

1. FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Practical Example 1

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

Particulars	Rs
Assets	
<u>Non-current assets</u>	
Property, Plant and Equipment	65,000
<u>Current assets</u>	
Inventories	30,000
<u>Financial assets</u>	
Trade receivables	20,000
Other asset	10,000
Cash and cash equivalents	5,000
	1,30,000
Equity and Liabilities	
<u>Equity</u>	
Share capital	60,000
Other Equity - Profit and Loss Account	25,000
<u>Non-current liabilities</u>	
10% Loan	35,000
<u>Current liabilities</u>	
Financial liabilities	
Trade payables	10,000
	1,30,000

Additional information:

- (a) The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.20X2 was Rs 60,000.
- (b) The trader's purchases and sales in 20X1-20X2 amounted to Rs 4 lakh and Rs 4.5 lakh respectively.
- (c) The cost and net realisable value of inventories on 31.03.20X2 were Rs 32,000 and Rs 40,000 respectively.
- (d) Employee benefit expenses for the year amounted to Rs 14,900.
- (e) Other asset is written off equally over 4 years.
- (f) Trade receivables on 31.03.20X2 is Rs 25,000, of which Rs 2,000 is doubtful. Collection of another Rs 4,000 depends on successful re-installation of certain product supplied to the customer.
- (g) Cash balance on 31.03.20X2 is Rs 37,100 before deduction of interest paid on loan.
- (h) There is an early repayment penalty for the loan Rs 2,500.

The Profit and Loss Accounts and Balance Sheets of the trader are shown below in two cases

- (i) assuming going concern (ii) not assuming going concern.

SOLUTION:

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

	Case (i) Rs	Case (ii) Rs
Revenue from operations - Sales (A)	4,50,000	4,50,000
Expenses		
Purchases	4,00,000	4,00,000
Changes in inventories	(2,000)	(10,000)
Employee benefit expenses	14,900	14,900

Finance cost	3,500	6,000
Depreciation and amortisation expenses	15,500	15,000
Other expenses - Provision for doubtful debts	2,000	6,000
Total Expenses (B)	4,33,900	4,31,900
Profit for the period (A-B)	16,100	18,100

Balance Sheet as at 31st March, 20X2

Liabilities	Case (i) Rs	Case (ii) Rs
Assets		
<u>Non-current assets</u>		
Property, Plant and Equipment	52,000	60,000
<u>Current Asset</u>		
Inventories	32,000	40,000
Financial assets		
Trade receivables (less provision)	23,000	19,000
Other asset	7,500	Nil
Cash and cash equivalents (after interest paid on loan)	33,600	33,600
	1,48,100	1,52,600
Equity and Liabilities		
<u>Equity</u>		
Share Capital	60,000	60,000
Other Equity - Profit & Loss A/c	41,100	43,100
<u>Non-current liabilities</u>		
10% Loan	35,000	37,500
<u>Current liabilities</u>		
Trade payables	12,000	12,000
	1,48,100	1,52,600

Practical Example 2:

A trader commenced business on 01/01/20X1 with Rs 12,000 represented by 6,000 units of a certain product at Rs 2 per unit. During the year 20X2 he sold these units at Rs 3 per unit and had withdrawn Rs 6,000. Thus:

Opening Equity = Rs 12,000 represented by 6,000 units at Rs 2 per unit.

Closing Equity = Rs 12,000 (Rs 18,000 - Rs 6,000) represented entirely by cash.

Retained Profit = Rs 12,000 - Rs 12,000 = Nil

The trader can start year 20X3 by purchasing 6,000 units at Rs 2 per unit once again for selling them at Rs 3 per unit. The whole process can repeat endlessly if there is no change in purchase price of the product.

Practical Example 3:

In the previous example, suppose that the average price indices at the beginning and at the end of year are 100 and 120 respectively.

Opening Equity = Rs 12,000 represented by 6,000 units at Rs 2 per unit.

Opening equity at closing price = (Rs 12,000 / 100) × 120 = Rs 14,400 (6,000 × Rs 2.40)

Closing Equity at closing price

= Rs 12,000 (Rs 18,000 - Rs 6,000) represented entirely by cash.

Retained Profit = Rs 12,000 - Rs 14,400 = (-) Rs 2,400

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund RS 12,000 is not sufficient to buy 6,000 units again at increased price Rs 2.40 per unit. In fact, he should have restricted his drawings to Rs 3,600 (Rs 6,000 - Rs 2,400).

Had the trader withdrawn Rs 3,600 instead of Rs 6,000, he would have left with Rs 14,400, the fund required to buy 6,000 units at Rs 2.40 per unit.

Practical Example 4:

In the previous example, suppose that the price of the product at the end of year is 2.50 per unit. In other words, the specific price index applicable to the product is 125.

Current cost of opening stock = $(Rs\ 12,000 / 100) \times 125 = 6,000 \times Rs\ 2.50 = Rs\ 15,000$

Current cost of closing cash = Rs 12,000 (Rs 18,000 - Rs 6,000)

Opening equity at closing current costs = Rs 15,000

Closing equity at closing current costs = Rs 12,000

Retained Profit = Rs 12,000 - Rs 15,000 = (Rs 3,000)

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund Rs 12,000 is not sufficient to buy 6,000 units again at increased price Rs 2.50 per unit. The drawings should have been restricted to Rs 3,000 (Rs 6,000 - Rs 3,000).

Had the trader withdrawn Rs 3,000 instead of Rs 6,000, he would have left with Rs 15,000, the fund required to buy 6,000 units at Rs 2.50 per unit.

Capital maintenance can be computed under all three bases as shown below:

Financial Capital Maintenance at historical costs

	Rs	Rs
Closing capital (At historical cost)		12,000
Less: Capital to be maintained		
Opening capital (At historical cost)	12,000	
Introduction (At historical cost)	Nil	(12,000)
Retained profit		Nil

Financial Capital Maintenance at current purchasing power

	Rs	Rs
Closing capital (At closing price)		12,000
Less: Capital to be maintained		
Opening capital (At closing price)	14,400	
Introduction (At closing price)	Nil	(14,400)
Retained profit		(2,400)

Physical Capital Maintenance

	Rs	Rs
Closing capital (At current cost)		12,000
Less: Capital to be maintained		
Opening capital (At current cost)	15,000	
Introduction (At current cost)	Nil	(15,000)
Retained profit		(3,000)