PRACTICE MANUAL

Intermediate (IPC)Course

PAPER : 5

ADVANCED ACCOUNTING

VOLUME – II

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This practice manual has been prepared by the faculty of the Board of Studies. The objective of the practice manual is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. Students should also supplement their study by reference to the recommended text books. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the practice manual has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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A Word About Practice Manual

The Board of Studies has been instrumental in imparting theoretical education to the students of Chartered Accountancy Course. The distinctive characteristics of the course i.e. distance education has emphasized the need for bridging the gap between the students and the Institute and for this purpose, the Board of Studies has been providing a variety of educational inputs for the students. Bringing out a series of subject wise Practice Manuals is one of the quality services provided by the Institute. These Practice Manuals are highly useful to the students preparing for the examination, since they get answers for all important questions relating to a subject at one place and that too grouped chapter-wise.

The Practice Manual in the subject of 'Advanced Accounting' is divided into nine chapters in line with Volume I of the study material. This will help the students to correlate the Practice Manual with the Study Material and facilitate in complete revision of each chapter. The students are expected to cover the entire syllabus and also do practice on their own while going through the practice manual. Exercises have been given at the end of each topic for independent practice. Practice Manual includes questions from past examinations at PE-II, PCC and IPCC levels which would facilitate in thorough understanding of the chapters explained in the study material volume I. Few questions have been added in some of the chapters to increase the practice base of the students.

New theoretical/case study based questions added in this edition of the practice manual have been highlighted in bold and italics while practical questions are indicated in grey background for easy identification. This Practice Manual contains a matrix showing the analysis of the past examinations. This matrix will help the students in getting an idea about the trend of questions being asked and relative weightage of each topic in the past examinations. It will serve as a useful and handy reference guide while preparing for the examination. It will guide the students to improve their performance in the examination and also help them to work upon their grey areas and plan a strategy to tackle practical problems.

Feedback form is given at the end of this Practice Manual wherein students are encouraged to give their feedback/suggestions. The concerned faculty members of Board of Studies have put in their best efforts in making this practice manual lucid and student-friendly. In case you need any clarification/guidance, you may send your queries at seema@icai.in; shilpa@icai.in and asha.verma@icai.in.

Happy Reading and Best Wishes!

Paper – 5: Advanced Accounting

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

Topics		Term of Examination														Total Marks	Average
		Nov. 2009		May, 2010		Nov. 2010		May, 2011		Nov. 2011		May 2012		Nov. 2012			
		Q	M	Q	M	Q	M	Q	M	Q	M	Q	M	Q	M		
1	Conceptual framework for presentation and preparation of financial statements									7(e)	**4**					4	0.57
2	Problems based on Accounting Standards	1(i) 1(ii) 1(iii) 1(iv) 1(vi) 1(vii) 1(ix) 6(b) 6(c)	**2** **2** **2** **2** **2** **2** **2** **5** **5** **24**	1(ii) 1(iii) 1(iv) 1(x) 6(c)	**2** **2** **2** **2** **4** **12**	1(iii) 1(iv) 7(b) 7(c) 7(e)	**5** **5** **4** **4** **4** **22**	1(a) 6(a) 7(b) 7(d)	**5** **8** **4** **4** **21**	1(a) 1(b) 7(a) 7(b) 7(d)	**5** **5** **4** **4** **4** **22**	1(a) 1(b) 1(d) 7(b) 7(c) 7(d) 7(e)	**5** **5** **5** **4** **4** **4** **4** **31**	1(c) 3(b) 7(a) 7(b) 7(c) 7(e)	**5** **4** **4** **4** **4** **4** **25**	157	22.43
3	Advanced issues in Partnership Accounts																
Unit 1	Dissolution of firms	6(a)	**6**	1(v)	**2**	2	**16**			2	**16**	2	**16**			56	8
Unit 2	Amalgamation, conversion and sale of partnership firm			2	**16**			2	**16**					2	**16**	48	6.86
4	Company Accounts																
Unit 1	ESOP and Buy-back of shares	1(v) 5(b)	**2** **8** **10**			3	**16**	1(d)	**5**	7(c)	**4**	3(a) 7(a)	**8** **4** **12**	3(a) 7(d)	**12** **4** **16**	63	9

Unit 2	Underwriting of shares and debentures			6(a)	**4**			1(b)	**5**					1(b)	**5**	14	2
Unit 3	Redemption of Debentures	1(x) 3	**2** **16** **18**	1 (i)	**2**	1 (i)	**5**	7 (a)	**4**	1 (c)	**5**	3(b)	**8**	6(a)	**8**	50	7.14
Unit 4	Amalgamation and Reconstruction	2	**16**	3	**16**	5	**16**	3	**16**	3	**16**	4	**16**	4	**16**	112	16
Unit 5	Liquidation of Companies			5 (b)	**8**	7 (d)	**4**	4 (a)	**8**	6 (a)	**8**					28	4
5	Financial Statements of Insurance Companies			1(vi) 4(b)	**2** **8** **10**	4(b)	**8**	6(b)	**8**	6(b)	**8**			5(b)	**8**	42	6
6	Financial Statements of Banking Companies	5(a)	**8**	1(viii) 5(a) 6(b)	**2** **8** **4** **14**	1(ii) 6(a)	**5** **8** **13**	5	**16**	5 (b)	**8**	1(c) 5(a)	**5** **8** **13**	1(a) 5(a)	**5** **8** **13**	85	12.14
7	Financial Statements of Electricity Companies			6 (d)	**4**	6 (b)	**8**			4	**16**	5(b)	**8**			36	5.14
8	Departmental Accounts	1(viii)	**2**			4 (a)	**8**	1(c)	**5**	5(a)	**8**			6(b)	**8**	31	4.42
9	Accounting for Branches including Foreign Branch Accounts	4	**16**	1(vii) 1(ix) 4(a)	**2** **2** **8** **12**	7(a)	**4**	4(b) 7(e)	**8** **4** **12**	1(d)	**5**	6	**16**	1(d)	**5**	70	10

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

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

CONTENTS

1

Framework for Preparation and Presentation of Financial Statements

BASIC CONCEPTS

The International Accounting Standards Committee (IASC) issued a Conceptual Framework to serve as a basis for the accounting standards. The Accounting Standards Board of the ICAI has issued a similar framework for the same purpose in July 2000. This framework provides the fundamental basis for development of new standards as also for review of existing standards. The framework sets out the concepts underlying the preparation and presentation of general-purpose financial statements prepared by enterprises for external users. This framework explains components, users, qualitative characteristics and elements of financial statements The framework also explains concepts of capital, capital maintenance and determination of profit.

Question 1

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?

Answer

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

1. *Understandability*: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities. It is not right to think that more disclosures are always better. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.
2. *Relevance*: The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of

information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user.

3. *Reliability*: To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless:
   - (a) Transactions and events reported are faithfully represented.
   - (b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'.
   - (c) The reporting of transactions and events are neutral, i.e. free from bias.
   - (d) Prudence is exercised in reporting uncertain outcome of transactions or events.
4. *Comparability*: Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
5. *True and Fair View*: Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

Question 2

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement?

Answer

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

2
Accounting Standards

BASIC CONCEPTS

Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements. Accounting Standards 4, 5, 11, 12, 16, 19, 20, 26, 29 are covered in this paper.

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

Question 1

You are an accountant preparing accounts of A Ltd. as on 31.3.2011. After year end the following events have taken place in April, 2011:

(i) A fire broke out in the premises damaging, uninsured stock worth ₹ 10 lakhs (Salvage value ₹ 2 lakhs).

(ii) A suit against the company's advertisement was filed by a party claiming damage of ₹ 20 lakhs.

Describe, how above will be dealt with in the accounts of the company for the year ended on 31.3.2011.

Answer

Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to para 15 of AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date'. Hence, fire accident and loss thereof must be disclosed.

Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

Question 2

MEC Limited could not recover an amount of ₹ 8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2011 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2011, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹ 8 lakhs in books of account for the year ended 31-3-2011?

Answer

As per para 8 of AS 4, 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

As per the information given in the question, the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2011 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹ 8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹ 8 lakhs in the books of account for the year ended 31st March, 2011.

Question 3

A major fire has damaged the assets in a factory of a Limited Company on 5th April – five days after the year end and closure of accounts. The loss is estimated at ₹ 10 crores out of which ₹ 7 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.

Answer

The loss due to break out of fire is an example of event occurring after the balance sheet date. The event does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS 4 states that disclosure is generally made of events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date. In the given case, the amount of loss of assets in a factory is material and may be considered as an event affecting the substratum of the enterprise. Hence, as recommended in paragraph 15 of AS 4, disclosure of the event should be made.

Question 4

A Company entered into an agreement to sell its immovable property to another company for ₹ 35 lakhs. The property was shown in the Balance Sheet at ₹ 7 lakhs. The agreement to sell was concluded on 15th February, 2011 and sale deed was registered on 30th April, 2011.

You are required to state, with reasons, how this event would be dealt with in the financial statements for the year ended 31st March, 2011.

Answer

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

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2011 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2011, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2011.

Question 5

In Raj Co. Ltd., theft of cash of ₹ 2 lakhs by the cashier in January, 2011 was detected in May, 2011. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2011. Decide.

Answer

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

Though the theft, by the cashier ₹ 2,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2011 for recognition of the loss amounting ₹ 2,00,000.

Question 6

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

Answer

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

Question 7

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

Answer

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

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

Question 8

In preparing the financial statements of Lotus Limited for the year ended 31st March, 2010 you come across the following information. State with reason, how you would deal with this in the financial statements?

The company invested ₹ 50 lakhs in April, 2010 in the acquisition of another company doing similar business, the negotiations for which had just started.

Answer

As per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority* to enable users of financial statements to make proper evaluations and decisions.

The investment of ₹ 50 lakhs in April 2010 for acquisition of another company is under negotiation stage, and has not been finalized yet. On the other hand it is also not affecting the figures stated in the financial statements of 2009-10, hence the details regarding such negotiation and investment planning of ₹ 50 lakhs in April, 2010 in the acquisition of another company should be disclosed in the Directors' Report* to enable users of financial statements to make proper evaluations and decision.

Question 9

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

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Board of Directors of the company ?

Answer

As per para 13 of AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

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

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* *To promote transparency, Exposure Draft has recently been issued by the ICAI on Limited Revision to AS 4 "Events occurring After the Balance Sheet Date". According to this Limited Revision, these events should be disclosed in the financial statements instead of in the report of the approving authority. However, it is pertinent to note that this Limited Revision has not yet been notified by the Govt.*

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

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

Question 10

When can a company change its accounting policy?

Answer

A change in accounting policy should be made in the following conditions:

(i) If the change is required by some statute or for compliance with an Accounting Standard.

(ii) Change would result in more appropriate presentation of the financial statement.

Change in accounting policy may have a material effect on the items of financial statements. For example, if depreciation method is changed from straight-line method to written-down value method, or if cost formula used for inventory valuation is changed from weighted average to FIFO, or if interest is capitalized which was earlier not in practice, or if proportionate amount of interest is changed to inventory which was earlier not the practice, all these may increase or decrease the net profit. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify the effect of change on financial statement items like assets, liabilities, profit / loss.

Question 11

When can an item qualify to be a prior period item as per AS 5?

Answer

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

Question 12

A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2010-2011.

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2011. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

Answer

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

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2010-2011. Subsequently in 2011 the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

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

Question 13

X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2006. The wage revision is with retrospective effect from 1.4.2008. The arrear wages upto 31.3.2012 amounts to ₹ 80 lakhs. Arrear wages for the period from 1.4.2012 to 30.06.2012 (being the date of agreement) amounts to ₹ 7 lakhs.

Decide whether a separate disclosure of arrear wages is required.

Answer

It is given that revision of wages took place in June, 2012 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2012 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 87 lakhs (from 1.4.2008 to 30.6.2012) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item.

However, as per para 12 of AS 5 (Revised),' Net Profit or loss for the Period, Prior Period Items and Changes in the Accounting Policies', when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

However, wages payable for the current year (from 1.4.2012 to 30.6.2012) amounting ₹ 7 lakhs is not a prior period item hence need not be disclosed separately. This may be shown as current year's wages.

Question 14

Goods of ₹ 5,00,000 were destroyed due to flood in September, 2008. A claim was lodged with insurance company, but no entry was passed in the books for insurance claim.

In March, 2011, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2011.

Answer

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

In the given instance, it is clearly a case of error in preparation of financial statements for the year 2008-09. Hence, claim received in the financial year 2010-11 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

Question 15

S.T.B. Ltd. makes provision for expenses worth ₹ 7,00,000 for the year ending March 31, 2009, but the actual expenses during the year ending March 31, 2010 comes to ₹ 9,00,000 against provision made during the last year. State with reasons whether difference of ₹ 2,00,000 is to be treated as prior period item as per AS-5.

Answer

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of ₹ 2 lakhs, is not a prior period item.

Therefore, in the given case expenses amounting ₹ 2,00,000 (i.e. ₹ 9,00,000 – ₹ 7,00,000) relating to the previous year recorded in the current year, should not be regarded as prior period item.

Question 16

A company created a provision of ₹ 75,000 for staff welfare while preparing the financial statements for the year 2007-08. On 31st March, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 1,00,000. The accounts were approved by Board of Directors on 15th April, 2008.

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

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹ 25,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2007-2008.

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

Question 17

Give two examples on each of the following items:

(i) Change in Accounting Policy

(ii) Change in Accounting Estimate

(iii) Extra Ordinary Items

(iv) Prior Period Items.

Answer

(i) Examples of Changes in Accounting Policy:

a. Change of depreciation method from WDV to SLM and vice-versa.

b. Change in cost formula in measuring the cost of inventories.

(ii) Examples of Changes in Accounting Estimates:

a. Change in estimate of provision for doubtful debts on sundry debtors.

b. Change in estimate of useful life of fixed assets.

(iii) Examples of Extraordinary items:

a. Loss due to earthquakes / fire / strike

b. Attachment of property of the enterprise by government

(iv) Examples of Prior period items:

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

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

AS 11 "THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES"

Question 18

A Ltd. purchased fixed assets costing ₹ 6,000 lakhs on 1.1.2010. This was financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40 and ₹ 45 as on 1.1.2010 and 31.12.2010 respectively. First instalment was paid on 31.12.2010.

You are required to state, how these transactions would be accounted for?

Answer

As per para 13 of AS 11 (Revised) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as an expense in the period in which they arise. Thus, exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expenses.

Calculation of exchange difference:

Foreign Exchange Loan $= \frac{6,000}{40}$ = US $ 150 lakhs

Exchange Difference = US $ 150 lakhs x (45 – 40) = ₹ 750 lakhs.

Loss due to exchange difference amounting ₹ 750 lakhs should be charged to profit and loss account for the year ended 31st December, 2010.

Question 19

Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2011 payable after 4 months. The company entered into a forward contract for 4 months @ ₹ 48.85 per dollar. On 31st December, 2011, the exchange rate was ₹ 47.50 per dollar.

How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2012.

Answer

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

	₹
Forward contract rate	48.85
Less: Spot rate	(47.50)
Loss	1.35
Forward Contract Amount	$20,000
Total loss on entering into forward contract = ($20,000 × ₹ 1.35)	₹ 27,000
Contract period	4 months
Loss for the period 1st January, 2012 to 31st March, 2012 i.e. 3 months falling in the year 2011-2012 will be ₹ 27,000 $\times \frac{3}{4}$ =	₹ 20,250

Balance loss of ₹ 6,750 (i.e. ₹ 27,000 – ₹ 20,250) for the month of April, 2012 will be recognised in the financial year 2012-2013.

Question 20

	Exchange Rate per $
Goods purchased on 1.1.2011 of US $ 10,000	*₹ 45*
Exchange rate on 31.3.2011	*₹ 44*
Date of actual payment 7.7.2011	*₹ 43*

Ascertain the loss/gain for financial years 2010-11 and 2011-12, also give their treatment as per AS 11.

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2011 and corresponding creditor would be recorded at ₹ 4,50,000 (i.e. $10,000 × ₹ 45)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2011 will be reported at ₹ 4,40,000 (i.e. $10,000 × ₹ 44) and exchange profit of ₹ 10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2010-11.

On 7.7.2011, creditor of $10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2011-12.

Question 21

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

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

Answer

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

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

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

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

Question 22

Mr. Y bought a forward contract for three months of US $ 2,00,000 on 1st December 2010 at 1 US $ = ₹ 44.10 when the exchange rate was 1 US $ = ₹ 43.90. On 31-12-2010, when he closed his books, exchange rate was 1 US $ = ₹ 44.20. On 31st January, 2011 he decided to sell the contract at ₹ 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mr. Y.

Answer

As per para 39 of AS 11 'Changes in Foreign Exchange Rates", in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised. This statement also does not apply to land unless it has a limited useful life for the enterprise.

Since the forward contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books. Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	₹
Sale rate	44.30
Less: Contract rate	(44.10)
Profit on sale of contract per US$	00.20

Contract Amount US $ 2,00,000

Total profit (2,00,000 x 0.20) ₹ 40,000

Disclosure:

An enterprise should disclosure the following:

(i) The amount of exchange differences included in the net profit or loss for the period.

(ii) Net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholder's funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

Question 23

Aman Ltd. borrowed US $ 5,00,000 on 31-12-2010 which will be repaid (settled) as on 30-6-2011. Aman Ltd. prepares its financial statements ending on 31-3-2011. Rate of *exchange between reporting currency (Rupee) and foreign currency (US $) on different dates are as under:*

31-12-2010 1 US $ = ₹ 44.00

31-3-2011 1 US $ = ₹ 44.50

30-6-2011 1 US $ = ₹ 44.75

(i) Calculate borrowings in reporting currency to be recognised in the books on above mentioned dates & also show journal entries for the same.

(ii) If borrowings was repaid (settled) on 28-2-2011 on which date exchange rate was 1 US$= ₹ 44.20 than what entry should be passed?

Answer

As per para 9 of AS 11 "Changes in Foreign Exchange Rates", a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Accordingly, on 31.12.2010, borrowings will be recorded at ₹ 2,20,00,000 (i.e $ 5,00,000 ×₹ 44.00)

As per para 11(a) of the standard, at each balance sheet date, foreign currency monetary items should be reported using the closing rate. Accordingly, on 31.12.2011, borrowings (monetary items) will be recorded at ₹ 2,22,50,000 (i.e $ 5,00,000 × ₹ 44.50).

In the books of Aman Ltd.
Journal Entries

	Date	*Particulars*		*₹*	*₹*
1.	31.12.2010	Bank A/c	Dr.	2,20,00,000	
		To Borrowings			2,20,00,000
2.	31.03.2011	P/L A/c (Difference in exchange) (W.N.1)	Dr.	2,50,000	
		To Borrowings			2,50,000
3.	30.06.2011	Borrowings A/c	Dr.	2,22,50,000	
		P/L A/c (Difference in exchange) (W.N.2)	Dr.	1,25,000	
		To Bank A/c			2,23,75,000

(ii) In case borrowing is repaid before balance sheet date, then the entry would be as follows:-

28-2-2011	Borrowings A/c	Dr.	2,20,00,000	
	P/L A/c (Difference in exchange) (W.N.3)	Dr.	1,00,000	
	To Bank A/c			2,21,00,000

Working Notes:

1. The exchange difference of ₹ 2,50,000 is arising because the transaction has been reported at different rate (₹ 44.50 =1 US $) from the rate initially recorded (i.e. ₹ 44 =1 US $).

2. The exchange difference of ₹ 1,25,000 is arising because the transaction has been settled at an exchange rate (₹ 44.75 =1 US $) different from the rate at which reported in the last financial statement (₹ 44.50= 1 US $).

3. The exchange difference of ₹ 1,00,000 is arising because the transaction has been settled at a different rate (i.e. ₹ 44.20 = 1 US $) than the rate at which initially recorded (1 US $ = ₹ 44.00).

AS 12 "ACCOUNTING FOR GOVERNMENT GRANTS"

Question 24

Explain the treatment of refund of Government Grants as per Accounting Standard 12.

Answer

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

(i) When government grant is related to revenue

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

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

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

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

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

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

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

A government grant that becomes refundable is treated as an extra-ordinary item as per AS 5.

Question 25

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 2010-11 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However, during the year 2011-12, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12.

Answer

As per para 11 of AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year 2011-12.

Question 26

A Ltd. purchased a machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

Answer

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

If the grant is credited to Fixed Assets Account:

			₹	₹
I	Fixed Assets A/c	Dr.	12 lakhs	
	To Bank A/c			12 lakhs
	(Being grant refunded)			

II The balance of fixed assets after two years depreciation will be ₹ 16 lakhs (W.N.1) and now it will become (₹ 16 lakhs + ₹ 12 lakhs) = ₹ 28 lakhs on which depreciation will be charged for remaining two years. Depreciation = (28-8)/2 = ₹ 10 lakhs p.a. will be charged for next two years.

If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 16 lakhs /4 years) = ₹ 4 lakhs p.a. x 2 years = ₹ 8 lakhs were credited to Profit and Loss Account and ₹ 8 lakhs was the balance of Deferred Grant Account after two years.
Therefore, on refund in the 3rd year, following entry will be passed:

			₹	₹
I	Deferred Grant A/c	Dr.	8 lakhs	
	Profit & Loss A/c	Dr.	4 lakhs	
	To Bank A/c			12 lakhs
	(Being Government grant refunded)			

II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at ₹ 24 lakhs (W.N.2) and depreciation will continue to be charged at ₹ 8 lakhs per annum.

Working Notes:

1. **Balance of Fixed Assets after two years but before refund (under first alternative)**

   Fixed assets initially recorded in the books = ₹ 40 lakhs – ₹ 16 lakhs = ₹ 24 lakhs

   Depreciation p.a. = (₹ 24 lakhs – ₹ 8 lakhs)/4 years = ₹ 4 lakhs per year

   Value of fixed assets after two years but before refund of grant

   = ₹ 24 lakhs – (₹ 4 lakhs x 2 years) = ₹ 16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under second alternative)**

   Fixed assets initially recorded in the books = ₹ 40 lakhs

   Depreciation p.a. = (₹ 40 lakhs – ₹ 8 lakhs)/4 years = ₹ 8 lakhs per year

   Book value of fixed assets after two years = ₹ 40 lakhs – (₹ 8 lakhs x 2 years)

   = ₹ 24 lakhs

   Note : It is assumed that the question requires the value of fixed assets is to be given after refund of government grant.

Question 27

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

Answer

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

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

Question 28

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2007-08 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2010-11, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2010-11 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2007-08 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2010?

Answer

As per para 21 of AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2010-11. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2007-08 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 30 lakhs. The increased cost of ₹ 30 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2010-11 shall be (84 + 30)/7 years = ₹ 16.286 lakhs presuming the depreciation is charged on SLM.

AS16 "BORROWING COSTS"

Question 29

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 30

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'

S. No.	*Particulars*	*Nature*	*Interest to be capitalized*	*Interest to be charged to P & L A/c*
			₹	₹
(i)	Construction of Factory Shed (Refer Note 1)	Qualifying Asset	$9,10,000 \times \frac{25}{70}$ = ₹ 3,25,000	
(ii)	Purchase of Machinery (Refer Note 2)	Not a Qualifying Asset		$9,10,000 \times \frac{20}{70}$ = ₹ 2,60,000
(iii)	Working Capital	Not a Qualifying Asset		$9,10,000 \times \frac{15}{70}$ = ₹ 1,95,000
(iv)	Advance for Purchase of Truck	Not a Qualifying Asset		$9,10,000 \times \frac{10}{70}$ = ₹ 1,30,000
Total			₹ 3,25,000	₹ 5,85,000

Notes:

1. It is assumed that construction of a factory shed was completed on 31st March, 2011.
2. It is assumed that the machinery was ready for its intended use at the time of its acquisition.

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 31

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 capitalised for borrowings as per AS 16 "Borrowing Costs":

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

Journal Entry

		₹	₹
31st March, 2012	Plant A/c Dr.	20,54,000	
	To Bank A/c		20,54,000
	[Being amount of cost of plant and borrowing cost thereon capitalised]		

Working Notes:

1. Computation of average accumulated expenses

		₹
1st April, 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
		13,50,000

2. Amount of interest capitalised

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

Question 32

Rohini Limited has obtained loan from an Institution for ₹ 500 lacs for modernization and renovation of its plant and machinery. The installation of plant and machinery was completed on 31.3.2012 amounting to ₹ 320 lacs and ₹ 50 lacs were advanced to suppliers of additional assets and the balance of ₹ 130 lacs has been utilized for working capital requirements. Total interest paid for the above loan amounted to ₹ 65 lacs during 2011-12. You are required to state how the interest on institutional loan is to be accounted for in the year 2011-12.

Answer

As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets[*] should be capitalised as part of the cost of that asset. Other borrowing costs are recognized as expense in the period in which they are incurred.

The treatment for total interest amount of ₹ 65 lakhs can be given as:

Purpose	*Nature*	*Interest to be capitalised (₹ in lakhs)*		*Interest to be charged to Profit and Loss A/c (₹ in lakhs)*	
Installation of Plant and Machinery	Qualifying asset	$320 \times \frac{65}{500} =$	41.60		
Advance to suppliers for additional assets	Qualifying asset	$50 \times \frac{65}{500} =$	6.50		
Working Capital	Not a qualifying asset			$130 \times \frac{65}{500} =$	16.90
			48.10		16.90

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

Question 33

On 1st April, 2011, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilized as under:

(i)	*Construction of sealink across two cities: (work was held up totally for a month during the year due to high water levels)*	:	*₹ 25 crores*
(ii)	*Purchase of equipments and machineries*	:	*₹ 3 crores*
(iii)	*Working capital*	:	*₹ 2 crores*
(iv)	*Purchase of vehicles*	:	*₹ 50,00,000*
(v)	*Advance for tools/cranes etc.*	:	*₹ 50,00,000*
(vi)	*Purchase of technical know-how*	:	*₹ 1 crores*
(vii)	*Total interest charged by the bank for the year ending 31st March, 2012*	:	*₹ 80,00,000*

Show the treatment of interest by Amazing Construction Ltd.

Answer

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

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

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

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

Question 34

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 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.

AS 19 " LEASES"

Question 35

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 proportion to 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 the period for which the asset is expected to be used.

Question 36

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 lower than 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 without major 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 37

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 38

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 Lessee

		₹	₹
Asset A/c	Dr.	1,49,888	
To Lessor			1,49,888
(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 39

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

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

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

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

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

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

Consider IRR = 10%.

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

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

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

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 40

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

Answer

(i) Determination of Nature of Lease

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

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

= ₹ 45,078

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

= ₹ 5,54,922

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

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

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

(ii) Calculation of Unearned Finance Income

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

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

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

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

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

Question 41

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

Value of machinery

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

Calculation of finance charges for each year

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

Question 42

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

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* Present value of minimum lease payments:
Annual lease rental x PV factor + Present value of guaranteed residual value
= ₹ 3,00,000 x (0.869 + 0.756 + 0.657) + ₹ 22,000 x (0.657)
= ₹ 6,84,600 + ₹ 14,454 = ₹ 6,99,054.

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

(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.

AS 20 "EARNINGS PER SHARE"

Question 43

Briefly describe, how do you calculate "Diluted Earnings per Share" as per Accounting Standard 20.

Answer

For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

The amount of net profit or loss[*] for the period attributable to equity shareholders should be adjusted, after taking into account any attributable change in tax expense for the period.

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[*] *An Exposure Draft on Limited Revision on AS 20 has been issued by ICAI to address the conceptual issues in arriving at earnings for computation of EPS. According to this Exposure Draft, for purpose of calculating basic earnings per share, net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting (i) preference dividends and any attributable tax thereto for the period and (ii) adjusting the amount in respect of an item of income or expense which is debited or credited to share premium account/ reserves, that is otherwise required to be recognized in the statement of profit and loss in accordance with accounting standards. It is pertinent to note that this Limited Revision is yet to be notified by the Govt.*

The number of equity shares should be the aggregate of the weighted average number of equity shares (as per paragraphs 15 and 22 of AS 20) and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.

An enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

Question 44

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) =

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

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

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 x 5/10 x 5/12 = 3,75,000
1.9.2010	14,40,000	10	14,40,000 x 7/12 = 8,40,000
1.9.2010	3,60,000	5	3,60,000 x 5/10 x 7/12 = 1,05,000
Total shares			13,20,000

Question 45

"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 $\dfrac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

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

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$= \dfrac{1,00,000 \times 100}{10}$ = 10,00,000 Equity shares

Weighted average number of equity shares used to compute diluted earnings per share

* Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

= [(20,00,000 x 12) + (10,00,000 x 9[**])]/12 = 27,50,000 shares

Diluted earnings per share = $\frac{89,70,000}{27,50,000 \text{ shares}}$ = ₹ 3.26 per share

Question 46

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 equity shares*	*Period outstanding*	*Weights (months)*	*Weighted average number of shares*
(1)	*(2)*	*(3)*	*(4)*	*(5) = (2) x (4)*
1st April, 2008	1,500 (Opening)	12 months	12/12	1,500
1st August, 2008	600 (Additional issue)	8 months	8/12	400
31st March, 2009	500 (Buy back)	0 months	0/12	-
Total				1,900

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

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

Question 47

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

[**] Interest on debentures for full year amounts to ₹ 8,00,000 (i.e. 8% of ₹ 1,00,00,000). However, interest expense amounting ₹ 6,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 9 months.

₹ 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

(a) Computation of Earnings Per Share

	Earnings ₹	*Shares*	*Earnings per share* ₹
Net Profit for the year 2009-10	30,00,000		
Weighted average number of shares outstanding during the year 2009-10		12,00,000	
Basic Earning Per Share $= \frac{30,00,000}{12,00,000}$			2.50
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value (As indicated in Working Note) $[2,00,000 \times \frac{15}{25}]$		(1,20,000)	
Diluted Earnings Per Share $[\frac{30,00,000}{12,80,000}]$	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 48

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

No. of shares 9.30 crores

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

Question 49

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

$= \dfrac{₹\ 25,00,000}{12,00,000\ \text{shares}}$	2.08	
EPS for the year 2009-10 restated for rights issue $= \dfrac{₹\ 25,00,000}{(12,00,000\ \text{shares} \times 1.06)}$*	1.97 (approx.)	
EPS for the year 2010-11 including effects of right issue $= \dfrac{40,00,000}{\left(12,00,000 \times 1.06 \times \frac{3}{12}\right) + \left(16,00,000 \times \frac{9}{12}\right)}$		2.64 (approx.)

Working Notes:

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

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

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

2. Computation of adjustment factor

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

Question 50

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 debentureholders to convert 20% of their holding into equity shares (Nominal Value ₹ 10) at a price of ₹ 15 per share. Debentureholders holding 2500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debentureholders exercising the option to the maximum.

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

Answer

Calculation of number of equity shares allotted to be debentureholders

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

Question 51

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

(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.

AS 26 "INTANGIBLE ASSETS"

Question 52

Decide when research and development cost of a project can be deferred to future periods as per AS 26.

Answer

As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research should be recognized. The expenditure incurred on development phase can be deferred to the subsequent years if the company can demonstrate all of the following conditions (as specified in para 44 of AS 26 'Intangible Assets'):

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

Question 53

How is software acquired for internal use accounted for under AS-26?

Answer

Paragraphs 10 and 11 of Appendix A to the Accounting Standard 26 on Intangible Assets, lays down the following procedure for accounting of software acquired for internal use:-

- The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this statement.
- The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use.
- Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement which deal with the method of accounting for 'Separate Acquisitions', 'Acquisitions as a part of Amalgamations', Acquisitions by way of Government Grant', and 'Exchanges of Assets', need to be considered, as appropriate.

Recognition criteria as per paragraphs 20 and 21 of the standard are stated below:-

- An intangible asset should be recognised if, and only if:
  - (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
  - (b) the cost of the asset can be measured reliably.
- An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

Question 54

What are the costs that are to be included in Research and Development costs as per AS 26.

Answer

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

Examples of research costs are:

- ➢ Costs of activities aimed at obtaining new knowledge;
- ➢ Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- ➢ Costs of the search for alternatives for materials, devices, products, processes, systems or services; and

- Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

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

Examples of development activities/costs are:

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

Question 55

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

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

You are asked to suggest how should Research and Development cost be charged to Profit and Loss account. If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

Answer

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

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

III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

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

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

Question 56

AB Ltd. launched a project for producing product X in October, 2009. The Company incurred ₹ 20 lakhs towards Research and Development expenses upto 31st March, 2011. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

Answer

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

Hence, the expenses amounting ₹ 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2011.

Question 57

NDA Corporation is engaged in research on a new process design for its product. It had incurred an expenditure of ₹ 530 lakhs on research upto 31st March, 2010.

The development of the process began on 1st April, 2010 and Development phase expenditure was ₹ 360 lakhs upto 31st March, 2011 which meets assets recognition criteria.

From 1st April, 2011, the company will implement the new process design which will result in after tax saving of ₹ 80 lakhs per annum for the next five years.

The cost of capital of company is 10%.

Explain:

(1) Accounting treatment for research expenses.

(2) The cost of internally generated intangible asset as per AS 26.

(3) The amount of amortization of the assets. (The present value of annuity factor of ₹ 1 for 5 years @ 10% = 3.7908)

Answer

(i) Research Expenditure - According to para 41 of AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 530 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2009-10. Hence, it should be written off as an expense in that year itself.

(ii) Cost of internally generated intangible asset - The question states that the development phase expenditure amounting ₹ 360 lakhs incurred upto 31st March, 2011 meets asset recognition criteria. As per AS 26 for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	80 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 80 lakhs x 3.7908)	303.26 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 360 lakhs or present value of future net cash flows ₹303.26 lakhs.

Hence, cost of an internally generated intangible asset will be ₹ 303.26 lakhs.

The difference of ₹ 56.74 lakhs (i.e. ₹ 360 lakhs – ₹ 303.26 lakhs) will be amortized by the enterprise for the financial year 2010-11.

(iii) Amortisation - The company can amortise ₹ 303.26 lakhs over a period of five years by charging ₹ 60.65 lakhs per annum from the financial year 2011-12 onwards.

Question 58

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

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

Advise the company as per the applicable Accounting Standard.

Answer

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

Question 59

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

(i) Import Duty : 20%

(ii) Purchase Tax : 10%

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

(iv) Installation expenses : ₹ 25,000

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

Compute the cost of Software to be capitalized.

Answer

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

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

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

Question 60

Base Limited is showing an intangible asset at ₹ 85 lakhs as on 1-4-2011. This asset was acquired for ₹ 112 lakhs on 1-4-2008 and the same was available for use from that date. The *company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.*

Answer

As per para 63 of AS 26 "Intangible Assets," the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortization should commence when the asset is available for use.

Base Limited has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, Base Limited would be required to restate the carrying amount of intangible asset as on 1.4.2011 at ₹ 112 lakhs less ₹ 33.6 lakhs $\left(\frac{112\text{ lakhs}}{10\text{ years}} \times 3\text{ years}\right)$ = ₹ 78.4 lakhs. The difference of ₹ 6.6 lakhs i.e. (₹ 85 lakhs – ₹ 78.4 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 78.4 lakhs would be amortized over remaining 7 years by ₹ 11.2 lakhs per year.

Question 61

Hera Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹ 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	*Production in bottles (in lakhs)*	*Net operating cash flow (₹ in lakhs)*
1	*300*	*900*
2	*600*	*1,800*
3	*650*	*2,300*
4	*800*	*3,200*
5	*800*	*3,200*
6	*800*	*3,200*
7	*800*	*3,200*
8	*800*	*3,200*
9	*800*	*3,200*
10	*800*	*3,200*

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method.

Answer

As per para 72 of AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. Initially net operating cash flow per thousand bottles is ₹ 3 lakhs for first two years and ₹ 4 lakhs from fourth year onwards, the pattern is established. Therefore Hera Ltd. should amortize the license fee of ₹ 200 lakhs as under:

Year	*Net Operating Cash Inflow (NOCI)*	*Ratio*	*Amortize amount (₹ in lakhs)*
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200	0.11 (bal.)	22
	27,400	1.00	200

AS 29 'PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS'

Question 62

X Ltd. has its financial year ended 31.3.2011, fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the probable outcomes as below:

Result	*Probability*	*Amount of Loss ₹*
For first ten cases:		
Win	*0.6*	*----*
Loss-low damages	*0.3*	*90,000*
Loss-high damages	*0.1*	*2,00,000*
For remaining five cases:		
Win	*0.5*	*----*
Loss-low damages	*0.3*	*60,000*
Loss-high damages	*0.2*	*1,00,000*

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Answer

According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning first 10 cases is 60% and for remaining five cases is 50%. In other words, probability of losing the cases is 40% and 50% respectively. According to AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the probability or possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore, disclosure by way of note of contingent liability amount may be calculated as under:

Expected loss in first ten cases	= [₹ 90,000 x 0.3 + ₹ 2,00,000 x 0.1] x 10
	= [₹ 27,000 + ₹ 20,000] x 10
	= ₹ 47,000 x 10 = ₹ 4,70,000
Expected loss in remaining five cases	= [₹ 60,000 x 0.3 + ₹ 1,00,000 x 0.2] x 5
	= [₹ 18,000 + ₹ 20,000] x 5
	= ₹ 38,000 x 5 = ₹ 1,90,000
Total contingent liability	= ₹ 4,70,000 + ₹ 1,90,000 = ₹ 6,60,000.

Question 63

Shyam Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2010-11, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2006 based on the recommendations of the commission. The company makes the provision of ₹ 680 lakhs for pay revision in the financial year 2010-11 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of ₹ 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made".

The accountant feels that the company should also book/recognise the income by ₹ 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit.

Answer

As per para 46 of AS-29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

In this case, the provision of salary to employees of ₹ 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be made reducing the claim to be made from the client. It appears that the whole amount of ₹ 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding non-recognition of income of ₹ 680 lakhs is not as per AS-29 and AS-9. However, the concept of prudence will not be followed if ₹ 680 lakhs is simultaneously recognized as income. ₹ 680 lakhs is not the revenue at present but only reimbursement of claim. However the accountant is correct to the extent as that non-recognition of ₹ 680 lakhs as income will result in the under statement of profit.

Question 64

A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?

Answer

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

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

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

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

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

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

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

Question 65

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

Answer

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

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

Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

EXERCISES

1. *The difference between actual expense or income and the estimated expense or income as accounted for in earlier years' accounts, does not necessarily constitute the item to be a prior period item comment.*

   (Hints: The statement given in the question is correct)

2. (i) *A major fire has damaged the assets in a factory of a limited company on 2nd April-two days after the year end closure of account. The loss is estimated at ₹ 20 crores out of which ₹ 12 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.*

   (ii) *There is a sales tax demand of ₹ 2.50 crores against a company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The grounds of appeal deal with points covering ₹ 2 crores of the demand. State how the matter will have to be dealt with in the final accounts for the year.*

   (Hints: (i) The loss due to break out of fire is an example of event occurring after the balance sheet date that does not relate to conditions existing at the balance sheet date. (ii) Company should disclose the disputed part of sales tax liability of ₹ 2 crore as contingent liability in their financial statements of the year.)

3

Advanced Issues in Partnership Accounts

UNIT 1 : DISSOLUTION OF PARTNERSHIP FIRMS

BASIC CONCEPTS

- On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards the capital contributed by partners is repaid and, if there is still surplus, it is distributed among the partners in their profit-sharing ratio.

  Conversely, after payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm left over are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their profit-sharing ratio.

  On dissolution of partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

  (a) Losses including deficiencies of capital are paid, first out of profits, next out of capital and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.

  (b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order :

  (i) in paying the debts of the firm to third parties;

  (ii) in paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital;

  (iii) in paying to each partner what is due to him on account of capital; and

  (iv) the residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.

  The death or retirement of a partner would not result in the dissolution of the partnership, if the partnership agreement so provides (Section 42).

- According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realisation of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

  The determination of capital ratio for this has been explained below. The provisions of the Indian Partnership Act are not contrary to *Garner* vs. *Murray* rule. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per deed should be applied.

Capital Ratio on Insolvency

- The partners are free to have either fixed or fluctuating capitals in the firm.
- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business shall not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.
- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances it is better not to transfer the amount of creditors to Realisation Account.
- Creditors may be paid the amount available including the amount contributed by the partners.

  The unsatisfied portion of creditor account is transferred to Capital Accounts of the partners in the profit sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.
- On dissolution

• assets are realized and all liabilities are paid off

  (*if any liability remains unpaid then it is to be realized from partners in their profit sharing ratio*).

Piecemeal describes two methods
• Maximum loss method- each instalment realised is considered to be the final payment.
• Highest relative capital method.- the partner whose capital is greater in proportion to his profit sharing ratio is first paid off.

DISSOLUTION

Question 1

X, Y and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4 : 3 : 2. Following is the Balance Sheet of the firm as at 31st March, 2012:

Balance Sheet as at 31st March, 2012

Liabilities	₹	*Assets*	₹
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above said date. It was found that a credit purchase of ₹20,000 in January, 2012 had not been recorded in the books of the firm.

Fixed assets realized ₹5,20,000 and book debts ₹4,40,000.

Stocks were valued at ₹2,50,000 and it was taken over by partner Y.

Creditors allowed discount of 5% and the expenses of realization amounted to ₹6,000.

You are required to prepare:

(i) Realisation account;

(ii) Partners capital account; and

(iii) Cash account.

Answer

(i) Realisation Account

		₹			₹
To	Fixed assets	5,00,000	By	Creditors	3,20,000
To	Stock in trade	3,00,000	By	Cash (5,20,000+4,40,000)	9,60,000

To	Debtors	5,00,000	By	Y (Stock taken over)	2,50,000
To	Cash - Expenses	6,000	By	Loss transferred to partners' capital accounts	
To	Cash -Creditors	3,23,000		X	44,000
	(3,40,000x 95%)			Y	33,000
				Z	22,000
		16,29,000			16,29,000

(ii) Partners' Capital Accounts

		X	Y	Z			X	Y	Z
		₹	₹	₹			₹	₹	₹
To	Realisation Account	44,000	33,000	22,000	By	Balance b/d	4,00,000	3,00,000	2,00,000
To	Realisation Account	-	2,50,000	-	By	General reserve	40,000	30,000	20,000
To	Cash	3,96,000	47,000	1,98,000					
		4,40,000	3,30,000	2,20,000			4,40,000	3,30,000	2,20,000

(iii) Cash Account

		₹			₹
To	Balance b/d	10,000	By	Realisation A/c (Expenses)	6,000
To	Realisation A/c (Fixed assets and book debts realized)	9,60,000	By	Realisation A/c (Creditors)	3,23,000
			By	Creditors	20,000
			By	X	3,96,000
			By	Y	47,000
			By	Z	1,98,000
		9,70,000			9,70,000

Question 2

P, Q and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 2011 is as follows:

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

They decided to dissolve the business. The following are the amounts realized:

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

Creditors allowed a discount of 5% and realization expenses amounted to ₹1,500. There was an unrecorded asset of ₹6,000 which was taken over by Q at ₹4,800. A bill for ₹4,200 due for sales tax was received during the course of realization and this was also paid.

You are required to prepare:

(i) Realisation account.

(ii) Partners' capital accounts.

(iii) Cash account.

Answer

Realisation Account

	Particulars		₹		*Particulars*		₹
To	Debtors		48,000	By	Creditors		48,000
To	Stock		60,000	By	Cash A/c (Assets realized):		
To	Fixtures		24,000		Plant and Machinery	1,02,000	
To	Plant and machinery		1,08,000		Fixtures	18,000	
To	Cash A/c (Creditors)		45,600		Stock	84,000	
To	Cash A/c (Sales tax)		4,200		Sundry Debtors	44,400	2,48,400
To	Cash A/c (Realisation expenses)		1,500	By	Q (Unrecorded asset)*		4,800
To	Profit on Realisation						
	P	3,960					
	Q	3,960					
	R	1,980	9,900				
			3,01,200				3,01,200

* An unrecorded asset is in the nature of gain hence realization account is credited. Since this asset has been taken over by Q, therefore, his account has been debited.

Partners' Capital Accounts

Particulars	*P*	*Q*	*R*	*Particulars*	*P*	*Q*	*R*
	₹	₹	₹		₹	₹	₹
To Realisation A/c (unrecorded asset)		4,800		By Balance b/d	1,20,000	48,000	24,000
To Cash (Bal. Fig.)	1,47,960	71,160	37,980	By Reserve fund	24,000	24,000	12,000
				By Realisation A/c (Profit)	3,960	3,960	1,980
	1,47,960	75,960	37,980		1,47,960	75,960	37,980

Cash Account

	Particulars	₹		*Particulars*	₹
To	Balance b/d	60,000	By	Realisation A/c (Creditors)	45,600
To	Realisation A/c (Assets)	2,48,400	By	Realisation A/c (Expenses)	1,500
			By	Realisation A/c (Sales Tax)	4,200
			By	P's Capital A/c	1,47,960
			By	Q's Capital A/c	71,160
			By	R's Capital A/c	37,980
		3,08,400			3,08,400

Question 3

Read, Write and Add give you the following Balance Sheet as on 31st March, 2011.

Liabilities		₹	*Assets*		₹
Read's Loan		*15,000*	*Plant and Machinery at cost*		*30,000*
Capital Accounts:			*Fixtures and Fittings*		*2,000*
Read	*30,000*		*Stock*		*10,400*
Write	*10,000*		*Debtors*	*18,400*	
Add	*2,000*	*42,000*	*Less: Provision*	*(400)*	*18,000*
Sundry Creditors		*17,800*	*Joint Life Policy*		*15,000*
Loan on Hypothecation of Stock		*6,200*	*Patents and Trademarks*		*10,000*
Joint Life Policy Reserve		*12,400*	*Cash at Bank*		*8,000*
		93,400			*93,400*

The partners shared profits and losses in the ratio of Read 4/9, Write 2/9 and Add 1/3. Firm was dissolved on 31st March, 2011 and you are given the following information:

(a) *Add had taken a loan from insurers for ₹ 5,000 on the security of Joint Life Policy.*

The policy was surrendered and Insurers paid a sum of ₹ 10,200 after deducting ₹ 5,000 for. Add's loan and ₹ 300 as interest thereon.

(b) One of the creditors took some of the patents whose book value was ₹ 6,000 at a valuation of ₹ 4,500. The balance to that creditor was paid in cash.

(c) The firm had previously purchased some shares in a joint stock company and had written them off on finding them useless. The shares were now found to be worth ₹ 3,000 and the loan creditor agreed to accept the shares at this value.

(d) The remaining assets realized the following amount:

	₹
Plant and Machinery	*17,000*
Fixtures and Fittings	*1,000*
Stock	*9,000*
Debtors	*16,500*
Patents 50% of their book value	

(e) The liabilities were paid and a total discount of ₹ 500 was allowed by the creditors.

(f) The expenses of realization amounted to ₹ 2,300.

Prepare the Realisation Account, Bank Account and Partners Capital Accounts in columnar form.

Answer

Realisation Account

		₹				₹
To	Plant and machinery	30,000	By	Provision for doubtful debts		400
To	Fixtures and fittings	2,000	By	Loan on hypothecation of stock (W.N.3)		3,000
To	Stock	10,400	By	Creditors (W.N.2)		500
To	Debtors	18,400	By	Joint Life Policy A/c (W.N.4)		12,900
To	Patents and Trademarks (W.N.5)	5,500	By	Bank		
				Plant and machinery	17,000	
To	Bank	2,300		Fixtures and fittings	1,000	
				Stock	9,000	
				Debtors	16,500	
				Patents and Trademarks	2,000	45,500
			By	Partners' Capital Accounts		
				Read	2,800	
				Write	1,400	
				Add	2,100	6,300
		68,600				68,600

Bank Account

	₹		₹
To Balance b/d	8,000	By Add's Capital A/c- drawings	5,300
To Joint Life Policy	15,500	By Loan on hypothecation of stock	3,200
To Realisation A/c	45,500		
To Add's Capital A/c	5,400	By Creditors	12,800
		By Realisation A/c (expenses)	2,300
		By Read's Loan A/c	15,000
		By Read's Capital A/c	27,200
		By Write's Capital A/c	8,600
	74,400		74,400

Partners' Capital Accounts

	Read	*Write*	*Add*		*Read*	*Write*	*Add*
	₹	₹	₹		₹	₹	₹
To Bank			5,300	By Balance b/d	30,000	10,000	2,000
To Realisation A/c	2,800	1,400	2,100				
				By Bank A/c (bal.fig.)			5,400
To Bank (Bal. Fig.)	27,200	8,600					
	30,000	10,000	7,400		30,000	10,000	7,400

Working Notes:

1. Read's Loan Account

	₹		₹
To Bank A/c	15,000	By Balance b/d	15,000
	15,000		15,000

2. Sundry Creditors Account

	₹		₹
To Patents and Trademarks A/c	4,500	By Balance b/d	17,800
To Realisation A/c	500		
To Bank A/c	12,800		
	17,800		17,800

3. Loan on Hypothecation of Stock Account

	₹		₹
To Realisation A/c	3,000	By Balance b/d	6,200
To Bank A/c	3,200		
	6,200		6,200

4. Joint Life Policy Account

		₹			₹
To	Balance b/d	15,000	By	Joint Life Policy Reserve A/c	12,400
To	Realisation A/c	12,900	By	Bank A/c (10,200 + 5,300)	15,500
		27,900			27,900

5. Patents and Trademarks Account

		₹			₹
To	Balance b/d	10,000	By	Creditors A/c	4,500
			By	Realisation A/c	1,500
			By	Realisation A/c (bal.fig.)	4,000*
		10,000			10,000

DISSOLUTION DUE TO INSOLVENCY OF ONE PARTNER

Question 4

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

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

Following information is given to you:

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

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

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

(iv) The other assets realized as follows:

Building	*105% of book value*
Stock	*₹ 78,000*

Investments	*The rest of investments were sold at a profit of ₹ 4,800*
Debtors	*The rest of the debtors were realized at a discount of 12%*

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

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

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

Prepare the necessary Ledger Accounts.

Answer

Realisation account

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

Cash account

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

Partners' Capital Accounts

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

Working Notes:

1. Amount paid to creditors

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

2. Amount received from sale of investments

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

3. Amount received from debtors

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

4. Deficiency of C

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

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

Accordingly,

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

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

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

Question 5

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

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

(i) The assets were realized as under:

	₹
Land & building	*2,30,000*
Furniture & fixtures	*42,000*
Stock	*72,000*
Debtors	*65,000*

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

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

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

Applying the principles laid down in Garner Vs. Murray, prepare the Realisation Account, Partners' Capital Accounts and Cash Account.

Answer

Realisation Account

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

		Q = 30,090 R = 20,060 S = 10,030	1,00,300
	6,55,300		6,55,300

Partners' Capital Accounts

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

Note: P, Q and S brought cash to make good, their share of the loss on realization. However, in actual practice they will not be bringing any cash, only a notional entry will be made.

Cash Account

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

Working Note:

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

Calculation of Capital Ratio of Solvent Partners

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

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

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

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

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

P = ₹ 21,060 X 3/5 = ₹ 12,636

Q = ₹ 21,060 X 2/5 = ₹ 8,424

Question 6

Neptune, Jupiter, Venus and Pluto had been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2003:

Liabilities	*₹*	*₹*	*Assets*	*₹*	*₹*
Capital Account:			*Premises*		*1,20,000*
Neptune	*1,00,000*		*Furniture*		*40,000*
Jupiter	*60,000*	*1,60,000*	*Stock*		*1,00,000*
General Reserve		*56,000*	*Debtors*		*40,000*
Capital Reserve		*14,000*	*Cash*		*8,000*
Sundry Creditors		*20,000*	*Capital Overdrawn:*		
Mortgage Loan		*80,000*	*Venus*	*10,000*	
			Pluto	*12,000*	*22,000*
		3,30,000			*3,30,000*

(i) The assets were realised as under:

	₹
Debtors	*24,000*
Stock	*60,000*
Furniture	*16,000*
Premises	*90,000*

(ii) Expenses of dissolution amounted to ₹ 4,000.

(iii) Further creditors of ₹ 12,000 had to be met.

(iv) General Reserve unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and the Cash Account assuming that Venus became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner vs Murray.

Answer

Realisation Account

		₹			₹	₹
To	Sundry assets A/c (transfer):		By	Sundry creditors A/c		20,000
			By	Cash A/c (assets		
	Premises	1,20,000		realised): Premises	90,000	
	Furniture	40,000		Furniture	16,000	
	Stock	1,00,000		Stock	60,000	
	Sundry Debtors	40,000		Debtors	24,000	1,90,000
To	Cash A/c (creditors paid)	32,000	By	Loss transferred to Capital Accounts:		
To	Cash A/c (expenses)	4,000		Neptune	54,000	
				Jupiter	36,000	
				Venus	18,000	
				Pluto	18,000	1,26,000
		3,36,000				3,36,000

Cash Account

			₹			₹
To	Balance b/d		8,000	By	Realisation A/c (creditors)	32,000
To	Realisation A/c (assets realised)		1,90,000	By	Realisation A/c (expenses)	4,000
				By	Mortgage loan	80,000
To	Capital A/c (realisation loss made good):			By	Neptune's Capital A/c	1,18,857
				By	Jupiter's Capital A/c	73,143
	Neptune	54,000				
	Jupiter	36,000				
	Pluto	18,000	1,08,000			
To	Pluto's Capital A/c		2,000			
			3,08,000			3,08,000

Partners' Capital Accounts

Particulars	Neptune	Jupiter	Venus	Pluto	Particulars	Neptune	Jupiter	Venus	Pluto
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d	–	–	10,000	12,000	By Balance b/d	1,00,000	60,000	–	–
To Realisastion A/c (loss)	54,000	36,000	18,000	18,000	By General reserve A/c (3 : 2 : 1 :1)	24,000	16,000	8,000	8,000
To Venus's Capital A/c (loss)	11,143	6,857	–	–	By Capital reserve A/c (3 : 2 : 1 :1)	6,000	4,000	2,000	2,000
To Cash A/c	1,18,857	73,143	–	–	By Cash A/c (loss on realization)	54,000	36,000	–	18,000
					By Neptune's Capital A/c	–	–	11,143	–
					By Jupiter's Capital A/c	–	–	6,857	–
					By Cash A/c	–	–	–	2,000
	1,84,000	1,16,000	28,000	30,000		1,84,000	1,16,000	28,000	30,000

Question 7

A, B and C are partners; A became insolvent on 15.4.2010. The capital account balance of partner B is on the debit side. Partner B is solvent. Should partner B bear the loss arising on account of the insolvency of partner A?

Answer

According to *Garner vs Murray* Rule, if a solvent partner is having a debit balance in his capital account, then he cannot be called upon to bear the loss on account of the insolvency of the other partner. Hence, 'B' needs not bear the loss due to insolvency of partner 'A'.

DISSOLUTION: PIECEMEAL DISTRIBUTION

Maximum Possible Loss Method

Question 8

A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were ₹9,600, ₹6,000 and ₹8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	₹		₹
Liability for interest on loans from :		*Investments*	*1,000*
Spouses of partners	*2,000*	*Furniture*	*2,000*
Partners	*1,000*	*Machinery*	*1,200*
		Stock	*4,000*

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.

Answer

Statement of Distribution of Cash

	Realisation	*Interest on loans from partners' spouses*	*Interest on loans from partners*	*Partners' Capitals*			
				A	*B*	*C*	*Total*
	₹	₹	₹	₹	₹	₹	₹
Balances due (1)		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	(1,000)	-				
		1,000	1,000				
(ii) Sale of furniture	2,000	(1,000)	(1,000)				
		-	-				
(iii) Sale of machinery	1,200						

Maximum possible loss ₹ 22,800 (total of capitals ₹ 24,000 less cash available ₹ 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2	(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit	(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C	1,800	840	(2,640)	–
Amount paid (2)	–	–	1,200	1,200
Balances in capital accounts(1 – 2) = (3)	9,600	6,000	7,200	22,800
(iv) Sale of stock 4,000				
Maximum possible loss 18,800 (₹ 22,800 – ₹ 4,000) Allocated to partners in the ratio 5 : 3 : 2	(9,400)	(5,640)	(3,760)	(18,800)
Amounts at credit and cash paid (4)	200	360	3,440	(4,000)
Balances in capital accounts left unpaid—Loss (3 – 4) = (5)	9,400	5,640	3,760	18,800

Question 9

Amar, Akbar and Antony are in partnership. The following is their Balance Sheet as at March 31, 2010 on which date they dissolved their partnership. They shared profit in the ratio of 5:3:2.

Liabilities		*₹*	*Assets*	*₹*
Creditors		*80,000*	*Plant and machinery*	*60,000*
Loan A/c –	*Amar*	*20,000*	*Premises*	*80,000*
Capital A/cs -	*Amar*	*1,00,000*	*Stock*	*60,000*
	Akbar	*30,000*	*Debtors*	*1,20,000*
	Antony	*90,000*		
		3,20,000		*3,20,000*

It was agreed to repay the amounts due to the partners as and when the assets were realised, viz.

April 15, 2010	*₹ 60,000*
May 1, 2010	*₹ 1,46,000*
May 31, 2010	*₹ 94,000*

Prepare a statement showing how the distribution should be made under maximum loss method and write up the cash account and partners' capital accounts.

Answer

(a) Statement of Distribution of Cash by 'Maximum Loss Method'

	Creditors ₹	*Amar's Loan* ₹	*Amar* ₹	*Akbar* ₹	*Antony* ₹
Balance due	80,000	20,000	1,00,000	30,000	90,000
15th April 2010 realised ₹ 60,000					
Paid to creditors	(60,000)	-	-	-	-
Balance due	20,000	20,000	1,00,000	30,000	90,000
1st May, 2010 realised ₹ 1,46,000					
Paid to creditors (₹ 20,000)	20,000	-	-	-	-
Paid to Amar's loan (₹ 20,000)	-	20,000	-	-	-
Balance due (1)	Nil	Nil	1,00,000	30,000	90,000
Balance ₹ 1,06,000					
Maximum Loss (1,00,000+30,000+90,000-1,06,000) =₹ 1,14,000 shared in Profit & Loss ratio 5:3:2			(57,000)	(34,200)	(22,800)
			43,000	(4,200)	67,200
Akbar's deficiency shared by Amar & Antony in capital ratio 100:90			(2,210)	4,200	(1,990)
Cash paid [2]			40,790	-	65,210
Balance due (3) [1-2]			59,210	30,000	24,790
31st May 2010 realised ₹ 94,000					
Maximum Loss [59,210+30,000+24,790-94,000]= ₹ 20,000 shared in 5:3:2			(10,000)	(6,000)	(4,000)
Cash paid (4)			49,210	24,000	20,790
Balance/Loss* on realisation (3-4)			10,000	6,000	4,000

Cash Account

	₹		₹
To Realization Account	60,000	By Creditors Account	60,000
To Realization Account	1,46,000	By Creditors Account	20,000
To Realization Account	94,000	By Amar's Loan Account	20,000
		By Amar's Capital Account	40,790
		By Antony's Capital Account	65,210

		By Amar's Capital Account	49,210
		By Akbar's Capital Account	24,000
		By Antony's Capital Account	20,790
	3,00,000		3,00,000

Partners' Capital Accounts

	Amar	*Akbar*	*Antony*		*Amar*	*Akbar*	*Antony*
	₹	₹	₹		₹	₹	₹
To Cash	40,790	-	65,210	By Balance b/d	1,00,000	30,000	90,000
To Cash	49,210	24,000	20,790				
To Balance c/d Realization loss*	10,000	6,000	4,000				
	1,00,000	30,000	90,000		1,00,000	30,000	90,000

* If no further realization takes place, then Amar, Akbar and Anthony will bear loss on realization ₹ 10,000, ₹ 6,000 and ₹ 4,000 respectively.

HIGHEST RELATIVE CAPITAL METHOD

Question 10

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

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

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

Assets were realized piecemeal as under:

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

Prepare a statement showing distribution of cash amongst the partners by 'Higher Relative Capital Method'.

Answer

Statement showing distribution of cash amongst the partners

		Creditors	*B's Loan*		*Capitals*	
				A(₹)	*B(₹)*	*C(₹)*
Balance Due		16,500	4,500	15,000	7,500	15,000
On 1st Instalment amount with the firm ₹ (275 + 18,650)	18,925					
Less: Dissolution expenses provided for	(3,000)					
	15,925					
Less: C's remuneration of 1% on assets realized (18,650 x 1%)	(187)					
	15,738					
Less: Payment made to creditors	(15,738)	(15,738)				
Balance due	Nil	762				
2nd instalment realised	17,320					
Less: C's remuneration of 1% on assets realized (17,320 x 1%)	(173)					
	17,147					
Less: Payment made to creditors	(162)	(162)				
Transferred to P& L A/c	16,985	600				
Less: Payment for B's loan A/c	(4,500)		(4,500)			
Amount available for distribution to partners	12,485		nil			

Less: C's remuneration of 10% of the amount distributed to partners (12,485 x 10/110)	(1,135)					
Balance distributed to partners on the basis of HRCM	11,350					
Less: Paid to C (W.N.1)	(3,750)					(3,750)
	7,600					11,250
Less: Paid to A and C in 4:3 (W.N.1)	(7,600)			(4,343)	-	(3,257)
Balance due	nil			10,657	7,500	7,993
Amount of 3rd instalment	10,000					
Less: C's remuneration of 1% on assets realized (10,000 x 1%)	(100)					
	9,900					
Less: C's remuneration of 10% of the amount distributed to partners (9,900 x 10/110)	(900)					
	9,000					
Less: Paid to A and C in 4:3 for (₹ 8,750 – 7,600) (W.N.1)	(1,150)			(657)	-	(493)
	7,850			10,000	7,500	7,500
Less: Paid to A, B and C in 4:3:3	(7,850)			(3,140)	(2,355)	(2,355)
Balance due	nil			6,860	5,145	5,145
Amount of 4th and last instalment	7,000					
Less: C's remuneration of 1% on assets realized (7,000 x 1%)	(70)					
	6,930					
Less: C's remuneration of 10% of the amount distributed to partners (6,930 x 10/110)	(630)					
	6,300					
Less: Paid to A, B and C in 4:3:3	(6,300)			(2,520)	(1,890)	(1,890)
Loss suffered by partners				4,340	3,255	3,255

Working Note:

(i) Highest Relative Capital Basis

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

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

EXERCISES

1 *The firm of Kapil and Dev has four partners and as of 31st March, 2011, its Balance Sheet stood as follows:*

Balance Sheet as on 31st March, 2011

Liabilities	₹	*Assets*	₹
Capital A/cs:		*Land*	*50,000*
F. Kapil	*2,00,000*	*Building*	*2,50,000*
S. Kapil	*2,00,000*	*Office equipment*	*1,25,000*
R. Dev	*1,00,000*	*Computers*	*70,000*
Current A/cs		*Debtors*	*4,00,000*
F. Kapil	*50,000*	*Stocks*	*3,00,000*
S. Kapil	*1,50,000*	*Cash at Bank*	*75,000*
R. Dev	*1,10,000*	*Other Current Assets*	*22,600*
Loan from NBFC	*5,00,000*	*Current A/c :*	
Current Liabilities	*70,000*	*B. Dev*	*87,400*
	13,80,000		*13,80,000*

The partners have been sharing profits and losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 1.4.2011 on the basis of the following understanding :

(a) The following assets are to be adjusted to the extent indicated with respect to the book values :

Land	*200%*
Building	*120%*
Computers	*70%*
Debtors	*95%*
Stocks	*90%*

(b) In the case of the loan, the lender's are to be paid at their insistence a prepayment premium of 1%.

(c) B. Dev is insolvent and no amount is recoverable from him. His father, R.Dev, however, agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.

Assuming that the realisation of the assets and discharge of liabilities is carried out immediately, show the Cash A/c, Realisation Account and the Partners' Accounts.

(Hints: Profit on realisation: F. Kapil ₹ 9,600, S. Kapil ₹ 9,600, R. Dev ₹ 2,400.,B. Dev ₹ 2,400)

2. *The firm of LMS was dissolved on 31.3.2011, at which date its Balance Sheet stood as follows:*

Liabilities	₹	*Assets*	₹
Creditors	*2,00,000*	*Fixed Assets*	*45,00,000*
Bank Loan	*5,00,000*	*Cash and Bank*	*2,00,000*
L's Loan	*10,00,000*		
Capital			
L	*15,00,000*		
M	*10,00,000*		
S	*5,00,000*		
	47,00,000		*47,00,000*

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are:

S.No.	Amount in ₹
1	5,00,000
2	15,00,000
3	15,00,000
4	30,00,000
5	30,00,000

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

(Hints: Realization profit credited to partners L ₹ 15,66,667, M ₹ 15,66,667, S ₹ 15,66,666)

3. *Ajay, Vijaya, Ram and Shyam are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 2011 :*

Liabilities		₹	*Assets*	₹
Sundry Creditors		*3,00,000*	*Sundry Debtors*	*3,50,000*
Capital A/cs :			*Less: Doubtful Debts*	*(50,000)*
Ajay	*7,00,000*			*3,00,000*
Shyam	*3,00,000*	*10,00,000*	*Cash in hand*	*1,40,000*
			Stocks	*2,00,000*
			Other Assets	*3,10,000*
			Capital A/cs:	
			Vijay	*2,00,000*
			Ram	*1,50,000*
		13,00,000		*13,00,000*

On 31st March, 2011, the firm is dissolved and the following points are agreed upon:

Ajay is to takeover sundry debtors at 80% of book value

Shyam is to takeover the stocks at 95% of the value and

Ram is to discharge sundry creditors.

Other assets realise ₹ 3,00,000 and the expenses of realisation come to ₹ 30,000.

Vijay is found insolvent and ₹ 21,900 is realised from his estate.

Prepare Realisation Account and Capital Accounts of the partners. Show also the Cash A/c.

The loss arising out of capital deficiency may be distributed following the decision in Garner vs Murray.

(Hints: Vijay's deficiency will be borne by Ajay and Shyam in the ratio of 7 : 3 i.e. on opening capitals of ₹ 7,00,000 and ₹ 3,00,000. Ram will not bear any portion of the loss since at the time of dissolution he had a debit balance in his capital account. Loss on realization- Ajay ₹ 28,000, Vijay ₹ 7,000, Ram ₹ 14,000, Shyam ₹ 21,000)

UNIT 2: AMALGAMATION, CONVERSION AND SALE OF PARTNERSHIP FIRM

BASIC CONCEPTS

- Amalgamation includes

  Closing the books of old firm:

  (a) Each firm should prepare a **Revaluation Account** relating to its own assets and liabilities and transfer the balance to the partners' capital accounts in the profit-sharing ratio.

  (b) Entries for **raising goodwill** should be passed.

  (c) **Assets and liabilities not taken over** by the new firm should be transferred to the capital accounts of partners in the ratio of their capitals.

  (d) The **new firm** should be debited with the difference between the value of assets and liabilities taken over by it; the assets should be credited and liabilities debited.

  (e) **Partners' capital accounts** should be transferred to the new firm's account;

  Opening the books of the new firm:

  Debit assets taken out at the agreed values

  Credit the liabilities taken over, and

  Credit individual partner's capital accounts with the closing balances in the erstwhile firm.

  When one firm is merged with another existing firm, entries will be in the pattern of winding up in the books of the firm which has ceased to exist. The other firm will record the transaction as that of a business purchase.

AMALGAMATION OF FIRMS

Question 1

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

Liabilities	*P & Co.* ₹	*R & Co.* ₹	*Assets*	*P & Co.* ₹	*R & Co.* ₹
Capitals:			*Fixed assets:*		

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

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

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

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

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

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

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

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

You are required to prepare the Balance Sheet of new firm and capital accounts of the partners in the books of old firms.

Answer

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

Liabilities		₹	*Assets*		₹
Capitals:			Building (₹ 1,00,000 + ₹ 60,000)		1,60,000
P	5,52,000		Plant & machinery (₹ 2,50,000+₹ 2,00,000)		4,50,000
Q	3,68,000		Office equipment (₹ 20,000+₹ 6,000)		26,000
R	1,84,000	11,04,000	Stock-in-trade (₹ 1,44,000+₹ 1,68,000)		3,12,000
Sundry creditors (1,20,000+1,16,000)		2,36,000	Sundry debtors (₹ 1,60,000+₹ 2,00,000)	3,60,000	

Bank overdraft		80,000	*Less:* Provision for doubtful debts (₹ 12,000+₹ 26,000)	(38,000)	3,22,000
			Bank balance (₹ 30,000+ ₹ 90,000)		1,20,000
			Cash in hand		30,000[*]
		14,20,000			14,20,000

In the books of P & Co.

Partners' Capital Accounts

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

In the books of R & Co.

Partners' Capital Accounts

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

Working Notes:

1. Computation of purchase considerations

	P & Co. ₹	*R & Co.* ₹
Assets:		
Goodwill	1,20,000	60,000
Building	1,00,000	60,000
Plant & machinery	2,50,000	2,00,000
Office equipment	20,000	6,000

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

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

2. Computation of proportionate capital

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

3. Computation of Capital Adjustments

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

4. In the books of P & Co.

Realisation Account

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

5. In the books of R & Co.

Realisation Account

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

SALE OF PARTNERSHIP FIRM TO A COMPANY

Question 2

'S' and 'T' were carrying on business as equal partner. Their Balance Sheet as on 31st March, 2011 stood as follows:

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

Bills payable	*62,500*	*Building*	*9,10,000*
	18,40,000		*18,40,000*

The operations of the business were carried on till 30th September, 2011. S and T both withdrew in equal amounts half the amount of profits made during the current period of 6 months after 10% per annum had been written off on building and plant and 5% per annum written off on furniture. During the current period of 6 months, creditors were reduced by ₹ 50,000, Bills payable by ₹ 11,500 and Bank overdraft by ₹ 75,000. The Joint Life policy was surrendered for ₹ 47,500 on 30th September, 2011. Stock was valued at ₹ 3,17,000 and debtors at ₹ 3,25,000 on 30th September, 2011. The other items remained the same as on 31st March, 2011.

On 30th September, 2011 the firm sold its business to ST Ltd. The value of goodwill was estimated at ₹ 5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 2011. The ST Ltd. paid the purchase consideration in equity shares of ₹ 10 each. You are required to prepare a Realization Account and Capital accounts of the partners.

Answer

Realisation Account

Particulars			₹	*Particulars*	₹
To	Sundry assets:			By Creditors	2,77,500
	Stock		3,17,000	By Bills payables	51,000
	Debtors		3,25,000	By Bank overdraft	75,000
	Plant		1,63,875	By Shares in ST Ltd. (W.N.3)	18,80,000
	Building		8,64,500		
	Furniture		73,125		
To	Profit:				
	S	2,70,000			
	T	2,70,000	5,40,000		
			22,83,500		22,83,500

Partners' Capital Accounts

Date	*Particulars*	*S*	*T*	*Date*	*Particulars*	*S*	*T*
		₹	₹			₹	₹
2011				2011			
April 1	To Cash – Drawings (W.N. 2)	20,000	20,000	April 1	By Balance b/d	6,40,000	6,60,000
Sept.	To Shares in	9,30,000	9,50,000	Sept.	By Profit	40,000	40,000

30	ST Ltd.			30		(W.N.2)		
					By	Realisation A/c (Profit)	2,70,000	2,70,000
		9,50,000	9,70,000				9,50,000	9,70,000

Working Notes:

(1) Ascertainment of total capital:

Balance Sheet as at 30th September, 2011

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

(2) Profit earned during six months to 30 September, 2011

		₹
Total capital (of S and T) on 30th September, 2011 (W.N.1)		13,40,000
Capital on 1st April, 2011		
S	6,40,000	
T	6,60,000	13,00,000
Net increase (after drawings)		40,000

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

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

(3) Purchase consideration:

	₹
Total assets (W.N.1)	17,43,500
Add: Goodwill	5,40,000

	22,83,500
Less: Liabilities (2,77,500 + 51,000 + 75,000)	(4,03,500)
Purchase consideration	18,80,000

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

CONVERSION OF PARTNERSHIP FIRM INTO A COMPANY

Question 3

Ramesh, Roshan and Rohan were partners of the firm '3R Enterprises' sharing profits and losses in the ratio of 3:2:1 respectively. On 31st March, 2011 their Balance Sheet stood as follows:

Liabilities	*₹*	*Assets*	*₹*
Ramesh's Capital A/c	*16,80,000*	*Land and Buildings*	*14,00,000*
Roshan's Capital A/c	*11,60,000*	*Machinery*	*11,00,000*
Rohan's Capital A/c	*6,70,000*	*Furniture*	*6,10,000*
General Reserve	*6,30,000*	*Stock*	*8,40,000*
Creditors	*6,00,000*	*Debtors*	*6,00,000*
		Cash at Bank	*1,90,000*
	47,40,000		*47,40,000*

On the above-mentioned date, the partners decided to convert their firm into a private limited company and named it '3R Enterprises (Private) Ltd.'. The company took over all the assets including cash at bank and all the creditors for ₹ 42,00,000 payable in the form of fully paid equity shares of ₹ 10 each. It recorded in its books, land and buildings at ₹ 16,40,000, machinery at ₹ 9,90,000 and created a provision for bad debts @ 5% on debtors. The expenses of the take-over came to ₹ 23,000 which were paid and borne by the company.

The expenses of getting the company incorporated were ₹ 57,000.

The partners distributed the company's shares amongst themselves in their profit sharing ratio. They settled their accounts by paying or receiving cash.

Prepare Realization Account and all the partners' capital accounts in the firm's ledger and pass journal entries in the books of the company for all of its transactions mentioned above.

Answer

In the books of 3R Enterprises

Realisation Account

	₹		₹
To Land and Buildings	14,00,000	By Creditors	6,00,000

To Machinery	11,00,000	By 3R Enterprises (Pvt.) Ltd. A/c	42,00,000
To Furniture	6,10,000		
To Stock	8,40,000		
To Debtors	6,00,000		
To Cash at Bank	1,90,000		
To Ramesh's capital	30,000		
To Roshan's capital	20,000		
To Rohan's capital	10,000		
	48,00,000		48,00,000

Partners' Capital Accounts

	Ramesh	*Roshan*	*Rohan*		*Ramesh*	*Roshan*	*Rohan*
	₹	₹	₹		₹	₹	₹
To Shares in 3R Enterprises (Pvt.) Ltd. A/c	21,00,000	14,00,000	7,00,000	By Balance b/d	16,80,000	11,60,000	6,70,000
				By General Reserve	3,15,000	2,10,000	1,05,000
To Bank A/c (Settlement)	-	-	85,000	By Realization A/c (Profit)	30,000	20,000	10,000
				By Bank A/c (Settlement)	75,000	10,000	-
	21,00,000	14,00,000	7,85,000		21,00,000	14,00,000	7,85,000

Journal Entries

			₹	₹
1.	Business Purchase A/c	Dr.	42,00,000	
	To M/s 3R Enterprises			42,00,000
	(Consideration payable for business purchased)			
2.	Land and Buildings A/c	Dr.	16,40,000	
	Machinery A/c	Dr.	9,90,000	
	Furniture A/c	Dr.	6,10,000	
	Stock A/c	Dr.	8,40,000	
	Debtors A/c	Dr.	6,00,000	
	Bank A/c	Dr.	1,90,000	
	To Creditors A/c			6,00,000
	To Provision for doubtful debts A/c			30,000
	To Business Purchase A/c			42,00,000
	To Capital Reserve A/c			40,000
	(Assets and liabilities taken over for ₹ 42,00,000; balance credited to capital reserve)			

3.	Capital reserve A/c	Dr.	23,000	
	To Bank A/c			23,000
	(Expenses for take over debited to capital reserve)			
4.	M/s 3R Enterprises A/c	Dr.	42,00,000	
	To Equity share capital A/c			42,00,000
	(Allotment of fully paid equity shares to discharge consideration for business)			
5.	Preliminary expenses A/c*	Dr.	57,000	
	To Bank A/c			57,000
	(Expenses incurred to get the company incorporated)			

- * As per para 56 of AS 26, preliminary expense is charged to Profit and Loss account in the year it is incurred.

4

Company Accounts

UNIT 1: ESOPS AND BUY BACK OF SHARES

BASIC CONCEPTS

- Buy back of shares can be made out of:

  (*i*) its free reserves; or

  (*ii*) the securities premium account; or

  (iii) the proceeds of any shares or other specified securities.
- No company shall purchase its own shares or other specified securities unless—
- the buy-back is or less than twenty-five per cent of the total paid-up capital and free reserves of the company:
- the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year.
- the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back:

  Explanation.—For the purposes of this clause, the expression "debt" includes all amounts of unsecured and secured debts;

➢ ESOP is an option given to whole-time directors, officers or employees of a company to purchase or subscribe the securities offered by the company at a future date, at a predetermined price.

➢ There are two methods of accounting for Employee Share Based Payments viz, the intrinsic value method or fair value method.

ESOP

Question 1

What is employee stock option plan? Explain the importance of such plans in the modern time.

Answer

Employee Stock Option Plan: It is a plan under which the enterprise grants employee stock options. Employee stock option is a contract that gives the employees of the enterprise the right, but not the obligation, for a specified period of time to purchase or subscribe the shares of the company at a fixed or determinable price.

Employee stock option plans encourage employees to have higher participation in the company. The importance of these plans is as follows:

1. Stock options provide an opportunity to employees to contribute in the growth of the company.
2. Stock option creates long term wealth in the hands of the employees.
3. They are important means to attract, retain and motivate the best available talent for the company.
4. It creates a common sense of ownership between the company and its employees.

Question 2

X Co. Ltd. has its share capital divided into equity shares of ₹ 10 each. On 1.4.2012 it granted 20,000 employees' stock option at ₹ 50 per share, when the market price was ₹ 120 per share. The options were to be exercised between 15th March, 2013 and 31st March, 2013. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal entries (with narration) as would appear in the books of the company up to 31st March, 2013.

Answer

In the books of X Co. Ltd.

Journal Entries

			₹	₹
15.03.2013	Bank A/c	Dr.	8,00,000	
to 31.3.13	Employee compensation expense A/c	Dr.	11,20,000	
	To Equity share capital A/c			1,60,000
	To Securities premium A/c			17,60,000
	(Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)			
31.3.13	Profit and Loss A/c	Dr.	11,20,000	
	To Employee compensation expenses A/c			11,20,000
	(Being transfer of employee compensation transfer to Profit and Loss Account)			

Question 3

S Ltd. grants 1,000 options to its employees on 1.4.2010 at ₹ 60. The vesting period is two and a half years. The maximum exercise period is one year. Market price on that date is ₹ 90. All the options were exercised on 31.7.2013. Journalize, if the face value of equity share is ₹ 10 per share.

Answer

Books of S Ltd.
Journal Entries

Date	*Particulars*		*Debit* ₹	*Credit* ₹
31.3.11	Employees Compensation Expense Account	Dr.	12,000	
	To Employees Stock Option Outstanding Account			12,000
	(Being compensation expense recognized in respect of 1,000 options granted to employees at discount of ₹ 30 each, amortized on straight line basis over 2½ years)			
	Profit and Loss Account	Dr.	12,000	
	To Employees Compensation Expense Account			12,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.3.12	Employees Compensation Expense Account	Dr.	12,000	
	To Employees Stock Option Outstanding Account			12,000
	(Being compensation expense recognized in respect of 1,000 options granted to employees at discount of ₹ 30 each, amortized on straight line basis over 2½ years)			
	Profit and Loss Account	Dr.	12,000	
	To Employees Compensation Expense Account			12,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.3.13	Employees Compensation Expense Account	Dr.	6,000	
	To Employees Stock Option Outstanding Account			6,000
	(Being balance of compensation expense amortized ₹ 30,000 less ₹ 24,000)			
	Profit and Loss Account	Dr.	6,000	
	To Employees Compensation Expense Account			6,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.7.13	Bank Account (₹ 60 × 1,000)	Dr.	60,000	

	Employees Stock Option Outstanding Account (₹ 30×1,000)	Dr.	30,000	
	To Equity Share Capital Account			10,000
	To Securities Premium Account			80,000
	(Being exercise of 1,000 options at an exercise price of ₹ 60)			

Working Notes:

1. Total employees compensation expense = 1,000 x (₹ 90 – ₹ 60) = ₹ 30,000
2. Employees compensation expense has been written off during 2½ years on straight line basis as under:

   I year = ₹ 12,000 (for full year)

   II year = ₹ 12,000 (for full year)

   III year = ₹ 6,000 (for half year)

Question 4

A company has its share capital divided into shares of ₹ 10 each. On 1-4-2012, it granted 5,000 employees stock option at ₹ 50, when the market price was ₹ 140. The options were to be exercised between 1-3-2013 to 31-03-2013. The employees exercised their options for 4,800 shares only; remaining options lapsed. Pass the necessary journal entries for the year ended 31-3-2013, with regard to employees' stock option.

Answer

In the books of Company
Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
1-3-13 to 31-3-13	Bank A/c	Dr.	2,40,000	
	Employees compensation expenses A/c	Dr.	4,32,000	
	To Equity Share Capital A/c			48,000
	To Securities Premium A/c			6,24,000
	(Being allotment to employees 4,800 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each)			
31-3-13	Profit and Loss account	Dr.	4,32,000	
	To Employees compensation expenses A/c			4,32,000
	(Being transfer of employees compensation expenses)			

Question 5

On 1st April, 2012, a company offered 100 shares to each of its 500 employees at ₹ 50 per share. The employees are given a year to accept the offer. The shares issued under the plan *shall be subject to lock-in on transfer for three years from the grant date. The market price of shares of the company on the grant date is ₹ 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 56 per share.*

On 31st March, 2013, 400 employees accepted the offer and paid ₹ 50 per share purchased. Nominal value of each share is ₹ 10.

Record the issue of share in the books of the company under the aforesaid plan.

Answer

Fair value of an option = ₹ 56 – ₹ 50 = ₹ 6

Number of shares issued = 400 employees x 100 shares/employee = 40,000 shares

Fair value of ESPP = 40,000 shares x ₹ 6 = ₹ 2,40,000

Vesting period = 1 month

Expenses recognized in 2010-11 = ₹ 2,40,000

Date	*Particulars*		₹	₹
31.03.2013	Bank (40,000 shares x ₹ 50)	Dr.	20,00,000	
	Employees compensation expense A/c	Dr.	2,40,000	
	To Share Capital (40,000 shares x ₹10)			4,00,000
	To Securities Premium (40,000 shares x ₹ 46)			18,40,000
	(Being option accepted by 400 employees & payment made @ ₹ 56 share)			
	Profit & Loss A/c	Dr.	2,40,000	
	To Employees compensation expense A/c			2,40,000
	(Being Employees compensation expense transferred to Profit & Loss A/c)			

BUY BACK

Question 6

What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares. Explain in brief.

Answer

As per section 77A of the Companies Act, 1956 a joint stock company has to fulfill the following conditions to buy-back its own equity shares:

(a) The buy-back is authorised by its articles.

(b) A special resolution* has been passed in general meeting of the company authorising the buy-back.

(c) The buy-back does not exceed 25% of the total paid up capital and free reserves of the company. Provided the buy–back must not exceed 25% of its total paid up equity capital in that financial year.

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

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

(f) The buy-back is made out of the free reserves (which include securities premium) or out of the proceeds of a fresh issue of any shares or other specified securities.

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

(h) The buy-back of the shares listed on any recognised stock exchange is in accordance with the regulations made by the SEBI in this behalf.

(i) 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.

Question 7

KG Limited furnishes the following summarized Balance Sheet as at 31st March, 2012.

Liabilities	*(₹ in lakhs)*	*Assets*	*(₹ in lakhs)*
Equity share capital	*1,200*	*Machinery*	*1,800*
(fully paid up shares of ₹ 10 each)		*Furniture*	*226*
Securities premium	*175*	*Investment*	*74*
General reserve	*265*	*Stock*	*600*
Capital redemption reserve	*200*	*Debtors*	*260*
Profit & loss A/c	*170*	*Cash at bank*	*740*
12% Debentures	*750*		
Sundry creditors	*745*		
Other current liabilities	*195*		
	3,700		*3,700*

On 1st April, 2012, the company announced the buy back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 75 lakhs.

* 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.

On 5th April, 2012, the company achieved the target of buy back. On 30th April, 2012 the company issued one fully paid up equity share of ₹ 10 by way of bonus for every four equity shares held by the equity shareholders.

You are required to:

(1) Pass necessary journal entries for the above transactions.

(2) Prepare Balance Sheet of KG Limited after bonus issue of the shares

Answer

In the books of KG Limited

Journal Entries

Date 2012	*Particulars*		*Dr. (₹ in lakhs)*	*Cr.*
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity shares buy back A/c	Dr.	450	
	To Bank A/c			450
	(Being the payment made on account of buy back)			
	Equity share capital A/c	Dr.	300	
	Premium payable on buy back A/c	Dr.	150	
	To Equity shares buy back A/c			450
	(Being the amount due to equity shareholders on buy back)			
April 5	General reserve A/c	Dr.	265	
	Profit and Loss A/c	Dr.	35	
	To Capital redemption reserve A/c			300
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)			
April 30	Capital redemption reserve A/c	Dr.	225	
	To Bonus shares A/c (W.N.1)			225
	(Being the utilization of capital redemption reserve to issue bonus shares)			

	Bonus shares A/c Dr.		225	
	To Equity share capital A/c			225
	(Being issue of one bonus equity share for every four equity shares held)			
	Securities premium A/c Dr.		150	
	To Premium payable on buy back A/c			150
	(Being premium payable on buy back adjusted from securities premium account)			

Balance Sheet (After buy back and issue of bonus shares)

Particulars	*Note No*	*Amount (₹ in Lakhs)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,125
(b) Reserves and Surplus	2	436
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		750
(3) Current Liabilities		
(a) Trade payables - Sundry creditors		745
(b) Other current liabilities		195
Total		3,251
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	3	2,026
(2) Current assets		
(a) Current investments		
(b) Stock		600
(c) Trade receivables		260
(d) Cash and cash equivalents (W.N. 2)		365
Total		3,251

Notes to Accounts

			₹
1.	Share Capital		
	Equity share capital (Fully paid up shares of ₹10 each)		1125

2.	Reserves and Surplus			
	General Reserve	265		
	Less: Transfer to CRR	(265)	-	
	Capital Redemption Reserve	200		
	Add: Transfer due to buy-back of shares from P/L	35		
	Transfer due to buy-back of shares from Gen. res.	265		
	Less: Utilisation for issue of bonus shares	(225)	275	
	Securities premium	175		
	Less: Adjustment for premium paid on buy back	(150)	25	
	Profit & Loss A/c	170		
	Add: Profit on sale of investment	1		
	Less: Transfer to CRR	(35)	136	436
3.	Tangible assets			
	Machinery		1800	
	Furniture		226	2026

Working Notes:

1. Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹ 225 lakhs
2. Cash at bank after issue of bonus shares

	₹ in lakhs
Cash balance as on 1st April, 2012	740
Add: Sale of investments	75
	815
Less: Payment for buy back of shares	(450)
	365

Note: In the given solution, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves also.

Question 8

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

Assets	₹	*Assets*	₹
Equity Shares of ₹ 10 Each fully paid	*12,50,000*	*Fixed Assets*	*46,50,000*
		Current Assets	*30,00,000*
Revenue reserve	*15,00,000*		
Securities Premium	*2,50,000*		

Profit & Loss Account	*1,25,000*		
Secured Loans:			
12% Debentures	*18,75,000*		
Unsecured Loans	*10,00,000*		
Current Liabilities	*16,50,000*		
Total	*76,50,000*	*Total*	*76,50,000*

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

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

Answer

Determination of Buy back of maximum no. of shares as per the Companies Act, 1956

1. Shares Outstanding Test

Particulars	*(Shares)*
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2. Resources Test

Particulars	
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000
25% of Shareholders fund (₹)	7,81,250
Buy back price per share	₹ 20
Number of shares that can be bought back (shares)	39,062

3. Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds (₹) (18,75,000+10,00,000+16,50,000)	45,25,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	22,62,500

(c)	Present equity/shareholders fund (₹)	31,25,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (31,25,000 – 2,87,500)	28,37,500*
(e)	Maximum permitted buy back of Equity (₹) [(d) – (b)]	5,75,000
(f)	Maximum number of shares that can be bought back @ ₹ 20 per share	28,750 shares

Summary statement determining the maximum number of shares to be bought back

Particulars	*Number of shares*
Shares Outstanding Test	31,250
Resources Test	39,062
Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 2012, as per the provisions of Section 77A of the Companies Act, 1956.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 1956.

Journal Entries for buy-back of shares

			Debit(₹)	*Credit (₹)*
(a)	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

* As per Section 77A of the Companies Act 1956, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Also as per the section, on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 80, utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.

Balance Sheet of M/s. Competent Ltd.
as on 31st March, 2012

			Particulars	Note No	Amount
					₹
			EQUITY AND LIABILITIES		
1			Shareholders' funds		
	(a)		Share capital	1	10,00,000
	(b)		Reserves and Surplus	2	16,25,000
2			Non-current liabilities		
	(a)		Long-term borrowings	3	28,75,000
3			Current liabilities		16,50,000
			Total		71,50,000
			ASSETS		
1			Non-current assets		
	(a)		Fixed assets		46,50,000
2			Current assets(30,00,000-5,00,000)		25,00,000
			Total		71,50,000

Notes to accounts

			₹	₹
1.	Share Capital			
	Equity share capital			
	1,00,000 Equity shares of ₹10 each			10,00,000
2.	Reserves and Surplus			
	Profit and Loss A/c		1,25,000	
	Revenue reserves	15,00,000		
	Less: Transfer to CRR	(2,50,000)	12,50,000	
	Securities premium	2,50,000		
	Less: Utilisation for share buy-back	(2,50,000)	-	
	Capital Redemption Reserves		2,50,000	16,25,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		10,00,000	28,75,000

Working Note

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$$(31{,}25{,}000 - x) - 22{,}62{,}500 = y \qquad (1)$$

$$\left(\frac{y}{20} \times 10\right) = x \qquad \text{Or} \qquad 2x = y \qquad (2)$$

by solving the above equation we get

,

x = ₹ 2,87,500

y = ₹ 5,75,000

Question 9

M Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2012 :

	₹ in '000	*₹ in '000*
Equity & Liabilities		
Share Capital:		
Authorised Capital:		*5,000*
Issued and Subscribed Capital :		
3,00,000 Equity shares of ₹ 10 each fully paid up	*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 investments at cost		*5,000*
Current assets, loans and advances (including cash and bank balances)		*4,000*
		11,750

(1) The company passed a resolution to buy back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs.

(2) The company redeemed the preference shares at a premium of 10% on 1st April, 2012.

(3) Included in its investments were 'Investments in own debentures' costing ₹ 3 lakhs (face value ₹ 3.30 lakhs). These debentures were cancelled on 1st April, 2012.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2012.

Answer

Journal Entries in the books of M Ltd.

			Dr.	*Cr.*
			₹ in '000	₹ in '000
1	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buy-back)			
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 share capital at premium of 10%)			
3	Preference shareholders A/c	Dr.	2,200	
	To Bank A/c			2,200
	(Being payment made to preference shareholders)			
4	Revenue Reserve A/c	Dr.	2,000	

	To Capital redemption reserve A/c (Refer Note)			2,000
	(Being creation of capital redemption reserve to the extent of nominal value of preference shares redeemed)			
5	Equity share capital A/c	Dr.	600	
	Securities Premium A/c (Premium payable on buy-back)	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back)			
6	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back)			
7	10% Debentures A/c	Dr.	330	
	To Own debentures A/c			300
	To Capital reserve A/c (Profit on cancellation)			30
	(Being own debentures cancelled at profit)			
8.	Securities Premium A/c	Dr.	200	
	To Premium on redemption of preference shares A/c			200
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of the M Ltd. as on 1st April, 2012

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

Notes to Accounts

			₹ in '000	*₹ in '000*
1.	Share Capital			
	Authorised share capital:			5,000
	Issued, subscribed and fully paid up share capital:			
	2,40,000 Equity shares of ` 10 each, fully paid up			2,400
	(60,000 equity shares had been bought back and cancelled during the year)			
2.	Reserves and Surplus			
	Capital Reserves	10		
	Add: Profit on cancellation of debentures	30	40	
	Securities Premium	500		
	Less: Premium on redemption of preference shares	(200)		
	Premium on buy-back of equity shares	(300)	-	
	Revenue Reserve	4,000		
	Less: Transfer to 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 investments			
	Balance as on 31.03.2012		5,000	
	Less: Investment sold		(3,000)	
	Own debentures cancelled		(300)	1,700
5	Current assets			
	Balance as on 31.03.2012		4,000	
	Add: Cash received on sale of investment		2,500	
	Less: Payment made to equity shareholders for buy back of shares		(900)	
	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.

UNIT 2 : UNDERWRITING OF SHARES AND DEBENTURES

- Underwriting contracts are basically of two types:
  - Wholly underwritten if one person is responsible to subscribe all the issue.
  - Partially underwritten, when some part of the issue is considered to be underwritten by company.
- Firm underwriting signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public.
- Underwriting Commission

  (1) No underwriting commission is payable on the shares taken up by the promoters, employees, directors, business associates, etc.

  (2) Commission is payable on the whole issue underwritten.

  (3) In case of shares, the commission paid or agreed to be paid should not exceed 5% of the price at which the shares are issued.

  (4) In case of debentures, the commission paid or agreed to be paid should not exceed 2.5% of the price at which the shares are issued.

  (5) Accounting Entries

  1. For Commission due

     Commission Account Dr.

     To Underwriter Account

  2. For payment of Commission

     Underwriter Account Dr.

     To Bank Account [Cheque]

     To Share Capital Account [Shares]

     To Debentures Account [Debentures]

- When the issue is Fully Underwritten [without Firm Underwriting]

  Method 1

  Under this method, all unmarked applications are divided between the underwriters in the ratio of gross liability of individual underwriter. For determining the liability of individual underwriter, the following steps are followed:

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- ➢ Underwriting Commission

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  (5) Accounting Entries

  2. For Commission due

     Commission Account Dr.

     To Underwriter Account

  2. For payment of Commission

     Underwriter Account Dr.

     To Bank Account [Cheque]

     To Share Capital Account [Shares]

     To Debentures Account [Debentures]

- ➢ When the issue is Fully Underwritten [without Firm Underwriting]

  Method 1

  Under this method, all unmarked applications are divided between the underwriters in the ratio of gross liability of individual underwriter. For determining the liability of individual underwriter, the following steps are followed:

  Step 1 Compute gross liability (if it has not been given) of individual underwriter on the basis of agreed ratio.

  Step 2 Subtract marked applications from gross liability of respective underwriters.

  Step 3 Determine the number of unmarked applications. (Unmarked application = Total applications received less marked applications). Divide unmarked applications between different underwriters in the ratio of gross liability. If the resultant figures are all positive or zero, then stop here. Now these figures represents the net liability of each underwriter.

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all negative figures and divide the resultant between the underwriters having positive figures in the ratio of gross liability.

Repeat Step 4 unless all figures are positive. Now these figures represent the net liability of each underwriter.

Method 2

Under this method, all unmarked applications are divided between the underwriters in the ratio of **gross liability less marked applications.** For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications from gross liability of respective underwriters, If some of the resultant figures are negative, then add all negative figures and divide their sum in the ratio of gross liability.

Step 3 Determine the number of unmarked applications. Divide unmarked applications between different underwriters in the **ratio of gross liability less marked applications**, i.e., the resultant figures of Step 2. If the resultant figures of Step 3 are **all positive** or zero, then stop here. Now these figures represent the net liability of each underwriter.

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all negative figures and divide their sum between the underwriters having positive figures in the same **ratio of Step 3.** Repeat Step 4 unless all figures are non-negative. Now these figures represents the net liability of each underwriter.

- When the Issue is Fully Underwritten [with Firm Underwriting]

There are two alternative ways:

(i) The benefit of firm underwriting is not given to individual underwriter, or

(ii) The benefit of firm underwriting is given to individual underwriter.

(i) **The benefit of firm underwriting is not given to individual Underwriter:**

For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide the resultant in the ratio of gross liability.

Step 3 Determine the number of unmarked applications as follows:

Total subscriptions (excluding firm underwriting)	******
Less: Marked applications (excluding firm underwriting)	******
Unmarked applications by public	******
Add: Applications under firm underwriting	******
Total unmarked applications	******

Divide the above calculated unmarked applications in the ratio of **gross liability.**

If the resultant figures of Step 3 are all positive or zero, then it represents **net liability** as per agreement. After this step, go to Step 5 (skip Step 4).

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all the negative figures and divide the resultant between the underwriters having positive figures in the ratio of **gross liability.** Repeat Step 4 unless all figures are non-negative. Now these figures represent the **net liability** as per agreement. After this step, to Step 5.

Step 5 Add firm underwriting with the **net liability** as per agreement. The resultant figures represent **total liability.**

Here,

(1) Firm underwriting is treated as unmarked applications and divided in the ratio of gross liability.

(2) The liability of underwriter consists of:

(a) Net liability as per agreement; and

(b) firm underwriting.

(ii) The benefit of firm underwriting is given to individual underwriter

For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide their sum in the ratio of gross liability.

Step 3 Determine the number of unmarked applications as follows:

Total subscriptions (excluding firm underwriting)	******
Less: Marked applications (excluding firm underwriting)	******
Unmarked applications by public	******

Divide the above calculated unmarked application in the ratio of gross liability.

Step 4 Subtract "firm underwriting" of individual underwriter from the respective figures of Step 3.

If the resultant figures of Step 4 are all positive or zero, then that represents net liability as per agreement. After this step, go to Step 6 (skip Step 5).

If some of the resultant figures are negative, then continue to Step 5.

Step 5 Add all negative figures and divide it between the underwriters having positive figures in the ratio of gross liability. Repeat Step 5 unless all figures are non-negative. Now these figures represent the net liability as per agreement. After this step, go to Step 6.

Step 6 Add firm underwriting with the net liability as per agreement. The resultant figures represent total liability.

Here,

(1) Firm underwriting is not treated as unmarked applications.

(2) Firm underwriting is credited to individual underwriters separately.

(3) The liability of Underwriter consists of:

(a) Net liability as per agreement; and

(b) Firm underwriting.

Question 1

"Firm" underwriting. Also give the accounting entries relating to firm underwriting in the books of: (i) the company, (ii) the underwriter

Answer

'Firm' underwriting signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him, i.e. the underwriter is obliged to take up :

1. the number of shares he has applied for 'firm'; and
2. the number of shares he is obliged to take up on the basis of the underwriting agreement.

For example, A underwrites 60% of an issue of 10,000 shares of ₹ 10 each of XY Co. Ltd. and also applies for 1,000 shares, 'firm'. The underwriting commission is agreed to at the rate of 2.5 percent. In case there are marked applications for 4,800 shares, he will have to take up 2,200 shares, i.e.

1,000 shares for which he applied 'firm' and 1,200 shares to meet his liability of underwriting contract. If, on the other hand, the underwriting contract has provided that an abatement would be allowed in respect of shares taken up 'firm', the liability of A in the above-mentioned case would only be for 1,200 shares in total. The accounting entries in relation to firm underwriting of 1,000 shares in the above example are given below :

Entries in the books of XY Co. Ltd. (Company)

			Dr. ₹	*Cr.* ₹
1.	A's Account	Dr.	10,000	
	To Equity Share Capital Account			10,000
	(Being allotment of underwritten equity shares in pursuance of firm underwriting contract, vide Board's resolution)			
2.	Underwriting Commission on Issue of Shares Account	Dr.	250	
	To A's Account			250
	(Being underwriting commission due to the underwriter under the firm underwriting contract)			
3.	Bank Account	Dr.	9,750	
	To A's Account			9,750
	(Being money received in full settlement of account from underwriter)			

Entries in the books of A (Underwriter)

			Dr. ₹	*Cr.* ₹
1.	Underwriting Account	Dr.	10,000	
	To XY Co. Ltd. Account			10,000
	(Being the liability to take up necessary number of shares of the company in pursuance of firm underwriting contract recorded)			
2.	XY Co. Ltd. Account	Dr.	250	
	To Underwriting Account			250
	(Being underwriting commission income credited to underwriting account)			
3.	XY Co. Ltd. Account	Dr.	9,750	
	To Bank Account			9,750
	(Being balance money paid to the company in full settlement of account			

Question 2

Write a short note on Firm underwriting and Partial underwriting along with firm underwriting.

Answer

In firm underwriting the underwriter agrees to subscribe upto a certain number of shares/debentures irrespective of the nature of public response to issue of securities. He gets these securities even if the issue is fully subscribed or over-subscribed. These securities are taken by the underwriter in addition to his liability for securities not subscribed by the public. Under partial underwriting along with firm underwriting, unless otherwise agreed, individual underwriter does not get the benefit of firm underwriting in determination of number of shares/debentures to be taken up by him.

Question 3

A joint stock company resolved to issue 10 lakh equity shares of ₹10 each at a premium of ₹1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @ 2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows :

X 30,000 shares, Y 20,000 shares and Z 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares.

Unmarked applications totalled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to:

(i) Prepare a statements calculating underwriters' liability for shares other than shares underwritten firm.

(ii) Pass journal entries for all the transactions including cash transactions.

Answer

(i) Statement showing underwriters' liability for shares other than shares underwritten firm

	X	*Y*	*Z*	*Total*
Gross liability (9,00,000 shares in the ratio of 65 : 25 : 10)	5,85,000	2,25,000	90,000	9,00,000

Less: Marked applications	(1,19,500)	(57,500)	(10,500)	(1,87,500)
	4,65,500	1,67,500	79,500	7,12,500
Less : Allocation of unmarked applications (including firm underwriting i.e. 7,00,000) in the ratio 65 : 25 : 10	(4,55,000)	(1,75,000)	(70,000)	(7,00,000)
	10,500	(7,500)	9,500	12,500
Surplus of Y allocated to X and Z in the ratio 65 : 10	(6,500)	7,500	(1,000)	–
	4,000	–	8,500	12,500

	₹	₹	₹
Liability amount @ ₹ 11	44,000	–	93,500
Underwriting commission payable			
(Gross liability × ₹ 11 × 2%)	(1,28,700)	(49,500)	(19,800)
Net Amount payable	(84,700)	(49,500)	-
Net Amount receivable	-	-	73,700

(ii) **Journal Entries**

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	11,00,000	
To Equity Shares Application A/c			11,00,000
(Being application money received on 1 lakh equity shares @ ₹ 11 per share)			
Bank A/c	Dr.	97,62,500	
To Equity Share Application A/c			97,62,500
(Application money received on 8,87,500 equity shares @ ₹ 11 per share from general public and underwriters for shares underwritten firm)			
Equity Share Application A/c	Dr.	1,08,62,500	
X’ s A/c	Dr.	44,000	
Z’ s A/c	Dr.	93,500	
To Equity Share Capital A/c			1,00,00,000
To Securities Premium A/c			10,00,000
(Allotment of 10 lakh equity shares of ₹ 10 each at a premium of ₹ 1 per share)			
Underwriting commission A/c	Dr.	1,98,000	

To X's A/c			1,28,700
To Y's A/c			49,500
To Z's A/c			19,800
(Amount of underwriting commission payable to X, Y and Z @ 2% on the amount of shares underwritten)			
Bank A/c	Dr.	73,700	
To Z's A/c			73,700
(Amount received from Z in final settlement)			
X's A/c	Dr.	84,700	
Y's A/c	Dr.	49,500	
To Bank A/c			1,34,200
(Amount paid to X and Y in final settlement)			

Question 4

Scorpio Ltd. came out with an issue of 45,00,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co; B & Co. and C & Co.

Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below:

	Shares
A & Co.	*7,25,000*
B & Co.	*8,40,000*
C & Co.	*13,10,000*
Total	*28,75,000*

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid alongwith application. You are required to:

(a) Compute the underwriters' liabilities (number of shares)

(b) Compute the amounts payable or due to underwriters; and

(c) Pass necessary journal entries in the books of Scorpio Ltd. relating to underwriting.

Answer

(a) Computation of liabilities of underwriters (No. of shares):

	A & Co.	B & Co.	C & Co.
Gross liability	12,00,000	12,00,000	12,00,000

Less: Firm underwriting	(1,00,000)	(1,00,000)	(1,00,000)
	11,00,000	11,00,000	11,00,000
Less: Marked applications	(7,25,000)	(8,40,000)	(13,10,000)
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked applications distributed to A & Co. and B & Co. in equal ratio	(1,12,500)	(1,12,500)	Nil
	2,62,500	1,47,500	(2,10,000)
Less: Surplus of C & Co. distributed to A & Co. and B & Co. in equal ratio	(1,05,000)	(1,05,000)	2,10,000
Net liability (excluding firm underwriting)	1,57,500	42,500	Nil
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (No. of shares)	2,57,500	1,42,500	1,00,000

(b) Computation of amounts payable by underwriters:

	₹	₹	₹
Liability towards shares to be subscribed @ 12 per share	30,90,000	17,10,000	12,00,000
Less: Commission (5% on 12 lakhs shares @ 10 each)	(6,00,000)	(6,00,000)	(6,00,000)
Net amount to be paid by underwriters	24,90,000	11,10,000	6,00,000

(c) In the Books of Scorpio Ltd.

Journal Entries

Particulars	*Dr.*	*Cr.*
	₹	₹
Underwriting commission A/c	Dr. 18,00,000	
To A & Co. A/c		6,00,000
To B & Co. A/c		6,00,000
To C & Co. A/c		6,00,000
(Being underwriting commission on the shares underwritten)		
A & Co. A/c	Dr. 30,90,000	
B & Co. A/c	Dr. 17,10,000	
C & Co. A/c	Dr. 12,00,000	
To Equity share capital A/c		50,00,000

To Share premium A/c		10,00,000
(Being shares including firm underwritten shares allotted to underwriters)		
Bank A/c	Dr. 42,00,000	
To A & Co. A/c		24,90,000
To B & Co. A/c		11,10,000
To C & Co. A/c		6,00,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)		

Question 5

Gemini Ltd. came up with public issue of 30,00,000 Equity shares of ₹ 10 each at ₹ 15 per share. A, B and C took underwriting of the issue in 3 : 2 : 1 ratio.

Applications were received for 27,00,000 shares.

The marked applications were received as under:

A	8,00,000 shares
B	7,00,000 shares
C	6,00,000 shares

Commission payable to underwriters is at 5% on the face value of shares.

(i) Compute the liability of each underwriter as regards the number of shares to be taken up.

(ii) Pass journal entries in the books of Gemini Ltd. to record the transactions relating to underwriters.

Answer

(i) Computation of liability of underwriters in respect of shares

	(In shares)		
	A	*B*	*C*
Gross liability	15,00,000	10,00,000	5,00,000
Less: Unmarked applications	(3,00,000)	(2,00,000)	(1,00,000)
	12,00,000	8,00,000	4,00,000
Less: Marked applications	(8,00,000)	(7,00,000)	(6,00,000)
	4,00,000	1,00,000	(2,00,000)
Surplus of C distributed to A & B in 3:2 ratio	(1,20,000)	(80,000)	2,00,000
Net liability	2,80,000	20,000	Nil

(ii) Journal Entries in the books of Gemini Ltd.

	₹	₹
A's Account Dr.	42,00,000	

B's Account	Dr.	3,00,000	
To Share Capital Account			30,00,000
To Securities Premium Account			15,00,000
(Being the shares to be taken up by the underwriters)			
Underwriting Commission Account	Dr.	15,00,000	
To A's Account			7,50,000
To B's Account			5,00,000
To C's Account			2,50,000
(Being the underwriting commission due to the underwriters)			
Bank Account	Dr.	34,50,000	
To A's Account			34,50,000
(Being the amount received from underwriter A for the shares taken up by him after adjustment of his commission)			
B's Account	Dr.	2,00,000	
To Bank Account			2,00,000
(Being the amount paid to underwriter B after adjustment of the shares taken by him against underwriting commission due to him)			
C's Account	Dr.	2,50,000	
To Bank Account			2,50,000
(Being the underwriting commission paid to C)			

Question 6

'X' Ltd., issued 1,00,000 equity shares of ₹10 each at par. The entire issue was underwritten as follows:

A – 60,000 shares (Firm underwriting 8,000 shares)

B – 30,000 shares (Firm underwriting 10,000 shares)

C – 10,000 shares (Firm underwriting 2,000 shares)

The total applications including firm underwriting were for 80,000 shares.

The marked applications were as follows:

A- 20,000 shares; B- 14,000 shares; C- 6,000 shares.

The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten. Determine the liability of each underwriter.

Answer

Statement showing liability of underwriters*

	No. of shares			
	A	*B*	*C*	*Total*
Gross Liability	60,000	30,000	10,000	1,00,000
Less: Firm underwriting	(8,000)	(10,000)	(2,000)	(20,000)
	52,000	20,000	8,000	80,000
Less: Marked applications	(20,000)	(14,000)	(6,000)	(40,000)
	32,000	6,000	2,000	40,000
Less: Unmarked applications (total application less firm underwriting less marked applications) in gross liability ratio (i.e. 80,000 – 20,000 –40,000)	(12,000)	(6,000)	(2,000)	(20,000)
Net Liability	20,000	-	-	20,000
Add: Firm underwriting	8,000	10,000	2,000	20,000
Total liability of underwriters	28,000	10,000	2,000	40,000

Question 7

Delta Ltd. issued 25,00,000 equity shares of ₹ 10 each at par. 7,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters P, Q & R in the ratio of 2 : 3 : 4 with firm underwriting of 50,000, 60,000 and 70,000 shares each respectively. Total subscription received 13,88,000 shares including marked application and excluding firm underwriting. Marked applications were as follows:

P 3,00,000
Q 3,50,000
R 4,50,000

Unmarked and surplus applications to be distributed in gross liability ratio.

Ascertain the liability of each underwriter.

Answer

Calculation of liability of underwriters

	(In shares)			
	P	*Q*	*R*	*Total*
Gross liability	4,00,000	6,00,000	8,00,000	18,00,000
Less: Firm underwriting	(50,000)	(60,000)	(70,000)	(1,80,000)
	3,50,000	5,40,000	7,30,000	16,20,000
Less: Marked applications received	(3,00,000)	(3,50,000)	(4,50,000)	(11,00,000)
	50,000	1,90,000	2,80,000	5,20,000

* The solution is given on the basis that 'the benefit of firm underwriting is given to individual underwriters.'

Less: Unmarked applications (In gross liability ratio 4:6:8)	(64,000)	(96,000)	(1,28,000)	(2,88,000)
Balance	(14,000)	94,000	1,52,000	2,32,000
Excess of P distributed to Q & R in ratio (3:4)	14,000	(6,000)	(8,000)	-
Net liability (other than firm underwriting)	-	88,000	1,44,000	2,32,000
Add: Firm underwriting	50,000	60,000	70,000	1,80,000
Total liability of underwriters including firm underwriting	50,000	1,48,000	2,14,000	4,12,000
Total liability in amount @ ₹ 10 each	₹ 5,00,000	₹ 14,80,000	₹ 21,40,000	₹ 41,20,000

Question 8

ABC Ltd. came up with public issue of 3,00,000 Equity Shares of ₹ 10 each at ₹ 15 per share. P, Q and R took underwriting of the issue in ratio of 3 : 2: 1 with the provisions of firm underwriting of 20,000, 14,000 and 10,000 shares respectively.

Applications were received for 2,40,000 shares excluding firm underwriting. The marked applications from public were received as under:

P - 60,000
Q - 50,000
R - 60,000
Compute the liability of each underwriter as regards the number of shares to be taken up assuming that the benefit of firm underwriting is not given to individual underwriters.

Answer

Calculation of liability of each underwriter (in shares) assuming that the benefit of firm underwriting is not given to individual underwriters

(Number of shares)

	P	*Q*	*R*	*Total*
Gross Liability	1,50,000	1,00,000	50,000	3,00,000
Less: Marked applications (excluding firm underwriting)	(60,000)	(50,000)	(60,000)	(1,70,000)
Balance	90,000	50,000	(10,000)	1,30,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(6,000)	(4,000)	10,000	-
Balance	84,000	46,000	-	1,30,000
Less: Unmarked applications including				

firm underwriting (Refer W.N.)	(57,000)	(38,000)	(19,000)	(1,14,000)
Net Liability	27,000	8,000	(19,000)	16,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(11,400)	(7,600)	19,000	-
	15,600	400	-	16,000
Add: Firm underwriting	20,000	14,000	10,000	44,000
Total Liability	35,600	14,400	10,000	60,000

Working Note:

Applications received from public	2,40,000 shares
Add: Shares underwritten firm (20,000 + 14,000 + 10,000)	44,000 shares
Total applications	2,84,000 shares
Less: Marked applications (60,000 + 50,000 + 60,000)	(1,70,000 shares)
Unmarked applications including firm underwriting	1,14,000 shares

EXERCISES

1. *Noman Ltd. issued 80,000 Equity Shares which were underwritten as follows:*

Mr. A	*48,000 Equity Shares*
Messrs B & Co.	*20,000 Equity Shares*
Messrs C Corp.	*12,000 Equity Shares*

The above mentioned underwriters made applications for 'firm' underwritings as follows:

Mr. A	*6,400 Equity Shares*
Messrs B & Co.	*8,000 Equity Shares*
Messrs C Corp.	*2,400 Equity Shares*

The total applications excluding 'firm' underwriting, but including marked applications were for 40,000 Equity Shares.

The marked Applications were as under:

Mr. A	*8,000 Equity Shares*
Messrs B & Co.	*10,000 Equity Shares*
Messrs C Corp.	*4,000 Equity Shares*

(The underwriting contracts provide that underwriters be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten)

You are required to show the allocation of liability. Workings will be considered as a part of your answer.

(**Hints**: Total liability of Mr. A - 27,200 shares, of M/s. B & Co. - 8,000 shares and C Corpn. - 4,800 shares)

UNIT 3 : REDEMPTION OF DEBENTURES

BASIC CONCEPTS

- Debenture creates a charge against some or all the assets of the company.
- Charge may be fixed or floating, depends upon the condition of issue.

Debentures may be redeemed after a fixed number of years or after a certain period has elapsed. Many debentures are issued with the notice that they may be redeemed at the option of the company within a specified period of time and at a price specified. The debentures may be redeemed in one of the four ways:

(a) By payment in lump sum at the end of a specified period of time; or

(b) By payment in annual installments;

(c) By purchasing its own debentures in the open market.

(d) By conversion into shares.

For redemption of Debentures a company shall maintain Debenture Redemption Reserve Fund

Question 1

State the guidelines of SEBI regarding issue of convertible debentures for issue of capital and disclosure requirements.

Answer

An issuer making a public issue or rights issue of convertible debt instruments shall comply with the following conditions:

(a) it has obtained credit rating from one or more credit rating agencies;

(b) it has appointed one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 and Securities and Exchange Board of India

(Debenture Trustees) Regulations, 1993;

(c) it has created debenture redemption reserve in accordance with the provisions of section 117C of the Companies Act, 1956;

(d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:

   (i) such assets are sufficient to discharge the principal amount at all times;

   (ii) such assets are free from any encumbrance;

   (iii) where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or *pari passu* charge has been obtained and submitted to the debenture trustee before the opening of the issue;

(iv) the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

The issuer shall redeem the convertible debt instruments in terms of the offer document.

Question 2

Libra Limited recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued 2,00,000; face value and issue price ₹ 100 per debenture.

(b) Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue.

(c) Date of closure of subscription lists 1.5.2010, date of allotment 1.6.2010, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion ₹ 60 (Face Value ₹ 10).

(d) Underwriting Commission 2%.

(e) No. of debentures applied for 1,50,000.

(f) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2011 (including cash and bank entries).

Answer

In the books of Libra Ltd.

Journal Entries

Date	*Particulars*		*Amount Dr.*	*Amount Cr.*
			₹	₹
1.5.2010	Bank A/c	Dr.	1,50,00,000	
	To Debenture Application A/c			1,50,00,000
	(Application money received on 1,50,000 debentures @ ₹ 100 each)			

1.6.2010	Debenture Application A/c	Dr.	1,50,00,000	
	Underwriters A/c	Dr.	50,00,000	
	To 15% Debentures A/c			2,00,00,000
	(Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)			
	Underwriting Commission	Dr.	4,00,000	
	To Underwriters A/c			4,00,000
	(Commission payable to underwriters @ 2% on ₹ 2,00,00,000)			
	Bank A/c	Dr.	46,00,000	
	To Underwriters A/c			46,00,000
	(Amount received from underwriters in settlement of account)			
30.9.2010	Debenture Interest A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Interest paid on debentures for 4 months @ 15% on ₹ 2,00,00,000)			
30.10.2010	15% Debentures A/c	Dr.	1,20,00,000	
	To Equity Share Capital A/c			20,00,000
	To Securities Premium A/c			1,00,00,0000
	(Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)			
31.3.2011	Debenture Interest A/c	Dr.	7,50,000	
	To Bank A/c			7,50,000
	(Interest paid on debentures for the half year)			

Working Note :

Calculation of Debenture Interest for the half year ended 31st March, 2011

On ₹ 80,00,000 for 6 months @ 15%	= ₹6,00,000
On ₹ 1,20,00,000 for 1 months @ 15%	= ₹ 1,50,000
	₹ 7,50,000

Question 3

Progressive Ltd. issued ₹ 10,00,000, 6% Debenture Stock at par on 21.1.2003, Interest was payable on 30th June and 31st December, in each year.

Under the terms of the Debentures Trust the owned stock is redeemable at par. The trust deed obliges the Company to pay to the trustees on 31st December, 2010 and annually thereafter the sum of ₹ 1,00,000 to be utilised for the redemption and cancellation of an equivalent amount of stock, which is to be selected by drawing lots.

Alternatively, the Company is empowered as from 1st January, 2010 to purchase its own debentures on the open market. These Debentures must be surrendered to the Trustees for cancellation and any adjustments for accrued interest recorded in the books of account. If in any year the nominal amount of the stock surrendered under this alternative does not amount to ₹ 1,00,000 then the shortfall is to be paid by the Company to the Trustees in cash on 31st December.

The following purchases of stock were made by the Company:

		Nominal value of stock purchased	Purchase price per ₹100 of stock
		₹	₹
(1)	30th September, 2010	1,20,000	98
(2)	31st May, 2011	75,000	95 (Ex-interest)
(3)	31st July, 2012	1,15,000	92

The Company fulfilled all its obligations under the trust deed.

Prepare the following Ledger Accounts :

(a) Debenture Stock A/c

(b) Debenture Redemption A/c

(c) Debenture Interest A/c

Note : *Ignore costs and taxation*

Answer

In the Books of Progressive Ltd.

Debenture Stock Account

2010		₹	2010		₹
Sept. 30	To Debenture Redemption A/c	1,20,000	Jan. 1	By Balance b/d	10,00,000
Dec. 31	To Balance c/d	8,80,000			
		10,00,000			10,00,000

2011		₹	2011		₹
May 31	To Debenture Redemption A/c	75,000	Jan. 1	By Balance b/d	8,80,000
Dec.31	To Debenture Redemption A/c	25,000			
	To Balance c/d	7,80,000			
		8,80,000			8,80,000
2012		**₹**	**2012**		**₹**
July 31	To Debenture Redemption A/c	1,15,000	Jan. 1	By Balance b/d	7,80,000
Dec.31	To Balance c/d	6,65,000			
		7,80,000			7,80,000

Debenture Redemption Account

2010		₹	2010		₹
Sept. 30	To Bank A/c (₹1,20,000×0.98 – ₹1,800)	1,15,800	Sept.30	By Debenture Stock A/c	1,20,000
	To Capital Reserve A/c	4,200			
		1,20,000			1,20,000
2011		**₹**	**2011**		**₹**
May 30	To Bank A/c (₹75,000 × 0.95)	71,250	May 31	By Debenture Stock A/c	75,000
	To Capital Reserve A/c (Profit on cancellation)	3,750	Dec. 31	By Debenture Stock A/c	25,000
Dec.31	To Bank A/c (Shortfall ₹1,00,000 – ₹75,000)	25,000			
		1,00,000			1,00,000
2012		**₹**	**2012**		**₹**
July 31	To Bank A/c (₹1,15,000 ×.92 – ₹575)	1,05,225	July 31	By Debenture Stock A/c	1,15,000
	To Capital Reserve A/c (Profit on cancellation)	9,775			
		1,15,000			1,15,000

Debenture Interest Account

2010		₹	2010		₹
June 30	To Bank A/c	30,000	Dec. 31	By Profit and Loss A/c	58,200
Sept. 30	To Bank A/c	1,800			
Dec. 31	To Bank A/c	26,400			
		58,200			58,200
2011		₹	2011		₹
May 31	To Bank A/c	1,875	Dec. 31	By Profit and Loss A/c	50,175
June 31	To Bank A/c	24,150			
Dec. 31	To Bank A/c	24,150			
		50,175			50,175
2012		₹	2012		₹
June 30	To Bank A/c	23,400	Dec. 31	By Profit and Loss A/c	43,925
July 31	To Bank A/c	575			
Dec. 31	To Bank A/c	19,950			
		43,925			43,925

Working Notes :

Interest paid on Debentures @6% per annum:

Date	*Amount of Debentures*	*Period*	*Interest*
	₹		₹
2010			
June 30	10,00,000	6 months	30,000
Sept. 30	1,20,000	3 months	1,800
Dec. 31	8,80,000	6 months	26,400
2011			
May 31	75,000	5 months	1,875
June 30	8,05,000	6 months	24,150
Dec. 31	8,05,000	6 months	24,150
2012			
June 30	7,80,000	6 months	23,400
July 31	1,15,000	1 month	575
Dec. 31	6,65,000	6 months	19,950

Notes : (1) It has been assumed that debentures are purchased for immediate cancellation.

(2) The purchases of 30th September, 2010 and 31st July, 2012 have been taken on cum-interest basis

Question 4

Pass journal entries in year 1 when ABC Co. Ltd. issued ₹ 1,00,000, 11% debentures at 95% redeemable at the end of 10th year.

(i) at 102%, and *(ii) at 98%*

Answer

ABC Co. Ltd.
Journal Entries

			Dr.	*Cr.*
			₹	₹
(i)	Bank A/c	Dr.	95,000	
	Discount on issue of debentures A/c	Dr.	5,000	
	Loss on issue of debentures A/c	Dr.	2,000	
	To 11% Debentures A/c			1,00,000
	To Premium on Redemption of debentures A/c			2,000
	(Issue of ₹ 1,00,000 11% debentures at a discount of 5% but redeemable at a premium of 2%)			
(ii)	Bank A/c	Dr.	95,000	
	Discount on issue of debentures A/c	Dr.	5,000	
	To 11% Debentures A/c			1,00,000
	(Issue of ₹ 1,00,000, 11% debentures at a discount of 5% and redeemable at discount of 2%)			

Question 5

On 1st April, 2010, in MK Ltd.'s ledger 9% debentures appeared with a opening balance of ₹ 50,00,000 divided into 50,000 fully paid debentures of ₹ 100 each issued at par.

Interest on debentures was paid half-yearly on 30th of September and 31st March every year.

On 31.5.2010, the company purchased 8,000 debentures of its own @ ₹ 98 (ex-interest) per debenture.

On 31.12.2010 it cancelled 5,000 debentures out of 8,000 debentures acquired on 31.5.2010.

On 31.1.2011 it resold 2,000 of its own debentures in the market @ ₹ 101 (ex-interest) per debenture.

You are required to prepare:

(i) Own debentures account;

(ii) Interest on debentures account; and

(iii) Interest on own debentures account.

Answer

MK Ltd.'s Ledger

(i) Own Debentures Account

		₹			₹
31.5.10	To Bank	7,84,000	31.12.10	By 9% Debentures A/c	5,00,000
31.12.10	To Capital Reserve (Profit on cancellation)	10,000	31.1.11	By Bank- Resale of 2,000 debentures	2,02,000
31.1.11	To Profit and Loss A/c (Profit on resale)	6,000	31.3.11	By Balance c/d	98,000
		8,00,000			8,00,000

(ii) Interest on Debentures Account

		₹			₹
31.5.10	To Bank (Interest for 2 months on 8,000 debentures)	12,000	31.3.11	By Profit and Loss A/c	4,38,750
30.9.10	To Interest on own debentures (Interest for 4 months on 8,000 debentures)	24,000			
30.9.10	To Bank (Interest for 6 months on 42,000 debentures)	1,89,000			
31.12.10	To Interest on own debentures (Interest for 3 months on 5,000 debentures)	11,250			
31.3.11	To Interest on own debentures (Interest for 6 months on 1,000 debentures)	4,500			
31.3.11	To Bank (Interest for 6 months on 44,000 debentures)	1,98,000			
		4,38,750			4,38,750

(iii) Interest on Own Debentures Account

		₹			₹
31.3.11	To Profit and Loss A/c	45,750	30.9.10	By Interest on Debentures A/c	24,000
			31.12.10	By Interest on Debentures A/c	11,250
			31.01.11	By Bank (interest for	6,000

					4 months on 2,000 debentures)	
			31.03.11	By	Interest on Debentures	4,500
		45,750				45,750

Working Note:

31.5.10	Acquired 8,000 Debentures @ 98 per debenture (ex-interest)		₹
	Purchase price of debenture (8,000 × ₹ 98)	=	7,84,000
	Interest for 2 months [₹ 8,00,000 × 9% × $\frac{2}{12}$]	=	12,000
30.9.10	Interest on own debentures		
	[₹ 8,00,000 × 9% × ½] less ₹12,000	=	24,000
	Interest on other debentures		
	₹ 42,00,000 × 9% × ½	=	1,89,000
31.12.10	Cancellation of 5,000 own debentures		
	Face value ₹100 less acquired at ₹ 98 = 2 × 5,000	=	10,000
31.1.11	Resale of 2,000 Debentures sold for 101 (ex-interest) acquired for ₹ 98 (ex-interest)		
	2,000 × ₹ 3 per debenture	=	6,000
31.12.10	Interest on cancelled 5,000 debentures		
	5,000 × ₹ 100 × 9% × $\frac{1}{4}$	=	11,250
31.3.11	Interest on 1,000 own debentures		
	₹ 1,00,000 × 9% × ½	=	4,500

Question 6

A company had 16,000, 12% debentures of ₹ 100 each outstanding as on 1st April, 2011, redeemable on 31st March, 2012. On that day, sinking fund was ₹ 14,98,000 represented by 2,000 own debentures purchased at the average price of ₹ 99 and 9% stocks face value of ₹ 13,20,000. The annual instalment was ₹ 56,800.

On 31st March, 2012 the investments were realized at ₹ 98 and the debentures were redeemed. You are required to write up the following accounts for the year ending 31st March 2012:

(1) 12% Debentures account

(2) Debenture redemption sinking fund account.

Answer

12% Debentures Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31st March, 2012	To Own debentures A/c	2,00,000	1st April, 2011	By Balance b/d	16,00,000
	To Bank A/c	14,00,000			
		16,00,000			16,00,000

Debenture Redemption Sinking Fund Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31st March, 2012	To 9% Stock A/c (loss) (W.N.5)	6,400	1st April, 2012	By Balance b/d	14,98,000
	To General reserve A/c (Bal.fig.)	16,93,200	31st March, 2012	By Profit and loss A/c	56,800
				By Interest on sinking fund A/c (W.N.3)	1,42,800
				By Own debentures A/c (W.N.4)	2,000
		16,99,600			16,99,600

Working Notes:

1. Amount of stock as on 1st April, 2011

	₹
Sinking fund balance as on 1st April, 2011	14,98,000
Less: Own debentures	(1,98,000)
	13,00,000

2. Sales value of 9% stock

= Face value / ₹ per stock

= ₹ 13,20,000 / ₹ 100 = 13,200 stock

Sales value = 13,200 stock x ₹ 98 per stock

= ₹ 12,93,600

3. Interest credited to Sinking Fund

(i) Interest on 9% stock (₹ 13,20,000 x 9%) ₹ 1,18,800

(ii) Interest on own debentures (2,000 Debentures x ₹ 100 x 12%) ₹ 24,000

₹ 1,42,800

4. Own Debentures Account

		₹			₹
1st April, 2011	To Balance b/d	1,98,000	31st March, 2012	By 12% Debentures A/c	2,00,000
31st March, 2012	To Sinking fund A/c	2,000			
		2,00,000			2,00,000

5. 9% Stock Account

		₹			₹
1st April, 2011	To Balance b/d (Face value ₹ 13,20,000) (W.N.1)	13,00,000	31st March, 2012	By Bank account (W.N.2)	12,93,600
				By Sinking fund (loss on sales)	6,400
		13,00,000			13,00,000

Question 7

Following is the extract of the Balance Sheet of S.T.B. Ltd. a listed company as at March 31, 2012:

Authorised Capital:	₹
40,000, 12% Preference shares of ₹ 10 each	*4,00,000*
4,00,000, Equity shares of ₹ 10 each	*40,00,000*
	44,00,000
Issued and Subscribed Capital:	
32,000, 12% Preference shares of ₹ 10 each fully paid	*3,20,000*
3,60,000 Equity shares of ₹ 10 each fully paid-up	*36,00,000*
Reserves and Surplus	
Revaluation reserves	*80,000*
General reserves	*5,00,000*
Capital reserve	*3,00,000*
Securities premium	*1,00,000*
Profit & Loss (Cr.)	*7,00,000*
Secured Loan:	
12% partly convertible debentures @ ₹ 100 each	*20,00,000*

On April 30, 2012, the company decided to capitalise its reserves by way of Bonus at the rate 1:4. Securities premium of ₹ 1,00,000 includes a premium of ₹ 20,000 for shares issued pursuant to a scheme of amalgamation. Capital reserve includes ₹ 1,60,000, being profit on sale of Plant and Machinery. 20% of 12% Debentures are convertible into Equity shares of ₹ 10 each fully paid on April 30, 2012.

State with reason on the following:

(i) Whether Revaluation Reserve be capitalised?

(ii) How much amount of Capital reserve can be capitalised?

(iii) How much amount of 'Securities Premium A/c' can be capitalised?

(iv) Are the convertible debentureholders entitled to Bonus shares?

(v) The minimum number of Equity shares to be issued by way of Bonus as on 30th April, 2012.

(vi) What should be the minimum amount of authorised capital, if the decision to issue Bonus shares gets implemented?

Answer

(i) As per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 "Reserves created by Revaluation of fixed assets cannot be capitalized."

(ii) As per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, 'Capital Reserve' realized in cash can be utilized for issue of fully paid Bonus shares. Therefore, ₹ 1,60,000 being profit on sale of plant, is a capital profit which has been realized in cash, can be utilized for issue of the bonus shares. For remaining balance in capital reserve account no further details of its constituent have been given. Therefore, no comment on it can be made.

(iii) As per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, Securities Premium collected in cash only can be utilized for Bonus issue; therefore i.e. (₹ 1,00,000 – ₹ 20,000) ₹ 80,000 can be utilized for Bonus issue.

(iv) As per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, no company can issue bonus shares to its shareholders without extending similar benefit to convertible debentureholders. Pending such conversion, necessary number of shares should be earmarked for convertible debentureholders. Therefore, convertible debentureholders are also entitled to the bonus shares in the same ratio as the equity shareholders.

(v) Minimum number of Equity shares to be issued as bonus shares

Issue of Bonus Shares to Equity Shareholders	90,000 Shares
Number of bonus shares to be issued after conversion $\left(\frac{20{,}00{,}000 \times 20\%}{10}\right) \times \frac{1}{4}$	10,000 Shares
Total bonus issue through equity shares	1,00,000 Shares

(vi) Minimum Authorised Share Capital

	Shares	₹
Equity share capital		
Existing Equity Shares	3,60,000	36,00,000
Bonus to Equity Shareholders	90,000	9,00,000
20% conversion of 12% Debentures	40,000	4,00,000
Bonus shares to be issued to Debentureholders after conversion	10,000	1,00,000
Authorised Equity Share Capital	5,00,000	50,00,000
Preference share capital		
12% Preference Shares	40,000	4,00,000
Minimum Authorised Capital	5,40,000	54,00,000

Question 8

The following balances appeared in the books of Paradise Ltd on 1-4-2011:

(i) 12 % Debentures ₹ 7,50,000

(ii) Balance of Sinking Fund ₹ 6,00,000

(iii) Sinking Fund Investment 6,00,000 represented by 10% ₹ 6,50,000 secured bonds of government of India.

Annual contribution to the Sinking Fund was ₹ 1,20,000 made on 31st March each year. On 31-3-2012, balance at bank was ₹ 3,00,000 before receipt of interest. The company sold the investment at 90% of cost, for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st march, 2012:

(1) Debentures Account

(2) Sinking Fund Account

(3) Sinking Fund Investment Account

(4) Bank Account

(5) Debenture Holders Account

Answer

1. 12% Debentures Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31st March, 2012	To Debenture holders A/c	7,50,000	1st April, 2011	By Balance b/d	7,50,000
		7,50,000			7,50,000

2. Sinking Fund Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31st March, 2012	To 10% Sec. Bond A/c (loss)	15,000	1st April, 2011	By Balance b/d	6,00,000
31st March, 2012	To General reserve A/c (Bal.fig.)	7,70,000	31st March, 2012	By Profit and loss A/c	1,20,000
				By Interest on sinking fund A/c (Interest on 10% stock (₹ 6,50,000 x 10%)	65,000
		7,85,000			7,85,000

3. 10% Secured Bonds of Govt. (Sinking Fund Investment) A/c

		₹			₹
1st April, 2011	To Balance b/d	6,00,000	31st March, 2012	By Bank A/c (6,50,000 x 90% = 5,85,000)	5,85,000
				By Sinking Fund A/c	15,000
		6,00,000			6,00,000

4. Bank A/c

		₹			₹
31st March, 2012	To Balance b/d	3,00,000	31st March, 2012	By 12% Debenture	8,25,000
	To Interest	65,000		By Balance c/d	1,25,000
	To Sinking fund Investment A/c	5,85,000			
		9,50,000			9,50,000

5. Debenture holders A/c

		₹			₹
31st March, 2012	To Bank A/c	8,25,000	31st March, 2012	By 12% Debentures	7,50,000
				By Premium on redemption of debentures	75,000
		8,25,000			8,25,000

Question 9

A Company had issued 20,000, 13% Convertible debentures of ₹ 100 each on 1st April, 2010. The debentures are due for redemption on 1st July, 2012. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debentureholders to convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share.

Debentureholders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debentureholders exercising the option to the maximum.

Answer

Calculation of number of equity shares to be allotted

	Number of debentures
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	(2,500)
Debenture holders opted for conversion	17,500
Option for conversion	20%
Number of debentures to be converted (20% of 17,500)	3,500
Redemption value of 3,500 debentures at a premium of 5% [3,500 x (100+5)]	₹ 3,67,500
Equity shares of ₹ 10 each issued on conversion [₹ 3,67,500/ ₹ 15]	24,500 shares

Question 10

Rama Limited issued 8% Debentures of ₹ 3,00,000 in earlier year on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase its own debentures in the open market for cancellation thereof. The following purchases were made during the financial year 2011-12 and cancellation made on 31st March, 2012:

(a) On 1st April, ₹ 50,000 nominal value debentures purchased for ₹ 49,450, ex-interest.

(b) On 1st September, ₹ 30,000 nominal value debentures purchased for ₹ 30,250 cum interest.

Show the Journal Entries for the transactions held in the year 2011-12.

Answer

In the books of Rama Limited

Journal Entries

			Dr. (₹)	*Cr. (₹)*
1st April, 2011	Own debentures A/c	Dr.	49,450	
	To Bank A/c			49,450
	(Being own debentures purchased ex- interest)			
1st Sept. 2011	Own debentures A/c	Dr.	29,250	
	Interest on own debentures A/c	Dr.	1,000	
	$[30,000 \times 8\% \times \frac{5}{12}]$			
	To Bank A/c			30,250
	(Being own debentures purchased cum- interest)			

30th Sept. 2011	Interest on debentures A/c Dr. To Bank A/c To Interest on own debentures A/c (Being interest @ 8% paid on ₹ 2,20,000 & adjustment of interest on ₹ 50,000 & ₹ 30,000 own debentures)	12,000	 8,800 3,200
31st March, 2012	Interest on debentures A/c Dr. To Bank A/c To Interest on own debentures A/c (Being interest @ 8% paid on ₹ 2,20,000 & adjustment of interest on ₹ 80,000 own debentures for 6 month)	12,000	 8,800 3,200
31st March, 2012	8% Debentures A/c Dr. To Own debentures A/c To Profit on cancellation of Debentures A/c (Being cancellation of own debentures)	80,000	 78,700 1,300
31st March, 2012	Interest on own debentures A/c Dr. To Profit and Loss A/c (3,200+3,200-1,000) (Being total interest paid on own debentures credited to P/L A/c)	5,400	 5,400
31st March, 2012	Profit and Loss A/c (12,000+12,000) Dr. To Interest on debentures A/c (Being total interest paid on debentures transferred to P/L A/c)	24,000	 24,000
31st March, 2012	Profit on cancellation of debentures A/c Dr. To Capital reserve A/c (Being profit on cancellation of debentures transferred to Capital Reserve A/c)	1,300	 1,300

Question 11

Himalayas Ltd. had ₹ 10,00,000, 8% Debentures of ₹ 100 each as on 31st March, 2011. The company purchased in the open market following debentures for immediate cancellation:

On 01-07-2011 – 1,000 debentures @ ₹ 97 (cum interest)

On 29-02-2012 – 1,800 debentures @ ₹ 99 (ex interest)

Debenture interest due date is 30th September and 31st March.

Give Journal Entries in the books of the company for the year ended 31st March, 2012.

Answer

In the books of Himalayas Ltd.
Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
1.07.2011	Own Debentures A/c	Dr.	95,000	
	Debenture Interest Account A/c [1,000×100×8%× (3/12)]	Dr.	2,000	
	To Bank A/c			97,000
	(Being 1,000 Debentures purchased @ ₹ 97 cum interest for immediate cancellation)			
1.07.2011	8% Debentures A/c	Dr.	1,00,000	
	To Own Debentures A/c			95,000
	To Capital reserve A/c (Profit on cancellation of debentures)			5,000
	(Being profit on cancellation of 1,000 Debentures transferred to capital reserve account)			
30.09.2011	Debenture interest A/c [9,000 × 100 × 8% × (1/2)]	Dr.	36,000	
	To Debenture holders A/c			36,000
	(Being interest accrued on 9,000 debentures and credited to debenture holders account)			
	Debentureholders A/c	Dr.	36,000	
	To Bank A/c			36,000
	(Being interest amount paid)			
29.02.2012	Own Debentures A/c	Dr.	1,78,200	
	Debenture Interest Account A/c [1,800 × 100 × 8% × (5/12)]	Dr.	6,000	
	To Bank A/c			1,84,200
	(Purchase of 1,800 Debentures @ ` 99 ex interest for immediate cancellation)			
29.02.2012	8% Debentures A/c	Dr.	1,80,000	
	To Own Debentures A/c			1,78,200

	To Capital reserve A/c (Profit on cancellation of debentures)			1,800
	(Being profit on cancellation of 1,800 Debentures transferred to capital reserve account)			
31.03.2012	Debentures Interest A/c	Dr.	28,800	
	[7,200 × 100 × 8% × (1/2)]			
	To Debentureholders A/c			28,800
	(Being interest accrued on 7,200 debentures and credited to debenture holders account)			
31.3.2012	Debentureholders A/c	Dr.	28,800	
	To Bank A/c			28,800
	(Being amount paid)			
31.03.2012	Profit and Loss A/c	Dr.	72,800	
	To Debentures Interest A/c			72,800
	(Being interest on debentures for the year transferred to profit and loss account at the year end)			

UNIT 4 : AMALGAMATION AND RECONSTRUCTION

BASIC CONCEPTS

INTERNAL RECONSTRUCTION

- Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
- Reconstruction account is a new account opened to transfer the sacrifice made by the shareholders for that part of capital which is not represented by lost assets.
- Reconstruction account is utilized for writing-off fictitious and intangible assets, writing down over-valued fixed assets, recording new liability etc.
- If some credit balance remains in the reconstruction account, the same should be transferred to the capital reserve account.
- Methods of Internal reconstruction :
  - Alteration of share capital :
    - Sub-divide or consolidate shares into smaller or higher Denomination
    - Conversion of share into stock or vice-versa
  - Variation of shareholders' rights :
    - Only the specific rights are changed. There is no change in the amount of capital.
  - Reduction of share capital
  - Compromise, arrangements etc.
  - Surrender of Shares.

AMALGAMATION

- Amalgamation means joining of two or more existing companies into one company, the joined companies lose their identity and form themselves into a new company.
- In absorption, an existing company takes over the business of another existing company. Thus, there is only one liquidation and that is of the merged company.
- A company which is merged into another company is called a transferor company or a vendor company.

- A company into which the vendor company is merged is called transferee company or vendee company or purchasing company.
- In amalgamation in the nature of merger there is genuine pooling of:
  - Assets and liabilities of the amalgamating companies,
  - Shareholders' interest, Also the business of the transferor company is intended to be carried on by the transferee company.
- In amalgamation in the nature of purchase, one company acquires the business of another company.
- Purchase Consideration can be defined as the aggregate of the shares and securities issued and the payment made in form of cash or other assets by the transferee company to the share holders of the transferor company.
- There are two main methods of accounting for amalgamation:
  - The pooling of interests method, and
  - The purchase method.
- Under pooling of interests method, the assets, liabilities and reserves of the transferor company will be taken over by transferee company at existing carrying amounts.
- Under purchase method, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

<u>AMALGAMATION</u>

Question 1

Exe Limited was wound up on 31.3.2011 and its Balance Sheet as on that date was given below:

Balance Sheet of Exe Limited as on 31.3.2011

Liabilities	₹	*Assets*			₹
Share capital:		*Fixed assets*			*9,64,000*
1,20,000 Equity shares of ₹10 each	*12,00,000*	*Current assets:* *Stock*		*7,75,000*	
Reserves and surplus:		*Sundry debtors*	*1,60,000*		
Profit prior to incorporation	*42,000*	*Less: Provision for bad and doubtful debts*	*(8,000)*	*1,52,000*	
Contingency reserve	*2,70,000*	*Bills receivable*		*30,000*	
Profit and loss A/c	*2,52,000*	*Cash at bank*		*3,29,000*	*12,86,000*
Current liabilities:					

Bills payable	*40,000*				
Sundry creditors	*2,26,000*				
Provisions:					
Provision for income tax	*2,20,000*				
	22,50,000				*22,50,000*

Wye Limited took over the following assets at values shown as under:

Fixed assets ₹12,80,000, Stock ₹7,70,000 and Bills Receivable ₹30,000.

Purchase consideration was settled by Wye Limited as under:

₹ 5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of ₹100 each. The balance was settled by issuing equity shares of ₹10 each at ₹ 8 per share paid up.

Sundry debtors realised ₹ 1,50,000. Bills payable was settled for ₹38,000. Income tax authorities fixed the taxation liability at ₹2,22,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹ 8,000.

You are required to:

(i) *Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.*

(ii) *Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limited account in the books of Exe Limited.*

(iii) *Pass journal entries in the books of Wye Limited.*

Answer

(i) Purchase consideration

	₹
Fixed assets	12,80,000
Stock	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares = ₹ 5,10,000

No. of preference shares to be allotted $= \dfrac{5,10,000}{100} = 5,100$ shares

Amount discharged by allotment of equity shares = ₹ 20,80,000 – ₹ 5,10,000

= ₹ 15,70,000

Paid up value of equity share = ₹ 8

Hence, number of equity shares to be issued $= \frac{15,70,000}{8}$ = 1,96,250 shares

(ii) Realisation Account

In the books of Exe Ltd.

		₹			₹
To	Fixed assets	9,64,000	By	Provision for bad and doubtful debts	8,000
To	Stock	7,75,000	By	Bills payable	40,000
To	Sundry debtors	1,60,000	By	Sundry creditors	2,26,000
To	Bills receivable	30,000	By	Provision for taxation	2,20,000
To	Bank account:		By	Wye Ltd. account	
	Liquidation expenses	8,000		(Purchase consideration)	20,80,000
	Bills payable	38,000	By	Bank account: Sundry debtors	1,50,000
	Tax liability	2,22,000			
	Sundry creditors	2,11,000			
To	Equity shareholders (profit transferred)	3,16,000			
		27,24,000			27,24,000

Cash/Bank Account

		₹			₹
To	Balance b/d	3,29,000	By	Realisation account:	
To	Realisation account:			Liquidation expenses	8,000
	Sundry debtors	1,50,000		Bills payable	38,000
				Tax liability	2,22,000
				Sundry creditors (Bal.fig.)	2,11,000
		4,79,000			4,79,000

Equity Shareholders Account

		₹			₹
To	10% Preference shares in Wye Ltd.	5,10,000	By	Equity share capital account	12,00,000
			By	Profit prior to incorporation	42,000
To	Equity shares in Wye Ltd.	15,70,000	By	Contingency reserve	2,70,000
			By	Profit and loss account	2,52,000
			By	Realisation account (Profit)	3,16,000
		20,80,000			20,80,000

Wye Limited Account

	₹		₹
To Realisation account	20,80,000	By 10% Preference shares in Wye Ltd.	5,10,000
		By Equity shares in Wye Ltd.	15,70,000
	20,80,000		20,80,000

(iii) Journal Entries

in the books of Wye Ltd.

Particulars		*Dr.*	*Cr.*
		Amount	*Amount*
		₹	₹
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			
Fixed assets account	Dr.	12,80,000	
Stock account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account	Dr.	20,80,000	
To 10% Preference share capital account			5,10,000
To Equity share capital account			15,70,000
(Being the allotment of 10% fully paid up preference shares and equity shares of ₹ 10 each, ₹ 8 each paid up as per agreement for discharge of purchase consideration)			

Question 2

Following is the summarized Balance Sheet as at March 31, 2012:

					(₹ '000)
Liabilities	*Max Ltd.*	*Mini Ltd.*	*Assets*	*Max Ltd.*	*Mini Ltd.*
Share capital:			*Goodwill*	*20*	–

Equity shares of ₹ 100 each	*1,500*	*1,000*	*Other fixed assets*	*1,500*	*760*
9% Preference shares of ₹ 100 each	*500*	*400*	*Debtors*	*651*	*440*
			Stock	*393*	*680*
General reserve	*180*	*170*	*Cash at bank*	*26*	*130*
Profit and loss account	*–*	*15*	*Own debenture*		
12% Debentures of ₹ 100 each	*600*	*200*	*(Nominal value ₹ 2,00,000)*	*192*	
Sundry creditors	*415*	*225*	*Discount on issue of debentures*	*2*	
			Profit and loss account	*411*	
	3,195	*2,010*		*3,195*	*2,010*

On 1.4.2012, Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of ₹ 10 each fully paid up. 50% of the equity share capital would be surrendered to the Company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.

(iii) Own debentures of ₹ 80,000 were sold at ₹ 98 cum-interest and remaining own debentures were cancelled.

(iv) Debentureholders of ₹ 2,80,000 agreed to accept one machinery of book value of ₹ 3,00,000 in full settlement.

(v) Creditors, debtors and stocks were valued at ₹ 3,50,000, ₹ 5,90,000 and ₹ 3,60,000 respectively. The goodwill, discount on issue of debentures and Profit and Loss (Dr.) are to be written off.

(vi) The Company paid ₹ 15,000 as penalty to avoid capital commitments of ₹ 3,00,000.

On 2.4.2012 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of ₹ 10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of ₹ 100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of ₹ 100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2012

Answer

In the Books of Max Ltd.

	Particulars		Dr.	Cr.
01.04.2012			Amount	Amount
			₹	₹
	Equity share capital A/c	Dr.	15,00,000	
	To Equity share capital A/c			15,00,000
	(Being sub-division of one share of ₹ 100 each into 10 shares of ₹ 10 each)			
	Equity share capital A/c	Dr.	7,50,000	
	To Capital reduction A/c			7,50,000
	(Being reduction of capital by 50%)			
	Capital reduction A/c	Dr.	13,500	
	To Bank A/c			13,500
	(Being payment in cash of 10% of arrear of preference dividend)			
	Bank A/c	Dr.	78,400	
	To Own debentures A/c			76,800
	To Capital reduction A/c			1,600
	(Being profit on sale of own debentures transferred to capital reduction A/c)			
	12% Debentures A/c	Dr.	1,20,000	
	To Own debentures A/c			1,15,200
	To Capital reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			
	12% Debentures A/c	Dr.	2,80,000	
	Capital reduction A/c	Dr.	20,000	
	To Machinery A/c			3,00,000
	(Being machinery taken up by debentureholders for ₹ 2,80,000)			
	Creditors A/c	Dr.	65,000	
	Capital reduction A/c	Dr.	29,000	
	To Debtors A/c			61,000
	To Stock A/c			33,000
	(Being assets and liabilities revalued)			

	Capital reduction A/c	Dr.	4,33,000	
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	(Being the balance of capital reduction transferred to capital reserve account)			
	Capital reduction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being penalty paid for avoidance of capital commitments)			
	Capital reduction A/c	Dr.	2,45,900	
	To Capital reserve A/c			2,45,900
	(Being penalty paid for avoidance of capital commitments)			
02.04.2012	Business Purchase A/c	Dr.	13,20,000	
	To Liquidators of Mini Ltd.			13,20,000
	(Being the purchase consideration payable to Mini Ltd.)			
	Fixed Assets A/c	Dr.	7,60,000	
	Stock A/c	Dr.	6,80,000	
	Debtors A/c	Dr.	4,40,000	
	Cash at Bank A/c	Dr.	1,30,000	
	To Sundry Creditors A/c			2,25,000
	To 12% Debentures A/c of Mini Ltd.			2,00,000
	To Profit and Loss A/c			15,000
	To General reserve A/c ₹ (1,70,000+80,000*)			2,50,000
	To Business purchase A/c			13,20,000
	(Being the take over of all assets and liabilities of Mini Ltd. by Max Ltd.)			
	Liquidators of Mini Ltd. A/c	Dr.	13,20,000	
	To Equity Share Capital			10,00,000
	To 9% Preference share capital			3,20,000
	(Being the purchase consideration discharged)			
	12% Debentures of Mini Ltd. A/c	Dr.	2,00,000	
	To 12% Debentures A/c			2,00,000
	(Being Max Ltd. issued their 12% Debentures in against of every Debentures of Mini Ltd.)			

* ₹ 80,000 is the balancing figure adjusted to general reserve A/c as per AS 14 "Accounting for Amalgamation".

Balance Sheet of Max Ltd. as at 2.4.2012

Particulars	Note No	Amount(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	25,70,000
(b) Reserves and Surplus	2	6,90,900
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		4,00,000
(3) Current Liabilities		
(a) Trade payables		5,75,000
Total		42,35,900
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets		19,60,000
(2) Current assets		
(a) Inventories		10,40,000
(b) Trade receivables		10,30,000
(c) Cash and cash equivalents		2,05,900
Total		42,35,900

Notes to Accounts

			₹
1	Share Capital		
	Equity Share Capital		17,50,000
	9% Preference share capital		8,20,000
			25,70,000
2	Reserves and Surplus		
	Profit and Loss A/c		15,000
	General Reserve		
	Share Capital of Mini Ltd. (Equity + Preference)	14,00,000	
	Less: Share Capital issued by Max Ltd.	13,20,000	
	General reserve (resulted due to absorption)	80,000	
	Add: General reserve of Mini Ltd.	1,70,000	
	General reserve of Max Ltd.	1,80,000	4,30,000
	Capital Reserve		2,45,900
			6,90,900

Working Note:

Purchase Consideration

Equity share capital $10{,}000 \times \frac{50}{5} \times ₹\,10$ = 10,00,000

9% Preference share capital $4{,}000 \times \frac{4}{5} \times 100$ = 3,20,000

₹ 13,20,000

Question 3

Ram Limited and Shyam Limited carry on business of a similar nature and it is agreed that they should amalgamate. A new company, Ram and Shyam Limited, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. On 31st March 2011 the Balance Sheets of the two companies were as under:

Ram Limited
Balance Sheet as at 31st March, 2011

Liabilities	*₹*	*Assets*	*₹*
Issued and Subscribed		*Freehold Property, at cost*	*2,10,000*
Share capital:		*Plant and Machinery, at cost less*	
30,000 Equity shares of ₹10		*depreciation*	*50,000*
each, fully paid	*3,00,000*	*Motor Vehicles, at cost*	
General Reserve	*1,60,000*	*less depreciation*	*20,000*
Profit and Loss Account	*40,000*	*Stock*	*1,20,000*
Sundry Creditors	*1,50,000*	*Debtors*	*1,64,000*
		Cash at Bank	*86,000*
	6,50,000		*6,50,000*

Shyam Limited
Balance Sheet as at 31st March, 2011

Liabilities	*₹*	*Assets*	*₹*
Issued and Subscribed		*Freehold Property, at cost*	*1,20,000*
Share Capital:		*Plant and Machinery, at cost less*	
16,000 Equity shares of ₹10		*depreciation*	*30,000*
each, fully paid	*1,60,000*	*Stock*	*1,56,000*

Profit and Loss Account	*40,000*	*Debtors*	*42,000*
6% Debentures	*1,20,000*	*Cash at Bank*	*36,000*
Sundry Creditors	*64,000*		
	3,84,000		*3,84,000*

Assets and Liabilities are to be taken at book-value, with the following exceptions:

(a) Goodwill of Ram Limited and of Shyam Limited is to be valued at ₹ 1,60,000 and ₹ 60,000 respectively.

(b) Motor Vehicles of Ram Limited are to be valued at ₹ 60,000.

(c) The debentures of Shyam Limited are to be discharged by the issue of 6% Debentures of Ram and Shyam Limited at a premium of 5%.

(d) The debtors of Shyam Ltd. realized fully and bank balance of Shyam Ltd, are to be retained by the liquidator and the sundry creditors of Shyam Ltd. are to be paid out of the proceeds thereof.

You are required to:

(i) Compute the basis on which shares in Ram and Shyam Limited will be issued to the shareholders of the existing companies assuming that the nominal value of each share in Ram and Shyam Limited is ₹ 10.

(ii) Draw up a Balance Sheet of Ram and Shyam Limited as of 1st April, 2011, the date of completion of amalgamation.

(iii) Write up journal entries, including bank entries, for closing the books of Shyam Limited.

Answer

Calculation of Purchase consideration

	Ram Ltd.	*Shyam Ltd.*
Purchase Consideration:	*₹*	*₹*
Goodwill	1,60,000	60,000
Freehold property	2,10,000	1,20,000
Plant and Machinery	50,000	30,000
Motor vehicles	60,000	-
Stock	1,20,000	1,56,000
Debtors	1,64,000	-
Cash at Bank	86,000	-
	8,50,000	3,66,000

Less: Liabilities:		
6% Debentures (1,20,000 x 105%)	-	(1,26,000)
Sundry Creditors	(1,50,000)	-
Net Assets taken over	7,00,000	2,40,000
To be satisfied by issue of shares of Ram and Shyam Ltd. @ ₹10 each	70,000	24,000

Balance Sheet Ram & Shyam Ltd. as at 1st April,2011

			Particulars	*Note No*	*Amount*
					₹
			EQUITY AND LIABILITIES		
1			Shareholders' funds		
	(a)		Share capital	1	9,40,000
	(b)		Reserves and Surplus	2	6,000
2			Non-current liabilities		
	(a)		Long-term borrowings	3	1,20,000
3			Current liabilities		
	(a)		Trade payables		1,50,000
			Total		12,16,000
			ASSETS		
1			Non-current assets		
	(a)		Fixed assets		
		i	Tangible assets	4	4,70,000
		ii	Intangible assets	5	2,20000
2			Current assets		
	(a)		Inventories(1,20,000+1,56,000)		2,76,000
	(b)		Trade receivables		1,64,000
	(c)		Cash and cash equivalents		86,000
			Total		12,16,000

Notes to accounts

		₹	₹
1.	Share Capital		
	Equity share capital		
	94,000 shares of ₹10 each	9,40,000	

2.	**Reserves and Surplus**		
	Securities Premium A/c (W.N.)	6,000	
3.	**Long-term borrowings**		
	Secured		
	6% Debentures	1,20,000	
4.	**Tangible assets**		
	Freehold property		
	Ram Ltd.	2,10,000	
	Shyam Ltd.	1,20,000	3,30,000
	Plant and Machinery		80,000
	Ram Ltd.	50,000	
	Shyam Ltd.	30,000	
	Motor vehicles Ram Ltd.		60,000
			4,70,000
5.	**Intangible assets**		
	Goodwill		
	Ram Ltd.	1,60,000	
	Shyam Ltd.	60,000	2,20,000

In the books of Shyam Ltd.
Journal Entries

			₹	₹
1.	Realisation A/c	Dr.	3,48,000	
	To Freehold Property			1,20,000
	To Plant and Machinery			30,000
	To Stock			1,56,000
	To Debtors			42,000
	(Being all assets except cash transferred to Realisation Account)			
2.	6% Debentures A/c	Dr.	1,20,000	
	Sundry Creditors A/c	Dr.	64,000	
	To Realisation A/c			1,84,000
	(Being all liabilities transferred to Realisation Account)			
3.	Equity Share Capital A/c	Dr.	1,60,000	
	Profit and Loss A/c	Dr.	40,000	

	To Realisation A/c (Being equity transferred to equity shareholders account)		2,00,000
4.	Ram and Shyam Ltd. Dr. To Realisation A/c (Being purchase consideration due)	2,40,000	 2,40,000
5.	Bank A/c Dr. To Realisation A/c (Being cash realized from debtors in full)	42,000	 42,000
6.	Realisation A/c Dr. To Bank A/c (Being payment made to creditors)	64,000	 64,000
7.	Shares in Ram and Shyam Ltd. Dr. To Ram and Shyam Ltd. (Being purchase consideration received in the form of shares of Ram and Shyam Ltd.)	2,40,000	 2,40,000
8.	Realisation A/c Dr. To Equity shareholders A/c (Being profit on Realisation account transferred to shareholders account)	54,000	 54,000
9.	Equity shareholders A/c Dr. To Shares in Ram and Shyam Ltd. To Bank A/c (Being final payment made to shareholders)	2,54,000	 2,40,000 14,000

Working Note:

Calculation of Securities Premium balance

Debentures issued by Ram and Shyam Ltd. to Shyam Ltd. at 5% premium

Therefore, securities premium account will be credited with (₹ 1,20,000 x 5%) ₹ 6,000.

Question 4

Following are the summarized Balance Sheet of Companies K Ltd. and W Ltd., as at 31-12-2011 :

Liabilities	*(₹ in '000)*		*Assets*	*(₹ in '000)*	
	K Ltd.	*W Ltd.*		*K Ltd.*	*W Ltd.*
Share Capital :			*Goodwill*	*20*	*-*
Equity shares of ₹ 100 each	*2,000*	*1,500*	*Other Fixed Assets*	*2,400*	*1,150*
10% Preference shares of ₹ 100 each	*700*	*400*	*Debtors*	*625*	*615*
			Stock	*412*	*680*

General Reserve	*240*	*170*	*Cash at bank*	*38*	*155*
Profit and Loss Account		*15*	*Own Debenture (Nominal value of ₹2,00,000)*	*192*	
12% Debentures of ₹100 each	*600*	*200*			
Sundry Creditors	*560*	*315*	*Discount on issue of debentures*	*2*	
			Profit and Loss Account	*411*	
	4,100	*2,600*		*4,100*	*2,600*

On 01-04-2012, K Ltd. adopted the following scheme of reconstruction:

(i) *Each equity share shall be sub-divided into 10 equity shares of ₹10 each fully paid up. 50% of the equity share capital would be surrendered to the company.*

(ii) *Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 80% of the dividend claim and accept payment for the balance.*

(iii) *Own debentures of ₹ 80,000 (nominal value) were sold at ₹ 98 cum interest and remaining own debentures were cancelled.*

(iv) *Debenture holders of ₹ 3,00,000 agreed to accept one machinery of book value of ₹3,20,000 in full settlement.*

(v) *Creditors, Debtors and stock were valued at ₹ 5,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively. Goodwill, discount on issue of debentures and Profit and Loss account (Dr.) are to be written off.*

(vi) *The company paid ₹ 20,000 as penalty to avoid capital commitments of ₹ 4,00,000.*

On 02.04.2012, a scheme of absorption was adopted. K Ltd. would take over W Ltd. The purchase consideration was fixed as below:

(a) *Equity shareholders of W Ltd. will be given 50 equity shares of ₹10 each fully paid up, in exchange for every 5 shares held in W Ltd.*

(b) *Issue of 10% preference shares of ₹100 each in the ratio of 4 preference shares of K Ltd. for every 5 preference shares held in W Ltd.*

(c) *Issue of 12% debentures of ₹100 each of K Ltd. for every 12% debenture in W Ltd.*

Pass necessary Journal entries in the books of K Ltd. and draw the resultant Balance Sheet as at 2nd April, 2012.

Answer

In the books of K Ltd.

Journal Entries

	Particulars		*Dr. Amount ₹*	*Cr. Amount ₹*
01.04.2012				
1.	Equity share capital A/c	Dr.	20,00,000	
	To Equity share capital A/c			20,00,000
	(Being sub-division of one share of ₹ 100 each into 10 shares of ₹ 10 each)			
2.	Equity share capital A/c	Dr.	10,00,000	
	To Capital reduction A/c			10,00,000
	(Being reduction of capital by 50%)			
3.	Capital reduction A/c	Dr.	42,000	
	To Bank A/c			42,000
	(Being payment in cash of 20% of arrears of 3 years' preference dividend)			
4.	Bank A/c	Dr.	78,400	
	To Own debentures A/c [(1,92,000/2,00,000) x 80,000]			76,800
	To Capital reduction A/c			1,600
	(Being profit on sale of own debentures transferred to capital reduction A/c)			
5.	12% Debentures A/c	Dr.	1,20,000	
	To Own debentures A/c [(1,92,000/2,00,000) x 1,20,000]			1,15,200
	To Capital reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			
6.	12% Debentures A/c	Dr.	3,00,000	
	Capital reduction A/c	Dr.	20,000	
	To Machinery A/c			3,20,000
	(Being machinery of ₹ 3,20,000 taken up by the debenture holders for ₹ 3,00,000)			

7.	Creditors A/c	Dr.	60,000	
	To Capital reduction A/c			60,000
	(Being liabilities revalued)			
8.	Capital reduction A/c	Dr.	10,04,400	
	To Debtors A/c			25,000
	To Stock A/c			12,000
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	To Bank A/c			20,000
	To Capital reserve A/c			5,14,400
	(Being assets revalued and losses written off and penalty paid off through capital reduction account and the balance of capital reduction account transferred to capital reserve account)			
02.04.2012				
9.	Business Purchase A/c	Dr.	18,20,000	
	To Liquidators of W Ltd.			18,20,000
	(Being the purchase consideration payable to W Ltd.)			
10.	Fixed assets A/c	Dr.	11,50,000	
	Stock A/c	Dr.	6,80,000	
	Debtors A/c	Dr.	6,15,000	
	Cash at bank A/c	Dr.	1,55,000	
	To Sundry creditors A/c			3,15,000
	To 12% Debentures A/c of W Ltd.			2,00,000
	To Profit and Loss A/c			15,000
	To General reserve A/c			1,70,000
	To Capital reserve A/c (W.N.2)			80,000
	To Business purchase A/c			18,20,000
	(Being the takeover of all assets and liabilities of W Ltd. by K Ltd.)			
11.	Liquidators of W Ltd. A/c	Dr.	18,20,000	
	To Equity share capital A/c			15,00,000

	To 10% Preference share capital A/c			3,20,000
	(Being the purchase consideration discharged)			
12.	12% Debentures of W Ltd. A/c	Dr.	2,00,000	
	To 12% Debentures A/c			2,00,000
	(Being K Ltd. issued their 12% Debentures against 12% Debentures of W Ltd.)			

Balance Sheet of K Ltd. as on 2nd April, 2012

Particulars	*Notes No.*	*Amount (₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	35,20,000
(b) Reserves and Surplus	2	10,19,400
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	3,80,000
(3) Current Liabilities		
(a) Trade payables	4	8,15,000
Total		57,34,400
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	5	32,30,000
(2) Current assets		
(a) Inventories	6	10,80,000
(b) Trade receivables	7	12,15,000
(c) Cash and cash equivalents	8	2,09,400
Total		57,34,400

Notes to Accounts

			₹
1	Share Capital		
	Equity Share Capital	20,00,000	
	Less: Surrender 50% equity capital	(10,00,000)	

	Add: Equity share capital issued to W Ltd.	15,00,000	25,00,000
	10% Preference share capital	7,00,000	
	Add: Preference share capital issued to W Ltd.	3,20,000	10,20,000
			35,20,000
2.	Reserves and Surplus		
	Profit and Loss A/c	15,000	
	General Reserve (2,40,000 + 1,70,000)	4,10,000	
	Capital Reserve (5,14,400 + 80,000)	5,94,400	10,19,400
3.	Long-term borrowings		
	12% Debentures	6,00,000	
	Less: Settled in consideration of machinery	(3,00,000)	
	Less: Cancelled debentures	(1,20,000)	
	Add: 12% Debentures issue to W Ltd.	2,00,000	3,80,000
4.	Trade payables		
	of K Ltd.	5,60,000	
	Less: Reduction due to revaluation	(60,000)	
	Add: Trade payables of W Ltd.	3,15,000	8,15,000
5.	Tangible assets		
	Balance of Other fixed assets	24,00,000	
	Less: Machinery taken up by debenture holders	(3,20,000)	
	Add: Other fixed assets of W Ltd.	11,50,000	32,30,000
6.	Inventories	4,12,000	
	Less: Reduction due to revaluation	(12,000)	
	Add: Inventories of W Ltd.	6,80,000	10,80,000
7.	Trade receivables	6,25,000	
	Less: Reduction due to revaluation	(25,000)	
	Add: Trade receivables of W Ltd.	6,15,000	12,15,000
8.	Cash and cash equivalents	38,000	
	Less: Payment of arrear of preference dividend	(42,000)	
	Add: Profit on sale of own debentures	78,400	
	Less: Penalty paid	(20,000)	
	Add: Cash and cash equivalents of W Ltd.	1,55,000	2,09,400

Working Notes:

1. **Purchase Consideration**

	₹
Equity share capital [(15,000 x 50/5) x ₹ 10]	15,00,000
10% Preference share capital [(4,000x 4/5) x ₹ 100] =	3,20,000
	18,20,000

2. **Capital Reserve**

	₹
Share Capital of W Ltd. (Equity + Preference)	19,00,000
Less: Share Capital issued by K Ltd.	(18,20,000)
Capital reserve	80,000

Note: In the question, summarised balance sheets of K Ltd. and W Ltd. as on 31.12.2011 are given. However, the internal reconstruction and amalgamation took place on 1.4.2012 and 2.4.2012 respectively. Since, no information have been provided for the intervening period of 3 months (i.e. from 1.1.2012 to 31.3.2012), the above solution is given assuming this date of summarised balance sheets as 31.3.2012 instead of 31.12.2011. Alternatively, the solution may be given on the basis of 31.12.2011. In that case, the only difference will be that dividend on preference shares and interest on debentures for period of 3 months (i.e. from 1.1.2012 to 31.3.2012) will be considered at the time of internal reconstruction.

Question 5

Given below are the summarized balance sheets of Vasudha Ltd. and Vaishali Ltd as at 31st March, 2012.

(Amount in ₹)

Liabilities	*Vasudha Ltd*	*Vaishali Ltd.*	*Assets*	*Vasudha Ltd.*	*Vaishali Ltd*
Issued Share Capital:			*Factory Building*	*2,10,000*	*1,60,000*
			Debtors	*2,86,900*	*1,72,900*
Equity Shares of ₹ 10 each	*5,40,000*	*4,03,300*	*Stock*	*91,500*	*82,500*
General Reserves	*86,000*	*54,990*	*Goodwill*	*50,000*	*35,000*
Profit & Loss A/c	*66,000*	*43,500*	*Cash at Bank*	*98,000*	*1,09,590*
Sundry Creditors	*44,400*	*58,200*			
	7,36,400	*5,59,990*		*7,36,400*	*5,59,990*

Goodwill of the Companies Vasudha Ltd. and Vaishali Ltd. is to be valued at ₹ 75,000 and ₹ 50,000 respectively. Factory Building of Vasudha Ltd is worth ₹1,95,000 and of Vaishali Ltd ₹ 1,75,000.Stock of Vaishali has been shown at 10% above of its cost.

It is decided that Vasudha Ltd will absorb Vaishali Ltd, by taking over its entire business by issue of shares at the Intrinsic Value.

You are required to draft the balance sheet of the Vasudha Ltd after putting through the scheme assuming that the assets & liabilities of Vaishali Ltd. were incorporated in Vasudha Ltd at fair value and assets and liabilities of Vasudha Ltd. have been carried at carrying values only.

Answer

Balance Sheet of Vasudha Ltd. as on 31st March, 2012

(After absorption)

		Particulars	*Note No*	*Amount*
				₹
		EQUITY AND LIABILITIES		
1		Shareholders' funds		
	(a)	Share capital	1	9,43,300
	(b)	Reserves and Surplus	2	2,72,990
2		Current liabilities		
	(a)	Trade payables (44,400+58,200)		1,02,600
		Total		13,18,890
		ASSETS		
1		Non-current assets		
	(a)	Fixed assets		
	i	Tangible assets	3	3,85,000
	ii	Intangible assets	4	1,00,000
2		Current assets		
	(a)	Inventories(91,500 + 75,000)		1,66,500
	(b)	Trade receivables(2,86,900 + 1,72,900)		4,59,800
	(c)	Cash and cash equivalents(98,000 + 1,09,590)		2,07,590
		Total		13,18,890

Notes to accounts

		₹	₹
1.	Share Capital		
	Equity share capital		
	(54,000 + 40,330) Equity shares of ₹10 each		9,43,300

2.	**Reserves and Surplus**		
	Profit and Loss A/c	66,000	
	General reserves	86,000	
	Securities Premium A/c (Refer W.N.)	1,20,990	2,72,990
3	**Tangible assets**		
	Factory building (2,10,000 + 1,75,000)		3,85,000
4.	**Intangible assets**		
	Goodwill (50,000+50,000)		1,00,000

Working Note:

Computation of shares issued on the basis of intrinsic values

	Vasudha Ltd.	*Vaishali Ltd.*
	₹	₹
Goodwill	75,000	50,000
Factory building	1,95,000	1,75,000
Debtors	2,86,900	1,72,900
Stock	91,500	(82,500/110%)= 75,000
Cash at Bank	98,000	1,09,590
	7,46,400	5,82,490
Less: Sundry Creditors	(44,400)	(58,200)
Net assets	7,02,000	5,24,290
Number of shares	54,000	40,330
Intrinsic value	₹13	₹13

Hence, Vasudha Ltd. will give its 40,330 shares of ₹10 each @ ₹13 each to Vaishali Ltd.

Discharge of Purchase consideration

	Share Capital ₹	*Securities Premium* ₹
40,330 Shares @ ₹ 10 each	4,03,300	
40,330 shares @ ₹ 3 each		1,20,990

RECONSTRUCTION

Question 6

The following is the summarized Balance Sheet of Rocky Ltd. as at March 31, 2012:

	₹ in lacs
Liabilities	
Fully paid equity shares of ₹ 10 each	*500*
Capital Reserve	*6*
12% Debentures	*400*
Debenture Interest Outstanding	*48*
Trade Creditors	*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*
Stock	*142*
Debtors	*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 Court, 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 debentureholders 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 creditors 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. Creditors 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*
Stock	*120*
Debtors	*76*

Pass Journal Entries for all the above mentioned transactions and draft the company's Balance Sheet immediately after the reconstruction.

Answer

Journal Entries

			₹ in lacs
		Dr.	*Cr.*
Equity Share Capital (₹ 10 each) A/c	Dr.	500	
To Equity Share Capital (₹ 2.50 each) A/c			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	
Debenture Interest Outstanding A/c	Dr.	48	
To 13% Debentures A/c			400
To Reconstruction A/c			48
(Conversion of 12% debentures into 13% debentures, Debentureholders forgoing outstanding debenture interest)			

Bank A/c	Dr.	125	
To Equity Share Application A/c			125
(Application money received for equity shares)			
Equity Share Application A/c	Dr.	125	
To Equity Share Capital (₹ 2.50 each) A/c			125
(Application money transferred to share capital)			
Trade Creditors 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 creditors for ₹ 64 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
(Capital Reserve being used for purpose of reconstruction)			
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 and Machinery A/c			66
To Stock A/c			22
To Debtors 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)			

Balance Sheet of Rocky Ltd. (and Reduced) as on 31st March, 2012

Particulars	*Note No.*	*Amount*
		₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	315

(2) Non-Current Liabilities		
(a) 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 creditors	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 and 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 :

1. (₹ in lacs)

Reconstruction Account

		₹			₹
To	Goodwill	15	By	Equity Share Capital A/c	375
To	Plant and Machinery	66	By	Director's Remuneration Outstanding A/c	10
To	Stock	22	By	Debenture Interest Outstanding A/c	48
To	Debtors	4	By	Trade Creditors	20
To	Discount on issue of Debentures	8	By	Capital Reserve	6
			By	Land and Building	46
To	Profit and Loss A/c	390			
		505			505

2. Cash at bank as on 31st March, 2012 (after reconstruction)

	₹
Cash at bank (before reconstruction)	27
Add: Proceeds from issue of equity shares	125
	152
Less: Payment made to creditors	(80)
	72

Question 7

The draft Balance Sheet of Y Limited as on 31st March, 2011 was as follows:

Liabilities	*Amount (₹)*	*Assets*	*Amount (₹)*
5,00,000 Equity shares of ₹ 10 each fully paid	*50,00,000*	*Goodwill* *Patent*	*10,00,000* *5,00,000*
9% 20,000 Preference shares of ₹100 each fully paid	*20,00,000*	*Land and Building* *Plant and Machinery*	*30,00,000* *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 creditors	*5,00,000*	*Debtors*	*5,00,000*
Directors' loan	*1,00,000*	*Stock*	*10,00,000*
Bank Overdraft	*1,00,000*	*Discount on issue of debentures*	*1,00,000*
Outstanding liabilities	*40,000*		
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 creditors for ₹ 1,00,000. B holds 10% first debentures for ₹ 2,00,000 and 10% second debentures for ₹ 4,00,000 and is also creditors for ₹ 50,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

(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 creditors (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*

Stock	*7,00,000*
Debtors	*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	Dr.	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 Creditors 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			7,00,000

	To Reconstruction A/c			6,00,000
	(Being ₹ 6,00,000 due to A (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			
(iv)	10% First Debentures A/c	Dr.	2,00,000	
	10% Second Debentures A/c	Dr.	4,00,000	
	Trade Creditors 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 creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			
(v)	Trade Creditors A/c	Dr.	1,75,000	
	To Reconstruction A/c			1,75,000
	(Being remaining creditors sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			60,000
	To Reconstruction A/c			40,000
	(Being Directors' 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 for cancellation of capital commitments.)			
(viii)	Bank A/c	Dr.	1,10,000	
	To Reconstruction A/c			1,10,000
	(Being refund of fees by directors 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.)			
(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 Stock A/c			3,00,000
	To Debtors A/c			2,00,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.)			

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 b/d	1,00,000
To	Reconstruction A/c (paid by directors)	1,10,000	By	Reconstruction A/c (capital commitment penalty paid)	15,000
			By	Reconstruction A/c (reconstruction expenses paid)	10,000
			By	Provision for tax A/c(tax paid)	80,000
			By	Balance c/d	5,000
		2,10,000			2,10,000

Questions 8

Following is the Balance Sheet of M Ltd. as at 31st March, 2011:

Liabilities	₹	*Assets*	₹
15,000, 10% Preference shares 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*	*Stock*	*6,00,000*
Creditors	*12,50,000*	*Debtors*	*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 court:

(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 Debentureholders 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 debentureholders 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, Stock and Debtors 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

	Particulars		*Dr. Amount (₹)*	*Cr. Amount (₹)*
1.	Equity Share Capital (₹ 100) A/c	Dr.	35,00,000	
	To Equity Share Capital (₹ 25) 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)			
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 of ₹ 50 each and one equity share of ₹ 25 each issued against 10% Preference Share of ₹ 75 each)			

4.	Capital Reduction A/c	Dr.	1,50,000	
	To Preference share dividend payable A/c			1,50,000
	(Being arrear 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 of Preference Share dividend)			
6.	7% Debentures A/c	Dr.	5,00,000	
	To Debenture holders A/c			5,00,000
	(Being balance of 7% Debentures transferred to Debenture holders A/c)			
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			25,000
	(Being 50% of Debenture 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 contingent liability of ₹ 1,50,000 is payable and 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 & Buildings A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being value of Land & Buildings 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 Stock A/c			1,00,000
	To Debtors A/c			1,50,000
	To Preliminary Expenses A/c			4,00,000
	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			1,70,000
	(Being various losses written off and balance of Capital Reduction A/c transferred to Capital Reserve A/c)			

Question 9

The summarised Balance Sheet of X Limited as on 31st March 2012, was as follows:

Liabilities	*(₹)*	*Assets*	*(₹)*
Authorised and subscribed capital:	*10,00,000*	*Fixed Assets:*	
10,000 Equity shares of ₹100 each		*Machineries*	*3,50,000*
fully paid		*Current Assets:*	
Unsecured loans:		*Stock*	*2,53,000*
15% Debentures	*3,00,000*	*Debtors*	*2,30,000*
Accrued interest	*45,000*	*Bank*	*20,000*
Current Liabilities:		*Profit & loss A/c*	*5,80,000*
Creditors	*52,000*		
Provision for income tax	*36,000*		
	14,33,000		*14,33,000*

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from the appropriate authorities. Accordingly, it was decided that:

(i) Each share be sub-divided into 10 fully paid up equity share of ₹ 10 each.

(ii) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debentureholders and creditors as necessary.

(iii) Out of shares surrendered 10,000 shares of ₹ 10 each shall be converted into 10% Preference shares of ₹ 10 each fully paid up.

(iv) The claims of the debentureholders shall be reduced by 50%. In consideration of the reduction, the debentureholder shall receive Preference Shares of ₹ 1,00,000 which are converted out of shares surrendered.

(v) Creditors claim shall be reduced by 25%. Remaining creditors are to be settled by the issue of equity shares of ₹ 10 each of out of shares surrendered.

(vi) Balance of Profit and Loss account to be written off.

(vii) The shares surrendered and not re-issued shall be cancelled.

Pass Journal Entries giving effect to the above and the resultant Balance Sheet.

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	Dr.	22,500	
	To Reconstruction A/c			1,72,500
	(Transferred 50% of the claims of the debentureholders to Reconstruction A/c in consideration of which 10% Preference shares are being issued, out of share surrender A/c as per capital reduction scheme)			

(iii)	Creditors A/c	Dr.	52,000	
	To Reconstruction A/c			52,000
	(Transferred claims of the creditors 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 debentureholders and the creditors 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) Reserves and Surplus	2	5,500
3	Non-current liabilities		
	Long-term borrowings	3	1,50,000
4	Current liabilities		
	a) Other current liabilities	4	22,500
	b) Short-term provisions	5	36,000
	Total		8,53,000

	Assets		
1	Non-current assets		
	a) Fixed assets		
	i) Tangible assets	6	3,50,000
2	Current assets		
	a) Inventories		2,53,000
	b) Trade receivables		2,30,000
	c) Cash and cash equivalents	7	20,000
	Total		8,53,000

Notes to Accounts

		₹
1.	**Share Capital**	
	53,900 Equity shares of ₹ 10 each	5,39,000
	10,000, 10% Preference share of ₹ 10 each	1,00,000
		6,39,000
	(all the above shares are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment received in cash)	
2.	**Reserves and Surplus**	
	Capital Reserves	5,500
3.	**Long-term borrowings**	
	Unsecured	
	15% Debentures	1,50,000
4.	**Other current liabilities**	
	Accrued Interest on 15% Debentures	22,500
5.	**Short-term provisions**	
	Provision for income tax	36,000
6.	**Tangible assets**	
	Machineries	3,50,000
7.	**Cash and cash equivalents**	
	Balances with banks	20,000

UNIT 5 : LIQUIDATION OF COMPANIES

BASIC CONCEPTS

In case of winding up of the company, a statement called Statement of affairs is prepared.

- Deficiency Account is the result of capital plus liabilities exceeding the assets or deficit or debit balance in the profit and loss account.
- Overriding preferential payments are the payments to be made for the workman's dues and debts secured to secured creditors to the extent they rank under section 529(1)(c).
- Creditors that have to be paid in priority to unsecured creditors or creditor having a floating charge.
- In case of voluntary winding up, the statement prepared by the Liquidator showing receipts and payment of cash is called "Liquidator's Statement of Account".
- The shareholders who transferred partly paid shares within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.

Question 1

Explain Overriding preferential payments under section 529A of the Companies Act, 1956.

Answer

The Companies (Amendment) Act, 1985 introduced Section 529A which states that certain dues are to be settled in the case of winding up of a company even before the payments to preferential creditors under Section 530. Section 529A states that in the event of winding up of a company, workmen's dues and debts due to secured creditors, to the extent such debts rank under Section 529(1)(c), shall be paid in priority to all other debts. The debts provable [Section 529(i)(a)] and the valuation of annuities and future and contingent liabilities [Section 529(1)(b)] shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Workmen's dues, in relation to a company, means the aggregate of the following sums:

1. all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;
2. all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order or resolution;

3. all amounts due in respect of any compensation or liability for compensation under Workmen's Compensation Act, 1923 in respect of death or disablement of any workman of the company;

4. all sum due to any workman from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the workmen, maintained by the company.

B LIST OF CONTRIBUTORIES

Question 2

B List of Contributories and the liability of contributories included in the list.

Answer

The shareholders who transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.

Their liability will crystallize only (i) when the existing assets available with the liquidator are not sufficient to cover the liabilties; (ii) when the existing shareholders fail to pay the amount due on the shares to the liquidator.

Question 3

Pessimist Ltd. has gone into liquidation on 10th May, 2011. The details of members, who have ceased to be members, within the year ended 31st March, 2011 are given below. The debts that could not be paid out of realisation of assets and contribution from present members ('A' contributories) are also given with their date-wise break up. Shares are of ₹ 10 each, ₹ 6 per share paid up.

You are to determine the amount realisable from each person.

Shareholders	*No. of shares transferred*	*Date of transfer*	*Proportionate unpaid debts*
P	*1,000*	*20.04.2010*	*3,000*
Q	*1,200*	*15.05.2010*	*5,000*
R	*1,500*	*18.09.2010*	*9,200*
S	*800*	*24.12.2010*	*10,500*
T	*500*	*12.03.2011*	*11,000*

Answer

Statement of liabilities of B List Contributories

Creditors outstanding on the date of transfer (ceasing to be member)			*Q*	*R*	*S*	*T*	*Amount to be paid to creditor*
No. of shares			1,200	1,500	800	500	
Date		₹	₹	₹	₹	₹	₹
15.5.2010		5,000	1,500	1,875	1,000	625	5,000
18.9.2010	9,200						
	–5,000	4,200	–	2,250	1,200	750	4,200
	10,500						
24.12.2010	-9,200	1,300	–	–	800	500	1,300
	11,000						
12.3.2011	10,500	500	–	–	–	500	125[*]
Total (a)		11,000	1,500	4,125	3,000	2,375	10,625
Maximum liability on shares held (b)			4,800	6,000	3,200	2,000	
Amount paid (a) and (b) whichever is lower			1,500	4,125	3,000	2,000	

Working Note:

P will not be liable since he transferred his shares prior to one year preceding the date of winding up. The amount of ₹ 5,000 outstanding on 15th May, 2010 will have to contributed by Q, R, S and T in the ratio of number of shares held by them, i.e. in the ratio of 12:15:8:5; thus Q will have to contribute ₹ 1,500; R ₹ 1,875; S ₹ 1,000; T ₹ 625. Similarly, the further debts incurred between 15th May, 2010 to 18th September, 2010, viz. ₹ 4,200 for which Q is not liable will be contributed by R, S and T in the ratio of 15:8:5. R will have to contribute ₹ 2,250. S and T will contribute ₹ 1,200 and ₹ 750 respectively. The further increase from ₹ 9,200 to ₹ 10,500 viz. ₹ 1,300 occurring between 18th September and 24th December will be shared by S and T who will be liable for ₹ 800 and ₹ 500 respectively. The increase between 24th December and 12th March, is solely the responsibility of T.

[*] Against T's liability of ₹ 2,375, he can be called upon to pay ₹ 2,000, the loss of ₹ 375 will have to be suffered by the creditors.

Question 4

Liquidation of YZ Ltd. commenced on 2nd April, 2011. Certain creditors could not receive payments out of the realisation of assets and out of the contributions from A list contributories. The following are the details of certain transfers which took place in 2010 and 2011:

Shareholders	*No. of Shares transferred*	*Date of Ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of such transfer*
A	*2,000*	*1st March, 2010*	*₹5,000*
P	*1,500*	*1st May, 2010*	*₹ 3,300*
Q	*1,000*	*1st October, 2010*	*₹4,300*
R	*500*	*1st November, 2010*	*₹4,600*
S	*300*	*1st February, 2011*	*₹6,000*

All the shares were of ₹ 10 each, ₹ 8 per share paid up. Show the amount to be realised from the various persons listed above ignoring expenses and remuneration to liquidator etc.

Answer

Statement of liabilities of B list contributories

Share-holders	*No. of shares transferred*	*Maximum liability (upto ₹ 2 per share)*	*Division of Liability as on*				
			1.5.2010	*1.10.2010*	*1.11.2010*	*1.2.2011*	*Total*
		₹	₹	₹	₹	₹	₹
P	1,500	3,000	1,500	–	–	–	1,500
Q	1,000	2,000	1,000	555	–	–	1,555
R	500	1,000	500	278	188	–	966
S	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Note:

Date	*Cumulative liability*	*Increase in liability*	*Ratio of no. of shares held by the members*
1.5.2010	3,300	–	30 : 20 : 10 : 6
1.10.2010	4,300	1,000	20 : 10 : 6
1.11.2010	4,600	300	10 : 6
1.2.2011	6,000	1,400	Only S

Liability of S has been restricted to the maximum allowable limit of ₹ 600, therefore amount payable by S is restricted to ₹ 21 only, on 1.2.2011.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2010 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

Question 5

M/s. ABC Limited has gone into liquidation on 25th June, 2012. Certain creditors could not receive payments out of realization of assets and contributions from A list contributories. The following are the details of certain transfers which took place in the year ended 31st March, 2012:

Shareholders	*No. of shares transferred*	*Date of ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of transfer (₹)*
P	4,000	10-5-2011	9,000
Q	3,000	22-7-2011	12,000
R	2,400	15-9-2011	13,500
S	1,600	14-12-2011	14,000
T	1,000	09-03-2012	14,200

All the shares are of ₹ 10 each, ₹ 8 per share paid up. Show the amount to be realized from the persons listed above. Ignore remuneration to liquidator and other expenses.

Answer

Statement of Liabilities of B List Contributories

Shareholder	*No. of shares transferred*	*Maximum liability upto ₹ 2 per share*	*Division of liability as on*				*Total*
			22.07.2011	*15.09.2011*	*14.12.2011*	*09.03.2012*	
Q	3,000	6,000	4,500	-	-	-	4,500
R	2,400	4,800	3,600	720	-	-	4,320
S	1,600	3,200	2,400	480	308	-	3,188
T	1,000	2,000	1,500	300	192	8	2,000
	8,000	16,000	12,000	1,500	500	8	14,008

Notes:

1. 'P' transferred shares before one year preceding the date of winding up, therefore, he cannot be held liable for any liability on liquidation.

2. Liability of 'T' has been restricted to the maximum allowable limit of ₹ 2,000. Therefore, amount payable by T on 09.03.2012 is ₹ 8 only.
3. 'Q' will not be responsible for further debts incurred after 10th May, 2011 (from the date when he ceases to be a member). Similarly, 'R' & 'S' will not be liable for the debts incurred after the date of their transfer of shares.

Working Note

Calculation of Ratio for Discharge of Liabilities

Date	*Cumulative liability (₹)*	*Increase in liabilities (₹)*	*Ratio of no. of shares held by Q, R, S & T*
22.07.2011	12,000	-	30: 24: 16: 10
15.09.2011	13,500	1,500	24: 16: 10
14.12.2011	14,000	500	16: 10
09.03.2012	14,200	200	Only T

LIQUIDATORS STATEMENT OF ACCOUNT

Question 6

What are the contents of "Liquidators' statement of account"? How frequently does a liquidator have to submit such statement?

Answer

The statement prepared by the liquidator showing receipts and payments of cash in case of voluntary winding up is called "Liquidators' statement of account" (Form No. 156 Rule 329 of the Companies Act, 1956). There is no double entry involved in the preparation of liquidator's statement of account. It is only a statement though presented in the form of an account.

While preparing the liquidator's statement of account, receipts are shown in the following order :

(a) Amount realised from assets are included in the prescribed order.

(b) In case of assets specifically pledged in favour of creditors, only the surplus from it, if any, is entered as 'surplus from securities'.

(c) In case of partly paid up shares, the equity shareholders should be called up to pay necessary amount (not exceeding the amount of uncalled capital) if creditors' claims/claims of preference shareholders can't be satisfied with the available amount. Preference shareholders would be called upon to contribute (not exceeding the amount as yet uncalled on the shares) for paying of creditors.

(d) Amounts received from calls to contributories made at the time of winding up are shown on the Receipts side.

(e) Receipts per Trading Account are also included on the Receipts side.

Payments made to redeem securities and cost of execution and payments per Trading Account are deducted from total receipts.

Payments are made and shown in the following order :

(a) Legal charges;

(b) Liquidator's expenses;

(d) Debentureholders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);

(e) Creditors:

   (i) Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge);

   (ii) Unsecured creditors;

(f) Preferential shareholders (Arrears of dividends on cumulative preference shares should be paid up to the date of commencement of winding up); and

(g) Equity shareholders.

Liquidator's statement of account of the winding up is prepared for the period starting from the commencement of winding up to the close of winding up. If winding up of company is not concluded within one year after its commencement, Liquidator's statement of account pursuant to section 551 of the Companies Act, 1956 (Form No. 153) is to be filed by a Liquidator within a period of two months of the conclusion of one year and thereafter until the winding up is concluded at intervals of not more than one year or at such shorter intervals, if any, as may be prescribed.

Question 7

The position of Valueless Ltd. on its liquidation is as under:

Issued and paid up Capital:

3,000 11% preference shares of ₹ 100 each fully paid.

3,000 Equity shares of ₹ 100 each fully paid.

1,000 Equity shares of ₹ 50 each ₹ 30 per share paid.

Calls in Arrears are ₹ 10,000 and Calls received in Advance ₹ 5,000. Preference Dividends are in arrears for one year. Amount left with the liquidator after discharging all liabilities is ₹ 4,13,000. Articles of Association of the company provide for payment of preference dividend arrears in priority to return of equity capital. You are required to prepare the Liquidators final statement of account.

Answer

Liquidators' Final Statement of Account

Receipts	₹	*Payments*	₹
Cash	4,13,000	Return to contributors:	

Realisation from:		Preference dividend	33,000
Calls in arrears	10,000	Preference shareholders	3,00,000
Final call of ₹ 5 per		Calls in advance	5,000
equity share of ₹ 50 each (₹ 5 × 1,000)	5,000	Equity shareholders of ₹ 100 each (3,000 × ₹ 30)	90,000
	4,28,000		4,28,000

Working Note:

		₹
Cash account balance		4,13,000
Less: Payment for dividend	33,000	
Preference shareholders	3,00,000	
Calls in advance	5,000	(3,38,000)
		75,000
Add: Calls in arrears		10,000
		85,000
Add: Amount to be received from equity shareholders of ₹ 50 each (1,000 × 20)		20,000
Amount disposable		1,05,000

Number of equivalent equity shares:

3,000 shares of ₹ 100 each = 6,000 shares of ₹ 50 each

1,000 shares of ₹ 50 each = 1,000 shares of ₹ 50 each

= 7,000 shares of ₹ 50 each

Final payment to equity shareholders = $\dfrac{\text{Amount left for distribution}}{\text{Total number of equivalent equity shares}}$

= ₹ 1,05,000 / 7,000 shares = ₹ 15 per share to equity shareholders of ₹ 50 each.

Therefore for equity shareholders of ₹ 100 each $\left(15 \times \dfrac{100}{50}\right)$

= ₹ 30 per share to equity shareholders of ₹ 100 each.

Calls in advance must be paid first, so as to pay the shareholders on prorata basis. Equity shareholders of ₹ 50 each have to pay ₹ 20 and receive ₹ 15 each. As a result, they are required to pay net ₹ 5 per share.

Question 8

The following particulars relate to a Limited Company which has gone into voluntary liquidation. You are required to prepare the Liquidator's Statement of Account allowing for his remuneration @ 2½% on all assets realized excluding call money received and 2% on the amount paid to unsecured creditors including preferential creditors.

Share capital issued:

10,000 Preference shares of ₹100 each fully paid up.

50,000 Equity shares of ₹10 each fully paid up.

30,000 Equity shares of ₹10 each, ₹8 paid up.

Assets realized ₹ 20,00,000 excluding the amount realized by sale of securities held by partly secured creditors.

	₹
Preferential creditors	*50,000*
Unsecured creditors	*18,00,000*
Partly secured creditors (Assets realized ₹ 3,20,000)	*3,50,000*
Debentureholders having floating charge on all assets of the company	*6,00,000*
Expenses of liquidation	*10,000*

A call of ₹2 per share on the partly paid equity shares was duly received except in case of one shareholder owning 1,000 shares.

Also calculate the percentage of amount paid to the unsecured creditors to the total unsecured creditors.

Answer

(a) (i) Liquidator's Statement of Account

	₹			₹.
To Assets Realised	20,00,000	By Liquidator's remuneration		
To Receipt of call money on 29,000 equity shares @ 2 per share	58,000	2.5% on 23,20,000*	58,000	
		2% on 50,000	1,000	
		2% on 13,12,745 (W.N.3)	26,255	85,255
		By Liquidation Expenses		10,000
		By Debenture holders having a floating charge on all assets		6,00,000
		By Preferential creditors		50,000
		By Unsecured creditors		13,12,745
	20,58,000			20,58,000

(ii) Percentage of amount paid to unsecured creditors to total unsecured creditors

$$= \frac{13,12,745}{18,30,000} \times 100 = 71.73\%$$

Working Notes:

1. Unsecured portion in partly secured creditors=₹ 3,50,000-₹ 3,20,000 = ₹ 30,000

* Total assets realised = ₹ 20,00,000 + ₹ 3,20,000 = ₹ 23,20,000

2. Total unsecured creditors = 18,00,000 + 30,000 (W.N.1) = ₹ 18,30,000

3. Liquidator's remuneration on payment to unsecured creditors

Cash available for unsecured creditors after all payments including payment to preferential creditors & liquidator's remuneration on it = ₹ 13,39,000

Liquidator's remuneration on unsecured creditors = $\frac{2}{102} \times 13,39,000 =$ ₹ 26,255

or on ₹ 13,12,754 x 2/100 = ₹ 26,255

Question 9

The summarized Balance Sheet of Full Stop Limited as on 31st March 2012, being the date of voluntary winding up is as under:

Liabilities	*(₹)*	*Assets*	*(₹)*
Share capital:		*Land & building*	*5,20,000*
5,000, 10% Cumulative		*Plant & machinery*	*7,80,000*
Preference shares of ₹ 100		*Stock in trade*	*3,25,000*
each fully paid up	*5,00,000*	*Book debts*	*10,25,000*
Equity share capital:		*Profit & loss account*	*5,50,000*
5,000 Equity shares of ₹ 100			
each ₹ 60 per share called			
and paid up	*3,00,000*		
5,000 Equity shares of ₹ 100			
each ₹ 50 per share called up			
and paid up	*2,50,000*		
Securities premium	*7,50,000*		
10% Debentures	*2,10,000*		
Preferential creditors	*1,05,000*		
Bank overdraft	*4,85,000*		
Trade creditors	*6,00,000*		
	32,00,000		*32,00,000*

Preference dividend is in arrears for three years. By 31-03-2012, the assets realized were as follows:

	₹
Land & building	*6,20,000*
Stock in trade	*3,10,000*
Plant & machinery	*7,10,000*
Book debts	*6,60,000*

Expenses of liquidation are ₹ 86,000. The remuneration of the liquidator is 2% of the realization of assets. Income tax payable on liquidation is ₹ 67,000. Assuming that the final payments were made on 31-03-2012, prepare the Liquidator's Statement of Account.

Answer

Liquidator's Statement of Account

Receipts	₹	*Payments*	₹
Land & building	6,20,000	Liquidator's remuneration	46,000
Stock in trade	3,10,000	Liquidation expenses	86,000
Plant & machinery	7,10,000	10% Debentures	2,10,000
Book debts	6,60,000	Preferential creditors	1,05,000
		Income tax payable	67,000
		Bank overdraft	4,85,000
		Trade creditors	6,00,000
		Preference shareholders:	
		Capital	5,00,000
		Arrears of preference dividend for 3 years	1,50,000
		Refund on 5,000 shares of ₹ 60 paid up @ ₹ 10.10 per share (Refer W.N.)	50,500
		Refund on 5,000 shares of ₹ 50 paid up @ ₹ 0.10 per share (Refer W.N.)	500
	23,00,000		23,00,000

Working Note:

	₹
Total equity capital paid up (3,00,000 + 2,50,000)	5,50,000
Less: Balance available after payment to secured, unsecured, preferential creditors and preference shareholders (23,00,000 – 46,000 – 86,000 – 2,10,000 – 1,05,000 – 67,000 – 4,85,000– 6,00,000 – 5,00,000 – 1,50,000)	(51,000)
Loss to be borne by 10,000 equity shareholders	4,99,000
Loss per share	₹ 49.90
Hence, amount of refund on ₹ 50 per share paid up (₹ 50 – ₹ 49.90)	₹ 0.10
Amount of refund on ₹ 60 per share paid up (₹ 60 – ₹ 49.90)	₹ 10.10

LIQUIDATOR'S REMUNERATION

Question 10

The liquidator of a company is entitled to a remuneration of 2% on assets realized and 3% on the amount distributed to unsecured creditors. The assets realized ₹ 10,00,000. Amount available for distribution to unsecured creditors before paying liquidator's remuneration is ₹ 4,12,000. Calculate liquidator's remuneration if the surplus is insufficient to pay off unsecured creditors, in toto.

Answer

Calculation of liquidator's remuneration:

	₹
Liquidator's remuneration on assets realised (₹ 10,00,000 x 2 /100)	20,000
Liquidator's remuneration on payment to unsecured creditors (₹ 4,12,000 x 3/103)	12,000
Total liquidator's remuneration	32,000

Question 11

A Liquidator is entitled to receive remuneration at 2% on the assets realized, 3% on the amount distributed to Preferential Creditors and 3% on the payment made to Unsecured Creditors. The assets were realized for ₹ 25,00,000 against which payment was made as follows:

Liquidation	*₹ 25,000*
Secured Creditors	*₹ 10,00,000*
Preferential Creditors	*₹ 75,000*

The amount due to Unsecured Creditors was ₹ 15,00,000. You are asked to calculate the total Remuneration payable to Liquidator. Calculation shall be made to the nearest multiple of a rupee.

Answer

Calculation of Total Remuneration payable to Liquidator

		Amount in ₹
2% on Assets realised	25,00,000 x 2%	50,000
3% on payment made to Preferential creditors	75,000 x 3%	2,250
3% on payment made to Unsecured creditors (Refer W.N)		39,255
Total Remuneration payable to Liquidator		91,505

Working Note:

Liquidator's remuneration on payment to unsecured creditors =

Cash available for unsecured creditors after all payments including liquidation expenses, payment to secured creditors, preferential creditors & liquidator's remuneration

= ₹ 25,00,000 – ₹ 25,000 – ₹ 10,00,000 – ₹ 75,000 – ₹ 50,000 – ₹ 2,250 = ₹ 13,47,750.

Liquidator's remuneration on payment to unsecured creditors = 3/103 x ₹ 13,47,750= ₹ 39,255

STATEMENT OF AFFAIRS (ON WINDING UP BY COURT)

Question 12

'A' Ltd is to be liquidated. Their summarised Balance Sheet as at 30th September, 2011 appears as under:

	₹
Liabilities:	
5,00,000 equity shares of ₹ 100 each	*50,00,000*
Secured debentures (on Land and Buildings)	*20,00,000*
Unsecured loans	*40,00,000*
Trade creditors	*70,00,000*
	1,80,00,000
Assets:	
Land and buildings	*10,00,000*
Other fixed assets	*40,00,000*
Current assets	*90,00,000*
Profit and loss account	*40,00,000*
	1,80,00,000
Contingent liabilities are:	
For bills discounted	*2,00,000*
For excise duty demands	*3,00,000*

On investigation, it is found that the contingent liabilities are certain to devolve and that the assets are likely to be realised as follows:

	₹
Land and Building	*22,00,000*
Other fixed assets	*36,00,000*
Current assets	*70,00,000*

Taking the above into account, prepare the statement of affairs.

Answer

Statement of Affairs of 'A' Ltd. (in Liquidation)

as at 30th September, 2011

		Estimated Realisable Value (₹)
	Assets not specifically pledged (as per List A):	
	Other Fixed Assets	36,00,000

	Current Assets					70,00,000
						1,06,00,000
	Assets specifically pledged (as per List B):					
		Estimated Realizable value	Due to secured creditors	Deficiency ranking as unsecured	Surplus carried to the last column	
		₹	₹	₹	₹	
	Land and Building	22,00,000	20,00,000	–	2,00,000	2,00,000
	Estimated total assets available for preferential creditors, debenture holders secured by a floating charge and unsecured creditors					1,08,00,000
	Summary of Gross Assets:					
	Gross realizable value of assets specifically pledged				22,00,000	
	Other Assets				1,06,00,000	
	Total Assets				1,28,00,000	
	Liabilities					
Gross Liabilities	*Liabilities*					
20,00,000	Secured creditors (as per List B) to the extent to which claims are estimated to be covered by assets specifically pledged					–
3,00,000	Preferential creditors (as per List C) – for demand of excise duty					3,00,000
	Balance of assets available for debentureholders secured by floating charge and unsecured creditors					1,05,00,000
–	Debentureholders secured by floating charge (as per List D)					–
	Unsecured creditors (as per List E):					
40,00,000	Unsecured Loans					40,00,000
70,00,000	Trade creditors					70,00,000
2,00,000	Liability for bills discounted (Contingent)					2,00,000
1,35,00,000	Estimated deficiency as regards creditors (difference between gross assets and gross liabilities)					7,00,000
	Issued and called up capital:					
	5,00,000 Equity shares of ₹ 10 each (as per List G)					50,00,000
	Estimated deficiency as regards members/ contributories					57,00,000

EXERCISES

1. *The following is the Balance Sheet of Y Limited as at 31st March, 2011:*

Liabilities	*₹*	*Assets*	*₹*
Share Capital:		*Fixed Assets :*	
2,000 Equity shares of ₹ 100 each ₹ 75 per share paid up	*1,50,000*	*Land & Buildings*	*4,00,000*
		Plant and Machineries	*3,80,000*
6,000 Equity shares of ₹ 100 each ₹ 60 per share paid up	*3,60,000*	*Current Assets :*	
		Stock at cost	*1,10,000*
2,000 10% Preference Share of ₹ 100 each fully paid up	*2,00,000*	*Sundry Debtors*	*2,20,000*
		Cash at Bank	*60,000*
10% Debentures (having a floating charge on all	*2,00,000*	*Profit and Loss A/c*	*2,40,000*

assets)			
Interest accrued on Debentures (also secured as above)	*10,000*		
Sundry Creditors	*4,90,000*		
	14,10,000		*14,10,000*

On that date, the company went into Voluntary Liquidation. The dividends on preference shares were in arrear for the last two years. Sundry Creditors include a loan of ₹ 90,000 on mortgage of Land and Buildings. The assets realised were as under:

	₹
Land and Buildings	*3,40,000*
Plant & Machineries	*3,60,000*
Stock	*1,20,000*
Sundry Debtors	*1,60,000*

Interest accrued on loan on mortgage of buildings upto the date of payment amounted to ₹ 10,000. The expenses of Liquidation amounted to ₹ 4,600. The Liquidator is entitled to a remuneration of 3% on all the assets realised (except cash at bank) and 2% on the amounts distributed among equity shareholders. Preferential creditors included in sundry creditors amount to ₹ 30,000. All payments were made on 30th June, 2011. Prepare the liquidator's final statement of account.

(Hints: Payment to Equity shareholders ₹35,000 (₹17.50 per share on 2,000 shares) & ₹15,000 (₹ 2.50 per share on 6,000 shares))

2. *In a winding up of a company, certain creditors remained unpaid. The following persons had transferred their holding sometime before winding up :*

Name	*Date of Transfer*	*No. of Shares transferred*	*Amount due to creditors on the date of transfer*
	2010		₹
P	*January 1*	*1,000*	*7,500*
Q	*February 15*	*400*	*12,500*
S	*March 15*	*700*	*18,000*
T	*March 31*	*900*	*21,000*
U	*April 5*	*1,000*	*30,000*

The shares were of ₹ 100 each, ₹ 80 being called up and paid up on the date of transfers.

A member, R, who held 200 shares died on 28th February, 2010 when the amount due to creditors was ₹ 15,000. His shares were transmitted to his son X.

Z was the transferee of shares held by T. Z paid ₹ 20 per share as calls in advance immediately on becoming a member.

The liquidation of the company commenced on 1st February, 2011 when the liquidator made a call on the present and the past contributories to pay the amount.

You are asked to quantify the maximum liability of the transferors of shares mentioned in the above table, when the transferees:

(i) pay the amount due as "present" member contributories;

(ii) do not pay the amount due as "present" member contributories.

Also quantity the liability of X to whom shares were transmitted on the demise of his father R.

(Hints: Liability of Q, R/X, S and U will be ₹ 2,174, ₹ 3,666, ₹ 5,830 and ₹ 18,330 respectively.)

5

Financial Statements of Insurance Companies

BASIC CONCEPTS

- *Claims:* it refers to the amount payable by insurer to the insured when policy becomes due or the mis-happening occurs.

  Claim = Claim intimated + Survey fees + Medical expenses – Claims received on insurance.

- *Premium* : it refers to the consideration received by the insurance company to undertake the risk of the loss. It is always net of premium paid on reinsurance.
- *Annuity (LIC):* it is fixed annual payment received regularly till insured lives. This is in consideration of lump-sum money paid by him in the beginning of the policy.
- *Bonus:* the profit of LIC is distributed among the shareholders and policy holders. The policy holders get 95% of the profit of LIC by way of bonus. The bonus may be of following types:
  - *Cash Bonus:* paid on declaration of bonus in cash.
  - *Revisionary Bonus:* it is paid with the policy maturity instead of cash amount now. This bonus is added in the amount of claims.
  - *Bonus in reduction of Premium:* Bonus is not paid in cash but adjusted against the future premiums.
  - *Interim Bonus:* it refers to bonus paid on the maturity of policy in the year for which the profit has not yet been determined. Such a bonus is included in claims.
- *Reinsurance :* if an insurer is not willing to bear the whole of the risk, it reinsure itself. Some risk retains with some other insurer.
- *Commission on Reinsurance Accepted:* the reinsurer generally allows commission to reinsured on part of business ceded. This is treated as expense of the company.
- *Commission on Reinsurance ceded:* Reinsurance generally gets commission for giving the business under reinsurance contract. It appears as an income in revenue

account.

- *Coinsurance:* when a large risk is offered to an insurance company, then that insurance company retains certain percentage of sum insured and contracts other insurance company to underwriter the balance of risk. In this way, all the companies jointly bear the risk. One is called as the leader who issues the policy and acts on behalf of others.
- *Reserve for unexpired Risk:*

  For Marine Business = 100% of net premium income

  For others = 40% of net premium income

  (Income tax authorities allow even a provision of 50% of net premium income from other sources)

Financial Statements

Life Insurance Business

The insurance company carrying life insurance business is required to prepare Balance sheet form A – BS Revenue account [Policy holders' account] Form A- RA Profit and loss account form A-PL. These forms have been given in the IRDA Regulations, 2002.

No form has been specified for cash flow statement.

General Insurance Business

The insurance company carrying on general insurance business is required to prepare Balance sheet form B – BS Revenue account [Policy holders' account] Form B- RA Profit and loss account form B-PL. These forms have been given in the IRDA Regulations, 2002.

No form has been specified for cash flow statement.

Question 1

Write short note on Unexpired Risks Reserve

Answer

In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies extend into the following year during which the risk continues. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance.

This reserve is based on the net premium income earned by the insurance company during the year

Question 2

Write short note on Re-insurance.

Answer

If an insurer does not wish to bear the whole risk of policy written by him, he may reinsure a part of the risk with some other insurer. In such a case the insurer is said to have ceded a part of his business to other insurer. The reinsurance transaction may thus be defined as an agreement between a 'ceding company' and 'reinsurer' whereby the former agreed to 'cede' and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement.

A 'ceding company' is the original insurance company which has accepted the risk and has agreed to 'cede' or pass on that risk to another insurance company or a reinsurance company. It may however be emphasised that the original insured does not acquire any right under a reinsurance contract against the reinsurer. In the event of loss, therefore, the insured's claim for full amount is against the original insurer. The original insurer has to claim the proportionate amount from the reinsurer.

There are two types of reinsurance contracts, namely, facultative reinsurance and treaty reinsurance. Under facultative reinsurance each transaction has to be negotiated individually and each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. Under treaty reinsurance a treaty agreement is entered into between ceding company and the reinsurer whereby the volume of the reinsurance transactions remain within the limits of the treaty.

Question 3

Give computation of "premium income," "claims expense" and "commission expense" in the case of an insurance company.

Answer

Premium income: The payment made by the insured as consideration for the grant of insurance is known as premium. The amount of premium income to be credited to revenue account for a year may be computed as:

PREMIUM EARNED [NET]

	Particulars	*Current Year*	*Previous Year*
		(₹000)	*(₹000)*
	Premium from direct business written	-	-
	Add: Premium on reinsurance accepted	-	-

	Less : Premium on reinsurance ceded	-	-
	Net Premium	-	-
	Adjustment for change in reserve for unexpired risks	-	-
	Total Premium Earned (Net)	=	=

Note: Reinsurance premiums whether on business ceded or accepted are to be brought into account, before deducting commission, under the head of reinsurance premiums.

Claims expenses: A claim occurs when a policy falls due for payment. In the case of a life insurance business, it will arise either on death or maturity of policy that is, on the expiry of the specified term of years. In the case of general insurance business, a claim arises only when the loss occurs or the liability arises.

The amount of claim to be charged to revenue account may be worked out as under :

CLAIMS INCURRED [NET]

Particulars	*Current Year*	*Previous Year*
	(₹'000)	*(₹'000)*
Claims paid	-	-
Direct	-	-
Add :Re-insurance accepted	-	-
Less :Re-insurance Ceded	-	-
Net Claims paid	-	-
Add : Claims Outstanding at the end of the year	-	-
Less : Claims Outstanding at the beginning	-	-
Total Claims Incurred	=	=

Notes:

(a) *Incurred But Not Reported (IBNR), Incurred but not enough reported [IBNER] claims should be included in the amount for outstanding claims.*

(b) *Claims includes specific claims settlement cost but not expenses of management*

(c) *The surveyor fees, legal and other expenses shall also form part of claims cost.*

(d) *Claims cost should be adjusted for estimated salvage value if there is a sufficient certainty of its realisation.*

Commission expenses: Insurance Regulatory and Development Authority Act, 1999 regulates the commission payable on policies to agents. Commission expense to be charged to revenue account is computed as follows:

COMMISSION

Particulars	*Current Year*	*Previous Year*
	(₹000)	*(₹000)*
Commission paid	-	-
Direct	-	-
Add: Re-insurance Accepted	-	-
Less: Commission on Re-insurance Ceded	-	-
Net Commission	=	=

Note: The profit/ commission, if any, are to be combined with the Re-insurance accepted or Re-insurance ceded figures.

Question 4

From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2011:

	Direct Business	*Re-Insurance*
	₹	*₹*
Claim paid during the year	*46,70,000*	*7,00,000*
Claim Payable — 1st April, 2010	*7,63,000*	*87,000*
31st March, 2011	*8,12,000*	*53,000*
Claims received	–	*2,30,000*
Claims Receivable — 1st April, 2010	–	*65,000*
31st March, 2011	–	*1,13,000*
Expenses of Management	*2,30,000*	–
(includes ₹35,000 Surveyor's fee and ₹45,000		
Legal expenses for settlement of claims)		

Answer

General Insurance Company (Abstract showing the amount of claims)

Net Claims incurred

		₹
Claims paid on direct business (46,70,000 + 35,000 + 45,000)		47,50,000
Add: Re-insurance	7,00,000	

Add: Outstanding as on 31.3.2011	53,000	
Less: Outstanding as on 1.4.2010	(87,000)	6,66,000
		54,16,000
Less : Claims received from re-insurance	2,30,000	
Add: Outstanding as on 31.3.2011	1,13,000	
Less: Outstanding as on 1.4.2010	(65,000)	(2,78,000)
		51,38,000
Add : Outstanding direct claims at the end of the year		8,12,000
		59,50,000
Less : Outstanding claims at the beginning of the year		(7,63,000)
Net claims incurred		51,87,000

Question 5

From the following balances extracted from the books of Perfect General Insurance Company Limited as on 31.3.2011, you are required to prepare Revenue Accounts in respect of Fire and marine Insurance business for the year ended 31.3.2011 to and a Profit and Loss Account for the same period :

	₹		₹
Directors' Fees	*80,000*	*Interest received*	*19,000*
Dividend received	*1,00,000*	*Fixed Assets (1.4.2010)*	*90,000*
Provision for Taxation		*Income-tax paid during*	
(as on 1.4. 2010)	*85,000*	*the year*	*60,000*

	Fire	*Marine*
	₹	₹
Outstanding Claims on 1.4.2010	*28,000*	*7,000*
Claims paid	*1,00,000*	*80,000*
Reserve for Unexpired Risk on 1.4.2010	*2,00,000*	*1,40,000*
Premiums Received	*4,50,000*	*3,30,000*
Agent's Commission	*40,000*	*20,000*
Expenses of Management	*60,000*	*45,000*
Re-insurance Premium (Dr.)	*25,000*	*15,000*

The following additional points are also to be taken into account :

(a) Depreciation on Fixed Assets to be provided at 10% p.a.

(b) Interest accrued on investments ₹ 10,000.

(c) Closing provision for taxation on 31.3.2011 to be maintained at ₹ 1,24,138

(d) Claims outstanding on 31.3.2011 were Fire Insurance ₹ 10,000; Marine Insurance ₹ 15,000.

(e) Premium outstanding on 31.3.2011 were Fire Insurance ₹ 30,000; Marine Insurance ₹ 20,000.

(f) Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.

(g) Expenses of management due on 31.3.2011 were ₹ 10,000 for Fire Insurance and ₹ 5,000 in respect of marine Insurance

Answer

Form B – RA (Prescribed by IRDA)
Perfect General Insurance Co. Ltd
Revenue Account for the year ended 31st March, 2011
Fire and Marine Insurance Businesses

	Schedule	*Fire Current Year*	*Marine Current Year*
		₹	₹
Premiums earned (net)	1	4,27,500	1,40,000
Interest, Dividends and Rent – Gross		—	—
Double Income Tax refund		—	—
Profit on sale of motor car		—	—
Total (A)		4,27,500	1,40,000
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	70,000	50,000
Bad debts		—	—
Indian and Foreign taxes		—	—
Total (B)		1,92,000	1,58,000
Profit from Marine Insurance business (A-B)		2,35,500	(18,000)

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)		*Fire Current Year*	*Marine Current Year*
		₹	₹
Premiums from direct business written		4,80,000	3,50,000
Less: Premium on reinsurance ceded		(25,000)	(15,000)
Total Premium earned		4,55,000	3,35,000
Less: Change in provision for unexpired risk		(27,500)	(1,95,000)
		4,27,500	1,40,000
Schedule – 2			
Claims incurred (net)		82,000	88,000
Schedule – 4			
Operating expenses related to insurance business			
Expenses of Management		70,000	50,000

Form B-PL

Perfect General Insurance Co. Ltd.

Profit and Loss Account for the year ended 31st March, 2011

Particulars	*Schedule*	*Current Year*	*Previous Year*
		₹	₹
Operating Profit/(Loss)			
(a) Fire Insurance		2,35,500	
(b) Marine Insurance		(18,000)	
(c) Miscellaneous Insurance		—	
Income From Investments			
Interest, Dividend & Rent–Gross		1,29,000	
Other Income (To be specified)			
Total (A)		3,46,500	
Provisions (Other than taxation)		—	
Depreciation		9,000	

Other Expenses –Director's Fee		80,000	
Total (B)		89,000	
Profit Before Tax		2,57,500	
Provision for Taxation		99,138	
Profit After Tax		1,58,362	

Working Notes:

		Fire	Marine
		₹	₹
1.	Claims under policies less reinsurance		
	Claims paid during the year	1,00,000	80,000
	Add: Outstanding on 31st March, 2011	10,000	15,000
		1,10,000	95,000
	Less : Outstanding on 1st April, 2010	(28,000)	(7,000)
		82,000	88,000
2.	Expenses of management		
	Expenses paid during the year	60,000	45,000
	Add: Outstanding on 31st March, 2011	10,000	5,000
		70,000	50,000
3.	Premiums less reinsurance		
	Premiums received during the year	4,50,000	3,30,000
	Add: Outstanding on 31st March, 2011	30,000	20,000
		4,80,000	3,50,000
	Less : Reinsurance premiums	(25,000)	(15,000)
		4,55,000	3,35,000

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance.

5. Provision for taxation account

	₹		₹
31.3.2011 To Bank A/c		1.4.2010 By Balance b/d	85,000
(taxes paid)	60,000	31.3.2011 By P & L A/c	99,138
31.3.2011 To Balance c/d	1,24,138		
	1,84,138		1,84,138

Question 6

From the following information as on 31st March, 2011, prepare the Revenue Accounts of Sagar Bhima Co. Ltd. engaged in Marine Insurance Business:

	Particulars	Direct Business (₹)	Re-insurance (₹)
I.	Premium :		
	Received	24,00,000	3,60,000
	Receivable – 1st April, 2010	1,20,000	21,000
	– 31st March, 2011	1,80,000	28,000
	Premium paid	2,40,000	–
	Payable – 1st April, 2010	–	20,000
	– 31st March, 2011	–	42,000
II.	Claims :		
	Paid	16,50,000	1,25,000
	Payable – 1st April, 2010	95,000	13,000
	– 31st March, 2011	1,75,000	22,000
	Received	–	1,00,000
	Receivable – 1st April, 2010	–	9,000
	– 31st March, 2011	–	12,000
III.	Commission :		
	On Insurance accepted	1,50,000	11,000
	On Insurance ceded	–	14,000

Other expenses and income:

Salaries – ₹ 2,60,000; Rent, Rates and Taxes – ₹ 18,000; Printing and Stationery – ₹ 23,000; Indian Income Tax paid – ₹ 2,40,000; Interest, Dividend and Rent received (net) – ₹ 1,15,500; Income Tax deducted at source – ₹ 24,500; Legal Expenses (Inclusive of ₹ 20,000 in connection with the settlement of claims) – ₹ 60,000; Bad Debts – ₹ 5,000; Double Income Tax refund – ₹ 12,000; Profit on Sale of Motor car ₹ 5,000.

Balance of Fund on 1st April, 2010 was ₹ 26,50,000 including Additional Reserve of ₹ 3,25,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

Answer

In exercise of the powers conferred by Section 114A of the Insurance Act, 1938 (4 of 1938), the Insurance Regulatory and Development Authority in consultation with the Insurance Advisory Committee prescribed the new formats for the financial statements of Insurance Companies i.e. preparation of Financial Statements and Auditor's Report of Insurance Companies Regulations, 2000. Therefore, the above revenue account can be prepared as:

Form B – RA (Prescribed by IRDA)
Revenue Account for the year ended 31st March, 2011
Marine Insurance Business

	Schedule	Current Year	Previous Year
		₹	₹
Premiums earned (net)	1	25,21,750	
Interest, Dividends and Rent – Gross		1,15,500	
Double Income Tax refund		12,000	
Profit on sale of motor car		5,000	
Total (A)		26,54,250	
Claims incurred (net)	2	17,81,000	
Commission	3	1,47,000	
Operating expenses related to Insurance business	4	3,41,000	
Bad debts		5,000	
Indian and Foreign taxes		2,40,000	
Total (B)		25,14,000	
Profit from Marine Insurance business (A-B)		1,40,250	

Schedules forming part of Revenue Account

		Current Year	Previous Year
		₹	₹
Schedule –1			
Premium earned (net)			
Premiums from direct business written		28,27,000	
Less: Premium on reinsurance ceded		(2,62,000)	
Total Premium earned (net)		25,65,000	
Change in provision for unexpired risk (₹ 26,93,250 – ₹ 26,50,000)		(43,250)	
Net Premium earned		25,21,750	
Schedule – 2			
Claims incurred (net)		17,81,000	
Schedule – 3			
Commission paid			
Direct		1,50,000	
Add: Re-insurance accepted		11,000	
Less: reinsurance ceded		(14,000)	
		1,47,000	

Schedule – 4			
Operating expenses related to insurance business			
Employees' remuneration and welfare benefits		2,60,000	
Rent, Rates and Taxes		18,000	
Printing and Stationery		23,000	
Legal and Professional charges		40,000	
		3,41,000	

Working Notes:

1.	Total Premium Income	*Direct*	*Re-insurance*
		₹	₹
	Received	24,00,000	3,60,000
	Add: Receivable on 31st March, 2011	1,80,000	28,000
		25,80,000	3,88,000
	Less: Receivable on 1st April, 2010	(1,20,000)	(21,000)
		24,60,000	3,67,000

Total premium income 24,60,000 + 3,67,000 = 28,27,000

2.	Premium Paid	₹
	Paid	2,40,000
	Add: Payable on 31st March, 2011	42,000
		2,82,000
	Less: Payable on 1st April, 2010	(20,000)
		2,62,000
3.	Claims Paid	
	Direct Business	16,50,000
	Re-insurance	1,25,000
	Legal Expenses	20,000
		17,95,000
	Less: Re-insurance claims received	(1,00,000)
		16,95,000
4.	Claims outstanding as on 31st March, 2011	
	Direct	1,75,000
	Re-insurance	22,000
		1,97,000
	Less: Recoverable from Re-insurers on 31st March, 2011	(12,000)
		1,85,000

5.	Claims outstanding as on 1st April, 2010	
	Direct	95,000
	Re-insurance	13,000
		1,08,000
	Less: Recoverable from Re-insurers on 1st April, 2010	(9,000)
		99,000
6.	Expenses of Management	
	Salaries	2,60,000
	Rent, Rates and taxes	18,000
	Printing and Stationery	23,000
	Legal Expenses	40,000
		3,41,000

Question 7

X Fire Insurance Co. Ltd. commenced its business on 1.4.2010. It submits you the following information for the year ended 31.3.2011:

	₹
Premiums received	*15,00,000*
Re-insurance premiums paid	*1,00,000*
Claims paid	*7,00,000*
Expenses of Management	*3,00,000*
Commission paid	*50,000*
Claims outstanding on 31.3.2011	*1,00,000*
Create reserve for unexpired risk @40%	
Prepare Revenue account for the year ended 31.3.2011.	

Answer

Form B – RA (Prescribed by IRDA)

Name of the Insurer: X Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA: …………………..

Revenue Account for the year ended 31st March, 2011

	Particulars	*Schedule*	*Current year ended on 31st March, 2011*
			₹
1.	Premiums earned (Net)	1	14,00,000
2.	Change in provision for unexpired risk (NIL–5,60,000)	2	(5,60,000)
	Total (A)		8,40,000

1.	Claims incurred (Net)	3	8,00,000
2.	Commission		50,000
3.	Operating Expenses	4	3,00,000
	Total (B)		11,50,000
	Operating Profit/(Loss) from Fire Insurance Business [C =(A – B)]		(3,10,000)

Schedule 1

Premiums earned (Net)

	₹
Premium received	15,00,000
Less: Premium on re-insurance paid	(1,00,000)
	14,00,000

Schedule 2

Reserve for unexpired risk @ 40% on net premium

₹ $14,00,000 \times \frac{40}{100} =$ ₹ 5,60,000

Schedule 3

Claims

	₹
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2011	1,00,000
	8,00,000

Schedule 4

Operating expenses

	₹
Expenses of Management	3,00,000

Question 8

Prepare the Fire Insurance Revenue A/c as per IRDA regulations for the year ended 31st March, 2011 from the following details:

	₹
Claims paid	*4,90,000*
Legal expenses regarding claims	*10,000*
Premiums received	*13,00,000*
Re-insurance premium paid	*1,00,000*
Commission	*3,00,000*
Expenses of management	*2,00,000*
Provision against unexpired risk on 1st April, 2010	*5,50,000*
Claims unpaid on 1st April, 2010	*50,000*
Claims unpaid on 31st March, 2011	*80,000*

Answer

FORM B - RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

Fire Insurance Revenue Account for the year ended 31st March, 2011

	Particulars	*Schedule*	*Amount (₹)*
(1)	Premium earned	1	11,50,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		11,50,000
(4)	Claims incurred	2	5,30,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,30,000
	Operating Profit (A)- (B)		1,20,000

Schedule 1 : Premium earned (net)	₹
Premium received	13,00,000
Less: Re-insurance premium	(1,00,000)
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	(50,000)
	11,50,000

Schedule 2 : Claims Incurred	₹
Claims paid including legal expenses (4,90,000 + 10,000)	5,00,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,30,000

Schedule 3 : Commission	₹
Commission paid	3,00,000
	3,00,000
Schedule 4: Operating expenses	**₹**
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	₹
Unexpired risk reserve on 31st March, 2011 = 50% of net premium	
i.e. 50% of ₹ 12,00,000 (See Schedule 1)	6,00,000
Less : Unexpired risk reserve as on 1st April, 2010	(5,50,000)
Change in the provision for unexpired risk	50,000

Question 9

Sunlife General Insurance Company submits the following information for the year ended 31st March 2010:

Particulars		*Direct Business* ₹	*Reinsurance* ₹
Premium received		*65,75,000*	*9,50,000*
Premium paid		---	*4,75,000*
Claims paid during the year		*42,50,000*	*5,00,000*
Claims payable	*1st April, 2009*	*6,25,000*	*87,000*
	31st March, 2010	*7,18,000*	*60,000*
Claims received		---	*3,25,000*
Claims receivable	*1st April, 2009*		*65,000*

31st March, 2010		*1,10,000*
Expenses of management	*2,30,000*	
Commission		
On insurance accepted	*1,50,000*	*11,000*
On insurance ceded		*14,000*

The following additional information is also available:

(1) *Expenses of management include ₹ 35,000 surveyor's fee and ₹ 45,000 legal expenses for settlement of claims.*

(2) *Reserve for unexpired risk is to be maintained @ 40%. The balance of reserve for unexpired risk as on 1.4.09 was ₹ 24,50,000.*

You are required to prepare the Revenue Account for the year ended 31st March, 2010.

Answer

Form B-RA (Prescribed by IRDA)

Sunlife General Insurance Company

Revenue Account for the year ended 31st March, 2010

Particulars	*Schedule*	*Amount (₹)*
Premium earned (net)	1	66,80,000
Interest, dividend and rent		--
Other income		--
Total (A)		66,80,000
Claims incurred (Net)	2	45,26,000
Commission	3	1,47,000
Operating expenses related to insurance business	4	1,50,000
Bad debts		-
Total (B)		48,23,000
Operating profit from insurance business (A-B)		18,57,000

Schedules forming part of revenue account

Schedule 1 : Premium Earned (Net)

Particulars	₹
Premium from direct business	65,75,000
Add: Premium on reinsurance accepted	9,50,000
Less: Premium on reinsurance ceded	(4,75,000)

Net premium	70,50,000
Adjustment for change in reserve for unexpired risks (W.N.2)	(3,70,000)
Total premium earned (net)	66,80,000

Schedule 2 : Claims Incurred (Net)

Particulars	₹
Claims paid on direct business (W.N.1)	43,30,000
Add: Re-insurance accepted (W.N.1)	4,73,000
Less: Re-insurance ceded (W.N.1)	(3,70,000)
Net claims paid	44,33,000
Add: Claims outstanding at the end of the year	7,18,000
Less: Claims outstanding at the beginning of the year	(6,25,000)
Total claims incurred	45,26,000

Schedule 3 : Commission

Particulars	₹
Commission paid on direct business	1,50,000
Add: Commission on reinsurance accepted	11,000
Less: Commission on reinsurance ceded	(14,000)
	1,47,000

Schedule 4 : Operating Expenses related to Insurance Business

Particulars	₹
Expenses of management (2,30,000 – 35,000 – 45,000)	1,50,000
	1,50,000

Working Notes:

1. Claims incurred

Particulars	*Direct business (₹)*	*Re-insurance accepted (₹)*	*Re-insurance ceded (₹)*
Paid/received	42,50,000	5,00,000	3,25,000
Add: Outstanding at the end of the year		60,000	1,10,000
Expenses in connection with settlement of claim (35,000 + 45,000)	80,000		

Less: Outstanding at the beginning of the year		(87,000)	(65,000)
	43,30,000	4,73,000	3,70,000

2. Change in reserve for unexpired risk

	₹
Opening reserve as on 31st March, 2009	24,50,000
Less: Closing reserve as on 31st March, 2010 (₹ 70,50,000 x 40%)	(28,20,000)
	(3,70,000)

Question 10

On 31st March, 2011 the books of Zee Insurance Company Limited, contained the following particulars in respect of fire insurance:

Particulars	*Amount (₹)*
Reserve for unexpired risks on March 31, 2010	*5,00,000*
Additional reserve for unexpired risks on March 31, 2010	*1,00,000*
Premiums	*11,20,000*
Claims paid	*6,40,000*
Estimated liability in respect of outstanding claims:	
On March 31, 2010	*65,000*
On March 31, 2011	*90,000*
Expenses of management (including ₹ 30,000 legal expenses paid in connection with the claims)	*2,80,000*
Interest and dividend	*64,250*
Income tax on the above	*6,520*
Profit on sale of investment	*11,000*
Commission paid	*1,52,000*

On 31st March, 2011 provide ₹ 5,60,000 as unexpired risk reserve and ₹ 75,000 as Additional reserve.

You are required to prepare the Fire Insurance Revenue account as per the regulations of IRDA, for the year ended 31st March, 2011.

Answer

FORM B– RA

Name of the Insurer: Zee Insurance Company Limited

Registration No. and Date of registration with IRDA: ……………………..

Revenue Account for the year ended 31st March, 2011

Particulars	*Schedule*	*Amount (₹)*
Premium earned (net)	1	10,85,000
Profit or loss on sale/redemption of investment		11,000
Others		–
Interest, dividend & rent (gross)		64,250
Total (A)		11,60,250
Claims incurred (Net)	2	6,95,000
Commission	3	1,52,000
Operating expenses related to insurance	4	2,50,000
Total (B)		10,97,000
Operating profit/loss from insurance business (B) – (A)		63,250

Schedule –1 Premium earned (net)

	₹
Premium received	11,20,000
Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.)	(35,000)
Total premium earned	10,85,000

Schedule -2 Claims incurred (net)

	₹
Claims paid	6,40,000
Add: Legal expenses regarding claims	30,000
	6,70,000
Add: Claims outstanding as on 31st March, 2011	90,000
	7,60,000
Less: Claims outstanding as on 31st March, 2010	(65,000)
	6,95,000

Schedule -3 Commission

	₹
Commission paid	1,52,000
Schedule-4 Operating expenses related to Insurance Business	
Expenses of management (₹ 2,80,000 – ₹ 30,000)	2,50,000

Working Note:

Calculation for change in Reserve for Unexpired risk:

		₹
Reserve for Unexpired Risk as on 31st March, 2011	5,60,000	
Additional Reserve as on 31st March, 2011	75,000	6,35,000
Less: Reserve for Unexpired Risk as on 31st March, 2010	5,00,000	
Additional Reserve as on 31st March, 2010	1,00,000	(6,00,000)
		35,000

Note: Interest and dividends are shown at gross value in Revenue account. Income tax on it will not be included in the Revenue account as it is the part of Profit and Loss account of an insurance company.

Question 11

From the following information furnished to you by Ayushman Insurance Co. Ltd., you are required to pass Journal entries relating to unexpired risk reserve and show in columnar form "Unexpired Risks Reserve Account" for 2011.

(a) On 31.12.2010, it had reserve for unexpired risks amounting to ₹ 40 crores. It comprised of ₹ 15 crores in respect of marine insurance business, ₹ 20 crores in respect of fire insurance business and ₹ 5 crores in respect of miscellaneous insurance business.

(b) Ayushman Insurance Co. Ltd. creates reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.

(c) During 2011, the following business was conducted:

		(₹ in crores)	
	Marine	*Fire*	*Miscellaneous*
Premium collected from:			
(a) Insured in respect of policies issued	*18.00*	*43.00*	*12.00*
(b) Other insurance companies in respect of risks undertaken	*7.00*	*5.00*	*4.00*
Premium paid/payable to other insurance companies on business ceded	*6.70*	*4.30*	*7.00*

Answer

In the books of Ayushman Insurance Co. Ltd.
Journal Entries

Date	Particulars		(₹ in crores) Dr.	Cr.
1.1.2011	Unexpired Risk Reserve (Fire) A/c	Dr.	20.00	
	Unexpired Risk Reserve (Marine) A/c	Dr.	15.00	
	Unexpired Risk Reserve (Miscellaneous) A/c	Dr.	5.00	
	To Fire Revenue Account			20.00
	To Marine Revenue Account			15.00
	To Miscellaneous Revenue Account			5.00
	(Being unexpired risk reserve brought forward from last year)			
31.12.2011	Marine Revenue A/c	Dr.	18.30	
	To Unexpired Risk Reserve A/c			18.30
	(Being closing reserve for unexpired risk created at 100% of net premium income amounting to ₹18.3 crores i.e.18+7-6.70)			
	Fire Revenue A/c	Dr.	21.85	
	To Unexpired Risk Reserve A/c			21.85
	(Being closing reserve for unexpired risk created at 50% of net premium income of ₹ 43.7 crores i.e.43+5-4.30)			
	Miscellaneous Revenue A/c	Dr.	4.50	
	To Unexpired Risk Reserve A/c			4.50
	(Being closing reserve for unexpired risk created at 50% net premium income of ₹ 9 crores i.e. 12+4-7)			

Unexpired Risk Reserve Account

Date	Particulars	Marine (₹)	Fire (₹)	Misc. (₹)	Date	Particulars	Marine (₹)	Fire (₹)	Misc. (₹)
1.1.2011	To Revenue A/c	15.00	20.00	5.00	1.1.2011	By Balance b/d	15.00	20.00	5.00
31.12.2011	To Balance c/d	18.30	21.85	4.50	31.12.2011	By Revenue A/c	18.30	21.85	4.50
		33.30	41.85	9.50			33.30	41.85	9.50

Question 12

From the following information of Reliable Marine Insurance Ltd. for the year ending 31st March, 2012 find out the

(i) Net premiums earned

(ii) Net claims incurred

	(₹) Direct Business	(₹) Re-insurance
Premium:		
Received	*88,00,000*	*7,52,000*
Receivable – 01.04.2011	*4,39,000*	*36,000*
Receivable – 31.03.2012	*3,77,000*	*32,000*
Paid	*6,09,000*	
Payable – 01.04.2011		*27,000*
Payable – 31.03.2012		*18,000*
Claims:		
Paid	*69,00,000*	*5,54,000*
Payable – 01.04.2011	*89,000*	*15,000*
Payable – 31.03.2012	*95,000*	*12,000*
Received		*2,01,000*
Receivable – 01.04.2011		*40,000*
Receivable – 31.03.2012		*38,000*

Answer

(i) Net Premium earned

		₹
Premium from direct business received	88,00,000	
Add : Receivable as 31.03.2012	3,77,000	
Less : Receivable as on 01.04.2011	(4,39,000)	87,38,000
Add : Premium on re-insurance accepted	7,52,000	
Add : Receivable as on 31.03.2012	32,000	
Less : Receivable as on 01.04.2011	(36,000)	7,48,000
		94,86,000
Less : Premium on re-insurance ceded	6,09,000	
Add : Payable as on 31.03.2012	18,000	
Less : Payable as on 01.04.2011	(27,000)	(6,00,000)
Net Premium earned		88,86,000

(ii) Net Claims incurred

		₹
Claims paid on direct business		69,00,000
Add: Re-insurance	5,54,000	
Add: Outstanding as on 31.3.2012	12,000	
Less: Outstanding as on 1.4.2011	(15,000)	5,51,000
		74,51,000
Less : Claims received from re-insurance	2,01,000	
Add: Outstanding as on 31.3.2012	38,000	
Less: Outstanding as on 1.4.2011	(40,000)	(1,99,000)
		72,52,000
Add : Outstanding direct claims at the end of the year		95,000
		73,47,000
Less : Outstanding claims at the beginning of the year		(89,000)
Net claims incurred		72,58,000

Question 13

Prepare the Fire Insurance Revenue A/c of Jasmine Fire Insurance Co. Ltd. as per IRDA regulations for the year ended 31st March, 2012 from the following details:

Particulars	*Amount (₹)*
Claims Paid	*5,00,000*
Legal Expenses regarding claims	*10,000*
Premiums received	*12,50,000*
Re-insurance premium paid	*50,000*
Commission	*3,00,000*
Expenses of Management	*2,00,000*
Provision against unexpired risk as on 1st April, 2011	*5,75,000*
Claims unpaid on 1st April, 2011	*50,000*
Claims unpaid on 31st March, 2012	*80,000*

Provide for unexpired risk @ 50% less reinsurance.

Answer

FORM B - RA

Name of the Insurer: Jasmine Fire Insurance Co. Ltd.

Registration No. and Date of Registration with the IRDA:

Revenue Account for the year ended 31st March, 2012

	Particulars	*Schedule*	*Amount (₹)*
(1)	Premium earned	1	11,75,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		11,75,000
(4)	Claims incurred	2	5,40,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,40,000
	Operating Profit (A)- (B)		1,35,000

Schedule 1 : Premium earned (net)	₹
Premium received	12,50,000
Less: Re-insurance premium	(50,000)
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	(25,000)
	11,75,000

Schedule 2 : Claims Incurred	₹
Claims paid including legal expenses (5,00,000 + 10,000)	5,10,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,40,000

Schedule 3 : Commission	₹
Commission paid	3,00,000
	3,00,000

Schedule 4: Operating expenses	₹
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	₹
Unexpired risk reserve on 31st March, 2012 =50% of net premium	
(i.e. 50% of ` 12,00,000)	6,00,000
Less : Unexpired risk reserve as on 1st April 2011	(5,75,000)
Change in the provision for unexpired risk	25,000

6

Financial Statements of Banking Companies

BASIC CONCEPTS

The banks have to classify their advances into four broad groups (*i*) standard assets, (*ii*) sub-standard assets, (*iii*) doubtful assets and (*iv*) loss assets.

Rates of Provisioning for Non-Performing Assets

Category of Advances	Revised Rate (%)
Standard Advances	
(a) direct advances to agricultural and SME	0.25
(b) advances to Commercial Real Estate (CRE) Sector	1.00
(c) all other loans and advances not included in (a) and (b) above	0.40
Sub- standard Advances	
• Secured Exposures	15
• Unsecured Exposures	25
• Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as escrow accounts are available.	20
Doubtful Advances – Unsecured Portion	100
Doubtful Advances – Secured Portion	
• For Doubtful upto 1 year	25
• For Doubtful > 1 year and upto 3 years	40
• For Doubtful > 3 years	100
Loss Advances	100

The provisions on standard assets should not be reckoned for arriving at net NPAs.

The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions Others' in Schedule 5 of the balance sheet.

GENERAL

Question 1

Write short notes on Slip system of posting and double voucher system.

Answer

Slip system of posting : Under this system used in banking companies, entries in the personal ledgers are made directly from vouchers instead of being posted from the day book. Pay-in-slips (used by the customers at the time of making deposits) and the cheques are used as slips which form the basis of most of the transactions directly recorded in the accounts of customers. As the slips are mostly filled by the customers themselves, this system saves a lot of time and labour of the bank staff. The vouchers entered into different personal ledgers are summarised on summary sheets every day, totals of which are posted to the different control accounts which are maintained in the general ledger.

Double voucher system : In a bank, two vouchers are prepared for every transaction not involving cash—one debit voucher and another credit voucher. This system is called double voucher system. The vouchers are sent to different clerks who make entries in books under their charge.

Question 2

What are the restrictions imposed by the Banking Regulations Act, 1949 on payment of dividend in case of banking companies?

Answer

As per the Banking Regulations Act 1949, a banking company cannot pay dividend on its shares until all its capitalized expenses including preliminary expenses, organization expenses, share selling commission, brokerage, amount of losses incurred by tangible assets and any other item of expenditure not represented by tangible assets are completely written off. However, as per the Act, it is permissible for a banking company to pay dividend on its shares without writing off:

(i) The depreciation in the value of its investments in approved securities where such depreciation has not actually been capitalized or otherwise accounted for as a loss.

(ii) The depreciation in the value of its investments in shares, debentures or bonds (other than approved securities) where adequate provision for such deprecation has been made to the satisfaction of its auditors; and

(iii) The bad debts where adequate provision for such bad debts has been made to the satisfaction of its auditors.

Question 3

Write short note on Classification of investments by a banking company.

Answer

The investment portfolio of a bank would normally consist of both approved securities (predominantly government securities) and other securities (shares, debentures, bonds etc.). Banks are required to classify their entire investment portfolio into three catogories : held-to-maturity, available-for-sale and held-for-trading. Securities acquired by banks with the intention to hold them upto maturity should be classified as 'held-to-maturity'. Securities acquired by banks with the intention to trade by taking advantage of short–term price interest rate movements should be classifed as held-for trading. Securities which do not fall within the above two categories should be classified as available-for-sale'.

NON-PERFORMING ASSETS AND THEIR PROVISIONING:

Question 4

Write short note on Non-Performing Assets.

Answer

An asset is classified as non-performing asset (NPA) if dues in the form of principal and interest are not paid by the borrower for a period of 90 days. If any advance or credit facility granted by a bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

Income from the non-performing assets can only be accounted for as and when it is actually received. In concept, any credit facility (assets) becomes non-performing when it eases to generate income. The RBI has issued guidelines to commercial banks regarding the classification of advances between performing and non-performing assets.

A term loan is treated as a non-performing assets (NPA) if interest and/or instalments of principal remains over due for a period of more than 90 days. A cash credit/overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated an 'out of order' if any of the following conditions is satisfied:

(a) the outstanding balance remains continuously in excess of the sanctional limit/drawing power.

(b) though the outstanding balance is less than the sanctioned limit/drawing power—

 (i) there are credits continuously for more than 90 days as on the date of balance sheet or

 (ii) credits during the aforesaid periods are not enough to cover the interest debited during the same period.

Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. Necessary provision should be made for non-performing assets after classifying them as sub-standard, doubtful or loss asset as the case may be.

Question 5

Write short note on Classification of advances in the case of a Banking Company.

Answer

Banks have to classify their advances into four broad groups:

(i) Standard Assets—Standard assets is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not a NPA as discussed earlier.

(ii) Sub-standard Assets—Sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months. In the case of term loans, those where instalments of principal are overdue for period exceeding one year should be treated as sub-standard. In other words, such an asset will have well-defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected.

(iii) Doubtful Assets—A doubtful asset is one which has remained sub-standard for a period exceeding 12 months. A loan classified as doubtful has all the weaknesses inherent in that classified as sub-standard with added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

(iv) Loss Assets—A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspectors but the amount has not been written off, wholly or partly.

The classification of advances should be done taking into account (i) Degree of well defined credit worthiness and (ii) Extent of dependence on collateral security.

The above classification is meant for the purpose of computing the amount of provision to be made in respect of advances and not for the purpose of presentation of advances in the balance sheet.

Question 6

From the following information find out the amount of provisions required to be made in the Profit & Loss Account of a commercial bank for the year ended 31st March, 2011 :

(i) Packing credit outstanding from Food Processors ₹ 60 lakhs against which the bank holds securities worth ₹ 15 lakhs. 40% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.

(ii) Other advances:

Assets classification	*₹ in lakhs*
Standard	*3,000*
Sub-standard	*2,200*
Doubtful :	
For one year	*900*
For two years	*600*
For three years	*400*
For more than 3 years	*300*
Loss assets	*600*

Answer

(i)

		(₹ in lakhs)
Amount outstanding (packing credit)	60	
Less : Realisable value of securities	(15)	
	45	
Less : ECGC cover (40%)	(18)	
Balance	27	
Required provision :		
Provision for unsecured portion (100%)		27.0
Provision for secured portion (100%)*		15.0
		42.0

(ii) Other advances:

			(₹ in lakhs)
Assets	*Amount*	*% of provision*	*Provision*
Standard	3,000	0.40	12
Sub-standard	2,200	15	330
Doubtful :			
For one year	900	25	225
For two years	600	40	240
For three years	400	40	160
For more than three years	300	100	300
Loss	600	100	600
Required provision			1,867

Note : Sub-standard and Doubtful advances have been assumed as fully secured. However, in case, the students assume that no security cover is available for these advances, provision will be made for @ 25% for sub-standard and 100% for doubtful advances.

Question 7

Bidisha Bank Ltd. had extended the following credit lines to a Small Scale Industry which had not paid any interest since March, 2005.

	Term Loan	*Export Credit*
Balance outstanding on 31.3.2011	*₹ 70 Lacs*	*₹ 60. Lacs*
DICGC/ECGC Cover	*50%*	*40%*
Securities held	*₹ 30 Lacs*	*₹ 25 Lacs*
Realisable value of securities	*₹ 20 Lacs*	*₹ 15 Lacs*

Compute the necessary provisions to be made for the year ended 31st March, 2011

Answer

	Term Loan	*Export Credit*
	₹ in Lacs	*₹ in Lacs*
Balance outstanding	70.00	60.00
Less : Realisable value of securities	(20.00)	(15.00)
	50.00	45.00
Less : DICGC/ECGC Cover	(25.00)	(18.00)
Net unsecured balance	25.00	27.00
Provision in respect of secured portion (100%)	20.00	15.00
Provision for unsecured portion (100%)	25.00	27.00
Provision required	45.00	42.00

Question 8

Rajatapeeta Bank Ltd. had extended the following credit lines to a Small Scale Industry, which had not paid any Interest since March, 2005:

	Term Loan	*Export Loan*
Balance Outstanding on 31.03.2011	*₹ 35 lakhs*	*₹ 30 lakhs*
DICGC/ECGC cover	*40%*	*50%*
Securities held	*₹ 15 lakhs*	*₹ 10 lakhs*
Realisable value of Securities	*₹ 10 lakhs*	*₹ 08 lakhs*

Compute necessary provisions to be made for the year ended 31st March, 2011.

Answer

	Term loan ₹ in lakhs	*Export credit ₹ in lakhs*
Balance outstanding on 31.3.2011	35.0	30.0
Less: Realisable value of Securities	(10.0)	(8.0)
	25.0	22.0
Less: DICGC cover @ 40%	10.0	
ECGC cover @ 50%	___	(11.0)
Unsecured balance	15.0	11.0

Required Provision:

100% for unsecured portion	15.0	11.0
100% for secured portion	10.0	8.00
Total provision required	25.0	19.0

Question 9

From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a Commercial Bank:

Assets	*(₹ in lakhs)*
Standard	*4,000*
Sub-standard	*2,000*
Doubtful upto one year	*900*
Doubtful upto three years	*400*
Doubtful more than three years	*300*
Loss Assets	*500*

Answer

Computation of provision:

Assets	*Amount (₹ in lakhs)*	*% of Provision*	*Provision (₹ in lakhs)*
Standard	4,000	0.40	16
Sub-standard*	2,000	15	300
Doubtful upto one year*	900	25	225
Doubtful upto three years*	400	40	160
Doubtful more than three	300	100	300

years*			
Loss	500	100	500
			1,501

* Sub-standard and doubtful assets are assumed as fully secured.

Question 10

From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial bank:

	Assets	₹ in lakhs
(i)	Standard (Value of security ₹6,000 lakhs)	7,000
(ii)	Sub-standard	3,000
(iii)	Doubtful	
	(a) Doubtful for less than one year (Realisable value of security ₹ 500 lakhs)	1,000
	(b) Doubtful for more than one year, but less than 3 years (Realisable value of security ₹ 300 lakhs)	500
	(c) Doubtful for more than 3 years (No security)	300

Answer

Statement showing Provisions on various performing and non-performing assets

	Amount	*% of*	Provision
	₹ in lakhs	*provision*	*₹ in lakhs*
Standard	7,000	0.40	28
Sub-standard	3,000	15	450
Doubtful (less than one year)			
On secured portion	500	25	125
On unsecured portion	500	100	500
Doubtful (more than one year but less than three years)			
On secured portion	300	40	120
On unsecured portion	200	100	200
Doubtful Unsecured (more than three years)	300	100	300
Total provision			1,723

Question 11

From the following information of details of advances of X Bank Limited calculate the amount of provisions to be made in profit and loss account for the year ended 31.3.2011:

Asset classification	*₹ in lakhs*
Standard	*6,000*
Sub-standard	*4,400*
Doubtful:	
For one year	*1,800*
For two years	*1,200*
For three years	*800*
For more than three years	*600*
Loss assets	*1,600*

Answer

Statement showing provisions on various performing and non-performing assets

Asset Classification	*Amount*	*Provision*	*Amount of Provision*
	₹ in lakhs	*%*	*₹ in lakhs*
Standard	6,000	0.40	24
Sub-standard**	4,400	15	660
Doubtful**			
One year	1,800	25	450
2 years	1,200	40	480
3 years	800	40	320
More than 3 years	600	100	600
Loss assets	1,600	100	1,600
			4,134

Question 12

Find out the income to be recognised at Good Bank Limited for the year ended 31.3.2010 in respect of Interest on advances (₹ in lakhs) as detailed below:

	Performing Assets		*N.P.A.*	
	Interest earned	*Interest received*	*Interest earned*	*Interest received*
Term loan	*240*	*160*	*150*	*10*
Cash credits and overdrafts	*1,500*	*1,240*	*300*	*24*
Bills purchased and discounted	*300*	*300*	*100*	*40*

** Sub standard and doubtful assets have been treated as fully secured.

Answer

Interest on performing assets to be recognized on accrual basis, but interest on Non-performing asset should be recognized on Cash Basis.

		₹ *in lakhs*
Interest on Term Loan	(240 + 10)	250
Cash Credits and Over Drafts	(1500 + 24)	1,524
Bills Purchases and Discounted	(300 + 40)	340
Total Interest to be recognized		2,114

Question 13

Mention the condition when a cash credit overdraft account is treated as 'out of order'.

Answer

A cash credit overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated as 'out of order' if any of the following conditions is satisfied:

(a) The outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

(b) Though the outstanding balance is less than the sanctioned limit/drawing power –

  (i) there are no credits continuously for more than 90 days as on the date of balance sheet; or

  (ii) credits during the aforesaid period are not enough to cover the interest debited during the same period.

(c) Further any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Question 14

From the following information of details of advances of Zenith Bank Ltd., calculate the amount of provisions to be made in Profit and Loss Account for the year ended on 31-3-2010:

Assets classification	*(₹in lakhs)*
Standard	*10,000*
Sub-standard	*6,400*
Doubtful:	
for one year	*3,200*
for two years	*1,800*
for three years	*900*
for more than three years	*1,100*
Loss assets	*3,000*

Answer

Statement showing provisions on various performing and non performing assets of Zenith Bank Ltd.

Assets classification	*Amount (₹ in lakhs)*	*Provision (%)*	*Amount of provision (₹ in lakhs)*
Standard	10,000	0.40	40
Sub-standard	6,400	15	960
Doubtful:			
for one year	3,200	25	800
for two years	1,800	40	720
for three years	900	40	360
for more than 3 years	1,100	100	1,100
Loss assets	3,000	100	3,000
Total			6,980

Note: It is assumed that sub-standard assets and all doubtful assets are fully secured.

Question 15

From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial Bank for the year ending on 31-03-2012.

Assets (Category of Advances)	*₹ in Lakhs*
Standard Advances	*7,000*
Sub-standard Advances	*3,500*
(Include secured exposures ₹ 1,000 Lakhs and balances unsecured exposures ₹ 2,500 Lakhs includes ₹ 1,500 Lakhs in respect of infrastructure loan accounts where escrow accounts are available)	
Doubtful advances- unsecured portion	*1,500*
Doubtful advances- secured portion	
For doubtful up to 1 year	*500*
For doubtful more than 1 year and up to 3 years	*600*
For doubtful more than 3 years	*300*
Loss Advances	*200*

Answer

Statement showing the amount of provisions on Assets:

			(₹ in lakhs)
Assets	*Amount*	*% of provision*	*Provision*
Standard	7,000	0.40	28
Sub-standard:			
Secured	1,000	15	150
Other unsecured	1,000	25	250
Unsecured infrastructure	1500	20	300
Doubtful:			
up to one year	500	25	125
up to 3 years	600	40	240
For more than three years	300	100	300
Doubtful unsecured	1,500	100	1,500
Loss	200	100	200
Required provision			3,093

Question 16

A loan account remains out of order as on the date of Balance Sheet of a Bank. The account has been classified as doubtful assets (upto 1 year).

Details of the accounts are :

Outstanding	*₹6,73,000*
ECGC coverage	*25% (Limited to ₹1,00,000)*
Value of security held	*₹1,50,000*

Compute the necessary provision to be made by a Bank as per applicable rates.

Answer

	₹
Doubtful Assets (upto 1 year)	6,73,000
Less: Value of security (excluding ECGC cover)	(1,50,000)
	5,23,000
Less: ECGC coverage (limited to ₹ 1,00,000)	(1,00,000)
Unsecured portion	4,23,000
Provision:	
for unsecured portion @100% on ₹ 4,23,000	4,23,000
for secured portion @ 25% on ₹ 1,50,000	37,500
Total provision to be made in the books of the bank	4,60,500

REBATE ON BILLS DISCOUNTED

Question 17

Write short note on Acceptances and endorsements

Answer

A bank has a more acceptable credit as compared to that of its customers. On this account, it is often called upon to accept or endorse bills on behalf of its customers. In such a case, the bank undertakes a liability towards the party which agrees to receive such a bill in payment of a debt or agreed to discount the bill after the same has been accepted by the bank. As against this liability, the bank has a corresponding claim against the customer on whose behalf it has undertaken to be a party to the bill, either as an acceptor or as an endorser. Such liabilities which are outstanding at the close of the year and the corresponding assets are disclosed as contingent liability in the financial statements. As a safeguard against the customer not being able to meet the demand of the bank in this respect, usually the bank requires the customer to deposit a security equivalent to the amount of the bill accepted on his behalf. A record of the particulars of the bills accepted as well as of the securities collected from the customers is kept in the Bills Accepted Register. A bank may not treat this book as part of the system of its account. In such a case no further record of the transactions is kept until the bill matures for payment. If the bill, at the end of its term, has to be retired by the bank and the amount cannot be collected from the customer on demand, the bank reimburses itself by disposing of the security deposited by the customer.

Question 18

The following particulars are extracted from the (Trial Balance) Books of the M/s Commercial Bank Ltd. for the year ending 31st March, 2011:

		₹
(i)	*Interest and Discounts*	*1,96,62,400*
(ii)	*Rebate on Bills Discounted (balance on 1.4.2010)*	*65,040*
(iii)	*Bills Discounted and purchased*	*10,67,45,400*

It is ascertained that proportionate discount not yet earned on the Bills Discounted which will mature during 2011-2012 amounted to ₹ 92,760.

Pass the necessary Journal entries with narration adjusting the above and show:

(a) Rebate on Bill Discounted Account; and

(b) Interest and Discount Account in the ledger of the Bank.

Answer

The Commercial Bank Ltd.
Journal Entries

Date			*Dr.*	*Cr.*
2011			₹	₹
March 31	Rebate on Bills Discounted A/c	Dr.	65,040	
	To Interest and Discount A/c			65,040
	(Being the amount of provision for unexpired discount brought forward from the previous year credited to Interest and Discount A/c)			
March 31	Interest and Discount A/c	Dr.	92,760	
	To Rebate on Bills Discounted A/c			92,760
	(Being provision for unexpired discount required at the end of the current year)			
March 31	Interest and Discount A/c	Dr.	1,96,34,680	
	To Profit & Loss A/c			1,96,34,680
	(Being transfer of balance to Profit and Loss A/c)			

(a) Rebate on Bills Discounted Account

2011			₹	2010			₹.
March 31	To	Interest and Discount A/c	65,040	April 1 2011	By	Balance b/d	65,040
2011				March 31	By	Interest and Discount	
March 31	To	Balance c/d	92,760			A/c (rebate required)	92,760
			1,57,800				1,57,800

(b) Interest and Discount Account

2011			₹	2010			₹
March 31	To	Rebate on Bills Discounted A/c	92,760	April 1 2011	By	Rebate on Bills Discounted A/c (opening balance)	65,040
March 31	To	Profit & Loss A/c (transfer)	1,96,34,680	March 31	By	Cash and Sundries	1,96,62,400
			1,97,27,440				1,97,27,440

Question 19

From the following details, prepare bills for collection (Asset) Account and Bills for collection (Liability) Account:

	₹
On 1.4.2010, Bills for Collection were	*51,00,000*
During the year 2010-11 Bills received for Collection amounted to	*75,00,000*
Bill collected during the year 2010-11	*98,47,000*
Bill dishonoured and returned during the year	*27,10,000*

Answer

Bills for collection (Asset) Account

		₹			₹
1.4.2010	To Balance b/d	51,00,000	2010-11	By Bills for collection (Liability) A/c	98,47,000
2010-11	To Bills for collection	75,00,000		By Bills for collection (Liability) A/c	27,10,000
			31.3.2011	By Balance c/d	43,000
		1,26,00,000			1,26,00,000
1.4.2011	To Balance b/d	43,000			

Bills for collection (Liability) Account					
2010-11	To Bills for collection (Asset) A/c	98,47,000	1.4.2010	By Balance b/d	51,00,000
	To Bills for collection (Asset) A/c	27,10,000	2010-11	By Bills for collection (Asset) A/c	75,00,000
31.3.2011	To Balance c/d	43,000			
		1,26,00,000			1,26,00,000
			1.4.2011	By Balance b/d	43,000

Question 20

The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2011:

Rebate on bills discounted as on 1-4-2010	*68,259 (Cr.)*
Discount received	*1,70,156 (Cr.)*

Analysis of the bills discounted reveals as follows:

Amount (₹)	*Due date*
2,80,000	*June 1, 2011*
8,72,000	*June 8, 2011*
5,64,000	*June 21, 2011*
8,12,000	*July 1, 2011*
6,00,000	*July 5, 2011*

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2011 and pass Journal Entries. The rate of discount may be taken at 10% per annum.

Answer

The amount of rebate on bills discounted as on 31st March, 2011 the period which has not been expired upto that day will be calculated as follows:

Discount on ₹ 2,80,000 for 62 days @ 10%	4,756
Discount on ₹ 8,72,000 for 69 days @ 10%	16,484
Discount on ₹ 5,64,000 for 82 days @ 10%	12,671
Discount on ₹ 8,12,000 for 92 days @ 10%	20,467
Discount on ₹ 6,00,000 for 96 days @ 10%	15,781
Total	70,159

The amount of discount to be credited to the profit and loss account will be:

	₹
Transfer from rebate on bills discounted as on 31.03.2010	68,259
Add: Discount received during the year	1,70,156
	2,38,415
Less: Rebate on bills discounted as on 31.03.2011 (as above)	(70,159)
	1,68,256

Journal Entries

		₹	₹
Rebate on bills discounted A/c	Dr.	68,259	
To Discount on bills A/c			68,259
(Transfer of unexpired discount on 31.03.2010)			
Discount on bills A/c	Dr.	70,159	

To Rebate on bills discounted (Unexpired discount on 31.03.2011 taken into account)			70,159
Discount on Bills A/c	Dr.	1,68,256	
To P & L A/c (Discount earned in the year, transferred to P&L A/c)			1,68,526

Question 21

As on 31st March 2009, Strong Bank Ltd. has a balance of ₹ 27 crores in "rebate on bills discounted" account. The bank provides you the following further information:

(1) During the financial year ending 31st March 2010, Strong Bank Ltd. discounted bills of exchange of ₹ 4,000 crores charging interest @ 15% p.a. and the average period of discount being 146 days.

(2) Bills of exchange of ₹ 600 crores were due for realization from the acceptors/customers after 31st March 2010, the average period outstanding after 31st March 2010, being 73 days.

You are required to pass necessary journal entries in the books of Strong Bank Ltd. for the above transactions.

Answer

In the books of Strong Bank Ltd.

Journal Entries

Particulars		*Debit (₹)*	*Credit (₹)*
Rebate on bills discounted A/c	Dr.	27	
To Discount on bills A/c			27
(Being the transfer of opening balance in 'Rebate on bills discounted A/c' to 'Discount on bills A/c')			
Bills purchased and discounted A/c	Dr.	4,000	
To Discount on bills A/c			240
To Clients A/c			3,760
(Being the discounting of bills of exchange during the year)			
Discount on bills A/c	Dr.	18	
To Rebate on bills discounted A/c			18
(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)			
Discount on bills A/c	Dr.	249	

To Profit and Loss A/c (Being the amount of income for the year from discounting of bills of exchange transferred to Profit and loss A/c)		249

Working Notes:

1. Discount received on the bills discounted during the year

   ₹ 4,000 crores $\times \frac{15}{100} \times \frac{146}{365}$ = ₹ 240 crores

2. Calculation of rebate on bill discounted

   ₹ 600 crores $\times \frac{15}{100} \times \frac{73}{365}$ = ₹ 18 crores

   (It is assumed that discounting rate of 15% is used for the bill of ₹ 600 crores also)

3. Income from bills discounted transferred to Profit and Loss A/c would be calculated by preparing Discount on bills A/c

Discount on bills A/c

₹ in crores

Date	*Particulars*	*Amount*	*Date*	*Particulars*	*Amount*
31 March 2010	To Rebate on bills discounted	18	1st April, 2009	By Rebate on bills discounted	27
"	To Profit and Loss A/c (Bal.Fig.)	249	2009-10	By Bills purchased and discounted	240
		267			267

Question 22

The following facts have been taken out from the records of Dee Bank Ltd. as on 31st March, 2011:

	Dr. (₹)	*Cr. (₹)*
Rebate on bills discounted (not due on March 31st, 2010)		*45,800*
Discount received		*2,02,500*
Bills discounted	*12,25,000*	

An analysis of the bills discounted is as follows:

	Amount ₹	*Due date 2009*	*Rate of discount*
(i)	*3,75,000*	*April 8*	*12%*
(ii)	*1,50,000*	*May 5*	*14%*

(iii)	*2,20,000*	*June 12*	*14%*
(iv)	*4,80,000*	*July 15*	*15%*

You are required to:-

(i) Calculate rebate on bills discounted as on 31st March, 2011.

(ii) The amount of discount to be credited to the profit and loss account.

(iii) Show necessary journal entries in the books of Dee Bank Ltd. as on 31st March, 2011.

Answer

(i) Calculation of Rebate on bills discounted

S.No.	*Amount (₹)*	*Due date (year 2011)*	*Unexpired portion from 31st March, 2011*	*Rate of discount*	*Rebate on bills discounted (₹)*
(i)	3,75,000	April 8	8 days	12%	986
(ii)	1,50,000	May 5	35 days	14%	2,014
(iii)	2,20,000	June 12	73 days	14%	6,160
(iv)	4,80,000	July 15	106 days	15%	20,910
	12,25,000				30,070

(ii) Amount of discount to be credited to the Profit and Loss Account

	₹
Transfer from Rebate on bills discounted A/c as on 31st March, 2010	45,800
Add: Discount received during the year ended 31st March, 2011	2,02,500
	2,48,300
Less: Rebate on bills discounted as on 31st March, 2011	(30,070)
Discount credited to Profit and Loss Account	2,18,230

(iii) In the books of Dee Bank Ltd.

Journal Entries

	Particulars		*Dr. (₹)*	*Cr. (₹)*
(1)	Rebate on bills discounted A/c	Dr.	45,800	
	To Discount on bills A/c			45,800
	(Being the transfer of opening balance of rebate on bills discounted account to discount on bills account)			
(2)	Discount on bills A/c	Dr.	30,070	

	To Rebate on bills discounted A/c			30,070
	(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)			
(3)	Discount on bills A/c	Dr.	2,18,230	
	To Profit and Loss A/c			2,18,230
	(Being the amount of income for the year transferred from Discount on bills A/c to Profit and Loss A/c)			

Question 23

Given below is an extract from the trial balance of T.K. Bank Limited as on 31st December, 2011:

Particulars	*Debit* ₹	*Credit* ₹
Bills discounted	*12,64,000*	*----*
Rebate on bills discounted (1.1.2011)	*----*	*8,340*
Discount received for the year		*85,912*

An analysis of the bills discounted is shown below:

Amount ₹	*Due date in 2012*	*Rate of discount (% p.a.)*
1,40,000	*March 6th*	*5*
4,36,000	*March 12th*	*4.5*
2,82,000	*March 26th*	*6*
4,06,000	*April 6th*	*4*

Show the workings, how the relevant items will appear in the bank's Profit and Loss account as on 31st December, 2011 and in bank's Balance Sheet as on 31st December, 2011.

Answer

Profit & Loss Account (an extract)
for the period ending 31.12.2011

	₹
Transfer from 'Rebate on bills discounted account' (01.01.2011)	8,340
Add: Discount for the year 2011	85,912
	94,252
Less: Rebate on bills discounted carried forward to the year 2012	13,274
	80,978

Balance Sheet (an extract) as on 31.12.2011

	₹
Other liabilities & provisions:	
Rebate on bills discounted	13,274

Working Note:

Statement of rebate on bills discounted as on 31.12.2011

Due date	*Amount (₹)*	*No. of days after 31.12.2011*	*Rate of discount (%)*	*Discount of the unexpired period*
March 6th	1,40,000	65	5	1,247
March 12th	4,36,000	71	4.5	3,816
March 26th	2,82,000	85	6	3,940
April 6th	4,06,000	96	4	4,271
Total rebate on bills discounted to be carried forward				13,274

CAPITAL ADEQUACY RATIO

Question 24

A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk adjusted asset and risk weighted assets ratio.

	(₹ in crores)
Equity share capital	*500.00*
Statutory reserve	*270.00*
Capital reserve (of which ₹ 16 crores were due to revaluation of assets and the balance due to sale of capital asset)	*78.00*
Assets:	
Cash balance with RBI	*10.00*
Balance with other banks	*18.00*
Other investments	*36.00*
Loans and advances:	
(i) Guaranteed by the Government	*16.50*
(ii) Others	*5,675.00*
Premises, furniture and fixtures	*78.00*
Off-Balance Sheet items:	
(i) Guarantee and other obligations	*800.00*
(ii) Acceptances, endorsements and letter of credit	*4,800.00*

Answer

		₹ *in crores*	₹ *in crores*
(i)	**Capital funds – Tier I**		
	Equity share capital		500
	Statutory reserve		270
	Capital reserve (arising out of sale of assets) (78-16)		62
			832
	Capital funds – Tier II		
	Capital reserve (arising out of revaluation of assets)	16	
	Less: Discount to the extent of 55%	(8.8)	7.2
			839.2

		₹ in crores	% of weight	₹ in crores
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	10	0	0
	Balance with other banks	18	20	3.60
	Other investments	36	100	36
	Loans and advances:			
	(i) Guaranteed by the government	16.5	0	0
	(ii) Others	5,675	100	5,675
	Premises, furniture and fixtures	78	100	78
				5,792.60
		₹ *in crores*	*Credit conversion factor*	
	Off-Balance Sheet items:			
	Guarantees and other obligations	800	100	800
	Acceptances, endorsements and letters of credit	4,800	100	4,800
				11,392.60

Risk Weighted Assets Ratio:

$$\frac{\text{Capital fund} \times 100}{\text{Risk adjusted assets}}$$

(839.2/11,392.60) x 100 = 7.37%

At present, capital adequacy ratio as per RBI norms is 9%.Therefore, Bank has to improve the ratio by introducing further Tier I capital.

PROFIT & LOSS ACCOUNT

Question 25

From the following information calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of Zed Bank Ltd. for the year ended 31.3.2011:

		(₹ in '000)
Interest and Discount		*8,860*
(Includes interest accrued on investments)		
Other Income		*220*
Interest expended		*2,720*
Operating expenses		*2,830*
Interest accrued on Investments		*10*
Additional Information:		
(a)	*Rebate on bills discounted to be provided for*	*30*
(b)	*Classification of Advances:*	
	(i) Standard assets	*4,000*
	(ii) Sub-standard assets	*2,240*
	(iii) Doubtful assets–(fully unsecured)	*390*
	(iv) Doubtful assets – covered fully by security	
	Less than 1 year	*100*
	More than 1 year, but less than 3 years	*600*
	More than 3 years	*600*
	(v) Loss assets	*376*
(c)	*Provide 35% of the profit towards provision for taxation.*	
(d)	*Transfer 25% of the profit to Statutory Reserve.*	

Answer

ZED Bank Ltd.

Profit and Loss Account for the year ended 31st March, 2011

(₹ in '000)

	Particulars	*Schedule No.*	*Year ended on 31st March, 2011*
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	220
	Total		9,050
II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		2,513.95
	Total		8,063.95
III.	Profit/Loss		
	Net profit/(loss) for the year		986.05
	Profit/(loss) brought forward		Nil
	Total		986.05
IV.	Appropriations		
	Transfer to statutory reserve @ 25%		246.51
	Balance carried to balance sheet		739.54
	Total		986.05

Working Notes:

1. Schedule 13 – Interest Earned

			(₹ '000s)
(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted	(30)	
	Interest accrued on investments	(10)	8,820
(ii)	Interest accrued on investments		10
			8,830

2. Calculation of Provisions and Contingencies

Assets	*Amount*	*% of Provision*	*Provision*
	(₹ in '000)		*(₹ in '000)*
Standard assets	4,000	0.40	16
Sub-standard assets*	2,240	15	336
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	25	25
More than 1 year but less than 3 years	600	40	240
More than 3 years	600	100	600
Loss assets	376	100	376
Total provision	8,306		1,983

*Note: It is assumed that sub-standard assets are fully secured.

3. Calculation of provision on tax = 35% (Total income – Total expenditure)

= 35% of ₹ [(9,050 – (2,720 + 2,830 + 1,983)]

= 35% of ₹ 1,517

= ₹ 530.95

4. Total provisions and contingencies = ₹ 1,983 + ₹ 530.95 = ₹ 2,513.95.

Question 26

The following are the figures extracted from the books of New Generation Bank Limited as on 31.3.2011:

	₹
Interest and discount received	*37,05,738*
Interest paid on deposits	*20,37,452*
Issued and subscribed capital	*10,00,000*
Salaries and allowances	*2,00,000*
Directors fee and allowances	*30,000*
Rent and taxes paid	*90,000*
Postage and telegrams	*60,286*
Statutory reserve fund	*8,00,000*
Commission, exchange and brokerage	*1,90,000*
Rent received	*65,000*

Profit on sale of investments	*2,00,000*
Depreciation on bank's properties	*30,000*
Statutory expenses	*40,000*
Preliminary expenses	*25,000*
Auditor's fee	*5,000*

The following further information is given:

(i) *A customer to whom a sum of ₹ 10 lakhs has been advanced has become insolvent and it is expected only 50% can be recovered from his estate.*

(ii) *There were also other debts for which a provision of ₹ 1,50,000 was found necessary by the auditors.*

(iii) *Rebate on bills discounted on 31.3.2010 was ₹ 12,000 and on 31.3.2011 was ₹ 16,000.*

(iv) *Provide ₹ 6,50,000 for Income-tax.*

(v) *The directors desire to declare 10% dividend.*

Prepare the Profit and Loss account of New Generation Bank Limited for the year ended 31.3.2011 and also show, how the Profit and Loss account will appear in the Balance Sheet, if the Profit and Loss account opening balance was Nil as on 31.3.2010.

Answer

New Generation Bank Limited

Profit and Loss Account for the year ended 31st March, 2011

		Schedule	*Year ended 31.03.2011*
			(₹ in '000s)
I.	Income:		
	Interest earned	13	3,701.74
	Other income	14	455.00
	Total		4,156.74
II.	Expenditure		
	Interest expended	15	2,037.45
	Operating expenses	16	480.29
	Provisions and contingencies (500 + 150 + 650)		1,300.00
	Total		3,817.74

IIII.	Profits/Losses		
	Net profit for the year		339.00
	Profit brought forward		Nil
			339.00
IV.	Appropriations		
	Transfer to statutory reserve (25%)		84.75
	Proposed dividend		100.00
	Balance carried over to balance sheet		154.25
			339.00

The Profit & Loss Account balance of ₹154.25 thousand will appear in the Balance Sheet under the head 'Reserves and Surplus' in Schedule 2.

		Year ended 31.3.2011 (₹ in '000s)
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	3,701.74
		3,701.74
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	190.00
II.	Profit on sale of investments	200.00
III.	Rent received	65.00
		455.00
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	2,037.45
		2,037.45
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees	200.00
II.	Rent, taxes and lighting	90.00
III.	Depreciation on bank's properties	30.00
IV.	Director's fee, allowances and expenses	30.00
V.	Auditors' fee	5.00
VI.	Law (statutory) charges	40.00
VII.	Postage and telegrams	60.29
VIII.	Preliminary expenses	25.00*
		480.29

*It is assumed that preliminary expenses have been fully written off during the year.

Working Note:

	(₹ in '000s)
Interest/discount (net of rebate on bills discounted)	3,705.74
Add: Rebate on bills discounted on 31.3.2010	12.00
Less: Rebate on bills discounted on 31.3.2011	(16.00)
	3701.74

Question 27

Following information is furnished to you by Sound Bank Ltd. for the year ended 31st March, 2011:

	(₹ in thousands)
Interest and discount - (Income)	*8,860*
Interest on public deposits – (Expenditure)	*2,720*
Operating expenses	*2,662*
Other incomes	*250*
Provisions and contingencies (it includes provision in respect of Non-performing Assets (NPAs) and tax provisions)	*2,004*
Rebate on bills discounted to be provided for as on 31.3.2011	*30*
Classification of Advances:	
Standard Assets	*5,000*
Sub-standard Assets	*1,120*
Doubtful Assets – fully unsecured	*200*
Doubtful assets – fully secured	
Less than 1 year	*50*
More than 1 year but less than 3 years	*300*
More than 3 years	*300*
Loss assets	*200*

You are required to prepare:

(i) Profit and Loss Account of the Bank for the year ended 31st March, 2011.

(ii) Provision in respect of advances.

Answer

Sound Bank Ltd.

Profit and Loss Account for the year ended 31st March, 2011

		Schedule No.	(₹ in thousands)
Income:	Interest and Discount (8,860 – 30)	13	8,830
	Other income	14	250
			9,080
Expenditure:	Interest expenses	15	2,720
	Operating expenses	16	2,662
	Provision and Contingencies		2,004
			7,386
Net Profit/Loss for the year			1,694

Assets	*Value*	*% of provision*	*Provision*
Standard Assets	5,000	0.40	20.00
Sub-standard Assets*	1,120	15	168.00
Doubtful Assets			
100% unsecured	200	100	200.00
Secured:			
Less than 1 year	50	25	12.50
More than 1 year but less than 3 years	300	40	120.00
More than 3 years	300	100	300.00
Loss Assets	200	100	200.00
Total Provision			1,020.50

Question 28

From the following information, you are required to prepare Profit and Loss Account of Zee Bank Ltd., for the year ending 31st March, 2012 :

	₹		₹
Interest and Discount	*44,00,000*	*Interest Expended*	*13,60,000*

* Sub-standards assets are assumed to be fully secured.

Other Income	*1,25,000*	*Operating Expenses*	*13,31,000*
Income on investments	*5,000*	*Interest on balance with RBI*	*25,000*

Additional information :

(a) Rebate on bills discounted to be provided for ₹ 15,000

(b) Classification of advances:

	₹
Standard Assets	*25,00,000*
Sub-standard Assets	*5,60,000*
Doubtful Assets not covered by security	*2,55,000*
Doubtful Assets covered by security	
For 1 year	*25,000*
For 2 year	*50,000*
For 3 year	*1,00,000*
For 4 year	*75,000*
Loss Assets	*1,00,000*

(c) Make Tax Provision @ 35 %

(d) Profit and Loss A/c (Cr.) ₹ 40,000.

Answer

Form 'B'

Zee Bank Ltd.

Profit & Loss Account for the year ended 31st March, 2012

	Particulars	Schedule No.	Year ended 31st March, 2012
I.	Income:		
	Interest Earned	13	44,15,000
	Other Income	14	1,25,000
	Total		45,55,000
II.	Expenditure		
	Interest Expended	15	13,60,000
	Operating Expense	16	13,31,000

	Provisions and Contingencies (W.N.3)		10,30,813
	Total		37,36,813
III.	**Profit/Loss**		
	Net profit for the year		8,18,187
	Profit brought forward		40,000
	Total		8,58,187
IV.	**Appropriations:**		
	Transfer to Statutory Reserve @ 25% on ₹ 8,18,187		2,04,547
	Balance carried forward to Balance Sheet		6,53,640
	Total		8,58,187

Schedule 13: Interest Earned

Particulars	₹
Interest and discount	44,00,000
Income on Investments	5,000
Interest on balance with RBI	25,000
Total	44,30,000
Less: Rebate on bills discount	(15,000)
	44,15,000

Working Notes:

1. Provisions for NPA

Particulars	*Amount*	*% of Provisions*	*Provision*
Standard Assets	25,00,000	0.40	10,000
Sub-Standard Assets*	5,60,000	15	84,000
Doubtful assets not covered by security	2,55,000	100	2,55,000
Doubtful Assets covered by security			
For 1 year	25,000	25	6,250
For 2 years	50,000	40	20,000
For 3 years	1,00,000	40	40,000

* *It is assumed that the all sub-standard assets are fully secured.*

For 4 years	75,000	100	75,000
Loss Assets	1,00,000	100	1,00,000
			5,90,250

2. Calculation of Tax

   Tax = 35% of [Total income – Total expenditure (excluding tax)].

   Tax = 35% of [44,15,000 + 1,25,000 – (13,60,000 + 13,31,000 + 5,90,250)]

   Tax = ₹ 4,40,563

3. Total amount of provisions and contingencies

   = Provision for NPA + Provision for Tax + Rebate on bills discounted

   = 5,90,250 + 4,40,563 = ₹ 10,30,813

Question 29

From the following information, calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of 'Hamara Bank Limited' for the year ending 31st March, 2012:

	₹ in lakhs		*₹ in lakhs*
Interest and discount	*4,430*	*Interest expended*	*1,360*
Other Income	*125*	*Operating Expenses*	*1,331*
Interest accrued on Investments	*10*		

Additional Information:

		₹ in lakhs
(i)	*Rebate on bills discounted to be provided for*	*15*
(ii)	*Classifications of Advances:*	
	Standard Assets	*2,500*
	Sub-Standard Assets	*560*
	Doubtful Assets not covered by security	*255*
	Doubtful Assets covered by security	
	For 1 year	*25*
	For 2 years	*50*
	For 3 years	*100*

	For 4 years	*75*
	Loss Assets	*100*
(iii)	*Make tax provisions @ 35% of the profit.*	
(iv)	*Profit and Loss Account (Cr.) brought forward from the previous year*	*40*

Answer

(a) Calculation of Provisions and Contingencies

(i) Provision on Non-Performing Assets

			₹in lakhs
Particulars	*Amount*	*% of Provision*	*Provision*
Standard Assets	2,500	0.4	10
Sub-standard Assets	560	15	84
Doubtful Assets not covered by security	255	100	255
Doubtful Assets covered by security:			
For 1 Year	25	25	6.25
For 2 Years	50	40	20
For 3 Years	100	40	40
For 4 Years	75	100	75
Loss Assets	100	100	100
	3,665		590.25

Note: It is assumed that all sub standards assets are fully secured.

(ii) Calculation of Provision for tax = 35% of [Total Income – Total Expenditure (excluding tax)]

= 35% of [(4,425+125) – (1,360+1,331+590.25)] = ₹ 444.06 lakhs

Total Provisions and contingencies = Provisions on NPAs + Provisions for tax

= 590.25 + 444.06 = ₹ 1,034.31 lakhs

Hamara Bank Limited

Profit and Loss Account for the year ended 31st March, 2012

	Particulars	*Schedule No.*	*₹ in lakhs*
I	Income		
	Interest Earned	13	4,425
	Other Income		125
			4,550

II	**Expenditures**		
	Interest Expended		1,360
	Operating Expenses		1,331
	Provisions & Contingencies		1,034.31
			3,725.31
III	**Profit/Loss**		
	Net Profit/Loss for the year		824.69
	Profit/Loss brought forward		40
			864.69
IV	**Appropriations**		
	Transfer to Statutory Reserve @ 25% of 824.69		206.17
	Transfer to Other Reserves		-
	Balance carried over to Balance Sheet		658.52
			864.69
	Schedule 13 – Interest earned		
I	Interest & Discount (4,430 – 15)		4,415
II	Income on Investments		10
			4,425

Question 30

From the following information prepare the Profit & Loss Account of Jawahar Bank Limited for the year ended 31st March, 2012. Also give necessary Schedules.

	Figures are in ₹ thousands
Interest earned on term loans	*17.26*
Interest earned on term loans classified as NPA	*4.52*
Interest received on term loans classified as NPA	*2.04*
Interest on cash credits and overdrafts	*38.54*
Interest earned but not received on cash credit and overdraft treated as NPA	*8.39*
Interest on deposits	*27.20*
Commission	*1.97*
Profit on sale of investments	*11.76*
Profit on revaluation of investments	*2.76*
Income from investments	*15.53*
Salaries, bonus and allowances	*18.75*

Rent, taxes and lighting	*1.70*
Printing and stationary	*0.75*
Director's fees, allowances expenses	*1.33*
Law charges	*0.22*
Repairs and maintenance	*0.18*
Insurance	*0.30*
Other information:	
Make necessary provision on risk assets:	
(i) Sub-standard	*15.00*
(ii) Doubtful for one year	*7.00*
(iii) Doubtful for two years	*2.40*
(iv) Loss assets	*0.65*
Investments	*3700*

Bank should not keep more than 25% of its investments as 'held-for-maturity' investment. The market value of its best 75% investments is ₹9,00,000 as on 31st March, 2012.

Answer

Jawahar Bank Limited

Profit & Loss Account for the year ended 31st March, 2012

		Schedule	₹ '000s
I.	Income		
	Interest earned	13	60.46
	Other income	14	16.49
	Total		76.95
II.	Expenditure		
	Interest expended	15	27.20
	Operating expenses	16	23.23
	Provisions & contingencies (Refer W.N.)		1,880.61
	Total		1,931.04
III.	Profit/Loss		(1,854.09)
IV.	Appropriations		Nil

Schedule 13 – Interest Earned

	₹ '000s
Interest / discount on advances bills	
Interest on term loans [17.26- (4.52-2.04)]	14.78

Interest on cash credits and overdrafts (38.54-8.39)	30.15
Income on investments	15.53
	60.46
Note : Interest on non-performing assets is recognized on receipt basis.	

Schedule 14 – Other Income

	₹ ’000s
Commission, exchange and brokerage	1.97
Profit on sale of investments	11.76
Profit on revaluation of investments	2.76
	16.49

Schedule 15 – Interest Expended

	₹ ’000s
Interest on deposits	27.20

Schedule 16 – Operating Expenses

	₹ ’000s
Payments to and provision for employees - salaries, bonus and allowances	18.75
Rent, taxes and lighting	1.70
Printing & stationery	0.75
Director’s fee, allowances and expenses	1.33
Law charges	0.22
Repairs & maintenance	0.18
Insurance	0.30
	23.23

Working Note:

Provisions & Contingencies		₹ ’000s
Provision for non-performing assets		
Sub-standard (15 x 15%)		2.25
Doubtful for one year (7 x 25%)		1.75
Doubtful for two years (2.40 x 40%)		0.96
Loss assets (0.65 x 100%)		0.65
		5.61

Diminution in the value of current Investments:		
Cost 75% of ₹ 3,700 thousands**	27,75	
Less: Market value	(900)	1875.00
		1,880.61

Note: 1. It is assumed that all sub-standard and doubtful assets are fully secured

2. As per RBI norms, provision of 0.40% should also be made on standard assets. However, in the absence of value of standard assets, in the question, no provision has been made on it.

BALANCE SHEET

Question 31

How will you disclose the following Ledger balances in the Final accounts of DVD bank:

	₹ in lacs
Current accounts	*700*
Saving accounts	*500*
Fixed deposits	*700*
Cash credits	*600*
Term Loans	*500*
Bills discounted & purchased	*800*

Additional information:

(i) Included in the current accounts ledger are accounts overdrawn to the extent of ₹250 lacs.

(ii) One of the cash credit account of ₹10 lacs (including interest ₹1 lac) is doubtful.

(iii) 60% of term loans are secured by government guarantees, 20% of cash credits are unsecured, other portion is secured by tangible assets.

Answer

Relevant Schedules (forming part of the Balance sheet) of DVD Bank

Schedule 3: Deposits

		₹ in lacs
A	Demand deposits (700 – 250)	450
B	Saving bank deposits	500
C	Term deposits	700
		1,650

** 25% of investments classified as 'held for maturity' need not be marked to market as per RBI Guidelines. However, the remaining 75% investments have been marked to market according to RBI Guidelines.

Schedule 9: Advances

			₹ *in lacs*
A	(i)	Bills discounted and purchased	800
	(ii)	Cash credits and overdrafts (600 + 250)	850
	(iii)	Term loans	500
			2,150
B.	(i)	Secured by tangible assets (bal. fig.)	1,730
	(ii)	Secured by Bank/Government guarantees (500 x 60%)	300
	(iii)	Unsecured (600 x 20%)	120
			2,150

Schedule 5: Other Liabilities & Provisions

	₹ *in lacs*
Others (Provision for doubtful debts)	10

Profit and Loss Account (an extract)

	₹ *in lacs*
Less: Provision for doubtful debts*	10

*Note: It is assumed that the cash credit has been in 'doubtful' category for more than three years.

Question 32

The following figures are extracted from the books of KLM Bank Ltd. as on 31-03-2012 :

	₹
Interest and discount received	*38,00,160*
Interest paid on deposits	*22,95,360*
Issued and subscribed capital	*10,00,000*
Salaries and allowances	*2,50,000*
Directors Fees and allowances	*35,000*
Rent and taxes paid	*1,00,000*
Postage and telegrams	*65,340*
Statutory reserve fund	*8,00,000*
Commission, exchange and brokerage	*1,90,000*

Rent received	*72,000*
Profit on sale of investment	*2,25,800*
Depreciation on assets	*40,000*
Statutory expenses	*38,000*
Preliminary expenses	*30,000*
Auditor's fee	*12,000*

The following further information is given:

(1) A customer to whom a sum of ₹ 10 lakhs was advanced has become insolvent and it is expected only 55% can be recovered from his estate.

(2) There was also other debts for which a provisions of ₹ 2,00,000 was found necessary.

(3) Rebate on bill discounted on 31-03-2011 was ₹ 15,000 and on 31-03-2012 was ₹ 20,000.

(4) Income tax of ₹ 2,00,000 is to be provided.

The directors desire to declare 5% dividend.

Prepare the Profit and Loss account of KLM Bank Ltd. for the year ended 31-03-2012 and also show, how the Profit and Loss account will appear in the Balance Sheet if the Profit and Loss account opening balance was NIL as on 31-03-2011.

Answer

KLM Bank Limited

Profit and Loss Account for the year ended 31st March, 2012

		Schedule	*Year ended 31.03.2012*
			₹
I.	Income:		
	Interest earned	13	37,95,160
	Other income	14	4,87,800
	Total		42,82,960
II.	Expenditure		
	Interest expended	15	22,95,360
	Operating expenses	16	5,70,340

	Provisions and contingencies			
	(4,50,000+2,00,000+2,00,000)			8,50,000
	Total			37,15,700
IIII.	Profits/Losses			
	Net profit for the year			5,67,260
	Profit brought forward			Nil
				5,67,260
IV.	Appropriations			
	Transfer to statutory reserve (25% of 5,67,260)			1,41,815
	Proposed dividend			50,000
	Balance carried over to balance sheet			3,75,445
				5,67,260

Profit & Loss Account balance of ₹ 3,75,445 will appear under the head 'Reserves and Surplus' in Schedule 2 of the Balance Sheet.

		Year ended 31.3.2012 ₹
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	37,95,160
		37,95,160
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	1,90,000
II.	Profit on sale of investment	2,25,800
III.	Rent received	72,000
		4,87,800
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	22,95,360
		22,95,360
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees (salaries & allowances)	2,50,000
II.	Rent, taxes paid	1,00,000
III.	Depreciation on assets	40,000
IV.	Director's fee, allowances and expenses	35,000
V.	Auditor's fee	12,000

VI.	Statutory (law) expenses	38,000
VII.	Postage and telegrams	65,340
VIII.	Preliminary expenses*	30,000
		5,70,340

Working Note:

	₹
Interest and discount received	38,00,160
Add: Rebate on bills discounted on 31.3.2011	15,000
Less: Rebate on bills discounted on 31.3.2012	(20,000)
	37,95,160

EXERCISES

1. *From the following information, prepare a Balance Sheet of International Bank Ltd. as on 31st March, 2012 giving the relevant schedules and also specify at least four important Principal Accounting Policies :*

	₹ in lakhs	
	Dr.	*Cr.*
Share Capital		*198.00*
19,80,000 Shares of ₹ 10 each		
Statutory Reserve		*231.00*
Net Profit Before Appropriation		*150.00*
Profit and Loss Account		*412.00*
Fixed Deposit Account		*517.00*
Savings Deposit Account		*450.00*
Current Accounts	*28.00*	*520.12*
Bills Payable		*0.10*
Cash credits	*812.10*	
Borrowings from other Banks		*110.00*
Cash in Hand	*160.15*	
Cash with RBI	*37.88*	
Cash with other Banks	*155.87*	
Money at Call	*210.12*	
Gold	*55.23*	
Government Securities	*110.17*	
Premises	*155.70*	
Furniture	*70.12*	
Term Loan	*792.88*	
	2,588.22	*2,588.22*

* It is assumed that preliminary expenses have been fully written off during the year.

Additional Information:

Bills for collection	18,10,000
Acceptances and endorsements	14,12,000
Claims against the Bank not acknowledged as debt	55,000
Depreciation charges—Premises	1,10,000
Furniture	78,000

50% of the Term Loans are secured by Government guarantees. 10% of cash credit is unsecured. Also calculate cash reserves required and statutory liquid reserves required.

Note : Cash reserves required 5.50% of demand and time liabilities; liquid reserves required 24% of demand and time liabilities.

(Hints: Balance sheet total ₹ 25,88.12 lacs)

2. *Following are the statements of interest on advances in respect of performing and non-performing assets of Madura Bank Ltd. Find out the income to be recognised for the year ended 31st March. 2012:*

		(₹ in lakhs)
Performing Assets	Interest earned	Interest received
Cash credit and overdrafts	1,800	1,060
Term loans	480	320
Bills purchased and discounted	700	550
Non-performing Assets		
Cash credit and overdrafts	450	70
Term loan	300	40
Bills purchased and discounted	350	36

(Hints: Total income to be recognized ₹ 3,126 lakhs)

7
Financial Statements of Electricity Companies

BASIC CONCEPTS

- The Electricity Act 2003 replaces the three existing legislations, namely, Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998.
- Under the Electricity Act 2003, activities like generation, transmission and distribution have been separately identified.
- The Central Electricity Regulation Commission (CERC) regulates the tariff of generating companies owned or controlled by the Central Government. It also regulates and determines the tariff for Inter-State transmission of electricity;

Question 1

From the following details of assets calculate weighted average rate of depreciation considering the rates as per Appendix-III of Regulations, 2009.

Particulars	*Closing balance at cost*
	₹
Land	
(a) Freehold	*3,34,900*
(b) Leasehold	*1,07,725*
Buildings	*18,42,675*
Railway Sidings	*5,850*
Plant and Machinery	
(a) Steam Station	*70,82,475*
(b) Others Including "Switchgears and Transformers"	*51,44,725*
Transmission and Distributing Systems	
(a) Overhead	*10,60,725*

(b) Underground	*42,24,025*
Electrical Fittings and Apparatus	*1,25,325*
Furniture, Fixture and Office Equipments	*1,75,900*
Vehicles	*53,700*
Total	*20,158,025*

Answer

Particulars	*Closing balance at cost*	*Rate of depreciation*	*Deprecation*
	₹		₹
Land			
(a) Freehold	3,34,900	0	
(b) Leasehold	1,07,725	3.34%	3,598.02
Buildings	18,42,675	3.34%	61,545.35
Railway Skiing	5,850	3.34%	195.39
Plant and Machinery	-		-
(a) Steam Station	70,82,475	5.28%	3,73,954.68
(b) Others including "Switchgears and Transformers"	51,44,725	5.28%	2,71,641.48
Transmission and Distributing Systems			-
(a) Overhead	10,60,725	5.28%	56,006.28
(b) Underground	42,24,025	5.28%	2,23,028.52
Electrical Fittings and Apparatus	1,25,325	6.33%	7,933.07
Furniture, Fixture and Office Equipments	1,75,900	6.33%	11,134.47
Vehicles	53,700	5.28 %	2,835.36
Total (other than land)	19,823,125		1,011,872.62

$$\text{Weighted average rate of depreciation} = \frac{1,011,872.62}{19,823,125} \times 100$$

$$= 5.10\% \text{ (approx.)}$$

Question 2

Calculate depreciation for 2010-11, 2011-12, 2012-13 as per 2009 Regulations from the following information of Excellent Power Generation Project

Date of commercial operation /Work completed date	*11^{th} January 1995*
Beginning of current year	*1^{st} April, 2010*
Useful life	*35 years*

S.N.		*(₹ in crores)*
1	*Capital cost at beginning of the year 2010-11*	*166.27*
2	*Additional capitalisation during the year*	
	2011-12	*0.72*
	2012-13	*6.11*
3	*Value of land*	*0*
4	*Depreciation recovered up to 2008-09*	*72.07*
5	*Depreciation recovered in 2009-10*	*4.77*

Note : Capital cost at the beginning of the year and accumulated depreciation are as per tariff order FY 2010-11.

Answer

Name of the Power Station	*Excellent Power Generation Project*
Date of commercial operation/Work completed date	11th January 1995
Beginning of current year	1st April, 2010
Useful life	35 years
Remaining useful Life	20 years

(₹ in crores)

S.No.		*2010-11*	*2011-12*	*2012-13*
	Capital cost at beginning of the year (in ₹)	166.27	166.27	166.99
	Additional capitalisation during the year (in ₹)	-	0.72	6.11
	Closing capital cost (in ₹)	166.27	166.99	173.10
1	Average capital cost (in ₹)	166.27	166.63	170.05
2	*Less* : Value of Land	-	-	-
3	Capital cost for depreciation (in ₹)	166.27	166.63	170.05
4	Depreciable value (90% of 3) (in ₹)	149.64	149.97	153.05
5	Depreciation recovered up to 2008-09 (in ₹)	72.07	-	-
6	Depreciation recovered in 2009-10 (in ₹)	4.77	-	-
7	Depreciation recovered upto previous year (5+6) (in ₹)	76.84	80.48	84.14
8	Balance depreciation to be recovered (in ₹)	72.80	69.49	68.91
9	Balance useful life out of 35 years (in years)	20	19	18
10	Yearly depreciation from 2010-11 (8/9) (in ₹)	3.64	3.66	3.83
11	Depreciation recovered upto the year (7+10) (in ₹)	80.48	84.14	87.97

Note: Capital cost at the beginning of the year and accumulated depreciation are as per tariff order F.Y. 2010-11.

Question 3

The trial balance of UP Electric Supply Ltd. for the year ended 31st March, 2012 is as below:

		(₹ '000)
Particulars	*Dr.*	*Cr.*
Share Capital :		
Equity Shares of ₹ 10 each		125,00
14% Preference Shares of ₹ 100 each		37,50
Patents and trademark	626	
15% Debentures		61,75
16% Term Loan		38,25
Land (additions during the year ₹512.5)	31,12.5	
Building (additions during the year ₹12,70)	87,83.5	
Plant & Machinery	142,64.5	
Mains	11,31	
Meters	787.5	
Electrical Instrument	382.5	
Office furniture	612.5	
Capital reserve		12,55
Contingency reserves		30,07.5
Transformers	41,10	
Net revenue account		13,37.5
Stock in hand	30,12.5	
Sundry debtors	15,61.5	
Contingency reserve investment	30,02.5	
Cash & Bank	813.5	
Public lamps	760	
Depreciation fund		64,54
Sundry Creditors		16,31
Proposed dividend		30,25
	429,60	429,60

During 2011-12, ₹ ('000) 25,00 of 14% preference shares were redeemed at a premium of 10% out of proceeds of fresh issue of equity shares of necessary amounts at a premium of 10%.

Prepare for the above period Balance Sheet as on 31st March, 2012 as per the revised Schedule VI.

Answer

Balance Sheet of U.P .Electric Supply Ltd. for the year ended March 31, 2012

			Particulars	Note No	₹ ('000)
			Equity and Liabilities		
1			Shareholders' funds		
	a		Share capital	1	16,250
	b		Reserves and Surplus	2	5,600
2			Non-current liabilities		
	a		Long-term borrowings	3	10,000
3			Current liabilities		-
	a		Trade Payables		1,631
	b		Other current liabilities	4	3,025
			Total		36,506
			Assets		-
1			Non-current assets		-
	a		Fixed assets		-
		i	Tangible assets	5	27,490
		ii	Intangible assets		626
			Other non-current assets	6	3,002.5
2			Current assets		-
	a		Inventories		3,012.5
	b		Trade receivables		1,561.5
	c		Cash and cash equivalents		813.5
			Total		36,506

Notes to financial statements

			₹ ('000)
1	Share Capital		
	Issued & subscribed		
	Equity share capital		
	10,00,000 Equity shares of ₹ 10 each	10,000	-
	Add: 2,50,000 Equity shares of ₹ 10 each issued during the year (A)	2,500	12,500
	Preference share capital		
	62,500 14% Preference shares of ₹ 100 each	6,250	
	Less: 25,000 Preference shares of ₹ 100 each		

	redeemed during the year (B)	(2,500)	3,750
	Total (A+B)	-	16,250
2	Reserves and Surplus		
	Capital reserve		1,255
	Contingency Reserve		3,007.5
	Balance of net return A/c		1,337.5
	Total		5,600
3	Long-term borrowings		
	Secured		
	15% Debentures		6,175
	16% Term Loan (considered secured)		3,825
	Total		10,000
4	Other Current liabilities		-
	Proposed dividend		3,025
	Total		3,025
5	Tangible assets		
	Land	2,600	
	Addition during the year	512.5	3,112.5
	Building	7,513.5	
	Addition during the year	1,270	8,783.5
	Plant & Machinery		
	Steam Power Plant	14,264.5	
	Transformers	4,110	
	Mains	1,131	
	Meters	787.5	
	Public Lamps	760	21,053
	General Equipments		
	Electrical Instruments	382.5	
	Office Furniture	612.5	995
			33,944
	Less: Depreciation fund		(6,454)
	Total		27,490
6	Other non-current assets		
	Contingency Reserve Investment (assumed as non-current item)		3,002.5

8

Departmental Accounts

BASIC CONCEPTS

- **Basis of Allocation of Common Expenditure among different Departments**

  1. Expenses incurred specially for each department are charged directly thereto, *e.g.,* insurance charges of stock held by a department.
  2. Common expenses, the benefit of which is shared by all the departments and which are capable of precise allocation are distributed among the departments concerned on some equitable basis considered suitable in the circumstances of the case.

S.No.	Expenses	Basis
1.	Rent, rates and taxes, repairs and maintenance, insurance of building	Floor area occupied by each department (if given) other wise on time basis
2.	Lighting and Heating expenses (eg. energy expenses)	Consumption of energy by each department
3.	Selling expenses, e.g., discount, bad debts, selling commission, freight outward, travelling sales manager's salary and other costs	Sales of each department
4.	Carriage inward/ Discount received	Purchases of each department
5.	Wages/Salaries	Time devoted to each department
6.	Depreciation, insurance , repairs and maintenance of capital assets	Value of assets of each department otherwise on time basis
7.	Administrative and other expenses, e.g., salaries of managers, directors, common advertisement expenses, etc.	Time basis or equally among all departments
8.	Labour welfare expenses	Number of employees in each department
9.	PF/ESI contributions	Wages and salaries of each department

- There are certain expenses and income, most being of financial nature, which cannot be apportioned on a suitable basis; therefore they are recognised in the combined Profit and Loss Account for example-interest on loan, profit/loss on sale of investment etc.

Question 1

Department X sells goods to Department Y at a profit of 25% on cost and to Department Z at 10% profit on cost. Department Y sells goods to X and Z at a profit of 15% and 20% on sales, respectively. Department Z charges 20% and 25% profit on cost to Department X and Y, respectively.

Department Managers are entitled to 10% commission on net profit subject to unrealised profit on departmental sales being eliminated. Departmental profits after charging Managers' commission, but before adjustment of unrealised profit are as under :

	₹
Department X	*36,000*
Department Y	*27,000*
Department Z	*18,000*

Stock lying at different departments at the end of the year are as under :

	Dept. X ₹	*Dept. Y* ₹	*Dept. Z* ₹
Transfer from Department X	—	*15,000*	*11,000*
Transfer from Department Y	*14,000*	—	*12,000*
Transfer from Department Z	*6,000*	*5,000*	—

Find out the correct departmental Profits after charging Managers' commission

Answer

Calculation of correct Profit

	Department X	*Department Y*	*Department Z*
	₹	₹	₹
Profit after charging managers' commission	36,000	27,000	18,000
Add back : Managers' commission (1/9)	4,000	3,000	2,000
	40,000	30,000	20,000
Less :Unrealised profit on stock (Working Note)	(4,000)	(4,500)	(2,000)
Profit before Manager's commission	36,000	25,500	18,000
Less : Commission for Department			
Manager @ 10%	(3,600)	(2,550)	(1,800)
	32,400	22,950	16,200

Working Note :

Stock lying with

	Dept. X	*Dept. Y*	*Dept. Z*	*Total*
	₹	₹	₹	₹
Unrealised Profit of:				
Department X		1/5×15,000 =3,000	1/11×11,000 =1,000	4,000
Department Y	0.15×14,000 =2,100		0.20×12,000 =2,400	4,500
Department Z	1/6×6,000 =1,000	1/5×5,000 =1,000		2,000

Question 2

FGH Ltd. has three departments I, J and K. The following information is provided for the year ended 31.3.2011:

	I	*J*	*K*
	₹	₹	₹
Opening stock	*5,000*	*8,000*	*19,000*
Opening reserve for unrealised profit	–	*2,000*	*3,000*
Materials consumed	*16,000*	*20,000*	–
Direct labour	*9,000*	*10,000*	–
Closing stock	*5,000*	*20,000*	*5,000*
Sales	–	–	*80,000*
Area occupied (sq. mtr.)	*2,500*	*1,500*	*1,000*
No. of employees	*30*	*20*	*10*

Stocks of each department are valued at costs to the department concerned. Stocks of I are transferred to J at cost plus 20% and stocks of J are transferred to K at a gross profit of 20% on sales. Other common expenses are salaries and staff welfare ₹ 18,000, rent ₹ 6,000.

Prepare Departmental Trading, Profit and Loss Account for the year ending 31.3.2011.

Answer

FGH Ltd.
Departmental Trading and Profit and Loss Account
for the year ended 31st March, 2011

	I	*J*	*K*	*Total*		*I*	*J*	*K*	*Total*
	₹	₹	₹	₹		₹	₹	₹	₹
To Opening stock	5,000	8,000	19,000	32,000	By Sales			80,000	80,000

To Material consumed	16,000	20,000		36,000	By Inter-departmental transfer	30,000	60,000		90,000
To Direct labour	9,000	10,000		19,000					
To Inter-departmental transfer		30,000	60,000	90,000	By Closing stock	5,000	20,000	5,000	30,000
To Gross profit	5,000	12,000	6,000	23,000					
	35,000	80,000	85,000	2,00,000		35,000	80,000	85,000	2,00,000
To Salaries and staff welfare	9,000	6,000	3,000	18,000	By Gross profit b/d	5,000	12,000	6,000	23,000
					By Net loss	7,000			7,000
To Rent	3,000	1,800	1,200	6,000					
To Net profit		4,200	1,800	6,000					
	12,000	12,000	6,000	30,000		12,000	12,000	6,000	30,000
To Net loss (I)				7,000	By Stock reserve b/d (J + K)				5,000
To Stock reserve (J+K) (Refer W.N.)				3,000	By Net profit (J + K)				6,000
To Balance transferred to profit and loss account				1,000					
				11,000					11,000

Working Note:

Calculation of unrealized profit on closing stock

	₹
Stock reserve of J department	
Cost	30,000
Transfer from I department	30,000
	60,000
Stock of J department	20,000

Proportion of stock of I department = ₹ 20,000 $\times \dfrac{₹\ 30,000}{₹\ 60,000}$ = ₹ 10,000

Stock reserve =₹ 10,000 $\times \frac{20}{120}$ = ₹ 1,667 (approx.)

Stock reserve of K department

	₹
Stock transferred from J department	5,000
Less: Profit (stock reserve) 5,000 × 20%	(1,000)
Cost to J department	4,000

Proportion of stock of I department = ₹ 4,000 $\times \frac{₹\ 30,000}{₹\ 60,000} =$ ₹ 2,000

Stock reserve $= 2,000 \times \frac{20}{120} =$ ₹ 333 (approx.)

Total stock reserve = ₹ 1,000 + ₹ 333 = ₹ 1,333

Question 3

Siva Ltd. has two departments X and Y. From the following particulars prepare departmental trading accounts and general profits and loss account for the year ending 31st March, 2011:

	Department X	*Department Y*
	₹	₹
Opening stock (at cost)	*80,000*	*48,000*
Purchases	*3,68,000*	*2,72,000*
Carriage inward	*8,000*	*8,000*
Wages	*48,000*	*32,000*
Sales	*5,60,000*	*4,48,000*
Purchased goods transferred		
By department Y to X	*40,000*	-
By department X to Y	-	*32,000*
Finished goods transferred		
By department Y to X	*1,40,000*	-
By department X to Y	-	*1,60,000*
Return of finished goods		
By department Y to X	*40,000*	-
By department X to Y	-	*28,000*
Closing stock		
Purchased goods	*18,000*	*24,000*
Finished goods	*96,000*	*56,000*

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 25% of the closing finished stock with each department represents finished goods received from the other department.

Answer

Departmental Trading Account in the books of Siva Ltd.

for the year ended 31st March 2011

Particulars	*Department X* ₹	*Department Y* ₹	*Particulars*	*Department X* ₹	*Department Y* ₹
To Opening stock	80,000	48,000	By Sales	5,60,000	4,48,000
To Purchases	3,68,000	2,72,000	By Transfers:		
To Carriage inward	8,000	8,000	Purchased goods	32,000	40,000
To Wages	48,000	32,000	Finished goods	1,20,000*	1,12,000*
To Transfers:			By Closing stock:		
Purchased goods	40,000	32,000	Purchased goods	18,000	24,000
Finished goods	1,12,000	1,20,000	Finished goods	96,000	56,000
To Gross profit c/d	1,70,000	1,68,000			
	8,26,000	6,80,000		8,26,000	6,80,000

Profit and Loss A/c

for the year ended 31st March, 2011

Particulars	₹	*Particulars*	₹
To Provision for unrealized profit included in closing stock		By Gross profit b/d	
Department X (W.N. 3)	7,200	Department X	1,70,000
Department Y (W.N. 3)	3,500	Department Y	1,68,000
To Net profit	3,27,300		
	3,38,000		3,38,000

* Net transfers of finished goods by
Department X to Y = ₹ 1,60,000 – ₹ 40,000 = ₹ 1,20,000
Department Y to X = ₹ 1,40,000 – ₹ 28,000= ₹ 1,12,000

Working Notes:

1. Calculation of rates of gross profit margin on sales

	Department X	*Department Y*
	₹	₹
Sales	5,60,000	4,48,000
Add: Transfer of finished goods	1,60,000	1,40,000
	7,20,000	5,88,000
Less: Return of finished goods	(40,000)	(28,000)
	6,80,000	5,60,000
Gross Profit	1,70,000	1,68,000
Gross profit margin =	$\frac{1,70,000}{6,80,000} \times 100 = 25\%$	$\frac{1,68,000}{5,60,000} \times 100 = 30\%$

2. Finished goods from other department included in the closing stock

	Department X	*Department Y*
	₹	₹
Stock of finished goods	96,000	56,000
Stock related to other department (25% of finished goods)	24,000	14,000

3. Unrealized profit included in the closing stock

Department X = 30% of ₹ 24,000 = ₹ 7,200

Department Y = 25% of ₹ 14,000 = ₹ 3,500

Question 4

Z Ltd. has three departments and submits the following information for the year ending on 31st March, 2011:

	A	*B*	*C*	*Total (₹)*
Purchases (units)	*6,000*	*12,000*	*14,400*	
Purchases (Amount)				*6,00,000*
Sales (Units)	*6,120*	*11,520*	*14,976*	
Selling Price (per unit) ₹	*40*	*45*	*50*	
Closing Stock (Units)	*600*	*960*	*36*	

You are required to prepare departmental trading account of Z Ltd., assuming that the rate of profit on sales is uniform in each case.

Answer

Departmental Trading Account for the year ended on 31st March, 2011

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To Opening Stock	11,520	8,640	12,240	By Sales	2,44,800	5,18,400	7,48,800
To Purchases	96,000	2,16,000	2,88,000	By Closing Stock	9,600	17,280	720
To Gross Profit	1,46,880	3,11,040	4,49,280				
	2,54,400	5,35,680	7,49,520		2,54,400	5,35,680	7,49,520

Working Notes:

(1)	Profit Margin Ratio	
	Selling price of unit purchased:	₹
	Department A 6,000 x 40	2,40,000
	Department B 12,000 x 45	5,40,000
	Department C 14,400 x 50	7,20,000
	Total Selling Price	15,00,000
	Less: Purchase (Cost) Value	(6,00,000)
	Gross Profit	9,00,000
	Profit Margin Ratio = $\frac{9,00,000}{15,00,000} \times 100 = 60\%$	

(2) Statement showing department-wise per unit Cost and Purchase Cost

	A	B	C
	₹	₹	₹
Selling Price (Per unit) (₹)	40	45	50
Less: Profit Margin @ 60% (₹)	(24)	(27)	(30)
Purchase price per unit (₹)	16	18	20
Number of units purchased	6,000	12,000	14,400
(Purchase cost per unit x Units purchased)	96,000	2,16,000	2,88,000

(3) Statement showing calculation of department-wise Opening Stock (in Units)

	A	B	C
Sales (Units)	6,120	11,520	14,976
Add: Closing Stock (Units)	600	960	36

	6,720	12,480	15,012
Less: Purchases (units)	(6,000)	(12,000)	(14,400)
Opening Stock (Units)	720	480	612

(4) Statement showing department-wise cost of Opening Stock and Closing Stock

	A	*B*	*C*
Cost of Opening Stock (₹)	720 x 16	480 x 18	612 x 20
₹	11,520	8,640	12,240
Cost of Closing Stock	600 x 16	960 x 18	36 x 20
₹	9,600	17,280	720

Question 5

Goods are transferred from Department P to Department Q at a price 50% above cost. If closing stock of Department Q is ₹ 27,000, compute the amount of stock reserve.

Answer

	₹
Closing Stock of Department Q	27,000
Goods send by Department P to Department Q at a price 50% above cost	
Hence profit of Department P included in the stock will be - $\frac{27{,}000 \times 50}{150} =$	9,000
Amount of the Stock Reserve will be ₹ 9,000.	

Question 6

Department R sells goods to Department S at a profit of 25% on cost and Department T at 10% profit on cost. Department S sells goods to R and T at a profit of 15% and 20% on sales respectively. Department T charges 20% and 25% profit on cost to Department R and S respectively.

Department managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission, but before adjustment of unrealized profit are as under:

		₹
Department	*R*	*54,000*
Department	*S*	*40,500*
Department	*T*	*27,000*

Stock lying at different departments at the end of the year are as under:

	Deptt. R ₹	*Deptt. S* ₹	*Deptt. T* ₹
Transfer from Department R	-	*22,500*	*16,500*
Transfer from Department S	*21,000*	-	*18,000*
Transfer from Department T	*9,000*	*7,500*	-

Find out the correct departmental profits after charging manager's commission.

Answer

	Departments		
	R ₹	*S* ₹	*T* ₹
Profit	54,000	40,500	27,000
Add : Managerial commission (1/9)	6,000	4,500	3,000
	60,000	45,000	30,000
Less: Unrealised profit on stock (Refer W.N.)	(6,000)	(6,750)	(3,000)
	54,000	38,250	27,000
Less: Managers' commission @ 10%	(5,400)	(3,825)	(2,700)
	48,600	34,425	24,300

Working Notes:

Value of unrealised profit

	₹
Transfer by department R to	
S department (22,500 ×25/125) = 4,500	
T department (16,500 ×10/110) = 1,500	6,000
Transfer by department S to	
R department (21,000 × 15/100) = 3,150	
T department (18,000 × 20/100) = 3,600	6,750
Transfer by department T to	
R department (9,000 × 20/120) = 1,500	
S department (7,500 × 25/125) = 1,500	3,000

Question 7

X Ltd has three departments A, B and C. From the particulars given below compute:

(a) the values of stock as on 31st Dec. 2011 and

(b) the departmental results

(i)

	A ₹	*B ₹*	*C ₹*
Stock (on 1.1.2011)	*24,000*	*36,000*	*12,000*
Purchases	*1,46,000*	*1,24,000*	*48,000*
Actual sales	*1,72,500*	*1,59,400*	*74,600*
Gross Profit on normal selling price	*20%*	*25%*	*33 1/3%*

(ii) During the year certain items were sold at discount and these discounts were reflected in the value of sales shown above. The items sold at discount were:

	A ₹	*B ₹*	*C ₹*
Sales at normal price	*10,000*	*3,000*	*1,000*
Sales at actual price	*7,500*	*2,400*	*600*

Answer

1. Calculation of Departmental Results (Actual Gross Profit):

	A (₹)	B (₹)	C (₹)
Actual Sales	1,72,500	1,59,400	74,600
Add back: Discount (Refer W.N.)	2,500	600	400
Normal sale	1,75,000	1,60,000	75,000
Gross profit % on normal sales	20%	25%	33.33%
Normal gross profit	35,000	40,000	25,000
Less: Discount	(2,500)	(600)	(400)
Actual gross profit	32,500	39,400	24,600

2. Computation of value of stock as on 31st Dec. 2011

Departments	A ₹	B ₹	C ₹
Stock (on 1.1.2011)	24,000	36,000	12,000

Add: Purchases	1,46,000	1,24,000	48,000
	1,70,000	1,60,000	60,000
Add: Actual gross profit	32,500	39,400	24,600
	2,02,500	1,99,400	84,600
Less: Actual Sales	(1,72,500)	(1,59,400)	(74,600)
Closing stock as on 31.12.2011 (bal.fig.)	30,000	40,000	10,000

Working Note:

Calculation of discount on sales:

Departments	A ₹	B ₹	C ₹
Sales at normal price	10,000	3,000	1,000
Less: Sales at actual price	(7,500)	(2,400)	(600)
	2,500	600	400

Question 8

Brahma Limited has three departments and submits the following information for the year ending on 31st March, 2011:

Particulars	*A*	*B*	*C*	*Total (₹)*
Purchases (units)	*5,000*	*10,000*	*15,000*	
Purchases (Amount)				*8,40,000*
Sales (units)	*5,200*	*9,800*	*15,300*	
Selling price (₹ per unit)	*40*	*45*	*50*	
Closing Stock (Units)	*400*	*600*	*700*	

You are required to prepare departmental trading account of Brahma Limited assuming that the rate of profit on sales is uniform in each case.

Answer

Departmental Trading Account for the year ended 31st March, 2011

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To Opening Stock (W.N.4)	14,400	10,800	30,000	By Sales	2,08,000	4,41,000	7,65,000
				By Closing stock	9,600	16,200	21,000

				(W.N.4)			
To Purchases (W.N.2)	1,20,000	2,70,000	4,50,000				
To Gross profit	83,200	1,76,400	3,06,000				
	2,17,600	4,57,200	7,86,000		2,17,600	4,57,200	7,86,000

Working Notes:

(1) Profit Margin Ratio

Selling price of units purchased:		₹
Department A	(5,000 units x ₹ 40)	2,00,000
Department B	(10,000 units x ₹ 45)	4,50,000
Department C	(15,000 units x ₹ 50)	7,50,000
Total selling price of purchased units		14,00,000
Less: Purchases		(8,40,000)
Gross profit		5,60,000

$$\text{Profit margin ratio} = \frac{\text{Gross profit}}{\text{Selling price}} \times 100 = \frac{5,60,000}{14,00,000} \times 100 = 40\%$$

(2) Statement showing department-wise per unit cost and purchase cost

Particulars	*A*	*B*	*C*
Selling price per unit (₹)	40	45	50
Less: Profit margin @ 40% (₹)	(16)	(18)	(20)
Purchase price per unit (₹)	24	27	30
No. of units purchased	5,000	10,000	15,000
Purchases (purchase cost per unit x units purchased)	1,20,000	2,70,000	4,50,000

(3) Statement showing calculation of department-wise Opening Stock (in units)

Particulars	*A*	*B*	*C*
Sales (Units)	5,200	9,800	15,300
Add: Closing Stock (Units)	400	600	700
	5,600	10,400	16,000
Less: Purchases (Units)	(5,000)	(10,000)	(15,000)
Opening Stock (Units)	600	400	1,000

(4) Statement showing department-wise cost of Opening and Closing Stock

Particulars	*A*	*B*	*C*
Cost of Opening Stock (₹)	600 x 24 14,400	400 x 27 10,800	1,000 x 30 30,000
Cost of Closing Stock (₹)	400 x 24 9,600	600 x 27 16,200	700 x 30 21,000

Question 9

M/s. AM Enterprise had two departments, Cloth and Readymade Clothes. The readymade clothes were made by the firm itself out of the cloth supplied by the Cloth Department at its usual selling price. From the following figures, prepare Departmental Trading and Profit & Loss Account for the year ended 31st March, 2011:

	Cloth Department ₹	*Readymade Clothes Department ₹*
Opening stock on 1st April, 2010	*31,50,000*	*5,32,000*
Purchases	*2,10,00,000*	*1,68,000*
Sales	*2,31,00,000*	*47,25,000*
Transfer to Readymade Clothes Department	*31,50,000*	*-*
Manufacturing expenses	*-*	*6,30,000*
Selling expenses	*2,10,000*	*73,500*
Rent & warehousing	*8,40,000*	*5,60,000*
Stock on 31st March, 2011	*21,00,000*	*6,72,000*

In addition to the above, the following information is made available for necessary consideration:

The stock in the Readymade Clothes Department may be considered as consisting of 75% cloth and 25% other expenses. The Cloth Department earned a gross profit at the rate of 15% in 2009-10. General expenses of the business as a whole amount to ₹ 10,85,000.

Answer

Departmental Trading and Profit and Loss Account
for the year ended 31st March, 2011

Particulars	*Cloth (₹)*	*Ready-made Clothes (₹)*	*Total (₹)*	*Particulars*	*Cloth (₹)*	*Ready-made Clothes (₹)*	*Total (₹)*
To Opening stock	31,50,000	5,32,000	36,82,000	By Sales	2,31,00,000	47,25,000	2,78,25,000
To Purchases	2,10,00,000	1,68,000	2,11,68,000	By Transfer to Ready-made Clothes Deptt.	31,50,000	-	31,50,000

To Transfer from Cloth Department	-	31,50,000	31,50,000	By Closing stock	21,00,000	6,72,000	27,72,000
To Manufacturing expenses	-	6,30,000	6,30,000				
To Gross profit c/d	42,00,000	9,17,000	51,17,000				
	2,83,50,000	53,97,000	3,37,47,000		2,83,50,000	53,97,000	3,37,47,000
To Selling expenses	2,10,000	73,500	2,83,500	By Gross profit b/d	42,00,000	9,17,000	51,17,000
To Rent & warehousing	8,40,000	5,60,000	14,00,000				
To Net profit	31,50,000	2,83,500	34,33,500				
	42,00,000	9,17,000	51,17,000		42,00,000	9,17,000	51,17,000

General Profit and Loss Account

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To General expenses	10,85,000	By Net profit	34,33,500
To Unrealized profit (Refer W.N.)	20,790		
To General net profit (Bal.fig.)	23,27,710		
	34,33,500		34,33,500

Working Note:

Calculation of Stock Reserve

Rate of Gross Profit of Cloth Department, for the year 2010-11 = $\frac{\text{Gross Profit}}{\text{Total Sales}}$ x 100

$$\frac{₹\ 42,00,000 \times 100}{₹\ (2,31,00,000 + 31,50,000)} \times 100 = 16\%$$

Closing Stock of cloth in Readymade Clothes Department = 75%

i.e. ₹ 6,72,000 x 75% = ₹ 5,04,000

Stock Reserve required for unrealized profit @ 16% on closing stock

₹ 5,04,000 x 16% = ₹ 80,640

Stock reserve for unrealized profit included in opening stock of readymade clothes @ 15% i.e.

(₹ 5,32,000 x 75% x 15%) = ₹ 59,850

Additional Stock Reserve required during the year = ₹ 80,640 – ₹ 59,850 = ₹ 20,790.

9

Accounting for Branches Including Foreign Branch Accounts

BASIC CONCEPTS

- Types of branches
  - Dependent branches
  - Independent branches
- Based on accounting point of view, branches may be classified as follows:
  - Branches in respect of which the whole of the accounting records are kept at the head office
  - Branches which maintain independent accounting records, and
  - Foreign Branches.
- System of accounting
  - Debtors System: under this system head office makes a branch account. Anything given to branch is debited and anything received from branch would be credited.
  - Branch trading and profit and loss account method/Final accounts method: Under this system head office prepares (a) profit and loss account (b) branch account taking each branch as a separate entity.
- Stock and debtors system: Under this system head office opens:
  - Branch stock account
  - Branch debtors account
  - Branch asset account
  - Branch expenses account
  - Branch adjustment account

- Branch profit and loss account

➢ Types of Foreign branches :

- Integral Foreign Operation (IFO): It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
- Non-Integral Foreign Operation (NFO): It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency.

➢ Non-Integral Foreign Operation -translation

- Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary – apply closing exchange rate.
- Items of income and expenses – At actual exchange rates on the date of transactions
- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".

➢ Integral Foreign Operation (IFO) - translation

- at the rate prevailing on the date of transaction

BRANCHES IN INDIA

Question 1

Why goods are marked on invoice price by the head office while sending goods to the branch?

Answer

Goods are marked on invoice price to achieve the following objectives:

(i) To keep secret from the branch manager, the cost price of the goods and profit made, so that the branch manager may not start a rival and competitive business with the concern; and

(ii) To have effective control on stock i.e stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.

(iii) To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

Question 2

Goods worth ₹ 50,000 sent by head office but the branch has received till the closing date goods for worth ₹ 40,000 only. Give journal entry in the books of H.O. and branch for goods in transit.

Answer

Journal entry in the books of Head Office

No entry

Journal entry in the books of Branch

	₹	₹
Goods-in-transit account Dr.	10,000	
To Head Office account		10,000
(Being goods sent by head office is still in transit)		

Question 3

Alphs having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account. On 31.3.2011, it was found that the goods dispatched by head office for ₹ 2,00,000 was received by the branch only to the extent of ₹ 1,50,000. The balance goods are in transit. What is the accounting entry to be passed by the branch for recording the goods in transit, in its books?

Answer

Nagpur branch must include the inventory in its books as goods in transit.

The following journal entry must be made by the branch:

Goods in transit A/c	Dr.	50,000	
To Head office A/c			50,000

[Being Goods sent by Head office is still in transit on the closing date]

Question 4

Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding ₹ 10,000 necessary for meeting immediate requirements of cash. On 31st March, 2012 the assets at the branch were as follows:

	₹ ('000)
Cash in Hand	*10*
Trade Debtors	*384*
Stock, at Invoice Price	*1,080*
Furniture and Fittings	*500*

During the accounting year ended 31st March, 2013 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at ₹ 72,000. Other transactions at the branch during the year were as follows:

	(₹ '000)
Cash Sales	*9,700*
Credit Sales	*3,140*
Cash collected by Branch from Credit Customers	*2,842*
Cash Discount allowed to Debtors	*58*
Returns by Customers	*102*
Bad Debts written off	*37*
Expenses paid by Branch	*842*

On 1st January, 2013 the branch purchased new furniture for ₹ 1 lakh for which payment was made by head office through a cheque.

On 31st March, 2013 branch expenses amounting to ₹ 6,000 were outstanding and cash in hand was again ₹ 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 2013.

Answer

In the Head Office Books

Branch Account

for the year ended 31st March, 2013

	₹ '000		₹'000
To Balance b/d		By Balance b/d	
Cash in hand	10	Stock reserve ₹ 1,080 × $\frac{1}{6}$	180
Trade debtors	384		
Stock	1,080	By Goods sent to branch A/c (Returns to H.O.)	72
Furniture and fittings	500		
To Goods sent to branch A/c	13,200	By Goods sent to branch A/c (Loading on net goods sent	2,188
To Bank A/c (Payment for	100		

furniture)			to branch – $\left(13{,}128\times\frac{1}{6}\right)$	
To Balance c/d Stock reserve $\left(1{,}470\times\frac{1}{6}\right)$	245	By	Bank A/c (Remittance from branch to H.O.)	11,700
To Outstanding expenses	6	By	Balance c/d	
To Profit and loss A/c (Net Profit)	1,096		Cash in hand	10
			Trade debtors	485
			Stock	1,470
			Furniture and fittings	516
	16,621			16,621

Working Notes :

1. Invoice price and cost

Let cost be		100
So, invoice price		120
Loading		20
Loading : Invoice price	= 20 : 120 = 1 : 6	

2. Invoice price of closing stock in branch

Branch Stock Account

	₹ *'000*		₹ *'000*
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. Closing balance of branch debtors

Branch Debtors Account

	₹ *'000*		₹ *'000*
To Balance b/d	384	By Branch cash	2,842
To Branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses	

		(Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. Closing balance of furniture and fittings

Branch Furniture and Fittings Account

	₹ '000		₹ '000
To Balance b/d	500	By Depreciation (80+4)	84
To Bank	100	By Balance c/d	516
	600		600

5. Remittance by branch to head office

Branch Cash Account

	₹ '000		₹ '000
To Balance b/d	10	By Branch expenses	842
To Branch stock	9,700	By Remittances to H.O.	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

Question 5

On 31st March, 2013 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Debit Balances	*₹ in lacs*
Furniture and Equipment	*18*
Depreciation on furniture	*2*
Salaries	*25*
Rent	*10*
Advertising	*6*
Telephone, Postage and Stationery	*3*
Sundry Office Expenses	*1*
Stock on 1st April, 2012	*60*
Goods Received from Head Office	*288*
Debtors	*20*
Cash at bank and in hand	*8*

Carriage Inwards	*7*
	448
Credit Balances	
Outstanding Expenses	*3*
Goods Returned to Head Office	*5*
Sales	*360*
Head Office	*80*
	448

Additional Information:

Stock on 31st March, 2013 was valued at ₹ 62 lacs. On 29th March, 2013 the Head Office despatched goods costing ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 2013. Hence, the figure of goods received from Head Office does not include these goods. Also the head office has charged the branch ₹ 1 lac for centralised services for which the branch has not passed the entry.

You are required to:

(i) Pass Journal Entries in the books of the Branch to make the necessary adjustments

(ii) Prepare Final Accounts of the Branch including Balance Sheet, and

(iii) Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance

Answer

(i) Books of Branch

Journal Entries

			(₹ in lacs)
		Dr.	*Cr.*
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 2013)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch
for the year ended 31st March, 2013

		₹ *in lacs*		₹ *in lacs*
To Opening Stock		60	By Sales	360
To Goods received from			By Closing Stock	62
Head Office	288			
Less : Returns	(5)	283		
To Carriage Inwards		7		
To Gross Profit c/d		72		
		422		422
To Salaries		25	By Gross Profit b/d	72
To Depreciation on Furniture		2		
To Rent		10		
To Advertising		6		
To Telephone, Postage & Stationery		3		
To Sundry Office Expenses		1		
To Head Office Expenses		1		
To Net Profit Transferred to				
Head Office A/c		24		
		72		72

Balance Sheet as on 31st March, 2013

Liabilities	₹ *in lacs*		*Assets*		₹ *in lacs*
Head Office	80		Furniture & Equipment	20	
Add : Goods in transit	10		*Less :* Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24		Goods in Transit		10
		115	Debtors		20
Outstanding Expenses		3	Cash at bank and in hand		8
		118			118

(iii)

Books of Head Office
Journal Entries

		₹	₹
		Dr.	*Dr.*
Branch Trading Account	Dr.	355	
To Branch Account			355
(The total of the following items in branch trial balance debited to branch trading account ₹ in lacs Opening Stock 60 Goods received from Head Office 288 Carriage Inwards 7)			
Branch Account	Dr.	427	
To Branch Trading Account			427
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows: ₹ in lacs Sales 360 Closing Stock 62 Goods returned to Head Office 5)			
Branch Trading Account	Dr.	72	
To Branch Profit and Loss Account			72
(Gross profit earned by branch credited to Branch Profit and Loss Account)			
Branch Profit and Loss Account	Dr.	48	
To Branch Account			48
(Total of the following branch expenses debited to Branch Profit & Loss Account ₹ in lacs Salaries 25 Rent 10 Advertising 6			

Telephone, Postage & Stationery	3			
Sundry Office Expenses	1			
Head Office Expenses	1			
Depreciation on furniture & Equipment	2			
Branch Profit & Loss Account		Dr.	24	
To Profit and Loss Account				24
(Net profit at branch credited to (general) Profit & Loss A/c)				
Branch Furniture & Equipment		Dr.	18	
Branch Stock		Dr.	62	
Branch Debtors		Dr.	20	
Branch Cash at Bank and in Hand		Dr.	8	
Goods in Transit		Dr.	10	
To Branch				118
(Incorporation of different assets at the branch in H.O. books)				
Branch		Dr.	3	
To Branch Outstanding Expenses				3
(Incorporation of Branch Outstanding Expenses in H.O. books)				

Question 6

Give Journal Entries in the books of Head Office to rectify or adjust the following:

(i) *Goods sent to Branch ₹ 12,000 stolen during transit. Branch manager refused to accept any liability.*

(ii) *Branch paid ₹ 15,000 as salary to the officer of Head Office on his visit to the branch.*

(iii) *On 28th March, 2012, the H.O. dispatched goods to the Branch invoiced at ₹ 25,000 which was not received by Branch till 31st March, 2012.*

(iv) *A remittance of ₹ 10,000 sent by the branch on 30th March, 2012, received by the Head Office on 1st April, 2012.*

(v) *Head Office made payment of ₹ 25,000 for purchase of goods by Branch and wrongly debited its own purchase account.*

Answer

In the books of Head Office
Journal Entries

	Particulars		Dr. Amount ₹	Cr. Amount ₹
(i)	Loss of goods due to theft during transit	Dr.	12,000	
	To Purchases account			12,000
	(Being goods lost on account of theft during transit)			
(ii)	Salaries account	Dr.	15,000	
	To Branch account			15,000
	(Being salary paid by the branch for H.O. employee)			
(iii)	No entry in the books of head office for goods sent to branch not received by branch till 31st March 2012			
(iv)	Cash in transit account	Dr.	10,000	
	To Branch account			10,000
	(Being remittance by branch not received by 31st March, 2012)			
(v)	Branch account	Dr.	25,000	
	To Purchases account			25,000
	(Being rectification of entry for payment for goods purchased by branch wrongly debited to purchase account)			

Note: In entry (i), it is assumed that refusal of branch manager (to accept liability of stolen goods) is accepted by the Head Office. Alternatively, Branch account will be credited on the basis of assumption that refusal of branch manager is not accepted by the Head Office.

Question 7

Show adjustment Journal entry in the books of Head Office at the end of April, 2013 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch accounts in its books.

A. Delhi Branch:

(1) Received goods from Mumbai – ₹ 35,000 and ₹ 15,000 from Kolkata.

(2) Sent goods to Chennai – ₹ 25,000, Kolkata – ₹ 20,000.

(3) Bill Receivable received – ₹ 20,000 from Chennai.

(4) Acceptances sent to Mumbai – ₹ 25,000, Kolkata – ₹ 10,000.

B. Mumbai Branch (apart from the above) :

(5) Received goods from Kolkata – ₹ 15,000, Delhi – ₹ 20,000.

(6) Cash sent to Delhi – ₹ 15,000, Kolkata – ₹ 7,000.

C. Chennai Branch (apart from the above) :

(7) Received goods from Kolkata – ₹ 30,000.

(8) Acceptances and Cash sent to Kolkata – ₹ 20,000 and ₹10,000 respectively.

D. Kolkata Branch (apart from the above) :

(9) Sent goods to Chennai – ₹ 35,000.

(10) Paid cash to Chennai – ₹15,000.

(11) Acceptances sent to Chennai – ₹15,000.

Answer

(a) Journal entry in the books of Head Office

Date	*Particulars*		*Dr.*	*Cr.*
			₹	₹
30th April, 2013	Mumbai Branch Account	Dr.	3,000	
	Chennai Branch Account	Dr.	70,000	
	To Delhi Branch Account			15,000
	To Kolkata Branch Account			58,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 2013)			

Working Note:

Inter – Branch transactions

		Delhi	*Mumbai*	*Chennai*	*Kolkata*
		₹	₹	₹	₹
A.	Delhi Branch				
(1)	Received goods	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
(2)	Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
(3)	Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
(4)	Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)

B.	Mumbai Branch				
(5)	Received goods	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)
(6)	Sent cash	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
C.	Chennai Branch				
(7)	Received goods			30,000 (Dr.)	30,000 (Cr.)
(8)	Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D.	Kolkata Branch				
(9)	Sent goods			35,000 (Dr.)	35,000 (Cr.)
(10)	Sent cash			15,000 (Dr.)	15,000 (Cr.)
(11)	Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
		15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Question 8

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

Answer

Books of Branch A
Journal Entries

	Particulars	*Dr. Amount ₹*	*Cr. Amount ₹*
(i)	Expenses account Dr.	3,500	
	To Head office account		3,500
	(Being the allocated expenditure by the head office recorded in branch books)		

(ii)	Depreciation account	Dr.	1,500	
	To Head office account			1,500
	(Being the depreciation provided)			
(iii)	Head office account	Dr.	2,000	
	To Salaries account			2,000
	(Being the rectification of salary paid on behalf of H.O.)			
(iv)	Head office account	Dr.	10,000	
	To Debtors account			10,000
	(Being the adjustment of collection from branch debtors)			
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account			3,000
	(Being the expenditure on account of Branch B, recorded in books)			

Question 9

M/s Shah commenced business on 1.4.2012 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office, where the goods were processed before sale. There was no loss or wastage in processing.

Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales, whether by Head Office or by the Branch, were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2013.

	Head Office		*Branch*	
	Dr. ₹	*Cr.* ₹	*Dr.* ₹	*Cr.* ₹
Capital		*3,10,000*		
Drawings	*55,000*			
Purchases	*19,69,500*			
Cost of processing	*50,500*			
Sales		*12,80,000*		*8,20,000*
Goods sent to Branch		*9,24,000*		
Administrative expenses	*1,39,000*		*15,000*	

Selling expenses	*50,000*		*6,200*	
Debtors	*3,09,600*		*1,13,600*	
Branch Current account	*3,89,800*			
Creditors		*6,01,400*		*10,800*
Bank Balance	*1,52,000*		*77,500*	
Head Office Current account				*2,61,500*
Goods received from H.O.			*8,80,000*	
	31,15,400	*31,15,400*	*10,92,300*	*10,92,300*

Following further information is provided:

(i) *Goods sent by Head Office to the Branch in March, 2013 of ₹ 44,000 were not received by the Branch till 2.4.2013.*

(ii) *A remittance of ₹ 84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2013.*

(iii) *Stock taking at the Branch disclosed a shortage of ₹ 20,000 (at selling price to the branch).*

(iv) *Cost of unprocessed goods at Head Office on 31.3.2013 was ₹ 1,00,000.*

Prepare Trading and Profit and Loss account in columnar form and Balance Sheet of the business as a whole as at 31.3.2013

Answer

In the Books of Shah

Trading and Profit and Loss Account for the year ended 31st March, 2013

	Particulars	*H.O.*	*Branch*	*Total*			*H.O.*	*Branch*	*Total*
		₹	₹	₹			₹	₹	₹
To	Purchases	19,69,500	–	19,69,500	By	Sales	12,80,000	8,20,000	21,00,000
To	Cost of processing	50,500	–	50,500	By	Goods sent to Branch	9,24,000	–	–
To	Goods received				By	Stock shortage	–	16,000	14,545
	from H.O.	–	8,80,000	–	By	Goods in transit			44,000
To	Gross profit c/d	3,40,000	1,64,000	5,02,545	By	Closing stock:			
						Processed goods	56,000	2,08,000	2,64,000
						Unprocessed goods	1,00,000	–	1,00,000
		23,60,000	10,44,000	25,22,545			23,60,000	10,44,000	25,22,545
To	Admn. Expenses	1,39,000	15,000	1,54,000	By	Gross profit b/d	3,40,000	1,64,000	5,02,545
To	Selling Expenses	50,000	6,200	56,200					
To	Stock shortage	–	16,000	14,545					

To	Stock reserve	22,909	–	22,909				
To	Net profit	1,28,091	1,26,800	2,54,891				
		3,40,000	1,64,000	5,02,545		3,40,000	1,64,000	5,02,545

Balance Sheet as at 31st March, 2013

Liabilities		₹	*Assets*		₹
Capital	3,10,000		Debtors		
Add: Net profit	2,54,891		H.O.		3,09,600
	5,64,891		Branch		1,13,600
Less: Drawings	(55,000)	5,09,891	Closing stock:		
Creditors:			Processed goods		
H.O.	6,01,400		H.O.	56,000	
Branch	10,800	6,12,200	Branch	2,08,000	
				2,64,000	
			Less: Stock reserve	18,909	2,45,091
			Unprocessed goods		1,00,000
			Bank Balance		
			H.O.		1,52,000
			Branch		77,500
			Goods in transit	44,000	
			Less: Stock reserve	4,000	40,000
			Cash in transit		84,300
		11,22,091			11,22,091

Working Notes:

1. Calculation of closing stock:

Stock at Head Office:

	₹
Cost of goods processed ₹ (19,69,500 + 50,500 – 1,00,000)	19,20,000
Less: Cost of goods sent to Branch	

$9,24,000 \times \frac{100}{110}$	8,40,000	
Cost of goods sold $12,80,000 \times \frac{100}{125}$	10,24,000	18,64,000
Stock of processed goods with H.O.		56,000

Stock at Branch:

		₹
Goods received from H.O. (at invoice price)		8,80,000
Less: Invoice value of goods sold		
$8,20,000 \times \frac{100}{125}$	6,56,000	
Invoice value of stock shortage $20,000 \times \frac{100}{125}$	16,000	(6,72,000)
Stock at Branch at invoice price		2,08,000
Less: Stock Reserve $2,08,000 \times \frac{10}{110}$		(18,909)
Stock of processed goods with Branch (at cost)		1,89,091

2. Stock Reserve:

	₹
Unrealised profit on Branch stock $\left(2,08,000 \times \frac{10}{110}\right)$	18,909
Unrealised profit on goods in transit $\left(44,000 \times \frac{10}{110}\right)$	4,000
	22,909

Question 10

Concept, with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33-1/3%. The following information is given in respect of the branch for the year ended 31st March, 2013:

	₹
Goods sent to Branch (Invoice price)	*4,80,000*
Stock at Branch on 1.4.2012 (Invoice price)	*24,000*

Cash sales	*1,80,000*
Return of goods by customers to the Branch	*6,000*
Branch expenses (paid in cash)	*53,500*
Branch debtors balance on 1.4.2012	*30,000*
Discount allowed	*1,000*
Bad debts	*1,500*
Collection from Debtors	*2,70,000*
Branch debtors cheques returned dishonoured	*5,000*
Stock at Branch on 31.3.2013 (Invoice price)	*48,000*
Branch debtors balance on 31.3.2013	*36,500*

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of the Head Office:

(i) Nagpur Branch Stock Account

(ii) Nagpur Branch Debtors Account

(iii) Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any.

Answer

In the books of head office

Nagpur Branch Stock Account

		₹					₹
1.4.2012	To Balance b/d	24,000	31.3.13	By	Bank A/c (Cash Sales)		1,80,000
31.3.2013	To Goods sent to Branch A/c	4,80,000		By	Branch Debtors (Credit Sales)		2,80,000
	To Branch Debtors	6,000		By	Stock shortage:		
					Branch P&L A/c	1,500*	
					Branch Adjustment A/c(Loading)	500	2,000
				By	Balance c/d		48,000
		5,10,000					5,10,000

Nagpur Branch Debtors Account

		₹			₹
1.4.2012	To Balance b/d	30,000	31.3.2013	By Bank A/c (Collection)	2,70,000
31.3.2013	To Bank A/c			By Branch Stock A/c	6,000
	(dishonour of cheques)	5,000		By Bad debts	1,500
	To Branch Stock A/c	2,80,000*		By Discount allowed	1,000
				By Balance c/d	36,500
		3,15,000			3,15,000

Nagpur Branch Adjustment Account

	₹		₹
To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	1,13,500		
	1,26,000		1,26,000
To Branch Stock A/c (Cost of loss)	1,500	By Gross Profit b/d	1,13,500
To Branch Expenses	56,000		
To Net Profit (Transferred to General P & L A/c)	56,000		
	1,13,500		1,13,500

*Balancing figure.

Working Notes:

1. Credit Sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is taken as credit sales
2. Loading is 33 $\frac{1}{3}$ % or Cost; i.e. 25% of invoice value

   Loading on opening stock = ₹ 24,000 × 25% = 6,000
3. Loading on goods sent = ₹ 4,80,000 × 25% = ₹1,20,000
4. Loading on Closing Stock = ₹48,000 × 25% = ₹12,000
5. Total Branch Expenses = Cash expenses + Bad debt + Discount allowed

   = ₹ 53,500 + ₹ 1,500 + ₹ 1,000 = ₹ 56,000

6. Gross Profit

Total sales (at invoice price) - Goods returned by customers (at invoice price) x $\frac{33.33}{100+33.33}$

{(₹ 1,80,000+ ₹ 2,80,000)- ₹ 6,000} x $\frac{33.33}{133.33}$ = ₹ 1,13,500

Question 11

Red and White of Mumbai started a branch at Bangalore on 1.4.2012 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2013:

	₹
Cost of goods sent to branch	*1,00,000*
Goods received by branch till 31.3.2013 at Invoice price	*1,08,000*
Credit sales for the year	*1,16,000*
Closing debtors on 31.3.2013	*41,600*
Bad debts written off during the year	*400*
Cash remitted to H.O.	*86,000*
Closing cash on hand at branch on 31.3.2013	*4,000*
Cash remitted by H.O. to branch during the year	*6,000*
Closing stock in hand at branch at invoice price	*12,000*
Expenses incurred at branch	*24,000*

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment A/c for ascertaining gross profit and Branch Profit and Loss A/c for ascertaining Branch profit.

Answer

Branch Debtors A/c

	₹		₹
To Branch Stock A/c	1,16,000	By Branch Cash A/c (balancing figure)	74,000
		By Bad Debts (written off)	400
		By Balance c/d	41,600
	1,16,000		1,16,000

Goods Sent to Branch A/c

		₹			₹
To	Branch Adjustment A/c $1,00,000\text{x} \frac{20}{100}$	20,000	By	Branch Stock A/c	1,20,000
To	Purchases/ Trading A/c	1,00,000			
		1,20,000			1,20,000

Branch Cash A/c

		₹			₹
To	Branch Debtors A/c	74,000	By	Branch Expenses A/c	24,000
To	H.O. A/c (cash remittance)	6,000	By	H.O. (cash remittance)	86,000
To	Branch Stock A/c		By	Balance c/d	4,000
	- Cash Sales (balancing figure)	34,000			
		1,14,000			1,14,000

Branch Stock A/c

		₹			₹
To	Goods sent to Branch A/c	1,20,000	By	Branch Debtors A/c	1,16,000
To	Branch Adjustment A/c	54,000	By	Branch Cash A/c (Sales)	34,000
	(Excess profit over normal loading - balancing figure)		By	Goods in Transit (1,20,000-1,08,000)	12,000
			By	Balance c/d	12,000
		1,74,000			1,74,000

Branch Expenses A/c

		₹			₹
To	Branch Cash A/c	24,000	By	Branch P&L A/c	24,000

Branch Adjustment A/c

		₹			₹
To	Stock Reserve A/c	2,000	By	Goods sent to Branch A/c	20,000
To	Goods in transit Reserve A/c	2,000	By	Branch Stock A/c	54,000
To	Branch P&L A/c (Balancing figure)	70,000			
		74,000			74,000

Branch P & L A/c

	₹		₹
To Branch Expenses A/c	24,000	By Branch Adjustment A/c	70,000
To Bad Debts	400		
To Net Profit (transferred to General P&L A/c)	45,600		
	70,000		70,000

Working Notes:

1. Loading is 20% of cost i.e. 16.67% (1/6th) of invoice value.

   Loading on closing stock = 1/6th of ₹ 12,000 =₹ 2,000.

2. Loading on goods sent to branch = 1/6th of ₹ 1,20,000 = ₹ 20,000.

3. Loading on goods in transit = 1/6th of ₹ 12,000 = ₹ 2,000.

Question 12

Neo with headquarters at Mumbai, maintains a branch at Goa. Goods are invoiced at cost plus 25%. In respect of Goa branch, the following information pertaining to the year ended 31st March, 2013 are made available to you:

	₹
Goods sent to Branch (at Invoice price)	*6,75,000*
Goods returned by branch during the year (at Invoice price)	*24,000*
Cash sales effected by branch	*1,85,000*
Discount allowed to customers	*2,500*
Amount received from branch debtors	*3,25,000*
Cheques of customers which got dishonoured	*8,000*
Branch expenses met in cash	*72,500*
Sales return at Goa branch	*10,000*
Bad debts	*5,500*

	On 31st March, 2013	*On 31st March, 2012*
Branch debtors	*1,05,000*	*50,000*
Stock at branch (at Invoice price)	*2,36,000*	*1,50,000*

Adopting the Stock and debtors system, you are required to prepare the following Ledger accounts, as appearing in the books of the Head Office:

(i) Goa branch debtors account;

(ii) *Goa branch adjustment account;*

(iii) *Goa branch profit and loss account.*

Answer

In the books of Neo (Head Office)

Goa Branch Debtors Account

Date		*Particulars*	₹	*Date*		*Particulars*	₹
1.4.2012	To	Balance b/d	50,000	31.3.2013	By	Bank (Collection from debtors)	3,25,000
31.3.2013	To	Bank A/c (Dishonour of cheques)	8,000		By	Branch Stock (Goods returned by customers)	10,000
	To	Branch Stock A/c (Credit sales)	3,90,000		By	Bad debts	5,500
					By	Discount allowed	2,500
					By	Balance c/d	1,05,000
			4,48,000				4,48,000

Goa Branch Adjustment Account

Date		*Particulars*	₹	*Date*		*Particulars*	₹
31.3.2013	To	Goods sent to Goa Branch A/c (goods returns to H.O.)	4,800	1.4.2012	By	Balance b/d (Opening stock reserve)	30,000
	To	Branch P & L A/c (Profit on sale at invoice price) (Bal. Fig.)	1,13,000	31.3.2013	By	Goods sent to Goa Branch A/c (Loading)	1,35,000
	To	Balance c/d (Closing stock reserve)	47,200				
			1,65,000				1,65,000

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

	Particulars	*Amount* ₹		*Particulars*	*Amount* ₹
To	Branch Expenses A/c	72,500	By	Branch Adjustment A/c	1,13,000
To	Branch Debtors - Discount	2,500			
	Bad debts	5,500			
To	Net Profit (Transferred to General Profit & Loss A/c)	32,500			
		1,13,000			1,13,000

Working Note:

Goa Branch Stock Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
1.4.2012	To Balance b/d	1,50,000	31.3.2013	By Bank (Cash sales)	1,85,000
31.3.2013	To Goods sent to Goa Branch	6,75,000		By Branch Debtors (Credit sales)	3,90,000
	To Branch Debtors (Goods Returned)	10,000		By Goods sent to Goa Branch (Goods returned to H.O.)	24,000
				By Balance c/d	2,36,000
		8,35,000			8,35,000

Question 13

Beta, having head office at Mumbai has a branch at Nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 2013:

	Head Office (₹)	*Branch (₹)*
Opening stock (as on 1.4.2012)	*2,25,000*	-
Purchases	*25,50,000*	-
Goods sent to branch (Cost to H.O. plus 80%)	*9,54,000*	-
Sales	*27,81,000*	*9,50,000*
Office expenses	*90,000*	*8,500*
Selling expenses	*72,000*	*6,300*
Staff salary	*65,000*	*12,000*

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 2013.

Answer

Trading and Profit and Loss A/c
For the year ended 31st March 2013

	Head office ₹	*Branch* ₹		*Head office* ₹	*Branch* ₹
To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000

To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	-
To Goods received from head office	-	9,54,000	By Closing stock (W.N.1 & 2)	7,00,000	99,000
To Gross profit c/d	16,60,000	95,000			
	44,35,000	10,49,000		44,35,000	10,49,000
To Office expenses	90,000	8,500	By Gross profit b/d	16,60,000	95,000
To Selling expenses	72,000	6,300			
To Staff salaries	65,000	12,000			
To Branch Stock Reserve (W.N.3)	44,000	-			
To Net Profit	13,89,000	68,200			
	16,60,000	95,000		16,60,000	95,000

Working Notes:

(1)	**Calculation of closing stock of head office:**	₹
	Opening Stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold [37,35,000* x 100/180]	(20,75,000)
		7,00,000
(2)	**Calculation of closing stock of branch:**	₹
	Goods received from head office [At invoice value]	9,54,000
	Less: Invoice value of goods sold [9,50,000 x 180/200]	(8,55,000)
		99,000
(3)	**Calculation of unrealized profit in branch stock:**	
	Branch stock ₹ 99,000	
	Profit included 80% of cost	
	Hence, unrealized profit would be = ₹ 99,000 x 80/180 =	₹ 44,000

Question 14

Pawan, of Delhi has a branch at Jaipur. Goods are invoiced to the branch at cost plus 25%. The branch is instructed to deposit the receipts everyday in the head office account with the bank. All the expenses are paid through cheque by the head office except petty cash expenses which are paid by the Branch.

From the following information, you are required to prepare Branch Account in the books of Head office:

	₹
Stock at invoice price on 1.4.2012	*1,64,000*
Stock at invoice price on 31.3.2013	*1,92,000*
Debtors as on 1.4.2012	*63,400*
Debtors as on 31.3.2013	*84,300*
Furniture & fixtures as on 1.4.2012	*46,800*
Cash sales	*8,02,600*
Credit sales	*7,44,200*
Goods invoiced to branch by head office	*12,56,000*
Expenses paid by head office	*2,64,000*
Petty expenses paid by the branch	*20,900*
Furniture acquired by the branch on 1.10.2012 (payment was made by the branch from cash sales and collection from debtors)	*5,000*

Depreciation to be provided on branch furniture & fixtures @ 10% p.a. on WDV basis.

Answer

In the Books of Pawan Delhi (Head Office)
Jaipur Branch Account

		₹			₹
To	Opening balances:		By	Branch stock reserve	32,800
	Branch stock A/c	1,64,000	By	Bank A/c (W.N.4)	15,00,000
	Branch debtors A/c	63,400	By	Goods sent to branch A/c (Loading)	2,51,200
	Branch furniture A/c	46,800			
To	Goods sent to branch	12,56,000	By	Closing Balances:	
To	Bank A/c (branch expenses)	2,64,000		Branch stock A/c	1,92,000
To	Branch stock reserve A/c	38,400		Branch debtors A/c	84,300
To	Profit and loss A/c (Bal. Fig.)	2,74,570		Branch furniture A/c (W.N.2)	46,870
		21,07,170			21,07,170

Working Notes:

1. Depreciation on furniture

	₹
10% p.a. on ₹ 46,800	4,680
10% p.a. for 6 months on ₹ 5,000	250
	4,930

2. Closing balance of branch furniture as on 31.3.2013

	₹
Branch furniture as on 1.4.2012	46,800
Add: Acquired during the year	5,000
	51,800
Less: Depreciation (W.N.1)	(4,930)
Branch furniture as on 31.3.2013	46,870

3. Collection from branch debtors

Branch Debtors Account

	₹		₹
To Balance b/d	63,400	By Bank A/c (Bal.Fig.)	7,23,300
To Sales	7,44,200	By Balance c/d	84,300
	8,07,600		8,07,600

4. Cash remitted by the branch to head office

Cash sales + Collection from debtors – Petty expenses – Furniture acquired by branch

₹ 8,02,600 + ₹ 7,23,300 (W.N. 3) – ₹ 20,900 – ₹ 5,000 = ₹ 15,00,000

Question 15

Ram of Chennai has a branch at Nagpur to which office, goods are invoiced at cost plus 25%. The branch makes sales both for cash and on credit. Branch expenses are paid direct from Head Office and the branch has to remit all cash received into the Head Office Bank Account at Nagpur.

From the following details, relating to the year 2013, prepare the accounts in Head Office Ledger and ascertain Branch Profit as per stock and debtors method. Branch does not maintain any books of accounts, but sends weekly returns to head office:

	₹
Goods received from head office at invoice price	*1,20,000*

Returns to head office at invoice price	*2,400*
Stock at Nagpur branch on 1.1.2013 at invoice price	*12,000*
Sales during the year – Cash	*40,000*
Credit	*72,000*
Debtors at Nagpur branch as on 1.1.2013	*14,400*
Cash received from debtors	*64,000*
Discounts allowed to debtors	*1,200*
Bad debts during the year	*800*
Sales returns at Nagpur branch	*1,600*
Salaries and wages at branch	*12,000*
Rent, rates and taxes at branch	*3,600*
Office expenses at Nagpur branch	*1,200*
Stock at branch on 31.12.2013 at invoice price	*24,000*

Answer

Nagpur Branch Stock Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Balance b/d	12,000	By	Goods sent to branch A/c (Returns)	2,400
To	Goods sent to branch A/c	1,20,000	By	Bank A/c (Cash sales)	40,000
To	Branch debtors A/c (Returns)	1,600	By	Branch debtors A/c (credit sales)	72,000
To	Branch adjustment A/c (Surplus over invoice price)	4,800	By	Balance c/d	24,000
		1,38,400			1,38,400

Nagpur Branch Adjustment Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Stock reserve - 20% of ₹ 24,000 (closing stock)	4,800	By	Stock reserve - 20% of ₹ 12,000 (Opening stock)	2,400
To	Branch profit & loss A/c (Gross profit)	25,920	By	Goods sent to branch A/c – 20% of ₹ 1,17,600	23,520
			By	Branch stock A/c	4,800
		30,720			30,720

Branch Profit & Loss Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Branch expenses A/c	16,800	By	Branch adjustment A/c	25,920
To	Branch debtors A/c (Discount)	1,200		(Gross Profit)	
To	Branch debtors A/c (Bad Debts)	800			
To	Net profit (transferred to Profit & Loss A/c)	7,120			
		25,920			25,920

Branch Expenses Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Bank A/c (Rent, rates & taxes)	3,600	By	Branch profit and loss A/c (Transfer)	16,800
To	Bank A/c (Salaries & wages)	12,000			
To	Bank A/c (Office expenses)	1,200			
		16,800			16,800

Branch Debtors Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Balance b/d	14,400	By	Bank A/c	64,000
To	Branch stock A/c	72,000	By	Branch profit and loss A/c (Bad debts and discount)	2,000
			By	Branch stock A/c (Sales returns)	1,600
			By	Balance c/d (bal.fig.)	18,800
		86,400			86,400

Goods sent to Branch Account

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Branch stock A/c	2,400	By	Branch stock A/c	1,20,000

To Branch adjustment A/c	23,520		
To Purchases A/c	94,080		
	1,20,000		1,20,000

Question 16

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 2013 from the following:

(1) Goods are invoiced to the branch at cost plus 20%.

(2) The sale price is cost plus 50%.

(3) Other informations:

	₹
Stock as on 01.04.2012 (invoice price)	*2,20,000*
Goods sent during the year (invoice price)	*11,00,000*
Sales during the year	*12,00,000*
Expenses incurred at the branch	*45,000*

Ascertain

(i) the profit earned by the branch during the year

(ii) branch stock reserve in respect of unrealized profit.

Answer

(i) Calculation of profit earned by the branch

In the books of Jammu Branch
Trading Account

Particulars	Amount ₹	Particulars	Amount ₹
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Gross profit	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit

= ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	₹	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less : Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Question 17

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars prepare branch account in the books of Head Office.

	(₹)		(₹)
Stock on 1st April 2011 (invoice price)	*30,000*	*Discount allowed to debtors*	*160*
Sundry Debtors on 1st April, 2011	*18,000*	*Expenses paid by head office:*	
Cash in hand as on 1st April, 2011	*800*	*Rent*	*1,800*
		Salary	*3,200*
Office furniture on 1st April, 2011	*3,000*	*Stationery & Printing*	*800*
Goods invoiced from the head office (invoice price)	*1,60,000*	*Petty expenses paid by the branch*	*600*
Goods return to Head Office	*2,000*	*Depreciation to be provided on branch*	
Goods return by debtors	*960*	*furniture at 10% p.a.*	
Cash received from debtors	*60,000*		
Cash Sales	*1,00,000*	*Stock on 31st March, 2012*	
Credit sales	*60,000*	*(at invoice price)*	*28,000*

Answer

In the books of Head Office – XYZ

Kolkata Branch Account (at invoice)

	₹		₹
To Balance b/d		By Stock reserve (opening)	6,000
Stock	30,000	By Remittances:	
Debtors	18,000	Cash Sales 1,00,000	
Cash in hand	800	Cash from Debtors 60,000	1,60,000
Furniture	3,000	By Goods sent to branch (loading)	32,000
To Goods sent to		By Goods returned by	
branch	1,60,000	branch (Return to H.O.)	2,000
To Goods returned by	400	By Balance c/d	
branch (loading)		Stock	28,000
To Bank (expenses		Debtors	16,880
paid by H.O.)		Cash (800-600)	200
Rent 1,800		Furniture (3,000-300)	2,700
Salary 3,200			
Stationary &			
printing 800	5,800		
To Stock reserve (closing)	5,600		
To Profit transferred to			
General Profit & Loss A/c	24,180		
	2,47,780		2,47,780

Working Note:

Debtors Account

	₹		₹
To Balance b/d	18,000	By Cash account	60,000
To Sales account (credit)	60,000	By Sales return account	960
		By Discount allowed account	160
		By Balance c/d	16,880
	78,000		78,000

Note: It is assumed that goods returned by branch are at invoice price.

FOREIGN BRANCHES

Question 18

On 31st March, 2012, the following ledger balances have been extracted from the books of Washington branch office:

Ledger Accounts	*$*
Building	*180*
Stock as on 1.4.2011	*26*
Cash and Bank Balances	*57*
Purchases	*96*
Sales	*110*
Commission receipts	*28*
Debtors	*46*
Creditors	*65*

You are required to convert above Ledger balances into Indian Rupees.

Use the following rates of exchange:

	₹ per $
Opening rate	*46*
Closing rate	*50*
Average rate	*48*
For fixed assets	*42*

Answer

Conversion of ledger balances (in Dollars) into Rupees

	$	Rate per $	Amount in ₹
Building	180	42	7,560
Stock as on 01.04.2011	26	46	1,196
Cash and bank balances	57	50	2,850
Purchases	96	48	4,608
Sales	110	48	5,280
Commission receipts	28	48	1,344
Debtors	46	50	2,300
Creditors	65	50	3,250

Question 19

Omega has a branch at Washington. Its Trial Balance as at 30th September, 2012 is as follows:

	Dr.	Cr.
	US $	US $
Plant and machinery	1,20,000	–
Furniture and fixtures	8,000	–
Stock, Oct. 1, 2011	56,000	–
Purchases	2,40,000	–
Sales	–	4,16,000
Goods from Omega (H.O.)	80,000	–
Wages	2,000	–
Carriage inward	1,000	–
Salaries	6,000	–
Rent, rates and taxes	2,000	–
Insurance	1,000	–
Trade expenses	1,000	–
Head Office A/c	–	1,14,000
Trade debtors	24,000	–
Trade creditors	–	17,000
Cash at bank	5,000	–
Cash in hand	1,000	–
	5,47,000	5,47,000

The following further information is given :

(1) *Wages outstanding – $ 1,000.*

(2) *Depreciate Plant and Machinery and Furniture and Fixtures @ 10 % p.a.*

(3) *The Head Office sent goods to Branch for ₹ 39,40,000.*

(4) *The Head Office shows an amount of ₹ 43,00,000 due from Branch.*

(5) *Stock on 30th September, 2012 – $ 52,000.*

(6) *There were no in transit items either at the start or at the end of the year.*

(7) *On September 1, 2010, when the fixed assets were purchased, the rate of exchange was ₹ 38 to one $.*

On October 1, 2011, the rate was ₹ 39 to one $.

On September 30, 2012, the rate was ₹ 41 to one $.

Average rate during the year was ₹ 40 to one $.

You are asked to prepare:

(a) Trial balance incorporating adjustments given under 1 to 4 above, converting dollars into rupees.

(b) Trading and Profit and Loss Account for the year ended 30th September, 2012 and Balance Sheet as on that date depicting the profitability and net position of the Branch as would appear in India for the purpose of incorporating in the main Balance Sheet .

Answer

(a) In the books of Omega

Washington Branch Trial Balance (in Rupees)

as on 30th September, 2012

	Dr.	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	*(₹ '000)*	*(₹ '000)*
Plant and Machinery	1,08,000		41	44,28,000	
Depreciation on plant and machinery	12,000		41	4,92,000	
Furniture and fixtures	7,200		41	2,95,200	
Depreciation on furniture and fixtures	800		41	32,800	
Stock, Oct. 1, 2011	56,000		39	21,84,000	
Purchases	2,40,000		40	96,00,000	
Sales		4,16,000	40		1,66,40,000
Goods from Omega (H.O.)	80,000			39,40,000	
Wages	3,000		40	1,20,000	
Outstanding wages		1,000	41		41,000
Carriage inward	1,000		40	40,000	
Salaries	6,000		40	2,40,000	
Rent, rates and taxes	2,000		40	80,000	
Insurance	1,000		40	40,000	
Trade expenses	1,000		40	40,000	
Head Office A/c		1,14,000			43,00,000
Trade debtors	24,000		41	9,84,000	
Trade creditors		17,000	41		6,97,000

Cash at bank	5,000		41	2,05,000	
Cash in hand	1,000		41	41,000	
Exchange gain (bal. fig.)					10,84,000
	5,48,000	5,48,000		2,27,62,000	2,27,62,000

(b) Washington Branch Trading and Profit and Loss Account

for the year ended 30th September, 2012

	₹		₹
To Opening stock	21,84,000	By Sales	1,66,40,000
To Purchases	96,00,000	By Closing stock	21,32,000
To Goods from Head Office	39,40,000	(52,000 US $ × 41)	
To Wages	1,20,000		
To Carriage inward	40,000		
To Gross profit c/d	28,88,000		
	1,87,72,000		1,87,72,000
To Salaries	2,40,000	By Gross profit b/d	28,88,000
To Rent, rates and taxes	80,000		
To Insurance	40,000		
To Trade expenses	40,000		
To Depreciation on plant and machinery	4,92,000		
To Depreciation on furniture and fixtures	32,800		
To Net Profit c/d	19,63,200		
	28,88,000		28,88,000

Balance Sheet of Washington Branch
as on 30th September, 2012

Liabilities	₹	₹	*Assets*	₹	₹
Head Office A/c	43,00,000		Plant and machinery	49,20,000	
Add : Net profit	19,63,200	62,63,200	*Less* : Depreciation	(4,92,000)	44,28,000
Foreign currency			Furniture and fixtures	3,28,000	
Translation reserve		10,84,000	*Less* : Depreciation	(32,800)	2,95,200
Trade creditors		6,97,000	Closing stock		21,32,000

Outstanding wages		41,000	Trade debtors		9,84,000
			Cash in hand		41,000
			Cash at bank		2,05,000
		80,85,200			80,85,200

Note:(1) Depreciation has been calculated at the given depreciation rate of 10% on WDV basis.

(2) The above solution has been given assuming that the Washington branch is a non-integral foreign operation of the Omega.

Question 20

The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 2012:

	$	$
Head office A/c	_	*22,800*
Sales	_	*84,000*
Debtors and creditors	*4,800*	*3,400*
Machinery	*24,000*	_
Cash at bank	*1,200*	_
Stock, 1 January, 2012	*11,200*	_
Goods from H.O.	*64,000*	_
Expenses	*5,000*	
	1,10,200	*1,10,200*

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

		₹			₹
To	*Balance b/d*	*8,10,000*	*By*	*Cash*	*28,76,000*
To	*Goods sent to branch*	*29,26,000*	*By*	*Balance c/d*	*8,60,000*
		37,36,000			*37,36,000*

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired on 31st January, 2007, when $ 1.00 = ₹ 40.

Rates of exchange were:

1st January, 2012	*$ 1.00*	=	*₹ 46*
31st December, 2012	*$ 1.00*	=	*₹ 48*
Average	*$ 1.00*	=	*₹ 47*

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Answer

(i) In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars)

for the year ended 31st December, 2012

	Particulars	*$*		*Particulars*	*$*
To	Opening stock	11,200	By	Sales	84,000
To	Goods from H.O.	64,000	By	Closing stock (W.N.2)	8,000
To	Gross profit c/d	16,800			
		92,000			92,000
To	Expenses	5,000	By	Gross profit b/d	16,800
To	Depreciation	2,400			
To	Manager's commission (W.N.1)	470			
To	Net profit c/d	8,930			
		16,800			16,800

(ii) (a) Converted Branch Trial Balance (into Indian Currency)

Particulars	*Rate per $*	*Dr. (₹)*	*Cr. (₹)*
Machinery	40	9,60,000	_
Stock January 1, 2012	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate		47,000	
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		₹ 3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 2012

	₹		₹
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from head office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		43,32,000
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on ₹ 9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		8,90,800

(c) Branch Account

	₹			₹
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	*Less:* Depreciation	(96,000)	8,64,000
To Creditors	1,63,200			
To Outstanding commission	22,560	By Closing stock		3,84,000
		By Debtors		2,30,400
		By Cash at bank		57,600
	15,36,000			15,36,000

Working Notes:

1. Calculation of manager's commission @ 5% on profit

i.e.	5% of $[16,800 – (5,000 + 2,400)]
Or	5% × $9,400 = $ 470
Manager's commission in Rupees = $ 470 × ₹ 48 = ₹ 22,560	

2. Calculation of closing stock	$
Opening stock	11,200

Add: Goods from head office	64,000
	75,200
Less: Cost of goods sold (at invoice price)	
i.e. $\frac{100}{125} \times 84{,}000$	(67,200)
Closing stock	8,000

Closing stock in Rupees = $8,000 x ₹ 48 = ₹ 3,84,000.

Question 21

DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 31st March, 2011, the branch furnishes the following trial balance in U.K. Pound:

Particulars	*£*	*£*
	Dr.	*Cr.*
Fixed assets (Acquired on 1st April, 2007)	*24,000*	
Stock as on 1st April, 2010	*11,200*	
Goods from head Office	*64,000*	
Expenses	*4,800*	
Debtors	*4,800*	
Creditors		*3,200*
Cash at bank	*1,200*	
Head Office Account		*22,800*
Purchases	*12,000*	
Sales		*96,000*
	1,22,000	*1,22,000*

In head office books, the branch account stood as shown below:

London Branch A/c

Particulars	*Amount ₹*	*Particulars*	*Amount ₹*
To Balance B/d	*20,10,000*	*By Bank A/c*	*52,16,000*
To Goods sent to branch	*49,26,000*	*By Balance C/d*	*17,20,000*
	69,36,000		*69,36,000*

The following further information are given:

(a) Fixed assets are to be depreciated @ 10% p.a. on straight line basis.

(b) On 31st March, 2010 :

Expenses outstanding	-	*£ 400*
Prepaid expenses	-	*£ 200*
Closing stock	-	*£ 8,000*

(c) Rate of Exchange :

1st April, 2007	-	*₹ 70 to £ 1*
1st April, 2010	-	*₹ 76 to £ 1*
31st March, 2011	-	*₹ 77 to £ 1*
Average	-	*₹ 75 to £ 1*

You are required to prepare:

(1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees.

(2) Trading and profit and loss account for the year ended 31st March, 2011 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head office of DM..

Answer

Trial Balance of London Branch as on 31st March, 2011

Particulars	*U.K. Pound*	*Rate Per U.K. Pound*	*Dr. (₹)*	*Cr. (₹)*
Fixed Assets	24,000	70	16,80,000	
Stock (as on 1st April, 2010)	11,200	76	8,51,200	
Goods from Head Office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 – 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding Expenses	400	77		30,800
Prepaid expenses	200	77	15,400	
Cash at Bank	1,200	77	92,400	
Head office Account		-		17,20,000
Difference in Exchange				12,400
			92,09,600	92,09,600

Closing stock will be (8,000 × 77) = ₹ 6,16,000

Trading and Profit & Loss A/c
for the year ended 31st March, 2011

	Particulars	*Amount (₹)*		*Particulars*	*Amount (₹)*
To	Opening Stock	8,51,200	By	Sales	72,00,000
To	Purchases	9,00,000	By	Closing Stock	6,16,000
To	Goods from H.O.	49,26,000			
To	Gross Profit	11,38,800			
		78,16,000			78,16,000
To	Expenses	3,75,000	By	Gross Profit	11,38,800
To	Depreciation	1,68,000	By	Profit due to Exchange difference	12,400
To	Net Profit	6,08,200			
		11,51,200			11,51,200

Balance Sheet as on 31st March, 2011

Liabilities	₹	₹	*Assets*	₹	₹
Head office			Fixed Assets	16,80,000	
Balance	17,20,000		*Less*: Depreciation	(1,68,000)	15,12,000
Add: Net Profit	6,08,200	23,28,200	Debtors		3,69,600
Outstanding expenses		30,800	Cash at bank		92,400
Creditors		2,46,400	Prepaid expenses		15,400
			Closing stock		6,16,000
		26,05,400			26,05,400

Working Note:

Since London Branch is an integral foreign operation. Hence,

(1) Fixed assets (cost and depreciation) are translated using the exchange rate at the date of purchase of the assets.

(2) Exchange difference arising on translation of the financial statement is charged to Profit and Loss Account.

Question 22

Moon Star has a branch at Verginia (USA). The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2012 is as follows:

Particulars	*US $*	
	Dr.	*Cr.*
Office equipments	*48,000*	
Furniture and Fixtures	*3,200*	
Stock (April 1, 2011)	*22,400*	
Purchases	*96,000*	
Sales	*---*	*1,66,400*
Goods sent from H.O	*32,000*	
Salaries	*3,200*	
Carriage inward	*400*	
Rent, Rates & Taxes	*800*	
Insurance	*400*	
Trade Expenses	*400*	
Head Office Account	*---*	*45,600*
Sundry Debtors	*9,600*	
Sundry Creditors	*---*	*6,800*
Cash at Bank	*2,000*	
Cash in Hand	*400*	
	2,18,800	*2,18,800*

The following further information's are given:

(1) Salaries outstanding $ 400.

(2) Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.

(3) The Head Office sent goods to Branch for ₹15,80,000

(4) The Head Office shows an amount of ₹ 20,50,000 due from Branch.

(5) Stock on 31st March, 2012 -$21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1, 2010 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2011, the rate was 47 per $. On March 31, 2012 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare:

(a) Trial balance incorporating adjustments given converting dollars into rupees.

(b) Trading, Profit and Loss Account for the year ended 31st March, 2012 and Balance Sheet as on date depicting the profitability and net position of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet.

Answer

In the books of Moon Star
Trial Balance (in Rupees) of Verginia (USA) Branch
as on 31st March, 2012

	Dr.	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	₹	₹
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2011)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange gain (bal. fig.)					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

(b) Trading and Profit and Loss Account of Verginia Branch
for the year ended 31st March, 2012

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US $ × 50)	
To Carriage inward	18,000		

	₹		₹
To Gross profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		15,92,200

Balance Sheet of Verginia Branch
as on 31st March, 2012

Liabilities	₹	₹	*Assets*	₹	₹
Head Office A/c	20,50,000		Office Equipment	24,00,000	
Add : Net profit	11,02,200	31,52,200	*Less* : Depreciation	(2,40,000)	21,60,000
Foreign Currency Translation Reserve		4,66,800	Furniture and fixtures	1,60,000	
Trade creditors		3,40,000	*Less* : Depreciation	(16,000)	1,44,000
Outstanding salaries		20,000	Closing stock		10,75,000
			Trade debtors		4,80,000
			Cash in hand		20,000
			Cash at bank		1,00,000
		39,79,000			39,79,000

EXERCISES

1. S & M Ltd., Bombay, have a branch in Sydney, Australia. At the end of 31st March, 2011, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office :

	Bombay		*Sydney*	
	(₹ thousands)		*(Austr dollars thousands)*	
	Debit	*Credit*	*Debit*	*Credit*
Share Capital	–	*2,000*	–	–
Reserves & Surplus	–	*1,000*	–	–
Land	*500*	–	–	–
Buildings (Cost)	*1,000*	–	–	–

Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.2010)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available :

(1) *Stock as at 31.3.2011 :*

Bombay ₹1,50,000

Sydney A $ 3,125

(2) *Head Office always sent goods to the Branch at cost plus 25%.*

(3) *Provision is to be made for doubtful debts at 5%.*

(4) *Depreciation is to be provided on buildings at 10% and on plant and machinery at 20% on written down values.*

(5) *The Managing Director is entitled to 2% commission on net profits.*

(6) *Income–tax is to be provided at 47.5%.*

You are required :

(a) *To convert the Branch Trial Balance into rupees;*

(use the following rates of exchange :

Opening rate A $ = ₹20

Closing rate A $ = ₹24

Average rate A $ = ₹22

For Fixed Assets A $ = ₹18).

(b) *To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2011 showing to the extent possible H.O. results and Branch results separately. (Balance Sheet not required.)*

(Hints: Exchange loss (balancing figure) in Sydney Branch Trial Balance ₹ 2,16,000; Net profit as per profit and loss account ₹ 9,88,000)

2. *Head Office passes adjustment entry at the end of each month to adjust the position arising out of inter–branch transactions during the month. From the following inter–branch transactions in January, 2011, make the entry in the books of Head Office :*

(a) *Bombay Branch*

(1) *Received Goods : ₹ 6,000 from Calcutta Branch, ₹ 4,000 from Patna Branch.*

(2) *Sent Goods to ₹ 10,000 to Patna, ₹ 8,000 to Calcutta.*

(3) *Received B/R : ₹ 6,000 from Patna.*

(4) *Sent Acceptance : ₹ 4,000 to Calcutta, ₹ 2,000 to Patna.*

(b) *Madras Branch (Apart from the above)*

(5) *Received Goods : ₹ 10,000 from Calcutta, ₹ 4,000 from Bombay.*

(6) *Cash Sent : ₹ 2,000 to Calcutta, ₹ 6,000 to Bombay.*

(c) *Calcutta Branch (Apart from the above)*

(7) *Sent Goods to Patna : ₹ 6,000.*

(8) *Paid B/P : ₹ 4,000 to Patna, ₹ 4,000 cash to Patna.*

(Hints: Madras Branch and Patna Branch debited by ₹ 6,000 and ₹ 16,000 respectively. Bombay branch and Calcutta Branch credited by ₹ 6,000 and ₹ 16,000 respectively.)

3. *T of Calcutta has a branch at Dibrugarh. The branch does not maintain separate books of accounts. The branch has the following assets and liabilities on 31st August, 2010 and 30th September, 2010 :*

	31st August, 2010	*30th September, 2010*
	₹	₹
Stock of tea	*1,80,000*	*1,50,000*
Advance to suppliers	*5,00,000*	*4,50,000*
Bank Balance	*75,000*	*1,00,000*
Prepaid expenses	*10,000*	*12,000*
Outstanding expenses	*13,000*	*11,000*
Creditors for purchases	*3,00,000*	*to be ascertained*

During the month, Dibrugarh branch :

(a) *received by electronic mail transfer ₹ 10,00,000 from Calcutta head office;*

(b) purchased tea worth ₹ 12,00,000;

(c) sent tea costing ₹ 12,30,000 to Calcutta, freight of ₹ 80,000 being payable at the destination by the receiver;

(d) spent ₹ 25,000 on office expenses;

(e) paid ₹ 3,00,000 as advance to suppliers;

(f) paid ₹ 6,50,000 to suppliers in settlement of outstanding dues.

In addition, T informs you that the Calcutta office had directly paid ₹ 3,50,000 to Dibrugarh suppliers by cheques drawn on bank accounts in Calcutta during the month. T informs you that for the purpose of accounting, Dibrugarh branch is not treated as an outsider. He wants you to write the detailed accounts relating to the transactions of the Dibrugarh branch as would appear in the books of Calcutta Head Office.

(Hints: Balances in Dibrugarh Tea Stock Account ₹ 1,50,000; Advance to Supplier's Account ₹ 4,50,000;Supplier's Account ₹ 1,50,000; bank account ₹ 1,00,000; Expenses Account ₹ 21,000;)