cash ₹	Bank ₹
To	Balance b/d	40,000	10,000	By	Cash A/c (Contra)*		10,000
To	Bank A/c (Contra)*	10,000		By	Y	80,000	
To	X	20,000					
To	Z	10,000					
		80,000	10,000			80,000	10,000

(ii) In the Books of ABC Ltd.

Journal Entries

			Dr. (₹)	Cr. (₹)
1.	Business Purchase Account	Dr.	6,00,000	
	To XYZ & Co.			6,00,000
	(Being business of XYZ & Co. purchased and payment due)			
2.	Plant and Machinery Account	Dr.	5,00,000	
	Furniture and Fixture Account	Dr.	50,000	
	Stock in Trade Account	Dr.	2,00,000	
	Sundry Debtors Account	Dr.	2,00,000	
	To Sundry Creditors Account			3,00,000
	To Unrecorded Liability Account			25,000
	To Business Purchase Account			6,00,000
	To Capital Reserve Account (Bal. Fig.)			25,000
	(Being take over of all assets and liabilities)			
3.	XYZ & Co.	Dr.	6,00,000	
	To Equity Share Capital Account			5,00,000
	To Securities Premium Account			1,00,000
	(Being purchase consideration discharged in the form of shares of ₹ 10 each issued at a premium of ₹ 2 each)			

* It is assumed that cash at bank has been withdrawn to pay ₹ 80,000 to partner Y. However, payment to Y of ₹ 80,000 can also be made by cash ₹ 70,000 & by cheque ₹ 10,000.

4.	Sundry Creditors Account	Dr.	1,00,000	
	To Sundry Debtors Account			1,00,000
	(Being mutual owings eliminated)			

Balance Sheet of ABC Ltd. (After take over of XYZ & Co.)

as at 31.3.2009

Liabilities	₹	*Assets*	₹
Share Capital :		Plant and Machinery (5,00,000 + 16,00,000)	21,00,000
2,50,000, Equity shares of ₹ 10 each fully paid up (out of which 50,000 shares has been issued for consideration other than cash)	25,00,000	Furniture and fixture (50,000 + 2,25,000)	2,75,000
Securities Premium	1,00,000	Stock in trade (2,00,000 + 8,50,000)	10,50,000
Capital Reserve	25,000	Sundry Debtors (2,00,000 + 8,25,000 – 1,00,000)	9,25,000
General Reserve	7,00,000	Cash at Bank	4,00,000
Sundry Creditors (3,00,000 + 13,00,000 – 1,00,000)	15,00,000	Cash in hand	1,00,000
Unrecorded Liability	25,000		
	48,50,000		48,50,000

Working Note:

Computation of purchase consideration:

50,000, Equity shares of ₹ 12 (10+2) each = ₹ 6,00,000

Equity shares distributed among partners:

Partner X	=	20,000 shares @ ₹ 12	= ₹ 2,40,000
Partner Y	=	20,000 shares @ ₹ 12	= ₹ 2,40,000
Partner Z	=	10,000 shares @ ₹ 12	= ₹ 1,20,000
			₹ 6,00,000

Question 5

P and Q are partners of P & Co. sharing Profit and Losses in the ratio of 3:1 and Q and R are partners of R & Co., sharing profits and losses in the ratio of 2:1. On 31st March, 2009, they *decide to amalgamate and form a new firm M/s PQR & Co., wherein P, Q and R would be partners sharing profits and losses in the ratio of 3:2:1. The Balance Sheets of two firms on the above date are as under:*

Liabilities	P & Co. ₹	R & Co. ₹	Assets	P & Co. ₹	R & Co. ₹
Capitals:			Fixed assets:		
P	2,40,000	----	Building	50,000	60,000
Q	1,60,000	2,00,000	Plant & machinery	1,50,000	1,60,000
R	----	1,00,000	Office equipment	20,000	6,000
Reserves	50,000	1,50,000	Current assets:		
Sundry creditors	1,20,000	1,16,000	Stock-in-trade	1,20,000	1,40,000
Due to P & Co.	----	1,00,000	Sundry debtors	1,60,000	2,00,000
Bank overdraft	80,000	-----	Bank balance	30,000	90,000
			Cash in hand	20,000	10,000
			Due from R & Co.	1,00,000	-----
	6,50,000	6,66,000		6,50,000	6,66,000

The amalgamated firm took over the business on the following terms:

(a) *Building of P & Co. was valued at ₹ 1,00,000.*

(b) *Plant and machinery of P & Co. was valued at ₹ 2,50,000 and that of R & Co. at ₹ 2,00,000.*

(c) *All stock in trade is to be appreciated by 20%.*

(d) *Goodwill valued of P & Co. at ₹ 1,20,000 and R & Co. at ₹ 60,000, but the same will not appear in the books of PQR & Co.*

(e) *Partners of new firm will bring the necessary cash to pay other partners to adjust their capitals according to the profit sharing ratio.*

(f) *Provisions for doubtful debts has to be carried forward at ₹ 12,000 in respect of debtors of P & Co. and ₹ 26,000 in respect of debtors of R & Co.*

You are required to prepare the Balance Sheet of new firm and capital accounts of the partners in the books of old firms. *(16 Marks, May, 2010) (IPCC)*

Answer

Balance Sheet of M/s PQR & Co. as at 31st March, 2009

Liabilities		₹	*Assets*		₹
Capitals:			Building (₹ 1,00,000 + ₹ 60,000)		1,60,000
P	5,52,000		Plant & machinery (₹ 2,50,000 + ₹ 2,00,000)		4,50,000
Q	3,68,000		Office equipment (₹ 20,000+₹ 6,000)		26,000
R	1,84,000	11,04,000	Stock-in-trade (₹ 1,44,000+₹ 1,68,000)		3,12,000
Sundry creditors (₹ 1,20,000 + ₹ 1,16,000)		2,36,000	Sundry debtors (₹ 1,60,000+ ₹ 2,00,000)	3,60,000	
Bank overdraft		80,000	*Less:* Provision for doubtful debts (₹ 12,000+₹ 26,000)	(38,000)	3,22,000
			Bank balance (₹ 30,000+₹ 90,000)		1,20,000
			Cash in hand		30,000*
		14,20,000			14,20,000

In the books of P & Co.

Partners' Capital Accounts

Particulars	*P* ₹	*Q* ₹	*Particulars*	*P* ₹	*Q* ₹
To Capital A/cs – M/s PQR & Co.	4,89,000	2,43,000	By Balance b/d	2,40,000	1,60,000
			By Reserve (3:1)	37,500	12,500
			By Profit on Realisation A/c (W.N.4)	2,11,500	70,500
	4,89,000	2,43,000		4,89,000	2,43,000

* ₹ 20,000+₹10,000+₹ 1,53,000+₹ 30,000 –₹ 1,83,000 = ₹ 30,000.

In the books of R & Co.

Partners' Capital Accounts

Particulars	*Q* ₹	*R* ₹	*Particulars*	*Q* ₹	*R* ₹
To Capital A/cs – M/s PQR & Co.	3,68,000	1,84,000	By Balance b/d	2,00,000	1,00,000
			By Reserve (2:1)	1,00,000	50,000
			By Profit on Realisation (W.N.5)	68,000	34,000
	3,68,000	1,84,000		3,68,000	1,84,000

Working Notes:

1. Computation of purchase considerations

		P & Co. ₹	*R & Co.* ₹
Assets:			
Goodwill		1,20,000	60,000
Building		1,00,000	60,000
Plant & machinery		2,50,000	2,00,000
Office equipment		20,000	6,000
Stock-in-trade		1,44,000	1,68,000
Sundry debtors		1,60,000	2,00,000
Bank balance		30,000	90,000
Cash in hand		20,000	10,000
Due from R & Co.		1,00,000	-
	(A)	9,44,000	7,94,000
Less: Liabilities:			
Creditors		1,20,000	1,16,000
Provision for doubtful debts		12,000	26,000
Due to P & Co.		-	1,00,000
Bank overdraft		80,000	-
	(B)	2,12,000	2,42,000
Purchase consideration	(A-B)	7,32,000	5,52,000

2. Computation of proportionate capital

	₹
M/s PQR & Co. (Purchase Consideration) (₹7,32,000+ ₹5,52,000)	12,84,000
Less: Goodwill adjustment	(1,80,000)
Total capital of new firm (Distributed in ratio 3:2:1)	11,04,000
P's proportionate capital	5,52,000
Q's proportionate capital	3,68,000
R's proportionate capital	1,84,000

3. Computation of Capital Adjustments

	P	*Q*	*R*	*Total*
	₹	₹	₹	₹
Balance transferred from P & Co.	4,89,000	2,43,000		7,32,000
Balance transferred from R & Co.		3,68,000	1,84,000	5,52,000
	4,89,000	6,11,000	1,84,000	12,84,000
Less: Goodwill written off in the ratio of 3:2:1	(90,000)	(60,000)	(30,000)	(1,80,000)
Existing capital	3,99,000	5,51,000	1,54,000	11,04,000
Proportionate capital	5,52,000	3,68,000	1,84,000	11,04,000
Amount to be brought in (paid off)	1,53,000	(1,83,000)	30,000	

4. In the books of P & Co.

Realisation Account

		₹			₹
To	Building	50,000	By	Creditors	1,20,000
To	Plant & machinery	1,50,000	By	Bank overdraft	80,000
To	Office equipment	20,000	By	M/s PQR & Co.	7,32,000
To	Stock-in-trade	1,20,000		(purchase consideration)	
To	Sundry debtors	1,60,000		(W.N.1)	
To	Bank balance	30,000			
To	Cash in hand	20,000			
To	Due from R & Co.	1,00,000			
To	Partners' capital A/cs				
	P 2,11,500				
	Q 70,500	2,82,000			
		9,32,000			9,32,000

5. In the books of R & Co.

Realisation Account

		₹			₹
To	Building	60,000	By	Creditors	1,16,000
To	Plant & machinery	1,60,000	By	Due to P & Co.	1,00,000
To	Office equipment	6,000	By	M/s PQR & Co.	5,52,000
To	Stock-in-trade	1,40,000		(purchase consideration)	
To	Sundry debtors	2,00,000		(W.N.1)	
To	Bank balance	90,000			
To	Cash in hand	10,000			
To	Partners' capital A/cs				
	Q 68,000				
	R 34,000	1,02,000			
		7,68,000			7,68,000

Question 6

A and B are partners of AB & Co. sharing profits and losses in the ratio of 2:1 and C and D are partners of CD & Co. sharing profits and losses in the ratio of 3:2. On 1st April 2011, they decided to amalgamate and form a new firm M/s. AD & Co. wherein all the partners of both the firm would be partners sharing profits and losses in the ratio of 2:1:3:2 respectively to A,B,C and D.

Their balance sheets on that date were as under:

Liabilities	*AB & Co. (₹)*	*CD & Co. (₹)*	*Assets*	*AB & Co. (₹)*	*CD & Co. (₹)*
Capitals					
A	*1,50,000*		*Building*	*75,000*	*90,000*
B	*1,00,000*		*Machinery*	*1,20,000*	*1,00,000*
C		*1,20,000*	*Furniture*	*15,000*	*12,000*
D		*80,000*	*Stock*	*24,000*	*36,000*
Reserve	*66,000*	*54,000*	*Debtors*	*65,000*	*78,000*
Creditors	*52,000*	*35,000*	*Due from CD & Co.*	*47,000*	
Due to AB & Co.		*47,000*			
			Cash at Bank	*18,000*	*15,000*
			Cash in hand	*4,000*	*5,000*
	3,68,000	*3,36,000*		*3,68,000*	*3,36,000*

The amalgamated firm took over the business on the following terms:

(a) Building was taken over at ₹ 1,00,000 and ₹ 1,25,000 of AB & Co. and CD & Co. respectively. And machinery was taken over at ₹ 1,25,000 and ₹ 1,10,000 of AB & Co. and CD & Co. respectively.

(b) Goodwill of AB & Co. was worth ₹ 75,000 and that of CD & Co. was worth ₹ 50,000. Goodwill account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.

(c) Provision for doubtful debts has to be carried forward at ₹ 5,000 in respect of debtors of AB & Co. and ₹ 8,000 in respect of CD & Co.

You are required:

(i) Compute the adjustments necessary for goodwill.

(ii) Pass the Journal Entries in the books of AD & Co. assuming that excess/deficit capital (taking D's capital as base) with reference to share in profits are to be transferred to current accounts. *(16 Marks, May, 2011) (IPCC)*

Answer

(i) Adjustment for raising & writing off of goodwill

	Goodwill raised in old profit sharing ratio			*Goodwill written off in new ratio*	*Difference*
	AB & Co.	*CD & Co.*	*Total*	*AD & Co.*	
	₹	₹	₹	₹	₹
A	50,000		50,000 Cr.	31,250 Dr.	18,750 Cr.
B	25,000		25,000 Cr.	15,625 Dr.	9,375 Cr.
C		30,000	30,000 Cr.	46,875 Dr.	16,875 Dr.
D		20,000	20,000 Cr.	31,250 Dr.	11,250 Dr.
	75,000	50,000	1,25,000	1,25,000	

(ii) In the books of AD & Co.

Journal Entries

Date	*Particulars*		*Debit*	*Credit*
			₹	₹
April 1, 2011	Building A/c	Dr.	1,00,000	
	Machinery A/c	Dr.	1,25,000	
	Furniture A/c	Dr.	15,000	
	Stock A/c	Dr.	24,000	
	Debtors A/c	Dr.	65,000	
	CD & Co. A/c	Dr.	47,000	

	Cash at bank A/c	Dr.	18,000	
	Cash in hand A/c	Dr.	4,000	
	To Provision for doubtful debts A/c			5,000
	To Creditors A/c			52,000
	To A's capital A/c (W.N. 2a)			2,10,667
	To B's capital A/c (W.N.2 a)			1,30,333
	(Being the sundry assets and liabilities of AB & Co. taken over at the values stated as per the agreement)			
April 1, 2011	Building A/c	Dr.	1,25,000	
	Machinery A/c	Dr.	1,10,000	
	Furniture A/c	Dr.	12,000	
	Stock A/c	Dr.	36,000	
	Debtors A/c	Dr.	78,000	
	Cash at bank A/c	Dr.	15,000	
	Cash in hand A/c	Dr.	5,000	
	To Provision for doubtful debts A/c			8,000
	To Creditors A/c			35,000
	To AB & Co. A/c			47,000
	To C's capital A/c (W.N. 2b)			1,74,600
	To D's capital A/c (W.N. 2b)			1,16,400
	(Being the sundry assets and liabilities of CD & Co. taken over at the values stated as per the agreement)			
	C's capital A/c	Dr.	16,875	
	D's capital A/c	Dr.	11,250	
	To A's capital A/c			18,750
	To B's capital A/c			9,375
	(Being adjustment in capital accounts of the partners on account of goodwill)			
	AB & Co. A/c	Dr.	47,000	
	To CD & Co. A/c			47,000
	(Being mutual indebtedness of AB & Co. and CD & Co. cancelled)			
	A's Capital A/c	Dr.	1,24,267	
	To A's Current A/c			1,24,267
	(Being excess amount in A's capital A/c transferred to A's current A/c - refer W.N.3)			

	B's Capital A/c	Dr.	87,133	
	To B's Current A/c			87,133
	(Being excess amount in B's capital A/c transferred to B's current A/c - refer W.N.3)			

Working Notes:

(1) Profit on Revaluation

	AB & Co.	*CD & Co.*
	₹	₹
Building (1,00,000 – 75,000)	25,000	
(1,25,000 – 90,000)		35,000
Machinery (1,25,000 – 1,20,000)	5,000	
(1,10,000 – 1,00,000)		10,000
	30,000	45,000
Less: Provision for doubtful debts	(5,000)	(8,000)
	25,000	37,000

(2) Balance of capital accounts of partners on transfer of business to AD & Co.

(a) AB & Co.

	A's Capital	*B's Capital*
	₹	₹
Balance as per the Balance Sheet	1,50,000	1,00,000
Reserves in the profits and losses sharing ratio	44,000	22,000
Profit on revaluation in the profits and losses sharing ratio (W.N.1)	16,667	8,333
	2,10,667	1,30,333

(b) CD & Co.

	C's Capital	*D's Capital*
	₹	₹
Balance as per the Balance Sheet	1,20,000	80,000
Reserves in the profits and losses sharing ratio	32,400	21,600
Profit on revaluation in the profits and losses sharing ratio (W.N.1)	22,200	14,800
	1,74,600	1,16,400

(

3) Calculation of capital of each partner in the new firm

Particulars	*A*	*B*	*C*	*D*
	₹	₹	₹	₹
Balance as per W.N.2	2,10,667	1,30,333	1,74,600	1,16,400
Adjustment for goodwill	18,750	9,375	(16,875)	(11,250)
	2,29,417	1,39,708	1,57,725	1,05,150
Total capital ₹ 4,20,600* in the new ratio of 2:1:3:2	(1,05,150)	(52,575)	(1,57,725)	(1,05,150)
Transfer to Current Account	1,24,267 Cr.	87,133 Cr.	-	-

* Taking D's capital as the base which is 2/8th of total capital; total capital will be 1,05,150 x 8/2 i.e. ₹ 4,20,600.

Question 7

P, Q and R are partners sharing profits and losses in the ratio 3 : 2 : 1 after allowing interest on capital @ 9% p.a. Their Balance Sheet as at 31st March, 2012 are as follows:

Liabilities	*₹*	*Assets*	*₹*
Capital Accounts:		*Plant & Machinery*	*1,08,000*
P 50,000		*Fixtures*	*20,000*
Q 30,000		*Stock*	*50,000*
R 20,000	*1,00,000*	*Sundry Debtors*	*30,000*
Reserve Fund	*60,000*		
Creditors	*48,000*		
	2,08,000		*2,08,000*

They applied for conversion of the firm into a Private Limited Company named PQR Pvt. Ltd. and the certificate was received on 01-04-2012. They decided to maintain same profit sharing ratio and to preserve the priority in regard to repayment of capital as far as possible. For that purpose, they decided to insert a clause of issuance of Preference shares in Memorandum of Association in addition to issuance of Equity shares of ₹ 10 each.

On 01-04-2012, the value of goodwill is to be determined on the basis of 2 years' purchase of the average profit from the business of the last 5 years. The particulars of profits are as under:

		₹
Year ended 31.03.2008	*Profit*	*10,000*
Year ended 31.03.2009	*Loss*	*5,000*

Year ended 31.03.2010	*Profit*	*18,000*
Year ended 31.03.2011	*Profit*	*27,000*
Year ended 31.03.2012	*Profit*	*30,000*

The loss for the year ended 31-03-2009 was on account of loss by strike to the extent of 10,000.

It was agreed that rest of the assets are valued on the basis of the Balance Sheet as at 31-03-2012 except Plant & Machinery which is valued at ₹ 1,02,000.

You are required to prepare (a) the Balance Sheet of the Company as at 01-04-2012, (b) Partners' Capital Accounts and (c) Statement showing the final settlement between the partners taking Q's capital as basis. (16 Marks, November 2012) (IPCC)

Answer

(a) Balance Sheet of the PQR Pvt. Ltd. as on 1-4-2012

	Note No.	₹
Equity and Liabilities		
Shareholders funds		
Share capital	1	1,90,000
Current liabilities		
Trade Payables		48,000
Total		2,38,000
Assets		
Non-current assets		
Fixed assets		
	2	1,22,000
	3	36,000
Current assets		
Inventories		50,000
Trade Receivables		30,000
Total		2,38,000

Notes to Accounts

	₹
1. *Share Capital*	
Equity share capital 18,000 fully paid shares of ₹ 10 each	1,80,000
Preference share capital (9% Preference Shares)	10,000
(All the shares have been issued for consideration other than cash)	1,90,000

2.	*Tangible assets*	
	Plant and Machinery	1,02,000
	Fixtures	20,000
		1,22,000
3.	*Intangible assets*	
	Goodwill	36,000

(b) In the books of Partnership Firm

Partners' Capital Accounts

	P ₹	*Q* ₹	*R* ₹		*P* ₹	*Q* ₹	*R* ₹
To Plant and machinery account	3,000	2,000	1,000	By Balance b/d	50,000	30,000	20,000
To Equity shares in PQR Pvt. Ltd.	90,000	60,000	30,000	By Reserve fund	30,000	20,000	10,000
To 9% Preference shares in PQR Pvt. Ltd.	5,000		5,000	By Realization* A/c (Profit on sale of business	18,000	12,000	6,000
	98,000	62,000	36,000		98,000	62,000	36,000

(c) Statement showing the final settlement between the Partners taking Q's capital as basis

	P	Q	R	Total
	₹	₹	₹	₹
Value of Equity Shares to be allotted, taking Q's capital as basis P's Capital = 60,000 × 3/2 R's Capital = 60,000 × 1/2	90,000	60,000	30,000	
Total Value of Equity Shares allotted to P,Q and R				1,80,000
9% Preference Shares to be allotted to P ₹ (95,000-90,000)	5,000			
9%Preference Shares to be allotted to R ₹ (35,000-30,000)			5,000	
Total Value of Preference Shares allotted to P and R				10,000
Total Purchase Consideration				1,90,000

Taking Q's capital as Basis, both P and R have ₹ 5,000 each as excess in their capital account balances. Since interest on capital is meant to compensate those whose capital is in excess of proportionate limits and since in the case of partners it is an appropriation of profit, it will be proper to give 9% preference shares to P and R for ₹ 5,000 each and the remaining amount of ₹ 1,80,000 in the form of Equity Shares to be divided among P, Q and R in the ratio 3:2:1. They will then share the company's profit in the ratio 3:2:1 after allowing preference dividend.

Working Notes:

1. Calculation of goodwill

	2007-08 ₹	*2008-09* ₹	*2009-10* ₹	*2010-11* ₹	*2011-12* ₹
Profits	10,000	(5,000)	18,000	27,000	30,000
Adjustment for abnormal loss in 2008-09	—	10,000	—	—	—
	10,000	5,000	18,000	27,000	30,000
Total Profit from 2007-08 to 2011-12					90,000
Average Profit (90,000 / 5)					18,000
Goodwill equal to 2 years' purchase					36,000

2 Purchase consideration Computation of Value placed on business:

Assets :	₹
Goodwill	36,000
Plant & Machinery	1,02,000
Fixtures	20,000
Stock	50,000
Sundry Debtors	30,000
	2,38,000
Less: Liabilities:	
Creditors	48,000
Purchase Consideration	1,90000

Question 8

The following is the Balance Sheet of M/s. P and Q as on 31st March, 2012:

Liabilities	₹	*Assets*	₹
Capital Accounts:		*Machinery*	*54,000*
P	*50,000*	*Furniture*	*5,000*

Q	*30,000*	*Investment*	*50,000*
Reserves	*20,000*	*Stock*	*20,000*
Loan Account of Q	*15,000*	*Debtors*	*21,000*
Creditors	*40,000*	*Cash*	*5,000*
	1,55,000		*1,55,000*

It was agreed that Mr. R is to be admitted for a fourth share in the future profits from 1st April, 2012. He is required to contribute cash towards goodwill and ₹ 15,000 towards capital.

The following further information is furnished:

(a) *P & Q share the profits in the ratio 3 : 2.*

(b) *P was receiving salary of ₹ 750 p.m. from the very inception of the firm in 2005 in addition to share of profit.*

(c) *The future profit ratio between P, Q & R will be 2:1:1. P will not get any salary after the admission of R.*

(d) *It was agreed that the value of goodwill of the firm shall appear in the books of the firm. The goodwill of the firm shall be determined on the basis of 3 years' purchase of the average profits from business of the last 5 years. The particulars of the profits are as under:*

Year ended	*Profit/(Loss)*
31st March, 2008	*25,000*
31st March, 2009	*12,500*
31st March, 2010	*(2,500)*
31st March, 2011	*35,000*
31st March, 2012	*30,000*

The above Profits and Losses are after charging the Salary of P. The Profit of the year ended 31st March, 2008 included an extraneous profit of ₹ 40,000 and the loss for the year ended 31st March, 2010 was on account of loss by strike to the extent of ₹ 20,000.

(e) *The cash trading profit for the year ended 31st March, 2013 was ₹ 50,000 before depreciation.*

(f) *The partners had drawn each ₹ 1,000 p.m. as drawings.*

(g) *The value of other assets and liabilities as on 31st March, 2013 were as under:*

	₹
Machinery (before depreciation)	*60,000*
Furniture (before depreciation)	*10,000*
Investment	*50,000*

Stock	*15,000*
Debtors	*30,000*
Creditors	*20,000*

(h) Provide depreciation @ 10% on Machinery and @ 5% on Furniture on the Closing Balance and interest is accumulated @ 6% on Q's loan. The loan alongwith interest would be repaid within next 12 months.

(i) Investments are held from inception of the firm and interest is received @ 10% p.a.

(j) The partners applied for conversion of the firm into a Private Limited Company. Certificate was received on 1st April, 2013. They decided to convert Capital A/cs of the partners into share capital in the ratio of 2:1:1 on the basis of a total Capital as on 31st March, 2013. If necessary, partners have to subscribe to fresh capital or withdraw.

Prepare the Profit and Loss Account of the firm for the year ended 31st March, 2013 and the Balance Sheet of the Company on 1st April, 2013. (16 Marks, May 2013) (IPCC)

Answer

M/s P, Q and R

Profit and Loss Account for the year ending on 31st March, 2013

		₹		₹
To Depreciation on Machinery		6,000	By Trading Profit	50,000
To Depreciation on furniture		500	By Interest on Investment	5,000
To Interest on Q's loan		900		
To Net Profit to :				
P's Capital A/c	23,800			
Q's Capital A/c	11,900			
R's Capital A/c	11,900	47,600		
		55,000		55,000

Balance Sheet of the PQR Pvt. Ltd. as on 1st April, 2013

		Notes No.	₹
I	Equity and Liabilities		
	Shareholders' funds		
	Share capital		1,41,600
	Current liabilities		
	Short term borrowings	1	15,900
	Trade payables		20,000
	Total		1,77,500

II	Assets		
	Non-current assets		
	Fixed assets		
	Tangible assets	2	63,500
	Non-current investments		50,000
	Current assets		
	Inventories		15,000
	Trade receivables		30,000
	Cash and cash equivalents		19,000
	Total		1,77,500

Notes to Accounts

			₹
1.	Short term borrowings		
	Loan from Q		15,900
2.	Tangible assets		
	Machinery	54,000	
	Furniture	9,500	63,500

Working Notes:

1. Calculation of goodwill

	2007-08 ₹	*2008-09* ₹	*2009-10* ₹	*2010-11* ₹	*2011-12* ₹
Profits/(Loss)	25,000	12,500	(2,500)	35,000	30,000
Adjustment for extraneous profit of 2007-08 and abnormal loss of 2009-10	(40,000)	-	20,000	—	—
	(15,000)	12,500	17,500	35,000	30,000
Add: Salary of P (750 x12)	9,000	9,000	9,000	9,000	9,000
	(6,000)	21,500	26,500	44,000	39,000
Less: Interest on non-trading investment*	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
	(11,000)	16,500	21,500	39,000	34,000
Total Profit from 2008-09 to 2011-12					1,11,000
Less : Loss for 2007-08					(11,000)
					1,00,000
Average Profit					20,000

Goodwill equal to 3 years' purchase					60,000
Contribution from R for ¼ share					15,000

* Investments are assumed to be non-trading investments.

2. Calculation of sacrificing ratio of Partners P and Q on admission of R

	Old share	*New share*	*Sacrificing share*	*Gaining share*
P	3/5	1/2	$\frac{3}{5}-\frac{1}{2}=\frac{6-5}{10}=\frac{1}{10}$	
Q	2/5	1/4	$\frac{2}{5}-\frac{1}{4}=\frac{8-5}{20}=\frac{3}{20}$	
R		1/4		1/4

3. Goodwill adjustment entry* through Partners' capital accounts (in their sacrificing ratio of 2:3)

	₹	₹
R' s capital A/c Dr.	15,000	
To P's capital A/c		6,000
To Q' s capital A/c		9,000
(R's share in goodwill adjusted through P and Q)		

4. Partners' Capital Accounts

	P ₹	*Q* ₹	*R* ₹		*P* ₹	*Q* ₹	*R* ₹
To Drawings (1,000 x 12)	12,000	12,000	12,000	By Balance b/d	50,000	30,000	—
To P			6,000	By General Reserve	12,000	8,000	—
To Q			9,000	By R	6,000	9,000	—
To Balance c/d	79,800	46,900	14,900	By Bank (15,000 + 15,000)	—	—	30,000
				By Profit & Loss A/c	23,800	11,900	11,900
	91,800	58,900	41,900		91,800	58,900	41,900

**As per AS 26 "Intangible Assets", only purchased goodwill should appear in the books. Therefore, goodwill though required to be shown in the books as per the requirement of the question, has been adjusted through capital accounts of the partners in line with the provisions of AS 26.*

5. Balance Sheet of the firm as on 31st March, 2013

Liabilities	₹	₹	*Assets*	₹	₹
P's Capital	79,800		Machinery	60,000	
Q's Capital	46,900		*Less* : Depreciation	(6,000)	54,000
R's Capital	14,900	1,41,600	Furniture	10,000	
			Less : Depreciation	(500	9,500
Q's Loan	15,000		Investments		50,000
Add : Interest due	900	15,900	Stock-in-trade		15,000
Creditors		20,000	Debtors		30,000
			Cash (W.N.6)		19,000
		1,77,500			1,77,500

6. Cash balance as on 31.3.2013

	₹	₹
Cash trading profit		50,000
Add: Investment Interest		5,000
Add: Decrease in Stock Balance		5,000
		60,000
Less: Increase in Debtors	9,000	
Less: Decrease in Creditors	20,000	(29,000)
		31,000
Add: Opening cash balance	5,000	
Add: Cash brought in by R	30,000	35,000
		66,000
Less: Drawings (12,000 +12,000 +12,000)	36,000	
Less: Additions to Machine (60,000 - 54,000)	6,000	
Furniture (10,000 - 5,000)	5,000	(47,000)
Closing cash balance		19,000

7. Distribution of shares – Conversion into Company

		₹
Capital :	P	79,800
	Q	46,900
	R	14,900
Share Capital		1,41,600
Distribution of shares :	P (1/2)	70,800
	Q (1/4)	35,400
	R (1/4)	35,400

P and Q should withdraw capital of ₹ 9,000 (₹ 79,800 – ₹ 70,800) and ₹11,500 (₹ 46,900 – ₹ 35,400) respectively and R should subscribe shares of ₹ 20,500 (₹35,400 – ₹ 14,900).

Question 9

Avi and Bishnu are partners of Abhay & Co. sharing profit and losses in the ratio 3 : 1 and Bishnu and Joe are partners of Bijoy & Co. sharing profit and losses in the ratio 2 : 1. On 31st March, 2013, they decided to amalgamate and form a new firm M/s Abeejay & Co., wherein Avi, Bishnu and Joe would be partners sharing profit and losses in the ratio 3 : 2 : 1. The Balance Sheets of the two firms on 31st March, 2013 were as under:

Liabilities	*Abhay & Co.*	*Bijoy & Co.*	*Assets*	*Abhay & Co.*	*Bijoy & Co.*
	₹	*₹*		*₹*	*₹*
Capitals:			*Building*	*3,50,000*	*2,80,000*
Avi	*5,31,000*		*Plant & Machinery*	*2,00,000*	*1,50,000*
Bishnu	*2,00,000*	*3,97,000*	*Vehicles*	*-*	*90,000*
Joe		*2,00,000*	*Furniture*	*-*	*10,000*
Reserves	*12,000*	*9,000*	*Office Equipments*	*38,000*	*45,000*
Sundry Creditors	*1,20,000*	*89,000*	*Stock in trade*	*65,000*	*70,000*
Bank O/D	*90,000*	*-*	*Sundry Debtors*	*1,00,000*	*90,000*
Due to R & Co.	*-*	*1,00,000*	*Bank Balances*	*80,000*	*60,000*
			Cash in hand	*20,000*	*-*
			Due from R & Co.	*1,00,000*	*-*
	9,53,000	*7,95,000*		*9,53,000*	*7,95,000*

The amalgamated firm M/s Abeejay & Co. took over the business on the following terms:

(a) *Goodwill of Abhay & co. was worth ₹ 42,000 and that of Bijoy & Co. ₹ 30,000. Goodwill account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.*

(b) *The* following assets were valued as below:

	Abhay & Co. (₹)	*Bijoy & Co. (₹)*
Building	*4,00,000*	*3,00,000*
Plant & Machinery	*2,50,000*	*2,00,000*
Vehicles	*-*	*98,000*
Furniture	*-*	*11,000*
Office Equipments	*39,000*	*50,000*
Stock in trade	*70,000*	*80,000*

(c) Provision for doubtful debt was carried forward at ₹ 4,000 in respect of Debtors of Abhay & co. and ₹ 3,000 in respect of Debtors of Bijoy & Co.

(d) Partners of new firm brought necessary cash to pay other partners to adjust their capitals according to the profit sharing ratio.

You are required to:

(i) Prepare the Balance Sheet of the new firm as on 31st March, 2013.

(ii) Prepare Capital Accounts of the partners in the books of old firms.

(16 Marks, November 2013) (IPCC)

Answer

Balance Sheet of M/s Abeejay & Co. as at 31st March, 2013

Liabilities	₹	₹	*Assets*	₹	₹
Capitals:			Building (₹ 4,00,000 + ₹ 3,00,000)		7,00,000
Avi	7,71,000				
Bishnu	5,14,000		Plant & machinery		
Joe	2,57,000	15,42,000	(₹ 2,50,000+₹ 2,00,000)		4,50,000
Sundry creditors (1,20,000+89,000)		2,09,000	Office equipment (₹ 39,000+₹ 50,000)		89,000
Bank overdraft		90,000	Vehicle		98,000
			Furniture		11,000
			Stock-in-trade (₹ 70,000+₹ 80,000)		1,50,000
			Sundry debtors (₹ 1,00,000+₹ 90,000)	1,90,000	
			Less: Provision for doubtful debts (₹ 4,000+₹ 3,000)	(7,000)	1,83,000
			Bank balance (₹ 80,000+₹ 60,000)		1,40,000
			Cash in hand		20,000*
		18,41,000			18,41,000

Partners' Capital Accounts in the books of Abhay & Co.

Particulars	Avi ₹	Bishnu ₹	*Particulars*	Avi ₹	Bishnu ₹
To Capital A/cs –	6,48,000	2,39,000	By Balance b/d	5,31,000	2,00,000

* ₹ 20,000+₹ 1,59,000+₹ 25,667 –₹ 1,84,667 = ₹ 20,000.

M/s Abeejay & Co.			By Reserve (3:1)	9,000	3,000
			By Profit on Realisation A/c (W.N.4)	1,08,000	36,000
	6,48,000	2,39,000		6,48,000	2,39,000

Partners' Capital Accounts in the books of Bijoy & Co.

Particulars	*Bishnu* ₹	*Joe* ₹	*Particulars*	*Bishnu* ₹	*Joe* ₹
To Capital A/cs –	4,83,667	2,43,333	By Balance b/d	3,97,000	2,00,000
M/s Abjeey & Co.			By Reserve (2:1)	6,000	3,000
			By Profit on Realisation (W.N.5)	80,667	40,333
	4,83,667	2,43,333		4,83,667	2,43,333

Working Notes:

1. Computation of purchase considerations

	Abhay & Co. ₹	*Bijoy& Co.* ₹
Assets:		
Goodwill	42,000	30,000
Building	4,00,000	3,00,000
Vehicle	-	98,000
Furniture	-	11,000
Plant & machinery	2,50,000	2,00,000
Office equipment	39,000	50,000
Stock-in-trade	70,000	80,000
Sundry debtors	1,00,000	90,000
Bank balance	80,000	60,000
Cash in hand	20,000	-
Due from R & Co.	1,00,000	-
(A)	11,01,000	9,19,000
Liabilities:		
Creditors	1,20,000	89,000
Provision for doubtful debts	4,000	3,000

Due to R & Co.	-	1,00,000
Bank overdraft	90,000	-
(B)	2,14,000	1,92,000
Purchase consideration (A-B)	8,87,000	7,27,000

2. Computation of proportionate capitals

	₹
M/s Abeejay & Co. (Purchase Consideration) (₹ 8,87,000+ ₹ 7,27,000)	16,14,000
Less: Goodwill adjustment	(72,000)
Total capital of new firm (Distributed in ratio 3:2:1)	15,42,000
Avi's proportionate capital	7,71,000
Bishnu's proportionate capital	5,14,000
Joe's proportionate capital	2,57,000

3. Computation of Capital Adjustments

	Avi	*Bishnu*	*Joe*	*Total*
	₹	₹	₹	₹
Balance transferred from Abhay & Co.	6,48,000	2,39,000		8,87,000
Balance transferred from Bijoy & Co.		4,83,667	2,43,333	7,27,000
	6,48,000	7,22,667	2,43,333	16,14,000
Less: Goodwill written off in the ratio of 3:2:1	(36,000)	(24,000)	(12,000)	(72,000)
Existing capital	6,12,000	6,98,667	2,31,333	15,42,000
Proportionate capital	7,71,000	5,14,000	2,57,000	15,42,000
Amount to be brought in (paid off)	1,59,000	(1,84,667)	25,667	

4. Realisation Account in the books of Abhay & Co.

	₹		₹
To Building	3,50,000	By Creditors	1,20,000
To Plant & machinery	2,00,000	By Bank overdraft	90,000
To Office equipment	38,000	By M/s Abeejay & Co. (purchase consideration) (W.N.1)	8,87,000
To Stock-in-trade	65,000		
To Sundry debtors	1,00,000		
To Bank balance	80,000		
To Cash in hand	20,000		
To Due from R & Co.	1,00,000		
To Partners' capital A/cs:			

Avi	1,08,000			
Bishnu	36,000	1,44,000		
		10,97,000		10,97,000

5. Realisation Account in the books of Bijoy & Co.

		₹		₹
To Building		2,80,000	By Creditors	89,000
To Plant & machinery		1,50,000	By Due to R & Co.	1,00,000
To Office equipment		45,000	By M/s Abjeejay & Co.	7,27,000
To Vehicle		90,000	(purchase consideration)	
To Furniture		10,000	(W.N.1)	
To Stock-in-trade		70,000		
To Sundry debtors		90,000		
To Bank balance		60,000		
To Partners' capital A/cs :				
Bishnu	80,667			
Joe	40,333	1,21,000		
		9,16,000		9,16,000

4
Company Accounts

Unit 1: ESOPs and Buy-back of Shares

Question1

Explain "Employee's stock option plan". *(2 Marks, November, 2009) (IPCC)*

Answer

"Employee Stock Option Plan" is a plan in which option is given for a specified period, to employees of a company, which gives such directors, officers or employees the right, but not the obligation, to purchase or subscribe to, the shares of the enterprise at a fixed or predetermined price generally below the prevailing market price..

Question 2

Dee Limited furnishes the following summarised Balance Sheet as at 31st March, 2008:

	₹ '000	₹ '000
Liabilities		
Share capital:		
Authorised capital		*30,00*
Issued and subscribed capital:		
2,50,000 Equity shares of ₹ 10 each fully paid up	*25,00*	
2,000, 10% Preference shares of ₹ 100 each		
(Issued two months back for the purpose of buy back)	*2,00*	*27,00*
Reserves and surplus:		
Capital reserve	*10,00*	
Revenue reserve	*30,00*	
Securities premium	*22,00*	
Profit and loss account	*35,00*	*97,00*
Current liabilities:		*14,00*
		1,38,00

Assets	
Fixed assets	*93,00*
Investments	*30,00*
Current assets (cash and bank balance)	*15,00*
	1,38,00

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

You are required to pass necessary journal entries and prepare the Balance Sheet.

(8 Marks, November, 2009) (IPCC)

Answer

In the books of Dee Limited

Journal Entries

	Particulars		*Dr.*	*Cr.*
			(₹ in '000)	
(i)	Bank Account	Dr.	22,00	
	Profit and Loss Account	Dr.	8,00	
	To Investment Account			30,00
	(Being the investments sold at loss for the purpose of buy back of Equity Shares)			
(ii)	Equity Share Capital Account	Dr.	5,00	
	Premium payable on buy back Account	Dr.	20,00	
	To Equity shares buy back Account			25,00
	(Being the amount due on buy back of 50,000 Equity Shares of ₹ 10/- each at ₹ 50/- each)			
(iii)	Securities Premium Account	Dr.	20,00	
	To Premium payable on buy back Account			20,00
	(Being the premium of ₹ 40/- per share payable on buy back adjusted against securities premium account)			
(iv)	Revenue Reserve Account*	Dr.	5,00	
	To Capital Redemption Reserve Account			5,00
	(Being the amount equal to nominal value of 50,000 equity shares bought back out of free reserves transferred to capital redemption reserve account)			

* Alternatively, 'Securities Premium' account may also be used for transfer to 'Capital Redemption Reserve Account.'

(v)	Equity shares buy-back Account To Bank Account (Being the payment made on buy back)	Dr.	25,00	 25,00

Balance Sheet of Dee Limited as on 1st April, 2008

(After buy back of shares)

	Particulars	Note No.	₹ '000
	EQUITY AND LIABILITIES		
1.	Shareholders' funds		
	Share capital	1	2200
	Reserves and Surplus	2	69,00
2.	Current liabilities		14,00
			10,500
	ASSETS		
1.	Non-current assets		
	Fixed Assets		93,00
2	Current assets		
	Cash and cash equivalents(15,00+22,00- 25,00)		12,00
			10,500

Notes to Accounts

		₹ '000
1.	Share Capital	
	Authorised capital:	30,00
	Issued and subscribed capital:	
	2,00,000 Equity shares of ₹ 10 each fully paid up	20,00
	2,000 10% Preference shares of ₹ 100 each fully paid up	2,00
	Total	22,00
2.	Reserves and Surplus	
	Capital reserve	10,00
	Securities Premium Account (22 – 2)	2.00
	Capital redemption reserve	5,00
	Revenue reserve (30 – 5)	25,00
	Profit and loss A/c (35,00 – 8,00)	27,00
	Total	69,00

Question 3

Extra Ltd. furnishes you with the following summarised Balance Sheet as on 31st March, 2010:

Liabilities	Amount	Assets	(₹ in lakhs) Amount
Equity shares of ₹ 10 each fully paid	*100*	*Fixed assets less depreciation*	*50*
9% Redeemable preference shares of ₹ 100 each fully paid	*20*	*Investments at cost*	*120*
		Current assets	*142*
Capital reserves	*8*		
Revenue reserves	*50*		
Securities premium	*60*		
10% Debentures	*4*		
Current liabilities	*70*		
	312		*312*

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 2010.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share.

The payment for the above were made out of huge bank balances, which appeared as a part of the current assets.

(iii) Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 2010.

(iv) The company had 1,00,000 equity stock options outstanding on the above mentioned date, to the employees at ₹ 20 when the market price was ₹ 30. (This was included under current liabilities). On 1.04.2010 employees exercised their options for 50,000 shares.

(v) Pass the journal entries to record the above.

(vi) Prepare Balance Sheet as at 01.04.2010. *(16 Marks, November, 2010) (IPCC)*

Answer

(₹ in lakhs)

Date	*Particulars*		*Debit*	*Credit*
01.04.2010	9% Redeemable preference share capital A/c	Dr.	20.00	
	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account for redemption at a premium of 10%)			

01.04.2010	Preference shareholders A/c	Dr.	22.00	
	To Bank A/c			22.00
	(Being payment made to preference shareholders on redemption of these shares)			
01.04.2010	Equity shares buy back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs* equity shares of ` 10 each bought back @ ` 30 per share)			
01.04.2010	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy back A/c			90.00
	(Being cancellation of equity shares bought back)			
01.04.2010	Revenue reserve A/c (20 + 30)	Dr.	50.00	
	To Capital redemption reserve A/c			50.00
	(Being the transfer to capital redemption reserve account from the Revenue Reserve to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)			
01.04.2010	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debentures A/c			0.20
	(Being cancellation of own debentures costing ` 2 lakhs, face value being ` 2.20 lakhs and the balance being profit on cancellation of debentures)			
1.04.2010	Profit on cancellation of debentures A/c	Dr.	0.20	
	To Capital reserve A/c			0.20
	(Being profit on cancellation of debentures transferred to capital reserve account)			
01.04.2010	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00

* The buy back of equity shares exceeds 25% of total equity shares as provisions of the Companies Act, 2013. Therefore, the company Extra Ltd. is subject to penalty under the Companies Act.

	To Securities premium A/c			10.00
	(Being the allotment to employees, of 50,000 equity shares* of ` 10 each at a premium of 20 per share in terms of stock option scheme for employees)			
01.04.2010	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preference shares A/c			2.00
	(Being premium on redemption of preference shares adjusted through securities premium A/c)			

Balance Sheet of Extra Ltd. as on 01.04.2010

Particulars	*Note No*	*(₹ in lakhs)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	75.00
(b) Reserves and Surplus	2	66.20
(2) Non-current Liabilities		
(a) Long term borrowings	3	1.80
(3) Current Liabilities		65.00
Total		208.00
II. Assets		
(1) Non-current assets		
(a) Fixed assets		50.00
(b) Non-current investments at cost		118.00
(2) Current assets		40.00
Total		208.00

Notes to Accounts

			₹ in lakhs
1	Share Capital		
	Equity share capital		
	Opening balance	100.00	

* Allotment of equity shares against ESOP may also result in the violation of the Companies Act (i.e. not to issue same category /class of shares). Therefore, the company is subject to penalty.

	Less : Cancellation of bought back shares	(30.00)	
	Add : Shares issued against ESOP	5.00	75.00
2	Reserves and Surplus		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-
	Securities Premium		
	Opening balance	60.00	
	Less : Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
			66.20
3	Long term borrowings		
	Secured		
	10% Debentures		1.80

Working Notes:

		(₹ in lakhs)
1.	10% Debentures	
	Opening balance	4.00
	Less: Cancellation of own debentures	(2.20)
		1.80
2.	Current liabilities	
	Opening balance	70.00
	Less: Adjustment for ESOP outstanding	(5.00)
		65.00
3.	Investments at cost	
	Opening balance	120.00
	Less: Investment in own debentures	(2.00)
		118.00

4.	**Current assets**	
	Opening balance	142.00
	Less : Payment to preference shareholders	(22.00)
	Less : Payment to equity shareholders	(90.00)
	Add : Share price received against ESOP	10.00
		40.00

Question 4

A Company has its share capital divided into shares of ₹ 10 each. On 1st April 2010, it granted 20,000 employees' stock options at ₹ 40, when the market price was ₹ 130. The options were to be exercised between 1st January 2011 to 15th March 2011. The employees exercised their options for 18,000 shares only; the remaining options lapsed. The company closes its books on 31st March every year. Pass Journal entries with regard to employees' stock options. (5 Marks, May, 2011) (IPCC)

Answer

Journal Entries

Date	*Particulars*		*Dr.*	*Cr.*
			₹	₹
April 1, 2010	Employees compensation expense A/c	Dr.	18,00,000	
	To Employees stock option outstanding A/c			18,00,000
	(Being grant of 20,000 stock option to employees at ₹ 40 when market price is ₹ 130)			
Jan. 1, 2011 to Mar. 15, 2011	Bank A/c	Dr.	7,20,000	
	Employees stock option outstanding A/c	Dr.	16,20,000	
	To Equity share capital A/c			1,80,000
	To Securities premium A/c			21,60,000
	(Being allotment to employees 18,000 equity shares of ₹ 10 each at a premium of ₹ 120 per share in exercise of their stock options)			
Mar.16, 2011	Employees stock option outstanding A/c	Dr.	1,80,000	
	To Employees compensation expense A/c			1,80,000
	(Being of the balance stock options for 2,000 shares having lapsed as not taken up resulting is reversal of the charge of Employee Compensation Exp and the closure of the Employee Stock Option O/s A/c)			

Mar.31,2011	Profit & Loss A/c Dr. To Employees compensation expense A/c (Being employees compensation expense on options exercised and taken up transferred to profit & loss account)	16,20,000	 16,20,000

Question 5

A company has its share capital divided into shares of ₹ 10 each. On 1-4-2010, it granted 5,000 employees stock option at ₹ 50, when the market price was ₹ 140. The options were to be exercised between 1-12-2010 to 28-2-2011. The employees exercised their options for 4,800 shares only; remaining options lapsed. Pass the necessary journal entries for the year ended 31-3-2011, with regard to employees' stock option. (4 Marks, November, 2011) (IPCC)

Answer

In the books of Company

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1st April, 2010	Employees compensation expenses A/c Dr. [₹ 5,000 x (140-50)] To Employees stock option outstanding A/c (Being grant of 5,000 ESOPs to employees @ ₹ 50 when market price was ₹ 140)	4,50,000	 4,50,000
1st Dec. 2010 to 28th Feb. 2011	Bank A/c Dr. Employees stock option outstanding A/c Dr To Equity share capital A/c To Securities premium A/c (Being allotment to employees 4,800 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each)	2,40,000 4,32,000	 48,000 6,24,000
31st Mar. 2011	Employees stock option outstanding A/c Dr To Employees compensation expenses A/c (Being reverse entry for lapse of 200 stock options)	18,000	 18,000
31st Mar. 2011	Profit and Loss A/c Dr. To Employees compensation expenses A/c (Being transfer of employees compensation expenses)	4,32,000	 4,32,000

Alternatively, one may pass following two entries to give effect to the exercise of options in the same year.

Journal Entries

Date	Particulars	Dr. ₹	Cr. ₹
1st Dec. 2010 to 28th Feb. 2011	Bank A/c Dr.	2,40,000	
	Employees compensation expenses A/c Dr.	4,32,000	
	To Equity Share Capital A/c		48,000
	To Securities Premium A/c		6,24,000
	(Being allotment to employees 4,800 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each)		
31st Mar. 2011	Profit and Loss account Dr.	4,32,000	
	To Employees compensation expenses A/c		4,32,000
	(Being transfer of employees compensation expenses)		

Question 6

Following is the Balance Sheet of M/s competent Limited as on 31st march, 2012:

Assets	*₹*	*Assets*	*₹*
Equity Shares of ₹ 10 Each fully paid	*12,50,000*	*Fixed Assets*	*46,50,000*
Revenue reserve	*15,00,000*	*Current Assets*	*30,00,000*
Securities Premium	*2,50,000*		
Profit & Loss Account	*1,25,000*		
Secured Loans:			
12% Debentures	*18,75,000*		
Unsecured Loans	*10,00,000*		
Current Liabilities	*16,50,000*		
Total	*76,50,000*	*Total*	*76,50,000*

The company wants to buy back 25,000 equity shares of ₹ 10 each , on 1st April, 2012 at ₹ 20 per share. Buy back of shares is duly authorized by its articles and necessary resolution passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as part of Current Assets.

Comment with your calculations, whether buy back of shares by company is within the provisions of the companies Act, 1956. If yes, pass necessary journal entries towards buy back of shares and prepare e Balance Sheet after buy back of shares.

(8 Marks, May 2012) (IPCC)

Answer

Determination of Buy back of maximum no. of shares as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	*(Shares)*
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000
25% of Shareholders fund (₹)	7,81,250
Buy back price per share	₹ 20
Number of shares that can be bought back (shares)	39,062
Actual Number of shares for buy back	25,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy Back

	Particulars	₹
(a)	Loan funds (₹) (18,75,000+10,00,000+16,50,000)	45,25,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	22,62,500
(c)	Present equity/shareholders fund (₹)	31,25,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (31,25,000 – 2,87,500)	28,37,500*
(e)	Maximum permitted buy back of Equity (₹) [(d) – (b)]	5,75,000
(f)	Maximum number of shares that can be bought back @ ₹ 20 per share	28,750 shares
(g)	Actual Buy Back Proposed	25,000 Shares

* As per Section 68 (2) (d) of the Companies Act 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69 (1), on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69 (2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.

Summary statement determining the maximum number of shares to be bought back

Particulars	*Number of shares*
Shares Outstanding Test	31,250
Resources Test	39,062
Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 2012.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

			Debit(₹)	*Credit (₹)*
(a)	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd.

as on 31st March, 2012

			Particulars	*Note No*	*Amount*
					₹
			EQUITY AND LIABILITIES		
1			Shareholders' funds		
	(a)		Share capital	1	10,00,000
	(b)		Reserves and Surplus	2	16,25,000

2			**Non-current liabilities**		
	(a)		Long-term borrowings	3	28,75,000
3			**Current liabilities**		16,50,000
			Total		71,50,000
			ASSETS		
1			**Non-current assets**		
	(a)		Fixed assets		46,50,000
2			**Current assets**(30,00,000-5,00,000)		25,00,000
			Total		71,50,000

Notes to accounts

			₹	₹
1.	**Share Capital**			
	Equity share capital			
	1,00,000 Equity shares of ₹10 each			10,00,000
2.	**Reserves and Surplus**			
	Profit and Loss A/c		1,25,000	
	Revenue reserves	15,00,000		
	Less: Transfer to CRR	(2,50,000)	12,50,000	
	Securities premium	2,50,000		
	Less: Utilisation for share buy-back	(2,50,000)	-	
	Capital Redemption Reserves		2,50,000	16,25,000
3.	**Long-term borrowings**			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		10,00,000	28,75,000

Working Note

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$$(31{,}25{,}000 - x) - 22{,}62{,}500 = y \qquad (1)$$

$\left(\frac{y}{20}\times10\right)$ = x Or 2x = y (2)

by solving the above equation we get

, x = ₹ 2,87,500

y = ₹ 5,75,000

Question 7

On 1st April, 2012 , a company offered 100 shares to each of its 400 employees at ₹ 25 per share. The employees are given a month to accept the shares. The shares issued under the plan shall be subject to lock-in to transfer for three years from the grant date i.e. 30, April 2012. The market price of shares of the company on the grant date is ₹ 30 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 28 per share.

Up to 30th April, 2012, 50% of employees accepted the offer and paid ₹ 25 per share purchased. Normal value of each share is ₹ 10. Record the issue of shares in the books of the company under the aforesaid plan. *(4 Marks, May 2012) (IPCC)*

Answer

Fair value of an option = ₹ 28

Difference between Fair value and Issue Price =₹ 28 – ₹ 25 = 3.

Number of employees accepting the offer = 400 employees x 50% = 200 employees

Number of shares issued = 200 employees x 100 shares/employee = 20,000 shares

Employee Compensation Expenses recognized in 2012-13 =20,000 shares x ₹ 3 = ₹ 60,000

Securities Premium A/c = ₹ 28 – 10 = ₹ 18 per share = 20,000 x 18 = ₹ 3,60,000

Journal Entry

Date	*Particulars*		*₹*	*₹*
30.04.2012	Bank (20,000 shares x ₹ 25)	Dr.	5,00,000	
	Employees compensation expense A/c	Dr.	60,000	
	To Share Capital			2,00,000
	To Securities Premium			3,60,000
	(Being stock purchase option accepted by 200 employees for 100 shares each at ₹ 25 per share on a Fair Value of ₹ 28 per share)			

Question 8

M Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2012 :

	₹ in '000	₹ in '000
Equity & Liabilities		
Share Capital:		
Authorised Capital:		*5,000*
Issued and Subscribed Capital :		
3,00,000 Equity shares of ₹ 10 each fully paid up		
20,000 9% Preference Shares of 100 each	*3,000*	
(issued two months back for the purpose of buy back)	*2,000*	*5,000*
Reserve and Surplus:		
Capital reserve	*10*	
Revenue reserve	*4,000*	
Securities premium	*500*	
Profit and Loss account	*1,800*	*6,310*
Non-current liabilities - 10% Debentures		*400*
Current liabilities and provisions		*40*
		11,750
Assets		
Fixed Assets: Cost	*3,000*	
Less: Provisions for depreciation	*250*	*2,750*
Non-current investments at cost		*5,000*
Current assets, loans and advances (including cash and bank balances)		*4,000*
		11,750

(1) The company passed a resolution to buy back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs.

(2) The company redeemed the preference shares at a premium of 10% on 1st April, 2012.

(3) Included in its investments were 'Investments in own debentures' costing ₹ 3 lakhs (face value ₹ 3.30 lakhs). These debentures were cancelled on 1st April, 2012.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2012. (12 Marks, November 2012) (IPCC)

Answer

In the books of M Ltd.

Journal Entries

			Dr.	*Cr.*
			₹ in '000	₹ in '000
1	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment of ₹ 30 Lakhs sold for the purpose of buy-back of Equity Sharess)			
2	9% Preference share capital A/c	Dr.	2,000	
	Premium on redemption of Preference Shares A/c	Dr.	200	
	To Preference shareholders A/c			2,200
	(Being redemption of preference share capital at premium of 10%)			
3	Preference shareholders A/c	Dr.	2,200	
	To Bank A/c			2,200
	(Being payment made to preference shareholders)			
4	Revenue Reserve A/c	Dr.	2,000	
	To Capital redemption reserve A/c (Refer Note)			2,000
	(Being transfer tof capital redemption reserve from the Revenue Reserve to the extent of nominal value of preference shares redeemed)			
5	Equity share capital A/c	Dr.	600	
	Securities Premium A/c (Premium payable on buy-back)	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of 60,000 equity shares at ₹ 15 each)			
6	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back)			
7	10% Debentures A/c	Dr.	330	
	To Investments A/c			300

	To Capital reserve A/c (Profit on cancellation)			30
	(Being own debentures cancelled at profit)			
8.	Securities Premium A/c	Dr.	200	
	To Premium on redemption of preference shares A/c			200
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of the M Ltd. as on 1st April, 2012

		Notes No.	*₹ in '000*
	Equity and Liabilities		
1	Shareholders funds		
	Share capital	1	2,400
	Reserves and Surplus	2	5,340
2	Non-current liabilities		
	Long term borrowings	3	70
	Current liabilities		40
	Total		7,850
	Assets		
1	Non-current assets		
	(a) Fixed assets		2,750
2	(b) Non-current investments	4	1,700
	Current assets	5	3,400
	Total		7,850

Notes to Accounts

			₹ in '000	*₹ in '000*
1.	Share Capital			
	Authorised share capital			5,000
	Issued, subscribed and fully paid up share capital			
	2,40,000 Equity shares of ₹ 10 each, fully paid up			2,400
	(60,000 equity shares bought back and cancelled)			
2.	Reserves and Surplus			
	Capital Reserves	10		
	Add: Profit on cancellation of debentures	30	40	
	Securities Premium	500		
	Less: Premium on redemption of preference shares	(200)		

	Premium on buy-back of equity shares	(300)	-	
	Revenue Reserve	4,000		
	Less: Transfer to CRR	(2,000)	2,000	
	Capital Redemption reserve		2,000	
	Surplus (Profit & Loss Account)	1,800		
	Less: Loss on sale of investment	(500)	1,300	5,340
3.	Long term borrowings			
	10% Debentures (400 - 330)			70
4.	Non-current investments			
	Balance as on 31.03.2012		5,000	
	Less: Investment sold		(3,000)	
	Less: Own debentures cancelled		(300)	1,700
5	Current assets			
	Balance as on 31.03.2012		4,000	
	Add: Cash received on sale of investment		2,500	
	Less: Payment made to equity shareholders for buy back of shares		(900)	
	Less: Payment made to preference shareholders		(2,200)	3,400

Note: In the given solution, it is assumed that buy-back of shares has been done out of the proceeds of issue of preference shares, no amount is transferred to capital redemption reserve for buy-back. However, if it is assumed that buy-back is from sale of investments and not from the proceeds of issue of preference shares, then, amount of revenue reserves transferred to capital redemption reserve will be ₹ 2,600 instead of ₹ 2,000.

Question 9

State the conditions of issuance of Sweat Equity Shares by Joint Stock Companies.

(4 Marks, November 2012) (IPCC)

Answer

A company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:-

(i) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.

(ii) the resolution specifies the number of shares, current market price, the consideration if any, and the class or classes of directors or employees to whom such equity shares are to be issued.

(iii) not less than one year has, at the time of the issue, elapsed since the date on which the company was entitled to commence business.

(iv) the sweat equity shares of company, whose equity shares are listed on a recognised stock exchange, are issued in accordance with the regulations made by the Securities and Exchange Board of India (SEBI) in this behalf. But in the case of company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

Question 10

Arihant Limited has its share capital divided into equity shares of ₹ 10 each. On 1-10-2012, it granted 20,000 employees' stock option at ₹ 50 per share, when the market price was ₹ 120 per share. The options were to be exercised between 10th December, 2012 and 31st March, 2013. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal Entries (with narration) as would appear in the books of the company upto 31st March, 2013. *(4 Marks, May 2013) (IPCC)*

Answer

Journal Entries in the books of Arihant Ltd.

			₹	₹
10.12.12	Bank A/c (16,000 x 50)	Dr.	8,00,000	
to 31.3.13	Employee compensation expense A/c (16,000 x 70)	Dr.	11,20,000	
	To Equity share capital A/c (16,000 x 10)			1,60,000
	To Securities premium A/c (16,000 x 110)			17,60,000
	(Being 16,000 equity shares issued to the employees against the stock options vested to them in pursuance of Employee Stock Option Plan on option price of ₹ 50 per share against the market price of ₹ 120 per share)			
31.3.13	Profit and Loss A/c	Dr.	11,20,000	
	To Employee compensation expense A/c			11,20,000
	(Being the transfer of employee compensation expenses to Profit and Loss Account)			

Unit 2: Underwriting of Shares

Question 1

Scorpio Ltd. came out with an issue of 45,00,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co; B & Co. and C & Co.

Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below:

A & Co.		*7,25,000 shares*
B & Co.		*8,40,000 shares*
C & Co.		*13,10,000 shares*
	Total	*28,75,000 shares*

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid alongwith application. You are required to:

(a) Compute the underwriters liability (number of shares)

(b) Compute the amounts payable or due to underwriters; and

(c) Pass necessary journal entries in the books of Scorpio Ltd. relating to underwriting.

(16 Marks, November 2005)(PE-II)

Answer

(a) Computation of liabilities of underwriters (No. of shares):

	A & Co.	*B & Co.*	*C & Co.*
Gross liability	12,00,000	12,00,000	12,00,000
Less: Firm underwriting	1,00,000	1,00,000	1,00,000
	11,00,000	11,00,000	11,00,000
Less: Marked applications	7,25,000		13,10,000
		8,40,000	
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked applications distributed to A & Co. and B & Co. in equal ratio	1,12,500	1,12,500	Nil
	2,62,500	1,47,500	(2,10,000)
Less: Surplus of C & Co. distributed to A & Co. and B & Co. in equal ratio	1,05,000	1,05,000	2,10,000
Net liability (excluding firm underwriting)	1,57,500	42,500	Nil
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (No. of shares)	2,57,500	1,42,500	1,00,000

Total Subscriptions received for 31,00,000 Shares out of which marked shares were 28,75,000/-, Hence unmarked shares received were 2,25,000 shares which will be distributed between A & Co and B & Co only equally (agreed ratio underwriting). C & Co has already exceeded the underwriting limit hence will not be required to absorb unmarked shares.

No of shares purchased by Underwriters collectively will be 5 Lakh shares as under:

Total Shares Issued	45,00,000
Less: Purchased by Promoters etc	9,00,000
Shares offered to the Publilc	36,00,000
Total Subscription received	31,00,000
Shares purchased by Underwriters including firm commitment	5,00,000

(b) Computation of amounts payable by underwriters:

Liability towards shares to be subscribed @ 12 per share	30,90,000	17,10,000	12,00,000
Less: Commission (5% on 12 lakhs shares @ 10 each)	6,00,000	6,00,000	6,00,000
Net amount to be paid by underwriters	24,90,000	11,10,000	6,00,000

(c) In the Books of Scorpio Ltd.

Journal Entries

Particulars	*Dr.*	*Cr.*
	₹	₹
Underwriting commission A/c	Dr. 18,00,000	
To A & Co. A/c		6,00,000
To B & Co. A/c		6,00,000
To C & Co. A/c		6,00,000
(Being underwriting commission on the shares underwritten)		
A & Co. A/c	Dr. 30,90,000	
B & Co. A/c	Dr. 17,10,000	
C & Co. A/c	Dr. 12,00,000	
To Equity share capital A/c		50,00,000
To Share premium A/c		10,00,000
(Being shares including firm underwritten shares allotted to underwriters)		

Bank A/c	Dr. 42,00,000	
To A & Co. A/c		24,90,000
To B & Co. A/c		11,10,000
To C & Co. A/c		6,00,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)		

Question 2

What do you understand by the term 'Firm Underwriting'? (2 Marks, November, 2007)(PCC)

Answer

'Firm underwriting' signifies a definite commitment by an underwriter to take up a specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him, i.e. the underwriter is obliged to take up:

1. the number of shares he has applied as 'firm'; and
2. the number of shares he is obliged to take up on the basis of the underwriting agreement.

Question 3

Albert Ltd. issued 50,00,000 Equity shares of ₹ 10 each. The whole issue was underwritten by A, B and C as below:

A	*15,00,000 shares*
B	*25,00,000 shares*
C	*10,00,000 shares*

Applications were received for 48,50,000 shares of which the marked applications were as follows:

A	*12,00,000 shares*
B	*25,00,000 shares*
C	*8,50,000 shares*

Calculate the number of shares to be taken up by the underwriters.(4 Marks) (May, 2008) (PCC)

Answer

(Number of shares)

	A	B	C
Gross Liability (3:5:2)	15,00,000	25,00,000	10,00,000
Less: Marked applications	12,00,000	25,00,000	8,50,000

	3,00,000	Nil	1,50,000
Less: Unmarked applications* in gross liability ratio i.e. 3:5:2	90,000	1,50,000	60,000
	2,10,000	(1,50,000)	90,000
Less: Surplus of B allocated to A & C in 3:2 ratio	90,000	1,50,000	60,000
Number of shares to be taken up by the underwriters	1,20,000	Nil	30,000

Question 4

Consider the following data pertaining to three underwriters, Ajay, Samay and Vijay:

Particulars	*Ajay*	*Samay*	*Vijay*
Shares underwritten	*8,000*	*16,000*	*24,000*
Marked application	*6,000*	*8,000*	*11,000*

If total applications received are for 44,800 shares, compute the final liability of Vijay.

(2 Marks, November, 2008) (PCC)

Answer

				(in shares)
Particulars	*Ajay*	*Samay*	*Vijay*	*Total*
Shares underwritten	8,000	16,000	24,000	48,000
Less: 19,800* Unmarked applications (in the ratio 1:2:3)	3,300	6,600	9,900	19,800
	4,700	9,400	14,100	28,200
Less: Marked applications	6,000	8,000	11,000	25,000
	(1,300)	1,400	3,100	3,200
Less: Surplus of Ajay's share (in the ratio 2:3)	1,300	520	780	Nil
Final liability	Nil	880	2,320	3,200

Question 5

A company entered into an underwriting agreement with Mr. B for 60% of the issue of ₹ 50,00,000, 15% debentures, with a firm underwriting of ₹5,00,000. Marked applications were in respect of debentures worth ₹35,00,000. Compute liability of Mr. B and commission payable to him. *(2 Marks, June, 2009) (PCC)*

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*48,50,000 shares – (12,00,000 + 25,00,000 + 8,50,000) =3,00,000 shares.

* Total Unmarked applications = Total applications received – Total marked applications i.e. 44,800 – 25,000 = 19,800 unmarked applications.

Answer

	₹
Gross Liability (₹50,00,000 $\times 60\%$)	30,00,000
Less: Marked applications ₹ 35,00,000 which is more than the Liability but credit will not be given as he is the sole underwriter.	<u>30,00,000</u>
Net liability	NIL
Add: Firm underwriting	<u>5,00,000</u>
Total liability	<u>5,00,000</u>
Calculation of underwriting commission = $30,00,000 \times \frac{2.5}{100} = ₹\ 75,000$	
Underwriting Commission payable on debentures is @ 2.5%*	75,000

Question 6

Chaitanya Limited issues 40,000 shares. Issue is underwritten by A, B and C in the ratio of 5:3:2 respectively. Unmarked applications totalled 2,000 whereas marked applications are as follows:

Underwriters	*Application (Number of debentures)*
A	*16,000*
B	*5,700*
C	*8,300*

Calculate the net liability of each one of the underwriters. *(4 Marks, May, 2010)(IPCC)*

Answer

Statement showing net liability of underwriters

	A	*B*	*C*	*Total*
Gross liability	20,000	12,000	8,000	40,000
Less: Unmarked applications in the Gross Liability ratio of 5:3:2	<u>(1,000)</u>	<u>(600)</u>	<u>(400)</u>	<u>(2,000)</u>
	19,000	11,400	7,600	38,000
Less: Marked applications	<u>(16,000)</u>	<u>(5,700)</u>	<u>(8,300)</u>	<u>(30,000)</u>
	3,000	5,700	(700)	8,000
Credit of C's surplus to A and B in the ratio of 5:3	<u>(438)</u>	<u>(262)</u>	<u>700</u>	<u>-</u>
Net liability	<u>2,562</u>	<u>5,438</u>	<u>-</u>	<u>8,000</u>

* The Companies Act provides that underwriting commission is provided only at a rate authorized by the articles of the company, not exceeding 2.5% of the issue price of debentures. Therefore, in the above solution, underwriting commission has been calculated at 2.5%.

Question 7

Delta Ltd. issued 25,00,000 equity shares of ₹ 10 each at par. 7,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters P, Q & R in the ratio of 2 : 3 : 4 with firm underwriting of 50,000, 60,000 and 70,000 shares each respectively. Total subscription received 13,88,000 shares including marked application and excluding firm underwriting. Marked applications were as follows:

P	*3,00,000*
Q	*3,50,000*
R	*4,50,000*

Unmarked and surplus applications to be distributed in gross liability ratio.

Ascertain the liability of each underwriter. *(5 Marks, May, 2011) (IPCC)*

Answer

Calculation of liability of underwriters

	(In shares)			
	P	*Q*	*R*	*Total*
Gross liability	4,00,000	6,00,000	8,00,000	18,00,000
Less: Firm underwriting	(50,000)	(60,000)	(70,000)	(1,80,000)
	3,50,000	5,40,000	7,30,000	16,20,000
Less: Marked applications received	(3,00,000)	(3,50,000)	(4,50,000)	(11,00,000)
	50,000	1,90,000	2,80,000	5,20,000
Less: Unmarked applications (In gross liability ratio 2:3:4)	(64,000)	(96,000)	(1,28,000)	(2,88,000)
Balance	(14,000)	94,000	1,52,000	2,32,000
Excess of P distributed to Q & R in ratio (3:4)	14,000	(6,000)	(8,000)	-
Net liability (other than firm underwriting)	-	88,000	1,44,000	2,32,000
Add: Firm underwriting	50,000	60,000	70,000	1,80,000
Total liability of underwriters including firm underwriting	50,000	1,48,000	2,14,000	4,12,000
Total liability in amount @ ₹ 10 each	₹ 5,00,000	₹ 14,80,000	₹ 21,40,000	₹ 41,20,000

Question 8

ABC Ltd. came up with public issue of 3,00,000 Equity Shares of ₹ 10 each at ₹ 15 per share. P, Q and R took underwriting of the issue in ratio of 3 : 2: 1 with the provisions of firm underwriting of 20,000, 14,000 and 10,000 shares respectively.

Applications were received for 2,40,000 shares excluding firm underwriting. The marked applications from public were received as under:

P - 60,000

Q - 50,000

R - 60,000

Compute the liability of each underwriter as regards the number of shares to be taken up assuming that the benefit of firm underwriting is not given to individual underwriters.

(5 Marks, November 2012) (IPCC)

Answer

Calculation of liability of each underwriter (in shares) assuming that the benefit of firm underwriting is not given to individual underwriters

(Number of shares)

	P	*Q*	*R*	*Total*
Gross Liability	1,50,000	1,00,000	50,000	3,00,000
Less: Marked applications (excluding firm underwriting)	(60,000)	(50,000)	(60,000)	(1,70,000)
Balance	90,000	50,000	(10,000)	1,30,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(6,000)	(4,000)	10,000	-
Balance	84,000	46,000	-	1,30,000
Less: Unmarked applications including firm underwriting (W.N.)	(57,000)	(38,000)	(19,000)	(1,14,000)
Net Liability	27,000	8,000	(19,000)	16,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(11,400)	(7,600)	19,000	-
	15,600	400	-	16,000
Add: Firm underwriting	20,000	14,000	10,000	44,000
Total Liability	35,600	14,400	10,000	60,000

Working Note

Application received from public	2,40,000 shares
Add: Shares underwritten firm (20,000 + 14,000 + 10,000)	44,000 shares
Total application	2,84,000 shares
Less: Marked applications (60,000 + 50,000 + 60,000)	1,70,000 shares
Unmarked application including firm underwriting	1,14,000 shares

Question 9

A company issued 1,50,000 shares of ₹ 10 each at a premium of ₹ 10. The entire issue was underwritten as follows:

X – 90000 shares (Firm underwriting 12000 shares)

Y – 37500 shares (Firm underwriting 4500 shares)

Z – 22500 shares (Firm underwriting 15000 shares)

Total subscriptions received by the company (excluding firm underwriting and marked applications) were 22500 shares.

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

X – 15000 shares

Y – 30000 shares

Z – 7500 shares

Commission payable to underwriters is at 5% of the issue price. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

(i) Determine the liability of each underwriter (number of shares);

(ii) Compute the amounts payable or due from underwriters; and

(iii) Pass Journal Entries in the books of the company relating to underwriting.

(12 Marks, May 2013) (IPCC)

Answer

(i) Computation of total liability of underwriters in shares

	(In shares)			
	X	Y	Z	*Total*
Gross liability	90,000	37,500	22,500	1,50,000
Less: Marked applications (excluding firm underwriting)	(15,000)	(30,000)	(7,500)	(52,500)

	75,000	7,500	15,000	97,500
Less: Unmarked applications in the ratio of gross liabilities of 12:5:3 (excluding firm underwriting)	(13,500)	(5,625)	(3,375)	(22,500)
	61,500	1,875	11,625	75,000
Less : Firm underwriting	(12,000)	(4,500)	(15,000)	(31,500)
	49,500	(2,625)	(3,375)	43,500
Less: Surplus of Y and Z adjusted in X's balance (2,625+3,375)	(6,000)	2,625	3,375	
Net liability	43,500	-	-	43,500
Add: Firm underwriting	12,000	4,500	15,000	31,500
Total liability	55,500	4,500	15,000	75,000

(ii) Calculation of amount payable to or due from underwriters

	X	*Y*	*Z*	*Total*
Total Liability in shares	55,500	4,500	15,000	75,000
Amount receivable @ ₹ 20 from underwriter (in ₹)	11,10,000	90,000	3,00,000	15,00,000
Less: Underwriting Commission payable @ 5% on no. of shares underwritten @ 20 each (in ₹)	(90,000)	(37,500)	(22,500)	(1,50,000)
Net amount receivable (in ₹)	10,20,000	52,500	2,77,500	13,50,000

(iii) Journal Entries in the books of the company (relating to underwriting)

			₹	₹
1.	X	Dr.	11,10,000	
	Y	Dr.	90,000	
	Z	Dr.	3,00,000	
	To Share Capital A/c			7,50,000
	To Securities Premium A/c			7,50,000
	(Being allotment of shares to underwriters in terms of the underwriting agreement)			
2.	Underwriting commission A/c	Dr.	1,50,000	
	To X			90,000
	To Y			37,500

	To Z			22,500
	(Being amount of underwriting commission payable to the underwriters @ 5% of no of shares underwritten by eacah @ ₹ 20 per share)			
3.	Bank A/c	Dr.	13,50,000	
	To X			10,20,000
	To Y			52,500
	To Z			2,77,500
	(Being net amount received by underwriters for shares allotted less underwriting commission in full settlement)			

Unit 3: Redemption of Debentures

Question 1

A company purchased its own 11% debentures in the open market for ₹ 50,00,000 (cum-interest). The interest amount included in the purchase price is ₹ 1,50,000. The face value of the debentures purchased is ₹ 52,00,000. The company cancelled the debentures so purchased.

Pass Journal Entries in the books of the company for purchase and immediate cancellation of debentures. (4 Marks, November, 2007) (PCC)

Answer

Journal Entries

		₹	₹
11% Own Debentures A/c	Dr.	48,50,000	
Debenture interest A/c	Dr.	1,50,000	
To Bank			50,00,000
[Being purchase of own 11% debentures cum interest from the market]			
11% Debentures A/c	Dr.	52,00,000	
To 11% Own Debentures A/c			48,50,000
To Capital Reserve			3,50,000
[Being the 11% own debentures purchased from open market cancelled and profit thereon transferred to Capital Reserve A/c]			

Question 2

The summarised Balance Sheet of Dee Limited on 31st March, 2009 was as follows:

Balance Sheet as at 31st March, 2009

Liabilities	*Amount ₹*	*Assets*	*Amount ₹*
Share capital:		*Fixed assets (at cost less depreciation)*	*8,00,000*
Authorised capital			
50,000, Equity shares of ₹ 10 each	*<u>5,00,000</u>*	*Debenture redemption fund investment*	*2,00,000*
Issued and subscribed capital		*Cash balance*	*2,50,000*
25,000 Equity shares of ₹ 10 each fully paid up	*2,50,000*	*Other current assets*	*10,00,000*

Reserves and surplus:			
General reserve	*2,75,000*		
Profit and loss A/c	*1,00,000*		
Debenture redemption reserve	*2,50,000*		
Secured loans:			
12% Convertible debentures (5,000 Debentures of ₹ 100 each)	*5,00,000*		
Other secured loans	*2,50,000*		
Current liabilities and provisions	*6,00,000*		
Proposed dividend	*25,000*		
	22,50,000		*22,50,000*

At the General Meeting it was resolved to:

1. *Pay proposed dividend of 10% in cash.*
2. *Give existing shareholders the option to purchase one share of ₹ 10 each at ₹ 15 for every five shares held. This option was taken up by all the shareholders.*
3. *Redeem the debentures at a premium of 5% and also confer option to the debentureholders to convert 50% of their holding into equity shares at a predetermined price of ₹ 15 per share and balance payment to be made in cash.*

Holders of 3,000 debentures opted to get their debentures redeemed in cash only while the rest opted for getting the same converted into equity shares as per the terms of issue. Debenture redemption fund investment realized ₹ 1,80,000 on sales.

You are required to redraft the Balance Sheet after giving effects to the right issue and redemption of debentures. Also show the calculations in respect of number of equity shares issued and cash payment. *(16 Marks, November, 2009) (IPCC)*

Answer

(a) Balance Sheet of Dee Ltd.

as at 31st March, 2009

	Particulars	Notes No.	₹ '000
	EQUITY AND LIABILITIES		
1	Shareholders' funds		
	(a) Share capital	1	3,70,000
	(b) Reserves and Surplus	2	6,40,000

3	**Non-current liabilities**		
	Long-term borrowings	3	2,50,000
4	**Current liabilities**		6,00,000
	Total		18,60,000
	ASSETS		
1	**Non-current assets**		
	Fixed assets		
	Tangible assets		8,00,000
2	**Current assets**		
	(a) Other current assets		10,00,000
	(b) Cash and cash equivalents		60,000
	Total		18,60,000

Notes to Accounts

		₹ '000
1.	**Share Capital**	
	Authorised Capital	
	50,000 Equity shares of ₹ 10 each	5,00,000
	Issued and subscribed capital	
	37,000 Equity shares of ₹ 10 each fully paid up	
	Total	3,70,000
2.	**Reserves and Surplus**	
	General reserve (W.N.2)	4,80,000
	Securities premium (W.N.3)	60,000
	Profit and loss A/c	1,00,000
	Total	6,40,000
3.	**Long-term borrowings**	
	Secured	
	Loan	2,50,000

(b)

Calculation of number of equity shares issued:		
I.	Number of equity shares issued as right issue (25,000 shares ÷ 5)	5,000 shares
II.	Debentureholders who opted for the scheme of conversion into equity shares	

	2,000 debentureholders opted for the scheme	
	Total value (2,000 debentures × ₹ 100)	₹ 2,00,000
	Premium on redemption @ 5%	₹ 10,000
		₹ 2,10,000
	50% of their holding converted into equity shares	₹ 1,05,000
	Number of equity shares to be issued to debentureholders $= \left[\frac{₹ 1,05,000}{₹ 15}\right]$	7,000 shares
	Total number of equity shares issued (5,000 + 7,000) shares	12,000 shares

(c) Cash payment to debentureholders:

			₹
I.	3,000 Debentureholders preferred cash		
	Total cash paid to them	3,00,000	
	Premium on redemption @ 5%	15,000	3,15,000
II.	2,000 Debentureholders opted for the scheme		
	Total value	2,00,000	
	Add: Premium on redemption @ 5%	10,000	
		2,10,000	
	50% of their value converted into equity shares	1,05,000	
	Balance paid to debentureholders in cash		1,05,000
	Total cash paid to debentureholders		4,20,000

Working Notes:

1. Debenture Redemption Reserve Account

	Particulars	₹		*Particulars*	₹
To	Premium on redemption of debentures (15,000 + 10,000)	25,000	By	Balance b/d	2,50,000
To	Loss on sale of Debenture Redemption Reserve Investment	20,000			
To	General Reserve	2,05,000			
		2,50,000			2,50,000

2. General Reserve Account

Particulars	₹	*Particulars*	₹
To Balance c/d	4,80,000	By Balance b/d	2,75,000
		By Debenture redemption reserve (W.N.1)	2,05,000
	4,80,000		4,80,000

3. Calculation of Securities Premium

Number of equity shares of ₹ 10 issued at ₹ 15 per share	12,000 shares
Security premium per share	₹ 5
Total securities premium (12,000 shares x ₹ 5)	₹ 60,000

4. Cash Account

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Balance b/d	2,50,000	By Proposed dividend	25,000
To Equity shareholders (5,000×15)	75,000	By Debentureholders (₹ 1,05,000+₹ 3,15,000)	4,20,000
To Sale of Debenture Redemption Reserve Investment	1,80,000	By Balance c/d	60,000
	5,05,000		5,05,000

Question 3

A Company had issued 20,000, 13% Convertible debentures of ₹100 each on 1st April, 2007. The debentures are due for redemption on 1st July, 2009. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debentureholders to convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debentureholders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debentureholders exercising the option to the maximum. *(2 Marks, May, 2010, May, 2011) (IPCC)*

Answer

Calculation of number of equity shares to be allotted

	Number of debentures
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	(2,500)

Debenture holders who opted for conversion	17,500
Option for conversion	20%
Number of debentures to be converted (20% of 17,500)	3,500

Redemption value of 3,500 debentures at a premium of 5% [3,500 x (100+5)]	₹ 3,67,500
Equity shares of ₹ 10 each issued on conversion	
[₹ 3,67,500/ ₹ 15]	24,500 shares

Question 4

Rama Limited issued 8% Debentures of ₹ 3,00,000 in earlier year on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase its own debentures in the open market for cancellation thereof. The following purchases were made during the financial year 2009-10 and cancellation made on 31st March, 2010:

(a) On 1st April, ₹ 50,000 nominal value debentures purchased for ₹ 49,450, ex-interest.

(b) On 1st September, ₹ 30,000 nominal value debentures purchased for ₹ 30,250 cum interest.

Show the Journal Entries (without narrations) for the transactions held in the year 2009-10.

(5 Marks, November, 2010, November, 2011) (IPCC)

Answer

In the books of Rama Limited

Journal Entries

			Dr. (₹)	*Cr. (₹)*
1st April, 2009	Own debentures A/c	D	49,450	
	To Bank A/c			49,450
	(Being own 8% debentures of face value ₹ 50,000 purchased ex- interest)			
1st Sept. 2009	Own debentures A/c	Dr.	29,250	
	Interest on own debentures A/c	Dr.	1,000	
	[30,000 x 8% x $\frac{5}{12}$]			
	To Bank A/c			30,250
	(Being own 8% debentures of nomnal value ₹ 30,000 purchased cum interest)			
30th Sept. 2009	Interest on debentures A/c	Dr.	12,000	
	To Bank A/c			8,800

	To Interest on own debentures A/c (Being the interest @8% on total 8% debentures booked as revenue and interest on ₹ 80,000 own 8% debentures credited as incnome and balance paid to debenture holders)		3,200
31st March, 2010	Interest on debentures A/c Dr. To Bank A/c To Interest on own debentures A/c (Being interest @8% paid on 8% debentures to the tune of ₹ 2,20,000 after adjustment of interest on ₹ 80,000 own debentures for 6 month)	12,000	 8,800 3,200
31st March, 2010	8% Debentures A/c Dr. To Own debentures A/c To Profit on cancellation of Debentures A/c (Being cancellation of own 8% debentures purchased during the year)	80,000	 78,700 1,300
31st March, 2010	Interest on own debentures A/c Dr. To Profit and Loss A/c (3,200+3,200-1,000) (Being total interest credited on own 8% debentures credited to P/L A/c)	5,400	 5,400
31st March, 2010	Profit and Loss A/c (1,000+12,000) Dr. To Interest on debentures A/c (Being total interest on 8% debentures transferred to P/L A/c at the end of the year)	24,000	 24,000
31st March, 2010	Profit on cancellation of debentures A/c Dr. To Capital reserve A/c (Being profit on cancellation of debentures transferred to capital Reserve A/c)	1,300	 1,300

Question 5

The following balances appeared in the books of Paradise Ltd on 1-4-2011:

(i) *12 % Debentures ₹ 7,50,000*

(ii) *Balance of Sinking Fund ₹ 6,00,000*

(iii) *Sinking Fund Investment ₹ 6,00,000 represented by 10% ₹ 6,50,000 secured bonds of government of India.*

Annual contribution to the Sinking Fund was ₹ 1,20,000 made on 31st March each year. On 31-3-2012,balance at bank was ₹ 3,00,000 before receipt of interest. The company sold the investment at 90%, 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, 2012:

(1) Debentures Account

(2) Sinking Fund Account

(3) Sinking Fund Investment Account

(4) Bank Account

(5) Debenture Holders Account *(8 Marks, May 2012) (IPCC)*

Answer

1. 12% Debentures Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31st March, 2012	To Debenture holders A/c	7,50,000	1st April, 2011	By Balance b/d	7,50,000
		7,50,000			7,50,000

2. Sinking Fund Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31st March, 2012	To Sinking Fund Investment A/c 10% Sec. Bond (loss)	15,000	1st April, 2011	By Balance b/d	6,00,000
31st March, 2012	To General reserve A/c (Bal.fig.)	7,70,000	31st March, 2012	By Profit and loss A/c (tfr for yr 11-12	1,20,000
				By Interest on sinking fund A/c [Interest on 10% Govt. bond (₹ 6,50,000 x 10%)]	65,000
		7,85,000			7,85,000

3. Sinking Fund Investment Account (10% Secured Bonds of Govt.)

		₹			₹
1st April, 2011	To Balance b/d	6,00,000	31st March, 2012	By Bank A/c (6,50,000 x 90% = 5,85,000)	5,85,000
				By Sinking Fund A/c	15,000
		6,00,000			6,00,000

4. Bank Account

		₹			₹
31st March, 2012	To Balance b/d	3,00,000	31st March, 2012	By 12% Debenture	8,25,000
	To Sinking Fund A/c (Interest)	65,000			
	To Sinking fund Investment A/c	5,85,000	31 March	By Balance c/d	1,25,000
		9,50,000			9,50,000

5. Debenture holders Account

		₹			₹
31st March, 2012	To Bank A/c	8,25,000	31st March, 2012	By 12% Debentures	7,50,000
				By Premium on redemption of debentures	75,000
		8,25,000			8,25,000

Question 6

Himalayas Ltd. had ₹10,00,000/- 8 % Debentures of ₹100 each as on 31st March, 2011. The company purchased in the open market following debentures for immediate cancellation:

On 01-07-2011 - 1000 debentures @ ₹ 97/ (cum interest)

On 29-02-2012 - 1800 debentures @ ₹99/ (ex interest)

Debenture interest due date is 30th September and 31st March.

Give Journal Entries in the books of the company for the year ended 31 t March, 2012.

(8 Marks, November 2012) (IPCC)

Answer

In the books of Himalayas Ltd.

Journal Entries

			Dr. ₹	Cr. ₹
1.07.2011	Own Debentures A/c	Dr.	95,000	
	Debenture Interest Account A/c [1,000×100×8%× (3/12)]	Dr.	2,000	
	To Bank A/c			97,000
	(Being 1,000 8% Debentures purchased @ ₹ 97 cum interest for immediate cancellation)			
1.07.2011	8% Debentures A/c	Dr.	1,00,000	
	To Own Debentures A/c			95,000
	To Capital reserve A/c (Profit on cancellation of debentures)			5,000
	(Being 1,000 8% debentures cancelled and profit thereon transferred to capital reserve account)			
30.09.2011	Debenture interest A/c [9,000 × 100 × 8% × (1/2)]	Dr.	36,000	
	To Debenture holders A/c			36,000
	(Being interest accrued on 9000 8% debentures for 6 months credited to debenture holders.)			
	Debenture holders	Dr.	36,000	
	To Bank A/c			36,000
	(Being the interest on 8% debentures amount paid)			
29.02.2012	Own Debentures A/c	Dr.	1,78,200	
	Debenture Interest Account A/c [1,800 × 100 × 8% × (5/12)]	Dr.	6,000	
	To Bank A/c			1,84,200
	(Purchase of 1,800 own 8% Debenture @ ₹ 99 ex interest for immediate cancellation and accrued interest thereon paid to the selling debenture holders)			

29.02.2012	8% Debentures A/c	Dr.	1,80,000	
	To Own Debentures A/c			1,78,200
	To Capital reserve A/c (Profit on cancellation on debentures)			1,800
	(Being 1,800 own 8% debentures cancelled and profit thereon transferred to capital reserve account)			
31.03.2012	Debentures Interest A/c	Dr.	28,800	
	[7,200 × 100 × 8% × (1/2)]			
	To Debenture holders A/c			28,800
	(Being the six monthly interest accrued on the remaining 7,200 8% debentures credited to debenture holders)			
31.3.2012	Debenture holders A/c	Dr.	28,800	
	To Bank A/c			28,800
	(Being the interest on debentures paid)			
31.03.2012	Profit and Loss A/c	Dr.	72,800	
	To debentures Interest A/c			72,800
	(Being interest on 8% debentures for the year charged to profit and loss account at the year end)			

Question 7

(a) *M Limited recently made a public issue of debentures. The following information is available in respect of the issue:*

(i) 3,00,000 partly convertible debentures of face value and issue price of ₹ 100 per debenture were issued;

(ii) Conversion of 50% of each debenture is to be done on expiry of 6 months from date of close of issue;

(iii) Date of closure of subscription list is 1st June, 2012. Date of allotment is 1st July, 2012;

(iv) Interest on debenture at the rate of 12% is payable from date of allotment;

(v) Equity share of ₹ 10 each are issued at ₹ 50 per share for the purpose of conversion;

(vi) Underwriting commission is 2%;

(vii) 2,25,000 debentures were applied for;

(viii) Interest on debentures is payable half yearly on 30th September and 31st March.

Give Journal entries for all transactions relating to the above, including cash and bank entries for the year ended 31st March, 2013. *(8 Marks, November 2013)* (IPCC)

(b) The summarized Balance Sheet of Entyce Ltd. as on 31st March, 2013 read as under:

	₹
Liabilities:	
Share Capital: 4,00,000 equity shares of ₹ 10 each fully paid up	*40,00,000*
General Reserve	*50,00,000*
Debenture Redemption Reserve	*35,00,000*
12% Convertible Debentures : 80,000 Debentures of ₹ 100 each	*80,00,000*
Other Loans	*45,00,000*
Current Liabilities and Provisions	*90,00,000*
	3,40,00,000
Assets:	
Fixed Assets (at cost less depreciation)	*1,50,00,000*
Debenture Redemption Reserve Investments	*30,00,000*
Cash and Bank Balances	*40,00,000*
Other Current Assets	*1,20,00,000*
	3,40,00,000

The debentures are due for redemption on 1st April, 2013. The terms of issue of debentures provided that they were redeemable at a premium 5% and also conferred option to the debentureholders to convert 25% of their holding into equity shares at a predetermined price of ₹ 11.90 per share and the balance payment in cash.

Assuming that:

(i) Except for debentureholders holding 12,000 debentures in aggregate, rest of them exercised the option for maximum conversion,

(ii) The investments realized ₹ 32,00,000 on sale,

(iii) All the transactions were taken place on 1st April, 2013 without any lag, and

(iv) Premium on redemption of debentures is to be adjusted against General Reserve.

Redraft the Balance Sheet of Entyce Ltd. as on 01.04.2013 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the cash payment necessary. *(8 Marks, November 2013) (IPCC)*

Answer

(a) Journal Entries

Date	Particulars		Amount Dr. ₹	Amount Cr. ₹
1.6.2012	Bank A/c	Dr.	2,25,00,000	
	To Debenture Application and Allotment A/c			2,25,00,000
	(Application money received on 2,25,000 debentures @ ₹ 100 each)			
1.7.2012	Debenture Application and Allotment A/c	Dr.	2,25,00,000	
	Underwriters' A/c	Dr.	75,00,000	
	To 12% Debentures A/c			3,00,00,000
	(Being the allotment of 2,25,000 debentures to applicants and balance 75,000 debentures to underwriters)			
	Underwriting Commission	Dr.	6,00,000	
	To Underwriters' A/c			6,00,000
	(Being commission payable to underwriters @ 2% on ₹ 3,00,00,000)			
	Bank A/c	Dr.	69,00,000	
	To Underwriters' A/c			69,00,000
	(Being the amount received from underwriters in settlement of account)			
30.09.2012	Debenture Interest A/c	Dr.	9,00,000	
	To Bank A/c			9,00,000
	(Being the interest paid on 12% debentures for 3 months @ 12% on ₹ 3,00,00,000)			
01.12.2012	12% Debentures A/c	Dr.	1,50,00,000	
	To Equity Share Capital A/c			30,00,000
	To Securities Premium A/c			1,20,00,000
	(Being the conversion of 50% of debentures into 3 lakh equity shares of ₹ 50 each with a face value of ₹ 10)			
31.3.2013	Debenture Interest A/c	Dr.	12,00,000	
	To Bank A/c			12,00,000
	(Interest paid on 12% debentures for the half year ending 31st March 2013 Ref: WN)			

31.03.2013	Profit & loss A/c	Dr.	6,00,000	
	To Underwriting commission			6,00,000
	(Being underwriting commission charged to Profit & loss A/c at the year end)			
31.03.2013	Profit & Loss A/c	Dr.	21,00,000	
	To Debenture Interest			21,00,000
	(Being interest on debenture 12,00,000 + 9,00,000 charged to Profit & loss A/c at the year end)			

Working Note:

Calculation of Debenture Interest for the half year ended 31st March, 2013

Interest on ₹1,50,00,000 for 6 months @ 12% = ₹ 9,00,000

Interest on ₹ 1,50,00,000 for 2 months @ 12% = ₹ 3,00,000

₹ 12,00,000

(b) Entyce Limited

Balance Sheet as on 01.04.2013

Particulars	Note No.	Figures as at the end of current reporting period
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	55,00,000
(b) Reserves and Surplus	2	85,85,000
(2) Non-Current Liabilities		
(a) Long-term borrowings - Unsecured Loans		45,00,000
(3) Current Liabilities		
(a) Short-term provisions		90,00,000
Total		2,75,85,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets		1,50,00,000
(2) Current assets		
(a) Cash and cash equivalents		5,85,000
(b) Other current assets		1,20,00,000
Total		2,75,85,000

Notes to Accounts

			₹
1	Share Capital		
	5,50,000 Equity Shares of ₹ 10 each		55,00,000
2	Reserve and Surplus		
	General Reserve	50,00,000	
	Add: Debenture Redemption Reserve transfer	35,00,000	
		85,00,000	
	Add: Profit on sale of investments	2,00,000	
		87,00,000	
	Less: Premium on redemption of debentures (80,000 x ₹ 5)	(4,00,000)	83,00,000
	Securities Premium Account (1,50,000 x ₹ 1.9)		2,85,000
			85,85,000

Working Notes:

(i) Calculation of number of shares to be allotted

Total number of debentures	80,000
Less : Number of debentures not opting for conversion	(12,000)
	68,000
25% of 68,000	17,000
Redemption value of 17,000 debentures	₹ 17,85,000

Number of Equity Shares to be allotted:

$= \frac{17,85,000}{11.90}$ = 1,50,000 shares of ₹ 10 each.

(ii) Calculation of cash to be paid

Number of debentures	80,000
Less: Number of debentures to be converted into equity shares	(17,000)
	63,000
Redemption value of 63,000 debentures (63,000 × ₹ 105)	₹ 66,15,000

(iii) Cash and Bank Balance

	₹
Balance before redemption	40,00,000
Add : Proceeds of investments sold	32,00,000
	72,00,000
Less : Cash paid to debenture holders	(66,15,000)
	5,85,000

Unit 4: Amalgamation & Reconstruction

Question 1

Exe Limited was wound up on 31.3.2004 and its Balance Sheet as on that date was given below:

Balance Sheet of Exe Limited as on 31.3.2004

Liabilities	*₹*	*Assets*			*₹*
Share capital:		*Fixed assets*			*9,64,000*
1,20,000 Equity shares of ₹10 each	*12,00,000*	*Current assets:* *Stock*		*7,75,000*	
Reserves and surplus:		*Sundry debtors*	*1,60,000*		
Profit prior to incorporation	*42,000*	*Less: Provision for bad and doubtful debts*	*8,000*	*1,52,000*	
Contingency reserve	*2,70,000*	*Bills receivable*		*30,000*	
Profit and loss A/c	*2,52,000*	*Cash at bank*		*3,29,000*	*12,86,000*
Current liabilities:					
Bills payable	*40,000*				
Sundry creditors	*2,26,000*				
Provisions:					
Provision for income tax	*2,20,000*				
	22,50,000				*22,50,000*

Wye *Limited took over the following assets at values shown as under:*

Fixed assets ₹12,80,000, Stock ₹7,70,000 and Bills Receivable ₹30,000.

Purchase consideration was settled by Wye Limited as under:

₹ 5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of ₹100 each. The balance was settled by issuing equity shares of ₹10 each at ₹8 per share paid up.

Sundry debtors realised ₹ 1,50,000. Bills payable was settled for ₹ 38,000. Income tax authorities fixed the taxation liability at ₹2,22,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹8,000.

You are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.

(ii) Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limited account in the books of Exe Limited.

(iii) Pass journal entries in the books of Wye Limite (16 Marks, May 2005)(PE-II)

Answer

(i) Purchase consideration

	₹
Fixed assets	12,80,000
Stock	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares = ₹ 5,10,000

No. of preference shares to be allotted $= \frac{5,10,000}{100} = 5,100$ shares

Amount discharged by allotment of equity shares = ₹ 20,80,000 – ₹ 5,10,000

= ₹ 15,70,000

Paid up value of equity share = ₹ 8

Hence, number of equity shares to be issued $= \frac{15,70,000}{8} = 1,96,250$ shares

(ii) Realisation Account

In the books of Exe Ltd.

	₹		₹
To Fixed assets	9,64,000	By Provision for bad and doubtful debts	8,000
To Stock	7,75,000	By Bills payable	40,000
To Sundry debtors	1,60,000	By Sundry creditors	2,26,000
To Bills receivable	30,000	By Provision for taxation	2,20,000
To Bank account:		By Wye Ltd. account	
Liquidation expenses	8,000	(Purchase consideration)	20,80,000
Bills payable	38,000	By Bank account: Sundry debtors	1,50,000
Tax liability	2,22,000		
Sundry creditors	2,11,000		
To Equity shareholders (profit transferred)	3,16,000		
	27,24,000		27,24,000

Cash/Bank Account

		₹			₹
To	Balance b/d	3,29,000	By	Realisation account:	
To	Realisation account:			Liquidation expenses	8,000
	Sundry debtors	1,50,000		Bills payable	38,000
				Tax liability	2,22,000
				Sundry creditors (Bal.fig.)	2,11,000
		4,79,000			4,79,000

Equity Shareholders Account

		₹			₹
To	10% Preference shares in Wye Ltd.	5,10,000	By	Equity share capital account	12,00,000
			By	Profit prior to incorporation	42,000
To	Equity shares in Wye Ltd.	15,70,000	By	Contingency reserve	2,70,000
			By	Profit and loss account	2,52,000
			By	Realisation account (Profit)	3,16,000
		20,80,000			20,80,000

Wye Limited Account

		₹			₹
To	Realisation account	20,80,000	By	10% Preference shares in Wye Ltd.	5,10,000
			By	Equity shares in Wye Ltd.	15,70,000
		20,80,000			20,80,000

(iii) Journal Entries

in the books of Wye Ltd.

Particulars		*Dr.* *Amount* ₹	*Cr.* *Amount* ₹
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			

Fixed assets account	Dr.	12,80,000	
Stock account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account	Dr.	20,80,000	
To 10% Preference share capital account			5,10,000
To Equity share capital account			15,70,000
(Being the allotment of 10% fully paid up preference shares and equity shares of ₹ 10 each, ₹ 8 each paid up as per agreement for discharge of purchase consideration)			

Question 2

Following is the Balance Sheet as at March 31, 2005:

					(₹'000)
Liabilities	*Max Ltd.*	*Mini Ltd.*	*Assets*	*Max Ltd.*	*Mini Ltd.*
Share capital:			*Goodwill*	*20*	*–*
Equity shares of ₹100 each	*1,500*	*1,000*	*Other fixed assets*	*1,500*	*760*
9% Preference shares of ₹100 each	*500*	*400*	*Debtors*	*651*	*440*
			Stock	*393*	*680*
General reserve	*180*	*170*	*Cash at bank*	*26*	*130*
Profit and loss account	*–*	*15*	*Own debenture (Nominal value ₹2,00,000)*	*192*	
12% Debentures of ₹100 each	*600*	*200*			
Sundry creditors	*415*	*225*	*Discount on issue of debentures*	*2*	
			Profit and loss account	*411*	
	3,195	*2,010*		*3,195*	*2,010*

On 1.4.2005, Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of ₹10 each fully paid up. 50% of the equity share capital would be surrendered to the Company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.

(iii) Own debentures of ₹ 80,000 were sold at ₹ 98 cum-interest and remaining own debentures were cancelled.

(iv) Debentureholders of ₹ 2,80,000 agreed to accept one machinery of book value of ₹ 3,00,000 in full settlement.

(v) Creditors, debtors and stocks were valued at ₹ 3,50,000, ₹ 5,90,000 and ₹ 3,60,000 respectively. The goodwill, discount on issue of debentures and Profit and Loss (Dr.) are to be written off.

(vi) The Company paid ₹ 15,000 as penalty to avoid capital commitments of ₹ 3,00,000.

On 2.4.2005 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of ₹ 10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of ₹ 100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of ₹ 100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2005. *(20 Marks, November 2005) (PE-II)*

Answer

In the Books of Max Ltd.

Particulars		*Dr.*	*Cr.*
01.04.2005		*Amount*	*Amount*
		₹	₹
Equity share capital A/c	Dr.	15,00,000	
To Equity share capital A/c			15,00,000
(Being sub-division of one equity share of ₹ 100 each into 10 equity shares of ₹ 10 each)			
Equity share capital A/c	Dr.	7,50,000	
To Capital reduction A/c			7,50,000
(Being reduction of equity paid up capital by 50%)			
Capital reduction A/c	Dr.	13,500	
To Bank A/c			13,500
(Being payment of 10% of the 3 year arrear of preference dividend 45,000 x 3 = 1,35,000 x 10% = 13,500)			

Bank A/c	Dr.	78,400	
To Own debentures A/c (80,000 x192 / 200)			76,800
To Capital reduction A/c			1,600
(Being profit on sale of own debentures transferred to capital reduction A/c)			
12% Debentures A/c	Dr.	1,20,000	
To Own debentures A/c (120000 x192 / 200)			1,15,200
To Capital reduction A/c			4,800
(Being the balance own debentures cancelled and profit thereon transferred to capital reduction A/c)			
12% Debentures A/c	Dr.	2,80,000	
Capital reduction A/c	Dr.	20,000	
To Machinery A/c			3,00,000
(Being a machinery of ₹ 3,00,000 taken up by debenture holders of value ₹ 2,80,000 in full settlement)			
Creditors A/c	Dr.	65,000	
Capital reduction A/c	Dr.	29,000	
To Debtors A/c			61,000
To Stock A/c			33,000
(Being assets and liabilities reduced on revaluation)			
Capital reduction A/c	Dr.	4,33,000	
To Goodwill A/c			20,000
To Discount on debentures A/c			2,000
To Profit and Loss A/c			4,11,000
(Being the above assets written off)			
Capital reduction A/c	Dr.	15,000	
To Bank A/c			15,000
(Being penalty paid for avoidance of capital commitments)			
Capital reduction A/c	Dr.	2,45,900	
To Capital reserve A/c			2,45,900
(Being the balance in the Capital Reduction A/s transferred to Capital Reserve A/c)			

02.04.2005 Business Purchase A/c	Dr.	13,20,000	
To Liquidators of Mini Ltd.			13,20,000
(Being the purchase consideration payable to Mini Ltd for purchase of its business.)			
Fixed Assets A/c	Dr.	7,60,000	
Stock A/c	Dr.	6,80,000	
Debtors A/c	Dr.	4,40,000	
Cash at Bank A/c	Dr.	1,30,000	
To Sundry Creditors A/c			2,25,000
To 12% Debentures A/c of Mini Ltd.			2,00,000
To Profit and Loss A/c			15,000
To General reserve A/c ₹ (1,70,000 + 80,000*)			2,50,000
To Business purchase A/c			13,20,000
(Being the take over of all assets and liabilities of Mini Ltd. by Max Ltd.)			
Liquidators of Mini Ltd. A/c	Dr.	13,20,000	
To Equity Share Capital			10,00,000
To 9% Preference share capital			3,20,000
(Being the purchase consideration on purchase of the business of Mini Ltd discharged)			
12% Debentures of Mini Ltd. A/c	Dr.	2,00,000	
To 12% Debentures A/c			2,00,000
(Being the issue of 12% Debentures against of every Debenture of Mini Ltd.)			

Balance Sheet of Max Ltd. as at 2.4.2005

Particulars	Note No	Amount(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	25,70,000
(b) Reserves and Surplus	2	6,90,900

* ₹ 80,000 is the balancing figure adjusted to general reserve A/c as per AS 14 "Accounting for Amalgamation".

(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		4,00,000
(3) Current Liabilities		
(a) Trade payables		5,75,000
Total		42,35,900
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets		19,60,000
(2) Current assets		
(a) Inventories		10,40,000
(b) Trade receivables		10,30,000
(c) Cash and cash equivalents		2,05,900
Total		42,35,900

Notes to Accounts

			₹
1	Share Capital		
	Equity Share Capital		17,50,000
	9% Preference share capital		8,20,000
			25,70,000
2	Reserves and Surplus		
	Profit and Loss A/c		15,000
	General Reserve		
	Share Capital of Mini Ltd. (Equity + Preference)	14,00,000	
	Less: Share Capital issued by Max Ltd.	13,20,000	
	General reserve (resulted due to absorption)	80,000	
	Add: General reserve of Mini Ltd.	1,70,000	
	General reserve of Max Ltd.	1,80,000	4,30,000
	Capital Reserve		2,45,900
			6,90,900

Working Note:

1. Arrear dividend to Preference Shareholders

   Preference Share Capital ₹ 500,000 @ 9% will yield dividend of ₹ 45,000/- per year and for 3 years = ₹ 1,35,000/-. Out of this only 10% is paid and the balance is waived off. Hence, amount paid = ₹ 13,500/-

2. Profit on redemption of own debentures

Own Debentures with Nominal Value of ₹ 80,000 sold for ₹ 98 per deb = 80,000 * 98/100 = ₹ 78,400/-.

Book Value = ₹ 1,92,000/ 2,00,000 X 80,000 = ₹ 76,800/-. Profit on own debentures sold = ₹ 78,400 – ₹ 76,800 = ₹ 1,600

Balance Own Debentures = ₹ 1,92,000 – 76,800 = ₹ 1,15,200 which are cancelled

3. Purchase Consideration

Equity share capital $10{,}000 \times \frac{50}{5} \times$ ₹ 10 = 10,00,000

9% Preference share capital $4{,}000 \times \frac{4}{5} \times 100$ = 3,20,000

₹ 13,20,000

Question 3

P and Q have been carrying on same business independently. Due to competition in the market, they decided to amalgamate and form a new company called PQ Ltd.

Following is the Balance Sheet of P and Q as at 31.3.2007:

Liabilities	*P*	*Q*	*Assets*	*P*	*Q*
	₹	*₹*		*₹*	*₹*
Capital	*7,75,000*	*8,55,000*	*Plant & machinery*	*4,85,000*	*6,14,000*
Current liabilities	*6,23,500*	*5,57,600*	*Building*	*7,50,000*	*6,40,000*
			Current assets	*1,63,500*	*1,58,600*
	13,98,500	*14,12,600*		*13,98,500*	*14,12,600*

Following are the additional information:

(i) The authorised capital of the new company will be ₹ 25,00,000 divided into 1,00,000 equity shares of ₹ 25 each.

(ii) Liabilities of P includes ₹ 50,000 due to Q for the purchases made. Q made a profit of 20% on sale to P.

(iii) P has goods purchased from Q, cost to him ₹ 10,000. This is included in the Current asset of P as at 31st March, 2007.

(iv) The assets of P and Q are to be revalued as under:

	P	*Q*
	₹	*₹*
Plant and machinery	*5,25,000*	*6,75,000*
Building	*7,75,000*	*6,48,000*

(v) The purchase consideration is to be discharged as under:

(a) *Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years.*

(b) *Profits for the preceding 2 years are given below:*

	P	*Q*
	₹	*₹*
1st year	*2,62,800*	*2,75,125*
IInd year	*2,12,200*	*2,49,875*
Total	*4,75,000*	*5,25,000*

(c) *Issue 12% preference shares of ₹10 each fully paid up at par to provide income equivalent to 8% return on capital employed in the business as on 31.3.2007 after revaluation of assets of P and Q respectively.*

You are required to:

(i) Compute the amount of equity and preference shares issued to P and Q.

(ii) Prepare the Balance Sheet of P & Q Ltd. immediately after amalgamation.

(16 Marks, May, 2007)(PCC)

Answer

(i) Calculation of amount of equity shares issued to P and Q

Profits of	*P*	*Q*
	₹	*₹*
Ist year	2,62,800	2,75,125
IInd year	2,12,200	2,49,875
Total	4,75,000	5,25,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability

24,000 x 475/1000		11,400 equity shares	
24,000 x 525/1000			12,600 equity shares

Calculation of amount of 12% Preference shares issued to P and Q

	P	Q
	₹	₹
Capital employed (Refer working note 1)	8,40,000	9,24,000
8% return on capital employed	67,200	73,920
12% Preference shares to be issued $\left[67{,}200 \times \frac{100}{12}\right]$	₹ 5,60,000	
$\left[73{,}920 \times \frac{100}{12}\right]$		₹ 6,16,000

Total Purchase Consideration

	P	Q
	₹	₹
Equity Shares	2,85,000	3,15,000
12% Preference shares	5,60,000	6,16,000
Total	8,45,000	9,31,000

(ii) Balance Sheet of PQ Ltd. (after amalgamation)

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	17,76,000
(2) Current Liabilities		
(c) Other current liabilities (W.N. 3)		11,31,100
Total		29,07,100
II. Assets		
(1) Non-current assets		
(a) Fixed assets	2	
Tangible assets		26,23,000
Intangible assets		14,000
(2) Current assets		
(a) Other current assets (W.N. 2)		2,70,100
Total		29,07,100

Notes to Accounts

			₹
1	**Share Capital**		
	Equity Share Capital		
	Authorised share capital:		
	1,00,000 Equity Share of ₹ 25 each		25,00,000
	Issued and subscribed share capital:		
	24,000 Equity Shares of ₹ 25 each	6,00,000	
	Preference Share Capital		
	1,17,600 12% Preference shares of ₹ 10 each (All of the equity and preference shares have been issued for consideration other than cash)	11,76,000	17,76,000
2	**Fixed Assets**		
	(i) Tangible assets		
	Plant and Machinery	12,00,000	
	Building	14,23,000	26,23,000
	(ii) Intangible assets		
	Goodwill (W.N.1)		14,000

Working Notes:

1. Goodwill

	P	*Q*
	₹	₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
	14,63,500	14,81,600
Less: Current liabilities	6,23,500	5,57,600
Net assets taken (capital employed)	8,40,000	9,24,000
Less: Purchase consideration	8,45,000	9,31,000
Goodwill	5,000	7,000
Total purchased goodwill of PQ Ltd		12,000
Add: Unrealised profit of ₹10,000 @ 20% = ₹ 2,000 is adjusted from current assets and from goodwill (since P & L A/c is not given)		2,000
Total Goodwill		14,000

2. Current Assets

	P	Q
	₹	₹
Balances before amalgamation	1,63,500	1,58,600
Less: Liabilities of P due to Q	-	50,000
Less: Unrealised Profit on stock i.e.₹10,000 x 20%	2,000	
Total	1,61,500	1,08,600
Grand Total PQ Ltd		2,70,100

3. Current Liabilities

	P	Q
	₹	₹
Balances before amalgamation	6,23,500	5,57,600
Less: Liabilities of P due to Q	50,000	-
Total	5,73,500	5,57,600
Grand Total PQ Ltd		11,31,100

Question 4

Following is the Balance Sheet of ABC Ltd. as at 31st March, 2007:

Liabilities	₹	*Assets*	₹
Share capital:		*Plant and machinery*	*9,00,000*
2,00,000 Equity shares of		*Furniture and fixtures*	*2,50,000*
₹10 each fully paid up	*20,00,000*	*Patents and copyrights*	*70,000*
6,000 8% Preference shares of ₹ 100 each	*6,00,000*	*Investments (at cost) (Market value ₹55,000)*	*68,000*
9% Debentures	*12,00,000*	*Stock*	*14,00,000*
Bank overdraft	*1,50,000*	*Sundry debtors*	*14,39,000*
Sundry creditors	*5,92,000*	*Cash and bank balance*	*10,000*
		Profit and Loss A/c	*4,05,000*
	45,42,000		*45,42,000*

The following scheme of reconstruction was finalised:

(i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.

(ii) Debentureholders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.

(iii) Stock equal to ₹5,00,000 in book value will be taken over by sundry creditors in full settlement of their dues.

(iv) Investment value to be reduced to market price.

(v) The company would issue 11% Debentures for ₹3,00,000 and augment its working capital requirement after settlement of bank overdraft.

Pass necessary Journal Entries in the books of the company. Prepare Capital Reduction account and Balance Sheet of the company after internal reconstruction.

(16 Marks, November, 2007) (PCC)

Answer

In the Books of ABC Ltd.
Journal Entries

Particulars		₹	₹
8% Preference share capital A/c	Dr.	6,00,000	
To Preference shareholders A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital in exchange of 11% Debentures under the scheme of reorganization]			
Preference shareholders A/c	Dr.	4,20,000	
To 11% Debentures A/c			4,20,000
[Being the issue of debentures to preference shareholders in pursuance of the scheme of reorganization]			
9% Debentures A/c	Dr.	12,00,000	
To Debenture holders A/c			12,00,000
[Being transfer of 9% debentures to debenture holders A/c]			
Debenture holders A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Being the settlement of dues to debenture holders by allotment of plant & machinery]			
Sundry creditors A/c	Dr.	5,92,000	
To Stock A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving stocks]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures to augment working capital]			

Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

Capital Reduction Account

	₹		₹
To Investments A/c	13,000	By Preference share capital A/c	1,80,000
To Profit and loss A/c	4,05,000	By 9% Debenture holders A/c	3,00,000
To Capital reserve A/c	1,54,000	By Trade payables A/c	92,000
	5,72,000		5,72,000

Balance Sheet of ABC Ltd. (And Reduced)
As on 31st March 2007

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000
Total		28,74,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets	4	
Tangible assets		2,50,000
Intangible assets		70,000
(b) Non-current investments	5	55,000

(2) Current assets		
(a) Current investments		
(b) Inventories (₹ 14,00,000 – ₹ 5,00,000)		9,00,000
(c) Trade receivables		14,39,000
(d) Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

			₹
1.	Share Capital		
	2,00,000 Equity shares of ₹ 10 each fully paid-up		20,00,000
2.	Reserve and Surplus		
	Capital Reserve		1,54,000
3.	Long Term Borrowings		
	11% Debentures (₹ 4,20,000 + ₹ 3,00,000)		7,20,000
4.	Fixed Assets		
	(i) Tangible assets		
	Plant & machinery	9,00,000	
	Less: Adjustment on scheme of reconstruction dated…	9,00,000	-
	Furniture & fixtures		2,50,000
	(ii) Intangible assets		
	Patents & copyrights		70,000
			3,20,000
5.	Non Current Investments		
	Investments (₹ 68,000 – ₹ 13,000)		55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid
= ₹ 10,000 + ₹ 3,00,000 – ₹ 1,50,000 = ₹ 1,60,000

Question 5

What are the two main methods of accounting for amalgamation of companies?

(2 Marks, November, 2007) (PCC)

Answer

Two main methods of accounting for amalgamations are

(i) **The Pooling of Interests method-** Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts after making the adjustments required in para 11 of AS 14.

(ii) **The Purchase method-** Under this method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or on the basis of their fair values at the date of amalgamation.

Question 6

Following are the summarised Balance Sheets of A Ltd. and B Ltd. as at 31.3.2008:

Particulars	*A Ltd.*	*B Ltd.*
Share capital: Equity shares 10 each (fully paid up)	*10,00,000*	*6,00,000*
Securities premium	*2,00,000*	*-*
General reserve	*3,00,000*	*2,50,000*
Profit and loss account	*1,80,000*	*1,60,000*
10% Debentures	*5,00,000*	*-*
Secured loan	*-*	*3,00,000*
Sundry creditors	*2,60,000*	*1,70,000*
	24,40,000	*14,80,000*
Land and building	*9,00,000*	*4,50,000*
Plant and machinery	*5,00,000*	*3,80,000*
Investment (5,000 shares of B Ltd.)	*80,000*	*-*
Stock	*5,20,000*	*3,50,000*
Debtors	*4,10,000*	*2,60,000*
Cash at bank	*30,000*	*40,000*
	24,40,000	*14,80,000*

The companies agree on a scheme of amalgamation on the following terms:

(i) A new company is to be formed by name AB Ltd.

(ii) AB Ltd. to take over all the assets and liabilities of the existing companies.

(iii) For the purpose of amalgamation, the shares of the existing companies are to be valued as under:

A Ltd. = ₹18 per share

B Ltd. = ₹20 per share

(iv) A contingent liability of A Ltd. of ₹60,000 is to be treated as actual existing liability.

(v) The shareholders of A Ltd. and B Ltd. are to be paid by issuing sufficient number of shares of AB Ltd. at a premium of ₹6 per share.

(vi) The face value of shares of AB Ltd. are to be of ₹10 each.

You are required to:

(i) Calculate the purchase consideration (i.e., number of shares to be issued to A Ltd. and B Ltd.

(ii) Pass journal entries in the books of A Ltd. for the transfer of assets and liabilities.

(iii) Pass journal entries in the books of AB Ltd. for acquisition of A Ltd. and B Ltd.

(iv) Prepare the Balance Sheet of AB Ltd. *(16 Marks, May, 2008) (PCC)*

Answer

(i) Statement showing calculation of purchase consideration

		(Number of shares)
	A Ltd.	*B. Ltd.*
Existing shares	1,00,000	60,000
Less: Shares held by A Ltd.(see Inv of A Ltd)	______	5,000
	1,00,000	55,000
Value per share	₹ 18	₹ 20
Total value	₹ 18,00,000	₹ 11,00,000
No. of shares to be issued at a premium of ₹ 6 per share i.e. ₹16 (10+6)	1,12,500 shares	68,750 shares
	₹	₹
Share capital at ₹ 10 per share	11,25,000	6,87,500
Add: Securities premium at ₹ 6 per share	6,75,000	4,12,500
Total purchase consideration	18,00,000	11,00,000

(ii) Journal Entries in the books of A Ltd.

	₹	₹
Realisation A/c Dr.	24,40,000	
To Land & building A/c		9,00,000
To Plant & machinery A/c		5,00,000
To Stock A/c		5,20,000
To Sundry debtors A/c		4,10,000
To Investments A/c		80,000

To Bank A/c			30,000
(Being assets transferred to Realisation A/c)			
Realization A/c	Dr.	60,000	
To Creditors A/c			60,000
(Being contingent liability treated as real liability)			
10% Debentures A/c	Dr.	5,00,000	
Creditors A/c	Dr.	3,20,000	
To Realisation A/c			8,20,000
(Being transfer of liabilities to Realisation A/c)			
AB Ltd.	Dr	18,00,000	
To Realisation A/c			18,00,000
(Being the purchase consideration accounted for)			
Share in AB Ltd. A/c	Dr.	18,00,000	
To AB Ltd.			18,00,000
(Being purchase consideration received)			
Share Capital A/c	Dr.	10,00,000	
Securities premium A/c	Dr.	2,00,000	
General Reserve A/c	Dr.	3,00,000	
Profit and Loss A/c	Dr.	1,80,000	
Realisation A/c (bal fig)	Dr.	1,20,000	
To Equity Shareholders A/c			18,00,000
(Being transfer of balances in Equity Share Capital and Reserves and Realization A/cs to equity shareholders' account)			
Equity Shareholders A/c	Dr.	18,00,000	
To Shares in AB Ltd.			18,00,000
(Being closure of equity shareholders a/c)			

(iii) Journal Entries in the Books of AB Ltd.

		₹	₹
Land & building A/c	Dr.	9,00,000	
Plant & machinery A/c	Dr.	5,00,000	
Stock A/c	Dr.	5,20,000	
Debtors A/c	Dr.	4,10,000	

Bank A/c	Dr.	30,000	
Goodwill A/c (Bal Fig)	Dr.	2,60,000	
To 10% Debentures A/c			5,00,000
To Sundry creditors A/c			3,20,000
To Liquidator of A Ltd. A/c			18,00,000
(Being the purchase consideration of A Ltd. accounted for)			
Land & building A/c	Dr.	4,50,000	
Plant & machinery A/c	Dr.	3,80,000	
Stock A/c	Dr.	3,50,000	
Debtors A/c	Dr.	2,60,000	
Bank A/c	Dr.	40,000	
Goodwill A/c (Bal Fig)	Dr.	90,000	
To Secured loan A/c			3,00,000
To Sundry creditors A/c			1,70,000
To Liquidator of B Ltd. A/c			11,00,000
(Being purchase consideration of B Ltd. accounted for)			
Liquidator of A Ltd. A/c	Dr.	18,00,000	
To Equity share capital A/c			11,25,000
To Securities premium A/c			6,75,000
(Being equity shares of ₹ 10 each issued at ₹ 16 each to Liquidator of A Ltd in settlement of the purchase consideration of assets and liabilities.)			
Liquidator of B Ltd. A/c	Dr.	11,00,000	
To Equity share capital A/c			6,87,500
To Securities premium A/c			4,12,500
(Being shares of ₹ 10 each issued at a premium of ₹ 6 each to Liquidator of B Ltd in settlement of the purchase consideration of assets & liabilities)			

(iv) Balance Sheet of AB Ltd.
(After amalgamation of A Ltd. & B Ltd.)

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	18,12,500
(b) Reserves and Surplus	2	10,87,500
(2) Non-current liabilities		
Long-term borrowings	3	8,00,000

(3) Current liabilities		
Trade Payables		4,90,000
Total		41,90,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	4	22,30,000
Intangible assets	5	3,50,000
(2) Current assets		
(a) Inventories		8,70,000
(b) Trade receivables	6	6,70,000
(c) Cash and cash equivalents		70,000
Total		41,90,000

Notes to Accounts

		₹
1.	Share Capital	
	Share capital:	
	1,81,250 Equity shares of ₹10 each fully paid up	18,12,500
	(above shares have been issued for consideration other than cash)	
2.	Reserve and Surplus	
	Securities premium	10,87,500
3.	Long-term borrowings	
	10% Debentures	5,00,000
	Secured loan	3,00,000
		8,00,000
4.	Fixed Assets	
	Land & building	13,50,000
	Plant & machinery	8,80,000
		22,30,000
5.	Intangible assets	
	Goodwill (2,60,000 + 90,000)	3,50,000

Question 7

The Balance Sheet of R Ltd., at March, 2008 was as follows:

	₹		₹
Share capital authorised	1,40,000	Intangibles	68,000
Issued: 64,000, 8% cumulative preference shares of ₹ 10 each, fully paid	6,40,000	Freehold premises at cost	1,40,000
64,000 Equity shares of ₹ 10 each, ₹ 7.5 paid	4,80,000	Plant and equipment at cost less depreciation	2,40,000
Loans from directors	60,000	Investments in shares in Q Ltd. at cost	3,24,000
Sundry creditors	4,40,000	Stocks	2,48,000
Bank overdraft	2,08,000	Debtors	3,20,000
		Deferred revenue expenditure	48,000
		Profit and loss account	4,40,000
	18,28,000		18,28,000

Note: *The arrear of preference dividends amount to ₹ 51,200.*

A scheme of reconstruction was duly approved with effect from 1st April, 2008 under the conditions stated below:

(a) *The unpaid amount on the equity shares would be called up.*

(b) *The preference shareholders would forego their arrear dividends. In addition, they would accept a reduction of ₹ 2.5 per share. The dividend rate would be enhanced to 10%.*

(c) *The equity shareholders would accept a reduction of ₹ 7.5 per share.*

(d) *R Ltd. holds 21,600 shares in Q Ltd. This represents 15% of the share capital of that company. Q Ltd. is not a quoted company. The average net profit (after tax) of the company is ₹ 2,50,000. The shares would be valued based on 12% capitalization rate.*

(e) *A bad debt provision at 2% would be created.*

(f) *The other assets would be valued as under:*

	₹
Intangibles	48,000
Plant	1,40,000
Freehold premises	3,80,000
Stocks	2,50,000

(g) *The profit and loss account debit balance and the balance standing to the debit of the deferred revenue expenditure account would be eliminated.*

(h) The directors would have to take equity shares at the new face value of ₹ 2.5 share in settlement of their loan.

(i) The equity shareholders, including the directors, who would receive equity shares in settlement of their loans, would take up two new equity shares for every one held.

(j) The preference shareholders would take up one new preference share for every four held.

(k) The authorised share capital would be restated to ₹ 14,00,000.

(l) The new face values of the shares-preferences and equity will be maintained at their reduced levels.

You are required to prepare:

(i) Necessary ledger accounts to effect the above; and

(ii) The Balance Sheet of the company after reconstruction. (16 Marks, November, 2008) (PCC)

Answer

In the books of R Ltd.

Ledger Accounts

Capital Reduction Account

		₹			₹
To	Intangibles (68,000 – 48,000)	20,000	By	8% Cumulative preference shares capital account	1,60,000
To	Plant and equipment account (2,40,000 – 1,40,000)	1,00,000	By	Equity share capital account	4,80,000
To	Deferred revenue expenditure account	48,000	By	Freehold premises account (3,80,000 – 1,40,000)	2,40,000
To	Profit and loss account	4,40,000	By	Stock account (2,50,000 –2,48,000)	2,000
To	Investment account (W.N. 2)	11,500			
To	Provision for doubtful debts	6,400			
To	Capital reserve account (Bal Fig)	2,56,100			
		8,82,000			8,82,000

Equity Share Capital Account

		₹			₹
To	Capital reduction account	4,80,000	By	Balance b/d	4,80,000
To	Balance c/d	6,60,000	By	Equity share final call account (64,000 × ₹ 2.5)	1,60,000

		By Loan from Directors account (60,000 / 2.5 = 24,000 Equity Shares	60,000
		By Bank account (Further issue of 64,000 +24,000 Equity Shares: 2 for every 1 share held = 1,76,000 shares @ ₹ 2.5 each)	4,40,000
	11,40,000		11,40,000

8% Cumulative Preference Share Capital Account

	₹		₹
To 10% Cumulative preference share capital account	4,80,000	By Balance b/d	6,40,000
To Capital reduction account	1,60,000		
	6,40,000		6,40,000

Bank Account

	₹		₹
To Equity share final call account	1,60,000	By Balance b/d (overdraft)	2,08,000
To Equity share capital account	4,40,000	By Balance c/d	5,12,000
To 10% Cumulative preference share capital account	1,20,000		
	7,20,000		7,20,000
To Balance b/d	5,12,000		

10% Cumulative Preferences Share Capital Account

	₹		₹
To Balance c/d	6,00,000	By 8% Cumulative preference share capital account	4,80,000

		By Bank (1 for every 4 pref shares held = 64,000 /4 = 16.000 shares @ ₹ 7.5 each)	1,20,000
	6,00,000		6,00,000
		By Balance b/d	6,00,000

R. Ltd., (and Reduced)

Balance Sheet as at 1 April, 2008

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,60,000
(b) Reserves and Surplus	2	2,56,100
(2) Current Liabilities	3	4,40,000
Total		19,56,100
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	4	5,20,000
Intangible assets		48,000
(b) Non-current investments	5	3,12,500
(2) Current assets		
(a) Inventories		2,50,000
(b) Trade receivables	6	3,13,600
(c) Cash and cash equivalents		5,12,000
Total		19,56,100

Notes to Accounts

		₹
1.	Share Capital	
	Authorised	14,00,000

	Issued: 80,000 10% Cumulative preference shares of ₹ 7.5 each	6,00,000
	2,64,000 equity shares of ₹ 2.5 each	6,60,000
		12,60,000
2.	Reserve and Surplus	
	Capital Reserve	2,56,100
3.	Current liability	
	creditors	4,40,000
4.	Fixed Assets	
	Freehold premises	3,80,000
	Plant and equipment	1,40,000
		5,20,000
5.	Non Current Investments	
	Investment in Q Ltd., (W.N.1)	3,12,500
6.	Trade receivables	
	Debtors less provision for doubtful debts (₹3,20,000 – ₹6,400)	3,13,600

Working Notes:

1. Valuation of investments in shares of Q Ltd., = $\frac{₹\,2,50,000}{12\%} \times \frac{15}{100} = ₹\,3,12,500$

2. Reduction in the value of investment in shares of Q Ltd.

   ₹ 3,24,000 – ₹3,12,500 = ₹11,500.

Question 8

Give the journal entry to be passed for accounting unrealized profit on stock, under amalgamation. *(2 Marks, June, 2009) (PCC)*

Answer

Journal entry to be passed for accounting unrealized Profit on stock:

Under amalgamation in the nature of merger:

General Reserve/Profit and Loss A/c Dr.

To Stock A/c (Stock Reserve A/c)

(Being amount adjusted for unrealized profit on stock)

OR

If amalgamation is in nature of purchase, Journal entry would be:

Goodwill or Capital Reserve A/c Dr.

To Stock A/c (Stock Reserve A/c)

(Being adjustment for unrealized profit on stock)

Question 9

Sun Ltd. and Moon Ltd. were amalgamated on and from 1st April, 2009. A new company Star Ltd. was formed to take over the business of the existing companies. The draft Balance Sheets of Sun Ltd. and Moon Ltd. as at 31st March, 2009 are given below:

(₹ in lakhs)

Liabilities	Sun Ltd.	Moon Ltd.	Assets	Sun Ltd.	Moon Ltd.
Share capital:			Fixed Assets:		
Equity shares of ₹ 100 each	400	375	Land & Building	275	200
12% Preference shares of ₹ 100 each	150	100	Plant & Machinery	175	125
			Investments	75	25
Reserves and surplus:			Current Assets, Loans and Advances:		
Revaluation reserve	75	50	Stock	175	125
General reserve	85	75	Sundry Debtors	125	150
Investment allowance reserve	25	25	Bills Receivables	25	25
			Cash and Bank balances	150	100
Profit and Loss Account	25	15			
Secured loan:					
10% Debentures (₹ 100 each)	30	15			
Current liabilities and provisions:					
Sundry creditors	135	60			
Acceptance	75	35			
	1,000	750		1,000	750

Additional information:

(a) *Star Ltd. will issue 5 equity shares for each equity share of Sun Ltd. and 4 equity shares for each equity share of Moon Ltd. The shares are to be issued @ ₹ 30 each, having a face value of ₹ 10 per share.*

(b) *Preference shareholders of the two companies are issued equivalent number of 15% preference shares of Star Ltd. at a price of ₹ 150 per share (face value ₹ 100).*

(c) *10% Debentureholders of Sun Ltd. and Moon Ltd. are discharged by Star Ltd., issuing such number of its 15% Debentures of ₹ 100 each so as to maintain the same amount of interest.*

(d) *Investment allowance reserve is to be maintained for 4 more years.*

(e) *Liquidation expenses are:*

Sun Ltd. ₹ 2,00,000

Moon Ltd. ₹ 1,00,000

It was decided that these expenses would be borne by Star Ltd.

(f) All the assets and liabilities of Sun Ltd. and Moon Ltd. are taken over at book value.

(g) Authorised equity share capital of Star Ltd. is ₹ 5,00,00,000, divided into equity shares of ₹ 10 each. After issuing required number of shares to the Liquidators of Sun Ltd. and Moon Ltd., Star Ltd. issued balance shares to Public. The issue was fully subscribed.

Required :

Prepare the Balance Sheet of Star Ltd. as at 1st April, 2009 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

(16 Marks, November, 2009) (IPCC)

Answer

Balance Sheet of Star Ltd. as at 1st April, 2009

	Particulars	*Notes No.*	*(₹ in Lakhs)*
	EQUITY AND LIABILITIES		
1	Shareholders' funds		
	a) Share capital	1	750
	b) Reserves and Surplus	2	875
2	Non-current liabilities		
	Long-term borrowings	3	30
3	Current liabilities		
	Trade Payables	4	305
	Total		1,960
	ASSETS		
1	Non-current assets		
	a) Fixed assets		
	i) Tangible assets	5	775
	ii) Intangible assets	6	13
	b)Non-current investments	7	100
	Other non-current assets	8	50
2	Current assets		
	a) Inventories(175+125)		300
	b) Trade receivables	9	325
	c) Cash and cash equivalents	10	397
	Total		1,960

Notes to Accounts

		(₹ in Lakhs)
1.	**Share Capital**	
	Authorised share capital:	
	50,00,000 Equity shares of ₹ 10 each	500
	Issued and subscribed:	
	50,00,000 Equity shares of ₹ 10 each	500
	2,50,000 Preference shares of ₹ 100 each	250
	(Of the above shares 35,00,000 equity shares and all preference shares are allotted as fully paid up for consideration other than cash)	
	Total	750
2.	**Reserves and Surplus**	
	Securities premium (₹ 50 per pref share on 2.5 Lakh Pref Shares + ₹ 20 per equity share on 35 Lakh equity shares issued to shareholders of Sun Ltd & Moon Ltd = ₹ 825 Lakhs)	825
	Investment allowance reserve (25+25)	50
	Total	875
3.	**Long-term borrowings**	
	Secured	
	15% Debentures	30
	Interest on Debentures of Sun Ltd is ₹ 3 Lakhs and of Moon Ltd is ₹ 1.5 Lakhs. Total int = ₹ 4.5 Lakhs. 15% debentures to be issued to equal interest of ₹ 4.5 Lakhs = ₹ 4.5 Lakhs / 15% = 30 Lakh 15% Debentures of ₹ 100 each = 30,000 debentures	
4.	**Trade Payables**	
	Acceptances (75+35)	110
	Sundry creditors (135+60)	195
	Total	305
5.	**Tangible assets**	
	Land and building (275+200)	475
	Plant and machinery (175+125)	300
	Total	775
6.	**Intangible assets**	
	Goodwill (10+2+1)	13
7.	**Non-current investments**	
	Other non-current investments(75+25)	100

8.	**Other non-current assets**		
	Amalgamation adjustment account		50
9.	**Trade receivables**		
	Sundry debtors (125+150)		275
	Bills receivables (25+25)		50
		Total	325
10	**Cash and cash equivalents**		
	Cash and bank (250+150-3)		397

Working Notes:

1.

Computation of Purchase Consideration			*₹ in lakhs*	
			Sun Ltd.	*Moon Ltd.*
(a)	Preference shareholders:			
	1,50,00,000/100 = 1,50,000 shares			
	Share capital = 1,50,000 shares × ₹ 100 each	150		
	Securities premium = 1,50,000 shares × ₹ 50 each	75	225	
	1,00,00,000/100 = 1,00,000 shares			
	Share capital = 1,00,000 shares × ₹ 100 each	100		
	Securities premium= 1,00,000 shares × ₹ 50 each	50		150
(b)	Equity shareholders:			
	4,00,00,000/100 × 5 = 20,00,000 shares			
	Share capital = 20,00,000 shares × ₹ 10 each	200		
	Securities premium=20,00,000 shares× ₹ 20 each	400	600	
	3,75,00,000/100 × 4 = 15,00,000 shares			
	Share capital = 15,00,000 shares ×₹ 10 each	150		
	Securities premium = 15,00,000 shares ×₹ 20 each	300		450
Amount of purchase consideration			825	600

2.

Calculation of number of debentures issued	*₹ in lakhs*	
	Sun Ltd.	*Moon Ltd.*
10% Debentures of ₹ 100 each	30	15
15% Debentures to be issued to maintain same amount of interest: Interest = ₹ 30,00,000 x 10% = ₹ 3,00,000 Value of 15% Debentures = $\frac{₹\,3,00,000}{15} \times 100$	20	

Interest = ₹ 15,00,000 x 10% Value of 15% Debentures = $\frac{₹1,50,000}{15} \times 100$		10

3. Net assets taken over	₹ in lakhs	
	Sun Ltd.	Moon Ltd.
Assets taken over		
Land and building	275	200
Plant and machinery	175	125
Investments	75	25
Stock	175	125
Sundry debtors	125	150
Bills receivable	25	25
Cash and bank	150	100
	1,000	750
Less: Liabilities taken over		
Debentures	20	10
Sundry Creditors	135	60
Bills payable	75	35
	230	105
Net assets taken over	770	645
Purchase consideration	825	600
(Goodwill)/ Capital Reserve	(55)	45
Net goodwill		(10)

4. As the Liquidation expenses of Sun Ltd. and Moon Ltd., ₹ 2 lakhs and ₹ 1 lakhs respectively are borne by Star Ltd the same will be debited to Goodwill account in the books of Star Ltd.

Question10

Following is the summarised Balance Sheet of XYZ Ltd. as on 31st March, 2010:

Liabilities	*₹*	*Assets*	*₹*
8,000 - 7½ Preference shares @ ₹ 100 each fully paid	*8,00,000*	*Plant and Machinery*	*8,50,000*
1,80,000 Equity shares @ ₹ 10 each fully paid	*18,00,000*	*Furniture and Fittings*	*1,60,000*
11% Debentures	*10,00,000*	*Patents and Copyright*	*60,000*
Bank overdraft	*1,65,000*	*Goodwill*	*35,000*
Loan from director	*15,000*	*Investments (at cost)*	*65,000*

Trade creditors	*6,20,000*	*Sundry debtors*	*12,00,000*
		Stock	*13,00,000*
		Cash in hand	*12,000*
		Profit & Loss A/c	*7,18,000*
	44,00,000		*44,00,000*

Due to heavy losses and overvaluation of assets, the following scheme of reconstruction was finalised:

(i) Preference shareholders will surrender their 20% shares and they have been allotted 9% (new) preference shares for the remaining amount.

(ii) Debentureholders having charge on plant and machinery would accept plant and machinery in full settlement.

(iii) Trade creditors accepted to take over the stock upto the value of ₹ 6,20,000.

(iv) Equity shareholders are to accept reduction of ₹ 4 per share.

(v) Investment is to be valued at market price i.e., ₹ 60,000.

(vi) Sundry debtors and remaining stock is to be valued at 90% of their book value.

(vii) Directors have to forgo their loan in full.

(viii) Patents and Copyright and Goodwill have no more value.

Pass necessary journal entries in the books of XYZ Ltd. assuming that all the legal formalities have been completed. Prepare capital reduction account and Balance Sheet of the company after reduction. *(16 Marks, May, 2010) (IPCC)*

Answer

In the books of XYZ Ltd.
Journal Entries

			₹	₹
(i)	7½% Preference share capital A/c	Dr.	8,00,000	
	To 9% Preference share capital A/c			6,40,000
	To Capital reduction A/c			1,60,000
	(Being surrender of 20% shares by 7.5% Preference shareholders and issuance of 9% preference shares for the balance as per the scheme of reconstruction)			
(ii)	11% Debentures A/c	Dr.	10,00,000	
	To Debenture holders A/c			10,00,000
	(Being 11% debentures transferred to debenture holders account)			

(iii)	Debenture holders A/c	Dr.	10,00,000	
	To Plant & machinery A/c			8,50,000
	To Capital reduction A/c			1,50,000
	(Being plant and machinery given to debenture holders in full settlement as per the scheme of reconstruction)			
(iv)	Trade creditors A/c	Dr.	6,20,000	
	To Stock A/c			6,20,000
	(Being stock given to trade creditors against their dues as per the scheme of reconstruction)			
(v)	Equity share capital A/c (₹ 10)	Dr.	18,00,000	
	To Equity share capital A/c (₹ 6)			10,80,000
	To Capital reduction A/c			7,20,000
	(Being reduction of ₹ 4 per equity share as per the scheme of reconstruction)			
(vi)	Capital reduction A/c	Dr.	10,06,000	
	To Debtors A/c			1,20,000
	To Investment A/c			5,000
	To Stock A/c			68,000
	To Patents and copyright			60,000
	To Goodwill			35,000
	To Profit and Loss A/c			7,18,000
	(Being writing off of losses and reduction in the values of assets as per the scheme of reconstruction)			
(vii)	Director's loan A/c	Dr.	15,000	
	To Capital reduction A/c			15,000
	(Being the loan forgone by directors as per the scheme of reconstruction)			
(viii)	Capital reduction A/c	Dr.	39,000	
	To Capital reserve A/c			39,000
	(Being balance of capital reduction account transferred to capital reserve account)			

Capital Reduction Account

		₹			₹
To	Provision for doubtful debts A/c	1,20,000	By	7½% Preference share capital A/c	1,60,000
To	Investment A/c	5,000	By	11% Debentures A/c	1,50,000
To	Stock A/c	68,000	By	Equity share capital A/c	7,20,000
To	Patents and copyright A/c	60,000	By	Director's loan A/c	15,000
To	Goodwill A/c	35,000			
To	Profit and loss A/c	7,18,000			
To	Capital reserve A/c (Bal Fig)	39,000			
		10,45,000			10,45,000

Balance Sheet (and reduced) of M/s XYZ Ltd.

	Particulars	Notes No.	₹
	EQUITY AND LIABILITIES		
1	Shareholders' funds		
	a) Share capital	1	17,20,000
	b) Reserves and Surplus	2	39,000
2	Current liabilities		
	Other current liabilities	3	1,65,000
	Total		19,24,000
	ASSETS		
1	Non-current assets		
	a) Fixed assets		
	i) Tangible assets	4	1,60,000
	b) Non-current investments	5	60,000
2	Current assets		
	a) Inventories		6,12,000
	b) Trade receivables	6	10,80,000
	c) Cash and cash equivalents	7	12,000
	Total		19,24,000

Notes to Accounts

		₹
1.	Share Capital	
	Issued and subscribed:	

	6,400, 9% Preference shares of ₹ 100 each		6,40,000
	1,80,000, Equity shares of ₹ 6 each		10,80,000
		Total	17,20,000
2.	**Reserves and Surplus**		
	Capital reserve		39,000
3.	**Other current liabilities**		
	Bank overdraft		1,65,000
4.	**Tangible assets**		
	Furniture and fittings		1,60,000
5.	**Non-current investments**		
	Investments		60,000
6.	**Trade receivables**		
	Sundry debtors		10,80,000
		Total	10,80,000
7	**Cash and cash equivalents**		
	Cash in hand		12,000

Note: As debtors have been written off in Capital Reduction A/c to the extent of 10% of their value, no provision for doubtful debts should be maintained for the amount reduced, i.e. for ₹ 1,20,000/-

Question 11

Following is the summarised Balance Sheet of Y Ltd., as at 31st March, 2010:

Liabilities	₹	*Assets*	₹
Share Capital:		*Fixed Assets:*	
Issued & paid up:		*Goodwill*	*8,00,000*
2,50,000 Equity shares of ₹ 10 each, ₹ 8 per share paid up	*20,00,000*	*Building*	*7,00,000*
1,00,000, 10% Preference shares of ₹ 10 each fully paid up	*10,00,000*	*Plant and machinery*	*13,00,000*
Reserves & Surplus:		*Current Assets:*	
General reserve	*6,00,000*	*Stock*	*7,00,000*
Profit & Loss A/c	*8,00,000*	*Sundry debtors*	*9,00,000*
Current Liabilities:		*Bank balance*	*6,60,000*
Creditors	*4,00,000*		

Workmen's profit sharing fund[*]	*3,00,000*	*Miscellaneous expenditure :*	
		Preliminary expense	*40,000*[**]
	51,00,000		*51,00,000*

X Ltd. decided to absorb the business of Y Ltd., at the respective book value of assets and trade liabilities except building which was valued at ₹ 12,00,000 and plant & machinery at ₹10,00,000.

The purchase consideration was payable as follows:

(i) Payment of liquidation expenses ₹ 5,000 and workmen's profit sharing fund at 10% premium;

(ii) Issue of equity share of ₹ 10 each fully paid at ₹ 11 per share for every preference share and every equity share of Y Ltd., and a payment of ₹ 4 per equity share in cash.

Calculate the purchase consideration, show the necessary ledger accounts in the books of Y Ltd., and opening journal entries in the books of X Ltd. (16 Marks, November, 2010) (IPCC)

Answer

	₹ *in lakhs*	₹ *in lakhs*
(i) Calculation of purchase consideration		
Cash payment for:		
Workmen's profit sharing fund at a prem of 10%	3,30,000	
Cash to equity shareholders (2,50,000 x ₹ 4)	10,00,000	13,30,000
Payment by Equity shares to :		
Preference shareholders (1,00,000 x 11)	11,00,000	
Equity shareholders (2,50,000 x 11)	27,50,000	38,50,000
Purchase consideration		51,80,000

(ii) In the books of Y Ltd.

Realisation A/c

	₹		₹
To Goodwill	8,00,000	By Creditors	4,00,000
To Building	7,00,000	By X Ltd.	51,80,000
To Plant & machinery	13,00,000		
To Stock	7,00,000		
To Sundry debtors	9,00,000		
To Bank	6,60,000		

[*] Workmen's profit sharing fund should be considered as part of 'Reserves and Surplus' instead of 'Current liabilities'.

[**] As per para 56 of AS 26, Preliminary expenses are not shown in the Balance Sheet.

To Workmen's profit sharing fund – Premium paid	30,000		
To Preference shareholders	1,00,000		
To Profit	3,90,000		
	55,80,000		55,80,000

X Ltd.'s A/c

	₹		₹
To Realisation A/c	51,80,000	By Bank	13,30,000
		By Equity shares in X Ltd.	38,50,000
	51,80,000		51,80,000

Bank A/c

	₹		₹
To X Ltd.	13,35,000	By Workmen's profit sharing fund	3,30,000
		By Equity shareholders	10,00,000
	13,30,000		13,30,000

Preference Shareholders A/c

	₹		₹
To Equity Shares in X Ltd.	11,00,000	By Preference share capital	10,00,000
		By Realisation A/c (Bal. fig.)	1,00,000
	11,00,000		11,00,000

Equity Shareholders A/c

	₹		₹
To Preliminary expenses	40,000	By Equity share capital	20,00,000
To Bank	10,00,000	By General reserve	6,00,000
To Equity shares in Y Ltd.	27,50,000	By Profit & Loss A/c	8,00,000
		By Profit on realisation (Bal.fig.)	3,90,000
	37,90,000		37,90,000

Equity Shares in X Ltd. A/c

	₹		₹
To X Ltd.	38,50,000	By Preference shareholders	11,00,000
		By Equity shareholders	27,50,000
	38,50,000		38,50,000

Workmen's Profit Sharing Fund A/c

	₹		₹
To Bank	3,30,000	By Balance b/d	3,00,000
		By Realisation (Bal. Fig.)	30,000
	3,30,000		3,30,000

(iii) In the books of X Ltd.

Journal Entries

			Dr. (₹)	Cr. (₹)
1.	Business purchase A/c	Dr.	51,80,000	
	To Liquidators of Y Ltd.			51,80,000
	(Being business of Y Ltd purchased)			
2.	Building A/c	Dr.	12,00,000	
	Plant & machinery A/c	Dr.	10,00,000	
	Stock A/c	Dr.	7,00,000	
	Debtors A/c	Dr.	9,00,000	
	Bank A/c	Dr.	6,60,000	
	Goodwill A/c (Bal. fig.)	Dr.	11,20,000	
	To Creditors			4,00,000
	To Business purchase A/c			51,80,000
	(Being assets and liabilities of Y Ltd taken over and the excess of purchase consideration over net assets purchased booked as Goodwill)			
2.	Liquidators of Y Ltd.	Dr.	51,80,000	
	To Bank A/c			13,30,000
	To Equity share capital A/c			35,00,000
	To Securities premium A/c			3,50,000
	(Being the payment of purchase consideration)			
3.	Goodwill A/c	Dr.	5,000	
	To Bank A/c			5,000
	(Being liquidation expenses of Y Ltd paid)			

Question 12

The Summarised Balance Sheet of X Limited as on 31st March 2012, was as follows:

Liabilities	*Amount (₹)*	*Assets*	*Amount (₹)*
Authorised and subscribed capital:	*10,00,000*	*Fixed Assets:*	
10,000 Equity shares of ₹ 100 each		*Machineries*	*3,50,000*
fully paid		*Current Assets:*	
Unsecured loans:		*Stock*	*2,53,000*
15% Debentures	*3,00,000*	*Debtors*	*2,30,000*
Accrued interest	*45,000*	*Bank*	*20,000*
Current Liabilities:		*Profit & loss A/c*	*5,80,000*
Creditors	*52,000*		
Provision for income tax	*36,000*		
	14,33,000		*14,33,000*

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from the appropriate authorities. Accordingly, it was decided that:

(i) Each share be sub-divided into 10 fully paid up equity share of ₹ 10 each.

(ii) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debentureholders and creditors as necessary.

(iii) Out of shares surrendered 10,000 shares of ₹ 10 each shall be converted into 10% Preference shares of ₹ 10 each fully paid up.*

(iv) The claims of the debentureholders shall be reduced by 50%. In consideration of the reduction, the debentureholder shall receive Preference Shares of ₹ 1,00,000 which are converted out of shares surrendered.

(v) Creditors claim shall be reduced by 25%. Remaining creditors are to be settled by the issue of equity shares of ₹ 10 each of out of shares surrendered.

(vi) Balance of Profit and Loss account to be written off.

(vii) The shares surrendered and not re-issued shall be cancelled.

Pass Journal Entries giving effect to the above and the resultant Balance Sheet.

(16 Marks, May, 2011, Modified) (IPCC)

* In the question paper, it was wrongly printed as 1,000 shares which has been corrected in the question given above.

Answer

In the books of X Limited

Journal Entries

			₹	₹
(i)	Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	
	To Share Surrender A/c			5,00,000
	To Equity Share Capital (₹ 10) A/c			5,00,000
	(Being the sub-division of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such sub-divided shares as per capital reduction scheme)			
(ii)	15% Debentures A/c	Dr.	1,50,000	
	Accrued Interest A/c	Dr.	22,500	
	To Reconstruction A/c			1,72,500
	(Being the transfer of 50% of the claims of the debentureholders to Reconstruction A/c in consideration of which 10% Preference shares are being issued, out of share surrender A/c as per capital reduction scheme)			
(iii)	Creditors A/c	Dr.	52,000	
	To Reconstruction A/c			52,000
	(Being the transfer of the creditors to Reconstruction A/c, 25% of which is waived and equity shares are issued in consideration of the balance amount)			
(iv)	Share Surrender A/c	Dr.	5,00,000	
	To 10% Preference Share Capital A/c			1,00,000
	To Equity Share Capital A/c			39,000
	To Reconstruction A/c			3,61,000
	(Being the issue of preference and equity shares from the surrendered equity shares to discharge the claims of the debentureholders and the creditors respectively as per scheme and the balance in share surrender account is transferred to reconstruction account for cancellation)			
(v)	Reconstruction A/c	Dr.	5,85,500	
	To Profit & Loss A/c			5,80,000

	To Capital Reserve A/c (Being the adjustment of the debit balance of profit and loss account against reconstruction account and the balance is transferred to Capital Reserve account)		5,500

X Limited (and reduced)

Balance Sheet as on …….

	Particulars	Notes No.	₹ '000
	EQUITY AND LIABILITIES		
1	Shareholders' funds		
	a) Share capital	1	6,39,000
	b) Reserves and Surplus	2	5,500
2	Non-current liabilities		
	Long-term borrowings	3	1,50,000
3	Current liabilities		
	a) Other current liabilities	4	22,500
	b) Short-term provisions	5	36,000
	Total		8,53,000
	ASSETS		
1	Non-current assets		
	a) Fixed assets		
	i) Tangible assets	6	3,50,000
2	Current assets		
	a) Inventories		2,53,000
	b) Trade receivables		2,30,000
	c) Cash and cash equivalents	7	20,000
	Total		8,53,000

Notes to Accounts

1. Share Capital	
53,900 Equity shares of ₹ 10 each	5,39,000
10,000, 10% Preference share of ₹ 10 each	1,00,000
(all the above shares are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment received in cash)	6,39,000

2.	**Reserves and Surplus**	
	Capital Reserves	5,500
3.	**Long-term borrowings**	
	Unsecured	
	15% Debentures	1,50,000
4.	**Other current liabilities**	
	Accrued Interest on 15% Debentures	22,500
5.	**Short-term provisions**	
	Provision for income tax	36,000
6.	**Tangible assets**	
	Machineries	3,50,000
7.	**Cash and cash equivalents**	
	Balances with banks	20,000

Question 13

Given below balance sheet of Vasudha Ltd. Vaishali Ltd as at 31st march, 2012.

(Amount in ₹)

Liabilities	*Vasudha Ltd*	*Vaishali Ltd.*	*Assets*	*Vasudha Ltd.*	*Vaishali Ltd*
Issued Share Capital:			*Factory Building*	*2,10,000*	*1,60,000*
Equity Shares of ₹ 10 each	*5,40,000*	*4,03,300*	*Debtors*	*2,86,900*	*1,72,900*
General Reserves	*1,01,000*	*65,000*	*Stock*	*91,500*	*82,500*
Profit & Loss A/c	*66,000*	*43,500*	*Goodwill*	*50,000*	*35,000*
Sundry Creditors	*44,400*	*58,200*	*Cash at Bank*	*98,000*	*1,09,590*
			Preliminary Expenses	*15,000*	*10,010*
Total	*7,51,400*	*5,70,000*	*Total*	*7,51,400*	*5,70,000*

Goodwill of the Companies Vasudha Ltd. and Vaishali Ltd. is to be valued at ₹ 75,000 and ₹ 50,000 respectively. Factory Building of Vasudha Ltd is worth ₹ 1,95,000 and of Vaishali Ltd ₹ 1,75,000. Stock of Vaishali Ltd. has been shown at 10% above of its cost.

It is decided that Vasudha Ltd will absorb Vaishali Ltd without liquidating later, by taking over its entire business by issue of shares at the Intrinsic Value*

* Kindly ignore following words: 'without liquidating later'

You are required to draft the balance sheet of the two companies[**] after putting through the scheme. *(16 Marks, May 2012) (IPCC)*

Answer

Balance Sheet of Vasudha Ltd. as on 31st March, 2012

(After absorption)

		Particulars	Note No	Amount
				₹
		EQUITY AND LIABILITIES		
1		Shareholders' funds		
	(a)	Share capital	1	9,43,300
	(b)	Reserves and Surplus	2	2,72,990
2		Current liabilities		
	(a)	Trade payables (44,400+58,200)		1,02,600
		Total		13,18,890
		ASSETS		
1		Non-current assets		
	(a)	Fixed assets		
	i	Tangible assets	3	3,85,000
	ii	Intangible assets	4	1,00,000
2		Current assets		
	(a)	Inventories(91,500 + 75,000)		1,66,500
	(b)	Trade receivables(2,86,900 + 1,72,900)		4,59,800
	(c)	Cash and cash equivalents(98,000 + 1,09,590)		2,07,590
		Total		13,18,890

Notes to accounts

		₹	₹
1.	Share Capital		
	Equity share capital		
	(54,000 + 40,330) Equity shares of ₹10 each		9,43,300
2.	Reserves and Surplus		
	Profit and Loss A/c	66,000	

[**] "two companies" to be read as "Vasudha Ltd. after absorption of Vaisahali Ltd".

	General reserves	1,01,000	
	Less: Preliminary expenses*	(15,000)	
	Securities Premium A/c (Refer W.N.)	1,20,990	2,72,990
3	Tangible assets		
	Factory building (2,10,000 + 1,75,000)		3,85,000
4.	Intangible assets		
	Goodwill (50,000+50,000)		1,00,000

NOTE: As the assets of Vasudha Ltd are shown in the Books after absorption at carrying value only, no adjustment for revaluation of the same has been done in the Balance Sheet. However, assets of Vaishali Ltd have been taken at the fair value as indicated.

Working Note:

1. Computation of shares issued on the basis of intrinsic values

	Vasudha Ltd.	Vaishali Ltd.
	₹	₹
Goodwill	75,000	50,000
Factory building	1,95,000	1,75,000
Debtors	2,86,900	1,72,900
Stock	91,500	(82,500/110%)= 75,000
Cash at Bank	98,000	1,09,590
	7,46,400	5,82,490
Less: Sundry Creditors	(44,400)	(58,200)
Net assets	7,02,000	5,24,290
Number of shares	54,000	40,330
Intrinsic value	₹ 13	₹ 13

Hence, Vasudha Ltd. will give its 40,330 shares of ₹ 10 each @ ₹ 13 each to Vaishali Ltd.

Discharge of Purchase consideration by Vasudha Ltd to the Liquidators of Vaishali Ltd.

	Share Capital	Securities Premium
	₹	₹
40,330 Shares @ ₹ 10 each	4,03,300	
40,330 shares @ ₹ 3 each		1,20,990

* As per para 56 of AS 26, preliminary expenses should be charged to Profit and loss account in the year it is incurred.

Note: If Vaishali Ltd. Company is not liquidated then above question will be solved on the basis of business acquisition.

Question 14

Following are the summarized Balance Sheet of Companies K Ltd. and W Ltd., as at 31-12-2011 :*

Liabilities	(₹ in '000)		Assets	(₹ in '000)	
	K Ltd.	W Ltd.		K Ltd.	W Ltd.
Share Capital :			Goodwill	20	-
Equity shares of ₹ 100 each	2,000	1,500	Other Fixed Assets	2,400	1,150
10% Preference shares of 100 each	700	400	Debtors	625	615
			Stock	412	680
General Reserve	240	170	Cash at bank	38	155
Profit and Loss Account		15	Own Debenture (Nominal value of ₹ 2,00,000)	192	
12% Debentures of ₹ 100 each	600	200			
Sundry Creditors	560	315	Discount on issue of debentures	2	
			Profit and Loss Account	411	
	4,100	2,600		4,100	2,600

On 01-04-2012, K Ltd. adopted the following scheme of reconstruction :

(i) Each equity share shall be sub-divided into 10 equity shares of ₹ 10 each fully paid up. 50% of the equity share capital would be surrendered to the company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 80% of the dividend claim and accept payment for the balance.

(iii) Own debentures of ₹ 80,000 (nominal value) were sold at ₹ 98 cum interest and remaining own debentures were cancelled.

(iv) Debenture holders of ₹ 3,00,000 agreed to accept one machinery of book value of ₹ 3,20,000 in full settlement.

(v) Creditors, Debtors and stock were valued at ₹ 5,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively. Goodwill, discount on issue of debentures and Profit and Loss account (Dr.) are to be written off.

(vi) The company paid ₹ 20,000 as penalty to avoid capital commitments of ₹ 4,00,000.

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* This date should be read as "31.3.2012".

On 02.04.2012, a scheme of absorption was adopted. K Ltd. would take over W Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of W Ltd. will be given 50 equity shares of ₹ 10 each fully paid up, in exchange for every 5 shares held in W Ltd.

(b) Issue of 10% preference shares of ₹ 100 each in the ratio of 4 preference shares of K Ltd. for every 5 preference shares held in W Ltd.

(c) Issue of 12% debentures of ₹ 100 each of K Ltd. for every 12% debenture in W Ltd.

Pass necessary Journal entries in the books of K Ltd. and draw the resultant Balance Sheet as at 2nd April, 2012 *(16 Marks, November 2012) (IPCC)*

Answer

In the books of K Ltd.

Journal Entries

	Particulars *01.04.2012*		*Dr. Amount* ₹	*Cr. Amount* ₹
1.	Equity share capital A/c	Dr.	20,00,000	
	To Equity share capital A/c			20,00,000
	(Being sub-division of one share of ₹ 100 each into 10 shares of ₹ 10 each)			
2.	Equity share capital A/c	Dr.	10,00,000	
	To Capital reduction A/c			10,00,000
	(Being reduction of capital by 50%)			
3.	Capital reduction A/c	Dr.	42,000	
	To Bank A/c			42,000
	(Being payment in cash of 20% of arrears of 3 years' preference dividend)			
4.	Bank A/c	Dr.	78,400	
	To Own debentures A/c [(1,92,000/2,00,000) x 80,000]			76,800
	To Capital reduction A/c			1,600
	(Being profit on sale of own debentures transferred to capital reduction A/c)			
5.	12% Debentures A/c	Dr.	1,20,000	

	To Own debentures A/c [(1,92,000/2,00,000) x 1,20,000]			1,15,200
	To Capital reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			
6.	12% Debentures A/c	Dr.	3,00,000	
	Capital reduction A/c	Dr.	20,000	
	To Machinery A/c			3,20,000
	(Being machinery of ₹ 3,20,000 taken up by the debenture holders for ₹ 3,00,000)			
7.	Creditors A/c	Dr.	60,000	
	To Capital reduction A/c			60,000
	(Being the creditors revalued and excess written off to Capital Reduction A/c)			
8.	Capital reduction A/c	Dr.	10,04,400	
	To Debtors A/c			25,000
	To Stock A/c			12,000
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	To Bank A/c			20,000
	To Capital reserve A/c			5,14,400
	(Being assets revalued and losses written off and penalty for avoidance of capital commitments paid off through capital reduction account and the balance in capital reduction account transferred to capital reserve account)			
02.04.2012				
9.	Business Purchase A/c	Dr.	18,20,000	
	To Liquidators of W Ltd.			18,20,000
	(Being the purchase consideration payable to W Ltd.)			
10.	Fixed assets A/c	Dr.	11,50,000	
	Stock A/c	Dr.	6,80,000	
	Debtors A/c	Dr.	6,15,000	

	Cash at bank A/c	Dr.	1,55,000	
	To Sundry creditors A/c			3,15,000
	To 12% Debentures A/c of W Ltd.			2,00,000
	To Profit and Loss A/c			15,000
	To General reserve A/c			1,70,000
	To Capital reserve A/c (W.N.2) (Bal Fig)			80,000
	To Business purchase A/c			18,20,000
	(Being the takeover of all assets and liabilities of W Ltd. by K Ltd and excess value of assets over liabilities transferred to Capital Reserve A/c.)			
11.	Liquidators of W Ltd. A/c	Dr.	18,20,000	
	To Equity share capital			15,00,000
	To 10% Preference share capital			3,20,000
	(Being the purchase consideration paid to the Liquidators of W Ltd)			
12.	12% Debentures of W Ltd. A/c	Dr.	2,00,000	
	To 12% Debentures A/c			2,00,000
	(Being K Ltd. issued their 12% Debentures against Debentures of W Ltd.)			

Balance Sheet of K Ltd. as on 2nd April, 2012

Particulars	*Note No*	*Amount (₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	35,20,000
(b) Reserves and Surplus	2	10,19,400
(2) Non-Current Liabilities		
(a) Long-term borrowings	3.	3,80,000
(3) Current Liabilities		
(a) Trade payables	4	8,15,000
Total		57,34,400
II. Assets		
(1) Non-current assets		
(a) Fixed assets		

(i) Tangible assets	5	32,30,000
(2) Current assets		
(a) Inventories	6	10,80,000
(b) Trade receivables	7	12,15,000
(c) Cash and cash equivalents	8	2,09,400
Total		57,34,400

Notes to Accounts

			₹
1	Share Capital		
	Equity Share Capital	20,00,000	
	Less: Surrender 50% equity capital	(10,00,000)	
	Add: Equity share capital issued to W Ltd.	15,00,000	25,00,000
	10% Preference share capital	7,00,000	
	Add: Preference share capital issued to W Ltd.	3,20,000	10,20,000
			35,20,000
2.	Reserves and Surplus		
	Profit and Loss A/c	15,000	
	General Reserve (2,40,000 + 1,70,000)	4,10,000	
	Capital Reserve (5,14,400 + 80,000)	5,94,400	10,19,400
3.	Long-term borrowings		
	12% Debentures	6,00,000	
	Less: Settled by payment of machinery	(3,00,000)	
	Less: Cancelled debentures	(1,20,000)	
	Add: 12% Debentures issue to W Ltd.	2,00,000	3,80,000
4.	Trade payables of K Ltd.	5,60,000	
	Less: Reduction due to revaluation	(60,000)	
	Add: Trade payables of W Ltd.	3,15,000	8,15,000
5.	Tangible assets		
	Balance of Other fixed assets	24,00,000	
	Less: machinery taken up by debenture holders	(3,20,000)	
	Add: Other fixed assets of W Ltd.	11,50,000	32,30,000
6.	Inventories	4,12,000	

	Less: Reduction due to revaluation	(12,000)	
	Add: Inventories of W Ltd.	6,80,000	10,80,000
7.	Trade receivables	6,25,000	
	Less: Reduction due to revaluation	(25,000)	
	Add: Trade receivables of W Ltd.	6,15,000	12,15,000
8.	Cash and cash equivalents	38,000	
	Less: payment of arrear of preference	(42,000)	
	Add: Sale of own debentures	78,400	
	Less: penalty paid on capital commitments	(20,000)	
	Add: Cash and cash equivalents of W Ltd.	1,55,000	2,09,400

Working Notes:

1. Purchase Consideration

		₹
Equity share capital	(15,000 x 50/5) x ₹ 10	15,00,000
10% Preference share capital	(4,000x 4/5) x ₹ 100 =	3,20,000
		18,20,000

2. Capital Reserve

	₹
Share Capital of W Ltd. (Equity + Preference)	19,00,000
Less: Share Capital issued by K Ltd.	18,20,000
Capital reserve	80,000

Question 15

The summarized Balance Sheet of Bad Luck Ltd. as on 31st March, 2013 was as follows:

	Note	*Amount ₹*	*Amount ₹*
A. Equity and Liabilities			
1. Shareholders' Fund			
(a) Share Capital	*1*	*7,50,000*	
(b) Reserves and Surplus	*2*	*(10,00,000)*	*(2,50,000)*
2. Non-current Liabilities			
(a) Long Term borrowings	*3*		*5,00,000*
3. Current Liabilities			
(a) Short Term Borrowings	*4*	*5,00,000*	

(b) Trade Payables		2,50,000	7,50,000
Total			10,00,000
B. Assets			
1. Non-current assets			
(a) Fixed Assets			
(i) Tangible assets	5	5,50,000	
(ii) Intangible assets	6	1,50,000	7,00,000
2. Current Assets			
(a) Inventories		1,50,000	
(b) Trade Receivables		1,25,000	
(c) Deferred revenue expenditure		25,000	3,00,000
Total			10,00,000

Notes to Accounts

		Amount ₹	Amount ₹
1.	Share Capital		
	Authorised, issued & fully paid		
	5,000 equity shares of ₹ 100 each	5,00,000	
	2,500 8% preference shares of ₹ 100 each	2,50,000	7,50,000
2.	Reserves and Surplus		
	Profit and Loss Account		(10,00,000)
3.	Long Term borrowings		
	8% Debentures		5,00,000
4.	Short Term Borrowings		
	Loan from Directors	3,00,000	
	Bank overdraft	2,00,000	5,00,000
5.	Tangible Assets		
	Freehold property	4,00,000	
	Plant	1,50,000	5,50,000
6.	Intangible Assets		
	Goodwill	1,00,000	
	Trademark	50,000	1,50,000

The following scheme of internal reconstruction was framed, approved by the Court, all the concerned parties and implemented:

(i) *The preference shares to be written down to ₹ 25 each and the equity shares to ₹ 20 each. Each class of shares then to be converted into shares of ₹ 100 each.*

(ii) The debenture holders to take over freehold property (book value ₹ 2,00,000) at a valuation of ₹ 2,50,000 in part repayment of their holdings. Remaining freehold property to be revalued at ₹ 6,00,000.

(iii) Loan from directors to be waived off in full.

(iv) Stock of ₹ 50,000 to be written off, ₹ 12,500 to be provided for bad debts.

(v) Profit and Loss account balance, Trademark, goodwill and deferred revenue expenditure to be written off.

Pass Journal Entries for all the above mentioned transactions. Also Prepare Capital Reduction account and company's Balance Sheet immediately after reconstruction.

(16 Marks, May 2013) (IPCC)

Answer

Journal entries in the books of Bad Luck Ltd.

	Particulars		*Debit(₹)*	*Credit(₹)*
i	8% Preference Share Capital A/c (₹ 100 each)	Dr.	2,50,000	
	To 8% Preference Share Capital A/c (₹ 25 each)			62,500
	To Capital Reduction A/c			1,87,500
	(Being the preference shares of ₹ 100 each reduced to ₹ 25 each as per the approved scheme)			
ii	Equity Share Capital A/c (₹ 100 each)	Dr.	5,00,000	
	To Equity Share Capital A/c (₹ 20 each)			1,00,000
	To Capital Reduction A/c			4,00,000
	(Being the equity shares of ₹ 100 each reduced to ₹ 20 each)			
iii	8% Preference Share Capital A/c (₹ 25)	Dr.	62,500	
	To 8% Preference Share Capital A/c (₹ 100)			62,500
	(Being conversion of 2500 8% preference shares of ₹ 25 each to 625 8% preference shares of ₹ 100 each)			
iv	Equity Share Capital A/c (₹ 20)	Dr.	1,00,000	
	To Equity Share Capital A/c (₹100)			1,00,000
	(Being conversion of 5,000 equity shares of ₹ 20 each to 1000 equity shares of ₹ 100 each)			
v	Freehold Property	Dr.	50,000	

	To Capital Reduction A/c			50,000
	(Being value of freehold property taken over by Debenture Holders appreciated)			
vi	8% Debentures A/c	Dr.	2,50,000	
	To Freehold Property			2,50,000
	(Being claim of Debenture holders settled in part by transfer of freehold property after revaluation)			
vii	Freehold Property	Dr.	4,00,000	
	To Capital Reduction A/c			4,00,000
	(Being appreciation in the value of the balance freehold property of book value ₹ 2,00,000)			
viii	Director's Loan A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being director's loan waived in full)			
ix	Capital Reduction A/c	Dr.	13,37,500	
	To Deferred Revenue Expenditure			25,000
	To Profit and Loss A/c			10,00,000
	To Provision of Doubtful Debts A/c			12,500
	To Inventories			50,000
	To Goodwill A/c			1,00,000
	To Trademark			50,000
	To Capital Reserve A/c			1,00,000
	(Being of the reduction in the value of various assets (tangible & intangible), profit and loss account debit balance written off and balance in Capital Reduction A/c transferred to capital reserve account as per the scheme)			

Capital Reduction Account

		(₹)			(₹)
To	Provision for Doubtful Debts	12,500	By	Preference Share Capital	1,87,500
To	Inventories	50,000	By	Equity Share Capital	4,00,000
To	Profit & Loss A/c	10,00,000	By	Freehold Property (50,000 + 4,00,000)	4,50,000
To	Trademark	50,000			

To	Goodwill	1,00,000	By	Director's Loan	3,00,000
To	Deferred Revenue Expenditure	25,000			
To	Capital Reserve (bal fig)	1,00,000			
		13,37,500			13,37,500

Balance Sheet of Bad Luck Ltd. (And Reduced)
As on 31st March 2013

Particulars	*Note No.*	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,62,500
(b) Reserves and Surplus	2	1,00,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	2,50,000
(3) Current Liabilities		
(a) Short Term borrowings	4	2,00,000
(b) Trade payable		2,50,000
		9,62,500
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	5	7,50,000
(2) Current assets		
(a) Inventories		1,00,000
(b) Trade receivables	6	1,12,500
Total		9,62,500

Notes to Accounts

		₹
1.	Share Capital	
	Authorised, issued and fully paid up	
	1,000 Equity shares of ₹100 each fully paid-up	1,00,000
	625, 8% Preference Share of ₹ 100 each	62,500
		1,62,500
2.	Reserve and Surplus	
	Capital Reserve	1,00,000

3.	Long Term Borrowings	
	8% Debentures ₹ (5,00,000-2,50,000)	2,50,000
4.	Short-Terms Borrowings	
	Bank Overdraft	2,00,000
5.	Tangible assets	
	Freehold Property	6,00,000
	Plant	1,50,000
		7,50,000
6.	Trade Receivables	
	Trade Receivables	1,25,000
	Less: Provision for doubtful debts	(12,500)
		1,12,500

Unit 5: Liquidation of Companies

Question 1

(a) *Liquidation of YZ Ltd. commenced on 2nd April, 2004. Certain creditors could not receive payments out of the realisation of assets and out of the contributions from A list contributories. The following are the details of certain transfers which took place in 2003 and 2004:*

Shareholders	*No. of Shares transferred*	*Date of Ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of such transfer*
A	*2,000*	*1st March, 2003*	₹ 5,000
P	*1,500*	*1st May, 2003*	₹ 3,300
Q	*1,000*	*1st October, 2003*	₹ 4,300
R	*500*	*1st November, 2003*	₹ 4,600
S	*300*	*1st February, 2004*	₹ 6,000

All the shares were of ₹ 10 each, ₹ 8 per share paid up. Show the amount to be realised from the various persons listed above ignoring expenses and remuneration to liquidator etc.

(b) *The position of Valueless Ltd. on its liquidation is as under:*

Issued and paid up Capital:

3,000 11% preference shares of ₹ 100 each fully paid.

3,000 Equity shares of ₹ 100 each fully paid.

1,000 Equity shares of ₹ 50 each ₹ 30 per share paid.

Calls in Arrears are ₹ 10,000 and Calls received in Advance ₹ 5,000. Preference Dividends are in arrears for one year. Amount left with the liquidator after discharging all liabilities is ₹ 4,13,000. Articles of Association of the company provide for payment of preference dividend arrears in priority to return of equity capital. You are required to prepare the Liquidators final statement of account. (8 + 8 = 16 Marks, November 2004)(PE-II)

Answer

(a) Statement of liabilities of B list contributories

Share holders	No. of shares transferred	Maximum liability (upto ₹ 2 per share)	Division of Liability as on				
			1.5.2003	1.10.2003	1.11.2003	1.2.2004	Total
		₹	₹	₹	₹	₹	₹
P	1,500	3,000	1,500	–	–	–	1,500
Q	1,000	2,000	1,000	555	–	–	1,555
R	500	1,000	500	278	188	–	966
S	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Note:

Date	Cumulative liability	Increase in liability	Ratio of no. of shares held by the members
1.5.2003	3,300	–	30 : 20 : 10 : 6
1.10.2003	4,300	1,000	20 : 10 : 6
1.11.2003	4,600	300	10 : 6
1.2.2004	6,000	1,400	Only S

Liability of S has been restricted to the maximum allowable limit of ₹ 600, therefore amount payable by S is restricted to ₹ 21 only, on 1.2.2004.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2003 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

(b) Liquidators' Final Statement of Account

Receipts	₹	*Payments*	₹
Cash	4,13,000	Return to contributors:	
Realisation from:		Arrears of Preference dividend	33,000
Calls in arrears	10,000	Preference shareholders	3,00,000
Final call of ₹ 5 per		Calls in advance	5,000

equity share of ₹ 50 each (₹ 5 × 1,000) See WN below	5,000	Equity shareholders of ₹ 100 each (3,000 × ₹ 30)	90,000
	4,28,000		4,28,000

Working Note:

		₹
Cash account balance		4,13,000
Less: Payment for dividend	33,000	
Preference shareholders	3,00,000	
Calls in advance	5,000	(3,38,000)
		75,000
Add: Calls in arrears		10,000
		85,000
Add: Amount to be received from equity shareholders of ₹ 50 each (1,000 × 20)		20,000
Amount disposable		1,05,000

Number of equivalent equity shares:

3,000 shares of ₹ 100 each = 6,000 shares of ₹ 50 each

1,000 shares of ₹ 50 each = 1,000 shares of ₹ 50 each

= 7,000 shares of ₹ 50 each

$$\text{Final payment to equity shareholders} = \frac{\text{Amount left for distribution}}{\text{Total number of equivalent equity shares}}$$

= ₹ 1,05,000 / 7,000 shares = ₹ 15 per share to equity shareholders of ₹ 50 each.

Therefore for equity shareholders of ₹ 100 each $\left(15 \times \frac{100}{50}\right)$

= ₹ 30 per share to equity shareholders of ₹ 100 each.

Calls in advance must be paid first, so as to pay the shareholders on pro rata basis. Equity shareholders of ₹ 50 each have to pay ₹ 20 and receive ₹ 15 each. As a result, they are required to pay net ₹ 5 per share.

Question 2

What is B list contributories? *(4 Marks, November, 2008)(PCC)*

Answer

B list contributories are the shareholders who had transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up. They may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors, as had existed on the date of transfer of such shares and cannot be paid out of the funds otherwise available with the liquidator, provided also that the existing shareholders have also failed to pay the amount due on such partly paid shares.

Question 3

From the data relating to a company which went into voluntary liquidation, you are required to prepare the liquidator's Final Statement of Account.

(i) Cash with liquidators (after all assets are realised and secured creditors and debentureholders are paid) is ₹ 7,50,000.

(ii) Preferential creditors to be paid ₹ 35,000.

(iii) Other unsecured creditors ₹ 2,30,000.

(iv) 5,000, 10% preference shares of ₹ 100 each fully paid.

(v) 3,000 equity shares of ₹ 100 each, ₹ 75 per share paid up.

(vi) 7,000 equity shares of ₹ 100 each, ₹ 60 per share paid up.

(vii) Liquidator's remuneration is 2% on payments to preferential and other unsecured creditors

(8 Marks, June, 2009) (PCC)

Answer

Liquidator's Final Statement of Account

		₹			₹
To	Cash in hand	7,50,000	By	Liquidator's remuneration (2% on 2,65,000*)	5,300
To	Cash / bank (Amount received on call for 7,000 equity shares @ ₹6.53 per share)	45,710	By	Preferential creditors	35,000
			By	Unsecured creditors	2,30,000
			By	Preference shareholders	5,00,000
			By	Equity shareholders (Amount paid to holders of 3,000 equity shares @ ₹8.47 per equity share)	25,410
		7,95,710			7,95,710

Working Note:

Calculation of amount receivable from equity shareholders or payable to equity shareholders

	₹	₹
Cash in hand (Assets realized)		7,50,000
Less: Payments made:		

* 35,000 + 2,30,000 = 2,65,000

Liquidator's remuneration	5,300	
Preference creditors	35,000	
Unsecured creditors	2,30,000	
Preference shareholders	5,00,000	7,70,300
		20,300
Add: Amount payable to equity shareholders (paid up):		
3,000 equity share of ₹100 each ₹ 75 paid up	2,25,000	
7,000 equity share of ₹100 each ₹ 60 paid up	4,20,000	6,45,000
Total shortfall to be borne by equity shareholders		6,65,300
No. of equity shares		10,000 shares
Shortfall per equity shares $\frac{6,65,300}{10,000} = ₹66.53$		
Amount receivable from Equity Shareholders = (Shortfall per share - Amt Paid up per share) X No of Shares held Amount receivable from 7,000 equity shareholders = 7,000 x 6.53 (i.e. 66.53 – 60) = ₹ 45,710 Amount payable to 3,000 equity shareholders = 3,000 $\times$ 8.47 (i.e. 75 – 66.53) = ₹ 25,410		

Question 4

From the following Trial Balance of PQ Ltd. on 31.12.2009, prepare liquidators' final statement of account:

	₹	₹
9% Preference share capital	----	*1,25,000*
(1,250 Preference shares @ ₹100 each fully paid up)		
Equity share capital:		
2,000 Equity shares @ ₹100 each fully paid up	---	*2,00,000*
2,000 Equity shares @ ₹100 each, ₹50 paid up	----	*1,00,000*
Plant	*3,00,000*	
Stock-in-trade	*3,60,000*	
Sundry debtors	*85,000*	---
Sundry creditors	---	*2,21,000*
Bank balance	*1,20,000*	
Preliminary expenses	*6,000*	---
6% Mortgage loan	----	*2,30,000*
Outstanding liabilities for expenses	---	*25,000*
Profit and loss account	*30,000*	
(Trading loss for the year 2009)		
	9,01,000	*9,01,000*

Following points should be kept in mind:

(i) *On 21st January, 2010 the liquidator of PQ Ltd. sold plant for ₹ 2,95,000 and stock in trade at 10% less than the book value. He realised 80% of Sundry debtors and incurred cost of collection of ₹ 1,850 (remaining debtors are to be treated as bad).*

(ii) *The loan mortagage was discharged on 31st January, 2010 along with interest for 6 months. Creditors were discharged subject to 5% discount. Outstanding expenses paid at 20% less.*

(iii) *Preference share dividend is due for one year and paid with final payment.*

(iv) *Liquidation expenses incurred are ₹ 1,800 and liquidators remuneration is settled at 4% on disbursement to members (excluding preference dividend), subject to minimum of ₹ 10,000.* *(8 Marks, May, 2010) (IPCC)*

Answer

PQ Ltd.

Liquidator's Final Statement of Account

	Receipts		₹		*Payment*		₹
To	Assets realised:			By	Liquidation expenses		1,800
	Bank	1,20,000		By	Liquidator's remuneration (W.N.1)		12,510
				By	Mortgage loan	2,30,000	
	Plant	2,95,000			*Add:* Interest for 6 months	6,900	2,36,900
	Stock	3,24,000		By	Unsecured creditors		2,09,950
	Debtors			By	Outstanding liabilities		20,000
	(₹ 68,000 – ₹ 1,850)	66,150	8,05,150	By	Preference shareholders:		
					Preference share capital	1,25,000	
					Arrears of dividend	11,250	1,36,250
				By	Equity shareholders		
					₹ 50 on 2,000 fully paid shares		1,00,000
					₹ 21.935 on 4,000 equity shares (W.N.2)		87,740
			8,05,150				8,05,150

Working Notes:

1. Liquidator's remuneration

	₹
Available surplus (payable on amt left for disbursement to shareholders excl preference dividend)	3,25,250*
Less: Liquidator's remuneration @ 4% (₹ 3,25,250 x $\frac{4}{104}$)	(12,510)
Balance to be paid to Members	3,12,740

2. Disposal of amount to members

	₹
Balance available for members	3,12,740
Less: Preference share capital	(1,25,000)
	1,87,740
Less: ₹ 50 on 2,000 fully paid Equity shares	(1,00,000)
₹ 21.827 on 4,000 Equity shares	87,740

Question 5

A company went into liquidation whose creditors are ₹ 36,000 includes ₹ 6,000 on account of wages of 15 men at ₹ 100 per month for 4 months immediately before the date of winding up; ₹ 9,000 being the salaries of 5 employees at ₹ 300 per month for the previous 6 months, Rent for godown for the last six months amounting to ₹ 3,000; Income-tax deducted out of salaries of employees ₹ 1,000 and Directors fee ₹ 500; in addition it is estimated that the company would have to pay ₹ 5,000 as compensation to an employee for injuries suffered by him, which was contingent liability not accepted by the company and not included in above said creditors figure.

Find the amount of Preferential Creditors. *(4 Marks, November, 2010) (IPCC)*

Answer

Calculation of Preferential Creditors

	₹
Tax deducted at source on salaries	1,000
Wages (15 men for 4 months at ₹ 100 each)	6,000
Salaries (5 men for 4 months at ₹ 300 each) (Refer Note 1)	6,000
Workmen's compensation	5,000
Total	18,000

* Surplus available
= ₹ 8,07,000 – ₹ 1,800 – ₹ 2,36,900 – ₹ 2,09,950 – ₹ 1,850 - ₹ 20,000 – ₹ 11,250 = ₹ 3,25,250.

Note :

(i) Salaries payable to any employee due for the period not exceeding 4 months within the twelve months next before commencement of winding up subject to maximum ₹ 20,000 per person.

(ii) Directors fee, rent for godown are not included in preferential creditors.

Question 6

The summarized Balance Sheet of Full Stop Limited as on 31st March 2011, being the date of voluntary winding up is as under:

Liabilities	*(₹)*	*Assets*	*(₹)*
Share capital:		*Land & building*	*5,20,000*
5,000, 10% Cumulative		*Plant & machinery*	*7,80,000*
Preference shares of ₹ 100		*Stock in trade*	*3,25,000*
each fully paid up	*5,00,000*	*Book debts*	*10,25,000*
Equity share capital:		*Profit & loss account*	*5,50,000*
5,000 Equity shares of ₹ 100			
each ₹ 60 per share called			
and paid up	*3,00,000*		
5,000 Equity shares of ₹ 100			
each ₹ 50 per share called up			
and paid up	*2,50,000*		
Securities premium	*7,50,000*		
10% Debentures	*2,10,000*		
Preferential creditors	*1,05,000*		
Bank overdraft	*4,85,000*		
Trade creditors	*6,00,000*		
	32,00,000		*32,00,000*

Preference dividend is in arrears for three years. By 31-03-2011, the assets realized were as follows:

	₹
Land & building	*6,20,000*
Stock in trade	*3,10,000*
Plant & machinery	*7,10,000*
Book debts	*6,60,000*

Expenses of liquidation are ₹ 86,000. The remuneration of the liquidator is 2% of the realization of assets. Income tax payable on liquidation is ₹ 67,000. Assuming that the final payments were made on 31-03-2011, prepare the Liquidator's Statement of Account.

(8 Marks, May, 2011) (IPCC)

Answer

Liquidator's Statement of Account

Receipts	₹	*Payments*	₹
Land & building	6,20,000	Liquidator's remuneration	46,000
Stock in trade	3,10,000	Liquidation expenses	86,000
Plant & machinery	7,10,000	10% Debentures	2,10,000
Book debts	6,60,000	Preferential creditors	1,05,000
		Income tax payable	67,000
		Bank overdraft	4,85,000
		Trade creditors	6,00,000
		Preference shareholders:	
		Capital	5,00,000
		Arrears of preference dividend	
		for 3 years	1,50,000
		Refund on 5,000 shares of ₹ 60 paid up @ ₹ 10.10 per share (Refer W.N.)	50,500
		Refund on 5,000 shares of ₹ 50 paid up @ ₹ 0.10 per share (Refer W.N.)	500
	23,00,000		23,00,000

Working Note:

	₹
Total equity capital paid up (3,00,000 + 2,50,000)	5,50,000
Less: Balance available after payment to secured, unsecured, preferential creditors and preference shareholders	(51,000)
(23,00,000 – 46,000 – 86,000 – 2,10,000 – 1,05,000 – 67,000	
– 4,85,000– 6,00,000 – 5,00,000 – 1,50,000)	
Loss to be borne by 10,000 equity shareholders	4,99,000

Loss per share	₹ 49.90
Hence, amount of refund on ₹ 50 per share paid up (₹ 50 – ₹ 49.90)	₹ 0.10
Amount of refund on ₹ 60 per share paid up (₹ 60 –₹ 49.90)	₹ 10.10

Question 7

M/s. ABC Limited has gone into liquidation on 25th June, 2011. Certain creditors could not receive payments out of realization of assets and contributions from A list contributories. The following are the details of certain transfers which took place in the year ended 31st March, 2011:

Shareholders	*No. of shares transferred*	*Date of ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of transfer (₹)*
P	4,000	10-5-2010	9,000
Q	3,000	22-7-2010	12,000
R	2,400	15-9-2010	13,500
S	1,600	14-12-2010	14,000
T	1,000	09-03-2011	14,200

All the shares are of ₹ 10 each, ₹ 8 per share paid up. Show the amount to be realized from the persons listed above. Ignore remuneration to liquidator and other expenses.

(8 Marks, November, 2011) (IPCC)

Answer

Statement of Liabilities of B List Contributories

Shareholder	No. of shares transferred	Maximum liability upto ₹ 2 per share	Division of liability as on				Total
			22.07.2010	15.09.2010	14.12.2010	09.03.2011	
Q	3,000	6,000	4,500	-	-	-	4,500
R	2,400	4,800	3,600	720	-	-	4,320
S	1,600	3,200	2,400	480	308	-	3,188
T	1,000	2,000	1,500	300	192	8	2,000
	8,000	16,000	12,000	1,500	500	8	14,008

Notes:

1. 'P' transferred shares before one year preceding the date of winding up, therefore, he cannot be held liable for any liability on liquidation.
2. Liability of 'T' has been restricted to the maximum allowable limit of ₹ 2,000. Therefore, amount payable by T on 09.03.2011 is ₹ 8 only.

3. ‘Q’ will not be responsible for further debts incurred after 10th May, 2010 (from the date when he ceases to be a member). Similarly, ‘R’ & ‘S’ will not be liable for the debts incurred after the date of their transfer of shares.

Working Note:

Calculation of Ratio for Discharge of Liabilities

Date	Cumulative liability (₹)	Increase in liabilities (₹)	Ratio of no. of shares held by Q, R, S & T
22.07.2010	12,000	-	30: 24: 16: 10
15.09.2010	13,500	1,500	24: 16: 10
14.12.2010	14,000	500	16: 10
09.03.2011	14,200	200	Only T

Question 8

The summarized Balance Sheet of Vasant Ltd. as on 31st March, 2013, being the date of voluntary winding up is as under:

Liabilities	*Amount ₹*	*Assets*	*Amount ₹*
Share Capital:		*Land & Building*	*1,30,000*
Issued: 10% Pref. Shares of ₹10 each	*1,50,000*	*Sundry Current Assets*	*4,36,000*
10,000 Equity Shares of ₹10 each, fully paid up	*1,00,000*	*Profit and Loss Account*	*35,000*
		Debenture issue expenses	
5,000 Equity Shares of ₹10 each, ₹8 per share paid up	*40,000*	*not written off*	*2,000*
13% Debentures	*1,50,000*		
Mortgage Loan	*70,000*		
Bank overdraft	*30,000*		
Trade Creditors	*38,000*		
Income Tax Arrears (assessment concluded in February, 2013)	*25,000*		
	6,03,000		*6,03,000*

Mortgage loan was secured against Land & Building. Debentures were secured by a floating charge on all assets. The company was unable to meet the payments and therefore the debentureholders appointed a Receiver for the debentureholders. He brought the Land & Buildings to auction and realized ₹1,60,000. He also took charge of Sundry Assets of value of ₹2,36,000 and realized ₹2,00,000. The Bank overdraft was secured by personal guarantee of the directors of the company and on the Bank raising a demand, the Directors paid off the due from their personal resources. Costs incurred by the Receiver were ₹ 1,950 and by the

Liquidator ₹3,000. The receiver was not entitled to any remuneration but the Liquidator was to receive 2% fee on the value of assets realized by him. Preference Shareholders have not been paid dividend for period after 31st March, 2011 and interest for the last half year was due to the Debentureholders. Rest of the assets were realized at ₹1,50,000.

Prepare the accounts to be submitted by the receiver and Liquidator.

(16 Marks, November 2013) (IPCC)

Answer

Receiver's Receipts and Payments Account

Receipts	₹	₹	*Payments*	₹	₹
Sundry Assets realised		2,00,000	Costs of the Receiver		1,950
Surplus received from Mortgage loan :			Preferential payments:		
Sale Proceeds of land			Income Taxes (raised within 12 months)	-	25,000
and building	1,60,000		Debentures holders :		
Less: Applied to			Principal amount	1,50,000	
discharge			Interest for half year	9,750	1,59,750
mortgage loan	(70,000)	90,000	Surplus transferred to the Liquidator		1,03,300
		2,90,000			2,90,000

Liquidator's Final Statement of Account

Receipts	₹	*Payments*		₹
Surplus received from Receiver	1,03,300	Cost of Liquidation		3,000
		Remuneration to Liquidator		
Assets Realised	1,50,000	(1,50,000 x 2%)		3,000
Calls on Contributories :		Unsecured Creditors :		
On holder of 5,000 Equity Shares at the rate of ₹ 1.38 per share	6,900	Trade	38,000	
		Directors for Bank O/D cleared	30,000	68,000
		Preferential Shareholders:		
		Capital	1,50,000	
		Arrears of Dividends	30,000	1,80,000
		Equity shareholders:		
		Return of money to holders of 10,000 equity shares at 62 paise each		6,200
	2,60,200			2,60,200

Working Note:

Call from partly paid shares

Deficit before call from Equity Shares		₹
= ₹ (1,03,300+1,50,000) – ₹(3,000+3,000+68,000+1,80,000) =		700
Notional call on 5,000 shares @ ₹ 2 each		10,000
Net balance after notional call	(a) 9,300	
No. of shares deemed fully paid	(b) 15,000	

Refund on fully paid shares $\frac{9,300}{15,000}$ = ₹ 0.62

Calls on partly paid share (₹ 2 — ₹ 0.62) = ₹ 1.38

5

Financial Statements of Insurance Companies

Question 1

The Life Insurance Fund of an Insurance Company was on 31.3.2004 ₹ 60 lakhs before providing for dividend of ₹ 20,000 for the year 2003-2004. While ascertaining the above fund figure, the following items were omitted:

(i) Interest received on investments ₹ 63,000 after deduction of tax at source 10%.

(ii) Bonus utilized for reduction of premium ₹ 14,000.

(iii) Death claim intimated, but not yet admitted ₹ 36,000.

(iv) Death claim covered under re-insurance ₹ 12,000.

(v) Consideration for annuities granted ₹ 9,000.

Interim bonus for the valuation period paid was ₹ 80,000.

Net liabilities as per valuation was ₹ 50 lakhs. It is now proposed to carry forward ₹ 2,70,000.

The company declared a reversionary bonus of ₹ 12 per ₹ 1,000 and gave the policyholders an option to get the bonus in cash for ₹ 5 per ₹ 1,000. Total business of the company is ₹ 15 crores, 40% of the policyholders decided to get bonus in cash.

Prepare:

(i) Valuation Balance Sheet as on 31.3.2004.

(ii) Distribution Statement showing the amount due to the policyholders.

Also give Journal Entries relating to reversionary bonus. (10 Marks, November 2004)(PE-II)

Note: This question is not in accordance with Insurance Regulatory Development Authority Regulations, 2002.

Question 2

Write a short note on Reserve for Unexpired Risks in an Insurance Company.

(4 Marks, November 2004) (PE-II)

Answer

In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies extend into the following year during which the risk continues. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance. This reserve is based on the net premium income earned by the insurance company during the year

Question 3

X Fire Insurance Co. Ltd. commenced its business on 1.4.2005. It submits you the following information for the year ended 31.3.2006:

	₹
Premiums received	*15,00,000*
Re-insurance premiums paid	*1,00,000*
Claims paid	*7,00,000*
Expenses of Management	*3,00,000*
Commission paid	*50,000*
Claims outstanding on 31.3.2006	*1,00,000*
Create reserve for unexpired risk @40%	
Prepare Revenue account for the year ended 31.3.2006.	

(4 Marks, May 2006) (PE-II)

Answer

Form B – RA (Prescribed by IRDA)

Name of the Insurer: X Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA: …………………..

Revenue Account for the year ended 31st March, 2006

	Particulars	*Schedule*	*Current year ended on 31st March, 2006* ₹
1.	Premiums earned (Net)	1	8,40,000
	Total (A)		8,40,000
1.	Claims incurred (Net)	2	8,00,000
2.	Commission	3	50,000

3.	Operating Expenses Total (B) Operating Profit/(Loss) from Fire Insurance Business [C =(A – B)]	4	3,00,000 11,50,000 (3,10,000)

Schedule 1

Premiums earned (Net)

	₹
Premium received	15,00,000
Less: Premium on re-insurance paid	(1,00,000)
	14,00,000
Less: Reserve required for unexpired risk @ 40% of Net Premium	5,60,000
Net Premium Earned	8,40,000

Schedule 2

Claims

	₹
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2013	1,00,000
	8,00,000

Schedule 3

Commission

Commission paid during the year	50,000
Total in the Year	50,000

Schedule 4

Operating expenses

	₹
Expenses of Management	3,00,000

Question 4

The life fund of Well-Life Assurance Co. was ₹ 90,00,000 as on 31st December, 2005. The interim bonus paid during the valuation period was ₹ 1,50,000. The periodical actuarial valuation determined the net liability at ₹ 75,00,000. Surplus brought forward from the previous valuation was ₹ 9,00,000. The directors of the company proposed to carry forward

₹ 10,00,000 and to divide the balance between the shareholders and the policy holders. You are required to show:

(i) The valuation Balance Sheet.

(ii) The Net Profit for the valuation period.

(iii) The distribution of the surplus. *(8 Marks, November 2006) (PE-II)*

Note: This question is not in accordance with Insurance Regulatory Development Authority Regulations, 2002.

Question 5

Domestic Assurance Co. Ltd. received ₹ 5,90,000 as premium on new policies and ₹ 1,20,000 as renewal premium. The company received ₹ 90,000 towards reinsurance accepted and paid ₹ 70,000 towards reinsurance ceded. How much will be credited to Revenue Account towards premium? *(2 Marks, May, 2008)(PCC)*

Answer

	₹
Premium received in respect of new policies	5,90,000
Add: Renewal premium	1,20,000
	7,10,000
Add: Re-insurance premium accepted	90,000
	8,00,000
Less: Re-insurance ceded	70,000
Premium amount to be credited to Revenue A/c	7,30,000

Question 6

Prepare Revenue Account in proper form for the year ended 31st March, 2008, from the following particulars related to Krishna General Insurance Co. for the year ended 2007 – 2008:

	Related to Direct business (₹)	*Related to Reinsurance (₹)*
Premiums:		
Amount received	*30,00,000*	*2,40,000*
Receivable at the beginning	*1,80,000*	*24,000*
Receivable at the end	*2,40,000*	*36,000*
Amount paid	--	*3,60,000*
Payable at the beginning	--	*30,000*
Payable at the end	--	*42,000*
Claims:		
Amount paid	*18,00,000*	*1,80,000*

Payable at the beginning	*60,000*	*12,000*
Payable at the end	*1,20,000*	*18,000*
Amount recovered	*--*	*1,20,000*
Receivable at the beginning	*--*	*18,000*
Receivable at the end	*--*	*12,000*
Commission:		
Amount paid	*72,000*	*10,800*
Amount received	*--*	*14,400*

Additional information:

(i) *Interest, dividend and rent received* *30,000*

Income-tax in respect of above *6,000*

(ii) *Management expenses including ₹ 12,000 related to legal expenses regarding claims* *1,32,000*

(iii) *Provision for income tax existing at the beginning of the year was ₹ 1,95,000, the income-tax actually paid during the year ₹ 1,68,000 and the provision necessary at the year end ₹ 2,07,000.*

(iv) *The net premium income of the company during the year 2006 – 2007 was ₹ 24,00,000 on which reserve for unexpired risk @ 50% and additional reserve @ 7 ½ % was created. This year, the balance to be carried forward is 50% of net premium on reserve for unexpired risk and 5% on additional reserve.* *(8 Marks, November, 2008) (PCC)*

Answer

FORM B – RA

Name of the Insurer: Krishna General Insurance Company

Registration no. and date of registration with IRDA : ……………….

Revenue Account for the year ended 31.3.2008

	Particulars	*Schedule*	*Amount (₹)*
1.	Premium earned (Net)	1	27,03,000
2.	Profit/Loss on sales/Redemption of investment	-	-
3.	Other	-	-
4.	Interest, dividend & rent (Gross)	-	30,000
	Total (A)		27,33,000
1.	Claims incurred (Net)	2	19,44,000
2.	Commission	3	68,400
3.	Operating expenses related to insurance business	4	1,20,000
	Total (B)		21,32,400

	Operating profit/Loss from insurance business (C) = (A-B)		6,00,600
	Appropriation:		
	Transfer to Shareholders account		-
	Transfer to Catastrophe Reserve		-
	Transfer to other reserves		-
	Total (D)		-

Schedule – 1 Premium Earned (Net)

Particulars	₹
Premium received from direct business (W.N.1)	30,60,000
Add: Premium on reinsurance accepted (2,40,000 + 36,000 – 24,000)	2,52,000
	33,12,000
Less: Premium on reinsurance ceded (3,60,000 + 42,000 – 30,000)	3,72,000
Net Premium	29,40,000
Adjustment for change in reserve for unexpired risk (W.N.2)	2,37,000
Total premium earned (Net)	27,03,000

Schedule – 2 Claims Incurred (Net)

Particulars	₹
Claims paid (Direct)	18,00,000
Add: Legal expenses regarding claims	12,000
	18,12,000
Add: Reinsurance Accepted	1,80,000
	19,92,000
Less: Reinsurance ceded (1,20,000 + 12,000 –18,000)	1,14,000
	18,78,000
Add: Claims outstanding at the end (1,20,000 + 18,000)	1,38,000
Less: Claims outstanding at the beginning (60,000 + 12,000)	72,000
Total claim incurred	19,44,000

Schedule –3 Commission

Particulars	₹
Commission paid Direct	72,000
Add: Re-insurance accepted	10,800
	82,800
Less: Re-insurance ceded	(14,400)
Net commission	68,400

Schedule – 4 Operating Expenses related to Insurance Business

Particulars	₹
Expenses of management (1,32,000 – 12,000)	1,20,000
	1,20,000

Working Notes:

1. Calculation of premium received from direct business

	₹
Premium on direct business	30,00,000
Add: Premium outstanding at the end	2,40,000
	32,40,000
Less: Premium outstanding at the beginning	1,80,000
	30,60,000

2. Computation of change in reserve for unexpired risk

	₹
Reserve for unexpired risk for the year 2007-08 (29,40,000 x 50%)	14,70,000
Add: Additional reserve for unexpired risk for the year 2007-08 (29,40,000 x 5%)	1,47,000
	16,17,000
Less: Reserve for unexpired risk for the year 2006-07 (24,00,000 x 50%)	(12,00,000)
Additional reserve for unexpired risk for the year (24,00,000 x 7.5%)	(1,80,000)
	2,37,000

Question 7

The Revenue Account of a Life Insurance Company shows the Life Assurance Fund on 31st March, 2009 at ₹ 62,21,310 before taking into account the following items:

(i) Claims recovered under re-insurance ₹ 12,000.

(ii) Bonus utilized in reduction of Life Insurance premium of ₹ 4,500.

(iii) Interest accrued on securities ₹ 8,260.

(iv) Outstanding premium ₹ 5,410.

(v) Claims intimated but not admitted ₹ 26,500.

Compute the Life Assurance Fund on 31st March, 2009, after taking into account the above omission. *(4 Marks, June, 2009) (PCC)*

<u>Note:</u> This question is not in accordance with Insurance Regulatory Development Authority Regulations, 2002.

Question 8

Briefly explain "Reserve for Unexpired Risks" under General Insurance Business. What are the percentages of such reserve to be created under IRDA Act for various General Insurance businesses? *(2 Marks, May, 2010) (IPCC)*

Answer

The need for unexpired risks reserve arises from the fact that all policies are renewed annually except in specific cases where short period policies are issued. Since the insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies normally extend beyond this date into the following year during which risks continue. In other words, at the closing date, there is unexpired liability under various policies, which may occur during the remaining term of the policy beyond the year end. According to the requirements of the Insurance Act, it is sufficient if the provision is made for unexpired risks at 50 per cent for Fire, Marine Cargo and Miscellaneous business except for Marine Hull which has to be 100 per cent.

Question 9

From the following information furnished to you by Ayushman Insurance Co. Ltd., you are required to pass Journal entries relating to unexpired risk reserve and show in columnar form "Unexpired Risks Reserve Account" for 2011.

(a) On 31.12.2010, it had reserve for unexpired risks amounting to ₹ 40 crores. It comprised of ₹ 15 crores in respect of marine insurance business, ₹ 20 crores in respect of fire insurance business and ₹ 5 crores in respect of miscellaneous insurance business.

(b) Ayushman Insurance Co. Ltd. creates reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.

(c) During 2011, the following business was conducted:

			(₹ in crores)
	Marine	*Fire*	*Miscellaneous*
Premium collected from:			
(a) Insured in respect of policies issued	*18.00*	*43.00*	*12.00*
(b) Other insurance companies in respect of risks undertaken	*7.00*	*5.00*	*4.00*
Premium paid/payable to other insurance companies on business ceded	*6.70*	*4.30*	*7.00*

(8 Marks, May, 2010) (IPCC)

Answer

In the books of Ayushman Insurance Co. Ltd.

Journal Entries

Date	*Particulars*		*(₹ in crores)*	
			Dr.	*Cr.*
1.1.2011	Unexpired Risk Reserve (Fire) A/c	Dr.	20.00	
	Unexpired Risk Reserve (Marine) A/c	Dr.	15.00	
	Unexpired Risk Reserve (Miscellaneous) A/c	Dr.	5.00	
	To Fire Revenue Account			20.00
	To Marine Revenue Account			15.00
	To Miscellaneous Revenue Account			5.00
	(Being unexpired risk reserve brought forward from last year)			
31.12.2011	Marine Revenue A/c	Dr.	18.30	
	To Unexpired Risk Reserve A/c			18.30
	(Being closing reserve for unexpired risk created at 100% of net premium income amounting to ₹ 18.3 crores i.e.18+7-6.70)			
	Fire Revenue A/c	Dr.	21.85	
	To Unexpired Risk Reserve A/c			21.85
	(Being closing reserve for unexpired risk created at 50% of net premium income of ₹ 43.7 crores i.e.43+5-4.30)			
	Miscellaneous Revenue A/c	Dr.	4.50	
	To Unexpired Risk Reserve A/c			4.50
	(Being closing reserve for unexpired risk created at 50% net premium income of ₹ 9 crores i.e. 12+4-7)			

Unexpired Risk Reserve Account

Date	*Particulars*	*Marine (₹)*	*Fire (₹)*	*Misc. (₹)*	*Date*	*Particulars*	*Marine (₹)*	*Fire (₹)*	*Misc. (₹)*
1.1.2011	To Revenue A/c	15.00	20.00	5.00	1.1.2011	By Balance b/d	15.00	20.00	5.00
31.12.2011	To Balance				31.12.2011	By Revenue			

	c/d	18.30	21.85	4.50		A/c	18.30	21.85	4.50
		33.30	41.85	9.50			33.30	41.85	9.50

Question 10

From the following information of Reliable Marine Insurance Ltd. for the year ending 31st March, 2010 find out the

(i) Net premiums earned

(ii) Net claims incurred

	(₹) Direct Business	(₹) Re-insurance
Premium:		
Received	*88,00,000*	*7,52,000*
Receivable – 01.04.2009	*4,39,000*	*36,000*
Receivable – 31.03.2010	*3,77,000*	*32,000*
Paid	*6,09,000*	
Payable – 01.04.2009		*27,000*
Payable – 31.03.2010		*18,000*
Claims:		
Paid	*69,00,000*	*5,54,000*
Payable – 01.04.2009	*89,000*	*15,000*
Payable – 31.03.2010	*95,000*	*12,000*
Received		*2,01,000*
Receivable – 01.04.2009		*40,000*
Receivable – 31.03.2010		*38,000*

(8 Marks, November, 2010) (IPCC)

Answer

(i) Net Premium earned

		₹
Premium from direct business received	88,00,000	
Add : Receivable as 31.03.2010	3,77,000	
Less : Receivable as on 01.04.2009	(4,39,000)	87,38,000
Add : Premium on re-insurance accepted	7,52,000	
Add : Receivable as on 31.03.2010	32,000	
Less : Receivable as on 01.04.2009	(36,000)	7,48,000
		94,86,000
Less : Premium on re-insurance ceded	6,09,000	

Add : Payable as on 31.03.2010	18,000	
Less : Payable as on 01.04.2009	(27,000)	(6,00,000)
Net Premium earned		88,86,000

(ii) Net Claims incurred

		₹
Claims paid on direct business		69,00,000
Add: Re-insurance	5,54,000	
Add: Outstanding as on 31.3.2010	12,000	
Less: Outstanding as on 1.4.2009	(15,000)	5,51,000
		74,51,000
Less : Claims received from re-insurance	2,01,000	
Add: Outstanding as on 31.3.2010	38,000	
Less: Outstanding as on 1.4.2009	(40,000)	(1,99,000)
		72,52,000
Add : Outstanding direct claims at the end of the year		95,000
		73,47,000
Less : Outstanding claims at the beginning of the year		(89,000)
Net claims incurred		72,58,000

Question 11

Modern Insurance Company's Fire Insurance division provide the following information, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2011.

	Direct Business	*Re-insurance*
	₹	₹
Claim paid during the year	*35,30,000*	*8,20,000*
Claim received		*3,20,000*
Claim payable		
1st April, 2010	*8,23,000*	*58,000*
31st March, 2011	*8,75,000*	*87,000*
Claim receivable:		
1st April, 2010	-	*85,000*
31st March, 2011	-	*1,42,000*
Expenses of management	*3,45,000*	
(Includes ₹ 38,000 Surveyor's fee		
and ₹ 42,000 Legal expenses for settlement of claims)		

(8 Marks, May, 2011) (IPCC)

Answer

Modern Insurance Company (Abstract showing the amount of claims)

Net Claims incurred

		₹
Claims paid on direct business (35,30,000 + 38,000 + 42,000)		36,10,000
Add: Re-insurance	8,20,000	
Add: Outstanding as on 31.3.2011	87,000	
Less: Outstanding as on 1.4.2010	(58,000)	8,49,000
		44,59,000
Less : Claims received from re-insurance	3,20,000	
Add: Outstanding as on 31.3.2011	1,42,000	
Less: Outstanding as on 1.4.2010	(85,000)	(3,77,000)
		40,82,000
Add : Outstanding direct claims at the end of the year		8,75,000
		49,57,000
Less : Outstanding claims at the beginning of the year		(8,23,000)
Net claims incurred		41,34,000

Question 12

From the following information of M/s. Bigfish Marine Insurance Co. Ltd., prepare the Revenue Account as per regulations of IRDA for the year ended 31st March, 2011:

Particulars	*Amount (₹)*
Premium received	*18,75,000*
Premium outstanding on March 31, 2011	*1,25,000*
Premium paid on reinsurance ceded	*2,28,000*
Claims paid	*10,54,000*
Estimated liability in respect of outstanding claims:	
On April 1, 2010	*1,89,000*
On March 31, 2011	*2,25,000*
Expenses of management (includes ₹ 45,000 surveyor's fee and ₹ 65,000 legal expenses paid for settlement of claims)	*4,85,000*
Interest and dividend (Gross)	*1,65,250*
Income tax on the above	*49,575*
Profit on sale of investments	*46,000*
Commission paid	*1,94,000*

Balance of fund on 1st April, 2010 was ₹ 18,50,000 including additional reserve of ₹ 1,80,000. Additional reserve has to be maintained at 10% of net premium for the year.

(8 Marks, November, 2011) (IPCC)

Answer

FORM B-RA

Name of the Insurer: M/s Bigfish Marine Insurance Co. Ltd.

Revenue Account for the year ended 31st March, 2011

Particulars	Schedule	₹
Premium earned (Net)	1	16,72,800
Profit on sale of investment		46,000
Interest, dividend and rent (Gross)		1,65,250
Total (A)		18,84,050
Claims incurred (Net)	2	12,00,000
Commission	3	1,94,000
Operating expenses related to insurance business	4	3,75,000
Total (B)		17,69,000
Profit for Marine Insurance Business (A-B)		1,15,050

Schedule -1

Premium Earned (Net)	₹
Premium received	18,75,000
Add: Outstanding premium as on 31.03.2011	1,25,000
	20,00,000
Less: Premium on reinsurance ceded	(2,28,000)
	17,72,000
Less: Adjustment for change in reserve for unexpired risk (Refer W.N. 1)	(99,200)
Net premium earned	16,72,800

Schedule -2

Claim Incurred (Net)	₹
Claim paid	10,54,000
Add: Surveyor's fee & legal expenses paid for settlement of claim (₹ 45,000 + ₹ 65,000)	1,10,000
Add: Outstanding claims as on 31.03.2011	2,25,000
	13,89,000

Less: Outstanding claims as on 01.04.2010	(1,89,000)
Claim incurred (Net)	12,00,000

Schedule -3

Commission	₹
Commission paid	1,94,000

Schedule -4

Operating expenses related to insurance business	₹
Expenses of Management	4,85,000
Less: Surveyor's fee & legal expenses	(1,10,000)
	3,75,000

Working Notes:

1. Calculation for change in Reserve for Unexpired Risk

		₹
Unexpired risk reserve at the beginning (including additional reserve)		18,50,000
Less: Reserve for unexpired risk as on 31.03.2011		
(100% of ₹ 17,72,000)	17,72,000	
Additional reserve as on 31.03.2011		
(10% of ₹ 17,72,000)	1,77,200	(19,49,200)
Change in provision for unexpired risk		99,200

2. Income tax on interest and dividend ₹ 49,575 is part of Profit & Loss Account, therefore, not given effect to in the Revenue Account.

Question 13

Prepare the Fire Insurance Revenue A/c of Jasmine Fire Insurance Co. Ltd. as per IRDA regulations for the year ended 31st March, 2012 from the following details:

Particulars	*Amount (₹)*
Claims Paid	*5,00,000*
Legal Expenses regarding claims	*10,000*
Premiums received	*12,50,000*
Re-insurance premium paid	*50,000*
Commission	*3,00,000*
Expenses of Management	*2,00,000*
Provision against unexpired risk as on 1st April, 2011	*5,75,000*

Claims unpaid on 1st April, 2011	*50,000*
Claims unpaid on 31st March, 2012	*80,000*

Provide for unexpired risk @ 50% less reinsurance *(8 Marks, November 2012) (IPCC)*

Answer

FORM B - RA

Name of the Insurer: Jasmine Fire Insurance Co. Ltd.

Registration No. and Date of Registration with the IRDA:

Revenue Account for the year ended 31st March, 2012

	Particulars	*Schedule*	*Amount (₹)*
(1)	Premium earned	1	11,75,000
(2)	Profit / Loss on sale / redemption of investments		-
(3)	Other income		-
(4)	Interest, dividend and rent		-
	Total (A)		11,75,000
(5)	Claims incurred	2	5,40,000
(6)	Commission	3	3,00,000
(7)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,40,000
	Operating Profit (A)- (B)		1,35,000

Schedule 1 : Premium earned (net)	₹
Premium received	12,50,000
Less: Re-insurance premium	(50,000)
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	(25,000)
	11,75,000
Schedule 2 : Claims Incurred	**₹**
Claims paid including legal expenses (5,00,000 + 10,000)	5,10,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,40,000

Schedule 3 : Commission	₹
Commission paid	3,00,000
	3,00,000
Schedule 4: Operating expenses	**₹**
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	₹
Unexpired risk reserve on 31st March, 2012 =50% of net premium	
(i.e. 50% of ₹ 12,00,000)	6,00,000
Less : Unexpired risk reserve as on 1st April 2011	(5,75,000)
Change in the provision for unexpired risk	25,000

Question 14

From the following information as on 31st March, 2013 of Bachao Insurance Co. Ltd. engaged in fire insurance business, prepare the Revenue Account, reserving 40% of the net premiums for unexpired risks and an additional reserve of ₹ 3,50,000:

Particulars	*Amount ₹*
Reserve for unexpired risk on 31st March, 2012	*7,50,000*
Additional reserve on 31st March, 2012	*1,50,000*
Claims paid	*9,60,000*
Estimated liability in respect of outstanding claims on 31st March, 2012	*97,500*
Estimated liability in respect of outstanding claims on 31st March, 2013	*1,35,000*
Expenses of management (including ₹ 45,000 in connection with claims)	*4,20,000*
Re-insurance premium paid	*1,12,500*
Re-insurance recoveries	*30,000*
Premiums	*16,80,000*
Interest and dividend	*75,000*
Profit on sale of investments	*15,000*
Commission	*1,75,000*

(8 Marks, May 2013) (IPCC)

Answer

FORM B– RA

Name of the Insurer: Bachao Insurance Company Limited

Registration No. and Date of registration with IRDA: ……………………..

Revenue Account for the year ended 31st March, 2013

Particulars	*Schedule*	*Amount (₹)*
Premium earned (net)	1	14,90,500
Profit on sale of investment		15,000
Others		–
Interest and dividend (gross)		75,000
Total (A)		15,80,500
Claims incurred (Net)	2	10,12,500
Commission	3	1,75,000
Operating expenses related to insurance	4	3,75,000
Total (B)		15,62,500
Operating profit from insurance business (A) – (B)		18,000

Schedule –1 Premium earned (net)

	₹
Premium received	16,80,000
Less: Premium on reinsurance ceded	(1,12,500)
Net Premium	15,67,500
Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.)	(77,000)
Total premium earned	14,90,500

Schedule -2 Claims incurred (net)

	₹
Claims paid	9,60,000
Add: Expenses regarding claims	45,000
	10,05,000
Less: Re-insurance recoveries	(30,000)
	9,75,000
Add: Claims outstanding as on 31st March, 2013	1,35,000
	11,10,000
Less: Claims outstanding as on 31st March, 2012	(97,500)
	10,12,500

Schedule -3 Commission

	₹
Commission paid	1,75,000

Schedule-4 Operating expenses related to Insurance Business

	₹
Expenses of management (₹4,20,000 – ₹45,000)	3,75,000

Working Note:

Calculation for change in Reserve for Unexpired risk:

		₹
Reserve for Unexpired Risk as on 31st March, 2013	6,27,000	
Additional Reserve as on 31st March, 2013	3,50,000	9,77,000
Less: Reserve for Unexpired Risk as on 31st March, 2012	7,50,000	
Additional Reserve as on 31st March, 2012	1,50,000	(9,00,000)
		77,000

Note: Interest and dividends are shown at gross value in Revenue account. It is assumed that amount of interest and dividend given in the question is before TDS.

Question 15

Explain in short, the following principles and term of insurance business:

(i) Principle of Indemnity;

(ii) Insurable interest;

(iii) Principle of "UBERRIMAE FIDEI".

(iv) Catastrophic Loss *(4 Marks, November 2013) (IPCC)*

Answer

(i) Principle of indemnity: Insurance is a contract of indemnity. The insurer is called indemnifier and the insured is the indemnified. In a contract of indemnity, only those who suffer loss are compensated to the extent of actual loss suffered by them. One cannot make profit by insuring his risks.

(ii) Insurable interest: All and sundry cannot enter into contracts of insurance. For example, A cannot insure the life of B who is a total stranger. But if B. happens to be his wife or his debtor or business manager, A has insurable interest i.e. vested interest and therefore he can insure the life of B. For every type of policy insurable interest is insisted upon. In the absence of such interest the contract will amount to a wagering contract.

(iii) Principle of UBERRIMAE FIDEI: Under ordinary law of contract there is no positive duty to tell the whole truth in relation to the subject-matter of the contract. There is only the negative obligation to tell nothing but the truth. In a contract of insurance, however there is an implied condition that each party must disclose every material fact known to him. All contracts of insurance are contracts of uberrima fidei, i.e., contracts of utmost good faith. This is because the assessment of the risk and the determination of the premium by the insurer depend on the full and frank disclosure of all material facts in the proposal form.

(iv) Catastrophic Loss: A loss (or related losses) which is unbearable i.e. it causes severe consequences such as bankruptcy to a family, organization, or insurer.

6

Financial Statements of Banking Companies

Question 1

Rajatapeeta Bank Ltd. had extended the following credit lines to a Small Scale Industry, which had not paid any Interest since March, 1997:

	Term Loan	*Export Loan*
Balance Outstanding on 31.03.2003	*₹ 35 lakhs*	*₹ 30 lakhs*
DICGC/ECGC cover	*40%*	*50%*
Securities held	*₹ 15 lakhs*	*₹ 10 lakhs*
Realisable value of Securities	*₹ 10 lakhs*	*₹ 08 lakhs*

Compute necessary provisions to be made for the year ended 31st March, 2003.

(6 Marks, May 2004)(PE- II)

Answer

	Term loan ₹ in lakhs	*Export credit ₹ in lakhs*
Balance outstanding on 31.3. 2003	35.0	30.0
Less: Realisable value of Securities	(10.0)	(8.0)
	25.0	22.0
Less: DICGC cover @ 40%	(10.0)	
ECGC cover @ 50%	___	(11.0)
Unsecured balance	15.0	11.0

Required Provision:

100% for unsecured portion	15.0	11.0
100% for secured portion	10.0	8.0
Total provision required	25.0	19.0

Note: Since no interest has been paid since 1997, the entire balance as on 31st March 2003 can be categorized as doubtful. Hence, provision has to be made at 100% of both the secured and the unsecured component.

Question 2

From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a Commercial Bank:

Assets	*₹ (in lakhs)*
Standard	*4,000*
Sub-standard	*2,000*
Doubtful upto one year	*900*
Doubtful upto three years	*400*
Doubtful more than three years	*300*
Loss Assets	*500*

(4 Marks, November 2004) (PE- II)

Answer

Computation of provision in the Profit & Loss Account of the Commercial Bank:

Assets	*Amount (₹ in lakhs)*	*% of Provision*	*Provision (₹ in lakhs)*
Standard	4,000	0.40	16
Sub-standard*	2,000	15	300
Doubtful upto one year*	900	25	225
Doubtful upto three years*	400	40	160
Doubtful more than three years*	300	100	300
Loss	500	100	500
			1,501

* Sub-standard and doubtful assets are assumed as fully secured as it is logical for a commercial bank to cover itself by adequate security in the making of loans and advances in the ordinary course of business.

Question 3

From the following information calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of Zed Bank Ltd. for the year ended 31.3.2004:

			(₹ in '000)
Interest and Discount			*8,860*
(Includes interest accrued on investments)			
Other Income			*220*
Interest expended			*2,720*
Operating expenses			*2,830*
Interest accrued on Investments			*10*
Additional Information:			
(a)	*Rebate on bills discounted to be provided for*		*30*
(b)	*Classification of Advances:*		
	(i)	*Standard assets*	*4,000*
	(ii)	*Sub-standard assets*	*2,240*
	(iii)	*Doubtful assets–(fully unsecured)*	*390*
	(iv)	*Doubtful assets – covered fully by security*	
		Less than 1 year	*100*
		More than 1 year, but less than 3 years	*600*
		More than 3 years	*600*
	(v)	*Loss assets*	*376*
(c)	*Provide 35% of the profit towards provision for taxation.*		
(d)	*Transfer 20% of the profit to Statutory Reserve.*		

(16 Marks, May 2005) (PE- II)

Answer

ZED Bank Ltd.

Profit and Loss Account

for the year ended 31st March, 2004

(₹ in '000)

	Particulars	*Schedule No.*	*Year ended on 31st March, 2004*
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	220
	Total		9,050

II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		2,513.95
	Total		8,063.95
III.	Profit/Loss		
	Net profit/(loss) for the year		986.05
	Profit/(loss) brought forward		Nil
	Total		986.05
IV.	Appropriations		
	Transfer to statutory reserve @ 20%		197.21
	Balance carried to balance sheet		788.84
	Total		986.05

Working Notes:

1. Schedule 13 – Interest Earned

			(₹ '000s)
(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted not provided	(30)	
	Interest accrued on investments	(10)	8,820
(ii)	Interest accrued on investments		10
			8,830

Note: Interest accrued on investments to be shown separately under Interest Earned.

2. Calculation of Provisions and Contingencies

Assets	*Amount*	*% of Provision*	*Provision*
	(₹ in '000)		*(₹ in '000)*
Standard assets	4,000	0.40	16
Sub-standard assets*	2,240	15	336
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	25	25
More than 1 year but less than 3 years	600	40	240

More than 3 years	600	100	600
Loss assets	376	100	376
Total provision	8,306		1,983

*Note: It is assumed that sub-standard assets are fully secured.

3. Calculation of provision on tax = 35% (Total income – Total expenditure)
   = 35% of ₹ [(9,050 – (2,720 + 2,830 + 1,983)]
   = 35% of ₹ 1,517
   = ₹ 530.95

4. Total provisions and contingencies = ₹ 1,983 + ₹ 530.95 = ₹ 2,513.95.

Question 4

From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial bank:

	Assets	*₹ in lakhs*
(i)	*Standard (Value of security ₹ 6,000 lakhs)*	*7,000*
(ii)	*Sub-standard*	*3,000*
(iii)	*Doubtful*	
	(a) Doubtful for less than one year (Realisable value of security ₹ 500 lakhs)	*1,000*
	(b) Doubtful for more than one year, but less than 3 years (Realisable value of security ₹ 300 lakhs)	*500*
	(c) Doubtful for more than 3 years (No security)	*300*

(8 Marks, May 2006) (PE- II)

Answer

Statement showing Provisions on various performing and non-performing assets

	Amount	*% of*	Provision
	₹ in lakhs	*provision*	*₹ in lakhs*
Standard	7,000	0.40	28
Sub-standard	3,000	15	450
Doubtful (less than one year)			
On secured portion	500	25	125
On unsecured portion	500	100	500
Doubtful (more than one year but less than three			

years)			
On secured portion	300	40	120
On unsecured portion	200	100	200
Doubtful Unsecured (more than three years)	300	100	300
Total provision			1,723

Question 5

From the following details, prepare bills for collection (Asset) Account and Bills for collection (Liability) Account:

	₹
On 1.4. 2005, Bills for Collection were	*51,00,000*
During the year 2005-06 Bills received for Collection amounted to	*75,00,000*
Bill collected during the year 2005-06	*98,47,000*
Bill dishonoured and returned during the year	*27,10,000*

(4 Marks, May 2006) (PE- II)

Answer

Bills for collection (Asset) Account

		₹			₹
1.4. 2005	To Balance b/d	51,00,000	2005-06	By Bills for collection (Liability) A/c	98,47,000
2005-06	To Bills for collection	75,00,000		By Bills for collection (Liability) A/c (dishonored bills)	27,10,000
			31.3. 2006	By Balance c/d	43,000
		1,26,00,000			1,26,00,000
1.4. 2006	To Balance b/d	43,000			

Bills for collection (Liability) Account

2005- 06	To Bills for collection (Asset) A/c	98,47,000	1.4. 2005	By Balance b/d	51,00,000
	To Bills for collection (Asset) A/c	27,10,000	2005- 06	By Bills for collection (Asset) A/c	75,00,000
31.3. 2006	To Balance c/d	43,000			
		1,26,00,000			1,26,00,000
			1.4. 2006	By Balance b/d	43,000

Question 6

The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2006:

Rebate on bills discounted as on 1-4- 2005	*68,259 (Cr.)*
Discount received	*1,70,156 (Cr.)*

Analysis of the bills discounted reveals as follows:

Amount (₹)	*Due date*
2,80,000	*June 1, 2006*
8,72,000	*June 8, 2006*
5,64,000	*June 21, 2006*
8,12,000	*July 1, 2006*
6,00,000	*July 5, 2006*

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2006 and pass Journal Entries. The rate of discount may be taken at 10% per annum. *(8 Marks, November 2006) (PE- II)*

Answer

The amount of rebate on bills discounted as on 31st March, 2006 the period which has not been expired upto that day will be calculated as follows:

Discount on ₹ 2,80,000 for 62 days @ 10%	4,756
Discount on ₹ 8,72,000 for 69 days @ 10%	16,484
Discount on ₹ 5,64,000 for 82 days @ 10%	12,671
Discount on ₹ 8,12,000 for 92 days @ 10%	20,467
Discount on ₹ 6,00,000 for 96 days @ 10%	15,781
Total	70,159

Note: The due date of the bills discounted is included in the number of days above.

The amount of discount to be credited to the profit and loss account will be:

	₹
Transfer from rebate on bills discounted as on 31.03. 2005	68,259
Add: Discount received during the year	1,70,156
	2,38,415
Less: Rebate on bills discounted as on 31.03. 2006 (as above)	(70,159)
	1,68,256

Journal Entries

	₹	₹
Rebate on bills discounted A/c Dr.	68,259	
To Discount on bills A/c		68,259
(Transfer of opening unexpired discount on 31.03. 2005)		
Discount on bills A/c Dr.	70,159	
To Rebate on bills discounted		70,159
(Unexpired discount on 31.03. 2006 taken into account)		
Discount on Bills A/c Dr.	1,68,256	
To P & L A/c		1,68,526
(Discount earned in the year, transferred to P&L A/c)		

Question 7

In X Bank Ltd., the doubtful assets (more than 3 years) as on 31.3.2007 is ₹ 1,000 lakhs. The value of security (including DICGC 100% cover of ₹ 100 lakhs) is ascertained at ₹ 500 lakhs. How much provision must be made in the books of the Bank towards doubtful assets?

(2 Marks, May, 2007and November, 2008)(PCC)

Answer

	(₹ in lakhs)
Doubtful Assets (more than 3 years)	1,000
Less: Value of security (excluding DICGC cover)	400
	600
Less: DICGC cover	100
Unsecured portion	500
Provision:	
for unsecured portion @100%	500 lakhs
for secured portion @ 100% w.e.f. 31.3.2007	400 lakhs
Total provision to be made	900 lakhs

Question 8

The following information is available in the books of X Bank Limited as on 31st March, 2007:

	₹
Bills discounted	*1,37,05,000*
Rebate on Bills discounted (as on 1.4.2006)	*2,21,600*
Discount received	*10,56,650*

Details of bills discounted are as follows:

Value of bill (₹)	*Due date*	*Rate of Discount*
18,25,000	*5.6.2007*	*12%*
50,00,000	*12.6.2007*	*12%*
28,20,000	*25.6.2007*	*14%*
40,60,000	*6.7.2007*	*16%*

Calculate the rebate on bills discounted as on 31.3.2007 and give necessary journal entries.

(8 Marks, November, 2007) (PCC)

Answer

Statement showing rebate on bills discounted

Value	*Due Date*	*Days after 31.3.2007*	*Rate of discount*	*Discount Amount*
18,25,000	5.6.2007	(30+ 31+5) = 66	12%	39,600
50,00,000	12.6.2007	(30+31+12) = 73	12%	1,20,000
28,20,000	25.6.2007	(30+31+25) = 86	14%	93,021
40,60,000	6.7.2007	(30+ 31+ 30+ 6) = 97	16%	1,72,633
1,37,05,000	Rebate on bills discounted on 31.3.2007			4,25,254

In the books of X Bank Ltd.
Journal Entries

			₹	₹
(i)	Rebate on bills discounted Account	Dr.	2,21,600	
	To Discount on bills Account			2,21,600
	[Being opening balance of rebate on bills discounted account transferred to discount on bills account]			
(ii)	Discount on bills Account	Dr.	4,25,254	
	To Rebate on bills discounted Account			4,25,254
	[Being provision made on 31st March, 2007]			
(iii)	Discount on bills Account	Dr.	8,52,996	
	To Profit and loss Account			8,52,996
	[Being transfer of discount on bills, of the year, to profit and loss account)			

Credit to Profit and Loss A/c will be as follows: 10,56,650 + 2,21,600 – 4,25,254 = ₹ 8,52,996

Question 9

What is the percentage of NPA provision to be made by banks in respect of fully secured doubtful advances of more than 3 years old? *(2 Marks, November, 2007)* (PCC)

Answer

In case of Banking Companies, 100% NPA provision is made in respect of fully secured doubtful advances of more than 3 years. This provision is made irrespective of whether the advance is fully / partly secured or unsecured. However, in the case of government guaranteed advances this rate of provision will not apply.

Question 10

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

(2 Marks, (May, 2008) (PCC)

Answer

Loan outstanding	₹ 50,00,000
Guaranteed by DICGC – Risk weight	50%
Value of risk adjusted asset ₹ 50,00,000 × 50% =	₹ 25,00,000

Question 11

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

	₹ in lakhs
Assets	
Standard	*20,000*
Substandard	*16,000*
Doubtful	
For one year (secured)	*6,000*
For two years and three years (secured)	*4,000*
For more than three years (secured by mortgage of plant and machinery ₹ 600 lakhs)	*2,000*
Non-recoverable Assets	*1,500*

(4 Marks, November, 2008) (PCC)

Answer

Calculation of amount of provision to be made in the Profit and Loss Account

Classification of Assets	*Amount of advances*	*% age of provision*	*Amount of provision*
	(₹ in lakhs)	*%*	*(₹ in lakhs)*
Standard assets	20,000	0.40	80
Sub-standard assets	16,000	15*	2,400
Doubtful assets:			
For one year (secured)	6,000	25	1,500
For two to three years (secured)	4,000	40	1,600
For more than three years (unsecured)	1,400	100	1,400
(secured)	600	100	600
Non-recoverable assets (Loss assets)	1,500	100	1,500
Total provision required			9,080

Question 12

Find out the income to be recognised in the case of X Bank Ltd. for the year ended 31st March, 2009:

	Performing Assets		*(₹ in lakhs) Non-performing Assets*	
	Interest accrued	*Interest received*	*Interest accrued*	*Interest received*
Term loans	*240*	*160*	*150*	*10*
Cash credits and overdrafts	*1,500*	*1,240*	*300*	*24*

(2 Marks, November, 2009) (PCC)

Answer

Interest on performing assets to be recognized on accrual basis, but interest on Non-performing asset should be recognized on Cash Basis.

		₹ in lakhs
Interest on Term Loan	(240 + 10)	250
Cash Credits and Over Drafts	(1500 + 24)	1,524
Total Interest to be recognized		1,774

* Sub-standards assets have been assumed as fully secured.

Note: The recognition of income in respect of NPAs on actual receipt is as per clause 3 of the Master Circular of the RBI on the subject dated 1st July 2013

Question 13

From the following information, you are required to prepare Profit and Loss Account of Zee Bank Ltd., for the year ending 31st March, 2009:

	₹		₹
Interest and Discount	*44,00,000*	*Interest expended*	*13,60,000*
Other Income	*1,25,000*	*Operating expenses*	*13,31,000*
Income on investments	*5,000*	*Interest on balance with RBI*	*25,000*

Additional information:

(a) *Rebate on bills discounted to be provided for ₹ 15,000*

(b) *Classification of advances:*

	₹
Standard assets	*25,00,000*
Sub-standard assets	*5,60,000*
Doubtful assets not covered by security	*2,55,000*
Doubtful assets covered by security	
For 1 year	*25,000*
For 2 years	*50,000*
For 3 years	*1,00,000*
For 4 years	*75,000*
Loss assets	*1,00,000*

(c) *Make tax provision @ 35%*

(d) *Profit and Loss A/c (Cr.) ₹ 40,000.* *(8 Marks, November, 2009) (IPCC)*

Answer

Form 'B'

Zee Bank Ltd.

Profit & Loss Account for the year ended 31st March, 2009

	Particulars	*Schedule No.*	*Year ended 31st March, 2009*
I.	Income:		
	Interest Earned	13	44,15,000

	Other Income	14	1,25,000
	Total		45,40,000
II.	**Expenditure**		
	Interest Expended	15	13,60,000
	Operating Expense	16	13,31,000
	Provisions and Contingencies (W.N.3)		10,30,813
	Total		37,21,813
III.	**Profit/Loss**		
	Net profit for the year		8,18,187
	Profit brought forward		40,000
	Total		8,58,187
IV.	**Appropriations:**		
	Transfer to Statutory Reserve @ 25% on ₹ 8,18,187		2,04,547
	Balance carried forward to Balance Sheet		6,53,640
	Total		8,58,187

Schedule 13: Interest Earned

Particulars	₹
Interest and discount	44,00,000
Income on Investments	5,000
Interest on balance with RBI	25,000
Total	44,30,000
Less: Rebate on bills discount	(15,000)
	44,15,000

Working Notes:

1. Provisions for NPA

Particulars	*Amount*	*% of Provisions*	*Provision*
Standard Assets	25,00,000	0.40	10,000
Sub-Standard Assets*	5,60,000	15	84,000
Doubtful assets not covered by security	2,55,000	100	2,55,000
Doubtful Assets covered by security			
For 1 year	25,000	25	6,250
For 2 years	50,000	40	20,000

* *It is assumed that the all sub-standard assets are fully secured.*

For 3 years	1,00,000	40	40,000
For 4 years	75,000	100	75,000
Loss Assets	1,00,000	100	1,00,000
			5,90,250

2. Calculation of Tax

Tax = 35% of [Total income – Total expenditure (excluding tax)].

Tax = 35% of [44,15,000 + 1,25,000 – (13,60,000 + 13,31,000 + 5,90,250)]

Tax = ₹ 4,40,563

3. Total amount of provisions and contingencies

= Provision for NPA + Provision for Tax = 5,90,250 + 4,40,563 = ₹ 10,30,813

Question 14

Mention the condition when a cash credit overdraft account is treated as 'out of order'.

(2 Marks, May, 2010) (IPCC)

Answer

A cash credit overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated as 'out of order' if any of the following conditions is satisfied:

(a) The outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

(b) Though the outstanding balance is less than the sanctioned limit/drawing power –

  (i) there are no credits continuously for more than 90 days as on the date of balance sheet; or

  (ii) credits during the aforesaid period are not enough to cover the interest debited during the same period.

Question 15

Given below is an extract from the trial balance of T.K. Bank Limited as on 31st December, 2009:

Particulars	*Debit* ₹	*Credit* ₹
Bills discounted	*12,64,000*	----
Rebate on bills discounted (1.1.2009)	----	*8,340*
Discount received for the year		*85,912*

An analysis of the bills discounted is shown below:

Amount ₹	*Due date in 2010*	*Rate of discount (% p.a.)*
1,40,000	*March 6th*	*5*
4,36,000	*March 12th*	*4.5*
2,82,000	*March 26th*	*6*
4,06,000	*April 6th*	*4*

Show the workings, how the relevant items will appear in the bank's Profit and Loss account as on 31st December, 2009 and in bank's Balance Sheet as on 31st December, 2009.

(8 Marks, May, 2010) (IPCC)

Answer

Profit & Loss Account (an extract)

for the period ending 31.12.2009

	₹
Transfer from 'Rebate on bills discounted account' (01.01.2009)	8,340
Add: Discount for the year 2009	85,912
	94,252
Less: Rebate on bills discounted carried forward to the year 2010	13,274
	80,978

Balance Sheet (an extract) as on 31.12.2009

	₹
Other liabilities & provisions:	
Rebate on bills discounted	13,274

Working Note:

Statement of rebate on bills discounted as on 31.12.2009

Due date 2010	*Amount (₹)*	*No. of days after 31.12.2009*	*Rate of discount (%)*	*Discount of the unexpired period*
March 6th	1,40,000	65	5	1,247
March 12th	4,36,000	71	4.5	3,816
March 26th	2,82,000	85	6	3,940
April 6th	4,06,000	96	4	4,271
Total rebate on bills discounted to be carried forward				13,274

Question 16

How will you disclose the following Ledger balances in the Final accounts of DVD bank:

	₹ in lacs
Current accounts	*700*
Saving accounts	*500*
Fixed deposits	*700*
Cash credits	*600*
Term Loans	*500*
Bills discounted & purchased	*800*

Additional information:

(i) Included in the current accounts ledger are accounts overdrawn to the extent of ₹ 250 lacs.

(ii) One of the cash credit account of ₹ 10 lacs (including interest ₹ 1 lac) is doubtful.

(iii) 60% of term loans are secured by government guarantees, 20% of cash credits are unsecured, other portion is secured by tangible assets. (4 Marks, May, 2010) (IPCC)

Answer

Relevant Schedules (forming part of the Balance sheet) of DVD Bank

Schedule 3: Deposits

		₹ in lacs
A	Demand deposits (700 – 250)	450
B	Saving bank deposits	500
C	Term deposits	700
		1,650

Schedule 9: Advances

			₹ in lacs
A	(i)	Bills discounted and purchased	800
	(ii)	Cash credits and overdrafts (600 + 250)	850
	(iii)	Term loans	500
			2,150
B	(i)	Secured by tangible assets (bal. fig.)	1,730
	(ii)	Secured by Bank/Government guarantees (500 x 60%)	300
	(iii)	Unsecured (600 x 20%)	120
			2,150

Schedule 5: Other Liabilities & Provisions

	₹ in lacs
Others (Provision for doubtful debts)	10

Profit and Loss Account (an extract)

	₹ in lacs
Less: Provision for doubtful debts*	10

Note: The overdrawn extent in Current Accounts will be shown as Overdrafts.

*Note: It is assumed that the cash credit has been in 'doubtful' category for more than three years hence provision made at 100%.

Question 17

From the following information of details of advances of Zenith Bank Ltd., calculate the amount of provisions to be made in Profit and Loss Account for the year ended on 31-3-2010:

Assets classification	*(₹ in lakhs)*
Standard	*10,000*
Sub-standard	*6,400*
Doubtful:	
for one year	*3,200*
for two years	*1,800*
for three years	*900*
for more than three years	*1,100*
Loss assets	*3,000*

(5 Marks, November, 2010) (IPCC)

Answer

Statement showing provisions on various performing and non performing assets of Zenith Bank Ltd.

Assets classification	*Amount (₹ in lakhs)*	*Provision (%)*	*Amount of provision (₹ in lakhs)*
Standard	10,000	0.40	40
Sub-standard	6,400	15	960
Doubtful:			

for one year	3,200	25	800
for two years	1,800	40	720
for three years	900	40	360
for more than 3 years	1,100	100	1,100
Loss assets	3,000	100	3,000
Total			6,980

Note: It is assumed that sub-standard assets and all doubtful assets are fully secured.

Question 18

A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk adjusted asset and risk weighted assets ratio.

	(₹ in crores)
Equity share capital	*500.00*
Statutory reserve	*270.00*
Capital reserve (of which ₹ 16 crores were due to revaluation of assets and the balance due to sale of capital asset)	*78.00*
Assets:	
Cash balance with RBI	*10.00*
Balance with other banks	*18.00*
Other investments	*36.00*
Loans and advances:	
(i) Guaranteed by the Government	*16.50*
(ii) Others	*5,675.00*
Premises, furniture and fixtures	*78.00*
Off-Balance Sheet items:	
(i) Guarantee and other obligations	*800.00*
(ii) Acceptances, endorsements and letter of credit	*4,800.00*

(8 Marks, November, 2010) (IPCC)

Answer

		₹ in crores	*₹ in crores*
(i)	**Capital funds – Tier I**		
	Equity share capital		500
	Statutory reserve		270
	Capital reserve (arising out of sale of assets) (78-16)		62
			832

	Capital funds – Tier II		
	Capital reserve (arising out of revaluation of assets)	16	
	Less: Discount to the extent of 55%	(8.8)	7.2
			839.2

		₹ in crores	% of weight	₹ in crores
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	10	0	0
	Balance with other banks	18	20	3.60
	Other investments	36	102.5	36.90
	Loans and advances:			
	(i) Guaranteed by the government	16.5	0	0
	(ii) Others	5,675	100	5,675
	Premises, furniture and fixtures	78	100	78
				5,793.50
		₹ in crores	*Credit conversion factor*	
	Off-Balance Sheet items:			
	Guarantees and other obligations	800	100	800
	Acceptances, endorsements and letters of credit	4,800	100	4,800
				11,393.50

Risk Weighted Assets Ratio:

$$\frac{\text{Capital fund} \times 100}{\text{Risk adjusted assets}}$$

(839.2/ 11,393.50) x 100 =7.37%

At present, capital adequacy ratio as per RBI norms is 9%. Therefore, Bank has to improve the ratio by introducing further Tier I capital.

Note: As per RBI Master Guidelines dated 1st July 2013, Revaluation Reserves have been advised to be discounted by 55%

Question 19

From the following information prepare the Profit & Loss Account of Jawahar Bank Limited for the year ended 31st March, 2011. Also give necessary Schedules.

	Figures are in ₹ thousands
Interest earned on term loans	*17.26*
Interest earned on term loans classified as NPA	*4.52*
Interest received on term loans classified as NPA	*2.04*
Interest on cash credits and overdrafts	*38.54*
Interest earned but not received on cash credit and overdraft treated as NPA	*8.39*
Interest on deposits	*27.20*
Commission	*1.97*
Profit on sale of investments	*11.76*
Profit on revaluation of investments	*2.76*
Income from investments	*15.53*
Salaries, bonus and allowances	*18.75*
Rent, taxes and lighting	*1.70*
Printing and stationary	*0.75*
Director's fees, allowances expenses	*1.33*
Law charges	*0.22*
Repairs and maintenance	*0.18*
Insurance	*0.30*
Other information:	
Make necessary provision on risk assets:	
(i) Sub-standard	*15.00*
(ii) Doubtful for one year	*7.00*
(iii) Doubtful for two years	*2.40*
(iv) Loss assets	*0.65*
Investments	*3700*

Bank should not keep more than 25% of its investments as 'held-for-maturity' investment. The market value of its best 75% investments is ₹9,00,000 as on 31st March, 2011.

(16 Marks, May, 2011) (IPCC)

Answer

Jawahar Bank Limited
Profit & Loss Account for the year ended 31st March, 2011

		Schedule	₹ '000s
I.	Income		
	Interest earned	13	60.46
	Other income	14	16.49
	Total		76.95
II.	Expenditure		
	Interest expended	15	27.20
	Operating expenses	16	23.23
	Provisions & contingencies (Refer W.N.)		1,880.61
	Total		1,931.04
III.	Profit/Loss		(1,854.09)
IV.	Appropriations		Nil

Schedule 13 – Interest Earned

	₹ '000s
Interest / discount on advances bills	
Interest on term loans [17.26- (4.52-2.04)]	14.78
Interest on cash credits and overdrafts (38.54-8.39)	30.15
Income on investments	15.53
	60.46
Note : Interest on non-performing assets is recognized on receipt basis.	

Schedule 14 – Other Income

	₹ '000s
Commission, exchange and brokerage	1.97
Profit on sale of investments	11.76
Profit on revaluation of investments	2.76
	16.49

Schedule 15 – Interest Expended

	₹ '000s
Interest on deposits	27.20

Schedule 16 – Operating Expenses

	₹ '000s
Payments to and provision for employees - salaries, bonus and allowances	18.75

Rent, taxes and lighting	1.70
Printing & stationery	0.75
Director's fee, allowances and expenses	1.33
Law charges	0.22
Repairs & maintenance	0.18
Insurance	0.30
	23.23

Working Note:

Provisions & Contingencies		₹ '000s
Provision for non-performing assets		
Sub-standard (15 x 15%)		2.25
Doubtful for one year (7 x 25%)		1.75
Doubtful for two years (2.40 x 40%)		0.96
Loss assets (0.65 x 100%)		0.65
		5.61
Diminution in the value of current Investments:		
Cost 75% of ₹ 3,700 thousands**	2,775	
Less: Market value	(900)	1,875.00
		1,880.61

Note: 1. It is assumed that all sub-standard and doubtful assets are fully secured.

2. As per RBI norms, provision of 0.40% should also be made on standard assets. However, in the absence of value of standard assets, in the question, no provision has been made on it.

Question 20

The following particulars are extracted from the records of M/s. Engco Bank Limited for the year ended 31st March, 2012:

	Amount (₹)
Rebate on bills discounted (not due on March 31st, 2011)	*60,610*
Discount received	*6,10,800*
Bills discounted	*24,42,250*

** 25% of investments classified as 'held for maturity' need not be marked to market as per RBI Guidelines. However, the remaining 75% investments have been marked to market according to RBI Guidelines.

An analysis of the bills discounted is a follows:

Amount (₹)	*Due Date*
3,75,000	*April 15, 2012*
4,90,000	*May 6, 2012*
2,45,000	*June 1, 2012*
3,68,000	*June 20, 2012*
4,85,000	*July 4, 2012*

The rate of discount is 12% per annum. You are required to :

(i) Calculate rebate on bills discounted as on 31st March, 2012.

(ii) Determine the amount of discount to be credited to the profit and loss account for the year ended 31st March, 2012.

(iii) Show the necessary journal entries in the books of M/s. Engco Bank Ltd. as on 31st March, 2012. *(8 Marks, November, 2011) (IPCC)*

Answer

(i) Calculation of Rebate on Bills Discounted as on 31st March, 2012

Amount (₹)	*Due date*	*No. of days from 31st March, 2012 to due date*	*Product*
3,75,000	April 15, 2012	15	56,25,000
4,90,000	May 06, 2012	36	1,76,40,000
2,45,000	June 01, 2012	62	1,51,90,000
3,68,000	June 20, 2012	81	2,98,08,000
4,85,000	July 04, 2012	95	4,60,75,000
19,63,000			11,43,38,000

Amount of rebate on bills = ₹ 11,43,38,000 × 12% × 1/365 = ₹ 37,591 (approx.)

Note: One can also calculate rebate on each bill individually.

(ii) Determination of amount of discount to be credited to the Profit and Loss Account for the year ended 31st March, 2012

	₹
Transfer from Rebate on bills discounted account as on 31.03.2011	60,610
Add: Discount received during the year	6,10,800
	6,71,410
Less: Rebate on bills discounted as on 31.03.2012	(37,591)
Amount transferred to Profit and Loss Account	6,33,819

In the books of Engco Bank Ltd.

Journal Entries

Date		Dr. (₹)	Cr. (₹)
(i)	Rebate on bills discounted A/c Dr.	60,610	
	To Discount on bills A/c		60,610
	(Being transfer of unexpired discoount on bills of 31.3.2011)		
(ii)	Discount on bills A/c Dr.	37,591	
	To Rebate on bills discounted A/c		37,591
	(Being unexpired discount of 31.03.2012 taken into account)		
(iii)	Discount on bills A/c Dr.	6,33,819	
	To Profit & Loss A/c		6,33,819
	(Being discount earned during the year transferred to Profit and Loss account)		

Question 21

From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial Bank for the year ending on 31-03-2012.

Assets (Category of Advances)	*₹ In Lakhs*
Standard Advances	*7,000*
Sub-standard Advances	*3,500*
(Include secured exposures ₹ 1,000 Lakhs and balances unsecured exposures ₹ 2,500 Lakhs includes ₹ 1,500 Lakhs in respect of infrastructure loan accounts where escrow accounts are available)	
Doubtful advances-unsecured portion	*1,500*
Doubtful advances-secured portion	
For doubtful up to 1 year	*500*
For doubtful more than 1 year and up to 3 years	*600*
For doubtful more than 3 years	*300*
Loss Advances	*200*

(5 Marks, May 2012) (IPCC)

Answer

Statement showing the amount of provisions on Assets:

Assets			*(₹ in lakhs)*
Assets	*Amount*	*% of provision*	*Provision*
Standard	7,000	0.40	28
Sub-standard:			
Secured	1,000	15	150
Other unsecured	1,000	25	250
Unsecured infrastructure	1500	20	300
Doubtful:			
up to one year	500	25	125
up to 3 years	600	40	240
For more than three years	300	100	300
Doubtful unsecured	1,500	100	1,500
Loss	200	100	200
Required provision			3,093

Question 22

A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier-1 and tier-II Capitals. Find out the risk-adjusted and risk weighted assets and capital adequacy ratio:

Capital Funds:	*(₹ in Crores)*
Paid up Equity Share Capital	*750*
Statutory Reserve	*150*
Share Premium	*150*
Capital Reserve (of which Capital Funds ₹ 40 Crore were due to revaluation of assets and balance due to sale)	*90*
Assets:	
Cash balance with RBI	*60*
Claims on Banks	*170*
Other Investments	*2,300*
Loss and Advances:	
Guaranteed by Government of India/State Government	*400*
Granted to Staff of bank. fully covered by Super Annuation Benefits and mortgage of Flat/House	*50*
Other Loans and Advances	*6,170*

Premises, Furniture and Fixtures, Other Assets	*3,925*
Intangible Assets	*15*
Off-Balance Sheet items:	
Acceptance, Endorsements and Letter of Credit, Guarantees and Other obligations.	*1,550*

(8 Marks, May 2012) (IPCC)

Answer

			₹ *in crores*	₹ *in crores*
(i)	Capital funds – Tier I			
	Equity share capital			750
	Statutory reserve			150
	Securities Premium			150
	Capital reserve (arising out of sale of assets) (90-40)			50
				1,100
	Less: Intangible Assets			(15)
				1,085
	Capital funds – Tier II			
	Capital reserve (arising out of revaluation of assets)		40	
	Less: Discount to the extent of 55%		(22)	18
				1,103
		₹ in crores	% of risk weight	₹ in crores
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	60	0	0
	Claims on banks	170	20	34
	Other investments	2,300	100	2,300
	Loans and advances:			
	(i) Guaranteed by the government	400	0	0
	(ii) Granted to staff of bank, fully covered by Super Annuation Benefits and mortgage of Flat/House	50	20	10
	(iii) Other loans and advances	6,170	100	6,170
	Other assets			
	Premises, furniture and fixtures and other assets	3,925	100	3,925
				12,439

	₹ in crores	*Credit conversion factor*	
Off-Balance Sheet items: Acceptances, endorsements and Letters of credit, Guarantees and other obligations	1,550	100	1,550 13,989

Capital Adequacy Ratio = $\frac{\text{Capital fund}}{\text{Risk adjusted assets + off balance sheet items}} \times 100$ = $\frac{₹\ 1{,}103 \text{ crores} \times 100}{₹\ 13{,}989 \text{ crores}}$ = 7.89%

Question 23

A loan account remains out of order as on the date of Balance Sheet of a Bank. The account has been classified as doubtful assets (upto 1 year).

Details of the accounts are :

Outstanding *₹6,73,000*

ECGC coverage *25 % (Limited to ₹100,000)*

Value of Security Held *₹1,50,000*

Compute the necessary provision to be made by a Bank as per applicable rates.

(5 Marks, November 2012) (IPCC)

Answer

	₹
Doubtful Assets (upto 1 year)	6,73,000
Less: Value of security (excluding ECGC cover)	(1,50,000)
	5,23,000
Less: ECGC coverage (limited to ₹ 1,00,000)	(1,00,000)
Unsecured portion	4,23,000
Provision:	
for unsecured portion @100% on ₹ 4,23,000	4,23,000
for secured portion @ 25% on ₹ 1,50,000	37,500
Total provision to be made in the books of the bank	4,60,500

Question 24

The following figures are extracted from the books of KLM Bank Ltd. as on 31-03-2012:

	₹
Interest and discount received	*38,00,160*
Interest paid on deposits	*22,95,360*
Issued and subscribed capital	*10,00,000*
Salaries and allowances	*2,50,000*
Directors Fees and allowances	*35,000*
Rent and taxes paid	*1,00,000*
Postage and telegrams	*65,340*
Statutory reserve fund	*8,00,000*
Commission, exchange and brokerage	*1,90,000*
Rent received	*72,000*
Profit on sale of investment	*2,25,800*
Depreciation on assets	*40,000*
Statutory expenses	*38,000*
Preliminary expenses	*30,000*
Auditor's fee	*12,000*

The following further information is given:

(1) A customer to whom a sum of ₹ 10 lakhs was advanced has become insolvent and it is expected only 55% can be recovered from his estate.

(2) There was also other debts for which a provisions of ₹ 2,00,000 was found necessary.

(3) Rebate on bill discounted on 31-03-2011 was ₹ 15,000 and on 31-03-2012 was ₹ 20,000.

(4) Income tax of ₹ 2,00,000 is to be provided.

The directors desire to declare 5% dividend.

Prepare the Profit and Loss account of KLM Bank Ltd. for the year ended 31-03-2012 and also show, how the Profit and Loss account will appear in the Balance sheet if the Profit and Loss account opening balance was NIL as on 31-03-2011. (8 Marks, November 2012) (IPCC)

Answer

(a) KLM Bank Limited

Profit and Loss Account for the year ended 31st March, 2012

		Schedule	*Year ended 31.03.2012*
			₹
I.	Income:		
	Interest earned	13	37,95,160

	Other income	14	4,87,800
	Total		42,82,960
II.	Expenditure		
	Interest expended	15	22,95,360
	Operating expenses	16	5,70,340
	Provisions and contingencies		
	(4,50,000+2,00,000+2,00,000)		8,50,000
	Total		37,15,700
IIII.	Profits/Losses		
	Net profit for the year		5,67,260
	Profit brought forward		Nil
			5,67,260
IV.	Appropriations		
	Transfer to statutory reserve (25% of 5,67,260)		1,41,815
	Proposed dividend		50,000
	Balance carried over to balance sheet		3,75,445
			5,67,260

The Profit & Loss Account balance of ₹ 3,75,445 will appear in the Balance Sheet under the head 'Reserves and Surplus' in Schedule 2

		Year ended 31.3.2012 ₹
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	37,95,160
		37,95,160
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	1,90,000
II.	Profit on sale of investment	2,25,800
III.	Rent received	72,000
		4,87,800
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	22,95,360
		22,95,360

	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees(salaries & allowances)	2,50,000
II.	Rent, taxes paid	1,00,000
III.	Depreciation on assets	40,000
IV.	Director's fee, allowances and expenses	35,000
V.	Auditors' fee	12,000
VI.	Statutory (law) expenses	38,000
VII.	Postage and telegrams	65,340
VIII.	Preliminary expenses*	30,000
		5,70,340

Working Note:

	₹
Interest and discount received	38,00,160
Add: Rebate on bills discounted on 31.3.2011	15,000
Less: Rebate on bills discounted on 31.3.2012	(20,000)
	37,95,160

Question 25

The following information is available in the books of X Bank Limited as on 31st March, 2013:

	₹
Bills discounted	*1,37,05,000*
Rebate on bills discounted (as on 1-4-2012)	*2,21,600*
Discount received	*10,56,650*

Details of bills discounted are as follows:

Value of Bills (₹)	*Due Date*	*Rate of Discount*
18,25,000	*05-06-2013*	*12%*
50,00,000	*12-06-2013*	*12%*
28,20,000	*25-06-2013*	*14%*
40,60,000	*06-07-2013*	*16%*

Calculate the rebate on bills discounted as on 31-3-2013 and give necessary Journal Entries in the books of X Bank Ltd. as on 31st March, 2013. *(8 Marks, May 2013) (IPCC)*

* It is assumed that preliminary expenses have been fully written off during the year.

Answer

Calculation of Rebate on bills discounted

S.No.	*Amount (₹)*	*Due date (year 2013)*	*Unexpired portion from 31st March, 2013*	*Rate of discount*	*Rebate on bills discounted (₹)*
(i)	18,25,000	June 5	66 days	12%	39,600
(ii)	50,00,000	June 12	73 days	12%	1,20,000
(iii)	28,20,000	June 25	86 days	14%	93,021
(iv)	40,60,000	July 6	97 days	16%	1,72,633
	1,37,05,000				4,25,254

Journal Entries in the books of X Bank Ltd.

	Particulars		*Dr. (₹)*	*Cr. (₹)*
(1)	Rebate on bills discounted A/c	Dr.	2,21,600	
	To Discount on bills A/c			2,21,600
	(Being the transfer of opening balance of rebate on bills discounted account to discount on bills account)			
(2)	Discount on bills A/c	Dr.	4,25,254	
	To Rebate on bills discounted A/c			4,25,254
	(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward to next year)			
(3)	Discount on bills A/c	Dr.	8,52,996	
	To Profit and Loss A/c			8,52,996
	(Being the amount of income for the year transferred from Discount on bills A/c to Profit and Loss A/c)			

Working Note:

Amount of discount to be credited to the Profit and Loss Account

	₹
Transfer from Rebate on bills discounted A/c as on 31st March, 2012	2,21,600
Add: Discount received during the year ended 31st March, 2013	10,56,650
	12,78,250
Less: Rebate on bills discounted as on 31st March, 2013	(4,25,254)
Discount credited to Profit and Loss Account	8,52,996

Question 26

From the following information of STP Bank Ltd. pertaining to the financial year 2012-13, compute the provisions to be made in the Profit and Loss Account:

	₹ in lakh
Assets	
Standard	*30,000*
Sub-standard	*20,000*
Doubtful:	
For one year (secured)	*8,000*
For two years and three years (secured)	*2,500*
For more than three years (secured by mortgage of Plant & Machinery ₹ 500 lakh)	*2,000*
Loss Assets	*1,700*

(4 Marks, November 2013) (IPCC)

Answer

Calculation of amount of provision to be made in the Profit and Loss Account

Classification of Assets	*Amount of Advances*	*% age of provision*	*Amount of provision*
	(₹ in lakhs)		*% (₹ in lakhs)*
Standard assets	30,000	0.40	120
Sub-standard assets *	20,000	15	3,000
Doubtful assets:			
For one year (secured)	8,000	25	2,000
For two to three years (secured)	2,500	40	1,000
For more than three years: unsecured	1,500	100	1,500
secured	500	100	500
Loss Assets	1,700	100	1,700
Total provision required			9,820

*Considered as fully secured.

7

Financial Statements of Electricity Companies

Question 1

Power Electric Company decides to replace one of its old plant by an improved plant with larger capacity. The cost of the new plant is ₹ 16,00,000.Materials and Labour earlier and now are in the ratio of 4 : 6.Original cost of the old plant is ₹ 3,00,000. Materials cost has gone up by 2½ times and Labour cost by 3 times since then. Old materials worth ₹ 10,000 were used in the construction of the new plant and ₹ 20,000 were realised from the sale of old materials. Give the necessary Journal Entries for recording the above transactions.

(6 Marks, November 2004) (PE II)

Note: This Question is based on replacement accounting as per Double Accounts System. This concept is not in line with the provisions of the Electricity Act, 2003 and CERC Regulations. Thus the question is redundant and is not relevant at present.

Question 2

An electricity company decided to replace some parts of its plant by an improved plant. The plant to be replaced was built in 1995 for ₹ 35,00,000. It is estimated that it would cost ₹65,00,000 to build a new plant of the same size and capacity. The cost of the new plant as per the improved design was ₹ 1,05,00,000 and in addition, material belonging to the old plant valued at ₹ 3,80,000 was used in the construction of the new plant. The balance of the plant was sold for ₹ 3,00,000.

Compute the amount to be written off to revenue and the amount to be capitalized. Also prepare Plant account and Replacement account. (8 Marks, June, 2009) (PCC)

Note: This Question is based on replacement accounting as per Double Accounts System. This concept is not in line with the provisions of the Electricity Act, 2003 and CERC Regulations. Thus the question is redundant and is not relevant at present.

Question 3

ABC Electricity Company laid down a main at a cost of ₹ 24,00,000. Some years later the company replaced by improving the plant 2/3 portion of the main at a cost of ₹ 40,00,000.

The cost of material and labour having gone up by 25%. Sale of old material realised ₹ 95,000. Old material value ₹ 1,05,000 were used in renewal (including in above).

Calculate the amount to be capitalised and show the journal entries for recording the transaction. (4 Marks, May, 2010) (IPCC)

Note: This Question is based on replacement accounting as per Double Accounts System. This concept is not in line with the provisions of the Electricity Act, 2003 and CERC Regulations. Thus the question is redundant and is not relevant at present.

Question 4

The Super Electricity Company maintains accounts under the Double Accounts System. It decides to replace one of its old plant with a technologically advanced plant with a larger capacity. The plant when installed in 2000, cost the company ₹ 90,00,000, the components of materials, labour and overheads being in the ratio 5 : 3 : 2.

It is ascertained that the costs of materials has gone up by 200% and the cost of labour has gone up by 300%. The proportion of material, labour and overheads has changed to 10 : 9 : 6.

The cost of the new plant is ₹ 2,80,00,000 and in addition, goods worth ₹ 12,60,000 have been used in the construction of the new plant. The old plant was scrapped and sold for ₹ 19,00,000.

Find out the amount to be capitalized and also the amount to be charged to revenue. Draw the necessary Ledger Accounts. (8 Marks, November, 2010)

Note: This Question is based on replacement accounting as per Double Accounts System. This concept is not in line with the provisions of the Electricity Act, 2003 and CERC Regulations. Thus the question is redundant and is not relevant at present.

Question 5

M/s. Access Electricity Company earned a profit of ₹ 75,00,000 (after tax for the year 2010-11) after paying ₹ 2,40,000 @ 12% as debenture interest for the year ended March 31, 2011. The following further information has been extracted from the books of company:

	Amount (₹)
Share capital	3,00,00,000
Fixed assets	9,00,00,000
Depreciation reserve on fixed assets	3,00,00,000
Loan from Electricity Board	1,20,00,000
Reserve fund investments, at par, invested in 8% Government securities	50,00,000
Contingencies reserve investments, at par, 10%	24,00,000
Tariff and dividends control reserve	16,00,000
Security deposits of consumers	10,00,000
Consumer's contribution to cost of fixed assets	3,40,000
Intangible assets	7,60,000

Monthly average of current assets, including amount due from consumers, ₹ 7,00,000	*34,60,000*
Development reserve	*12,00,000*

Show, how the profits have to be dealt with by the company under the provisions of the Electricity Act. Assume the bank rate to be 10%. (16 Marks, November, 2011) (IPCC)

Note: This concept is not in line with the provisions of the new Electricity Act and CERC Regulations. Thus the question is redundant and is not relevant at present.

Question 6

M/s Mars Electricity Company laid down a Main at a cost of ₹ 40,00,000 in 2008. During 2011 company laid down an auxiliary Main for one-fourth of the old Main at a cost of ₹ 15,00,000. It also replaced the rest of the length of the old Main at a cost of ₹ 45,00,000. The cost of material and labour gone up by 15%. Sale of old materials realized ₹ 1,00,000. Old materials valued at ₹ 1,50,000 were used in auxiliary Main and those valued at ₹ 1,00,000 were used in replacement of the old Main. Show the Journal entries for recording the above transactions along with required workings. (8 Marks, May 2012)

Note: This Question is based on replacement accounting as per Double Accounts System. This concept is not in line with the provisions of the new Electricity Act and CERC Regulations. Thus the question is redundant and is not relevant at present.

Question 7

Following information has been provided in respect of Watson Power Generation Project:

1. *Date of commercial operation/work completed date : 1st April, 1995*
2. *Capital Cost at the beginning of the year 2010-11 : ₹ 135.39 Crore*
3. *Useful Life 35 years*
4. *Details of allowed capital expenditure, details of actual repayment of loan and weighted average rate of interest on loan is as follows:*

	2010-11	*2011-12*	*2012-13*
	(₹ in Crore)	*(₹ in Crore)*	*(₹ in Crore)*
Additional Capital Expenditure (allowed above)	*1.63*	*0.98*	*0.52*
Repayment of Loan during the year (net)	*0.96*	*0.87*	*0.68*
Weighted Average Rate of Interest on Loan	*7.35%*	*7.48%*	*7.50%*
Value of Land	*0.00*	*0.00*	*0.00*

5. *Depreciation recovered upto 2008-09 = ₹ 49.05 Crore*
6. *Depreciation recovered in 2009-10 = ₹ 3.26 Crore*
7. *Cumulative Repayment of Loan upto 2009-10 = ₹ 14,00 Crore*

From the above information, calculate the following as per the Central Electricity Commission (Terms and Conditions of Tariff) Regulations, 2009:

(a) Average Capital Cost;

(b) Return on Equity;

(c) Interest on Loans;

(d) Depreciation. *(16 Marks, November 2013)*

Answer

(a) Average capital cost

Capital Cost *(₹ in crores)*

	2010-11	*2011-12*	*2012-13*
	₹	₹	₹
Opening capital cost (A)	135.39	137.02	138
Additional capital expenditure (allowed above) (B)	1.63	0.98	0.52
Closing Capital cost (A)+(B)	137.02	138	138.52
Average Capital cost	136.21	137.51	138.26

(b) Return on equity

Debt-Equity ratio

Debt-Equity ratio for the purpose of return on equity for the period 2010-13 is 70:30

	2010-11 ₹	*2011-12* ₹	*2012-13* ₹
Opening Capital cost (A)	135.39	137.02	138
Equity-Opening considered now [(A) x 0.30] = (B)	40.617	41.106	41.4
Additional allowable capital expenditure (C)	1.63	0.98	0.52
Addition of Equity due to admitted additional capital expenditure [(C) x 0.30]=(D)	0.489	0.294	0.156
Equity-Closing ((B)+(D))=(E)	41.106	41.4	41.556
Average equity [(B)+(E)]/2 = (F)	40.861	41.253	41.478
Return on Equity @ 23.84% of (F)	9.59	9.69	9.74

(c) Interest on loan

	2010-11 ₹	*2011-12* ₹	*2012-13* ₹
Opening Capital cost (A)	135.39	137.02	138
Gross Opening loan -considered at 70% of (A)=(B)	94.773	95.914	96.6

Cumulative Repayment of Loan upto previous year (C)	14	14.96	15.83
Net Loan Opening (B)-(C)=(D)	80.773	80.954	80.77
Additional capital expenditure (allowed above) (E)	1.63	0.98	0.52
Addition of loan due to approved additional capital expenditure- considered at 70% of (E)=(F)	1.141	0.686	0.364
Repayment of loan during the year (net)(G)	0.96	0.87	0.68
Net Loan Closing [(D)+(F)-(G)=(H)]	80.954	80.77	80.454
Average Loan[(D)+(H)/2]=I	80.864	80.862	80.612
Weighted Average Rate of Interest on Loan (J)	7.35%	7.48%	7.50%
Interest on Loan(I) x (J)	5.944	6.048	6.046

(d) Depreciation

Name of the Power Station : Wastan Power Generation Project

Date of commercial operation /Work Completed Date	1/4/95
Beginning of Current year	1/4/10
Useful life	35 Years
Remaining Useful Life	20 Years

(Figures in ₹ crores)

S.N.		*2010-11*	*2011-12*	*2012-13*
	Capital cost at beginning of the year	135.39	137.02	138
	Additional capitalisation during the year	1.63	0.98	0.52
	Closing capital cost	137.02	138	138.52
1	Average capital cost	136.205	137.51	138.26
2	*Less*: Value of Land	0.000	0.000	0.000
3	Capital cost for depreciation (1-2)	136.205	137.51	138.26
4	Depreciable value (90% of 3)	122.585	123.759	124.434
5	Depreciation recovered up to 2008-09	49.05		
6	Depreciation recovered in 2009-10	3.26		
7	Depreciation recovered upto previous year	52.31	55.824	59.400
8	Balance depreciation to be recovered (4-7)	70.27	67.936	65.035
9	Balance useful life of 35 years	20	19	18
10	Yearly depreciation from 2010-11 (8/9)	3.514	3.576	3.613
11	Depreciation recovered upto the year (7+10)	55.824	59.400	63.013

8
Departmental Accounts

Question 1

FGH Ltd. has three departments I.J.K. The following information is provided for the year ended 31.3.2004:

	I	*J*	*K*
	₹	*₹*	*₹*
Opening stock	*5,000*	*8,000*	*19,000*
Opening reserve for unrealised profit	–	*2,000*	*3,000*
Materials consumed	*16,000*	*20,000*	–
Direct labour	*9,000*	*10,000*	–
Closing stock	*5,000*	*20,000*	*5,000*
Sales	–	–	*80,000*
Area occupied (sq. mtr.)	*2,500*	*1,500*	*1,000*
No. of employees	*30*	*20*	*10*

Stocks of each department are valued at costs to the department concerned. Stocks of I are transferred to J at cost plus 20% and stocks of J are transferred to K at a gross profit of 20% on sales. Other common expenses are salaries and staff welfare ₹ 18,000, rent ₹ 6,000.

Prepare Departmental Trading, Profit and Loss Account for the year ending 31.3.2004.

(10 Marks, November 2004) (PE II)

Answer

FGH Ltd.
Departmental Trading and Profit and Loss Account
for the year ended 31st March, 2004

		I	*J*	*K*	*Total*			*I*	*J*	*K*	*Total*
		₹	₹	₹	₹			₹	₹	₹	₹
To	Opening stock	5,000	8,000	19,000	32,000	By	Sales			80,000	80,000
To	Material consumed	16,000	20,000		36,000	By	Inter-departmental transfer	30,000	60,000		90,000
To	Direct labour	9,000	10,000		19,000						
	Inter-						Closing stock				

To departmental transfer		30,000	60,000	90,000	By	5,000	20,000	5,000	30,000
To Gross profit	5,000	12,000	6,000	23,000					
	35,000	80,000	85,000	2,00,000		35,000	80,000	85,000	2,00,000
To Salaries and staff welfare	9,000	6,000	3,000	18,000	By Gross profit b/d	5,000	12,000	6,000	23,000
					By Net loss	7,000			7,000
To Rent	3,000	1,800	1,200	6,000					
To Net profit		4,200	1,800	6,000					
	12,000	12,000	6,000	30,000		12,000	12,000	6,000	30,000
To Net loss (I)				7,000	By Stock reserve b/d (J + K)				5,000
To Stock reserve (J+K) (Refer W.N.)				3,000	By Net profit (J + K)				6,000
To Balance transferred to profit and loss account				1,000					
				11,000					11,000

Working Note:

Calculation of unrealized profit on closing stock

	₹
Stock reserve of J department	
Cost	30,000
Transfer from I department	30,000
	60,000
Stock of J department	20,000

Proportion of stock of I department = ₹ 20,000 $\times \frac{₹\ 30,000}{₹\ 60,000}$ = ₹ 10,000

Stock reserve =₹ 10,000 $\times \frac{20}{120}$ = ₹ 1,667 (approx.)

Stock reserve of K department

	₹
Stock transferred from J department	5,000
Less: Profit (stock reserve) 5,000 × 20%	(1,000)
Cost to J department	4,000

Proportion of stock of I department = ₹ 4,000 $\times \dfrac{₹\ 30{,}000}{₹\ 60{,}000}$ = ₹ 2,000

Stock reserve $= 2{,}000 \times \dfrac{20}{120}$ = ₹ 333 (approx.)

Total stock reserve = ₹ 1,000 + ₹ 333 = ₹ 1,333

Question 2

Goods are transferred from Department P to Department Q at a price 50% above cost.

If closing stock of Department Q is ₹27,000, compute the amount of stock reserve.

(2 Marks, November, 2009)(IPCC)

Answer

Calculation of Stock Reserve

	₹
Closing stock of Department Q	27,000
Goods sent by Department P to Department Q at a price 50% above cost	
Hence, profit of Department P included in the stock will be $\left(\dfrac{₹\ 27{,}000 \times 50}{150}\right)$	9,000
Amount of stock reserve will be ₹ 9,000	

Question 3

Department R sells goods to Department S at a profit of 25% on cost and Department T at 10% profit on cost. Department S sells goods to R and T at a profit of 15% and 20% on sales respectively. Department T charges 20% and 25% profit on cost to Department R and S respectively.

Department managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission, but before adjustment of unrealized profit are as under:

		₹
Department	*R*	*54,000*
Department	*S*	*40,500*
Department	*T*	*27,000*

Stock lying at different departments at the end of the year are as under:

	Deptt. R ₹	*Deptt. S* ₹	*Deptt. T* ₹
Transfer from Department R	-	*22,500*	*16,500*

Transfer from Department S	*21,000*	*-*	*18,000*
Transfer from Department T	*9,000*	*7,500*	*-*

Find out the correct departmental profits after charging manager's commission.

(8 Marks, November, 2010) (IPCC)

Answer

	Departments		
	R ₹	*S* ₹	*T* ₹
Profit	54,000	40,500	27,000
Add : Managerial commission (1/9)	6,000	4,500	3,000
	60,000	45,000	30,000
Less: Unrealised profit on stock (Refer W.N.)	(6,000)	(6,750)	(3,000)
	54,000	38,250	27,000
Less: Managers' commission @ 10%	(5,400)	(3,825)	(2,700)
	48,600	34,425	24,300

Working Notes:

Value of unrealised profit

	₹
Transfer by department R to	
S department (22,500 ×25/125) = 4,500	
T department (16,500 ×10/110) = 1,500	6,000
Transfer by department S to	
R department (21,000 × 15/100) = 3,150	
T department (18,000 × 20/100) = 3,600	6,750
Transfer by department T to	
R department (9,000 × 20/120) = 1,500	
S department (7,500 × 25/125) = 1,500	3,000

Question 4

Brahma Limited has three departments and submits the following information for the year ending on 31st March, 2011:

Particulars	*A*	*B*	*C*	*Total (₹)*
Purchases (units)	*5,000*	*10,000*	*15,000*	
Purchases (Amount)				*8,40,000*
Sales (units)	*5,200*	*9,800*	*15,300*	

Selling price (₹ per unit)	*40*	*45*	*50*	
Closing Stock (Units)	*400*	*600*	*700*	

You are required to prepare departmental trading account of Brahma Limited assuming that the rate of profit on sales is uniform in each case. (5 Marks, May, 2011) (IPCC)

Answer

Departmental Trading Account for the year ended 31st March, 2011

Particulars	*A*	*B*	*C*	*Particulars*	*A*	*B*	*C*
	₹	₹	₹		₹	₹	₹
To Opening Stock (W.N.4)	14,400	10,800	30,000	By Sales	2,08,000	4,41,000	7,65,000
				By Closing stock (W.N.4)	9,600	16,200	21,000
To Purchases (W.N.2)	1,20,000	2,70,000	4,50,000				
To Gross profit	83,200	1,76,400	3,06,000				
	2,17,600	4,57,200	7,86,000		2,17,600	4,57,200	7,86,000

Working Notes:

(1) Profit Margin Ratio

Selling price of units purchased:		₹
Department A	(5,000 units x ₹ 40)	2,00,000
Department B	(10,000 units x ₹ 45)	4,50,000
Department C	(15,000 units x ₹ 50)	7,50,000
Total selling price of purchased units		14,00,000
Less: Purchases		(8,40,000)
Gross profit		5,60,000

Profit margin ratio = $\frac{\text{Gross profit}}{\text{Selling price}} \times 100 = \frac{5,60,000}{14,00,000} \times 100 = 40\%$

(2) Statement showing department-wise per unit cost and purchase cost

Particulars	*A*	*B*	*C*
Selling price per unit (₹)	40	45	50
Less: Profit margin @ 40% (₹)	(16)	(18)	(20)
Purchase price per unit (₹)	24	27	30
No. of units purchased	5,000	10,000	15,000
Purchases (purchase cost per unit x units purchased)	1,20,000	2,70,000	4,50,000

(3) Statement showing calculation of department-wise Opening Stock (in units)

Particulars	*A*	*B*	*C*
Sales (Units)	5,200	9,800	15,300
Add: Closing Stock (Units)	400	600	700
	5,600	10,400	16,000
Less: Purchases (Units)	(5,000)	(10,000)	(15,000)
Opening Stock (Units)	600	400	1,000

(4) Statement showing department-wise cost of Opening and Closing Stock

Particulars	*A*	*B*	*C*
Cost of Opening Stock (₹)	600 x 24	400 x 27	1,000 x 30
	14,400	10,800	30,000
Cost of Closing Stock (₹)	400 x 24	600 x 27	700 x 30
	9,600	16,200	21,000

Question 5

M/s. AM Enterprise had two departments, Cloth and Readymade Clothes. The readymade clothes were made by the firm itself out of the cloth supplied by the Cloth Department at its usual selling price. From the following figures, prepare Departmental Trading and Profit & Loss Account for the year ended 31st March, 2011:

	Cloth Department ₹	*Readymade Clothes Department* ₹
Opening stock on 1st April, 2010	*31,50,000*	*5,32,000*
Purchases	*2,10,00,000*	*1,68,000*
Sales	*2,31,00,000*	*47,25,000*
Transfer to Readymade Clothes Department	*31,50,000*	-
Manufacturing expenses	-	*6,30,000*
Selling expenses	*2,10,000*	*73,500*
Rent & warehousing	*8,40,000*	*5,60,000*
Stock on 31st March, 2011	*21,00,000*	*6,72,000*

In addition to the above, the following information is made available for necessary consideration:

The stock in the Readymade Clothes Department may be considered as consisting of 75% cloth and 25% other expenses. The Cloth Department earned a gross profit at the rate of 15% in 2009-10. General expenses of the business as a whole amount to ₹ 10,85,000.

(8 Marks, November, 2011) (IPCC)

Answer

Departmental Trading and Profit and Loss Account

for the year ended 31st March, 2011

Particulars	*Cloth (₹)*	*Ready-made Clothes (₹)*	*Total (₹)*	*Particulars*	*Cloth (₹)*	*Ready-made Clothes (₹)*	*Total (₹)*
To Opening stock	31,50,000	5,32,000	36,82,000	By Sales	2,31,00,000	47,25,000	2,78,25,000
To Purchases	2,10,00,000	1,68,000	2,11,68,000	By Transfer to Ready-made Clothes Deptt.	31,50,000	-	31,50,000
To Transfer from Cloth Department	-	31,50,000	31,50,000	By Closing stock	21,00,000	6,72,000	27,72,000
To Manufacturing expenses	-	6,30,000	6,30,000				
To Gross profit c/d	42,00,000	9,17,000	51,17,000				
	2,83,50,000	53,97,000	3,37,47,000		2,83,50,000	53,97,000	3,37,47,000
To Selling expenses	2,10,000	73,500	2,83,500	By Gross profit b/d	42,00,000	9,17,000	51,17,000
To Rent & warehousing	8,40,000	5,60,000	14,00,000				
To Net profit	31,50,000	2,83,500	34,33,500				
	42,00,000	9,17,000	51,17,000		42,00,000	9,17,000	51,17,000

General Profit and Loss Account

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To General expenses	10,85,000	By Net profit	34,33,500
To Unrealized profit (Refer W.N.)	20,790		
To General net profit (Bal.fig.)	23,27,710		
	34,33,500		34,33,500

Working Note:

Calculation of Stock Reserve

Rate of Gross Profit of Cloth Department, for the year 2010-11 = $\frac{\text{Gross Profit}}{\text{Total Sales}}$ x 100

$$\frac{₹\ 42,00,000 \times 100}{₹\ (2,31,00,000 + 31,50,000)} \times 100 = 16\%$$

Closing Stock of cloth in Readymade Clothes Department = 75%

i.e. ₹ 6,72,000 x 75% = ₹ 5,04,000

Stock Reserve required for unrealized profit @ 16% on closing stock

₹ 5,04,000 x 16% = ₹ 80,640

Stock reserve for unrealized profit included in opening stock of readymade clothes @ 15% i.e.

(₹ 5,32,000 x 75% x 15%) = ₹ 59,850

Additional Stock Reserve required during the year = ₹ 80,640 – ₹ 59,850 = ₹ 20,790.

Question 6

Department A sells goods to Department B at a profit of 20% on cost and Department C at 15% profit on cost. Department B sells goods to A and C at a profit of 10% and 20% on sales respectively. Department C sells goods to A and B at 15% and 10% profit on cost respectively.

Departmental managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission, but before adjustment of unrealized profit are as under:

	₹
Department A	*36,000*
Department B	*27,000*
Department C	*18,000*

Stock lying at different departments at the end of the year are as below:

	Department A	*Department B*	*Department C*
	₹	₹	₹
Transfer from Department A	-	*7,200*	*5,750*
Transfer from Department B	*19,000*	-	*15,000*
Transfer from Department C	*4,600*	*3,300*	-

Find out correct departmental profits after charging manager's commission.

(8 Marks, November 2012) (IPCC)

Answer

Calculation of correct Departmental Profit

	Department A	Department B	Department C
	₹	₹	₹
Profit after charging managers' commission but before adjustment for unrealized profit	36,000	27,000	18,000
Add back : Managers' commission (1/9)	4,000	3,000	2,000
	40,000	30,000	20,000
Less: Unrealised profit on stock (Working Note)	(1,950)	(4,900)	(900)
Profit before Manager's commission	38,050	25,100	19,100
Less: Commission for Department Manager @10%	(3,805)	(2,510)	(1,910)
Correct profit after charging manager commision	34,245	22,590	17,190

Working Note :

	Department A	*Department B*	*Department C*	*Total*
	₹	₹	₹.	₹
Unrealised Profit on transfer to:				
Department A	__	*7,200 x 20/120 = 1,200*	*5,750 x 15/115= 750*	1,950
Department B	*19,000 x 10% = 1,900*	__	*15,000 x 20% = 3,000*	4,900
Department C	*4,600 x 15/115= 600*	*3,300 x 10/110= 300*	__	900

Question 7

Department A sells goods to Department B at a profit of 50% on cost and to Department C at 20% on cost. Department B sells goods to A and C at a profit of 25% and 15% respectively on sales. Department C charges 30% and 40% profit on cost to Department A and B respectively.

Stock lying at different departments at the end of the year are as under:

	Department A	*Department B*	*Department C*
	₹	₹	₹
Transfer from Department A	-	*45,000*	*42,000*
Transfer from Department B	*40,000*	-	*72,000*
Transfer from Department C	*39,000*	*42,000*	-

Calculate the unrealized profit of each department and also total unrealized profit.

(4 Marks, May 2013) (IPCC)

Answer

Calculation of unrealized profit of each department and total unrealized profit

	Dept. A	*Dept. B*	*Dept. C*	*Total*
	₹	₹	₹	₹
Unrealized Profit of:				
Department A		45,000 x 50/150 = 15,000	42,000 x 20/120 = 7,000	22,000
Department B	40,000 x .25 = 10,000		72,000 x .15= 10,800	20,800
Department C	39,000 x 30/130 = 9,000	42,000 x 40/140 = 12,000		21,000
				63,800

Question 8

Martis Ltd. has several departments. Goods supplied to each department are debited to a Memorandum Departmental Stock Account at cost, plus a fixed percentage (mark-up) to give the normal selling price. The mark-up is credited to a memorandum departmental 'Mark-up account', any reduction in selling prices (mark-down) will require adjustment in the stock account and in mark-up account. The mark up for Department A for the last three years has been 25%. Figures relevant to Department A for the year ended 31st March, 2013 were as follows:

Opening stock as on 1st April, 2012, at cost	*₹ 65,000*
Purchase at cost	*₹ 2,00,000*
Sales	*₹ 3,00,000*

It is further ascertained that :

(1) *Shortage of stock found in the year ending 31.03.2013, costing ₹ 1,000 were written off.*

(2) *Opening stock on 01.04.12 including goods costing ₹ 6,000 had been sold during the year and bad been marked down in the selling price by* ₹ 600. *The remaining stock had been sold during the year.*

(3) *Goods purchased during the year were marked down by ₹ 1,200 from a cost of ₹ 15,000. Marked-down stock costing ₹ 5,000 remained unsold on 31.03.13.*

(4) *The departmental closing stock is to be valued at cost subject to adjustment for mark-up*

and mark-down.

You are required to prepare :

(i) A Departmental Trading Account for Department A for the year ended 31st March, 2013 in the books of Head Office.

(ii) A Memorandum Stock Account for the year.

(iii) A Memorandum Mark-up Account for the year. (12 Marks, November 2013) (IPCC)

Answer

(i) Department Trading Account
For the year ending on 31.03.2013
In the books of Head Office

Particulars	₹	*Particulars*	₹
To Opening Stock	65,000	By Sales	3,00,000
To Purchases	2,00,000	By Shortage	1,000
To Gross Profit c/d	58,880	By Closing Stock	22,880
	3,23,880		3,23,880

(ii) Memorandum stock account (for Department A) (at selling price)

Particulars	₹	*Particulars*	₹
To Balance b/d (₹ 65,000+25% of ₹ 65,000)	81,250	By Profit & Loss A/c (Cost of Shortage)	1,000
To Purchases (₹ 2,00,000 + 25% of ₹ 2,00,000)	2,50,000	By Memorandum Departmental Mark up A/c (Load on Shortage) (₹ 1,000 x 25%)	250
		By Memorandum Departmental Mark-up A/c (Mark-down on Current Purchases)	1,200
		By Debtors A/c (Sales)	3,00,000
		By Memorandum Departmental Mark-up A/c (Mark Down on Opening Stock)	600
		By Balance c/d	28,200
	3,31,250		3,31,250

(iii) Memorandum Departmental Mark-up Account

Particulars	₹	*Particulars*	₹
To Memorandum Departmental Stock A/c (₹ 1,000 × 25/100)	250	By Balance b/d (₹ 81,250 x 25/125)	16,250

To Memorandum Departmental Stock A/c	1,200	By Memorandum Departmental Stock A/c	50,000
To Memorandum Departmental Stock A/c	600	(₹ 2,50,000 x 25/125)	
To Gross Profit transferred to Profit & Loss A/c	58,880		
To Balance c/d [(₹ 28,200 + 400*) x 25/125 - ₹ 400]	5,320		
	66,250		66,250

*[₹ 1,200 ×5,000/15,000] = ₹ 400

Working Notes:

(i) Calculation of Cost of Sales

		₹
A	Sales as per Books	3,00,000
B	*Add*: Mark-down in opening stock (given)	600
C	*Add*: mark-down in sales out of current Purchases (₹ 1,200 x 10,000 /15,000)	800
D	Value of sales if there was no mark-down (A+B+C)	3,01,400
E	*Less*: Gross Profit (25/125 of ₹ 3,01,400) subject to Mark Down (₹ 600 + ₹ 800)	(60,280)
F	Cost of sales (D-E)	2,41,120

(ii) Calculation of Closing Stock

		₹
A	Opening Stock	65,000
B	*Add*: Purchases	2,00,000
C	*Less*: Cost of Sales	(2,41,120)
D	*Less*: Shortage	(1,000)
E	Closing Stock (A+B-C-D)	22,880

Question 9

State the basis on which the following common expenses, the benefit of which is shared by all the departments is distributed among the departments:

(i) Rent, rates and taxes, insurance of building;

(ii) Selling expenses such as discount, bad debts, selling commission and other such selling expenses;

(iii) *Carriage Inward;*

(iv) *Depreciation;*

(v) *Interest on loan;*

(vi) *Profit or loss on sale of investment;*

(vii) *Wages;*

(viii) *Lighting and Heating Expenses.* *(4 Marks, November 2013) (IPCC)*

Answer

Allocation of Expenses

S.No.	*Expenses*	*Basis*
1.	Rent, rates and taxes, repairs, insurance of building	Floor area occupied by each department (if given) other wise on time basis.
2.	Selling expenses, *e.g.,* discount, bad debts, selling commission, and other such selling expenses	Sales of each department.
3.	Carriage inward	Purchases of each department.
4.	Depreciation	Value of assets of each department otherwise on time basis.
5	Interest on loan	Utilisation of loan amount in each department (if can be identified), otherwise in combined P& L A/c.
6	Profit & loss on sale of investment	Value of investments sold in each department (if value can be identified), otherwise in combined P& L A/c.
7	Wages	Time devoted to each department
8.	Lighting and Heating expenses (eg. energy expenses)	Consumption of energy by each department.

9

Accounts for Branches including Foreign Branches

Question 1

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

(6 Marks, November 2004) (PE II)

Answer

Books of Branch A
Journal Entries

	Particulars		*Dr. Amount ₹*	*Cr. Amount ₹*
(i)	Expenses account	Dr.	3,500	
	To Head office account			3,500
	(Being the allocated expenditure by the head office recorded in branch books)			
(ii)	Depreciation account	Dr.	1,500	

	To Head office account (Being the depreciation provided)			1,500
(iii)	Head office account	Dr.	2,000	
	To Salaries account (Being the rectification of salary paid on behalf of H.O.)			2,000
(iv)	Head office account	Dr.	10,000	
	To Debtors account (Being the adjustment of collection from branch debtors)			10,000
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account (Being the expenditure on account of Branch B, recorded in books)			3,000

Question 2

M/s Shah commenced business on 1.4.2004 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office, where the goods were processed before sale. There was no loss or wastage in processing.

Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales, whether by Head Office or by the Branch, were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2005.

	Head Office		*Branch*	
	Dr.	*Cr.*	*Dr.*	*Cr.*
	₹	₹	₹	₹
Capital		*3,10,000*		
Drawings	*55,000*			
Purchases	*19,69,500*			
Cost of processing	*50,500*			
Sales		*12,80,000*		*8,20,000*
Goods sent to Branch		*9,24,000*		
Administrative expenses	*1,39,000*		*15,000*	
Selling expenses	*50,000*		*6,200*	
Debtors	*3,09,600*		*1,13,600*	

Branch Current account	*3,89,800*			
Creditors		*6,01,400*		*10,800*
Bank Balance	*1,52,000*		*77,500*	
Head Office Current account				*2,61,500*
Goods received from H.O.			*8,80,000*	
	31,15,400	*31,15,400*	*10,92,300*	*10,92,300*

Following further information is provided:

(i) Goods sent by Head Office to the Branch in March, 2005 of ₹ 44,000 were not received by the Branch till 2.4.2005.

(ii) A remittance of ₹ 84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2005.

(iii) Stock taking at the Branch disclosed a shortage of ₹ 20,000 (at selling price to the branch).

(iv) Cost of unprocessed goods at Head Office on 31.3.2005 was ₹ 1,00,000.

Prepare Trading and Profit and Loss account in columnar form and Balance Sheet of the business as a whole as at 31.3.2005. (16 Marks, November 2005) (PE II)

Answer

In the Books of Shah & Co.

Trading and Profit and Loss Account for the year ended 31st March, 2005

	Particulars	H.O.	Branch	Total			H.O.	Branch	Total
		₹	₹	₹			₹	₹	₹
To	Purchases	19,69,500	–	19,69,500	By	Sales	12,80,000	8,20,000	21,00,000
To	Cost of processing	50,500	–	50,500	By	Goods sent to Branch	9,24,000	–	–
To	Goods received				By	Stock shortage	–	16,000	14,545
	from H.O.	–	8,80,000	–	By	Goods in transit			44,000
To	Gross profit c/d	3,40,000	1,64,000	5,02,545	By	Closing stock:			
						Processed goods	56,000	2,08,000	2,64,000
						Unprocessed goods	1,00,000	–	1,00,000
		23,60,000	10,44,000	25,22,545			23,60,000	10,44,000	25,22,545
To	Admn. Expenses	1,39,000	15,000	1,54,000	By	Gross profit b/d	3,40,000	1,64,000	5,02,545
To	Selling Expenses	50,000	6,200	56,200					
To	Stock shortage	–	16,000	14,545					
To	Stock reserve	22,909	–	22,909					
To	Net profit	1,28,091	1,26,800	2,54,891					
		3,40,000	1,64,000	5,02,545			3,40,000	1,64,000	5,02,545

Balance Sheet as at 31st March, 2005

Liabilities		₹	*Assets*		₹
Capital	3,10,000		Debtors		
Add: Net profit	2,54,891		H.O.		3,09,600
	5,64,891		Branch		1,13,600
Less: Drawings	(55,000)	5,09,891	Closing stock:		
Creditors:			Processed goods		
H.O.	6,01,400		H.O.	56,000	
Branch	10,800	6,12,200	Branch	2,08,000	
				2,64,000	
			Less: Stock reserve	18,909	2,45,091
			Unprocessed goods		1,00,000
			Bank Balance		
			H.O.		1,52,000
			Branch		77,500
			Goods in transit	44,000	
			Less: Stock reserve	4,000	40,000
			Cash in transit		84,300
		11,22,091			11,22,091

Working Notes:

1. **Calculation of closing stock:**

Stock at Head Office:

		₹
Cost of goods processed ₹ (19,69,500 + 50,500 – 1,00,000)		19,20,000
Less: Cost of goods sent to Branch		
$9,24,000 \times \frac{100}{110}$	8,40,000	
Cost of goods sold $12,80,000 \times \frac{100}{125}$	10,24,000	18,64,000
Stock of processed goods with H.O.		56,000

Stock at Branch:

		₹
Goods received from H.O. (at invoice price)		8,80,000
Less: Invoice value of goods sold		
$8{,}20{,}000 \times \frac{100}{125}$	6,56,000	
Invoice value of stock shortage $20{,}000 \times \frac{100}{125}$	16,000	(6,72,000)
Stock at Branch at invoice price		2,08,000
Less: Stock Reserve $2{,}08{,}000 \times \frac{10}{110}$		(18,909)
Stock of processed goods with Branch (at cost)		1,89,091

2. Stock Reserve:

	₹
Unrealised profit on Branch stock $\left(2{,}08{,}000 \times \frac{10}{110}\right)$	18,909
Unrealised profit on goods in transit $\left(44{,}000 \times \frac{10}{110}\right)$	4,000
	22,909

Question 3

Concept, with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33 1/3%. The following information is given in respect of the branch for the year ended 31st March, 2006:

	₹
Goods sent to Branch (Invoice price)	*4,80,000*
Stock at Branch on 1.4.2005 (Invoice price)	*24,000*
Cash sales	*1,80,000*
Return of goods by customers to the Branch	*6,000*
Branch expenses (paid in cash)	*53,500*
Branch debtors balance on 1.4.2005	*30,000*
Discount allowed	*1,000*
Bad debts	*1,500*
Collection from Debtors	*2,70,000*

Branch debtors cheques returned dishonoured	*5,000*
Stock at Branch on 31.3.2006 (Invoice price)	*48,000*
Branch debtors balance on 31.3.2006	*36,500*

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of the Head Office:

(i) Nagpur Branch Stock Account

(ii) Nagpur Branch Debtors Account

(iii) Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any. *(16 Marks, May 2006) (PE II)*

Answer

In the books of head office

Nagpur Branch Stock Account

		₹				₹
1.4.2005	To Balance b/d	24,000	31.3.06	By Bank A/c (Cash Sales)		1,80,000
31.3.2006	To Goods sent to Branch A/c	4,80,000		By Branch Debtors (Credit Sales)		2,80,000
	To Branch Debtors	6,000		By Stock shortage:		
				Branch P&L A/c	1,500*	
				Branch Adjustment A/c(Loading)	500	2,000
				By Balance c/d		48,000
		5,10,000				5,10,000

Nagpur Branch Debtors Account

		₹			₹
1.4.2005	To Balance b/d	30,000	31.3.2006	By Bank A/c (Collection)	2,70,000
31.3.2006	To Bank A/c			By Branch Stock A/c	6,000
	(dishonour of cheques)	5,000		By Bad debts	1,500
	To Branch Stock A/c	2,80,000*		By Discount allowed	1,000
				By Balance c/d	36,500
		3,15,000			3,15,000

Nagpur Branch Adjustment Account

	₹		₹
To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	1,13,500		
	1,26,000		1,26,000
To Branch Stock A/c (Cost of loss)	1,500	By Gross Profit b/d	1,13,500
To Branch Expenses	56,000		
To Net Profit (Transferred to General P & L A/c)	56,000		
	1,13,500		1,13,500

*Balancing figure.

Working Notes:

1. Credit Sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is taken as credit sales
2. Loading is 33 $\frac{1}{3}$ % of Cost; i.e. 25% of invoice value

   Loading on opening stock = 24,000 $\times$ 25% = 6,000
3. Loading on goods sent = 4,80,000 $\times$ 25% = ₹1,20,000
4. Loading on Closing Stock = ₹48,000 $\times$ 25% = ₹12,000
5. Total Branch Expenses = Cash expenses + Bad debt + Discount allowed

   = ₹53,500 + ₹1,500 + ₹1,000 = ₹56,000
6. Gross Profit

   Total sales (at invoice price) - Goods returned by customers (at invoice price) x $\frac{33.33}{100+33.33}$

   {(₹ 1,80,000+ ₹ 2,80,000)- ₹ 6,000} x $\frac{33.33}{133.33}$ = ₹ 1,13,500

Question 4

Alphs having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account. On 31.3.2007, it was found that the goods dispatched by head office for ₹ 2,00,000 was received by the branch only to the extent of ₹ 1,50,000. The balance goods are in transit. What is the accounting entry to be passed by the branch for recording the goods in transit, in its books?

(2 Marks, May, 2007)(PCC)

Answer

Nagpur branch must include the inventory in its books as goods in transit.

The following journal entry must be made by the branch:

Goods in transit A/c	Dr.	50,000	
To Head office A/c			50,000

[Being Goods sent by Head office is still in transit on the closing date]

Question 5

Beta having head office at Mumbai has a branch at Nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 2007:

	Head Office (₹)	*Branch (₹)*
Opening stock (as on 1.4.2006)	*2,25,000*	*-*
Purchases	*25,50,000*	*-*
Goods sent to branch (Cost to H.O. plus 80%)	*9,54,000*	*-*
Sales	*27,81,000*	*9,50,000*
Office expenses	*90,000*	*8,500*
Selling expenses	*72,000*	*6,300*
Staff salary	*65,000*	*12,000*

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 2007. *(8 Marks, November, 2007) (PCC)*

Answer

Trading and Profit and Loss A/c

For the year ended 31st March 2007

	Head office	Branch		Head office	Branch
	₹	₹		₹	₹
To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000
To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	-
To Goods received			By Closing stock	7,00,000	99,000

	from head office	-	9,54,000		(W.N.1 & 2)		
To	Gross profit c/d	16,60,000	95,000				
		44,35,000	10,49,000			44,35,000	10,49,000
To	Office expenses	90,000	8,500	By	Gross profit b/d	16,60,000	95,000
To	Selling expenses	72,000	6,300				
To	Staff salaries	65,000	12,000				
To	Branch Stock Reserve (W.N.3)	44,000	-				
To	Net Profit	13,89,000	68,200				
		16,60,000	95,000			16,60,000	95,000

Working Notes:

(1)	**Calculation of closing stock of head office:**	₹
	Opening Stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold [37,35,000* x 100/180]	20,75,000
		7,00,000
(2)	**Calculation of closing stock of branch:**	₹
	Goods received from head office [At invoice value]	9,54,000
	Less: Invoice value of goods sold [9,50,000 x 180/200]	8,55,000
		99,000
(3)	**Calculation of unrealized profit in branch stock:**	
	Branch stock ₹ 99,000	
	Profit included 80% of cost	
	Hence, unrealized profit would be = ₹ 99,000 x 80/180 =	₹ 44,000

Question 6

Goods worth ₹ 50,000 sent by head office but the branch has received till the closing date goods for worth ₹40,000 only. Give journal entry in the books of H.O. and branch for goods in transit. *(2 Marks) (November, 2008)* (PCC)

* ₹27,81,000 + ₹9,54,000

Answer

Journal entry in the books of Head Office

No entry

Journal entry in the books of Branch

		₹	₹
Goods-in-transit account	Dr.	10,000	
To Head Office account			10,000
(Being goods sent by head office is still in transit)			

Question 7

Pawan of Delhi has a branch at Jaipur. Goods are invoiced to the branch at cost plus 25%. The branch is instructed to deposit the receipts everyday in the head office account with the bank. All the expenses are paid through cheque by the head office except petty cash expenses which are paid by the Branch.

From the following information, you are required to prepare Branch Account in the books of Head office:

	₹
Stock at invoice price on 1.4.08	*1,64,000*
Stock at invoice price on 31.3.09	*1,92,000*
Debtors as on 1.4.08	*63,400*
Debtors as on 31.3.09	*84,300*
Furniture & fixtures as on 1.4.08	*46,800*
Cash sales	*8,02,600*
Credit sales	*7,44,200*
Goods invoiced to branch by head office	*12,56,000*
Expenses paid by head office	*2,64,000*
Petty expenses paid by the branch	*20,900*
Furniture acquired by the branch on 1.10.08 (payment was made by the branch from cash sales and collection from debtors)	*5,000*

Depreciation to be provided on branch furniture & fixtures @ 10% p.a. on WDV basis.

(8 Marks, November, 2009) (PCC)

Answer

In the Books of Pawan & Co., Delhi (Head Office)

Jaipur Branch Account

	₹		₹
To Opening balances:		By Branch stock reserve	32,800
Branch stock A/c	1,64,000	By Bank A/c (W.N.4)	15,00,000
Branch debtors A/c	63,400	By Goods sent to branch A/c (Loading)	2,51,200
Branch furniture A/c	46,800		
To Goods sent to branch	12,56,000	By Closing Balances:	
To Bank A/c (branch expenses)	2,64,000	Branch stock A/c	1,92,000
To Branch stock reserve A/c	38,400	Branch debtors A/c	84,300
To Profit and loss A/c (Bal. Fig.)	2,74,570	Branch furniture A/c (W.N.2)	46,870
	21,07,170		21,07,170

Working Notes:

1. Depreciation on furniture

	₹
10% p.a. on ₹46,800	4,680
10% p.a. for 6 months on ₹5,000	250
	4,930

2. Closing balance of branch furniture as on 31.3.2009

	₹
Branch furniture as on 1.4.2008	46,800
Add: Acquired during the year	5,000
	51,800
Less: Depreciation (W.N.1)	4,930
Branch furniture as on 31.3.2009	46,870

3. Collection from branch debtors

Branch Debtors Account

	₹		₹
To Balance b/d	63,400	By Bank A/c (Bal.Fig.)	7,23,300
To Sales	7,44,200	By Balance c/d	84,300
	8,07,600		8,07,600

4. Cash remitted by the branch to head office

   Cash sales + Collection from debtors – Petty expenses – Furniture acquired by branch

   ₹8,02,600 + ₹7,23,300 (W.N. 3) – ₹20,900 – ₹5,000 = ₹15,00,000

Question 8

DM, Delhi has a branch in London. London branch is an integral foreign operation of DM At the end of the year 31st March, 2009, the branch furnishes the following trial balance in U.K. Pound:

Particulars	*£*	*£*
	Dr.	*Cr.*
Fixed assets (Acquired on 1st April, 2005)	*24,000*	
Stock as on 1st April, 2008	*11,200*	
Goods from head office	*64,000*	
Expenses	*4,800*	
Debtors	*4,800*	
Creditors		*3,200*
Cash at bank	*1,200*	
Head office account		*22,800*
Purchases	*12,000*	
Sales		*96,000*
	1,22,000	*1,22,000*

In head office books, the branch account stood as shown below:

London Branch A/c

Particulars	*Amount*	*Particulars*	*Amount*
	₹		*₹*
To Balance b/d	*20,10,000*	*By Bank A/c*	*52,16,000*
To Goods sent to branch	*49,26,000*	*By Balance c/d*	*17,20,000*
	69,36,000		*69,36,000*

The following further information are given:

(a) Fixed assets are to be depreciated @ 10% p.a on straight line basis.

(b) On 31st March, 2009 :

Expenses outstanding	-	*£ 400*
Prepaid expenses	-	*£ 200*
Closing stock	-	*£ 8,000*

(c) Rate of Exchange:

1st April, 2005	*-*	*₹70 to £ 1*
1st April, 2008	*-*	*₹76 to £ 1*
31st March, 2009	*-*	*₹77 to £ 1*
Average	*-*	*₹75 to £ 1*

You are required to prepare:

(i) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees.

(ii) Trading and profit and loss account for the year ended 31st March, 2009 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head office of DM. (16 Marks, November, 2009) (IPCC)

Answer

(i) Trial Balance of London Branch as on 31st March, 2009

Particulars	*U.K. Pound*	*Rate per U.K. Pound*	*Dr. (₹)*	*Cr. (₹)*
Fixed assets	24,000	70	16,80,000	
Stock (as on 1st April, 2008)	11,200	76	8,51,200	
Goods from head office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 – 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding expenses	400	77		30,800
Prepaid expenses	200	77	15,400	
Cash at bank	1,200	77	92,400	
Head office account		-		17,20,000
Difference in foreign exchange translation				12,400
			92,09,600	92,09,600

Closing stock will be (£ 8,000 × ₹ 77) = ₹6,16,000

(ii) Trading and Profit & Loss Account
for the year ended 31st March, 2009

	Particulars	Amount (₹)		Particulars	Amount (₹)
To	Opening stock	8,51,200	By	Sales	72,00,000
To	Purchases	9,00,000	By	Closing stock	6,16,000
To	Goods from head office	49,26,000			
To	Gross profit	11,38,800			
		78,16,000			78,16,000
To	Expenses	3,75,000	By	Gross profit	11,38,800
To	Depreciation	1,68,000	By	Profit due to foreign exchange difference	12,400
To	Net profit	6,08,200			
		11,51,200			11,51,200

(iii) Balance Sheet as on 31st March, 2008

Liabilities	₹	₹	Assets	₹	₹
Head office			Fixed Assets	16,80,000	
Balance	17,20,000		*Less*: Depreciation	1,68,000	15,12,000
Add: Net profit	6,08,200	23,28,200	Debtors		3,69,600
Outstanding expenses		30,800	Prepaid expenses		15,400
Creditors		2,46,400	Closing stock		6,16,000
			Cash at bank		92,400
		26,05,400			26,05,400

Question 9

On 31st March, 2010, the following ledger balances have been extracted from the books of Washington branch office:

Ledger Accounts	*$*
Building	*180*
Stock as on 1.4.2009	*26*
Cash and Bank Balances	*57*
Purchases	*96*
Sales	*110*
Commission receipts	*28*
Debtors	*46*
Creditors	*65*

You are required to convert above Ledger balances into Indian Rupees.

Use the following rates of exchange:

	₹ per $
Opening rate	*46*
Closing rate	*50*
Average rate	*48*
For fixed assets	*42*

(2 Marks, May, 2010) (IPCC)

Answer

(i) Conversion of ledger balances (in Dollars) into Rupees

	$	Rate per $	Amount in ₹
Building	180	42	7,560
Stock as on 01.04.2011	26	46	1,196
Cash and bank balances	57	50	2,850
Purchases	96	48	4,608
Sales	110	48	5,280
Commission receipts	28	48	1,344
Debtors	46	50	2,300
Creditors	65	50	3,250

Question 10

Ram of Chennai has a branch at Nagpur to which office, goods are invoiced at cost plus 25%. The branch makes sales both for cash and on credit. Branch expenses are paid direct from Head Office and the branch has to remit all cash received into the Head Office Bank Account at Nagpur.

From the following details, relating to the year 2009, prepare the accounts in Head Office Ledger and ascertain Branch Profit as per stock and debtors method. Branch does not maintain any books of accounts, but sends weekly returns to head office:

	₹
Goods received from head office at invoice price	*1,20,000*
Returns to head office at invoice price	*2,400*
Stock at Nagpur branch on 1.1.2009 at invoice price	*12,000*
Sales during the year – Cash	*40,000*
Credit	*72,000*
Debtors at Nagpur branch as on 1.1.2009	*14,400*
Cash received from debtors	*64,000*

Discounts allowed to debtors	*1,200*
Bad debts during the year	*800*
Sales returns at Nagpur branch	*1,600*
Salaries and wages at branch	*12,000*
Rent, rates and taxes at branch	*3,600*
Office expenses at Nagpur branch	*1,200*
Stock at branch on 31.12.2009 at invoice price	*24,000*

(8 Marks, May, 2010) (IPCC)

Answer

Nagpur Branch Stock Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Balance b/d	12,000	By	Goods sent to branch A/c (Returns)	2,400
To	Goods sent to branch A/c	1,20,000	By	Bank A/c (Cash sales)	40,000
To	Branch debtors A/c (Returns)	1,600	By	Branch debtors A/c (credit sales)	72,000
To	Branch adjustment A/c (Surplus over invoice price)	4,800	By	Balance c/d	24,000
		1,38,400			1,38,400

Nagpur Branch Adjustment Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Stock reserve - 20% of ₹24,000 (closing stock)	4,800	By	Stock reserve - 20% of ₹12,000 (Opening stock)	2,400
To	Branch profit & loss A/c (Gross profit)	25,920	By	Goods sent to branch A/c – 20% of ₹1,17,600	23,520
			By	Branch stock A/c	4,800
		30,720			30,720

Branch Profit & Loss Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Branch expenses A/c	16,800	By	Branch adjustment A/c (Gross Profit)	25,920

To	Branch debtors A/c (Discount)	1,200			
To	Branch debtors A/c (Bad Debts)	800			
To	Net profit (transferred to Profit & Loss A/c)	7,120			
		25,920			25,920

Branch Expenses Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Bank A/c (Rent, rates & taxes)	3,600	By	Branch profit and loss A/c (Transfer)	16,800
To	Bank A/c (Salaries & wages)	12,000			
To	Bank A/c (Office expenses)	1,200			
		16,800			16,800

Branch Debtors Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Balance b/d	14,400	By	Bank A/c	64,000
To	Branch stock A/c	72,000	By	Branch profit and loss A/c (Bad debts and discount)	2,000
			By	Branch stock A/c (Sales returns)	1,600
			By	Balance c/d (bal.fig.)	18,800
		86,400			86,400

Goods sent to Branch Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Branch stock A/c	2,400	By	Branch stock A/c	1,20,000
To	Branch adjustment A/c	23,520			
To	Purchases A/c	94,080			
		1,20,000			1,20,000

Question 11

Following is the information of the Jammu branch of Best, New Delhi for the year ending 31st March, 2010 from the following:

(1) Goods are invoiced to the branch at cost plus 20%.

(2) The sale price is cost plus 50%.

(3) Other informations:

	₹
Stock as on 01.04.2009	*2,20,000*
Goods sent during the year	*11,00,000*
Sales during the year	*12,00,000*
Expenses incurred at the branch	*45,000*

Ascertain

(i) the profit earned by the branch during the year

(ii) branch stock reserve in respect of unrealized profit. (4 Marks, November, 2010) (IPCC)

Answer

(i) Calculation of profit earned by the branch

In the books of Jammu Branch

Trading Account

Particulars	Amount ₹	Particulars	Amount ₹
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Gross profit	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit

= ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price		
	₹	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less : Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Note :It is assumed that all figures given in the questions is at invoice price.

Question 12

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars prepare branch account in the books of Head Office.

	(₹)		(₹)
Stock on 1st April 2010 (invoice price)	*30,000*	*Discount allowed to debtors*	*160*
Sundry Debtors on 1st April, 2010	*18,000*	*Expenses paid by head office:*	
Cash in hand as on 1st April, 2010	*800*	*Rent*	*1,800*
		Salary	*3,200*
Office furniture on 1st April, 2010	*3,000*	*Stationery & Printing*	*800*
Goods invoiced from the head office (invoice price)	*1,60,000*	*Petty expenses paid by the branch*	*600*
Goods return to Head Office	*2,000*	*Depreciation to be provided on branch furniture at 10% p.a.*	
Goods return by debtors	*960*		
Cash received from debtors	*60,000*		
Cash Sales	*1,00,000*	*Stock on 31st March, 2011 (at invoice price)*	
Credit sales	*60,000*		*28,000*

(8 Marks May, 2011) (IPCC)

Answer

In the books of Head Office – XYZ

Kolkata Branch Account (at invoice)

	₹		₹
To Balance b/d		By Stock reserve (opening)	6,000
Stock	30,000	By Remittances:	
Debtors	18,000	Cash Sales 1,00,000	
Cash in hand	800	Cash from Debtors 60,000	1,60,000
Furniture	3,000	By Goods sent to branch (loading)	32,000
To Goods sent to branch	1,60,000	By Goods returned by branch (Return to H.O.)	2,000

To Goods returned by branch (loading)		400	By Balance c/d		
To Bank (expenses paid by H.O.)			Stock		28,000
Rent	1,800		Debtors		16,880
Salary	3,200		Cash (800-600)		200
Stationary & printing	800	5,800	Furniture (3,000-300)		2,700
To Stock reserve (closing)		5,600			
To Profit transferred to General Profit & Loss A/c		24,180			
		2,47,780			2,47,780

Working Note:

Debtors Account

	₹		₹
To Balance b/d	18,000	By Cash account	60,000
To Sales account (credit)	60,000	By Sales return account	960
		By Discount allowed account	160
		By Balance c/d	16,880
	78,000		78,000

Note: It is assumed that goods returned by branch are at invoice price.

Question 13

Why goods are marked on invoice price by the head office while sending goods to the branch?

(4 Marks, May, 2011) (IPCC)

Answer

Goods are marked on invoice price to achieve the following objectives:

(i) To keep secret from the branch manager, the cost price of the goods and profit made, so that the branch manager may not start a rival and competitive business with the concern; and

(ii) To have effective control on stock i.e stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.

(iii) To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

Question 14

Global has a branch which closes its books of account every year on 31st March. This is an independent branch which maintains comprehensive books of account for recording their transactions.

You are required to show journal entries in the books of branch on 31st March, 2011 to rectify or adjust the following:

(i) Head Office allocates ₹ 1,35,000 to the branch as head office expenses, which have not yet been recorded by branch.

(ii) Depreciation of branch fixed assets, whose accounts are kept by head office in its books, not yet recorded in the branch books, ₹ 1,15,000.

(iii) Branch paid ₹ 1,40,000 as salary to an official from head office on visit to branch and debited the amount to its Salaries Account.

(iv) Head Office collected ₹ 1,30,000 directly from a branch customer on behalf of the branch, but no intimation was received earlier by the branch. Now the branch learns about it.

(v) It is learnt that a remittance of ₹ 1,50,000 sent by the branch has not been received by head office till date. *(5 Marks, November, 2011) (IPCC)*

Answer

In the books of Branch
Journal Entries

S.No.	*Particulars*	*Dr. (₹)*	*Cr. (₹)*
(i)	Head Office Expenses A/c Dr.	1,35,000	
	To Global (H.O.) A/c		1,35,000
	(Being expenses allocated to branch by head office)		
(ii)	Depreciation A/c Dr.	1,15,000	
	To Global (H.O.) A/c		1,15,000
	(Being depreciation on fixed assets of branch, whose account are maintained by head office)		
(iii)	Global (H.O.) A/c Dr.	1,40,000	
	To Salaries A/c		1,40,000
	(Being the rectification of salary paid, on behalf of the head office)		
(iv)	Global (H.O.) A/c Dr.	1,30,000	
	To Debtors A/c		1,30,000
	(Being adjustment of direct collection from branch debtors, by head office)		
(v)	No entry will be passed in the Branch books		

Note: Cash-in-transit of ₹ 1,50,000 will be shown in the books of Head office.

Question 15

An Indian company Moon Star Limited has a branch at Verginia (USA). The Branch is a non-integral foreign operation of the Indian Company. The trial balance of the Branch as at 31st March, 2012 is as follows:

Particulars	*US $*	
	Dr.	*Cr.*
Office equipments	*48,000*	
Furniture and Furniture's	*32,00*	
Stock (April 1, 2011)	*22,400*	
Purchases	*96,000*	
Sales	*---*	*1,66,400*
Goods Sent from HO	*32,000*	
Salaries	*3,200*	
Carriage inward	*400*	
Rent, Rate & Taxes	*800*	
Insurance	*400*	
Trade Expenses	*400*	
Head office Account	*---*	*45,600*
Sundry Debtors	*9,600*	
Sundry Creditors	*---*	*6,800*
Cash at Bank	*2,000*	
Cash in Hand	*400*	
	2,18,800	*2,18,800*

The following further information's are given:

(1) Salaries outstanding $400.

(2) Depreciate office equipment and Furniture & Fixtures @10% p.a. at written down value.

(3) The Head Office sent goods to Branch for ₹ 15,80,000

(4) The Head Office shown an amount of ₹ 20,50,000 due from Branch.

(5) Stock on 31st March, 2013 -$ 21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1,2010 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2011, the rate was ₹ 47 per $. On March 31, 2012 the rate was ₹ 50 per $. Average Rate during the year was ₹ 45 to one $.

Prepare:

(a) Trial balance incorporating adjustments given converting dollars into rupees.

(b) Trading, Profit and Loss Account for the year ended 31st March, 2012 and Balance Sheet as on date depicting the profitability and net position of the Branch as would appear in the books of Indian company for the purpose of incorporating in the main Balance Sheet.

(16 Marks, May 2012) (IPCC)

Answer

In the books of Moon Star Ltd. - an Indian Company

Trial Balance (in Rupees) of Verginia (USA) Branch

as on 31st March, 2012

Particulars	*Dr.*	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	*₹*	*₹*
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2011)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange gain (bal. fig.)					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Trading and Profit and Loss Account of Verginia Branch
for the year ended 31st March, 2012

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US $ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		15,92,200

Balance Sheet of Verginia Branch
as on 31st March, 2012

Liabilities	₹	₹	*Assets*	₹	₹
Head Office A/c	20,50,000		Office Equipment	24,00,000	
Add : Net profit	11,02,200	31,52,200	*Less* : Depreciation	2,40,000	21,60,000
Foreign Currency Translation Reserve		4,66,800	Furniture and fixtures	1,60,000	
Trade creditors		3,40,000	*Less* : Depreciation	16,000	1,44,000
Outstanding salaries		20,000	Closing stock		10,75,000
			Trade debtors		4,80,000
			Cash in hand		20,000
			Cash at bank		1,00,000
		39,79,000			39,79,000

Question 16

Give Journal Entries in the books of Head Office to rectify or adjust the following:

(i) *Goods sent to Branch ₹ 12,000 stolen during transit. Branch manager refused to accept any liability.*

(ii) *Branch paid ₹ 15,000 as salary to the officer of Head Office on his visit to the branch.*

(iii) *On 28th March, 2012, the H.O. dispatched goods to the Branch invoiced at ₹ 25,000*

which was not received by Branch till 31st March, 2012.

(iv) A remittance of ₹ 10,000 sent by the branch on 30th March, 2012, received by the Head Office on 1st April, 2012.

(v) Head Office made payment of ₹ 25,000 for purchase of goods by Branch and wrongly debited its own purchase account. (5 Marks, November 2012) (IPCC)

Answer

In the books of Head Office

Journal Entries

	Particulars		*Dr. Amount ₹*	*Cr. Amount ₹*
(i)	Loss of goods due to theft during transit	Dr.	12,000	
	To Purchases account*			12,000
	(Being goods lost on account of theft during transit)			
(ii)	Salaries account	Dr.	15,000	
	To Branch account			15,000
	(Being salary paid by branch for H.O. employee)			
(iii)	No entry in the books of head office for goods sent to branch not received by 31st March 2012			
(iv)	Cash in transit account	Dr.	10,000	
	To Branch account			10,000
	(Being remittance by branch not received by 31st March, 2012)			
(v)	Branch account	Dr.	25,000	
	To Purchases account			25,000
	(Being rectification of entry for payment for goods purchased by branch wrongly debited to purchase account)			

Question 17

ABCD, Delhi has a branch in New York, USA, which is an integral foreign operation of the company. At the end of 31st March, 2013, the following ledger balances have been extracted from the books of the Delhi office and the New York Branch:

Particulars	*Delhi*	*New York*

* It is assumed that refusal of branch manager (to accept liability of stolen goods) is accepted by the Head Office.

	(₹ thousands)		($ thousands)	
	Debit	Credit	Debit	Credit
Share Capital		*1,250*		
Reserves and Surplus		*940*		
Land	*475*			
Building (cost)	*1,000*			
Buildings Depreciation Reserve		*200*		
Plant & Machinery (cost)	*2,000*		*100*	
Plant & Machinery Depreciation Reserve		*500*		*20*
Trade receivables/payables	*500*	*270*	*60*	*20*
Stock (01-04-2012)	*250*		*25*	
Branch Stock Reserve		*65*		
Cash & Bank Balances	*125*		*4*	
Purchases/Sales	*275*	*600*	*25*	*125*
Goods sent to Branch		*1,500*	*30*	
Managing Director's salary	*50*			
Wages & Salaries	*100*		*18*	
Rent			*6*	
Office Expenses	*25*		*12*	
Commission receipts		*275*		*100*
Branch/H.O. Current A/c	*800*	—	—	*15*
	5,600	*5,600*	*280*	*280*

The following information is also available:

(1) Stock as at 31-03-2013

Delhi - ₹ 2,00,000

New York - $ 10 (all stock received from Delhi)

(2) Head Office always sent goods to the Branch at cost plus 25%.

(3) Provision is to be made for doubtful debts at 5%.

(4) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down values.

You are required:

(a) To convert the branch Trial Balance into rupees, using the following rates of exchange:

Exchange:

Opening rate 1 $ = ₹ 50

Closing rate 1 $ = ₹ 55

Average rate *1 $ = ₹ 52*

For fixed assets *1 $ = ₹ 45*

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2013, showing to the extent possible, Head Office results and Branch results separately.

(16 Marks, May 2013) (IPCC)

Answer

(a) ABCD

New York Branch Trial Balance
As on 31st March 2013

	($ '000)				*(₹ '000)*
	Dr.	*Cr.*	*Conversion rate per $*	*Dr.*	*Cr.*
Plant & Machinery (cost)	100		₹ 45	4,500	
Plant & Machinery Dep. Reserve		20	₹ 45		900
Trade receivable/payable	60	20	₹ 55	3,300	1,100
Stock (1.4.2012)	25		₹ 50	1,250	
Cash & Bank Balances	4		₹ 55	220	
Purchase / Sales	25	125	₹ 52	1,300	6,500
Goods received from H.O.	30		Actual	1,500	
Wages & Salaries	18		₹ 52	936	
Rent	6		₹ 52	312	
Office expenses	12		₹ 52	624	
Commission Receipts		100	₹ 52		5,200
H.O. Current A/c		15	Actual		800
				13,942	14,500
Exchange loss (bal. fig.)				558	
	280	280		14,500	14,500
Closing stock	.010		₹ 55	0.55	

(b)

Trading and Profit & Loss Account for the year ended 31st March, 2013

	H.O.	Branch	Total		H.O.	Branch	Total
							(₹000)
To Opening Stock	250	1,250.00	1,500.00	By Sales	600	6,500.00	7,100.00
To Purchases	275	1,300.00	1,575.00	By Goods sent to Branch	1,500	–	1,500.00
To Goods received from Head Office	–	1,500.00	1,500.00	By Closing Stock	200	0.55	200.55
To Wages & Salaries	100	936.00	1,036.00				
To Gross profit c/d	1,675	1,514.55	3,189.55				
	2,300	6,500.55	8,800.55		2,300	6,500.55	8,800.55
To Rent	–	312.00	312.00	By Gross profit b/d	1,675	1,514.55	3,189.55
To Office expenses	25	624.00	649.00	By Commission receipts	275	5,200.00	5,475.00
To Provision for doubtful debts @ 5%	25	165.00	190.00				
To Depreciation (W. N. 1)	380	720.00	1,100.00				
To Balance c/d	1,520	4,893.55	6,413.55				
	1,950	6,714.55	8,664.55		1,950	6,714.55	8,664.55
To Exchange loss			558.00	By Balance b/d			6,413.55
To Managing Director's Salary			50.00	By Branch Stock Reserve (W. N. 2)			64.89
To Balance c/d			5,870.44				
			6,478.44				6,478.44

Working Notes:

(1) Calculation of Depreciation

	H.O ₹ '000	*Branch ₹ 000*
Building – Cost	1,000	
Less : Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,000	4,500
Less : Dep. Reserve	(500)	(900)
	1,500	3,600
Depreciation @ 20% (B)	300	720
Total Depreciation (A+B)	380	720

(2) Calculation of Additional Branch Stock Reserve

	(₹'000)
Closing stock of Branch	0.55
Reserve on closing stock (0.55 × 1/5)	0.11
Less : Branch Stock Reserve (as on 1.4.2012)	(65)
Reversal of Stock Reserve	(64.89)