Paper 12 – Company Accounts and Audit

Section A – Generally Accepted Accounting Principles (GAAP)

(1) (A) Give a brief note on the component of Financial Statement.

Answer:

Financial Statement Components	Source / Type of Companies
Profit and Loss Account Schedule and Notes Forming Part thereto	Under section 210(1) of the companies Act in accordance with the provisions of the Companies Act and the Indian GAAP, to be prepared by all the companies. As per section 211(3B) all applicable accounting standards should be followed. Otherwise reasons of departure from accounting standards and financial effect should be disclosed. Compliance with accounting standards without any deviation is mandatory for the listed companies as per clause 50 of the Listing Agreement vide SEBI Circulars SMRP/ Policy/ Cir-44/01, Aug 31,2001
Cash Flow Statement	As per clause 32 of the Listing Agreement vide SEBI circular SMD-II/Policy/cir-80/2000 February 4, 2000. Cash Flow Statement should be prepared in accordance with the requirements of AS- 3 issued by the ICAI. To be prepared by listed companies.
Consolidated Financial Statements	Applicable to listed companies as per the SEBI circular SMRP/policy/cir-44/01, Aug.31,2001 Companies Listed in a recognized stock exchange shall be mandatorily required to publish Consolidated Financial Statements in the annual report in addition to the individual financial Statements shall be mandatory. To be prepared in accordance with AS-21 and AS-23. Section 217 (2AA) requires that board's Report shall include a Director's Responsibility Statement in which it is to be indicated that in the preparation of annual accounts, the applicable accounting standards are followed.

(B) What are the Accounting assumptions in preparation and presentation of a Financial Statement?

Answer:

Accounting Assumption

Underlying assumptions for the preparation and presentation of financial statements are accrual and going concern. Under accrual assumption, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the books of account and reported in the financial statements of the periods to which they relate. It helps in performance measurement in a better manner and identifying the financial position appropriately.

Under going concern assumption, the financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Therefore, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis. In case going concern basis could not be used, the entity shall disclose the basis used as well.

2. (A) UPC Ltd. purchased fixed assets for US $ 50 lakhs costing ₹ 1825 lakhs on 1.4.2011 and the same was fully financed by the foreign currency loan [i.e.US Dollars] repayment in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = ₹ 36.50]. As on 31.3.2012 the first installment was paid when 1 US Dollar fetched ₹41.50. The entire loss on exchange was included in cost of goods sold etc. UPC Ltd. normally provides depreciation on fixed assets at 20% on WDV basis.

Solution:

In this case AS-11 (pre-revised 1994) shall be applicable on Accounting for effects of changes in Foreign Exchange Rates, as the transaction in foreign currency has been entered into by the reporting enterprises before 1.4.2012. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, should be adjusted in the carrying amount of the respective fixed assets. The carrying amount of such fixed assets to the extent not already so adjusted or otherwise accounted for , also to be adjusted to account for any increase or decrease in the liability of enterprise, as expressed in the reporting currency by applying the closing rate, for making payments towards the whole or a part of the cost of the assets of for repayment of the whole or a part of the monies borrowed by the enterprise from any person directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

Thus the entire exchange loss due to variation of ₹ 50 lakhs on 31-3-2012 on payment of US $ 10 lakhs should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Further, depreciation on the unamortized depreciable amount should also be provided, in accordance with AS-6 on Depreciation Accounting.

Calculation Exchange loss:

Foreign currency loan = $\frac{1825 \text{ lakh}}{36.50 \text{ lakh}}$ = 50 lakhs US Doller

Exchange loss on outstanding loan on 31-3-2012 = 40 lakhs US $ X (41.50-36.50) = ₹ 200 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan.

Calculation of additional depreciation on account of increase in the depreciable amount of fixed assets = 20% of ₹ 250 lakhs = ₹50 lakhs

(B) AD Softex (India) Ltd. entered into purchase of forward contract as under:

Amt. of foreign currency	**US $ 100000**
Date of entering in forward cover	**28-2-2014**
Exchange rate of this date	**₹ 47.10 per US $**
Forward Rate	**₹ 48**
Period of forward cover	**3 months (31-5-2014)**
Spot Rate on reporting date (31-3-2014)	**₹ 47.85**
Forward Rate available at the reporting date For the remaining maturity of the contract	**₹47.50**

Forward cover has been entered into for sole purchase of managing risk associated with change of exchange rate for payment to supplier against purchase.

Required:

a) Calculate the forward premium/discount
b) Accounting for such forward premium/discount.
c) Calculate the exchange difference on 31-3-2014 (reporting date)
d) If the forward contract entered into is for speculation, what is the profit/loss for the period?

Answer:

(a) As per AS-11 forward premium is to be calculated as under:

(Forward contract rate less spot rate on the date of entering forward contract)

= (48.00 - 47.10) = 0.90 X 1, 00,000 = ₹ 90,000 is premium paid for forward contract.

(b) This premium should be amortized as expense over the life of the contract in absence of clear cut method of amortization in AS-11, it is better to amortize on straight-line method over three months. One month for the reporting period 31-3-2014 = 90,000/3 = ₹ 30,000

Two months for the next accounting period (April and May 2014) = 90,000/3 X 2 = 60,000

(c) Exchange difference on reporting date 31-3-2014

Rate at the inception of forward contract ₹47.10 per US$

Rate on the reporting date ₹47.75 per US $

Difference (47.85-47.10) = 0.75 X 100,000 = ₹ 75,000 credited to Profit and Loss A/c as exchange gain on forward contract.

(d) If the forward contract is for speculation -

The forward contract value should be marked to market on the reporting date

Rate of forward contract ₹48.00 per US$

Forward contract available for remaining period of maturity on the reporting date = ₹47.50 per US $ (Current market value)

If forward contract is marked to market there will be a loss of ₹ 50,000 as under:

Difference (48.00-47.50) X 1,00,000 = ₹50,000 (loss)

This loss should be debited to profit and loss account for the period ended 31-3-2014.

(C) Shyam Management Institute furnishes you the following information in respect of Development Fund in the year 2013-14:

Particulars	(₹ in crores)
Govt. grant received for construction of Building	**50**
Private grants for acquisition of Land	**25**
Transfer from unrestricted fund for purchase of furniture	**1**
Income from fixed deposit (Fixed deposit for one year ₹ 25 crores)	**2**
Cost of Land	**30**
Advance payment made for acquisition of further land	**5**
Furniture purchased	**1**
Payment made to contractors for construction of Building	**8**

Prepare a Statement of changes in balance of Development Fund for the year 2013-14 and Balance Sheet for the Development Fund as on 31.03.2014.

Solution:

(a) Statement of changes in Balance of Development Fund.

Particulars		(₹ in crores)
Government grant		50
Private grant		25
Transfer from unrestricted fund		1
Income from fixed deposit		2
		78
Less: Payments:		
Cost of Land	30	
Furniture Purchased	1	31
		47

(b) Balance Sheet for the Development Fund as at 31.03.2014

Liabilities	Amount ₹ crores	Assets	Amount ₹ crores
Development Fund Balance	47	Advance Payment of Land	5
		Fixed Deposits	25
		Construction of Building	8
		Cash at Bank	9*
	47		47

**Balance of Cash and Bank Receipts

Particulars		(₹ in lakhs)
Government grant		50
Private grant		25
Transfer from unrestricted fund		1
Income from fixed deposit		2
		78
Less: Payments:		
Land	30	
Advance for Land	5	
Fixed Deposit	25	
Furniture	1	69
Contractors	8	
		9

3. (A) A limited company has set up its business in a designated backward area which entitles it to receive, as per a public scheme, announced by the Govt. of India, a subsidy of 25% of the cost of investment. Having fulfilled all the conditions laid down under the scheme, the company, on its investment of ₹ 300 lakhs in capital assets during its accounting year ended 31.3.2014, received a subsidy of ₹ 75 lakhs in January 2014 from the Govt. of India. The accountant of the company would like to record the receipt as an item of revenue and to reduce the losses on the Profit and Loss Account for the year ended 31.3.2014.

Is his action justified? Discuss.

Solution:

As per para 8.4, AS 12, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation of income is usually made over the periods and in the proportion in *which* depreciation on related assets is charged.

Thus, in the present case, the subsidy amounting to ₹ 75 lakhs which had been received for the acquisition of capital asset is a depreciable in character. As per above provisions the above subsidy should not be credited to Profit and Loss Account for the period ended 31.3.2014; rather, the said amount of subsidy should be credited to Profit and Loss Account as a recognised one in proportion to depreciation charges.

(B) Based on the following information, calculate the actual return on pension plan assets:

Particulars	Amount (₹)	Amount (₹)
Benefit payments	**2,50,000**	
Contribution	**2,90,000**	
Fair market value of plan assets		
End of year		**7,90,000**
Beginning of year		**7,20,000**

Solution: The actual return on pension plan assets follows:

Particulars	Amount (₹)	Amount (₹)
Change in fair market value of plan assets (7,90,000 – 7,20,000)		70,000
Adjustments:		
Employer Contribution	2,90,000	
Less: Benefit payments	2,50,000	40,000
Actual return on plan assets		30,000

(C) A company reports the following information regarding pension plan assets. Calculate the fair value of plan assets at the end of the year.

Particulars	Amount (₹)
Fair market value of plan assets (beginning of year)	**6,30,000**
Employer Contribution	**1,70,000**
Actual return on plan assets	**90,000**
Benefit payments to retirees	**3,40,000**

Solution:

The actual return on pension plan assets follows:

Particulars	Amount (₹)
Fair market value of plan assets (beginning of year)	6,30,000
Employer Contribution	1,70,000
Actual return	90,000
Benefit payments	(3,40,000)
Fair market value of plan assets (end of year)	5,50,000

4. (A) R Ltd. (the lessee) acquired machinery on lease from S Ltd. (the Lessor) on January1,2010. The lease term covers the entire economic life of the machinery i.e. 3 years. The fair value of the machinery on January 1, 2010 is ₹3,50,000. The lease agreement requires the lessee to pay an amount of ₹1,50,000 per year beginning on December 31,2010. The lessee has guaranteed a residual value of ₹11,400 on December 31, 2012 to the lessor. The lessor however estimates that the machinery will have a salvage value of only ₹10,000 on December 31, 2012. The implicit rate of interest is 15% p.a. Compute the value of machinery to be recognized by the lessee and also the finance charges every year on the basis of AS-19. PV Factor of 15% in three years is 2.283.

Solution:

As per para 11 of AS-19, at the inception of a finance lease, the lessee should recognize the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of leased asset exceeds the present value of minimum lease payments 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. In this case fair value of the machinery is ₹3,50,000 and the net present value of minimum lease payment from the minimum lease payment is not less than the fair value, then the machinery will be recognized by the lessee at ₹3,50,000.

Present value of minimum lease payment:

Annual lease rental X P.V Factor + Present value of Guaranteed residual value

= ₹1,50,000 X (0.8695 +0.7561 +0.6575) +11,400 X 0.6575

=₹(3,42,465 +7,496) = Payment ₹3,49,961. Rounded off to ₹3,50,000

Year	Finance Charges ₹	Payment ₹	Reduction in Outstanding Liability ₹	Outstanding Liability ₹
Year 1(January 1)	-	-	-	3,50,000
(Dec.31)	52,500	1,50,000	97,500	2,52,500
Year 2 (Dec.31)	37,875	1,50,000	1,12,125	1,40,375
Year 3(Dec.31)	21,056	1,50,000	1,28,944	11,431

(B) An Equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair market value of the equipment are ₹3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹40,000. The (internal rate of return) 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.

(i) State with reason whether the lease constitute finance lease

(ii) Calculate unearned finance income.

Solution:

As per the question, IRR of the investment is 10%

Investment in lease is ₹ 3,00,000

If IRR is 10% that means P.V. of minimum lease payment (MLP) from lessor point of view plus unguaranteed residual value is equal to ₹ 3,00,000.

P.V. of unguaranteed residual value - (40,000 X 0.7513) = ₹ 30,052

P.V. of M.L.P. should be ₹(3,00,000 -30,052) = ₹ 2,69,948

As at the beginning of lease period the P.V. of M.L.P cover substantially the initial fair value i.e., 2,69,948/3,00,000 = 90% approx.

Moreover lease period covers major part of the lease of the asset

Hence, it is a finance lease.

Calculation of annual lease payment to the lessor	=	2,69,948/2.4868	= ₹1,08,552
Gross investment in lease – 1,08,552 X 3	=	₹ 3,25,657	
Unguaranteed residual value -		₹ 40,000	
		₹ 3,65,657	
Less: P.V. of Gross investment in lease		₹ 3,00,000	
Unearned finance income		₹ **65,657**	

(C) Briefly discuss how do you calculate diluted earning per share as per AS 20.

Answer:

As per paras 26, 27, and 30 of AS 20:

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.

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period.

The amount of net profit or loss should be adjusted by the following after taking into account any attributable change in tax expense for the period:

(a) any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders as calculated in accordance with paragraph 11;

(b) interest recognised in the period for the dilutive potential equity shares; and

(c) any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

After the potential equity shares are converted into equity shares the dividends, interest and other expenses or income associated with those potential equity shares will no longer be incurred (or earned). Instead, the new equity shares will be entitled to participate in the net profit attributable to equity shareholders.

5. (A) M Ltd. presented the following particulars for the period ended 31st March 2012, from which you are requested to calculate the diluted earnings per share:

Particulars	Amount
Net Profit earned for the year 2011-12 (₹)	**20,00,000**
No of equity shares outstanding at the end of the period	**10,00,000**
No. of 12% Convertible Debentures of ₹ 100 each to be convertible into 10 equity shares	**25,000**
Income Tax Rate	**30%**

Answer:

Interest to be paid to 12% Convertibles Debenture holders

Particulars	Amount ₹
No. of Debentures x Value per Debenture = 25,000 x ₹ 100	25,00,000
$\therefore$ Interest = ₹ 25,00,000 x $\frac{12}{100}$	3,00,000
Tax on the said interest = ₹ 3,00,000 x 30%	90,000

Adjusted Net Profit

Particulars	Amount ₹
Net Profit	20,00,000
Add: Debenture Interest	3,00,000
	23,00,000
Less: Tax on Debenture Interest @30%	90,000
Adjusted Net Profit	22,10,000

Ordinary Earning per Share = $\frac{\text{Net Profit}}{\text{No. of Equity Shares}} = \frac{20,00,000}{10,00,000}$ = ₹ 2.00

Diluted Earnings per Share =

No. of additional equity shares for conversion of debentures will be 25,000 x 10 = 2,50,000 Shares.

$\therefore$ Diluted Earnings per Share =

$$\frac{\text{Adjusted Net Profit}}{(\text{No. of Equity Shares + Convertible EquityShares})} = \frac{22,10,000}{(10,00,000 + 2,50,000)}$$

= ₹ 1.768

(B) Prava Ltd., in the past three years, spent ₹ 75,00,000 to develop a drug to treat cancer, which is charged to Profit and Loss A/c since they did not meet AS 8 criteria for capitalisation. In the current year, approval of the concerned Govt. Authority, has been received. The company wishes to capitalise ₹ 75,00,000 and disclose it as a prior period item. Is it correct? Give reasons for your answer.

Answer:

As per paras 58 and 59 of AS 26, expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date.

Similarly, subsequent expenditure on an intangible asset, after its purchase or its completion, should be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) the expenditure can be measured and attributed to the asset reliably.

Thus, from the above, it becomes clear that AS 26 prohibits reinstating the expenditure as recognised expenses. So, the company cannot capitalised the amount of ₹ 75,00,000 as it has already been adjusted against Profit and Loss Account in the previous accounting periods.

(C) An intangible asset appears in Balance Sheet of C Ltd. at ₹ 16 lakhs as on 31.3.2004. The asset was acquired for ₹ 40 lakhs in April 1991. The company has been amortising the asset value on Straight Line Basis. The policy is to amortise it for 20 years.

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

Answer:

We know that AS 26 came into effect on or after 1.4.2003 and was mandatory in nature.

As per para 67 of AS 26, if there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than 10 years then, in the circumstances, no adjustment is needed as on 1.4.2003.

Para 63 states that the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of the 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. Amortisation should commence when that asset is available for use.

As such, in the present case, as the amortisation period has already been expired on 1.4.2003, as per para 63, ₹ 16 lakhs should be eliminated along with an adjustment to be made with the opening balance of revenue reserve as on that date.

6. (A) What will be the treatment of the following in the final statement of accounts for the year ended 31.3.2012, of a limited company?

In 2010-11, the company has spent and carried forward in the books a total of ₹ 5,00,000 on developing a cure for cancer. During the current year, i.e., 2011-12, it is decided to terminate this product, as test results in the current year have proved adverse.

Answer:

As per para 87 of AS 26, an intangible asset should be derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal. As per para 88 of AS 26, gains or losses arising from the retirement or disposal of an intangible asset should be recognised as income or expense in the Statement of Profit and Loss.

In this case, however, the company decided ultimately to discontinue the product due to adverse test result. As such, the entire amount of ₹ 5 lakhs should be treated as an expense which should be adjusted against current year's P&L A/c.

(B) Ravan Ltd. Was involved in wage negotiation with trade unions of their organization as on 31st March 2013. Wage revision proposals could be finalized only after obtaining the final approval from the Head Office of the Company located at Chennai. The final approval was granted on

15th April 2013 w.e.f. 1st April 2011. The settlement covered period from 01.04.2011 to 31.03.2013. the liability upto 31st March 2013 was disclosed on account of the above settlement in the notes forming part of the Accounts. As an Auditor, you may advise whether such disclosure is proper.

Answer:

As per AS-29, a provision should be recognized if the following conditions are satisfied –

(i) Present obligation as a result of past event – Wage revision is for the period covered by Financial Statements, i.e. 2012-2013, and consists of the Company's present obligation.

(ii) Outflow of resources to settle the obligation is probable – Post Balance Sheet date events (i.e. sanction from H.O.) that the payment of revised wages is probable, i.e. more likely than not.

(iii) Reliable estimate of the amount – Though not quantified in the question, wage payable on the revised scale can be estimated reliable.

Since all the conditions for recognition of a provision are satisfied, the Provision should be recognized for the year ending 31st March 2013. Also, under AS-5, when items of Income and Expenses within Profit & 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, they should be disclosed separately. Since the company has only disclosed the fact and not created any provision, the treatment given by the company is not correct.

(C) Paras Ltd is in the process of finalizing its Accounts for the year ended 31st March 2013. The company seeks your advice on the following:

(i) The Company's Sales Tax Assessment for the A.Y. 2010-2011 has been completed on 10th February 2013 with a demand of ₹ 2 crores. The company paid the entire due under protest without prejudice to its right of appeal. The company files its appeal before the Appellate Authority wherein the grounds of appeal cover Tax on additions made in the Assessment Order for a Sum of ₹ 1.75 crore.

(ii) The company has entered into a Wage Agreement in April 2013 whereby Labour Union has accepted a revision in wage from July 2012. The agreement provided that the hike till April 2013 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September 2013.

Answer:

Since the company is not appealing against the addition of ₹ 0.25 crores, the same should be provided for in its Accounts for the year ended on 31st March 2013. The amount paid under protest can be kept under the head "Loans and Advances" and disclosed along with the contingent liability of ₹ 1.75 crores.

The arrears for the period from July 2012 to March 2013 are required to be provided for in the Accounts of Company for the year ended on 31st March 2013.

Section B – Accounts of Joint Stock Companies

7. (A) A limited Company was registered with a capital of ₹ 5,00,000 in share of ₹ 100 each and issued 2,000 such shares at a premium of ₹ 20 per share, payable as ₹ 20 per share on application (including ₹ 10 as premium), ₹ 50 per share on allotment (including balance of premium) and ₹ 20 per share on first call made three months later. All the money payable on application, and allotment were duly received but when the first call was made, one shareholder paid the entire balance on his holding of 30 shares, and another shareholder holding 100 shares failed to pay the first call money. Subsequently, those 100 shares were forfeited and reissued at ₹ 95 each, ₹ 100 fully called up and paid up.

Required:

Give Journal entries to record the above transactions.

Answer:

Journal

Particulars		L.F.	Dr. Amount ₹	Cr. Amount ₹
Bank A/c To Share Application A/c [Being the issue of 2,000 shares and application money received @ ₹ 20 per share]	Dr		40,000	 40,000
Share Application A/c To Share Capital A/c To Securities Premium A/c [Being the transfer of application money on 2,000 shares @ ₹ 10 per share to Share Capital A/c and ₹10 to Securities Premium)	Dr		40,000	 20,000 20,000
Share Allotment A/c To Share Capital A/c (2,000 x 40) To Securities Premium A/c (2,000 x 10) (Being the allotment money on 2,000 shares @ ₹ 50 including balance premium of ₹ 10 made due)	Dr		1,00,000	 80,000 20,000
Bank A/c To Share Allotment A/c (Being the allotment money on 2,000 shares @ ₹ 50 per share received)	Dr		1,00,000	 1,00,000
Share First Call A/c To Share Capital A/c (Being the first call money on 2,000 shares @ ₹ 20 per share made due)	Dr		40,000	 40,000
Bank A/c Calls-in-Arrear A/c (100 x 20) To Share First Call A/c To Call-paid-in-advance A/c (Being the first call money on 1,900 shares @ ₹ 20 per share and share Second call money on 30 shares @ ₹ 30 per share received in advance)	Dr Dr		38,900 2,000	 40,000 900

Particulars		L.F.	Dr. Amount ₹	Cr. Amount ₹
Share Capital A/c [100 (10+40+20)] Note: Share Capital is debited upto the amount of capital called up To Calls-in-Arrear A/c (amount not paid on 1st call) To Share Forfeiture A/c (amount paid towards capital on application and allotment) [100 (10+40)] ***Note: Since the shareholder has paid the amount due on application and allotment, there is no adjustment made towards Securities Premium, since the amount is already realized.*** ***Bank A/c Dr (100 x 95) (No. of shares reissued x reissue price)*** ***Share Forfeiture A/c Dr (100 x 5) (No. of shares reissued x discount on reissue)*** ***To Share Capital A/c (100 x 100) (No. of shares reissued x paid up capital per share)***	Dr		7,000 ***9,500*** ***500***	 2,000 5,000 ***10,000***

(B) Alpha Co. Ltd. has a paid up equity share capital of ₹ 20,00,000 in 2,00,000 shares of ₹ 10 each. It resolved to buy-back 50,000 equity shares at ₹ 15 per share. For this purpose it issued 20,000 12% preference shares of ₹ 10 each, at par, payable along with application. The company has to its credit ₹ 2,50,000 in securities premium account and ₹ 10,00,000 in the general reserve account. Pass the necessary journal entries.

Answer:

In the Books of Alpha Co. Ltd

Journal Entries

Date	Particulars		Debit ₹	Credit ₹
	Bank A/c To 12% Preference Share Application A/c (Application money on 20,000 preference shares at ₹ 10 each)	Dr.	2,00,000	 2,00,000
	12% Preference Share Application A/c To 12% Preference Share Capital A/c (Transfer of application money to preference share capital account on shares being allotted)	Dr	2,00,000	 2,00,000
	Equity Share Capital A/c Securities Premium A/c To Equity Shareholders A/c (Amount due to equity shareholders consequent upon buy-back of 50,000 Shares at ₹ 15)	Dr. Dr.	5,00,000 2,50,000	 7,50,000

	Equity Shareholders A/c To Bank A/c (Payment to equity shareholders for amount due to them on buy-back of shares)	Dr	7,50,000	7,50,000
	General Reserve A/c To Capital Redemption Reserve A/c (Transfer of the amount equal to net nominal value of shares bought back.) In this case, the equity shares were bought back both from fresh issue of preference shares as well as from reserves. As per rule, the amount which is utilized from reserves, shall only be considered for transferring it from General Reserve to Capital Redemption Reserve. In this case, Equity Share Capital was Rs.5,00,000 and from issue of 12% Preference Shares, Rs.2,00,000 was collected. Hence, from reserves/ profits, the balance is to be taken. [= 5,00,000 (-) 2,00,000]	Dr.	3,00,000	3,00,000

8. (A) The following was the Balance Sheet of Diamond Ltd. as at 31st March, 2014.

Liabilities	₹ in lakhs
10% Redeemable Preference Shares of ₹ 10 each, fully paid up	2,500
Equity Shares of ₹ 10 each fully paid up	8,000
Capital Redemption Reserve	1,000
Securities Premium	800
General Reserve	6,000
Profit and Loss Account	300
9% Debentures	5,000
Trade Payables	2,300
Sundry Provisions	1,000
	26,900

Assets	₹ in lakhs
Non-Current Assets (including investments Rs.3,000)	17,000
Cash at Bank	1,650
Other Current assets	8,250
	26,900

On 1st April, 2014 the company redeemed all of its preference shares at a premium of 10% and bought back 25% of its equity shares @ ₹ 20 per share. In order to make cash available, the company sold all the investments for ₹ 2,850 lakh and raised a bank loan amounting to ₹ 2,000 lakhs on the security of the company's plant.

Pass journal entries for all the above mentioned transactions including cash transactions and prepare the company's balance sheet immediately thereafter. The amount of securities premium has been utilized to the maximum extent allowed by law.

Answer:

Journal Entries

	Particulars		Debit ₹	Credit ₹
1.	Bank A/c	Dr.	2,850	
	Profit and Loss A/c	Dr.	150	
	To Investment A/c			3,000
	(Being sale of investments at a loss)			
2.	Bank A/c	Dr.	2,000	
	To Bank Loan A/c			2,000
	(Being loan taken from bank)			
3.	10% Redeemable preference Share capital A/c	Dr.	2,500	
	Premium on redemption of preference shareholder A/c	Dr.	200	
	To Preference shareholder A/c			2,750
	(Being redemption of preference shares)			
4	Preference shareholders A/c	Dr.	2,750	
	To Bank A/c			2,750
	(Being payment of amount due to preference shareholders)			
5.	Securities premium A/c	Dr.	250	
	To Premium on redemption of preference share A/c			250
	(Being use of securities premium to provide premium on redemption of preference shares)			
6.	Equity Share capital A/c	Dr.	2,000	
	Securities premium A/c [800 - 250]	Dr.	550	
	General reserves A/c	Dr.	1,450	
	[(200×20) - 2000 - 550]			
	To Equity shareholders A/c			4,000
	(being buy back of equity shares)			
	Note : Balance of General Reserve			
	[6000 - 1450] = ₹ 4550.			

	Particulars		Debit	Credit
			₹	₹
7.	General Reserves A/ c	Dr.	4,500	
	To Capital redemption reserve A/c (2000 + 2500)			4,500
	(Being creation of capital redemption reserve to the extent of the face value of preference share redeemed and equity shares bought back).			
	Note: Balance in General reserve as on 01.04.2012 (4550 - 4500) = ₹ 50.			
8.	Equity shareholders A/c	Dr.	4,000	
	To Bank A/c			4,000
	(Being payment of amount due to equity shareholders).			
	Note: Cash at Bank [1650+2,850+2000-2750-4000] = (₹ 250). This is an Overdraft Balance.			

Balance Sheet of Diamond Ltd., as on 01.04.2014 (relevant extracts)

Balance Sheet as at: 01.04.2014 (₹ in lakhs)

Ref No.	Particulars	Note No.	Current Year Reporting Period	Previous Year Reporting Period
			₹	₹
1	EQUITY AND LIABILITIES			
	(a) Share capital	1	6,000	
	(b) Reserves and surplus	2	5,750	
	(c) Money received against share warrants			
2	Share application money pending allotment			
3	Non-current liabilities			
	(a) Long-term borrowings	3	7,000	
	(b)Deferred tax liabilities (Net)			
	(c) Other Long term liabilities			
	(d) Long-term provisions			

4	Current Liabilities			
	(a) Short-term borrowings			
	(b) Trade payables		2,300	
	(c)Other current liabilities - Bank Overdraft		250	
	(d) Short-term provisions	4	1,000	
	Total(1+2+3+4)		22,050	
1	ASSETS			
	Non-current assets			
	(a) Fixed assets			
	(i) Tangible assets	5	14,000	
	(ii) Intangible assets			
	(iii) Capital work-in-progress			
	(iv) Intangible assets under development			
	(b) Non-current investments (Market value of Investment)			
	(c)Deferred tax assets (Net)			
	(d) Long-term loans and advances			
	(e) Other non-current assets			
2	Current assets			
	(a)Current investments			
	(b) inventories			
	(c) trade receivables			
	(d) Cash and cash equivalents		50	
	(e)Short-term loans and advances			
	(f) Other current assets		8,250	
	Total(1+2)		22,300	

Notes to the Accounts

(₹ in crores)

Note 1. Share Capital	Current Year Reporting Period (₹)	Previous Year Reporting Period(₹)
Issued Capital , Subscribed and Paid Up capital		
Equity Shares of ₹ 10 each	6,000	
Total	6,000	

Note 2. Reserve and Surplus	Current Year Reporting Period	Previous Year Reporting Period
Capital Redemption Reserve (1,000+4,500)	5,500	
General Reserve	50	
Profit and Loss(300-150)	150	
Total	5,750	

Note 3. Long Term borrowings	Current Year Reporting Period	Previous Year Reporting Period
9% Debenture	5,000	
Bank Loan	2,000	
Total	7,000	

Note 4. Short Term Provisions	Current Year Reporting Period	Previous Year Reporting Period
Sunday Provision	1,000	
Total	1,000	

Note 4. Tangible Assets	Current Year Reporting Period	Previous Year Reporting Period
Fixed Assets	14,000	
Total	14,000	

(B) On 01.04.08, P Ltd. issued 1,000, 15% Debentures of ₹ 100 each at a discount of 10% redeemable at par.

Required: Show the 'Discount on Issue of Debentures A/c if (a) such debentures are redeemable after 4 years, and (b) such debentures are redeemable by equal annual drawings in 4 years. A Ltd. follows financial year as its accounting year.

Answer:

(a) When such debentures are redeemable after 4 years:

A. Total discount allowed (₹ 1,00,000 × 10/100) = ₹ 10,000

B. Period for which debentures are held = 4 Years

C. Amount of discount to be written off to P & L A/c every year (A/B) = ₹ 2,500

Dr. Discount on Issue of Debentures Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.08	To 15% Debentures A/c	10,000	31.03.09	By P & L A/c	2,500
				By Balance c/d	7,500
		10,000			10,000
01.04.09	To Balance b/d	7,500	31.03.10	By P & L A/c	2,500
				By Balance c/d	5,000
		7,500			7,500
01.04.10	To Balance b/d	5,000	31.03.11	By P & L A/c	2,500
				By Balance c/d	2,500
		5,000			5,000
01.04.11	To Balance b/d	2,500	31.03.12	By P & L A/c	2,500
		2,500			2,500

(b) When such debentures are redeemable by equal annual drawings in 4 years:

Statement Showing the Debentures Discount to be Written Off Each Year

Year ended on A	Face Value of Deb. used B	Period of Use (Month) C	Product D = B×C D	Ratio E	Amount of Discount to be w/o 10,000×E/10
31.03.09	1,00,000	12 months	12,00,000	4	4,000
31.03.10	75,000	12 months	9,00,000	3	3,000
31.03.11	50,000	12 months	6,00,000	2	2,000
31.03.12	25,000	12 months	3,00,000	1	1,000

Dr. Discount on Issue of Debentures Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.08	To 15% Debentures A/c	10,000	31.03.09	By P & L A/c	4,000
				By Balance c/d	6,000
		10,000			10,000
01.04.09	To Balance b/d	6,000	31.03.10	By P & L A/c	3,000
				By Balance c/d	3,000
		6,000			6,000
01.04.10	To Balance b/d	3,000	31.03.11	By P & L A/c	2,000
				By Balance c/d	1,000
		3,000			3,000
01.04.11	To Balance b/d	1,000	31.03.12	By P & L A/c	1,000
		1,000			1,000

9. (A) On 01.01.2009 E Ltd. issued 500, 10% Debentures of ₹ 100 each, at a discount of 10% redeemable at a premium of 10%.

Required: Show the 'Loss on Issue of Debentures A/c', if (i) such debentures are redeemable after 4 years, and (ii) such debentures are redeemable by equal annual drawings in 4 years. E Ltd. follows calendar year as it accounting year.

Answer:

Loss on Issue at Discount = 10%; Loss on Redemption at premium = 10%

∴Total Loss = 20%

(i) When such debentures are redeemable after 4 years:

A.	Total Loss (₹ 50,000 × 20/100)	= ₹ 10,000
B.	Period for which debentures are held	= 4 Years
C.	Amount of discount to be written off to P & L A/c every year (A/B)	= ₹ 2,500

Dr. Loss on Issue of Debentures Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.09	To 10% Debentures A/c	5,000	31.12.09	By P & L A/c	2,500
	To Premium on redemption	5,000		By Balance c/d	7,500
		10,000			10,000
01.01.10	To Balance b/d	7,500	31.12.10	By P & L A/c	2,500
				By Balance c/d	5,000
		7,500			7,500
01.01.11	To Balance b/d	5,000	31.12.11	By P & L A/c	2,500
				By Balance c/d	2,500
		5,000			5,000
01.01.12	To Balance b/d	2,500	31.12.12	By P & L A/c	2,500
		2,500			2,500

(ii) When such debentures are redeemable by equal annual drawings in 4 years:

Statement Showing the Debentures Discount to be Written Off Each Year

Year ended on A	Face Value of Deb. used B	Period of Use (Month) C	Product D = B×C D	Ratio E	Amount of Discount to be w/o 10,000×E/10
31.03.09	1,00,000	12 months	6,00,000	4	4,000
31.03.10	75,000	12 months	4,50,000	3	3,000
31.03.11	50,000	12 months	3,00,000	2	2,000
31.03.12	25,000	12 months	1,50,000	1	1,000

Dr. Discount on Issue of Debentures Account *Cr.*

Date	Particulars	₹	Date	Particulars	₹
01.01.09	To 10% Debentures A/c	5,000	31.12.09	By P & L A/c	4,000
	To Premium on redemption	5,000		By Balance c/d	6,000
		10,000			10,000
01.01.10	To Balance b/d	6,000	31.12.10	By P & L A/c	3,000
				By Balance c/d	3,000
		6,000			6,000
01.01.11	To Balance b/d	3,000	31.12.11	By P & L A/c	2,000
				By Balance c/d	1,000
		3,000			3,000
01.01.12	To Balance b/d	1,000	31.12.12	By P & L A/c	1,000
		1,000			1,000

(B) On 1st April 2008. H Ltd. issued 442, 10% Debentures of ₹ 1000 each at a discount of 10% redeemable at a premium of 5% after 4 years. It was decided to create a Sinking Fund for the purposes of accumulating sufficient funds to redeem the Debentures and to invest in some radily convertible securities yielding 10% interest p.a. Reference to the table shows that ₹ 1.00 p.a. at 10% compound interest amounts to ₹ 4.641 in 4 years. Investments are to be made in the Bonds of ₹ 1000 each available at par.

On 31st March 2012, the investments realised ₹ 3,40,000 and debentures were redeemed. The bank balance as on that date was ₹ 50,000.

Required: Prepare Debenture Redemption Fund Account and Debenture Redemption Fund Investments Account for 4 years.

Answer:

DRF = Debenture Redemption Fund, DRFI = Debenture Redemption Fund Investment

Discount on Issue of Debentures Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.09	To Balance c/d	1,00,000	31.03.09	By P & L App. A/c	1,00,000
31.03.10	To Balance c/d	2,10,000	01.04.09	By Balance b/d	1,00,000
			31.03.10	By Interest on DRFI A/c	10,000

				By P & L App. A/c	1,00,000
		2,10,000			2,10,000
31.03.11	To Balance c/d	3,31,000	01.04.10	By Balance b/d	2,10,000
31.03.11				By Interest on DRFI A/c	21,000
				By P & L App. A/c	1,00,000
		3,31,000			3,31,000
31.03.12	To Loss on issue of		01.04.11	By Balance b/d	3,31,000
	Debentures			By Interest on DRFI A/c	33,100
	(premium)	22,100		By P & L App. A/c	91,000
	To Debenture			By Debenture Red.	
	Redemption			Fund Investment A/c	
	Reserve A/c	4,52,000		(profit)	19,000
		4,74,100			4,74,100

Debentures Redemption Fund Investment (DRFI) Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
31.03.09	To Bank A/c	1,00,000	31.03.09	By Balance c/d	1,00,000
01.04.09	To Balance b/d	1,00,000	31.03.10	By Balance c/d	2,10,000
31.03.10	To Bank A/c	1,10,000			
		2,10,000			**2,10,000**
01.04.10	To Balance b/d	2,10,000	31.03.11	By Balance c/d	3,31,000
31.03.11	To Bank A/c	1,21,000			
		3,31,000			**3,31,000**
01.04.11	To Balance b/d	3,31,000	31.03.12	By Bank A/c	3,50,000
31.03.12	To Debenture			(Sales)	
	Redemption				
	Fund A/c (Profit)	9,000			
		3,50,000			**3,50,000**

Working Note:

(i) Calculation of the amount of profit set aside

		₹
a.	Face Value of Debentures	4,42,000
b.	Premium Premium Payable on Redemption	22,100
c.	Depreciable Cost (A + B)	4,64,100
d.	Value of annuity per Re 1	4,641
e.	Annual amount to be charged (C/D)	1,00,000

(ii) Calculation of the amount of investments and interest

Year	Opening Balance	Interest	Saving	Investments	Closing Balance
a	b	c = b×10/100	d	e = c + d	f = b + e
2008-09	—	—	1,00,000	1,00,000	1,00,000
2009-10	1,00,000	10,000	1,00,000	1,10,000	2,10,000
2010-11	2,10,000	21,000	1,00,000	1,21,000	3,31,000
2011-12	3,31,000	33,100	1,00,000	—	—

10. (A) On 01.01.2011, Hudco Ltd. issued 1,000, 15% Convertible Debentures of ₹ 200 each at a discount of 5% redeemable at par after 4 years by coverting their holdings into equity shares of ₹ 100 each at a premium of 25%. As per terms of issue, the holders of these Debentures also have an option to convert their holdings as aforesaid at any time after 6 months but within 3 years. On 31.12.2011, a holder of 250 Debentures notified his intention to exercise the option.

Requirements: (a) Give Journal entries as on 01.01.2011, 31.12.2011 and on 31.12.2012 (ignoring interest), and (b) Prepare the Balance Sheet as on 31.12.2012 (showing related items only).

Answer:

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
01.01.07	Bank A/c	Dr.		1,90,000	
	Discount on Issue of Debentures A/c	Dr.		10,000	
	To 15% Debenture A/c				2,00,000
	(Being the issue of 1,000 debentures at a discount of 5%)				

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
31.12.11	15% Debentures A/c	Dr.		50,000	
	To Discount on Issue Debentures A/c				2,500
	To Equity Shares Capital A/c				38,000
	To Securities Premium A/c				9,500
	(Being the issue of 380 shares at 25% premium to a holder of 500 Debentures as per Board Resolution dated....)				
31.12.12	15% Debentures A/c	Dr.		1,50,000	
	To Equity Share Capital A/c				1,20,000
	To Securities Premium A/c				30,000
	(Being the issue of 1,200 share @ 25% premium to the holders of 1,500 Debentures as per Board's Resolution dated...)				

An Extract of Balance Sheet as at 31st December 2012

Liabilities	₹	Assets	₹
Share Capital:		Miscellaneous Expenditure:	
Equity Shares of ₹ 100 each fully paid up	38,000	Discount on Issue of Debentures	7,500
Reserves & Surplus:			
Securities Premium	9,500		
Secured Loans:			
750, 15% Debentures of ₹ 200 each	1,50,000		

Working Notes:

(i) It has been assumed that no portion of Discount on Issue of Debentures has yet been written off.

(ii) Calculation of No. of Shares to be issued on 31.12.2012.

a.	Normal Value of Debentures to be converted (250 × 200)	₹ 50,000
b.	Less: Reversal of Discount @ 5%	₹ 2,500
c.	Amount actually received (a – b)	₹ 47,500
d.	Issued price of an Equity Share (₹ 100 + 25%)	₹ 125
e.	No. of Shares to be issued (c/d)	380

New Shares have been issued exactly equal to be amount actually received (i.e., Net of discount) at the time of issue of Debentures, otherwise it would amount to an issue of shares at discount indirectly without complying with the provision of Sec. 79 of the Companies Act, 1956.

(iii) Calculation of No. of Shares to be issued on 31.12.2010.

a.	Nominal Value of Debentures to be converted	₹ 1,50,000
b.	Issue Price of an Equity Share (₹ 100 + 25%)	₹ 125
c.	No. of Equity Shares to be issued (a/b)	1,200

Since the debentures are due for redemption and the conversion of debentures into shares is on the basis of terms and conditions mutually agreed upon at the time of issue for redemption, even the debentures originally issued at a discount can be converted into shares.

(B) On 01.01.2007 S Ltd. had 2,000, 12% Debentures of ₹ 100 each. On 01.05.2007 the company purchased 400 own Debentures at ₹ 97 cum-interest in the open market. Interest on debenture is payable on 30the June and 31st Dec. each year.

Required: Give the necessary journal entires assuming (a) that the own Debentures purchased were cancelled immediately and (b) the the own Debentures purchased were retained as investments till 31.12.2012 on which date they were cancelled.

Answer:

(a) If own Debentures were cancelled immediately on date of purchase

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2007 May 01	12% Debentures A/c Debentures Interest A/c To Bank A/c To Capital Reserve A/c (Being 400 debentures cancelled by purchase @ ₹ 97 cum-interest)	Dr. Dr.		40,000 1,600	 38,800 2,800
June 30	Debentures Interest A/c To Bank A/c (Being the interest paid on ₹ 1,60,000 @ 12% p.a. for 6 months)	Dr.		9,600	 9,600
Dec. 31	Debenture Interest A/c To Bank A/c (Being the interest paid on ₹ 1,60,000 @ 12% p.a. for 6 months)	Dr.		9,600	 9,600
Dec. 31	Profit & Loss A/c To Debenture Interest A/c (Being the transfer of debenture interest to P & L A/c)	Dr.		20,800	 20,800
Dec. 31	Profit & Loss Appropriation A/c To Debenture Redemption Reserve A/c (Being the transfer of an amount equivalent to the cash sum applied (towards principal) in redeeming the debentures to DRR out of profits)	Dr.		37,200	 37,200

(b) If own debentures were cancelled on 31.12.2012.

Journal entries in the books of X Ltd

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
May 01	Own Debentures A/c Debentures Interest A/c To Bank A/c (Being the purchase of 400 debentures @ ₹ 97 cum-interest)	Dr.		37,200	 1,600 38,800
June 30	Debentures Interest A/c To Interest on Own Debentures A/c To Bank A/c (Being the Interest paid/credited on ₹ 1,60,000 debentures held by outsiders for 6 months & on ₹ 40,000 own debentures for 2 months)	Dr.		10,400	 800 9,600
Dec. 31	Debenture Interest A/c To Bank A/c To Interest on Own Debentures A/c (Being the interest paid/credited on ₹ 1,60,000 debentures held by outsiders and ₹ 40,000 own debentures for 6 months)	Dr.		12,000	 9,600 2,400
Dec. 31	Profit & Loss A/c To Debenture Interest A/c (Being the transfer of debenture interest to P & L A/c)	Dr.		24,000	 24,000
Dec. 31	Interest on Own Debentures A/c To Profit & Loss A/c (Being the transfer of interest on own debentures to P & L A/c)	Dr.		3,200	 3,200
Dec. 31	12% Debentures A/c To Own Debentures A/c To Capital Reserve A/c (Being the cancellation of 200 own debentures)	Dr.		40,000	 37,200 2,800
Dec. 31	Profit & Loss Appropriation A/c To Debenture Redemption Reserve A/c (Being the transfer of an amount equivalent to the cash sum applied in redeeming the debentures)	Dr.		37,200	37,200

11. (A) At the beginning of year 1, an enterprise grants 300 options to each of its 1,000 employees. The contractual life (comprising the vesting period and the exercise period) of options granted is 6 years. The other relevant terms of the grant are as below:

Vesting Period	**3 years**
Exercise Period	**3 years**

Expected Life	**5 years**
Exercise Price	**₹ 50**
Market Price	**₹ 50**
Expected forfeitures per year	**3%**

The fair value of options, calculated using an option-pricing model, is ₹ 15 per option. Actual forfeitures, during the year 1, are 5% and at the end of year 1, the enterprise still expects that actual forfeitures would average 3% per year over the 3 year vesting period. During the year 2, however, the management decides that the rate of forfeitures is likely to continue to increase, and the expected forfeiture rate for the entire award is changed to 6% per year. It is also assumed that 840 employees have actually completed 3 years vesting period. Suggest Accounting Treatment.

Answer:

Year 1

1. At the grant date, the enterprise estimates the fair value of the options expected to vest at the end of the vesting period as below

   Number of options expected to vest
   =300×1,000×0.97×0.97×0.97=2,73,802 options

   Fair value of options expected to vest
   =2,73,802 options × ₹ 15 = ₹ 41,07,030

2. At the balance sheet date, since the enterprise still expects actual for forfeitures to average 3% per year over the 3 year vesting period, no change is required in the estimates made at the grant date. The enterprise, therefore, recognize one-third of the amount estimated at (1) above (i.e. ₹ 41,07,030/3) towards the employee services received by passing the following entry:

Employee Compensation Expenses A/c	Dr.	₹ 13,69,010	
To Stock Options Outstanding A/c			₹ 13,69,010
(Being compensation expenses recognized in respect of the ESOP)			

3. Credit balance in the 'Stock Option Outstanding A/c' may be disclosed in the balance sheet under a separate heading, between 'Share Capital' and 'Reserve and Surplus'.

Year 2

1. At the end of the financial year, management has changed its estimate of expected forfeiture rate from 3% to 6% per year. The revised number of options expected to vest is 2,49,175 (3,00,000×.94×.94×.94). Accordingly the fair value of revised options expected to vest is ₹ 37,37,625 (2,49,175 × ₹15). Consequent to the change in the expected forfeitures, the expenses to be recognized during the year are determined as below:

Revised total fair value	₹ 37,37,625
Revised cumulative expenses at the end of the year 2= (₹ 37,37,625×2/3)	₹ 24,91,750
Expenses already recognized in year 1	₹ 13,69,010
Expenses to be recognized in year 2	₹ 11,22,740

2. The enterprise recognizes the amount determined at (1) above (i.e. ₹ 11,22,740) towards the employee services received by passing the following entry:
3. Credit balance in the 'Stock Option Outstanding A/c' may be disclosed in the balance sheet under separate heading between 'Share Capital' and 'Reserve and Surplus'.

Year 3

1. At the end of financial year, the enterprise would examine its actual forfeitures and make necessary adjustment, if any, to reflect expenses for the number of options that actually vested. Considering that 840 employees have completed three years vesting period, the expenses to be recognized during the year is determined as below:

   Number of options actually vested =840×300= 2,52,000

Fair value of options actually vested (₹ 2,52,000×₹15)	₹37,80,000
Expenses already recognized	₹ 24,91,750
Expenses to be recognized in year 3	₹ 12,88,250

2. The enterprise recognized the amount determined at (1) above towards the employee service received by passing the following entry:

Employee compensation expenses A/c	Dr.	₹ 12,88,250	
To Stock Options Outstanding A/c			₹ 12,88,250
(Being compensation expenses recognized in respect of the ESOP)			

3. Credit balance in the 'Stock Option Outstanding A/c' may be disclosed in the balance sheet under separate heading between 'Share Capital' and 'Reserve and Surplus'.

(B) What are the disclosure requirements under Director's Report for Employees Stock Option Scheme?

Answer:

Disclosure in the Director's Report – The Board of Directors shall inter alia, disclosure either in the Director's Report or in the annexure to the Director's Report, the following details of the ESOS:

a. Options granted;
b. The pricing formula;
c. Options vested;
d. Options exercised;
e. The total number of shares arising as a result of exercise of option;
f. Options lapsed;
g. Variation of terms of options;
h. Money realized by exercise of options;
i. Total number of options in force;
j. Employee-wise details of options granted to:
   (i) Senior managerial personnel;

(ii) Any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;

(iii) Identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

k. 'diluted earnings per share' pursuant to issue of shares on exercise of option calculated in accordance with IAS-33.

12. (A) ABCL grants 1,250 options on 1st May 2009 at ₹ 80 when the market price is ₹ 200 and the face value of ₹ 10. The vesting period is 3 years. The maximum exercise period is one year. 450 unvested options lapse on 1st June 2011, 800 options are exercised on 30th Sept. 2012. Pass necessary journal entries to record the above transactions and also show Deferred Employee Compensation Expense Account and Employee Stock Options Outstanding Account and state how these accounts will be shown in the Balance Sheet.

Answer:

Value of options = 1,250 x ₹ (200 – 80) = ₹ 1,50,000

Amount to be amortised = ₹ 1,50,000 /3 = ₹ 50,000 each year.

In the books of ABC Ltd

Journal

Date	Particulars	L.F.	₹	₹
01.06.09	Deferred Employee Compensation Expenses A/c. Dr. To, Employee Stock Options Outstanding A/c. (being the grant of 1,250 options at a discount of ₹ 80 each)		1,50,000	1,50,000
31.3.10	Employee Compensation Expense A/c. Dr. To, Deferred Employee Compensation Expense A/c. (being the amortization of the deferred compensation over three years on straight line basis)		50,000	50,000
31.3.11	Employee Compensation Expense A/c. Dr. To, Deferred Employee Compensation Expense A/c. (being the amortization of the deferred compensation over two years on straight line basis)		50,000	50,000
01.06.11	Employee Stock Options Outstanding A/c. (Note 1) Dr. To, Deferred Employee Compensation Expense A/c.(Note 2) To, Employee Compensation Expense A/c. (Note 3) (being the reversal of compensation accounting on lapse of 450 options)		54,000	18,000 36,000
31.3.12	Employee Compensation Expense A/c Dr. To, Deferred Employee Compensation Expense A/c. (being the amortization of the balance deferred compensation)		32,000	32,000
30.09.12	Bank A/c. (800 x ₹ 80) Dr. Employee Stock Options Outstanding A/c Dr. To Equity Share Capital A/c. To Securities Premium A/c (being the exercise of 800 options)		64,000 96,000	8,000 1,52,000

Deferred Employee Compensation Expense Account

Dr. Cr.

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
01.06.09	To, Employee Stock Options Outstanding A/c	1,50,000	31.1.10	By, Employee Compensation Expense A/c By, Balance c/d	50,000 1,00,000
		1,50,000			1,50,000
01.04.10	To Balance b/d	1,00,000	31.3.11	By, Deferred Employee Compensation Expense A/c	50,000 50,000
		1,00,000			1,00,000
01.04.11	To Balance b/d	50,000	31.3.12	By, Employee Compensation Expense A/c By, Balance c/d	18,000 32,000
		50,000			50,000

Employee Stock Options Outstanding Account

Dr. Cr.

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
31.3.10	To, Balance c/d	1,50,000	01.04.09	By, Deferred Employee Compensation Expense A/c.	1,50,000
		1,50,000			1,50,000
31.3.11	To Balance c/d	1,50,000	01.04.10	By, Balance b/d	1,50,000
		1,50,000			1,50,000
31.3.12 30.9.12	To Deferred Employee Compensation Expense A/c. To, Employee Compensation Expense A/c. To, Equity Share Capital A/c To Securities Premium A/c	18,000 36,000 4,800 91,200	01.04.11	By, Balance b/d	1,50,000
		1,50,000			1,50,000

Disclosure in the Balance Sheet:

(i) Employee Stock Options Outstanding will appear in the Balance Sheet as part of net worth or shareholders' equity.

(ii) Deferred employee compensation expense will appear as a negative item as part of net worth or shareholders' equity.

Working notes:

(i) $\frac{\text{Total Value of Compensation}}{\text{Total Number of Options}}$ x Number of Options not excercise = $\frac{1,50,000}{1,250}$ x 450 = ₹ 54,000

(ii) $\frac{\text{Not yet Amortised Value of Compensation}}{\text{Total Number of Options}}$ x Number of Options not excercise = $\frac{50,000}{1,250}$ x 450

= ₹ 18,000

(iii) $\frac{\text{Amortised Value of Compensation}}{\text{Total Number of Options}}$ x Number of Options not excercise = $\frac{1,00,000}{1,250}$ x 450

= ₹ 36,000

(iv) $\frac{\text{Total Value of Compensation}}{\text{Total Number of Options}}$ x Number of Options not excercise = $\frac{1,50,000}{1,250}$ x 800

= ₹ 96,000

(B) Virat Company made a public issue of 1,25,000 Equity Shares of ₹ 100 each, ₹ 50 payable on application. The entire issue was underwritten by four parties - Amal, Badal, Chapal and Dhabal in the proportion of 30%, 25%, 25% and 20% respectively. The Underwriting Commission was 5%. Amal, Badal, Chapal and Dhabal had also agreed on "Firm" Underwriting of 4,000, 6,000, NIL and 15,000 Shares respectively.

The total subscriptions, excluding Firm Underwriting, including Marked Applications were for 90,000 Shares. Marked Applications received were as under: Amal - 24,000 Shares; Badal -20,000 Shares; Chapal - 12,000 Shares; and Dhabal - 24,000 Shares.

Ascertain the liability of the Individual Underwriters and also show the Journal Entries that you would make in the books of the Company. All workings should form part of your answer.

Solution:

The Underwriters' Liability can be determined under two possible assumptions-
• When Benefit of Firm Underwriting is GIVEN to Underwriters - Assumption 1
• When Benefit of Firm Underwriting is NOT GIVEN to Underwriters - Assumption 2

1. Underwriters Liability under Assumption 1 (Figures in No. of Shares)

If Benefit of Firm Underwriting is GIVEN to Underwriters

Particulars	Amal	Badal	Chapal	Dhabal	Total
Ratio of Gross Liability	30%	25%	25%	20%	100%
Gross Liability	37,500	31,250	31,250	25,000	1,25,000
Less: Unmarked forms in ratio of Gross Liability [90,000-(24,000+20,000+12,000+24,000)]	(3,000)	(2,500)	(2,500)	(2,000)	(10,000)
	34,500	28,750	28,750	23,000	1,15,000
Less: Marked Applications	(24,000)	(20,000)	(12,000)	(24,000)	(80,000)
	10,500	8,750	16,750	(1,000)	35,000
Less: Firm Underwriting	(4,000)	(6,000)	NIL	(15,000)	(25,000)

Particulars	Amal	Badal	Chapal	Dhabal	Total
Balance to be taken under Contract	6,500	2,750	16,750	(16,000)	10,000
Adjust: Dhabal's surplus transferred to Amal, Badal and Chapal in Gross Liability Ratio [30:25:25]	(6,000)	(5,000)	(5,000)	16,000	-
Balance	500	(2,250)	11,750	-	10,000
Adjust: Badal's surplus transferred to Amal and Chapal Gross Liability Ratio [30:25]	(1,127)	2,250	(1,023)	-	-
Balance	(727)	-	10,727	-	10,000
Adjust: Amal's surplus transferred to Chapal	727	-	(727)	-	-
Net Liability	-	-	10,000	-	10,000
Add: Firm Underwriting	4,000	6,000	NIL	15,000	25,000
Total Liability	4,000	6,000	10,000	15,000	35,000

2. Calculation of Amount due from Underwriters under Assumption 1

Particulars	Amal	Badal	Chapal	Dhabal	Total
Total Liability	4,000	6,000	10,000	15,000	35,000
Amount Payable at ₹ 50 for Net Liability (₹)	2,00,000	3,00,000	5,00,000	7,50,000	17,50,000
Less: Underwriting Commission at 2% (₹)	(75,000)	(62,500)	(62,500)	(50,000)	2,50,000
Amount Receivable / Payable (₹)	1,25,000	2,37,500	4,37,500	7,00,000	15,00,000

3. Journal Entries in the books of Company under Assumption 1

S. No.	Particulars	Dr. ₹	Cr. ₹
1.	Bank A/c Dr. To, Equity Share Application A/c [Being amount received at ₹50 per share from public on 90,000 shares)	45,00,000	 45,00,000
2.	Amal A/c Dr. Badal A/c Dr. Chapal A/c Dr. Dhabal A/c Dr. Equity Share Application A/c Dr. To, Equity Share Application A/c (Being amount transferred to Share Capital due in respect of Total Liability of Underwriters and amount received from public)	2,00,000 3,00,000 5,00,000 7,50,000 45,00,000	 62,50,000

3.	Underwriting Commission A/c Dr. To, Amal A/c To, BadalA/c To, Chapal A/c To, Dhabal A/c (Being underwriting commission due 2%)	2,50,000	 75,000 62,500 62,500 50,000
4.	Bank A/c Dr. To, Amal A/c To, Badal A/c To, Chapal A/c To, Dhabal A/c (Being amount received from underwriters in final settlement)	2,50,000	 1,25,000 2,37,500 4,37,500 7,00,000

4. **Underwriters Liability under Assumption 2 (Figures in No. of Shares)**

If Benefit of Firm Under writing is NOT given to underwriters

(Under this assumption "Firm Underwriting" is also treated as "Unmarked Applications". Hence, "Unmarked Applications + Firm Underwriting Applications" are first apportioned in Gross Liability ratio)

Particulars	Amal	Badal	Chapal	Dhabal	Total
Gross Liability	37,500	31,250	31,250	25,000	1,25,000
Less: Unmarked Application and Firm Underwriting (10,000+25,000)	(10,500)	(8,750)	(8,750)	(7,000)	(36,000)
	27,000	22,750	22,750	18,000	90,000
Less: Marked Applications	(24,000)	(20,000)	(12,000)	(24,000)	(80,000)
	3,000	2,500	10,500	(6,000)	10,000
Adjust: Dhabal's surplus transferred to Amal, Badal and Chapal in Gross Liability Ratio[30:25:25]	(2,250)	(1,875)	(1,875)	6,000	-
	750	625	8,625	-	10,000
Adjust: Firm Underwriting	4,000	6,000	NIL	15,000	25,000
Total Liability	4.750	6.625	8.625	15,000	35,000

5. **Calculation of Amount due from Underwriters under Assumption 2**

Particulars	Amal	Badal	Chapal	Dhabal	Total
Total Liability	4.750	6.625	8.625	15,000	35,000
Amount Payable at ₹50 for (₹)	2,37,500	3,31,250	4,31,250	7,50,000	17,50,000
Less: Underwriting Commission at 2% (₹)	(75,000)	(62,500)	(62,500)	(50,000)	2,50,000
Amount Receivable / Payable (₹)	1,62,500	2,68,750	3,68,750	7,00,000	15,00,000

6. Journal Entries in the books of Company under Assumption 2

S. No.	Particulars	Dr. ₹	Cr. ₹
1.	Bank A/c Dr. To, Equity Share Application A/c (Being amount received at ₹50 per share from public and 90,000 Shares)	45,00,000	 45,00,000
2.	Amal A/c Dr. Badal A/c Dr. Chapal A/c Dr. Dhabal A/c Dr. Equity Share Application A/c Dr. To, Equity Share Application A/c(1,25,000 Shares × ₹50) (Being amount transferred to Share Capital due in respect of Total Liability of Underwriters and amount received from public)	2,37,500 3,31,250 4,31,250 7,50,000 45,00,000	 62,50,000
3.	Underwriting Commission A/c Dr. To, Amal A/c To, Badal A/c To, Chapal A/c To, Dhabal A/c (Being underwriting commission due 2%)	2,50,000	 75,000 62,500 62,500 50,000
4.	Bank A/c Dr. To, Amal A/c To, Badal A/c To, Chapal A/c To, Dhabal A/c (Being amount received from underwriters in final settlement)	2,50,000	 1,62,500 2,68,750 3,68,750 7,00,000

13. (A) Explain the disclosure requirement of Money received against Share Warrant & Share Application Money pending allotment under revised schedule VI.

Answer:

Money Received Against Share Warrants

Sch. VI Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	• In case of Listed Companies, Share warrants are issued to Promoters & others in terms of the Guidelines for Preferential Issues viz. SEBI (Issue of Capital and Disclosure Requirements), Guidelines, 2009. • Effectively, Share Warrants are amounts which would ultimately form part of the Shareholder's Funds. Since Shares are yet to be allotted against the same, these are not reflected as part of Share Capital, but as a separate line – item.

Share Application Money Pending Allotment

Sch. VI Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	• Share Application Money not exceeding the Issued Capital and to the extent not refundable, is to be disclosed as a separate line item after "Share Holders Funds" and before "Non-Current Liabilities". • If the Company's Issued Capital is more than the Authorized Capital, and approval of increase in Authorized Capital is pending, the amount of Share Application Money received over and above the Authorized Capital should be shown under the head "Other Current Liabilities". • The amount shown as 'Share Application Money Pending Allotment' will not include Share Application Money to the extent refundable. For example, the amount in excess of Issued Capital, or where Minimum Subscription requirement is not met. Such amount will have to be shown separately under 'Other Current Liabilities'. • Calls Paid in Advance are to be shown under "Other Current Liabilities". The amount of interest which may accrue on such advance should also is to be reflected as a Liability.

(B) Explain the disclosure requirement of Current Investment & Inventories under Revised Schedule VI.

Answer:

Current Investments

Schedule VI Disclosure Requirement	Points
Current Investments shall be classified as – (a) Investments in Equity Instruments, (b) Investment in Preference Shares, (c) Investments in Government or Trust Securities, (d) Investments in Debentures or Bonds, (e) Investments in Mutual Funds, (f) Investments in Partnership Firms, (g) Other Investments (specify nature). Notes: 1. Under each classification, details shall be given of Names of Bodies Corporate [indicating separately whether such Bodies are – (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose Entities] in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (Showing Separately Investments which are party-paid). In regard to Investments in the Capital of Partnership Firms, the names of the Firms (with the names of all their Partners, Total Capital and the Shares of each Partner) shall be given.	Principles given for Non-current Investments will apply here, to the extent relevant. However, Trade vs. Non-Trade Classification, is not required for Current Investments.

2. The following shall also be disclosed: (a) Basis of Valuation of individual Investments, (b) Aggregate Amount of Quoted Investments and Market Value thereof, (c) Aggregate Amount of Unquoted Investments, (d) Aggregate Provision made for Diminution in Value of Investments.	

Inventories

Schedule VI Disclosure Requirement	Points
Inventories shall be classified as – (a) Raw materials, (b) Work In Progress, (c) Finished Goods, (d) Stock-in-Trade (in respect of goods acquired for Trading), (e) Stores and Spares, (f) Loose Tools, (g) Others (specify nature) **Note:** Goods-in-Transit shall be disclosed under the relevant sub-head of Inventories. Mode of Valuation shall be stated.	• Goods in Transit should be included under relevant heads with suitable disclosure. • The heading "Finished Goods" should comprise of all Finished Goods other than those acquired for trading purposes. Those acquired for trading purposes are to be shown under "Stock in Trade".

14. (A) The following balances are extracted from the books of Supreme Ltd., a real estate company, on 31st March, 2013:

		(₹ '000)
	Dr.	**Cr.**
Sales		**13,800**
Purchases of materials	**6,090**	
Share capital fully paid		**500**
Land purchased in the year as stock	**365**	
Leasehold premises	**210**	
Creditors		**2,315**
Debtors	**3,675**	
Directors' salaries	**195**	
Wages	**555**	
Work in progress on 01.04.2013	**1,050**	
Sub-contractors' cost	**4,470**	

Equipment, Fixtures and Fittings at cost on 01.04.2013	1,320	
Stock on 01.04.2013	295	
Profit and Loss Account, Credit Balance on 01.04.2013		640
Secured Loan		560
Bank Overdraft		525
Interest on Loan and Overdraft	110	
Depreciation on Equipment on 01.04.2013		820
Administration Expenses	735	
Office Salaries	90	
	19,160	19,160

You also obtain the following information:

(a) On 31st March, 2014, stock on hand including the land acquired during the year, is valued at ₹ 7,10,000. Work in progress at that date is valued at ₹7,00,000.

(b) On 1st October, 2013 the company moved to new premises. The premises are on a 12 years lease and the lease premium paid amounted to ₹2,10,000. The company used sub-contract labour of ₹2,00,000 and materials at cost of ₹1,90,000 in the refurbishment of the premises. These are to be considered as part of the cost of leasehold premises.

(c) A review of the debtors reveals specific doubtful debts of ₹1,75,000 and the directors wish to provide for these together with a general provision based on 2% of the balance.

(d) Depreciation on equipment, fixtures and fittings is provided at 15% on the written down value.

(e) Supreme Ltd. sued Shallow Ltd. for supplying defective materials which has been written off as valueless. The Directors are confident that Shallow Ltd. will agree for a settlement of ₹2,50,000.

(f) The directors propose a dividend of 25%.

(g) ₹1,00,000 is to be provided as audit fee.

(h) The company will provide 10% of the pre-tax profit as bonus to employees in the accounts before charging the bonus.

(i) Income tax to be provided at 50% of the profits.

You are required:

(i) to prepare the company's financial statements for the year ended 31st March, 2014 as near as possible to proper form of company final accounts; and

(ii) to prepare a set of Notes to accounts including significant accounting policies.

Notes: Workings should form part of your answer.

Previous year figures can be ignored.

Figures are to be rounded off to nearest thousands.

Solution:

Name of the Company: Supreme Ltd.

Balance Sheet as at: 31st March, 2014 (₹ in '000)

Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
	1	EQUITY AND LIABILITIES			
		(a) Share capital	1	500	
		(b) Reserves and surplus	2	945	
		(c) Money received against share warrants			
	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings	3	560	
		(b) Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
		(a) Short-term borrowings	4	525	
		(b) Trade payables	5	2,315	
		(c) Other current liabilities	6	100	
		(d) Short-term provisions	7	895	
		Total (1+2+3+4)		5840	
	II	ASSETS			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	7	1,000	
		(ii) Intangible assets			
		(iii) Capital work-in-progress			

Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
		(iv) Intangible assets under development			
		(b) Non-current investments			
		(c) Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	Current assets			
		(a) Current investments			
		(b) inventories	8	1,410	
		(c) trade receivables	9	3,430	
		(d) Cash and cash equivalents			
		(e) Short-term loans and advances			
		(f) Other current assets			
		Total (1+2)		5840	

Name of the Company: Supreme Ltd.

Profit and Loss Statement for the year ended: 31st March, 2012 (₹ in '000)

Ref. No.	Particulars	Note No.		As at 31st March, 2014	As at 31st March, 2013
I	REVENUE FROM OPERATIONS	11		13,800	
	Less: Excise duty			Nil	
				13,800	
II	OTHER INCOME			Nil	
III	TOTAL REVENUE(I+II)			13,800	
IV	EXPENSES:				
	(a) Cost of material consumed	12		11,025	
	(b) Purchase of products for sale				
	(c) changes in inventories of finished goods, work-in-progress and products for sale				

Ref. No.	Particulars	Note No.		As at 31st March, 2014	As at 31st March, 2013
	(d) Employees cost/ benefits expenses	13		405	
	(e) Finance cost			110	
	(f) Depreciation and amortization expenses			100	
	(g) Other expenses	14		1,080	
	TOTAL EXPENSES			12,720	
V	PROFIT BEFORE EXCEPTIONAL AND EXTRAORDINARY ITEMS AND TAX (III-IV)			1,080	
VI	EXCEPTIONAL ITEMS				
VII	PROFIT BEFORE EXTRAORDINARY ITEMS AND TAX (V-VI)			1,080	
VIII	EXTRAORDINARY ITEMS				
IX	PROFIT BEFORE TAX FRON CONTINUING OPERATIONS (VII-VIII)			1,080	
X	Tax expenses:				
	(1) Current Tax			650	
	(2) deferred tax				
XI	PROFIT AFTER TAX FOR THE YEAR FROM CONTINUING OPERATION(IX-X)			430	
XII	Profit (loss) from discontinuing operations				
XIII	Tax expenses from discontinuing operations				
XIV	Profit(loss) from discontinuing operations (after tax)(XII-XIII)				
XV	PROFIT (LOSS) FOR THE PERIOD (XI+XIV)			430	
	Balance brought forward from previous year			640	
	Profit available for appropriation			1,070	
	Appropriation:				
	Proposed dividend		125		
	Transfer to General Reserve		45	170	
	Balance carried forward			900	

Ref. No.	Particulars	Note No.		As at 31st March, 2014	As at 31st March, 2013
XVI	Earning per equity share:				
	(1) Basic				
	(2) Diluted				

(₹ In '000)

Note 1. Share Capital	As at 31st March, 2014	As at 31st March, 2013
Authorized, Issued, Subscribed and paid-up Share capital:		
50,000 Equity share of ₹ 10 each	500	
Total	500	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2014		As at 31st March, 2013	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11 (Figure in '000)	50	500		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	50	500		
Less: Buy Back of share				
Total	50	500		

Note 2. Reserve & Surplus	As at 31st March, 2014	As at 31st March, 2013
General Reserve	45	
Profit and loss A/c	900	
Total	945	

Note 3. Long term borrowings	As at 31st March, 2014	As at 31st March, 2013
Secured Loan	560	
Total	560	

Note 4. Short-term borrowings	As at 31st March, 2014	As at 31st March, 2013
Bank Overdraft	525	
Total	525	

Note 5. Trade Payables	As at 31st March, 2014	As at 31st March, 2013
Sundry Creditors	2,315	
Total	2,315	

Note 6. Other Current Liabilities	As at 31st March, 2014	As at 31st March, 2013
Audit fees	100	
Total	100	

Note 7. Short- term provisions	As at 31st March, 2014	As at 31st March, 2013
Proposed dividend	125	
Provision for Taxation	650	
Provision for bonus	120	
Total	895	

Note 8. Tangible Assets		As at 31st March, 2014	As at 31st March, 2013
Equipment, Fixtures & Fittings at cost- Opening	1,320		
Less: Depriciation	895	425	
Leasehold premises (210+200+190)	600		
Less: Witten off	25	575	
Total		1,000	

Note 9. Inventories	As at 31st March, 2014	As at 31st March, 2013
Stock – Finished stock	710	
Work in progress	700	
Total	1410	

Note 10.Trade Receivables	As at 31st March, 2014	As at 31st March, 2013
Trade Debtors (more than six months)	3,675	
Less: Provision for doubtful debts	245	
Total	3,430	

Note 11. Revenue from operation	As at 31st March, 2014	As at 31st March, 2013
Sales (net of Excise Duty)	13,800	
Total	13,800	

Note 12. Cost of materials Consumed		As at 31st March, 2014	As at 31st March, 2013
Manufacturing expenses- Opening Stock (FG)	295		
Opening WIP	1,050	1,345	
Purchase of materials (6,090-190)		5,900	
Purchase of land as stock		365	
Wages		555	
Sub-contract Cost (4,470-200)		4,270	
Less: Closing Stock- Finished goods	710		
Work in progress	700	(1,410)	
Total		11,025	

Note 13. Employees benefit expenses	As at 31st March, 2014	As at 31st March, 2013
Salary- office staff (90+195)	285	
Bonus	120	
Total	405	

Note 14. Other Expenses	As at 31st March, 2014	As at 31st March, 2013
Administrative Expenses	735	
Provision for doubtful debts	245	
Auditors remuneration	100	
Total	1,080	

NOTES ON ACCOUNTS FOR THE YEAR ENDED 31ST MARCH, 2014

Significant Accounting Policies:

(a) Basis for preparation of financial statements: The financial statements have been prepared under the historical cost convention, in accordance with the generally accepted accounting principles and the provisions of the companies Act, 1956 as adopted consistently by the company.

(b) Fixed Assets: Fixed assets are shown at cost less depreciation. Cost comprises the purchase price and other attributable expenses.

(c) Depreciation: Depreciation on fixed assets is provided using the written down method. Lease-hold premises/improvements are being amortised over the lease period.

(d) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.

1. Other Matters:

(a) The cost of leasehold premises includes the cost of refurbishment to the extent of ₹ 3,90,000 (Materials ₹ 1,90,000 + Labour ₹ 2,00,000).

(b) Shallow Ltd. has been sued for supplying defective materials. Settlement of ₹ 2,50,000 is hopeful however it has not been recognized in the accounts as it represents contingent gain.

(1a)	Administration Expenses		735
	Directors' Salaries		195
	Provision for Doubtful Debts [175 + 2% of (3675 – 175)]		245
	Audit Fees		100
	Other expenses		1,275
b)	Employee Benefits:		
	Office salaries		90
			120
	Bonus		210
(2)	Bonus Calculation		
	Sales		13,800
	Less: Manufacturing Expenses	11,025	
	Other Exp. (excluding bonus)	1,365	
	Depreciation	100	
	Interest	110	12,600
	Pre-tax Profit		1,200
	Bonus (10%)		120
(3)	Fixed Asset:		
	Tangible Asset		
	(a) Gross block		
	Furniture and Fixture		1,320
	Leasehold Premises (210 + 200 + 190)		600
			1,920

(b) Depreciation

Furniture and fixture(1.4.2011) 820	820	
For the year [15% on (1,320– 820)]	75	895
Cost of Leasehold Premises written off		
[(210 + 200 + 190) X 1/12 X 1/2]		25
		920

(4) Provision for Taxation

Profit as per Profit and Loss Account		1,080
Add back: Provision for doubtful debts	245	
Cost of Leasehold premises written off	25	
Depreciation on equipment, fixtures and fittings	75	345
		1,425
Less: Depreciation under Income-tax Act		125
		1,300
Provision for Tax (@ 50%)		650

(It has been assumed that depreciation calculated under Income-tax Act amounts to ₹ 1,25,000)

(B) The following is the Profit and Loss Account (as per Schedule VI) of ABC Ltd., for the year ended 31st March, 2014:

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
Administrative, Selling and distribution expenses	8,22,542	Balance b/d	5,72,350
Donation to Charitable Funds	25,500	Balance form Trading A/c	40,25,365
Directors Fees	66,750	Subsidies received from Govt.	2,32,560
Interest on debentures	31,240	Interest on Investments	15,643
Compensation for breach of contracts		Transfer fees	722
Managerial remuneration	42,530	Profit on sale of machinery:	
Depreciation on fixed assets	2,85,350	Amount realized 55,000	
Provision for taxation	5,22,543	Written down value 30,000	25,000
General reserve	11,42,500		
Investment Revaluation Reserves	5,00,000		
Balance c/d	12,500		
	14,20,185		
	48,71,640		48,71,640

Additional Information:

(i) Original cost of the machinery sold was ₹40,000.

(ii) Depreciation on fixed assets as per Schedule XIV of the Companies Act,1956 was ₹5,75,345.

You are required to comment on the managerial remuneration in the following situations:

(a) There is only one whole time director;

(b) There are two whole time director;

(c) There are two whole time directors, a part time director, and a manager.

Solution:

Calculation of Profits u/s 349 of the Companies Act,1956

Particulars	Amount (₹)
Net Profit (bal c/d)	14,20,185
(+) Managers remuneration	2,85,350
(+) Depreciation charged	5,22,543
(+) Provision for taxation	11,42,500
(+) General Reserve	5,00,000
(+) Investment Revaluation Reserve	12,500
(-) Opening Profit	5,72,350
(-) Profit on machinery — Capital Profit (₹55,000-₹40,000)	15,000
(-) Depreciation as per Schedule XIV	5,75,345
Book Profit	27,20,383

(a) 5% of ₹27,20,383 = ₹1,36,019

(b) 10% of ₹27,20,383 = ₹2,72,038

(c) 11% of ₹27,20,383 = ₹2,99,242

15. (A) Why Cash Flow Statement is Prepared?

Answer:

Cash Flow Statement is considered to be a summarized statement showing sources of Cash Inflows and application of cash outflows of an enterprise during a particular period of time. It is prepared on the basis of the published data as disclosed by the Financial Statement of two different financial periods. It is an essential tool for managerial decision-making. Cash Flow reports the management Net Cash Flow (i.e. cash inflow less cash outflow or vice versa) from each activity of the enterprise as well as of the overall business of the enterprise. The management of the enterprise gets a picture of movement of cash resources from the Cash Flow Statement and can assess the stronger and weaker area of movement of cash for different activities of the business for drawing up the future planning.

(B) Explain the Importance of Cash flows.

Answer:

Cash flows are crucial to business decisions. Cash is invested in the business and the rationality of such investment is evaluated taking into account the future cash flows it is expected to generate. Economic value of an asset is derived on the basis of its ability to generate future cash flows. Economic value of an asset is given by the present value of future cash flows expected to be derived from the asset.

Profit is an accounting concept. Profit is derived on accrual assumption. Profit and cash flows from operational activities are not the same. Dividend decision is taken on the basis of profit, although it is to be paid in cash. Similarly, debt servicing capacity of a company is determined on the basis of cash flows from operations before interest. Plugging back of profit is a much talked about source of financing modernisation, expansion and diversification. Unless retained profit is supported by cash, plugging back is not possible. Thus cash flows analysis is an important basis for making several management decisions.

(C) Given below is Profit and Loss Account of ABC Ltd. and relevant Balance Sheet information:

Profit and Loss Statement for the year ended 31st March, 2014 (₹ in lakhs)

	Particulars	Note No.	As at 31st March,2014	As at 31st March,2013
I	REVENUE FROM OPERATION		4,150	
II	OTHER INCOME		100	
III	TOTAL REVENUE(I+II)		4,250	
IV	EXPENSES:			
	(a) Cost of material consumed			
	(b) Purchase of products for sale		2,400	
	(C) changes in inventories of finished goods, work-in-progress and products for sale		(20)	
	(d) Employees cost/ benefits expenses		800	
	(e) Finance cost		60	
	(f) Depreciation and amortization expenses		100	
	(g) Product development expenses/Engineering expenses			
	(h) Other expenses		200	
	(i) Expenditure transfer to capital and other account			
	TOTAL EXPENSES		3,540	
V	PROFIT BEFORE EXCEPTIONAL AND EXTRAORDINARY ITEMS AND TAX (III-IV)		710	
VI	EXCEPTIONAL ITEMS		-	
VII	PROFIT BEFORE EXTRAORDINARY ITEMS AND TAX (V-VI)		710	
VIII	EXTRAORDINARY ITEMS		-	
IX	PROFIT BEFORE TAX FROM CONTINUING OPERATIONS (VII-VIII)		710	
X	Tax expenses:			
	(1) Current Tax		200	
	(2) deferred tax		-	
XI	PROFIT AFTER TAX FOR THE YEAR FROM CONTINUING OPERATION(IX-X)		510	
XII	Profit (loss) from discontinuing operations			
XIII	Tax expenses from discontinuing operations			
XIV	Profit(loss) from discontinuing operations (after tax)(XII-XIII)			
XV	PROFIT (LOSS) FOR THE PERIOD (XI+XIV)			
	Balance brought forward from previous year		50	
	Profit available for appropriation		560	

	Particulars	Note No.	As at 31st March,2014	As at 31st March,2013
	Appropriation:			
	Proposed dividend		300	
	Transfer to General Reserve		200	
	Distribution Tax		30	
	Total		530	
	Balance carried forward		30	
XVI	Earning per equity share:			
	(1) Basic			
	(2) Diluted			

Notes on Accounts

1. Revenue from operation	As at 31st March,2014	As at 31st March,2013
Sales (net of Excise Duty)	4,150	
Total	4,150	

2. Other Income	As at 31st March,2014	As at 31st March,2013
Interest and Dividend	100	
Total	100	

3. Employees Cost/ Benefits Expenses	As at 31st March,2014	As at 31st March,2013
Wages and Salaries	800	
Total	800	

4. Finance Expenses	As at 31st March,2014	As at 31st March,2013
Interest	60	
Total	60	

Relevant Balance Sheet information	31-03-2014 ₹ in lakhs	31-03-2013 ₹ in lakhs
Debtors	400	250
Inventories	200	180
Creditors	250	230
Outstanding wages	50	40
Outstanding expenses	20	10

Advance tax	**195**	**180**
Tax provision	**200**	**180**
Assessed tax liability		**180**

Compute cash flow from operating Activities under Direct & Indirect method.

Answer:

Computation of cash flow from Operating Activities

Under Direct Method

Cash Receipts (a)	₹ in lakhs
Cash sales & Collection from debtors	
Sales + Opening Debtors - Closing Debtors (4,150+250-400)	4000
Cash Payments (b)	
Cash purchases & Payment to creditors	
Purchases+ Opening Creditors - Closing creditors (2,400+230-250)	2380
Wages & salaries paid (800+40-50)	790
Cash Expenses (200+10-20)	190
Taxes paid - Advance tax	195
	3555
Cash Flow from Operating Activities (a-b)	445

Under Indirect Method

Profit before tax	710
Add : Non-cash items : Depreciation	100
Add : Interest : Financing cash outflow	60
Less : Interest and Dividend : Investment	100
Cash inflow	770
Less : Tax paid	195
Working Capital Adjustments	575
Debtors 250-400	150
Inventories 180-200	-20

Creditors 250-230	20
Outstanding wages 50-40	10
Outstanding expenses 20-10	10
Cash Flow from Operating Activities	445

(D) The following is the Income statement XYZ Company for the year 2013-14:

(₹)

Sales			**1,62,700**
***Add*: Equity In ABC Company's earning**			**6,000**
			1,68,700
Expenses		**(₹)**	
Cost of goods sold		**89,300**	
Salaries		**34,400**	
Depreciation		**7,450**	
Insurance		**500**	
Research and development		**1,250**	
Patent amortisation		**900**	
Interest		**10,650**	
Bad debts		**2,050**	
Income tax :			
Current	**6,600**		
Deferred	**1,550**	**8,150**	
Total expenses			**1,54,650**
Net income			**14,050**

Additional information are:

(i) 70% of gross revenue from sales were on credit.
(ii) Merchandise purchases amounting to ₹ 92,000 were on credit.
(iii) Salaries payable totaled ₹ 1,600 at the end of the year.
(iv) Amortisation of premium on bonds payable was ₹ 1,350.
(v) No dividends were received from the other company.
(vi) XYZ Company declared cash dividend of ₹ 4,000.
(vii) Changes in Current Assets and Current Liabilities were as follows:

	Increase/ (Decrease)
	₹
Cash	**500**
Marketable securities	**1,600**
Accounts receivable	**(7,150)**
Allowance for bad debt	**(1,900)**
Inventory	**2,700**
Prepaid insurance	**700**
Accounts payable (for merchandise)	**5,650**
Salaries payable	**(2,050)**
Dividends payable	**(3,000)**

Prepare a statement showing the amount of cash flow from operations.

Answer:

Statement showing cash flow from Operations

	₹	₹
Cash flow from operations		
Cash sales (30% 1,62,700)	48,810	
Collection from debtors	1,20,890	
Total cash from operations		1,69,700
Uses of cash from operations		
Payment to suppliers	86,350	
Salaries expense	36,450	
Payment for insurance	1,200	
Research and development	1,250	
Interest payment	12,000	
Income tax payment	6,600	
Total operating cash payment		1,43,850
Net cash flow from operations		25,850

Notes:

(1)	Collection from debtors		₹
	Credit sales (70%× 1,62,700)		1,13,890
	Less : Bad debts (2,050 less 1,900)		150
			1,13,740
	Add : decrease in accounts receivables		7,150
	Collection from debtors on credit sales		1,20,890
(2)	Dividends earned ₹ 6,000 on equity of ABC Company has not been considered as it has not been received in cash.		
		₹	
(3)	Payment to suppliers		
	Cost of goods sold	89,300	
	Add: Increase in inventory	2,700	
	Purchases	92,000	
	Less: increase in accounts payable	5,650	
	Payment to suppliers	86,350	
(4)	Calculation of salaries payment		
	Salary expense	34,400	
	Add : decrease in salary payable	2,050	
	Payment of salaries	36,450	
(5)	Insurance payments		
	Insurance	500	
	Add : increase in prepaid insurance	700	
	Payment for insurance	1,200	
(6)	Interest payment		
	Interest expenses	10,650	
	Add : Amortisation of bond premium	1,350	
	Interest payments	12,000	
(7)	Income tax payments	₹	
	Income tax expense	8,150	
	Less: Deferred tax	1,550	
		6,600	
	Changes in current tax payable	Nil	
	Income tax payments	6,600	

(E) From the following information prepare cash flow statement:

Name of the Company: XYZ Ltd.

Balance Sheet as at 31-12-2012 and 31-12-2013

					(₹ in '000)
Ref No.	**Particulars**		**Note No.**	**31.12.2013**	**31.12.2012**
I		**EQUITY AND LIABILITIES**			
	1	**Shareholders' fund**			
		(a) Share capital		**1,500**	**1,250**
		(b) Reserves and surplus		**3,410**	**1,380**
		(c) Money received against share warrants			
	2	**Share application money pending allotment**			
	3	**Non-current liabilities**			
		(a) Long-term borrowings		**1,110**	**1,040**
		(b)Deferred tax liabilities (Net)			
		(c)Other Long term liabilities			
		(d) Long-term provisions			
	4	**Current Liabilities**			
		(a) Short-term borrowings			
		(b) Trade payables		**150**	**1,890**
		(c)Other current liabilities		**230**	**100**
		(d) Short-term provisions		**400**	**1,000**
		Total		**6,800**	**6,660**
II		**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			

(₹ in '000)

Ref No.	Particulars		Note No.	31.12.2013	31.12.2012
		(i) Tangible assets		730	850
		(ii) Intangible assets			
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
		(b) Non-current investments		2,500	2,500
		(c)Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	Current assets			
		(a)Current investments		670	135
		(b) Inventories		900	1,950
		(c) Trade receivables		1,700	1,200
		(d) Cash and cash equivalents		200	25
		(e)Short-term loans and advances			
		(f) Other current assets			
		Total		6,800	6,660

Notes on Accounts (₹ in '000)

1. Other Current Liabilities	31.12.2013	31.12.2012
Interest Payable	230	100
Total	230	100

2.Short Term Provision	31.12.2013	31.12.2012
Income Tax Payable	400	1,000
Total	400	1,000

3. Fixed Assets	31.12.2013	31.12.2012
Fixed Assets at cost	2,180	1,910
Less: Accumulated Depreciation	1,450	1,060
Total	730	850

4. Other Current Assets	31.12.2013	31.12.2012
Interest Receivable	100	-
Total	100	-

Statement of Profit and Loss for the year ended 31-12-2013 *(₹ in '000)*

Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administration and selling expenses	(910)
Interest expenses	(400)
Interest income	300
Dividend income	200
Foreign exchange loss	(40)
Net profit before taxation and extraordinary item	3,350
Extraordinary item - Insurance proceeds from earthquake disaster settlement	180
Net profit after extraordinary item	3,530
Income-tax	(300)
Net profit	3,230

Additional information (₹ in thousands):

(a) An amount of ₹250 was raised from the issue of share capital and a further ₹ 250 was raised from long-term borrowings.

(b) Interest expense was ₹ 400 of which ₹170 was paid during the period. ₹ 100 relating to interest expenses of the prior period was also paid during the period.

(c) Dividends paid were ₹ 1,200.

(d) Tax deducted at source on dividends received (included in the tax expenses of ₹ 300 for the year) amounted to ₹ 40

(e) During the period, the enterprise acquired fixed assets for ₹ 350. The payment was made in cash.

(f) Plant with original cost of ₹ 80 and accumulated depreciation of ₹ 60 was sold for ₹ 20.

(g) Foreign exchange loss of ₹ 40 represents reduction in the carrying amount of a short-term investment in foreign currency designated bonds arising out of a change in exchange rate between the date of acquisition of the investments and the balance sheet date.

(h) Sundry debtors and sundry creditors include amounts relating to credit sales and credit purchases only.

Answer:

Cash Flow Statement (Direct Method) *(₹ in '000)*

Cash Flows from Operating Activities:		
Cash receipts from customers	30,150	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2,550	
Income taxes paid	(860)	
Cash flow before extraordinary item :	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities (a)		1,870
Cash Flows from Investing Activities:		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividend received	160	
Net cash from investing activities (b)		30
Cash Flows from Financing Activities:		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowing	250	
Repayments of long-term borrowings	(180)	
Interest paid	(270)	
Dividend paid	(1,200)	
Net cash used in financing activities (c)		(1,150)
Net increase in cash and cash equivalents		750
Add: Cash and cash equivalents at beginning of period		160
Cash and cash equivalents at end of period		910

Cash Flow Statement (Indirect Method)

Cash flows from Operating Activities		
Net profit before taxation, and extraordinary item	3,350	
Adjustments for:		
Depreciation	450	
Foreign exchange loss	40	
Interest income	(300)	
Dividend income	(200)	
Interest expenses	400	
Operating profit before working capital changes	3,740	
Increase in sundry debtors	(500)	
Decrease in inventories	1,050	
Decrease in sundry creditors	(1,740)	
Cash generated from operations	2,550	
Income taxes paid	(860)	
Cash flow before extraordinary item :	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1,870
Cash Flows from Investing Activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividend received	160	
Net cash from investing activities		30
Cash Flows from Financing Activities:		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayment of long-term borrowings	(180)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning of period		160
Cash and cash equivalents at end of period		910

Working Notes:

1. Cash and Cash Equivalents

   Cash and cash equivalents consist of cash on hand and balance with banks, and investments in money-market instruments. Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amounts:

Particulars	**2013**	**2012**
Cash on hand and balances with banks	200	25
Short-term investments	670	135
Cash and cash equivalents	870	160
Effect of exchange rate changes	40	
Cash and cash equivalents as restated	910	160

   Cash and cash equivalents at the end of the period include deposits with banks of 100 held by a branch which are not freely remissible to the company because of currency exchange restrictions. The company has undrawn borrowing facilities of 2,000 of which 700 may be used only for future expansion.

2. Total tax paid during the year (including tax deducted at source on dividends received) amounted to 900.

3. Cash receipts from customers

Sales	30,650
Add : Sundry debtors at the beginning of the year	1,200
	31,850
Less : Sundry debtors at the end of the year	1,700
	30,150

4. Cash paid to suppliers and employees

Cost of sales			26,000
Administrative & selling expenses			910
			26,910
Add :	Sundry creditors at the beginning of the year	1,890	
	Inventories at the end of the year	900	2,790
			29,700
Less :	Sundry creditors at the end of the year	150	
	Inventories at the beginning of the year	1,950	2,100
			27,600

5. Income taxes paid (including tax deducted at source from dividends received)

Income tax expenses for the year (including tax)	
deducted at source from dividends received)	300
Add : Income tax liability at the beginning of the year	1,000
	1,300
Less : Income tax liability at the end of the year	400
	900

Out of 900, tax deducted at source on dividends received (amounting to 40) is included in cash flows from investing activities and the balance of 860 is included in cash flows from operating activities.

6. Repayment of long-term borrowing

Long-term debt at the beginning of the year	1,040
Add : Long-term borrowings made during the year	250
	1,290
Less : Long-term borrowings at the end of the year	1,110
	180

7. Interest Paid

Interest expenses for the year	400
Add : Interest payable at the beginning of the year	100
	500
Less : Interest payable at the end of the year	230
	270

16. (A) Explain the concept & disclosure requirement of reportable segments under Accounting Standard 17 on "Segment Reporting".

Answer:

Reportable Segments -

A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

(b) its segment result, whether profit or loss, is 10 per cent or more of -

(i) the combined result of all segments in profit, or

(ii) the combined result of all segments in loss,

whichever is greater in absolute amount; or

(c) its segment assets are 10 per cent or more of the total assets of all segments.

A business segment or a geographical segment which is not a reportable segment, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent, until at least 75 per cent of total enterprise revenue is included in reportable segments.

Disclosure Requirements -

An enterprise should disclose the following for each reportable segment:

(a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

(b) segment result;

(c) total carrying amount of segment assets;

(d) total amount of segment liabilities;

(e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);

(f) total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and

(g) total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

(B) Define Business Segment and Geographical Segment as per AS 17.

Answer:

Business segment -

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products or services;
(b) the nature of the production processes;
(c) the type or class of customers for the products or services;
(d) the methods used to distribute the products or provide the services; and
(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

Geographical segment -

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

(a) similarity of economic and political conditions;
(b) relationships between operations in different geographical areas;
(c) proximity of operations;
(d) special risks associated with operations in a particular area;
(e) exchange control regulations; and
(f) the underlying currency risks.

(C) From the following information of a company having two primary segments, prepare a statement classifying the same under appropriate heads.

		(₹ in lakh)
Segment Revenue	**A**	**27,050**
Segment Revenue	**B**	**3,280**
Inter Segment Revenue	**A**	**50**
Segment Profit	**A**	**4,640**
	B	
Segment Profit	**Loss**	**197**
Dividend Income		**285**
Interest Expense		**35**
Tax Provision		**1,675**
Capital Expenditure	**A**	**1,300**

Capital Expenditure	**B**	**16**
Non Cash Expenses (excluding depreciation)		
Segment	**A**	**114**
Segment	**B**	**16**
Liabilities	**A**	**3,430**
Liabilities	**B**	**770**
Other Liabilities		**2,200**
Assets	**A**	**19,450**
Assets	**B**	**2,700**
Other Assets		**6,550**
Depreciation	**A**	**110**
Depreciation	**B**	**15**

Answer:

		Particulars	Segment A	Segment B	Others	Eliminations	Total
I	Revenue:						
	a)	External Revenue	27,050	3,280			30,330
	b)	Inter segment Revenue	50			-50	
Total			27,100	3,280		-50	30,330
II	Result:		4,640	-197			4,443
	a)	Income from Investment					285
	b)	Interest Expenses					-35
	c)	Tax provision					-1,675
	d)	Net profit					3,018
III	Assets:						
	a)	Segment assets (directly attributable & allocated)	19,450	2,700			22,150
	b)	Unallocated assets					6,550
IV	Liabilities						
	a)	Segment assets (directly attributable & allocated)	3,440	770			4,200
	b)	Unallocated liabilities					2,200
V	Others:						
	a)	Depreciation	110	15			125
	b)	Non cash expenses	114	16			130
	c)	Capital Expenditure	1,300	16			1,316

(D) Information relating to five segments of V Ltd. is as under: **(₹ in lakhs)**

Segments	A	B	C	D	E	Total
Segment Revenue	**100**	**300**	**200**	**100**	**300**	**1,000**
Segment Result	**40**	**(60)**	**90**	**10**	**(30)**	**50**
Segment Assets	**45**	**55**	**140**	**20**	**40**	**300**

As a cost accountant of this company management wishes to know from you which company need to be reported.

Answer: (₹ in lakh)

Particulars		A	B	C	D	E	Total
1.	Segment Revenue	100	300	200	100	300	1,000
2.	% of Segment Revenue	10%	30%	20%	10%	30%	
3.	Segment Result: Profit Loss	40	(60)	90	10	(30)	140 (90)
4.	% of segment Result, absolute amount of profit/ whichever is higher, i.e. as a % of 140	28.57%	42.88%	64.29%	7.14%	21.43%	
5.	Segment Assets	45	55	140	20	40	300
6.	% of Segment Assets	15%	18.33%	46.67%	6.66%	13.33%	
	Reportable Segment	Yes	Yes	Yes	Yes	Yes	
	Criteria satisfied	Revenue, Result & Assets	Revenue Result & Assets	Revenue, Result & Assets	Revenue	Revenue, Result & Assets	

17. (A) The Balance Sheet (in Conventional Format) of MM Ltd. on 31st March, 2014 is as under:

Liabilities	₹	Assets	₹
Authorised, issued equity share capital		**Goodwill**	**5,00,000**
50,000 shares of ₹ 100 each	**50,00,000**	**Plant and machinery**	**45,00,000**
25,000 preference shares (7%) of		**Stock**	**7,50,000**
₹ 100 each	**25,00,000**	**Debtors**	**18,75,000**

Sundry creditors	**17,50,000**	**Preliminary expenses**	**2,50,000**
Bank overdraft	**7,50,000**	**Cash**	**3,75,000**
		Profit and loss account (Dr.)	**17,50,000**
	1,00,00,000		**1,00,00,000**

Two years' preference dividends are in arrears. The company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend provided the capital base is reduced.

An internal reconstruction scheme as follows was agreed to by all concerned:

(i) Creditors agreed to forego 50% of the claim.

(ii) Preference shareholders withdrew arrear dividend claim. They also agreed to lower their capital claim by 20% by reducing nominal value in consideration of 9% dividend effective after reorganization in case equity shareholders' loss exceed 50% on the application of the scheme.

(iii) Bank agreed to convert overdraft into term loan to the extent required for making current ratio equal to 2: 1.

(iv) Revalued figure for plant and machinery was accepted as ₹37,50,000.

(v) Debtors to the extent of ₹10,00,000 were considered good.

(vi) Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reorganisation.

Show:

(a) Total loss to be borne by the equity and preference shareholders for the reorganization;

(b) Share of loss to the individual classes of shareholders;

(c) New structure of share capital after reorganization;

(d) Working capital of the reorganized Company; and

(e) A proforma balance sheet after reorganization.

Answer:

(a) Loss to be borne by Equity and Preference Shareholders

	₹
Profit and loss account (debit balance)	17,50,000
Preliminary expenses	2,50,000
Goodwill	5,00,000
Plant and machinery (₹ 45,00,000 – ₹ 37,50,000)	7,50,000
Debtors (₹ 18,75,000 – ₹ 10,00,000)	8,75,000
Amount to be written off	41,25,000
Less: 50% of sundry creditors	8,75,000
Total loss to be borne by the equity and preference shareholders	32,50,000

(b) Share of loss to preference shareholders and equity shareholders

Total loss of ₹ 32,50,000 being more than 50% of equity share capital i.e. ₹ 25,00,000.

Preference shareholders' share of loss = 20% of ₹ 25,00,000	= ₹ 5,00,000
Equity shareholders' share of loss (₹ 32,50,000 – ₹ 5,00,000)	= ₹ 27,50,000
Total loss	₹ 32,50,000

(c) New structure of share capital after reorganisation

Equity shares:	₹
50,000 equity shares of ₹ 45 each, fully paid up (₹ 50,00,000 – ₹ 27,50,000)	22,50,000
Preference shares:	
25,000, 9% preference shares of ₹ 80 each, fully paid up (₹ 25,00,000 – ₹ 5,00,000)	20,00,000
	42,50,000

(d) Working capital of the reorganized company

Current Assets:	₹	₹
Stock		7,50,000
Debtors		10,00,000
Cash		3,75,000
		21,25,000
Less: Current liabilities:		
Creditors	8,75,000	
Bank overdraft	1,87,500	10,62,500
Working capital		10,62,500

Note:

Current ratio shall be 2: 1, i.e. total current liabilities shall be 50% of ₹ 21,25,000 (i.e. ₹ 7,50,000 +

10,00,000 + 3,75,000) = ₹ 10,62,500. Therefore, Bank overdraft = ₹ 1,87,500 (₹ 10,62,500 less creditors ₹ 8,75,000).

(e)

Name of the Company: MM Ltd.
Balance Sheet of (and reduced) as at 31st March, 2014

					(₹)
Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
	1	EQUITY AND LIABILITIES			
		(a) Share capital	1	42,50,000	
		(b) Reserves and surplus			
		(c) Money received against share warrants			
	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings	2	5,62,500	
		(b)Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
		(a) Short-term borrowings	3	1,87,500	
		(b) Trade payables	4	8,75,000	
		(c)Other current liabilities			
		(d) Short-term provisions			
		Total (1+2+3+4)		58,75,000	
	II	ASSETS			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	5	37,50,000	
		(ii) Intangible assets			
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
		(b) Non-current investments			
		(c)Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			

(₹)

Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
	2	Current assets			
		(a)Current investments			
		(b) inventories	6	7,50,000	
		(c) trade receivables	7	10,00,000	
		(d) Cash and cash equivalents	8	3,75,000	
		(e)Short-term loans and advances			
		(f) Other current assets			
		Total (1+2)		58,75,000	

(₹)

Note 1. Share Capital	As at 31st March, 2014	As at 31st March, 2013
Authorized share capital		
50,000 equity share of ₹ 100 each	50,00,000	
25,000 7% Preference share of ₹ 100 each	25,00,000	
Issued, Subscribed and paid-up share capital		
50,000 Equity share of ₹ 45 each	22,50,000	
25,000 7% Preference share of ₹ 80 each	20,00,000	
Total	42,50,000	

Reconciliation of Share Capital

FOR EQUITY SHARE	As at 31st March, 2014		As at 31st March, 2013	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	50,000	22,50,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	50,000	22,50,000		
Less: Buy Back of share				
Total	50,000	22,50,000		

FOR 7% PREFERENCE SHARE	As at 31st March, 2014		As at 31st March, 2013	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	25,000	20,00,000		
Add: Fresh Issue (Including share issued other	Nil	Nil		

than cash)				
	25,000	20,00,000		
Less: Redemption of Preference shares	Nil	Nil		
Total	25,000	20,00,000		

Note 2. Long-term borrowings	As at 31st March, 2014	As at 31st March, 2013
Term Loan - Unsecured	5,62,500	
Total	5,62,500	

Note 3. Short-term borrowings	As at 31st March, 2014	As at 31st March, 2013
Bank Overdraft	1,87,500	
Total	1,87,500	

Note 4. Trade Payables	As at 31st March, 2014	As at 31st March, 2013
Sundry Creditors	8,75,000	
Total	8,75,000	

Note 5. Tangible Assets	As at 31st March, 2014	As at 31st March, 2013
Plant and machinery	37,50,000	
Total	37,50,000	

Note 6. Inventories	As at 31st March, 2014	As at 31st March, 2013
Stock	7,50,000	
Total	7,50,000	

Note 7.Trade receivables	As at 31st March, 2014	As at 31st March, 2013
Sundry Debtors	10,00,000	
Total	10,00,000	

Note 8.Cash and cash equivalent	As at 31st March, 2014	As at 31st March, 2013
Cash	3,75,000	
Total	3,75,000	

(B) Jay Ltd., and Krishna Ltd., had the following financial position as at 31st March, 2014.

	Jay Ltd.	Krishna Ltd.		Jay Ltd.	Krishna Ltd.
Share capital : Equity shares of ₹ 100 each fully paid	24,00,000	18,00,000	Goodwill	15,00,000	3,00,000
			Fixed assets	12,00,000	21,00,000
			Investment at cost	9,00,000	6,00,000
General Reserve	9,00,000	6,00,000	Current assets	9,00,000	7,50,000
Investment Allowance Reserve	—	9,00,000			
Liabilities	12,00,000	4,50,000			
	45,00,000	37,50,000		45,00,000	37,50,000

It was decided that Jay Ltd. will take over the business of Krishna Ltd., on that date, on the basis of the respective share values adjusting, wherever necessary, the book values of assets and liabilities on the strength of information given below:

1) **Investment of Krishna Ltd., included 3,000 shares in Jay Ltd., acquired at a cost of ₹ 150 per share. The other investments of Krishna Ltd., have a market value of ₹ 75,000;**
2) **Investment Allowance Reserve was in respect of additions made to Fixed assets by Krishna Ltd., in the years 2009-2012 on which Income Tax relief has been obtained. In terms of the Income Tax Act, the company has to carry forward till 2013, reserve of ₹ 4,50,000 for utilisation;**
3) **Goodwill of Jay Ltd., and Krishna Ltd., are to be taken at ₹ 12,00,000 and ₹ 6,00,000 respectively;**
4) **The market value of investments of Jay Ltd., was ₹ 6,00,000;**
5) **Current assets of Jay Ltd., included ₹24,00,000 of stock in trade obtained from Krishna Ltd. which company sold at a profit of 25% over cost ;**
6) **Fixed assets of Jay Ltd., and Krishna Ltd., are valued at ₹15,00,000 and ₹22,50,000 respectively.**

Suggest the scheme of absorption and show the journal entries necessary in the books of Jay Ltd. Also prepare the Balance Sheet of that company after takeover of the business of Krishna Ltd.

Answer:

Part I: Purchase Consideration

WN # 1: Intrinsic Value of Shares

Particulars	Jay Ltd. ₹	Krishna Ltd. ₹
Goodwill	12,00,000	6,00,000
Fixed assets	15,00,000	22,50,000
Investments - Outside	6,00,000	75,000
- Inter Co. [13,000 shares @ ₹ 125 each]	—	3,75,000
Current assets	9,00,000	7,50,000
Liabilities	(12,00,000)	(4,50,000)
Net assets	30,00,000	36,00,000
No. of shares outstanding	24,000	18,000
Intrinsic value per share (30,00,000/24,000); (36,00,000/18,000)	125	200

WN # 2: *Purchase Consideration*

Particulars	Krishna Ltd. ₹
Total no. of shares outstanding in Krishna Ltd.	18,000
Value of shares @ ₹ 200/- each	36,00,000
No. of shares issuable on the basis of Intrinsic value of share (36,00,0000 ÷ 125)	28,800
Less : Shares already held	(3,000)
No. of shares to be issued	25,800
Shares price	125
Purchase Consideration (25,800 × 125)	32,25,000

Part II: In the Books of Jay Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

Particulars		Debit ₹	Credit ₹
1. For Purchase Consideration Due			
Business Purchase A/c	Dr.	32,25,000	
To Liquidator of Krishna Ltd A/c			32,25,000
2. For Assets and Liabilities taken over:			
Goodwill A/c	Dr.	6,00,000	
Fixed Assets A/c	Dr.	22,50,000	
Investments A/c	Dr.	75,000	
Current Assets A/c	Dr.	7,50,000	
To Liabilities A/c			4,50,000
To Business Purchase A/c			32,25,000
3. For Discharge of Purchase consideration			
Liquidator of Krishna Ltd A/cDr.		32,25,000	
To Equity Share Capital A/c			25,80,000
To Securities Premium A/c			6,45,000
4. Contra entry for statutory reserve			
Amalgamation adjustment A/c	Dr.	4,50,000	
To Investment allowance A/c			4,50,000
5. For adjustment of stock reserve			
Goodwill A/c	Dr.	48,000	
To Stock Reserve A/c			48,000

Name of the Company: Jay Ltd.					
Balance Sheet as at 31.03.2014					
Ref No.	Particulars		Note No.	After absorption	Before absorption
				₹	₹
	I.	Equity and Liabilities			
	1	Shareholders' funds			
		(a) Share capital	1	49,80,000	
		(b) Reserves and surplus	2	19,95,000	
		(c) Money received against share warrants			
	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings			
		(b)Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
		(a) Short-term borrowings			
		(b) Trade payables			
		(c)Other current liabilities	3	16,50,000	
		(d) Short-term provisions			
		Total(1+2+3)		86,25,000	
	II.	Assets			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	4	34,50,000	
		(ii) Intangible assets	5	21,48,000	
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
		(b) Non-current investments	6	9,75,000	
		(c)Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets	7	4,50,000	

	2	Current assets			
		(a)Current investments			
		(b) Inventories			
		(c) Trade receivables			
		(d) Cash and cash equivalents			
		(e) Short-term loans and advances			
		(f) Other current assets	8	16,02,000	
		Total(1+2)		86,25,000	

		(₹)
Note 1. Share Capital	After absorption	Before absorption
Authorised, Issued, Subscribed and paid up:- 49,800 Equity Shares of ₹ 1000 (of which 25,800 shares of ₹ 1,000 each issued for consideration other than cash)	49,80,000	
Total	49,80,000	

Reconciliation of Share Capital				
For equity share:-	After absorption		Before absorption	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.13	24,000	24,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	25,800	25,80,000	NIL	NIL
	49,800	49,80,000	NIL	NIL
Less: Buy Back of shares	-	-	-	-
Closing Balance as on 31.03.14	49,800	49,80,000	NIL	NIL

Note 2. Reserves and Surplus	After absorption	Before absorption
Securities Premium	6,45,000	
Investment allowance Reserve	4,50,000	
General Reserve	9,00,000	
Total	19,95,000	

Note 3. Other Current Liabilities	After absorption	Before absorption
Current Liabilities	16,50,000	
Total	16,50,000	

Note 4. Tangible assets	After absorption	Before absorption
Fixed Assets	34,50,000	
Total	34,50,000	

Note 5. Intangible assets	After absorption	Before absorption
Goodwill	21,48,000	
Total	21,48,000	

Note 6. Non Current Investments	After absorption	Before absorption
Investment at cost	9,75,000	
Total	9,75,000	

Note 7. Other Non Current Assets	After absorption	Before absorption
Amalgamation Adjustment Accounts	4,50,000	
Total	4,50,000	

Note 8. Other Current Assets	After absorption	Before absorption
Current Assets	16,02,000	
Total	16,02,000	

(C) The following is the summarized Balance Sheet of XY Ltd. as on 31.3.2014:

Liabilities	**₹**	**Assets**	**₹**
Authorized and Issued Capital:		**Goodwill**	**1,20,000**
30,000,6% Pref. Shares of ₹10 each	**3,00,000**	**Land and Buildings**	**2,67,000**
6,00,000 Equity Shares of ₹1 each	**6,00,000**	**Plant**	**2,55,000**
		Shares – in- Subsidiary Ltd. (at cost)	**75,000**
8% Debentures			
(Secured on Land & Building) 1,20,000		**Stock**	**2,25,000**
Accrued Interest 6,000	**1,26,000**	**Debtors**	**2,70,000**
		Profit and Loss A/c	**2,64,000**
Bank Overdraft (Secured on Stock)	**1,65,000**		
Directors' Loan	**75,000**	**Deferred Expenditure:**	
Creditors	**2,70,000**	**Advertisement**	**60,000**
	15,36,000		**15,36,000**

Notes:

(a) There is a contingent liability for damages of ₹30,000.

(b) Preference shares are cumulative and dividends are in arrears for three years. A Capital Reduction Scheme settling the following terms was duly approved;

(i) The preference shares to be reduced to ₹8 per share and the Equity shares to 25 paise each and to be consolidated as shares of ₹10 each and ₹1each, fully paid, respectively. The Preference shareholders waive 2/3 rd of the dividend arrear and receive Equity shares for the balance. The authorized Capital to be restored to: 30,000 Preference shares of ₹10 each and 6,00,000 Equity Shares of ₹1 each.

(ii) The Share-in-Subsidiary Ltd. are sold to an outside interest for ₹1,50,000.

(iii) All intangible assets are to be eliminated and bad debts of ₹12,000 and obsolete Stock of ₹30,000 to be written –off.

(iv) The debenture holders to take over one of the company's property (Book Value ₹54,000) at a price of ₹60,000 in part satisfaction of the Debentures and to provide further cash of ₹45,000 on a floating charge. The arrears of interest are paid.

(v) The contingent liability materialized in the sum stated but the company recovered ₹15,000 of these damages in action against one of its Directors. This was debited to his Loan Account of ₹24,000, the balance of which was paid in cash on his resignation.

(vi) The remaining Directors agreed to take Equity Shares in satisfaction of their loans.

You are required to:

1. Give the necessary journal entries, including cash transactions;

2. Set-out the revised Balance Sheet after giving effect to the foregoing entries.

Solution:

In the Books of XY Ltd.

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2014 Mar.31	6% Pref. Share Capital (₹10)A/c Dr. To 6% Pref. Share Capital (₹8) A/c " Capital Reduction A/c (Reduction in value of Pref. Shares from ₹10 to ₹8 each as per scheme of capital reduction)		3,00,000	 2,40,000 60,000
	6% Pref. Share Capital (₹8) A/c Dr To 6% Pref. Share Capital (₹10) A/c (Consideration of 30,000 shares of ₹8 each to 24,000 shares of ₹10 each)		2.40,000	 2,40,000
	Equity Share Capital (₹1) A/c Dr To Equity Share Capital (₹0.25) A/c To Capital Reduction A/c (Reduction in value of equity shares from ₹1 to ₹0.25 each as per scheme of capital reduction)		6,00,000	 1,50,000 4,50,000
	Equity Share Capital A/c (₹0.25) Dr To Equity Share Capital (₹1) A/c (Consolidation of 6,00,000 equity shares of ₹0.25 to 1,50,000 equity shares of ₹1 each)		1,50,000	 1,50,000

	Capital Reduction A/c Dr To Equity Share Capital A/c (Discharge arrear pref. dividend by the issue of equity shares of ₹1 each)		18,000	 18,000
	Bank A/c Dr To Shares – in- Subs. Co. A/c To Capital Reduction A/c (Share-in-Subs. Sold at a profit, profit being transferred to Capital Reduction Account)		1,50,000	 75,000 75,000
	8% Debenture A/c Dr To Debenture holders A/c (Amount of debenture transferred to Debenture holders Account)		60,000	 60,000
	Debenture holders A/c Dr To Properties A/c To Capital Reduction A/c (Profit on discharge of debenture holders transferred to Capital Reduction Account)		60,000	 54,000 6,000
	Bank A/c Dr To 8% Debenture A/c (Amount received by the issue of 8% Debentures)		45,000	 45,000
	Accrued Interest A/c Dr To Bank A/c (Accrued Interest paid)		6,000	 6,000
	Directors' Loan A/c Dr Capital Reduction A/c Dr To Bank A/c (Damages adjusted against Directors' loan and loss being debited to Capital Reduction Account)		15,000 15,000	 30,000
	Directors' Loan (24,000 -15,000) A/c Dr To Bank A/c (Balance due to said Directors' loan paid)		9,000	 9,000
	Directors' Loan A/c (75,000-24,000) Dr To Equity Share Capital A/c (Equity shares were issued in satisfaction of the balance of Directors' loan)		51,000	 51,000
	Capital Reduction A/c Dr To Profit and Loss A/c To Advertisement A/c To Goodwill A/c To Bad Debt A/c To Stock A/c To Capital Reserve (bal. fig.) A/c (Various fictitious assets are eliminated and the balance transferred to Capital Reserve Account)		5,58,000	 2,64,000 60,000 1,20,000 12,000 30,000 72,000

Name of the Company: XY Ltd.
Balance Sheet as at 31st March, 2014 (and reduced)

(₹)

Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
	1	EQUITY AND LIABILITIES			
		(a) Share capital	1	4,59,000	
		(b) Reserves and surplus	2	72,000	
		(c) Money received against share warrants			
	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings	3	1,05,000	
		(b)Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
		(a) Short-term borrowings	4	1,65,000	
		(b) Trade payables	5	2,70,000	
		(c)Other current liabilities			
		(d) Short-term provisions			
		Total (1+2+3+4)		10,71,000	
	II	ASSETS			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	6	4,68,000	
		(ii) Intangible assets			
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
		(b) Non-current investments			
		(c)Deferred tax assets (Net)			

		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	Current assets			
		(a)Current investments			
		(b) inventories	7	1,95,000	
		(c) trade receivables	8	2,58,000	
		(d) Cash and cash equivalents	9	1,50,000	
		(e)Short-term loans and advances			
		(f) Other current assets			
		Total (1+2)		**10,71,000**	

(₹)

Note 1. Share Capital	As at 31st March, 2014	As at 31st March, 2013
Authorized share capital		
6,00,000 Equity shares of ₹ 1 each	6,00,000	
30,000 ,6 % Pref. shares of ₹ 10 each	3,00,000	
	9,00,000	
Issued, Subscribed and paid-up share capital		
2,19,000 Equity share of ₹ 1 each fully paid	2,19,000	
24,000 6 % Pref. shares of ₹ 10 each fully paid	2,40,000	
Total	4,59,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2014		As at 31st March, 2013	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	2,19,000	2,19,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	2,19,000	2,19,000		
Less: Buy Back of share				
Total	2,19,000	2,19,000		

For Preference Share	As at 31st March, 2014		As at 31st March, 2013	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	24,000	2,40,000		
Add: Fresh Issue				
Total	24,000	2,40,000		

Note 2. Reserve & Surplus	As at 31st March, 2014	As at 31st March, 2013
Capital Reserve	72,000	
Total	72,000	

Note 3. Long-term borrowings	As at 31st March, 2014	As at 31st March, 2013
8% Debenture- secured	1,05,000	
Total	1,05,000	

Note 4. Short-term borrowings	As at 31st March, 2014	As at 31st March, 2013
Bank overdraft - unsecured	1,65,000	
Total	1,65,000	

Note 5. Trade Payables	As at 31st March, 2014	As at 31st March, 2013
Sundry Creditors	2,70,000	
Total	2,70,000	

Note 6. Tangible Assets	As at 31st March, 2014	As at 31st March, 2013
Land and buildings (2,67,000 – 54,000)	2,13,000	
Plant	2,55,000	
Total	4,68,000	

Note 7. Inventories	As at 31st March, 2014	As at 31st March, 2013
Stock (2,25,000 – 30.000)	1,95,000	
Total	1,95,000	

Note 8.Trade receivables	As at 31st March, 2014	As at 31st March, 2013
Sundry Debtors (2,70,000 - 12,000)	2,58,000	
Total	2,58,000	

Note 9.Cash and Cash equivalents	As at 31st March, 2014	As at 31st March, 2013
Bank (1,50,000 + 45,000 -6,000 -30,000 - 9,000)	1,50,000	
Total	1,50,000	

(D) Following is the Balance Sheet as at 31st March 2014:

Liabilities	**Max ₹**	**Mini ₹**	**Assets**	**Max ₹**	**Mini ₹**
Share Capital			**Goodwill**	**20**	**-----**
Equity Shares of ₹100 each	**1,500**	**1,000**	**Other Fixed Assets**	**1,500**	**760**
			Debtors	**651**	**440**
9% Pref. Shares of ₹100 each	**500**	**400**	**Stock**	**393**	**680**
			Cash at Bank	**26**	**130**
General Reserve	**180**	**170**	**Own Debentures**		
Profit & Loss A/c	**-----**	**15**	**(Nominal value ₹2,00,000)**	**192**	
12% Debentures (₹100 each)	**600**	**200**			
			Discount on Issue of Debentures	**2**	
Sundry Creditors	**415**	**225**			
			Profit & Loss A/c	**411**	
	3,195	**2,010**		**3,195**	**2,010**

On 1.4.2014 Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided in to 10equity 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) Debenture holders 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 Account (Dr) are to be written-off.

(vi) The company paid ₹15,000 as penalty to avoid Capital commitments of ₹3,00,000.

On 2.4.2014, scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of ₹10each, fully paid, in exchange for 5 shares had in Mini Ltd.

(b) Issue of 9% Pref. shares of ₹100 each in the ratio of 4 Pref. shares of Max Ltd. for every 5 Pref. shares of Mini Ltd.

(c) Issue of one 12% debentures 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.

Answer:

In the Books of Max Ltd.
Journal

Date	Particulars	L.F	Debit (₹)	Credit (₹)
2014 Apr.1	Equity Share Capital A/c(₹100) Dr To Equity Share Capital A/c (₹10) (Subdivision of one share of ₹100 each into 10 shares of ₹10 each)		15,00,000	 15,00,000
	Equity Share Capital A/c (₹10) Dr To Capital Reduction A/c (50% of the Equity Share Capital to be surrendered as per scheme of capital reduction)		7,50,000	 7,50,000
	Capital Reduction A/c Dr To Bank A/c (10% of the arrear Pref. dividend paid i.e., ₹45,000 X 3 = ₹1,35,000 X 10%)		13,500	 13,500
	Bank A/c (₹80,000 X ₹98) Dr To Own Debenture A/c To Capital Reduction A/c (Own debenture sold at ₹98- Cum. Interest)		78,400	 76,800 1,600
	12% Debentures A/c Dr To Own Debentures A/c (₹1,92,000-₹76,800) To Capital Reduction A/c (Profit on cancellation of own debentures transferred)		1,20,000	 1,15,200 4,800
	12% Debentures A/c Dr Capital Reduction A/c Dr To Machinery A/c (Machinery taken over by the debenture holders)		2,80,000 20,000	 3,00,000
	Creditors A/c Dr To Capital Reduction A/c (Creditors are reduced)		65,000	 65,000
	Capital Reduction A/c Dr To Profit and Loss A/c To Goodwill A/c To Discount on Debenture A/c To Debtors A/c To Stock A/c To Capital Reserve A/c (bal.fig) (Various assets are written – off and Sundry Asset written-down as per scheme of Capital Reduction)		7,72,900	 4,11,000 20,000 2,000 61,000 33,000 2,45,900

	Capital reduction A/c Dr To Bank A/c (Penalty paid for Capital commitment)			15,000	15,000
	Fixed Assets A/c Dr Stock A/c Dr Debtors A/c Dr Cash and Bank A/c Dr To Sundry Creditors A/c To Liabilities for 12% Debentures of Mini Ltd A/c To Liquidator of Mini Ltd A/c To Capital Reserve A/c (bal.fig) (Various assets and liabilities taken over and purchase consideration payable)			7,60,000 6,80,000 4,40,000 1,30,000	2,25,000 2,00,000 13,20,000 2,65,000
	Liquidation of Mini Ltd A/c Dr To Equity Share Capital A/c To 9% Pref. Share Capital A/c (Payment of Purchase Consideration made)			13,20,000	10,00,000 3,20,000
	Liabilities for 12%Debentures of Mini Ltd A/c Dr To 12% Debenture A/c (Liabilities for debenture discharged)			2,00,000	2,00,000

Workings

Calculation of Purchase Consideration

	₹	From
1. Payment to Equity Shareholders----- 10,000 Equity Share ÷ 5= 2,000 X 50 X ₹10 = Payment to Pref. Shareholders --- 4,000 Pref. Share ÷ 5 = 800 x4 x ₹100 =	10,00,000 3,20,000	Equity Shares 9% Pref. Shares
	13,20,000	

(E) On 1st June, 2012 Amit Patel and Co. sold their business to Asha Private Ltd. as of 1st April, 2012 for a total consideration of ₹ 1,00,000 – for Goodwill – ₹ 30,000; Building – ₹ 30,000; Machinery – ₹ 15,000 and stock – ₹ 25,000.

Asha Private Ltd was incorporated on 1st June,2012 and the purchase consideration was met by Issue of shares. The business was carried on by the Vendors on behalf of the Company from 1st April,2012 and the same set of account books was maintained till 30th June,2012 when the following Trial Balance was prepared -

Particulars	Debit	Credit
Capital Account - Amit	-	36,000
Capital Account - Patel	-	30,000
Sundry Creditors (including for June purchases of ₹5,000)	-	10,000
Sales	-	1,00,000
Salaries and Wages (including ₹1,000 being Sitting Fees to Directors)	12,000	-
Rent	1,500	-
Purchases	36,000	-

AB Private Ltd.	**10,000**	**-**
Expenses	**5,000**	**-**
Bank	**3,500**	**-**
Goodwill	**25,000**	**-**
Building	**20,000**	**-**
Machinery (purchases after 1st April were ₹1 0,000)	**25,000**	**-**
Stocks on 1st April	**25,000**	**-**
Sundry Debtors (including Sales of ₹8,000 in June)	**13,000**	
Total	**1,76,000**	**1,76,000**

Stocks on Hand on 30th June,2012 were ₹18,000.

On 30th June,2012 Amit Patel & Co. paid ₹10,000 for additional shares and out of this amount, the Company incurred Preliminary Expenses of ₹6,000 and purchased a typewriter for ₹3,000. Debtors and Creditors prior to 1st June were to be taken over by Amit Patel & Co.

Prepare the Profit and Loss Account of Asha Private Ltd. for the 3 months ended 30th June 2012 and a Balance Sheet as at that date. All workings are to form part of your answer.

Answer:

Dr. 1. Profit & Loss of Asha Pvt. Ltd for the period from 1st April to 30th June 2012 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	25,000	By Sales	1,00,000
To Purchases	36,000	By Closing Stock	18,000
To Salaries and Wages (excl. Dir. Fees)	11,000		
To Rent	1,500		
To Expenses	5,000		
To Net Profit c/d	39,500		
Total	1,18,000		1,18,000

2.

Particulars	April-May	June	Particulars	April-May	June
	Pre Incorp	Post Incorp		Pre Incorp	Post Incorp
To Director Fees	-	1,000	By Net Profit (in the time ratio of 2:1)	26,333 [39500x2/3]	13,167 [39500x1/3]
To Capital Reserve- Pre-Incorporation Profit	26,333	-			
To profit and Loss- Post Incorporation Profit	-	12,167			
	26,333	13,167		26,333	13,167

3. Journal Entries in books of Asha private Ltd

Sl. No	Particulars	Dr	Cr
1.	Goodwill A/c Dr Building A/c Dr To Asha Private Ltd(Vendor) A/c (Being Goodwill and Building revalued as agreed upon and gain transferred to Asha Private Ltd a/c as such revaluation gain belongs Amit Patel & Co.)	5,000 10,000	 15,000
2.	Amit's Capital A/c Dr Patel's Capital A/c Dr Trade Creditors A/c [10,000 – 5,000] Dr To Asha Private Ltd (Vendor) A/c (Being Liabilities not taken over by Asha Private Ltd transferred to Amit Patel & Co.)	36,000 30,000 5,000	 71,000
3.	Amit Patel & Co. (Vendor) A/c Dr. To Asha Private ltd A/c To Trade Debtors A/c [13,000-8,000] To Bank A/c (Being Assets not taken over by Asha Private Ltd transferred to Amit Patel & Co. A/c)	18,500	 10,000 5,000 3,500
4	Amit Patel & Co.(Vendor) A/c Dr To Equity Share Capital A/c (Being issue of 10,000 Equity Shares of Rs.10 as fully paid, in discharge of purchase Consideration due to Amit Patel & Co.)	1,00,000	 1,00,000
5	Bank A/c Dr. To Equity Share Capital A/c (Being additional 1,000 Equity Shares at ₹10 each subscribed by and allotted to Amit Patel & Co.)	10,000	 10,000
6	Preliminary Expenses A/c Dr. Typewriter A/c Dr. To Bank A/c (Being preliminary expenses incurred and typewriter purchased out of amount received on subscription to additional share capital)	6,000 3,000	 9,000

Dr 4. Asha Pvt Ltd's Bank Account Cr.

Receipts	₹	Payments	₹
To Equity Share Capital – additional Shares subscribed by Amit Patel & Co.	10,000	By Preliminary Expenses By Typewriter By balance c/d-balancing figure	6,000 3,000 1,000
Total	10,000	Total	10,000

Note: Amit Patel & Co. Firm's Bank A/c is retained by the Firm only, not taken over by the Company.

Dr 5. Amit Patel & Co.(Vendor) Account Cr.

Particulars	₹	Particulars	₹
To Assets not taken over by Asha Private Ltd. - Balance in Asha Pvt Ltd A/c -Trade Debtors [13,000-8,000] -Bank To Equity Share Capital- Settlement of Purchase Consideration	 10,000 5,000 3,500 1,00,000	By Liabilities not taken over by Asha pvt. Ltd. -Balance in Capital Account of Amit -Balance in Capital Account of Patel -Trade Creditors [10,000-5,000] By gain on Revaluation of : - Goodwill[30,000-25,000] -Buildings [30,000-20,000] By balance c/d [balancing figure]	 36,000 30,000 5,000 5,000 10,000 32,500
Total	**1,18,500**	**Total**	**1,18,500**

6. Balance Sheet of Asha Private Ltd as at 30th June 2012
Name of the Company: Asha Private Ltd.
Balance Sheet as at : 30.06.12

Ref No.		Particulars	Note No.	As at 30.06.12 (₹)
I		EQUITY AND LIABILITIES		
	1	Shareholders' fund		
		(a) Share capital	1	1,10,000
		(b) Reserves and surplus-	2	12,167
		(c) Money received against share warrants		
	2	Share application money pending allotment		
	3	Non-current liabilities		
		(a) Long-term borrowings		
		(b)Deferred tax liabilities (Net)		
		(c)Other Long term liabilities		
		(d) Long-term provisions		
	4	Current Liabilities		
		(a) Short-term borrowings		
		(b) Trade payables	3	5,000
		(c)Other current liabilities		
		(d) Short-term provisions		
		Total		1,27,167
II		ASSETS		
	1	Non-current assets		
		(a) Fixed assets		
		(i) Tangible assets	4	58,000
		(ii) Intangible assets	5	3,667
		(iii) Capital work-in-progress		
		(iv) Intangible assets under development		
		(b) Non-current investments		

		(c)Deferred tax assets (Net)		
		(d) Long-term loans and advances		
		(e) Other non-current assets		
	2	Current assets		
		(a)Current investments		
		(b) Inventories	6	18,000
		(c) Trade receivables	7	40,500
		(d) Cash and cash equivalents	8	1,000
		(e)Short-term loans and advances		
		(f) Other current assets	9	6,000
		Total		**1,27,167**

Workings:

1. Authorized Capital	As at 30.06.12
11,000 Equity Share capital fully paid @ ₹ 10 each	1,10,000
Issued and paid up capital	
11,000 Equity shares @ ₹ 10 each fully paid (out of the above 10,000 shares were issued pursuant to a contract, without payment being received in cash)	1,10,000
Total	1,10,000

2. Reserve and Surplus	As at 30.06.12
Profit & Loss A/c	12,167
Total	12,167

3. Trade Payable	As at 30.06.12
Sundry Creditors	5,000
Total	5,000

4. Tangible Assets	As at 30.06.12
Building (At Cost)	30,000
Plant and Machinery (At Cost)	25,000
Typewriter (At Cost)	3,000
Total	58,000

5.Intangible Assets	As at 30.06.12
Goodwill	30,000
Less: Pre Incorporation Profit	26,333
Total	3,667

6. Inventories	As at 30.06.12
Stock	18,000
Total	18,000

7. Trade Receivable	As at 30.06.12
Sundry Debtors	8,000
Due from vendor Company	32,500
Total	40,500

8. Cash & Cash Equivalent	As at 30.06.12
Bank	1,000
Total	1,000

9. Other Current Assets	As at 30.06.12
Preliminary Expenses	6,000
Total	6,000

(F) Pele, and Maradona, who have been carrying on a partnership business, agreed on conversion of the Firm into a Private Limited Company with effect from 1st April 2012. The agreement among other things includes the following -

(i) Since the Bank desires that the Term Loan should be liquidated, the Partners bring in the required amount in proportion to their Capitals.

(ii) Goodwill of the Firm is to be revalued at ₹ 1,20,000.

(iii) Certain Assets are to be revalued at their Current Realizable Values as indicated below: (a) Furniture - ₹ 40,000; (b) Car - ₹ 13,000; and (c) Plant and Equipment - ₹ 4,00,000.

(iv) Partners agree that revaluation be carried out before dissolution and surplus be adjusted in their Current A/c.

(v) The New Company to be called WC Ltd shall issue shares of ₹10 each to the Partners in consideration of take-over of the business.

(vi) The New Company shall not assume the Debtors and Creditors but shall assist the Vendor Firm in realization and settlement.

The Balance Sheet of Pele and Maradona on 31st March immediately before the agreement reads as below:

Liabilities	₹	Assets	₹
Sundry Creditors	1,60,000	Cash and Bank	50,000
Cash Credit from Bank	1,52,000	Sundry Debtors	60,000
Term Loan from Bank	1,60,000	Stock and Stores	2,00,000
Partners' Capitals:		Furniture	50,000
- Pele	1,60,000	Motor Car	12,000
- Maradona	80,000	Plant and Machinery	3,00,000
		Partner's Current Accounts	
		- Pele	15,000
		- Maradona	25,000
	7,12,000		7,12,000

Calculate the number of shares to be allotted by the New Company way of purchase consideration and suggest the equitable distribution thereof between the Partners

Solution:

Calculation of Purchase consideration

Particulars	₹	₹
Assets taken over : Goodwill Furniture Car plant & Machinery Stock & Stores Less : Cash Credits	 1,20,000 40,000 13,000 4,00,000 2,00,000 	 7,73,000 (1,52,000)
Net assets taken over = Purchase Consideration		6,21,000

Distribution of Purchase consideration

Particulars	No. of shares	₹
Distribution based on balance in Capital a/c. : In the ratio of 2:1 (See note) Pele - ₹ 6,21,000 x 2/3 Maradona - ₹ 6,21,000 x 1/3	 41,400 20,700	 4,14,000 2,07,000
Total	62,100	6,21,000

Note : The Purchase Consideration may also be distributed on the following alternative bases :

Based on the profit sharing ratio (this is not given in the question, hence to be presumed as equal shares)

Based on the ratio of capital (after adjusting for Current account Balances and settling Term Loan from Bank) prior to dissolution. However, this will require the profit sharing ratio since the gain on creation of goodwill/ realization of assets should be distributed to the partners based on the profit sharing ratio.

Verification for Vendor's Suspense Account

The net amount in Vendor's Suspense will be ₹ 1,00,000 credit, which is equal to the total of the debit balance of the Partner's Accounts in the dissolved firm, determined as under :

a. Revaluation Account

Dr. Cr.

Particulars	₹	Particulars	₹
To, Furniture – downward revaluation	10,000	By, Motor Car – upward revaluation	1,000
To, Capital A/c. – Gain transferred 2:1 Pele (2/3 x 91,000) = 60,667 Maradona (1/3 x 91,000) = 30,333	 91,000	By, Plant & machinery – upward revaluation	1,00,000
	1,01,000		1,01,000

b. Partner's Capital Account

Dr. Cr.

Particulars	Pele ₹	Maradona ₹	Particulars	Pele ₹	Maradona ₹
To, Current a/c. – transfer	15,000	25,000	By, balance c/d	1,60,000	80,000
To, Equity shares in Ltd.	4,14,000	2,07,000	By, Goodwill (1,20,000 as 2:1)	80,000	40,000
			By, Revaluation A/c. (profit as 2:1)	60,667	30,333
			By, Bank – Term Loan settled (2:1)	73,333	36,667
			By, Balance c/d – balancing figure	55,000	45,000
	4,29,000	2,32,000		4,29,000	2,32,000

Note: Amount required to settle the Bank Term Loan = ₹ 1,60,000 Less Present Bank Balance as given in the Balance sheet ₹ 50,000 = ₹ 1,10,000. This amount will be brought in by the Partners in the ratio 2:1. Hence, Balance in Partner's Capital Accounts before adjusting debtors and creditors = ₹ 1,00,000 Dr.

Journal entries in the books of the Company (for clarification purpose only)

S. No.	Particulars	Dr.	Cr.
1	Business Purchase A/c. Dr. To, Vendor Firm A/c. (being purchase of Pele & Maradona Firm's business vide agreement dated ....)	6,21,000	 6,21,000
2	Goodwill A/c. Dr. Furniture A/c. Dr. Motor Car A/c. Dr. Plant and Machinery A/c. Dr. Stocks A/c. Dr. To, Bank Cash Credit A/c. To, Business Purchase A/c. (being the recording of various assets and liabilities taken over from Firm)	1,20,000 40,000 13,000 4,00,000 2,00,000	 1,52,000 6,21,000
3	Vendor Firm A/c. Dr. To, Equity Share Capital A/c. (being the discharge of purchase consideration by allotment of 62,100 equity shares of ₹ 10 each at par)	6,21,000	 6,21,000
4	Vendors Debtors A/c. Dr. To, Equity Share Capital A/c. (being recording of Vendors Debtors not taken over, to be realized and settled)	60,000	 60,000
5	Vendors Creditors suspense A/c. Dr. To, Vendors Creditors A/c. (being recording of Vendors Creditors not taken over, to be settled by vendors)	1,60,000	 1,60,000

18. (A) What are the Procedure in Creditors' Voluntary Winding up?

Answer:

Procedure in Creditors' Voluntary Winding up:

(i) Meeting of creditors: The Company calls a meeting of its creditors. The board of directors lay before the meeting a full statement of the position of the company's affairs and a list of the creditors of the company and the estimated amount of their claim. A copy of the resolution passed at the creditors' meeting is filed with the Registrar of Companies.

(ii) Appointment of liquidator: Appointment of liquidator is made by nomination both by the members and creditors at their respective meetings. If they nominate different persons, ordinarily, the creditors' nominee shall be the liquidator. But any director, member or creditor may apply to the Tribunal for an order that the company's nominee or the official liquidator or some other person should be appointed. If no person is nominated by the creditors, the members' nominee shall be the liquidator. Likewise, if no nomination is made by the members, the creditors' nominee shall be the liquidator.

(iii) Inspection committee: (a) The creditors of the company may appoint a committee of inspection consisting of five persons; (b) Company can also in its general meeting appoint 5 members to work as members of inspection committee.

(iv) Meeting of members and creditors: If the winding up process continues for more than a year, the liquidator shall call a general meeting of members and creditors at the end of each year within three months from the expiry of such year. In the meeting, he will present an account of his acts and dealings and the progress of the winding up during the year.

(v) Final meeting: When the affairs of the company are fully wound up, an account of the winding up is prepared to show how the winding up has been conducted and the property of the company has been disposed off. The account is presented before the final meeting of members. Besides, a copy of the account along with a report is sent to the National Company Law Tribunal and the Registrar within one week of the meeting. The company is deemed to have been dissolved from the date of submission of the report.

(B) Liquidation of YZ Ltd. commenced on 2nd April, 2012. 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 2011 and 2012:

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, 2011	₹ 5,000
P	1,500	1st May, 2011	₹ 3,300
Q	1,000	1st October, 2011	₹ 4,300
R	500	1st November, 2011	₹ 4,600
S	300	1st February, 2012	₹ 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

Shareholders	No. of shares transferred	Maximum liability (upto ₹ 2 per share)	Division of Liability as on				
			1.5.2011	1.10.2011	1.11.2011	1.2.2012	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
1.5.2011	3,300	–	30 : 20 : 10 : 6
1.10.2011	4,300	1,000	20 : 10 : 6
1.11.2011	4,600	300	10 : 6
1.2.2012	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 1.2.2012.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2003 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

(C) Following is the Balance Sheet of "Forum Ltd". as on 30.09.2012: (Amount in ₹)

Liabilities	₹	Assets	₹
Share Capital:		**Land and Building**	**1,20,000**
11% Preference Shares of ₹ 10 each	**1,00,000**	**Sundry Current Assets**	**3,95,000**
10,000 Equity Shares of ₹10 each, fully paid	**1,00,000**	**Profit & Loss Account**	**38,500**
5,000 Equity Shares of ₹ 10 each, ₹ 7.50 paid	**37,500**	**Debenture Issue expenses not written off**	**2,000**
13% Debentures	**1,50,000**		
Mortgage Loan	**80,000**		
Bank Overdraft	**30,000**		
Creditors for Trade	**32,000**		
Arrears of Income tax (Assessments			

Liabilities	₹	Assets	₹
concluded in July 2004)			
Assessment Year 2010-2011 - 21,000			
Assessment Year 2011-2012 - 5,000	26,000		
Total	5,55,500	Total	5,55,500

Other Information

- **Mortgage Loan was secured against Land and Buildings. Debentures were secured by a Floating Charge on all the other assets.**
- **The Company was unable to meet the payments and therefore the Debenture holders appointed a Receiver and this was followed by a resolution for Members Voluntary Winding Up.**
- **The Receiver for the Debenture holders brought the Land and Buildings to auction and realized ₹ 1,50,000. He also took charge of Sundry Assets of the value of ₹ 2,40,000 and realized ₹ 2,00,000.**
- **The Liquidator realized ₹ 1,00,000 on the sale of the balance of Sundry Current Assets.**
- **The Bank Overdraft was secured by a personal guarantee of two of the Directors of the Company and on the Bank raising a demand, the Directors paid off the dues from their personal resources.**
- **Costs incurred by the Receiver were ₹ 2,000 and by the Liquidator ₹ 2,800.**
- **The Receiver was not entitled to any remuneration but the Liquidator was to receive 3% Fee on the value of assets realized by him.**
- **Preference Shareholders had not been paid dividend for the period after 30.9.2010 and interest for the last half-year was due to Debenture holders.**

From the above information, prepare the Liquidator's Receipts and Payments Account.

Answer:

Determination of Surplus received by Liquidator from Receiver

Receipts	₹	Payments	₹
Land and Buildings	1,50,000	Debenture Interest (1,50,000 x 13% x 6/12)	9,750
Sundry Current Assets	2,00,000	Income Tax Arrears (21,000 + 5,000)	26,000
		Expenses of Receiver Given	2,000
		Mortgage Loan Given	80,000
		Debenture holders Principal Amount	1,50,000
		Balance Surplus handed over to Liquidator (b/f)	82,250
Total	3,50,000		3,50,000

Liquidator's Receipts & Payments Account

Receipts	₹	Payments		₹
Surplus received from Receiver (WN 1)	82,250	Remuneration to Liquidator (1,00,000 x 3%)		3,000
		Liquidation Expenses		2,800
Sundry Assets realized	1,00,000	Unsecured Creditors:		
Calls on Contributories:		Trade Creditors	32,000	
From 5,000 Partly Paid Shares at ₹ 2.17 per share (See WN 3 below)	10,850	Directors (for Bank Overdraft paid)	30,000	62,000
		Preference Shareholders:		
		Share Capital	1,00,000	
		Arrears of Dividend (2 yrs)	22,000	1,22,000
		Equity Shareholders' Final Payment:		
		Return of money to holders of 10,000 Fully		
		Paid Shares at ₹ 0.33 each		3,300
Total	1,93,100	Total		1,93,100

Calls from Holders of Partly Paid Shares

Particulars	₹
a. Total of Receipts before considering Call Money (82,250 + 1,00,000)	1,82,250
b. Total Payments before final payment to Equity Shares (2,800 + 3,000 + 62,000 + 1,22,000)	1,89,800
c. Deficit from above from Calls made on Equity Shares (a-b)	(7,550)
d. Notional Call on 5,000 Partly Paid Shares at ₹ 2.50 each	12,500
e. Surplus Cash Balance after Notional Call (comparing c and d)	4,950
f. Number of Shares deemed fully paid (10,000 + 5,000)	15,000
g. Hence, Refund on Fully Paid Shares ₹ 4,950 / 15,000 Shares (e ÷ f)	33paise
h. Therefore, Required Call on Partly Paid Shares (2.50 – 0.33)	₹ 2.17

(D) The following is the Balance Sheet of "Moon" Ltd. as at 31.3.2011:

Liabilities	**₹**	**Assets**	**₹**
Share Capital :		**Fixed Assets:**	
2,000 Equity Shares of ₹ 100, ₹ 75 paid up	**1,50,000**	**Land & Buildings**	**4,00,000**
6,000 Equity Shares of ₹ 100, ₹ 60 paid up	**3,60,000**	**Plant & Machineries**	**3,80,000**
2,000 10% Pref. Share of ₹ 100, fully paid up	**2,00,000**	**Current Assets:**	
10% Debentures (floating Charge on all assets)	**2,00,000**	**Stock at Cost**	**1,10,000**
Int. accrued on Deb. (also secured as above)	**10,000**	**Sundry Debtors**	**2,20,000**
Sundry Creditors	**4,90,000**	**Cash at Bank**	**60,000**
		Profit and Loss A/c	**2,40,000**
Total	**14,10,000**	**Total**	**14,10,000**

On that date, the Company went into Voluntary Liquidation. The dividends on Preference Shares were in arrears for the last two years. Sundry Creditors include a loan of ₹ 90,000 on Mortgage of Land and Buildings. The assets realized were as under: (a) Land & Buildings ₹ 3,40,000; (b) Plant & Machinery ₹ 3,60,000; (c) Stock ₹ 1,20,000;and (d) 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 realized (except cash at bank) and 2% on the amounts distributed among Equity Shareholders. Preferential Creditors included in Sundry Creditors amount ₹ 30,000. All payments were made on 30.06.2011. Prepare the Liquidator's Final Statement of Account.

Answer:

Liquidator's Final Statement of Account

Receipts	Amount	Amount	Receipts	Amount
Assets realized:			Liquidator's Remn.[3% on(6,40,000 +	
Cash at Bank		60,000	3,40,000)]	29,400
Sundry Debtors	1,60,000		[2% as computed in WN 4]	1,000
Stock	1,20,000		Liquidation Expenses (given)	4,600
Plant & Machinery	3,60,000	6,40,000	Debentureholders	
			10% Debentures 2,00,000	
Surplus from Securities			Interest accrued as per B/S 10,000	
Land & Buildings	3,40,000		Further Interest (WN 2) 5,000	2,15,000
Less: Mortgage Loan	(90,000)		Preferential Creditors (given)	30,000
Less Interest upon date of A/c	(10,000)	2,40,000	Unsecured Creditors (WN 3)	3,70,000
			Preference Shareholders	
			Preference Share Capital 2,00,000	
			Divd Arrears at 10% for 2 yrs 40,000	2,40,000
			Equity Share Holders (WN 4)	
			On 6,000 Shares at ₹ 2.50 per share	15,000
			On 2,000 Shares at ₹17.50 per share	35,000

Total		9,40,000	Total	9,40,000

2. Interest on Debentures: As the Company is solvent, Interest on Debentures should be paid up to the date of final settlement i.e., for the period 01.04.2011 to 30.06.2011 i.e. ₹ 2,00,000 x 10% x 3/12 = 5,000.

3. Balance Unsecured Creditors=Creditors as per B/s – Mortgage Loan – Preferential Creditors

= (4,90,000 – 90,000 – 30,000) = 3,70,000

4. Payment to Equity Shareholders and Liquidators' Remuneration:

Particulars		₹
a.	Total of Receipts before considering Call Money (from the above account)	9,40,000
b.	Total Payments before final payment to Equity Shares & Liquidators' Remn. at 2% thereon (29,400 + 4,600 + 2,15,000 + 30,000 + 3,70,000 + 2,40,000)	8,89,000
c.	Surplus from above before Liquidators' Remuneration & Calls made on Equity Shares (a-b)	51,000
d.	Liquidators' Remuneration on payment to Equity Share = 2% of amount paid = 2/102 x 51,000	1,000
e.	Surplus from above before Calls made on Equity Shares (c-d)	50,000
f.	Notional Call on 6,000 Partly Paid Shares at ₹ 15 each (to make all shares ₹ 75 paid up)	90,000 1,40,000
g.	Surplus Cash balance after Notional Call (comparing e and f)	8,000
h.	Number of Shares deemed paid at ₹ 75 per share (2,000 + 6,000)	₹ 17.50
i.	Hence, Refund on every ₹ 75 paid up Share (g ÷ h)	₹ 57.50
j.	Loss per ₹ 75 paid up Equity Share = Paid Up Value ₹ 75 – Refund as above ₹ 17.50	

The final settlement is made in any of the following ways –

(a) Calling ₹ 15 on 6,000 Shares presently ₹ 60 paid up, so as to make all Shares ₹ 75 paid up, and then refunding ₹ 17.50 per share for all 8,000 Shares.

(b) Refunding ₹ 17.50 per Share (₹ 75 – ₹ 57.50 Loss) for 2,000 Shares; and Refunding ₹ 2.50 per Share
(₹ 60 – ₹ 57.50 Loss) for the balance 6,000 Shares, without calling the further money from those Shares.

Alternative (b) is adopted in the above presentation.

Section C - Auditing

19. Comment on the following statements based on legal provisions:

(A) According to Sec 227(1) of the Companies Act, 1956, the auditor can call for *any* explanations or information from the officers and employees of the company.

Answer:

The statement is false. According to the Companies Act, 1956 the auditor can call for explanations or information which he thinks is relevant for the purpose of audit and proper discharge of his duties.

(B) The scope of verification is much wider than that of vouching.

Answer:

The statement is true. Vouching enables the auditor to know whether the transactions are genuine and valid to enable the auditor to report on the financial statements with reference to relevant documentary evidence. Vouching is the substantive testing/examination of transaction at their *point of origin*. On other hand, verification process encompasses the inquiry into the ownership/ title, existence, valuation, completeness and presentation of assets and liabilities in the balance sheet. Verification usually deals with the *final balance* in the Final Accounts viz the balance sheet and profit and loss account.

(C) Auditor is entitled to rely on work performed by others.

Answer:

SA 200 (AAS 1) on, "Basic Principles Governing an Audit" envisages manifold circumstances when an auditor would have to depend upon the work performed by others. Such other parties may be experts, other auditors including branch auditors or his own assistants.

SA 200 while laying down "Work Performed by Others" as one of the basic principle governing an audit makes it clear that in cases where the auditor is required to delegate a part of his work to his assistants or use the work performed by other auditors/experts, he continues to remain responsible for expressing his opinion on the financial statements. Thus, he can rely on work performed by others provided he exercises reasonable skill and care and he has no reason to believe that he should not have so relied.

The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

In case of statutory assignments, like relying on audit report of branches conducted by other auditors, he should expressly state the fact of such reliance.

(D) The Cost Auditor of a company cannot function as an internal auditor of the same company.

Answer:

The statement is true. The Cost Auditor is required to comment on the scope and performance of the internal audit as per the provisions of the Cost Audit (Report) Rules, 2011. If the Cost Auditor also functions as internal auditor, he will not be able to discharge his duties in proper and dispassionate manner.

(E) Reclassification of long term investment as short term investment is made at cost as on the date of classification.

Answer:

The statement is false. As per AS-13 , 'Accounting for Investments' the transfer should be at lower of cost and carrying amount of the investment at the date of reclassification of long term as short term investment.

(F) Where the accounts of the company do not present a 'true and fair ' view, the auditor of the company can give a qualified opinion.

Answer:

The statement is false. An adverse opinion is appropriate where the reservations or the objections are so substantial that the auditor feels, that the accounts do not give a 'True and Fair' view. Qualified opinion would imply that the financial statement project a 'True and Fair' view subject to certain reservations.

(G) For calculating minority interest there is a need to distinguish between capital and revenue profits of the subsidiary.

Answer:

The statement is false. Minorities are concerned with their stakes in the holding company. Their right consists of capital and reserves & surplus. To ascertain minority interests, neither capital profit nor revenue profit is necessary.

(H) Internal check is part and parcel of internal control.

Answer:

The statement is true. Internal control is a plan of organisation and covers all methods and procedures adopted by management to assist its objectives of ensuring the orderly and efficient conduct of business. It includes financial and physical control and covers internal check and internal audit also. Hence internal check is part of internal control.

(I) Audit is concerned with ethics of business.

Answer:

The statement is false. Audit is not concerned with ethics of business unless the business itself is illegal or unlawful.

(J) A company can refuse to provide access to its books of accounts to the company's auditor outside normal working hours of the company , as it will inconvenience the accounts staff.

Answer:

The statement is false. Section 227(1) of the Companies Act, 1956, provides that every auditor of a company shall have a right of access to books , accounts and vouchers of the company at all times and shall be entitled to require from the officers of the company such information and explanations as he may think necessary for proper performance of his duties. The auditor thus has the right of access to the records kept by the company at all times and may therefore, inspect them in the course of performance of his duties as auditor. As per law, the company cannot refuse to provide such access after regular office hours.

(K) The appointment of Mr. A as statutory auditor was held to be void ab initio. So the company holds another annual general meeting and appoints Mr. B , through a special resolution.

Answer:

Where the appointment of an auditor is void ab initio, it is as if no auditor has been appointed at all. Section 224(3) of the Companies Act, 1956 will come into play. As per this subsection, where at an annual general meeting, no auditors are appointed or reappointed, the Central Government shall appoint a person to fill the vacancy. Hence, in the given situation, the vacancy cannot be filled up by the company, but only by the Central Government. Accordingly, the appointment of Mr. B as new auditor at subsequent meeting will not be valid.

(L) Operational audit is merely an extension of Internal Audit.

Answer:

The statement is true. In operational audit function, the internal auditor goes beyond financial controls and looks into operational areas also. Operational auditing having scope and objectives similar to that of Internal Audit is therefore an extent ion of Internal Audit.

(M) Audit Committee has a two-fold relationship and has therefore, to react only with management and Internal Auditor.

Answer:

The statement is false. The audit committee has a fourfold responsibility and therefore has to interact with management, internal auditor, statutory auditor and the public.

(N) Shareholders, by a majority vote, have authorized the Board of Directors to keep the books of accounts of the company in its Administrative Office, as against the earlier practice of keeping them in the Registered Office. The ROC was not informed about this change. Company intends that this practice is in order.

Answer:

The statement is false. As per Section 209 of the Companies Act, 1956 , the books of accounts can be kept in a place other than its registered office also, but the Board of Directors should within seven days , file a written notice to the Registrar of Companies , the full address of the new place. Here the company has not complied with this mandatory requirement.

(O) There is no need to design better internal controls in an EDP or computerized system.

Answer:

The statement is false. Computerisation, automatically implies a constant review of the system to increase the efficiency in producing reliable data. As a result, the internal controls are normally better designed under computerized systems. Automatic checks are instituted and the responsibilities of various people are clearly stated.

20. (A) What is an "Audit Evidence"?

(B) What are the assertions with which an auditor is concerned with while obtaining audit evidence from substantive procedures?

(C) Discuss the principles, which are useful in assessing the reliability of audit evidence.

Answer:

(A) Audit evidence refers to any information, verbal or written, obtained by the auditor on which he bases his opinion on financial statements.

The audit evidence may be of varied nature and can assume various forms. For example, a signature on the voucher of a designated official, the payee's receipt, etc. Even the information obtained by the auditor by discussing with the officials of the company also constitutes audit evidence

AAS 1 (SA 200) on "Basic Principles Governing and Audit", mention audit evidence as one of the basic principles and requires that the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

According to AAS 5 (SA 500) on Audit Evidence, sufficiency and appropriateness are inter-related and apply to evidence obtained from both compliance and substantive procedures.

(B) An auditor is concerned with following assertions:-

(i) Existence:That an asset or liability exists at a given date.

(ii) Rights and obligations: That an asset is a right of the concern and a liability is an obligation at a given date.

(iii) Occurrence: That a transaction or event which took place pertains to the entity during the relevant period.

(iv) Completeness: That there are no unrecorded assets, liabilities or transaction.

(v) Valuation: That an asset or liability is recorded at an appropriate carrying value.

(vi) Measurement: That a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period.

(vii) Presentation and disclosure hat an item is disclosed classified and described in accordance with recognized accounting policies and practices and relevant statutory requirements.

(C) The reliability of audit evidence depends on its source-internal or external, and on its nature-visual, documentary, or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:

(i) External evidence (e.g. confirmation received from third party) is usually more reliable than internal evidence.

(ii) Internal evidence is more reliable when related internal control is satisfactory.

(iii) Evidence in the form of documents and written representations is usually more reliable than oral representations.

(iv) Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

21. (A) Auditors of M/s FBG (P) Ltd. were changed for the accounting year 2012-13. The closing stock of the company as on 31.3.2012 amounting to ₹ 350 lacs continued as it is and became closing stock as on 31.3.2013. The auditors of the company propose to exclude from their audit programme the audit of closing stock of ₹ 350 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. Give your comments.

Answer:

According to SA 510 "Initial Engagements – Opening Balances", requires that for initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

(a) the closing balances of the preceding period have been correctly brought forward to the current period;

(b) the opening balances do not contain misstatements that materially affect the financial statements for the current period; and

(c) appropriate accounting policies are consistently applied.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the balance sheet date. The contention of the management that the stock has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the stock lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude from his audit programme the audit of closing stock.

(B) No depreciation has been charged for the year ended 31st March 2013, in respect of a spare Car purchased during the year and kept ready by the company for use as a stand-by on the ground that it was not used during the year. State your views as an auditor.

Answer:

As per AS 6 on "Depreciation Accounting", depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Thus, depreciation has to be charged even in case of these assets which are not used at all during the year but by mere effluxion of time provided such assets qualify as depreciable assets. When the spare car was kept ready for use as stand-by, it means it was intended to be used for the purpose of business. Depreciation in respect of this bus ought to have been provided in the accounts for the year ended 31st March, 2013. If there is an intention to use an asset, though it may not have actually been used, it is a 'constructive' or 'passive' use and eligible for claim of depreciation.

(C) Fixed assets have been revalued by HIG Ltd. and the resulting surplus has been adjusted against the brought forward losses. What is your opinion as an auditor?

Answer:

The revaluation of fixed assets is a normally accepted practice which involves writing up the book value of fixed assets. AS 10 on 'Accounting for Fixed Assets' requires that "an increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution". Thus, creation of revaluation reserves does not result into any cash inflows and represents unrealised gains. However, brought forward losses are in the nature of revenue losses. As a matter of prudence, revenue losses can be adjusted against revenue reserves only and not the capital reserves. Therefore, the accounting treatment followed by the entity is not correct and the auditor should qualify the audit report by mentioning the above fact.

22. (A) Draft the audit programme for audit of receipt of participation fees from delegates to the National Cost Convention.

Answer:

The organization of three-day National Cost Convention is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas:

(I) Internal Control System

(i) Examine the organization structure of special cell created for the National Cost Convention, if any, and division of responsibilities amongst persons and control/custody over receipt books.

(ii) Verify the internal control system for restricting the participation of unregistered **delegates.**

(II) Rate of Participation Fees

(i) Verify with reference to resolution passed by the Organizing Committee

(ii) Also verify the rate from the literature/registration form circulated for promotion of conference.

(III) Receipts of Participation Fees

(i) Verify counter foil of the receipts issued for individual registration.

(ii) Ensure that receipts are issued for all the registration received in cash.

(iii) Trace the receipts in Bank Statement or Cash Book – as the case may be.

(iv) Verify Bank Reconciliation Statement and list out dishonored cheques.

(v) Verify subsequent recovery in respect of dishonored cheques.

(IV) Overall Checking

(i) Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.

(ii) Cross check the total number of delegates with reference to the following:

(a) Kits distributed to participants.

(b) Bill of caterer for providing meals during conference.

(c) Capacity of the Hall.

(d) Participation Certificate if any issued.

(V) Foreign Delegates: In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.

(VI) *Special Issues*

(i) Take out list of absentees and in case of nil absentees, probe the issue further.

(ii) If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

(B) The HIJ College, an institution managed by WB Trust, has received a grant of ` 5 crore from Government nodal agencies for funding a project of research on rural health systems in India. Draft an audit programme for auditing this fund in the accounts of the college.

Answer:

Audit of grant fund of a college:

(i) The auditor should obtain the basic documents about the constitution of the college, objectives of the trust, rules of college etc.

(ii) The government policy on grant should be checked with the relevant application, brochure, and sanction advices.

(iii) The conditions stipulated in award of grant should be studied.

(iv) The receipt of grant should be vouched with bank statement.

(v) The budgeted heads of expenses for the project and actual utilization of the fund should be checked.

(vi) The purchase of capital items covered within the project should be correctly capitalized. The same should be properly and distinctly shown in the balance sheet of the college. The cost of the asset should be adjusted for the grant amount.

(vii) The expenses of revenue nature incurred from and out of grant in the form of salaries to field staff, materials purchased, traveling, survey and field work expenses and analysis and preparation of reports etc should be vouched with the relevant vouchers.

(viii) The expenses should be accounted as withdrawal of amounts from the fund. It is to be checked that these expenses are not accounted in income and expenditure of the college.

(ix) In balance sheet, the fund account should be shown as a liability with a separate schedule indicating the receipts, payments and balance as on the date of closing of accounts.

(x) The fund balance should be cross checked with the periodical statements of accounts submitted to the nodal agencies.

(xi) The physical verification of assets pertaining to the project should be done by the management of the college.

(xii) The progress of the project may be ascertained from the minutes, committee meeting extracts and reports. This must be done to ensure that the project fund is genuinely utilized for the purposes it intended for.

(23) As an auditor, how will you vouch and/or verify the following?

(A) Work-in-progress

(B) Receipt of special backward area subsidy from Government:

(C) Recovery of Bad Debts written off.

(D) Borrowing from Banks

(E) Machinery acquired under Hire-purchase system.

Answer:

(A) Work-in-progress:

The audit procedures regarding work-in-progress are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-progress for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production/costing records (i.e., cost sheets), hold discussions with the personnel concerned, and obtain expert opinion, where necessary. The auditor may advise his client that where possible the work-in-progress should be reduced to the minimum before the closing date. Cost sheets of work-in-progress should be verified as follows:

(i) Ascertain that the cost sheets are duly attested by the works engineer and works manager.

(ii) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost sheets by reference to the records maintained in respect thereof.

(iii) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimated cost expected.

(iv) Ensure that the allocation of overhead expenses had been made on a rational basis.

Compare the cost sheet in detail with that of the previous year. If they vary materially, investigate the cause thereof.

(B) Receipt of special backward area subsidy from Government:

i. The claim for backward area subsidy submitted to the authorities should be studied.

ii. It should be ascertained whether the grant is of a capital nature for funding assets or of a revenue nature. Mere computation formula of quantum of grant with reference to the cost of project of itself will not make the grant a capital nature is to facto.

iii. The accounting of grant should be in accordance with AS 12 "Accounting for Government Grants". The revenue grant can be taken to income statement, with appropriate disclosure.

iv. The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to profit and loss account each year in proportion to depreciation of that asset charged in profit and loss account.

v. The receipt of the grant should be checked with bank statement, remittance challan etc.

vi. The conditions attached to grant should be fulfilled by the company. The auditor should check whether any liability or refund of grant for breach of conditions could arise.

(C) Recovery of Bad Debts written off:

(i) Ascertain the total amount of bad debts.

(ii) Ensure that all recoveries of bad debts have been properly recorded in the books of account.

(iii) Examine notification from the Court or from bankruptcy trustee, letters from collecting agencies or from debtors should also be seen.

(iv) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.

(D) Borrowing from Banks:

Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows:

(i) Reconcile the balances in the overdraft or loan account with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.

(ii) Obtain a certificate from the bank showing particulars of securities deposited with the bank as security for the loans or of the charge created on an asset or assets of the concern and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.

(iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.

(iv) Confirm, in the case of a company, that the restraint contained in Section 293 of the Companies Act, 1956 as regards the maximum amount of loan that the company can raise has not been contravened.

Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity

(E) Machinery acquired under Hire-purchase system.

(i) Examine the Board's Minute Book approving the purchase on hire-purchase terms.

(ii) Examine the hire-purchase agreement carefully and note the description of the machinery, cost of the machinery, hire purchase charges, terms of payment and rate of purchase.

(iii) Ascertain that the machinery has been included in the related assets account at its cash value. Also instalments due have been paid and the hire-purchase charges applicable to the period from the commencement of the agreement to the end of the financial year have been charged against current profits.

(iv) Ensure that machinery acquired on hire purchase basis has been included at its cash value in the balance sheet and depreciation has been calculated on the cash value from the date of the purchase. The amount due to the hire purchase company in respect of the capital outstanding has either been shown as a deduction from the machinery account or as a separate amount under current liabilities.

24. As an auditor, comment on the following situations:

(A) One of the debtors of PQR Ltd. From whom ₹7 lacs is recoverable for credit sales gives a motor car in full settlement of dues. The directors estimate that the market value of the car transferred is ₹7.50 lacs. As on date of Balance Sheet, the car has not been registered in the name of PQR Ltd.

Answer:

According to AS-10, Accounting for Fixed Assets, when fixed asset is acquired in exchange or in part exchange for another asset, the cost of asset acquired should be recorded either at fair market value or net book value of the asset given up. In present case book value is more evident than fair value of car estimated by the directors. Hence, Debtor' A/c should be credited with ₹7 lacs and motor car recorded at the same amount.

Taking principle of substance over form into consideration as laid down in AS 1, the auditor should ensure that the car's acquisition is recorded in the present year though the car is not registered in the name of the auditee.

(B) M/s XYZ Ltd. has taken a Group Gratuity Policy from an Insurance Company. During accounting year 2012-13 it received a communication from an Insurance Company informing that premium amount for the accounting year 2011-12 was less charged by ₹95

lacs on account of arithmetical error on the part of Insurance Company. M/s XYZ Ltd. paid the said sum of ₹95 lacs during the accounting year 2012-13 by debiting the same to prior period expenses.

Answer:

AS-5 has defined prior period expenses as those which arise in current period as a result of error or omission in the preparation of financial statement of one or more prior periods. The nature and amount of prior period items should be separately disclosed in the Profit & Loss A/c in a manner that their impact on current profit or loss can be prescribed.

In the given case-

i) Arithmetical mistake of ₹95 lacs in computing the amount of premium is not a prior period expense as per AS 5.

ii) The error was on part of insurance company.

iii) The accounting treatment by M/s XYZ Ltd. is thus incorrect.

iv) The auditor should ensure that the disclosure of ₹95 lacs is an ordinary item in current year's Profit & Loss A/c. This may be disclosed in Notes to Accounts.

25. As an auditor, what would you do in the following situations?

(A) The company has sent semi-finished goods to third parties for further processing, which is lying with them at the end of the year.

Answer:

Semi-finished goods being composite part of the inventories, normally, constitute significant item in case of any entity. It is the duty of the auditor to ensure that entire inventories which are owned by the enterprise exist on that date and valuation thereof is also proper. Since the semi-finished goods belong to the company, it is necessary to ensure that the same have been included for in valuation of inventories. The auditor should also obtain direct confirmation about the quantity of inventories lying with the processors at the end of the year. Also, the auditor should see that the valuation has been made properly with reference to the stage of completion in respect of work-in-process inclusive of expenses incurred in sending the goods for processing. In case, the amount happens to be material, such stock may be disclosed separately as stocks with processors.

(B) The management has obtained a certificate from an actuary regarding provision of gratuity payable to employees.

Answer:

The computation of gratuity liability payable to employees is dependent upon several factors such as age of the employee, expected span of service in the organisation, life expectancy of the employee, prevailing economic environment, etc. Thus, it gives rise to uncertainty in the determination of provisions of liabilities. Under such circumstances, the management is required to make an assessment and estimate the amount of provision. In view of this, the management may engage an expert in the field to assist them in arriving at fair estimation of the liability. Therefore, it is an accepted auditing practice to use the work of an expert.

SA 620(AAS 9) on "Using the Work of an Expert" also states that an expert may be engaged/employed by the client. It further requires the auditor to assess skill, competence and objectivity of the expert amongst other factors and evaluate the work of an expert independently to conclude whether or not to rely upon such a certificate obtained by the management from the actuary. Therefore, the auditor must follow the requirements of SA

620(AAS 9) before relying upon the certificate obtained by the management from the actuary.

26. Comment on the following situations:

(A) At an Annual General Meeting, Mr. B a retiring auditor claims that he has been reappointed automatically, as the intended resolution of which a notice had been given to appoint Mr. A, could not be proceeded with, due to Mr. A's death.

Answer:

Section 224(2) of the Companies Act, 1956 dealing with reappointment of auditors specifies that subject to the provisions of sub-section (1B) and section 224A, at any Annual General Meeting a retiring auditor, by whatsoever authority appointed, shall be re-appointed unless, *inter alia*:

"Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or dis-qualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with."

However, it should be noted that even for the re-appointment of a retiring auditor, the passing of a resolution is essential. Section 224 of the Companies Act, 1956, requires that a resolution has to be passed by the company every year. In the absence of a resolution, the retiring auditor is not re-appointed automatically.

Thus, the claim of Mr. B would not hold good.

(B) One of the directors of XYZ Ltd. is attracted by the disqualification under Section 274(1)(g).

Answer:

Section 227(3)(f) as inserted by the Companies (Amendment) Act, 2000 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as directors under Section 274(1)(g) of the Companies Act, 1956. To this end, the auditor has to ensure that written representation have been obtained by the Board from each director that one is not hit by Section 274(1)(g).

Since in this case, one of the directors is attracted by disqualification u/s 274(g) of the Act, the auditor shall state in his report u/s 227 about the disqualification of the particular director.

(C) PQR Limited with its registered office at Bangalore has two branch offices located at Mumbai and Kolkata. The accounting transactions of the branches are recorded and the accounting records are maintained in the branches themselves. Only quarterly summarized Trial balance, Profit and Loss account and Balance Sheet are sent to Bangalore office by the branch Accountants. Do you think that the Company is at fault of not maintaining proper books at registered office as per the Company law provisions?

Answer:

According to Section 227 of the Companies Act, 1956, the auditor has to report whether the company has maintained proper books of account. According to section 209 of the Companies Act, the company has to keep at its registered office all the accounting records specified therein.

As regards, the records of the branch, Section 209 permits that the same may be maintained at branches provided summarized returns of the branch are sent to registered office at such frequent intervals not less than a quarter.

In the present case, since the branches are sending quarterly summarized returns of accounting details, it is deemed that proper books of accounts are maintained at registered office.

Hence, there is no statutory violation committed by the company.

It may be noted, still the company auditor has right of access (at registered office itself by calling for records) and right to visit the branch.

(D) The members of XYZ Ltd. preferred a complaint against the auditor stating that he has failed to send the auditor's report to them.

Answer:

Section 227 of the Companies Act, 1956 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. It will be for the secretary or the director to convene a general meeting and send the balance sheet and report to the members (or other person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.

27. As a Company Auditor, how would you deal with the following situations?

(A) In the books of accounts of M/s WBS Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accounts Officer informs that this is common due to huge volume of business done by the company during the year.

Answer:

The huge differences found between control accounts and subsidiary records in the books of M/s WBS Ltd. indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. The contention of Chief Accounts Officer cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date. Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements.

As per SA 240(AAS 4), "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements" when the auditor encounters circumstances that there is material misstatement, the auditor should perform procedures to determine whether the financial statements are materially misstated. If as a result of such examination the auditor comes across any material information involving fraud or gross irregularity the same shall be reported by him appropriately.

B) The surplus arising from a change in the basis of accounting was set off by X Ltd., against a non-recurring loss.

Answer:

AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" states that any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change.

Transactions which are of an abnormal on non-recurring nature may also be considered material, even though *prima facie*, they do not appear to be material.

Materiality is an important and relevant consideration in determining whether or not such exclusion/non-disclosure will distort the true and fair view of the financial statements. Thus, it would be important that users must know the quantum of non-recurring loss. In offsetting and aggregating items, care need to be taken to ensure that material items are not offset against each other.

Accordingly, it would not be prudent to set off the surplus emanating from a 'change in the basis of accounting' against a 'non-recurring loss'. Accordingly, it would be better to disclose surplus on account of change in the basis of accounting and non-recurring loss separately.

C) Interest on share capital was paid to the shareholders by GHI Ltd. as the company had a long gestation period before it could become operational.

Answer:

Section 208 of the Companies Act, 1956 permits payment of interest to shareholders out of capital, where there is a long gestation period. Payment of interest on capital is, however, capitalised as part of cost of construction of the project. The auditor should ensure that following conditions have been complied whenever such interest has been paid:

(i) Payment is authorised by the Articles or by special resolution of shareholders in general meeting;

(ii) Payment is approved by the Central Government;

(iii) It is paid only for the period determined by the Central Government not exceeding six months after the half-year in which the project has been completed.

(iv) The rate shall not exceed 12% p.a. or such other rate as may be prescribed by the Government.

(v) The payment of interest shall not operate as a reduction of the amount paid-up on the shares in respect of which it is paid.

28. Explain how following are dealt in Auditor's Report as per CARO, 2003?

(A) No Cost Accounting records are maintained though the company is required to maintain the same.

Answer:

Under CARO, 2003 where maintenance of cost records, where maintenance of cost records has been prescribed by the Central Government, the auditor of the company is specifically required to state whether such accounts and records as prescribed have been made and maintained.

Whether cost audit is ordered or not, the auditor should report on non maintenance of cost records.

(B) A Term Loan was obtained from a bank for ₹ 90 lacs for acquiring R&D equipment, out of which ₹15 lacs was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

Answer:

Under CARO, 2003, an auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained.

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, since term loan taken for the purpose of R&D equipment has been utilized for purchase of car which has no relation with R&D equipment. Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that the out of term loan of R&D lack, ₹15 lacs was not utilised for the purpose of acquiring the R & D equipment.

(C) Fixed assets comprising 1/3rd of the total assets have been disposed off during the year by LMN ltd.

Answer:

Under CARO, 2003, an auditor is required to state if substantial part of the fixed assets have been disposed off during the year, whether it has affected the going concern. This clause requires the auditor to carry out adequate audit procedures to satisfy himself that the company shall be able to continue as going concern for the foreseeable future despite the sale of substantial part of the fixed assets.

Accordingly, in the instant case, the auditor should satisfy himself as to whether disposal off of 1/3rd of fixed assets during the year had any effect on the going concern assumption on account of such sale of fixed assets.

The Auditor is required to exercise his professional judgement to determine whether disposal off of one-third of total assets constitutes substantial part or not. Depending upon the judgement arrived at by the auditor, he shall report whether substantial part of fixed assets have been disposed off or not during the year and it has affected or not affected the going concern status of the company.

Alternatively, in case the auditor is of the opinion that it constitutes substantial sale but the going concern assumption is appropriate because of mitigating factors then he has to ensure that the same are disclosed in the financial statements or else he shall have to modify the auditor report. The manner of reporting shall also be modified appropriately in case the going concern assumption is resolved or not.

29. (A) In XYZ LTD, F a junior accountant was given additional responsibility of making recoveries from the debtors. On one occasion, when an insurance claim of ₹85,000 was received, he credited the same to the account of a debtor and misappropriated the cash which he had recovered from the said debtor. Pinpoint weaknesses in the internal control system which led to this situation.

Answer:

Following two essential features of internal control are relevant here:

(i) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end and

(ii) Segregation of accounting and custodial functions.

<u>Weakness in internal control system in the instant case:</u>

i) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.

ii) It also appears that system for issuing receipts for amount received - whether cash or cheque is also lacking.

iii) In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking.

Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.

(B) Elaborate the principles of internal check system that should be followed with regard to cash payments.

Answer:

The principles to be followed are enumerated below:

i) Making all payments through cheques except petty cash payments.

ii) Segregating duties: The employee in charge of receipts should not be involved in making payments.

ii) All payments should be duly authorized. Payments above ₹20000 should be tendered through crossed cheque.

iv) The unused cheques should be under proper custody.

v) The vouchers supporting payments should be stamped as 'paid' so that they are not presented twice.

vi) Statement of dues received from creditors should be verified with invoices and ledger accounts before authorizing payments. Confirmation of accounts should be made with creditors.

vii) Monthly or periodic payments should be always be made on fixed dates.

viii) Bank reconciliation statements should be made at least monthly to locate the difference between cash and bank book if any. The statement should be prepared by an independent person not in charge of receipts or payments.

(C) How would you audit 'Inventory Control and Management' as an Internal Auditor?

Answer:

The Internal Auditor should ensure the following as regards 'Inventory Control and Management':

(i) Has the inventory been classified for proper control? Is A, B, C system of inventory classification followed?

(ii) How the inventory levels – maximum, minimum, reorder, economic order quantity fixed?

(iii) Is material budget prepared in advance to regulate purchase?

(iv) Study the opening/closing stocks of the last few years.

(v) Study the procurement of materials for the last 2/3 years and see whether the same compares favourably with production.

(vi) Is there any regular system to assess slow-moving/non-moving stores items for early disposal in cases considered necessary?

(vii) Who is the person to declare some material as surplus? Who authorizes its disposal?

(viii) Review whether value analysis, PERT etc. are applied for better management of stores.

(ix) Work out inventory ratios to judge the reasonableness of inventory build up

(a) working capital to store inventory

(b) Current assets to store inventory

(c) Inventory turnover.

Some General Aspects:-

(i) Sometimes used materials are returned to stores. In such cases procedure for recording would be the same as followed in case of unused materials except that these may or may not be priced. Usually separate stores ledger / bin cards are opened. See whether the procedure in this regard has been observed.

(ii) Review whether any study has been made in regard to mechanization in stores receipt/issue, store accounting.

(iii) Review whether proper numerical accounts have been kept in respect to stand by spares.

(iv) See whether there is any Material Receiving Report pending disposal – recording valuation in stores ledger/bin card, accounting the accounts records etc.

(v) Review the mode of valuation of closing stock.

(vi) How soon the stores schedule is prepared for annual accounts purpose?

(vii) Are the stores materials adequately covered by insurance against loss from fire and other risks?

(viii) Is there proper coordination between –

(a) Central Purchase Department

(b) Local Purchase Department

(c) Stores Department

(d) Stock – verification Department

(ix) In case there are number of factories producing same / similar products make comparative study regarding –

(a) Surplus materials

(b) Obsolete/slow-moving materials.

(c) Finished/work-in-progress stock

(d) Opening/closing stock of raw material, etc.

Apart from the above O and M study may be carried out for standardization of forms, modification of work flow for improvement in efficiency in various directions etc.

30. (A) Discuss the qualities a management auditor should possess.

Answer:

The management auditor should possess the following qualities:

i) Ability to understand the nature and objectives and problems faced by the organisation.
ii) He should have general understanding of different laws and regulations like Tax Laws, Company Laws etc.
iii) Expert knowledge of management principles such as delegation of authority, management by exception, budgetary control, flow charts, etc.
iv) Sufficient knowledge and experience in preparing and presenting reports to different levels of management.
v) Working knowledge of engineering, costing, statistics, management accounting, industrial psychology etc.
vi) Dynamic, tactfulness and a pleasing personality.

(B) What are the main points involved in 'Performance Audit' under Government Accounting system?

Answer:

Performance audit refers to an examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies.

The scope of audit has been extended to cover efficient, economy and effectiveness audit or performance audit.

Efficiency audit look into whether various schemes/projects are executed and their operations conducts economically & see that amount spent gives expected result & projects carried out in an economical manner.

Economy aspect looks whether government has acquired financial, human and physical resources in an economical manner and that sanctioning and spending authority have observed economy.

Effectiveness looks into appraisal of performance of programmes, schemes, projects with overall targeted objectives.

Efficiency cum performance audit is examination of Financial & operational aspect of performance.

The performance audit involves preliminary study, planning & execution of audit & reporting.

(C) In a system based audit, test checking approach provides a good base for the auditor to form an opinion on the Financial statement. Explain your views.

Answer:

System-based audit is done by evaluating the accounting system and internal control and ascertaining their reliability through audit tests. Depending upon the size and nature of the business concerned, an accounting system will incorporate necessary internal control to provide assurance that:

(i) All the transactions and information have been recorded,

(ii) Fraud and errors, if any, in preparing the accounts will be identified,

(iii) All the assets and liabilities recorded in the books of account do exist and are shown at correct amounts,

(iv) There is compliance with statutory regulations.

After the auditor has ascertained the client's accounting system, he should assess it to satisfy the above-mentioned requirements. The auditor, therefore, after evaluating internal control system, tests the same to ascertain whether it is actually in operation. For this purpose, he assorts to actual testing of the system in operation. This he does on a selective basis, i.e., he adopts test checking technique. He plans this testing in such a manner that all the important areas stated above are covered. The test checking is done by application of procedural test and/or by auditing in depth. This approach is adopted in system based audit which is the modern audit approach. The system-based audit approach begins by evaluating the accounting system and internal control and then by testing them to ascertain their reliability. By this, the auditor first establishes how reliable the system is and then decides how much detailed checking of the transactions and verification of assets and liabilities he must undertake. If the system is found to be good, the detailed checking could be curtailed, but if system is week, more detailed checking would be necessary. However, checking cannot be completely eliminated; it can only be scaled down if state of the system is satisfactory. In case the initial evaluation itself shows weaknesses, extensive checking should invariably be undertaken.