CA INTERMEDIATE

ADVANCED ACCOUNTING

PART - A

CAINTERMEDIATE

ADVANCED ACCCOUNTING

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PART - A

Update (20.07.2023)

CHAPTER; 4
UNIT - 2
AS 3 CASH FLOW STATEMENT

1. OBJECTIVE:

- Cash flow Statement (CFS) is an additional information provided to the users of accounts in the form of an statement, which reflects the various sources from where cash was generated (inflow of cash) by an enterprise during the relevant accounting year and how these inflows were utilised (outflow of cash) by the enterprise.
- This helps the users of accounts :
  - **(i)** To identify the historical changes in the flow of cash & cash equivalents.
  - **(ii)** To determine the future requirement of cash & cash equivalents.
  - **(iii)** To assess the ability to generate cash & cash equivalents.
  - **(iv)** To estimate the further requirement of generating cash & cash equivalents.
  - **(v)** To compare the operational efficiency of different enterprises.
  - **(vi)** To study the insolvency and liquidity position of an enterprise.
  - **(vii)** As an indicator of amount, timing and certainty of future cash flows.
  - **(viii)** To check the accuracy of past assessments of future cash flows In examining the relationship between profitability and net cash flow and the impact of changing prices.

2. SOME IMPORTANT DEFINITIONS

CASH	CASH EQUIVALENT	CASH FLOWS
i. Cash in hand ii. **Demand deposit** with bank	If all 3 condition fulfilled i. Short term investment **(maximum 3 month)** ii. Readily marketable iii. Insignificant risk Example: **i.** Treasury bill **ii.** Certificate of deposit **iii.** Commercial Paper	• Inflows & outflows of cash & CE

3. LOANS/ADVANCES GIVEN AND INTERESTS EARNED

(a) Loans and advances given and interests earned on them in the ordinary course of business are operating cash flows for financial enterprises.

(b) Loans and advances given and interests earned on them are investing cash flows for non-financial enterprises.

(c) Loans and advances given to subsidiaries and interests earned on them are investing cash flows for all enterprises.

(d) Loans and advances given to employees and interests earned on them are operating cash flows for all enterprises.

(e) Advance payments to suppliers and interests earned on them are operating cash flows for all enterprises.

(f) Interests earned from customers for late payments are operating cash flows for non-financial enterprises.

4. **LOANS/ADVANCES TAKEN AND INTERESTS PAID**

(a) Loans and advances taken and interests paid on them in the ordinary course of business are operating cash flows for financial enterprises.

(b) Loans and advances taken and interests paid on them are financing cash flows for non-financial enterprises.

(c) Loans and advances taken from subsidiaries and interests paid on them are financing cash flows for all enterprises.

(d) Advance taken from customers and interests paid on them are operating cash flows for non-financial enterprises.

(e) Interests paid to suppliers for late payments are operating cash flows for all enterprises.

(f) Interests taken as part of inventory costs in accordance with AS 16 are operating cash flows.

5. **INVESTMENTS MADE AND DIVIDENDS EARNED**

(a) Investments made and dividends earned on them in the ordinary course of business are operating cash flows for financial enterprises.

(b) Investments made and dividends earned on them are investing cash flows for non-financial enterprises.

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

6. **DIVIDENDS PAID**

Dividends paid are financing cash outflows for all enterprises.

7. ***INCOME TAX***

(a) *Tax paid on operating income is operating cash outflows for all enterprises*

(b) *Tax deducted at source against income are operating cash outflows if concerned incomes are operating incomes and investing cash outflows if the concerned incomes are investment incomes, e.g. interest earned.*

(c) *Tax deducted at source against expenses are operating cash inflows if concerned expenses are operating expenses and financing cash inflows if the concerned expenses are financing expenses, e.g. interests paid.*

8. **INSURANCE CLAIMS RECEIVED**

(a) *Insurance claims received against loss of stock or loss of profits are extraordinary operating cash inflows for all enterprises.*

(b) *Insurance claims received against loss of fixed assets are extraordinary investing cash inflows for all enterprises.*

(c) *AS 3 requires separate disclosure of extraordinary cash flows, classifying them as cash flows from operating, investing or financing activities, as may be appropriate.*

9. **PROFIT OR LOSS ON DISPOSAL OF FIXED ASSETS**

Profit or loss on sale of fixed asset is not operating cash flow. The entire proceeds of such transactions should be taken as cash inflow from investing activity.

10. **REPORTING CASH FLOWS ON NET BASIS**

- *AS 3 forbids netting of receipts and payments from investing and financing activities.*
- *Thus, cash paid on purchase of fixed assets should not be shown net of cash realised from sale of fixed assets.*
- *For example, if an enterprise pays ₹50,000 in acquisition of machinery and realises ₹10,000 on disposal of furniture, it is not right to show net cash outflow of ₹40,000.*

- *The exceptions to this rule are stated below. Cash flows from the following operating, investing or financing activities may be reported on a net basis.*
  - **(a)** *Cash receipts and payments on behalf of customers, e.g. cash received and paid by a bank against acceptances and repayment of demand deposits.*
  - **(b)** *Cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short, e.g. purchase and sale of investments by an investment company.*
  - **(c)** *AS 3 permits financial enterprises to report cash flows on a net basis in the following three circumstances.*
  - **(d)** *Cash flows on acceptance and repayment of fixed deposits with a fixed maturity date*
  - **(e)** *Cash flows on placement and withdrawal deposits from other financial enterprises*
  - **(f)** *Cash flows on advances/loans given to customers and repayments received there from.*

11. INTEREST AND DIVIDENDS

- *Cash flows from interest and dividends received and paid should each be disclosed separately.*
- *Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities.*
- *In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities.*
- *Dividends paid should be classified as cash flows from financing activities.*

12. *NON-CASH TRANSACTIONS*

- *Investing and financing transactions that do not require the use of cash or cash equivalents, e.g. issue of bonus shares, should be excluded from a cash flow statement.*
- *Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.*

13. *BUSINESS PURCHASE*

- *The aggregate cash flows arising from acquisitions and disposals of subsidiaries or other business units should be presented separately and classified as cash flow from investing activities.*
  - **(a)** *The cash flows from disposal and acquisition should not be netted off.*
  - **(b)** *An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following:*
    - (i) *The total purchase or disposal consideration; and*
    - (ii) *The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.*

14. *TREATMENT OF CURRENT ASSETS AND LIABILITIES TAKEN OVER ON BUSINESS PURCHASE*

- Business purchase is not operating activity. Thus, while taking the differences between closing and opening current assets and liabilities for computation of operating cash flows, the closing balances should be reduced by the values of current assets and liabilities taken over.
- This ensures that the differences reflect the increases/decreases in current assets and liabilities due to operating activities only.

15. ***EXCHANGE GAINS AND LOSSES***

- The foreign currency monetary assets (e.g. balance with bank, debtors etc.) and liabilities (e.g. creditors) are initially recognised by translating them into reporting currency by the rate of exchange transaction date.
- On the balance sheet date, these are restated using the rate of exchange on the balance sheet date. The difference in values is exchange gain/loss.
- The exchange gains and losses are recognised in the statement of profit and loss.
- The exchange gains/losses in respect of cash and cash equivalents in foreign currency (e.g. balance in foreign currency bank account) are recognised by the principle aforesaid, and these balances are restated in the balance sheet in reporting currency at rate of exchange on balance sheet date.
- The change in cash or cash equivalents due to exchange gains and losses are however not cash flows.
- This being so, the net increases/decreases in cash or cash equivalents in the cash flow statements are stated exclusive of exchange gains and losses.
- The resultant difference between cash and cash equivalents as per the cash flow statement and that recognised in the balance sheet is reconciled in the note on cash flow statement.

16. ***DISCLOSURES***

- AS 3 requires an enterprise to disclose the amount of significant cash and cash equivalent balances held by it but not available for its use, together with a commentary by management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.
- AS 3 encourages disclosure of additional information, relevant for understanding the financial position and liquidity of the enterprise together with a commentary by management. Such information may include:
  (a) The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and
  (b) The aggregate amount of cash flows required for maintaining operating capacity, e.g. purchase of machinery to replace the old, separately from cash flows that represent increase in operating capacity, e.g. additional machinery purchased to increase production.

PRACTICE QUESTIONS
AS 3

Question 1—

What are the main features of the Cash Flow Statement? Explain with special reference to AS 3.

Answer—

- According to AS 3 (Revised) on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities.
- Cash flows from operating activities can be reported using either
  a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
  b) The indirect method, whereby net profit or loss is adjusted for the effects of transactions of non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.
- As per para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.
- A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.
- This statement also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

Chapter 4
Presentation & Disclosures Based Accounting Standards
(Unit- 5)
AS – 20 Earnings Per Share

1. OBJECTIVE AND APPLICATION

The objective of AS 20 is to describe principles for determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise.

Earnings per share (EPS) is a financial ratio indicating the amount of profit or loss for the period attributable to each equity share and AS 20 gives computational methodology for determination and presentation of basic and diluted earnings per share.

This Accounting Standard is mandatory for all companies. However, disclosure of diluted earnings per share (both including and excluding extraordinary items) is not mandatory for SMCs. Such companies are however encouraged to make these disclosures.

In consolidated financial statements, the information required by AS 20 should be presented on the basis of consolidated information.

2. BASIC EPS

$$\text{Basic EPS} \frac{\text{Earning available to Eqity Shareholder}}{\text{Weighted average o/s no.of equity sheres}}$$

Note 1:

Earnings available to Equity Shareholder:

EBIT	**XXXX**
Less :INTEREST	**(xx)**
PBT	**xxxxx**
Less: TAX	**(xx)**
PAT/NP	**xxxx**
Less: Preference Shares Dividend & tax	**(xx)**
Earnings available to ESH	**XXX**

Note 2: Weighted average o/s no. of equity shares:-

No. of equity shares averaged with time proportionate out of twelve months and paid up value proportionate out of face value

Note 3: Issue of bonus shares

- It will never be time adjusted even if its issued in current year.
- Calculate adjusted EPS of previous year including bonus issue assuming that it has been issued even prior to previous year.

Note 4: EPS in case of issue of right shares–

Step 1 - Calculation of Ex-theoretical value per equity shares;

$$= \frac{\text{Total fair value of existing share} + \text{Totalissue price of right share}}{\text{Total no. of equity share including right share}}$$

Step 2 – Calculation of Adjusted Factor

$$= \frac{\textbf{Fair value per equity share}}{\textbf{Ex.Theoretical Value}}$$

Step 3- Calculation of EPS of previous year

$$\textbf{A. Basic EPS} = \frac{\textbf{EATESH}}{\textbf{Existing no.of Equity Shares}}$$

$$B. Adjusted\ EPS = \frac{\textbf{EATESH}}{\textbf{Existing no.of Equity Share} \times \textbf{ Adjusted Factor}}$$

Step 4 – EPS of Current Year =

$$= \frac{\text{EATESH}}{\left(Existing\ no.of\ Equity\ Shares \times Adjusted\ Factor \times \frac{time}{12}\right) + \left(Total\ no.of\ shares \times \frac{time}{12}\right)}$$

3. DILUTED EPS

- It is calculated only when potential equity shares exist in balance sheet.
- It is calculated only for current year in addition to basic EPS.
- Potential equity shares means those liabilities which will get converted in to equity shares in future
- For example convertible debenture, convertible Preference Share & ESOP
- If EPS is anti- diluted (if increase due to potential equity share then it will not be calculated)

$$Diluted\ EPS = \frac{Adjusted\ earning\ available\ to\ ESH}{\text{Adjusted weighted average no. of shares}}$$

Note 5 : Calculation of adjusted earning and weighted average no. of shares

	Potential Equity share	Adjusted earnings available to Equity shareholder		Adjusted weighted average no. of Equity Shares	
	If convertible debentures	Existing EATESH	xx	Existing no. of equity shares	xx
		Add: Interest	xx	issued on convers…	xx
		Less: Tax saving on Interest	(xx)		
			xxx		xxx

	If convertible preference shares	Existing earning available to ESH xxx Add: Pref. shares Dividend including DT xx Xxx	Same as above
	If ESOP o/s	No change (only existing earningavailable to ESH)	Existing no. of equity shares xxx Add: part of ESOP issued as free of cost xx xxx

1. DISCLOSURE

An enterprise should disclose the following:

a. Where the statement of profit and loss includes extraordinary items (as defined is AS 5), basic and diluted EPS computed on the basis of earnings excluding extraordinary items (net of tax expense);

b. The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

c. The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

d. The nominal value of shares along with the earnings per share figures.

If an enterprise discloses, in addition to basic and diluted earnings per share, per share amounts using a reported component of net profit other than net profit or loss for the period attributable to equity shareholders, such amounts should be calculated using the weighted average number of equity shares determined in accordance with AS 20. If a component of net profit is used which is not reported as a line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss. Basic and diluted per share amounts should be disclosed with equal prominence.

Questions and Answer

Question: 1

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash. Also define Potential Equity Share.

Answer

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given situations:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles, or may entitle its holder to equity shares.

Question 2—

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.

Answer:

Computation of earnings per share

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

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.

Question 3.

In April, 2010, A Limited issued 18,00,000 Equity shares of ₹ 10 each, ₹ 5 per share was called up on that date which was paid by all the shareholders. The remaining ₹ 5 was called up on 1-9-2010. All the Shareholders (except one having 3,60,000 shares) paid the sum in September 2010. The net profit for the year ended 31-3-2011 is ₹ 33 lakhs after dividend on preference shares and dividend distribution tax of ₹ 6.60 lakhs.

Compute the basic EPS for the year ended 31st March, 2011 as per AS 20.

Answer

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$= \frac{33,00,000}{13,20,000\ Shares\ (as\ per\ working\ note)}$ ₹ 2.5 per share

Working Note:

Calculation of weighted average number of equity shares

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

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
	₹	₹	₹
1.4.2010	18,00,000	5	18,00,000 × 5/10 × 5/12 = 3,75,000
1.9.2010	14,40,000	10	14,40,000 × 7/12 = 8,40,000
1.9.20110	3,60,000	5	3,60,000 × 5/10 × 7/12 = <u>1,05,000</u>
Total shares			**<u>13,20,000</u>**

Question 4—

"While calculating diluted earning per share, effect is given to all dilutive potential equity shares that were outstanding during that period." Explain. Also calculate the diluted earnings per share from the following information:

Net profit for the current year	₹ 85,50,000
No. of equity shares outstanding	20,00,000
No. of 8% convertible debentures of ₹ 100 each	1,00,000
Each debenture is convertible into 10 equity shares	
Interest expenses for the current year	₹ 6,00,000
Tax relating to interest expenses	30%

Answer

"In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per para 26 of AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Computation of diluted earnings per share $\frac{\textbf{Adjusted net profit for the current year}}{\text{Weighted average number or equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year (assumed to be after tax)	85,50,000
Add: Interest expense for the current year	6,00,000
Less: Tax relating to interest expense (30% of 6,00,000)	(1,80,000)
Adjusted net profit for the current year	89,70,000

Note: Conversion of convertible debentures into Equity Share is a dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Note: In the given question company having 8% debentures of Rs. 1 Crore it means amount of annual interest is Rs. 8 lac. but in the question interest of Rs. 6 lac. is given it menas it is for nine months therefore number of equity shares to be issued on conversion has been averaged with 9 months out of 12 months.

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$= \frac{1{,}00{,}1000 \times 10}{10} = 10{,}00{,}000\ Equity\ shares$

Weighted average number of equity shares used to compute diluted earnings per share = [(20,00,000 × 12) + (10,00,000 x 9**)]/12 = 27,50,000 shares

Diluted earning per share = $\frac{89,70,000}{27,50,000\ shares}$ =₹ 3,26 per share

Question : 5 –

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.

Answer

Computation of weighted average number of shares outstanding during the period

Date	No. of equityshares	Period outstanding	Weights (months)	Weighted averagenumber 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(Additionalissue)	8 months	8/12	400
31st March, 2009	500 (Buy back)	0 months	0/12	–
Total				1,900

Basic Earnings Per Share =

Question 6—

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

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

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.

Answer

Computation of Earnings Per Share

	Earnings ₹	Shares	Earning 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 $\left[\frac{30,00,000}{12,80,000}\right]$	30,00,000	12,80,000	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

Question: 7

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

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

EPS = $\frac{Net\ profit}{No.of\ shares} = \frac{27.90}{9.30}$ =₹ 3 Per share.

Question: 8

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.

Answer:

(a) Computation of basic earnings per share (EPS)

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

Working Notes:

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

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

$$= \frac{(₹\ 28 \times 12{,}00{,}00\ shares) + (₹\ 2 \times 4{,}00{,}000\ shares)}{12{,}00{,}000\ shares + 4{,}00{,}000\ shares} = ₹\ 26.50$$

2. Computation of adjustment factor

$$= \frac{Fair\ value\ per\ share\ prior\ to\ exercise\ of\ rights}{Theoretical\ ex\text{-}right\ value\ per\ share} = \frac{₹\ 28}{₹\ 26.5} = 1.06\ (approx.)$$

Question: 9

XYZ Ltd. had issued 30,000, 15% convertible debentures of 100 each on 1st April, 2008.

The debentures are due for redemption on 1st March, 2011. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal Value 10) at a price of 15 per share. Debenture holders holding 2500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debenture holders exercising the option to the maximum.

Answer:

Calculation of number of equity shares allotted to be debenture holders

	No. of debenture
Total number of debentures	30,000
Less: Debenture holders not opted for conversion	(2,500)
	27,500
Option for conversion	20%
	5,500
Number of debentures for conversion $\left(27{,}500 \times \frac{50}{100}\right)$	
Redemption value at a premium of 5% (5,500 × ₹ 105)	₹ 5,5,77,500
Number of equity shares to be allotted $\frac{`5{,}77{,}500}{`15}$	38,500 shares

Question 10—

(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 case:

		No. of shares
1st April, 2010	Balance of equity shares	7,20,000
31st August, 2010	Equity shares issued for cash	2,40,000
1st February, 2011	Equity shares bought back	1,20,000
31st March, 2011	Balance of equity shares	8,40,000

(ii) Compute adjusted earnings per share and basic EPS based on the following information:

Net profit 2009-10	₹ 7,20,000
Net profit 2010-11	₹ 24,00,000
No. of equity shares outstanding until 31st December, 2010	8,00,000

Bonus issue on 1st January, 2011, 2 equity shares for each equity share outstanding at 31st December, 2010.

Answer:

(i) As per para 16 of AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares

7,20,000 × 5/12	= 3,00,000 shares
9,60,000 × 5/12	= 4,00,000 shares
8,40,000 × 2/12	= 1,40,000 shares
	= 8,40,000 shares

(ii) Earning per share

Basic EPS 2010-11 = 24,00,000/24,00,000 = 1 Adjusted EPS 2009-10 = 7,20,000/24,00,000 = 0.30

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 2009-10, the earliest period reported.

Question 11—

The following information is available for AB Ltd. for the accounting year 2012-13 and 2013-14:

Net profit for		₹
Year	2012-13	22,00,000
Year	2013-14	30,00,000

No of shares outstanding prior to right issue 10,00,000 shares.

Right issue : One new share for each five shares outstanding i.e. 2,00,000 shares.

: Right Issue price ₹ 25

: Last date to exercise right 31st July, 2013

Fair value of one equity share immediately prior to exercise of rights on 31.07.2013 is ₹ 32.

You are required to compute:

(i) Basic earnings per share for the year 2012-13.

(ii) Restated basic earnings per share for the year 2012-13 for right issue.

(iii) Basic earnings per share for the year 2013-14.

Answer:

Computation of Basic Earnings per Share

		Year 2012-13 (₹)	Year 2012-13 (₹)
(i)	EPS for the year 2012-13 as originally reportedm = Net profit for the year attributable to equity share holder/weighted average number of equity shares outstanding during the year $\frac{₹22,00,000}{10,00,000\text{shares}}$	2.20	
(ii)	EPS for the year 2012-13 restated for the right issue $\frac{₹22,00,000}{10,00,000\text{shares}\times 1.04}$	2.12	
(iii)	EPS for the year 2013-14 (including effect of right issue) $\frac{₹30,00,000}{(10,00,000\times 1.04\times 4/12)\ (12,00,000\times 8/12)}$	2.62	

Working Notes:

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

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

$$\frac{(₹32\times 10,00,000)(₹25,\times 2,00,000)}{10,00,000+2,00,000}$$

= ₹ 30.83

2. Compulation of adjustment factor

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

$$= \frac{₹\,32}{30.8.} = 1.04 \text{ (Approx)}$$

Question 12—

What do you mean by "Weighted average number of equity shares outstanding during the period" and why is it required to be calculated? Compute weighted average number of equity shares in the following case:

		No. of shares
1st April, 2014	Balance of Equity Shares	5,00,000
30th June, 2014	Balance Shares issued for cash	1,00,000
15th January, 2015	Equity Shares bought back	50,000
31st March, 2015	Balance of Equity Shares	5,50,000

Answer

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time.

For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Computation of weighted average number of shares outstanding during the period

Date	No. of equity shares	Period outstanding	Weights (months)	Weighted averagenumber of shares
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1st April, 2014	5,00,000 (Opening)	3 months	3 /12	1,25,000
30th June 2014	6,00,000 (after Additional issue)	6.5months	6.5/12	3,25,000
15th Jan, 2015	5,50,000 (after Buy back)	2.5 months	2.5/12	1,14,583
31st March, 2015	5,50,000 (Balance)	0 month	0/12	–
Total				5,64,583

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CHAPTER 5 (UNIT – 2)
ACCOUNTING STANDARDS - 10
PROPERTY PLANT & EQUIPMENT (REVISED)

AS 6 Accounting for Depreciation

AS 10 Accounting for Fixed Asset (Old)

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Withdrawn by ICAI

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Introduced AS 10 (revised) Property, Plant and Equipment (PPE)

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To bring uniformity with Ind. AS 16 and IFRS

1. OBJECTIVE

- Prescribe Accounting treatment for Property, Plant and Equipment (PPE)
- Recognition of the assets
- Determination of carrying amount of PPE
- Depreciation charges
- Impairment losses

2. SCOPE OF AS 10

- AS 10 should be applied in accounting for PPE.
- Exception: When another Accounting Standard requires or permits a different accounting treatment.

AS 10 Not Applicable to

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- Biological Assets (other than Bearer Plants) Related to Agricultural activity
- Wasting Assets including Mineral rights, Expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources

Note 1 Biological asset include living animal and plant

Note 2 Bearer plant is a plant:

✓ **To be used in supply or production of agriculture product**

✓ **Life more than 12 month**

✓ **Plant not to be sold in ordinary course of business except as scrap**

3. DEFINITION OF PPE

- It is Tangible Assets
- Held for
  - ✓ To be used in production OR Rendering Services
  - ✓ To be used in Administrative work
  - ✓ To be used in other purpose (i.e. rental purpose)
- Life more than 12 months

Note 3 Asset acquired for safety or environmental purpose will be also PPE.

4. RECOGNITION CRITERIA OF PPE

- If following two conditions is fulfil then PPE is to be recognized.
  - **a.** Future Expected Economic Benefit
  - **b.** Reliably Measurable Cost (Measurement)

Note 4

- It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value.
- An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.

5. SPARE PARTS & STAND BY EQUIPMENTS

- If it fulfils definition of PPE than consider as a part of PPE
- If it is not fulfil definition of PPE than considered part of inventory under AS 2

6. TREATMENT OF SUBSEQUENT COSTS

Cost of day to day servicing

i. Not recognize as PPE
ii. Part of Repair and maintenance
iii. Debited to PL account

Replacement of Parts of PPE

i. Recognize if fulfil criteria of PPE
ii. Increase existing carrying amount
iii. Derecognize existing carrying amount for replaced part

Regular Major Inspections

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Similar to replacement of Parts

7. MEASUREMENT OF PPE

Initial Recognition

It is to be recognized using cost model that is total cost incurred to bring PPE present location and condition for available to use

Subsequent

Two Option

Cost Model

Continue with total Cost of assets

Revaluation Model

Revise the value of Assets as per his fair value

8. COST OF PPE

If Purchased

It includes all the cost up to ready to use

(i) Purchase Price (deducted by Discount, subsidy or rebate)
(ii) Taxes & duties (Non-refundable)
(iii) Any other cost to get Assets ready to use

If Self Constructed

It includes:

(i) Cost of Material (deducted by recovery)
(ii) Directly attributable labour & overhead up to read to use
(iii) Exclude Internal Profit

Under Exchange

(i) If transaction is under commercial substance than cost PPE taken will be fair value of PPE taken
(ii) If not under commercial substance than cost of PPE will be book value of Assets given

Note 5 INCLUSIONS IN COST OF PPE (Other expenses)

- **i.** Site Preparation
- **ii.** Installation
- **iii.** registration
- **iv.** Testing& Trial
- **v.** Initial delivery and handling costs
- **vi.** Professional fees etc.

Note 6

Estimated present value of cost of dismantling & decommissioning will be also part of cost of PPE

Note7 EXCLUSIONS FROM COST OF PPE

- **i.** Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
- **ii.** Initial operating losses, such as those incurred while demand for the output of an item builds up.
- **iii.** Costs of relocating or reorganising part or all of the operations of an enterprise.
- **iv.** Cost of opening new facility
- **v.** Borrowing cost unless AS 16 permits
- **vi.** Cost of advertisement and promotional exp.
- **vii.** Abnormal wastage/Losses

9. ACCOUNTING OF REVALUATION OF PPE

(a) If PPE revalued first time :

- **i.** If increase then credit to revaluation reserve account.
- **ii.** If Decrease then debit to PL account.

(b) If PPE revalued subsequently :

- **i.** If previously increase and now also increase then credit to revaluation reserve account.
- **ii.** If previously increase and now decrease then debit revaluation reserve up to balance available in due to previous increase and for excessive decrease debit PL account.
- **iii.** If previously decrease and now also decrease then debit to PL account.
- **iv.** If previously decrease and now increase then credit to PL account up to previous decrease and for balance increase credit revaluation reserve account.

(c) Revaluation is to be done class wise on group of Assets

(d) If PPE is discontinued or sold out in future than existing balance of revaluation reserve account for Such category of Assets is to be transfer to General Reserve A/c

(e) Revaluation interval

- **i.** If value of Assets changed significantly year to year then Revaluation every year
- **ii.** If value changed insignificantly Revaluation with Interval of 3 to 5 year

10. DEPRECIATION

- Depreciation is to be charged year to year on PPE.
- It is to be charged on depreciable amount.
- It is to be charged on systematic basis.
- Method of depreciation may be SLM, WDV, Unit of production method any other will be used.

- If a particular PPE is having significant components than depreciation is to be charged on each component separately (OR similar group of component)
- Review/change in :
  - **(a)** Carrying Amount of Assets
  - **(b)** Useful life
  - **(c)** Salvage Value
  - **(d)** Rate of Depreciation
  - **(e)** Method of depreciation

  Will be considered as change in estimation and it will have prospective effect.
- Depreciation is to be charged from the date of Assets become ready to use.
- Depreciation ceases to be charged when asset's residual value exceeds or equal to its carrying amount

11. <u>Disclosure</u>

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General	Additional	Disclosures related to Revalued Assets

General Disclosures—

The financial statements should disclose, for each class of PPE:

(a) The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;

(b) The depreciation methods used;

(c) The useful lives or the depreciation rates used.

(d) In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;

(e) The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(f) A reconciliation of the carrying amount at the beginning and end of the period showing:

Additional Disclosures—

The financial statements should also disclose:

(a) The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) The amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) The amount of contractual commitments for the acquisition of property, plant and equipment;

(d) If it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and

(e) The amount of assets retired from active use and held for disposal.

Disclosures related to Revalued Assets:

If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:

(a) The effective date of the revaluation;

(b) Whether an independent valuer was involved;

(c) The methods and significant assumptions applied in estimating fair values of the items;

(d) The extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and

(e) The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders

Illustration 1—

A company bought an asset for 100,000 with an expected useful life of five years. After two years of use company decided to change the depreciation method from straight-line basis to reducing balance method at the rate of 15%.

Required: Calculate the depreciation for the third and fourth year

Solution—

as per AS 10 Revised PPE, change in method of depreciation will be considered as change in estimation and now it will have prospective effect therefore calculation will be as under:-

Step 1: Find the carrying amount at the date of change

Change in depreciation is made after two years so we will depreciate the asset for two years and it was on straight line basis.

100,000 / 5 = 20,000 per year

For two years it will be 20,000 x 2 = 40,000

Thus, carrying amount of the asset at the end of second year was 100,000 - 40,000 = 60,000

Step 2: Depreciate the carrying amount on the new basis from the date of change

Carrying amount at the date of change = 60,000

New basis of depreciation = Reducing balance method @ 15%

Depreciation for the third year will be calculated as follows: 60,000 × 0.15 = 9,000

Depreciation for the fourth year will be calculated as follows: (60,000 – 9,000) × 0.15 = 7,650

Questions & Answer

Question 1—

What are depreciable assets as per Accounting Standard-10? Explain why AS 10 does not apply to Land.

Answer—

- As per AS 10 "PPE', depreciable assets are the assets which are expected to be used during more than one accounting period; and
- Have a limited useful life; and
- Are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.
- AS 10 does not apply to 'land' as land is considered to have unlimited useful life. Therefore, it is not appropriate to charge depreciation on land.

Question 9—

A machinery costing ₹ 20 lakhs has useful life for 5 years. At the end of 5 years its scrap value would be ₹ 2 lakhs. How much depreciation is to be charged in the books of the company as per Accounting Standard 10?

Answer—

Calculation of depreciation as per Straight Line Method

	₹
Cost of machinery	20,00,000
Less: Scrap value at the end of its useful life (i.e. after 5 years)	(2,00,000)
Amount to be written off during the useful life of the machinery	18,00,000
Useful life of the machinery	5 years
Depreciation to be provided each year (₹ 18,00,000 / 5 years)	₹ 3,60,000

Question 2—

MIs Progressive Company Limited has not charged depreciation for the year ended on 31st March, 2015, in respect of a spare bus purchased during the financial year 201 4-15 and kept ready by the company for use as a stand-by, on the ground that, it was not actually used during the year. State your views with reference to Accounting Standard 10 "PPE".

Answer—

- According to AS 10, "PPE'', depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable assets arising from use, effluxion of time or obsolescence through technology and market changes.
- Accordingly, depreciation may arise even the asset is not used in the current year but was ready for use in that year.
- The need for using the stand by bus may not have arisen during the year but that does not imply that the useful life of the bus has not been affected.
- Therefore, non-provision of depreciation on the ground that the bus was not used during the year is not tenable. So, depreciation should be changed on Spare Parts.

Question 3—

A computer costing ₹ 60,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Calculate depreciation as per the provisions of Accounting Standard 10 "PPE".

Answer—

Depreciation per year = ₹ 60,000 / 10 = ₹ 6,000

Depreciation on SLM charged for three years = ₹ 6,000 × 3 years = ₹ 18,000

Book value of the computer at the end of third year = ₹ 60,000 - ₹ 18,000 = ₹ 42,000.

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 5 years

Depreciation from the fourth year onwards = ₹ 42,000 / 5 = ₹ 8,400 per annum

Question 4

Narmada Ltd. purchased an existing bottling unit from Kaveri Ltd. Kaveri Ltd. followed straight line method of charging depreciation on machinery of the sold unit whereas Narmada Ltd. followed written down value method in its other units. The directors of Narmada Ltd. want to continue to charge depreciation for the acquired unit in Straight Line Method which is not consistent with the WDV method followed in other units. Discuss the contention of the directors with reference to the Accounting Standard 10. Further during the year, Narmada Ltd. set up a new plant on coastal land. In view of the corrosive climate, the Company felt that its machine life is reducing faster. Can the Company charge a higher rate of depreciation?

Answer–

- According to AS 10 "PPE'', there are several methods of allocating depreciation over the useful life of the assets.
- The management of a business selects the most appropriate method(s) based on various important factors e.g., (i) type of asset, (ii) the nature of the use of such asset and (iii) circumstances prevailing in the business.
- A combination of more than one method is sometimes used.
- A company may adopt different methods of depreciation for different types of assets, provided the same methods are followed consistently.
- Thus Narmada Ltd. can continue to charge depreciation for the acquired unit as per straight line method.
- The statute governing an enterprise may provide the basis for computation of the depreciation.
- For example, the Companies Act lays down the rates of depreciation in respect of various assets.
- Where the managements estimate of the useful life of an asset of the enterprise is shorter than that envisaged under the provisions of the relevant statute, the depreciation provision is appropriately computed by applying a higher rate.
- Therefore, in the given case, the Company can charge higher rates of depreciation based on its estimate of the useful life of machinery, provided that such estimate is not less than the rate prescribed by the Companies Act, for that class of assets.
- However, such higher depreciation rates and/or the reduced useful lives of the assets should be disclosed by way of notes to the accounts in the Financial Statements.

Question 5

On 01.04.2010 a machine was acquired at ₹ 4,00,000. The machine was expected to have a useful life of 10 years. The residual value was estimated at 10% of the original cost. At the beginning of the 4th year, an attachment was made to the machine at a cost of ₹ 1,80,000 to enhance its capacity. The attachment was expected to have a useful life of 10 years and zero terminal value. During the same time the original machine was revalued upwards by ₹ 90,000 and remaining useful life was reassessed at 9 years and residual value was reassessed at NIL.

Find depreciation for the fourth year, if

(i) Attachment retains its separate identity.

(ii) Attachment becomes integral part of the machine

Answer --

Depreciation of Original Machine

	₹
Original cost of Machine as on 01.04.2010	4,00,000
Less: Residual Value 10%	(40,000)
Depreciable Value	3,60,000
Useful life	10 Years
Depreciation per year	36,000
Depreciation for 3 Years	1,08,000
Written down value at the beginning of 4th year (as on 1.04.2013) (4,00,000 – 1,08,000)	2,92,000
Add: Revaluation	90,000
Total Book Value after revaluation	3,82,000

Reassessed remaining useful life 9 Years	
Depreciation per year from 2013-14	42,444

Depreciation of Attachment

	₹
Original cost of Attachment as on 01.04.2013	1,80,000
Useful life	10Years
Depreciation per year from 2013-14	18,000

Depreciation for the year 2013-14

(i) If Attachment retains its separate identity:

Depreciation of Original Machine	₹ 42,444
Depreciation of Attachment	₹ 18,000
Total Depreciation for 2013-14	₹ 60,444

(ii) If Attachment becomes integral part of the Machine:

Total value of Machine as on 01.04.2013	
Original Machine at revalued cost (W.N.1)	₹ 3,82,000
Cost of attachment	₹ 1,80,000
	₹ 5,62,000
Useful life	9 Years
Depreciation for 2013-14	₹ 62,444

Question 6—

A machinery with a useful life of 6 years was purchased on 1st April, 2012 for ₹ 1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost.

In the beginning of fourth year the company reassessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of original cost.

The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year.

Answer—

- As per AS 10 "PPE", when there is a revision of the estimated useful life of an asset, the unamortized depreciable amount should be charged over the revised remaining useful life. Accordingly revised depreciation shall be calculated prospectively.
- Thus, the treatment done by the accountant regarding recalculating the revised depreciation historically i.e. retrospectively is incorrect.
- As per AS10, if the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets.
- In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

Calculation of Depreciation

Depreciation per year charged for first three years= ₹ (1,50,000 - 15,000) / 6 = ₹ 22,500

WDV of the machine at the beginning of the fourth year = ₹ 1,50,000 - (₹ 22,500× 3) = ₹ 82,500

Depreciable amount after reassessment of residual vale = ₹ 82,500 - (1,50,000 x 5%) = ₹ 75,000

Remaining useful life as per revised estimate = 4 years

Depreciation from the fourth year onwards = ₹ 75,000 / 4 = ₹ 18,750

Question 7—

During the current year 2014-15, X Limited made the following expenditure relating to its plant building:

	₹ in lakhs
Routine Repairs	4
Repairing	1
Partial replacement of roof tiles	0.5
Substantial improvements to the electrical wiring system which will increase efficiency	10

What amount should be capitalized?

Answer—

- As per of AS 10 "PPE", expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity.
- Hence, in the given case, Repairs amounting ₹ 5 lakhs and Partial replacement of roof tiles should be charged to profit and loss statement.
- ₹ 10 lakhs incurred for substantial improvement to the electrical writing system which will increase efficiency should be capitalized.

Question 8—

During the year 2014-15, P Limited incurred the following expenses on machinery:

₹ 2.50 lacs as routine repairs and ₹ 75,000 on partial replacement of a part.₹ 7 lacs on replacement of part of a machinery which will improve the efficiency of the machine. Which amount should be capitalized as per AS 10?

Answer—

- As per AS 10 "PPE", only those expenditures that increase the future benefits from the existing assets, is to be included in the gross book value. Example: Increase in capacity.
- Hence, in the given case, amount of ₹ 3.25 lacs spent on repairs and partial replacement of a part of the machinery should be charged to Profit and Loss Account as they will help in maintaining the capacity but will not improve the efficiency of the machine.
- However, ₹ 7 lacs incurred on replacement of a part of the machinery, which will increase the efficiency, should be capitalized by inclusion in the gross book value of assets.

Question 9—

During the year MIs Progressive Company Limited made additions to its factory by using its own workforce, at a cost of ₹ 4,50,000 as wages and materials. The lowest estimate from an outside contractor to carry out the same work was ₹ 6,00,000. The directors contend that, since they are fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with ₹ 6,00,000. Comment whether the directors' contention is right in view of

Answer—

- AS 10, "PPE", clearly states that the gross book value of the self constructed fixed asset includes the cost of construction that relate directly to the specific asset and the costs that are attributable to the construction activity in general can be allocated to the specific asset.
- If any internal profit is there it should be eliminated.
- Thus, only ₹ 4,50,000 should be debited to the factory building account and not ₹ 6,00,000. Hence, the contention of the directors of the company to capitalize ₹ 6,00,000

as cost of factory building, on the ground that the company is fully entitled to employ an outside contractor is not justifiable.

Question 10—

PQR Ltd. constructed a fixed asset and incurred the following expenses on its construction:

	(₹)
Materials	16,00,000
Direct Expenses	3,00,000
Total Direct Labour (1/15th of the total labour time was chargeable to the construction)	6,00,000
Total Office & Administrative Expenses (4% of office and administrative expenses are specifically attributable to construction of a fixed asset)	9,00,000
Depreciation on assets used for the construction of this asset	15,000

Calculate the cost of the fixed asset

Answer—

Calculation of cost of fixed asset

	₹
Materials	16,00,000
Direct expenses	3,00,000
Direct labour (1/15th of ₹ 6,00,000)	40,000
Office and administrative expenses (4% ₹ 9,00,000)	36,000
Depreciation on assets	15,000
Cost of fixed asset	19,91,000

Question 11—

Amna Ltd. contracted with a supplier to purchase a specific machinery to be installed in Department A in two months time. Special foundations were required for the plant, which were to be prepared within this supply lead time. The cost of site preparation and laying foundations were ₹ 47,290. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 15,000 per month. The Technician's services were given to Department A by Department B, which billed the services at ₹ 16,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 52,78,000. Sales Tax was charged at 4% on the invoice ₹ 18,590 transportation charges were incurred to bring the machine to the factory. An Architect was engaged at a fee of ₹ 10,000 to supervise machinery installation at the factory premises. Also, payment under the invoice was due in 3 months. However, the Company made the payment in 2nd month. The company operates on Bank Overdraft@ 11%.

Ascertain the amount at which the asset should be capitalized under AS 10.

Answer—

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

Particulars		₹
Purchase Price	Given	52,78,000
Add: Sales Tax at 4%	₹ 52,78,000 × 4%	2,11,120
Site Preparation Cost	Given	47,290
Technician's Salary	Specific/Attributable overheads for 2 months (See Note)	30,000
Initial Delivery Cost	Transportation	18,590
Professional Fees for Installation	Architect's Fees	10,000
Total Cost of Asset		55,95,000

Note:

(i) Interest on Bank Overdraft for earlier payment of invoice is not relevant under AS 10.

(ii) Internally booked profits should be eliminated in arriving at the cost of Fixed Assets.

(iii) It has been assumed that the purchase price of ₹ 52,78,000 excludes amount of sales tax.

Question 12—

M/s. Versatile Limited purchased machinery for ₹ 4,80,000 (inclusive of excise duty of ₹ 40,000). CENVAT credit is available for 50% of the duty paid. The company incurred the following other expenses for installation.

	₹
Cost of preparation of site for installation	21,000
Total labour charges .	66,000
(200 out of the total of 600 men hours worked, were spent for installation of the machinery)	
Spare parts and tools consumed in installation	6,000
Total salary of supervisor	24,000
(time spent for installation was 25% of the total time worked.)	
Total administrative expenses	32,000
(1/10 relates to the plant installation)	
Test run and experimental production expenses	23,000
Consultancy changes to architect for plant set up	9,000
Depreciation on assets used for the installation	12,000

The machine was ready for use on 15-1-2015 but was used from 1-2-2015. Due to this delay further expenses of ₹ 19,000 were incurred. Calculate the value at which the plant should be capitalized in the books of M/s. Versatile Limited.

Particulars		₹
Purchase Price	Given	4,80,000
Add:		
Site Preparation Cost	Given	21,000
Labour charges	(66,000/600x200)	22,000
Spare parts	Given	6,000
Supervisor's Salary	25% of ₹ 24,000	6,000
Administrative costs	1/10 of ₹ 32,000	3,200

Test run and experimental production charges	Given	23,000
Architect Fees for set up	Given	9,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		5,82,200
Less: Cenvat credit receivable	50% of ₹ 40,000	20,000
		5,62,200

Note: Expense of ₹ 19,000 from 15.1.2015 to 1.2.2015 to be charged to profit and loss A/c as plant were ready for production on 15.1.2015.

Question 13—

Briefly explain the treatment of following items as per relevant accounting standards:

(i) An expense of ₹ 5 crores was incurred on a Machine towards its Repairs and Maintenance. The accountant wants to capitalize the same considering the significance of amount spent.

(ii) A plant was ready for commercial production on 01.04.2014 but could commence actual production only on 01.06.2014. The company incurred ₹ 50 Iakhs as administrative expenditure during the period of which 20% was allocable to the plant. The accountant added ₹ 10 lakhs to cost of plant.

Answer—

(i) Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. The cost of an addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is usually added to its gross book value. Any other expenses incurred, though substantial, on machine towards its repairs and maintenance should not be capitalized but charged to profit and loss account since it does not increase capacity.

(ii) If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement.

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CHAPTER 5 (UNIT – 4)

AS 16 BORROWING COSTS

1. MEANING OF BORROWING COST

- It includes different types of cost relating to debt.
- e.g. interest on debt, Discount issue of debt, premium on redemption of debt and issue expenses of debt
- Dividend cost is not considered part of borrowing cost—

2. ACCOUNTING TREATMENT OF BORROWING COSTS

CAPITAL NATURE	REVENUE NATURE
• Added to cost of related assets if these 3 conditions are fulfilled :— **(i)** Amount is used for qualifying asset **(ii)** Expected future economic benefit **(iii)** Reliable measurement on estimation basis.	• If these 3 conditions are not fulfilled • Debited to profit and loss account

3. QUALIFYING ASSETS

- Asset or stock which is not already in ready to use or ready to sale condition.
- It will take substantial time to get ready to use/sale then it known as qualifying assets
- E.g. Construction of building/plant, timber plantation business etc.
-

4. TIMING OF CAPITALIZATION

Commencement of capitalization	Suspension of work	Ceasation of capitalization
• Expenditure for the acquisition, construction or production of a qualifying asset is being incurred • Borrowing costs are being incurred. • Activities that are necessary to prepare the asset for its intended use or sale are in progress	• Suspension is due to expected reason then Capitalized it • Suspension is due to unexpected reason Charge to P/L	• Capitalization of interest will cease when asset/ stock will become ready to sale/use condition • It means work is almost/ fully completed

5. TYPES OF BORROWINGS

Specific Borrowing
Will be used in priority to general borrowing.

General Borrowing

Note

- If more than one type of general borrowing then calculate WACC (Weighted average cost of capital)
- If amount of borrowing has been temporary invested then income from such investment is to be deducted from overall borrowing cost.

6. DISCLOSURE:

The financial statements should disclose:

(i) The accounting policy adopted for borrowing costs; and
(ii) The amount of borrowing costs capitalised during the period.

PRACITCAL QUESTIONS & ANSWERS

AS 16

Question 1—

When capitalisation of borrowing cost should cease as per Accounting Standard 16?

Answer—

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

Question 2—

GHI Limited obtained a loan for ₹ 70 lakhs on 15th April, 2010 from JKL Bank, to be utilized as under:

	₹ in lakhs
Construction of Factory shed	25
Purchase of Machinery	20
Working capital	15
Advance for purchase of Truck	10

In March 2011, construction of the factory shed was completed and machinery, which was ready for its intended use, was installed. Delivery of Truck was received in the next financial year. Total interest of ₹ 9,10,000 was charged by the bank for the financial year ending 31-03-2011.

Show the treatment of interest under AS 16 and also explain the nature of Assets.

Answer—

Treatment of Interest (Borrowing cost) as per AS 16 'Borrowing Costs'

Particulars	**Nature**	**Interest to be capitalized**	**Interest to be charged to P&L A/c**
Construction of Factory Shed	Qualifying Asset	$9,10,000 \times \frac{25}{70} = ` 3,25,000$	
Purchase of Machinery (Refer	Not a Qualifying Asset		$9,10,000 \times \frac{20}{70} = ` 2,60,000$
Working Capital	Not a Qualifying Asset		$9,10,000 \times \frac{15}{70} = ` 1,95,000$
Advance for purchase of Truck	Not a Qualifying Asset		9,10,000×10/70=₹ 1,30,000
		₹ 3,25,000	**₹ 5,85,000**

Notes:—

1. It is assumed thatconstruction of a factory shed was completed on 31st March, 2011.
2. It is assumed that the machinery being a non-qualifying asset in this case, hence the interest cost would not be capitalized as it was ready for its intended use at the time of its acquisition
3. As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets should be capitalized as part of the cost of that asset. Other borrowing costs are recognized as expense in the period in which they are incurred.
4. Since the advance for the purchase of truck was paid before March 2011 although the delivery was received in the next financial year, the money was used for its intended purpose and hence the interest will not be capitalized.

   As per AS 16, assets have been defined as 'qualifying asset' and 'non-qualifying asset'.

(i) Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale; whereas,

(ii) Non-qualifying asset is an asset which is ready for its intended use or sale at the time of its acquisition.

Question 3—

Axe Limited began construction of a new plant on 1st April, 2011 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, 2011	5,00,000
1st August, 2011	12,00,000
1st January, 2012	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, 2012. 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.

Answer—

Total expenses to be capitalized 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, 2012	Plant A/c Dr. To Bank A/c [Being amount of cost of plant and borrowing cost thereon capitalised]	20,54,000	20,54,000

Working Notes:

1. Computation of average accumulated annual borrowing:

		₹
1st April, 2011	$` 5,00,000 \times \frac{12}{12}$	5,00,000
1st August, 2011	$` 12,00,000 \times \frac{8}{12}$	8,00,000
1st January, 2012	$` 2,00,000 \times \frac{3}{12}$	50,000
	Annual Average Borrowing	13,50,000

2. Amount of interest capitalized

	₹
On specific borrowing (₹ 4,00,000×10%)	40,000
On non-specific borrowings (₹ 13,50,000 – ₹ 4,00,000) =	1,14,000
9,50,000 × 12% Amount of interest to be capitalized	1,54,000

Question 4—

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2013, to be utilized as under:

Particulars	Amount (₹ in lakhs)
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2014, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2014 was ₹ 11,00,000. During the year 2013-14, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

Answer—

- According to para 6 of AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

- Also para 10 of AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

- Thus, eligible borrowing cost= ₹ 11,00,000 - ₹ 2,00,000 = ₹ 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss A/c (₹)
i.	Construction of factory building	Qualifying Asset*	9,00,000×40/100 = ₹ 3,60,000	NIL
ii.	Purchase of Machinery	Not a qualifying Asset	NIL	9,00,000 ×35/100 = ₹ 3,15,000
iii.	Working Capital	Not a qualifying Asset	NIL	9,00,000×25/100 = ₹ 2,25,000
	Total		**₹ 3,60,000**	**₹ 5,40,000**

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 5—

A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. Comment on the accounting treatment done by the company in context of the relevant AS.

Answer—

- The Accounting Standard Board (ASB) has opinioned that investments other than investment in properties are not qualifying assets as per AS-16 Borrowing Costs.
- Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale.
- Also, where the investment properties meet the definition of 'qualifying asset', for the capitalization of borrowing costs, the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS-16 have to be complied with.

Question 6—

M/s. Ayush Ltd. began construction of a new building on 1st January, 2014. It obtained₹ 3 lakh special loan to finance the construction of the building on 1st January, 2014 at an interest rate of 12% p.a. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 6,00,000	11% p.a.
₹ 11,00,000	13% p.a.

The expenditure that were made on the building project were as follows:

01.01.2014	₹ 3,00,000
01.04.2014	₹ 3,50,000
01.07.2014	₹ 5,50,000
01.12.2014	₹ 1,50,000

Building was completed on 31st December, 2014. Following the principles prescribed in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized and pass one Journal entry for capitalizing the cost and borrowing in respect of the building.

Answer

(i) Computation of average accumulated expenses

		₹
₹ 3,00,000 x 12 / 12	=	3,00,000
₹ 3,50,000 x 9 / 12	=	2,62,500
₹ 5,50,000 x 6 / 12	=	2,75,000
₹ 1,50,000 x 1 / 12	=	12,500
13,50,000		8,50,000

(ii) Calculation of average interest rate other than for specific

Amount of loan (₹)	Rate of interest		Amount of interest(₹)
6,00,000	11%	=	66,000
11,00,000	13%	=	1,43,000
17,00,000			2,09,000

Weighted average rate of interest $\left(\frac{2,09,000}{17,00,000} \times 100\right)$ = 12.29%

(iii) Interest amount to be capitalized

		₹
Specific borrowings (₹ 3,00,000 x 12%)	=	36,000
Non-specific borrowings [₹ 5,50,000(₹ 8,50,000 – ₹ 3,00,000) x 12.29%]	=	67,595
Amount of interest to be capitalized	=	**1,03,595**

(iv) Journal Entry

Date	Particulars	Dr. (₹)	Cr. (₹)
31.12.2014	Building account (13,50,000+1,03,595) Dr.	14,53,595	
	To Bank account		14,53,595
	(Being amount of cost of building and borrowing cost thereon capitalized)		

Question 7—

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2014-15 for its residential project at LIBOR + 3 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2015 ₹ 62 per US $. If Shan Builders Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2015 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Answer—

(i) Interest for the period 2014-15 = US $ 10 lakhs x 4% × ₹ 62 per US $ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount = US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

- Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

- Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

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Chapter 5 (Unit- 5)
AS – 19
LEASES

1. MEANING OF LEASING –

- Contract between two parties' lessor and lessee.
- Lessor transfers his assets to lessee for use of asset by lessee for a certain period.
- Lessee will pay lease rental on periodic basic
- After expiry of lease period, asset is returned back to lessor

2. TYPES OF LEASING:

Financing Lease

When all the risks and rewards related to asset has been transferred to lessee without transfer of ownership

Operating Lease

Which is not financing lease

Eg. Of Financing lease-

(i) If lease period covers almost of the asset

(ii) If asset is having specified nature that can only be used by lessee

(iii) Total present value of payment by leassee almost cover fair value of asset today.

(iv) On expiry of lease period, ownership is to be transferred from lessor to lessee.

(v) On expiry of lease period, lessee will have option to purchase asset for a price less than its fair value end of lease period.

3. SALES AND LEASE BACK

- When asset is sold to a person and the same asset is leased back by purchaser to s
- Accounting treatment

If Financing Lease

Difference of sale value and WDV as a profit or loss on sale will written off over the total time period of lease agreement and fair value is to be ignored.

If Operating Lease

(i) If sales value is more than fair value, than profit with difference will amortize over the total time period of lease agreement.

(ii) All other profit/loss will recognize immediately and transferred to P/L a/c.

2. ACCOUNTING TREATMENT OF LEASING :

Financing Lease

Accounting almost similar to hire purchase

Lessee will record it as an assets lower of :

i) Fair value of asset
ii) Total present value of payment by lessee

Entry:

Asset A/c Dr.
To Lessor A/c

Depreciation will be charged by lessee

Lease rent will be treated as instalment amount

If will include interest (Financecharge) and principle

Operating Lease

Accounting is almost similar to rental contract

Lease rent will be income for lessor and expense for lessee that will be transferred to P/L account. Total of LR is to be transferred to PL a/c in the ratio of future expected benefit and difference if any between annual LR and amount debited/credited to LR

Asset and depreciation will be disclosed by lessor in his books of accounts

Note: 1

Total P.V. of payment by lessee = P.V. of annual lease rental + P.V. of guaranteed residual value(GRV)

Note 2:

Calculation of unearned finance lease income–

Total value of inflow to lessee without PV:	
1. Total value of LR	xxx
2. Total value of GRV	xxx
3. Total value of UGRV	xxx
Less: Cost of asset	xxx
Unearned Finance Income	**xxx**

5. DISCLOSURES MADE BY THE LESSEE

The lessee should, in addition to the requirements of AS 10 (Revised), Property, Plant and Equipment, and the governing statute, make the following disclosures for finance leases:

(a) assets acquired under finance lease as segregated from the assets owned;

(b) for each class of assets, the net carrying amount at the balance sheet date;

(c) a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:

   (i) not later than one year;

   (ii) later than one year and not later than five years;

   (iii) later than five years;

(d) contingent rents recognised as expense in the statement of profit and loss for the period;

(e) the total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date; and

(f) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

   (i) the basis on which contingent rent payments are determined;

   (ii) the existence and terms of renewal or purchase options and escalation clauses; and

   (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

6. DISCLOSURES

The lessor should make the following disclosures for finance leases:

(a) a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:

   (i) not later than one year;

   (ii) later than one year and not later than five years;

   (iii) later than five years;

(b) unearned finance income;

(c) the unguaranteed residual values accruing to the benefit of the lessor;

(d) the accumulated provision for uncollectible minimum lease payments receivable;

(e) contingent rents recognised in the statement of profit and loss for the period;

(f) a general description of the significant leasing arrangements of the lessor; and

(g) accounting policy adopted in respect of initial direct costs.

Note:

The Level II and Level III non-corporate entities (and SMCs) need not make disclosures required by (a) and (f) above.

7. DISCLOSURES BY LESSEES

The paragraph 25 requires lessees to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Note:

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

8. DISCLOSURES BY LESSORS

As per AS 19, the lessor should, in addition to the requirements of AS 10 (Revised) and the governing statute, make the following disclosures for operating leases:

(a) for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and

(i) the depreciation recognised in the statement of profit and loss for the period;

(ii) impairment losses recognised in the statement of profit and loss for the period;

(iii) impairment losses reversed in the statement of profit and loss for the period;

(b) the future minimum lease payments under non-cancelable operating leases in the aggregate and for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(c) total contingent rents recognised as income in the statement of profit and loss for the period;

(d) a general description of the lessor 's significant leasing arrangements; and

(e) accounting policy adopted in respect of initial direct costs.

Note:

The Level II and Level III non-corporate entities (and SMCs) need not make disclosures required by (b) and (d) above.

Questions & Answer

Question 1—

Write short note on Sale and Lease Back Transactions as per Accounting Standard 19.

Answer

As per AS 19 on 'Leases', a sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the asset back to the vendor. The lease payments and the sale price are usually interdependent, as they are negotiated as a package. The accounting treatment of a sale and lease back transaction depends upon the type of lease involved.

If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sale proceeds over the carrying amount should be deferred and amortised over the lease term in proportionto the depreciation of the leased asset.

If sale and leaseback transaction results in a operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over theperiod for which the asset is expected to be used.

Question 2—

Explain the types of lease as per AS 19.

Answer

For the purpose of accounting AS 19 'Leases' classify the lease into two categories as follows:

(i) Finance Lease

(ii) Operating Lease

Finance Lease: It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership. As per para 8 of the standard, in following situations, the lease transactions are called Finance lease:

- ♦ The lessee will get the ownership of leased asset at the end of the lease term.
- ♦ The lessee has an option to buy the leased asset at the end of the lease term at price, which is lowerthan its expected fair value at the date on which option will be exercised.
- ♦ The lease term covers the major part of the life of asset even if title is not transferred.
- ♦ At the beginning of lease term, present value of minimum lease rental covers the initial fair value.

- ♦ The asset given on lease to lessee is of specialized nature and can only be used by the lessee withoutmajor modification.

Operating Lease: It is lease, which does not transfer all the risks and rewards incidental to ownership. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question: 3

Define the term Finance Lease. State any three situations when a lease would be classified as finance lease.

Answer

As per AS 19 'Leases', a finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

As per para 8 of the standard, classification of lease into a finance lease or an operating lease depends on the substance of the transaction rather than its form. Three 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 4—

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.

Answer

Journal entry in the books of Leases

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

Working Note:

Year	Lease Payments ₹	Discounting Factor (12.6%)	Present Value ₹
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 (GRV)	0.552	7,728
			1,49,888

Question 5.

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 2010, 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 2012

(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.

Answer

(i) 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.

(ii) 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 6—

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 installments 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.

Answer

(i) Determination of Nature of Lease

It is assumed that the fair value of the leased equipment's 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: 7

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.

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 recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

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 ₹	Outstandin gliability ₹
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**

Question 8—

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.

Answer:

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.

Question 9—

What do you understand by the term "Interest rate implicit on lease"? Calculate the interest rate implicit on lease from the following details:

Annual Lease Rent	₹ 80,000 at the end of each year
Lease Period	5 Years
Guaranteed Residual Value	₹ 40,000
Unguaranteed Residual Value	₹ 24,000
Fair Value at the inception of the lease	₹ 3,20,000

Discounted rates for the first 5 years are as below:

At 10% 0.909, 0.826, 0.751, 0.683, 0621

At 14% 0.877, 0.769, 0.675, 0.592, 0.519

Answer

As per para 3 of AS 19 ' Leases' the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Present value at discount rate of 10%

Year	Lease Payments (₹)	Disc. Factor (10%)	Present Value (₹)
1	80,000	0.909	72,720
2	80,000	0.826	66,080
3	80,000	0.751	60,080
4	80,000	0.683	54,640
5	80,000	0.621	49,680

5	40,000	0.621	24,840
5	24,000	0.621	14,904
	Total		3,42,944

Present value at discount rate of 14%

Year	Lease Payments (₹)	Disc. Factor (10%)	Present Value (₹)
1	80,000	0.877	70,160
2	80,000	0.769	61,520
3	80,000	0.675	54,000
4	80,000	0.592	47,360
5	80,000	0.519	41,520
5	40,000	0.519	20,760
5	24,000	0.519	12,456
	Total		**3,07,776**

Interest Rate Implicit on Lease = 10% + $\frac{14\%-10\%}{3{,}42{,}944-3{,}07{,}7763} \times (3{,}42{,}944 - 3{,}20{,}000)$

= 10% + 2.609% = 12.609% or say 12.61%

Question 10 -

A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4th year is ₹ 70,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 4th year at 10% IRR is 3.169. The present value of ₹ 1 due at the end of 4th year at 10% rate of interest is 0.683.

State with reasons whether the lease constitutes finance lease and also compute the unearned finance income.

Answer:

(i) Determination of nature of lease Fair value of asset ₹ 7,00,000

Unguaranteed residual value ₹ 70,000

Present value of residual value at the end of 4th Year = ₹ 70,000 x 0.683 = ₹ 47,810

Present value of lease payment recoverable = ₹ 7,00,000 - ₹ 47,810

= ₹ 6,52,190

The percentage of present value of lease payment to fair value of the asset is

= (₹ 6,52,190/ ₹ 7,00,000) x 100

= 93.17%

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

(ii) Calculation of Unearned finance income

Annual lease payment	=	₹ 6,52,190 / 3.169
	=	₹ 2,05,803 (approx.)

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

	=	(₹ 2,05,803 x 4) + ₹ 70000
	=	₹ 8,23,212 + ₹ 70,000 = ₹ 8,93,212

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

Question 11—

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

The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and present value of annuity factor of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹ 1 due at the end of 3rd year at 10% IRR is 0.7513.

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

Answer:

Determination of Nature of Lease

Present value of unguaranteed residual at the end of 3rd year

	=	₹ 50,000 × 0.7513
	=	₹ 37,565
Present value of lease payment	=	₹ 5,00,000 - ₹ 37,565
	=	₹ 4,62,435

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

(₹ 4,62,435/ ₹ 5,00,000) x 100 = 92.487%.

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

Calculation of Unearned Finance Income

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

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

= (₹ 1,85,956 × 3) +₹ 50,000

= ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868

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

= ₹ 6,07,868 – ₹ 5,00,000 = ₹ 1,07,868

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CHAPTER: 8 Revenue Based Accounting Standards
UNIT - 2
AS 9 Revenue Recognition

1. OBJECTIVE AND APPLICATION

- AS 9 is mandatory for all enterprises.
- AS 9 deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. The Standard is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from
- the sale of goods
- the rendering of services
- the use by others of enterprise resources yielding interest, royalties and dividends

AS 9 does not deal with the following aspects of revenue recognition to which special considerations apply:

(i) Revenue arising from construction contracts;
(ii) Revenue arising from hire-purchase, lease agreements;
(iii) Revenue arising from government grants and other similar subsidies;
(iv) Revenue of insurance companies arising from insurance contracts.

Examples of items not included within the definition of "revenue" for the purpose of AS 9 are:

(i) Realised gains resulting from the disposal of, and unrealised gains resulting from the holding of, non-current assets e.g. appreciation in the value of fixed assets;
(ii) Unrealised holdinggains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products;
(iii) Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;
(iv) Realised gains resulting from the discharge of an obligation at less than its carrying amount;
(v) Unrealised gains resulting from the restatement of the carrying amount of an obligation.

2. MEANING OF REVENUE:

It is gross total of amount received or receivable

in form of cash or other consideration

Due to

- the sale of goods
- the rendering of services
- the use by others of enterprise resources yielding interest, royalties and dividends

BASIS OF RECOGNITION OF REVENUE UNDER DIFFERENT CASES

Cases	Conditions – 1	Condition – 2	Condition– 3
1. Sale of goods	Ownership and Risk & Rewardand effective control has been transferred	Certainty	Measurability
2. Rendering services (Completed in same year)	Service has been rendered	Certainty	Measurability
3. Service More than 1 year	Two options: a. Proportionate or stage of completion b. Completion method	Certainty	Measurability
4. Dividend Income	When Right to Receive is established in AGM	Certainty	Measurability
5. Interest/ Royalty	Accrual or due basis	Certainty	Measurability

Notes:

- Here certainty means there is no uncertainly exist about the ultimate collection of the amount
- Here measurability means the amount can be measured on reliable basis.

4. EXAMPLE OF REVENUE RECOGNITION:

(1) Delay of delivery on buyer's request: Recognize Revenue immediately

(2) Sales on approval basis: Revenue recognized when-

- Receiving confirmation of buyer or
- Given time is expired or
- Reasonable time is expired or
- Not possible to return back from buyer

(3) Sale with installation or pending obligation of seller: Revenue Recognized only when duty from sellers point of view is completed.

(4) Guaranteed/ Sales/Warranted sale/Sale with money back guarantee: Recognized Revenue immediately with creating certain provision percentage as per past experience.

(5) Revision of Price with back date: Postpone Revenue until it will become certain

(6) Income by membership fee/publication fees: Time proportionate recognition according to total time period covered.

(7) Sale with cash on delivery: Revenue will be recognized when payment is received for that delivery

(8) Revenue by advertisement: When it Published/Telecasted

(9) If goods sent on consignment basis there revevnue is to be recognised only when consignee sold out goods to 3rd party.

5. **DISCLOSURE:** An enterprise should disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Questions & Answer

Question 1—

Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2015, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9?

Answer

As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

Question 2—

The Board of Directors of X Ltd. decided on 31.3.2015 to increase sale price of certain items of goods sold retrospectively from 1st January, 2015. As a result of this decision the company has to receive 5 lakhs from its customers in respect of sales made from 1.1.2015 to 31.3.2015. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

Answer

As per para 10 of AS 9 "Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of ₹ 5 lakhs to be recognised as income for financial year 2014-15, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Question 3—

A Ltd. entered into a contract with B Ltd. to despatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of 1,00,000 and A Ltd. started despatching the goods. In third month, due to a natural calamity, B Ltd. requested A

Ltd. not to despatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for despatch. A Ltd. accounted ₹ 50,000 as sales and transferred the balance to Advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9.

Answer:

As per para 11 of AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. A Ltd. should recognize the entire sale of ₹ 1,00,000 (₹ 25,000 x 4) and no part of the same is to be treated as Advance Receipt against Sales.

Question 4—

M/s. Moon Ltd. sold goods worth ₹ 6,50,000 to Mr. Star. Mr. Star asked for a trade discount amounting to 53,000 and same was agreed to by M/s. Moon Ltd. The sale was effected and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth ₹ 67,000 are defective. Mr. Star returned defective goods to M/s. Moon Ltd. and made payment due amounting to ₹ 5,30,000. The accountant of M/s. Moon Ltd. booked the sale for ₹ 5,30,000. Discuss the contention of the accountant with reference to Accounting Standard (AS) 9.

Answer

As per AS 9 "Revenue Recognition', revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods. However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue. Revenue from sales should be recognized at the time of transfer of significant risks and rewards. If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched.

In the given case, if trade discounts allowed by M/s. Moon Ltd. are given in the ordinary course of business, M/s. Moon Ltd. should record the sales at ₹ 5,97,000 (i.e. ₹ 6,50,000 - 53,000) and goods returned worth ₹ 67,000 are to be recorded in the form of sales return. However, when trade discount allowed by M/s. Moon Ltd. is not in the ordinary course of business, M/s. Moon Ltd. should record the sales at gross value of ₹ 6,50,000. Discount of ₹ 53,000 in price and return of goods worth ₹ 67,000 are to be adjusted by suitable provisions. M/s Moon Ltd. might have sent the credit note of ₹ 1,20,000 to Mr. Star to account for these adjustments. In both the cases, the contention of the accountant to book the sales for ₹ 5,30,000 is not correct.

Question: 5

Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue. Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014 ?

Answer

As per para 12 of AS 9 "Revenue Recognition', "In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished".

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2014, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + 60,000) is recognized as income in March, 2014. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2014 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2014 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2015 after the magazine is published on 02.04.2014. The amount received from sale of advertising space on 10.03.2014 of ₹ 2,40,000 will be considered as an advance from advertisers for the year ended 31st March, 2014.

Question 6—

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

Answer:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2015.

Case (ii)

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third part y.

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

Case (iv)

Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2015 in the books of M/s Paper Products Ltd.

Question 7—

M/s Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/ s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard-9.

Answer:

As per para 9.2 of AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹ 1,72,000 should not be recognized in the books for the year ended 31st March, 2015. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹ 1,72,000 as interest amount.

CHAPTER – 11 (UNIT 1)
PREPARATION OF FINANCIAL STATEMENT

1: PREPARATION OF BALANCE SHEET OF A COMPANY

- Financial statement of a company needs to be prepared as per revised format provided by Companies Act, 2013
- It is applicable from 1st April, 2014 on onwards
- Only vertical format is available
- However, it not applicable to F/S of banking and insurance company as they have been provided their separate formats.
- Format will include previous year column along with current year in order to compare result however, if detail of previous year is not available then no need to prepare previous year column
- There will be column of "Note No.". it will be reference for Notes to Accounts prepared along with main F/S.
- Notes to Accounts are the detailed description for information disclosed in main statement. (it is annexure to main statement)
- If a particular heading is having more than one item or involves calculation for single item or required different part of presentation for a single item or not resemble with name of heading, then that heading will required Notes to Accounts
- If a heading is having only one item with no calculations and no different part of presentation and resemble with name of that heading, then Notes to Accounts is not prepared for that item
- In a particular question, if heading of particular item not having information, then no need to disclose it
- If a statement is to be prepared partly, then it is known as "Extract" of that statement.
- Balance Sheet is to be prepared as per part-I of Schedule III.
- Other clarifications related to Balance Sheet is as under:

1. Share Capital—

- Always prepare notes to accounts
- Disclose authorized and issued capital separately if available
- Disclose detail of equity and preference share separately, if available
- Issue as bonus share or for consideration other than cash, then disclose it separately. Issue of bonus share is to be disclosed separately for next five years. However, source of bonus issue is not needed.
- Deduct calls in arrear
- Disclose balance of share forfeited A/c until re-issue of shares forfeited as a part of share capital
- Calls in advance is not disclosed here. It will be part of other current liability

2. Reserve and Surplus—

- Disclose all types of reserves
- Generally notes to accounts is prepared for that
- Disclose final balance of each reserve
- Debit balance of P/L A/c is to be disclosed as negative item
- Appropriation is to be adjusted in balance of P&L A/c under the head of reserve & Surplus
- Reserves & Surplus include balance of P/L A/c, G/R A/c, Revenue Reserve A/c, Securities Premium A/c, CR A/c, CRR A/c Revaluation Reserve A/c, DRR A/c etc.

3. Money Received Against Share Warrant

- If the share is issued in bearer form, then it is known as share warrant
- It is transferable by mere delivery

  Details of share holder is not maintained by company

4. Share Application Money Received Pending Allotment:

- Application money has been received before end of year but shares is to be allotted in next year then it is known as "application money received pending allotment"

5. Long Term Borrowing:

- It includes debentures, long term loan, bond and public deposits etc.
- By default, all these will be having long term nature.
- Disclose separately, detail of secured and unsecured part.
- Outstanding interest of such borrowings will be part of other current liability

6. Long Term Provisions:

- Provision created against outsider liabilities, having long term nature
- For example: PF Fund, Gratuity fund etc.

7. Deferred Tax:

- Difference in tax liability calculated by income from companies act & income tax act is known as "Deferred Tax"

8. Short-Term Borrowings:

- It includes bank overdraft, cash credit limit, short term loan and other short term borrowings
- Part of long term borrowings payable within next 12

9. Short Term Provisions:

- It includes provisions for tax and other short term provisions

10. Trade Payable:

- It includes creditors & B/P
- Disclose separately payable within 6 months and payable after 6 months

11. Other Current Liability

- Which is not covered in other 3 headings of current liability

- It includes calls in advance, unearned income and outstanding expenses etc.
- It include dividend declared by company until it is paid to shareholder.

12. Tangible Fixed Assets

- Disclose at historical cost if possible
- Deduct total accumulated depreciation

13. Capital work-in-progress (CWIP)

- If tangible fixed asset is under construction
- For example, building under construction, plant under construction etc
- When it becomes ready to use it is transferred to corresponding tangible asset

14. Intangible Under Development:

- The intangible asset which is not ready to use at the end of year. For eg. Software under development
- Transferred to corresponding intangible asset account when it becomes ready to use

15. Inventory:

- It is to be classified as
  - (i) Raw material
  - (ii) WIP
  - (iii) Finished goods
  - (iv) Stock in trade
  - (v) Loose tools & spares

16. Trade Receivables:

- It includes debtor and B/R
- Disclose separately receivable within 6 months & receivable other 6 months

17. Cash and Cash Equivalents:

- It includes cash & Bank Balances
- Disclose separately bank balances with scheduled banks and other
- Disclose separately, normal bank balance and "Ear-marked" Bank Balance.

18. Other Current Assets:

- It includes prepaid expenses, accrued income & other current assets

Note 1: Contingent Liabilities & Capital Commitments:

- It includes contingent liabilities like claim pending in court, B/R discounted with bank, guarantee given, investment in partly paid up shares and arrear of preference share dividend etc.
- Capital commitment means capital nature contract which having executory nature at the end of year. For eg., a new factory is to be opened next year.
- As per amendment in AS-4, proposed dividend is now not disclosed in Balance Sheet as a part of short term provision. It is also to be disclosed under this head as a part of notes to Accounts

Note 2: **Always classify detail of particular item as much as possible according to information given in the question**

Note 3: **By default, investment is to be considered as non-current investment and non trade.**

BALANCE SHEET FORMAT

Balance Sheet of ………… as at…………………

	Particulars	Note No	C.Y.	P.Y.
	Equity & Liabilities			
I)	**Share Holders Fund**			
	(a) Share Capital:			
	(b) Reserve & Surplus			
	(c) Money Received Against Share Warrant			
II)	**Share Application Money received Pending Allotment**			
III)	**Non-Current Liabilities :**			
	(a) Long term Borrowings			
	(b) Deferred Tax Liability (Net)			
	(c) Other non-current Liability			
	(d) Long term provisions			
iv)	**Current Liabilities :**			
	(a) Short Term Borrowings			
	(b) Trade Payable			
	(c) Other Current Liabilities			
	(d) Short term Provisions			

	Assets			
i)	**Non-Current Assets**			
(a)	PPE			
(b)	Intangible Assets			
(c)	CWIP			
(d)	Intangible under development			
(e)	Non-current investment			
(f)	Deferred Tax Asset (Net)			

(g)	Non-current loans & advances			
(h)	Other noncurrent asset			
ii)	**Current Assets**			
	(a) Current Investment			
	(b) Inventory			
	(c) Trade Receivable			
	(d) Cash & Cash Equivalents			
	(e) Current Loans & Advances			
	(f) Other Current Assets			

TOPIC 2: PREPARATION OF STATEMENT OF PROFIT AND LOSS OF COMPANY

- The format of P&L A/c of company is known as statement of profit & Loss and it is to be prepared as per part-II of schedule III of Companies Act, 2013
- Following points are to be considered:

i) Revenue from operation

- It includes revenue by way of sale of goods, rendering services and other principle revenue

ii) Other income

- It includes interest income, dividend income, profit on sale of fixed assets/investment and other income other than revenue from operation, exceptional item and extra ordinary item

iii) Detail of inventory:

- It is to be classified in following manner:
  a) Raw material consumed = Opening RM + Purchase of RM - Closing RM
  b) Purchase of stock in trade: Stock in trade means goods kept for sale which are not manufactured by the company itself
  c) Change in value of stock in trade
  d) Change in value of Work-in-progress and finished goods

Note 4:

Finished goods means goods kept for sale which are manufactured by the company itself

Note 5:

If opening stock is more than closing stock the change in value of stock is to be disclosed as a positive item and vice-versa

iv) Employee Benefit Cost

It includes all types of payment to employees other than directors

v) Finance Cost

It includes interest on different types of borrowings

vi) Depreciation & other amortization

It includes current year depreciation on fixed asset and current year's amortization amount of intangible assets

vii) Other expenses

It includes all other expenditure other than covered by above specific topics, exceptional and extraordinary items

For Example – Office expense (other than employee) selling & distribution cost, fictitious assets written off

viii) Exceptional item:

- It includes expenses/income by way of operational nature item but the amount of such items occur abnormally
- For example, huge amount of bad debts as compared to past experience.

ix) Extra ordinary item

- It includes abnormal nature item like claim, compensation, damages received or paid, loss by strike, loss due to natural calamities, refund of government grant, etc.

Statement of profit and loss of ………………for the year ending………………

	Particulars	Note No.	C.Y.	P.Y.
A)	**Income**			
	I) Revenue from operation			
	II) Other Income			
B)	**Expenses**			
	I) Raw Material Consumed			
	II) Purchase of stock in trade			
	III) Change in value of stock in trade			
	IV) Change in value of WIP and finished goods			
	V) Employee Benefit Cost			
	VI) Finance Cost			
	VII) Depreciation and other amortization			
	VIII) Other Expenses			
	Profit before tax, exceptional and extra ordinary item			
	Add/Less: Exceptional items			
	Add/Less: Extra ordinary items			
	PBT			
	Less : Provision for tax			
	PAT/NP/EAT/ IAT			

TOPIC NO. 4
SOURCES OF DIVIDEND & MAXIMUM DIVIDEND OUT OF SOURCE OF DIVIDEND

- Dividend means cash distribution by company to its shareholders.
- Following are the main sources of dividend

Out of Current year Profit

- Maximum divided will be equal to divisible profit
- It will be current year's profit after adjustment of current year depreciation and unabsorbed depreciation as per company law.
- However, previous years carry forwarded losses are not adjustment here.

Out of Past Reserves

Only free Reserve can be utilized

First utilize current year profit up to divisible profit thereafter free reserve can be used.

Maximum utilization of past reserve will be within following three criteria:

i) Rate of dividend shall not exceed past three years average rate of dividend.

ii) Maximum withdrawal from reserve is equal to 10% of paid up capital & free reserves.

iii) Minimum required free reserve after withdrawal will be 15% of paid up capital.

Out of funds provided by government for the purpose of dividend

Chapter 11 (Unit - 2)
CASH FLOW STATEMENT

MEANING OF CASH FLOW STATEMENT

- A cash flow statement is a statement which discloses the changes in cash position between the two periods,
- To provide assistance in efficient cash management.

SOME IMPORTANT DEFINITIONS

CASH	CASH EQUIVALENT	CASH FLOWS
i. Cash in hand ii. **Demand deposit** with bank	If all 3 condition fulfilled i. Short term investment **(maximum 3 month)** ii. Readily marketable iii. Insignificant risk Example: **i.** Treasury bill **ii.** Certificate of deposit **iii.** Commercial Paper	• Inflows & outflows of cash & CE

UTILITY/ USES OF CASH FLOW STATEMENT

- Helps in efficient cash management.
- Helps in internal financial management.
- Discloses the movements of cash.
- Discloses the success or failure of cash planning.

LIMITATIONS OF CASH FLOW STATEMENT

- Considers only cash item
- Manipulations is possible
- Cannot replace income statement or fund flow statement

TYPES OF ACTIVITIES IN CFS

i. Cash flow from operating activity	ii. Cash flow from Investing activity	iii. Cash flow from Financing activity

CASH FLOW FROM OPERATING ACTIVITY

PRINCIPAL REVENUE GENERATING ACTIVITIES OF THE ENTERPRISE	
CASH INFLOW	**CASH OUTFLOW**
➢ Sale of goods for cash ➢ Cash receipts from debtors ➢ Cash receipts from the rendering of services ➢ Cash receipts from **royalties, fees, commissions** and other operational revenue ➢ Cash received from extraordinary item other than relating to investing and financing ➢ Refund of income tax ➢ Cash receipts relating to futures contracts,	➢ purchase of goods for cash ➢ Cash payments to suppliers for goods ➢ cash payments of operating expenses i. Payment of direct expenses ii. Payment of office expenses iii. Payment of selling and distribution expenses etc. ➢ Cash paid from extraordinary item other than relating to investing and financing

forward contracts, option contracts and swap contracts **when the contracts are held for dealing or trading purposes.** ➢ Cash receipts of an **insurance enterprise** for premiums and claims, annuities and other policy benefits	➢ Income tax paid ➢ Cash payments relating to futures contracts, forward contracts, option contracts and swap contracts **when the contracts are held for dealing or trading purposes.** ➢ Cash payments of an **insurance enterprise** for premiums and claims, annuities and other policy benefits

CASH FLOW FROM INVESTING ACTIVITY

ACTIVITIES RELATING TO THE ACQUISITION AND DISPOSAL OF LONG-TERM ASSETS AND OTHER INVESTMENTS	
CASH INFLOW	**CASH OUTFLOW**
➢ Sale of fixed asset for cash ➢ Sale of investment for cash ➢ Interest received on investment ➢ Dividend received on investment ➢ Cash receipts for futures contracts, forward contracts, option contracts and swap contracts **except when the contracts are held for dealing or trading purposes** ➢ Repayments of Cash advances and loans made to third parties & **(other than advances and loans made by a financial enterprise)** ➢ Cash receipt from disposing shares, warrants or debt instruments of other enterprises and interests in joint ventures	➢ purchase of fixed asset for cash ➢ Purchase of investment for cash ➢ Cash payments for futures contracts, forward contracts, option contracts and swap contracts **except when the contracts are held for dealing or trading purposes** ➢ Cash advances and loans made to third parties **(other than advances and loans made by a financial enterprise)** ➢ Cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures

CASH FLOW FROM FINANCING ACTIVITY

ACTIVITIES THAT RESULT IN CHANGES IN THE SIZE AND COMPOSITION OF THE SHARE CAPITAL AND BORROWINGS OF THE ENTERPRISE	
CASH INFLOW	**CASH OUTFLOW**
➢ Cash proceeds from issuing shares, debentures, loans, notes, bonds and other short or long term borrowings	➢ Cash repayments of shares, debentures, loans, notes, bonds and other short or long term borrowings ➢ Payment of interest & dividend on share capital and borrowing

TREATMENT OF CASH FLOWS FROM SOME SPECIAL TRANSACTIONS AS PER AS-3 (REVISED)

A. FOREIGN CURRENCY CASH FLOWS

- Cash flows arising from transactions in a foreign currency should be recorded in an Enterprises reporting currency

- The reporting should be done by applying the exchange rate at the date of cash flow statement.
- A rate which approximates the actual rate may also be used. For example, weighted average
- cash and cash equivalents held in foreign currency should be reported as a separate part in the form of reconciliation
- Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows

B. INTEREST AND DIVIDENDS

- The treatment of interest and dividends, received and paid, depends upon the nature of the enterprise i.e., financial enterprises and other enterprises.
- In case of financial enterprises, cash flows arising from interest paid and interest & Dividends received, should be classified as cash flows from operating activities.
- In case of other enterprises Cash outflows arising from interest paid on terms loans and debentures should be classified as cash outflows from financing activities and
- Dividend paid on equity and preference share capital should be classified as cash outflow from financing activities.
- Interest and dividends received should be classified as cash inflow from investing activities.

C. TAXES ON INCOME

- Cash flows arising from taxes on income should be separately disclosed. It should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

D. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

- Cash flow arising shall be recorded as a part of investing activity.

E. TREATMENT OF SOME SPECIFIC ITEM

- Inflow and outflow of a particular item will relate to nature of main item like:

(a) Advance to supplier, interest received on Advance to supplier, Advance received from customer & Interest paid on advance received from customers will have operational nature.

(b) Claim & compensation relating to stock & Employees will be part of operating activity

(c) Claim & compensation relating to Fixed Assets & Investments will be part of investing activity

(d) Expenses paid on purchase of investment or fixed assets will be part of investing activity.

(e) TDS deducted from interest or dividend income is to be adjusted to investing activity.

(f) Dividend tax paid on dividend to shareholder will be part of financing Activity.

<u>METHODS OF CASH FLOW STATEMENT</u>

i. DIRECT METHOD
ii. INDIRECT METHOD

<u>CFS BY DIRECT METHOD</u>

- Under direct method cash from operation of operating activity is calculated by **disclosing directly operational nature cash inflows and outflows.**
- After calculation of cash from operation remaining part of CFS under the both method will be same.

- If CFS is required to prepare on the basis of cash account or cash summary given then it is always prepared by direct method.
- In such case all the information is provided in form of cash inflows& outflows So No need to provide any kind of working notes.

FORMAT OF CASH FLOW STATEMENT BY DIRECT METHOD

(a) Cash Flow from Operating Activities:		
Cash sales of goods & service rendered	xxx	
Cash receipts from customers	xxx	
Cash purchase of goods	(xxx)	
Cash paid to suppliers	(xxx)	
Cash payments of operational expenses	(xxx)	
Cash generated from operations	**XXX**	
Income tax paid	(xxx)	
Cash flow before extraordinary items	**XXX**	
Extraordinary items	(xxx)	
Net cash generated from Operating Activities (a)		**XXX**
(b) Cash Flows from Investing Activities:		
Proceeds from sale of F.A. or Investment	xxx	
Interest received	xxx	
Dividend received	xxx	
Purchase of fixed assets or Investment for cash	(xxx)	
Net cash from generated investing Activities (b)		**XXX**
(c) *Cash Flows from Financing Activities:*		
Proceeds from issue of share capital	xxx	
Proceeds from long-term or short term borrowings	xxx	
Redemption of Share capital	(xxx)	
Repayments of long-term or short term borrowings	(xxx)	
Interest paid	(xxx)	
Dividend paid	(xxx)	
Net cash generated from Financing Activities (c)		**XXX**
Net Cash Generated From (A+B+C) Activity		**XXX**
Cash and Cash Equivalents at beginning of period		**XXX**
CASH AND CASH EQUIVALENT AT END OF PERIOD		**XXX**

(B) CASH FLOW STATEMENT BY INDIRECT METHOD

(a) *Cash Flow from Operating Activities:*		
Profit before tax and extraordinary items	xxx	
Adjustments for:		
Depreciation	xxx	
Fictitious or intangible assets written off/ Amortised	xxx	
Foreign exchange loss	xxx	
Loss on sale of fixed assets or investment	xxx	
Interest expenses	xxx	
Premium on redemption of share or debentures	xxx	
Foreign exchange gain	(xxx)	
Amortization of capital grant	(xxx)	
Gain on sale of fixed assets or investment	(xxx)	
Interest or dividend income	(xxx)	
Operating Activity before working capital changes	**XXX**	
Increase current liabilities	xxx	
Increase in current assets	(xxx)	
Decrease in current assets	xxx	
Decrease in current liabilities	(xxx)	
Cash generated from operations	**XXX**	
Income tax paid	(xxx)	
Cash flow before extraordinary items	**XXX**	
Extraordinary items	(xxx)	
Net cash generated from Operating Activities (a)		**XXX**
(b) Cash Flows from Investing Activities:		
Proceeds from sale of F.A. or Investment	xxx	
Interest received	xxx	
Dividend received	xxx	
Purchase of fixed assets or Investment for cash	(xxx)	
Net cash from generated investing Activities (b)		**XXX**
(c) *Cash Flows from Financing Activities:*		
Proceeds from issue of share capital	xxx	
Proceeds from long-term or short term borrowings	xxx	
Redemption of Share capital	(xxx)	
Repayments of long-term or short term borrowings	(xxx)	
Interest paid	(xxx)	
Dividend paid	(xxx)	
Net cash generated from Financing Activities (c)		**XXX**
Net Cash Generated From (A+B+C) Activity		**XXX**
Cash and Cash Equivalents at beginning of period		**XXX**
CASH AND CASH EQUIVALENT AT END OF PERIOD		**XXX**

INCOME STATEMENT / REVENUE STATEMENT / TRADING AND P&L A/C

Net Sales Less : COGS Opening Stock + Purchase + Direct Exp. – Closing Stock	xxx (xxx)
Gross Profit **Add : Operating income of P & L A/c :–** Brokerage Income Discount Income Commission Income Etc.	**XXX** xxx xxx xxx
Less : Operating expenses of P & L A/c :– Selling & Distribution Exp. Admin. / Office Exp. Depreciation on Fixed Asset Fictitious & Intangible w/off or amortised	**XXX** (xxx) (xxx) (xxx) (xxx)
Operating Profit **Add : Non operating Income of P & L A/c :–** Profit on sale of FA or Investment Amortization of capital grant Foreign exchange gain Interest and Dividend Income etc.	**XXX** xxx xxx xxx xxx
Less: Non operating Exp. or Losses of P & L A/c:– Loss on sale of FA or Investment Premium on Redemption of shares or Debentures etc. Foreign exchange Loss etc.	**XXX** (xxx) (xxx) (xxx)
PBIT or EBIT Less: Interest expenses	**XXX** (xxx)
PBT or EBT Less: Provision for Tax	**XXX** (xxx)
PAT or EAT or NP Less: Preference share dividend	**XXX** (xxx)
Profit Available to ESH Less: ES Dividend Transfer to General Reserve	**XXX** (xxx) (xxx)
NP of C.Y. after appropriation Add : opening Balance of P & L A/c	**XXX** **Xxx**
CLOSING BALANCE OF P&L A/C	**XXX**

ADJUSTMENT OF CHANGE IN WORKING CAPITAL ITEM

- Changes in items relating to the current assets and current liabilities are to be disclosed.
- It is disclosed to convert the entire operational item from accrual basis to cash basis.
- Disclosed only those CA & CL which are relating to operational nature item.
- **It will be Excluding:**
  - **a)** Cash & Cash equivalent item
  - **b)** Those current assets & Current liabilities which are not related to operational nature item like short term loan, prepaid interest, outstanding interest, Accrued interest & unearned Interest etc.
- If directly change in net working capital is given then it is to be disclosed assuming similar to current Assets. If increase in working capital then deducted & if decrease in working capital then added.

Note:

Reversal of non-operational income & expenditure [Elimination of effect] from operating Activity only if it is already adjusted to P & L A/c.

SELECTION OF PBT

1. If income statement is given	Pick PBT from that income statement directly	No Adjustment of provision for tax, Dividend & GR
2. If NP is given in additional information	Pick that NP & calculate PBT by adding CY tax provision	No Adjustment of Dividend & GR
3. If balance of PL a/c is given for PY & CY	Pick difference of balance of PL a/c & thereafter calculate PBT	Difference of balance of PL a/c xx (+) Transfer to GR xx (+) Provision for Tax in CY xx (+) Dividend declared in CY xx **PBT XXX**

ADJUSTMENT OF EXTRA ORDINARY ITEM

- It may be of operating, investing & Financing Nature.
- By default belong to operating activity.
- Adjustment in CFS will be as under

Reversal in calculation of PBT & extraordinary item if already adjusted to P & L A/c

Disclose as inflow or outflow according to his nature in the related activity

CALCULATION & ADJUSTMENT OF PROVISION FOR TAX

- If only opening & closing balance given then opening balance will become tax paid in CY & Closing Balance will become provision of tax made in CY.
- If Tax paid in CY is given, along with opening & closing balance then provision for tax made in CY will be balancing figure.
- If CY tax provision is given, along with opening & closing Balance then tax paid in CY will be balancing figure.
- If opening & closing balance not given then tax paid & Provision of tax in CY Both will be same.
- **Adjustment in CFS:**
  - **a)** CY tax provision is to be only used for Calculation of PBT under the Indirect method
  - **b)** Tax paid in CY will be outflow of operating just after calculation of cash from operation.

Provision for Tax A/C

Particulars	Amount	Particulars	Amount
To Bank **(Paid in C.Y.)**	xxx	By Balance b/d	xxx
To Balance c/d	xxx	By P & L a/c **(Provision made in C.Y.)**	xxx

Note

If amount of tax is given in income statement / revenue statement/ P& L a/c etc. then it will amount of tax provision made in CY.

CALCULATION & ADJUSTMENT OF DIVIDEND PAYABLE (FINAL DIVIDEND)

- If only opening & closing balance given then opening balance will become dividend paid in CY & Closing Balance will become dividend declared in CY.
- If dividend paid in CY is given, along with opening & closing balance then dividend declared in CY will be balancing figure.
- If dividend declared in CY is given, along with opening & closing Balance then Dividend paid in CY will be balancing figure.
- If opening & closing balance not given then dividend paid & declared in CY Both will be same.

Adjustment in CFS:

- **a)** CY dividend declared is to be only used for Calculation of PBT under the Indirect method
- **b)** Dividend paid in CY will be outflow of financing activity.

Dividend Payable A/C

Particulars	Amount	Particulars	Amount
To Bank **(Paid in C.Y.)**	xxx	By Balance b/d	xxx
To Balance c/d	xxx	By P & L a/c **(Declared in C.Y.)**	xxx
	xxx		xxx

CALCULATION & ADJUSTMENT OF INTERIM DIVIDEND

- Interim dividend paid & declared in C.Y. both will same because opening & Closing Balance of interim dividend generally not given.
- Not to be mixed with dividend payable A/c & always disclose separately.
- Presentation will be similar to final dividend in CFS

Note

- Calculation & Adjustment of dividend tax will similar to Calculation & Adjustment of Dividend.
- If amount of dividend is given in income statement / revenue statement/ P& L a/c etc. then it will amount of dividend declared in CY.
- If dividend amount is directly given by company then it already includes preference share dividend so in such case no need not to calculate preference share dividend separately.

CALCULATION OF AMOUNT OF INTEREST OR DIVIDEND	
IF IT IS ASSUMED THAT ISSUE & REDEMPTION WAS AT THE BEGINNING OF CY	**IF IT IS ASSUMED THAT ISSUE & REDEMPTION AT THE END OF THE YEAR**
calculation of Internet or dividend on closing balance	calculation of Interest or dividend on Opening Balance

FIXED ASSETS ACCOUNT

- If opening & closing balance of provision for Depreciation /Depreciation Reserve / Depreciation fund / Accumulated Depreciation / Depreciation are given in the question then FA A/c is to be prepared at cost and in such case provision for depreciation A/c is to be also prepared.
- Opening & closing balance of provision for depreciation may be given as deduction from value of FA or in liability side or in Additional information
- If opening & Closing balance of provision for depreciation is given in additional information it means value of FA given are at WDV convert them into cost by adding opening & Closing Balance of provision to opening & closing value of FA respectively.
- If FA A/c is prepared at cost then total depreciation charge in C.Y. is to be disclosed in credit side of provision for Depreciation A/c & total depreciation accumulated on FA sold / Discarded is to be disclosed in FA A/c & provision for Depreciation A/c.
- If opening & Closing Balance of provision for depreciation not given in the question then FA A/c is to be prepared at WDV & in such case provision A/c need not to be prepared.
- In such case total accumulated depreciation on FA disposed / sold is to be ignored and total depreciation charge in C.Y. is to be disclosed in FA A/c.

Fixed Asset Account (At WDV)

Particulars	Amount	Particulars	Amount
To Balance b/d **(After deducting depreciation)**	xxx	By Bank a/c **(Sale)**	xxx
To P/L a/c **(Profit on Sale)**	xxx	By P/L a/c **(Loss on sale)**	xxx
To Bank a/c **(Purchase of FA for cash)**	xxx	By Depreciation **(Total C.Y. Depreciation)**	xxx
To Equity Share Capital a/c **(FA is purchased by issued shares)**	xxx	By Balance c/d **(After deducting depreciation)**	xxx
	xxx		**xxx**

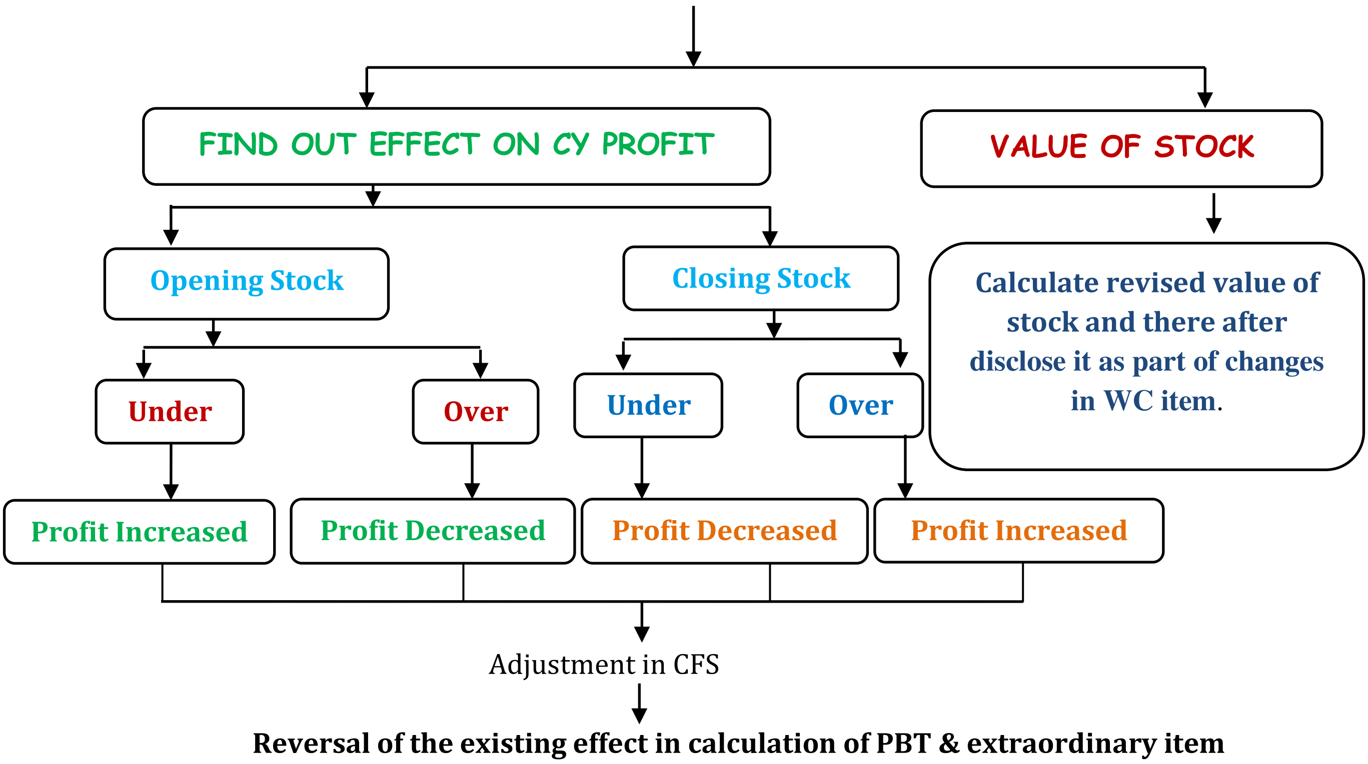
Fixed Asset Account (At Cost)

Particulars	Amount	Particulars	Amount
To Balance b/d **(Before deducting depreciation)**	xxx	By Bank a/c **(Sale)**	xxx
To P/L a/c **(Profit on Sale)**	xxx	By P/L a/c **(Loss on sale)**	xxx
To Bank a/c **(Purchase of FA for cash)**	xxx	By Provision for Depreciation a/c **(Total accumulated depreciation on FA sold)**	xxx
To Equity Share Capital a/c **(FA is purchased by issued shares)**	xxx	By Balance c/d **(Before deducting depreciation)**	xxx
	xxx		xxx

Provision for Depreciation or Accumulated Depreciation A/C

Particulars	Amount	Particulars	Amount
To Assets a/c **(Total accumulated depreciation on FA sold)**	xxx	By Balance b/d	xxx
To Balance c/d	xxx	By P & L a/c **(C.Y. Depreciation)**	xxx
	xxx		xxx
	xxx		xxx

UNDER / OVER VALUATION OF STOCK



ISSUE OR REDEMPTION OF SHARE CAPITAL, DEBENTURE, BONDS ETC.

- If issued or redemption for consideration other than cash then there will be no inflow or outflow.
- If issued or redemption for cash then it will be inflow or outflow of financing activity Activity After adjusting premium or discount on such issue or redemption.
- Further adjustment of premium or discount will be as under:
  - **a) Discount on issues:** Part of discount on issue which has been written off from P & L A/c in current year is to be added to operating activity.
  - **b) premium on issue:** No further adjustment except inflow in financing activity
  - **c) Premium on redemption:**
    - ✓ If it is provided out of balance of P&L a/c then it is to be added to operating Activity.
    - ✓ If it is provided out of balance of security premium a/c then no adjustment in operating activity.
    - ✓ If balance of SPR is available then it is to be assumed that premium on redemption is taken out of balance of SPR in otherwise it is taken out of balance of P &L A/c.

PROVISION FOR TAX ACCOUNT WITH ADVANCE TAX A/C

(A) *SETTLEMENT OF TAX LIABILITY OF PY*		
a) Checking For Adequacy Of Provision For Previous Year By Comparing Actual Tax Liability Of PY With Opening Balance Of Provision	**b) Adjusting opening Balance of advance tax against the tax liabilities of previous year**	**c) Final Settlement for previous year tax liabilities due to excessive or short payment**
Creating further provision if short provision due opening provision is less than actual tax liabilities of previous year P & L A/c Dr. To Provision for Tax A/c	Provision for Tax a/c Dr. To Advance tax A/c [With opening provision of Advance Tax]	**Further payment of tax if advance tax adjusted is less than tax liability of previous year** Provision for tax A/c Dr. To Bank a/c
Reversal of excess provision if opening provision is more than actual tax liability of previous year Provision for tax A/c Dr. To P & L A/c		**Receiving refund for excessive payment if advance tax adjusted is more than actual tax liabilities previous year** Bank A/c Dr. To Provision for tax A/c
No further adjustment if opening provision is equal to actual tax liabilities of previous year		**No further adjustment if advance tax adjusted is equal to actual tax liability of previous year**

(B) **TAX ADJUSTMENT FOR CURRENT YEAR**	
a) Payment of Advance Tax in current year	**b) Creating provision at the end of current year for estimated tax liabilities of C.Y.**
Advance Tax A/c Dr. To Bank A/c	P & L A/c Dr. To Provision for Tax A/c

(C) ADVANCE TAX A/C

Particulars	Amount	Particulars	Amount
To Balance b/d**[Opening Balance]**	xxx	By Provision for Tax A/c **[Advance tax opening Bal. adjusted to tax liability]**	xxx
To Bank A/c **(Advance Tax paid CY)**	xxx	By Balance c/d **(closing Balance)**	xxx
	xxx		xxx

(D) PROVISION FOR TAX A/C

Particulars	Amount	Particulars	Amount
To P & L A/c **(Reversal of excess provision of PY)**	xxx	By Bal. b/d **[Opening Balance]**	xxx
To Advance tax A/c **[Opening balance of advance tax adjusted]**	xxx	By P & L A/c **[Creating further provision for PY]**	xxx
To Bank A/c **[Further Payment for PY tax liabilities]**	xxx	By Bank **[Refund for excess payment for PY]**	xxx
To Balance c/d **(closing Balance)**	xxx	By P & L A/c **[Tax provision for CY]**	xxx
	xxx		xxx

(E) PRESENTATION IN CFS	
Overall net effect of tax paid & refund in the both a/c will be outflow or inflow of operating activity just after calculation of cash from operation	Overall net effect of creating or reversal of provision with P & L A/c is to be used for the purpose of calculation of PBT & Extra ordinary item.

CHAPTER; 4
UNIT - 2
AS 3 CASH FLOW STATEMENT

1. OBJECTIVE:

- Cash flow Statement (CFS) is an additional information provided to the users of accounts in the form of an statement, which reflects the various sources from where cash was generated (inflow of cash) by an enterprise during the relevant accounting year and how these inflows were utilised (outflow of cash) by the enterprise.
- This helps the users of accounts :
  (i) To identify the historical changes in the flow of cash & cash equivalents.
  (ii) To determine the future requirement of cash & cash equivalents.
  (iii) To assess the ability to generate cash & cash equivalents.
  (iv) To estimate the further requirement of generating cash & cash equivalents.
  (v) To compare the operational efficiency of different enterprises.
  (vi) To study the insolvency and liquidity position of an enterprise.
  (vii) As an indicator of amount, timing and certainty of future cash flows.
  (viii) To check the accuracy of past assessments of future cash flows In examining the relationship between profitability and net cash flow and the impact of changing prices.

2. SOME IMPORTANT DEFINITIONS

CASH	CASH EQUIVALENT	CASH FLOWS
iii. Cash in hand iv. **Demand deposit** with bank	If all 3 condition fulfilled iv. Short term investment **(maximum 3 month)** v. Readily marketable vi. Insignificant risk Example: **i.** Treasury bill **ii.** Certificate of deposit **iii.** Commercial Paper	• Inflows & outflows of cash & CE

3. LOANS/ADVANCES GIVEN AND INTERESTS EARNED

(a) Loans and advances given and interests earned on them in the ordinary course of business are operating cash flows for financial enterprises.
(b) Loans and advances given and interests earned on them are investing cash flows for non-financial enterprises.
(c) Loans and advances given to subsidiaries and interests earned on them are investing cash flows for all enterprises.
(d) Loans and advances given to employees and interests earned on them are operating cash flows for all enterprises.
(e) Advance payments to suppliers and interests earned on them are operating cash flows for all enterprises.
(f) Interests earned from customers for late payments are operating cash flows for non-financial enterprises.

4. LOANS/ADVANCES TAKEN AND INTERESTS PAID

(a) Loans and advances taken and interests paid on them in the ordinary course of business are operating cash flows for financial enterprises.

(b) Loans and advances taken and interests paid on them are financing cash flows for non-financial enterprises.

(c) Loans and advances taken from subsidiaries and interests paid on them are financing cash flows for all enterprises.

(d) Advance taken from customers and interests paid on them are operating cash flows for non-financial enterprises.

(e) Interests paid to suppliers for late payments are operating cash flows for all enterprises.

(f) Interests taken as part of inventory costs in accordance with AS 16 are operating cash flows.

5. INVESTMENTS MADE AND DIVIDENDS EARNED

(a) Investments made and dividends earned on them in the ordinary course of business are operating cash flows for financial enterprises.

(b) Investments made and dividends earned on them are investing cash flows for non-financial enterprises.

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

6. DIVIDENDS PAID

Dividends paid are financing cash outflows for all enterprises.

7. *INCOME TAX*

(a) *Tax paid on operating income is operating cash outflows for all enterprises*

(b) *Tax deducted at source against income are operating cash outflows if concerned incomes are operating incomes and investing cash outflows if the concerned incomes are investment incomes, e.g. interest earned.*

(c) *Tax deducted at source against expenses are operating cash inflows if concerned expenses are operating expenses and financing cash inflows if the concerned expenses are financing expenses, e.g. interests paid.*

8. INSURANCE CLAIMS RECEIVED

(a) *Insurance claims received against loss of stock or loss of profits are extraordinary operating cash inflows for all enterprises.*

(b) *Insurance claims received against loss of fixed assets are extraordinary investing cash inflows for all enterprises.*

(c) *AS 3 requires separate disclosure of extraordinary cash flows, classifying them as cash flows from operating, investing or financing activities, as may be appropriate.*

9. PROFIT OR LOSS ON DISPOSAL OF FIXED ASSETS

Profit or loss on sale of fixed asset is not operating cash flow. The entire proceeds of such transactions should be taken as cash inflow from investing activity.

10. REPORTING CASH FLOWS ON NET BASIS

- *AS 3 forbids netting of receipts and payments from investing and financing activities.*
- *Thus, cash paid on purchase of fixed assets should not be shown net of cash realised from sale of fixed assets.*
- *For example, if an enterprise pays ₹50,000 in acquisition of machinery and realises ₹10,000 on disposal of furniture, it is not right to show net cash outflow of ₹40,000.*
- *The exceptions to this rule are stated below. Cash flows from the following operating, investing or financing activities may be reported on a net basis.*

(a) *Cash receipts and payments on behalf of customers, e.g. cash received and paid by a bank against acceptances and repayment of demand deposits.*

(b) *Cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short, e.g. purchase and sale of investments by an investment company.*

(c) *AS 3 permits financial enterprises to report cash flows on a net basis in the following three circumstances.*

(d) *Cash flows on acceptance and repayment of fixed deposits with a fixed maturity date*

(e) *Cash flows on placement and withdrawal deposits from other financial enterprises*

(f) *Cash flows on advances/loans given to customers and repayments received there from.*

11. INTEREST AND DIVIDENDS

- *Cash flows from interest and dividends received and paid should each be disclosed separately.*
- *Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities.*
- *In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities.*
- *Dividends paid should be classified as cash flows from financing activities.*

12. *NON-CASH TRANSACTIONS*

- *Investing and financing transactions that do not require the use of cash or cash equivalents, e.g. issue of bonus shares, should be excluded from a cash flow statement.*
- *Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.*

13. *BUSINESS PURCHASE*

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

  (a) *The cash flows from disposal and acquisition should not be netted off.*

  (b) *An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following:*

  (i) *The total purchase or disposal consideration; and*

  (ii) *The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.*

14. *TREATMENT OF CURRENT ASSETS AND LIABILITIES TAKEN OVER ON BUSINESS PURCHASE*

- Business purchase is not operating activity. Thus, while taking the differences between closing and opening current assets and liabilities for computation of operating cash flows, the closing balances should be reduced by the values of current assets and liabilities taken over.
- This ensures that the differences reflect the increases/decreases in current assets and liabilities due to operating activities only.

15. *EXCHANGE GAINS AND LOSSES*

- The foreign currency monetary assets (e.g. balance with bank, debtors etc.) and liabilities (e.g. creditors) are initially recognised by translating them into reporting currency by the rate of exchange transaction date.
- On the balance sheet date, these are restated using the rate of exchange on the balance sheet date. The difference in values is exchange gain/loss.
- The exchange gains and losses are recognised in the statement of profit and loss.
- The exchange gains/losses in respect of cash and cash equivalents in foreign currency (e.g. balance in foreign currency bank account) are recognised by the principle aforesaid, and these balances are restated in the balance sheet in reporting currency at rate of exchange on balance sheet date.
- The change in cash or cash equivalents due to exchange gains and losses are however not cash flows.
- This being so, the net increases/decreases in cash or cash equivalents in the cash flow statements are stated exclusive of exchange gains and losses.
- The resultant difference between cash and cash equivalents as per the cash flow statement and that recognised in the balance sheet is reconciled in the note on cash flow statement.

16. *DISCLOSURES*

- AS 3 requires an enterprise to disclose the amount of significant cash and cash equivalent balances held by it but not available for its use, together with a commentary by management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.
- AS 3 encourages disclosure of additional information, relevant for understanding the financial position and liquidity of the enterprise together with a commentary by management. Such information may include:
  (a) The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and
  (b) The aggregate amount of cash flows required for maintaining operating capacity, e.g. purchase of machinery to replace the old, separately from cash flows that represent increase in operating capacity, e.g. additional machinery purchased to increase production.

Practical Questions

Question 1—

Explain Classification of activities (with two examples) as suggested in AS 3, to be used for preparing a cash flow statements.

Answer—

AS 3 (Revised) on Cash Flow Statements requires that the cash flow statement should report cash flows by operating, investing and financing activities.

(A) Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities. Cash receipts from sale of goods and cash payments to suppliers of goods are two examples of operating activities.

(B) Investing activities are acquisition and disposal of long-term assets and other investments not included in cash equivalents. Payment made to acquire machinery and cash received for sale of furniture are examples of investing activities.

(C) Financial activities are those activities that result in changes in the size and composition of the owner's capital (including preference share capital in the case of a company) and borrowings of the enterprise. Cash proceeds from issue of shares and cash paid to redeem debentures are two examples of financing activities.

Question 2—

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3, (AS 3) revised.

Answer—

As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(A) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(B) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

a) from the accounting records of the enterprise; or
b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for:
c) changes during the period in inventories and operating receivables and payables;
d) other non-cash items; and
e) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

a) changes during the period in inventories and operating receivables and payables;
b) non-cash items such as depreciation, provisions, deferred taxes and unrealised foreign exchange gains and losses; and
c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses, excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Question 3—

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2015:

(i) Total sales for the year were ₹ 199 crore out of which cash sales amounted to ₹ 131 crore.

(ii) Cash collections from credit customers during the year, totalled ₹ 67 crore.

(iii) Cash paid to suppliers of goods and services and to the employees of the enterprise amounted to ₹ 159 crore.

(iv) Fully paid preference shares of the face value of ₹ 16 crore were redeemed and equity shares of the face value of ₹ 16 crore were allotted as fully paid up at a premium of 25%.

(v) ₹ 13 crore were paid by way of income tax.

(vi) Machine of the book value of ₹ 21 crore was sold at a loss of ₹ 30 lakhs and a new machine was installed at a total cost of ₹ 40 crore.

(vii) Debenture interest amounting ₹ 1 crore was paid.

(viii) Dividends totalling ₹ 11.7 crore (including CDT) was paid on equity and preference shares.

(ix) On 31st March, 2014 balance with bank and cash on hand totalled ₹ 9 crore.

Answer—

Cash Flow Statement
For the Year Ended 31st March, 2015

	(₹ in crores)	(₹ in crores)
Cash flow from operating activities		
Cash sales	131	
Cash collected from credit customers	67	
Less: Cash paid to suppliers for goods & services and to employees	(159)	
Cash from operations	39	
Less: Income tax paid	(13)	
Net cash generated from operating activities		26.00
Cash flow from investing activities		
Payment for purchase of Machine	(40.00)	
Proceeds from sale of Machine	20.70	
Net cash used in investing activities		(19.30)
Cash flow from financing activities		
Redemption of Preference shares	(16.00)	
Proceeds from issue of Equity shares	20.00	
Debenture interest paid	(1.00)	
Dividend Paid	(11.70)	
Net cash used in financing activities		(8.70)
Net decrease in cash and cash equivalent		(2.00)
Add: Cash and cash equivalents as on 1.04.2014		9.00
Cash and cash equivalents as on 31.3.2015		7.00

Question 4—

Raj Ltd. gives you the following information for the year ended 31st March, 2015:

(i) Sales for the year ₹ 48,00,000. The Company sold goods for cash only.

(ii) Cost of goods sold was 75% of sales.

(iii) Closing inventory was higher than opening inventory by ₹ 50,000.

Additional information:—

(i) Trade payables on 31.3.2015 exceed the outstanding on 31.3.2014 by ₹ 1,00,000.

(ii) Tax paid during the year amounts to ₹ 1,50,000.

(iii) Amounts paid to Trade payables during the year ₹ 35,50,000.

(iv) Administrative and Selling expenses paid ₹ 3,60,000.

(v) One new machinery was acquired in December, 2014 for ₹ 6,00,000.

(vi) Dividend paid during the year ₹ 1,20,000.

(vii) Cash in hand and at Bank on 31.3.2015 ₹ 70,000.

(viii) Cash in hand and at Bank on 1.4.2014 ₹ 50,000.

Prepare Cash Flow Statement for the year ended 31.3.2015 as per the prescribed Accounting standard.

Answer—

Cash flow statement of Raj Limited for the year ended 31.3.2015

Direct Method

Cash flow from operating activities:	(₹)	(₹)
Sales (Cash only)	48,00,000	
Payment to supplier	(35,50,000)	
Adm. & Selling Expenses payment	(3,60,000)	
Cash generated from operation	8,90,000	
Less: Tax paid	(1,50,000)	
Net cash from operating activities		7,40,000
Cash flow from investing activities:		
Purchase of fixed assets	(6,00,000)	
Net cash used in investing activities		(6,00,000)
Cash flow from financing activities:		
Dividend Paid	(1,20,000)	
Net cash from financing activities		(1,20,000)
Net cash flow from all activities		20,000
Add: Opening balance of Cash in Hand and at Bank		50,000
Cash in Hand and at Bank on 31.3.2015		70,000

Question 5—

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2014 and 2015:

Liabilities	**As on 31.3.2014 (₹)**	**As on 31.3.2015 (₹)**
Equity share capital	15,00,000	16,50,000
Capital Reserve	—	10,000
General Reserve	2,50,000	3,00,000
Profit and Loss A/c	1,50,000	1,80,000

Trade payables	5,00,000	4,00,000
Provision for Taxation	50,000	60,000
Dividend payable	1,00,000	1,25,000
	25,50,000	27,25,000
Assets	**Year 2014**	**Year 2015**
Land and Building	5,00,000	4,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	1,50,000
inventory	3,00,000	2,80,000
Trade receivables	4,00,000	4,20,000
Cash in Hand	2,00,000	1,65,000
Cash at Bank	3,00,000	4,10,000
	25,50,000	**27,25,000**

Additional Information:

(i) Dividend of ₹ 1,00,000 was paid during the year ended March 31, 2015.

(ii) Machinery during the year purchased for ₹ 1,25,000.

(iii) Machinery of another company was purchased for a consideration of ₹ 1,00,000 payable in equity shares.

(iv) Income-tax provided during the year ₹ 55,000.

(v) Company sold some investment at a profit of ₹ 10,000, which was credited to Capital reserve.

(vi) There was no sale of machinery during the year.

(vii) Depreciation written off on Land and Building ₹ 20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2015 as per AS 3 (Indirect method)

Answer—

Cash Flow Statement for the year ending on March 31, 2015

		(₹)	(₹)
I.	**Cash flows from Operating Activities**		
	Net profit made during the year (W.N.1)	2,60,000	
	Adjustment for depreciation on Machinery (W.N.2)	55,000	
	Adjustment for depreciation on Land & Building	20,000	
	Operating profit before change in Working Capital	3,35,000	
	Decrease in inventory	20,000	
	Increase in trade receivables	(20,000)	
	Decrease in trade payables	(1,00,000)	
	Income-tax paid	(45,000)	
	Net cash from operating activities		1,90,000
II.	**Cash flows from Investing Activities**		
	Purchase on Machinery	(1,25,000)	
	Sale of Investments	60,000	(65,000)
III.	**Cash flows from Financing Activities**		
	Issue of equity shares (1,50,000-1,00,000)	50,000	
	Dividend paid	(1,00,000)	(50,000)
	Net increase in cash and cash equivalent		75,000
	Cash and cash equivalents at the beginning of the period		5,00,000
	Cash and cash equivalents at the end of the period		5,75,000

Working Notes:

(i) Net Profit made during the year ended 31-3-2015

		(₹)
Increase in P & L (Cr.) Balance		30,000
Add:	Transfer to general reserve	50,000
Add:	Provision for taxation made during the year	55,000
Add:	Dividend payable during the year	1,25,000
		2,60,000

(ii) Machinery Account

		(₹)		(₹)
To	Balance b/d	7,50,000	By Depreciation (Bal. Fig.)	55,000
To	Bank	1,25,000	By Balance c/d	9,20,000
To	Equity share capital	1,00,000		
		9,75,000		**9,75,000**

(iii) Provision for Taxation Account

		(₹)		(₹)
To	Cash (Bal. Fig.)	45,000	By Balance b/d	50,000
To	Balance c/d	60,000	By P & L A/c	55,000
		1,05,000		**1,05,000**

(iv) Dividend Payable Account

		(₹)		(₹)
To	Bank	1,00,000	By Balance b/d	1,00,000
To	Balance c/d	1,25,000	By P & L A/c(Bal. Fig.)	1,25,000
		2,25,000		**2,25,000**

(v) Investment Account

		(₹)		(₹)
To	Balance b/d	1,00,000	By Bank A/c (Balanceing figure for investment Sold)	60,000
To	Capital Reserve A/c (Profit on sale of investment)	10,000	By Balance c/d	50,000
		1,10,000		**1,10,00**

Question 6—

From the following information, prepare cash flow statement of A (P) Ltd. as at 31st March, 2015 by using indirect method:

Balance Sheet

	2014 (₹)	**2015** (₹)
Liabilities:		
Share capital	12,00,000	12,00,000
Profit and loss account	8,50,000	10,00,000
Long term loans	10,00,000	10,60,000
Trade payables	3,50,000	4,00,000
	34,00,000	36,60,000
Assets:		
Fixed assets	17,00,000	20,00,000
Investment in shares	2,00,000	2,00,000
Inventory	6,80,000	7,00,000
Trade receivables	7,60,000	6,90,000
Cash	60,000	70,000
	34,00,000	**36,60,000**

Income Statement For the Year Ended 31st March, 2015

		(₹)
Sales		40,80,000
Less: Cost of sales		(27,20,000)
Gross profit		13,60,000
Less: Operating expenses:		
Administrative expenses	4,60,000	
Depreciation	2,20,000	(6,80,000)
Operating profit		6,80,000
Add: Non-operating incomes (dividend received)		50,000
		7,30,000
Less: Interest paid		(1,40,000)
Profit before tax		5,90,000
Less: Income-tax		(2,60,000)
Profit after tax		**3,30,000**

Statement of Retained Earnings

	(₹)
Opening balance	8,50,000
Add: Profit	3,30,000
	11,80,000
Less: Dividend paid	(1,80,000)
Closing balance	**10,00,000**

Answer—

Cash Flow Statement of A (P) Ltd.
For the Year ended 31st March 2015

		Amount (₹)	Amount (₹)
(i)	**Cash flows from operating activities**		
	Profit before tax	5,90,000	
	Adjustments for		
	Depreciation	2,20,000	
	Interest paid	1,40,000	
	Dividend received	(50,000)	
	Operating profit before working capital changes	9,00,000	
	Add:		
	Decrease in trade receivables	70,000	
	Increase in trade payables	50,000	
		10,20,000	
	Less: Increase in inventory	(20,000)	
	Cash generated from operations	10,00,000	
	Less: Tax paid	(2,60,000)	
	Cash flow from operating activities		7,40,000
(ii)	**Cash flows from investing activities**		
	Purchase of fixed assets	(5,20,000)	
	[20,00,000+2,20,000-17,00,000]		
	Dividend on investments	50,000	
	Cash used in investing activities		(4,70,000)
(iii)	**Cash flows from financing activities**		
	Long term loan taken	60,000	
	Interest paid	(1,40,000)	
	Dividend paid	(1,80,000)	
	Cash used in financing activities		(2,60,000)
Net increase in cash during the year			10,000
Add: Opening cash balance			60,000
Closing Cash Balance			70,000

Question 7—

The Balance Sheets of X Ltd. as on 31st March, 2014 and 31st March, 2015 are as follows:

Liabilities	2014 Amount (₹)	2015 Amount (₹)	Assets	2014 Amount (₹)	2015 Amount (₹)
Share Capital	5,00,000	7,00,000	Land and Buildings	80,000	1,20,000
General Reserve	50,000	70,000	Plant and Machinery	5,00,000	8,00,000
Profit and Loss A/c	1,00,000	1,60,000	Inventory	1,00,000	75,000
Trade payables	1,93,000	240,000	Trade receivables	1,50,000	1,60,000
			Cash	20,000	20,000
Outstanding Expenses	7,000	5,000		.	.
	8,50,000	11,75,000		8,50,000	11,75,000

(i) Plant having WDVRs.5,000 sold for Rs.8,000

(ii) Current year depreciation on plant 50,000

Prepare Cash Flow Statement.

Answer—

Cash Flow Statement for the year ended 31st March, 2015

		Amount (₹)	Amount (₹)
I	**Cash Flows from Operating Activities**		
	Closing Balance as per Profit & Loss A/c		1,60,000
	Less: Opening Balance as per Profit & Loss A/c		(1,00,000)
			60,000
	Add: Transfer to General Reserve		20,000
	Net Profit before taxation and extra-ordinary items		80,000
	Add: Depreciation on Plant and Machinery		50,000
	Less: Profit on sale of machinery (Refer W.N.)		(3,000)
	Operating Profit		1,27,000
	Add: Decrease in Inventory	25,000	
	Increase in trade payables	47,000	72,000
			1,99,000
	Less: Increase in trade receivables	(10,000)	
	Decrease in Outstanding expenses	(2,000)	(12,000)
	Net Cash from Operating Activities		1,87,000
II.	**Cash Flows from Investing Activities**		
	Purchase of Land & Building	(40,000)	
	Proceeds from Sale of Machinery (Refer W.N.)	8,000	
	Purchases of Plant & Machinery (Refer W.N.)	(3,55,000)	
Net Cash Used in Investing Activities			(3,87,000)
III.	**Cash Flows from Financing Activities**		
	Proceeds from Issuance of Share Capital	2,00,000	
	Net Cash from Financing Activities		2,00,000
Net Increase/Decrease in Cash & Cash Equivalents			0
Add:	Cash in hand at the beginning of the year		20,000
Cash in hand at the end of the year			20,000

Working Note:

Plant and Machinery Account

	(₹)		(₹)
To Balance b/d	5,00,000	By Bank	8,000
To Profit and Loss A/c(Profit on sale)	3,000	By Depreciation	50,000
To Purchases (Bal. fig.)	3,55,000	By Balance c/d	8,00,000
	8,58,000		**8,58,000**

Question 8—

The following are the summarized Balance Sheet of Star Ltd. as on 31st March, 2014 and 2015:

		(₹ '000)
	2015	**2014**
Equity share capital of ₹ 10 each	3,400	3,800
Profit and Loss A/c	400	540
Securities Premium	40	80
14% Debentures	800	900
Long term borrowings	180	240
Trade payables	360	440
Provision for Taxation	20	40
Dividend payable	300	480
	5,500	**6,520**
Sundry Fixed Assets:		
Gross Block	3,200	4,000
Less: Depreciation	(640)	(1,440)
Net Block	2,560	2,560
Investment	1,200	1,400
Inventories	1,000	1,400
Trade receivables	640	900
Cash and Bank Balance	100	260
	5,500	**6,520**

The Profit and Loss account for the year ended 31st March, 2015 disclosed:

	(₹ '000)
Profit before tax	780
Less: Taxation	(160)
Profit after tax	620
Less: Dividend payable	(480)
Retained Profit	**140**

The following information are also available:

(1) 40,000 equity shares issued at a premium of ₹ 1 per share.

(2) The Company paid taxes of ₹ 1,40,000 for the year 2014–15.

(3) During the period, it discarded fixed assets costing ₹ 4 lacs, (accumulated depreciation ₹ 80,000) at ₹ 40,000 only.

You are required to prepare a cash flow statement as per AS 3 (Revised), using indirect method.

Answer—

Cash Flow Statement for the year ended 31st March, 2015

			₹ ('000)
(A)	**Cash flow from operating activities**		
	Net profit before tax	780	
	Add: Adjustment for depreciation	880	
	Loss on sale of fixed assets	280	
	Interest on debentures*	126	
	Operating profit before changes in working capital	2,066	
	Less: Increase in trade receivables	(260)	
	Less: Increase in Inventories	(400)	
	Add: Increase in trade payables	80	
Cash generated from operations		1,486	
Less: Income tax paid (W.N.1)		(140)	
Net cash from operating activities			**1,346**
(B)	**Cash Flow From investing activities**		
	Purchase of fixed assets	(1,200)	
	Sale of fixed assets	40	
	Purchase of investments	(200)	
	Net cash used in investing activities		(1,360)
(C)	**Cash flow from Financing Activities**		
	Proceeds from issue of shares including premium (400 + 40)	440	
	Proceeds from issue of 14% debentures (900 - 800)	100	
Proceeds from long term borrowings		60	
	Interest on debentures	(126)	
	Payment of dividend	(300)	
	Net cash from financing activities		174
	Net increase in cash and cash equivalents (A+B+C)		160
	Cash and cash equivalents at the beginning of the year		100
	Cash and cash equivalents at the end of the year		**260**

Working Notes:

* It is assumed that debentures of ₹ 1,00,000 were issued at the beginning of the year.

		₹ ('000)
(1)	**Calculation of Income Tax paid during the year**	
	Income tax expense for the year	160
	Add: Income tax liability at the beginning of the year	20
		180
	Less: Income tax liability at the end of the year	(40)
	Income tax paid during the year	140
(2)	**Calculation of Fixed assets purchased during the year**	
	Closing balance of gross block of fixed assets	4,000
	Add: Cost of assets discarded during the year	400
		4,400
	Less: Opening balance of gross block of fixed assets	(3,200)
	Fixed assets purchased during the year	1,200

(3)	Calculation of Depreciation charged during the year	
	Closing balance of accumulated depreciation	1,440
	Add : Depreciation charged on assets discarded during the year	80
		1,520
	Less: Opening balance of accumulated depreciation	(640)
	Depreciation charged during the year	880

Question 9—

The following figures have been extracted from the books of X Limited for the year ended on 31.3.2015. You are required to prepare a cash flow statement.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 20 lakhs:

a. Depreciation on Fixed Assets ₹ 5 lakhs.

b. Discount on issue of Debentures written off ₹ 30,000.

c. Interest on Debentures paid ₹ 3,50,000.

d. Book value of investments ₹ 3 lakhs (Sale of Investments for ₹ 3,20,000).

e. Interest received on investments ₹ 60,000.

f. Compensation received ₹ 90,000 by the company in a suit filed.

(ii) Income tax paid during the year ₹ 10,50,000.

(iii) 15,000, 10% preference shares of ₹ 100 each were redeemed on 31.3.2015 at a premium of 5%. Further the company issued 50,000 equity shares of ₹ 10 each at a premium of 20% on2.4.2014. Dividend on preference shares were paid at the time of redemption.

(iv) Dividend paid for the year 2013-2014 ₹ 5 lakhs and interim dividend paid ₹ 3 lakhs for the year 2014-2015.

(v) Land was purchased on 2.4.2014 for ₹ 2,40,000 for which the company issued 20,000 equity shares of ₹ 10 each at a premium of 20% to the land owner as consideration.

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

	As on 31.3.2014 (₹)	As on 31.3.2015 (₹)
Inventory	12,00,000	13,18,000
Trade receivables	258000	253100
Cash in hand	1,96,300	35,300
Trade payables	211000	211300
Outstanding expenses	75,000	81,800

Answer—

X Ltd.

Cash Flow Statement For the year ended 31st March, 2015

Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		20,00,000
Adjustments for:		
Depreciation on fixed assets	5,00,000	
Discount on issue of debentures	30,000	
Interest on debentures paid	3,50,000	
Interest on investments received	(60,000)	
Profit on sale of investments	(20,000)	8,00,000
Operating profit before working capital changes		28,00,000

Adjustments for:		
Increase in inventory	(1,18,000)	
Decrease in trade receivable	4,900	
Increase in trade payables	300	
Increase in outstanding expenses	6,800	(1,06,000)
Cash generated from operations		26,94,000
Income tax paid		(10,50,000)
		16,44,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		90,000
Net cash flow from operating activities		17,34,000
Cash flow from Investing Activities		
Sale proceeds of investments	3,20,000	
Interest received on investments	60,000	
Net cash flow from investing activities		3,80,000
Cash flow from Financing Activities		
Proceeds by issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(15,75,000)	
Preference dividend paid	(1,50,000)	
Interest on debentures paid	(3,50,000)	
Dividend paid (5,00,000 + 3,00,000)	(8,00,000)	
Net cash used in financing activities		(22,75,000)
Net decrease in cash and cash equivalents during the year		(1,61,000)
Add: Cash and cash equivalents as on 31.3.2014		1,96,300
Cash and cash equivalents as on 31.3.2015		35,300

Note: Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

Question 10—

Surya Ltd. has provided you the following particulars. Prepare Cash Flow from Operating Activities by Indirect Method in accordance with AS 3 :

Profit & Loss Account of Surya Ltd. for the year ended 31st March, 2015

Particulars	₹	Particulars	₹
To Depreciation	86,700	By Operating Profit before depreciation	11,01,600
To Patents written off	35,000	By Profit on Sale on Investments	10,000
To Provision for Tax	1,25,000	By Refund of Tax	3,000
To Dividend payable	72,000	By Insurance Claim-Major Fire Settlement	1,00,000
To Transfer to Reserve	87,000		
To Net Profit	8,08,900		
	12,14,600		**12,14,600**

Additional Information:

	31.3.2014	31.3.2015
Inventory	1,20,000	1,60,000
Trade Receivables	7,500	75,000
Trade Payables	23,735	87,525

Provision for Tax	1,18,775	1,25,000
Prepaid Expenses	15,325	12,475
Marketable Securities	11,775	29,325
Cash Balance	25,325	35,340

Answer—

Indirect Method

Cash flow from Operating activities for the year ended 31st March, 2015

		(₹)
Net Profit as per Profit & Loss A/c		8,08,900
Add: Dividend payable		72,000
Add: Transfer to reserve		87,000
Add: Provision for Tax made during the Current Year		1,25,000
Less: Refund of tax		(3,000)
Less: Extraordinary items (i.e. Insurance Claim - Major Fire Settlement)		(1,00,000)
Net Profit before taxation, and extraordinary items		9,89,900
Add: Depreciation		86,700
Add: Patents written off		35,000
Less: Profit on sale of investments		(10,000)
Operating profit before working capital changes		11,01,600
Increase in Inventory	(40,000)	
Increase in trade receivables	(67,500)	
Increase in trade payables	63,790	
Decrease in prepaid expenses	2,850	(40,860)
Cash generated from operations		10,60,740
Income taxes paid (net of refund)		1,15,775
Cash flow before extraordinary item		9,44,965
Insurance claim recovery (major fire settlement)		1,00,000
Net cash from operating activities		10,44,965

PRACTICE QUESTIONS
AS 3

Question 1—

What are the main features of the Cash Flow Statement? Explain with special reference to AS 3.

Answer—

- According to AS 3 (Revised) on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities.
- Cash flows from operating activities can be reported using either
  a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
  b) The indirect method, whereby net profit or loss is adjusted for the effects of transactions of non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.
- As per para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.
- A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.
- This statement also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

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CHAPTER: 12
Buyback of Securities

BUY BACK OF SHARES

- Buy back is the process by which Company buy-back its own Shares or **other specified securities**
- Usually at a price higher than the market price.
- It is governed by section 68 of the Companies Act, 2013.
- Applicable listed, private and public companies.

BENEFIT OF BUY BACK

i. remedy for over capitalisation
ii. improve the earnings per share

A COMPANY CANNOT BUY BACK ITS SHARES

- Through its subsidiary
- Through investment or group of investment companies
- If default in repayment of debt or interest is subsist

CONDITIONS FOR BUYBACK (GUIDELINES)

A. General Guidelines

i. Provision in Article of Association (AOA)
ii. Buyback of only fully paid up shares.

B. Maximum limits of Buyback

i. With Board Resolution
- 10% of (paid up share capital + free reserves)

ii. With Special Resolution
- 25% of (paid up share capital + free reserves)
- In case of equity share capital it will be only 25% of total paid up equity share capital only

iii. Debt equity ratio
- After Buyback, debt equity ratio shall not exceed 2:1
- Debt includes long term and short term
- Debt includes secured and unsecured

C. Time limits

i. Completion of procedures within 12 months
ii. Destroying of securities within 7 days
iii. Minimum Gap between two buyback is 12 months
iv. Not to issue same class of shares for next 6 months
- Exception:
  a. Issue of Bonus Shares
  b. ESOP / sweat equity shares
  c. Conversion preference share or debenture
  d. Settlement of other obligation

D. Conditions related to outsiders

i. Declaration of solvency
- At least 2 directors
- One of them shall be managing director
- Declaration in form number SH 9

ii. Maintenance of registers of buy back in form no. SH 10
iii. SEBI guidelines
iv. ROC compliances

- File return within 30 days from completion of buy back
- Form no. SH 11 along with form No. SH 15
- Signed by at least 2 director
- One of them shall be managing director

E. Conditions for accounting purpose

i. Sources of Buy Back

- Free reserves
- Securities premium
- Fresh issue of shares or other specified securities

ii. Buyback out-of:

- Purchase from open market
- Proportionate Basis from existing share holders
- Taken back from employee ESOP and sweat equity shares.

iii. need to create capital redemption reserve (CRR)

- Face Value of shares buyback, out of reserves.

(1) Providing premium on shares buyback

S.P. A/c Dr.
↓
Free Reserves A/c Dr.
To Premium on Buy Back a/c

(2) Due entry of Buy Back

Equity share capital A/c Dr.
Premium on shares buyback a/c Dr.
To Share Buyback A/c

(3) Payment of Shares Buyback

Share Buyback A/c Dr.
To Bank A/c

(4) Creating CRR for buyback

Reserve A/c Dr
To CRR A/c

Note:

(1) Calculation of amount of CRR

Total face value of equity share buyback	xxx
Less : Fresh issue of capital for buyback	(xx)
Amount of CRR	xxx

(2) Order of use of reserve for the purpose of CRR is case of shares buyback

Revenue Reserve A/c
↓
General reserve a/c
↓
PL A/c
↓
Securities Premium A/c

(3) CRR

- For calculation of amount of CRR, only face value of equity shares capital buy back is to be considered even if it is buy back at premium.
- Only fresh issue of share capital is deducted.
- If shares have been issued at par or premium, then par value (only capital part) is deducted
- If share is issued at discount, then discounted price is deducted

(4) If multiple transaction occur on same date, then record first of all that transaction which result inflows thereafter transactions of out flows

CALCULATION OF MAX. BUY BACK OF NO. OF SHARES PERMITTED AS PER LAW

It will be lower of the following three criteria's :

(1) Shares O/s test

- It will be equal to 25% of existing no. of equity shares.

(2) Resource Test

- Max. permissible amount of Buyback = 25% of existing shareholders fund
- Max. no. of shares Buyback = Max. permissible amt. of buyback / Buy back price

(3) Debt Equity Ratio Test

After Buy Back of shares D.E. Ratio shall not exceed 2:1 excluding CRR.

- Debt includes short term borrowings.
- Debt is constant factor and will base for calculation.

Notes

- Criteria of Buy Back will be applied only if question requires otherwise normal entry of Buy Back is to be passed according to desired Buy Back by Co.
- Share Holder Fund = Paid up Share Capital + free reserve + Security Premium

Questions & Answers

Question 1—

What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as per Compa- nies Act, 2013. Explain in brief.

Answer

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. The key provisions in this regard are as under:

(a) A company may purchase its own shares or other specified securities out of:
   (i) Its free reserves;
   (ii) The securities premium account;
   (iii) The proceeds of the issue of any shares or other specified securities (not being the proceeds of an earlier issue of the same kind of shares or other specified securities).

(b) The buy-back is authorized by its articles.

(c) A special resolution has been passed in general meeting of the company authorising the buy-back (except where the buy back is of less than 10% of the paid up equity capital and free reserves of the company and the buy back is authorized by the Board by means of a resolution passed at a duly convened Board Meeting)

(c) The buy-back does not exceed 25% of the total paid up capital and free reserves of the company. Provided that in case of buy back of equity shares in any financial year, the 25% of paid up capital shall be construed as 25% of the total paid up equity capital in that financial year.

(d) The ratio of the secured and unsecured debt owed by the company after the buy back is not more than twice the paid up capital and its free reserves.

(e) All the shares and other securities for buy-back are fully paid up.

(f) The buy-back is completed within 12 months of the passing of the special resolution or a resolution passed by the Board.

(g) The buy-back of the shares listed on any recognized stock exchange is in accordance with the regulations made by the SEBI in this behalf.
(h) Before making such buy-back, a listed company has to file with the Registrar and the SEBI a declaration of solvency in the prescribed form.
(i) The buy back may be from
(i) the existing shareholders or security holders on proportionate basis;
(ii) the open market;
(iii) the shares or securities issued to the employees of the company pursuant to a scheme of Stock Option or Sweat Equity.
(j) Where a company purchases its own shares out of its free reserves or securities premium account it shall transfer an amount equal to the nominal value of such shares to Capital Redemption Reserve Account and details of such transfers should be given in the Balance Sheet.
* If the buy-back by the company is or less than 10% of the total paid-up equity capital and free reserves of the company then it can be authorised by the Board by means of resolution passed at its meeting and no special resolution will be required.

Question 2—
M. Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2013:

	₹ in '000	₹ in '000
Equity & Liabilities		
Share Capital:		
Authorized Capital:		5,000
Issued and Subscribed:		
3,00,000 Equity shares of 10 each fully paid up	3,000	
20,000 9% Preference Shares of 100 each	2,000	
(Issued two months back for the purpose of buy back)		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: Provision for depreciation	250	2,750
Non-current investment at cost		5,000
Current assets, loans and adverse (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, 2013.

(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, 2013.
You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2013.

Answer:

Journal Entries in the books of M Ltd.

			Dr. ₹ in '000	Cr. ₹ in '000
1.	Bank A/c	Dr.	2,500	
	Profit And Loss A/c		500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	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 shareholders)			
3.	Preference Shareholders A/c	Dr.	2,200	
	To Bank A/c			2,200
	(Being the amount due on buy-back of equity shares)			
4.	Equity Share Capital A/c	Dr.	600	
	Securities Premium A/c (Premium payable on buy-back)	Dr.	300	
	To Equity Share buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
5.	Equity Shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back of equity shares)			
6.	10% Debentures A/c	Dr.	330	
	To Own Debentures A/c			300
	To Capital reserve A/c (Profit on cancelation)			
	(Being own debentures cancelled at profit.)			
7.	Securities Premium A/c	Dr.	200	
	To Premium on redemption of pref. Shares A/c			200
	(Being premium on redemption of preference shares adjusted through securities premium)			
8.	Revenue Reserve A/c	Dr.	2,000	
	To Capital Redemption reserve A/c (Refer Note)			2,000
	(Being creation of capital redemption reserve to the extent of nominal value of preference shares redeemed)			

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

	Note No.	₹ in '000
Equity and Liabilities		
1. Shareholders' funds		
Share capital	1	2,400
Reserve and Surplus	2	5,340
2. Non-current liabilities		
Long term borrowings	3	70
3. Current Liabilities		40
	Total	**7,850**
Assets		
1. Non-current Assets		
(a) Fixed Assets		2,750
(b) PPE	4	1,700
2. Current Assets	5	3,400
	Total	**7,850**

Notes to Accounts

		in '000	₹ in '000	
1.	**Share Capital**			
	Authorized 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 had been bought back and cancelled during the year)			
2.	**Reserve and Surplus**			
	Capital Reserve	10		
	Add: Profit on cancelation of debentures	30	40	
	Securities Premium	500		
	Less: Premium on redemption of preference	(200)		
	Premium on buy-back of equity shares	(300)		
	Revenue Reserve	4,000		
	Less: Transfer to Capital Redemption Reserve	(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 investment**			
	Balance as on 31.03.2013		5,000	
	Less: Investment sold		(3,000)	

	Own Debentures cancelled	(300)	1,700
5.	**Current Assets**		
	Balance as on 31.3.2013	4,000	
	Add: Cash received on sale of investment	2,500	
	Less: payment made to equity shareholders for buy back of shares	(900)	
	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, therefore, 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.

Chapter: 14
Accounting for Reconstruction of Companies

MEANING OF RECONSTRUCTION OF COMPANIES:

- It is a process to reorganize the company by incorporating major changes in the Balance Sheet to overcome from the poor financial position and liquidity crises.
- It is generally adopted when financial position of the company is very poor and company needsto revive itself
- Reconstruction is classified into two categories

Internal Reconstruction
↓
Reconstruction of company without liquidating itself
↓
Existence of company will

Continue in future

External Reconstruction
↓
Reconstruction by liquidating itself and restart the same business by incorporating new company
↓
It is covered by the topic of amalgamation

PROCESS OF INTERNAL RECONSTRUCTION

- Company will call a meeting of interested parties related to liability side of company
- Parties will agree to forgone part of their amount due in the interest of company.
- Accordingly scheme of internal reconstruction is drafted in meeting of company
- Approval of court is obtained for such scheme
- After obtaining approval of court, journal entries will be passed for that scheme
- Use 'AND REDUCED' with name of company for a specified time prescribed by court

CAPITAL REDUCTION/RECONSTRUCTION A/C

- Nominal nature
- Debited for every kind of losses by scheme of internal reconstruction
- Credited for every kind of profit by scheme of IR
- Final Result of the account will have credit balance and disclosed total accumulated profit by scheme of internal reconstruction
- Such profit will be used to write off losses of company.
- After writing off all losses balance if any of capital reduction account is to be trans ferred to capital reserve account

ACCOUNTING FOR INTERNAL RECONSTRUCTION

1. TYPES OF REORGANISATION OF SHARE CAPITAL

Alteration in Share Capital	Reduction in Share Capital

2. ALTERATION IN SHARE CAPITAL

- ✓ Form of share capital is changed
- ✓ Ordinary resolution is required
- ✓ Total of paid up share capital will be same
- ✓ Paid up share Capital is not reduced
- ✓ No use of capital reduction account
- ✓ Journal entries

Old share capital A/c Dr.
To New Share Capital A/c

3. TECHNIQUES OF ALTERATION IN SHARE CAPITAL

(A) Subdivision or Splitting of Share Capital	
• Face value of share is decreased and • Quantity is increased	Share capital(old face value) A/c Dr. To Share Capital (New face value) A/c
(B) Consolidation of Share Capital	
• Face value of share is increased and • Quantity is decreased	Share capital(old face value) A/c Dr. To Share Capital (New face value) A/c
(C) Conversion of Share Capital into Equity Stock	
• Face value and quantity of the share is removed • New shares can be issued in fractional form	Share capital A/c Dr. To Equity Stock A/c
(D) Conversion of Equity Stock into Share Capital	
• Capital divided into standard face value and quantity • New shares cannot be issued in fractional form	Equity Stock A/c Dr. To Share capital A/c

4. REDUCTION IN SHARE CAPITAL

- ✓ Section 66 of the Companies Act, 2013
- ✓ Confirmation by the Tribunal
- ✓ Special resolution
- ✓ techniques of capital reduction
  - A. Cancellation of unpaid amount on shares
  - B. Paying off of paid-up share capital which is in excess of its requirements (simple journal entry payment of share capital)
  - C. Cancelling of paid-up share capital

REDUCTION IN SHARE CAPITAL BY CANCELLING OF PAID-UP SHARE CAPITAL

- Share holder agreed to sacrifice part of his paid up capital
- Accordingly paid up capital is reduced
- Sacrificed part is credited to capital reduction account

Reduction In Capital Without Change In Face Value	Reduction In Capital With Change In Face Value
Share capital a/c Dr. To Capital Reduction A/c	Share capital (old face value) a/c Dr. To Share Capital(new face value) A/c To Capital Reduction A/c

5. ADJUSTMENT OF RECORDED LIABILITY (LIABILITY EXIST IN BALANCE SHEET)

Payment of Liability	Foregone of Liability	Settlement of Liability in Future
Liability A/c Dr. To Bank A/c	Liability A/c Dr. To Capital Reduction A/c	No Entry

6. ADJUSTMENT OF UNRECORDED LIABILITY (LIABILITY NOT EXIST IN BALANCE SHEET)

Payment of Liability	Foregone of Liability	Settlement of Liability in Future
Capital Reduction A/c Dr. To Bank A/c	No Entry	Capital Reduction A/c Dr. To Liability A/c

7. TREATMENT OF INCREASE IN VALUE OF ASSET

Asset A/c Dr.

To Capital Reduction A/c

Note: Decrease in value of asset will be adjusted by big entry

8. PAYMENT FOR PENALTY ON CANCELLATION OF CONTRACT/RECONSTRUCTION EXPENSES

Capital Reduction A/c Dr.

To Bank A/c

9. ADJUSTMENT OF BALANCE OF CAPITAL REDUCTION A/C [BIG ENTRY]

Capital Reduction A/c Dr.

To Fictitious Asset [100%] To Goodwill [100%]

To other asset [up to required to decrease] To Capital Reserve [Balancing Figure]

Note:

(i) Profit/Loss on sale of asset is adjusted with capital reduction a/c

(ii) Discount on issue of security will be adjusted by capital reduction A/c However premium on issue of securities will be credited to securities premium a/c

10. CONCEPT OF SHARE SURRENDER UNDER I.R

- ❖ Share surrender is updated method for sacrificing of share capital in the interest of company
- ❖ Under earlier system share holder sacrifice part of his paid up capital per share
- ❖ Under share surrender shareholder sacrifice by way of surrender of part of his holding in the interest of the company
- ❖ Such surrendered share company can reissue for the settlement of different liabilities
- ❖ After reissue balance of share surrender a/c is transferred to capital reduction a/c
- ❖ Accounting will be as under:

(1) On Surrender of Shares

↓

If not to be reissued	If it is to be reissued
↓	↓
Share Capital A/c Dr. To Capital Reduction A/c	Share Capital A/c Dr. To Share Surrender A/c

(2) On conversion of surrendered shares form one form of share capital to other form

- No entry

(3) Settlement of liability by issue of shares out of share surrender

(1) Settlement of Liability by issue of shares out of share surrender

Issue of share
Share surrender a/c Dr.
To Share Capital A/c

Settlement of liability with amount ofliability settled instead of amount sacrificed:
Liability A/c Dr.
To Capital Reduction A/c

(4) **Transfer of Balance of Share surrender to capital reduction A/c**

Share Surrender A/c Dr.
To Capital Reduction A/c

Questions and Answer

M/s Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the company as on 31st March, 2014 before reconstruction:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital			
50,000 shares of 50		Goodwill	22,00,000
each fully paid up	25,00,000	Land & Building	42,70,000
1,00,000 shares of 50		Machinery	8,50,000
each 40 paid up	40,00,000	Computers	5,20,000
Capital Reserve	5,00,000	Inventories	3,20,000
8% Debentures of 100 each	4,00,000	Trade Receivable	10,90,000
12% Debentures of 100 each	6,00,000	Cash at Bank	2,68,000
Trade Creditors	12,40,000	Profit & Loss A/c	7,82,000
Outstanding Expenses	10,60,000		
Total	**1,03,00,000**	**Total**	**1,03,00,000**

Following is the interest of Mr. Shiv and Mr. Ganesh in M/s. Platinum Limited:

	Mr. Shiv	Mr. Ganesh
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹ 40 each.

(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of ₹ 40 each for ₹ 12,50,000.

(3) Trade Creditors are given option of either to accept fully paid equity shares of ₹ 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade Creditors for ₹ 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.

(4) Mr. Shiv agrees to cancel debentures amounting to ₹ 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to ₹ 1,00,000.

(5) Mr. Ganesh agrees to cancel debentures amounting to ₹ 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

(6) Land & Building to be revalued at ₹ 51,84,000 Machinery at ₹ 7,20,000, Computers at ₹ 4,00,000, Inventories at ₹ 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.

(7) Outstanding Expenses are fully paid in cash.

(8) Goodwill and Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all th e above transactions and draft the company's Balance Sheet immediately after the reconstruction.

Answer:

Journal Entries

Bank A/c	Dr.	10,00,000	
To Equity			10,00,000
(Being money on final call received)			
Equity share capital (₹ 50)A/c	Dr.	75,00,000	
To Equity share capital (₹ 40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital 50 each ofinto ₹ 40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at ₹ 40 each)			
Trade Creditors A/c	Dr.	12,40,000	
To Equity Share Capital A/c			7,50,000
To Bank A/c (₹ 4,90,000 × 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to creditors in shares or cashto the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	

To Shive A/c			7,00,000
(Being cancellation of 8% and 12% debentures of Shiv)			
Shiv A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To Shive A/c			1,00,000
(Being new debentures subscribed by Shiv)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c	Dr.	2,00,000	
To Ganesh A/c			3,00,000
(Being cancellation of 8% and 12% debentures of Ganesh)			
Ganesh A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reductions A/c			50,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Land and Building	Dr.	9,14,000	
(51,84,000 – 42,70,000)			
Inventories	Dr.	30,000	
To Capital Reduction A/c			9,44,000
(Being value of assests appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000
(Being outstanding Expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade Receivables A/c			1,09,000
To Goodwill A/c			22,00,000
To Profit and Loss A/c			7,82,000
(Being amount of capital reduction utilized in writing off P & L A/c (Dr.) balance, goodwill and downfall in value of other assests.)			
Capital Reserve A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being debit balance of capital reduction account adjusted against capital reserve.)			

Balance Sheet (as reduced) as 31.3.2014

Particulars			Notes	( )Equity and Liabilities ₹
1.		**Shareholders' funds**		
	(a)	Share Capital	1	80,00,000
2.		**Non-current Liabilities**		
	(a)	Long-term borrowings	2	8,50,000
			Total	**88,50,000**
	Assets			
1		**Non-current assets**		
	(a)	PPE	3	63,04,000
2		**Current Assets**		
	(a)	Inventories		3,50,000
	(b)	Trade receivables		9,81,000
	(c)	Cash and cash equivalents		12,15,000
			Total	**88,50,000**

Notes to accounts

			(₹)
1.	**Share Capital**		
	2,00,000 Equity Shares of 40		80,00,000
2.	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3.	**PPE**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. Cash at Bank A/c

	Particulars	(₹)		Particulars	(₹)
To	Balance b/d	2,68,000	By	Trade Creditors	3,43,000
To	Equity Share Capital A/c	10,00,000	By	Outstanding Expenses A/c	10,60,000
To	Equity Share Capital	12,50,000	By	Balance c/d (bal. fig.)	12,15,000
To	Shiv A/c	1,00,000			.
		26,18,000			**26,18,000**

2. Capital Reduction Account

Particulars	₹	Particulars	₹
To Machinery A/c	1,30,000	By Equity Share Capital A/c	15,00,000
To Computers A/c	1,20,000	By Trade Creditors A/c	1,47,000

To	Trade receivables A/c	1,09,000	By	Shiv A/c	2,00,000
To	Goodwill A/c	22,00,000	By	Ganesh A/c	50,000
To	Profit and Loss A/c	7,82,000	By	Land & Building	9,14,000
			By	Inventories	30,000
			By	Capital Reserve A/c	5,00,000
		33,41,000			33,41,000

Question 2—

The summarised Balance Sheet of M/s. Ice Ltd. as on 31-03-2015 is given below:

Liabilities	₹	Assets	₹
1,00,000 Equity shares of 10 each fully paid up	10,00,000	Freehold property	5,50,000
		Plant and machinery	2,00,000
4,000, 8% Preference shares of 100 each fully paid	4,00,000	Trade investment (at cost)	2,00,000
		Trade receivables	4,50,000
6% Debentures 4,00,000 (secured by freehold property)		Inventories-in trade	3,00,000
		Profit and loss account	5,25,000
Arrear interest 24,000	4,24,000		
Trade payables	1,01,000		
Director's loan	3,00,000		
	22,25,000		22,25,000

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective stakeholders:

(i) Preference shares are to be written down to ₹ 80 each and equity shares to ₹ 2 each.

(ii) Preference dividend in arrear for 3 years to be waived by 2/3 rd and for balance 1/3rd, equity shares of ₹ 2 each to be allotted.

(iii) Debentureholders agreed to take one freehold property at its book value of ₹ 3,00,000 in part pay- ment of their holding. Balance debentures to remain as liability of the company.

(iv) Arrear debenture interest to be paid in cash.

(v) Remaining freehold property to be valued at ₹ 4,00,000.

(vi) Investment sold out for ₹ 2,50,000.

(vii) 75% of Director's loan to be waived and for the balance, equity shares of ₹ 2 each to be allotted.

(viii) 40% of Trade receivables, 80% of Inventories and 100% of debit balance of profit and loss account to be written off.

(ix) Company's contractual commitments amounting to ₹ 6,00,000 have been settled by paying 5% pen- alty of contract value.

Show the Journal Entries for giving effect to the internal re-construction and draw the Balance Sheet of the company after effecting the scheme.

Answer

In the books of Ice Ltd.
Journal Entries

	Particulars		Debit (₹)	Credit (₹)
i	8% Preference share Capital A/c (₹ 100 each)		4,00,000	
	To 8% Preference Share A/c (₹80 each)			3,20,000
	To Capital Reduction A/c			80,000
	(Being the preference shares of ₹ 100 each reduced to ₹ 80 each as per the approved scheme)			
ii.	Equity Share capital A/c (₹ 10 each)	Dr.	10,00,000	
	To Equity Share capital A/c (₹ 2 each)			2,00,000
	To Capital Reduce A/c			8,00,000
	(Being the equity shares of ₹10 each reduced to ₹2 each)			
ii.	Capital reduction A/c	Dr.	32,000	
	To Equity Share Capital A/c (₹ 2 each)			32,000
	(Being arrears of preference share dividend of one year to besatisfied by issue of ₹ 16,000 equity shares of ₹ 2 each)			
iv.	6% Debentures A/c	Dr.	3,00,000	
	To Freehold Property A/c			3,00,000
	(Being claim settled in part by transfer of freehold property)			
v.	Accrued Debenture Interest A/c	Dr.	24,000	
	To Bank A/c			24,000
	(Being accrued debenture interest paid)			
vi.	Freehold Property A/cq	Dr.	1,50,000	
	To Capital reduction A/c			1,50,000
	(Being appreciation in the value of freehold property)			
vii.	Bank A/c	Dr.	2,50,000	
	To Trade Investment A/c			2,00,000
	To Capital Reduction A/c			50,000
	(Being trade investment sold on profit)			
viii.	Director's loan A/c	Dr.	3,00,000	
	To Equity Share Capital A/c ₹2 each)			75,000
	To Capital Reduction A/c			2,25,000
	(Being director's loan waived by 75% and balancebeing discharged by issue of 37,500 equity sharesof ₹ 2 each)			
(ix)	Capital Reduction A/c	Dr.	9,75,000	
	To Profit and Loss A/c			5,25,000
	To Trade receivables A/c			1,80,000

	To Inventories-in-trade A/c			2,40,000
	To Bank A/c			30,000
	(Being various assets, penalty on cancellation ofcontract, profit and loss account debit balance written off through capital reduction account)			
(x)	Capital Reduction A/c	Dr.	2,98,000	
	To Capital Reserve A/c			2,98,000
	(Being balance transferred to capital reserve A/c as per the scheme)			

Balance Sheet of Ice Ltd. (As reduced)

		Particulars	Notes	(₹)
1.		**Shareholders' funds**		
	(a)	Share Capital	1	6,27,000
	(b)	Reserve and Surplus	2	2,98,000
2.		**Non-current Liabilities**		
		Long-term borrowings	3	1,00,000
3.		**Current Liabilities**		
	(a)	Trade Payables		1,01,000
			Total	**11,26,000**
		Assets		
1.		**Non-current Assets**		
	(a)	PPE	4	6,00,000
2.		**Current Assets**		
	(a)	Inventories		60,000
	(b)	Trade receivables		2,70,000
	(c)	Cash and cash equivalents	5	1,96,000
			Total	**11,26,000**

Note to Accounts

(₹)

1.	**Share Capital**	
	1,53,500 Equity shares of ₹ 2 each	3,07,000
	(out of which 53,500 shares have been issued for consideration other than cash) 4,000, 8% Preference shares of ₹ 80 each fully paid up	3,20,000
	Total	6,27,000
2.	**Reserves and Surplus**	
	Capital Reserve	2,98,000
3.	**Long-term borrowings**	
	Secured	1,00,000

4.	6% Debentures		
	Tangible assets		4,00,000
	Freehold property		2,00,000
	Plant and machinery		6,00,000
5.		Total	
	Cash and cash equivalents		1,96,000
	Cash at bank (2,50,000 – 24,000 –30,000)		

Question 3-

The Balance Sheet of M/s. Cube Limited as on 31-03-2015 is given below:

Particulars	Note No.	Amount (₹ in lakh)
Equity & Liabilities		
Shareholders' Funds		
Shares' Capital	1	700
Reserves & Surplus	2	(261)
Non-Current Liabilities		
Long term Borrowings	3	350
Current Liabilities		
Trade Payables	4	51
Other Liabilities	5	12
Total		852
Assets		
Non-Current Assets		
Fixed Assets		
Tangible Assets	6	375
Current Assets		
Current Investments	7	100
Inventories	8	150
Trade Receivables	9	225
Cash & Cash Equivalents	10	2
Total		852

Notes to accounts:

			₹ in Lakhs
(1)	**Shares Capital**		
	Authorized:		
	100 lakh shares of ₹ 10 each		100
	4 lakh, 8% Preference Shares of ₹ 100 each		400
	Issued, Subscribed and paid up:		
	50 lakh Equity Shares of ₹ 10each, full paid up		500
	2 lakh 8% Preference Shares of ₹ 100 each, fully paid up	200	
	Total	700	(2)

(2)	**Reserve and Surplus**	
	Debit Balance of Profit & Loss A/c	(261)
(3)	**Long Term Borrowings**	
	6% Debentures (Secured by Freehold Property)	200
	Director's Loan	150
		350
(4)	**Trade Payables**	
	Trade Payables for Goods	51
(5)	**Others Current Liabilities**	
	Interest Accrued and Due on 6% Debentures	12
(6)	**PPE**	
	Freehold Property	275
	Plant & Machinery	100
		375
(7)	**Current Investment**	
	Investment in Equity Instruments	100
(8)	**Inventories**	
	Finished Goods	150
(9)	**Trade Receivables**	
	Trade receivables for Goods	225
(10)	**Cash and Cash Equivalents**	
	Balance with Bank	2

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹ 80 each and Equity Shares to ₹ 2 each.

(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹ 2 each to be allotted.

(3) Debenture holders agreed to take one Freehold Property at its book value of ₹ 150 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.

(4) Interest accrued and due on Debentures to be paid in cash.

(5) Remaining Freehold Property to be valued at ₹ 200 lakh.

(6) All investments sold out for ₹ 125 lakh.

(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹ 2 each to be allowed.

(8) 40% of Trade receivables and 80% of Inventories to be written off.

(9) Company's contractual commitments amounting to ₹ 300 lakh have been settled by paying 5% penalty of contract value.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;

(b) Prepare Reconstruction Account; and

(c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the simple- mentation of scheme of internal reconstruction.

Answer:

(a) Journal Entries in the books of M/s Cube Ltd.

	Particulars		Debit (₹ in lakhs)	Credit (₹ in lakhs)
(i)	8% Preference Share Capital A/c (₹ 100 each)	Dr.	200	
	To 8% Preference share capital A/c (₹ 80 each)		160	
	To Capital Reduction A/c			40
	(Being the preference shares of ₹ 100 each reduced to ₹ 80each as per the approved scheme.)			
(ii)	Equity Share Capital A/c (₹ 10 each)	Dr.	500	
	To Equity Share Capital A/c (₹ 2 each)			100
	To Capital Reduction A/c			400
	(Being the equity shares of ₹ 10 each reduced to ₹ 2 each)			
(iii)	Capital Reduction A/c	Dr.	16	
	To Equity Share Capital A/c (₹ 2 each)			16
	(Being 1/3rd arrears of preference share dividend of3 years to be satisfied by issue of ₹ 8 lakhs equity shares of ₹ 2 each)			
(iv)	6% Debentures A/c	Dr.	150	
	To Freehold Property A/c			150
	(Being claim of Debenture holders settled in partby transfer of freehold property)			
(v)	Accrued Debentures Interest A/c	Dr.	12	
	To Bank A/c			12
	(Being accrued debenture interest paid)			
(vi)	Freehold Property A/c	Dr.	75	
	To Capital Reduction A/c			75
	(Being appreciation in the value of freehold property)			
(vii)	Bank A/c	Dr.	125	
	To Investment A/c			100
	To Capital Reduction A/c			25
	(Being investment sold at profit)			
(viii)	Director's Loan A/c	Dr.	150	
	To Equity Share Capital A/c (₹ 2 each)			45
	To Capital Reduction A/c			105
	(Being director's loan waived by 70% and balance being discharged by issue of ₹ 22.5 lakhs equity shares of ₹ 2 each.)			
(ix)	Capital Reduction A/c	Dr.	483	
	To Profit and Loss A/c			261

		Dr.		
	To Trade Receivables A/c (₹ 225 × 40%)			90
	To Inventories-in-trade A/c (₹ 150 × 80%)			120
	To Bank A/c (₹ 300 × 5%)			15
	(Being certain value of various assets, penaltyon cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account)			
(x)	Capital Reduction A/c	Dr.	143	
	To Capital Reserve A/c			143
	(Being balancey transferred to capital reserve account as per the scheme)			

Capital Reduction Account

Dr. **Cr.**

	(₹ in lakhs)		(₹ in lakhs)
To Equity Share Capital	16	By Preference Capital	40
To Trade Receivables	90	By Equity Share Capital	400
To Finished Goods	120	By Freehold Property	75
To Profit & Loss A/c	261	By Bank	25
To Bank A/c	15	By Director's Loan	105
To Capital Reserve	143		.
	645		645

(c) Notes to Balance Sheet

		(₹ in lakhs)	(₹ in lakhs)
1.	**Share Capital**		
	Authorised:		
	100 lakhs Equity shares of ₹ 2 each		200
	4 lakhs 8% Preference shares of ₹ 80 each		320
			520
	Issued:		
	80.5 lakhs equity shares of ₹ 2 each		161
	2 lakhs Preference Shares of ₹ 80 each		160
			321
2.	Tangible Assets	275	
	Free hold Property	(150)	
		125	
	Add: Application	75	200
	Plant and Machinery		100
			300

Question 4—

The Balance Sheet of M/s. Clean Ltd. as on 31st March, 2015 was summarized as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital:		Land & Building	75,00,000
Equity shares of 50 each, fully paid up	60,00,000	Plant & Machinery	22,00,000
9% Preference Shares of 10 each, fully paid up	40,00,000	Trade Investment	16,50,000
7% Debentures (secured by plant & Machinery)	23,00,000	Inventories	9,50,000
8% Debentures	17,00,000	Trade Receivable	18,00,000
Trade Payables	6,00,000	Balances	3,60,000
Provision for Tax	75,000	Profit & Losss A/c	2,15,000
	1,46,75,000		1,46,75,000

The Board of Directors of the company decided upon the following scheme of reconstruction duly approved by all concerned parties:

(1) The equity shareholders agreed to receive in lieu of their present holding of ₹ 1,20,000 shares of ₹ 50 each as under:

(a) New fully paid equity shares of ₹ 10 each equal to 2/3rd of their holding.

(b) 9% preference shares of 8 each to the extent of 25% of the above new equity share capital.

(c) ₹ 2,80,000, 10% debentures of ₹ 80 each.

(2) The preference shareholders agreed that their ₹ 10 shares should be reduced to ₹ 8 by cancellation of ₹ 2 per share. They also agreed to subscribe for two new equity shares of ₹ 10 each for every five preference shares held.

(3) The taxation liability of the company is settled at ₹ 66,000 and the same is paid immediately.

(4) One of the trade creditors of the company to whom the company owes ₹ 1,00,000 decides to forgo 30% of his claim. He is allotted equity shares of ₹ 10 each in full satisfaction of his balance claim.

(5) Other trade creditors of ₹ 5,00,000 are given option of either to accept fully paid 9% preference shares of ₹ 8 each for the amount due to them or to accept 80% of the amount due to them in cash in full settlement of their claim. Trade creditors for ₹ 3,50,000 accepted preference shares option and rest of them opted for cash towards full settlement of their claim.

(6) Company's contractual commitments amounting to ₹ 6,50,000 have been settled by paying 4% penalty of contract value.

(7) Debenture holders having charge on plant and machinery accepted plant and machinery in full settlement of their dues.

(8) The rate of interest on 8% debentures is increased to 10%. The debenture holders surrender their existing debenture of ₹ 50 each and agreed to accept 10% debentures of ₹ 80 each for every two debentures held by them.

(9) The land and building to be depreciated by 5%.

(10) The debit balance of profit and loss account is to be eliminated.

(11) 1/4th of trade receivables and 1/5th of inventory to be written off.

Pass Journal Entries and prepare Balance Sheet after completion of the reconstruction scheme in the books of M/s Clean Ltd. as per Schedule III to the Companies Act, 2013.

Answer:

Journal Entries

(i)	Equity Share Capital (₹ 50) A/c	Dr.	60,00,000	
	To Equity Share Capital (₹ 10)*A/c			8,00,000
	To 9% Preference Share Capital A/c			2,00,000
	To 10% Debentures A/c			2,80,000
	To Capital Reduction A/c			47,20,000
	(Being payment made in lieu of equity share capital of ₹ 50 each by issue of equity shares of ₹ 10 each, 9% Preference share capital and 10% Debentures as per reconstruction scheme)			
(ii)	9% Preference Share Capital (₹ 10) A/c	Dr.	40,00,000	
	To 9% Preference Share Capital (₹ 8)A/c			32,00,000
	To Capital Reduction A/c			8,00,000
	(Being 9% preference share capital of ₹ 10 each reduced to ₹ 8 each as per reconstruction scheme)			
(iii)	Bank A/c	Dr.	16,00,000	
	To Equity Share Capital (₹ 10)A/c			16,00,000
	(Being preference shareholders subscribed for 2 new equity shares of 10 each against every 5 shares)			
(iv)(a)	Provision for Taxation A/c	Dr.	75,000	
	To Capital Reduction A/c			9,000
	To Taxation Liability A/c (Being liability for taxation settled)			66,000
(b)	Taxation Liability A/c	Dr.	66,000	
	To Bank A/c			66,000
	(Being Liability for taxation paid)			
(v)	Trade payables A/c	Dr.	1,00,000	
	To Equity Share Capital A/c (7,000 × ₹ 10)			70,000
	To Capital Reduction A/c			30,000
	(Being payment made to creditors in shares to the extent of 70% as per reconstruction scheme)			
(vi)	Trade Payables A/c	Dr.	5,00,000	
	To 9% Preference share capital A/c (43,750 × 8)		3,50,000	
	To Bank A/c			1,20,000
	To Capital Reduction A/c			30,000

	(Being payment made to creditors in shares and cash asper reconstruction scheme)			
(vii)	Capital Reduction A/c	Dr.	26,000	
	To Bank A/c			26,000
	(Being contractual commitment settled by paymentof 4% penalty)			
(viii)	7% Debentures A/c	Dr.	23,00,000	
	To Plant & Machinery A/c			22,00,000
	To Capital Reduction A/c			1,00,000
	(Being 7% debentures holders settled through chargeof plant & machinery as per reconstruction scheme)			
(ix)	8% Debentures A/c	Dr.	17,00,000	
	To 10% Debentures A/c (₹ 17,000 × 80)			13,60,000
	To Capital Reduction A/c			3,40,000
	(Being conversion of 8% debentures to 10% debenturesat one for every two debentures held by them as per reconstruction scheme)			
(x)	Capital Reduction A/c	Dr.	12,30,000	
	To Land & Building A/c			3,75,000
	To Profit & Loss A/c			2,15,000
	To Trade Receivables A/c			4,50,000
	To Inventories			1,90,000
	(Being amount of Capital Reduction utilized in writing off Profit & loss Dr. bal., Land & building, Current Assets, Inventories through capital reduction account)			
(xi)	Capital Reduction A/c	Dr.	47,73,000	
	To Capital Reserve A/c			47,73,000
	(Being Balance in capital reduction account transferred to capital reserve account)			

(ii) Balance Sheet of M/s. Clean Ltd. (as reduced) as on 31.3.2015

	Particulars	Notes	(₹)
1	**Equity and Liabilities**		
	Shareholders' funds		
	a Share Capital	1	62,20,000
	b Reserve and Surplus	2	47,73,000
2.	**Non-current liabilities**		
	a Long-term Borrowings	3	16,40,000
		Total	**1,26,33,000**
	Assets		
1	**Non-current Assets**		
	a PPE	4	71,25,000
	b Investments		16,50,000

2	**Current Assets**		
	a Inventories	5	7,60,000
	b Trade Receivables	6	13,50,000
	c Cash and Cash equivalents		17,48,000
		Total	**1,26,33,000**

Notes to accounts

			(₹)
1.	**Share Capital**		
	Equity Share Capital		
	Issued subscribed and paid up		
	₹ 2,47,000 equity shares of ₹ 10 each		24,70,000
	(out of which ₹ 7,000 equity shares have been issued for consideration for other that cash)		
	Preference Share Capital		
	Issued, subscribed and paid up		
	4,68,750 Preference Shares of ₹ 8 each		37,50,000
	(out of which 43,750 equity shares have been issued forconsideration for other that cash)		62,20,000
2.	**Reserves and Surplus**		
	Capital Reserve		47,73,000
3.	**Long-term borrowings**		
	Secured		
	20,500 10% Debentures of ₹ 80 each		16,40,000
4.	**PPE**		
	Land & Building	75,00,000	
	Adjustment under scheme of reconstruction	(3,75,000)	71,25,000
5.	**Inventors**	9,50,000	
	Adjustment under scheme of reconstruction	(1,90,000)	7,60,000
6.	**Trade Receivables**	18,00,000	
	Adjustment under scheme of reconstruction	4,50,000	13,50,000

Working Notes:

1. Cash at Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	3,60,000	By Taxation liability	66,000
To Equity Share capital A/c	16,00,000	By Trade Payables A/c	1,20,000
		By Penalty A/c	26,000
		By Balance c/d (bal. Fig.)	17,48,000
	19,66,000		**19,66,000**

2. Capital Reduction Account

Particulars	(₹)	Particulars	(₹)
To Land & Building	3,75,000	By Equity Share Capital A/c	47,20,000

To Machinery A/c	2,15,000	By 9% Preference Share Capital	8,00,000
To Trade receivables A/c	4,50,000	By 7% Debentures	1,00,000
To Inventories A/c	1,90,000	By Provision for tax	9,000
To Bank	26,000	By Trade Payables	60,000
To Capital Reserve (bal. Fig.)	47,73,000	(30,000+30,000)	
		By 8% Debentures	3,40,000
	60,29,000		**60,29,000**

Question: 5

The following is the summarized Balance Sheet of Rocky Ltd. as at March 31, 2013:

	₹ in lacs
Liabilities	
Fully paid equity shares of 10 each	500
Capital Reserve	6
12% Debentures	400
Debenture Interest Outstanding	48
Trade payables	165
Directors' Remuneration Outstanding	10
Other Outstanding Expenses	11
Provisions	33
	1,173
Assets	
Goodwill	15
Land and Building	184
Plant and Machinery	286
Furniture and Fixtures	41
Inventory	142
Trade receivables	80
Cash at Bank	27
Discount on Issue of Debentures	8
Profits and Loss Account	390
	1,173

The following scheme of internal reconstruction was framed, approved by the Tribunal all the concerned parties and implemented:

(i) All the equity shares be converted into the same number of fully-paid equity shares of ₹ 2.50 each.

(ii) Directors agree to forego their outstanding remuneration.

(iii) The debenture holders also agree to forego outstanding interest in return of their 12% debentures being converted into 13% debentures.

(iv) The existing shareholders agree to subscribe for cash, fully paid equity shares of ₹ 2.50 each for ₹ 125 lacs.

(v) Trade payables are given the option of either to accept fully-paid equity shares of ₹ 2.50 each for the amount due to them or to accept 80% of the amount due in cash. Trade payables for ₹ 65 lacs accept equity shares whereas those for ₹ 100 lacs accept 80 lacs in cash in full settlement.

(vi) The Assets are revalued as under:

	₹ in lacs
Land and building	230
Plant and Machinery	220
Inventory	120
Trade receivables	76

Pass Journal Entries for all the above mentioned transactions and draft the company's Balance Sheet immediately after the reconstruction.

Answer

Journal Entries

		Dr.	₹ in lacs Cr.
Equity Share Capital (₹ 10 each) A/c	Dr.	500	
To equity Share Capital (₹ 2.5 each)			125
To Reconstruction A/c			375
(Conversion of all the equity shares into the same number of fully paid equity shares of ₹ 2.50 each as per scheme of reconstruction			
Director's Remuneration Outstanding A/c	Dr.	10	
To Reconstruction A/c			10
(Outstanding remuneration foregone by the directors as per scheme of reconstruction)			
12% Debentures A/c	Dr.	400	
Debentures Interest Outstanding A/c	Dr.	48	
To 13% Debentures A/c			400
To Reconstruction A/c			48
(Conversion of 12% debentures into 13% debentures, Debenture holders forgoing outstanding debenture interest)		125	
Bank A/c	Dr.	125	
To Equity Share Application A/c			125
(Application money received for fully paid equity shares of ₹ 2.5 each from existing shareholders)			
Equity Share Application A/c	Dr.	125	
To Equity Share Capital (2.50 each)A/c			125
(Application money transferred to share capital)			
Trade Payable A/c	Dr.	165	
To Equity Share Capital (2.50 each)A/c			65
To Bank A/c			80

To Reconstruction A/c			20
(Trade payable for ₹ 65 lakhs accepting shares for full amount and those for ₹ 100 lakhs accepting cash equal to 80% of claim in full settlement)			
Capital Reserve A/c	Dr.	6	
To Reconstruction A/c			6
(Being the loss on reconstruction (balance in the reconstruction A/c) transferred to Capital Reserve)			
Land and building A/c	Dr.	46	
To Reconstruction A/c			46
(Appreciation made in the value of land and building as per scheme of reconstruction)			
Reconstruction A/c	Dr.	505	
To Goodwill A/c			15
To Plant & Machinery A/c			66
To Inventory A/c			22
To Trade receivable A/c			4
To Discount on issue of Debentures A/c			8
To Profit And Loss A/c			390
(Writing off losses and reduction in the values of assets as per scheme of reconstruction – W.N. 1)			

Note: In a scheme of Reconstruction, Goodwill, Losses etc. should be written off against the Reconstruction Account whether or not it is mentioned in the question.

Balance Sheet of Rocky Ltd. (and Reduced) as on 31st March, 2013

	Particulars	Note No.	Amount
1.	**Equity and Liabilities**		
	(a) Share Capital	1	315
2.	**Non-Current Liabilities**		
	(b) Long-term borrowings – 13% Debentures		400
3.	**Current Liabilities**		
	(a) other current liabilities		11
	(b) Short-term provisions		33
		Total	**759**
II.	**Assets**		
	(1) Non-current Assets		
	(a) Fixed assets		
	(i) Tangible Assets	2	491
	(ii) intangible Assets	3	0
	(2) Current Assets		
	(a) Current investments		
	(b) Inventories		120
	(c) Trade Receivables		76
	(d) Cash and cash equivalents (W.N. 2)		72
		Total	**759**

Notes to Accounts

			(₹)
1.	**Share Capital**		
	Equity Share Capital (2.50 each)	125	
	Add: Fresh issue	125	
	Add: Equity shares issued to trade payables	65	
	1,26,000 fully paid equity Shares of 2.50 each		315
	(26,000 shares have been issued for consideration other than cash)		
2.	**Tangible Assets**		
	(a) Land & Building	184	
	Add : Amount of appreciation under scheme of reconstruction	46	230
	(b) Plant and Machinery	286	
	Less: Amount written off under scheme of reconstruction dated.	66	220
	(c) Furniture and Fixtures		41
			491
3.	**Intangible Assets**		
	Goodwill	15	
	Less: amount written off under scheme of reconstruction	15	-

Working Notes:

To	Goodwill	15	By Equity Share Capital A/c	375
To	Plant and Machinery	66	By Director's Remuneration Outstanding A/c	10
To	Inventory	22	By Debenture Interest Outstanding A/c	48
To	Trade receivables	4	By Trade payables	20
To	Discount on issue of Debentures	8	By Capital Reserve (Balancing Figure)	6
			By Land and Building	46
To	Profit and Loss A/c	390		
		505		**505**

2. Cash at bank as on 31st March, 2013 (after reconstruction)

	(₹)
Cash at bank (before reconstruction)	27
Add: Proceeds from issue of equity shares	125
	152
Less: Payment made to trade payables (80% of ₹ 100 Lakhs)	(80)
	72

Question 6—

The draft Balance Sheet of Y Limited as on 31st March, 2013was as follows:

Liabilities	**Amount (₹)**	**Assets**	**Amount (₹)**
₹ 5,00,000 Equity shares of10 each fully paid	50,00,000	Goodwill	10,00,000
		Patent	5,00,000
9% ₹ 20,000 Preference shares of 100 each fully paid	20,00,000	Land and Building	30,00,000
		Plant and Machinery	10,00,000

10% First debentures	6,00,000	Furniture and Fixtures	2,00,000
10% Second debentures	10,00,000	Computers	3,00,000
Debentures interest outstanding	1,60,000	Trade Investment	5,00,000
Trade payables	5,00,000	Trade receivables	5,00,000
Directors' loan	1,00,000	Inventory	10,00,000
Bank Overdraft	1,00,000	Discount on issue of	
Outstanding liabilities	40,000	debentures	1,00,000
Provision for tax	1,00,000	Profit and Loss Account (Loss)	15,00,000
	96,00,000		**96,00,000**

Note: Preference dividend is in arrears for last three years.

A holds 10% first debentures for ₹ 4,00,000 and 10% second debentures for ₹ 6,00,000. He is also trade payables for ₹ 1,00,000. B holds 10% first debentures for ₹ 2,00,000 and 10% second debentures for ₹ 4,00,000 and is also trade payables for ₹ 50,000.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares be converted into fully paid equity shares of 5 each.

(ii) The preference shares be reduced to ₹ 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. 'A' is to cancel ₹ 6,00,000 of his total debt including interest on debentures and to pay 1 lakh to the company and to receive new 12% debentures for the Balance amount.

(iv) Mr. 'B' is to cancel ₹ 3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

(v) Trade payables (other than A and B) agreed to forego 50% of their claim.

(vi) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

(vii) There were capital commitments totalling ₹ 3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(viii) The Directors refund₹ 1,10,000 of the fees previously received by them.

(ix) Reconstruction expenses paid ₹ 10,000.

(x) The taxation liability of the company is settled at ₹ 80,000 and the same is paid immediately.

(xi) The assets are revalued as under:

	(₹)
Land and Building	28,00,000
Plant and Machinery	4,00,000
Inventory	7,00,000
Trade receivables	3,00,000
Computers	1,80,000
Furniture and Fixtures	1,00,000
Trade Investment	4,00,000

Pass Journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit & Loss Account and Discount on issue of debentures. Prepare Bank Account and working of allocation of Interest on Debentures between A and B.

Answer

Journal Entries in the Books of Y Ltd.

			Dr. (₹)	Cr. (₹)
(i)	Equity Share Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (₹ 100 each)	A/c	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% First Debentures A/c	Dr.	4,00,000	
	10% Second Debentures A/c	Dr.	6,00,000	
	Trade Payable A/c	Dr.	1,00,000	
	Interest on Debentures outstanding A/c	Dr.	1,00,000	
	Bank A/c	Dr.	1,00,000	
	To 12% New Debentures A/c (bal. fig.)			7,00,000
	To Reconstruction A/c			6,00,000
	(Being ₹ 6,00,000 due to A (including trade payable) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.			
(iv)	10% First Debentrues A/c	Dr.	2,00,000	
	10% Second Debentures A/c	Dr.	4,00,000	
	Trade Payables A/c	Dr.	50,000	
	Interest on Debentures Outstanding A/c	Dr.	60,000	
	To 12% New Debentures A/c			4,10,000
	To Reconstruction A/c			3,00,000
	(Being ₹ 3,00,000 due to B (including trade payables) cancelled and 12% new debentures allotted for balanceamount as per scheme of reconstruction.)			
(v)	Trade Payables A/c	Dr.	1,75,000	
	To Reconstruction A/c			1,75,000
	(Being remaining trade payables sacrificed 50% of theirclaim.)			

(vi)	Director's Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (5) A/c			60,000
	To Reconstruction A/c			40,000
	(Being Directions' loan claim settled by issuing 12,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 lakhs)			
(viii)	Bank A/c	Dr.	1,10,000	
	To Reconstruction A/c			
	(Being refund of fees by Directions credited to reconstruction A/c)			
(ix)	Reconstruction A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			80,000
	To Reconstruction A/c			20,000
	(Being payment of tax for 80% of liability in full settlement against provision for tax.)			
(xi)	Reconstruction A/c	Dr.	47,20,000	
	To Goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			15,00,000
	To Discount on issue of Debentures A/c			1,00,000
	To Land and Building A/c			2,00,000
	To Plant and Machinery A/c			6,00,000
	To Furniture & Fixture A/c			1,00,000
	To Computers A/c			1,20,000
	To Trade Investment A/c			1,00,000
	To Inventory A/c			3,00,000
	To Trade receivables A/c			2,00,000

(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.

Note: Goodwill, patents, losses should be written off under a scheme of reconstruction whether or not it is mentioned in the question. The objective of reconstruction is to remove fictitious values from the assets of the Company and correspondingly reduce capital or pump in additional capital.

Working Notes:

(1) Outstanding interest on debentures have been allocated between A and B as follows:

			(₹)
A's Share			
10% First Debentures		4,00,000	
10% Second Debentures		6,00,000	10,00,000
10% on 10,00,000 i.e.	(A)		1,00,000
B's Share			
10% First Debentures		2,00,000	
10% Second Debentures		4,00,000	6,00,000
10% on 6,00,000 i.e.	(B)		60,000
Total (A + B)			1,60,000

(2) Bank Account

		(₹)		(₹)
To	A (Reconstruction)	1,00,000	By Balance c/d	1,00,000
To	Reconstruction A/c	1,10,000	By Reconstruction A/c	15,000
	(Refund of earlierfees by directors)		(capital commitment penalty paid)By Reconstruction A/c	10,000
			(reconstruction expenses paid)	
			By Provision for tax A/c (tax paid)	80,000
			By Balance c/d	5,000
		2,10,000		2,10,000

Question: 7

Following is the Balance Sheet of M Ltd. as at 31st March, 2013.

Liabilities	(₹)	Assets	(₹)
₹ 15,000 10% Preference Sh. of ₹ 100 each	15,00,000	Goodwill	3,50,000
₹ 35,000 Equity Shares of ₹ 100 each	35,00,000	Land & Buildings	15,00,000
Securities Premium account	1,00,000	Plant & Machinery	10,00,000
7% Debentures of ₹ 100 each	5,00,000	Inventory	6,00,000
Trade Payables	12,50,000	Trade receivables	15,00,000
Loan from Director	1,50,000	Cash at bank	1,00,000
		Profit & Loss A/c	19,50,000
	70,00,000		70,00,000

No dividend on Preference shares has been paid for the last 5 years.

The following scheme of reorganization was duly approved by the Tribunal:

(i) Each Equity share to be reduced to ₹ 25.

(ii) Each existing Preference share to be reduced to ₹ 75 and then exchanged for 1 new 13% Preference share of ₹ 50 each and ₹ 1 Equity share of ₹ 25 each.

(iii) Preference shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity Shares of ₹ 25.

(iv) The Debenture holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of ₹ 50 each issued at par. One half (in value) of the debenture holders accepted Preference shares for their claims. The rest were paid cash.

(v) Contingent liability of ₹ 1,50,000 is payable, which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the company.

(vi) Goodwill does not have any value in the present. Decrease the value of Plant and Machinery, Inventory and Trade receivables by ₹ 4,00,000, ₹ 1,00,000 and ₹ 1,50,000 respectively. Increase the value of Land and Buildings to ₹ 18,00,000.

(vii) ₹ 40,000 new Equity shares of ₹ 25 each are to be issued at par, payable in full on application. The issue was underwritten for a commission of 4%.

Shares were fully taken up.

(viii) The total expenses incurred by the company in connection with the scheme excluding underwriting commission amounted to ₹ 15,000.

Pass necessary Journal Entries to record the above transactions.

Answer –

In the books of M Ltd. Journal Entries

			Dr. Amount (₹)	Cr. Amount (₹)
1.	Equity Share Capital (₹ 100) A/c	Dr.	35,00,000	
	To Equity Share Capital A/c			8,75,000
	To Capital Reduction A/c			26,25,000
	(Being Equity shares of ₹ 100 each reduced to ₹ 25 each and balance transferred to Capital Reduction A/c)			
2.	10% Preference Share Capital (₹ 100) A/c	Dr.	15,00,000	
	To 10% Preference Share Capital (₹ 75)A/c			11,25,000
	To Capital Reduction A/c			3,75,000
	(Being Preference shares of ₹ 100 each reduced to ₹ 75 each and balance transferred to Capital Reduction A/c.Total Pref Shares = 15,000)			
3.	10% Preference Share Capital (₹ 75) A/c	Dr.	11,25,000	
	To 13% Preference Share Capital (₹ 50) A/c			7,50,000
	To Equity Share Capital A/c			3,75,000
	(Being one new 13% Preference share ₹ 50 each and one of equity share of ₹ 25 each issued against 10% Preference Share of₹ 75 each. Total Pref Shares = ₹ 15,000)			

4.	Capital Reduction A/c	Dr.	1,50,000	
	To Preference Share Dividend Payable A/c			1,50,000
	(Being arrears of Preference share dividend payable for one year)			
5.	Preference Share dividend payable A/c	Dr.	1,50,000	
	To Equity Share Capital A/c			1,50,000
	(Being Equity shares of ₹ 25 each issued for arrears ofPreference share dividend)			
6.	7% Debenture A/c	Dr.	5,00,000	
	To Debenture holders A/c			5,00,000
	(Being balance of 7% Debentures transferred to Debentures holders A/c)			
7.	7% Debenture holders A/c	Dr.	5,00,000	
	To 13% Preference share Capital A/c			2,50,000
	To Bank A/c			2,25,000
	To Capital Reduction A/c			25,00
	(Being 50% of Debentures holders opted to take 13% Preference shares at par and remaining took 90% cash payment for their claims.)			
8.	Loan from Director A/c	Dr.	1,50,000	
	To Provision for Contingent Liability A/c			1,50,000
	(Being provision for contingent liability of ₹ 1,50,000 as it is payable and the same is adjusted against Loan from Director A/c)			
9.	Bank A/c	Dr.	10,00,000	
	To Equity Share Application & Allotment A/c		10,00,000	
	(Being application money received on ₹ 40,000 equity shares @ ₹ 25 each)			
10.	Equity Share Application & Allotment A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(Being Application money transferred to capital A/c,on allotment)			
11.	Underwriting Commission A/c	Dr.	40,000	
	To Bank A/c			40,000
	(Being underwriting commission paid)			
12.	Land & Building A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being value of Land & Building appreciated)			
13.	Expenses on Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of expenses on reconstruction)			
14.	Capital Reduction A/c	Dr.	31,75,000	
	To Goodwill A/c			3,50,000

To Plant & Machinery A/c	4,00,000
To Inventory A/c	1,00,000
To Trade Receivables A/c	1,50,000
To Profit & Loss A/c	19,50,000
To Expenses on Reconstruction A/c	15,000
To Underwriting Commission A/c	40,000
To Capital Reserve A/c (bal. fig.)	1,70,000
(Being various losses written off and balance of Capital Reduction A/c transferred to Capital A/c)	

Note: Capital Reduction Account is inter changeable with Internal Reconstruction Account or Reconstruction Account. Any Account from may be used in answering the question.

Question 8—

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) Reserve 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
B.	**Assets**				
	1.	Non-current Assets			
		(a) PPE	5	5,50,000	
		(b) 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		
	Authorized, 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.	Reserve and Surplus		
	Profit and Loss		(10,00,000)
3.	AccountLong Term		
	borrowings		5,00,000
4.	8%		
	DebenturesShort	3,00,000	
	Term Borrowings		
	Loan from Directors		
	Bank overdraft	2,00,000	5,00,000
5.	Tangible Assets		
	Freehold property	4,00,000	
	Plant	1,50,000	5,50,000
6.	PPE		
	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) Inventory 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 writ- ten off.

Pass Journal Entries for all the above mentioned transactions. Also Prepare Capital Reduction account and company's Balance Sheet immediately after reconstruction.

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 eachas 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.	Preference Share Capital A/c (₹ 25)	Dr.	62,500	
	To Preference Share Capital A/c (₹ 100)			62,500
	(Being conversion of ₹ 2,500 shares of ₹ 25 each to 625 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 value of freehold property appreciated)			
v.	Freehold Property	Dr.	50,000	
	To Capital Reduction A/c			50,000
	(Being value of freehold property 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 transferof freehold property.)			
vii.	Freehold property	Dr.	4,00,000	
	To Capital Reduction A/c			4,00,000
	(Being appreciation in the value of freehold property)			
viii.	Director's 'Loan A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being appreciation in the value of freehold property)			
ix.	Capital Reduction A/c	Dr.	13,37,500	
	To Deferred Revenue Expenditure A/c			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 A/c	50,000
To Capital Reserve A/c	1,00,000
(Being certain value of various assets (tangible & intangible),profit and loss account debit balance written off and balance 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
			By Equity ShareCapital	4,00,000
To	Inventories	50,000	By Freehold Property (50,000 + 4,00,000)	4,50,000
To	Profit & Loss A/c	10,00,000	By Director's Loan	3,00,000
To	Trademark	50,000		
To	Goodwill	1,00,000		
To	Deferred Revenue Expenditure	25,000		
To	Capital Reserve	1,00,000		
		13,37,500		**13,37,500**

Balance Sheet for Bad Lucko Ltd. (and Reduced)
As on 31st March, 2013

	Particulars	Note No.	(₹)
1.	**Equity and Liabilities**		
	(1) Shareholder's Funds		
	(a) Share Capital	1	1,62,500
	(b) Reserve 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) PPE	5	7,50,000
	(2) Current Assets		
	(a) Inventories		1,00,000
	(b) Trade receivables	6	1,12,500
			9,62,500

Notes to Accounts

		(₹)
1.	Share Capital	
	Authorized, 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-Term Borrowings	
	Bank Overdraft	2,00,000
5.	PPE	
	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)
		1,12500

Question 9—

The Balance Sheet of X Ltd. as at 31st March, 2014 was as follows:

X Limited

Balance Sheet as at 31.03.2014

	Particulars	**Amount (₹)**
I	**Equity and Liabilities**	
1	Shareholders Fund	
	Share Capital	
	₹ 40,000 equity Share of ₹ 100 each fully paid	40,00,000
	₹ 20,000, 10% Preference shares of ₹ 100 each fully paid	20,00,000
	Reserve & Surpluse	
	(a) Securities Premium Account	1,50,000
	(b) Profit and Loss Account	(23,00,000)
2.	Non-Current Liabilities	
	Long Term Borrowing 7% Debentures of 100 each	4,00,000
3.	Current Liabilities	
	Other Current Liabilities	
	(a) Creditors	10,00,000
	(b) Loan from Director	2,00,000

	Total Liabilities		**54,50,000**
II.	Assets		
1.	Non-Current Assets		
	PPE		
	(a) Land & Building	20,00,000	
	(b) Plant & Machinery	12,00,000	32,00,000
	Intangible Assets		
	Goodwill		4,00,000
2.	Current Assets		
	(a) Debtors	12,00,000	
	(b) Stock	5,00,000	
	(c) Cash at Bank	1,50,000	18,50,000
		Total Assets	**54,50,000**

No Dividend on Preference Shares has been paid for last 5 Years.

The following scheme of reorganisation was duly approved by the Court:

(i) Each equity share to be reduced to ₹ 25.

(ii) Each existing Preference Share to be reduced to ₹ 75 and then exchanged for one new 13% Preference Share of ₹ 50 each and one Equity Share of ₹ 25 each.

(iii) Preference Shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity shares of ₹ 25.

(iv) The Debenture Holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13 % Preference Shares of ₹ 50 each issued at par. One-fourth (in value) of the Debenture Holders accepted Preference Shares for their claims. The rest were paid in cash.

(v) Contingent Liability of ₹ 2,00,000 is payable which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the Company.

(vi) Goodwill does not have any value in the present. Decrease the value of Plant & Machinery, Stock and Debtors by ₹ 3,00,000; ₹ 1,00,000 and ₹ 2,00,000 respectively. Increase the value of Land & Building to ₹ 25,00,000.

(vii) ₹ 50,000 new Equity Shares of ₹ 25 each are to be issued at par payable in full on application. The issue was underwritten for a commission of 4%. Shares were fully taken up.

(viii) Total expenses incurred by the Company in connection with the Scheme excluding underwriting Commission amounted to ₹ 20,000.

Pass necessary Journal Entries to record the above transactions.

Answer

In the books of X Ltd.

Journal Entries

Particulars		Amount (₹)	Amount (₹)
Equity Share Capital (₹ 100) A/c	Dr.	40,00,000	
To Equity Shar Capital (₹ 25) A/c			10,00,000
To Capital Reduction A/c			30,00,000
(Being Equity Shares of ₹ 100 each reduced to ₹ 25 each andbalance transferred to Capital Reduction A/c)			
10% Preference Share Capital (₹ 100) A/c	Dr.	20,00,000	
To 10% Preference Share Capital (₹ 75) A/c			15,00,000
To ESC (₹ 25) A/c			5,00,000
(Being Preference Shares of 100 each reduced to ₹ 75each and balance transferred to Capital Reduction A/c)			
10% Preference Share Capital (₹ 75)A/c	Dr.	15,00,000	
To 13% Preference Share capital (₹ 75)A/c			10,00,000
To Capital Reduction A/c			5,00,000
(Being one new 13% Preference Share of₹ 50 each and one Equity Share of ₹ 25 each issued against 10% Preference Share of₹ 75 each)			
Capital Reduction A/c	Dr.	2,00,000	
To Preference Share Divided Payable A/c			
			2,00,00
0(Being arrear of Preference Share Dividend payable for one year)			
Preference Share Dividend Payable A/c	Dr.	2,00,000	
To Equity Share Capital ₹ (25)A/c			2,00,000
(Being Equity Shares of ₹25 each issued for arrears of PreferenceShare Dividend)			
7% Debenture A/c	Dr.	4,00,000	
To Debenture Holder A/c			4,00,000
(Being balance of 7% Debentures transferred to Deb. holder A/c)			
Debenture Holder A/c	Dr.	4,00,000	
To 13% Preference Share Capital A/c			1,00,000
To Bank A/c			2,70,000
To Capital A/c			30,000
(Being 25% of Debenture Holders opted to take 13% Preference Shares at par and remaining took 90% cashpayment for their claims)			

Loan from Director	Dr.	2,00,000	
To Provision for Contingent Liability A/c			2,00,000
(Being contingent liability of ₹2,00,000 is payable and adjusted against loan from Director A/c.)			
Bank A/c	Dr.	12,50,000	
To Equity Share Application & Allotment A/c			12,50,000
(Being application money received on 50,000 Equity Shares @ ₹25 each)			
Equity Share Application & Allotment A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being application money transferred to Capital A/c on allotment)			
Underwriting Commission	Dr.	50,000	
A/cTo Bank A/c			50,000
(Being value of land & Building appreciated)			
Land & Building A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being value of land & Building Appreciated)			
Expenses on Reconstruction A/c	Dr.	20,000	
To Bank A/c			20,000
(Being payment of Expenses on Reconstruction)			

Question 10—

The summarised Balance Sheet of X Limited as on 31st March 2013, was as follows:

Liabilities	(₹)	Assets	(₹)
Authorised and subscribed capital:	10,00,000	Fixed Assets:	
₹ 10,000 Equity Shares of ₹ 100 each fully paid		Machineries	3,50,000
Unsecure loans:		Current Assets	
15% Debentures	3,00,000	Inventory	2,53,000
Accrued Interest	45,000	Trade Receivables	2,30,000
Current Liabilities:		Bank	20,000
Trade payables	52,000	Profit & Loss A/c	5,80,000
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 debenture holders and trade payables 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 debenture holders shall be reduced by 50%. In consideration of the reduction, the debenture holder shall receive Preference Shares of ₹ 1,00,000 which are converted out of shares surrendered.

(v) Trade payables claim shall be reduced by 25%. Remaining trade payables 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.

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
	(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 (proportionate 50%)	Dr.	22,500	
	To Remonstration A/c			1,72,000
	(Transfer 50% of the claims of the debenture holders 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)	Trade Payable A/c	Dr.	52,000	
	To Reconstruction A/c			52,000
	(Transferred claims of the trade payables to Reconstruction A/c, 25% of which is reduction 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
	(Issued preference and equity shares to discharge the claims of the debentures holders and the trade payable respectively as per scheme and the balance in share surrender account is transferred to reconstruction account)			

(v)	Reconstruction A/c	Dr.	5,85,500	
	To Profit & Loss A/c			5,80,000
	To Capital Reserve A/c			5,500
	Adjusted debit balance of profit and loss account against reconstruction account and the balance is transferred to Capital Reserve account)			

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) Reserve and Surplus l;	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) PPE	6	3,50,000
2.	Current Assets		
	(a) Inventories		2,53,000
	(b) Trade receivables		2,30,000
	(c) Cash and cash equivalents	7	**8,53,000**

	None to Assets	**(₹)**
1.	**Share Capital**	
	53,900 Equity Shares of ₹ 10 each	5,39,000
	10,000, 10% Preference share of ₹ 10 each	1,00,000
		6,39,000
	(all the above shares are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares withoutpayment received in cash)	
2.	**Reserve and Surplus**	
	Capital Reserves	5,500

3.	**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.	**PPE**	
	Machineries	3,50,000
7.	**Cash and cash equivalents**	
	Balances with banks	20,000