CA INTER

ADVANCED ACCOUNTING (MODULE – 3)

INDEX

11. FINANCIAL STATEMENTS OF COMPANIES

UNIT 1: PREPARATION OF FINANCIAL STATEMENTS

LEARNING OUTCOMES

After studying this unit, you will be able to –

- Know how to maintain books of account of a company.
- Learn about statutory books of a company.
- Prepare and present the financial statements of a company as per Schedule III to the Companies Act, 2013
- Appreciate the term divisible profits and dividends.

Knowledge Pulse - This chapter is the sole of accounting, without this chapter we cannot proceed to consolidation or amalgamation. How a doctor knows it is very basic and important to know how to use a stethoscope the same for a CA, a CA should know how to prepare financial statements and we are going to learn that in this chapter

1.1 MEANING OF COMPANY

As per Section 2(20) of the Companies Act, 2013, "Company" means a company incorporated under the Companies Act, 2013 or under any previous company law (e.g., the Companies Act, 1956).

Different types of companies have been defined (under various sub-sections of the Companies Act, 2013) as follows:

2(21) **"company limited by guarantee"** means a company having **the liability of its members limited** by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up;

2(22) **"Company limited by shares"** means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them;

2(42) **"Foreign company"** means any company or body corporate incorporated outside India which

a. has a place of business in India whether by itself or through an agent physically or through electronic mode; and

b. conducts any business activity in India in any other manner.

2(45) **"Government company"** means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a government company;

2(62) **"One Person Company"** means a company which has only one person as a member;

2(68) **"Private company"** means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

i. restricts the right to transfer its shares;

ii. except in case of One Person Company, limits the number of its members to two hundred: Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this sub-clause, be treated as a single member:

Provided further that—

A. persons who are in the employment of the company; and

B. persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,

shall not be included in the number of members; and

iii. prohibits any invitation to the public to subscribe for any securities of the company;

2(71) **"Public Company"** means a company which—

a. is not a private company; and

b. has a minimum paid-up share capital as may be prescribed: Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

2(85) **"Small company"** means a company, other than a public company, -

i. paid-up share capital of which does not exceed Rs.50 lakhs or such higher amount as may be prescribed which shall not be more than Rs.10 crores; and

ii. turnover of which as per profit and loss account for the immediately preceding financial year does not exceed Rs.2 crores or such higher amount as may be prescribed which shall not be more than Rs.100 crores:

Provided that nothing in this clause should apply to:

A. a holding company or a subsidiary company

B. a company registered under section 8

C. a company or body corporate governed by any special Act

As per the Companies (Specification of Definitions Details) Rules, 2014, for the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed Rs.4 crores and Rs.40 crores respectively.

Authors Note -> Current limit of small company – Paid up share capital not to exceed 4 crores and turnover not to exceed 40 crores (However it is important to note that this limit keep changing and have an eye on Latest RTP and our lectures if there is any amendment)

2(92) **"Unlimited company"** means a company not having any limit on the liability of its members;

2(46) **"Holding company",** in relation to one or more other companies, means a company of which such companies are subsidiary companies;

Explanation.–For the purposes of this clause, the expression "company" includes any body corporate.

2(87) **"Subsidiary company"**, or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company-

i. controls the composition of the Board of Directors; or

ii. exercises or controls more than **one-half of the total share capital** either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed should not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation – For the purposes of this clause, -

a. a company should be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

b. the **composition of a company's Board of Directors** should be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

c. the expression "company" includes anybody corporate;

d. "layer" in relation to a holding company means its subsidiary or subsidiaries;

Companies (Accounting Standards) Rules, 2021 define Small and Medium Sized Company as follows:

2(e) "Small and Medium Sized Company" (SMC) means, a company-

i. whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

ii. which is not a bank, financial institution or an insurance company;

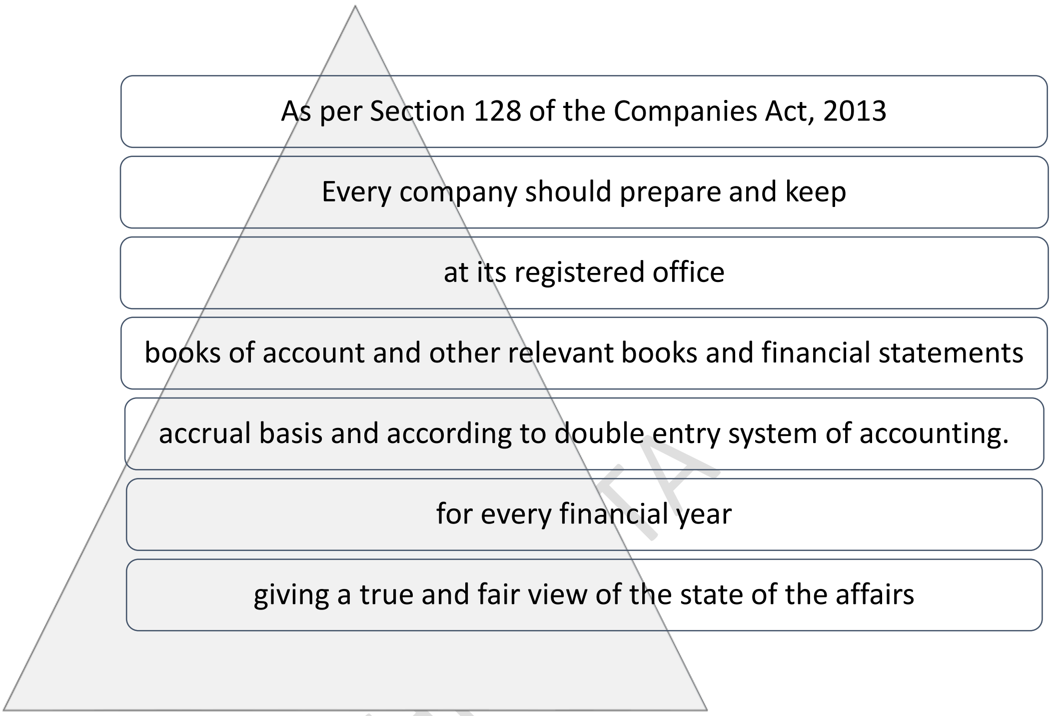
iii. whose turnover (excluding other income) does not exceed two hundred and fifty crore rupees in the immediately preceding accounting year;

iv. which does not have borrowings (including public deposits) in excess of fifty crore rupees at any time during the immediately preceding accounting year; and

v. which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation: For the purposes of this clause, a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

1.2 MAINTENANCE OF BOOKS OF ACCOUNT



As per Section 128 of the Companies Act, 2013, every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books should be kept on accrual basis and according to the double entry system of accounting:

Maintenance at Place other than Registered Office

It is a duty of the company to inform the Registrar of Companies within seven days of the decision in case the Board of Directors decides to maintain books at the place other than the registered office.

In Case of Branch Office

Where a company has a branch office in India or outside India, it should be deemed to have complied with the provisions of the Act, if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or such other place as the Board of Directors has decided.

Section 128 (3) further lays down that the books of account and other books and papers maintained by the company within India should be open for inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information should be maintained and produced for inspection by any director subject to such conditions as may be prescribed. **Section 128(5)** further states that the books of account of every company relating to a period of not less than 8 financial years immediately preceding a financial year, or where the company had been in existence for a period less than 8 years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account should be kept in good order.

Books of Accounts maintained in electronic mode

A company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India, at all times, so as to be usable for subsequent reference.

Provided that for the financial year commencing on or after the 1st day of April, 2022, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.

The information in the electronic record of the document shall be capable of being displayed in a legible form.

There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law;

Provided that the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a daily basis.

The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement-

a. the name of the service provider;

b. the internet protocol address of service provider;

c. the location of the service provider (wherever applicable);

d. where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.

Explanation.- For the purposes of this rule, the expression "electronic mode" includes "electronic form" as defined in clause (r) of sub-section (1) of section 2 of Information Technology Act, 2000 and also includes an electronic record as defined in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 and "books of account " shall have the meaning assigned to it under the Act.

Where the service provider is located outside India, the name and address of the person in control of the books of account and other books and papers in India.

1.3 STATUTORY BOOKS

The following statutory books are required to be maintained by a company under different sections of the Companies Act, 2013:

- Register of Investments of the company held in its own name (Section 187)
- Register of Charges (Section 85)
- Register of Members (Sections 88)
- Register of Debenture-holders and other Security holders (Section 88)
- Minute Books (Section 118)
- Register of Contracts, or arrangements in which directors are interested (Section 189)
- Register of directors and key managerial personnel and their shareholding (Section 170)
- Register of Loans and Investments by Company (Section 186)

  In addition, a company usually maintains a number of statistical books to keep a record of its transactions which have resulted either in the payment of money to it or constitute the basis on which certain payments have been made by it.
- Registers and documents relating to the issue of shares are:
  - **i.** Share Application and Allotment Book.
  - **ii.** Share Call Book
  - **iii.** Certificate Book
  - **iv.** Register of Members
  - **v.** Share Transfer Book
  - **vi.** Dividend Register.

1.4 ANNUAL RETURN

In accordance with **Section 92** of the Companies Act, 2013, every company should prepare an annual return in the form prescribed by the Companies Act, 2013 **signed by a director and the company secretary**, or where there is no company secretary, by a company secretary in practice: Provided that in relation to One Person Company and small company, the annual return should be signed by the company secretary, or where there is no company secretary, by the director of the company.

The **annual return** should be filed with the **Registrar within 60 days** from the day on which each of the annual general meeting (AGM) is held or where no AGM is held in any year, within 60 days from the date on which AGM should have been held along with a statement showing the reasons why AGM was not held.

1.5 FINAL ACCOUNTS

Under Section 129 of the Companies Act, 2013, at the annual general meeting of a company, the Board of Directors of the company should lay financial statements before the company:

Financial Statements as per Section 2(40) of the Companies Act, 2013, inter-alia include –

i. a balance sheet as at the end of the financial year;

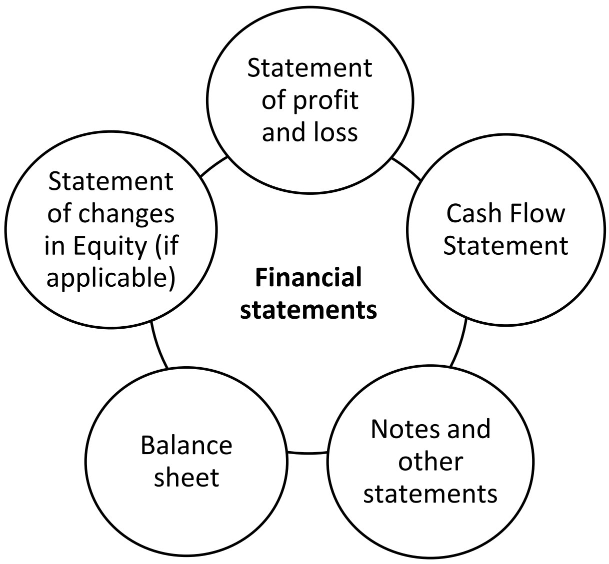
ii. a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

iii. cash flow statement for the financial year;

iv. a statement of changes in equity, if applicable; and

v. any explanatory note annexed to, or forming part of, any document referred to in (i) to (iv) above:

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.



The financial statements of a one person company, small company, dormant company or a private company (if such a private company is a start-up), may not include the cash flow statement.

Periodic Financial Statements

The Central Government may, require such class or classes of unlisted companies, as may be prescribed,—

a. to prepare the financial results of the company on such periodical basis and in such form as may be prescribed;

b. to obtain approval of the Board of Directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and

c. file a copy with the Registrar within a period of thirty days of completion of the relevant period with such fees as may be prescribed.

Requisites of Financial Statements

It should give a true and fair view of the state of affairs of the company as at the end of the financial year.

Provisions Applicable

1. Specific Act is Applicable

For instance, any

a. insurance company

b. banking company or

c. any company engaged in generation or supply of electricity* or

d. any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company

2. In case of all other companies

Balance Sheet as per Form set out in Part I of Schedule III and Statement of Profit and Loss as per Part II of Schedule III.

Division	Applicable to:
Division I	Companies that are required to apply Accounting Standards notified under Section 133 of the Companies Act, 2013.
Division II	Companies that are required to apply Indian Accounting Standards notified under Section 133 of the Companies Act, 2013.
Division III	Non-Banking Finance Companies (NBFCs) that are required to apply Indian Accounting Standards notified under Section 133 of the Companies Act, 2013.

Points to be kept in mind while preparing final accounts:

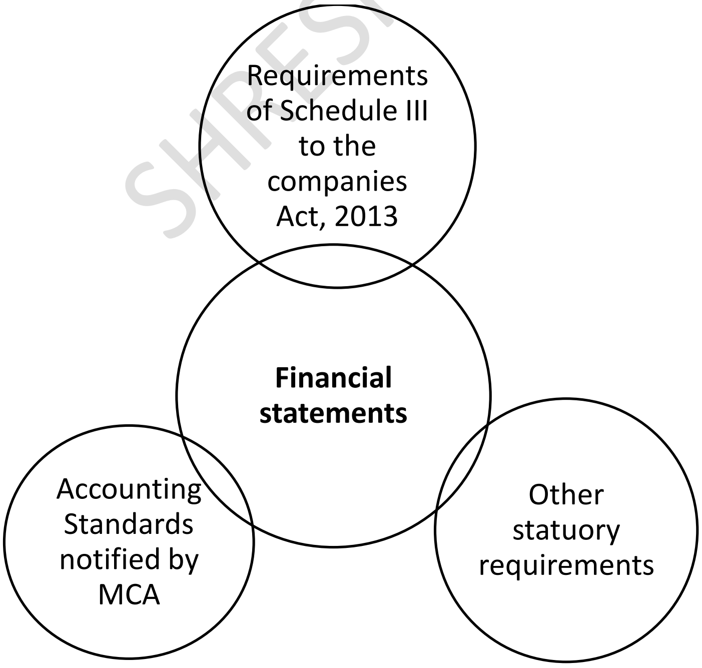
- Requirements of Schedule III to the Companies Act;
- Other statutory requirements;
- Accounting Standards notified by Ministry of Corporate Affairs (MCA) (AS 1 to AS 292);
- Statements and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI); which are necessary for understanding the accounting treatment/ valuation/ disclosure suggested by the ICAI.

Compliance with Accounting Standards

As per section 133 of the Companies Act, it is mandatory to comply with accounting standards notified by the Central Government from time to time.

Schedule III of the Companies Act, 2013

As per section 129 of the Companies Act, 2013, Financial statements should give a true and fair view of the state of affairs of the company or companies and comply with the accounting standards notified under section133 and should be in the form or forms as may be provided for different class or classes of companies in Schedule III under the Act. Schedule III to the Companies Act, 2013 has been given as Annexure at the end of this chapter.



Example 1

In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of Rs. 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment.

Solution

Schedule III has come into force for the Balance Sheet and Profit and Loss Account prepared for the financial year commencing on or after 1st April, 20X1. As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 20X2 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. Schedule III does not require a company to disclose the source from which bonus shares have been issued. Therefore, non disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

Example 2

The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III.

Solution

Schedule III to the companies Act does not require that the amounts of WIP at the beginning and at the end of the accounting period to be disclosed in the statement of profit and loss. Only changes in inventories of WIP need to be disclosed in the statement of profit and loss. Non-disclosure of such change in the statement of profit and loss by the company may not amount to violation of Schedule III if the differences between opening and closing WIP are not material.

Example 3

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 20X1:

Particulars	Amount Rs. in lakhs
Securities Premium Account	**80**
Capital Reserve	**60**
General Reserve	**90**

The company had an accumulated loss of Rs. 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013.

Solution

Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) should be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, should be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceeds the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus, the presentation by the company is incorrect.

Example 4

Sumedha Ltd. took a loan from bank for Rs. 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20X1 of Rs. 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III.

Solution

In the given case, instalments due on 30.09.20X1 and 31.03.20X2 will be shown under the head 'short term borrowings' as current maturities of loan from bank as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Therefore, in the balance sheet as on 31.3.20X1, Rs. 8,00,000 (Rs. 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and Rs. 2,00,000 (Rs. 1,00,000 x 2 instalments) will be shown under the heading 'short term borrowings'.

Example 5

Prince Ltd. presents its provisions for contingencies under "Reserves and Surplus" in Notes to Accounts in its financial statements. Whether this presentation is correct?

Solution

The ICAI's Glossary of Terms Used in Financial Statements defines the term '**Reserve**' as "the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability." 'Reserves' should be distinguished from 'provisions'. For this purpose, reference may be made to the definition of the expression Rs. Provision' in AS-29 Provisions, Contingent Liabilities and Contingent Assets.

As per AS-29, a Rs. **Provision'** is "a liability which can be measured only by using a substantial degree of estimation". A '**liability**' is "a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits." Present obligation' – "an obligation is a present obligation if, based on the evidence available, its existence at the Balance Sheet date is considered probable, i.e., more likely than not."

Example 6

Anek Ltd. is a company that is required to present its financial statements as per the Division I of Schedule III. The company has trade receivables at the balance sheet date. What are the disclosures that are applicable with respect to trade receivables in the financial statements?

Solution

Under Schedule III, trade receivables are required to be classified into long-term (non-current) trade receivables and short-term (current) trade receivables. Trade Receivables, shall be sub-classified as:

i.

- **a.** Secured, considered good;
- **b.** Unsecured considered good;
- **c.** Doubtful

ii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

iii. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

For trade receivables outstanding, following ageing schedule shall be given:

Particulars	**Outstanding for following periods from due date of payment#**					**Total**
	Less than 6 months	**6 months - 1 year**	**1-2 years**	**2-3 years**	**More than 3 years**	
i. Undisputed Trade Receivables – considered good						
ii. Undisputed Trade Receivables – considered doubtful						
iii. Disputed Trade Receivables – considered good						
iv. Disputed Trade Receivables – considered doubtful						

*similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Note: Students may note that the questions based on preparation of Statement of Profit and Loss and Balance Sheet and explanatory notes as per Schedule III have been given in this Unit. However, questions requiring preparation of cash flow statements have been separately given in the next unit of this chapter.

1.6 DISTRIBUTABLE PROFIT

One of the important functions of company accounting is to determine the amount of profits which is available for distribution to the shareholders as dividend. This is necessary since the amount of profits disclosed by the Profit & Loss Account, in every case, is not available for distribution. The availability of profits for distribution depends on a number of factors, e.g., their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.

Meaning of Dividend

a. A dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights attaching thereto.

b. Such a distribution may or may not entail a release of assets; it would be where a distribution involves payment of cash.

c. But when profits are capitalised and the amount distributed is applied towards payment of bonus shares, issued free to the shareholders, no part of the assets of the company can be said to have been released since, in such a case, profits are only capitalised, thereby increasing the paid up capital of the company. The company does not give up any asset.

As per Section 2 (35) of the Companies Act, 2013, term "Dividend" includes interim dividend also.

Under Section 123 (1) of the Companies Act, 2013, no dividend should be declared or paid by a company for any financial year except-

a. Out of the profits of the company for that financial year arrived at after providing for depreciation in accordance with the provisions of section 123(2), or

b. Out of the profits for any previous financial years arrived at after providing for depreciation in accordance with the provisions of that sub section and remaining undistributed; or

c. Out of both the above;

d. Out of the moneys provided by the Central Government or any State Government for the payment of dividend by the Company in pursuance of any guarantee given by that government

Provided that no dividend should be declared or paid by a company from its reserves other than free reserves.

Sub-section (3) of Section 124 further states that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared:

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

Dividends cannot be declared except out of profits.

Capital cannot be returned to the shareholders by way of dividend.

Dividend can be declared and paid by a company only out of the profits or free reserves (other than moneys provided by Central or State Govt.) as the payment of dividend from any other source will amount to payment of dividend from capital units.

Section 123(2) states that depreciation must be provided to the extent specified in Schedule II to the Companies Act, 2013.Further, when the assets are sold, discarded, demolished or destroyed in any financial year, the excess of the written down value over its sale proceeds as scrap, if any should be written off in the same financial year.

Declaration and Payment of Dividend

For the purpose of second proviso to sub-section (1) of section 123, a company may declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserves, in the event of inadequacy or absence of profits in any year, subject to the fulfilment of the following conditions as per Companies (Declaration and Payment of Dividend) Rules, 2014:

1. The rate of dividend declared should not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: provided that this sub-rule should not apply to a company, which has not declared any dividend in each of the three preceding financial years.
2. The total amount to be drawn from such accumulated profits should not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
3. The amount so drawn should first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
4. The balance of reserves after such withdrawal should not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.
5. No company should declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

Transfer to Reserves

i. The Board of Directors are free and can appropriate a part of the profits to the credit of a reserve or reserves as per section 123 (1) of the Companies Act, 2013.

ii. Appropriation of a part of profit is sometimes made under law.

a. For example, under the Banking Regulation Act, a fixed percentage of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed.
b. Transfer of a part of profit to a reserve is also necessary where the company has undertaken, at the time of raising of loan, that before any part of its profit is distributed, a specified percentage of the profit every year should be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount should remain invested in a specified manner.

iii. Apart from appropriations aforementioned, it may also be necessary to provide for losses and arrears of depreciation and to exclude capital profit, as mentioned earlier, to arrive at the amount of divisible profit.

Declaration of Dividend

As per Section 123 of the Companies Act, 2013, Board of Directors of a company may declare dividend including interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared:

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

The amount of the dividend, including interim dividend, should be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

No dividend should be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and should not be payable except in cash:

Provided that nothing in Section 123 should be deemed to prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company:

Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

Dividend on preference shares

a. Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.
b. But such a right can be exercised subject to there being profits and the Directors recommending payment of the dividend.

Dividend on partly paid shares:

- A company may if so authorised by its Article, pay a dividend in proportion to the amount paid on each share (Section 51 of the Companies Act, 2013).

Calls in Advance

Calls paid in advance do not rank for payment of dividend.

Payment of Dividend

As per Section 124 of the Companies Act, 2013:

1. Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company should, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.
2. The company should, within a period of ninety days of making any transfer of an amount under this section to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.
3. If any default is made in transferring the total amount or any part thereof to the Unpaid Dividend Account of the company, it should pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12% per annum and the interest accruing on such amount should ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.
4. Any person claiming to be entitled to any money transferred to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.
5. Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer should be transferred by the company along with interest accrued, if any, thereon to the Fund “Investor Education and Protection Fund” established section 125 and the company should send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority should issue a receipt to the company as evidence of such transfer.

6. All shares in respect of which unpaid or unclaimed dividend has been transferred to **"Investor Education and Protection Fund"** should also be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed: Provided that any claimant of shares transferred above should be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.
7. If a company fails to comply with any of the requirements of this section, the company will be punishable with fine which will not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default will be punishable with fine which will not be less than one lakh rupees but which may extend to five lakh rupees.

(Refer Illustration 1 - 6)

SUMMARY

- Definitions of various types of companies as per the Companies Act, 2013.
- Books of accounts should be maintained at Registered office of company.
- Proper books are not deemed to be kept if they do not provide a true and fair view of state of affairs of company.
- A number of Statutory Books have been prescribed under Companies Act which is to be maintained along with statistical books to keep a record of all transactions.
- Annual Return is to be filed by every company within 60 days of holding Annual general meeting.
- Financial statements of a company should be as per Schedule III to the Companies Act, 2013 and they should give true and fair view.
- Determining amount of profits available for distribution is an important function and depends on a number of factors, like their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.
- Capital cannot be returned to shareholders by way of dividend.
- Appropriating a part of profits may be done as a result of decision of Board of directors or as per law.
- Dividend may be declared out of reserves subject to certain conditions. Dividends cannot be declared except out of profits.

ILLUSTRATIONS

Illustration 1

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilised from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	Rs.
17,500 9% Preference shares of Rs.100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs.10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	25,00,000
Capital Reserves as on 1.4.20X1	3,00,000
Revaluation Reserves as on 1.4.20X1	3,50,000
Net profit for the year ended 31st March, 20X2	3,00,000
Average rate of dividend during the last three years has been 12%.	

Solution

Amount that can be drawn from reserves for 10% dividend		
10% dividend on Rs.80,00,000		Rs. 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilised from reserves		6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves i.e. Rs.12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III

The balance of reserves after drawl Rs.18,42,500 (Rs.25,00,000 - Rs.6,57,500) should not fall below 15 % of its paid up capital i.e. Rs.14,62,500 (15% of Rs.97,50,000]

Since all the three conditions are satisfied, the company can withdraw Rs.6,57,500 from accumulated reserves (as per Declaration and Payment of Dividend Rules, 2014.)

Illustration 2

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures in Rs. '000)

	Debit		Credit
Land at cost	220	Equity Capital (Shares of Rs.10 each)	300
Plant & Machinery at cost	770		
Trade Receivables	96	10% Debentures	200
Inventories (31.3.X2)	86	General Reserve	130
Bank	20	Profit & Loss A/c	72
Adjusted Purchases	320	Securities Premium	40
Factory Expenses	60	Sales	700
Administration Expenses	30	Trade Payables	52
Selling Expenses	30	Provision for Depreciation	172
Debenture	20	Suspense Account	4
Interest Interim Dividend Paid	18		
	1670		1670

Additional Information:

i. The authorised share capital of the company is 40,000 shares of Rs.10 each.

ii. The company on the advice of independent valuer wish to revalue the land at Rs.3,60,000.

iii. Declared final dividend @ 10% on 2nd April, 20X2.

iv. Suspense account of Rs.4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was Rs.10,000 and the accumulated depreciation thereon being Rs.8,000.

v. Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

Solution

Omega Limited Balance Sheet as at 31st March

Particulars	Note No.	(Rs. in 000)
Equity and Liabilities		
1. Shareholders' funds		
A. Share capital	1	300

B. Reserves and Surplus	2	530
2. Non-Current liabilities		
A. A Long term borrowings	3	200
3. Current liabilities		
A. Trade Payables		52
Total		**1082**
Assets		
1. Non-current assets		
A. PPE (Property, Plant & Equipment)	4	880
2. Current assets		
A. Inventories		86
B. Trade receivables		96
C. Cash and bank balances		20
Total		**1082**

Omega Limited Statement of Profit and Loss for the year ended 31st March, 20X2

Particulars	Note No.	(Rs. in 000)
i. Revenue from operations		700
ii. Other Income	5	2
iii. Total Income		**702**
iv. Expenses:		
Purchases		320
Finance costs	6	20
Depreciation (10% of 760∗)		76
Other expenses	7	120
Total Expenses		**536**
v. Profit (Loss) for the period (III – IV)		**166**

Notes to accounts

			(Rs. in 000)
1.	**Share Capital**		
	Equity share capital		
	Authorised		
	40,000 shares of Rs. 10 each		400
	Issued & subscribed & called up		

	30,000 shares of Rs. 10 each			300
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	General reserve			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	220
				530
3.	**Long term borrowing**			
	10% Debentures			200
4.	**PPE**			
	Land			
	Opening balance		220	
	Add: Revaluation adjustment		140	
	Closing balance			360
	Plant and Machinery			
	Opening balance		770	
	Less: Disposed off		(10)	
			760	
	Less: Depreciation (172 – 8 + 76)		(240)	
	Closing balance			520
	Total			880
5.	**Other Income**			
	Profit on sale of machinery:			
	Sale value of machinery		4	
	Less: Book value of machinery (10-8)		(2)	2
6.	**Finance costs**			
	Debenture interest			20
7.	**Other expenses:**			
	Factory expenses		60	

	Selling expenses	30	
	Administrative expenses	30	120

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Illustration 3

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemicals Ltd. Trial Balance as at 31st March, 20X1

Particulars	Rs.	Particulars	Rs.
Inventory	6,80,000	Equity Shares	
Furniture	2,00,000	Capital (Shares of Rs.10	
Discount	40,000	each)	25,00,000
Loan to Directors	80,000	11% Debentures	5,00,000
Advertisement	20,000	Bank loans	6,45,000
Bad debts	35,000	Trade payables	2,81,000
Commission	1,20,000	Sales	42,68,000
Materials consumed	23,19,000	Rent received	46,000
Plant and Machinery	8,60,000	Transfer fees	10,000
Rentals	25,000	Profit & Loss account	1,39,000
Current account	45,000	Depreciation provision:	
Cash	8,000	Machinery	1,46,000
Interest on bank loans	1,16,000		
Preliminary expenses	10,000		
Fixtures	3,00,000		
Wages	9,00,000		
Consumables	84,000		
Freehold land	15,46,000		
Tools & Equipment	2,45,000		
Goodwill	2,65,000		
Trade receivables	4,40,000		

Dealer aids	21,000		
Transit insurance	30,000		
Trade expenses	37,000		
Distribution freight	54,000		
Debenture interest	55,000		
	85,35,000		**85,35,000**

Additional information: Closing Inventory on 31-3-20X1: Rs.8,23,000.

Solution

Haria Chemicals Ltd.

Balance Sheet as at 31st March, 20X1

	Schedule No. (1)	**Rupees as at the end of 31st March 20X1 (2)**
Equity and Liabilities		
1. Shareholders' funds :		
a. Share Capital	1	25,00,000
b. Reserves and Surplus	2	7,40,000
2. Non-Current Liabilities		
a. Long term borrowings	3	11,45,000
3. Current Liabilities		
a. Trade payables		2,81,000
Total		**46,66,000**
Assets		
1. Non-current assets		
a. PPE	4	30,05,000
b. Intangible assets (goodwill)		2,65,000
2. Current assets		
a. Inventories		8,23,000
b. Trade receivables		4,40,000
c. Cash and bank balances	5	53,000
d. Short term loans and advances	6	80,000
Total		**46,66,000**

Haria Chemicals Ltd.

Statement of Profit and Loss for the year ended 31st March, 20X1

	Schedule	Figures	
Revenue from operations		42,68,000	
Other income	7	56,000	
(A)		43,24,000	
Expenses			
Cost of materials consumed		23,19,000	
Change in inventory of finished goods	8	(1,43,000)	
Employee benefit expenses	9	9,00,000	
Finance cost	10	1,71,000	
Other expenses	11	4,76,000	
(B)		37,23,000	
Profit before tax (A – B)			6,01,000
Provision for tax			—
Profit for the period			6,01,000

Notes to Accounts

	Rs.
1. Share capital	
Authorised:	
Equity share capital of Rs. 10 each	25,00,000
Issued and Subscribed:	
Equity share capital of Rs. 10 each	25,00,000
2. Reserves and Surplus	
Balance as per last balance sheet	1,39,000
Balance in profit and loss account	6,01,000
	7,40,000
3. Long term Borrowings	
11% Debentures	5,00,000
Bank loans (assumed long-term)	6,45,000
	11,45,000

4. **PPE**			
	Gross block	**Depreciation**	**Net Block**
Freehold land Furniture	15,46,000		15,46,000
Fixtures	2,00,000		2,00,000
Plant & Machinery	3,00,000	1,46,000	3,00,000
Tools & Equipment	8,60,000		7,14,000
Total	2,45,000	________	2,45,000
	31,51,000	1,46,000	30,05,000

5. Cash and bank balances		
Cash and cash equivalents		
Current account balance		45,000
Cash		8,000
Other bank balances		Nil
		53,000
6. Short-term loans and Advances		
Loan to directors		80,000
7. Other Income		
Rent received		46,000
Transfer fees		10,000
		56,000
8. Changes in inventory of finished goods, WIP & Stock in trade		
Opening inventory	6,80,000	
Closing inventory	(8,23,000)	(1,43,000)
9. Employee benefit expense		
Wages		9,00,000
10. Finance cost		
Interest on bank loans		1,16,000
Debenture interest		55,000
		1,71,000
11. Other Expenses		
Consumables		84,000
Preliminary expenses		10,000
Bad debts		35,000

Discount	40,000
Rentals	25,000
Commission	1,20,000
Advertisement	20,000
Dealers' aids	21,000
Transit insurance	30,000
Trade expenses	37,000
Distribution freight	54,000
	4,76,000

Illustration 4

You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 20X2:

	Dr. Rs.	Cr. Rs.
Authorised Capital-divided into 5,000 6% Preference Shares of Rs.100 each and 10,000 equity Shares of Rs.100 each		15,00,000
Subscribed Capital –		
5,000 6% Preference Shares of Rs.100 each		5,00,000
Equity Capital		8,05,000
Purchases - Wines, Cigarettes, Cigars, etc.	45,800	
- Foodstuffs	36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	
Sales - Wines, Cigarettes, Cigars, etc.		68,400
- Food		57,600
Coal and Firewood	3,290	
Carriage and Cooliage	810	
Sundry Expenses	5,840	
Advertising	8,360	
Repairs	4,250	
Rent of Rooms		48,000

Billiard			5,700
Miscellaneous Receipts			2,800
Discount received			3,300
Transfer fees			700
Freehold Land and Building		8,50,000	
Furniture and Fittings		86,300	
Inventory on hand, 1st April, 20X1			
Wines, Cigarettes. Cigars, etc.		12,800	
Foodstuffs		5,260	
Cash in hand		2,200	
Cash with Bankers		76,380	
Preliminary and formation expenses		8,000	
2,000 Debentures of Rs.100 each (6%)			2,00,000
Profit and Loss Account			41,500
Trade payables			42,000
Trade receivables		19,260	
Investments		2,72,300	
Goodwill at cost		5,00,000	
General Reserve		-	2,00,000
		19,75,000	19,75,000
Wages and Salaries Outstanding	1,280		
Inventory on 31st March, 20X2			
Wines, Cigarettes and Cigars, etc.	22,500		
Foodstuffs	16,400		

Depreciation: Furniture and Fittings @ 5% p.a.: Land and Building @ 2% p.a.

The Equity capital on 1st April, 20X1 stood at Rs. 7,20,000, that is 6,000 shares fully paid and 2,000 shares Rs. 60 paid. The directors made a call of Rs. 40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ Rs. 90 per share as fully paid. The Directors declared a dividend of 8% on equity shares on 2nd April, 20X2, transferring any amount that may be required from General Reserve. Ignore Taxation.

Solution

Balance Sheet of International Hotels Ltd. as at 31st March, 20X2

Particulars	Note No	Rs.
Equity and Liabilities		
1. Shareholders' funds		
a. Share capital	1	13,00,000
b. Reserves and Surplus	2	2,68,745
2. Non-current liabilities		
a. Long-term borrowings	3	2,00,000
3. Current liabilities		
a. Trade Payables	4	42,000
b. Other current liabilities	5	13,280
Total		**18,24,025**
ASSETS		
1. Non-current assets		
i. PPE	6	9,14,985
ii. Intangible assets (Goodwill)		5,00,000
iii. Non-current investments		2,72,300
2. Current assets		
i. Inventories	7	38,900
ii. Trade receivables		19,260
iii. Cash and bank balances	8	78,580
Total		**18,24,025**

Statement of Profit and Loss of International Hotels Ltd. for the year ended 31st March, 20X2

	Particulars	Notes	Amount
i.	Revenue from operations	9	1,79,700
ii.	Other income	10	6,800
iii.	**Total Income (I + II)**		**1,86,500**
iv.	**Expenses:**		
	Cost of materials consumed	11	25,060
	Purchases of Inventory-in-Trade	12	45,800
	Changes in inventories of finished goods work in-progress and Inventory-in-Trade	13	(9,700)

	Employee benefits expense	14	29,580
	Other operating expenses	15	18,000
	Selling and administrative expenses	16	14,200
	Finance costs	17	12,000
	Depreciation and amortisation expense	18	21,315
	Other expenses (Preliminary expenses written off)		8,000
	Total expenses		**1,64,225**
v.	**Profit (Loss) for the period (III - IV)**		**22,245**

Notes to accounts

		Rs.
1. Share Capital		
Equity share capital		
Authorised 10,000		
Equity shares of Rs.100 each		10,00,000
Issued & subscribed		
8,000 Equity Shares of Rs.100 each	(A)	8,00,000
Preference share capital		
Authorised		
5,000 6% Preference shares of Rs.100 each		5,00,000
Issued & subscribed		
5,000 6% Preference shares of Rs.100 each	(B)	5,00,000
Total (A + B)		**13,00,000**
2. Reserves and Surplus		
Capital reserve [100 x (90 – 40)]		5,000
General reserve		2,00,000
Surplus (Profit & Loss A/c)	22,245	
Add: Balance from previous year	41,500	63,745
Total		**2,68,745**
3. Long-term borrowings		
Secured		
6% Debentures		2,00,000
Total		**2,00,000**
4. Trade Payables		42,000

5.	**Other current liabilities**		
	Wages and Salaries Outstanding	1,280	
	Interest on debentures	12,000	13,280
	Total		**13,280**
6.	**PPE**		
	Freehold land & Buildings	8,50,000	
	Less: Depreciation	(17,000)	8,33,000
	Furniture and Fittings	86,300	
	Less: Depreciation	(4,315)	81,985
	Total		**9,14,985**
7.	**Inventories**		
	Wines, Cigarettes & Cigars, etc.		22,500
	Foodstuffs		16,400
	Total		**38,900**
8.	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		76,380
	Cash in hand		2,200
	Other bank balances		Nil
	Total		**78,580**
9.	**Revenue from operations**		
	Sale of products		
	Wines, Cigarettes, Cigars etc.	68,400	
	Food	57,600	1,26,000
	Sale of services		
	Room Rent	48,000	
	Billiards	5,700	53,700
	Total		1,79,700
10.	**Other Income**		
	Transfer fees	700	
	Miscellaneous Receipts	2,800	
	Discount received	3,300	
	Total		**6,800**

11. Cost of materials consumed		
Opening Inventory	5,260	
Add: Purchases during the year	36,200	
Less: Closing Inventory	(16,400)	25,060
Total		**25,060**
12. Purchases of Inventory-in-Trade		
Wines, Cigarettes etc.		45,800
Total		45,800
13. Changes in inventories of finished goods work-in-progress and Inventory-in-Trade		
Wines, Cigarettes etc.		
Opening Inventory	12,800	
Less: Closing Inventory	(22,500)	(9,700)
Total		**(9,700)**
14. Employee benefits expense		
Wages and Salaries	28,300	
Add: Wages and Salaries Outstanding	1,280	29,580
Total		**29,580**
15. Other operating expenses		
Rent, Rates and Taxes		8,900
Coal and Firewood		3,290
Laundry		750
Carriage and Cooliage		810
Repairs		4,250
Total		**18,000**
16. Selling and administrative expenses		
Advertising		8,360
Sundry Expenses		5,840
Total		**14,200**
17. Finance costs		
Interest on Debentures (2,00,000 x 6%)		12,000
Total		**12,200**

18. Depreciation and amortisation expense		
Land and Buildings (8,50,000 x 2%)	17,000	
Furniture & Fittings (86,300 x 5%)	4,315	21,315
Total		**21,315**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Illustration 5

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary –

		Debit Rs.	Credit Rs.
Equity Capital (Face value of Rs.100)			**10,00,000**
Calls in Arrears		**1,000**	
Land		**2,00,000**	
Building		**3,50,000**	
Plant and Machinery		**5,25,000**	
Furniture		**50,000**	
General Reserve			**2,10,000**
Loan from State Financial Corporation			**1,50,000**
Inventory :			
Finished Goods	**2,00,000**		
Raw Materials	**50,000**	**2,50,000**	
Provision for Taxation			**68,000**
Trade receivables		**2,00,000**	
Advances		**42,700**	
Dividend Payable			**60,000**
Profit and Loss Account			**86,700**
Cash Balance		**30,000**	

Cash at Bank	**2,47,000**	
Loans (Unsecured)		**1,21,000**
Trade payables (For Goods and Expenses)		**2,00,000**
	18,95,700	**18,95,700**

The following additional information is also provided:

1. **2,000 equity shares were issued for consideration other than cash.**
2. **Trade receivables of Rs.52,000 are due for more than six months.**
3. **The cost of assets:**

Building	**Rs.4,00,000**
Plant and Machinery	**Rs.7,00,000**
Furniture	**Rs.62,500**

4. **The balance of Rs.1,50,000 in the loan account with State Finance Corporation is inclusive of Rs.7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.**
5. **Balance at Bank includes Rs.2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.**
6. **The company had contract for the erection of machinery at Rs.1,50,000 which is still incomplete.**

Solution

Pioneer Ltd. Balance Sheet as at 31st March, 20X1

Particulars	**Notes**	**Rs.**
Equity and Liabilities		
1. Shareholders' funds		
a. Share capital	1	9,99,000
b. Reserves and Surplus	2	2,96,700
2. Non-current liabilities		
a. Long-term borrowings	3	2,63,500
3. Current liabilities		
a. Trade Payables		2,00,000
b. Other current liabilities	4	67,500
c. Short-term provisions	5	68,000
Total		**18,94,700**

Assets		
1. Non-current assets		
a. PPE	6	11,25,000
2. Current assets		
a. Inventories	7	2,50,000
b. Trade receivables	8	2,00,000
c. Cash and bank balances	9	2,77,000
d. Short-term loans and advances		42,700
Total		**18,94,700**

Notes to accounts

Particulars		**Rs.**
1. Share Capital		
Equity share capital		
Issued & subscribed & called up		
10,000 Equity Shares of Rs.100 each (Of the above 2,000 shares have been issued for consideration other than cash)	10,00,000	
Less: Calls in arrears	(1,000)	9,99,000
Total		**9,99,000**
2. Reserves and Surplus		
General Reserve		2,10,000
Surplus (Profit & Loss A/c)		86,700
Total		**2,96,700**
3. Long-term borrowings		
Secured- Term Loans		
Loan from State Financial Corporation (1,50,000 – 7,500)		1,42,500
(Secured by hypothecation of Plant and Machinery)		
Unsecured loan		1,21,000
Total		**2,63,500**
4. Other current liabilities		
Interest accrued but not due on loans (SFC)		7,500
Dividend Payable		60,000
Total		**67,500**

5. Short-term provisions		
Provision for taxation		68,000
Total		**68,000**
6. PPE		
Land		2,00,000
Buildings	4,00,000	
Less: Depreciation	(50,000) (b.f.)	3,50,000
Plant & Machinery	7,00,000	
Less: Depreciation	(1,75,000) (b.f.)	5,25,000
Furniture & Fittings	62,500	
Less: Depreciation	(12,500) (b.f.)	50,000
Total		**11,25,000**
7. Inventories		
Raw Material		50,000
Finished goods		2,00,000
Total		**2,50,000**
8. Trade receivables		
Debts outstanding for a period exceeding six months		52,000
Other Debts		1,48,000
Total		**2,00,000**
9. Cash and bank balances		
Cash and cash equivalents		
Cash at bank		
with Scheduled Banks	2,45,000	
with others (Perfect Bank Ltd.)	2,000	2,47,000
Cash in hand		30,000
Other bank balances		Nil
Total		**2,77,000**

Note: Estimated amount of contract remaining to be executed on capital account and not provided for Rs.1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Illustration 6

Following is the trial balance of Delta limited as on 31.3.20X2.

(Figures in Rs. '000)

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital (shares of Rs.10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.X1)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-X2)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information:

i. **The authorized share capital of the company is 80,000 shares of Rs.10 each.**

ii. **The company revalued the land at Rs.9,60,000.**

iii. **Equity share capital includes shares of Rs.50,000 issued for consideration other than cash.**

iv. **Suspense account of Rs.10,000 represents cash received from the sale of some of the machinery on 1.4.20X1. The cost of the machinery was Rs.24,000 and the accumulated depreciation thereon being Rs.20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.**

v. **Depreciation is to be provided on plant and machinery at 10% on cost.**

vi. **Balance at bank includes Rs.5,000 with ABC Bank Ltd., which is not a Scheduled Bank.**

vii. **Make provision for income tax @30%.**

viii. **Trade receivables of Rs.50,000 are due for more than six months.**

You are required to prepare Delta Limited's Balance Sheet as at 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule Ill. Ignore previous year's figures & taxation.

Solution

Delta Limited Balance Sheet as at 31st March 20X2

Particulars	Notes	Rs.
Equity and Liabilities		
1. Shareholders' funds		
a. Share capital	1	495.00
b. Reserves and Surplus	2	807.20
2. Non-current liabilities		
a. Long-term borrowings	3	300.00
3. Current liabilities		
a. Trade Payables		30.00
b. Short-term provisions	4	163.80
Total		1,796.00
Assets		
1. Non-current assets		
a. PPE		
2. Current assets	5	1,550.00
a. Inventories		
b. Trade receivables		96.00
c. Cash and bank balances	6	120.00
d. Short-term loans and advances	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 20X2

Particulars	Notes	Rs.
i. Revenue from Operations		1200.00
ii. Other Income	8	6.00
iii. Total Income (I +II)		1,206.00
iv. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)		80.00
Other expenses	10	150.00
Total Expenses		660.00

v. Profit / (Loss) for the period before tax (III – IV)		546.00
vi. Tax expenses @30%		163.80
vii. Profit for the period		382.20

Notes to Accounts

	Particulars		(Rs.in '000)
1	Share Capital		
	Equity Share Capital		
	Authorised		
	80,000 Shares of Rs.10/- each		800
	Issued, Subscribed and Called-up		
	50,000 Shares of Rs.10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve Rs.(960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance	75.00	
	Opening Balance	382.20	457.20
	Add: Profit for the period		807.20
3	Long-Term Borrowings		
	10% Debentures		300
4	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	

		800	
	Less: Depreciation Rs.(150 – 20 + 80)	(210)	
	Closing Balance		590
	Total		1,550
6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery	10	
	Sale value of machinery	(4)	6
	Less: Book value of machinery (24 – 20)		
9	Finance Costs		
	Debenture Interest		30
10	Other Expenses:		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	45	150

TEST YOUR KNOWLEDGE

MCQs

1. **Trade payables as per Schedule III will include:**
   a. **Dues payable in respect to statutory obligation**
   b. **Interest accrued on trade payables**
   c. **Bills payables.**
   d. **Bills receivables**

2. **Securities Premium Account is shown on the liabilities side in the Balance Sheet under the heading:**
   a. **Reserves and Surplus.**
   b. **Current Liabilities.**
   c. **Share Capital.**
   d. **Share application money pending allotment**

3. **"Fixed assets held for sale" will be classified in the company's balance sheet as**
   a. **Current asset**
   b. **Non-current asset**
   c. **Capital work- in- progress**
   d. **Deferred tax assets**

4. **Current maturities of long- term debt will come under**
   a. **Current Liabilities.**
   b. **Short term borrowings.**
   c. **Long term borrowings.**
   d. **Short term provisions**

5. **Declaration of dividends for current year is made after providing for**
   a. **Depreciation of past years only.**
   b. **Depreciation on assets for the current year and arrears of depreciation of past years (if any).**
   c. **Depreciation on current year only and by forgoing arrears of depreciation of past years.**
   d. **Excluding current year depreciation**

ANSWERS/HINTS

MCQs

1.	**c.**	Bills payables.
2.	**a.**	Reserves and Surplus.
3.	**a.**	Current asset
4.	**b.**	Short term borrowings.
5.	**b.**	Depreciation on assets for the current year and arrears of depreciation of past years (if any).

<u>THEORETICAL QUESTIONS</u>

Q.NO.1. State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

i. Share application money received in excess of issued share capital.

ii. Share option outstanding account.

iii. Unpaid matured debenture and interest accrued thereon.

iv. Uncalled liability on shares and other partly paid investments.

v. Calls unpaid.

vi. Money received against share warrant.

<u>SOLUTION</u>

i. Current Liabilities/ Other Current Liabilities

ii. Shareholders' Fund / Reserve & Surplus

iii. Current liabilities/Other Current Liabilities

iv. Contingent Liabilities and Commitments

v. Shareholders' Fund / Share Capital

vi. Shareholders' Fund / Money received against share warrants

Q.NO.2. On 31st March, 20X1 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 20X1:

Credit Balances:

	Rs.
Equity shares capital, fully paid shares of Rs.10 each	**70,00,000**
General Reserve	**15,49,100**
Loan from State Finance Corporation	**10,50,000**

(Secured by hypothecation of Plant & Machinery Repayable within one year Rs.2,00,000)	
Loans: Unsecured (Long term)	**8,47,000**
Sundry Creditors for goods &expenses	**14,00,000**
(Payable within 6 months)	
Profit & Loss Account	**7,00,000**
Provision for Taxation	**8,16,900**
	1,33,63,000

Debit Balances:

	Rs.
Calls in arrear	**7,000**
Land	**14,00,000**
Buildings	**20,50,000**
Plant and Machinery	**36,75,000**
Furniture& Fixture	**3,50,000**
Inventories: Finished goods	**14,00,000**
Raw Materials	**3,50,000**
Trade Receivables	**14,00,000**
Advances: Short-term	**2,98,900**
Cash in hand	**2,10,000**
Balances with banks	**17,29,000**
Preliminary Expenses	**93,100**
Patents & Trademarks	**4,00,000**
	1,33,63,000

The following additional information is also provided in respect of the above balances:

i. **4,20,000 fully paid equity shares were allotted as consideration for land & buildings.**
ii. **Cost of Building Rs.28,00,000**
iii. **Cost of Plant & Machinery Rs.49,00,000; Cost of Furniture & Fixture Rs.4,37,500**
iv. **Trade receivables for Rs.3,80,000 are due for more than 6 months.**
v. **The amount of Balances with Bank includes Rs.18,000 with a bank which is not a scheduled Bank and the deposits of Rs.5 lakhs are for a period of 9 months.**
vi. **Unsecured loan includes Rs.2,00,000 from a Bank and Rs.1,00,000 from related parties.**

vii. Entire amount of Preliminary expenses to be written off, by adjusting from opening balance of General Reserve.

You are not required to give previous year's figures. You are required to prepare the Balance Sheet of the Company as on 31stMarch, 20X1 as required under Schedule III to the Companies Act, 2013.

SOLUTION

Bose and Sen Ltd.

Balance Sheet as at 31st March, 20X1

		Particulars	Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities				
1		Shareholders' funds		
	a	Share capital	**1**	69,93,000
	b	Reserves and Surplus	**2**	21,56,000
2		Non-current liabilities		
	a	Long-term borrowings	**3**	16,97,000
3		**Current liabilities**		
	a	Trade Payables		14,00,000
	b	Short term borrowings	**4**	2,00,000
	c	Short-term provisions	**5**	8,16,900
		Total		**1,32,62,900**
Assets				
1		**Non-current assets**		
	a	PPE	**6**	74,75,000
	b	Intangible assets (Patents & Trade Marks)		4,00,000
2		**Current assets**		
	a	Inventories	**7**	17,50,000
	b	Trade receivables	**8**	14,00,000
	c	Cash and bank balances	**9**	19,39,000
	d	Short-term loans and advances		2,98,900
		Total		**1,32,62,900**

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up		
	7,00,000 Equity Shares of Rs.10 each (Out of the above 4,20,000 shares have been issued for consideration other than cash)	70,00,000	
	Less: Calls in arrears	(7,000)	69,93,000
	Total		69,93,000
2	**Reserves and Surplus**		
	General Reserve	15,49,100	
	Less: Preliminary expenses	(93,100)	14,56,000
	Surplus (Profit & Loss A/c)		7,00,000
	Total		21,56,000
3	**Long-term borrowings**		
	Secured		
	Term Loans		8,50,000
	Loan from State Finance Corporation		
	(Rs.10,50,000 - Rs.2,00,000) (Secured by		
	hypothecation of Plant and Machinery)		
	Unsecured		
	Bank Loan	2,00,000	
	Loan from related parties	1,00,000	
	Others	5,47,000	8,47,000
	Total		16,97,000
4	**Short term borrowings**		
	Current maturities of long-term debt- loan		
	Instalment repayable within one year		2,00,000
5	**Short-term provisions**		
	Provision for taxation		8,16,900
6	**Property, plant and equipment**		
	Land		14,00,000

	Buildings	28,00,000	
	Less: Depreciation	(7,50,000) (b.f.)	20,50,000
	Plant & Machinery	49,00,000	
	Less: Depreciation	(12,25,000)	
		(b.f.)	36,75,000
	Furniture & Fittings	4,37,500	
	Less: Depreciation	(87,500) (b.f.)	3,50,000
	Total		74,75,000
7	**Inventories**		
	Raw Material		3,50,000
	Finished goods		14,00,000
			17,50,000
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		3,80,000
	Other Debts		10,20,000
9	**Total**		14,00,000
	Cash and bank balances		
	Cash and cash equivalents		
	Cash at bank with Scheduled Banks	12,11,000	
	with others	18,000	12,29,000
	Cash in hand		2,10,000
	Other bank balances		
	Bank deposits for period of 9 months		5,00,000
	Total		19,39,000

Q.NO.3. **From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March 20X1 as required by Part I, Schedule III to the Companies Act, 2013.**

Particulars		Debit Rs.	Credit Rs.
Equity Share Capital (Face value of Rs.100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation Inventory:			7,50,000
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000
		94,78,500	94,78,500

The following additional information is also provided:

i. 10,000 Equity shares were issued for consideration other than cash.

ii. Trade receivables of Rs.2,60,000 are due for more than 6 months.

iii. The cost of the Assets were: Building Rs.30,00,000, Plant & Machinery Rs.35,00,000 and Furniture Rs.3,12,500

iv. The balance of Rs.7,50,000 in the Loan Account with State Finance Corporation is inclusive of Rs.37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

v. Balance at Bank includes Rs.10,000 with Omega Bank Ltd., which is not a Scheduled Bank.

vi. Transfer Rs.20,000 to general reserve is proposed by Board of directors.

vii. Board of directors declared dividend of 5% on the paid up capital on 2nd April, 20X1.

SOLUTION

Alpha Ltd.

Balance Sheet as at 31st March, 20X1

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	49,95,000
	b	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	a	Trade Payables		8,00,000
	b	Short-term provisions	5	6,40,000
	c	Short-term borrowings	4	2,00,000
	d	Other Current Liabilities: Interest accrued but not due on loans (SFC)		37,500
		Total		94,73,500
1		**Assets**		
		Non-current assets		
		PPE	6	56,25,000
2		Current assets		
	a	Inventories	7	12,50,000
	b	Trade receivables	8	10,00,000
	c	Cash and bank balances	9	13,85,000
	d	Short-term loans and advances		2,13,500
		Total		94,73,500

Notes to accounts

		Rs.
1. Share Capital		
Equity share capital		
Issued & subscribed & called up		
50,000 Equity Shares of Rs.100 each		
(of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	

	Less: Calls in arrears	(5,000)	49,95,000
	Total		**49,95,000**
2.	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	4,13,500
	Total		**14,83,500**
3.	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan		
	(7,50,000-37,500)		7,12,500
	(Secured by hypothecation of Plant and Machinery)		
	Unsecured Loan		6,05,000
	Total		**13,17,500**
4.	**Short term Borrowings**		
	Loans and advances		2,00,000
5.	**Short-term provisions**		
	Provision for taxation		6,40,000
6.	**Property, plant and equipment**		
	Land and Building	30,00,000	
	Less: Depreciation	(2,50,000)(b.f.)	27,50,000
	Plant & Machinery	35,00,000	
	Less: Depreciation	(8,75,000)(b.f.)	26,25,000
	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500) (b.f.)	2,50,000
	Total		**56,25,000**
7.	**Inventories**		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		**12,50,000**

8. **Trade receivables**		
Outstanding for a period exceeding six months		2,60,000
Other Amounts		7,40,000
Total		**10,00,000**
9. **Cash and bank balances**		
Cash and cash equivalents		
Cash at bank		
with Scheduled Banks	12,25,000	
with others (Omega Bank Ltd.)	10,000	12,35,000
Cash in hand		1,50,000
Other bank balances		Nil
Total		**13,85,000**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X1. Such dividends will be disclosed in notes only.

Q.NO.4. Ring Ltd. was registered with a nominal capital of Rs.10,00,000 divided into shares of Rs.100 each. The following Trial Balance is extracted from the books on 31st March, 20X2:

Particulars	Rs.	Particulars		Rs.
Buildings	**5,80,000**	**Sales**		**10,40,000**
Machinery	**2,00,000**	**Outstanding Expenses**		**4,000**
Closing Stock	**1,80,000**	**Provision for Doubtful**		**6,000**
Loose Tools	**46,000**	**Debts (1-4-20X1)**		
Purchases (finished goods)	**4,20,000**	**Equity Share Capital**		**4,00,000**
Salaries	**1,20,000**	**General Reserve**		**80,000**
Directors' Fees	**20,000**	**Profit and Loss A/c**		**50,000**
Rent	**52,000**	**(1-4-20X1)**		
Depreciation	**40,000**	**Creditors**		**1,84,000**
Bad Debts	**12,000**	**Provision for depreciation:**		
Investment	**2,40,000**	**On Building**	**1,00,000**	
		On Machinery	**1,10,000**	**2,10,000**

Interest accrued on investment	**4,000**	**14% Debentures**	**4,00,000**
Debenture Interest	**56,000**	**Interest on Debentures accrued but not due**	**28,000**
Advance Tax	**1,20,000**		
Sundry expenses	**36,000**	**Interest on Investments**	**24,000**
Debtors	**2,50,000**	**Unclaimed dividend**	**10,000**
Bank	**60,000**		
	24,36,000		**24,36,000**

You are required to prepare statement of Profit and Loss for the year ending 31st March, 20X2 and Balance sheet as at that date after taking into consideration the following information:

a. **Closing stock is more than opening stock by Rs.1,60,000.**

b. **Provide to doubtful debts @ 4% on Debtors.**

c. **Make a provision for income tax @30%.**

d. **Depreciation expense included depreciation of Rs.16,000 on Building and that of Rs.24,000 on Machinery.**

e. **The directors declared a dividend @ 25% on 2nd April, 20X2 and transfer to General Reserve @ 10%.**

f. **Bills Discounted but not yet matured Rs.20,000.**

SOLUTION

Ring Ltd. Profit and Loss Statement for the year ended 31st March, 20X2

	Particulars	Note No.	(Rs. In lacs)
I	**Revenue from operations**		10,40,000
II	**Other income** (interest on investment)		24,000
III	**Total income [I + II]**		**10,64,000**
IV	**Expenses:**		
	Cost of purchase [4,20,000+ 1,60,000]		5,80,000
	Changes in inventories [20,000-1,80,000] Employee		(1,60,000)
	Benefits Expense		1,20,000
	Finance Costs (debenture interest)		56,000
	Depreciation and Amortisation Expenses		40,000
	Other Expenses	8	1,24,000
	Total Expenses		**7,60,000**
V	Profit before Tax (III-IV)		3,04,000
VI	**Tax Expenses @ 30%**		(91,200)
VII	**Profit for the period**		**2,12,800**

Balance Sheet of Ring Ltd. as at 31ST March, 20X2

		Particulars	Note No.	Rs.
I		**EQUITY AND LIABILITIES**		
	(1)	**Shareholders' Funds**		
		a. Share Capital	1	4,00,000
		b. Reserves and Surplus	2	3,42,800
	(2)	**Non-Current Liabilities**		
		a. Long-term Borrowings (14% debentures)		4,00,000
	(3)	**Current Liabilities**		
		a. Trade Payable (Sundry Creditors)		1,84,000
		b. Other Current Liabilities	3	42,000
		c. Short-Term Provisions	4	91,200
		Total		**14,60,000**
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		a. PPE	5	5,70,000
		b. Non-current Investments		2,40,000
	(2)	**Current Assets**		
		a. Inventories	6	2,26,000
		b. Trade Receivables	7	2,40,000
		c. Cash and bank balances		60,000
		d. Short Term Loans and Advances (Advance Payment of Tax)		1,20,000
		e. Other Current Assets (Interest accrued on investments)		4,000
		Total		**14,60,000**

Note: There is a Contingent Liability for bills discounted but not yet matured amounting to Rs.20,000.

Notes to Accounts:

1.	**Share Capital**		
	Authorised Capital		
	10,000 Equity Shares of Rs.100 each		10,00,000

	Issued Capital		
	4,000 Equity Shares of Rs.100 each		4,00,000
	Subscribed Capital and fully paid		
	4,000 Equity Shares of Rs.100 each		4,00,000
2.	**Reserve and Surplus**		
	General Reserve [Rs.80,000 + Rs.21,280]		1,01,280
	Balance of Statement of Profit & Loss Account		
	Opening Balance	50,000	
	Add: Profit for the period	2,12,800	
		2,62,800	
	Appropriations		
	Transfer to General Reserve @ 10%	(21,280)	2,41,520
			3,42,800
3.	**Other Current Liabilities**		
	Unclaimed Dividend		10,000
	Outstanding Expenses		4,000
	Interest accrued on Debentures		28,000
			42,000
4.	**Short-Term Provision**		
	Provision for Tax		91,200
5.	**Property, plant and equipment**		
	Buildings	5,80,000	
	Less: Provision for Depreciation	1,00,000	4,80,000
	Plant and Equipment	2,00,000	
	Less: Provision for Depreciation	1,10,000	90,000
			5,70,000
6.	**Inventories**		
	Closing Stock of Finished Goods	1,80,000	
	Loose Tools	46,000	2,26,000
7.	**Trade Receivables**		
	Sundry Debtors	2,50,000	
	Less: Provision for Doubtful Debts	(10,000)	2,40,000
8.	**Other Expenses**		
	Rent		52,000

	Directors' Fees		20,000
	Bad Debts		12,000
	Provision for Doubtful Debts (4% of Rs.2,50,000 less Rs.6,000)		4,000
	Sundry Expenses		36,000
			1,24,000

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Q.NO.5. On 31st March, 20X1, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 20X1.

Particulars	Amount (Rs.)	
	Debit	**Credit**
Equity Share Capital, fully paid shares of Rs.50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	
Plant & Machinery	24,00,000	
Furniture & Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation		26,30,000
(Secured by Hypothecation of Land)		
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	
Trade Payables		8,13,000

Provision for Taxation		3,80,000
Unpaid Dividend		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	1,76,24,000	1,76,24,000

The following additional information was also provided in respect of the above balances:

1. **50,000 fully paid equity shares were allotted as consideration for land.**
2. **The cost of assets were:**

Building	Rs.32,00,000
Plant and Machinery	Rs.30,00,000
Furniture and Fixture	Rs.16,50,000

3. **Trade Receivables for Rs.4,86,000 due for more than 6 months.**
4. **Balances with banks include Rs.56,000, the Naya bank, which is not a scheduled bank.**
5. **Loan from Public Finance Corporation repayable after 3 years.**
6. **The balance of Rs.26,30,000 in the loan account with Public Finance Corporation is inclusive of Rs.1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.**
7. **Other long term loans (unsecured) includes:**

Loan taken from Nixes Bank	Rs.13,80,000
(Amount repayable within one year	Rs.4,80,000)
Loan taken from Directors	Rs.8,50,000

8. **Bills Receivable for Rs.1,60,000 maturing on 15th June, 20X1 has been discounted.**
9. **Short term borrowings includes:**

Loan from Naya bank	Rs.1,16,000 (Secured)
Loan from directors	Rs.48,000

10. **Transfer of Rs.35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.**
11. **Inventory of finished goods includes loose tools costing Rs.5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)**

You are required to prepare the Balance Sheet of the Company as on March 31st 20X1 as required under Part - I of Schedule III of the Companies Act, 2013.

You are not required to give previous year figures.

SOLUTION

SR Ltd. Balance Sheet as at 31st March, 20X1

Particulars	Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities		
1. Shareholders' funds		
a. Share capital	1	79,85,000
b. Reserves and Surplus	2	30,21,000
2. Non-current liabilities		
a. Long-term borrowings	3	42,66,000
3. Current liabilities		
a. Short-term borrowings	4	9,40,000
b. Trade Payables		8,13,000
c. Other current liabilities	5	2,04,000
d. Short-term provisions	6	3,80,000
Total		1,76,09,000
Assets		
1. Non-current assets		
a. PPE	7	92,00,000
2. Current assets		
a. Inventories	8	58,00,000
b. Trade receivables	9	17,50,000
c. Cash and cash equivalents	10	4,84,000
d. Short-term loans and advances		3,75,000
Total		1,76,09,000

Notes to accounts

1.	Share Capital Equity share capital Issued, subscribed and called up 1,60,000 Equity Shares of Rs.50 each (Out of the above 50,000 shares have been issued for consideration other than cash)	80,00,000	

	Less: Calls in arrears	(15,000)	79,85,000
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss account	35,000	9,76,000
	Securities premium		15,00,000
	Surplus (Profit & Loss A/c)	5,80,000	
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	**Long-term borrowings**		
	Secured: Term Loans		
	Loan from Public Finance Corporation [repayable after 3years (Rs.26,30,000 - Rs.1,34,000 for interest accrued but not due)]		24,96,000
	(secured by hypothecation of land)		
	Unsecured		
	Bank Loan (Nixes bank) 9,00,000		
	(Rs.13,80,000 - Rs.4,80,000 repayable within 1 year)		
	Loan from Directors 8,50,000		
	Others 20,000		17,70,000
	Total		42,66,000
4.	**Short-term borrowings**		
	Loan from Naya bank (Secured)	1,16,000	
	Loan from Nixes bank repayable within one year (Current maturity of Long term borrowing)	4,80,000	
	Loan from Directors	48,000	
	Others	2,96,000	9,40,000
5.	**Other current liabilities**		
	Unpaid dividend	70,000	
	Interest accrued but not due on borrowings	1,34,000	2,04,000
6.	**Short-term provisions**		
	Provision for taxation		3,80,000
7.	PPE		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	

	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	Inventories		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	Trade receivables		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	Cash and cash equivalents		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000

Note: There is a contingent liability amounting to Rs.1,60,000

UNIT 2: CASH FLOW STATEMENTS

LEARNING OUTCOMES

After studying this unit, you will be able to–

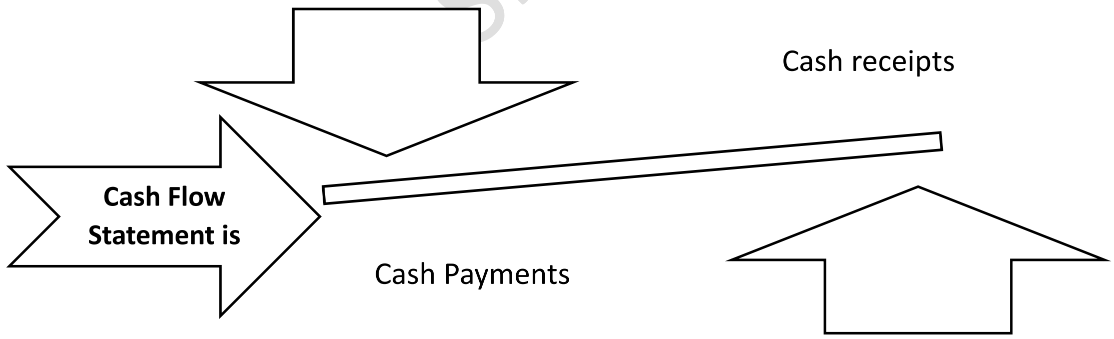
- Define cash flow statement as per AS 3 “Cash Flow Statements”.
- Differentiate operating, investing and financing activities.
- Learn the various elements of cash and cash equivalents.
- Prepare cash flow statement both by direct method and indirect method.

2.1 INTRODUCTION

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

The Standard deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

This statement provides relevant information in assessing a company’s liquidity, quality of earnings and solvency.



Benefits:

a. Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise.

b. Identifies cash generated from trading operations.

c. The operating cash surplus which can be applied for investment in fixed assets.

d. Portion of cash from operations is used to pay dividend and tax and the other portion is ploughed back.

e. Very useful tool of planning.

Purpose:

Cash flow statements are prepared to explain the cash movements between two points of time.

Sources of Cash:

1. Issue of shares and debentures and raising long-term loan.
2. Sale of investments and other fixed assets.
3. Cash from operations (Net Operating Profit).

Applications of Cash

1. Redemption of preference shares and debentures and repayment of long term loan.
2. Purchase of investments and other fixed assets.
3. Payment of tax.
4. Payment of dividend.
5. Loss on Operation (Net Operating Loss)

Note: Cash includes Bank Account also. Increase in cash or decrease in cash is put in the applications and the sources respectively just to balance the cash flow statement. At this juncture, you may note that changes in all balance sheet items are to be taken into consideration separately in cash flow statement for explaining movement of cash.

2.2 ELEMENTS OF CASH

As per AS 3, issued by the Council of the ICAI,

'Cash' include:

a. Cash in hand,
b. Demand deposits with banks, and

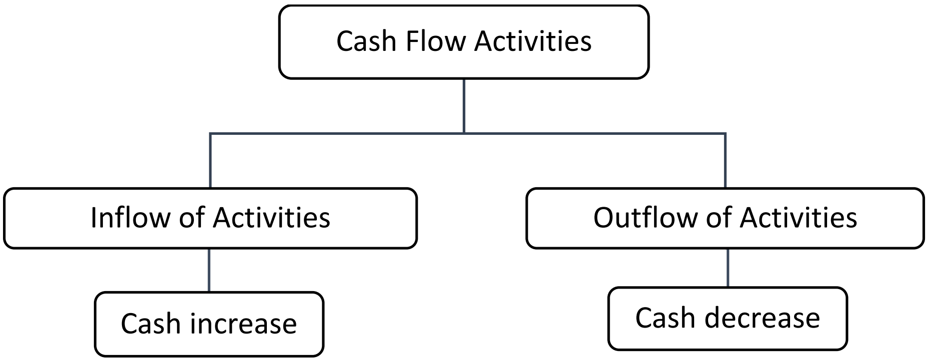
Cash equivalents include:

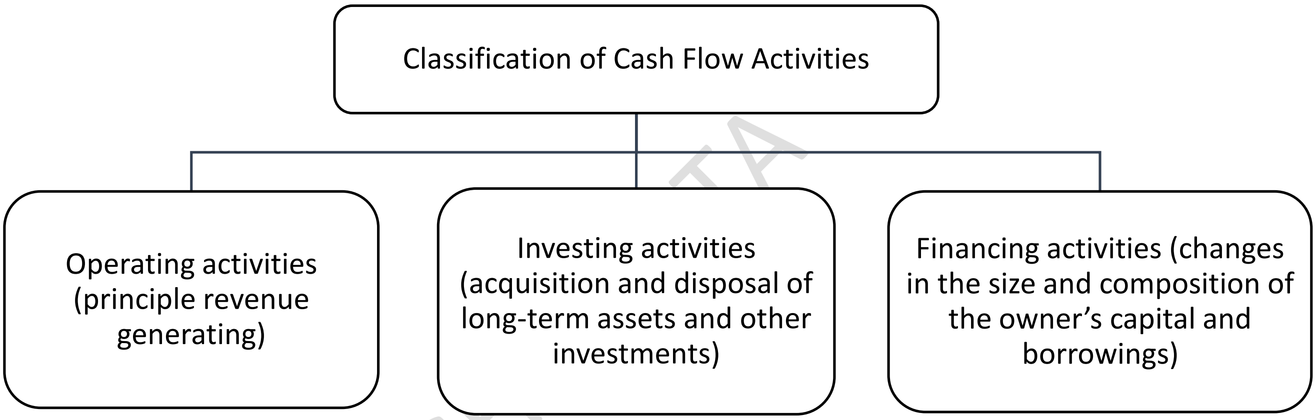
a. Components
   - Short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value
   - Securities with short maturity period of, say, three months or less from the date of acquisition
b. Objective
   - Deploy, for a short period, idle cash required to meet short-term cash commitments.
c. Examples
   - Acquisition of preference shares, shortly before their specified redemption date, bank deposits with short maturity period, etc.

Conclusion: Thus, cash flow statement deals with flow of cash funds but does not consider the movements among cash, bank balance payable on demand and investment of excess cash in cash equivalents. Examples are cash withdrawn from current account, cash deposited in bank for 60 days, etc.

2.3 CLASSIFICATION OF CASH FLOW ACTIVITIES

AS 3 provides explanation for changes in cash position of the business entity. As per Accounting Standard 3, cash flows during the period are classified as Operating; Investing and Financing activities.





2.3.1 Operating Activities

1. Definition: These are the <u>principal revenue generating activities</u> of the enterprise.
2. Net Impact: Net impact of operating activities on flow of cash is reported as 'Cash flows from operating activities' or 'cash from operations.
3. Key Indicator: The amount of <u>cash flows from operating activities</u> is a key indicator of the extent to which the operations of the enterprises have generated sufficient cash flows to:
   a. Maintain the operating capability of the enterprise;
   b. Pay dividends, repay loans; and
   c. Make new investments without recourse to external sources of financing.
4. Information Provided: It provides <u>useful information about financing</u> through working capital.
5. Benefits: Information about the specific components of <u>historical operating cash flows</u> is useful, in conjunction with other information, in forecasting future operating cash flows.

Cash flows arising from operating activities

Key indicator of the extent to which the operations of the entity have generated sufficient cash flows to

- repay loans
- maintain the operating capability of the entity
- pay dividends
- make new investments with out recourse to external sources of financing

Primarily derived from the principal revenue-producing activities of the entity

Generally ,result from the transactions and other events that have role in the determination of net profit or loss

Example

a. Cash receipts from the sale of goods and the rendering of services

b. Cash receipts from royalties, fees, commissions, and other revenue

c. Cash payments to suppliers for goods and services

d. Cash payments to and on behalf of employees

e. Cash receipts and cash payments of an insurance entity for premiums and claims, annuities, and other policy benefits

f. Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities

g. cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

h. Cash flows arising from the purchase and sale of dealing or trading securities

i. Cash advances and loans made by financial institutions since they relate to their main revenue-producing activity.

2.3.2 Investing activities

1. Definition: These are the **acquisition and disposal of long-term assets and other investments** not included in cash equivalents.
2. Separate Disclosure: Separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which the expenditures have been made for resources intended to generate future incomes and cash flows.

Cash flows arising from investing activities

Represent the extent to which expenditures have been made for resources intended to generate future income and cash flows

Examples

a. cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;

b. cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

c. cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

d. cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

e. cash advances and loans made to other parties (other than advances and loans made by a financial institution);

f. cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

g. cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

h. cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

2.3.3 Financing activities

1. Definition: These are the activities that result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
2. Separate Disclosure: The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

Cash flows arising from financing activities

- useful in predicting claims on future cash flows by providers of capital to the entity
- Examples
  - **a.** cash proceeds from issuing shares or other equity instruments;
  - **b.** cash payments to owners to acquire or redeem the entity's shares;
  - **c.** cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
  - **d.** cash repayments of amounts borrowed; and
  - **e.** cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

2.4 CALCULATION OF CASH FLOWS FROM OPERATING ACTIVITIES

1. Components: Cash flows from operating activities result from the transactions and other events that enter into the determination of net profit or loss.
2. Methods: An enterprise can determine cash flows from operating activities using either:

Methods

- Direct Method
- Indirect Method

a. **Direct Method**: The direct method, whereby major classes of gross cash receipts and gross cash payments are considered; or

b. **Indirect Method**: The indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing activities.

2.4.1 Direct Method

1. **Information Required**
   - a. Gross receipts and gross cash payments may be obtained from the accounting records to ascertain cash flows from operating activities.
   - b. For example,
     - i. information about cash received from trade receivables,
     - ii. payment to trade payables, cash expenses etc., which may be obtained by an analysis of cash book.
   - c. In actual practice, the relevant information is obtained by adjusting sales, cost of sales and other items in the profit and loss accounts for:
     - ➢ Changes during the period in inventories and operating receivables and payables;
     - ➢ Other non-cash items such as depreciation on fixed assets, goodwill written off, preliminary expenses written off, loss or gain on sale of fixed assets etc.; and
     - ➢ Other items for which the cash effects are investing or financing cash flows. Examples are interest received and paid, dividend received and paid etc., which are related to financing or investing activities and are shown separately in the cash flow statement.
2. The **direct method** provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method.
3. However, indirect method of determining the cash from operating activities is more popular in actual practice.

2.4.2 Indirect Method

Under the indirect method, the net cash from operating activities is determined by adjusting net profit or loss instead of individual items appearing in the profit and loss account. Net profit or loss is also adjusted for the effect of:

a. changes during the period in inventories and operating receivables and payables;

b. non-cash items such as depreciation; and

c. all other items for which the cash effects are financing or investing cash flows.

2.4.3 Conclusion

1. It is worth noting that both direct and indirect methods adjust current assets and current liabilities related to operating activities to determine cash from operating activities.
2. But direct method adjust individual items of profit and loss account and indirect method adjusts overall net profit (or loss) to determine cash from operation.
3. Therefore, indirect method fails to provide break-up of cash from operations.

Proforma of 'Cash Flow from Operating Activities' by indirect method

		Rs.
Net Profit for the year		-
Add: Non-Cash and Non-Operating Expenses:	–	
Depreciation	–	
Loss on Sale of Assets	–	
Provision for taxation, etc.	–	
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Assets	–	
Net Profit after Adjustment for Non-Cash Items		(-)

Cash from operation	=	Net Profit (after adjustment for Non-cash Items)
	-	Increase in Current Assets
	+	Decrease in Current Assets
	+	Increase in Current Liabilities
	-	Decrease in Current Liabilities

2.5 CALCULATION OF CASH FLOWS FROM INVESTING ACTIVITIES

1. These activities are related to the acquisition and disposal of long-term assets, non-operating current assets and investments which results in outflow of cash.
2. Disposal of the aforesaid assets results in inflow of cash.
3. Thus**, inflows and outflows related to acquisition and disposal of assets**, other than those related to operating activities, are shown under this category.

2.6 CALCULATION OF CASH FLOWS FROM FINANCING ACTIVITIES

1. These activities are basically related to the changes in capital and borrowing of the enterprise which affect flow of cash.
2. Redemption of shares and repayment of borrowings results in outflow of cash.

3. Thus, inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.

Note: Students are advised to refer full text of Accounting Standard on Cash Flow Statements (AS 3) for the better understanding of the chapter.

SUMMARY

- Cash flow statement dealt under AS 3.
- Benefits include providing information relating to changes in cash and cash equivalents of an enterprise.
- Cash include: (a) Cash in hand and (b) Demand deposits with banks
- Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
- Cash flow activities may be classified as inflow and outflow but as per AS-3 they are classified as Operating Activities, Investing activities, Financing activities.
- Operating activities are principal revenue generating activities.
- Investing Activities relate to acquisition and disposal of long-term assets and other investments.
- Financing Activities include the ones which result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
- Methods to calculate cash flow from operating activities include: (a) Direct Method (b) Indirect Method
- In order to calculate cash flow from investing activities inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category.
- In order to calculate cash flow from financing activities inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.

ILLUSTRATIONS

Illustration 1

Intelligent Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

i. Loans and Advances given to the following and interest earned on them:

1. to suppliers

2. to employees

3. to its subsidiaries companies

ii. Investment made in subsidiary Smart Ltd. and dividend received

iii. Dividend paid for the year

iv. TDS on interest income earned on investments made

v. TDS on interest earned on advance given to suppliers

vi. Insurance claim received against loss of fixed asset by fire Discuss in the context of AS 3 Cash Flow Statement.

Solution

i. Loans and advances given and interest earned

1. to suppliers	Operating Cash flow
2. to employees	Operating Cash flow
3. to its subsidiary companies	Investing Cash flow

ii. Investment made in subsidiary company and dividend received

Investing Cash flow

iii. Dividend paid for the year

Financing Cash Outflow

iv. TDS on interest income earned on investments made

Investing Cash Outflow

v. TDS on interest earned on advance given to suppliers

Operating Cash Outflow

vi. Insurance claim received of amount loss of fixed asset by fire

Extraordinary item to be shown under a separate heading as ‘Cash inflow from investing activities’.

Illustration 2

Following are extracts of the Balance Sheets of Ajay Ltd.:

		Particulars	Notes	31.3.20X1 Rs.	31.3.20X2 Rs.
		Equity and Liabilities Shareholder's funds			
	a.	Share capital	1	5,00,000	5,00,000
	b.	Reserve & surplus	2	50,000	90,000
		Non-current liabilities			
	a.	Long-term borrowings	3	5,00,000	7,50,000
		Current liabilities			
	a.	Other current liabilities	4	---	5,000
		Assets			
		Non-current assets			
	a.	Intangible assets	5	2,05,000	1,80,000

Notes to accounts

		31.3.20X1 Rs.	31.3.20X2 Rs.
1	**Share Capital**		
	50,000 Equity Shares of Rs.10 each	5,00,000	5,00,000
2	**Reserve & surplus**		
	Profit & Loss A/c	50,000	90,000
3	**Long-term borrowings**		
	10% Debentures	5,00,000	7,50,000
4	**Other current liabilities**		
	Unpaid interest	---	5,000
5	**Intangible assets**		
	Goodwill	2,05,000	1,80,000

You are required to show the related items in Cash Flow Statement.

Solution

An Extract of Cash Flow Statement for the year ending 31.3.20X2

	Rs.
Cash flows from operating activities:	
Closing balance as per Profit & Loss A/c	90,000
Less: Opening balance as per Profit & Loss A/c	(50,000)
Add: Goodwill amortisation	25,000
Add: Interest on Debentures (Refer Note 1)	75,000
Net Cash from Operating Activities	1,40,000

Note 1: Interest has been computed on the closing balance of debentures as on 31.3.20X2 assuming that all the additions/ deletions were made, if any, at the beginning of the year.

Cash flows from financing activities:

Proceeds from debentures (Refer Working Note)	2,50,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,80,000

Working Note:

10% Debentures Account

Particulars	Rs.	Particular	Rs.
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,50,000
	7,50,000		7,50,000

Illustration 3

From the following information, calculate cash flow from operating activities:

Summary of Cash Account for the year ended March 31, 20X1

Particulars	Rs.	Particular	Rs.
To Balance b/d	**1,00,000**	**By Cash Purchases**	**1,20,000**
To Cash sales	**1,40,000**	**By Trade payables**	**1,57,000**
To Trade receivables	**1,75,000**	**By Office & Selling Expenses**	**75,000**
To Trade Commission	**50,000**	**By Income Tax**	**30,000**
To Sale of Investment	**30,000**	**By Investment**	**25,000**
To Loan from Bank	**1,00,000**	**By Repayment of Loan**	**75,000**

To Interest & Dividend	**1,000**	**By Interest on loan**	**10,000**
		By Balance c/d	**1,04,000**
	5,96,000		**5,96,000**

Solution

Cash Flow Statement of ……

for the year ended March 31, 20X1(Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

Illustration 4

The following summary cash account has been extracted from the company's accounting records:

Summary Cash Account

		(Rs.'000)
Balance at 1.3.20X1		**35**
Receipts from customers		**2,783**
Issue of shares		**300**
Sale of fixed assets		**128**
		3,246
Payments to suppliers	**2,047**	
Payments for property, plant & equipment	**230**	
Payments for overheads	**115**	
wages and salaries	**69**	
Taxation	**243**	
Dividends	**80**	

Repayments of bank loan	**250**	**(3,034)**
Balance at 31.3.20X2 212		**212**

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 20X2 in accordance with AS-3 (Revised).

The company does not have any cash equivalents.

<u>Solution</u>

Hills Ltd.

Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)

		(Rs.'000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents Cash and cash equivalents		177
at beginning of period		35
Cash and cash equivalents at end of period		212

Illustration 5

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 20X1 with the help of the following information:

1. **Company sold goods for cash only.**
2. **Gross Profit Ratio was 30% for the year, gross profit amounts to Rs.3,82,500.**
3. **Opening inventory was lesser than closing inventory by Rs.35,000.**
4. **Wages paid during the year Rs.4,92,500.**
5. **Office and selling expenses paid during the year Rs.75,000.**
6. **Dividend paid during the year Rs.30,000.**
7. **Bank loan repaid during the year Rs.2,15,000 (included interest Rs.15,000).**
8. **Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by Rs.25,000.**
9. **Amount paid to trade payables during the year Rs.4,60,000.**
10. **Tax paid during the year amounts to Rs.65,000 (Provision for taxation as on 31.03.20X1 Rs.45,000).**
11. **Investments of Rs.7,00,000 sold during the year at a profit of Rs.20,000.**
12. **Depreciation on fixed assets amounts to Rs.85,000.**
13. **Plant and machinery purchased on 15th November, 20X0 for Rs.2,50,000.**
14. **Cash and Cash Equivalents on 31st March, 20X0 Rs.2,00,000.**
15. **Cash and Cash Equivalents on 31st March, 20X1 Rs.6,07,500.**

Solution

M/s MNT Ltd. Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	**Rs.**	**Rs.**
Cash flows from Operating Activities		
Cash sales (Rs.3,82,500/.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from investing activities		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	

Net cash used in investing activities (B)		4,70,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A + B + C)		4,07,500
Cash and cash equivalents at beginning of the period		2,00,000
Cash and cash equivalents at end of the period		6,07,500

Illustration 6

Ryan Ltd provides you the following information at the year-end, March 31, 20X1:

	Rs.	**Rs.**
Sales		**6,98,000**
Cost of Goods Sold		**(5,20,000)**
		1,78,000
Operating Expenses		
(including Depreciation Expense of Rs.37,000)		**(1,47,000)**
		31,000
Other Income / (Expenses):		
Interest Expense paid	**(23,000)**	
Interest Income received	**6,000**	
Gain on Sale of Investments	**12,000**	
Loss on Sale of Plant	**(3,000)**	
		(8,000)
		23,000
Income tax		**(7,000)**
		16,000

Information available:

	31st March 20X1	**31st March 20X0**
	Rs.	**Rs.**
Plant	**7,15,000**	**5,05,000**
Less: Accumulated Depreciation	**(1,03,000)**	**(68,000)**
	6,12,000	**4,37,000**

Investments (Long term)	**1,15,000**	**1,27,000**
Inventory	**1,44,000**	**1,10,000**
Trade receivables	**47,000**	**55,000**
Cash	**46,000**	**15,000**
Prepaid expenses	**1,000**	**5,000**
Share Capital	**4,65,000**	**3,15,000**
Reserves and surplus	**1,40,000**	**1,32,000**
Bonds	**2,95,000**	**2,45,000**
Trade payables	**50,000**	**43,000**
Outstanding liabilities	**12,000**	**9,000**
Income taxes payable	**3,000**	**5,000**

Analysis of selected accounts and transactions during 20X0-X1

1. **Purchased investments for Rs.78,000.**
2. **Sold investments for Rs.1,02,000. These investments cost Rs.90,000.**
3. **Purchased plant assets for Rs.1,20,000.**
4. **Sold plant assets that cost Rs.10,000 with accumulated depreciation of Rs.2,000 for Rs.5,000.**
5. **Issued Rs.1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 20X1.**
6. **Repaid Rs.50,000 of bonds at face value at maturity.**
7. **Issued 15,000 shares of Rs.10 each.**
8. **Paid cash dividends Rs.8,000.**

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

<u>Solution</u>

Ryan Ltd.

Cash Flow Statement for the year ending 31st March, 20X1

	Rs.	**Rs.**
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	

Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in trade receivables	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in trade payables	7,000	
Increase in outstanding liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash generated from operating activities		47,000
Cash flows from investing activities		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

Note: Significant non-cash adjustments: Issued Rs.1,00,000 of bonds at face value for acquisition of plant on 31st March, 20X1.

Working Note

	Rs.
Income taxes paid:	
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000

	12000
Less: Income tax liability at the end of the year	(3,000)
	9000

Illustration 7

The balance sheets of Sun Ltd. as at 31st March 20X1 and 20X0 were as:

Particulars	Notes	20X1 Rs.	20X0 Rs.
Equity and Liabilities			
1. Shareholder's funds			
a. Share capital	1	60,000	50,000
b. Reserve & surplus	2	5,000	4,000
2. Current liabilities			
a. Trade Payables		4,000	2,500
b. Other current liabilities	3	-	1,000
c. Short term provision (provision for tax)		1,500	1,000
Total		**70,500**	**58,500**
Assets			
1. Non-current assets			
a. Property, Plant & Equipment	4	39,500	29,000
2. Current assets			
a. Current investments		2,000	1,000
b. Inventories		17,000	14,000
c. Trade receivables		8,000	6,000
d. Cash & cash equivalents	5	4,000	8,500
		70,500	**58,500**

Notes to accounts

		20X1 Rs.	20X0 Rs.
1	**Share Capital**		
	Equity Shares of Rs.10 each	60,000	50,000
2	**Reserve & surplus**		
	Profit and Loss Account	5,000	4,000

3	**Other current liabilities**		
	Dividend Payable	-	1000
4	**Property, plant and equipment (at WDV)**		
	Building	10,000	10,000
	Fixtures	17,000	11,000
	Vehicles	12,500	8000
	Total	39,500	29,000
5	**Cash and cash equivalents**		
	Cash and Bank	4,000	8,500

The profit and loss statement for the year ended 31st March, 20X1 disclosed:

Particulars	Rs.
Profit before tax	4,500
Tax expense: Current tax	(1,500)
Profit for the year	3,000
Declared dividend	(2,000)
Retained Profit	1,000

Further information is available:

	Fixtures Rs.	Vehicles Rs.
Depreciation for the year	1,000	2,500
Disposals:		
Proceeds on disposal of vehicles	—	1,700
Written down value	—	(1,000)
Profit on disposal		700

Prepare a Cash Flow Statement for the year ended 31st March, 20X1.

Solution

Sun Ltd.

Cash Flow Statement for the year ended 31st March, 20X1

	Rs.	Rs.
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		

Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid **(W.N.1)**	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of current investments	(1,000)	
Purchase of vehicles **(W.N.3)**	(8,000)	
Purchase of fixtures **(W.N.3)**	(7,000)	
Net cash used in investing activities		(14,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid **(W.N.2)**	(3,000)	
Net cash generated from financing activities		7,000
Net decrease in cash and cash equivalents		(4,500)
Cash and cash equivalents at beginning of period (See Note)		8,500
Cash and cash equivalents at end of period (See Note)		4,000
Note to the Cash Flow Statement		
Cash and Cash Equivalents		
	31.3.20X1	31.3.20X0
Bank and Cash	4,000	8,500
Cash and cash equivalents	4,000	8,500

Working Notes:

			Rs.
1.	**Income taxes paid**		
	Income tax expense for the year		1,500
	Add: Income tax liability at the beginning of the year		1,000
			2,500

	Less: Income tax liability at the end of the year		(1,500)
			1,000
2.	**Dividend paid**		
	Declared dividend for the year		2,000
	Add: Amount payable at the beginning of the year		1,000
			3,000
	Less: Amount payable at the end of the year		-
			3,000
3.	**Property, plant and equipment acquisitions**	**Fixtures Rs.**	**Vehicles Rs.**
	W.D.V. at 31.3.20X1	17,000	12,500
	Add back:		
	Depreciation for the year	1,000	2,500
	Disposals	—	1,000
		18,000	16,000
	Less: W.D.V. at 31.12.20X0	(11, 000)	(8,000)
	Acquisitions during 20X0-20X1	7,000	8,000

Note: Current investments may not be readily convertible to a known amount of cash and may not be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

Illustration 8

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 20X1:

	(Rs.in lakhs)
Net Profit	**25,000**
Dividend paid	**8,535**
Provision for Income tax	**5,000**
Income tax paid during the year	**4,248**
Loss on sale of assets (net)	**40**
Book value of the assets sold	**185**
Depreciation charged to the Statement of Profit and Loss	**20,000**

Profit on sale of Investments	**100**
Carrying amount of Investment sold	**27,765**
Interest income received on investments	**2,506**
Interest expenses of the year	**10,000**
Interest paid during the year	**10,520**
Increase in Working Capital (excluding Cash & Bank Balance)	**56,081**
Purchase of Fixed assets	**14,560**
Investment in joint venture	**3,850**
Expenditure on construction work in progress	**34,740**
Proceeds from calls in arrear	**2**
Receipt of grant for capital projects	**12**
Proceeds from long-term borrowings	**25,980**
Proceeds from short-term borrowings	**20,575**
Opening cash and bank balance	**5,003**
Closing cash and bank balance	**6,988**

Prepare the Cash Flow Statement for the year ended 31 March 20X1 in accordance with AS 3. (Make necessary assumptions)

Solution

Star Oils Limited Cash Flow Statement for the year ended 31st March, 20X1

		(Rs.in lakhs)
Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bank balance)	(56,081)	
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)

Cash flows from investing activities		
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Receipt of grant for capital projects	12	
Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,622)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	27,502
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note:

1.	Book value of the assets sold	185
	Less: Loss on sale of assets	(40)
	Proceeds on sale	145

Illustration 9

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.20X1

	Rs.'000		Rs.'000
Balance on 1.4.20X0	**50**	**Payment to Suppliers**	**2,000**
Issue of Equity Shares	**300**	**Purchase of Fixed Asset**	**200**
Receipts from Customers	**2,800**	**Overhead expense**	**200**
Sale of Fixed Assets	**100**	**Wages and Salaries**	**100**

		Taxation	**250**
		Dividend	**50**
		Repayment of Bank Loan	**300**
		Balance on 31.3.20X1	**150**
	3,250		**3,250**

Solution

X Ltd. Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

	Rs.'000	Rs.'000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash generated from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at the beginning of the year		50
Cash at the end of the year		150

Illustration 10

Given below are the relevant extracts of the Balance Sheet and the Statement of Profit and Loss of ABC Ltd. along with additional information:

Extract of Balance sheet

		Particulars	Notes	31.3.20X1 (Rs.in lakhs)	31.3.20X0 (Rs.in lakhs)
		Equity and Liabilities Current liabilities			
1		Trade Payables			
	a	Short term Provisions		250	230
	b	Other current liabilities	1	200	180
	c	Assets	2	70	50
2		Current assets			
	a	Inventories		200	180
	b	Trade Receivables		400	250
	c	Other current assets	3	195	180

Statement of Profit and Loss of ABC Ltd. for the year ended 31st March, 20X1

	Particulars	Notes	Rs.in lakhs
I	Revenue from operations		4,150
II	Other income	4	100
III	Total income (I + II)		4,250
	Expenses:		
	Purchases of Stock-in-Trade		2,400
	Change in inventories of finished goods		(20)
	Employee benefits expense		800
	Depreciation expense		100
	Finance cost	5	60
	Other expenses		200
IV	Total expenses		3,540
V	Profit before tax (III – IV)		710
VI	Tax expense:		
	Current tax		200
VII	Profit for the year from continuing operations		510

Appropriations

Balance of Profit and Loss account brought forward	**50**
Transfer to general reserve	**200**
Dividend paid	**330**

Notes to accounts:

		20X1 (Rs.in lakhs)	20X0 (Rs.in lakhs)
1	**Short term Provisions:**		
	Provision for Tax	**200**	**180**
2	**Other current liabilities:**		
	Outstanding wages	**50**	**40**
	Outstanding expenses	**20**	**10**
	Total	**70**	**50**
3	**Other current assets:**		
	Advance tax	**195**	**180**
4	**Other income:**		
	Interest and dividend	**100**	
5	**Finance cost:**		
	Interest	**60**	

Compute cash flow from operating activities using both direct and indirect method

Solution

Cash Flows from Operating Activities

	Rs.in lakhs	Rs.in lakhs
Using Direct Method		
Cash Receipts:		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 – 400	4,000
Cash payments:		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables – Closing Trade payables	2,400 + 230 – 250	2,380
Wages and salaries paid	800 + 40 − 50	790

Cash expenses	200 + 10 – 20		190
Taxes paid – Advance tax			195
(B)			3,555
Cash flow from operating activities (A – B)			445
Using Indirect Method			
Profit before tax			710
Add: Non-cash items : Depreciation			100
Add: Interest : Financing cash inflow			60
Less: Interest and Dividend : Investment cash outflow			(100)
Less: Tax paid			(195)
Working capital adjustments			
Trade receivables	250−400	(150)	
Inventories	180−200	(20)	
Trade payables	250−230	20	
Outstanding wages	50−40	10	
Outstanding expenses	20−10	10	(130)
Cash flow from operating activities			445

Illustration 11

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:

1. **Sales for the year amounted to Rs.135 crores out of which 60% was cash sales.**
2. **Purchases for the year amounted to Rs.55 crores out of which credit purchase was 80%.**
3. **Administrative and selling expenses amounted to Rs.18 crores and salary paid amounted to Rs.22 crores.**
4. **The Company redeemed debentures of Rs.20 crores at a premium of 10%. Debenture holders were issued equity shares of Rs.15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was Rs.1.5 crores.**
5. **Dividend paid during the year amounted to Rs.11.7 crores.**
6. **Investment costing Rs.12 crores were sold at a profit of Rs.2.4 crores.**
7. **Rs.8 crores was paid towards income tax during the year.**
8. **A new plant costing Rs.21 crores was purchased in part exchange of an old plant. The book value of the old plant was Rs.12 crores but the vendor took over the old plant at a value of Rs.10 crores only. The balance was paid in cash to the vendor.**

9. **The following balances are also provided:**

	Rs.in crores 1.4.20X0	Rs.in crores 31.3.20X1
Debtors	**45**	**50**
Creditors	**21**	**23**
Bank	**6**	**18.2**

Solution

Gamma Ltd. Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	Rs.in crores	Rs.in crores
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors	49	
[45+ (135x40%) - 50]		
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers	(42)	
[21+ (55x80%) – 23]		
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	
Payments for purchase of fixed assets (21 – 10)	(11)	
Net cash generated from investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Significant non-cash items:

a. Debenture-holders received equity shares of Rs.15 crores on redemption of the debentures.

b. Plant having book value of Rs.12 crores was given in exchange of an asset costing Rs.21 crores. The said plant was transferred at a value of Rs.10 crores only, and Rs.11 crores was paid for the balance dues towards the plant.

Illustration 12

From the following information of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.20X1:

Ledger balances of Mr. Zen as of 20X0 and 20X1

	As on 1.4.20X0 Rs.	**As on 1.4.20X1 Rs.**
Zen's Capital A/c	**10,00,000**	**12,24,000**
Trade payables	**3,20,000**	**3,52,000**
Mrs. Zen's loan	**2,00,000**	**--**
Loan from Bank	**3,20,000**	**4,00,000**
Land	**6,00,000**	**8,80,000**
Plant and Machinery (net block)	**6,40,000**	**4,40,000**
Inventories	**2,80,000**	**2,00,000**
Trade receivables	**2,40,000**	**4,00,000**
Cash	**80,000**	**56,000**

Additional information:

A machine costing Rs.80,000 (accumulated depreciation there on Rs.24,000) was sold for Rs.40,000. The provision for depreciation on 1.4.20X0 was Rs.2,00,000 and 31.3.20X1 was Rs.3,20,000. The net profit for the year ended on 31.3.20X1 was Rs.3,60,000.

Solution

Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.20X1

		Rs.
i. Cash flow from operating activities		
Net Profit (given)		3,60,000
Adjustments for		
Depreciation on Plant & Machinery (W.N.2)	1,44,000	
Loss on Sale of Machinery (W.N.1)	16,000	1,60,000

	Operating Profit before working capital changes		5,20,000
	Decrease in inventories	80,000	
	Increase in trade receivables	(1,60,000)	
	Increase in trade payables	32,000	(48,000)
	Net cash generated from operating activities		4,72,000
ii.	**Cash flow from investing activities**		
	Sale of Machinery (W.N.1)	40,000	
	Purchase of Land (8,80,000 – 6,00,000)	(2,80,000)	
	Net cash used in investing activities		(2,40,000)
iii.	**Cash flow from financing activities**		
	Repayment of Mrs. Zen's Loan	(2,00,000)	
	Drawings (W.N.3)	(1,36,000)	
	Loan from Bank	80,000	
	Net cash used in financing activities		(2,56,000)
	Net decrease in cash		(24,000)
	Opening balance as on 1.4.20X0		80,000
	Cash balance as on 31.3.20X1		56,000

Working Notes:

1. Plant & Machinery A/c

	Rs.		Rs.
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision for Depreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 64,000)	16,000
		By Balance c/d (4,40,000+3,20,000)	7,60,000
	8,40,000		8,40,000

2. Provision for depreciation on Plant and Machinery A/c

	Rs.		Rs.
To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c (Bal. fig.)	1,44,000
	3,44,000		3,44,000

3. **To find out Mr. Zen's drawings:**

	Rs.
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,000)
Drawings	1,36,000

Note: Students may note that in case there is an increase in the amount of debentures/ loans during the year and the interest is required to be computed, then in such a case, students may choose either to compute interest on the closing balance of the debentures or may compute interest on opening balance for full year (in case of no repayment) and proportionate interest on additions. Suitable note for assumption may be given in the solution for this.

TEST YOUR KNOWLEDGE

MCQs

1. **While preparing cash flow statement, conversion of debt to equity**
   a. **Should be shown as a financing activity.**
   b. **Should be shown as an investing activity.**
   c. **Should not be shown as it is a non-cash transaction**
   d. **Should not be shown as operating activity**

2. **Which of the following would be considered a 'cash-flow item from an "investing" activity'?**
   a. **Cash outflow to the government for payment of taxes.**
   b. **Cash outflow to purchase bonds issued by another company.**
   c. **Cash outflow to shareholders as dividends**
   d. **Cash outflow to make payment to trade payables**

3. **All of the following would be included in a company's operating activities except:**
   a. **Income tax payments**
   b. **Collections from customers or Cash payments to suppliers**
   c. **Dividend payments**
   d. **Office and selling expenses.**

4. **Hari Uttam, a stock broking firm, received Rs.1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?**
   a. **Operating Activities.**
   b. **Investing Activities.**
   c. **Financing Activities.**
   d. **Non-cash transaction**

5. **As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as**
   a. **Operating activity.**
   b. **Financing activity.**
   c. **Investing activity.**
   d. **Non-cash transaction**

ANSWERS/ HINTS

MCQ

1.	**c.**	Should not be shown as it is a non-cash transaction
2.	**b.**	Cash outflow to purchase bonds issued by another company.
3.	**c.**	Dividend payments
4.	**a.**	Operating Activities.
5.	**c.**	Investing activity.

THEORETICAL QUESTIONS

Q.NO.1. What is the significance of cash flow statement? Explain in brief.

ANSWER

Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.

Q.NO.2. Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

ANSWER

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

a. The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

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

PRACTICAL QUESTIONS

Q.NO.1. Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).

- **a. Brokerage paid on purchase of investments**
- **b. Underwriting commission paid**
- **c. Trading commission received**
- **d. Proceeds from sale of investment**
- **e. Purchase of goodwill**
- **f. Redemption of preference shares**
- **g. Rent received from property held as investment**
- **h. Interest paid on long-term borrowings**
- **i. Marketable securities (having risk of change in value)**
- **j. Refund of income tax received**

SOLUTION

Classification of activities with reference to AS 3

a.	Brokerage paid on purchased of investments	Investing Activities
b.	Underwriting Commission paid	Financing Activities
c.	Trading Commission received	Operating Activities
d.	Proceeds from sale of investment	Investing Activities
e.	Purchase of goodwill	Investing Activities
f.	Redemption of Preference shares	Financing Activities
g.	Rent received from property held as investment.	Investing Activities
h.	Interest paid on long term borrowings.	Financing Activities
i.	Marketable securities	Not a Cash equivalent
j.	Refund of Income tax received.	Operating activities

Q.NO.2. How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?

i. 10% Debentures issued: As on 01-04-20X1 Rs.1,10,000
As on 31-03-20X2 Rs.77,000

ii. Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

iii. Unpaid Interest on Debentures: As on 01-04-20X1 Rs.275
As on 31-03-20X2 Rs.1,175

iv. Debtors of Rs.36,000 were written off against the Provision for Doubtful Debts A/c during the year.

v. 10% Bonds (Investments): As on 01-04-20X1 Rs.3,50,000

As on 31-03-20X2 Rs.3,50,000

vi. Accrued Interest on Investments: As on 31-03-20X2 Rs.10,500

<u>SOLUTION</u>

Cash Flow Statement of M/s Gagan Ltd.

for the year ended March 31, 20X2

A	Cash Flow from Operating Activities	
	Net Profit as per Profit & Loss A/c	xxxxx
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	Cash Flow from Investing Activities	
	Interest on Investments [35,000-10,500]	24,500
C	Cash Flow from Financing Activities	
	Interest on Debentures paid	(10,100)
	[11,000 - (1,175 - 275)] - outflow	
	Redemption of Debentures	(34,650)
	[(1,10,000 - 77,000) at 5% premium] - outflow	

Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.

Q.NO.3. From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1:

Particulars			Notes	31st March, 20X1	31st March, 20X0
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**		**10,00,000**	**8,00,000**
	B	**Reserves and Surplus**	**1**	**3,00,000**	**2,10,000**
2		**Non-current liabilities**			
		Long term borrowings	**2**	**2,00,000**	**-**

3		Current liabilities			
	A	Trade Payables		7,00,000	8,20,000
	B	Other current liabilities	3	-	1,00,000
	C	Short term provision		1,00,000	70,000
		(provision for tax)			
		Total		23,00,000	20,00,000
		Assets			
1	A	Non-current assets			
	B	Property, plant and Equipment	4	13,00,000	9,00,000
		Non-Current Investments		1,00,000	-
2		Current assets			
	A	Inventories		4,00,000	2,00,000
	B	Trade receivables		5,00,000	7,00,000
	C	Cash and Cash equivalents		-	2,00,000
		Total		23,00,000	20,00,000

Notes to accounts

No.	Particulars	31st March, 20X1	31st March, 20X0
1	Reserves and Surplus		
	General reserve	2,00,000	1,50,000
	Profit and Loss account	1,00,000	60,000
	Total	3,00,000	2,10,000
2	Long term borrowings		
	Debentures (issued at end of year)	2,00,000	--
3	Other current liabilities		
	Dividend payable	-	1,00,000
4	Property, plant and equipment		
	Plant and machinery	7,00,000	5,00,000
	Land and building	6,00,000	4,00,000
	Net carrying value	13,00,000	9,00,000

i. Depreciation @ 25% was charged on the opening value of Plant and Machinery.

ii. At the year end, one old machine costing Rs.50,000 (WDV Rs.20,000) was sold for Rs.35,000. Purchase was also made at the year end.

iii. **Rs.50,000 was paid towards Income tax during the year.**

iv. **Construction of the building got completed on 31.03.20X1 and hence no depreciation may be charged on the same. Prepare Cash flow Statement.**

<u>SOLUTION</u>

Cash Flow Statement of Grow More Ltd.

for the year ended 31st March, 20X1

Cash Flow from Operating Activities

		Rs.
Increase in balance of Profit and Loss Account (1,00,000 – 60,000)	40,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	2,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	<u>1,20,000</u>	
Cash generated from operations	1,60,000	
Income tax paid	(50,000)	
Net Cash generated from operating activities		1,10,000

Cash Flow from Investing Activities

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

Cash Flow from financing activities

Proceeds from issue of shares (10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	<u>(1,00,000)</u>	
Net cash generated from financing activities		<u>3,00,000</u>

Net decrease in cash and cash equivalents		(2,00,000)
Cash and Cash equivalents at the beginning of the year		2,00,000
Cash and Cash equivalents at the end of the year		Nil

Working Notes:

1. Provision for taxation account

	Rs.		Rs.
To Cash (Paid)	50,000	By Balance b/d	70,000
To Balance c/d	1,00,000	By Profit and Loss A/c (Balancing figure)	80,000
	1,50,000		1,50,000

2. Plant and Machinery account

	Rs.		Rs.
To Balance b/d	5,00,000	By Depreciation	1,25,000
To Profit and Loss A/c (profit on sale of machine)	15,000	By Cash (sale of machine)	35,000
To Cash (Balancing figure)	3,45,000	By Balance c/d	7,00,000
	8,60,000		8,60,000

Q.NO.4. From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

		Particulars	Notes	31st March, 20X1 Rs.	31st March, 20X0 Rs.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**6,00,000**	**7,00,000**
	B	**Reserves and Surplus**	**2**	**4,20,000**	**3,00,000**
2		**Non-current liabilities**			
		Long term borrowings	**3**	**2,00,000**	**-**
3		**Current liabilities**			
	A	**Trade Payables**		**1,15,000**	**1,10,000**
	B	**Other current liabilities**	**4**	**30,000**	**80,000**
	C	**Short term provision (provision for tax)**		**95,000**	**60,000**
		Total		**14,60,000**	**12,50,000**

		Assets			
1		Non-current assets			
	A	Property, plant and Equipment	5	9,15,000	7,00,000
	B	Non-Current Investments		50,000	80,000
2		Current assets			
	A	Inventories		95,000	90,000
	B	Trade receivables		2,50,000	2,25,000
	C	Cash and Cash equivalents		50,000	90,000
	D	Other Current assets		1,00,000	65,000
		Total		14,60,000	12,50,000

Notes to accounts

No.	Particulars		31st March, 20X0	31st March, 20X1
1.	Share capital			
	Equity share capital		6,00,000	5,00,000
	10% Redeemable Preference share capital		--	2,00,000
	Total		6,00,000	7,00,000
2.	Reserves and Surplus			
	Capital redemption reserve		1,00,000	-
	Capital reserve		70,000	-
	General reserve		1,50,000	2,50,000
	Profit and Loss account		1,00,000	50,000
	Total		4,20,000	3,00,000
3.	Long term borrowings			
	9% Debentures		2,00,000	--
4.	Other current liabilities			
	Dividend payable		-	60,000
	Liabilities for expenses		30,000	20,000
	Total		30,000	80,000
5.	Property, plant and equipment			
	Plant and machinery		7,65,000	5,00,000
	Land and building		1,50,000	2,00,000
	Net carrying value		9,15,000	7,00,000

Additional information:

i. **A piece of land has been sold out for Rs.1,50,000 (Cost – Rs.1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.**

ii. **On 1st April, 20X0 a plant was sold for Rs.90,000 (Original Cost – Rs.70,000 and W.D.V. – Rs.50,000) and Debentures worth Rs.1 lakh were issued at par as part consideration for plant of Rs.4.5 lakhs acquired.**

iii. **Part of the investments (Cost – Rs.50,000) was sold for Rs.70,000.**

iv. **Pre-acquisition dividend received Rs.5,000 was adjusted against cost of investment.**

v. **Interim dividend was declared and paid @ 15% during the current year.**

vi. **Income-tax liability for the current year was estimated at Rs.1,35,000.**

vii. **Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.**

SOLUTION

Cash Flow Statement of Ryan Limited

For the year ended 31st March, 20X1

	Rs.	**Rs.**
Cash flow from operating activities		
Net Profit before taxation (W.N.1)	2,75,000	
Adjustment for		
Depreciation (W.N.3)	1,35,000	
Profit on sale of land	(30,000)	
Profit on sale of plant (W.N.3)	(40,000)	
Profit on sale of investments (W.N.4)	(20,000)	
Interest on debentures (2,00,000 X 9%)	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	
Increase in trade receivables	(25,000)	
Increase in Other current assets (W.N.9)	(35,000)	
Increase in Trade payables	5,000	
Increase in liabilities for expenses	10,000	
Cash generated from operations	2,88,000	
Income taxes paid (W.N.8)	(1,00,000)	
Net cash generated from operating activities		1,88,000

Cash flow from investing activities		
Proceeds from sale of land (W.N.2)	1,50,000	
Proceeds from sale of plant (W.N.3)	90,000	
Proceeds from sale of investments (W.N.4)	70,000	
Purchase of plant (W.N.3)	(3,50,000)	
Purchase of investments (W.N.4)	(25,000)	
Pre-acquisition dividend received (W.N.4)	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares (6,00,000 – 5,00,000)	1,00,000	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(1,50,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(1,68,000)
Net decrease in cash and cash equivalents		(90,000)
Cash and cash equivalents at the beginning of the year		
Cash and Cash equivalents at the end of the year		50,000

Significant Non-cash Items:

Debentures amounting to Rs.1,00,000 have been issued as part consideration for acquisition of plant of Rs.4,50,000.

Working Notes:

1.

	Rs.
Net profit before taxation	
Retained profit	1,00,000
Less: Balance as on 31.3.20X0	(50,000)
	50,000
Provision for taxation	1,35,000
Dividend	90,000
	2,75,000

2. **Land and Building Account**

	Rs.		Rs.
To Balance b/d	2,00,000	By Cash (Sale)	1,50,000
To Profit and Loss A/c (Profit on sale)	30,000	By Balance c/d	1,50,000
To Capital reserve (Revaluation profit)	70,000		
	3,00,000		3,00,000

3. **Plant and Machinery Account**

	Rs.		Rs.
To Balance b/d	5,00,000	By Cash (Sale)	90,000
To Profit and Loss account	40,000	**By Depreciation**	1,35,000
To Debentures	1,00,000	By Balance c/d	7,65,000
To Bank	3,50,000		
	9,90,000		9,90,000

4. **Investments Account**

	Rs.		Rs.
To Balance b/d	80,000	By Cash (Sale)	70,000
To Profit and Loss	20,000	By Dividend (Pre-acquisition)	5,000
To account Bank (Balancing figure)	25,000	By Balance c/d	50,000
	1,25,000		1,25,000

5. **Capital Reserve Account**

	Rs.		Rs.
To Balance b/d	70,000	By Profit on revaluation of land	70,000
	70,000		70,000

6. **General Reserve Account**

	Rs.		Rs.
To Capital redemption reserve	1,00,000	By Balance b/d	2,50,000
To Balance c/d	1,50,000		
	2,50,000		2,50,000

7. Dividend payable Account

	Rs.		Rs.
To Bank (Balancing figure)	1,50,000	By Balance b/d	60,000
To Balance c/d	-	By Profit and loss account	90,000
	1,50,000		1,50,000

8. Provision for Taxation Account

	Rs.		Rs.
To Bank (Balancing figure)	1,00,000	By Balance b/d	60,000
To Balance c/d	95,000	By Profit and loss account	1,35,000
	1,95,000		1,95,000

9. Other Current Assets Account

	Rs.		Rs.
To Balance b/d	65,000	By Balance c/d	1,00,000
To Bank (Balancing figure)	35,000		
	1,00,000		1,00,000

Q.NO.5. The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

		Particulars	Notes	31st March, 20X0 Rs.	31st March, 20X1 Rs.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**16,00,000**	**18,80,000**
	B	**Reserves and Surplus**		**8,40,000**	**11,00,000**
2		**Non-current liabilities**	**2**		
		Long term borrowings	**3**	**4,00,000**	**2,80,000**
3		**Current liabilities**			
	A	**Other current liabilities**	**4**	**6,00,000**	**5,20,000**
	B	**Short term provision (provision for tax)**		**3,60,000**	**3,40,000**
		Total		**38,00,000**	**41,20,000**

		Assets			
		Non-current assets			
1	**A**	**Property, plant and Equipment**	**5**	**22,80,000**	**26,40,000**
	B	**Non-Current Investments**		**4,00,000**	**3,20,000**
		Current assets			
	A	**Cash and Cash equivalents**		**10,000**	**10,000**
2	**B**	**Other Current assets**		**11,10,000**	**11,50,000**
		Total		**38,00,000**	**41,20,000**

Notes to accounts

No.	Particulars		31st March, 20X0	31st March, 20X1
1.	**Share capital**			
	Equity share capital		**12,00,000**	**16,00,000**
	10% Preference share capital		**4,00,000**	**2,80,000**
	Total		**16,00,000**	**18,80,000**
2.	**Reserves and Surplus**			
	General reserve		**6,00,000**	**7,60,000**
	Profit and Loss account		**2,40,000**	**3,40,000**
	Total		**8,40,000**	**11,00,000**
3.	**Long term borrowings**			
	9% Debentures		**4,00,000**	**2,80,000**
	Total		**4,00,000**	**2,80,000**
4.	**Other current liabilities**			
	Dividend payable		**1,20,000**	**-**
	Current Liabilities		**4,80,000**	**5,20,000**
	Total		**6,00,000**	**5,20,000**
5.	**Property, Plant and Equipment**			
	Property, plant and equipment		**32,00,000**	**38,00,000**
	Less: Depreciation		**(9,20,000)**	**(11,60,000)**
	Net carrying value		**22,80,000**	**26,40,000**

Additional information:

i. The company sold one property, plant and equipment for Rs.1,00,000, the cost of which was Rs.2,00,000 and the depreciation provided on it was Rs.80,000.

ii. The company also decided to write off another item of property, plant and equipment costing Rs.56,000 on which depreciation amounting to Rs.40,000 has been provided.

iii. Depreciation on property, plant and equipment provided Rs.3,60,000.

iv. Company sold some investment at a profit of Rs.40,000.

v. Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the year end.

vi. Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was Rs.2,16,000. The inventory on 31.3.20X1 was correctly valued at Rs.3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

SOLUTION

New Light Ltd.

Cash Flow Statement for the year ended 31st March, 20X1

A.	**Cash Flow from operating activities**	**Rs.**	**Rs.**
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment		
	[Rs.3,40,000 – (Rs.2,40,000 + Rs.24,000)]	76,000	
	Transfer to general reserve	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	5,76,000	
	Adjustments for:		
	Depreciation	3,60,000	
	Loss on sale of property, plant and equipment	20,000	
	Decrease in value of property, plant and equipment	16,000	
	Profit on sale of investment	(40,000)	
	Premium on redemption of preference share capital	6,000	
	Interest on debentures	36,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	9,80,000	
	Increase in current liabilities		
	(Rs.5,20,000 –Rs.4,80,000)	40,000	
	Increase in other current assets		
	[Rs.11,50,000 – (Rs. 11,10,000 + Rs.24,000)]	(16,000)	

	Cash generated from operations	10,04,000	
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		6,44,000
B.	**Cash Flow from investing activities**		
	Purchase of property, plant and equipment (W.N.3)	(8,56,000)	
	Proceeds from sale of property, plant and equipment (W.N.3)	1,00,000	
	Proceeds from sale of investment (W.N.2)	1,20,000	
	Net Cash used in investing activities		(6,36,000)
C.	**Cash Flow from financing activities**		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital	(1,26,000)	
	(Rs.1,20,000 + Rs.6,000)		
	Redemption of debentures	(1,26,000)	
	(Rs. 1,20,000 +Rs. 6,000)		
	Dividend paid	(1,20,000)	
	Interest on debentures	(36,000)	
	Net Cash generated from financing activities		(8,000)
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

Working Notes:

1. Revaluation of inventory will increase opening inventory by Rs. 24,000.

2,16,000/90 x 10 = Rs. 24,000

Therefore, opening balance of other current assets would be as follows:

Rs. 11,10,000 + Rs. 24,000 = Rs. 11,34,000

Due to under valuation of inventory, the opening balance of profit and loss account be increased by Rs. 24,000.

The opening balance of profit and loss account after revaluation of inventory will be Rs. 2,40,000 + Rs. 24,000 = Rs. 2,64,000

2. Investment Account

	Rs.		Rs.
To Balance b/d	4,00,000	By Bank A/c	1,20,000
To Profit and Loss A/c		(balancing figure being	
(Profit on sale of investment)	40,000	investment sold)	
		By Balance c/d	3,20,000
	4,40,000		4,40,000

3. Property, Plant and Equipment Account

	Rs.		Rs.	Rs.
To Balance b/d	32,00,000	By Bank A/c (sale of	1,00,000	
To Bank A/c (balancing		assets)		
figure being assets	8,56,000	By Accumulated		
purchased)		depreciation A/c	80,000	
		By Profit and loss A/c		
		(loss on sale of assets)	20,000	2,00,000
		By Accumulated		
		depreciation A/c	40,000	
		By Profit and loss A/c		
		(assets written off)	16,000	56,000
		By Balance c/d		38,00,000
	40,56,000			40,56,000

4. Accumulated Depreciation Account

	Rs.		Rs.
To Property, plant and	80,000	By Balance b/d	9,20,000
equipment A/c			
To Property, plant and		By Profit and loss A/c (depreciation for	
equipment A/c	40,000	the year)	3,60,000
To Balance c/d	11,60,000		
	12,80,000		12,80,000

Q.NO.6. **ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:**

		Particulars	Notes	31st March, 20X0 Rs.	31st March, 20X1 Rs.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**		50,00,000	50,00,000
	B	**Reserves and Surplus**		26,50,000	36,90,000
2		**Non-current liabilities**			
		Long term borrowings	1	-	9,00,000
3		**Current liabilities**			
	A	**Short-term borrowings (Bank loan)**		1,50,000	3,00,000
	B	**Trade payables**		8,80,000	8,20,000
	C	**Other current liabilities**	2	4,80,000	2,70,000
		Total		91,60,000	1,09,80,000
		Assets			
1		**Non-current assets**			
	A	**Property, plant and Equipment**	3	21,20,000	32,80,000
2	B	**Current assets**			
	A	**Current Investments**		11,80,000	15,00,000
	B	**Inventory**		20,10,000	19,20,000
	C	**Trade receivables**	4	22,40,000	26,40,000
	D	**Cash and Cash equivalents**		15,20,000	15,20,000
	E	**Other Current assets (Prepaid expenses)**		90,000	1,20,000
		Total		91,60,000	1,09,80,000

Notes to accounts

No.	Particulars		Rs.20X0	Rs.20X1
1.	**Long term borrowings**			
	9% Debentures (issued at the end of year)		-	9,00,000

	Total			**-**	**9,00,000**
2.	**Other current liabilities**				
	Dividend payable			1,50,000	-
	Liabilities for expenses			3,30,000	2,70,000
	Total			**4,80,000**	**2,70,000**
3.	**Property, plant and equipment**				
	Plant and machinery			27,30,000	40,70,000
	Less: Depreciation			(6,10,000)	(7,90,000)
	Net carrying value			**21,20,000**	**32,80,000**
4.	**Trade receivables**				
	Gross amount			23,90,000	28,30,000
	Less: Provision for doubtful debts			(1,50,000)	(1,90,000)
	Total			**22,40,000**	**26,40,000**

Additional Information:

i. **Net profit for the year ended 31st March, 20X1, after charging depreciation Rs.1,80,000 is Rs.10,40,000.**

ii. **Trade receivables of Rs.2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.**

SOLUTION

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities		**Rs.**	**Rs.**
Net Profit		10,40,000	
Add: Adjustment For Depreciation (Rs.7,90,000 – Rs.6,10,000)		1,80,000	
Add: Adjustment for Provision for Doubtful Debts			
(Rs. 4,20,000 – Rs.1,50,000)		2,70,000	
Operating Profit Before Working Capital Changes		14,90,000	
Add: Decrease in Inventories (Rs. 20,10,000 – Rs. 19,20,000)		90,000	
		15,80,000	
Less: Increase in Current Assets			
Trade Receivables			
(Rs. 30,60,000 – Rs.23,90,000)	6,70,000		
Prepaid Expenses (Rs. 1,20,000 – Rs.90,000)	30,000		
Decrease in Current Liabilities:			

Trade Payables (Rs. 8,80,000 – Rs. 8,20,000)	60,000		
Expenses Outstanding			
(Rs. 3,30,000 – Rs. 2,70,000)	60,000	(8,20,000)	
Net Cash generated from Operating Activities			7,60,000
Cash Flows from Investing Activities			
Investment in Current Investments		(3,20,000)	
Purchase of Plant & Machinery			
(Rs. 40,70,000 – Rs. 27,30,000)		(13,40,000)	
Net Cash Used in Investing Activities			(16,60,000)
Cash Flows from Financing Activities			
Bank Loan Raised (Rs. 3,00,000 – Rs. 1,50,000)		1,50,000	
Issue of Debentures		9,00,000	
Payment of Dividend		(1,50,000)	
Net Cash Used in Financing Activities			9,00,000
Net Increase in Cash During the Year			-
Add: Cash and Cash Equivalents as on 1.4.20X0			15,20,000
Cash and Cash Equivalents as on 31.3.20X1			15,20,000

Note:

1. Bad debts amounting Rs.2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

12. BUY-BACK OF SECURITIES

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Elucidate the meaning of buy-back of securities;
- Comprehend the Accounting Treatment buy-back of securities;
- Learn the provisions of the Companies Act regarding buy-back of securities.

1. INTRODUCTION

Buy-back of shares means purchase of its own shares by a company. When shares are bought back by a company, they have to be cancelled by the company. Thus, shares buy-back results in decrease in share capital of the company. A company cannot buy its own shares for the purpose of investment. A company having sufficient cash may decide to buy-back its own shares.

The following may be the objectives/advantages of Buy-back of shares:

a. To increase earnings per share if there is no dilution in company's earnings as the buy-back of shares reduces the outstanding number of shares.

b. To increase promoters holding as the shares which are bought back are cancelled.

c. To discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.

d. To support the share price on the stock exchanges when the share price, in the opinion of company management, is less than its worth, especially in the depressed market.

e. To pay surplus cash to shareholders when the company does not need it for business.

The Companies Act, 2013 under Section 68 (1) permits companies to buy-back their own shares and other specified securities out of:

i. its free reserves; or

ii. the securities premium account; or

iii. The proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. For example, if equity shares are to be bought back, then, preference shares may be used for the purpose.

The other important provisions relating to the buy-back are:

1. Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

a. the buy-back is authorised by its articles;
b. A special resolution has been passed in general meeting of the company authorising the buy-back;
   However, the above provisions do not apply where the buy-back is ten percent or less of the paid-up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.
c. the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)
d. Further, the buy-back of shares in any financial year must not exceed 25% of its total paid-up capital and free reserves: (Share Outstanding Test)
e. The ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test) Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.
f. all the shares or other specified securities for buy-back are fully paid up;
g. the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

2. The notice of meeting at which special resolution is supposed to be passed must be accompanied by an explanatory statement stating- (a) a full and complete disclosure of all material facts; (b) the necessity of the buy-back; (c) the class of security intended to be purchased under the buy-back; (d) the amount to be invested under the buy-back; (e) the time limit for completion of the buy-back.
3. Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors.
4. The buy-back may be— (a) from the existing security holders on a proportionate basis; or (b) from the open market; or (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

5. Where a company has passed a special resolution under clause (b) of Subsection (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board of Directors has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board of Directors. It must be signed by at least two directors of the company, one of whom shall be the managing director, if any:

   Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.
6. Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.
7. Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.
8. Where a company buy-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.
9. A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.
10. If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company may be punishable with a fine which shall not be less than Rs. One Lakh but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but which may extend to three lakh rupees or with both.
11. Section 69 (1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

12. The shares or other specified securities which are proposed to be bought back must be fully paid-up.

13. The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

14. Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against free reserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buy-back of securities.

Some Important Terms

a. "Specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time;

b. "Free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that-

i. any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

ii. Any change in carrying amount of an asset or a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

2. PROVISIONS OF SECTION 70 OF THE COMPANIES ACT 2013

1. No company shall directly or indirectly purchase its own shares or other specified securities—

- **a.** through any subsidiary company including its own subsidiary companies; or
- **b.** through any investment company or group of investment companies; or
- **c.** if a default is subsisting, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank. Provided that the buy–back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.

2. In accordance with schedule III, no company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (filling of annual return), 123 (payment of dividend within 30 days of declaration), 127 (failure to distribute dividend) and 129 (preparation of financial statement of the company).

Explanation I. — For the purposes of Section 68 and Section 70 of the companies Act, 2013 "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

Explanation II. — For the purposes of Section 68, "free reserves" includes securities premium account.

Note: In exercise of the powers conferred under section 30 of the Securities and Exchange Board of India Act, 1992, SEBI made Securities and Exchange Board of India (Buy-back of Securities) (Amendment) Regulations, 2013 to amend the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998. The important provisions of the new regulations are: (i) No offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market. (ii)A company shall not make any offer of buy-back within a period of one year reckoned from the date of closure of the preceding offer of buy-back, if any. (iii)The company shall ensure that at least fifty per cent of the amount earmarked for buy-back is utilized for buying-back shares or other specified securities.

SUMMARY

- Buy-back of shares can be made out of:
  i. Its free reserves; or
  ii. the securities premium account; or
  iii. The proceeds of any shares or other specified securities.
- No company shall purchase its own shares or other specified securities unless—
  - The buy-back is authorized by the Articles of Association and by a special resolution passed at a general meeting. However, in case the buy-back is for a sum less than or equal to ten percent of the paid-up equity shares + free reserves the same may be authorized by the resolution of the directors passed at a duly convened Board Meeting.
  - the buy-back is or less than or equal to twenty-five per cent of the total paid-up capital and free reserves of the company:
  - Partly paid shares cannot be bought back by a company;
  - The buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year.
  - No offer of buy-back will be made within a period of one year from the date of closing of the previous buy-back if any. Hence, there can be a maximum of one buy-back in one year.
  - the ratio of the debt owed by the company (both secured and unsecured) is not more than twice the paid-up capital and its free reserves after such buy-back:

Knowledge Pulse – Two key Concepts you should know

1. Why does free reserves include securities premium for the purpose of this section?

2. Why are we transferring amount to CRR?

These 2 questions will not come in exam, but it Is something you need to be aware of as a concept *(we will learn in the class)*

ILLUSTRATIONS

Illustration 1

M Ltd. furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	Rs. (in 000)
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	5,000
	B	Reserves and Surplus	2	6,310
2		Non-current liabilities		
		Long term borrowings	3	400
3		Current liabilities		
	A	Trade Payables		40
		Total		11,750
		Assets		
1		Non-current assets		
	A	Property, plant and Equipment	4	2,750
	B	Non-Current Investments (at cost)		5,000
2		Current assets		
	A	Inventories		1,000
	B	Trade receivables		2000
	C	Cash and Cash equivalents		1,000
		Total		11,750

Notes to accounts

No.	Particulars		Rs. in ('000)
1	Share Capital		
	Authorized, Issued and Subscribed Capital:		
	3,00,000 Equity shares of Rs.10 each fully paid up		3,000
	20,000 9% Preference Shares of 100 each		2,000
	Total		5,000
2	Reserves and Surplus		
	Capital reserve		10
	Revenue reserve		4,000
	Securities premium		500

	Profit and Loss account		**1,800**
	Total		**6,310**
3	**Long term borrowings**		
	10% Debentures		**400**
4	**Property, Plant and Equipment (PPE)**		
	PPE: Cost		**3,000**
	Less: Provision for depreciation		**(250)**
	Net carrying value		**2,750**

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

You are required to pass necessary Journal entries.

Solution

Journal Entries in the books of M Ltd.

Rs. in '000

	Particulars		**Dr.**	**Cr.**
1	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3000
	(Being investment sold for the purpose of buy back of Equity Shares)			
2	Equity share capital A/c	Dr.	600	
	Premium payable on buy-back	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
3	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back of equity shares			
4	Securities Premium A/c	Dr.	300	
	To Premium payable on buy-back			300
	(Being premium payable on buy-back charged from Securities premium)			
5	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c			600
	(Being creation of capital redemption reserve to the extent of the equity shares bought back)			

Illustration 2

Anu Ltd. (a non-listed company) furnishes you with the following balance sheet as at 31st March, 20X1:

(in crores Rs.)

Particulars			Notes	Rs.
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	100
	B	Reserves and Surplus	2	300
2		Current liabilities		
	A	Trade Payables		40
		Total		440
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	3	–
	B	Non-Current Investments	4	100
2		Current assets		
	A	Trade receivables		140
		Cash and Cash equivalents		200
		Total		440

Notes to accounts

No.	Particulars		Rs.
1	Share Capital		
	Authorized, Issued and Subscribed Share Capital:		
	12% Redeemable preference shares of Rs.100 each, fully paid up		75
	Equity shares of Rs.10 each fully paid up		25
	Total		100
2	Reserves and Surplus		
	Capital reserve		15
	Securities premium		25
	Revenue reserve		260
	Total		300
3	Property, Plant and Equipment		
	PPE: Cost		100

	Less: Provision for depreciation		**(100)**
	Net carrying value		**Nil**
4	**Non-Current Investments**		
	Non-current investments at cost (Market value Rs. 400 Cr.)		**100**

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of Rs.10 each at Rs.50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

i. Pass journal entries to record the above.

ii. Prepare balance sheet as at 1.4.20X1.

Solution

i. Journal entries in the books of Anu Ltd.

Rs. in crores

	Particulars	**Dr.**	**Cr.**
1st April, 20X1	12% Preference share capital A/c Dr. To Preference shareholders A/c (Being preference share capital account transferred to shareholders account)	75	 75
	Preference shareholders A/c Dr. To Bank A/c (Being payment made to shareholders)	75	 75
	Shares buy-back A/c Dr. To Bank A/c (Being 50 lakhs equity shares bought back @ Rs. 50 per share)	25	 25
	Equity share capital A/c (50 lakhs x Rs. 10) Dr. Securities premium A/c (50 lakhs x Rs. 40) Dr. To Shares buy-back A/c (Being cancellation of shares bought back) 25	5 20	 25
	Revenue Reserve A/c Dr. To Capital Redemption Reserve A/c (75 + 5) (Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)	80	 80

ii. **Balance Sheet of Anu Ltd as at 1.4.20X1**

(In crores Rs.)

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	20
	B	Reserves and Surplus	2	280
2		Current liabilities		
	A	Trade Payables		40
		Total		340
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	–
	B	Non-Current Investments	4	100
2		**Current assets**		
	A	Trade receivables		140
	B	Cash and Cash equivalents		100
		Total		340

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Authorized, issued and subscribed share capital 200 lakhs Equity shares of Rs. 10 each fully paid		20
	Total		20
2	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280

3	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4	**Non-Current Investments**		
	Non-current investments at cost		100
	(Market value Rs. 400 Crores)		
5	**Cash and Cash Equivalents**		
	Cash and Cash Equivalents as on 31.3.20X1		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

Illustration 3

Dee Limited (a non-listed company) furnishes the following Balance Sheet as at 31st March, 20X1:

(in thousand Rs.)

		Particulars	**Notes**	**Rs.**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	1	**2,700**
	B	**Reserves and Surplus**	2	**9,700**
2		**Current liabilities**		
	A	**Trade Payables**		**1,400**
		Total		**13,800**
		Assets		
1		**Non-current assets**		
	A	**Property, plant and equipment**		**9,300**
	B	**Non-Current Investments**		**3,000**
2		**Current assets**		
	A	**Inventories**		**500**
	B	**Trade receivables**		**200**
	C	**Cash and Cash equivalents**		**800**
		Total		**13,800**

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of Rs. 10 each fully paid up		**2,500**
	2,000, 10% Preference shares of Rs. 100 each		**200**
	(Issued two months back for the purpose of buy-back)		
	Total		**2700**
2	**Reserves and Surplus**		
	Capital reserve		**1,000**
	Revenue reserve		**3000**
	Securities premium		**2,200**
	Profit and loss account		**3,500**
	Total		**9,700**

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

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

Solution

Journal Entries in the books of Dee Limited

(in thousand Rs.)

	Particulars		Dr.	Cr.
i.	Bank Account	Dr.	2,200	
	Profit and Loss Account	Dr.	800	
	To Investment Account			3,000
	(Being the investments sold at loss for the purpose of buy-back)			
ii.	Equity Share buy-back Account	Dr.	2,500	
	To Bank Account			2,500
	(Being the payment made on buy-back)			
iii.	Equity Share Capital Account	Dr.	500	
	Premium Payable on Buy-Back Account	Dr.	2,500	
	To Equity Shares Buy-Back Account			2,500
	(Being the buy-back amount allocated to equity share capital)			
iv.	Securities premium Account	Dr.	2,000	

	To Premium payable on buy-back Account (Being the premium payable on buy-back adjusted against securities premium account)		2,000
v.	Revenue reserve Account Dr. To Capital Redemption Reserve Account (Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)	300	 300

Balance Sheet of Dee Limited as at 1st April, 20X1

(After buy-back of shares)

(in thousand Rs.)

		Particulars	**Notes**	**Rs.**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,200
	B	Reserves and Surplus	2	6,900
2		**Current liabilities**		
	A	Trade Payables		1,400
		Total		10,500
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment		9,300
2		**Current assets**		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		800
		Total		10,500

Notes to accounts

No.	**Particulars**		**Rs.**
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of Rs. 10 each fully paid up		2,000

	2,000, 10% Preference shares of Rs. 100 each		200
	(Issued two months back for the purpose of buy-back)		_____
	Total		2,200
2	**Reserves and Surplus**		
	Capital reserve		1000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	
	Less: Loss on investment	(800)	2,700
	Total		6,900

Illustration 4

Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March, 20X1:

(in lakhs Rs.)

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**120**
	B	**Reserves and Surplus**	**2**	**118**
2		**Non-Current liabilities**		
		Long term borrowings	**3**	**4**
3		**Current liabilities**		
	A	**Trade Payables**		**70**
		Total		**312**
		Assets		
1		**Non-current assets**		
	A	**Property, plant and equipment**		**50**
	B	**Non-Current Investments**		**120**
2		**Current assets**		
	A	**Cash and Cash equivalents**		**142**
		Total		**312**

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity shares of Rs. 10 each fully paid		**100**
	9% Redeemable preference shares of Rs. 100 each fully paid		**20**
	Total		**120**
2	**Reserves and Surplus**		
	Capital reserve		**8**
	Revenue reserves		**50**
	Securities Premium		**60**
	Total		**118**
3	**Long term borrowings**		
	10% Debentures		**4**

i. **The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.**

ii. **It also bought back 3 lakhs equity shares of Rs. 10 each at Rs. 30 per share. The payment for the above was made out of huge bank balances.**

iii. **Included in its investment were "investments in own debentures" costing Rs. 2 lakhs (face value Rs. 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.**

iv. **The company had 1,00,000 equity stock options outstanding on the abovementioned date, to the employees at Rs. 20 when the market price was Rs.30 (This was included under current liabilities) On 1.04.20X1 employees exercised their options for 50,000 shares.**

v. **Pass the journal entries to record the above.**

vi. **Prepare Balance Sheet as at 01.04.20X1.**

Solution

(Rs. in lakhs)

Date	Particulars		Debit	Credit
20X1	9% Redeemable preference share capital A/c	Dr.	20.00	
1st April	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			

	Preference shareholders A/c To Bank A/c (Being payment made to shareholders)	Dr.	22.00	 22.00
	Equity shares buy-back A/c To Bank A/c (Being 3 lakhs equity shares of Rs. 10 each bought back @ Rs. 30 per share)	Dr.	90.00	 90.00
	Equity share capital A/c Securities premium A/c Dr. To Equity Shares buy-back A/c (Being cancellation of shares bought back)		30.00 60.00	 90.00
	Revenue reserve A/c To Capital redemption reserve A/c (Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)	Dr.	50.00	 50.00
	10% Debentures A/c To Investment (own debentures) A/c To Profit on cancellation of own debentures A/c (Being cancellation of own debentures costing Rs. 2 lakhs, face value being Rs. 2.20 lakhs and the balance being profit on cancellation of debentures)	Dr.	2.20	 2.00 0.20
	Bank A/c Employees stock option outstanding (Current liabilities) A/c To Equity share capital A/c To Securities premium A/c (Being the allotment to employees, of 50,000 shares of Rs. 10 each at a premium of 20 per share in exercise of stock options by employees)	Dr. Dr.	10.00 5.00	 5.00 10.00
	Securities premium A/c To Premium on redemption of preference shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	Dr.	2.00	 2.00

Balance Sheet of Extra Ltd. as at 01.04.20X1

(in lakhs Rs.)

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	75.00
	B	Reserves and Surplus	2	66.20
2		**Non-Current liabilities**		
		Long term borrowings	3	1.80
3		**Current liabilities**		
	A	Other Current Liabilities	4	65.00
		Total		208
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment		50
	B	Non-Current Investments	5	118.00
2		**Current assets**		
	A	Cash and Cash equivalents	6	40.00
		Total		208

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Equity shares of Rs. 10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance 8.00	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-

	Securities Premium		
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
	Total		66.20
3	**Long term borrowings**		
	10% Debentures		4.00
	Less: Cancellation of own debentures		(2.20)
	Total		1.80
4	**Other Current liabilities**		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		(5.00)
	Total		65.00
5	**Non-current investments**		
	Opening balance		120.00
	Less: Investment in own debentures		(2.00)
	Total		118.00
6	**Cash and Cash Equivalents**		
	Opening balance		142.00
	Less: Payment to preference shareholders		(22.00)
	Less: Payment to equity shareholders		(90.00)
	Add: Share price received against ESOP		10.00
	Total		40.00

Illustration 5

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 20X1:

Particulars	Rs.	Rs.
Equity Share Capital (shares of Rs. 10 each fully paid		**30,00,000**
Reserves & Surplus		
General Reserve	**32,50,000**	
Security Premium Account	**6,00,000**	

Profit & Loss Account	**4,30,000**	
Revaluation Reserve	**6,20,000**	**49,00,000**
Loan Funds		**42,00,000**

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy-back is Rs. 30 per share.

Solution

Debt Equity Ratio Test

	Particulars	**Rs.**
a.	Loan funds	42,00,000
b.	Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs. in crores)	21,00,000
c.	Present equity shareholders fund (Rs. in crores)	72,80,000
d.	Future equity shareholder fund (Rs. in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
e.	Maximum permitted buy-back of Equity (Rs. in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
f.	Maximum number of shares that can be bought back @ Rs.30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	**Rs.**
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity.

(72,80,000 –x) - 21,00,000 = y (1)

Since 51,80,000 – x = y

Equation 2: $\left(\dfrac{\text{Maximum buy-back}}{\text{Offer price for buy}-\text{back}} \times \text{Nominal value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

$= \left(\dfrac{y}{30} \times 10\right) = x$

= 3x = y (2)

x = Rs. 12,95,000 crores and y

= Rs. 38,85,000 crores

Illustration 6

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.20X1:

	Particulars	(Rs. in crores)	
1.	Equity Share Capital (Shares of Rs. 10 each fully paid)	-	330
2.	Reserves and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-
	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
3.	Loan Funds		1,800

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.20X1 a proposal to buy-back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs. 25 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Development Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either Rs. 1,200 crores or Rs. 1,500 crores.

Assuming that the entire buy-back is completed by 09.12.20X1, show the accounting entries in the company's books in each situation.

Solution

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	When loan fund is		
	Rs.1,800 crores	**Rs.1,200 crores**	**Rs. 1,500 crores**
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy-Back

(applicable only when loan fund is Rs.1,200 crores)

Rs. in crores

	Particulars		Debit	Credit
a.	Equity share buy-back account	Dr.	112.5	
	To Bank account			112.5
	(Being buy-back of 3.75 crores equity shares of Rs. 10 each @ Rs.30 per share)			
b.	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
	To Equity share buy-back account			112.5
	(Being cancellation of shares bought back)			
c.	General reserve account	Dr.	37.5	
	To Capital redemption reserve account			37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. **Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. Resources Test

Particulars	
Paid up capital (Rs. in crores)	330
Free reserves (Rs. in crores)	420
Shareholders' funds (Rs. in crores)	750
25% of Shareholders fund (Rs. in crores)	Rs. 187.5 crores
Buy-back price per share	Rs. 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3. Debt Equity Ratio Test

	Particulars	When loan fund is		
		Rs. 1,800 crores	Rs. 1,200 crores	Rs. 1,500 crores
a.	Loan funds (Rs. in crores)	1,800	1,200	1,500
b.	Minimum equity to be maintained **after** buy-back in the ratio of 2:1 (Rs. in crores)	900	600	750
c.	Present equity shareholders fund (Rs. in crores)	750	750	750
d.	Future equity shareholder fund (Rs. in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
e.	Maximum permitted buy-back of Equity (Rs. in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
f.	Maximum number of shares that can be bought back @ Rs. 30 per share (shares in crores) **(See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.
2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. In the question, it is stated that the company has surplus funds to dispose of therefore, it is presumed that buy- back is out of free reserves or securities premium and hence a sum equal to the nominal value of the

share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from present equity.

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

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buyback of equity

$$(750 - x) - 600 = y \qquad (1)$$

Since $150 - x = y$

Equation 2: $\left(\dfrac{\text{Maximum buy-back}}{\text{Offer price for buy} - \text{back}} \times \text{Nominal value} \right)$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10 \right) = x$$

[here (30 = 25% x 120]

Or

$$3x = y \qquad (2)$$

by solving the above two equations we get

x = Rs. 37.5 crores

y = Rs. 112.5 crores

TEST YOUR KNOWLEDGE

MCQs

1. **As per section 68(1) of the Companies Act, buy-back of own shares by the company, shall not exceed**
   a. **25% of the total paid-up capital and free reserves of the company.**
   b. **20% of the total paid-up capital and free reserves of the company.**
   c. **15% of the total paid-up capital and free reserves of the company.**
   d. **10% of the total paid-up capital and free reserves of the company.**

2. **The companies are permitted to buy-back their own shares out of**
   a. **Free reserves and Securities premium**
   b. **Proceeds of the issue of any shares.**
   c. **Both (a) and (b)**
   d. **Neither (a) nor (b).**

3. **When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to**
   a. **Revenue redemption reserve.**
   b. **Capital redemption reserve.**
   c. **Buy-back reserve**
   d. **Special reserve**

4. **State which of the following statements is true?**
   a. **Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.**
   b. **Partly paid shares cannot be bought back by a company.**
   c. **Buy-back of equity shares in any financial year shall exceed twenty-five per cent of its total paid-up equity capital in that financial year.**
   d. **Partly paid shares can be bought back by a company.**

5. **Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against**
   a. **Free reserves.**
   b. **Securities premium.**
   c. **Both (a) and (b).**
   d. **Neither (a) nor (b).**

6. **Advantages of Buy-back of shares include to**

   a. **Encourage others to make hostile bid to take over the company.**

   b. **Decrease promoters holding as the shares which are bought back are cancelled.**

   c. **Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.**

   d. **All of the above.**

ANSWERS/HINTS

MCQs

1.	**a.**	25% of the total paid-up capital and free reserves of the company.
2.	**c.**	Both a. and b.
3.	**b.**	Capital redemption reserve.
4.	**b.**	Partly paid shares cannot be bought back by a company.
5.	**c.**	Both a. and b.
6.	**c.**	Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.

THEORETICAL QUESTIONS

Q.NO.1. What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as per Companies Act, 2013? Explain in brief.

ANSWER

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. For details, refer Para 1.1 and 1.2 of the chapter.

Q.NO.2. SMM Ltd. has the following capital structure as on 31st March, 20X1:

Rs. in crore

	Particulars	Situation I	Situation II
i.	Equity share capital (shares of Rs. 10 each)	1,200	1,200
ii.	Reserves:		
	General Reserves	1,080	1,080
	Securities Premium	400	400
	Profit & Loss	200	200
	Infrastructure Development Reserve (Statutory Reserve)	320	320
iii.	Loan Funds	3,200	6,000

The company has offered buy-back price of Rs.30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries.

SOLUTION

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	**When loan fund is**	
	Rs.3,200 crores	**Rs.6,000 crores**
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil
Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy-Back

(applicable only when loan fund is Rs.3,200 crores)

			Rs. in crores
	Particulars	**Debit**	**Credit**
a.	Equity shares buy-back account Dr.	720	
	To Bank account		720
	(Being payment for buy-back of 24 crores equity shares of Rs.10 each @ Rs.30 per share)		
b.	Equity share capital account Dr.	240	
	Premium Payable on buy-back account Dr.	480	
	To Equity share buy-back account		720
	(Being cancellation of shares bought back)		
	Securities Premium account Dr.	400	
	General Reserve / Profit & Loss A/c Dr.	80	
	To Premium Payable on buy-back account		480
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)		
c.	General Reserve / Profit & Loss A/c Dr.	240	
	To Capital redemption reserve account		240
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)		

Working Notes:

1. **Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	120
25% of the shares outstanding	30

2. **Resources Test**

Particulars	
Paid up capital (Rs. in crores)	1,200
Free reserves (Rs. in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (Rs. in crores)	2,880
25% of Shareholders fund (Rs. in crores)	Rs. 720 crores
Buy-back price per share	Rs. 30
Number of shares that can be bought back	24 crores shares

3. **Debt Equity Ratio Test:** Loans cannot be in excess of twice the Equity Funds post Buy-Back

Particulars	When loan fund is	
	Rs. 3,200 crores	Rs. 6,000 crores
a. Loan funds (Rs.)	3,200	6,000
b. Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs.) (a/2)	1,600	3,000
c. Present equity shareholders fund (Rs.)	2,880	2,880
d. Future equity shareholders fund (Rs.) (see W.N.4)	2,560 (2,880-320)	N.A.
e. Maximum permitted buy back of Equity (Rs.) [(d) – (b)]	960	Nil
f. Maximum number of shares that can be bought back @ Rs. 30 per share	32 crore shares	Nil
As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

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

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

Equation 1: (Present Equity- Transfer to CRR) - Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

y/30 x 10 = x

or

3x = y (2)

By solving the above two equations we get

x= Rs. 320

y = Rs. 960

Q.NO.3. KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	**Notes**	**Rs.**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**1,200**
	B	**Reserves and Surplus**	**2**	**810**
2		**Non-Current liabilities**		
		Long term borrowings	**3**	**750**
3		**Current liabilities**		
	A	**Trade Payables**		**745**
		Other Current Liabilities		**195**
		Total		**3,700**
		Assets		
1		**Non-current assets**		
	A	**Property, plant and equipment**	**4**	**2,026**
	B	**Non-Current Investments**		**74**
2		**Current assets**		
	A	**Inventories**		**600**
	B	**Trade receivables**		**260**
	C	**Cash and Cash equivalents**		**740**
		Total		**3,700**

No.	Particulars	Rs.
1	**Share Capital**	
	Authorized, issued and subscribed capital	
	Equity share capital (fully paid up shares of Rs.10 each)	1,200
2	**Reserves and Surplus**	
	Securities premium	175
	General reserve	265
	Capital redemption reserve	200
	Profit & loss A/c	170
	Total	810
3	**Long term borrowings**	
	12% Debentures	750
4	**Property, plant and equipment**	
	Land and Building	1,800
	Plant and machinery	226
	Net carrying value	2,026

On 1st April, 20X1, the company announced the buy-back of 25% of its equity shares @ Rs. 15 per share. For this purpose, it sold all of its investments for Rs. 75 lakhs.

On 5th April, 20X1, the company achieved the target of buy-back. On 30th April, 20X1 the company issued one fully paid up equity share of Rs. 10 by way of bonus for every four equity shares held by the equity shareholders.

You are required to:

1. **Pass necessary journal entries for the above transactions.**
2. **Prepare Balance Sheet of KG Limited after bonus issue of the shares.**

SOLUTION

In the books of KG Limited Journal Entries

Date 20X1	Particulars		Dr.	Cr.
			(Rs. in lakhs)	
April 1	Bank A/c Dr.		75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	300	
	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450

	(Being the amount due to equity shareholders on buy-back)		
	Equity shares buy-back A/c Dr. To Bank A/c (Being the payment made on account of buy back of 30 Lakh Equity Shares)	450	450
April 5	General reserve A/c Dr. Profit and Loss A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)	265 35	300
April 30	Capital redemption reserve A/c Dr. To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	225	225
	Bonus shares A/c Dr. To Equity share capital A/c (Being issue of one bonus equity share for every four equity shares held)	225	225

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

		Particulars	**Notes**	**Rs.**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,125
	B	Reserves and Surplus	2	436
2		**Non-Current liabilities**		
		Long term borrowings	3	750
3		**Current liabilities**		
	A	Trade Payables		745
		Other Current Liabilities		195
		Total		3,251
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026
2		**Current assets**		
	A	Inventories		600

	B	Trade receivables		260
	C	Cash and Cash equivalents		365
		Total		3,251

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid up shares of Rs. 10 each)		1,125
2	**Reserves and Surplus**		
	General Reserve	265	
	Less: Transfer to CR	(265)	–
	Capital Redemption Reserve	200	
	Add: Transfer due to buy-back of shares from P/L	35	
	Add; Transfer due to buy-back of shares from General Reserve	265	
	Less: Utilisation for issue of bonus shares	(225)	275
	Securities premium	175	
	Less: Adjustment for premium paid on buy back	(150)	25
	Profit & Loss A/c	170	
	Add: Profit on sale of investment	1	
	Less: Transfer to CRR	(35)	136
	Total		436
	Long term borrowings		
3	12% Debentures		750
	Property, Plant and Equipment		
4	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working Notes:

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

Particulars	Rs. in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

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

Q.NO.4. Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	1	12,50,000
	B	**Reserves and Surplus**	2	18,75,000
2		**Non-Current liabilities**		
		Long term borrowings	3	28,75,000
3		**Current liabilities**		
	A	**Other Current Liabilities**		16,50,000
		Total		76,50,000
		Assets		
1		**Non-current assets**		
	A	**Property, plant and equipment**	4	46,50,000
2		**Current assets**		
	A	**Other Current Assets**		30,00,000
		Total		76,50,000

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid up shares of Rs. 10 each)		12,50,000
	Reserves and Surplus		
2	**Securities premium**		2,50,000
	Profit and loss account		1,25,000
	Revenue reserve		15,00,000
	Total		18,75,000
	Long term borrowings		
3	**14% Debentures**		18,75,000

	Unsecured Loans		**10,00,000**
	Total		**28,75,000**
4	**Property, plant and equipment**		
	Land and Building		**19,30,000**
	Plant and machinery		**18,00,000**
	Furniture and fitting		**9,20,000**
	Net carrying value		**46,50,000**

The company wants to buy-back 25,000 equity shares of Rs. 10 each, on 1st April, 20X1 at Rs. 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy-back of shares by company is within the provisions of the Companies Act, 2013. If yes, pass necessary journal entries towards buy-back of shares and prepare the Balance Sheet after buy-back of shares.

SOLUTION

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

1. Shares Outstanding Test

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

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

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

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	Rs.
a.	Loan funds (Rs.) (18,75,000 + 10,00,000 + 16,50,000)	45,25,000

b.	Minimum equity to be maintained after buy back in the ratio of 2:1 (Rs.) (a/2)	22,62,500
c.	Present equity/shareholders fund (Rs.)	31,25,000
d.	Future equity/shareholders fund (Rs.) (see W.N.) (31,25,000 – 2,87,500)	28,37,500∗
e.	Maximum permitted buy-back of Equity (Rs.) [(d) – (b)]	5,75,000
f.	Maximum number of shares that can be bought back @ Rs. 20 per share	28,750 shares
g.	Actual Buy-Back Proposed	25,000 Shares

∗As per Section 68 (2) (d) of the Companies Act 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69 (1), on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69 (2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.

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

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

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1.

However, company wants to buy-back only 25,000 equity shares @ Rs. 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

	Particulars		Debit (Rs.)	Credit (Rs.)
a.	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy-back of 25,000 equity shares of Rs. 10 each @ Rs. 20 per share)			
b.	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
c.	Revenue reserve account	Dr.	2,50,000	

	To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)		2,50,000

Balance Sheet of M/s. Competent Ltd. as at 31st March, 20X1

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	10,00,000
	B	Reserves and Surplus	2	16,25,000
2		**Non-Current liabilities**		
		Long term borrowings	3	28,75,000
3		Current liabilities		
	A	Other Current Liabilities		16,50,000
		Total		71,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets(30,00,000 – 5,00,000)		25,00,000
		Total		71,50,000

Notes to accounts

No.	Particulars		Rs.
1	**Share Capital**		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid up shares of Rs. 10 each)		10,00,000
	Reserves and Surplus		
2	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	(2,50,000)	12,50,000
	Securities premium	2,50,000	
	Less: Utilization for share buy-back	(2,50,000)	-
	Capital Redemption Reserves		2,50,000

	Total		16,25,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

Working Note:

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

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

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

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

by solving the above equation, we get

x = Rs.2,87,500

y = Rs. 5,75,000

13. AMALGAMATION OF COMPANIES

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Understand the term "Amalgamation" and the methods of accounting for amalgamations.
- Appreciate the concept of transferee Company and the transferor company.
- Meaning of purchase consideration and Calculation of Purchase consideration under various Methods.
- Pass the entries to close the books of the vendor company.
- Pass the journal entries in the books of purchasing company to incorporate the assets and liabilities of the vendor company and also giving effect to other adjustments.
- Preparation of Balance sheet of transferee company after Amalgamation.

1. INTRODUCTION

In today's modern world, we are witnessing, the rise of different business ideas every other day. This has attributed to the immense increase in the competition. Some of the shrewd businesses survive through this cut throat competition, whereas some of them are wiped out due to the dynamics of this very competition.

Like the strategies to set up businesses, there has been wide increase in realizing the need to stay in the business through the different difficult market situations. Hence, the business world has also seen the growing importance of business saving strategies.

There can be different strategies to ensure the business continues to exist, or existing companies find ways to increase market share by eliminating the competitors or to come out of financial crisis by restructuring the present capital structure and the like.

Such strategies are termed using different words like "corporate marriages", "strategic alliances", "business partnering", etc. The same has been defined in the Accounting Standard 14 (AS 14).

In this chapter we shall understand the terms, meanings, methods, accounting treatments related to amalgamation in detail.

2. MEANING OF AMALGAMATION

Amalgamation refers to the process of merger of two or more companies into a single entity or where one company takes over the other by outright purchase. Therefore, the term 'amalgamation' contemplates two kinds of activities:

i. two or more companies join to form a new company (Popularly known as Amalgamation) or

ii. Absorption and blending of one by the other (Popularly known as Absorption).

As discussed, this arrangement is sought by companies to receive various advantages such as economies of large-scale production, avoiding competition, increasing efficiency, expansion, increase in market share, etc.

In amalgamation we have generally two companies called as – 1) vendor or Transferor Company and 2) Vendee or Transferee Company. Let us understand the concepts through the following examples

Example 1- Company A and Company B amalgamate to form Company C. Company A and Co B are called transferor companies and Company C is called as the transferee company- this strategy is called as **AMALGAMATION.**

Example 2- Company A is taken over by Company B (purchased). Here, Company A is called as Transferor Company and Company B is Transferee Company. This strategy is called as **ABSORPTION.**

Example 3- Company A has been suffering from losses for past 5 years, a new Company B is floated to take over the existing Company A. Here, Company A is the transferor company and Company B is Transferee Company. This strategy is termed as **EXTERNAL RECONSTRUCTION.**

The concept of the examples given above can be understood from the following table of differences-

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and a **new company** is formed to take over their business.	In this case **an existing company** takes over the business of **one or more** existing companies.	In this case, a **newly formed company** takes over the business of an **existing company.**
Minimum number of Companies involved	At least three companies are involved.	At least two companies are involved.	Only two companies are involved.
Number of new resultant companies	Only one resultant company is formed. Two companies are wound up to form a **single** resultant company.	No new resultant company is formed.	Only one resultant company is formed. Under this case **a newly formed company** takes over the business of an existing company.

Objective	Amalgamation is done to cut competition & reap the economies in large scale.	Absorption is done to cut competition & reap the economies in large scale.	External reconstruction is done to reorganize the financial structure of the company.

In every type of amalgamation, the assets and liabilities of the transferor company are amalgamated or transferred to the transferee company. The accounting treatment in the books of both the transferor and transferee is given in further sections.

3. TYPES OF AMALGAMATION

The Institute of Chartered Accountants of India has introduced Accounting Standard -14 (AS 14) on 'Accounting for Amalgamations'. The standard recognizes two types of amalgamation –

Amalgamation in the nature of merger is an amalgamation where there is a genuine pooling not only of assets and liabilities of the transferor and transferee companies but also of the shareholders' interests and of the businesses of the companies. The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the respective figures of the transferor and transferee companies.

Amalgamation in the nature of merger is an amalgamation, as per para 3(e) of AS-14, which satisfies all the following conditions:

- **i.** All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- **ii.** Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
- **iii.** The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- **iv.** The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- **v.** No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies. For example, if transferor company

is following weighted average method for inventory valuation, the book value of the inventory of the transferor company will be revised by applying the FIFO method (if the transferee company follows FIFO method for inventory valuation).

If any one or more of the above conditions are not satisfied in an amalgamation, such amalgamation is called **amalgamation in the nature of purchase.**

Difference between amalgamation in the nature of merger and amalgamation in the nature of purchase

Best of Distinction	Amalgamation in the Nature of Merger	Amalgamation in the Nature of Purchase
a. Transfer of Assets and Liabilities	There is transfer of all assets & liabilities.	There need not be transfer for all assets & liabilities.
b. Shareholders of transferor company	Equity shareholders holding 90% equity shares in transferor company become shareholders of transferee company.	Equity shareholders need not become shareholders of transferee company
c. Purchase Consideration	Purchase consideration is discharged wholly by issue of equity shares of transferee company (except cash only for fractional shares)	Purchase consideration need not be discharged wholly by issue of equity shares.
d. Same Business	The same business of the transferor company is intended to be carried on by the transferee company.	The business of the transferor company need not be intended to be carried on by the transferee company.
e. Recording of Assets & Liabilities	The assets & liabilities taken over are recorded at their existing carrying amounts except where adjustment is required to ensure uniformity of accounting policies.	The assets & liabilities taken over are recorded at their existing carrying amounts or the basis of their fair values.
f. Method of Accounting	Journal entries for recording the merger are passed by pooling of interest method.	Journal entries for recording the purchase of business are passed by purchase method.

4. PURCHASE CONSIDERATION

For purpose of accounting for amalgamations, we are essentially guided by AS 14 'Accounting for Amalgamations'. Para 3(g) of AS 14 defines the term purchase consideration as the "**aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company".**

In simple words, it is the price payable by the transferee company to the transferor company for taking over the business of the transferor company.

The important point to be noted here is the amount paid towards the equity shareholders and preference shareholders is only considered as part of the purchase consideration as per the definition under AS-14. Hence, it should be noted that purchase consideration **does not include** the sum which the transferee company will directly pay to the debenture-holders or creditors of the transferor company. If a certain liability of the transferor company has not been taken over by the transferee company it will be discharged by the transferor company.

The purchase consideration can be computed in the following methods

1. **Lumpsum method**- Under this method, the transferee company agrees to pay a lumpsum/fixed amount to shareholders of the transferor company.
2. **Net payment method**- Under this method the transferee company makes individual payments to the equity shareholders and preference shareholders either by way of cash, issue of shares and debentures.
3. **Net assets method**- Under this method, the purchase consideration is arrived based on the value of the Assets less the outside liabilities (excluding share capital and reserves) taken over by the transferee company. As per AS 14, the value of the assets and liabilities shall be at the value as agreed between the two parties. If there is no value agreed, then assets and liabilities taken at the book value.

   The purchase consideration essentially depends upon the fair value of its elements.
4. **Intrinsic value or share exchange method** – Under this method, the purchase consideration is calculated at the intrinsic value of shares of the transferor or transferee company. The ratio of shares to be issued is computed and multiplied with intrinsic value. Total share capital of the transferor company shall be divided by the total number of shares

   Any of the methods or a combination of the above methods can be used by the companies to calculate the purchase consideration.

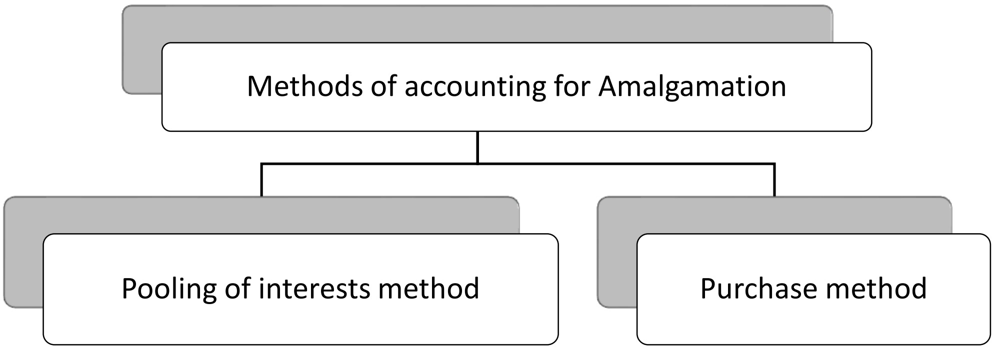
   Purchase consideration either recorded at Issue price or at Par value.

   The above methods have been explained in the following illustrations.

(Refer Illustration 1 - 4)

5. METHODS OF ACCOUNTING FOR AMALGAMATIONS

There are two main methods of accounting for amalgamation viz,



The first method is used in case of amalgamation in the nature of merger where the conditions as per para 3(e) of AS-14, required are fulfilled and the second method is used in case of amalgamation in the nature of purchase.

Pooling of Interest Method

Under pooling of interests method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies.

As a result the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in the reserves of the financial statements of Transferee company (recorded as deduction from the reserves where the capital issued is more than the capital of the transferor company).

In simple terms, where in case of pooling method- the amount to be adjusted against the reserves- can be computed in the following 3 steps-

Step I- Equity Share capital + Preference share capital issued+ any other additional consideration in form of cash and other assets by the Transferee Company.

Step II- Existing Equity share capital + Existing Preference share capital in the books of Transferor Company.

Step III- Step I- Step II= amount to be adjusted from the reserves of Transferee company.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized as goodwill in the financial statement of the transferee company. Any short fall should be shown as capital reserve. Goodwill should be amortized over period of five years unless a somewhat longer period can be justified.

In simple terms, where in case of purchase method- the amount to be transferred to capital reserve or to be recorded as Goodwill- can be computed in the following 3 steps-

Step I- Find out the **Net assets** amount using the following formula- Total assets - Outside liabilities (Non-current liabilities + Current Liabilities)

Step II- Compute the **purchase consideration** using any of the methods as given under Purchase consideration computation.

Step III- (a) If Step I- Step II= Positive amount- then it is capital reserve- since the assets received more than the amount paid as purchase consideration to acquire them.

(b) If Step I- Step II= Negative amount- then it is to be recorded as Goodwill (intangible asset) - since the amount paid for acquiring business is more than the Net assets, which is technically due to its goodwill.

Treatment of reserves under purchase method

No reserves, other than statutory reserves, of the transferor company should be incorporated in the financial statements of transferee-company.

The balance of Profit and Loss account, general reserves of the transferor company are not recorded at all.

Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made only in respect of statutory reserves and such reserves shall retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, till the time their identity is required to be maintained to comply with the relevant statute.

This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with.

Statutory reserves of the transferor company should be incorporated in the balance sheet of transferee company by way of the following journal entry.

Amalgamation Adjustment Reserve A/c Dr.

To Statutory Reserves

'Amalgamation Adjustment Reserve' is debited to bring in the statutory reserves of the transferor company. This is represented as deduction from the reserves of the transferee company after amalgamation.

Once after the time period to show such statutory reserves is over, both the reserves and the aforesaid account are reversed. **<u>Amalgamation Adjustment Reserve'</u>** has to be shown as a separate line item - which implies, that this debit "cannot be set off against statutory reserve taken over" and therefore, the presentation will be as follows:

Reserves

Description	Amount (Current year)	Amount (Previous Year)
Statutory Reserve (taken over from transferor company)		
General Reserve		
Retained Earnings		
Amalgamation Adjustment Reserve (negative balance)	(--)	(--)

6. JOURNAL ENTRIES TO CLOSE THE BOOKS OF VENDOR COMPANY

In case of amalgamation under any of the above methods, there shall be an accounting treatment both in the books of vendor (transferor) and vendee (transferee) companies.

We will now, understand the treatment in the books of vendor under this section Since the books of the vendor will be closed upon amalgamation- the assets and the liabilities at the book values are transferred to a separate account called as the "Realization account".

The purchase consideration receivable is credited to the Realization account. On the receipt of the purchase consideration, it is debited to equity shareholders and preference shareholders' account.

The balance of realization account (either profit/loss) is transferred to the equity shareholders' account.

Those assets and liabilities which are not taken over by Vendee Company but settled by the vendor company are also shown in the books of the vendor only.

The journal entries have been explained with the following illustration:

(Refer Illustration 5)

7. ENTRIES IN THE BOOKS OF PURCHASING COMPANY

In the books of the purchasing/ vendee/ transferee company, the assets and liabilities which are taken overs are recorded at the agreed values and where there is no agreed value then at the book values.

Continuing with the information given in Illustration 5:

1. Debit Business Purchase Account and Credit Liquidator of the vendor company with the account of the purchase consideration. Thus –

		Rs.	Rs.
Business Purchase A/c	Dr.	17,20,000	
To Liquidator of Zed Ltd.			17,20,000

(Amount payable to Zed Ltd. as per agreement dated....)

2.

i. <u>Debit assets acquired</u> (except goodwill) at the value placed on them by the purchasing company;

ii. <u>Credit liabilities taken</u> over at agreed values and credit Business Purchase Account with the amount of purchase consideration; and

iii. If the credits as per (ii) above exceed debits as per (i) above, the difference should be debited to Goodwill Account, in the reverse case, the difference should be credited to Capital Reserve.

Note: The amount of Goodwill or Capital Reserve that shall be included will be the amount as has been arrived at only in foregoing manner.

In the above case the entry to be passed shall be:

		Rs.	Rs.
Land and Building A/c	Dr.	5,50,000	
Plant and Machinery A/c	Dr.	6,50,000	
Patents A/c	Dr.	20,000	
Inventory A/c	Dr.	1,50,000	
Trade receivables	Dr.	1,80,000	
Goodwill	Dr.	5,05,000	
To			
Provision for Workmen's Compensation A/c			5,000
Trade payables			1,20,000
Debentures in Z Ltd.			2,10,000
Business Purchases Account			17,20,000

(Various assets and liabilities taken over from Zed Ltd. Goodwill ascertained as a balancing figure)

3. On the payment to the vendor company the balance at its credit, the entry to be made by Wye Ltd. shall be:

		Rs.	Rs.
Liquidator of Zed Ltd.	Dr.	17,20,000	
To Cash			2,00,000

To 9% Preference Share Capital A/c		4,00,000
To Equity Share Capital A/c		8,00,000
To Securities Premium A/c		3,20,000
(Payment of cash and issue of shares in satisfaction of purchase consideration)		

4.

	Rs.	**Rs.**
Debentures in Z Ltd. A/c Dr.	2,10,000	
To 7% Debentures A/c		2,00,000
To Premium on Debentures A/c		10,000
(Debentures issued)		

5. If the purchasing company is required to pay the expenses of liquidation of the vendor company, the amount should be debited to the Goodwill or Capital Reserve Account, as the case may be. In the instant case, the entry shall be:

	Rs.	**Rs.**
Goodwill Account Dr.	10,000	
To Cash Account		10,000
(Amount paid towards liquidation expenses on Zed Ltd.)		

Typical adjustments which shall be noted while working out the problems

Entries at par value - The students will note that purchasing company is left with a large debit in the Goodwill Account (Step No. 2) accompanied by quite a large amount in the Securities Premium Account (Step No. 3). The two cannot be adjusted. However, it would be permissible to negotiate on the basis to the market value of the shares but to make entries only on the basis of par of shares of purchasing company. This will mean that Goodwill Account (or Capital Reserve) will be automatically adjusted for the securities premium.

Inter Company-owing - Should the purchasing company owe an amount to the vendor company or vice versa, the amount will be included in the book debts of one company and trade payables of the other. This should be adjusted by the entry:

Trade payables Dr.

To Trade receivables

The entry should be made after the usual acquisition entries have been passed. At the time of preparing the Realization Account and passing the business purchase entries, no attention need be paid to the fact that the two companies involved owed money mutually.

Adjustment of the value of stock - Inter-company owing's arise usually from purchase and sale of goods; it is likely, therefore, that at the time, of the sale of business, the debtor company also has goods in stock which it purchased from the creditor company - the cost of the debtor company will include the profit made by the creditor company. After the takeover of the business it is essential that such a profit is eliminated. The entry for this will be made by the purchasing company. If it is the vendor company which has such goods in stock, at the time of passing the acquisition entries, the value of the stock should be reduced to its cost to the company which is acquiring the business; automatically goodwill or capital reserve, as the case may be, will be adjusted. But if the original sale was made by the vendor company and the stock is with the company acquiring the business, the latter company will have to debit Goodwill (or Capital Reserve) and credit stock with the amount of the profit included in the stock.

Inter-company Loans- Where there is any loan taken by the transferor company from the transferee company then the amount of the loan shall be taken over by the transferee company and adjustment entry to be passed as follows-

	Rs.	**Rs.**
Loan (liability of Transferor co) A/c Dr To Loans and advances (assets) (Elimination of the inter-company loans taken by the transferor from transferee company).	XXX	 XXX

(Refer Illustration 6 - 11)

SUMMARY

- Amalgamation means joining of two or more existing companies into one company, the joined companies lose their identity and form themselves into a new company.
- Amalgamation includes- absorption and external reconstruction within its scope as per AS 14.
- In absorption, an existing company takes over the business of another existing company. Thus there is only one liquidation and that is of the merged company.
- A company which is merged into another company is called a transferor company or a vendor company.
- A company into which the vendor company is merged is called Transferee Company or Vendee Company or purchasing company.
- Amalgamation is of two types- in the nature of merger and in the nature of purchase.
- In amalgamation in the nature of merger there is genuine pooling of:
  - **a.** Assets and liabilities of the amalgamating companies,
  - **b.** Shareholders' interest.

Also the business of the transferor company is intended to be carried on by the transferee company. The conditions as laid down in para 3(e) of AS-14 should be satisfied in full. Even if one condition is not satisfied, then it will be called as amalgamation in nature of purchase.

- In amalgamation in the nature of purchase, one company acquires the business of another company.
- Purchase Consideration can be defined as the aggregate of the shares and securities issued and the payment made in form of cash or other assets by the transferee company to the shareholders of the transferor company.
- There can be different methods to compute the purchase consideration Lumpsum payment method, Net Payment method, Net assets method, Intrinsic value or share exchange method.
- There are two main methods of accounting for amalgamation:
  a. The pooling of interests method, and
  b. The purchase method.
- Under pooling of interests method, the assets, liabilities and reserves of the transferor company will be taken over by transferee company at existing carrying amounts and the difference between the share capital issued by the transferee company to the transferor and the actual existing share capital is adjusted with the reserves.
- Under purchase method, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.
- The difference between the purchase consideration and the net assets (at agreed values) of the transferor company shall be recorded as goodwill or capital reserve in the books of the transferee company.

All inter-company adjustments shall be eliminated from the books of the transferee company after the amalgamation.

ILLUSTRATIONS

Illustration 1

S. Ltd. is absorbed by P. Ltd. S ltd. gives the following information on the date of absorption:

	Rs.
Sundry Assets	13,00,000
Share capital:	
2,000 7% Preference shares of Rs. 100 each (fully paid-up)	2,00,000
5,000 Equity shares of Rs. 100 each (fully paid-up)	5,00,000
Reserves	3,00,000
6% Debentures	2,00,000
Trade payables	1,00,000

Additional information:

P. Ltd. has agreed:

i. **To issue 9% Preference shares of Rs. 100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.**

ii. **to issue to the debenture-holders in S Ltd. 8% Mortgage Debentures at Rs. 96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%;**

iii. **to pay Rs. 20 per share in cash and to issue six equity shares of Rs. 100 each issued at the market value Rs. 125 in lieu of every five shares held in S. Ltd.; and**

iv. **To assume the liability to trade payables. You are required to calculate the purchase consideration.**

Solution

The purchase consideration will be

		Rs.	**Form**
Preference shareholders:	2,000 × 3/4 × 100	1,50,000	9% Pref. shares
Equity shareholders:	5,000 × 20	1,00,000	Cash
	5,000 × 6/5 × 125	7,50,000	Equity shares
		10,00,000	

Note:

1. According to AS 14, 'consideration' excludes the any amount payable to debenture-holders. The liability in respect of debentures of S Ltd. will be taken by P Ltd., which will then be settled by issuing new 8% debentures.

2.	The issue of the equity shares is done at Rs. 125 (market value) as it has been mentioned in the question. The face value shall not be considered for this purpose.

Illustration 2

Following is the balance sheet of A Ltd. as on 31st March, 20X1

		Particulars	Notes	Rs. (000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**22,50**
	B	**Reserves and Surplus**	**2**	**9,00**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**7,00**
3		**Current liabilities**		
	A	**Trade Payables**		**5,00**
		Total		**43,50**
		Assets		
1		**Non-current assets**		
	A	**Property, Plant and Equipment**	**4**	**32,50**
	B	**Non-current investments**	**5**	**6,00**
2		**Current assets**		
	a	**Inventories**		**2,00**
	b	**Trade receivables**		**2,00**
	c	**Cash and Cash equivalents**		**1,00**
		Total		**43,50**

Notes to accounts

1	**Share Capital**		**Rs. in ('000)**
	Equity share capital		
	1,50,000 Equity Shares of Rs. 10 each		**15,00**
	7,500 14% Preference Shares of Rs. 100 each		**7,50**
			22,50
2	**Reserves and Surplus**		
	General reserve		**9,00**
3	**Long-term borrowings**		
	Secured		

	15% Debentures		**7,00**
4	**Property, plant and Equipment**		
	Land and Building		**32,50**
5	**Non-current investments**		
	Investments at cost		**6,00**

B Ltd agreed to take over the assets and liabilities on the following terms and conditions:

a. **Discharge 15% debentures at a premium of 10% by issuing 15% debentures of X Ltd.**
b. **PPE at 10% above the book value and investments at par value.**
c. **Current assets at a discount of 10% and Current liabilities at book value.**
d. **Preference shareholders are discharged at a premium of 10% by issuing 15% preference shares of Rs.100 each.**
e. **Issue 3 equity shares of Rs. 10 each for every 2 equity shares in B Ltd. and pay the balance in cash.**

Calculate Purchase consideration.

Solution

Calculation of Purchase Consideration (Net Asset value Method)

Particulars	(Rs. in '000's)
Value of assets taken over:	
Property, Plant and Equipment	35,75
Non-Current Investments	6,00
Current Assets	4,50
Total Assets (A)	46,25
Less: **Liabilities taken over:**	
15% Debentures	7,70
Current Liabilities	5,00
Total Liabilities (B)	12,70
Purchase consideration (A -B)	33,55
Mode of Purchase Consideration	
In the form of 15% Preference shares	8,25
In the form of Equity shares	22,50
In the form of Cash (Balance)	2,80
Total	33,55

Illustration 3

Let us consider the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs. (000)
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	100,00
	B	Reserves and Surplus	2	12,50
2		Non-current liabilities		
	A	Long-term borrowings	3	40,00
3		Current liabilities		
	A	Trade Payables		20,00
		Total		172,50
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment	4	105,50
	B	Non-current investments	5	5,00
2		Current assets		
	a	Inventories		23,00
	b	Trade receivables		24,00
	c	Cash and Cash equivalents		15,00
		Total		172,50

Notes to accounts

1	Share Capital		Rs. in ('000)
	Equity share capital		
	7,50,000 Equity Shares of Rs. 10 each		75,00
	25,000 14% Preference Shares of Rs. 100 each		25,50
			100,00
2	Reserves and Surplus		
	General reserve		12,50
			12,50
3	Long-term borrowings		
	Secured		
	14% Debentures		40,00

			40,00
4	**Property, plant and Equipment**		
	Land and Building		**50,00**
	Non-current investments		**45,00**
	Investments at cost		**10,50**
			105,50
5	**Non-current investments**		
	Investments at cost		**5,00**
			5,00

Other Information:

i. **Y Ltd. takes over X Ltd. on 10th April, 20X1.**

ii. **Debenture holders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.**

iii. **14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value Rs. 100 each).**

iv. **Intrinsic value per share of X Ltd. is Rs. 20 and that of Y Ltd. Rs. 30. Y Ltd. will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, the entry should be made at par value only. The nominal value of each equity share of Y Ltd. is Rs.**

Compute the purchase consideration.

Solution

Computation of Purchase consideration	(Rs. in '000)	Form
For Preference Shareholders of X Ltd.	3,000	30,000 15% Preference shares in Y Ltd.
For shareholders of X Ltd. (20/30 × 7,50,000) × Rs. 10	5,000	5,00,000 Equity shares of Y Ltd. of Rs. 10 each
Total Purchase consideration	8,000	

Note: According to AS 14, amount paid to the debenture holders should not be included in the purchase consideration calculation. Such debentures will be taken over by Y Ltd. and then discharged by them later.

Illustration 4

Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04.20X1. Following is the Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3.20X1:

		Particulars	Notes	Neel	Gagan
		Equity and Liabilities			
1		Shareholders' funds			
	A	Share capital		7,75,000	8,55,000
2		Current liabilities		6,23,500	5,57,600
		Total		13,98,500	14,12,600
		Assets			
1		Non-current assets			
	A	Property, Plant and Equipment	1	12,35,000	12,54,000
2		Current assets		1,63,500	1,58,600
		Total		13,98,500	14,12,600

Notes to accounts:

1	Property, plant and Equipment			
	Land and Building		7,50,000	6,40,000
	Plant and machinery		4,85,000	6,14,000
			12,35,000	12,54,000

Following is the additional information:

i. **The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:**

	Neel	Gagan
	Rs.	Rs.
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

ii. **The purchase consideration is to be discharged as under:**

a. **Issue 24,000 equity shares of Rs. 25 each fully paid up in the proportion of their profitability in the preceding 2 years.**

b. **Profits for the preceding 2 years are given below:**

	Neel	Gagan
	Rs.	Rs.
1st year	2,62,800	2,75,125
IInd year	2,12,200	2,49,875
Total	4,75,000	5,25,000

c. **Issue 12% preference shares of Rs. 10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as on 31.3.20X1 after revaluation of assets of Neel Ltd. and Gagan Ltd. Respectively.**

You are required to compute the

i. **Equity and preference shares issued to Neel Ltd. and Gagan Ltd.,**

ii. **Purchase consideration.**

Solution

i. **Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.**

Profits of	**Neel**	**Gagan**
	Rs.	**Rs.**
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

The total profits- Rs. 4,75,000+ Rs. 5,25,000= Rs. 10,00,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profits.

	Neel	**Gagan**
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. and Gagan Ltd.

	Neel	**Gagan**
	Rs.	**Rs.**
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued	56,000 shares	
$\left(67{,}200 \times \frac{100}{12}\right) = 5{,}60{,}000$ @Rs.10each		
$\left(73{,}920 \times \frac{100}{12}\right) = 6{,}16{,}000$ @Rs.10each		61,600 shares

ii. **Total Purchase Consideration**

	Neel	**Gagan**
	Rs.	**Rs.**
Equity shares @ of Rs. 25 each	2,85,000	3,15,000
12% Preference shares @ of Rs. 10 each	5,60,000	6,16,000
Total	8,45,000	9,31,000

Working Note:

Calculation of Net assets as on 31.3.20X1

	Neel	Gagan
	Rs.	Rs.
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	(6,23,500)	(5,57,600)
	8,40,000	9,24,000

Note: Since the income from the preference shares shall be equal to the 8% return on assets, the shares are computed in such way that 12% dividend on them shall be equal to 8% of the return on Net assets.

Illustration 5

Wye Ltd. acquires the business of Zed Ltd. whose balance sheet as at 31st March, 20X1 is as under:

		Particulars	Notes	Rs. (000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**12,00,00**
	B	**Reserves and Surplus**	**2**	**1,58,000**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**2,00,000**
3		**Current liabilities**		
	A	**Trade Payables**		**1,20,000**
	B	**Other current liabilities**		**12,000**
		(Interest payable on debentures)		
		Total		**16,90,000**
		Assets		
1		**Non-current assets**	**4**	**10,00,000**
	A	**Property, Plant and Equipment**	**5**	**2,90,000**
	B	**Intangible assets**		
2		**Current assets**		

	a	Inventories		1,50,000
	b	Trade receivables		1,80,000
	c	Cash and Cash equivalents		70,000
		Total		16,90,000

Notes to accounts:

		Rs.
1	Share Capital	
	Equity Share capital (Rs. 100 each)	8,00,000
	6% Preference Share capital (Rs. 100 each)	4,00,000
		12,00,000
2	Reserves and Surplus	
	Capital reserve	1,00,000
	Profit and loss A/c	50,000
	Workmen compensation reserve	
	(Expected liability Rs. 5,000)	8,000
		1,58,000
3	Long-term borrowings	
	6% Debentures	2,00,000
		2,00,000
4	Property, Plant and Equipment	
	Land and Building	4,00,000
	Plant and machinery	6,00,000
		10,00,000
5	Intangible assets	
	Goodwill	2,40,000
	Patents	50,000
		2,90,000

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts:

i. **Rs. 2,00,000 7% Debentures (Rs. 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth Rs. 105.**

ii. **For each preference share in Zed Ltd. Rs. 10 in cash and one 9% preference share of Rs. 100 each in Wye Ltd.**

iii. **For each equity share in Zed Ltd. Rs.20 in cash and one equity share in Wye Ltd. of Rs.100 each having the market value of Rs.140.**

iv. **Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of Rs.10,000. Actual expenses amounted to Rs.12,500. Wye Ltd. valued Land and building at Rs.5,50,000 Plant and Machinery at Rs.6,50,000 and patents at Rs.20,000 of Zed Ltd for the purpose of amalgamation.**

Solution:

Purchase Consideration

			Rs.	**Form**
i.	Preference Shares: Rs. 10 per share	40,000		Cash
	Preference shares	4,00,000	4,40,000	Preference shares
ii.	Equity shares: Rs. 20 per share	1,60,000		Cash
	8,000 equity shares in			
	Wye Ltd. @ Rs. 140	11,20,000	12,80,000	Equity shares
			17,20,000	

Steps to close the Books of the Vendor Company

1. Open Realization Account and transfer all assets at book value.

   Exception: If cash is not taken over by the purchasing company, it should not be transferred.

   Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realization Account.

   The journal entry in the above case is:

	Rs.	**Rs.**
Realization A/c Dr.	16,20,000	
To Sundries —		
Goodwill		2,40,000
Land & Building		4,00,000
Plant & Machinery		6,00,000
Patents		50,000
Inventory		1,50,000
Trade receivables		1,80,000

   (Transfer of assets to Realization Account on sale of business to Wye Ltd.)

2. Transfer to the Realization Account the liabilities which the purchasing company is to take over. In case of the provisions, the portion which represents liability expected to arise in future should

be so transferred and the portion which is not required (i.e., the reserve portion) should be treated as profit. Accordingly, the following entry will be recorded:

		Rs.	Rs.
6% Debentures in Wye Ltd.	Dr.	2,00,000	
Workmen's Compensation Reserve	Dr.	5,000	
Trade payables	Dr.	1,20,000	
To Realization A/c			3,25,000

(Transfer of liabilities taken over by Wye Ltd. to Realization A/c)

For liabilities not take over by the purchasing company, the profit or loss on discharge of such liabilities shall be transferred to Realization Account.

3. Debit purchasing company and credit Realization Account with the purchase consideration.

		Rs.	Rs.
Wye Ltd. -	Dr.	17,20,000	
To Realization A/c			17,20,000

(Amount receivable from Wye Ltd. for sale of business)

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company. Thus —

		Rs.	Rs.
Cash	Dr.	2,00,000	
9% Preference shares in Wye Ltd.	Dr.	4,00,000	
Equity shares in Wye Ltd.	Dr.	11,20,000	
To Wye Ltd.			17,20,000

(Receipt of purchase consideration from the purchase company)

5. Expenses of liquidation have to be dealt with according to the circumstances of each case.

a. If the vendor company has to bear and pay them: Realization Account should be debited and Cash Account credited.

b. If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:

i. It may be ignored in the books of the vendor company.

ii. If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed:

a. Debit Purchasing company and credit Cash Account when expenses are paid by the vendor company; and

b. Debit Cash Account and credit purchasing company (on the expenses being reimbursed).

In the above mentioned case Wye Ltd. has to pay maximum of Rs. 10,000 only whereas, the amount spent is Rs. 12,500. Hence Rs. 2,500 is to be borne by Zed Ltd.; the entries required will be:

		Rs.	Rs.
Wye Ltd.	Dr.	10,000	
Realization A/c	Dr.	2,500	
To Cash A/c			12,500

(Liquidation expenses out of which Rs. 10,000 is payable by Wye Ltd.)

		Rs.	Rs.
Cash A/c	Dr.	10,000	
To Wye Ltd.			10,000

(Account reimbursed by Wye Ltd. for expense)

6. Liabilities not assumed by the purchasing company, have to be paid off. On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realization Account. Zed Ltd. shall pass the following entries in this respect:

		Rs.	Rs.
Interest Outstanding	Dr.	12,000	
To Debenture holders A/c			12,000
Debenture holders	Dr.	12,000	
To Cash A/c			12,000

(Debenture holders paid cash Rs. 12,000 for outstanding interest)

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realization Account. Thus —

		Rs.	Rs.
6% Pref. Share Capital A/c	Dr.	4,00,000	
Realization A/c	Dr.	40,000	
To Preference Shareholders A/c			4,40,000

(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)

Note: In the absence of any indication to the contrary, preference shareholders will be entitled only to the capital contributed by them. But if funds available after paying off creditors are not sufficient to satisfy the claim of preference shareholders fully, they will have to suffer a loss to the extent of the deficit.

8. Pay off preference shareholders by debiting them and crediting whatever is given to them. The entry in the above case is:

		Rs.	Rs.
Preference shareholders A/c	Dr.	4,40,000	
To Cash A/c			40,000
To 9% Preference shares in Wye Ltd.			4,00,000

(Cash and preference shares in Wye Ltd. given to preference shareholders)

9. Transfer equity share capital and account representing profit or loss (including the balance in Realization Account) to Equity Shareholders Account. This will determine the amount receivable by the equity shareholders. Zed Ltd. shall pass the following entries in this regard:

		Rs.	Rs.
Equity Share Capital A/c	Dr.	8,00,000	
Capital Reserve A/c	Dr.	1,00,000	
Profit and Loss A/c	Dr.	50,000	
Workmen's Compensation Reserve A/c	Dr.	3,000	
Realization A/c	Dr.	3,82,500	
To Equity Shareholders A/c			13,35,500

(Various accounts representing capital and profit transferred to Equity Shareholders Account)

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them. Hence:

		Rs.	Rs.
Equity Shareholders A/c	Dr.	13,35,500	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c (W.N.2)			2,15,500

Working Notes

1. Realization Account

Particulars	Rs.	Particulars	Rs.
To Sundry Assets	16,20,000	By Sundry Liabilities	3,25,000
To Cash (excess expenses of liquidation)	2,500		

To Preference Shareholders	40,000		
To Equity Shareholders A/c –			
profit transferred	3,82,500	By Wye Ltd.	17,20,000
	20,45,000		20,45,000

2. Cash Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	70,000	By Realization	2,500
To Wye Ltd.	2,00,000	By Wye Ltd.	10,000
(Consideration for amalgamation)		By Debenture-holders	12000
To Wye Ltd.	10,000	By Preference shareholder	40000
(Liquidation expenses reimbursed)	______	By Equity Shareholder (B/F)	215500
	280000		280000

Illustration 6

The following Balance Sheets are given as at 31st March, 20X1:

		Particulars	Rs. Best Ltd. (in lakhs)	Rs. Better Ltd. (in lakhs)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	20	10
		(shares of Rs. 100 each, fully pad)		
	B	**Reserves and Surplus**	10	8
2		**Current liabilities**	20	2
		Total	50	20
		Assets		
1		**Non-current assets**		
	A	**Property, Plant and Equipment**	25	15
	B	**Non-current investments**	5	-
2		**Current assets**	20	5
		Total	50	20

The following further information is given:

a. **Better Limited issued bonus shares on 1st April, 20X1, in the ratio of one share for every two held, out of Reserves and Surplus.**

b. **It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.**

c. **The value of shares in Best Ltd. was considered to be Rs. 150 and the shares in Better Ltd. were valued at Rs. 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.**

d. **Liabilities of Better Ltd., included Rs. 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of Rs. 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.**

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 20X1 after the takeover.

Solution

LEDGER OF BETTER LIMITED

Property, Plant and Equipment (PPE) Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	15,00,000	By Realization A/c (transfer)	15,00,000

Current Assets Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	5,00,000	By Realization A/c (transfer)	5,00,000

Liabilities Account

Particulars	Rs.	Particulars	Rs.
To Realization A/c	2,00,000	By Balance b/d	2,00,000

Realization Account

Particulars	Rs.	Particulars	Rs.
To PPE A/c”	15,00,000	By Liabilities A/c	2,00,000
Current Assets A/c	5,00,000	” Best Limited (Purchase Consideration)	15,00,000
		” Shareholders’ A/c (Loss on Realization)	3,00,000
			-
	20,00,000		20,00,000

Share Capital Account

Particulars	Rs.	Particulars	Rs.
To Sundry shareholders A/c - (transfer)	15,00,000	By Balance b/d	10,00,000
		” Reserves & Surplus A/c (Bonus issue)	5,00,000
	15,00,000		15,00,000

Reserves & Surplus Account

Particulars	Rs.	Particulars	Rs.
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
" Sundry Shareholders	3,00,000		
	8,00,000		8,00,000

Best Ltd.

Particulars	Rs.	Particulars	Rs.
To Realization A/c - Purchase Consideration	15,00,000	By Shares in Best Ltd	15,00,000
	15,00,000		15,00,000

Shares in Best Ltd.

Particulars	Rs.	Particulars	Rs.
To Best Ltd.	15,00,000	By Sundry Shareholders	15,00,000

Sundry Shareholders Account

Particulars	Rs.	Particulars	Rs.
To Realization A/c (Loss)	3,00,000	By Share Capital A/c	15,00,000
"Share in Best Ltd.	15,00,000	" Reserves & Surplus A/c	3,00,000
	18,00,000		18,00,000

Journal of Best Ltd.

20X1		Dr. Rs.	Cr. Rs.
Apr. 1 Property, Plant and Equipment A/c	Dr.	15,00,000	
Current Assets A/c	Dr.	5,00,000	
To Liabilities A/c			2,00,000
To Liquidator of Better Ltd.			15,00,000
To Capital Reserve A/c			3,00,000
(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of Rs.15,00,000 as per agreement dated....)			
Liquidator of Better Ltd.	Dr.	15,00,000	
To Share Capital A/c			10,00,000
To Securities Premium A/c			5,00,000

(Discharge of Purchase consideration by the issue of equity shares of Rs. 10,00,000 at a premium of Rs. 50 per share as per agreement)		
Trade payables A/c Dr. To Trade receivables A/c (Amount due from Better Ltd., and included in its creditors taken over, cancelled against own Trade receivables)	1,00,000	1,00,000
Capital Reserve A/c Dr. To Current Asset (Stock) A/c (Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account. 20% on sale value of Rs.50,000 shall be eliminated as unrealized profit)	10,000	10,000

Working Note:

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at Rs.100 per share Rs.15,00,000

Purchase consideration has been discharged by Best Ltd. by the issue of shares for Rs.10,00,000 at a premium of Rs. 5,00,000. This gives the value of Rs.150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	Notes	Rs. (000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
	b	Reserves and Surplus	2	17,90,000
2		**Current liabilities**		21,00,000
		Total		68,90,000
		Assets		
1		**Non-current assets**		
		Property, Plant and Equipment	3	40,00,000
	a	Non-current investments		5,00,000
2	**b**	**Current assets**		23,90,000
		Total		68,90,000

Notes to accounts

		Rs.
1. Share Capital Equity share capital		
Issued & Subscribed		
30,000 shares of Rs.100 (of the above 10,000 shares have		
been issued for consideration other than cash)		30,00,000
Total		30,00,000
2. Reserves and Surplus		
Capital Reserve (3,00,000 – 10,000)		2,90,000
Securities Premium		5,00,000
Other reserves and surplus		10,00,000
Total		17,90,000
3. Property, Plant and Equipment		
PPE	25,00,000	
Acquired during the year	<u>15,00,000</u>	40,00,000
Total		40,00,000

<u>Illustration 7</u>

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies as at the date of amalgamation was as under:

		Particulars	Notes	Rs. K Ltd.	Rs. L Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	1	12,00,000	6,00,000
	B	**Reserves and Surplus**	2	3,71,375	1,97,175
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	3	2,00,000	2,00,000
3		**Current liabilities**			
	A	**Trade Payables**		<u>1,00,000</u>	<u>2,10,000</u>
		Total		<u>18,71,375</u>	<u>12,07,175</u>
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	4	11,30,000	8,20,000

	B	Intangible assets	5	80,000	-
		Current assets			
2		Current assets			
	A	Inventories		2,25,000	1,40,000
	B	Trade receivables		2,75,000	1,75,000
	C	Cash and Cash equivalents	6	1,61,375	72,175
		Total		18,71,375	12,07,175

Notes to accounts

1	Share Capital		K Ltd.	L Ltd.
	Equity shares of Rs.100 each		8,00,000	3,00,000
	7% Preference Shares of Rs.100 each		4,00,000	3,00,000
			12,00,000	6,00,000
2	Reserves and Surplus			
	General reserve		-	1,00,000
	Profit and loss account		3,71,375	97,175
			3,71,375	1,97,175
3	Long-term borrowings			
	5% Debentures		2,00,000	–
	Secured loan		-	2,00,000
			2,00,000	2,00,000
4	Property, plant and Equipment			
	Land and Building		4,50,000	3,00,000
	Plant and machinery		6,20,000	5,00,000
	Furniture and fittings		60,000	20,000
			11,30,000	8,20,000
5	Intangible assets			
	Goodwill		80,000	-
			80,000	-
6	Cash and Cash Equivalents			
	Cash at Bank		1,20,000	55,000
	Cash in hand		41,375	17,175
			1,61,375	72,175

The terms of amalgamation are as under:

A.

1. **The assumption of liabilities of both the Companies.**
2. **Issue of 5 Preference shares of Rs. 20 each in LK Ltd. @ Rs. 18 paid up at premium of Rs. 4 per share for each preference share held in both the Companies.**
3. **Issue of 6 Equity shares of Rs. 20 each in LK Ltd. @ Rs. 18 paid up at a premium of Rs. 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.**
4. **Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.**

B.

1. **The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively to be raised.**
2. **The trade receivables of K Ltd. include Rs. 20,000 due from L Ltd.**

C. The LK Ltd. is to issue 15,000 new equity shares of Rs. 20 each, Rs. 18 paid up at premium of Rs. 4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

Solution

Books of K Ltd.

Realization Account

Particulars	Rs.	Particulars	Rs.
To Goodwill	80,000	By 5% Debentures	2,00,000
To Land & Building	4,50,000	By Trade payables	1,00,000
To Plant & Machinery	6,20,000	By LK Ltd.	15,60,000
To Furniture & Fitting	60,000	(Purchase consideration)	
To Trade receivables	2,75,000	By Equity shareholders A/c	51,375
To Stores & inventory	2,25,000	(loss)	
To Cash at Bank	1,20,000		
To Cash in hand	41,375		
To Preference shareholders (excess payment)	40,000		
	19,11,375		**19,11,375**

Equity Shareholders Account

Particulars	Rs.	Particulars	Rs.
To Realization A/c (loss)	51,375	By Share capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit & Loss A/c	3,71,375
To Cash	64,000		
	11,71,375		11,71,375

7% Preference Shareholders Account

Particulars	Rs.	Particulars	Rs.
To Preference Shares in LK Ltd.	4,40,000	By Share capital	4,00,000
		By Realization A/c	40,000
	4,40,000		**4,40,000**

LK Ltd. Account

Particulars	Rs.	Particulars	Rs.
To Realization A/c	15,60,000	By Equity Shares in LK Ltd.	
		For Equity 10,56,000	
		Pref. 4,40,000	14,96,000
		By Cash a/c	64,000
	15,60,000		**15,60,000**

Books of L Ltd. Realization Account

Particulars	Rs.	Particulars	Rs.
To Land & Building	3,00,000	By Trade payables	2,10,000
To Plant & Machinery	5,00,000	By Secured loan	2,00,000
To Furniture & Fittings	20,000	By LK Ltd.	
To Trade receivables To Inventory	1,75,000	(Purchase consideration)	7,90,000
of stores	1,40,000	By Equity shareholders A/c—	
To Cash at bank	55,000	Loss	37,175
To Cash in hand	17,175		
To Pref. shareholders	30,000		
	12,37,175		**12,37,175**

Equity Shareholders Account

Particulars	Rs.	Particulars	Rs.
To Equity shares in LK Ltd.	3,96,000	By Share Capital	3,00,000

To Realization	37,175	By Profit & Loss A/c	97,175
To Cash	64,000	By Reserve	1,00,000
	4,97,175		4,97,175

7% Preference Shareholders Account

Particulars	Rs.	Particulars	Rs.
To Preference Shares in LK Ltd.	3,30,000	By Share capital	3,00,000
		By Realization A/c	30,000
	3,30,000		3,30,000

LK Ltd. Account

Particulars	Rs.	Particulars		Rs.
To Realization A/c 7,90,000	7,90,000	By Equity shares in LK Ltd.		
		For Equity	3,96,000	
		Preference	3,30,000	7,26,000
		By Cash		64,000
	7,90,000			7,90,000

Working Notes:

i. Purchase consideration

	K Ltd. Rs.	L Ltd. Rs.
Payable to preference shareholders:		
Preference shares at Rs. 22 per share	4,40,000	3,30,000
Equity Shares at Rs. 22 per share	10,56,000	3,96,000
Cash [See W.N. (ii)]	64,000	64,000
	15,60,000	7,90,000

ii. Value of Net Assets

	K Ltd. Rs.		L Ltd. Rs.
Goodwill	80,000		
Land & Building	4,50,000		3,00,000
Plant & Machinery	6,20,000		5,00,000
Furniture & Fittings	60,000		20,000
Trade receivables less 2.5%	2,68,125		1,70,625
Inventory less 2%	2,20,500		1,37,200

Cash at Bank		1,20,000		55,000
Cash in hand		41,375		17,175
		18,60,000		12,00,000
Less : Debentures	2,00,000		-	
Trade payables	1,00,000		2,10,000	
Secured Loans	–	(3,00,000)	2,00,000	(4,10,000)
		15,60,000		7,90,000
Payable in shares		14,96,000		7,26,000
Payable in cash		64,000		64,000

Illustration 8

Consider the following balance sheets of X Ltd. and Y Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs. X Ltd. ('000)	Rs. Y Ltd. ('000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	1	72,00	47,00
	B	**Reserves and Surplus**	2	15,50	10,50
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	3	5,00	3,50
3		**Current liabilities**			
	A	**Trade Payables**		4,50	3,50
	B	**Other current liabilities**		2,00	1,50
		Total		99,00	66,00
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	4	63,25	36,00
	B	**Non-current investments**	5	7,00	5,00
2		**Current assets**			
	A	**Inventories**		12,50	9,50

	B	Trade receivables		9,00	10,30
	C	Cash and Cash equivalents		7,25	5,20
		Total		99,00	66,00

Notes to accounts

		X Ltd ('000)	Y Ltd ('000)
1	Share Capital		
	Equity share capital (Rs. 10 each)	50,00	30,00
	14% Preference Shares capital Rs. 100 each	22,00	17,00
		72,00	47,00
2	Reserves and Surplus		
	General reserve	5,00	2,50
	Export profit reserve	3,00	2,00
	Investment allowance reserve	-	1,00
	Profit and loss account	7,50	5,00
		15,50	10,50
3	Long-term borrowings		
	13% Debentures of Rs. 100 each	5,00	3,50
		5,00	3,50
4	Property, Plant and Equipment		
	Land and Building	25,00	15,50
	Plant and machinery	32,50	17,00
	Furniture	5,75	3,50
		63,25	36,00
5	Non-current investments		
	Investments at cost	7,00	5,00
		7,00	5,00

X Ltd. takes over Y Ltd. on 1st April, 20X1. X Ltd. discharges the purchase consideration as below:

i. **Issued 3,50,000 equity shares of Rs. 10 each at par to the equity shareholders of Y Ltd.**

ii. **Issued 15% preference shares of Rs. 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.**

The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years. Show the (i) Journal entries and (ii) Balance sheet of X Ltd. after amalgamation on the assumption that:

a. **The amalgamation is in the nature of merger.**

b. **The amalgamation is in the nature of purchase.**

Solution

a. **Amalgamation in the nature of merger:**

i. **Journal Entries in the Books of X Ltd.**

		Dr. Rs.	Cr. Rs.
Business Purchase	Dr.	53,70,000	
To Liquidator of Y Ltd.			53,70,000
(Consideration payable for business taken over from Y Ltd)			
Sundry Assets of Y Ltd	Dr.	66,00,000	
General Reserve (Related to X Ltd)		4,20,000	
To Sundry Liabilities of Y Ltd			8,50,000
To Export profit Reserve			2,00,000
To Investment allowance Reserve			1,00,000
To Profit & Loss			5,00,000
To Business Purchase			53,70,000
(Incorporation of various assets and liabilities taken over from Y Ltd. at book values and difference of share capital and purchase consideration being adjusted with free Reserves)			
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000
(Discharge of consideration for Y Ltd.'s business)			
Sundry Liabilities in Y Ltd (13% Debentures in Y Ltd.)	Dr.	3,50,000	
To 13% Debentures			3,50,000
(Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)			

ii. **Balance Sheet of X Ltd.**

		Particulars	Notes	Rs. X Ltd. ('000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570

	b	Reserves and Surplus	2	1,930
2		**Non-Current liabilities**		
	a	Long-term borrowings	3	850
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		**16,500**
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	9,925
	b	Non-current investments		1,200
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and Cash equivalents		1,245
		Total		**16,500**

Notes to accounts

			Rs.in ('000)
1. Share Capital			
Equity share capital			
8,50,000 Equity Shares of Rs. 10 each			8,500
Preference share capital			
18,700, 15% Preference Shares of Rs. 100 each			1,870
22,000, 14% Preference Shares of Rs. 100 each			2,200
Total			12,570
2. Reserves and Surplus			
General Reserve of X Ltd.	500		
Add: General reserve of Y Ltd.	250	750	
Less: Adjustment for amalgamation*		(670)	80
Export Profit Reserve of X Ltd. 300		300	
Add: Export Profit Reserve of Y Ltd.		200	500
Investment Allowance Reserve			100

Profit & Loss A/c of X Ltd.	750	
Add: Profit & Loss A/c of Y Ltd.	500	1,250
Total		1,930
3. Long-term borrowings		
Secured		
8,500 13% Debentures of Rs. 100 each		850
Total		850
4. Property, Plant and Equipment		
Land & Buildings		4,050
Plant & Machinery		4,950
Furniture & Fittings		925
Total		9,925

*The difference between the amount recorded as share capital issued and the amount of share capital of transferor-company should be adjusted in reserves.

Thus, Adjustment for amalgamation = Rs. '000 (53,70 – 47,00) = Rs. ('000) 670

b. Amalgamation in the nature of purchase:

i. Journal Entries in the Books of X Ltd.

		Dr. Rs.	Cr. Rs.
Business Purchase	Dr.	53,70,000	
To Liquidator of Y Ltd.			53,70,000
(Consideration payable for business taken over from Y Ltd)			
Sundry Assets of Y Ltd	Dr.	66,00,000	
To Sundry Liabilities of Y Ltd			8,50,000
To Capital Reserve			3,80,000
To Business Purchase			53,70,000
(Incorporation of various assets and liabilities taken over from Y Ltd. at book values and difference of share capital and purchase consideration being adjusted with free Reserves)			
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000
(Discharge of consideration for Y Ltd.'s business)			

Sundry Liabilities in Y Ltd (13% Debentures in Y Ltd.) Dr.	3,50,000	
To 13% Debentures		3,50,000
(Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)		

Balance Sheet of X Ltd.

		Particulars	Notes	Rs. X Ltd. ('000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570
	b	Reserves and Surplus	2	1,930
2		**Non-Current liabilities**		
	a	Long-term borrowings	3	850
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		16,500
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	9,925
	b	Non-current investments		1,200
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and Cash equivalents		1,245
		Total		16,500

Notes to accounts

		Rs.in ('000)
1. Share Capital		
Equity share capital		
8,50,000 Equity Shares of Rs. 10 each		8,500
Preference share capital		
18,700, 15% Preference Shares of Rs. 100 each		1,870

22,000, 14% Preference Shares of Rs. 100 each Total		2,200
		12,570
2. Reserves and Surplus		
Capital Reserve		380
General Reserve		500
Amalgamation adjustment reserve		(300)
Export Profit Reserve		500
Investment Allowance Reserve		100
Surplus (Profit & Loss A/c)		750
Total		1,930
3. Long-term borrowings		
Secured		
8,500 13% Debentures of Rs. 100 each		850
Total		850
4. Property, Plant and Equipment		
Land & Buildings		4,050
Plant & Machinery		4,950
Furniture & Fittings		925
Total		9,925

Workings Notes:

Capital Reserve arising on Amalgamation:

A. Net Assets taken over:	**Rs. ('000)**	**Rs. ('000)**
Sundry Assets		66,00
Less: 13% Debentures	3,50	
Trade payables	3,50	
Other current liabilities	1,50	(8,50)
		57,50
B. Purchase consideration:		
To Equity Shareholders of Y Ltd.		35,00
To Preference Shareholders of Y Ltd.		18,70
		53,70
C. Capital Reserve (A – B)		3,80

Illustration 9

The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs. P Ltd	Rs. Q Ltd
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	8,00,000	4,00,000
	B	Reserves and Surplus		3,00,000	2,00,000
2		**Non-Current liabilities**			
	A	Long-term borrowings	2	2,00,000	1,50,000
3		**Current liabilities**			
	A	Trade Payables		2,50,000	1,50,000
		Total		15,50,000	9,00,000
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		7,00,000	2,50,000
	B	Non-current investments		80,000	80,000
2		**Current assets**			
	A	Inventories		2,40,000	3,20,000
	B	Trade receivables		4,20,000	2,10,000
	C	Cash and Cash equivalents		1,10,000	40,000
		Total		15,50,000	9,00,000

Notes to accounts

			P Ltd.	Q Ltd.
1	**Share Capital**			
	Equity shares of Rs. 10 each		6,00,000	3,00,000
	10% Preference Shares of Rs. 100 each		2,00,000	1,00,000
			8,00,000	4,00,000
2	**Long term borrowings**			
	12% Debentures		2,00,000	1,50,000
			2,00,000	1,50,000

Details of Trade receivables and trade payables are as under:

	P Ltd. (Rs.)	Q Ltd. (Rs.)
Trade receivables		
Debtors	3,60,000	1,90,000
Bills Receivable	60,000	20,000

	4,20,000	2,10,000
Trade payables		
Sundry Creditors	2,20,000	1,25,000
Bills Payable	30,000	25,000
	2,50,000	1,50,000

Property, plant and equipment of both the companies are to be revalued at 15% above book value.

Both the companies are to pay 10% Equity dividend, but Preference dividend having been already paid.

After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

i. 8 Equity Shares of Rs.10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.

ii. 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of Rs.100 each at par in P Ltd.

iii. 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.

iv. Rs.30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include Rs.10,000 due to P Ltd.

v. Inventory in Trade and Debtors are taken over at 5% lesser than their book value by P Ltd.

Prepare:

a. Journal entries in the books of P Ltd.

b. Statement of consideration payable by P Ltd.

<u>Solution</u>

a. Journal Entries in the Books of P Ltd.

		Dr. Rs.	Cr. Rs.
Property, Plant and Equipment	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of PPE at 15% above book value)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			

Business Purchase Account	Dr.	4,90,000	
To Liquidator of Q Ltd. 4,90,000			4,90,000
(Consideration payable for the business taken over from Q Ltd.)			
Property, Plant and Equipment (115% of Rs. 2,50,000)	Dr.	2,87,500	
Inventory (95% of Rs. 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(Rs. 40,000 –Rs. 30,000 dividend paid)			
To Provision for Bad Debts (5% of Rs. 1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (Rs. 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders of Q Ltd. at a discount of 10%)			
Sundry Creditors of Q Ltd.	Dr.	10,000	
To Sundry Debtors of P Ltd.			10,000
(Cancellation of mutual owing)			
Goodwill	Dr.	30,000	
To Bank			30,000

(Being liquidation expenses reimbursed to Q Ltd.)			
Capital Reserve	Dr.	30,000	
To Goodwill			30,000
(Being goodwill set off)			

b. Statement of Consideration payable by P Ltd. for 30,000 shares (payment method)

Shares to be allotted $\frac{30,000}{6} \times 8 = 40,000$ shares of p Ltd.

Issued 40,000 shares of Rs. 10 each i.e.	Rs. 4,00,000	(i)
For 10% preference shares, to be paid at 10% discount		
$Rs.1,00,000 \times \frac{90}{100}$	Rs.90,000	(ii)
Consideration amount [(i) + (ii)]	Rs. 4,90,000	

<u>Illustration 10</u>

The financial position of two companies Hari Ltd. and Vayu Ltd. as at 31st March, 20X1 was as under:

		Particulars	Notes	Hari Ltd.	Vayu Ltd
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	1	11,00,000	4,00,000
	B	**Reserves and Surplus**	2	70,000	70,000
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	3	50,000	20,000
3		**Current liabilities**			
	A	**Trade Payables**		1,30,000	80,000
		Total		13,50,000	5,70,000
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	4	8,00,000	2,50,000
	B	**Non-current investments**	5	50,000	25,000
2		**Current assets**			
	A	**Inventories**		2,50,000	1,75,000

	B	Trade receivables		2,00,000	1,00,000
	C	Cash and Cash equivalents		50,000	20,000
		Total		13,50,000	5,70,000

Notes to accounts

			Hari Ltd.	Vayu Ltd.
1	Share Capital			
	Equity shares of Rs.10 each		10,00,000	3,00,000
	9% Preference Shares of Rs.100 each		1,00,000	--
	10% Preference Shares of Rs.100 each		-	1,00,000
			11,00,000	4,00,000
2	Reserves and Surplus			
	General reserve		70,000	70,000
			70,000	70,000
3	Long term Provisions			
	Retirement gratuity fund		50,000	20,000
			50,000	20,000
4	Property, plant and Equipment			
	Land and Building		3,00,000	1,00,000
	Plant and machinery		5,00,000	1,50,000
			8,00,000	2,50,000
5	Intangible assets			
	Goodwill		50,000	25,000
			50,000	25,000

Hari Ltd. absorbs Vayu Ltd. on the following terms:

a. **10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.**

b. **Goodwill of Vayu Ltd. is valued at Rs. 50,000, Buildings are valued at Rs. 1,50,000 and the Machinery at Rs. 1,60,000.**

c. **Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.**

d. **Equity Shareholders of Vayu Ltd. will be issued necessary Equity Shares @ 5% premium.**

Prepare necessary Ledger Accounts to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 20X1.

Solution

In the Books of Vayu Ltd.

Realization Account

Particulars	Rs.	Particulars	Rs.
To Sundry Assets	5,70,000	By Retirement Gratuity Fund	20,000
To Preference Shareholders		By Trade payables	80,000
(Premium on Redemption)	10,000		
To Equity Shareholders		By Hari Ltd. (Purchase	
(Profit on Realization)	50,000	Consideration)	5,30,000
	6,30,000		6,30,000
To Equity Shares of Hari Ltd.	4,20,000	By Share Capital	3,00,000
		By General Reserve	70,000
		By Realization Account	
		(Profit on realization)	50,000
	4,20,000		4,20,000

Preference Shareholders Account

Particulars	Rs.	Particulars	Rs.
To 9% Preference Shares of Hari		By Preference Share Capital	1,00,000
Ltd.	1,10,000	By Realization Account (Premium	
		on Redemption of Preference	
		Shares)	10,000
	1,10,000		1,10,000

Hari Ltd. Account

Particulars	Rs.	Particulars	Rs.
To Realization Account	5,30,000	By 9% Preference Shares	1,10,000
		By Equity Shares	4,20,000
	5,30,000		5,30,000

In the Books of Hari Ltd.

Journal Entries

		Dr. Rs.	Cr. Rs.
Business Purchase A/c	Dr.	5,30,000	
To Liquidators of Vayu Ltd. Account			5,30,000
(Being business of Vayu Ltd. taken over)			

Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Inventory Account	Dr.	1,57,500	
Trade receivables Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Retirement Gratuity Fund Account			20,000
To Trade payables Account			80,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			5,30,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Vayu Ltd. A/c	Dr.	5,30,000	
To 9% Preference Share Capital A/c			1,10,000
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			20,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Hari Ltd. (after absorption)

as at 31st March, 20X1

		Particulars	Notes	Rs. X Ltd. ('000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	16,10,000
	B	Reserves and Surplus	2	90,000
2		**Non-Current liabilities**		
	A	Long-term borrowings	3	70,000
3		**Current liabilities**		
	A	Trade Payables		2,10,000
		Total		19,80,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	11,10,000
	B	Non-current investments	5	1,00,000
2		**Current assets**		
	A	Inventories		4,07,500

	B	Trade receivables	6	2,92,500
	C	Cash and Cash equivalents		70,000
		Total		19,80,000

Notes to accounts

		Rs.
1. Share Capital		
Equity share capital		
1,40,000 Equity Shares of Rs. 10 each fully paid (Out of above 40,000 Equity Shares were issued in consideration other than for cash)		14,00,000
Preference share capital		
2,100 9% Preference Shares of Rs. 100 each (Out of above 1,100 Preference Shares were issued in consideration other than for cash)		2,10,000
Total		16,10,000
2. Reserves and Surplus		
Securities Premium		20,000
General Reserve		70,000
Total		90,000
3. Long-term provisions		
Retirement Gratuity fund		70,000
Total		70,000
4. Property, Plant and Equipment		
Buildings		4,50,000
Machinery		6,60,000
Total		11,10,000
5. Intangible assets		
Goodwill		1,00,000
		3,00,000
6. Trade receivables		
Less: Provision for Doubtful Debts		7,500
		2,92,500

Working Notes:

Purchase Consideration:	**Rs.**
Goodwill	50,000

Building	1,50,000
Machinery	1,60,000
Inventory	1,57,500
Trade receivables	92,500
Cash at Bank	20,000
	6,30,000
Less: Liabilities:	
Retirement Gratuity Fund	(20,000)
Trade payables	(80,000)
Net Assets/ Purchase Consideration	5,30,000
To be satisfied as under:	
10% Preference Shareholders of Vayu Ltd.	1,00,000
Add: 10% Premium	10,000
1,100 9% Preference Shares of Hari Ltd.	1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium	4,20,000
Total	5,30,000

Illustration 11

The following are the Balance Sheets of A Ltd. and B Ltd. as at 31.3.20X1:

		Particulars	Notes	Rs. A Ltd (in '000)	Rs. B Ltd (in '000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**2,000**	**1,000**
	B	**Reserves and Surplus**	**2**	**1,000**	**(800)**
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	**3**	**750**	**450**
3		**Current liabilities**			
	A	**Trade Payables**		**300**	**300**
	B	**Short term Borrowings –**			
		Bank overdraft		**--**	**50**
		Total		**4,050**	**1,000**

		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**		**2,700**	**850**
	B	**Non-current investments**		**700**	**--**
2		**Current assets**			
	A	**Trade receivables**		**400**	**150**
	B	**Cash and Cash equivalents**		**250**	**--**
		(cash at bank)			
		Total		**4050**	**1000**

Notes to accounts

1	**Share capital**	**A Ltd. ('000)**	**B Ltd. ('000)**
	Equity shares of Rs.100 each	**2000**	**1000**
		2000	**1000**
2	**Reserves and Surplus**		
	General reserve	**1000**	**–**
	Profit and loss A/c (debit balance)	**--**	**(800)**
		1000	**(800)**
3	**Long term borrowings**		
	10% debentures	**500**	**–**
	Loan from banks	**250**	**450**
		750	**450**

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

i. **Banks agreed to waive off the loan of Rs.60 thousands of B Ltd.**

ii. **B Ltd. will reduce its shares to Rs.10 per share and then consolidate 10 such shares into one share of Rs.100 each (new share).**

iii. **Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.**

iv. **Trade payables of B Ltd. includes Rs.100 thousands payable to A Ltd. Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merge**

Solution

Calculation of purchase consideration

One share of B Ltd. will be issued in exchange of every share of A Ltd. (i.e. 20,000 equity shares of B Ltd. will be issued against 20,000 equity shares of A Ltd.)	20,000 shares

Journal Entries in the books of B Ltd.

Date		(Rs.in thousands)	
20X1		**Dr.**	**Cr.**
March,31	Loan from bank A/c Dr.	60	
	To Capital reduction A/c		60
	(Being loan from bank waived off to the extent of Rs.60 thousand)		
	Equity share capital A/c (Rs.100) Dr.	1,000	
	To Equity share capital A/c (Rs.10)		100
	To Capital reduction A/c		900
	(Being equity shares of Rs.100 each reduced to Rs.10 each)		
	Equity share capital A/c (Rs.10) Dr.	100	
	To Equity share capital A/c (Rs.100 each)		100
	(Being 10 equity shares of Rs.10 each consolidated to one share of Rs.100 each)		
	Capital reduction A/c Dr.	960	
	To Profit and loss A/c		800
	To Capital reserve A/c		160
	(Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)		
	Property, plant and equipment A/c Dr.	2,700	
	Investment A/c Dr.	700	
	Trade receivables A/c Dr.	400	
	Cash at bank A/c Dr.	250	
	To Trade payables A/c		300
	To Loans from bank A/c		250
	To 10% Debentures A/c		500
	To Liquidator of A Ltd. A/c		2,000
	To Reserves A/c		1,000
	(Being assets, liabilities and reserves taken over under pooling of interest method and amount due to Liquidator)		
	Liquidator of A Ltd. A/c Dr.	2,000	
	To Equity share capital A/c		2,000
	(Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)		

	Trade payables A/c	Dr.	100	
	To Trade receivables A/c			100
	(Being mutual owing cancelled)			

Balance Sheet of B Ltd. after merger as at 31.3.20X1

		Particulars	Notes	Rs. In '000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	2,100
	b	Reserves and Surplus	2	1,160
2		**Non-Current liabilities**		
	a	Long-term borrowings	3	1,140
3		**Current liabilities**		
	a	Trade Payables		500
	b	Short term Borrowings	4	50
		Total		4,950
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment		3,550
	b	Non-current investments		700
2		**Current assets**		
	a	Trade receivables		450
	b	Cash and Cash equivalents		250
		Total		4,950

Notes to accounts

		('000)
1. Share Capital		
21,000, Equity shares of Rs.100 each fully paid		2,100
(Out of the above, 20,000 shares have been issued for consideration other than cash)		
2. Reserves and Surplus		
Capital reserve	160	
General reserve	1,000	
Total		1,160

3.	**Long Term Borrowings**		
	10% Debentures	500	
	Loan from Bank (250+450-60)	640	1,140
4.	**Short term borrowings**		
	Bank overdraft		50

TEST YOUR KNOWLEDGE

MCQs

1. **In case of amalgamation, the entry for elimination of unrealized profit or loss on stock is made**
   a. **By the vendor company**
   b. **By the purchasing company**
   c. **By the third party**
   d. **By the court**

2. **If expenses of liquidation of the vendor company are paid by the purchasing company then, in purchasing company's book, the account debited is**
   a. **Goodwill account.**
   b. **Liquidation expense account.**
   c. **Vendor company account.**
   d. **General reserve.**

3. **Amalgamation adjustment reserve is opened in the books of the amalgamated company to incorporate**
   a. **Assets of the amalgamating company.**
   b. **Non- Statutory reserves of the amalgamating company.**
   c. **Statutory reserves of the amalgamating company.**
   d. **General reserve of the amalgamating company.**

4. **Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as**
   a. **Other current asset.**
   b. **Separate line item with a negative sign under the head 'Reserves and Surplus'.**
   c. **Other non-current assets.**
   d. **Investment of the company**

5. **A company into which the vendor company is merged is called**
   a. **Transferee company.**
   b. **Transferor company.**
   c. **Selling company.**
   d. **Acquiree company.**

6. **If the purchase consideration is more than net assets (at agreed values) of the transferor company, difference shall be recorded as __________ in the books of the transferee company.**

   a. **Goodwill.**

   b. **Capital Reserve.**

   c. **Profit.**

   d. **Loss.**

ANSWERS/HINTS

MCQs

1.	**b.**	By the purchasing company
2.	**a.**	Goodwill account.
3.	**c.**	Statutory reserves of the amalgamating company.
4.	**b.**	Separate line item with a negative sign under the head 'Reserves and Surplus'.
5.	**a.**	Transferee company.
6.	**a.**	Goodwill.

THEORETICAL QUESTIONS

Q.NO.1. What are the conditions, which, according to AS 14 on Accounting for Amalgamations, must be satisfied for an amalgamation in the nature of merger?

ANSWER

Refer Para 3 of chapter.

Q.NO.2. Distinguish between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation.

ANSWER

Refer Para 5 of chapter.

PRACTICAL QUESTIONS

Q.NO.1. The following are the Balance Sheets of Yes Ltd. and No Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs. Yes Ltd (in crores)	Rs. No Ltd (in crores)
		Equity and Liabilities			
1		Shareholders' funds			
	A	Share capital	1	12	5
	B	Reserves and Surplus		88	10
2		Non-Current liabilities			
	A	Long-term borrowings	2	--	10
3		Current liabilities		33	15
		Total		133	40
		Assets			
1	A	Non-current assets			
	B	Property, Plant and Equipment	3	20	6
		Non-current investments	4	13	--
2		Current assets		100	34
		Total		133	40

Notes of accounts

			Yes Ltd.	No Ltd.
1	Share Capital			
	Equity share capital			
	Authorized share capital		25	5
	Issued and subscribed:			
	Equity shares of Rs.10 each fully paid		12	5
			12	5
2	Long term borrowings			
	Unsecured loan from Yes Ltd.		--	10
			--	10

3	**Property, Plant and Equipment**			
	Gross value		**70**	**30**
	Depreciation		**(50)**	**(24)**
			20	**6**
4	**Non-current investments**			
	30 lakhs equity shares of Rs.10 each		**3**	**–**
	Long term loan to No Ltd.		**10**	**–**
			13	**–**

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity share of Yes Ltd. issued at a premium of Rs.2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.

You are asked to pass journal entries in the books of the two companies to give effect to the above if the amalgamation is in the nature of merger.

SOLUTION

Journal Entries in the books of No Ltd.

		(Rupees in crores)	
		Dr.	**Cr.**
Realization Account	Dr.	64.00	
To Property, plant and equipment Account			30.00
To Current Assets Account			34.00
(Being the assets taken over by Yes Ltd. transferred to Realization Account)			
Provision for depreciation Account	Dr.	24.00	
Current Liabilities Account	Dr.	15.00	
Unsecured Loan from Yes Ltd. Account	Dr.	10.00	
To Realization Account			49.00
(Being the transfer of liabilities and provision to Realization Account)			
Yes Ltd.	Dr.	1.2	
To Realization Account			1.2
(Being the amount of consideration due from Yes Ltd. credited to Realization Account)			
Equity Shareholders Account	Dr.	13.80	
To Realization Account			13.80
(Being the loss on Realization transferred to equity share holders account)			

Equity Share Capital Account	Dr.	5.00	
Reserves and Surplus Account	Dr.	10.00	
To Equity Shareholders Account			15.00
(Being the amount of share capital, reserves and surplus credited to equity shareholders account)			
Equity shares of Yes Ltd.	Dr.	1.20	
To Yes Ltd.			1.20
(Being the receipt of 10 lakhs equity shares of Rs.10 each at Rs.12 per share for allotment to shareholders)			
Equity shareholders Account	Dr.	1.20	
To Equity shares of Yes Ltd.			1.20
(Being the distribution of equity shares received from Yes Ltd. to shareholders)			

Journal Entries in the books of Yes Ltd.

		(Rupees in crores)	
		Dr.	Cr.
Business Purchase Account	Dr.	1.2	
To Liquidator of No Ltd. Account			1.2
(Being the amount of purchase consideration agreed under approved scheme of amalgamation- W.N. 1)			
Property, plant and equipment	Dr.	6.00	
Current Assets	Dr.	34.00	
To Current Liabilities			15.00
To Unsecured Loan (from Yes Ltd.)			10.00
To Business Purchase Account			1.20
To Reserve & Surplus A/c			10.00
To Profit & loss A/c*			3.80
(Being the assets and liabilities taken over and the surplus transferred to Profit and loss account)			
Liquidator of No Ltd.	Dr.	1.20	
To Equity Share Capital Account			1.00
To Securities Premium Account			0.20
(Being the allotment to shareholders of No Ltd. 10 lakhs equity shares of Rs.10 each at a premium of Rs.2 per share)			

Unsecured Loan (from Yes Ltd.)	Dr.	10.00	
To Loan to No. Ltd.			10.00
(Being the cancellation of unsecured loan given to No Ltd.)			

Working Note:

Purchase Consideration	**Rs.in crores**
$\frac{50\,\text{lakhs}}{5} \times \text{Rs.}12$ i.e., 10 lakhs equity shares at Rs.12 per share	1.20
Number of equity shares of Rs.10 each to be issued $\left[\frac{1.20\text{crores}}{12}\right]$=10 lakhs.	

Q.NO.2. The following are the Balance Sheets of X Ltd. and Y Ltd:

		Particulars	Notes	Rs. X Ltd.	Rs. Y Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**1,00,000**	**50,000**
	B	**Reserves and Surplus**	**2**	**10,000**	**(10,000)**
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	**3**	**--**	**15,000**
3		**Current liabilities**			
	A	**Trade Payables**		**25,000**	**5,000**
		Total		**135,000**	**60,000**
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**		**1,20,000**	**60,000**
	B	**Non-current investments**	**4**	**15,000**	**--**
		Total		**135,000**	**60,000**

Notes to accounts

1	**Share Capital**		**X Ltd.**	**Y Ltd.**
	Equity share capital		**1,00,000**	**50,000**
			1,00,000	**50,000**
2	**Reserves and Surplus**			
	Profit and loss A/c		**10,000**	**–**

	Profit and loss A/c (debit balance)		**--**	**(10,000)**
			10,000	**(10,000)**
3	**Long term borrowings**			
	Loan from X Ltd.		**--**	**15,000**
4	**Non-current investments**		**15,000**	**--**
	Loan to Y Ltd.		**15,000**	**--**

A new company XY Ltd. is formed to acquire the sundry assets and trade payables of X Ltd. and Y Ltd. and for this purpose, the sundry assets of X Ltd. are revalued at Rs.1,00,000. The debt due to X Ltd. is also to be discharged in shares of XY Ltd.

Show the Ledger Accounts to close the books of X Ltd.

SOLUTION

Books of X Ltd. Realization Account

Particulars	Rs.	Particulars	Rs.
To Sundry Assets	1,20,000	By Trade payables	25,000
		By XY Ltd. (Purchase consideration)	75,000
		By Shareholders (Loss on realization)	20,000
	1,20,000		1,20,000

Shareholders Account

Particulars	Rs.	Particulars	Rs.
To Realization Account (Loss)	20,000	By Equity Share Capital	1,00,000
To Shares in XY Ltd.	90,000	By Profit and Loss Account	10,000
	1,10,000		1,10,000

Loan Y Ltd.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	15,000	By Shares in XY Ltd.	15,000

Shares in XY Ltd.

Particulars	Rs.	Particulars	Rs.
To XY Ltd.	75,000	By Shareholders	90,000
To Loan Y Ltd.	15,000		
	90,000		90,000

XY Ltd.

Particulars	Rs.	Particulars	Rs.
To Realization Account	75,000	By Shares in XY Ltd.	75,000

Q.NO.3. Super Express Ltd. and Fast Express Ltd. were in competing business. They decided to form a new company named Super Fast Express Ltd. The balance sheets of both the companies were as under:

		Particulars	Notes	Super Express Ltd. Rs.	Fast Express Ltd. Rs.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**20,00,000**	**10,00,000**
	B	**Reserves and Surplus**	**2**	**1,00,000**	**2,60,000**
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	**3**	**1,00,000**	**--**
3		**Current liabilities**			
	A	**Trade Payables**		**60,000**	**40,000**
		Total		**22,60,000**	**13,00,000**
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	**4**	**14,00,000**	**11,00,000**
	B	**Intangible assets**	**5**	**--**	**1,00,000**
2		**Current assets**			
	A	**Inventories**		**3,00,000**	**40,000**
	B	**Trade receivables**		**2,40,000**	**40,000**
	C	**Cash and Cash equivalents**	**6**	**3,20,000**	**20,000**
		Total		**22,60,000**	**13,00,000**

Notes to accounts

			Super Express Ltd.	Fast Express Ltd.
1	**Share Capital**			
	Equity shares of Rs.100 each		**20,00,000**	**10,00,000**

2	**Reserves and Surplus**			
	Insurance reserve		**1,00,000**	**–**
	Employee profit sharing reserve		**--**	**60,000**
	Reserve account		**--**	**1,00,000**
	Surplus		**--**	**1,00,000**
			1,00,000	**2,60,000**
3	**Long term provisions**			
	Provident fund		**1,00,000**	**--**
	Total		**1,00,000**	**--**
4	**Property, Plant and Equipment**			
	Land and Building		**10,00,000**	**6,00,000**
	Plant and machinery		**4,00,000**	**5,00,000**
			14,00,000	**11,00,000**
5	**Intangible assets**			
	Goodwill		**--**	**1,00,000**
			--	**1,00,000**
6	**Cash and Cash Equivalents**			
	Cash at Bank		**2,20,000**	**10,000**
	Cash in hand		**1,00,000**	**10,000**
			3,20,000	**20,000**

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of Rs.100 each in lieu of purchase consideration amounting to Rs.30,000 (20,000 for Super-Fast Express Ltd and 10,000 for Fast Express Ltd.).

Prepare opening balance sheet of Super Fast Express Ltd. considering pooling method

SOLUTION

Balance Sheet of Super Fast Express Ltd.

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
	b	Reserves and Surplus	2	3,60,000
2		**Non-current liabilities**		
	a	Long-term provisions	3	1,00,000

3		**Current liabilities**		
	a	Trade Payables		1,00,000
		Total		35,60,000
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	25,00,000
	b	Intangible assets	5	1,00,000
2		**Current assets**		
		Inventories		3,40,000
		Trade receivables		2,80,000
		Cash and cash equivalents	6	3,40,000
		Total		35,60,000

Notes to Accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	30,000 Equity shares of Rs.100 each		30,00,000
	Total		30,00,000
2	Reserves and Surplus		
	Reserve account		1,00,000
	Surplus		1,00,000
	Insurance reserve		1,00,000
	Employees profit sharing account		60,000
	Total		3,60,000
3	**Long-term provisions**		
	Provident fund		1,00,000
	Total		1,00,000
4	**Property, Plant and Equipment**		
	Buildings		16,00,000
	Machinery		9,00,000
	Total		25,00,000

5	Intangible assets		
	Goodwill		1,00,000
	Total		1,00,000
6	**Cash and cash equivalents**		
	Balances with banks		2,30,000
	Cash on hand		1,10,000
	Total		3,40,000

Q.NO.4. The following were the Balance Sheets of P Ltd. and V Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs. P Ltd (Rs.in Lakhs)	Rs. V Ltd (Rs.in Lakhs)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	1	15,000	6,000
	B	**Reserves and Surplus**	2	15,370	4,335
2		**Non-Current liabilities**			
	A	**Long-term borrowings**	3	-	1,000
3		**Current liabilities**			
	A	**Trade Payables**		1,200	463
	B	**Short term provisions**		1,830	702
		Total		33,400	12,500
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	4	22,304	6,750
2		**Current assets**			
	A	**Inventories**		7,862	4,041
	B	**Trade receivables**		2,120	1,100
	C	**Cash and Cash equivalents**		1,114	609
		Total		33,400	12,500

Notes to accounts

			Rs. P Ltd (Rs.in Lakhs)	Rs. V Ltd (Rs.in Lakhs)
1	**Share Capital**		15,000	6,000
2	**Reserves and Surplus**			
	Securities premium		3,000	–
	Foreign project reserve		--	310
	General reserve		9,500	3,200
	Profit and loss account		2,870	825
			15,370	4,335
3	**Long term borrowings**			
	12% debentures		--	1,000
			--	1,000
4	**Property, Plant and Equipment**			
	Land and Building		6,000	–
	Plant and machinery		14,000	5,000
	Furniture and fixtures		2,304	1,750
			22,304	6,750

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.

On 1st April 20X1, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P Ltd. would allot three fully paid equity shares of Rs.10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Details of trade receivables and trade payables as under:

	P Ltd. (Rs.in lakhs)	V Ltd. (Rs.in lakhs)
Trade payables		
Bills Payable	120	–
Trade Creditors	1,080	463
	1,200	463
Trade receivables		
Trade debtors	2,120	1,020

Bills Receivable	—	80
	2,120	1,100

Expenses of amalgamation amounting to Rs.1 lakh were borne by P Ltd.

You are required to:

1. **pass journal entries in the books of P Ltd. and**
2. **Prepare P Ltd.'s Balance Sheet immediately after the merger.**

SOLUTION

Books of P Ltd.

Journal Entries

		Dr. (Rs.in Lacs)	Cr. (Rs.in Lacs)
Business Purchase Account	Dr.	9,000	
To Liquidator of V Ltd.			9,000
(Being business of V Ltd. taken over for Consideration settled as per agreement)			
Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1750	
Inventory	Dr.	4,041	
Debtors	Dr.	1,020	
Cash at Bank	Dr.	609	
Bills Receivable	Dr.	80	
To Foreign Project Reserve			310
To General Reserve (3,200 - 3,000)			200
To Profit and Loss A/c (825)			825
To Liability for 12% Debentures			1,000
To Creditors			463
To Provisions			702
To Business Purchase			9,000
(Being assets & liabilities taken over from V Ltd.)			
Liquidator of V Ltd. A/c	Dr.	9,000	
To Equity Share Capital A/c			9,000
(Purchase consideration discharged in the form of equity shares)			

Goodwill A/c To Bank A/c (Liquidation expenses paid by P Ltd debited to Goodwill A/c)	Dr.	1	 1
Profit and loss A/c To Goodwill A/c (being the Goodwill charged to Profit and loss account)	Dr.	1	 1
Liability for 12% Debentures A/c To 13% Debentures A/c (12% debentures discharged by issue of 13% debentures)	Dr.	1,000	 1,000
Bills Payable A/c To Bills Receivable A/c (Cancellation of mutual owing on account of bills)	Dr.	80	 80

Balance Sheet of P Ltd. as at 1st April, 20X1 (after merger)

		Particulars	Notes	Rs. (Rs.in Lakhs)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**24,000**
	B	**Reserves and Surplus**	**2**	**16,704**
2		**Non-Current liabilities**		
	A	**Long-term borrowings**	**3**	**1,000**
3		**Current liabilities**		
	A	**Trade Payables (1,543 + 40)**		**1,583**
	B	**Short term provisions**		**2,532**
		Total		**45,819**
		Assets		
1		**Non-current assets**		
	A	**Property, Plant and Equipment**	**4**	**29,054**
2		**Current assets**		
	A	**Inventories**		**11,903**
	B	**Trade receivables**		**3,140**
	C	**Cash and Cash equivalents**		**1,722**
		Total		**45,819**

Notes to accounts

		Rs.
1	**Share Capital**	
	Equity share capital	
	Authorized, issued, subscribed and paid up	
	24 crores equity shares of Rs.10 each	24,000
	(Of the above shares, 9 crores shares have been issued for consideration other than cash)	
	Total	24,000
2	**Reserves and Surplus**	
	General Reserve	9,700
	Securities Premium	3,000
	Foreign Project Reserve	310
	Profit and Loss Account	3,694
	Total	16,704
3	**Long-term borrowings**	
	Secured	
	13% Debentures	1,000
4	**Property, Plant and Equipment**	
	Land & Buildings	6,000
	Plant & Machinery	19,000
	Furniture & Fittings	4,054
	Total	29,054

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = $\text{Rs.}6{,}000 \text{ lacs} \times \frac{3}{2} = \text{Rs.}9{,}000 \text{ lacs}$

Q.NO.5. **Sun and Neptune had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of Rs.4,00,000 divided into 80,000 equity shares of Rs.5 each. On 31st March, 20X3 the respective information of Sun and Neptune were as follows:**

	Sun (Rs.)	Neptune (Rs.)
Share capital	3,65,000	3,52,500
Current liabilities	5,97,000	1,80,250
Property, Plant and Equipment	6,35,000	3,65,000
Current assets	3,27,000	1,67,750

Additional Information:

a. **Revalued figures of non-current and Current assets were as follows:**

	Sun (Rs.)	Neptune (Rs.)
Property, Plant and Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

b. **The debtors and creditors include Rs.43,350 owed by Sun to Neptune. The purchase consideration is satisfied by issue of the following shares and debentures.**

   i. **60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:**

	Sun (Rs.)	Neptune (Rs.)
20X1 Profit	4,49,576	2,73,900
20X2 (Loss)/Profit	(2,500)	3,42,100
20X3 Profit	3,77,924	3,59,000

   ii. **15% debenture in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31st March, 20X3 after revaluation of assets.**

You are required to:

1. **Compute the amount of debentures and shares to be issued to Sun and Neptune.**
2. **A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.**

SOLUTION

1. Computation of Amount of Debentures and Shares to be issued:

	Sun	Neptune
i. Average Net Profit		
Rs. (4,49,576 - 2,500 + 3,77,924)/3	= 2,75,000	
Rs. (2,73,900 + 3,42,100+3,59,000)/3		= 3,25,000

ii. Equity Shares Issued

a. Ratio of distribution

Sun:	Neptune
275	325

b. Number

Sun	:	27,500
Neptune	:	32,500
		60,000

c. Amount

27,500 shares of Rs.5 each = 1,37,500

32,500 shares of Rs.5 each = 1,62,500

iii.

Capital Employed (after revaluation of assets)	**Rs.**	**Rs.**
Property, plant and equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750
	10,09,500	5,47,750
Less: Current Liabilities	(5,97,000)	(1,80,250)
	4,12,500	3,67,500

iv. Debentures Issued

8% Return on capital employed 33,000 29,400

15% Debentures to be issued to provide equivalent income:

Sun: $33,000 \times \frac{100}{15}$ = 2,20,000

Neptune: $29,400 \times \frac{100}{15}$ = 1,96,000

2. Balance Sheet of Jupiter Ltd. As at 31st March 20X3 (after amalgamation)

Particulars	Note No	Rs.
I. Equity and Liabilities		
1. Shareholders' Funds	1	3,00,000
a. Share Capital	2	64,000
b. Reserves and Surplus		
2. Non-Current Liabilities		
a. Long-term borrowings	3	4,16,000
3. Current Liabilities		
a. Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
1. Non-current assets		
PPE		11,00,000
2. Current assets		
a. Other current assets		4,13,900
Total		15,13,900

Notes to Accounts

		Rs.
1	Share Capital	
	Authorized	
	80,000 Equity Shares of Rs.5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of Rs.5 each	3,00,000
	(all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash) 2 Reserve and	
2	Surplus	
	Capital Reserve	64,000
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	4,16,000

Working Notes:

	Sun Rs.	Neptune Rs.	Total Rs.
1. Purchase Consideration			
Equity Shares Issued	1,37,500	1,62,500	3,00,000
15% Debentures Issued	2,20,000	1,96,000	4,16,000
	3,57,500	3,58,500	7,16,000
2. Capital Reserve			
a. Net Assets taken over			
Property, plant & equipment	7,10,000	3,90,000	11,00,000
Current Assets	2,99,500	1,14,400*	4,13,900
	10,09,500	5,04,400	15,13,900
Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
	4,55,850	3,24,150	7,80,000
b. Purchase Consideration	3,57,500	3,58,500	7,16,000
b. Capital Reserve [(a) - (b)]	98,350		
c. Goodwill [(b) –		34,350	
Capital Reserve			64,000
[Final Figure(c) -(d)]			

*1,57,750–43,350= 1,14,400

** 5,97,000–43,350= 5,53,650

14. INTERNAL RECONSTRUCTION

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Understand the meaning of term "reconstruction" and the types of reconstruction.
- Understand the concept of Sub-division and consolidation of shares, conversion of shares into stock and vice versa
- Understand the meaning of Capital reduction account and rules regarding the presentation of accounts post reconstruction in accordance with the provisions of the Companies Act 2013.

1. MEANING OF RECONSTRUCTION

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered, by reducing the paid-up value of shares and/or varying the rights attached to different classes of shares. The object of reconstruction is usually to reorganize capital or to compound with creditors so that company can be bailed out from present situation without winding up the existing company.

However, there may be external reconstruction. Wherever an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is external reconstruction. Such external reconstruction is essentially covered under the category of 'amalgamation in the nature of merger' in AS 14.

Basis	Internal Reconstruction	External Reconstruction
Liquidation and formation of new company	The existing company is not liquidated rather the capital and debt structure is changed to bring the company back to normalcy	The existing company is liquidated to form a new company in which the existing shareholders become shareholders of new company as well
Reduction of capital and varying rights	There is certain reduction of capital and sometimes the outside liabilities like debenture holders may have to reduce their claim in this scheme.	There is no reduction of capital. In fact, there is a fresh share capital of the company. The shareholders need not vary their rights in company

Legal position	Internal reconstruction is done as per provisions of section 61 and 66 of the Companies Act, 2013.	External reconstruction is regulated by section 232 of the Companies Act, 2013.
Legal formalities	It requires court's confirmation and other legal procedures before it can be implemented	It can be affected without the court's interference and less time-consuming process.

2. METHODS OF INTERNAL RECONSTRUCTION

For properly deploying the process of internal reconstruction following methods are generally employed or used simultaneously:

2.1 Alteration of Share Capital

According to Section 61 of the Companies Act 2013, a limited company can alter its share capital, if so authorized by its Articles, by passing an ordinary resolution in the general meeting. The provisions of the relevant sections of Companies Act will be applicable, but in this chapter, we are going to focus on the accounting treatment of the various conditions pertaining to internal reconstruction.

The following types of Alteration can be done under Section 61-

a. Increase of authorized share capital;

b. Consolidation and sub-division into shares of larger or smaller denominations;

c. Conversion of all or any of the shares into stock or vice versa;

d. Cancellation of shares which have not been taken or agreed to be taken by any person.

Sub-division and Consolidation of Shares

The existing share capital can be sub-divided or consolidated into the shares into those of a smaller or higher denomination than that fixed by the Memorandum of Association, so long as the proportion between the paid up and unpaid amount, if any, on the shares continues to be the same as it was in the case of the original shares.

For example, a company with a capital of Rs.10,00,000 divided into 10,000 equity shares of Rs. 100 each on which Rs. 75 is paid up decides to reorganize its capital by splitting one equity share of Rs.100 each into 10 such shares of Rs. 10 each. The consequential entry to be passed in such a case would be—

		Dr.	Cr.
		Rs.	Rs.
Equity Share Capital (Rs. 100) A/c To Equity Share Capital (Rs. 10) A/c	Dr.	7,50,000	 7,50,000

(Being the sub-division of 10,000 shares of Rs. 100 each with Rs. 75 paid up thereon into 1,00,000 shares of Rs. 10 each with Rs. 7.50 paid up thereon as per the resolution of shareholders passed in the General Meeting held on...)		

Similar entries will be passed on consolidation of shares of a smaller amount into those of a larger amount.

(Refer Illustration 1)

Conversion of Fully Paid Shares into Stock and Stock into Shares

According to section 61 of Companies Act, 2013, a company can convert its fully paid shares into stock and reconversion of stock into shares. If authorized by its Articles, a company may, in a general meeting by passing an ordinary resolution, can convert its fully paid shares into stock and reconversion of stock into shares. Stock is the consolidation of the share capital into one unit divisible into aliquot parts. Stock is a bundle of fully paid shares put together for convenience so that it may be divided into any amount and transferred into any fractions and sub-divisions without regard to the original face value of the shares. While it is impossible for share capital to be one share, any amount of stock may be transferred. In practice, however, companies restrict the transfer of stock to multiples say, Rs.100.

A company can convert its fully paid shares into stock. Upon the company converting its shares into stock, the book-keeping entries merely record the transfer from share capital account to stock account. A separate Stock Register is started in which details of members' holdings are entered and the annual return is modified accordingly.

(Refer Illustration 2)

2.2 Variation of Shareholders Rights

Section 48 of the Companies Act, 2013 provides that when a company has issued different classes of shares with different rights or privileges attached to such shares e.g. rights as to dividend, voting rights etc., any of such right may be changed in any manner. The provisions will be applicable as per the Companies Act 2013, the accounting treatment is discussed in detail here.

For example, the company may change rate of (a) dividend on preference shares or (b) convert cumulative preference shares into non-cumulative preference shares without changing the amount of share capital by passing the following journal entries:

a. Debit (Old) % Cum. Pref. Share Capital Account
Credit (New) % Cum. Pref. Share Capital Account

b. Debit % Cum. Pref. Share Capital Account
Credit …% Non-cum. Pref. Share Capital Account

2.3 Reduction of Share Capital

Section 66 of the Companies Act, 2013 lays down the procedure in respect of reduction of share capital. Subject to confirmation by the Tribunal on an application by the company, a company may, by a special resolution, reduce the share capital in the following manner-

a. Extinguishing or reducing the liability of the shareholders in respect of unpaid amount on the shares held by them; or

b. Paying off any paid-up share capital which is in excess of its requirements;

c. Cancelling any paid-up share capital which is lost or is unrepresented by available assets.

Generally, reduction in share capital is followed when a company has been suffering losses continuously for a long time, is not truly represented by its assets. In such a case, any scheme for capital reduction should write-off that portion of capital which is already lost.

This reduction is a sacrifice by the shareholders and the amount of reduction or sacrifice is credited to a new account called <u>Capital Reduction Account (or Reconstruction Account)</u>. The accounting treatment is as follows:

a. When liability of the shareholders is extinguished or reduced in respect of unpaid amount on the shares held by them: Here the shareholders are not called upon to pay the unpaid amount on shares held by them in future. For example, a company decides to reduce Rs. 10 per share, into Rs. 7.5 per share fully paid up, by cancelling the unpaid amount of Rs. 2.5 per share. The entry in this case would be

Share Capital (Partly Paid-Up) Account Dr. (Rs. 7.5 (Fv Rs.10) X No. of Shares)

  To Share Capital (Fully Paid-up) Account (Rs. 7.5 (Fv Rs.7.5) X No. of Shares)

b. When excess paid up capital is paid off: When its not possible for the company to employ profitably its paid up capital, then in such case it may decide to refund the excess capital to its shareholders. For example, a company having fully paid-up share of Rs. 10 each, decides to pay-off Rs. 2 per share to make it of Rs. 8 fully paid-up, entries in that case would be

Share Capital Account (Rs. 10)	Dr.	(Rs. 10 x No. of Shares)	
To Share Capital Account (Rs. 8)			(Rs. 8 x No. of Shares)
To Sundry Shareholders Account			(Rs. 2 x No. of Shares)
Sundry Shareholders Account	Dr.	(Rs. 2 x No. of Shares)	
To Bank Account			(Rs. 2 x No. of Shares)

c. When the paid up capital which is lost or not represented is cancelled: Reduction in paid up value only- Here the nominal value of the share remains the same and only the paid value is reduced. For example, the shareholders may agree to reduce the paid capital of Rs. 100 per share to paid value of Rs. 10 per share. The sacrifice is Rs. 90 and the entry will be

Share Capital Account Dr. (Rs. 90 X No. of Shares)

To Capital Reduction Account (Rs. 90 X No. of Shares)

Reduction in both nominal and paid up values- In this case, both the paid up capital and nominal value of the shares are reduced. Continuing the above example, the entry will be:

Share Capital Account (Rs. 100 Share) Dr. (Rs. 100 X No. of Shares)

To Share Capital (Rs. 10 Share) (Rs. 10 X No. of Shares)

To Capital Reduction Account (Rs. 90 X No. of Shares)

Thus in such treatment we debit the original Share Capital Account so as to close it, credit new Share Capital Account with the amount treated as paid up; and credit Capital Reduction Account with the difference.

2.4 Compromise/Arrangements

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement therefore also involves sacrifices by shareholders, or creditors or debenture holders or by all of them. Accounting treatment for some of the cases is as follows:

a. When equity shareholders give up their right over the reserves and accumulated profits of the company:

Reserves Account Dr. (With the amount of reserves)

To Reconstruction Account

b. Settlement of outside liabilities at lesser amount: Liabilities such as sundry creditors may agree to accept less amount in lieu of final settlement. Treatment will be as follows:

Outside Liabilities Account Dr. (With the amount of sacrifice)

Provision Account (if any) Dr. (made by creditors, debenture holders etc.)

To Reconstruction Account

2.5 Surrender of Shares

In this method, shares are divided into shares of smaller denominations and then the shareholders are made to surrender their shares to the company. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled by transferring them to Reconstruction Account.

3. ENTRIES IN CASE OF INTERNAL RECONSTRUCTION

On a scheme of internal reconstruction being adopted (through special resolution confirmed by the Court), the accounting treatment of the different situations and the entries to be passed are as follows:

1. Under the above-mentioned methods- the alteration of share capital and the varying of the shareholders rights do not involve opening the capital reduction/reconstruction account.
2. It is only under the reduction of share capital, unrepresented reserves, compromise/ arrangements with the outsiders liabilities and surrender of shares, there shall be capital reduction/reconstruction account used to which the unrepresented assets/liabilities will be transferred as per the arrangement.
3. An appreciation in the value of an asset or reduction in the amount of a liability should be debited to the account concerned and credited to Capital Reduction Account (or Reconstruction Account).
4. Eliminate debit balance of profit and loss account and all over-valuation of assets by crediting the accounts concerned and debiting the Capital Reduction (or Reconstruction) Account. For this purpose, any reserve appearing in the books of the company may be used. If any balance is left in the Capital Reduction (or Reconstruction) Account, it should be transferred to the Capital Reserve Account.
5. If there is any balance in the reconstruction account it is finally transferred to the Capital reserve under Reserves and Surplus. But if the amount for writing off the assets and accumulated losses is more than the reconstruction amount, then reserves will be adjusted against the same.

While preparing the balance sheet of a reconstructed company, the following points are to be kept in mind:

a. After the name of the company, the words **"and Reduced"** should be added only if the Court so orders.
b. In case of fixed assets, the **amount written off under the scheme of reconstruction must be shown for five years.**

(Refer Illustration 3 - 8)

SUMMARY

1. Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered and by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
2. Reconstruction account is a new account opened to transfer the sacrifice made by the shareholders for that part of capital which is represented by lost assets.
3. Reconstruction account is utilized for writing-off fictitious assets, writing down over-valued fixed assets, recording new liability etc.
4. If some credit balance remains in the reconstruction account, the same should be transferred to the capital reserve account.

5. Methods of Internal reconstruction:

- Alteration of share capital:
  - ✓ Sub-divide or consolidate shares into smaller or higher Denomination
  - ✓ Conversion of share into stock or vice-versa
- Variation of shareholders' rights:
  - ✓ Only the specific rights are changed. There is no change in the amount of capital.
- Reduction of share capital
- Compromise, arrangements etc.
- Surrender of Shares.

6. Under the Alteration and the variation of the shareholders rights, there is no capital reduction account opened, only under the reduction of share capital, compromises and surrender of shares- capital reduction account comes in the journal entries. The balance of the reconstruction account to be transferred to the Capital reserve.

ILLUSTRATIONS

Illustration 1

On 31-12-20X1, B Ltd. had 20,000, Rs.10 Equity Shares as authorized capital and the shares were all issued on which Rs.8 was paid up. In June, 20X2 the company in general meeting decided to sub-divide each share into two shares of Rs. 5 with Rs. 4 paid up. In June, 20X3 the company in general meeting resolved to consolidate 20 shares of Rs. 5, Rs. 4 per share paid up into one share of Rs. 100 each, Rs. 80 paid up.

Pass entries and show how share capital will appear in notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

20X2		Rs.	Rs.
June	Equity Share Capital (Rs. 10) A/c Dr.	1,60,000	
	To Equity Share Capital (Rs. 5) A/c		1,60,000
	(Being the sub-division of 20,000 shares of Rs. 10 each with Rs. 8 paid up into 40,000 shares Rs. 5 each with Rs. 4 paid up by resolution in general meeting dated....)		
20X3	Equity Share Capital (Rs. 5) A/c Dr.	1,60,000	
June	To Equity Share Capital (Rs. 100) A/c		1,60,000
	(Being consolidation of 40,000 shares of Rs. 5 with Rs. 4 paid up into 2,000 Rs. 100 shares with Rs. 80 paid up)		

Notes to Balance Sheet

Liabilities:	Rs.
As on 31-12-20X1	
1. Share Capital	
Authorized:	
20,000 Equity Shares of Rs. 10 each	2,00,000
Issued, Subscribed and Paid up:	
20,000 Equity Shares of Rs. 10 each Rs. 8 per share paid up	1,60,000
As on 31-12-20X2	
1. Share Capital	
Authorized:	

40,000 Equity Shares of Rs. 5 each	2,00,000
Issued, Subscribed and Paid up:	
40,000 Equity Shares of Rs. 5 each Rs. 4 per share paid up	1,60,000
As on 31-12-20X3	Rs.
1. Share Capital	
Authorized:	
2,000 Equity Shares of Rs. 100 each	2,00,000
Issued, Subscribed and Paid up:	
2,000 Equity Shares of Rs. 100 each Rs. 80 per share paid up	1,60,000

Note: Some accountants prefer not to make any entry as the amount remains same. Even when an entry is passed it applies only to the called-up portion, and not to uncalled or unissued portion of share capital.

Illustration 2

C Ltd. had Rs. 5,00,000 authorized capital on 31-12-20X1 divided into shares of Rs. 100 each out of which 4,000 shares were issued and fully paid up. In June 20X2 the Company decided to convert the issued shares into stock. But in June, 20X3 the Company re-converted the stock into shares of Rs. 10 each, fully paid up.

Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

			Rs.	Rs.
20X2 June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c			4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of Rs.100 into Rs.4,00,000 Equity Stock as per resolution in general meeting dated…)			
20X3 June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of Rs. 4,00,000 Equity Stock into 40,000 shares of Rs. 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Notes to Balance Sheet

	Rs.
As on 31-12-20X1	
Share Capital	
Authorized	
5,000 Equity Shares of Rs.100 each	5,00,000
Issued and Subscribed	
4,000 Equity Shares of Rs.100 each fully called up	4,00,000
As on 31-12-20X2	Rs.
Share Capital	
Authorized	
5,000 Equity Shares of Rs.100 each	5,00,000
Issued and Subscribed	
Equity Stock- 4,000 Equity Shares of Rs.100 converted into Stock	4,00,000
As on 31-12-20X3	Rs.
Share Capital	
Authorized 50,000 Equity Shares of Rs.10 each	5,00,000
Issued and Subscribed	
40,000 Equity Shares of Rs.10 each fully called up	4,00,000

Illustration 3

The Balance Sheet of A & Co. Ltd. as at 31-3-20X2 is as follows:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**11,50,000**
	B	**Reserves and Surplus**	**2**	**(5,35,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**3,75,000**
3		**Current liabilities**		
	A	**Trade Payables**		**3,00,000**
		Short term borrowings - Bank Overdraft		**1,95,000**
		Other current liabilities	**4**	**1,22,500**

		Total		16,07,500
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment	5	4,75,000
	B	Intangible assets	6	1,67,500
	C	Non-current investments	7	55,000
2		Current assets		
	A	Inventories		4,25,000
	B	Trade receivables		4,85,000
		Total		16,07,500

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital:	
	75,000 Equity Shares of Rs. 10 each	7,50,000
	Preference share capital:	
	4,000 6% Cumulative Preference Shares of Rs. 100 each	4,00,000
		11,50,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(5,35,000)
		(5,35,000)
3	Long-term borrowings	
	Secured	
	6% Debentures (secured on the freehold property)	3,75,000
		3,75,000
4	Other current liabilities	
	Loan from directors	1,00,000
	Interest payable on 6% debentures	22,500
		1,22,500
5	Property plant and Equipment	
	Freehold property	4,25,000
	Plant	50,000
		4,75,000

6	**Intangible assets**	
	Goodwill	**1,30,000**
	Patents	**37,500**
		1,67,500
7	**Non-current investments**	
	Investments at cost	**55,000**
		55,000

The Court approved a Scheme of re-organization to take effect on 1-4-20X2, whereby:

i. The Preference shares to be written down to Rs. 75 each and Equity Shares to Rs. 2 each.

ii. Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of Rs. 2 each to be allotted for the remaining quarter.

iii. Interest payable on debentures to be paid in cash.

iv. Debenture-holders agreed to take over freehold property, book value Rs. 1,00,000 at a valuation of Rs. 1,20,000 in part repayment of their holdings and to provide additional cash of Rs. 1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.

v. Patents and Goodwill to be written off.

vi. Inventory to be written off by Rs. 65,000.

vii. Amount of Rs. 68,500 to be provided for bad debts.

viii. Remaining freehold property after giving to debenture holders, to be revalued at Rs. 3,87,500.

ix. Investments be sold for Rs. 1,40,000.

x. Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of Rs. 2 each and as to 5% in cash, and balance 5% being waived.

xi. There were capital commitments totalling Rs. 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

xii. Ignore taxation and cost of the scheme.

You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the Scheme.

Solution

Journal of A & Co. Ltd.

			Dr. Rs.	**Cr. Rs.**
20X2 April 1	Equity Share Capital A/c (Rs. 10)	Dr.	7,50,000	
	To Capital Reduction A/c			6,00,000

	To Equity Share Capital A/c (Rs. 2) (Reduction of equity shares of Rs. 10 each to shares of Rs. 2 each as per Reconstruction Scheme dated...)		1,50,000
	6% Cum. Preference Share Capital A/c (Rs. 100) Dr. To Capital Reduction A/c To Pref. Share Capital A/c (Rs. 75) (Reduction of preference shares of Rs. 100 each to shares of Rs. 75 each as per reconstruction scheme)	4,00,000	 1,00,000 3,00,000
	Capital Reduction Account Dr. To Equity Share Capital Account (Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, Rs. 96,000)	24,000	 24,000
	Freehold Property A/c Dr. To Capital Reduction A/c (Appreciation in the value of property: Book value Revalued Figure Rs. 1,00,000 Rs. 1,20,000 Rs. 3,25,000 Rs. 3,87,500 Total Rs. 4,25,000 Rs. 5,07,500 Profit on revaluation: Rs. 82,500)	82,500	 82,500
	6% Debentures A/c Dr. To Freehold Property A/c (Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)	1,20,000	 1,20,000
	Interest payable A/c Dr. To Bank A/c (Debenture interest paid)	22,500	 22,500
	Bank A/c Dr. To 8% Debentures A/c (8% Debentures issued for cash)	1,30,000	 1,30,000
	Bank A/c Dr. To Investment A/c	1,40,000	 55,000

	To Capital Reduction A/c (Sale of Investment for Rs. 1,40,000 cost being Rs. 55,000; profit credited to Capital Reduction Account)		85,000
	Directors' Loan A/c Dr. To Equity Share Capital A/c To Bank A/c To Capital Reduction A/c (Directors' loan discharged by issue of equity shares of Rs. 90,000, cash payments of Rs. 5,000 and surrender of Rs. 5,000, vide Scheme of Reconstruction)	1,00,000	 90,000 5,000 5,000
	Capital Reduction A/c Dr. To Patents To Goodwill To Inventory To Provision for Doubtful Debts To Bank To Profit & Loss Account (Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)	8,48,500	 37,500 1,30,000 65,000 68,500 12,500 5,35,000

Note: Penalty charges for cancellation of the contract amounts to Rs.12,500 (2,50,000X5%) being paid in cash.

Balance Sheet of A & Co. Ltd. (And Reduced) as at 1st April, 20X2

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,64,000
2		**Non-current liabilities**		
	A	Long-term borrowings	2	3,85,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000

		Total		12,49,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	4,37,500
	B	Intangible assets	4	-
2		**Current assets**		
	A	Inventories		3,60,000
	B	Trade receivables	5	4,16,500
	C	Cash and cash equivalents		35,000
		Total		12,49,000

Notes to accounts

1	**Share Capital**		
	Equity share capital		
	1,32,000 Equity shares of Rs. 2 each (of the above 57,000 shares have been issued for consideration other than cash)		2,64,000
	Preference share capital		
	4,000 6% Preference shares of Rs. 75 each		3,00,000
	Total		5,64,000
2	**Long-term borrowings**		
	Secured		2,55,000
	6% Debentures		1,30,000
	8% Debentures		3,85,000
	Total		
3	**Property, plant and equipment**		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	(1,20,000)	3,87,500
	Plant		50,000
	Net carrying value		4,37,500
4	**Intangible assets**		
	Goodwill	1,30,000	
	Less: Written off under scheme of Reconstruction	(1,30,000)	
	Net carrying value		NIL

	Patents	37,500	
	Less: Written off under scheme of Reconstruction	(37,500)	–
	Net carrying value	-	NIL
5	**Trade Receivables**	4,85,000	
	Less: Provision for doubtful debts	68,500	
			4,16,500

Illustration 4

Given below is the Balance sheet of Rebuilt Ltd. as at 31.3.20X1:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	13,50,000
	B	Reserves and Surplus	2	(4,51,000)
2		**Non-current liabilities**		
	A	Long-term borrowings (Loan)	3	5,73,000
3		**Current liabilities**		
	A	Trade Payables		2,07,000
	B	Other current liabilities		35,000
		Total		17,14,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	6,68,000
	B	Intangible assets	5	3,18,000
2		**Current assets**		
	A	Inventories		4,00,000
	B	Trade receivables		3,28,000
		Total		17,14,000

Notes to accounts

		Rs.
1	**Share Capital**	
	Equity share capital	7,50,000
	15,000 Equity Shares of Rs. 50 each	
	Preference share capital	
	12,000, 7% Cumulative Preference Shares of Rs. 50 each (Preference	
	dividend is in arrears for five years)	6,00,000
	Total	13,50,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(4,51,000)
		(4,51,000)
3	**Long-term borrowings**	
	Loan	5,73,000
		5,73,000
4	**Property, plant and Equipment**	
	Building at cost less depreciation	4,00,000
	Plant at cost less depreciation	2,68,000
		6,68,000
5	**Intangible assets**	
	Trademarks and Goodwill at cost	3,18,000
		3,18,000

The Company is not earning profits, short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

a. **The equity shareholders have agreed that their Rs. 50 shares should be reduced to Rs. 2.50 by cancellation of Rs. 47.50 per share. They have also agreed to subscribe for three new equity shares of Rs. 2.50 each for each equity share held.**
b. **The preference shareholders have agreed to cancel the arrears of dividends and to accept for each Rs. 50 share, 4 new 5% preference shares of Rs. 10 each, plus 6 new equity shares of Rs.2.50 each, all credited as fully paid.**
c. **Lenders to the company for Rs. 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of Rs. 10 each and 12,000 new equity shares of Rs. 2.50 each.**

d. The directors have agreed to subscribe in cash for 40,000, new equity shares of Rs. 2.50 each in addition to any shares to be subscribed by them under (a) above.

e. Of the cash received by the issue of new shares, Rs. 2,00,000 is to be used to reduce the loan due by the company.

f. The equity share capital cancelled is to be applied:

i. To write off the debit balance in the profit and loss A/c; and

ii. To write off Rs. 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capital as reduced is to be increased to Rs. 6,50,000 for preference share capital and Rs. 7,50,000 for equity share capital.

Solution

In the books of Rebuilt Ltd. Journal Entries

	Particulars		**Debit (Rs.)**	**Credit (Rs.)**
1.	Equity share capital A/c (Rs. 50)	Dr.	7,50,000	
	To Equity share capital A/c (Rs. 2.50)			37,500
	To Capital reduction A/c			7,12,500
	(Being equity capital reduced to nominal value of Rs.2.50 each)			
2.	Bank A/c	Dr.	1,12,500	
	To Equity share capital			1,12,500
	(Being 3 right shares against each share was issued and subscribed)			
3.	7% Preference share capital A/c (Rs. 50)	Dr.	6,00,000	
	Capital reduction A/c	Dr.	60,000	
	To 5% Preference share capital (Rs. 10)			4,80,000
	To equity share capital (Rs. 50)			1,80,000
	(Being 7% preference shares of Rs. 50 each converted to 5% preference shares of Rs. 10 each and also given to them 6 equity shares for every share held)			
4.	Loan A/c	Dr.	1,50,000	
	To 5% Preference share capital A/c			1,20,000

	To Equity share capital A/c (Being loan to the extent of Rs. 1,50,000 converted into share capital)		30,000
5.	Bank A/c Dr. To Equity share application money A/c (Being shares subscribed by the directors)	1,00,000	1,00,000
6.	Equity share application money A/c Dr. To Equity share capital A/c (Being application money transferred to capital A/c)	1,00,000	1,00,000
	Loan A/c Dr. To Bank A/c (Being loan repaid)	2,00,000	2,00,000
7.	Capital reduction A/c Dr. To Profit and loss A/c To Plant A/c To Trademarks and Goodwill A/c (Bal. fig.) (Being losses and assets written off to the extent required)	6,52,500	4,51,000 35,000 1,66,500

Balance sheet of Rebuilt Ltd. (and reduced)

as at 31.3.20X1

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	10,60,000
2		**Non-current liabilities**		
	a	Long-term borrowings		2,23,000
3		**Current liabilities**		
	a	Trade Payables		2,07,000
	b	Other current liabilities		35,000
		Total		15,25,000
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	2	6,33,000
	b	Intangible assets	3	1,51,500

2		**Current assets**		
	a	Inventories		4,00,000
	b	Trade receivables		3,28,000
	c	Cash and cash equivalents	4	12,500
		Total		15,25,000

Notes to accounts

			Rs.
1.	Share Capital		
	Authorized capital:		
	65,000 Preference shares of Rs.10 each	6,50,000	
	3,00,000 Equity shares of Rs.2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:		
	1,80,000 equity shares of Rs.2.5 each	4,60,000	
	60,000, 5% Preference shares of Rs.10 each	6,00,000	10,60,000
2.	Property plant and equipment		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3.	Intangible assets		
	Trademarks and goodwill		1,51,500
4.	Cash and cash equivalents		
	Bank (1,12,500 + 1,00,000 - 2,00,000)		12,500

Illustration 5

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

	Rs.
Property, Plant and Equipment	**2,50,00,000**
Investments (Market-value Rs. 19,00,000)	**20,00,000**
Current Assets	**2,00,00,000**
P & L A/c (Dr. balance)	**12,00,000**
Share Capital: Equity Shares of Rs.100 each	**2,00,00,000**
6%, Cumulative Preference Shares of Rs.100 each	**1,00,00,000**
5% Debentures of Rs.100 each	**80,00,000**
Creditors	**1,00,00,000**
Provision for taxation	**2,00,000**

The following scheme of Internal Reconstruction is sanctioned:

i. **All the existing equity shares are reduced to Rs.40 each.**

ii. **All preference shares are reduced to Rs.60 each.**

iii. **The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of Rs.100 each and exchange the same for fresh debentures of Rs.70 each for every debenture held by them.**

iv. **Property, Plant and Equipment is to be written down by 20%.**

v. **Current assets are to be revalued at Rs.90,00,000.**

vi. **Investments are to be brought to their market value.**

vii. **One of the creditors of the company to whom the company owes Rs.40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of Rs.40 each in full and final settlement of his claim.**

viii. **The taxation liability is to be settled at Rs.3,00,000.**

ix. **It is decided to write off the debit balance of Profit & Loss A/c.**

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

Solution

Journal Entries in the books of Vaibhav Ltd.

		Rs.	Rs.
i.	Equity share capital (Rs. 100) A/c Dr.	2,00,00,000	
	To Equity Share Capital (Rs. 40) A/c		80,00,000
	To Capital Reduction A/c		1,20,00,000
	(Being conversion of equity share capital of Rs. 100 each into Rs.40 each as per reconstruction scheme)		
ii.	6% Cumulative Preference Share capital (Rs. 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference Share Capital (Rs. 60) A/c		60,00,000
	To Capital Reduction A/c		40,00,000
	(Being conversion of 6% cumulative preference shares capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)		
iii.	5% Debentures (Rs. 100) A/c Dr.	80,00,000	
	To 6% Debentures (Rs. 70) A/c		56,00,000
	To Capital Reduction A/c		24,00,000

	(Being 6% debentures of Rs. 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		
iv.	Sundry Creditors A/c Dr.	40,00,000	
	To Equity Share Capital (Rs.40) A/c		24,00,000
	To Capital Reduction A/c		16,00,000
	(Being a creditor of Rs.40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of Rs.40 each in full settlement of his dues as per reconstruction scheme)		
v.	Provision for Taxation A/c Dr.	2,00,000	
	Capital Reduction A/c Dr.	1,00,000	
	To Liability for Taxation A/c		3,00,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)		
vi.	Capital Reduction A/c Dr.	199,00,000	
	To P & L A/c		12,00,000
	To Property, Plant and Equipment A/c		50,00,000
	To Current Assets A/c		110,00,000
	To Investments A/c		1,00,000
	To Capital Reserve A/c (Bal. fig.)		26,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)		
vii.	Liability for Taxation A/c Dr.	3,00,000	
	To Current Assets (Bank A/c)		3,00,000
	(Being the payment of tax liability)		

Balance Sheet of Vaibhav Ltd. (and reduced) as at 31st March, 20X1

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	1,64,00,000
	b	Reserves and Surplus	2	26,00,000

2		**Non-current liabilities**		
	a	Long-term borrowings	3	56,00,000
3		**Current liabilities**		
	a	Trade Payables (1,00,00,000 less 40,00,000)		60,00,000
		Total		3,06,00,000
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	2,00,00,000
	b	Investments	5	19,00,000
2		**Current assets**	6	87,00,000
		Total		3,06,00,000

Notes to accounts

			Rs.
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	2,60,000 equity shares of Rs.40 each		
	(of the above 60,000 shares have been issued for consideration other than cash)		1,04,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	1,00,000 6% Cumulative Preference shares of Rs.60 each		60,00,000
	Total		1,64,00,000
2.	**Reserves and Surplus**		
	Capital Reserve		26,00,000
3.	**Long-term borrowings**		
	Secured		
	6% Debentures		56,00,000
4.	**Property, Plant and Equipment**		
	Carrying value	2,50,00,000	
	Adjustment under scheme of reconstruction	(50,00,000)	2,00,00,000
5.	**Investments**		
		20,00,000	

	Adjustment under scheme of reconstruction	(1,00,000)	19,00,000
6.	**Current assets**		
		2,00,00,000	
	Adjustment under scheme of reconstruction	(1,10,00,000)	
		90,00,000	
	Taxation liability paid	(3,00,000)	87,00,000

Working Note:

Capital Reduction Account

To Liability for taxation A/c	1,00,000	By Equity share capital	1,20,00,000
To P & L A/c	12,00,000		
To Property, plant and equipment	50,00,000	By 6% Cumulative preferences	40,00,000
To Current assets	1,10,00,000		
To Investment	1,00,000	Share capital	24,00,000
To Capital Reserve (Bal. fig.)	26,00,000	By 5% Debentures	16,00,000
	2,00,00,000	By Sundry creditors	2,00,00,000

Illustration 6

Following is the Balance Sheet of ABC Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**26,00,000**
	B	**Reserves and Surplus**	**2**	**(4,05,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**12,00,000**
3		**Current liabilities**		
	A	**Trade Payables**		**5,92,000**
	B	**Short term borrowings - Bank overdraft**		**1,50,000**
		Total		**41,37,000**
		Assets		
1		**Non-current assets**		
	A	**Property, Plant and Equipment**	**4**	**11,50,000**
	B	**Intangible assets**	**5**	**70,000**

	C	Non-current investment	6	68,000
2		Current assets		
	A	Inventory		14,00,000
	B	Trade receivables		14,39,000
	C	Cash and cash equivalents		10,000
		Total		41,37,000

Notes to accounts:

		Rs.
1	Share Capital	
	Equity share capital:	
	2,00,000 Equity Shares of Rs. 10 each	20,00,000
	6,000, 8% Preference shares of Rs. 100 each	6,00,000
		26,00,000
2	Reserves and Surplus	
	Debit balance of Profit and loss A/c	(4,05,000)
		(4,05,000)
3	Long-term borrowings	
	9% debentures	12,00,000
		12,00,000
4	Property, Plant and Equipment	
	Plant and machinery	9,00,000
	Furniture and fixtures	2,50,000
		11,50,000
5	Intangible assets	
	Patents and copyrights	70,000
		70,000
6	Non-current investments	
	Investments (market value of Rs. 55,000)	68,000
		68,000

The following scheme of reconstruction was finalized:

i. **Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.**

ii. **Debenture holders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.**

iii. **Inventory equal to Rs.5,00,000 in book value will be taken over by trade payables in full settlement of their dues.**
iv. **Investment value to be reduced to market price.**
v. **The company would issue 11% Debentures for Rs.3,00,000 and augment its working capital requirement after settlement of bank overdraft.**

Pass necessary Journal Entries in the books of the company. Prepare Capital Reduction account and Balance Sheet of the company after internal reconstruction.

Solution

In the Books of ABC Ltd.

Journal Entries

Particulars		Rs.	Rs.
8% Preference share capital A/c	Dr.	6,00,000	
To 11% Debentures A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital and issue of 11% debentures]			
9% Debentures A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment of plant & machinery]			
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving Inventories]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000

To Capital reserve A/c [Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]		1,54,000

Capital Reduction Account

	Rs.		Rs.
To Investments A/c	13,000	By Preference share capital A/c	1,80,000
To Profit and loss A/c	4,05,000	By 9% Debenture holders A/c	3,00,000
To Capital reserve A/c	1,54,000	By Trade payables A/c	92,000
	5,72,000		5,72,000

Balance Sheet of ABC Ltd. (And Reduced) As at 31st March 20X1

Particulars	Note No	Rs.
I. Equity and Liabilities		
1. Shareholder's Funds		
a. Share Capital	1	20,00,000
b. Reserves and Surplus 2 1,54,000	2	1,54,000
2. Non-Current Liabilities		
a. Long-term borrowings 3 7,20,000	3	7,20,000
Total		28,74,000
II. Assets		
1. Non-current assets		
a. Property, plant and equipment	4	2,50,000
b. Intangible assets	5	70,000
Non-current investments	6	55,000
2. Current assets		
a. Inventories (Rs. 14,00,000 – Rs. 5,00,000)		9,00,000
b. Trade receivables		14,39,000
c. Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

			Rs.
1	**Share Capital**		
	2,00,000 Equity shares of Rs. 10 each fully paid-up		20,00,000
2	**Reserve and Surplus**		
	Capital Reserve		1,54,000
3	**Long Term Borrowings**		
	11% Debentures (Rs. 4,20,000 + Rs. 3,00,000)		7,20,000
4	**Property, Plant and Equipment**		
	Plant & machinery	9,00,000	
	Less: Adjustment on scheme of reconstruction	9,00,000	-
	Furniture & fixtures		2,50,000
5	**Intangible assets**		
	Patents & copyrights		70,000
			3,20,000
6	**Non-Current Investments**		
	Investments (Rs.68,000 – Rs.13,000)		55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid

= Rs. 10,000 + Rs. 3,00,000 – Rs. 1,50,000 = Rs. 1,60,000

Illustration 7

The Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	1	**10,00,000**
	B	**Reserves and Surplus**	2	**(6,00,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	3	**2,00,000**
3		**Current liabilities**		
	A	**Trade Payables**		**72,000**
	B	**Other current liabilities**	4	**24,000**

	C	Short term provisions	5	24,000
		Total		7,20,000
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment	6	1,00,000
		Non-current investment		
2		Current assets		
	A	Inventory		3,20,000
	B	Trade receivables		2,70,000
	C	Cash and cash equivalents		30,000
		Total		7,20,000

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	10,000 Equity Shares of Rs. 100 each	10,00,000
		10,00,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(6,00,000)
		(6,00,000)
3	Long-term borrowings	
	12% debentures	2,00,000
		2,00,000
4	Other current liabilities	
	Interest payable on debentures	24,000
		24,000
5	Short term provisions	
	Provision for taxation	24,000
		24,000
6	Property, Plant and Equipment	
	Machinery	1,00,000
		1,00,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

a. **Each share is sub-divided into ten fully paid up equity shares of Rs.10 each.**
b. **After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.**
c. **Out of shares surrendered, 10,000 shares of Rs.10 each shall be converted into 12% preference shares of Rs.10 each, fully paid up.**
d. **The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of Rs.1,00,000 which are converted out of shares surrendered.**
e. **Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of Rs.10 each out of shares surrendered.**
f. **Balance of profit and loss account to be written off.**
g. **The shares surrendered and not re-issued shall be cancelled.**

You are required to show the journal entries giving effect to the above and the resultant Balance Sheet.

Solution

		Dr. Rs.	Cr. Rs.
Equity Share Capital (Rs. 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000
To Equity Share Capital (Rs. 10) A/c			5,00,000
(Subdivision of 10,000 equity shares of Rs. 100 each into 1,00,000 equity shares of Rs. 10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			
12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	

To Reconstruction A/c (Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)		72,000
Share Surrender A/c Dr. To 12% Preference Share Capital A/c To Equity Share Capital A/c To Reconstruction A/c (Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)	5,00,000	 1,00,000 36,000 3,64,000
Reconstruction A/c Dr. To Profit and Loss A/c To Capital Reserve A/c (Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)	6,04,000	 6,00,000 4,000

Balance Sheet of Revise Limited (and reduced) as at...

Particulars	Note No.	Rs.
I. Equity and Liabilities		
1. Shareholder's Funds		
a. Share Capital	1	6,36,000
b. Reserves and Surplus	2	4,000
2. Non-Current Liabilities		
a. Long-term borrowings	3	50,000
3. Current Liabilities		
a. Other current liabilities	4	6,000
b. Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
1. Non-current assets		
a. Property, plant and equipment	6	1,00,000

2. Current assets		
a. Inventories		3,20,000
b. Trade receivables		2,70,000
c. Cash and cash equivalents		30,000
Total		**7,20,000**

Notes to Accounts

		Rs.
1.	**Share Capital**	
	Equity Share Capital	
	Issued Capital: 53,600 Equity Shares of Rs. 10 each	5,36,000
	Preference Share Capital	
	Preference Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
2.	**Reserve and Surplus**	
	Capital Reserve	4,000
3.	**Long-term borrowings**	
	Unsecured Loans	
	12% Debentures	50,000
4.	**Other current liabilities**	
	Interest payable on debentures	6,000
5.	**Short-term provisions**	
	Provision for Income-tax	24,000
6.	**Property, plant and Equipment**	
	Machinery	1,00,000

Illustration 8

Recover Ltd. decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 20X1 is as follows-

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	3,50,000
	B	Reserves and Surplus	2	(70,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	50,000
3		Current liabilities		
	A	Trade Payables		80,000
		Short term Borrowings – Bank		
	B	Overdraft		90,000
	C	Other Current Liabilities (Interest payable on Debentures)		5,000
		Total		5,05,000
		Assets		
		Non-current assets		
1	A	Property, Plant and Equipment	4	3,35,000
	B	Intangible assets	5	50,000
	C	Non-current investments	6	40,000
2		Current assets		
	A	Inventory		30,000
	B	Trade receivables		50,000
				5,05,000

Notes to accounts:

1.	Share Capital		Rs.
	Equity share capital:		
	20,000 Equity Shares of Rs. 10 each		2,00,000
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of Rs. 10 each		
	(preference dividend has been in arrears for 4 years)		1,50,000
			3,50,000

2.	**Reserves and surplus**		
	Profit and loss account (debit balance)		**(70,000)**
			(70,000)
3.	**Long-term borrowings**		
	Secured		
	10% Debentures (secured on the freehold property)		**50,000**
			50,000
4.	**Property, Plant and Equipment**		
	Freehold property		**1,20,000**
	Leasehold property		**85,000**
	Plant and machinery		**1,30,000**
			3,35,000
5.	**Intangible assets**		
	Goodwill		**50,000**
			50,000
6.	**Non-current investments**		
	Non-Trade investments at cost		**40,000**
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

i. **The preference shares were reduced to Rs. 2.5 per share, and the equity shares to Rs. 1 per share.**
ii. **One new equity share of Rs. 1 was issued for the arrears of preferred dividend for past 4 years.**
iii. **The debenture holders took over the freehold property at an agreed figure of Rs. 75,000 and paid the balance to the company after deducting the amount due to them.**
iv. **Plant and Machinery was written down to Rs. 1,00,000.**
v. **Non-trade Investments were sold for Rs. 32,000.**
vi. **Goodwill and obsolete stock (included in the value of inventories) of Rs. 10,000 were written off.**
vii. **A contingent liability of which no provision had been made was settled at Rs. 7,000 and of this amount, Rs. 6,300 was recovered from the insurance.**

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

Solution

Journal entries in the books of Recover Ltd

Particulars		**Dr. Rs.**	**Cr. Rs.**
8% Cumulative Preference share capital (Rs. 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (Rs.2.5) A/c			37,500
To Reconstruction (Rs. 7.5) A/c			1,12,500
(Preference shares being reduced to shares of Rs. 2.5 per share and remaining transferred to reconstruction account as per internal reconstruction scheme)			
Equity share capital A/c (Rs.10)	Dr.	2,00,000	
To Equity Share capital A/c (Rs. 1)			20,000
To Reconstruction A/c (Rs. 9)			1,80,000
(Equity shares reduced to Rs. 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of Rs. 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
10% Debentures A/c	Dr.	50,000	
Interest payable on debentures A/c	Dr	5,000	
Bank A/c	Dr.	20,000	
Reconstruction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the reconstruction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000

(The assets written off as a part of the internal reconstruction scheme)		
Bank A/c Dr. Reconstruction A/c Dr. To Investments A/c (Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)	32,000 8,000	 40,000
Contingent Liability A/c Dr. To Bank A/c (Contingent liability paid as a part of the internal reconstruction scheme)	7,000	 7,000
Bank A/c Dr. Reconstruction A/c Dr. To Contingent Liability A/c (The insurance company remitting part of the contingency payment amount)	6,300 700	 7,000
Reconstruction A/c Dr. To Profit and loss A/c (Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)	70,000	 70,000
Reconstruction A/c Dr. To Capital reserve A/c (The balance in reconstruction account transferred to capital reserve as a part of the internal reconstruction scheme)	30,800	 30,800

Balance sheet of Recover Ltd. as at 31st March 20X1 (and reduced)

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,05,000
	B	Reserves and Surplus	2	30,800
2		**Non-current liabilities**		
	A	Long-term borrowings		-

3		**Current liabilities**		
	A	Trade Payables		80,000
	B	Short term Borrowings – Bank Overdraft		90,000
		Total		**3,06,300**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	1,85,000
2		**Current Assets**		
	A	Inventory		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	51,3000
		Total		**3,06,300**

Notes to accounts:

	Particulars	**Rs.**
1.	**Share Capital**	
	Equity Share Capital	
	68,000 Equity Shares of Rs. 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of Rs. 2.5 each	37,500
		1,05,500
2.	**Reserves and surplus**	
	Capital reserve	30,800
3.	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
		1,85,000
4.	**Cash and cash equivalents**	
	Bank A/c (20,000 + 32,000 – 7000 + 6,300)	51,300

TEST YOUR KNOWLEDGE

MCQs

1. **When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called**
   a. **Internal reconstruction with liquidation**
   b. **Internal reconstruction without liquidation of the company**
   c. **External reconstruction**
   d. **None of the above.**

2. **The accumulated losses under scheme of internal reconstruction are written off against**
   a. **Capital Reduction account**
   b. **Share Capital account**
   c. **Shareholders' account**
   d. **Reserve and surplus.**

3. **A process of reconstruction, which is carried out without liquidating the company and forming a new one is called**
   a. **Internal reconstruction.**
   b. **External reconstruction.**
   c. **Amalgamation in the nature of merger.**
   d. **Amalgamation in the nature of purchase.**

4. **Reconstruction is a process by which affairs of a company are reorganized by**
   a. **Revaluation of assets and Reassessment of liabilities.**
   b. **Writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.**
   c. **Both a. and b.**
   d. **None of the above.**

5. **For reduction of the share capital, the permission has to be sought from**
   a. **Court.**
   b. **Controller.**
   c. **State government.**
   d. **Shareholders.**

6. In case of internal reconstruction

a. Only one company is liquidated.

b. Two or more companies are liquidated.

c. No company is liquidated.

d. Two companies amalgamated.

ANSWERS/HINTS

MCQs

1.	**b.**	Internal reconstruction without liquidation of the company
2.	**a.**	Capital Reduction account
3.	**a.**	Internal reconstruction.
4.	**c.**	Both a. and b.
5.	**a.**	Court.
6.	**c.**	No company is liquidated.

THEORETICAL QUESTIONS

Q.NO.1. What are the methods of internal reconstruction generally followed by companies?

ANSWER

Methods of Internal reconstruction:

- Sub-division or consolidation of shares into smaller or higher Denomination and Conversion of share into stock or vice-versa
- Variation of shareholders' rights
- Reduction of share capital
- Compromise, arrangements etc.
- Surrender of Shares.

PRACTICAL QUESTIONS

Q.NO.1. Parth Ltd, had laid down the following terms upon the sanction of the reconstruction plan by the court-1.

1. **Furniture and Fixtures which stood at the books at Rs. 1,50,000 to be written down to Rs. 95,000. The freehold premises which was valued at Rs. 7,00,000 showed an appreciation of Rs. 55,000.**
2. **Plant and machinery showed fall in value of Rs. 89,000, to be recorded in the books. Investment at Rs. 2,00,000 was brought down to the existing market value at Rs. 1,05,000.**
3. **Debenture holders accepted to receive the following in lieu of their present 9% debentures of Rs. 2,50,000-**
   a. **1/5th of the total to be paid in cash to them.**
   b. **To take over the land and buildings of value Rs. 72,000**
   c. **To forgo the remaining unpaid portion as a policy of reconstruction.**

Write off the profit and loss A/c debit balance at Rs. 70,000 which had been accumulated over the years. In case of any shortfall, the balance of the General reserve of Rs. 1,50,000 can be utilized to write off the losses under reconstruction scheme.

Show the necessary journal entries as part of the reconstruction process considering that balance in general reserve utilized to write off the losses as per reconstruction scheme.

<u>SOLUTION</u>

Journal entries in the books of Parth Ltd.

		Dr.	Cr.
		Rs.	**Rs.**
Reconstruction A/c	Dr.	2,39,000	
To Furniture and Fixtures A/c			55,000
To Plant and machinery A/c			89,000
To Investment A/c			95,000
(Writing off overvalued assets as per Reconstruction Scheme dated.)			
Freehold premises A/c	Dr.	55,000	
To Reconstruction A/c			55,000
(Being the increase in the premises credited to reconstruction account as per reconstruction scheme)			
9% Debentures A/c	Dr.	2,50,000	
To Bank A/c			50,000
To Land and building A/c			72,000

To Reconstruction A/c (Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)		1,28,000
Reconstruction A/c Dr. To Profit and loss A/c (Being the loss written off as per reconstruction scheme)	70,000	70,000
General reserve A/c Dr. To Reconstruction A/c (Being the balance in general reserve utilized to write off the losses as per reconstruction scheme)	1,26,000	1,26,000

Q.NO.2. The following scheme of reconstruction has been approved for Win Limited:

i. The shareholders to receive in lieu of their present holding at 1,00,000 shares of Rs. 10 each, the following:

a. New fully paid Rs. 10 Equity shares equal to 3/5th of their holding.

b. 10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.

c. Rs. 40,000, 8% Debentures.

ii. An issue of Rs. 1 lakh 10% first debentures was made and allotted, payment for the same being received in cash forthwith.

iii. Goodwill which stood at Rs. 1,40,000 was completely written off.

iv. Plant and machinery which stood at Rs. 2,00,000 was written down to Rs. 1,50,000.

v. Freehold property which stood at Rs. 1,50,000 was written down by Rs. 50,000.

You are required to draw up the necessary Journal entries in the Books of Win Limited for the above reconstruction. Suitable narrations to Journal entries should form part of your answer.

SOLUTION

	Rs.	Rs.
Equity Share Capital (old) A/c Dr.	10,00,000	
To Equity Share Capital (Rs. 10) A/c		6,00,000
To 10% Preference Share Capital A/c		1,20,000
To 8% Debentures A/c		40,000
To Capital Reduction A/c		2,40,000
(Being new equity shares, 10% Preference Shares, 8% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)		

Bank A/c	Dr.	1,00,000	
To 10% First Debentures A/c 1,00,000			1,00,000
(Being allotment of 10% first Debentures)			
Capital Reduction A/c	Dr.	2,40,000	
To Goodwill Account			1,40,000
To Plant and Machinery Account			50,000
To Freehold Property Account			50,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery and Freehold property as per the scheme)			

Q.NO.3. Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the Company as at 31.3.20X1 before reconstruction:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**65,00,000**
	B	**Reserves and Surplus**	**2**	**(20,00,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**15,00,000**
3		**Current liabilities**		
	A	**Trade Payables**		**5,00,000**
		Total		**65,00,000**
		Assets		
1		**Non-current assets**		
	A	**Property, Plant and Equipment**	**4**	**45,00,000**
	B	**Intangible assets**	**5**	**20,00,000**
2		**Current assets**		**Nil**
		Total		**65,00,000**

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	Authorized share capital	
	1,50,000 Equity shares of Rs. 50 each	75,00,000
	Issued, subscribed and paid up capital	
	50,000 Equity Shares of Rs. 50 each	25,00,000
	1,00,000 Equity shares of Rs. 50 each, Rs. 40 paid up	40,00,000
		65,00,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(20,00,000)
3	Long-term borrowings	
	Secured: 12% First debentures	5,00,000
	12% Second debentures	10,00,000
		15,00,000
4	Property, Plant and Equipment	
	Building	10,00,000
	Plant	10,00,000
	Computers	25,00,000
		45,00,000
5	Intangible assets	20,00,000
	Goodwill	20,00,000

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X Rs.	Mr. Y Rs.
12% First Debentures	3,00,000	2,00,000
12% Second Debentures	7,00,000	3,00,000
Trade payables	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up Rs. 50 shares	3,00,000	2,00,000
Partly paid up shares (Rs. 40 paid up)	5,00,000	5,00,000

The following Scheme of Reconstruction is approved by all parties interested and also by the Court:

a. **Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of Rs. 20 each.**
b. **Mr. X is to cancel Rs. 7,00,000 of his total debt (other than share amount) and to pay Rs. 2 lakhs to the company and to receive new 14% First Debentures for the balance amount.**
c. **Mr. Y is to cancel Rs. 3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.**
d. **The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.**

You are required to draw the Journal Entries to record the same and also show the Balance Sheet of the reconstructed company.

SOLUTION

Journal Entries in books of Green Limited

		Dr.	Cr.
		Rs.	**Rs.**
Bank Account	Dr.	10,00,000	
To Equity Share Capital Account			10,00,000
(Balance of Rs. 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)			
Equity Share Capital Account (Rs. 50)	Dr.	75,00,000	
To Equity Share Capital Account (Rs. 20)			30,00,000
To Capital Reduction Account			45,00,000
(Reduction of equity shares of Rs. 50 each to shares of Rs. 20 each as per reconstruction scheme)			
12% First Debentures Account	Dr.	3,00,000	
12% Second Debentures Account	Dr.	7,00,000	
Trade payables Account	Dr.	2,00,000	
To X			12,00,000
(The total amount due to X, transferred to his account)			
Bank Account	Dr.	2,00,000	
To X			2,00,000
(The amount paid by X under the reconstruction scheme)			

12% First Debentures Account	Dr.	2,00,000	
12% Second Debentures Account	Dr.	3,00,000	
Trade payables Account	Dr.	1,00,000	
To Y			6,00,000
(The total amount due to Y, transferred to his account)			
Y	Dr.	6,00,000	
To 14% First Debentures Account			3,00,000
To Capital Reduction Account			3,00,000
(The amount due to Y discharged by issue of 14% first debentures)			
X	Dr.	14,00,000	
To 14% First Debentures Account			7,00,000
To Capital Reduction Account			7,00,000
(The cancellation of Rs. 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)			
Capital Reduction Account	Dr.	55,00,000	
To Goodwill Account 20,00,000			20,00,000
To Profit and Loss Account 20,00,000			20,00,000
To Computers Account 15,00,000			15,00,000
(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss account, and computers— Working Note)			

Balance Sheet of Green Limited (and reduced) as at 31st March, 20X1

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	30,00,000
2		Non-current liabilities		
	a	Long-term borrowings	2	10,00,000
3		Current liabilities		
	a	Trade Payables		2,00,000
		Total		42,00,000
		Assets		
1		Non-current assets		

2	a	Property, plant and equipment	3	30,00,000
		Current assets		
		Cash and cash equivalents		12,00,000
		Total		42,00,000

Notes to accounts

	Rs.
1. Share Capital	
Equity share capital	
Issued, subscribed and paid up	
1,50,000 equity shares of Rs. 20 each	30,00,000
Total	30,00,000
2. Long-term borrowings	
Secured	
14% First Debentures	10,00,000
Total	10,00,000
3. Property, Plant and Equipment	
Building	10,00,000
Plant	10,00,000
Computers	10,00,000
Total	30,00,000

Working Note:

Capital Reduction Account

	Rs.		Rs.
To Goodwill A/c	20,00,000	By Equity Share Capital A/c	45,00,000
To P & L A/c	20,00,000	By X	7,00,000
To Computers (Bal. Fig.)	15,00,000	By Y	3,00,000
	55,00,000		55,00,000

Q.NO.4. The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	1,50,00,000
	B	Reserves and Surplus	2	(6,00,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	40,00,000
3		Current liabilities		
	A	Trade Payables		50,00,000
	B	Short term provisions	4	1,00,000
		Total		2,35,00,000
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment		1,25,00,000
	B	Non-current investment	5	10,00,000
2		Current assets		1,00,00,000
		Total		2,35,00,000

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	1,00,000 Equity Shares of Rs. 100 each	1,00,00,000
	50,000, 12% Cumulative Preference shares of Rs. 100 each	50,00,000
		1,50,00,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(6,00,000)
		(6,00,000)
3	Long-term borrowings	
	40,000, 10% debentures of Rs.100 each	40,00,000
		40,00,000
4	Short term provisions	
	Provision for taxation	1,00,000
		1,00,000

5	**Non-current investments**	
	Investments (market value of Rs. 9,50,000)	**10,00,000**
		10,00,000

The following scheme of reorganization is sanctioned:

i. **All the existing equity shares are reduced to Rs. 40 each.**

ii. **All preference shares are reduced to Rs. 60 each.**

iii. **The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs.70 each for every debenture held by them.**

iv. **One of the creditors of the company to whom the company owes Rs.20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of Rs.40 each in full satisfaction of his claim.**

v. **Property, plant and equipment are to be written down by 30%.**

vi. **Current assets are to be revalued at Rs.45,00,000.**

vii. **The taxation liability of the company is settled at Rs.1,50,000.**

viii. **Investments to be brought to their market value.**

ix. **It is decided to write off the debit balance of Profit and Loss account.**

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

SOLUTION

Journal Entries in the books of Weak Ltd.

			Rs.	Rs.
i.	Equity share capital (Rs. 100) A/c	Dr.	1,00,00,000	
	To Equity Share Capital (Rs. 40) A/c			40,00,000
	To Capital Reduction A/c			60,00,000
	(Being conversion of equity share capital of Rs. 100 each into Rs. 40 each as per reconstruction scheme)			
ii.	12% Cumulative Preference Share capital (Rs. 100) A/c Dr.	Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (Rs. 60) A/c			30,00,000
	To Capital Reduction A/c			20,00,000
	(Being conversion of 12% cumulative preference share capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)			

iii.	10% Debentures A/c	Dr.	40,00,000	
	To 12% Debentures A/c			28,00,000
	To Capital Reduction A/c			12,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)			
iv.	Trade payables A/c	Dr.	20,00,000	
	To Equity Share Capital A/c			12,00,000
	To Capital Reduction A/c			8,00,000
	(Being a creditor of Rs. 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of Rs. 40 each in full settlement of his dues as per reconstruction scheme)			
v.	Provision for Taxation A/c	Dr.	1,00,000	
	Capital Reduction A/c.	Dr.	50,000	
	To Current Assets (bank A/c) A/c			1,50,000
	(Being liability for taxation settled)			
vi.	Capital Reduction A/c	Dr.	99,00,000	
	To P & L A/c			6,00,000
	To Property, plant and equipment A/c			37,50,000
	To Current Assets A/c			55,00,000
	To Investments A/c			50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, plant and equipment, Current Assets, Investments through capital reduction account)			
vii.	Capital Reduction A/c	Dr.	50,000	
	To capital Reserve A/c			50,000
	(Being balance in capital reduction account transferred to capital reserve account)			

Balance Sheet of Weak Ltd. (and reduced) as at 31.3.20X1

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	82,00,000
	b	Reserves and Surplus	2	50,000
2	a	**Non-current liabilities**		
		Long-term borrowings	3	28,00,000
3	a	**Current liabilities**		
		Trade Payables		30,00,000
		Total		1,40,50,000
		Assets		
1	a	**Non-current assets**		
	b	Property, plant and equipment	4	87,50,000
		Investments	5	9,50,000
2		**Current assets**	6	43,50,000
		Total		1,40,50,000

Notes to accounts

	Rs.	Rs.
1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
1,30,000 equity shares of Rs. 40 each		52,00,000
Preference share capital		
Issued, subscribed and paid up		
50,000 12% Cumulative Preference shares of Rs. 60 each		30,00,000
Total		82,00,000
2. Reserves and Surplus		
Capital Reserve		50,000
3. Long-term borrowings		
Secured		
12% Debentures		28,00,000
4. Property, plant and Equipment		

	Total PPE	1,25,00,000	
	Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5.	Investments	10,00,000	
	Adjustment under scheme of reconstruction	(50,000)	9,50,000
6.	Current assets	45,00,000	
	Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:

Capital Reduction Account

	Rs.		**Rs.**
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative	
To Property, plant and equipment	37,50,000	preference share capital	20,00,000
To Current assets	55,00,000	By 10% Debentures	12,00,000
To Investment	50,000	By Trade payables	8,00,000
To Capital Reserve (bal. fig.)	50,000		
	1,00,00,000		1,00,00,000

Q.NO.5. The following is the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	**Notes**	**Rs.**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	**1**	**36,00,000**
	B	**Reserves and Surplus**	**2**	**(14,40,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	**3**	**6,00,000**
3		**Current liabilities**		
	A	**Trade Payables**		**3,00,000**
	B	**Short term borrowings - Bank overdraft**		**6,00,000**
		Total		**36,60,000**
		Assets		
1		**Non-current assets**		
	A	**Property, Plant and Equipment**	**4**	**30,00,000**
	B	**Intangible assets**	**5**	**90,000**

2		Current assets		
	A	Inventories		2,60,000
	B	Trade receivables		2,80,000
	C	Cash and cash equivalents		30,000
		Total		36,60,000

Notes to accounts

		Rs.
1	Share capital	
	24,000 Equity Shares of Rs.100 each	24,00,000
	12,000, 10% Preference Shares of Rs.100 each	12,00,000
	Total	36,00,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(14,40,000)
		(14,40,000)
3	Long-term borrowings	
	10% debentures	6,00,000
		6,00,000
4	Property, plant and Equipment	
	Land and Building	12,00,000
	Plant and Machinery	18,00,000
		30,00,000
5	Intangible assets	
	Goodwill	90,000
		90,000

On the above date, the company adopted the following scheme of reconstruction:

i. **The equity shares are to be reduced to shares of Rs.40 each fully paid and the preference shares to be reduced to fully paid shares of Rs.75 each.**

ii. **The debenture holders took over Inventories and Trade receivables in full satisfaction of their claims.**

iii. **The Land and Building to be appreciated by 30% and Plant and machinery to be depreciated by 30%.**

iv. **The debit balance of profit and loss account and intangible assets are to be eliminated.**

v. **Expenses of reconstruction amounted to Rs.5,000. Give journal entries incorporating the above scheme of reconstruction and prepare the reconstructed Balance Sheet.**

SOLUTION

31st March, 20X1			Rs.	Rs.
i.	Equity Share Capital A/c (Rs.100)	**Dr.**	24,00,000	
	To Equity Share Capital A/c (Rs.40)			9,60,000
	To Capital Reduction A/c			14,40,000
	(Being 24,000 equity shares of Rs.100 each reduced to Rs.40 each fully paid up)			
ii.	10% Preference Share Capital A/c (Rs.100)	**Dr.**	12,00,000	
	To 10% Preference Share Capital A/c (Rs.75)			9,00,000
	To Capital Reduction A/c			3,00,000
	(Being 12,000 Preference shares of Rs.100 each reduced to Rs.75 each fully paid up)			
iii.	10% Debentures A/c	**Dr.**	6,00,000	
	To Inventories A/c			2,60,000
	To Trade receivables A/c			2,80,000
	To Capital Reduction A/c			60,000
	(Being debenture holders given Inventories and Trade receivables in full settlement of their claims)			
iv.	Land & Building A/c	**Dr.**	3,60,000	
	To Capital Reduction A/c			3,60,000
	(Being Land & Building appreciated by 30%)			
v.	Capital reduction A/c	**Dr.**	5,000	
	To Cash A/c			5,000
	(Being expenses of reconstruction paid)			
vi.	Capital Reduction A/c	**Dr.**	20,70,000	
	To Goodwill A/c			90,000
	To Profit and Loss A/c			14,40,000
	To Plant & Machinery A/c			5,40,000
	(Being various losses written off, assets written down through Capital Reserve A/c)			

vii.	Capital Reduction	**Dr.**	85,000	
	To Capital Reserve A/c (Bal. Fig.)			85,000
	(Being balance in Capital Reduction A/c transferred to Capital Reserve A/c)			

Balance Sheet (And Reduced) of X Ltd.

as at 31st March, 20X1

		Particulars	**Notes**	**Rs.**
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	18,60,000
	b	Reserves and Surplus	2	85,000
2		current liabilities		
	a	Long-term borrowings		3,00,000
	b	Short term borrowings		6,00,000
		Total		28,45,000
		Assets		
1		Non-current assets		
	a	Property, plant and equipment	3	28,20,000
2		Current assets		
	a	Cash and cash equivalents (30,000 - 5,000)		25,000
		Total		28,45,000

Notes to accounts

		Rs.	
1.	**Share capital**		
	Equity share capital		
	24,000 equity shares of Rs.40 each fully paid up		9,60,000
	Preference share capital		
	12,000, 10% Preference shares of Rs.75 each fully paid up		9,00,000
	Total		18,60,000
2.	**Reserves and Surplus**		
	Capital Reserve		85,000
3.	**Property, plant and Equipment**		
	Land and Building	15,60,000	
	Plant and Machinery	12,60,000	
	Total		28,20,000

15. ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES

LEARNING OUTCOMES

After studying this chapter, you will be able to–

- Understand concept of branches and their classification from accounting point of view.
- Distinguish between the accounting treatment of dependent branches and independent branches.
- Learn various methods of charging goods to branches.
- Solve the problems, when goods are sent to branch at wholesale price.
- Prepare the reconciliation statement of branch and head office transactions after finding the reasons for their disagreement.
- Incorporate branch balances in the head office books.
- Differentiate between integral and non-integral foreign branches.
- Learn the techniques of foreign currency translation in case of foreign branches.
- Dependent Branches for which whole accounting records are kept at Head Office
- Independent Branches which maintain independent accounting records

1. INTRODUCTION

A branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office; for there can be no branch without a head office - the principal place of business.

From the accounting point of view, branches may be classified as follows:

- Inland Branches which can be further classified as:
    - **a.** Independent Branches which maintain independent accounting records
    - **b.** Dependent Branches for which whole accounting records are kept at Head Office
- Foreign Branches

Difference between branch and department

Branch: Establishment at location different from Head Office to carry either same or substantially same activity as carried on by Head Office

Department: Division of a large organization dealing with a various kind of activity at the same location.

Let's take an example of a CA Firm working in the field of Auditing, Taxation and Finance having office at Mumbai, Chennai and Delhi practicing such fields. The CA firm has various branches in different cities, i.e., Mumbai, Chennai and Delhi, also it has various department of Auditing, Taxation and Finance at one particular branch (location).

2. DISTINCTION BETWEEN BRANCH ACCOUNTS AND DEPARTMENTAL ACCOUNTS

Basis of distinction	Branch Accounts	Departmental Accounts
1. Maintenance of accounts	Branch accounts may be maintained **either at branch or at head office**.	Departmental accounts are **maintained at one place only**.
2. Apportionment of common expenses	As expenses in respect of each branch can be identified, so the **apportionment problem never arises.**	Common expenses are **distributed among the departments concerned on some equitable basis** considered suitable in the case.
3. Reconciliation	Reconciliation of head office and branch accounts is necessary in case of Branches maintaining independent accounting records at the end of the accounting Year.	Such problem never arises.
4. Conversion of foreign currency figures	At the time of finalization of accounts, conversion of figures of foreign branch is necessary.	Such problem never arises.

3. DEPENDENT BRANCHES

When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it, the branch is described as Dependent branch. Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch. Some of the significant types of branches that are operated in this manner are described below:

a. A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office;

b. A branch established at a commercial center for the sale of goods supplied by the head office, and under its direction all collections are made by the H.O.; and

c. A branch for the retail sale of goods, supplied by the head office.

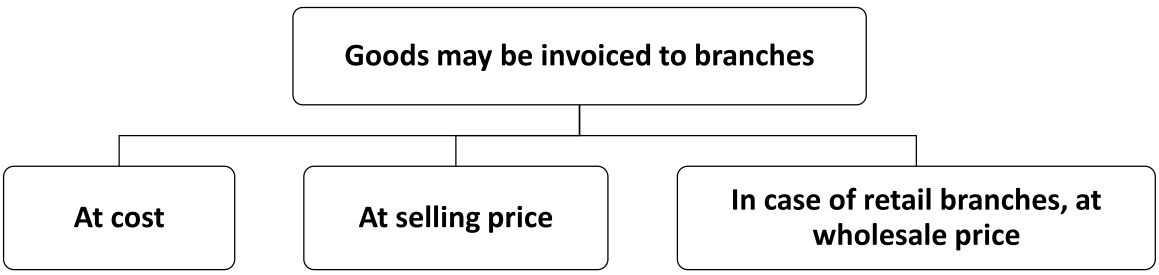
Accounting in the case of first two types is simple. Only a record of expenses incurred at the branch has to be maintained.

But however, a retail branch is essentially a sale agency that principally sells goods supplied by the head office for cash and, if so authorized, also on credit to approved customers. Generally, cash collected is deposited into a local bank to the credit of the head office and the head office issues cheques or transfers funds thereon for meeting the expenses of the branch. In addition, the Branch Manager is provided with a 'float' for petty expenses which is replenished from time to time on an imprest basis. If, however, the branch also sells certain lines of goods, directly purchased by it, the branch retains a part of the sale proceeds to pay for the goods so purchased.

4. METHODS OF CHARGING GOODS TO BRANCHES

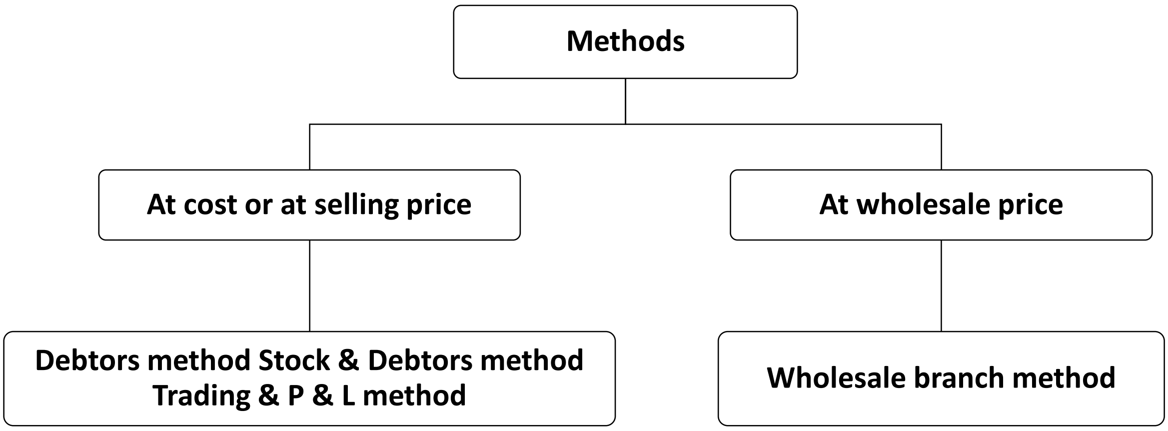
Goods may be invoiced to branches (1) at cost; or (2) at selling price; or (3) in case of retail branches, at wholesale price.

Selling price method is adopted where the goods would be sold at a fixed price by the branch. It is suitable for dealers in tea, petrol, ghee, etc. In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit.



5. ACCOUNTING FOR DEPENDENT BRANCHES

Dependent branch does not maintain a complete record of its transactions. The Head office may maintain accounts of dependent branches in any of the following methods:



5.1 When goods are invoiced at cost

If goods are invoiced to the branch at cost, the trading results of branch can be ascertained by following any of the three methods: **(i) Debtors Method,** (ii)**Stock and Debtors method, (iii) Trading and Profit and Loss Account (Final Accounts) Method**.

For finding out the trading results of branch, it is assumed that the branch is an entity separate from the head office. On this basis, a Branch Account is stated in the head office books to which the price of goods or services provided or expenses paid out are debited and correspondingly, the value of benefits and cash received from the branch are credited.

Debtors method This method of accounting is suitable for small sized branches. Under this method, separate branch account is maintained for each branch to compute profit or loss made by each branch. Various accounting adjustments to respective branch account are as follows:

- The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as any direct purchases made by branch (for which Head Office makes the payment), expenses of the branch paid by the head office, e.g., salaries, rent, insurance, etc., are also debited to it.
- Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited.
- At the end of the year, the value of unsold stock, the total of customers' balances outstanding and that of petty cash are brought into the branch account on the credit side.
- Accordingly, the branch account will reveal profit or loss; Debit 'balance' will be the loss suffered by the working of the branch and vice versa.

If the branch is allowed to make small purchases of goods locally as well as to incur expenses out of its cash receipts, it will be necessary for the branch to supply to the head office a copy of the Cash Account, showing details of cash collections and disbursements. To illustrate the various entries which are made in the Branch Account, the proforma of a Branch Account is shown below:

Proforma Branch Account

To Balance b/d	By Bank A/c (Cash remitted)
Cash	By Return to H.O.
Stock	
Debtors	By Balance c/d
Petty Cash Fixed Assets	Cash
Prepaid Expenses	Stock Debtors
To Goods sent to Branch	Petty Cash
To Bank A/c	Fixed Assets
Salaries	Prepaid Expenses
Rent	
Sundry Expenses	By Profit and Loss A/c—Loss
To Profit & Loss A/c—Profit	(if debit side is larger)
(if credit side is larger)	

Note:

1. Having credited the Branch Account by the actual cash received from debtors, it would be incorrect to debit the Branch Account, in respect of discount or allowances to debtors.
2. The accuracy of the trading results as disclosed by the Branch Account, so maintained, if considered necessary, can be proved by preparing a Memorandum Branch Trading and Profit & Loss Account, in the usual way, from the balances of various items of income and expenses contained in the Branch Account.

Example 1

XP Ltd opened a branch at Delhi and sent goods costing Rs.50,000 to Delhi branch. Delhi Branch sold entire goods on credit at Rs.62,000. No other transaction occurred at the branch. Prepare branch account in Head Office Books and find out the profit.

Solution

We know that branch earned net profit of Rs.12,000, now see how same can be find out by branch account.

Branch Account

Particulars	Amount Rs.	Particulars		Amount Rs.
To Opening branch assets	Nil	By Closing branch assets		
To Goods sent to branch	50,000	Stock	Nil	
To Net Profit	12,000	Debtor	62,000	62,000
	62,000			62,000

Example 2

XP Ltd opened a new branch at Delhi. XP Ltd sent goods costing Rs.50,000 to Delhi branch. Delhi branch sold entire goods in cash at Rs.70,000. Branch paid expenses of Rs.8,000. No other transaction occurred at the branch. Prepare branch account in HO Books and find out the profit.

Solution

We know that branch earned net profit of Rs.12,000 (i.e. Gross Profit Rs.20,000 less expenses of Rs.8,000), Let's see how same can be find out by branch account:

Branch Account

Particulars	Amount	Particulars		Amount
To Opening branch assets	Nil	By Closing branch assets		
		Stock	Nil	
To Goods sent to branch	50,000	Debtor	Nil	
To Net Profit transferred to General P&L A/c	12,000	Cash (70,000 - 8,000)	62,000	62,000
	62,000			62,000

Example 3

Prepare branch account and find out profit earned by branch if transactions are as under:

Goods sent to branch	Rs.50,000
Furniture sent to branch	Rs.10,000 (at the beginning of year)
Credit sales at branch	Rs.62,000
Bad Debts	Rs.1,000
Other information:	
Closing stock at branch	Rs.10,000
Closing Debtor	Rs.61,000
Furniture (after depreciation@20%)	Rs.8,000

Solution

Branch Account

Particulars	Amount	Particulars	Amount
To Opening branch assets-			
(Furniture)	10,000	By Closing branch assets-	
To Goods sent to branch	50,000	Stock 10,000	
To Net Profit transferred to General	19,000	Debtor 61,000	
P & L A/c		Furniture 8,000	79,000
	79,000		79,000

(Refer Illustration 1 (a))

Stock and Debtors method

If it is desired to exercise a more detailed control over the working of a branch, the accounts of the branch are maintained under Stock and Debtors Method. According to this method, the following accounts are maintained by the Head Office:

Account	Purpose
1. Branch Stock Account (or Branch Trading Account)	Ascertainment of shortage or surplus
2. Branch Debtors Account	Ascertainment of closing balance of debtors
3. Branch Expenses Account	Ascertainment of total expenses incurred
4. Goods sent to Branch Account	Ascertainment of cost of goods sent to branch
5. Branch Cash / Bank Account	Know about cash flow at branch (eg: where branch is allowed to incur expenses locally)
6. Branch Fixed Asset Account	Control over branch Fixed Assets
7. Branch Profit and Loss Account	Calculation of net profit or loss

The manner in which entries are recorded in the above method is shown below:

	Transaction	Account debited	Account credited
a.	Cost of goods sent to the Branch	Branch Stock A/c	Goods sent to Branch A/c
b.	Remittances for expenses	Branch Cash A/c	Cash A/c
c.	Any asset (e.g. furniture) provided by H.O.	Branch Asset (Furniture) A/c	Asset A/c
d.	Cost of goods returned by the branch	Goods sent to Branch A/c	Branch Stock A/c

e.	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
f.	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
g.	Return of goods by debtors to the Branch	Branch Stock A/c	Branch Debtors A/c
h.	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
i.	Discount & allowance to debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
j.	Remittances to H.O.	Cash A/c	Branch Cash A/c
k.	Branch Expenses directly paid by H.O. Expenses met by	Branch Expenses A/c	Cash A/c
l.	Branch	Branch Expenses A/c	Branch Cash A/c

m. Closing Stock: Credit the Branch Stock Account with the value of closing stock at cost. It will be carried down as opening balance (debit) for the next accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.

Other Steps:

n. Transfer Balance of Branch Stock Account to the Branch Profit and Loss Account.

o. Transfer Balance of Branch Expenses Account to the debit of Branch Profit & Loss Account.

p. The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit & Loss Account.

q. The credit balance in the Goods sent to Branch Account is afterwards transferred to the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

Branch Trading and Profit and Loss Account (Final Accounts Method)

In this method, Trading and Profit and Loss accounts are prepared considering each branch as a separate entity. The main advantage of this method is that, it is easy to prepare and understand. It also gives complete information of all transactions which are ignored in the other methods. It should be noted that Branch Trading and Profit and Loss account is merely a memorandum account and therefore, the entries made there in do not have double entry effect.

(Refer Illustration 1 (b) & 2)

5.2 When goods are invoiced at selling price

Whenever, goods sent to branch are invoiced at selling price, certain considerations need to be kept in mind such as:

a. It would be obvious that, if Branch Account is debited with the sales price of goods and subsequent to the debit being raised there is a change in the sale price, the amount of debit either has to be increased or reduced on a consideration of the quantity of unsold stock that was there at the branch at the time the change took place. Such an adjustment will be necessary as often as the change in sale price occurs.

b. Moreover, the amount of anticipatory or unrealized profit, included in the value of unsold stock with the branch at the close of the year will have to be **eliminated** before the accounts of the branch are incorporated with that of the head office. This will be done by creating a reserve.

It may also be necessary to adjust the value of closing stock on account of the physical losses of stock due to either pilferage or wastages which may have occurred during the year. This adjustment is made by debiting the cost of such goods to Goods Lost Account and the amount of loading (included in the lost goods), to the Branch Adjustment Account.

The three different methods that are usually adopted for maintaining accounts on this basis are described below:

I. Stock and Debtors Method

Under this method, when goods are invoiced at selling price, one additional account i.e. 'Branch Adjustment account' is also prepared in addition to all the accounts which are maintained on cost basis. (Refer para 5.1)

- When goods are invoiced at selling price, the following points should be kept in mind under this method:

i. Journal Entries:

Transaction		Accounts debited	Accounts credited
a.	Sale price of the goods sent from H.O. to the Branch	Branch Stock A/c (at selling price)	**i.** Goods sent to Branches A/c with cost of the goods sent. **ii.** Branch Adjustment A/c (with the loading i.e., Difference between the selling and cost price).

b.	Return of goods By the Branch to H.O.	**i.** Goods sent to Branch A/c (with the cost of goods returned). **ii.** Branch Adjustment A/c (with the loading)	Branch Stock A/c
c.	Cash sales at the Branch	Branch Cash/Bank A/c	Branch Stock A/c
d.	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
e.	Goods returned to Branch by customer	Branch Stock A/c	Branch Debtors A/c (at selling price)
f.	Goods lost in Transit or stolen	**i.** Goods Lost in Transit A/c or Goods Stolen A/c (with cost of the goods) **ii.** Branch Adjustment A/c (with the loading)	Branch Stock A/c

ii. Closing Stock

The balance in the Branch Stock Account at the close of the year normally should be equal to the unsold stock at the Branch valued at sale price. But quite often the value of stock actually held at the branch is either more or less than the balance of the Branch Stock Account. In that event, as discussed earlier, it will be necessary that the balance in the Branch Stock Account is increased or reduced by debit or credit to Goods Lost Account (at cost price of goods) and Branch Adjustment Account (with the loading). The Stock Account at selling price, thus reveals loss of stock (or surplus) and serves as a check on the branch in this respect.

The discrepancy in the amount of balance in the Branch Stock Account and the value of stock actually in hand, valued at sale price, may be the result of one or more of the under-mentioned factors:

- An error in applying the percentage of loading.
- Goods having been sold either below or above the established selling price.
- A Commission to adjust returns or allowances.
- Physical loss of stock due to natural causes or pilferage.
- Errors in Stock-taking.

For example, the balance brought down in the Branch Stock Account is Rs.100 in excess of the value of stock actually held by the branch when the goods were invoiced by the head office to the branch at 25% above cost and the discrepancy is either due to pilferage or loss by fire, the actual loss to the firm would be Rs.80, since 20% of the invoice (same as 25% above cost) price would represent the element of profit. The adjusting entry in such a case would be:

		Dr. Rs.	Cr. Rs.
Goods Lost A/c	Dr.	80	
Branch Adjustment A/c	Dr.	20	
To Branch Stock A/c			100

If on the other hand, a part of the sale proceeds has been misappropriated, then in that case Loss by Theft A/c would be debited, rest of the entry being same.

Rebates and allowances allowed to customers debited to P&L A/c & credited to debtors A/c.

In the Goods Sent to Branch Account, the cost of the goods sent out to a branch for sale is credited by debiting Branch Stock Account. Conversely, the cost of goods returned by the branch is debited to this account. As such the balance in the account at the end of the year will be the cost of goods sent to the branch; therefore, it will be transferred either to the Trading Account or to Purchases Account of the head office.

The amount of profit anticipated on sale of goods sent to the branch is credited to the Branch Adjustment Account and conversely, the amount of profit not realized in respect of goods returned by the branch to head office or that in respect to stock remaining unsold with the branch at the close of the year is debited to Branch Adjustment Account. The balance in this account, at the end of year thus will consist of the amount of Gross Profit earned on sale by the branch. On that account, it will be transferred to the Branch Profit and Loss Account.

iii. Elimination of unrealized profit in the closing stock

The balance in the Branch Stock account would be at the **sale price**; therefore, it would be necessary to eliminate the element of profit included in such closing stock. This is done by creating a reserve against unrealized profit, by debiting the Branch Adjustment Account and crediting Stock Reserve Account with an amount equal to the difference in the cost and selling price of unsold stock. Sometimes instead of opening a separate account in respect of the reserve, the amount of the difference is credited to Branch Stock Account. In that case, the credited balance of such a reserve is also carried forward separately, along with the debit balance in the Branch Stock Account; the difference between the two would be the value of stock at cost. In either case, the credit balance will be deducted out of the value of closing stock for the purpose of disclosure in the balance sheet, so that the stock is shown at cost.

An Alternative method: Where the gross profit of each branch is not required to be ascertained separately, although the selling price is uniform, the amount of goods sent to the branch is recorded only in two accounts namely - Branch Stock Account and Goods Sent to Branch A/c. In this method, at the end of the year the Branch Stock Account is closed by transfer of the balance representing the value of closing stock, at sale price, to the **Goods Sent to Branch Account.** This has the effect of altogether eliminating from the books the value of stock at the branch. The balance of Goods sent to Branch Account is afterwards transferred to the **Trading Account** representing the net sale price of goods sold at the branch. In that case, the value of closing stock at the branch at cost will be subsequently introduced in the Trading Account together with that of closing stock at the head office.

(Refer Illustration 3 (a))

II. Debtors Method

Under this method, the principal accounts that will be maintained are:

- The Branch Account;
- The Goods Sent to Branch Account; and
- The Stock Reserve Account.

Entries in these accounts will be made in the following manner:

	Transaction	Account debited	Account credited
a.	Goods sent to Branch at selling price	Branch A/c	Goods Sent to Branch A/c
b.	'Loading being the difference between selling price and cost of goods	Goods Sent to Branch A/c	Branch A/c
c.	Returns to H.O. at selling price	Goods Sent to Branch A/c	Branch A/c
d.	'Loading' in respect of goods returned to H.O.	Branch A/c	Goods Sent to Branch A/c
e.	'Loading' included in the opening stock to reduce it	Stock Reserve A/c	Branch A/c
f.	Closing stock at selling price	Branch Stock A/c	Branch A/c
g.	'Loading' included in closing stock to reduce it to cost	Branch A/c	Stock Reserve A/c

It will be observed that entries in the Branch Account in respect of goods sent to a branch or returned by it, as well as those for the opening and closing stock, will be at selling price. In consequence, the Branch Account is maintained at selling price.

Hence, the Branch Account will not correctly show the trading profit of the Branch unless these amounts are adjusted to cost. Such an adjustment is effected by making contra entries in 'Goods Sent to Branch A/c' and 'Stock Reserve Account'. In respect of closing stock at branch for the purpose of disclosure in the Balance Sheet, the credit balance in the 'Stock Reserve Account' at the end of the year will be deducted from the value of the closing stock, so as to reduce it to its cost; it will be carried forward as a separate balance to the following year, for being transferred to the credit of the Branch Account.

(Refer Illustration 3 (b) - 7)

5.3 Goods invoiced at wholesale price to retail branches

Under this method, the Head Office (particularly, the manufacturing concern) supplies goods to its retail branches at wholesale price which is cost plus wholesale profit.

Profit of branch = Sale proceeds at shop - wholesale price of the goods sold.

For this purpose, it is assumed that Manufacturer would always be able to sell the goods on wholesale terms thereby Manufacturer profit = Wholesale price - Cost.

Many concerns, therefore, invoice goods to such shops at wholesale price and determine profit or loss on sale of goods on this basis.

Branch Stock Account or the Trading Account is debited with:

a. the value of opening stock at the Branch; and

b. Price of goods sent during the year at wholesale price. It is credited by:

a. sales effected at the shop; and

b. Closing stock of goods valued at wholesale price.

The value of goods lost due to accident, theft etc. also is credited to the Branch Stock Account or Trading Account calculated at the **wholesale price**. At this stage, the Branch Stock or Trading Account will reveal the amount of gross profit (or loss). It is transferred to the Branch Profit and Loss Account. On further being debited with the expenses incurred at the shop and the wholesale price of goods lost, the Branch Profit and Loss Account will disclose the net profit (or loss) at the shop.

Since the closing stock at the branch has to be valued at wholesale price, it would be necessary to create a stock reserve equal to the difference between its wholesale price and its cost (to the head office) by debiting the amount in the Head Office Profit and Loss Account. This Stock Reserve is carried forward to the next year and then transferred to the credit of the (Head Office) Profit and Loss Account.

(Refer Illustration 8)

6. ACCOUNTING FOR INDEPENDENT BRANCHES

When the size of the business is big, it is desirable that the branch maintains complete records of its transactions. These branches are called independent branches and each independent branch maintains comprehensive account books for recording their transactions; therefore, a separate trial balance of each branch can be prepared. The head office maintains one ledger account for each such branch, wherein all transactions between the head office and the branches are recorded.

Salient features of accounting system of an independent branch are as follows:

1. Branch maintains its entire books of account under double entry system.
2. Branch opens in its books a Head Office account to record all transactions that take place between Head Office and branch. The Head Office maintains a Branch account to record these transactions.
3. Branch prepares its Trial Balance, Trading and profit and loss Account at the end of the accounting period and sends copies of these statements to Head Office for incorporation.
4. After receiving the final statements from branch, Head Office reconciles between the two – Branch account in Head Office books and Head Office account in Branch books.
5. Head office passes necessary journal entries to incorporate branch trial balance in its books.

The Head Office Account in branch books and Branch Account in head office books is maintained respectively.

	Transactions	Head office books		Branch books	
i.	Dispatch of goods to branch by H.O.	Branch A/c To Good sent to Branch A/c	Dr.	Goods received from H.O. A/c To Head Office A/c	Dr.
ii.	When goods are returned by the Branch to H.O.	Goods sent to Branch A/c To Branch A/c	Dr.	Head Office A/c To Goods received from H.O. A/c	Dr.
iii.	Branch Expenses are paid by the Branch	No Entry		Expenses A/c To Bank or Cash A/c	Dr.
iv.	Branch Expenses paid by H.O.	Branch A/c To Bank or cash	Dr.	Expenses A/c To Head Office A/c	Dr.
v.	Outside purchases made by the Branch	No Entry		Purchases A/c To Bank (or) Creditors A/c	Dr.
vi.	Sales effected by the Branch	No Entry		Cash or Debtors A/c To Sales	Dr.

vii.	Collection from Debtors of the Branch recd. by H.O.	Cash or Bank A/c To Branch A/c	Dr.	Head office A/c To Sundry Debtors A/c	Dr.
viii.	Payment by H.O. for purchase made by Branch	Branch A/c To Bank	Dr.	Purchases (or) Sundry Creditors A/c To Head Office	Dr.
ix.	Purchase of Asset by Branch	No Entry		Sundry Assets To Bank (or) Liability	Dr.
x.	Asset purchased by the Branch but Asset A/c retained at H.O. books	Branch Asset A/c To Branch A/c	Dr.	Head office To Bank (or) Liability	Dr.
xi.	Depreciation on (x) above	Branch A/c To Branch Asset	Dr.	Depreciation A/c To Head Office A/c	Dr.
xii.	Remittance of funds by H.O. to Branch	Branch A/c To Bank	Dr.	Bank A/c To Head Office	Dr.
xiii.	Remittance of funds by Branch to H.O.	Reverse entry of (xii) above i.e.		Reverse entry of (xii) above	
xiv.	Transfer of goods from one Branch to another branch	(Recipient) Branch A/c To Supplying Branch A/c	Dr.	**<u>Supplying Branch</u>** H.O. A/c To Goods sent to H.O. A/c	Dr.
				<u>Recipient Branch</u> Goods Received from H.O. A/c To Head Office A/c	Dr.

Students may find a few further practical situations and it is hoped that they can pass entries on the basis of accounting principles explained above.

The final result of these adjustments will be that so far as the Head Office is concerned, the branch will be looked upon either as a debtor or creditor, as a debtor if the amount of its assets is in excess of its liabilities and as a creditor if the position is reverse.

A debit balance in the Branch Account should always be equal to the net assets at the branch. The important thing to remember, when independent sets of accounts are maintained, is that the branch and head office books are connected with each other only through the medium of the

Branch and the Head Office Account which are converse of each other. Also, when the accounts of branch and head office are consolidated, both the Branch and Head Office Accounts will be eliminated.

7. ADJUSTMENT AND RECONCILIATION OF BRANCH AND HEAD OFFICE ACCOUNTS

If the branch and the head office accounts, converse of each other, do not tally, these must be **reconciled** before the preparation of the final accounts of the concern as a whole.

For example, if Head Office has sent goods worth Rs.50,000 but the branch has received till the closing date goods only Rs.40,000, then the branch should treat Rs.10,000 as goods in transit and should pass the following entry:

		Dr.	Cr.
Goods in transit A/c	Dr.	10,000	
To Head Office A/c			10,000

However, there will be no entry in Head office books being the point where the event has been recorded in full, hence no further entries in Head office books.

7.1 Reasons for Disagreement

Following are the possible reasons for the disagreement between Branch A/c in Head office books and Head office A/c in Branch books on the closing date:

- Goods dispatched by the Head office not received by the branch .These goods may be in transit or loss in transit .
- Goods returned by the branch to Head office may have been received by the H.O Again,these goods may be in transit or lost in transit .
- Amount remitted to branch or vice versa remaining in transit on the closing date .
- Receipt of income or payment or expenses relating to the Branch transacted directly by the head office or vice versa,hence not recorded at the respective ends where in they are normally to be recorded.

The technique of reconciliation has been illustrated through the example given below:

	Head office		Branch	
	Dr.	**Cr.**	**Dr.**	**Cr.**
Goods sent to Branch		1,50,000	-	

Goods recd. from H.O. A/c		-	1,40,000	
Branch A/c	1,12,000			
Head office A/c	-	-	-	78,500

On analysis of Branch A/c in Head office books and Head office A/c in branch books, you find:

- Goods valued Rs.10,000 sent by head office has not been received by branch, hence not recorded in the branch books.
- Rs.15,000 remitted by the branch has not been received, hence not recorded in the head office books.
- Direct collection of Rs.10,500 from a customer of the branch by Head office not informed to the branch, hence not recorded by the branch.
- A sum of Rs.14,500 paid by branch to the suppliers of head office not recorded at Head office.
- Head office expenditure allocation to the branch Rs.12,000 not recorded in the branch.
- Rs.7,500 being FD interest of head office received by the branch on oral instructions from H.O., not recorded in the head office books.

			Head Office Books			**Branch Books**	
			Dr. Rs.	**Cr. Rs.**		**Dr. Rs.**	**Cr. Rs.**
i.	Goods in transit (Rs.10,000)		-	-	Goods in Transit A/c	10,000	
					To Head office A/c		10,000
ii.	Cash in Transit:	Cash in Transit A/c	15,000		(No Entry)		
		To Branch A/c		15,000			
iii.	Direct Collection by H.O. on behalf of the Branch				Head Office A/c	10,500	
					To Debtors A/c		10,500
iv.	Direct payment of Rs.14,500 by Branch on behalf of H.O	Sundry Creditors A/c	14,500				
		To Branch A/c		14,500			
v.	Expenditure Allocated to Branch				Branch Exp. A/c	12,000	
					To H.O. A/c		12,000
vi.	Fixed Deposit interest of Rs.7,500 directly received by the Branch	Branch A/c	7,500				
		To Sundry Income		7,500			

In Branch Books Head Office Account

	Rs.		Rs.
To Sundry Debtors A/c	10,500	By Balance b/d	78,500
To Balance c/d	90,000	By Goods in transit	10,000
		By Branch expenses	12,000
	1,00,500		1,00,500
		By Balance b/d	90,000

In the Books of Head Office Branch A/c

	Rs.		Rs.
To Balance b/d	1,12,000	By Cash in Transit	15,000
To Sundry Income	7,500	By Sundry Creditors	14,500
		By Balance c/d	90,000
	1,19,500		1,19,500
To Balance b/d	90,000		

Important Points to be noted:

i. The balance of Head Office A/c in Branch books and Branch A/c in Head Office books have tallied.

ii. Adjustment are made only at the point: Where the recording has been omitted, and

Other than the point where action has already been effected.

7.2 Other points

1. **Inter-Branch Transactions**

   Inter-branch transactions (i.e. transaction between two branches) are usually adjusted as if they were entered into only with the head office. It is a very convenient method of treating such transaction especially where the number of branches are large. Suppose Kolkata Branch incurred an expenditure on advertisement of Rs.1,000 on account of Delhi Branch, the entries that would be made in such a case would be as follows:

		Dr.	Cr.
		Rs.	
In Kolkata Books:			
Head Office A/c	Dr.	1,000	
To Cash			1,000
In Delhi Books:			
Advertisement A/c	Dr.	1,000	

To H.O. A/c			1,000
In H.O. Books:			
Delhi Branch A/c	**Dr.**	1,000	
To Kolkata Branch A/c			1,000

2. Fixed Assets

Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry by head office:

Branch Account Dr.

To Branch Asset Account

The branch will pass the following entry:

Depreciation Account Dr.

To Head Office Account

3. Head office Expenses charged to Branch

Usually the head office devotes considerable time in attending to the affairs of the branch; on that account, it may decide to raise a charge against the branch in respect of the cost of such time. In such a case the amount is debited to the branch (being receivable from branch) and is credited to appropriate expense head such as Salaries Accounts, General Charges Account, Entertainment Account etc. (i.e. reducing the expense in head office books). The branch credits the H.O. Account and debits Expenses Account.

(Refer Illustration 9, 10)

8. INCORPORATION OF BRANCH BALANCE IN HEAD OFFICE BOOKS

The method that will be adopted for incorporating the trading result of the branch with that of the head office would depend on whether it is desired to prepare

a. Standalone P&L & Balance Sheet for each Branch, or

b. Consolidated statement of Branch & H.O.

Method I: Separate P&L & Balance Sheet for each Branch

Amount of P&L is shown by Branch & is transfer to H.O. in Branch books & converse entry is passed in H.O. Books as:

Branch A/c Dr.

To Profit & Loss A/c

In such a case, not only P&L but also separate Balance Sheet for Branch & H.O. is to be prepared.

The Branch Balance Sheet would show the amount advanced by H.O. to it as "Capital." In H.O. Books such amount would be shown as "Advance to Branch"

Method II: Prepare a consolidated Profit & Loss Account and Balance Sheet

Individual balances of all the revenue accounts would be separately transferred to the Head Office Account by debit or credit in the branch books and the converse entries would be passed in the head office books. The effect thereof will be similar to the amount of net profit or loss of the branch having been transferred since it would be composed of the balances that have been transferred. In case it is also desired that consolidated balance sheet of the branch and the head office should be prepared, it will also be necessary to transfer the balance of assets and liabilities of the branch to the head office. The adjusting entries that would be passed in this respect in the books of branch are shown below:

a. Head Office Account Dr.

To Asset (individual) Account

b. (Individual) Liability Account Dr.

To Head Office Account

Converse entries are passed in the head office books.

It is obvious that after afore-mentioned entries have been passed, the Branch Account in the Head Office books and Head Office Account in the branch books will be closed and it will be necessary to restart them at the beginning of the next year.

In consequence, at the beginning of the following year, the under-mentioned entry is recorded by the branch:

Asset Account (In Detail) Dr.

To Liability Accounts (In Detail)

To H.O. Account (The difference between assets and liabilities)

(Refer Illustration 11 - 13)

9. INCOMPLETE INFORMATION IN BRANCH BOOKS

If it is desired that profitability of the branch should be kept secret from the branch staff, the head office would hold back some key information from the branch, e.g., amount of opening stock, cost of goods sent to the branch, etc. The head office, in such a case would maintain a record of goods sent to the branch by passing the entry:

Goods Supplied to the Branch Account Dr.

To Purchases Account

The value of the closing stock will also be adjusted only in head office books.

In such a case, for closing its books at the end of the year, the branch will simply transfer various revenue accounts to the head office without drawing up a Trading and Profit & Loss Account.
On that basis, supplemented by the record of transactions maintained at the head office, it will be possible to construct the Trading and Profit & Loss Account of the branch.

(Refer Illustration 14)

10. FOREIGN BRANCHES

Foreign branches generally maintain independent and complete record of business transacted by them in currency of the country in which they operate. Thus, problems of incorporating balances of foreign branches relate mainly to translation of foreign currency into Indian rupees. This is because exchange rate of Indian rupee is not stable in relation to foreign currencies due to international demand and supply effects on various currencies. The accounting principles which apply to inland branches also apply to a foreign branch after converting the trial balance of the foreign branch in the Indian currency.

11. ACCOUNTING FOR FOREIGN BRANCHES

For the purpose of accounting, AS 11 (revised 2003) classifies the foreignbranches may be classified into two types:

- Integral Foreign Operation;
- Non- Integral Foreign Operation.

Let us discuss these two types of foreign branches in detail.

11.1. Integral Foreign Operation (IFO)

It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting enterprise's operations. For example, sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.

11.2. Non-Integral Foreign Operation (NFO)

It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. An NFO may also enter into transactions in foreign currencies, including transactions in the reporting currency. An example of NFO may be production in a foreign currency out of the resources available in such country independent of the reporting enterprise.

The following are the indicators of Non- Integral Foreign Operation-

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation, the activities of foreign operation are carried independently without much dependence on reporting enterprise.

- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words, it raises finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency, not in the reporting currency.
- Day-to-day cash flow of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day-to-day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

The above are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and, therefore, judgment is necessary to determine the appropriate classification.

Controversies may arise in deciding the foreign branches of the enterprises into integral or non-integral. However, there may not be any controversy that subsidiary associates and joint ventures are non-integral foreign operation.

In case of branches classified as independent for the purpose of accounting are generally classified as non-integral foreign operations.

<u>12. TECHNIQUES FOR FOREIGN CURRENCY TRANSLATION</u>

12.1. Integral Foreign Operation (IFO)

Following are the standard recommendations for foreign currency translation:

1. All transactions of IFO be translated at the rate prevailing on the date of transaction. This will require date wise details of the transaction entered by that operation together with the rates. Weekly or monthly average rate is permitted if there are no significant variations in the rate.

2. Translation at the balance sheet date-

   i. Monetary items at closing rate;

   ii. Non-monetary items: The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.

iii. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

iv. Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.

12.2. Non-Integral Foreign Operation

Accounts of non-integral foreign operation are translated using the following principles:

- Balance sheet items i.e. Assets and Liabilities both monetary and non- monetary – apply closing exchange rate.
- Items of income and expenses – At actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.
- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non- integral foreign operation".

Items	Integral Foreign Operations	Non Integral Foreign Operations
Monetary Items (Cash, Bank Balance, Debtor, Creditor, Loans, Bills receivable, Bills Payable)	Closing rate	Closing rate
Non-Monetary Items (Fixed Assets)	Rate on date of purchase	Closing rate
Inventory	Generally, closing rate (but if rate on the date of purchase of inventory is available, then that rate)	Closing rate
Profit and Loss items (revenue items)	Average rate (but if rate on the date of transaction is available, then that rate)	Average rate (but if rate on the date of transaction is available, then that rate)
Exchange Difference	Charge to P & L account.	Accumulated in Foreign Currency Translation reserve.

13. CHANGE IN CLASSIFICATION

When there is a change in classification, accounting treatment is as under-

13.1. Integral to Non-Integral

i. Translation procedure applicable to non-integral shall be followed from the date of change.

ii. Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.

13.2. Non-Integral to Integral

i. Translation procedure as applicable to integral should be applied from the date of change.

ii. Translated amount of non-monetary items at the date of change is treated as historical cost.

iii. Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

(Refer Illustration 15 - 17)

SUMMARY

- **Types of branches**
  - Dependent branches
  - Independent branches
- **Classification of Branches from accounting point of view**
  - Branches in respect of which the whole of the accounting records are kept at the head office (Dependent Branches)
  - Branches which maintain independent accounting records (Independent Branches), and
  - Foreign Branches.
- **Systems of accounting followed by Dependent Branches**
  - Debtors System: under this system head office makes a branch account. Anything given to branch is debited and anything received from branch would be credited.
  - Branch trading and profit and loss account (Final accounts) method/branch account method: Under this system head office prepares (a) profit and loss account (b) branch account taking each branch as a separate entity.
  - **Stock and debtors system: Under this system head office opens:**
    - Branch Stock Account
    - Branch Profit and Loss Account
    - Branch Debtors Account
    - Branch Expenses Account
    - Goods sent to Branch Account
    - Branch Asset Account

- **Maintenance of comprehensive account books by Independent Branches** Preparation of separate trial balance of each branch in H.O. books.
- **Types of Foreign branches**
  - Integral Foreign Operation (IFO): It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
  - Non-Integral Foreign Operation (NFO): It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency.
- **Non-Integral Foreign Operation -translation**
  - Balance sheet items i.e. Assets and Liabilities both monetary and non- monetary – apply closing exchange rate.
  - Items of income and expenses – At actual exchange rates on the date of transactions
  - Resulting exchange rate difference should be accumulated in a “foreign currency translation reserve” until the disposal of “net investment in non-integral foreign operation”.
- **Integral Foreign Operation (IFO) - translation**
  - All transactions at the rate prevailing on the date of transaction Translation at the balance sheet date-
  - Monetary items at closing rate;
  - Non-monetary items: The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.
  - The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.
  - Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.

ILLUSTRATIONS

Illustration 1 (a)

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost to their branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

	Rs.		Rs.
Opening balance (1-1-20X1) Imprest Cash	2,000	Bad Debts	1,000
Sundry Debtors	25,000	Discount to Customers	2,000
Stock: Transferred from H.O.	24,000	Remittances to H.O.	
Direct Purchases	16,000	(received by H.O.)	1,65,000
Cash Sales	45,000	Remittances to H.O.	
Credit Sales	1,30,000	(not received by H.O. so far)	5,000
Direct Purchases	45,000	Branch Exp. directly paid by H.O.	30,000
Returns from Customers	3,000	Closing Balance (31-12-20X1)	
Goods sent to branch from H.O.	60,000	Stock: Direct Purchase	10,000
Transfer from H.O. for Petty Cash expenses	4,000	Transfer from H.O.	15,000
		Debtors	?
		Imprest Cash	?
		Petty Cash expenses	4,000

Solution

In the Books of Buckingham Bros, Bombay Nagpur Branch Account

Particulars	Rs.	Particulars		Rs.
To Opening Branch Assets- Stock (24,000 + 16,000)	40,000	By Bank – Remittances received from branch Cash Sales	45,000	

Debtors	25,000	Cash from Debtors *	1,20,000	
		Cash in transit *	5,000	1,70,000
Imprest Cash	2,000	By Closing Branch Assets		
To Goods sent to Branch A/c	60,000	Stock (15,000 +10,000)		25,000
To Creditors (Direct Purchases)	45,000	Debtors (W.N. 1)		24,000
		Imprest Cash (W.N. 2)		2,000
To Bank (Sundry exp.)	30,000			
To Bank (Petty cash exp.)	4,000			
To Net Profit transferred to General Profit & Loss A/c	15,000			
	2,21,000			**2,21,000**

Working Notes:

1. Memorandum Debtors A/c

Particulars		Rs.	Particulars		Rs.
To	To Bal b/d	25,000	By	By Sales Return	3,000
To	To Sales	130,000	By	By Bad Debts	1,000
			By	By Discount	2,000
			By	By Cash *	125,000
			By	By Bal c/d	24,000
		155,000			155,000

1. Memorandum Petty Cash

Particulars	Rs.	Particulars	Rs.
To Bal b/d	2,000	By Expenses (met by Branch)	4,000
To Transfer from H.O.	4,000	By Bal c/d	2,000
	6,000		6,000

* Collection from Debtors = Total Remittances (1,65,000+5,000) – Cash Sales (45,000) = Rs.1,25,000

Illustration 1 (b)

From the information given in the illustration 1(a), prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

Solution

Buckingham Bros. Bombay

Nagpur Branch-Trading and Profit and Loss Account for the year ending 31st December, 20X1

Particulars	Rs.	Particulars	Rs.	Rs.
To Opening Stock	40,000	By Sales		
To Goods transferred from		Cash	45,000	
Head Office	60,000	Credit sales	1,30,000	
To Purchases	45,000		1,75,000	
To Gross Profit c/d	52,000	Less: Returns	(3,000)	1,72,000
	1,97,000	By Closing Stock		25,000
To Expenses	30,000			1,97,000
To Discounts	2,000	By Gross Profit b/d		52,000
To Bad Debts	1,000			
To Petty Cash Expenses	4,000			
To Net Profit transferred to				
General P&L A/c	15,000			
	52,000			52,000

The students may note that Gross Profit and Net Profit earned by the branch are ascertainable in this method and also evaluating the performance of the branch is very much easier in this method than in the 'Debtors method'.

Solving Illustration by all three methods

Given below is a simple problem, the solution whereto has been prepared in all the three methods so as to show the distinguishing features of these methods.

Illustration 2

The Bombay Traders invoiced goods to its Delhi branch at cost. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the Branch. All the cash collected by the branch was banked on the same day to the credit of the Head Office. The following is a summary of the transactions entered into at the branch during the year ended December 31, 20X1.

	Rs.		Rs.
Balances as on 1.1.20X1:			
Stock	**7,000**	**Bad Debts**	**600**
Debtors	**12,600**	**Goods returned by customers**	**500**
Petty Cash,	**200**	**Salaries & Wages**	**6,200**
Goods sent from H.O.	**26,000**	**Rent & Rates**	**1,200**
Goods returned to H.O.	**1,000**	**Sundry Expenses**	**800**
Cash Sales	**17,500**	**Cash received from Sundry**	
Credit Sales	**28,400**	**Debtors**	**28,500**
Allowances to customers	**200**	**Balances as on 31.12.20X1:**	
Discount to customers	**1,400**	**Stock**	**6,500**
		Debtors	**9,800**
		Petty Cash	**100**

Prepare: (a) Branch Account (Debtors Method), (b) Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and (c) Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.

Solution

a. Debtors Method

Delhi Branch Account

20X1		Rs.	Rs.	20X1		Rs.	Rs.
Jan. 1	To Opening branch assets:			Dec 31	24 Bank		
					Cash Sales	17,500	
					Cash from Sundry		
	Stock	7,000			Debtors	28,500	46,000
	Debtors	12,600			By Goods sent to Branch A/c –		
	Petty cash	200	19,800				
Dec. 31	To Goods sent to				Returns to H.O.		1,000
	Branch A/c		26,000		By Closing branch assets		
	To Bank:						
	Salaries & Wages	6,200			Stock	6,500	
					Debtors	9,800	

	Rent & Rates	1,200			Petty Cash	100	16,400
	Sundry Exp.	800	8,200				
	To Net profit ts/f to General P&L A/c		9,400				
Jan.1,			63,400				63,400
20X2	To Balance b/d		16,400				

a. Stock and Debtors Method

Branch Stock Account

20X1			Rs.	20X1				Rs.
Jan. 1	To	Balance b/d - Opening Stock	7,000	Dec. 31	By	Sales:		
Dec. 31	To	Goods Sent to Branch A/c	26,000			Cash	17,500	
						Credit	28,400	
	To	Branch P& L A/c	19,900			Less: Return	(500)	45,400
					By	Goods sent to Branch A/c - Return		1,000
					By	Balance c/d - Closing Stock		6,500
			52,900					52,900
20X2 Jan. 1	To	Balance b/d - Opening Stock	6,500					

Delhi Branch Debtors Account

20X1		Rs.	20X1		Rs.
Jan. 1	To Balance b/d	12,600	Dec. 31	By Cash	28,500
Dec. 31	To Sales	28,400		By Returns	500
				By Allowances	200
				By Discounts	1,400
				By Bad debts	600
				By Balance c/d	9,800

		41,000			41,000
20X2 Jan. 1	To Balance b/d	9,800			

Delhi Branch Expenses Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Salaries & Wages	6,200	Dec. 31	By Branch P & L A/c	10,500
	To Rent & Rates	1,200			
	To Sundry Expenses	800			
	To Petty Cash expenses (200-100)	100			
	To Allowance to customers	200			
	To Discount	1,400			
	To Bad Debts	600			
		10,500			10,500

Delhi Branch Profit & Loss Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Branch Exp. A/c	10,500	Dec. 31	By Gross Profit b/d	19,900
	To Net Profit t/f to General P & L A/c	9,400			
		19,900			19,900

a. Branch Trading and Profit and Loss Account

	Rs.	Rs.			Rs.	Rs.
To Stock		7,000	By Sales: Cash		17,500	
To Goods sent from H.O.	26,000		Credit	28,400		
Less: Returns to H.O.	(1,000)	25,000	Less: returns	(500)	27,900	45,400
			By Closing Stock			6,500
To Gross profit c/d		19,900				51,900
		51,900	By Gross Profit b/d			19,900
To Salaries & Wages		6,200				
To Rent & Rates		1,200				
To Sundry Exp.		800				
To Petty Cash Exp.		100				
To Allowances to						

Customers		200			
To Discounts		1,400			
To Bad Debts		600			
To Net Profit		9,400			
		19,900			19,900

Illustration 3 (a)

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December, 20X1:

		Rs.
Cost of goods sent to Branch at cost		**2,00,000**
Goods received by Branch till 31-12-20X1 at invoice price		**2,20,000**
Credit Sales for the year @ invoice price		**1,65,000**
Cash Sales for the year @ invoice price		**59,000**
Cash Remitted to head office		**2,22,500**
Expenses paid by H.O.		**12,000**
Bad Debts written off		**750**
Balances as on	**1-1-20X1**	**31-12-20X1**
	Rs.	**Rs.**
Stock	**25,000 (Cost)**	**28,000 (invoice price)**
Debtors	**32,750**	**26,000**
Cash in Hand	**5,000**	**2,500**

Show necessary ledger accounts in the books of the head office and determine the Profit or Loss of the Branch for the year ended 31st December, 20X1.

Solution

Books of Harrison Branch Stock Account

	Rs.		Rs.
To Balance b/d – Op Stock	30,000	By Branch Debtors (Sales)	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Cash	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	

(Balancing Figure – Excess of Sale over Invoice Price)		Goods in Transit (Rs.2,40,000 – Rs.2,20,000)	20,000
		Closing Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock A/c (Sales)	1,65,000	By Branch Cash (bal. fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Branch Cash Account

	Rs.		Rs.
To Balance b/d	5,000	By Bank Remittance to H.O.	2,22,500
To Branch Stock	59,000	By Branch Expenses	10,000
To Branch Debtors	1,71,000	[met by Branch (Bal. fig.)]	
		By Balance c/d	2,500
	2,35,000		2,35,000

Branch Adjustment Account

	Rs.		Rs.
		By Stock Reserve opening (25,000 × 20%)	5,000
To Branch P &L - Gross Profit (Bal. fig.)	39,000	By Goods sent to Branch A/c	40,000
To Stock Reserve (on closing stock (48,000 × 1/6)	8,000	By Branch Stock A/c	2,000
	47,000		47,000

Branch Expenses

	Rs.		Rs.
To Cash (H.O) To Branch Cash	12,000		
	10,000	By Branch P&L A/c	22,000
	22,000		22,000

Branch Profit and Loss Account

	Rs.		Rs.
To Branch Expenses	22,000	By Gross Profit (from Branch	39,000

To Branch Debtors (bad debts)	750	Adjustment A/c)	
To Net Profit	16,250		
	39,000		39,000

Goods Sent to Branch Account

	Rs.		Rs.
To Branch Adjustment A/c To Purchase A/c - Transfer	40,000 2,00,000	By Branch to Stock A/c	2,40,000
	2,40,000		2,40,000

Illustration 3 (b)

Take figures from Illustration 3 (a) and prepare branch account following debtors' Method.

Solution

Books of Harrison New Delhi Branch Account

	Rs.		Rs.
To Balance B/d			
Stock	30,000	By Stock Reserve	5,000
Debtors	32,750		
Cash	5,000		
To Goods Sent to Branch A/c (2,00,000 + 20%)	2,40,000	By Goods Sent to Branch A/c	40,000
To Cash (Exp. Paid by H.O.)	12,000	By Cash – Remittance from branch	2,22,500
To Net Profit t/f to H.O. Profit & Loss A/c (Balancing Figure)	16,250	By Balance c/d Debtors	26,000
To Stock reserve (48,000 x 20 / 120)	8,000	Stock (including Transit – W.N 2)	48,000
		Cash	2,500
	3,44,000		3,44,000

Working Note:

Closing Stock = Stock at branch + Stock in Transit (Goods sent by HO – Goods Received by Branch) = Rs.28,000 + (Rs.2,40,000 - Rs.2,20,000) = Rs.48,000.

<u>Illustration 4</u>

Sell Well who carried on a retail business opened a branch X on January 1st, 20X1 where all sales were on credit basis. All goods required by the branch were supplied from the Head Office and were invoiced to the branch at 10% above cost.

The following were the transactions:

	Jan. 20X1	**Feb. 20X1**	**March 20X1**
	Rs.	**Rs.**	**Rs.**
Goods sent to Branch (Purchase Price)	40,000	50,000	60,000
Sales as shown by the branch monthly report	38,000	42,000	55,000
Cash received from Debtors and remitted to H.O.	20,000	51,000	35,000
Returns to H.O. (Invoice price to Branch)	1,200	600	2,400

The stock of goods held by the branch on March 31, 20X1 amounted to Rs.53,400 at invoice to branch.

Record these transactions in the Head Office books, showing balances as on 31st March, 20X1 and the branch gross profit for the three months ended on that date.

All workings should form part of your solution.

Books of Sell Well Branch Account

	Rs.			Rs.
To Goods sent to Branch	1,65,000	By Goods sent to		15,000
A/c (1,50,000 + 10%)		Branch-Loading		
To Goods sent to Branch A/c	382	By Goods sent to		
(4,200 X 10/110)		Branch-returns		4,200
		By Bank		1,06,000
		By Balance c/d –		
		Closing Branch		
		Assets		
To Stock Reserve	4,855	Stock	53,400	
(53,400 X 10/110)				
		Debtors	<u>29,000</u>	82,400
To Net Profit (Bal fig) ts/f to	37,363	(Sales- Collection)		
General P&L A/c				
	2,07,600			2,07,600

Working Note:

Memorandum Branch Debtors Account

	Rs.		Rs.
To Balance b/d	---	By Cash/Bank	1,06,000
To Sales	1,35,000	By Balance c/d	29,000
	1,35,000		1,35,000

Goods Sent to Branch Account

	Rs.		Rs.
To Branch A/c – Loading	15,000	By Branch A/c	1,65,000
To Branch A/c – Returns	4,200	By Branch A/c – Loading on returns	382
To Purchases A/c	1,46,182		
	1,65,382		1,65,382

iii. **Trading and Profit and Loss Account (Final Accounts) Method**

All items of memorandum Branch Trading and Profit and Loss Account are to be converted into cost price if the goods are invoiced to branch at selling price. Other points will remain same as already discussed in Para 5.1 for this method if goods are invoiced at cost.

<u>Illustration 5</u>

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 20X2 from the following:

1. **Goods are invoiced to the branch at cost plus 20%.**
2. **The sale price is cost plus 50%.**
3. **Other information:**

	Rs.
Stock as on 01.04.20X1 (invoice price)	**2,20,000**
Goods sent during the year (invoice price)	**11,00,000**
Sales during the year	**12,00,000**
Expenses incurred at the branch	**45,000**

Ascertain

i. **The profit earned by the branch during the year.**

ii. **Branch stock reserve in respect of unrealized profit.**

Solution

i. Calculation of profit earned by the branch In the books of Jammu Branch

Trading Account and Profit and Loss Account

Particulars	Amount	Particulars	Amount
	Rs.		**Rs.**
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit (Bal fig)	1,95,000		
	15,60,000		15,60,000

ii. Stock reserve in respect of unrealised profit

= Rs.3,60,000 x (20/120) = Rs.60,000

Working Note:

	Rs.	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	**Rs.**	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less: Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Illustration 6

Hindustan Industries Mumbai has a branch in Cochin to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch Expenses are paid direct from head office, and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit. Branch does not maintain any books of account, but sends weekly returns to the Head Office:

	Rs.
Goods received from Head Office at invoice price	6,00,000
Returns to Head Office at invoice price	12,000
Stock at Cochin as on 1st Jan., 20X1	60,000
Sales in the year – Cash	2,00,000
Credit	3,60,000
Sundry Debtors at Cochin as on 1st Jan. 20X1	72,000
Cash received from Debtors	3,20,000
Discount allowed to Debtors	6,000
Bad debts in the year	4,000
Sales returns at Cochin Branch	8,000
Rent, Rates, Taxes at Branch	18,000
Salaries, Wages, Bonus at Branch	60,000
Office Expenses	6,000
Stock at Branch on 31st Dec. 20X1 at invoice price	1,20,000

Prepare Branch accounts in books of head office by Stock and debtors method.

Solution

Books of Hindustan Industries, Mumbai Cochin Branch Stock Account

	Rs.		Rs.
To Balance b/d – Op Stock	60,000	By Bank A/c – Cash Sales	2,00,000
To Branch Debtors A/c – Sales Return	8,000	By Branch Debtors A/c – Credit Sales	3,60,000
To Goods sent to Branch A/c	6,00,000	By Goods sent to Branch (Returns to H.O.)	12,000
To Branch Adjustment A/c (Excess of Selling Price over Invoice Price)	24,000	By Balance c/d – Closing stock	1,20,000
	6,92,000		6,92,000

Cochin Branch Stock Adjustment Account

	Rs.		Rs.
To Goods sent to Branch A/c (1/5 of Rs.12,000) (on returns)	2,400	By Balance b/d (1/5 of Rs.60,000)	12,000
To Branch P & L A/c (Profit on sale) – Bal fig	1,29,600	By Goods sent to Branch A/c (1/5 of Rs.6,00,000)	1,20,000
To Balance c/d (1/5 of Rs.1,20,000)	24,000	By Branch Stock	24,000
	1,56,000		1,56,000

Goods Sent to Branch Account

	Rs.		Rs.
To Cochin Branch Stock Adjustment A/c	1,20,000	By Cochin Branch Stock A/c	6,00,000
To Cochin Branch Stock A/c (Returns)	12,000	By Cochin Branch Stock Adj. A/c	2,400
To Purchases A/c	4,70,400		
	6,02,400		6,02,400

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	72,000	By Bank	3,20,000
To Branch Stock A/c	3,60,000	By Branch P&L A/c Discount	6,000
		By Branch P&L A/c – Bad Debts	4,000
		By Branch Stock – Sales Returns	8,000
		By Balance c/d	94,000
	4,32,000		4,32,000

Branch Expenses Account

	Rs.		Rs.
To Bank A/c (Rent, Rates & Taxes)	18,000	By Branch Profit & Loss A/c (Transfer)	84,000
To Bank A/c (Salaries & Wages)	60,000		
To Bank A/c (office exp.)	6,000		
	84,000		84,000

Branch Profit & Loss Account for the year ending 31st Dec. 20X1

	Rs.		Rs.
To Branch Expenses A/c	84,000	By Branch Stock Adj. A/c	1,29,600
To Branch Debtors A/c	6,000		
To Branch Debtors A/c	4,000		
To Net Profit transferred to Profit & Loss A/c	35,600		
	1,29,600		1,29,600

Illustration 7

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He dispatches 25 tins of Oil @ Rs.1,000 per tin and 15 tins of Ghee @ Rs.1,500 per tin on 1st of every month. The branch incurs some expenditure which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

		Delhi	Lucknow
		Rs.	**Rs.**
Purchases	**Ghee**	**14,75,000**	**-**
	Oil	**29,32,000**	**-**
Direct expenses		**3,83,275**	**-**
Expenses paid by H.O.		**-**	**14,250**
Sales	**Ghee**	**18,46,350**	**3,42,750**
	Oil	**27,41,250**	**3,15,730**
Collection during the year (including Cash Sales)		**-**	**6,47,330**
Remittance by Branch to Head Office		**-**	**6,13,250**

	(Delhi)	
Balance as on:	**1-1-20X1**	**31-12-20X1**
Stock: Ghee	**1,50,000**	**3,12,500**
Oil	**3,50,000**	**4,17,250**
Debtors	**7,32,750**	**-**
Cash on Hand	**70,520**	**55,250**
Furniture & Fittings	**21,500**	**19,350**
Plant/Machinery	**3,07,250**	**7,73,500**

	(Lucknow)	
Balance as on:	**1-1-20X1**	**31-12-20X1**
Stock: Ghee	**17,000**	**13,250**
Oil	**27,000**	**44,750**
Debtors	**75,750**	**?**
Cash on Hand	**7,540**	**12,350**
Furniture & Fittings	**6,250**	**5,625**
Plant/Machinery	**-**	

Addition to Plant/Machinery on 1-1-20X1 Rs.6,02,750.

Rate of Depreciation: Furniture / Fittings @ 10% and Plant / Machinery @ 15% (already adjusted in the above figures).

The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of Rs.2,000 p.m. General expenses incurred by H.O. Rs.24,000.

Prepare Branch Account in the head office books and also prepare the Arnold's Trading and Profit and Loss A/c (excluding branch transactions).

Solution

In the books of Arnold Lucknow Branch Account

		Rs.		Rs.
To	Balance b/d		By Bank (Remittance)	6,13,250
	-Opening Branch Assets		By Closing Branch Assets	
	Opening stock:		Closing stock:	
	Ghee	17,000	Ghee	13,250
	Oil	27,000	Oil	44,750
	Debtors	75,750	Debtors (W.N. 1)	86,900
	Cash on hand	7,540	Cash on hand (W.N. 2)	12,350
	Furniture & fittings	6,250	Furniture & fittings	5,625
To	Goods sent to Branch A/c			
	Ghee (15 x 1500 x 12)	2,70,000		
	Oil (25 x 1000 x 12)	3,00,000		
To	Bank (Expenses paid)	14,250		
To	Branch Manager commission			
	(Rs.58,335 × 1/11)	5,303		

To Net Profit transferred to General P & L A/c	53,032		
	7,76,125		7,76,125

Arnold Trading and Profit and Loss account

for the year ended 31st December, 20X1 (Excluding branch transactions)

		Rs.		Rs.
To Opening Stock:			By Sales:	
Ghee		1,50,000	Ghee	18,46,350
Oil		3,50,000	Oil	27,41,250
To Purchases:			By Closing Stock:	
Ghee	14,75,000		Ghee	3,12,500
Less: Goods sent			Oil	4,17,250
to Branch	(2,70,000)	12,05,000		
Oil	29,32,000			
Less: Goods sent				
to Branch	(3,00,000)	26,32,000		
To Direct Expenses		3,83,275		
To Gross Profit c/d		5,97,075		
		53,17,350		53,17,350
To Manager's Salary		24,000	By Gross Profit b/d	5,97,075
To General Expenses		24,000	By Branch Profit transferred	53,032
To Depreciation:				
Furniture @10%	2,150			
Plant & Machinery				
@ 15% (W.N.3)	1,36,500	1,38,650		
To General Manager's				
Commission @ 10%				
(i.e., 4,63,457 × 1/11)		42,132		
To Net profit		4,21,325		
		6,50,107		6,50,107

Working Notes:

1. **Memorandum Branch Debtors Account**

	Rs.		Rs.
To Balance b/d	75,750	By Cash Collections (including Cash Sales)	6,47,330
To Sales (including Cash Sales)		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		7,34,230

2. **Memorandum Branch Cash Account**

	Rs.		Rs.
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350
	6,54,870		6,54,870

3. **Depreciation on Plant & Machinery**

   3,07,250 x 15% + 6,02,750 x 15% = Rs.1,36,500

<ins>**Illustration 8**</ins>

M/s Rahul operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.20X2:

	Rs.
Stock at the outlet 1.4.20X1	**30,000**
Goods invoiced to the outlet during the year	**3,24,000**
Gross profit made by the outlet	**60,000**
Goods lost by fire	**?**
Expenses of the outlet for the year	**20,000**
Stock at the outlet 31.3.20X2	**36,000**

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.20X2:

a. **Outlet Stock Account.**
b. **Outlet Profit & Loss Account.**

c. **Stock Reserve Account.**

Solution

Outlet Stock Account

	Rs.		Rs.
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent to outlet	3,24,000	By Goods lost by fire (b.f.)	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

	Rs.		Rs.
To Expenses	20,000	By Gross Profit b/d	60,000
To Goods lost by fire (W.N.2)	18,000		
To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

	Rs.		Rs.
To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d (Stock Res. required)	7,200	By HO P & L A/c (W.N. 3)	7,200
	13,200		13,200

Working Notes:

		Rs.
Wholesale Price	100 + 25	= 125
Retail Price	125 + 20%	= 150
Gross Profit at the outlet		
Wholesale Price – Retail Price (150 – 125)		25

Retail sales value = $60{,}000 \times \frac{150}{25}$ =Rs.3,60,000

1. Goods lost by fire

Opening Stock + Goods Sent + Gross Profit – Sales – Closing Stock

30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = Rs.18,000

2. Stock Reserve

Opening Stock = $30{,}000 \times \frac{25}{125}$ =Rs.6,000

Closing Stock = $36{,}000 \times \frac{25}{125}$ =Rs.7,200

Illustration 9

Give Journal Entries in the books of an independent Branch to rectify or adjust the following:

i. **Branch paid Rs.5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.**

ii. **Asset Purchased by branch for Rs.25,000, but the Asset account was retained in H.O Books.**

iii. **A remittance of Rs.8,000 sent by the branch has not been received by H.O.**

iv. **H.O collected Rs.25,000 directly from the customer of Branch but fails to give the intimation to branch.**

v. **Remittance of funds by H.O to branch Rs.5,000 not entered in branch books.**

Solution

Journal Entries in Books of Branch

	Particulars	Dr. Amount Rs.	Cr. Amount Rs.
i.	Head office account Dr. To Salaries account (Being the rectification of salary paid on behalf of H.O.)	5,000	5,000
ii.	Head office account Dr. To Bank / Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)	25,000	25,000
iii.	No Entry in Branch Books		
iv.	Head office account Dr. To Debtors account (Being the amount of branch debtors collected by H.O.)	25,000	25,000
v.	Bank A/c Dr. To Head Office (Remittance of Funds by H.O. to Branch)	5,000	5,000

Illustration 10

The following Trial balances as at 31st December, 20X1 have been extracted from the books of Major Ltd. and its branch at a stage where the only adjustments requiring to be made prior to the preparation of a Balance Sheet for the undertaking as a whole are to be done.

	Head Office		Branch	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
Share Capital		1,50,000		
Fixed Assets	75,125		18,901	
Current Assets	1,21,809		23,715	(Note 3)
Current Liabilities		34,567		9,721
Stock Reserve, 1st Jan., 20X1				
(Note 2)		693		
Revenue Account		43,210		10,250
Branch Account	31,536			
Head Office Account				22,645
	2,28,470	**2,28,470**	**42,616**	**42,616**

You are required to record the following in the appropriate ledger accounts in both sets of books.

Note:

1. Goods transferred from Head Office to the Branch are invoiced at cost plus10% and both Revenue Accounts have been prepared on the basis of the prices charged.
2. Relating to the Head Office goods held by the Branch on 1st January, 20X1.
3. Includes goods received from Head Office at invoice price Rs.4,565.
4. Goods invoiced by Head Office to Branch at Rs.3,641 were in transit at 31st December, 20X1, as was also a remittance of Rs.3,500 from the Branch.
5. At 31st December, 20X1, the following transactions were reflected in the Head Office books but unrecorded in the Branch books.
6. The purchase price of lorry, Rs.2,500, which reached the Branch on December 25th; a sum received on December 30, 20X1 from one of the Branch debtors, Rs.750.

Solution

H.O. Books Branch Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Balance b/d	31,536	Dec. 31	By Cash in transit	3,500
				By Balance c/d	28,036
		31,536			31,536

Cash in transit Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Branch A/c	3,500	Dec. 31	By Balance c/d	3,500

Stock Reserve Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Balance c/d	746	Jan. 1	By Balance b/d	693
	(4,565+3,641) x 10/110			By Revenue A/c (b.f.)	53
		746			746

Revenue Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Stock Reserve	53	Dec. 31	By Balance b/d	43,210
	To Balance c/d	43,157			
		43,210			43,210

Branch Books Head Office Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Current Assets	750	Dec. 31	By Balance b/d	22,645
				By Goods in transit	3,641
	To Balance c/d	28,036		By Motor Vehicle	2,500
		28,786			28,786

Goods in Transit Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Head Office	3,641	Dec. 31	By Balance c/d	3,641

Motor Vehicle Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Head Office	2,500	Dec. 31	By Balance c/d	2,500

Sundry Current Assets A/c

20X1		Rs.	20X1		Rs.
Dec. 31	To Balance b/d	23,715	Dec. 31	By H.O. (Remittance by Debtor)	750
				By Balance c/d	22,965
		23,715			23,715

Illustration 11

KP manufactures a range of goods which it sells to wholesale customers only from its head office. In addition, the H.O. transfers goods to a newly opened branch at factory cost plus 15%. The branch then sells these goods to the general public on only cash basis.

The selling price to wholesale customers is designed to give a factory profit which amounts to 30% of the sales value. The selling price to the general public is designed to give a gross margin (i.e., selling price less cost of goods from H.O.) of 30% of the sales value.

KP operates from rented premises and leases all other types of fixed assets. The rent and hire charges for these are included in the overhead costs shown in the trial balances.

From the information given below, you are required to prepare for the year ended 31st Dec., 20X1 in columnar form.

a. A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

b. Balance Sheet as on 31st Dec., 20X1 for the entire business.

	H.O.		Branch	
	Rs.	Rs.	Rs.	Rs.
Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1-20X1				
Raw materials	1,800			
Finished goods	13,000		9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen Salaries	22,500		6,200	
Other administrative & selling overheads	12,500		2,300	
Inter-unit accounts	5,000			2,000
Capital		50,000		
Sundry Creditors		13,000		
Provision for unrealized profit in stock		1,200		
Sales		2,00,000		65,200
Goods sent to Branch		46,000		
Goods received from H.O.			44,500	
	3,10,200	3,10,200	67,200	67,200

Note:

1. On 28th Dec., 20X1 the branch remitted Rs.1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also, on the same date, the H.O. dispatched goods to the branch invoiced at Rs.1,500 and these too have not yet been entered into the branch books. It is the company's policy to adjust items in transit in the books of the recipient.
2. The stock of raw materials held at the H.O. on 31st Dec., 20X1 was valued at Rs.2,300.
3. You are advised that:
   - There were no stock losses incurred at the H.O. or at the branch.
   - It is KP's practice to value finished goods stock at the H.O. at factorycost.
   - There were no opening or closing stock of work-in-progress.
4. Branch employees are entitled to a bonus of Rs.156 under a bilateral agreement.

Solution

In the books of KP

Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

	H.O. Rs.	Branch Rs.	Total Rs.		H.O. Rs.	Branch Rs.	Total Rs.
To Opening stock of finished goods	13,000	9,200	22,200	By Sales	2,00,000	65,200	2,65,200
To Material consumed (W.N.1)	34,500	-	34,500				
To Wages	1,08,500	-	1,08,500	By Goods Sent to Branch	46,000	-	-
To Factory Overheads	39,000	-	39,000				
To Goods from H.O.		46,000		By Closing stock including transit (W.N.2)	15,000	9,560 (Bal Fig)	24,560
To Gross Profit c/d (W.N.3)	66,000 (Bal Fig)	19,560	85,560				
	2,61,000	74,760	2,89,760		2,61,000	74,760	2,89,760
To Admn. Salaries	13,900	4,000	17,900	By Gross Profit b/d	66,000	19,560	85,560
To Salesmen Salaries	22,500	6,200	28,700				
To Other Admn. & selling Overheads	12,500	2,300	14,800				

To Stock Reserve (W.N.4)	47	-	47				
To Bonus to Staff	-	156	156				
To Net Profit	17,053	6,904	23,957				
	66,000	**19,560**	**85,560**		**66,000**	**19,560**	**85,560**

Balance Sheet as on 31st Dec., 20X1

		Rs.	H.O. Rs.	Branch Rs.	Total Rs.		H.O. Rs.	Branch Rs.	Total Rs.
Capital			50,000	-	50,000	Fixed Assets	-	-	-
Profit:	H.O.	17,053				Current Assets:			
	Branch	<u>6,904</u>	23,957		23,957	Raw material	2,300		2,300
Trade Creditors			13,000		13,000	Finished Goods	15,000	9,560	23,313*
Bonus Payable				156	156	(Less Stock Res.)			
H.O. Account*				10,404		Debtors	37,000	-	37,000
Stock Reserve (W.N.4)			1,247			Cash (including transit item)	23,500	1,000	24,500
						Branch A/c	10,404**		
			88,204	10,560	87,113		88,204	10,560	87,113

*9,560 × 100/115 i.e., (8,313 + 15,000) = Rs.23,313 or (15,000 + 9,560) – 1,247 (Stock reserve)

** (5,000 + 6,904) – 1500 = Rs.10,404.

Working Notes:

1. Material consumed

   Opening raw material + Raw Material Purchased – Closing raw material

   = 1,800 + 35,000 - 2,300 = 34,500

2. Closing stock at head office

   a. Calculation of total factor cost = Material consumed + Wages + Factory overhead

      = 34,500 + 1,08,500 + 39,000 = 1,82,000

   b. Cost (factory cost) of goods sold = Sales – Gross profit

      = 2,00,000 – 2,00,000 x 30% = 1,40,000

   c. Stock transferred to branch = 46,000 x 100/115 = 40,000

   d. Closing stock = 13,000 (Opening Stock) + 1,82,000 – 1,40,000 – 40,000 = 15,000

3. Gross profit of Branch = Sales x Gross profit ratio

   = 65,200 x 30% = 19,560

4. Closing stock reserve = 9,560 x 15/115 = 1,247

   Charge to profit and loss = 1,247 – 1,200 (existing) = 47

Illustration 12

AFFIX of Kolkata has a branch at Delhi to which the goods are supplied from Kolkata but the cost thereof is not recorded in the Head Office books. On 31st March, 20X1 the Branch Balance Sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Creditors Balance	40,000	Debtors Balance	2,00,000
Head Office	1,68,000	Building Extension A/c closed by transfer to H.O. A/c	—
		Cash at Bank	8,000
	2,08,000		2,08,000

During the six months ending on 30-9-20X1, the following transactions took place at Delhi.

	Rs.		Rs.
Sales	2,40,000	Manager's Salary	4,800
Purchases	48,000	Collections from Debtors	1,60,000
Wages paid	20,000	Discounts allowed	8,000
Salaries (inclusive of advance		Discount earned	1,200
of Rs.2,000)	6,400	Cash paid to Creditors	60,000
General Expenses	1,600	Building Account (further payment)	4,000
Fire Insurance (paid for one year)	3,200	Cash in Hand	1,600
Remittance to H.O.	38,400	Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-20X1. Also give journal entries in the Delhi books.

Solution

Journal Entries

20X1 30 Sept.		Dr. Rs.	Cr. Rs.
Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance Account)			
Prepared Insurance A/c (3,200 x 6/12)	Dr.	1,600	
To Fire Insurance A/c			1,600
(Six months premium transferred to the Prepaid Insurance A/c)			

Head Office Account	Dr.	88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c (6,400 – 2,000)			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c (3,200 x 6/12)			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
Sales Accounts	Dr.	2,40,000	
Discount Earned A/c	Dr.	1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			
Head Office Account	Dr.	4,000	
To Building Account			4,000
(Transfer of amounts spent on building extension to H.O. A/c)			

Head Office Account

20X1		Rs.	20X1		Rs.
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries (Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 20X1

Liabilities	Rs.	Assets	Rs.
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600
		Building Extension A/c transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

	Rs.			Rs.
To Balance b/d	8,000	By Wages		20,000
To Collection from Debtors	1,60,000	By Salaries		6,400
		By Insurance		3,200
		By General Exp.		1,600
		By H.O. A/c		38,400
		By Manager's Salary		4,800
		By Creditors		60,000
		By Building A/c		4,000
		By Balance c/d		
		By Cash in Hand	1,600	
		By Cash at Bank	28,000	29,600
	1,68,000			1,68,000

Debtors Account

	Rs.		Rs.
To Balance b/d	2,00,000	By Cash Collection	1,60,000
To Sales	2,40,000	By Discount (allowed)	8,000
		By Balance c/d	2,72,000
	4,40,000		4,40,000
To Balance b/d	2,72,000		

Creditors Account

	Rs.		Rs.
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000
		By Balance b/d	26,800

Illustration 13

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December, 20X1.

Head Office Trial Balance

	Rs.	Rs.
Share Capital (Authorized: 10,000 Equity Shares of Rs.100 each):		
Issued: 8,000 Equity Shares		8,00,000
Profit & Loss Account - 1-1-20X1		25,310
General Reserve		1,00,000
Fixed Assets	5,30,000	
Stock	2,22,470	
Debtors and Creditors	50,500	21,900
Profit for 20X1		52,200
Cash Balance	62,730	
Branch Current Account	1,33,710	
	9,99,410	9,99,410

Branch Trial Balance

	Rs.	Rs.
Fixed Assets	95,000	
Profit for 20X1		31,700
Stock	50,460	
Debtors and Creditors	19,100	10,400
Cash Balance	6,550	
Head Office Current Account		1,29,010
	1,71,110	1,71,110

The difference between the balances of the Current Account in the two sets of books is accounted for as follows:

a. **Cash remitted by the Branch on 31st December, 20X1, but received by the Head Office on 1st January 20X2 - Rs.3,000.**
b. **Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not credited to Head Office in the Branch books as the Branch Manager declined to admit any liability (not covered by insurance) - Rs.1,700.**

Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal.

Solution

The Branch Current Account in the Head Office Books and Head Office Current Account in the Branch Books do not show the same balances. Therefore, in order to reconcile them, the following journal entries will be passed in the Head Office books:

Journal Entries

		Dr.	Cr.
20X1		Rs.	Rs.
Dec., 31	Cash in Transit A/c Dr.	3,000	
	To Branch Current A/c		3,000
	(Cash sent by the Branch on 31st Dec., 20X1 but received at H.O. on 1st Jan., 20X2)		
	Loss by theft A/c Dr.	1,700	
	To Branch Current A/c		1,700
	(Stock lost in transit from H.O. to Branch)		

In order to incorporate, in the H.O. books, the given Branch trial balance which has been drawn up after preparing the Branch Profit & Loss Account, the following journal entries will be necessary:

Journal Entries

20X1			**Rs.**	**Rs.**
Dec. 31	Branch Current Account	Dr.	31,700	
	To Profit & Loss Account			31,700
	(Branch Profit for the year)			
	Branch Fixed Assets	Dr.	95,000	
	Branch Stock	Dr.	50,460	
	Branch Debtors	Dr.	19,100	
	Branch Cash	Dr.	6,550	
	To Branch Current Account			1,71,110
	(Branch assets brought into H.O. Books)			
	Branch Current A/c	Dr.	10,400	
	To Branch Creditors			10,400
	(Branch creditors brought into H.O. Books)			

Branch Current Account

	Rs.		Rs.
To Balance b/d	1,33,710	By Cash in transit	3,000
To Profit & Loss A/c	31,700	By Loss of theft	1,700
To Branch Creditors	10,400	By Sundry Branch Assets	1,71,110
	1,75,810		1,75,810

Profit and Loss Account for 20X1

	Rs.			Rs.
To Loss by Theft	1,700	By Balance b/d		25,310
To Balance c/d	1,07,510	By Year's Profit:	H.O.	52,200
			Branch	31,700
	1,09,210			1,09,210

Illustration 14

Messrs Ramchand & Co., Hyderabad has a branch in Delhi. The Delhi Branch deals not only in the goods from Head Office but also buys some auxiliary goods and deals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the year and open them afresh on the basis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office.

The goods from the Head Office are invoiced at selling prices to give a profit of 20 per cent on the sale price. The goods sent from the branch to Head Office are at cost. From the following prepare Branch Trading and Profit & Loss Account and Branch fixed Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-20X1

Debit	Rs.	Credit	Rs.
Head office opening balance on 1-1-20X1	**15,000**	**Sales**	**1,00,000**
Goods from H.O.	**50,000**	**Goods to H.O.**	**3,000**
Purchases	**20,000**	**Head Office Current A/c**	**15,000**
Opening Stock		**Sundry Creditors**	**3,000**
(H.O. supplies goods at invoice prices)	**4,000**		
Opening Stock of other goods	**500**		
Salaries	**7,000**		
Rent	**3,000**		

Office expenditure	**2,000**		
Cash on Hand	**500**		
Cash at Bank	**4,000**		
Sundry Debtors	**15,000**		
	1,21,000		**1,21,000**

The Branch balances as on 1st January, 20X1, were as under: Furniture Rs.5,000; Sundry Debtors Rs.9,500; Cash Rs.1,000, Creditors Rs.30,000. The closing stock at branch of the head office goods at invoice price is Rs.3,000 and that of purchased goods at cost is Rs.1,000. Depreciation is to be provided at 10 per cent on branch assets.

Solution

Delhi Branch Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

		Rs.			Rs.
To Opening Stock:			By Sales		1,00,000
Head office Goods	3,200				
(4,000 x 80%)			By Goods from Branch		3,000
Others	500	3,700	By Closing Stock:		
			Head Office goods		
			(3,000 x 80%)		
			Others	2,400	
To Goods to Branch		40,000		1,000	3,400
(50,000 x 80%)					
To Purchases		20,000			
To Gross Profit c/d		42,700			
		1,06,400			1,06,400
To Salaries		7,000	By Gross Profit b/d		42,700
To Rent		3,000			
To Office Expenses		2,000			
To Dep. on furniture @ 10%		500			
To Net profit		30,200			
		42,700			42,700

Branch (Fixed) Assets Account (In Head Office Books)

20X1		Rs.	20X1		Rs.
Jan. 1	To Balance b/d	5,000	Dec. 31	By Delhi Branch A/c	500
				By (Depreciation) Balance c/d	4,500
		5,000			5,000
20X2					
Jan. 1	To Balance b/d	4,500			

Note: Furniture A/c is maintained in Head office books; it is not a part of either opening or closing balance.

Illustration 15

On 31st December, 20X2 the following balances appeared in the books of Chennai Branch of an English firm having its HO office in New York:

	Amount in Rs.	Amount in Rs.
Stock on 1st Jan., 20X2	**2,34,000**	
Purchases and Sales	**15,62,500**	**23,43,750**
Debtors and Creditors	**7,65,000**	**5,10,000**
Bills Receivable and Payable	**2,04,000**	**1,78,500**
Salaries and Wages	**1,00,000**	**-**
Rent, Rates and Taxes	**1,06,250**	**-**
Furniture	**91,000**	**-**
Bank A/c	**5,68,650**	
New York Account	**-**	**5,99,150**
	36,31,400	**36,31,400**

Stock on 31st December, 20X2 was Rs.6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 20X2 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 20X1 was Rs.52 and on 31st December, 20X2 was Rs.51. The average rate for the year was Rs.50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch assuming integral foreign operation.

Solution

In the books of English Firm (Head Office in New York)

Chennai Branch Profit and Loss Account

for the year ended 31st December, 20X2

	$		$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Chennai Branch as on 31st December, 20X2

Liabilities	$	$	Assets	$
Head Office A/c	13,400		Furniture	1,750
Add: Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Calculation of Exchange Translation Loss Chennai Branch Trial Balance (converted in $) as on 31st December, 20X2

	Dr. Rs.	Cr. Rs.	Conversion Rate	Dr. ($)	Cr. ($)
Stock on 1st Jan., 20X2	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	

Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

<u>Illustration 16</u>

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operation of S & M Ltd.

At the end of 31st March, 20X2, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

	Bombay (Rs. thousands)		Sydney (Austr dollars thousands)	
	Debit	**Credit**	**Debit**	**Credit**
Share Capital	**–**	**2,000**	**–**	**–**
Reserves & Surplus	**–**	**1,000**	**–**	**–**
Land	**500**	**–**	**–**	**–**
Buildings (Cost)	**1,000**	**–**	**–**	**–**
Buildings Dep. Reserve	**–**	**200**	**–**	**–**
Plant & Machinery (Cost)	**2,500**	**–**	**200**	**–**
Plant & Machinery Dep. Reserve	**–**	**600**	**–**	**130**
Debtors / Creditors	**280**	**200**	**60**	**30**
Stock (1.4.20X1)	**100**	**–**	**20**	**–**
Branch Stock Reserve	**–**	**4**	**–**	**–**
Cash & Bank Balances	**10**	**–**	**10**	**–**
Purchases / Sales	**240**	**520**	**20**	**123**
Goods sent to Branch	**–**	**100**	**5**	**–**
Managing Director's salary	**30**	**–**	**–**	**–**
Wages & Salaries	**75**	**–**	**45**	**–**
Rent	**–**	**–**	**12**	**–**
Office Expenses	**25**	**–**	**18**	**–**
Commission Receipts	**–**	**256**	**–**	**100**
Branch / H.O. Current A/c	**120**	**–**	**–**	**7**
	4,880	**4,880**	**390**	**390**

The following information is also available:

1. **Stock as at 31.3.20X2: Bombay Rs.1,50,000; Sydney A $ 3,125**

   You are required to convert the Sydney Branch Trial Balance into rupees;

   Use the following rates of exchange:

   Opening rate A $ = Rs.20

   Closing rate A $ = Rs.24

   Average rate A $ = Rs.22

   For Fixed Assets A $ = Rs.18

Solution

Sydney Branch Trial Balance (in Rupees)

As on 31st March, 20X2

(Rs. '000)

Conversion	Rate per A $	Dr.	Cr.
Plant & Machinery (cost)	Rs.18	36,00	
Plant & Machinery Dep. Reserve	Rs.18		23,40
Debtors / Creditors	Rs.24	14,40	7,20
Stock (1.4.20X1)	Rs.20	4,00	
Cash & Bank Balances	Rs.24	2,40	
Purchase / Sales	Rs.22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	Rs.22	9,90	
Rent	Rs.22	2,64	
Office expenses	Rs.22	3,96	
Commission Receipts	Rs.22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Illustration 17

M/s Carlin has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch is an integral foreign operation of Carlin & Co.

Mumbai branch furnishes you with its trial balance as on 31st March, 20X2 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 20X1	300	–
Purchases and sales	800	1,200
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Wages and salaries	560	–
Rent, rates and taxes	360	–
Sundry charges	160	–
Computers	240	
Bank balance	420	–
New York office a/c	–	1,620
	3,360	3,360

Additional information:

a. Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the supplier's. Depreciate computers at 60% for the year.

b. Unsold stock of Mumbai branch was worth Rs.4,20,000 on 31st March, 20X2.

c. The rates of exchange may be taken as follows:

- on 1.4.20X1 @ Rs.40 per US $
- on 31.3.20X2 @ Rs.42 per US $
- average exchange rate for the year @ Rs.41 per US $
- conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 20X2 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.20X2 in New York books and there were no items pending reconciliation.

Solution

M/s Carlin

Mumbai Branch Trial Balance in (US $) as on 31st March, 20X2

	Conversion	Dr.	Cr.
	rate per US $ (Rs.)	US $	US $
Stock on 1.4.X1	40	7,500.00	–

Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

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

	US $		US $
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock (4,20,000/42)	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on Computers (US $ 6,000 × 0.6)	3,600.00		
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch as on 31st March, 20X2

Liabilities		US $	Assets	US $	US $
New York Office A/c	39,609.18		Computers	6,000.00	
Less: Net Loss	(17,685.38)	21,923.80	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		2,857.14
		34,780.95			34,780.95

TEST YOUR KNOWLEDGE

MCQs

1. If goods are invoiced to branches at cost, trading results of branch can be ascertained by

a. Debtors method.

b. Stock and debtors method.

c. Either (a) or (b).

d. Both (a) and (b).

2. Under branch trading and profit loss account method

a. H.O prepares profit and loss account.

b. Each branch is treated separate entity.

c. Both (a) and (b).

d. Either (a) or (b).

3. Goods may be invoiced to branch at

a. Cost or Selling price.

b. Wholesale price.

c. Both (a) and (b).

d. Either (a) or (b).

4. Under debtors method, opening balance of debtors is

a. Debited to branch account.

b. Credited to branch account.

c. Debited to H.O account.

d. Credited to H.O account.

5. Cost of goods returned by branch will have the following effect

a. Goods sent to branch account will be debited.

b. Branch stock account will be credited.

c. Both (a) and (b).

d. Either (a) or (b).

ANSWERS/HINTS

MCQs

1.	**c.**	Either a. or b.
2.	**c.**	Both a and b.
3.	**c.**	Both a. and b.
4.	**a.**	Debited to branch account.
5.	**c.**	Both a. and b.

THEORETICAL QUESTIONS

Q.NO.1. Why goods are marked on invoice price by the head office while sending goods to the branch?

ANSWER

Goods are marked on invoice price to achieve the following objectives:

i. To keep secret from the branch manager, the cost price of the goods and profit made, so that the branch manager may not start a rival and competitive business with the concern; and

ii. To have effective control on stock i.e. stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.

iii. To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

Q.NO.2. Differentiate Branch Accounts with Departmental accounts.

ANSWER

Branch accounts may be maintained either at branch or at head office and no allocation problem arises since the expenses in respect of each branch can be identified However, Departmental accounts are maintained at one place only. Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case. For details, refer Para 2 of the Chapter to know the differences.

PRACTICAL QUESTIONS

Q.NO.1. Goods worth Rs.50,000 sent by head office but the branch has received till the closing date goods for worth Rs.40,000 only. Give journal entry in the books of H.O. and branch for goods in transit.

SOLUTION

Journal entry in the books of Head Office

No entry

Journal entry in the books of Branch

	Rs.	Rs.
Goods-in-transit account **Dr.**	10,000	
To Head Office account		10,000
(Being goods sent by head office is still in transit)		

Q.NO.2. Alphs having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account. On 31.3.20X1, it was found that the goods dispatched by head office for Rs.2,00,000 was received by the branch only to the extent of Rs.1,50,000. The balance goods are in transit. What is the accounting entry to be passed by the branch for recording the goods in transit, in its books?

SOLUTION

Nagpur branch must include the inventory in its books as goods in transit.

The following journal entry must be made by the branch:

Goods in transit A/c	Dr.	50,000	
To Head office A/c			50,000

[Being Goods sent by Head office is still in transit on the closing date]

Q.NO.3. Show adjustment journal entry in the books of head office at the end of April, 20X1 for incorporation of inter-branch transactions assuming that only head office maintains different branch accounts in its books.

A. Delhi branch:

1. **Received goods from Mumbai – Rs.35,000 and Rs.15,000 from Kolkata.**
2. **Sent goods to Chennai – Rs.25,000, Kolkata – Rs.20,000.**
3. **Bill Receivable received – Rs.20,000 from Chennai.**
4. **Acceptances sent to Mumbai – Rs.25,000, Kolkata – Rs.10,000.**

B. Mumbai Branch (apart from the above):

5. Received goods from Kolkata – Rs.15,000, Delhi – Rs.20,000.

6. Cash sent to Delhi – Rs.15,000, Kolkata – Rs.7,000.

C. Chennai Branch (apart from the above) :

7. Received goods from Kolkata – Rs.30,000.

8. Acceptances and Cash sent to Kolkata – Rs.20,000 and Rs.10,000 respectively.

D. Kolkata Branch (apart from the above):

9. Sent goods to Chennai – Rs.35,000.

10. Paid cash to Chennai – Rs.15,000.

11. Acceptances sent to Chennai – Rs.15,000.

<u>SOLUTION</u>

Journal entry in the books of Head Office

Date	Particulars	Dr.	Cr.
		Rs.	Rs.
30th April, 20X1	Mumbai Branch Account Dr.	3,000	
	Chennai Branch Account Dr.	70,000	
	To Delhi Branch Account		15,000
	To Kolkata Branch Account		58,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 20X1)		

Working Note:

Inter – Branch transactions

	Delhi	Mumbai	Chennai	Kolkata
	Rs.	Rs.	Rs.	Rs.
A. Delhi Branch				
(1) Received goods	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
(2) Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
(3) Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
(4) Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)
B. Mumbai Branch				
(5) Received goods	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)

(6) Sent cash	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
C. Chennai Branch				
(7) Received goods			30,000 (Dr.)	30,000 (Cr.)
(8) Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D. Kolkata Branch				
(9) Sent goods			35,000 (Dr.)	35,000 (Cr.)
(10) Sent cash			15,000 (Dr.)	15,000 (Cr.)
(11) Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
	15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Q.NO.4. Give Journal Entries in the books of Branch A to rectify or adjust the following:

i. **Head Office expenses Rs.3,500 allocated to the Branch, but not recorded in the Branch Books.**

ii. **Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for Rs.1,500.**

iii. **Branch paid Rs.2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.**

iv. **H.O. collected Rs.10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.**

v. **A remittance of Rs.15,000 sent by the Branch has not yet been received by the Head Office.**

vi. **Branch A incurred advertisement expenses of Rs.3,000 on behalf of Branch B.**

SOLUTION

Books of Branch A

Journal Entries

	Particulars	Dr. Amount Rs.	Cr. Amount Rs.
i.	Expenses account Dr. To Head office account (Being the allocated expenditure by the head office recorded in branch books)	3,500	 3,500
ii.	Depreciation account Dr. To Head office account (Being the depreciation provided)	1,500	 1,500

iii.	Head office account Dr. To Salaries account (Being the rectification of salary paid on behalf of H.O.)	2,000	 2,000
iv.	Head office account Dr. To Debtors account (Being the adjustment of collection from branch debtors)	10,000	 10,000
v.	No entry in branch books		
vi.	Head Office account Dr. To Cash account (Being the expenditure on account of Branch B, recorded in books)	3,000	 3,000

Note: Entry (vi) Inter branch transactions are routed through Head Office.

Q.NO.5. Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding Rs.10,000 necessary for meeting immediate requirements of cash. On 31st March, 20X1 the assets at the branch were as follows:

	Rs. ('000)
Cash in Hand	**10**
Trade Debtors	**384**
Stock, at Invoice Price	**1,080**
Furniture and Fittings	**500**

During the accounting year ended 31st March, 20X2 the invoice price of goods dispatched by the head office to the branch amounted to Rs.1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at Rs.72,000. Other transactions at the branch during the year were as follows:

	(Rs.'000)
Cash Sales	**9,700**
Credit Sales	**3,140**

Cash collected by Branch from Credit Customers	**2,842**
Cash Discount allowed to Debtors	**58**
Returns by Customers	**102**
Bad Debts written off	**37**
Expenses paid by Branch	**842**

On 1st January, 20X2 the branch purchased new furniture for Rs.1 lakh for which payment was made by head office through a cheque.

On 31st March, 20X2 branch expenses amounting to Rs.6,000 were outstanding and cash in hand was again Rs.10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 20X2.

SOLUTION

In the Head Office Books

Branch Account

for the year ended 31st March, 20X2

	Rs. '000		**Rs. '000**
To Balance b/d		By Balance b/d	
Cash in hand	10	Stock Rs.1,080 × $\frac{1}{6}$	180
Trade debtors	384		
Stock	1,080	By Goods sent to branch A/c (Returns to H.O.)	72
Furniture and fittings	500		
To Goods sent to branch A/c	13,200	By Goods sent to branch A/c (Loading on net goods sent to branch – $\left(13{,}128\times\frac{1}{6}\right)$	2,188
To Bank A/c (Payment for furniture)	100		
To Balance c/d Stock reserve $\left(1{,}470\times\frac{1}{6}\right)$	245	By Bank A/c (Remittance from branch to H.O.) (W.N.5)	11,700
To Net profit transferred to General P/L account	1,096	By Balance c/d	
		Cash in hand	10
To Balance c/d - Outstanding expenses	6	Trade debtors (W.N.3)	485
		Stock (W.N.1)	1,470
		Furniture and fittings (W.N.4)	516
	16,621		16,621

Working Notes:

1. **Invoice price and cost**

Let cost be	100
So, invoice price	120
Loading	20
Loading: Invoice price= 20 : 120	= 1 : 6

2. Memorandum Branch Stock Account

	Rs. '000		Rs. '000
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. **Memorandum Branch Debtors Account**

	Rs. '000		Rs. '000
To Balance b/d	384	By Branch cash	2,842
To Branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses (Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. **Memorandum Branch Furniture and Fittings Account**

	Rs. '000		Rs. '000
To Balance b/d	500	By Depreciation [(500x16%) + (100 x 16% x 3/12)]	84
To Bank	100	By Balance c/d	516
	600		600

Note: Since the new furniture was purchased on 1st Jan 20X2 depreciationwill be for 3 months.

5. **Memorandum Branch Cash Account**

	Rs. '000		Rs. '000
To Balance b/d	10	By Branch expenses	842

To Branch stock	9,700	By Remittances to H.O. (b.f)	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

Q.NO.6. On 31st March, 20X2 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow:

Debit Balances	**Rs.in lacs**
Furniture and Equipment	**18**
Depreciation on furniture	**2**
Salaries	**25**
Rent	**10**
Advertising	**6**
Telephone, Postage and Stationery	**3**
Sundry Office Expenses	**1**
Stock on 1st April, 20X1	**60**
Goods Received from Head Office	**288**
Debtors	**20**
Cash at bank and in hand	**8**
Carriage Inwards	**7**
	448
Credit Balances	
Outstanding Expenses	**3**
Goods Returned to Head Office	**5**
Sales	**360**
Head Office	**80**
	448

Additional Information:

Stock on 31st March, 20X2 was valued at Rs.62 lacs. On 29th March, 20X2 the Head Office dispatched goods costing Rs.10 lacs to its branch. Branch did not receive these goods before 1st April, 20X2. Hence, the figure of goods received from Head Office does not include these goods. Also, the head office has charged the branch Rs.1 lac for centralized services for which the branch has not passed the entry.

You are required to:

i. **Pass Journal Entries in the books of the Branch to make the necessary adjustments**

ii. **Prepare Final Accounts of the Branch including Balance Sheet, and**

iii. **Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance.**

SOLUTION

i. Books of Branch

Journal Entries

		(Rs.in lacs)	
		Dr.	**Cr.**
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 20X2)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

ii. Trading and Profit & Loss Account of the Branch for the year ended 31st March, 20X2

		Rs.in lacs		Rs.in lacs
To Opening Stock		60	By Sales	360
To Goods received from			By Closing Stock including transit	72
Head Office	288 + 10			
Less: Returns	(5)	293		
To Carriage Inwards		7		
To Gross Profit c/d		72		
		432		432
To Salaries		25	By Gross Profit b/d	72
To Depreciation on Furniture		2		
To Rent		10		
To Advertising		6		
To Telephone, Postage & Stationery		3		
To Sundry Office Expenses		1		

To Head Office Expenses (centralised services) To Net Profit Transferred to Head Office A/c	1 24		
	72		72

Balance Sheet as on 31st March, 20X2

Liabilities	Rs.in lacs		Assets	Rs.in lacs	
Head Office	80		Furniture & Equipment	20	
Add: Goods in transit	10		Less: Depreciation	(2)	18
			Stock in hand		62
Head Office			Goods in Transit		10
Expenses	1		Debtors		20
Net Profit	24	115	Cash at bank and in hand		8
Outstanding Expenses		3			
		118			118

iii. Books of Head Office Journal Entries

	Rs. Dr.	Rs. Dr.
Branch Trading Account Dr. To Branch Account (The total of the following items in branch trial balance debited to branch trading account: **Rs.in lacs** Opening Stock 60 Goods received from Head Office Goods purchased but not 288 received 10 Carriage Inwards 7)	365	365
Branch Account Dr. To Branch Trading Account	437	437
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows:		

Rs.in lacs			
Sales 360 Closing Stock 62 Goods in transit 10 Goods returned to Head Office (5)			
Branch Trading Account	Dr.	72	
To Branch Profit and Loss Account			72
(Gross profit earned by branch credited to Branch Profit and Loss Account)			
Branch Profit and Loss Account	Dr.	48	
To Branch Account			48
(Total of the following branch expenses debited to Branch Profit & Loss Account: **Rs.in lacs** Salaries 25 Rent 10 Advertising 6 Telephone, Postage & Stationery 3 Sundry Office Expenses 1 Head Office Expenses 1 Depreciation on furniture 2)			
Branch Profit & Loss Account	Dr.	24	
To Profit and Loss Account			24
(Net profit at branch credited to general Profit & Loss A/c)			
Branch Furniture & Equipment	Dr.	18	
Branch Stock	Dr.	62	
Branch Debtors	Dr.	20	
Branch Cash at Bank and in Hand	Dr.	8	
Goods in Transit	Dr.	10	
To Branch			118
(Incorporation of different assets at the branch in H.O. books)			
Branch	Dr.	3	
To Branch Outstanding Expenses			3
(Incorporation of Branch Outstanding Expenses in H.O. books)			

Q.NO.7. **M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit.**

Branch Expenses are paid direct from head office and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit under Stock and Debtors Method'.

Branch does not maintain any books of account, but sends weekly returns to the Head Office.

	Rs.
Goods received from Head Office at invoice price	**45,00,000**
Returns to Heads Office at invoice price	**90,000**
Stock at Bangalore as on 1st January, 20X1	**4,50,000**
Sales during the year - Cash	**15,00,000**
- Credit	**27,00,000**
Sundry Debtors at Bangalore as on 1st January, 20X1	**5,40,000**
Cash received from Debtors	**24,00,000**
Discount allowed to Debtors	**45,000**
Bad Debts in the year	**30,000**
Sales returns at Bangalore Branch	**60,000**
Rent, Rates and Taxes at Branch	**1,35,000**
Salaries, Wages and Bonus at Branch	**4,50,000**
Office Expenses	**45,000**
Stock at Branch on 31st December, 20X1 at invoice price	**9,00,000**

SOLUTION

Bangalore Branch Stock Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d	4,50,000	By Goods sent to branch A/c (Returns)	90,000
To Goods sent to branch A/c	45,00,000	By Bank A/c (Cash sales)	15,00,000
To Branch debtors A/c (Returns)	60,000	By Branch debtors A/c (credit sales)	27,00,000
To Branch adjustment A/c (Surplus over invoice price)*	1,80,000	By Balance c/d	9,00,000
	51,90,000		51,90,000

*Alternatively, this may directly be transferred to Branch P&L A/c without routing it through Branch Adjustment Account.

Bangalore Branch Adjustment Account

	Particulars	Amount (Rs.)		Particulars	Amount (Rs.)
To	Stock reserve - 20% of Rs.9,00,000 (closing stock)	1,80,000	By	Stock reserve - 20% of Rs.4,50,000 (Opening stock)	90,000
To	Branch profit & loss A/c (Gross profit)	9,72,000	By	Goods sent to branch A/c – 20% of Rs.44,10,000 (45,00,000 – 90,000)	8,82,000
			By	Branch stock A/c	1,80,000
		11,52,000			11,52,000

Branch Profit & Loss Account

	Particulars	Amount (Rs.)		Particulars	Amount (Rs.)
To	Branch expenses A/c	6,30,000	By	Branch adjustment A/c (Gross Profit)	9,72,000
To	Branch debtors A/c (Discount)	45,000			
To	Branch Debtors A/c (Bad debts)	30,000			
To	Net profit (transferred to Profit & Loss A/c)	2,67,000			
		9,72,000			9,72,000

Branch Expenses Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Bank A/c (Rent, rates & taxes)	1,35,000	By Branch profit and loss A/c (Transfer)	6,30,000
To Bank A/c (Salaries, wages & bonus)	4,50,000		

To Bank A/c (Office expenses)	45,000		
	6,30,000		6,30,000

Branch Debtors Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d	5,40,000	By Bank A/c	24,00,000
To Branch stock A/c	27,00,000	By Branch profit and loss A/c (Bad debts and discount)	75,000
		By Branch stock A/c (Sales returns)	60,000
		By Balance c/d (bal. fig.)	7,05,000
	32,40,000		32,40,000

Goods sent to Branch Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Branch stock A/c	90,000	By Branch stock A/c	45,00,000
To Branch adjustment A/c	8,82,000		
To Purchases A/c	35,28,000		
	45,00,000		45,00,000

Q.NO.8. Beta, having head office at Mumbai has a branch at Nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 20X1:

	Head Office (Rs.)	Branch (Rs.)
Opening stock	**2,25,000**	
Purchases	**25,50,000**	
Goods sent to branch (Cost to H.0. plus 80%)	**9,54,000**	
Sales	**27,81,000**	**9,50,000**
Office expenses	**90,000**	**8,500**
Selling expenses	**72,000**	**6,300**
Staff salary	**65,000**	**12,000**

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 20X1.

SOLUTION

Trading and Profit and Loss A/c For the year ended 31st March 20X1

	Head office Rs.	Branch Rs.		Head office Rs.	Branch Rs.
To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000
To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	_
To Goods received from head office	-	9,54,000	By Closing stock (W.N.1 & 2)	7,00,000	99,000
To Gross profit c/d	16,60,000	95,000			
	44,35,000	10,49,000		44,35,000	10,49,000
To Office expenses	90,000	8,500	By Gross profit b/d	16,60,000	95,000
To Selling expenses	72,000	6,300			
To Staff salaries	65,000	12,000			
To Branch Stock Reserve (W.N.3)	44,000	_			
To Net Profit	13,89,000	68,200			
	16,60,000	95,000		16,60,000	95,000

Working Notes:

1.	**Calculation of closing stock of head office:**	**Rs.**
	Opening Stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold [37,35,000 x 100/180]	(20,75,000)
		7,00,000
2.	Calculation of closing stock of branch:	Rs.
	Goods received from head office [At invoice value]	9,54,000

	Less: Invoice value of goods sold [9,50,000 x 180/200]	(8,55,000)
		99,000
3.	Calculation of unrealized profit in branch stock: Branch stock Rs.99,000 Profit included 80% of cost Hence, unrealized profit would be = Rs.99,000 x 80/180	Rs.44,000

Q.NO.9. Pass necessary Journal entries in the books of an independent Branch of a business entity to rectify or adjust the following:

i. **Income of Rs.2,800 allocated to the Branch by Head Office but not recorded in the Branch books.**
ii. **Branch paid Rs.3,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.**
iii. **Branch incurred travelling expenses of Rs.5,000 on behalf of other Branches, this was not recorded in the books of Branch.**
iv. **A remittance of Rs.1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.**
v. **Head Office allocates Rs.75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.**
vi. **Head Office collected Rs.30,000 directly from a Branch Customer. The intimation of the fact has been received by the Branch only now, not recorded till now.**
vii. **Goods dispatched by the Head office amounting to Rs.10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.**

SOLUTION

Books of Branch

Journal Entries

Amount in Rs.

Sr. No	Particulars	Dr.	Cr.
i.	Head Office Account Dr. To Income Account (Being the income allocated by the Head office not recorded earlier, now recorded)	2,800	2,800

ii.	Head Office Account Dr. To Salaries Account (Being rectification of salary paid on behalf of Head Office)	3,000	3,000
iii.	Head Office Account Dr. To Cash Account (Being expenditure incurred on account of other branch, now recorded in books)	5,000	5,000
iv.	No entry in Branch Books is required.		
v.	Expenses Account Dr. To Head Office Account (Being allocated expenses of Head Office recorded)	75,000	75,000
vi.	Head Office Account Dr. To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)	30,000	30,000
vii.	Goods -in- transit Account Dr. To Head Office Account (Being goods sent by Head Office still in-transit)	10,000	10,000

Q.NO.10. The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 20X1:

	$	**$**
Head office A/c	_	**22,800**
Sales	_	**84,000**
Debtors and creditors	**4,800**	**3,400**
Machinery	**24,000**	_
Cash at bank	**1,200**	_
Stock, 1 January, 20X1	**11,200**	_
Goods from H.O.	**64,000**	_
Expenses	**5,000**	_
	1,10,200	**1,10,200**

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

		Rs.			Rs.
To	Balance b/d	8,10,000	By	Cash	28,76,000
To	Goods sent to branch	29,26,000	By	Balance c/d	8,60,000
		37,36,000			37,36,000

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%.

Machinery was acquired in past, when \$ 1.00 = Rs.40.

Rates of exchange were:

1st January, 20X1	\$ 1.00	=	Rs.46
31st December, 20X1	\$ 1.00	=	Rs.48
Average	\$ 1.00	=	Rs.47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

i. Prepare the Branch Trading & Profit & Loss A/c in dollars.

ii. Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

SOLUTION

i. In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars) for the year ended 31st December, 20X1

Particulars		\$	Particulars		\$
To	Opening stock	11,200	By	Sales	84,000
To	Goods from H.O.	64,000	By	Closing stock (W.N.2)	8,000
To	Gross profit c/d	16,800			
		92,000			92,000
To	Expenses	5,000	By	Gross profit b/d	16,800
To	Depreciation (24,000 x 10%)	2,400			
To	Manager's commission (W.N.1)	470			
To	Net profit c/d	8,930			
		16,800			16,800

ii. a. Converted Branch Trial Balance (into Indian Currency)

Particulars	Rate per $	Dr. (Rs.)	Cr. (Rs.)
Machinery	40	9,60,000	_
Stock January 1, 20X1	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate (b.f.)		47,000	_
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		Rs.3,84,000

b. Branch Trading and Profit & Loss A/c for the year ended 31st December, 20X1

	Rs.		Rs.
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from head office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		43,32,000
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on Rs.9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		8,90,800

Branch Account

	Rs.			Rs.
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	Less: Depreciation	(96,000)	8,64,000
To Creditors	1,63,200	By Closing stock		3,84,000
To Outstanding commission	22,560	By Debtors		2,30,400
		By Cash at bank		57,600
	15,36,000			15,36,000

Working Notes:

1. **Calculation of manager's commission @ 5% on profit**

i.e. 5% of $[16,800 – (5,000 + 2,400)]

Or 5% × $9,400 = $ 470

Manager's commission in Rupees = $ 470 x Rs.48 = Rs.22,560

2. **Calculation of closing stock**

	$
Opening stock	11,200
Add: Goods from head office	64,000
Less: Cost of goods sold (at invoice price)	75,200
i.e. $\frac{100}{125} \times 84,000$	(67,200)
Closing stock	8,000

Closing stock in Rupees = $8,000 x Rs.48 = Rs.3,84,000.

Note: Manager is entitled to commission on profits earned at the end of the year.

THE END