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MEMBERS OF B.O.S. IN ACCOUNTANCY

Preface

Modern approach of the business propounds the concept of accounting with new horizon. The effectiveness and efficiency can be attained by specific and scientific tools and techniques which can support managerial decision making. Accounting is such a branch of knowledge, which creat information, record transactions and present financial statements and assists the management for planning, controlling and decision-making for each and every facets of management. It is expected that the students from M. Com. should be familiar with and skilled in various tools and techniques of accounting. Hence, this self instructional material has been developed to the students on distance mode to learn this subject smoothly and it covers both theoretical and practical aspects.

This book contains four units. The first unit puts light on accounting for mergers and acquisitions. The second unit covers accounting for cooperative societies whereas the third unit consist of accounting for lease. The fourth unit includes accounting of electrical companies.

The students should learn recent trends in accounting of different types of organisations. Practical approach to learning has been adopted in every unit especially to develop analytical skills and decision-making skills.

We express our deep sense of gratitude to Hon. Vice-Chancellor and Director, the Centre for Distance Education for giving us opportunity to contribute this book. We would welcome suggestions for improvement in the book, from stakeholders of all corners.

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M. Com. Part-I

SIM IN ADVANCED ACCOUNTANCY PAPER V

INDEX

Each Unit begins with the section objectives -

Objectives are directive and indicative of :

1. what has been presented in the unit and
2. what is expected from you
3. what you are expected to know pertaining to the specific unit, once you have completed working on the unit.

The self check exercises with possible answers will help you understand the unit in the right perspective. Go through the possible answers only after you write your answers. These exercises are not to be submitted to us for evaluation. They have been provided to you as study tools to keep you in the right track as you study the unit.

Dear Students

The SIM is simply a supporting material for the study of this paper. It is also advised to see the new syllabus 2023-24 and study the reference books & other related material for the detailed study of the paper.

Unit-1
Accounting for Mergers and Acquisitions of Companies (Purchase Method Only)

Index :

1.0 Objectives:

After studying the unit, you will be able to:

1. Understand the concepts of mergers and acquisitions.
2. Explain the real motives of mergers and acquisitions.
3. Know the accounting for mergers and acquisitions.

1.1 Introduction:

Corporate restructuring includes Mergers and Acquisitions (M&A), amalgamation, take-overs, spin-offs, leveraged buyouts, buyback of shares, capital reorganization, sale of business units and assets etc. M&A are the most popular means of corporate restructuring or business combinations. They have played an important role in the external growth of a number of leading companies the world over. During 1976-86 in India, about 1180 proposals for amalgamation of corporate bodies involving about 2400 companies were field with the High Courts. In the year 2003-04, 834 mergers and acquisitions deals involved Rs. 35980 crore. In 2008 the M&A deals were worth US $ 19.8 billion. In 2018, the M&A deals amounted to US $ 129.4 billion. A number of mega-mergers and hostile takeovers could be witnessed in India now.

1.2 Subject Matter:

1.2.1 Types of Business Combinations:

A merger is said to occur when two or more companies combine into one company. Mergers may take any one of the following forms.

1.2.1.1 Merger or Amalgamation:

The term merger and amalgamation are used interchangeably in practice. A merger is said to occur when two or more companies combine into one company. One or more companies may merge with an existing company or they may merge to form a new company. In a merger, there is a complete amalgamation of the assets and liabilities as well as shareholders' interests and businesses of the merging companies. There is yet another mode of merger. Here one company may purchase another company without continuing the business of the acquired company.

Merger or amalgamation may take two forms:

- Merger through absorption
- Merger through consolidation

Merger through absorption is a combination of two or more companies into an existing company. All companies except one lose their identity in a merger through absorption e.g. Tata Chemicals Ltd. (TCL) absorbs Tata fertilizers Ltd. Here, TCL is an acquiring company (a buyer), survived after merger while TFL is an acquired company (a seller), loose its existence.

Merger through consolidation is a combination of two or more companies into a new company. In this form of merger, all companies are legally dissolved and a new entity is created. In a consolidation, the acquired company transfers its assets, liabilities and shares e.g. Hindustan Computers Ltd., Hindustan Instruments Ltd., Indian Software Company Ltd. and Indian Reprographics Ltd. decided to consolidate and form a new company called HCL Ltd. in 1986.

In short:

1. In the pure sense of the term, a merger happens when two firms agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals".
2. A merger refers to the process whereby at least two companies combine to form one single company. Business firms make use of mergers and acquisitions for consolidation of markets as well as for gaining a competitive edge in the industry.

1.2.1.2 Acquisition:

Acquisition may be defined as an act of acquiring effective control over assets or management of a company by another company without any combination of businesses or companies. A substantial acquisition occurs when an acquiring firm acquires substantial quantity of shares or voting rights of the target company. Thus, in an acquisition, two or more companies may remain independent, separate legal entity, but there may be a change in control of companies. An acquirer may be a company or persons acting in concert, that act together for the purpose of substantial acquisition of shares or voting rights or gaining control over the target company.

1.2.1.3 Takeover:

A takeover generally involves the acquisition of a certain stake in the equity capital of a company which enables the acquirer to exercise control over the affairs of the company. Takeover implies acquisition of controlling interest in a company by another company. It doesn't lead to the dissolution of the company whose shares are being/ have been acquired. It simply means a change of controlling interest in a company through the acquisition of its shares by another group. e.g. HINDALCO took over INDAL by acquiring a 54% stake in INDAL from its overseas parent, Alcan. However, INDAL was merged into HINDALCO.

1.2.1.4 Demerger:

Demerger or split or division of a company is opposite of mergers and amalgamations.

e.g. Hero Honda demerged from Honda and became Hero.

1.2.1.5 Reverse merger:

A private company can become a public company through an initial public offering (IPO). Alternatively, it can merge with an existing company which is dormant. A reverse merger is used by a private company as a means of becoming public by merging with a dormant public limited company. In a reverse merger, the private company buys the majority shares of the public company and becomes a public limited company.

1.2.2 Objectives of Mergers and Acquisitions

To create a more cost-efficient operation.

To expand a firm's geographic coverage.

To extend a firm's business into new product categories or international markets.

To gain quick access to new technologies or competitive capabilities.

To invent a new industry and lead the convergence of industries whose boundaries are blurred by changing technologies and new market opportunities.

1.2.3 Types of Mergers:

Different types of merger and acquisitions can also be classified on the basis of the functional relationship between two companies and the economic impact of the merger on their operations. The merger may take place in any of the following situations:

1.2.3.1 Horizontal Merger:

This is a combination of two or more firms in a similar type of production, distribution or area of business. Both acquiring and the target company belong to same industry. Main purpose is to obtain economies of scale in production by eliminating duplicationof facilities and operations.

Motives of Horizontal Merger:

- ➢ Elimination or reduction in competition
- ➢ Putting an end to price cutting
- ➢ Economies of scale in production
- ➢ Research and development
- ➢ Better control over Marketing and Management.
- ➢ Increase market power.

- e.g. i) combining of book publishers or two manufacturing Co's to gain dominant market share.(Mittal's Strategy)

ii) Tata Oil Mills Ltd. with the Hindustan Lever Ltd.

iii) The acquisition of American Motors by Chrysler in 1987 represents a horizontal combination or merger.

iv) Bank of Madura was merged with ICICI Bank.

- Horizontal mergers increase monopoly power of the combined firm.

1.2.3.2 Vertical Merger:

It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities. On the other hand, forward integration may result if a company decides to take over the retailer or customer company. Vertical merger may result in many operating and financial economies. The transferee firm will get a stronger position in the market as its production /distribution chain will be more integrated than that of competitors. Merger of ICICI Ltd. with ICICI Bank was a case of vertical merger.

- This occurs between firms in different stages of production and operation.
- Expands the espousing backward integration to assimilate sources of supply and forward integration towards market outlets.
- Vertical merger occurs when a firm acquires firms 'Upstream' from it or firms'downstream' from it.
- In case of an 'Upstream' merger it extends to the firms supplying raw materials and tothose firms that sell eventually to the consumer in the event of a 'down-stream' merger.
- When co combines with the supplier of materials it is called backward merger and whenit combines with the customer it is known forward merger.
- EX: **Vertical Forward Integration –** Buying a customer
- Indian Rayon's acquisition of Madura Garments along with brand rights
- **Vertical Backward Integration –** Buying a supplier.

  e.g. IBM's acquisition of Daksh

1.2.3.2.1 Merits of vertical mergers:

- Low buying cost of materials
- Lower distribution costs
- Assured supplies and market
- Increasing or creating barriers to entry for potential competitors
- Placing them at a cost of disadvantage. Control over product specification
- Technological Economies

1.2.3.3 Conglomerate Merger:

It is a merger of two or more firms operating in different and unrelated industries. It is an expansion of a company into areas unrelated to existing lines of business. In this case, the company may not get the operating economies. In fact, the conglomerate merger results in portfolio of lines of business.

The conglomerate merger may be called pure when the activities of two firms being merged are totally unrelated e.g. merger of an cement company with automobile company.

The conglomerate merger does not reduce the number of competitors in an industry but may result in some operating and financial economies to the company.

- This occurs between companies engaged into two unrelated industries.
- Conglomerate merger represents a merger of firms engaged in unrelated lines of business.
- **Rationale for such merger: Diversification of risk.**

1.2.3.3.1 Types of Conglomerate merger:

- **Product-extension mergers:**

These are mergers between firms in related business activities and may also be called **concentric mergers**. These mergers broaden the product lines.

Product Extension: New product in Present territory

e.g. P&G acquires Gillette to expand its product offering in the household sector and smooth out fluctuations in earning.

- **Geographic market-extension mergers:**

It involves two firms whose operations have been conducted in non-overlapping geographic areas.

e.g. Pizza Hut a fast-food chain restaurant centered in USA, sought to wow Indian customers by opening their restaurant in all most all major urban centers of India.

- **Pure conglomerate mergers**:

It involves unrelated business activities. These would not qualify as either product-extension or market extension.

e.g. New product & New territories

Indian Rayon's acquisition of PSI Data Systems.

Mohta Steels with Vardhaman Spinning Mills Ltd.

1.2.3.4 Congeneric Merger:

A congeneric merger is also known as a Product Extension merger. In this type, it is a combining of two or more companies that operate in the same market or sector which overlapping factors, such as technology, marketing, production processes and research and development (R&D). a product extension merger is achieved when a new product line from one company is added to an existing product line of the other company. When two companies become one under a product extension, they are able to gain access to a larger group of consumers and thus, a larger market share. e.g. Citigroup's union merged with Travelers Insurance, two companies with complementing products.

1.2.4 Styles of Merger:

Irrespective of the types of mergers, there are at least two firms involved. One, the buying company which acquires the other company and survives after merger. This firm is known as an acquiring firm or transferee company. The other company which is merged and loses its identity in the process is called acquired or transferor company or the target company. There are various modes in which the acquiring firm can attempt a merger move and therefore, a merger can also be classified on the basis of initiative style, or the procedure adopted by the acquiring firm. These are as follows:

1.2.4.1 Negotiated Merger:

It is also called a friendly merger. In this case, the management / owners of both the firms sit together and negotiated the merger. So, the willingness of the management of the target firm is implied here. The merger of ITC Classic Ltd. with ICICI Ltd. and merger of Tata Oil Mills Ltd. with Hindustan Lever Ltd. were negotiated mergers.

However, if the management of the target firm is not agreeable to the merger proposal, then the acquiring firm may go for other procedures i.e. tender offer or hostile takeovers.

1.2.4.2 Tender offer:

A tender offer is a bid to acquire controlling interest in a target firm by the acquiring firm by purchasing shares of the target firm at a fixed price. The acquiring firm approaches the shareholders of the target firm directly to sell their shareholding to the acquiring firm at a fixed price. This offered price is generally, kept at a level higher than the current market price in order to include the shareholders to dis-investment their holding in favour of the acquiring firm. The acquiring firm may also stipulate in the tender offer as to how many shares it is willing to buy or may purchase all the shares that are offered for sale.

Example: Consolidated Coffee Ltd. was taken over by Tata Tea Ltd. by making a tender offer to the shareholders of the former at a price which was higher than the prevailing market price.

1.2.4.3 Hostile Take-over Bid:

The acquiring firm, without the knowledge and concept of the management of the target firm, may unilaterally pursue the efforts to gain a controlling interest in the largest firm, by purchasing shares of the later firm at the stock exchanges. Such case of merger / acquisition is popularly known as 'raid'. The Caparo Group of the UK made a hostile take-over bid in 1988 to take-over DCM Ltd. and Escorts Ltd.

1.2.4.4 Arranged Mergers:

In India, the Board for Industrial and Financial Reconstruction (BIFR) has also been active for arranging mergers of financially sick companies with other companies under the package of rehabilitation. These merger schemes are framed in consultation with the lead bank, the target firm and the acquiring firm. These mergers are motivated and the lead bank takes the initiative and decides terms and conditions of merger. Example- Modi Cement Ltd. by Gujrat Ambuja Cement Ltd. was an arranged take-over after the financial reconstruction of Modi Cement Ltd.

1.2.5 Motives and Reasons behind Mergers and Acquisitions:

Mergers and Acquisitions are strategic decisions leading to the maximization of a company's growth by enhancing it production and marketing operations. They have become popular in the recent times because of the enhanced competition, breaking of trade barriers, free flow of capital across countries and globalization of business as a number of economies are being deregulated and integrated with other economies. A number of reasons are attributed to the occurrence of mergers and acquisitions.

1.2.5.1 Economies of Scale:

Economies of scale arise when an increase in the volume of production leads to a reduction in the cost of production per unit. A merger may help to expand the volume of production without a corresponding increase in fixed costs. Thus, fixed costs are distributed over a large volume of production causing the unit cost of production to decline. Economies of scale may also arise from other indivisibilities such as production facilities, management resources and systems. This happens because a given function, facility or resource is utilized for a larger scale of operation.

1.2.5.2 Operating Economies:

In addition to economies of scale, a combination of two or more firms may result in cost reduction due to operating economies. A combined firm may avoid or reduce overlapping functions and facilities. It can consolidate it's management functions such as manufacturing marketing research and development and reduce operating cost for example a combined firm may eliminate duplicate channels of distribution Or create a centralized training center or introduce an integrated planning and control system.

In a vertical merger, a firm may either combine its suppliers of input and /or with its customers. Search merger facilitates better coordination and administration of the different stages of business operations - purchasing, manufacturing and marketing- eliminates the need for bargaining (with suppliers and/or customers) and minimizes uncertainty of supply of inputs and demand for product and saves cost of communication.

1.2.5.3 Synergy:

Synergy implies a situation where the combined form is more valuable than the sum of the individual combining firms. It is defined as 2 + 2 equal to 5 phenomena. Synergy refers to benefits other than those related to economies of scale. Operating economies are one form of synergy benefits. But apart from operating economies, synergy may also arise from enhanced managerial capabilities, creativity, innovativeness, R&D and market coverage capacity due to the complementarities of resources and skills and a widened horizon of opportunities. Following are the types of synergy

1.2.5.3.1 Operating synergy

Operating synergy or operating economies may be involved in horizontal and vertical mergers. For horizontal mergers the source of operating economies must represent a form of economies of scale. The economies, in turn, may reflect indivisibilities and better utilization of capacity after the merger.

Another area in which operating economies may be achieved is vertical integration. Combining firms at different stages of an industry may achieve more efficient coordination of the different levels. Costs of communication, and various forms of bargaining and opportunistic behaviour can be avoided by vertical integration.

1.2.5.3.2 Financial synergy

The motive of the merger is to capture investment opportunities available in the acquired firm's industry by lowering the costs of capital of the combined firm through the merger and also utilizing lower-cost internal funds of the acquiring firm. The opportunity for utilizing the cash flows of the acquiring firm will be enhanced if the cash flow of the acquired firm is low.

The decrease in bankruptcy probability may decrease the expected value of bankruptcy costs and increase the expected value of tax savings from interest payments for premerger debts, and thus increase the value of the combined firm by lowering its cost of capital.

Internal funds do not involve transaction costs of the flotation process and may have differential tax advantages over external funds.

The acquiring firms may supply lower-cost internal funds to the combined firm. Further, the acquired firms will typically have low free cash flows because high expected demand growth in their industries requires greater investments. The low free cash flows of the acquired firms provide synergistic opportunities in financing.

Economies of scale in floatation and transaction costs of securities are another potential source of financial synergy.

1.2.5.3.3 Managerial synergy

Now imagine a production process employing four factor inputs - generic managerial capabilities, industry-specific managerial capabilities, firm-specific nonmanagerial human capital and capital investment.

The firm-specific non-managerial human capital can only be supplied by a long-term learning effort or by merging with existing firms in the same industry. The industry-specific managerial resources can be obtained by internal learning or by merging with a firm in the same or related industries.

Suppose that a firm, call It B has 'excess capacity' in industry specific resources and that another firm in a related industry, call it T experiences 'shortages' in these resources.

The acquisition of T by B will make the firms realize more balanced factor proportions between industry-specific and firm-specific resources by transferring the excess capacity of B in the industry-specific capabilities to T's operation.

An example of the T-type firm will be an R&D oriented firm lacking marketing organizations andbeing acquired by a B-type firm with strong marketing capabilities in related fields of business.

1.2.5.4 Diversification:

Diversification into new areas and new products can also be a motive of merger and acquisition. A firm operating in South India, if merges with another firm operating in North India, can definitely cover broader economic areas. Moreover, product diversification resulting from merger can also help the new firm fighting the cyclical/seasonal fluctuations.

1.2.5.5 Earnings Per Share (EPS):

Increasing the EPS of the firm can also be a motive for the merger. A firm can increase its EPS by acquiring another firm which is profitable and has a low-Price Earning (PE) ratio.

1.2.5.6 Corporate Control:

Many hostile take-over bids are justified on the basis of existence of a value for corporate control i.e. the investors and firms are willing to pay large premiums over the market price to control the management of other firms. The value of getting control of a firm is inversely proportional to the perceived quality of the existing management and its capacity to maximize the value. In general, the value of control will be much greater for a poorly managed firm that operates at below optimum capacity than for a well-managed firm. The value of controlling a firm comes from changes that can be made to existing policies. These changes cover several areas such as assets can be acquired or disposed of; the financing mix can be changed; the dividend policy can be re-evaluated and the firm can be reconstructed to maximise the value. The value of the control can be calculated as follows:

Value of control= Value of the firm (after reconstruction) – Value of the firm (without reconstruction).

1.2.6 Distinction between mergers and acquisitions:

Although often used synonymously, the terms **merger** and **acquisition** mean slightly different things.

When one company takes over another and clearly establishes itself as the new owner, the purchase is called an a**cquisition**. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded.

In the pure sense of the term, a **merger** happens when two firms agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals". The firms are often of about the same size. Both companies' stocks are surrendered and new company stock is issued in its place. For example, in the 1999 merger of Glaxo Welcome and Smith Kline Beecham, both firms ceased to exist when they merged, and a new company, Glaxo Smith Kline was created.

A purchase deal will also be called a **merger** when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

1.2.7 Largest M&A Deals in India:

i) Tata Steel-Corus, $12.2 billion: On 30th January,2007, Tata Steel purchased a 100% stake in the Corus Group at 608 pence per share in an all cash deal, cumulatively valued at $12.2 billion. The deal is the largest Indian takeover of a foreign company till date and made Tata Steel the world's fifth largest steel group.

ii) Vodaphone-Hutchison Essar, $11.1 billion: On 11th February, 2007, Vodaphone agreed to buy out the controlling interest of 67% held by Li Ka Shing Holdings in Hutch-Essar for $11.1 billion. Vodaphone Essar is owned by Vodaphone 52%, Essar Group 33% and other Indian nationals 15%.

iii) Vodaphone-Idea Merger, $23 billion (2018): One of the significant deals in the Indian telecom sector, the Vodaphone-Idea merger, brought together two prominent telecom companies to form Vodaphone Idea Limited. Valued at approximately $23 billion, the merger aimed to combine the market reach and resources of Vodaphone India and Idea Cellular. This consolidation at the time created a formidable player in the highly competitive Indian telecom market.

iv) Walmart-Flipkart Acquisition (2018): In a landmark move, retail giant Walmart acquired a majority stake in Flipkart, one of India's leading e-commerce companies. With a valuation of $16 billion, the acquisition marked Walmart's entry into Indian market. The deal enabled Walmart to tap into India's e-commerce sector and leverage Flipkart's extensive customer base and supply chain infrastructure.

1.2.8 Impact of M & A on stakeholders:

Acquisitions are generally assumed to be objective, or focused on the numbers. Consistent with this perspective, synergy is the most common justification for acquisition activity. Achieving synergy involves integrating firms to produce a combined performance greater than what they achieved independently. An implicit challenge then is to coordinate the efforts of groups with different interests to realize expected gains. This means that acquisitions quickly go from numbers to considering the impacts on people, as achieving synergy requires clear communication of the implications of an acquisition to impacted groups. As a result, considering and enlisting stakeholders becomes important to achieve success for any acquisition. Accomplishing a stakeholder analysis during acquisition planning can identify and address issues by helping to communicate information to influential groups. Still, gaps between different stakeholder groups are often not addressed in acquisitions, or they are considered too late. The starting point for any stakeholder analysis is identifying different groups and their interests. The perspective of seven stakeholder groups is briefly reviewed as a guide to improving acquisition outcomes.

1.2.8.1 Employees:

The first group to consider relates to the impacted employees, as even the best strategy will fail if it does not consider the people needed to execute it. When employees learn of a merger, they expect and are prepared for dramatic changes. Employees will be hungry for information to cope with the uncertainty created by an acquisition. Employees will look to see that a plan for creating a better organization exists and for signals that people matter, as well as answers to what the acquisition means for them. This means employees will have little tolerance for delays that fail to set a clear direction that communicates their place in a merged firm. An example of something that can help reduce employee anxiety in large companies is an e-mail from the CEO to employees about a merger, so they learn about it from work and not the press. In smaller firms, a face to face meeting would be a better option to share news and implications of an acquisition. Without these steps, a lack of information to employees will only lead to speculation and resulting anxiety that will complicate integration efforts. Employee commitment to a merged firm is lowest following an acquisition announcement and increased employee turnover is a primary suspect in poor acquisition performance. An obvious reason for this is that the first employees to leave are generally the best and brightest. In other words, if an acquirer does not take steps to address the concerns of their employees they will likely find what they bought walked out the door when they were not looking. For example, many employees will get job offers from competitors within five days of an acquisition announcement. Successful acquirers focus on retaining employees, if for no other reason than to avoid the need to recruit old employees back at a higher salary. However, if the employees are not "on board" with the business and communication plan, competitors have a greater ability to frame the discussion with the market.

1.2.8.2 Competitors:

While obvious in hindsight, it is easy to overlook this group. Failing to consider the actions of groups that want to see you fail can hurt your success, and competitive pressures driving the use of an acquisition to meet firm goals do not end once an acquisition is announced. Acquisition announcements are public and clarify what competitors can expect. Often competitors treat the inevitable distraction of combining firms as an opportunity. Not bound by restrictions of regulatory review competitors can immediately plant doubts with customers and employees. For example, quality disruptions frequently occur during acquisitions from downsizing manufacturing capacity and transferring work to facilities with people unfamiliar with the products and processes used to produce them. Meanwhile, employees will also have lower commitment to a new organization. As a result, competitors also actively recruit from the employees and customers of firms involved in a merger when those firms are most valunerable.

1.2.8.3 Customers:

Merging firms often focus on internal issues during integration at the expense of external market issues, and customers of both acquirer and target firms are sometimes overlooked. For example, service disruptions during an acquisition result in two-thirds of merged businesses losing market share. Again, failing to address customer impacts in a communication plan will provide competitors an opportunity to frame customer perceptions on the impact of a merger. A strong emphasis on communicating with customers can reduceuncertainty and lower customer defection, as retaining customers may be more important to acquisition performance than reducing costs. In one example, while a combination of two high technology companies was meant to better serve IBM, uncertainty about implications of the merger led IBM to cut its orders for the firms in half because no one communicated what the acquisition meant to this important customer. Firms that communicate a continued commitment to their customers by considering their perspective during a merger can expect improved success.

1.2.8.4 Advisors:

Completing an acquisition depends on advisors and incorporating an external perspective can enable better acquisition decisions. Additionally, more prestigious advisors can provide important reputation advantages. However, increasing the number of advisors increases the amount of time and money to complete a deal. This becomes an important consideration as the primary advantage of acquisitions involves speed or faster access to needed resources than internal development. Another consideration for public firms and sellers is that advisors may be required to help ensure managers fulfill their fiduciary obligations to shareholders. For example, as part of due diligence following an announcement to purchase Titan Corp for $2.4 billion, Lockheed Martin uncovered improper overseas payments that led to a Justice Department investigation and cancellation of the deal. It is unlikely irregularities, such as this one, could be found without the help of external auditors. Having a team of seasoned advisors can help find and account for negative information that can effect a deal's value.

1.2.8.5 Lenders:

Most acquirers include debt as part of their payment for a target, making lenders an important advisor. While lenders are interested in available collateral and the use of provided funds, they will also be interested in the projections of the merged firm and its ability to pay off the increased debt load. Selection of lenders is an important consideration, as more prestigious underwriters are associated with positive outcomes, such as completing deals faster. Banks may also be interested in marketing other services—a circumstance that can complicate their interests. For example, Barclays Capital recently agreed to pay Del Monte shareholders almost $90 million following conflict of interest surrounding allegations it steered the sale of Del Monte to bidders using it for financing. The desire for advisory fees may bias bank lending decisions, so prudence may drive keeping deal advisors and lenders separate.

1.2.8.6 Vendors:

Acquisitions can also be disruptive to businesses a merged firm depends on. Suppliers of goods and services of merging companies will have a vested interest in their ability to continue to supply a business and in being paid on a timely basis. It is not uncommon for vendors to require updated credit data for merging firms. Still, an acquisition offers the opportunity to consolidate vendors and increase bargaining power. As a result, vendors will want information about continued business. Communication with vendors, especially the key ones, is another critical piece of the overall acquisition communication plan. The last thing an acquiring company wants to learn is that a key vendor is skittish about the transaction and that they may not deliver scheduled product or service! In other words, without vendor support a merged firm can find it difficult to maintain normal operations.

1.2.8.7 Government Regulators:

Firms planning an acquisition generally make filings with government agencies for regulatory approval that is followed by a waiting period that allows regulators to review information to consider labor or anticompetitive implications, and any conditions for completing a deal. For example, plant closings often require advance notice under state and federal law before it can be accomplished. Requirements for regulatory review go beyond the state and nation where firms are headquartered. For example, the European Union required concessions from Intel prior to providing regulatory approval of its McAfee acquisition. Only focusing on U.S. requirements likely hurt approval of the NYSE Euronext and Deutsche Borse merger, as Duncan Niederauer (CEO of NYSE Euronext) commented that he “misjudged the process” and that it was unlikely the merger would happen. While the focus for regulators is satisfying requirements, a more proactive approach goes from anticipating regulatory review to influencing it. However, going beyond providing information to regulators is a higher riskstrategy. For example, AT&T employed a team of 93 lobbyists in Washington D.C. and spent $46 million in campaign contributions to both parties in a failed effort to get its bid for T-Mobile approved. This suggests that an obvious way to strengthen regulatory resistance is to announce a deal as a fait accompli before or during regulatory review. The risk of a deal failing regulatory approval has to be considered and dealt with along with at the start of in the negotiation process.

1.2.8.8 Management at the top:

Impact of mergers and acquisitions on top level management may actually involve a “clash of the egos”. There might be variations in the cultures of the two organizations. Under the new set up the manager may be asked to implement such policies or strategies, which may not be quite approved by him. When such a situation arises, the main focus of the organization gets diverted and executives become busy either settling matters among themselves or moving on. If however, the manager is well equipped with a degree or has sufficient qualification, the migration to another company may not be troublesome at all.

1.2.8.9 Shareholders:

We can further categorize the shareholders into two parts:

1.2.8.9.1 Shareholders of the acquired firm:

The shareholders of the acquired company benefit the most. The reason being, it is seen in majority of the cases that the acquiring company usually pays a little excess than it what should. Unless a man lives in a house he has recently bought, he will not be able to know its drawbacks. So that the shareholders forgo their shares, the company has to offer an amount more than the actual price, which is prevailing in the market. Buying a company at a higher price can actually prove to be beneficial for the local economy.

1.2.8.9.2 Shareholders of the acquiring firm:

They are most affected. If we measure the benefits enjoyed by the shareholders of the acquired company in degrees, the degree to which they were benefited, by the same degree, these shareholders are harmed. This can be attributed to debt load, which accompanies an acquisition.

Strategic decisions need to go beyond the numbers to consider the stakeholders, or any group that is affected by a firm's initiatives. Once identified, planning to balance the interests of different groups can begin. Going "beyond the numbers" to consider the perspectives of different groups can provide a better appreciation of acquisition challenges and enable improved outcomes. The groups outlined here represent important groups, or a place to start, for any firm considering an acquisition.

1.2.9 Accounting for Merger and Acquisitions

Mergers and acquisitions involve complex accounting treatment. A merger, defined as amalgamation in India, involves the absorption of the target company by the acquiring company, which results in the uniting of the interests of the two companies. The merger should be structured as a pooling of interest. In the case of acquisition, where the acquiring company purchases the shares of the target company, the acquisition should be structured as a purchase.

1.2.9.1 The pooling of interest method:

This method is followed in case of an amalgamation in the nature of merger. Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts and in the same form as at the date of amalgamation. The difference between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets on the one hand and the amount of share capital of the transferor company on the other hand is adjusted in reserves.

Note: However, Pooling of Interest method is not included in syllabus, here, we discussed only Purchase method.

1.2.9.2 Purchase Method:

Under the purchase method, the assets and liabilities of the acquiring firm after acquisition of the target firm may be stated at their existing carrying amounts or at the target company. The assets and liabilities after merger are generally revalued under the purchase method.

If the acquirer pays a price greater than the fair market value of assets and liabilities, the excess amount is shown as **goodwill** in the acquiring company's books.

On the contrary, if the fair value of assets and liabilities is less than the purchase price paid, then this difference is recorded as a **capital reserve**.

Let us consider an example:

Firm Q acquires Firm R by assuming all its assets and liabilities. The fair value of fixed assets and current liabilities of Firm R is Rs.26 crore and Rs.7 crore respectively. Current liabilities are valued at book value while the fair value of debt is estimated to be Rs. 15 crore. Firm Q raises cash of Rs. 15 crore to pay to R's shareholders. The balance sheets of the firms before the acquisition are given below.

Balance Sheets

(Rs. in crore)

	Firm R	**Firm Q**
Assets		
Net fixed assets	24	37
Current assets	08	13
Total	**32**	**50**
Liabilities		
Shareholders fund	10	18

Borrowings	16	20
Current liabilities	06	12
Total	**32**	**50**

Solution:

Goodwill = Payment to Target firm – Fair value of net assets of target firm

Calculation of fair value of net assets of target firm:

(Rs. in crore)

Fair value of fixed assets	26
Fair value of current assets	7
Total (A)	**33**
Less: Fair value of borrowings	15
Fair value of current liabilities	6
Total (B)	**21**
∴ **Fair value of net assets (A-B)**	**12**

∴ **Goodwill = 15-12 = 3**

Balance – Sheet in the books of Q (after acquisition)

(Rs. in crore)

Assets:	
Net fixed assets (37 + 26)	63
Current assets (13+ 7)	20
Goodwill (as per calculation)	03
Total	**86**
Liabilities:	
Shareholders fund (18+15)	33
Borrowings (20+15)	35
Current liabilities (12+6)	18
Total	**86**

1.2.9.2.1 Methods of Consideration:

- **Lump-sum Method:**

It is the simplest method. In it, the consideration is stated as a lump-sum. For example, it may be stated that P Ltd. takes over the business of S Ltd. for Rs.50,00,000. Here, the sum of Rs.50,00,000 is the consideration.

- **Net Assets Method:**

Under this method, the consideration is arrived at by adding the agreed values of all the assets taken over by the transferee company and deducting there from the agreed values of the liabilities taken over by the transferee company. The agreed value means the amount at which the transferor company has agreed to sell and the transferee company has agreed to take over a particular asset or a liability.

- **Net Payment Method:**

Under this method, consideration is ascertained by adding up the cash paid, agreed value of assets given and the agreed values of the securities allotted by the transferee company to the transferor company in discharge of consideration. Suppose P Ltd. for business taken over from S Ltd. agrees to pay Rs.5,00,000 in cash and allot to S Ltd. 4,00,000 equity shares of Rs.10 each fully paid at an agreed value of Rs.15 per share. In this case, the consideration will be Rs. 65,00,000 (5,00,000 + 60,00,000).

- **Intrinsic Worth/value Method:**

Consideration may have to be calculated on the basis of the agreed value of shares of the transferor company. That consideration amount will be discharged through allotting shares of transferee company to the transferor company. Suppose P. Ltd. takes over the business of S Ltd. and it is agreed between S Ltd. and P Ltd. that the value of one share of S Ltd. is Rs.13(paid up value is Rs.10 per share for 60,000 shares). Then, the consideration is Rs.13*60,000=Rs.78,00,000. This amount will be discharged through allotting shares of P Ltd. to S Ltd. One share value of P Ltd. is Rs.25 (paid up value is Rs.10 per share). So, P. Ltd. will allot Rs.78,00,000/25=3,12,000 shares to S Ltd. This is called intrinsic worth/value method.

1.2.10 Journal entries in the books of Transferor/ Acquirer/ Purchaser company.

1. For transferring the assets to the Realization Account:

Realisation A/C------------Dr.

To Various Assets (individually) A/C

Note: All the assets except bank and cash balances should be transferred to the Realisation A/C at book value irrespective of whether the transferee company has taken over the assets or not. Cash and Bank balances should be transferred only if they are taken over by the transferee company. Profit and Loss A/C (Dr. balance) and expenses not written off are not transferred to the Realisation A/C. If there is a provision against an asset, such an asset is transferred to the Realisation A/C at gross figure. The related provision is transferred to the realization by means of separate entry.

2. Transfer of all liabilities taken over by the transferee company to the Realisation A/C at book figure:

Sundry Creditors A/C -------------------------Dr.

Bills Payable A/C------------------------------.Dr.

To Realisation A/C

Note: In case of any fund or reserve only that portion of the fund or reserve which denotes liability should be transferred to the realization a/c i.e. workmen compensation fund etc.

3. For the purchase consideration:

Transferee Co., A/C --------------------------Dr.

To Realisation A/C

4. For the discharge of purchase consideration.

Bank A/C--------------------------- Dr.

Equity Sh. in purchasing Co. A/C Dr.

Debentures in purchasing Co. A/C Dr.

To Transferee Company A/C

5. If any asst is not taken over by the transferee company and otherwise disposed off.

Bank A/C -----------------------------Dr.

To Realisation A/C

6. Expenses of realization should be dealt with according to the circumstances of each case.

- If the transferor company bears the expenses:

Realisation A/C ------------------------Dr.

To Cash A/C

i) If the expenses are to be borne by transferee company:

No entry in the books of transferor company.

ii) If the expenses of liquidation are paid by the transferor company first and reimbursed by the transferee company later:

Entries will be:

a. Transferee Co., A/C ------------Dr.

To Cash A/C

b. Cash A/C -------------------------Dr.

To Transferor Co., A/C

iii) **If purchasing company included the amount of expenses in the purchase consideration:**

On payment of expenses by the transferor company

a. Realisation A/C ------------------- Dr.

To Bank A/C

(with the amount of expenses)

b. Transferee Co., A/C --------------Dr.

To Realisation A/C

(with the amount of expenses recoverable)

7. For the discharge of liabilities not taken over by the transferee company.

Liabilities A/C ------------Dr.

To Bank A/C

The difference, if any, between the book value by the amount paid should be transferred to the realization account.

8. For transfer of Preference share capital to the preference shareholders:

a. If the preference shareholders are paid more than the credit balance of preference share capital. Entry will be:

Preference Share Capital a/c ----------Dr.

Realisation a/c ------------------ Dr. (with the excess amount payable if any)

To Preference Shareholders a/c (total amount payable)

b. If the preference shareholders have agreed to accept less than the credit balance of preference share capital. Entry will be:

Preference share capital a/c -----------Dr.

To Preference Shareholders a/c

To Realisation a/c

9. For transfer of Equity share capital:

Equity share capital a/c/ --------------- Dr.

To Equity shareholders a/c

10. Transfer of accumulated profits and reserves to the equity shareholders account:

Capital reserve a/c-----------------------Dr.

General reserve a/c----------------------Dr.

Share premium a/c-----------------------Dr.

Profit & Loss (Cr.) a/c------------------ Dr.

To Equity shareholders a/c

11. For transfer of items under the heading miscellaneous expenditure:

Equity shareholders a/c------------------Dr.

To Preliminary expenses a/c

To Profit & Loss (Dr.) a/c

To Discount on issue of shares a/c

To Underwriting commission a/c

12. For transfer of Profit or Loss from the realization account:

a. If realization account shows profit:

Realisation a/c ---------------------------------Dr.

To Equity shareholder's account

b. If realization account shows loss:

Equity shareholder's account-----------------Dr.

To Realisation a/c

13. For the balance payable to equity shareholders:

Equity shareholders a/c----------------------------Dr.

To Bank a/c

1.2.11 Journal entries in the books of Transferee/ Acquiring/ Purchasing company.

1. Business purchase a/c -------------------------Dr.

   To Liquidators of transferors Co., a/c

2. Assets taken (excluding Goodwill) a/c ---Dr. (with agreed values)

   *Goodwill a/c ------------------------------ Dr. (Balancing figure)

   To Liabilities taken over a/c (with agreed values)

   To Business purchase a/c (Purchase consideration)

   *To Capital Reserve a/c (Balancing figure)

*If in the above-mentioned entry, the total credits exceed the total debits, such an excess is treated as Goodwill. On the other hand, if the total debits exceed the total credits such an excess is treated as capital reserve.

3. To record the Statutory Reserve of the transferor company:

   Amalgamation Adjustment a/c---------------Dr.

   To Statutory Reserve a/c

4. For discharge of Purchase Consideration:

   Liquidator of Transferor Co. a/c--------------Dr.

   To Bank a/c

   To Equity Share Capital a/c

   To Preference Share Capital a/c

   To Debentures a/c

Note: If the allotment of shares is made at premium, the amount of premium should be credited. On the other hand, if the shares and debentures are issued at discount, the discount on issue of shares or debentures should be debited.

5. If the transferee company bears the expenses of liquidation of the transferor company:

   Goodwill or Capital reserve a/c ---------------Dr.

   To Bank a/c

1.2.12 Graded illustrations:

Illustration 1.

On 31st March, 2023 the Balance Sheet of A Ltd. stood as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital (70000 eq. sh. of Rs.10 each fully paid-up)	7,00,000	Plant & Machinery	5,00,000
General Reserve	3,30,000	Furniture & Fixtures	40,000
P&L Account	80,000	Stock	4,50,000

Creditors	1,60,000	Debtors	1,00,000
		Cash at bank	1,80,000
Total	**12,70,000**	**Total**	**12,70,000**

On this date, A Ltd. took over the business of B Ltd. for Rs.5,00,000 payable in the form of its equity shares of Rs.10 each at par, the balance sheet of B Ltd. being as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital (60,000 eq. sh. of Rs.10 each fully paid-up)	6,00,000	Furniture & Fittings	60,000
Creditors	1,00,000	Stock	4,00,000
		Debtors	1,00,000
		Cash at bank	40,000
		P&L a/c	1,00,000
Total	**7,00,000**	**Total**	**7,00,000**

You are required to:

i. Pass journal entries and prepare important ledger accounts in the books of B Ltd.

ii. Show journal entries for the purchase of business in the books of A Ltd. and draw A Ltd's Balance Sheet after takeover.

Solution:

Journal entries in the books of B Ltd.

Date	Particulars	L/F	Debit (Rs.)	Credit (Rs.)
2023 March, 31	Realisation a/c -------------------------Dr		6,00,000	
	To Furniture & fittings a/c			60,000
	To Stock a/c			4,00,000
	To Debtors a/c			1,00,000
	To Cash & Bank a/c			40,000
	(Transfer of all the assets to realization a/c)			

31	Creditors a/c ----------------------------Dr. To Realisation a/c (Transfer of creditors to realization a/c)		1,00,000	1,00,000
31	A Ltd. a/c -------------------------------Dr. To Realisation a/c (Amount of Purchase consideration receivable from A Ltd.)		5,00,000	5,00,000
31	Shares in A Ltd. a/c--------------------Dr. To A Ltd. a/c (for allotment of equity shares in discharge of PC)		5,00,000	5,00,000
31	Equity share capital a/c ---------------Dr. To Equity shareholders a/c (Transfer of eq. sh. capital to eq. shareholders a/c)		6,00,000	6,00,000
31	Eq. Shareholders a/c ------------------Dr. To Profit & Loss a/c (Transfer of debit balance of P&L a/c to Equity shareholders)		1,00,000	1,00,000
31	Eq. shareholders a/c -------------------Dr. To Shares in A Ltd. a/c (Shares in A Ltd. allotted to equity shareholders)		5,00,000	5,00,000

Ledger accounts in the books of B Ltd.

Dr. **Realisation Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Furniture & Fittings	60,000	By Creditors	1,00,000
To Stock	4,00,000	By A Ltd	5,00,000
To Debtors	1,00,000		
To Cash & Bank	40,000		
Total	**6,00,000**	**Total**	**6,00,000**

Dr. **Equity Shareholders Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Profit & Loss a/c To Shares in A Ltd.	1,00,000 5,00,000	By Equity Share Capital	6,00,000
Total	**6,00,000**	**Total**	**6,00,000**

Dr. **A Ltd. Co. Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Realisation a/c	5,00,000	By Shares in A Ltd.	5,00,000
Total	**5,00,000**	**Total**	**5,00,000**

Dr. **Shares in A Ltd Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To A Ltd.	5,00,000	By Equity shareholders a/c	5,00,000
Total	**5,00,000**	**Total**	**5,00,000**

Journal entries in the books of A Ltd.

Date	Particulars	L/F	Debit (Rs.)	Credit (Rs.)
2023 March, 31	Business Purchase a/c-------------------Dr. To Liquidators of B Ltd. (Consideration payable to B Ltd.)		5,00,000	 5,00,000
31	Furniture & fittings a/c Stock a/c Debtors a/c Cash & Bank a/c To Creditors a/c To Business purchase a/c (For the assets and liabilities taken over)		60,000 4,00,000 1,00,000 40,000	 1,00,000 5,00,000

31	Liquidators of B Ltd a/c To Eq. Sh. Capital a/c (Allotment of equity shares to liquidators of B Ltd.)		5,00,000	5,00,000

Balance Sheet of A Ltd.
as on 31st March, 2023

Liabilities	Rs.	Assets	Rs.
Share Capital (120000 eq. sh. of Rs.10 each fully paid-up)	12,00,000	Plant & machinery Furniture & Fittings	5,00,000 1,00,000
General reserve	3,30,000	Stock	8,50,000
Profit & Loss a/c	80,000	Debtors	2,00,000
		Cash at bank	2,20,000
Creditors	2,60,000		
Total	**18,70,00,00**	**Total**	**18,70,00,00**

Illustration 2.

The following is the Balance Sheet of V Ltd. as on 31st March, 2023

Liabilities	Rs.	Assets	Rs.
Eq. Share Capital	10,00,000	Goodwill	2,00,000
General Reserve	1,00,000	Land & Buildings	2,00,000
Workmen's accident compensation reserve	60,000	Plant & Machinery	4,50,000
Profit & Loss a/c	60,000	Patent & Trademarks	20,000
Sundry Creditors	1,60,000	Stock	2,00,000
		Sundry Debtors 180000 Less: R.D.D. 12000	1,68,000
		Cash at bank	1,22,000
		Preliminary Exps.	20,000
Total	**13,80,000**	**Total**	**13,80,000**

The company is acquired by D Ltd. which pays Rs.1500000 in all. Rs.1200000 fully paid shares of Rs.10 each and balance in cash. There was a contingent liability under the Workmen's Compensation Act. The claim was not taken over, D Ltd. and V Ltd. had to pay ultimately a sum of Rs. 20000 against the claim. The Balance Sheet of D Ltd. on 31st March, 2023 is as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital: 200000 eq. sh. of Rs.10 each	20,00,000	Goodwill	2,00,000
General Reserve	2,00,000	Land & Buildings	6,00,000
Profit & Loss a/c	1,00,000	Plant & Machinery	8,00,000
13% Debentures	3,50,000	Sundry Debtors	3,00,000
Sundry Creditors	2,00,000	Stock	5,00,000
		Cash at bank	4,50,000
Total	**28,50,000**	**Total**	**28,50,000**

The expenses of liquidation of V Ltd. came to Rs.10000.

a. Show the important ledger accounts in the books of V Ltd.

b. Journal entries in the books of D Ltd. and redraft D's Balance Sheet after the absorption is completed.

Solution:

In the books of V Ltd.

Dr. **Realisation Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Goodwill	200000	By Sundry Creditors	160000
To Land & Building	200000	By RDD	12000
To Plant & Machinery	450000	By D Ltd	1500000
To Patent & Trademark	20000		
To Stock	200000		
To Sundry Debtors	180000		
To Cash & Bank	122000		
To Bank (expenses)	10000		

To Equity Shareholders	290000		
Total	**1672000**	**Total**	**16,72,000**

Dr. **A Ltd. Co. Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Realisation a/c	15,00,000	By Shares in V Ltd. By Bank a/c	12,00,000 3,00,000
Total	**15,00,000**	**Total**	**15,00,000**

Dr. **Bank Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To balance b/d	1,22,000	By Realisation a/c	1,22,000
To D Ltd.	3,00,000	By Realisation a/c	10,000
		By Workmen's Accident Compensation Reserve	20,000
		By Equity shareholders a/c	2,70,000
Total	**4,22,000**	**Total**	**4,22,000**

Dr. **Equity Shareholders Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Preliminary Expenses a/c	20,000	By Eq. Share Capital By General Reserve	10,00,000 1,00,000
To Equity Shares in D Ltd	12,00,000	By Workmen's Accident Compensation Reserve	40,000
To Bank a/c	2,70,000	By Profit & Loss a/c Realisation a/c	60,000 2,90,000
Total	**14,90,000**	**Total**	**14,90,000**

In the books of D Ltd.

Date	Particulars	L/F	Debit (Rs.)	Credit (Rs.)
2023 March, 31	Business Purchase a/c----------------Dr. To Liquidators of V Ltd. (Consideration payable to V Ltd.)		15,00,000	 15,00,000
31	Land & Building a/c……………Dr. Plant & Machinery a/c………….Dr. Patent & Trademark a/c………...Dr. Stock a/c………………………..Dr. Sundry Debtors a/c……………..Dr. Bank a/c………………………...Dr. Goodwill a/c……………………Dr. To Sundry Creditors a/c To R.D.D. a/c To Business purchase a/c (For the assets and liabilities taken over)		2,00,000 4,50,000 20,000 2,00,000 1,80,000 1,22,000 5,00,000	 1,60,000 12,000 15,00,000
31	Liquidators of V Ltd a/c To Eq. Sh. Capital a/c To Bank a/c (Allotment of equity shares and payment of cash in satisfaction of the P.C.)		15,00,000	 12,00,000 3,00,000

Balance Sheet of D Ltd.

as on 31st March, 2023

Liabilities	Rs.	Assets	Rs.
Share Capital (320000 eq. sh. of Rs.10 each fully paid-up)	32,00,000	Goodwill Land & Building Plant & Machinery	7,00,000 8,00,000 12,50,000

		Patent & Trademark	20,000
General reserve	2,00,000	Stock	7,00,000
Profit & Loss a/c	1,00,000	Debtors 4,80,000 Less RDD 12,000	4,68,000
13% Debentures	3,50,000	Cash at bank	2,72,000
Creditors	3,60,000		
Total	**42,10,000**	**Total**	**42,10,000**

Illustration 3. (Calculation of purchase consideration at intrinsic value of shares)

The following are the Balance Sheets of A Ltd. and B Ltd. as on 31st March, 2023.

Liabilities	A Ltd (Rs.)	B Ltd (Rs.)	Assets	A Ltd (Rs.)	B Ltd (Rs.)
Share Capital: 5000 Sh. @ Rs.100 each	5,00,000	--	Goodwill Other fixed assets	20,000 8,30,000	-- 16,00,000
80000 sh. @ Rs 10 each		8,00,000	Investments	1,70,000	--
Capital Reserve	1,00,000	--	Current Assets	6,90,000	16,80,000
General Reserve	3,60,000	10,00,000			
Secured Loans	--	4,00,000			
Unsecured Loans	2,20,000	--			
creditors	4,20,000	4,60,000			
Provision for tax	1,10,000	5,20,000			
Proposed dividend	--	1,00,000			
Total	**17,10,000**	**32,80,000**	**Total**	**17,10,000**	**32,80,000**

A Ltd. was absorbed by B Ltd. with effect from 31st March, 2023.

For the purpose of absorption, the Goodwill of A Ltd. was considered valueless. A Ltd. had arrears of depreciation amounting to Rs.40000.

The shareholders of A Ltd. are allotted, in full satisfaction of their claims, shares in B Ltd. in the same proportion as the respective intrinsic value of the shares of the two companies bear to each other.

Close the books of A Ltd. by preparing the necessary ledger accounts and pass journal entries in the books of B Ltd. regarding absorption of ALtd's business.

Solution:

Calculation of intrinsic value per share:

Particulars	A Ltd.		B Ltd.	
Fixed Assets	7,90,000		16,00,000	
Investment	1,70,000		--	
Current Assets	6,90,000		16,80,000	
Total A		16,50,000		32,80,000
Less Liabilities:				
Secured loans	--		4,00,000	
Unsecured loans	2,20,000		--	
creditors	4,20,000		4,60,000	
Provision for tax	1,10,000		5,20,000	
Proposed dividend	--		1,00,000	
Total B		7,50,000		14,80,000
Intrinsic value (A-B)		9,00,000		18,00,000
Value per share =	9,00,000/5,000 = Rs.180		18,00,000/80,000 =Rs.22.5	

Ledger accounts in the books of A Ltd.

Dr. **Realisation Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Goodwill	20,000	By Sundry Creditors	4,20,000
To Other fixed assets	8,30,000	By Unsecured Loans	2,20,000
To Investments	1,70,000	By Provision for tax	1,10,000
To Current assets	6,90,000	By B Ltd. (PC)	9,00,000
		By Eq. Shareholders a/c	60,000
Total	**17,10,000**	**Total**	**17,10,000**

Dr. **B Ltd. Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Realisation a/c	9,00,000	By Shares in B Ltd.	9,00,000
Total	**9,00,000**	**Total**	**9,00,000**

Dr. **Shares in B Ltd. Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To B Ltd.	9,00,000	By Eq. shareholders a/c	9,00,000
Total	**9,00,000**	**Total**	**9,00,000**

Dr. **Eq. shareholders Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Realisation a/c (Loss)	60,000	By Share capital a/c	5,00,000
To Shares in B Ltd.	9,00,000	By Capital Reserve a/c	1,00,000
		By General Reserve a/c	3,60,000
Total	**9,60,000**	**Total**	**9,60,000**

Journal Entries in the Books of B.Ltd.

Date	Particulars	L/F	Debit (Rs.)	Credit (Rs.)
2023 March, 31	Business Purchase a/c----------------Dr. To Liquidators of A Ltd. (Consideration payable to A Ltd.)		9,00,000	 9,00,000
31	Fixed Assets a/c………………...Dr. Investments a/c…………………Dr. Current Assets a/c………………Dr. To Sundry Creditors a/c To Unsecured loan a/c To Provision for tax a/c To Business purchase a/c (For the assets and liabilities taken over)		7,90,000 1,70,000 6,90,000	 4,20,000 2,20,000 1,10,000 9,00,000
31	Liquidators of A Ltd a/c…………..Dr. To Eq. Sh. Capital a/c To Share Premium a/c (Allotment of 40000 equity shares of Rs.10 each at a premium of Rs.12.50 per share in discharge of P.C.)		9,00,000	 4,00,000 5,00,000

1.2.13 Check your progress:

A) Choose the correct alternatives from the following.

1. A firm can acquire target firm by…………

   a) Purchasing assets of Target

   b) Purchasing shares of Target

   c) Purchasing assets or shares of Target

   d) Purchasing Liabilities of target.

2. ABC Ltd. acquires substantial number of equity shares in XYZ Ltd. It is a

case of :

a) Merger b) Acquisition c) Amalgamation d) Absorption

3. Merger of two companies under BIFR supervision is known as:

a) Reverse Merger b) Negotiated Merger

c) Offer for Sale d) Arranged Merger

4. PQR Ltd. is a profit-making company. It is absorbed into another group company XYZ Ltd. which is a loss company. This is a case of:

a) Hostile takeover bid b) Horizontal Merger

c) Reverse Merger d) Takeover

5. An acquirer offers to buy shares directly from the shareholders is known as:

a) Poison Rell b) White Knight c) Tender offer d) Takeover

B) Fill in the blanks.

1. Merger through ---------------- is a combination of two or more companies into an existing company.
2. ---------------- implies acquisition of controlling interest in a company by another company.
3. ----------------merger is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system.
4. ---------------- implies a situation where the combined form is more valuable than the sum of the individual combining firms.
5. When one company takes over another and clearly establishes itself as the new owner, the purchase is called an ----------------.

1.3 Summary:

Corporate restructuring attained through mergers, tender offers, joint ventures, divestitures and spin-offs.

Mergers could be of four types - Horizontal Mergers, Vertical Mergers, Conglomerate Mergers and Congeneric Merger. Horizontal mergers are associated with providing economies of scale. Vertical mergers achieve cost efficiencies by internalizing transactions. Financial conglomerates improve the resource allocation in the combined firm whereas the managerial and concentric conglomerates show potentials for synergy and transfer of managerial capabilities.

1.4 Terms to Remember:

i) **Merger:** A merger is said to occur when two or more companies combine into one company. One or more companies may merge with an existing company or they may merge to form a new company. In a merger, there is a complete amalgamation of the assets and liabilities as well as shareholders' interests and businesses of the merging companies. There is yet another mode of merger. Here one company may purchase another company without continuing the business of the acquired company.

ii) **Acquisition:** Acquisition may be defined as an act of acquiring effective control over assets or management of a company by another company without any combination of businesses or companies.

iii) **Horizontal merger:** This is a combination of two or more firms in a similar type of production, distribution or area of business. Both acquiring and the target company belong to same industry. Main purpose is to obtain economies of scale in production by eliminating duplication of facilities and operations.

iv) **Vertical merger:** It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities.

v) **Conglomerate merger:** It is a merger of two or more firms operating in different and unrelated industries. It is an expansion of a company into areas unrelated to existing lines of business. In this case, the company may not get the operating economies. In fact, the conglomerate merger results in portfolio of lines of business.

1.4 Answers to Check your progress:

A) 1=b, 2=b, 3=d, 4=c, 5=c

B) 1= absorption, 2= Takeover, 3= Vertical, 4= Synergy, 5= acquisition

1.5 Exercise:

i) What is a merger? Is it the same as amalgamation?

ii) Define horizontal, vertical and conglomerate merger.

iii) What is the difference between takeover and acquisition?

iv) How does M&A enhance profitability?

v) Explain the motives and benefits of mergers and acquisitions.

1.7 Reference for further study:

i) Pandey I.M. (2023); “Financial Management”, Pearson India Education Services Pvt. Ltd., Noida

ii) Rustagi R.P.(2011); “Financial Management’, Taxmann Publications Pvt. Ltd., New Delhi.

iii) Bhalla V.K. (2022); “Financial Management”. S.Chand & Company Ltd. New Delhi.

iv) ICFAI Material (2012); “Mergers & Acquisitions”, The Icfai University Press, Hydrabad.

v) Chandra Prasanna (2011); “Financial Management”, Tata McGraw Hill Education Private Ltd. New Delhi.

❑❑❑

Unit-2

Accounting of Cooperative Societies

INDEX:

2.0 Objectives

After studying this unit you will be able to:

1. Understand the accounting process of cooperative societies
2. Know the list of books of accounts maintained by cooperative societies
3. Understand the components of financial statements of cooperative societies
4. Prepare financial statements of cooperative societies

5. Understand the difference between accounting of credit cooperatives, processing cooperatives and consumer cooperatives etc.

2.1 Introduction

The cooperative movement has played catalytic role in the economic development of the country. AMUL, Warana, Pravara etc. are very good examples of cooperative development in India. There is three tier system of cooperative sector is in existence. The financial performance of cooperatives is critical issue when the growth and sustainability of business organization in the form of cooperatives are concerned. A society which has proclaimed as its objective the promotions of economic interests of its members in accordance with cooperative principles or a society formed with the object of facilitating the functioning of such a society may be registered under the appropriate Act. The Cooperative Credit Societies Act. 1904 was the first act regarding cooperative societies enacted such act in India. Now cooperative movement is not only confined to supply of credit but extended to all sorts of economic activities. To promote the economic interests of the members of the societies or of public in general, each of the state has enacted its own cooperative societies Act.

Accounting for cooperative societies includes the recording the transactions and presenting the financial performance in the form of financial statements at the end of accounting year.

2.2 Presentation of Subject Matter

Before going to understand the accounting of cooperative societies, we have to be familiar with cooperative principles with which they are expected to be operated. This chapter intends inculcate familiarity with knowledge and skill of preparing main financial statements of cooperative organizations i.e. -

(i) Trading Account

(ii) Profit and Loss Account

(iii) Profit and Loss Appropriation Account

(iv) Balance Sheet.

2.2.1 Cooperative Principles:

The cooperative organizations are based on the cooperative principles. Cooperatives around the world generally operate according to the same core principles and values, adopted by the International Co-operative Alliance in 1995. Cooperatives trace the roots of these principles to the first modern cooperative founded in Rochdale, England in 1844.

1) **Voluntary and Open Membership:** Co-operatives are voluntary organizations, open to all people able to use its services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2) **Democratic Member Control:** Co-operatives are democratic organizations controlled by their members- those who buy the goods or use the services of the cooperative-who actively participate in setting policies and making decisions.

3) **Members' Economic Participation:** Members contribute equally to, and democratically control, the capital of the cooperative. This benefits members in proportion to the business they conduct with the cooperative rather than on the capital invested.

4) **Autonomy and Independence:** Co-operatives are autonomous, self-help organizations controlled by their members. If the co-operative enters into agreements with other organization so raises capital from external sources, it is done so based on terms that ensure democratic control by the members and maintains the cooperative's autonomy.

5) **Education, Training and Information:** Co-operatives provide education and training for members, elected representatives, managers and employees so they can contribute effectively to the development of their cooperative. Members also inform the general public about the nature and benefits of cooperatives.

6) **Co-operation among Cooperatives:** Co-operatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

7) **Concern for Community:** While focusing on member needs, cooperatives work for the sustainable development of communities through policies and programs accepted by the members.

2.2.2 Types of Cooperative Societies:

The co-operative societies have different nomenclatures which are defined in The Maharashtra Co-Operative Societies Act 1960 as mentioned below:

1) **Agricultural Marketing Society:** It means a society- (a) the object of which is the marketing of agricultural produce and the supply of implements and other requisites for agricultural production, and (b) not less than three-fourth so the members of which are agriculturists, or societies formed by agriculturists.

2) **Consumer's Society:** It means a society the object of which is- (a) the procurement, production or processing, and distribution of goods to, or the performance of other services for, its members as also other customers and (b) the distribution among its members and customers, in the proportion prescribed by rules or by the bylaws of the society, of the profits accruing from such procurement, production or processing, and distribution.

3) **Co-operative Bank:** It means a society, which is doing the business of banking as defined in clause (b) of sub-section (1) of section 5 of the Banking Companies Act, 1949 and includes any society which is functioning or is to function as [an Agriculture and Rural Development Bank] under Chapter XI of the Act.

4) **Housing Society:** It means a society, the object, of which is, to provide its members with open plots for housing, dwelling houses or flats; or if open plots, the dwelling houses or flats are already acquired, to provide its members common amenities and services.

5) **Lift Irrigation Society:** It means a society the object of which is to provide water supply: by motive power or otherwise to its members, for irrigation and otherwise.

6) **Processing Society:** It means a society the object of which is the processing of goods.

7) **Producers' Society:** It means a society the object of which is the production and disposal of goods or the collective disposal of the labour of the members thereof.

8) **Resource Society:** It means a society the object of which is the obtaining for its members of credit, goods or services required by them.

Check your progress-1

(A) Choose the most appropriate alternative:

1. …………was the first act regarding cooperative societies enacted such act in India.

   (a) The Maharashtra Cooperative Societies Act 1960

   (b) The Cooperative Credit Societies Act 1904

   (c) The Companies Act 1956

   (d) The Cooperative Societies Act 1890

2. ………………….. are cooperative principles.

   1) Voluntary and Open Membership, 2) Democratic Member Control, 3) Members' Economic Participation 4) Autonomy and Independence and 5) Capital investment

   (a) 1, 2, 3 and 4 only

   (b) all 1, 2, 3, 4 and 5

   (c) 1 and 2 only

   (d) 1, 2 and 3 only

(B) State whether the following statement is 'true' or 'false':

1. The Maharashtra Co-Operative Societies Act 1960 describes Agricultural Marketing Society as one of the cooperative societies.
2. Processing society is not one of the cooperative societies as per The Maharashtra Co-Operative Societies Act.
3. Cooperative society may be Lift Irrigation Society.

2.2.3 Preparation of Financial Statements:

At the end of the year, as any business unit want to know its financial performance in the form of financial result for the year (profit or loss) and financial position on the date (assets and liabilities), they have to prepare financial statements for this purpose. On the last date of the year i. e. 31st March, a cooperative society has to prepare Profit and Loss Account in prescribed forms. However, the Registrar of Cooperative Societies may allow a certain society or a class of societies to adopt such other form as he may deem fit. The financial statements are to be placed before the members in their Annual General Meeting for their approval.

2.2.3.1 Trading Account: In case of marketing societies, consumers' societies and other societies undertaking trading activities, a separate Trading Account is prepared and the gross profit shown by this account is transferred to Profit and Loss Account as usual.

Trading Account

Last Year's Figures	Particulars	Current Year's Figures	Last Year's Figures	Particulars	Current Year's Figures
	To Opening Stock			By Sales	
	To Purchase			By Other incomes relating to goods	
	To Cost of Purchases			By Closing Stock	
	To Other trading expenses			By Gross Loss (if any)	
	To Gross Profit				
	Total			Total	

2.2.3.2 Profit and Loss Account: Profit and Loss Account of cooperative society is prepared in the prescribed form as given below:

Profit and Loss Account

Dr. **Cr.**

Last Year's Figures	Particulars	Current Year's Figures	Last Year's Figures	Particulars	Current Year's Figures
1)	Interest		1)	Interest received	
	(a) Paid (b) Payable			(a) On loans & advances (b) On investments	
2)	Bank Charges		2)	Dividend received	

3)	Salaries & Allowances of staff
4)	Contribution to Staff Provident Fund
5)	Salary and Allowances of Managing Director
6)	Attendance Fees and Travelling expenses of Directors and Committee Members
7)	Travelling Expenses
8)	Rent, Rates & Taxes
9)	Postage, Telegram and Telephone charges
10)	Printing & Stationary
11)	Audit Fees
12)	General Expenses
13)	Bad debts written off or provision made for bad debts
14)	Depreciation
15)	Land Income

	on shares	
3)	Commission	
4)	Miscellaneous Income (a) Share Transfer Fees (b) Rent (c) Rebate in Interest (d) Sale of forms (e) Other items	
5)	Land Income & Expenditure Account	
6)	Gross Profit from Trading Account (if there is Trading Account)	

	Account				
16)	Other item				
17)	Net Profit				
	Total		Total		

2.2.3.3 Balance Sheet: Balance Sheet of co-operative societies is being prepared in the following format:

Balance Sheet

Last Year's Figures	Particulars	Current Year's Figures	Last Year's Figures	Particulars	Current Year's Figures
	1. Share Capital: Less : Calls in arrears Add : Calls in advances (1-(A) Subscriptions towards shares)			**1. Cash & Bank Balance:** Cash on hand Cash in hand Current Account Saving Account Call Deposits on Banks	
	2. Reserve Fund and Other Funds: (a) Statutory Reserve Fund (b) Building Fund (c) Special Development Fund (d) Bad & Doubtful Debts Reserve (e) Investment Fluctuation Fund (f) Dividend Equalization Fund			**2. Investments** (a) Govt. Securities (b) Other Trustee Securities (c) Non-trustee Securities (d) Shares of other Co-op. Societies	

	(g) Bonus Equalization Fund (h) Reserve for Overdue Interest (i) Other Funds			(e) Shares, Debentures or Bonds of Companies (f) Fixed deposits with Central Banks and other approved bankers	
	3. Staff Provident Funds:			**3. Investment of Staff Provident Fund:** Advances against staff provident fund	
	4. Secured Loans: (a) Debentures (b) Loans Overdrafts and cash credit from banks (c) Loans from Government (d) Other secured loan			**4. Loans & Advances:** (a) Loans (b) Overdrafts (c) Cash Credits (i) against Pledge of goods (ii) against hypothecation of gods (iii) clean (of which overdraft Rs.) (iv) Loan Due by managing Committee member Rs... Loans due by Secretary and other employees Rs.)	
	5. Unsecured Loans: (a) Loans, Cash credit & overdrafts from (b) From Government (c) From others (d) Bills Payable				
	6. Deposits: (a) Fixed Deposits (b) Recurring Deposits (c) Thrift or Savings Deposits			**5. Sundry Debtors:** (a) Credit Sales	

	(d) Current Deposits (e) Deposits at Call (f) Other Deposits (g) Credit balance in cash credit and overdraft accounts			(b) Advances (c) Others	
	7. Current Liabilities and Provisions: (a) Sundry Creditors (b) Outstanding Creditors			**6. Current Assets** (a) Stores & Spares (b) Loose Tools (c) Stock in trade (d) Work in Progress	
	(i) for purchases			**7. Fixed Assets:**	
	(ii) for expanses			(a) Land &Building	
	(c) Advances, recovered for the portion for which value has still to be given, viz. Unexpired, Subscription, premiums, Commission etc.			(b) Leaseholds (c) Plant and Machinery (d) Dead Stock (e) Furniture & Fittings (f) Live Stock (g) Vehicles etc.	
	8. Unpaid Dividends:			**8. Miscellaneous Expenses & Loans**	
	9. Interest accrued due but not paid			1. Goodwill	
	10. Other Liabilities			2. Preliminary Expenses	
	11. Profit and Loss Account			3. Shares / Debentures	

	Profit for last year Less: Appropriation Add: Current profit (Contingent Liabilities)			issue expenses, including brokerage, Underwriting Commission etc. **4.** Deferred Revenue Expenditure	
				9. Other Items: (a) Prepaid expenses (b) Interest accrued (c) other items	
				10. Profit and Loss Account Accumulated Losses not written off	
				11. Current Losses	
	Total		**Total**		

(i) Asset Side:

1. **Investments:** Nature and mode of valuation should be stated. If book value of any security is less than its market value, a remark to that effect be made
2. **Investment of Staff P.F.:** Quoted and Unquoted securities should be shown separately.
3. **Loan &Advances:** In case of central Bank and other federal societies loan due by societies and individual members be shown separately.
4. **Current Assets:** Mode of valuation of stock should be stated.
5. **Fixed Assets:** Original cost plus addition during the year less deduction - less total depreciation up to the date of B/S.

(ii) Liabilities Side:

1. **Share Capital:** Authorized capital, issued capital, Subscribed and paid up capital to be shown separately.
2. **Reserve fund & other funds:** Last year's balance plus addition during the year shown separately.

3. **Secured Loan:** Nature of security given to be stated mention of guarantee given, if any, by Central and State government to be made.
4. **Deposits:** From societies and from individuals to be shown separately.
5. **Contingent Liabilities:** not provided for to be shown by way of foot note.

2.2.3.4 Adjustments for Preparation of Final Accounts: As usual the adjustments are made for the preparation of final accounts but some specific adjustments are required to make as per the provisions in the Act.

Writing off bad debts and losses (Section 49): All loans including interest thereon and recovery charges in respect thereof which are found irrecoverable (and are certified as bad debts by the auditor appointed under Section 81) shall first be written off against the Bad Debt Fund and the balance, if any, may be written off against the Reserve Fund and the share capital of the society.

All other dues and accumulated losses or any other loss sustained by the society which cannot be recovered and have been certified as irrecoverable by the auditor may be written off against the Reserve Fund or share capital of the society:

Provided that-

(1) no bad debts or losses shall be written off without the sanction of the general body;

(2) before any such bad debts or losses are so written off, the society, if it is affiliated and indebted to a Central Bank, shall first obtain the approval of that bank in writing and also the approval of the Registrar. If the society is affiliated but not indebted to the Central Bank and in all other cases it shall obtain the approval of the Registrar in writing. If the society itself is a Central Bank, approval of the State Co-operative Bank and the approval of the Registrar shall first be obtained:

Provided that in case of societies classified as A or B at the time of last audit, no such permission need be taken if the bad debts are to be written off against the Bad Debt Fund specially created for the purpose :

Provided further that the Registrar may, while giving the approval, impose such conditions as to the recoupment of the Bad Debt Fund and restoration of part or whole of the amount written off against the Reserve Fund, from out -of future profits as he deems fit.

Calculation of net profits (Section 49A):

(1) A society shall calculate the net profits by deducting the following from the gross profits for the year-

(i) All interest accrued and accruing on amount sofover due loans(excepting overdue amounts of loans against fixed deposit, gold, etc.);

(ii) Interest payable on loans and deposits;

(iii) Establishment charges;

(iv) Audit fees or supervision fees;

(v) Working expenses including repairs, rent and taxes;

(vi) Depreciation;

(vii) Bonus payable to employees under the Payment of Bonus Act, 1965;

(viii) Provision for payment of Income-tax;

(ix) Amount to be paid as contribution to the Education Fund at the State Federal Society which may be notified by the State Government in this behalf;

(x) Amount to be paid for contribution to the Co-operative Cadre Employment Fund;

(xi) Provision for bad and doubtful debts;

(xii) Provision for share capital Redemption Fund;

(xiii) Provision for Investment Fluctuations Fund;

(xiv) Provision for retirement benefits to the employees;

(xv) Provision for any other claims admissible under any other law;

(xvi) Provision for bad debts and revenue losses not adjusted against any fund created out of profits.

(2) In addition to the sums referred to in sub-rule (1) of this rule, the following sums shall be deducted by a society from its profits :-

(i) Contribution, if any. to be made to any sinking fund or guarantee fund, constituted under the provisions of the Act, these rules or by-laws of the society for ensuring due fulfillment of guarantee given by Government in respect of loans raised by the society;

Footnotes:

(1) Ins. by G.N. of 16-10-1987.

(2) Provision considered necessary for depreciation in the value of any Security Bonds or Shares held by the society as part of its investments.

(3) The net profit thus arrived at together with the amount of profits brought forward from the previous year shall be available for appropriation.

Appropriation of profits (Section-50):

(1) The other purposes for which a society may appropriate its profits shall be education and enlightenment of the members of the society as also any co-operative or charitable purpose including relief to the poor, education, medical relief and advancement of any other general public utility, provided that the expenditure on such items does not exceed 10 per cent of the net profits.

(2) The net profits calculated in accordance with the provisions of rule shall be appropriated for the creation of-

(a) Development Fund.

(b) Dividend Equalisation Fund, or

(c) Any other fund created under by-laws.

Amounts to be deducted by a Society from its profits before arriving at its net profits (Section 51) : In addition to the sums referred to in sub-section (i) of Section 65, the following sums shall be deducted by a society from its profits before arriving at its profit for the purposes of sub-section (2) of Section 65 ;

(i) Contribution, if any to be made to any sinking fund or guarantee fund constituted under the provision of the Act. these rules or bye-laws of the society for ensuring due fulfillment of guarantee given by Government in respect of loans raised by the society.

(ii) Provision considered necessary for depreciation in the value of any security, bonds or shares held by the society as part of its investment,

(iii) Any provision required to be made for the redemption and share capital contributed by Government or by a Federal Society.

Bonus and Dividend Equalization Fund(Section 52):

(1) A society may create out of its net profits a fund to be called the Bonus Equalization Fund 2] for payment of bonus to persons other than its paid employees 3] who are not its members].

(2) Except otherwise specifically authorised by the Registrar, 2[the fund] so created shall be utilised in accordance with the provisions of the bye-laws of the society only 4 [for payment of such bonus].

(3) A society may create the Dividend Equalization Fund and credit to it a sum need exceeding 2 percent of the paid-up share capital in any year, until the total amount in such Fund amounts to 9 percent of the paid-up share capital. The society may draw upon this fund in any year only when it is unable to maintain a uniform rate of dividend it has been paying during the last preceding five years or more.

(4) No society shall declare a dividend at a rate exceeding that recommended by its committee.

Footnotes:

1. Subs by G.N. of 16-10-1987
2. Subs by G.N. of 8-11-1972
3. Added by G.N. of 21-9-1972 4. Subs. By G.N. of 7-11-1990

Utilization and investment of reserve fund(Section 54):

(1) A society shall, in addition to the modes specified in clauses (a) to (d) of Section 70, invest or deposit its reserve fund in any one or more of the following permitted modes namely-

(i) In the case of Primary Societies in the Central Financing Agencies,

(ii) In the case of Central Co-operative Banks and Urban Banks in the State Cooperative Bank.

(iii) In debentures issued by the Apex Land Development Bank or in Government loans, or

(iv) In any immovable property specified by the Registrar by a general or special order: Provided that, in the case of a society whose reserve fund is equal to or more than its paid-up share capital, the Registrar may, by general or special order, permit that society to invest that portion of the reserve fund which is in excess of its paid-up share capital, or a portion thereof, in its business:

Provided further that, in the case of Central Co-operative Banks and the State Co-operative Bank, the Registrar may, by general or special order, authorize such Banks to invest fifty per cent of their reserve fund in their business.

(2) No society whose, reserve fund has been separately invested or deposited shall draw upon, pledge or otherwise employ such fund except with the sanction of the Registrar previously obtained in writing.

(3) In the case of a society constituted with the object of co-operative housing on a co-partnership basis, the reserve fund may be utilised for expenditure on the maintenance, repair, and renewal of buildings of society.

(4) In the case of a processing society the reserve fund may be utilised in the acquisition, purchase or construction of lands, buildings and machinery.

Investment of other funds (Section 55):

(1) A society may invest any of its funds (other than the reserve fund) in any of the modes specified in Section 70 when such funds are not utilised for the business of the society.

Explanation: For the purpose of this sub-rule, "business of society" shall include any investment made by the society in immovable property with the prior sanction of the Registrar in the process of recovery of the society's normal dues or for the purpose of construction of building or buildings for its own use.

(2) The Registrar may, in the case of any society or class of societies, specify by a special or general order the maximum amounts to be invested in any class or classes of securities.

(3) Every society which has invested an amount not less than 10 per cent of its working capital in securities shall be required to constitute an investment

fluctuation fund. The Registrar may direct that a specified per cent of the net profits every year shall be credited to the investment fluctuation fund until, in his opinion, the amount of the funds is adequate to cover anticipated losses arising out of the disposal of securities.

(4) Proportion of paid-up share capital of the investing society or a class of society shall be determined by the Registrar by special or general order, from time to time, for investment in the shares or security bonds or debentures issued by any other society. While determining such proportion, the Registrar may impose such conditions as he may deem fit.

(5) When any society or societies have been permitted to enter into collaboration as provided under sub-section (I) of Section 20A, if it is necessary to invest the funds of the society or societies in such collaboration, the Registrar may, in addition to any general or special order of the State Government as specified in clause (e) of Section 70, impose such additional conditions as may be necessary in the interest of the society:

Provided that, the Registrar may for ensuring the safety of the funds of the societyorsocietiesinvestedinsuchcollaborationforbeneficialutilisationofthefunds in furtherance of the objects may be regulated to the extent and manner of such investment from time to time.

Maintenance and administration of provident fund (Section 56): A society which has established a provident fund for its employees under Section 71 shall, with the previous approval of the Registrar, frame regulations for the maintenance and utilisation of the provident fund for its employees. Among other matters, such regulations shall provide for the following -

(i) Amount (not exceeding ten per cent of the employee’s salary) of contribution to be deducted from the employees* salary;

(ii) The rate of contribution (not exceeding the annual contribution made by the employee) to be made by the society;

(iii) Advances which may be made against the security of the provident fund;

(iv) Refund of employees' contribution and contribution made by the society;

(v) Mode of investment of the provident fund and payment of interest thereon.

Now we will see the process of preparing the financial statements of cooperative societies through Practical examples.

Check your progress-2

(A) Choose the most appropriate alternative:

1. The statutory reserve is to be made every year from its net profit equal to …..
   (a) 25%
   (b) ¼ %
   (c) 4 times
   (d) 0.25%

2. Prepaid expenses are shown under the heading ……….. in balance sheet of cooperatives.
   (a) Loans and Advances
   (b) Current Assets
   (c) Sundry Debtors
   (d) Other Items

(B) State whether the following statement is 'true' or 'false':

1. The financial statements of cooperatives are to be placed before the members in their Annual General Meeting for their approval.
2. Contingent Liabilities not provided for is to be shown by way of foot note.
3. A society shall calculate the net profits by deducting Expenses and Depreciation from the gross profits for the year.

2.2.4 Illustrations:

Illustration-1:

From the following Trial Balance of Gokul Co-operative Consumers Society Ltd. as on 31st March, 2019, prepare Trading and Profit and Loss Account for the year ended 31st March, 2019 and Balance Sheet as on that date, after considering the adjustments given thereafter.

Trial Balance

Particulars	Debit Rs.	Credit Rs.
Share Capital		3,20,000
Calls in Arrears	20,000	
Reserve Fund		30,000
Common Good Fund		10,000
Opening Stock of Consumer Goods	2,20,000	
Furniture	96,000	
Education Fund		16,000
Sundry Creditors		40,000
Sundry Debtors	60,000	
Commission Payable		8,000
Salaries	1,42,000	
Commission	34,800	
Rent, Rates, Taxes	40,000	
Postages	24,200	
Land	18,000	
Interest on Investment		20,000
Equipments	40,000	
Purchases	32,80,000	
Investments	2,00,000	
Sales		41,21,000
Cash in hand	50,000	
Cash at Bank	3,40,000	
Total	45,65,000	45,65,000

Adjustments:

1. Outstanding rent payable on 31/03/2019 was Rs.2,000.
2. Charge 5% Depreciation on Furniture.
3. Closing stock of consumers goods is valued at cost Rs.2,80,000.
4. Interest accrued on investment Rs.4,000.

5. Outstanding salary on 31/03/2019 was Rs.4,000 and Rs.6,000 paid in advance.

6. Authorised Capital 40,000 shares of Rs.10 each.

Solution:

Trading, Profit and Loss Account of Gokul Cooperative Consumers Society Ltd. for the year ended 31st March 2019

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	2,20,000	By Sales	41,21,000
To Purchases	32,80,000	By Closing Stock	2,80,000
To Gross Profit*	9,01,000		
	44,01,000		44,01,000
To Salaries 1,42,000		By Gross Profit	9,01,000
Add: Outstanding 4,000		By Interest on Investment	24,000
1,46,000		20,000	
Less: Prepaid 6,000	1,40,000	Add: Accrued 4,000	
To Commission	34,800		
To Rent, Rates & Taxes			
40,000			
Add: Outstanding 2,000	42,000		
To Postage	24,200		
To Depreciation on furniture	4,800		
To Net Profit	6,79,200		
	9,25,000		**9,25,000**

Balance Sheet of Gokul Cooperative Consumers Society Ltd. as on 31st March 2019

Liabilities	Amount Rs.	Assets	Amount Rs.
1. Share Capital:		**1. Cash & Bank Balances**	
Authorized Capital:	4,00,000	(a) Cash on Hand	50,000
40,000 Equity Shares of		(b) Cash at Bank	3,40,000

Rs.10 each Issued, Subscripted and Paid up Capital: 32,000 Shares of Rs.10 each	 3,20,000	**2. Investments** **3. Staff Provident Fund Investments** **4. Loans and Advances**	2,00,000
Less: Calls in arrears	20,000 3,00,000	**5. Sundry Debtors** **6. Current Assets**	60,000
2. Reserve Fund Other Funds:		Stock of Consumer Goods	2,80,000
(a) Reserve Fund 30,000 + 1,69,800	1,99,800	**7. Fixed Assets** Furniture (at cost)	 96.000
(b) Common Goods Fund	10,000	Equipments	40,000
(c) Depreciation Fund	4,800	Land	18,000
(d) Education Fund	16,000		
3. Staff Provident Fund		8. Misc. Expenses	
4. Current Liabilities & Provisions		**9. Other Items:** Prepaid Salaries	 6,000
(a) Sundry Creditors	40,000	Interest accrued	4,000
(b) Outstanding Creditors for Salaries 4,000 Commission 8,000 Rent <u>2,000</u>	 14,000		
1. **Profit & Loss A/c** (6,79,200 – 1,69,800)	5,09,400		
	10,94,000		**10,94,000**

(Note: Contribution to Reserve Fund is 25% of net profit which is taken 1,69,800 which 25% of 6,79,200)

Illustration-2: The Trial Balance of Peoples Consumer's Co-operative Society Ltd. for the year ended 31st March 2005 is given below. Prepare Trading Account, Profit & Loss Account for the year ended 31st March 2005 and Balance Sheet as on that date.

Trial Balance

Particulars	Debit Balance Rs.	Credit Balance Rs.
Purchase and Sales	12,00,000	16,00,000
Share Capital	--	8,00,000
Calls in arrears	10,000	---
Reserve Fund	---	2,40,000
Stock on 1st April 2004	2,00,000	---
Carriage	10,000	--
Salaries & Allowances of Manager	48,000	---
Salaries & Allowances of Staff	90,000	---
Building Fund	---	1,31,000
Share Capital Redemption Fund	---	24,000
Contribution Provident Fund	10,000	---
Staff Provident Fund	---	34,000
Bad Debts	8,000	---
Bad Debts Fund	---	20,000
Postage & Telegram	6,000	---
Machinery at Cost	28,000	---
Travelling Expenses	9,000	---
Bonus to Employees	12,000	---
Printing & Stationery	4,600	---
Insurance	12,000	---
Buildings at Cost	6,00,000	---
Furniture at Cost	1,00,000	--
Depreciation on Fund	---	87,600
Sundry Debtors and Sundry Creditors	2,00,000	24,000
Investment in Shares of Co-operative	1,20,000	---

Societies		
Fixed Deposit with K.D.C.C.Bank	1,60,000	---
Staff Provision Fund Investment	20,000	---
Sundry Expenses	12,000	---
Repairs	32,000	--
Interest on Fixed Deposits	--	16,000
Dividend on Shares	--	12,000
Transfer Fees	--	2,000
Profit & Loss Appropriation A/c	--	9,000
(Balance of last year after all appropriations)	96,000	--
Cash at Bank	11,400	--
Bank Charges	600	--

Adjustments:

1. Outstanding Salaries on 31st March 2005 was ₹ 7,000.
2. Outstanding Audit Fees ₹ 1,200.
3. Insurance paid in Advance was ₹ 1,800.
4. Provide 5% on Debtors for Bad Debts Fund.
5. Provide Depreciation for the year as under

   Building-30,000; Furniture- 10,000; Machinery-2,800
6. Transfer to Education Fund ₹ 200.
7. Provide for Share Capital Redemption fund ₹ 2,000.
8. Stock on 31st March 2005 was valued at ₹ 3,00,000.

Solution:

Peoples Consumer's Co-operative Society Ltd., Trading Account for the year ended 31st March, 2005.

Profit & Loss Account

for the year ended 31st March, 2005

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Opening Stock	2,00,000	By Sales	16,00,000
To Purchases	12,00,000		
To Carriage	10,000	By Closing	3,00,000
To Gross Profit	4,90,000		
Total	**19,00,000**	**Total**	**19,00,000**

Profit & Loss Account

for the year ended 31st March, 2005.

Dr. **Cr.**

Particulars		**₹**	**Particulars**	**₹**
To Bank Charges		600	By Interest Received	16,000
To Salaries &	90,000			
Allowancesof	7,000		By Dividend	12,000
Staff Outstanding		97,000		
To Contribution to Staff			By Transfer Fees	2,000
Provision Fund		10,000		
To Salaries & Allowances			By Gross Profit	4,90,000
of Manager		48,000		
To Traveling Expenses		9,000		
To Postage & Telegram		6,000		
To Printing & Stationery		4,600		
To Insurance	12,000			
Less: Prepaid	1,800	10,200		
To Audit Fees		1,200		
To Sundry Expenses		12,000		
To Provision for Bad Debts		10,000		
To Depreciation				
Building	30,000			

Furniture 10,000 Machinery 2,800	42,800		
To Repairs Building 24,000 Furniture 4,000 Machinery 4,000	32,000		
To Education Fund	200		
To Capital Redemption Fund	2,000		
To Bonus to Employees	12,000		
To Net Profit	2,22,400		
Total	**5,20,000**	Total	**5,20,000**

Balance Sheet as on 31st March, 2005

Liabilities	₹	Assets	₹
2. Share Capital		**4. Cash & Bank Balances**	
Subscribed Called up		(a) Cash on Hand	11,400
&Paid-up Capital 8,00,000		(b) Cash at Bank	96,000
Less: Calls in arrears 10,000	7,90,000	**5. Investments**	
3. Reserve Fund Other Funds		Shares in Co-operative	
(c) Reserve Fund	2,40,000	Societies	1,20,000
(d) Building Fund	1,31,000	Fixed Deposit in	
(e) Share Capital		K.D.C.C. Bank	1,60,000
Redemption Fund 24,000		**6. Staff Provident Fund**	
Addition 2,000	26,000	**Investments**	20,000
(f) Education Fund	200		
(g) Depreciation Fund 87,600		**7. Sundry Debtors**	2,00,000
Addition 42,800	1,30,400	**8. Current Assets**	

(h) Bad Debts Fund			Closing Stock	3,00,000
Balance	20,000		**9. Advances**	
Addition	10,000		Prepaid Insurance	1,800
Less: Bad Debts	8,000	22,000		
4. Staff Provident Fund		34,000	**10. Fixed Assets**(at cost)	
5. Current Liabilities & Provisions			Building	6,00,000
			Furniture	1,00,000
(c) Sundry Creditors		24,000	Machinery	28,000
(d) Outstanding Creditors for				
Salaries	7,000			
Audit Fees	1,200	8,200		
6. **Profit & Loss A/c**				
Net Profit of 1988-89	9,000			
Net Profit for 1989-90	2,22,400	2,31,400		
		16,37,200		**16,37,200**

Illustration 3: Kolhapur Co-operative Society Ltd. has prepared Trial Balance as on 31st March 2005. Prepare Trading and Profit & Loss account for the year ended 31st March, 2005 and Balance Sheet as on that date after considering the adjustments given thereafter.

Trial Balance

as on 31st March 2005

Particulars	**Debit Balance** ₹	**Credit Balance** ₹
Share Capital	--	3,36,000
Reserve Fund	---	60,000
Creditors	---	40,000
Profit and Loss A/c 1-7-1994	---	1,76,000
Opening Stock	3,92,000	---
Furniture & Equipment's	1,24,000	---

Container Deposit	32,000	---
Salaries	3,00,000	---
Sundry Debtors	60,000	---
Commission	88,000	---
Rent and Taxes	60,000	---
Postages	8,000	---
Travelling & Conveyance	18,000	---
Printing &Statinery	14,000	---
Admission Fee	---	2,000
Purchases	63,40,000	---
Coolie Charges, Freight & Carriage	1,60,000	---
Invesments	2,40,000	---
Sales	---	76,20,000
Cash in hand	6,000	---
Bank Balance	4,00,000	---
Development Fund	---	8,000
Total	**82,42,000**	**82,42,000**

Adjustments:

1. Outstanding Rent ₹ 4,000 and Commission Payable ₹ 20,000.
2. Closing Stock was valued at ₹ 4,40,000.
3. Provision for Audit Fees ₹ 600.
4. ₹ 8,000 Salary was paid in advance as on 31-4-2005.
5. Accrued Income on Investment ₹ 20,000.
6. Provide 10% depreciation on furniture & equipment's.

Solution :

Kolhapur Co-operative Society Ltd.,
Trading Account
for the year ended 31st March, 2005

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	3,92,000	By Sales	76,20,000
To Purchases	63,40,000		
To Coolie Charges,		By Closing Stock	4,40,000
Freight & Carriage	1,60,000		
To Gross Profit transf.			
to Profit & Loss A/c	11,68,000		
Total	**80,60,000**	**Total**	**80,60,000**

Kolhapur Co-operative Society Ltd.,
Profit & Loss Account
for the year ended 31st March, 2005

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Salaries	3,00,000		By Accrued Income	
Less: Advance	8,000	2,92,000	on Investment	20,000
To Travelling & Conveyance		18,000	By Admission Fees	2,000
To Rent & Taxes	60,000			
Add: O/s Rent	4,000	64,000	By Gross Profit	11,68,000
To Postage		8,000		
To Printing & Stationery		14,000		
To Provision for Audit fee		600		
To Depreciation on				
Furniture & Equipment's		12,400		
To Commission	88,000			

Add: Outstanding 20,000	1,08,000		
To Net Profit	6,73,000		
Total	**11,90,000**	**Total**	**11,90,000**

Balance Sheet as on 31st March, 2005

Liabilities	₹	Assets	₹
1. Share Capital		**1. Cash & Bank Balances**	
Called up & Paid-up Capital	3,36,000	(a) Cash on Hand	6,000
2. Reserve Fund Other Funds		(b) Cash at Bank	4,00,000
Reserve Fund	60,000	**2. Investments:**	
Development Fund	8,000	Investments	2,40,000
3. Current Liabilities & Provisions		Container Deposits	32,000
Sundry Creditors	40,000	**3. Sundry Debtors**	60,000
Outstanding Rent	4,000	(a) Salary Advance	8,000
Commission Payable	20,000	(b) Interest Accrued on Investment	20,000
Provision for Audit Fees	600	**4. Current Assets**	
4. Profit & Loss Account		Closing Stock	4,40,000
1-7-1994 1,76,000		**5. Fixed Assets**	
Net Profit 6,73,000	8,49,000	Furniture & Equipment's 1,24,000	
		Less: Deprecation 12,400	1,11,600
Total	**13,17,600**	**Total**	**13,17,600**

Illustration 4: From the following Trial Balance of Prudence Co-operative Credit Society as on 31st March, 2009 and other information, prepare profit and loss account for the year ended 31st March, 2009 and Balance Sheet as on that date.

Trial Balance

Debit Balance	₹	Credit Balance	₹
Cash in hand	700	Share Capital	7,50,000
Cash with Banks	14,000	Reserve Fund	50,000
Fixed Deposit with M.S.		Members Deposits	22,47,750
Co-operative Bank	1,55,000	Unpaid Dividend	2,100
Office Furniture	7,000	Dividend Equalization	
Interest on Deposits	80,000	Reserve	18,000
Interest due on loans	8,000	Staff Provident Fund	20,000
Salary & Allowances	30,000	Profit & Loss	
Establishment for		Appropriation A/c	31,000
Executive		Balance	
Officer	5,000	Interest	1,78,000
Printing & Stationery	400	Renewal Fees	4,000
Travelling & Conveyance	600	Sundry Income	300
Insurance Premium	1,000	Co-op. Development Fund	2,050
Contribution to Provident		Education Fund	500
Fund	2,000		
Loans due from Members	30,00,000		
Total	33,03,700	Total	33,03,700

Adjustments:

1. Interest due on members deposits ₹ 5,000.
2. Interest accrued due but not received ₹ 2,000.
3. Addition to furniture during the year ₹ 1,000. Charge depreciation at 10% on closing balance.
4. Salary due but not paid ₹ 300, whereas one employee is given salary in advance on 30-6-99 ₹ 500.
5. Audit Fee unpaid for the year ₹ 3,000.
6. Authorized Capital was 1,00,000 shares of ₹ 10 each.
7. Directors propose the following appropriations for the current year.
   (i) Dividend to shareholders at 5%.

(ii) Necessary amount to Reserve Fund.

(iii) 5% Net Profit (after contribution to Reserve Fund) to Co-operative Development Fund.

(iv) Contribution to Dividend Equalization Reserve ₹ 2,000.

(v) Transfer to Building Fund ₹ 10,000.

Solution:

Prudence Co-operative Credit Society Ltd.,

Profit & Loss Account

for the year ended 31st March, 2009

Particulars	₹	Particulars	₹
To Interest on Deposits 80,000 Add: Due but not paid 5,000	85,000	By Interest Received 1,78,000 Receivable 2,000	1,80,000
To Salaries & Allowances 30,000 Less: Advances 500 29,500 Add :Outstanding 300	29,800	By Renewal Fees	4,000
		By Sundry Income	300
To Audit Fees	3,000		
To Establishment for Executive Officer	5,000		
To Printing & Stationery	400		
To Travelling & Conveyance	600		
To Insurance Premium	1,000		
To Contribution to Provident Fund	2,000		
To Depreciation on Furniture	700		
To Net Profit (Carried to Balance Sheet)	56,800		
Total	**1,84,300**	**Total**	**1,84,300**

Prudence Co-operative Credit Society Ltd.,

Balance Sheet

as on 31st March, 2009

Liabilities	₹	Assets	₹
1. Share Capital		**1. Cash & Bank Balances**	
(a) Authorized 1,00,000		(a) Cash on Hand	700
Shares of Rs.10 each	1,00,000	(b) Cash at Bank	14,000
(b) Issued, Subscribed		**2. Investments**	
Called & Paid up Capital		Fixed Deposit with MS coop.	1,55,000
75000 Shares of Rs.10 each		**3. Loan**	
fully called and paid	7,50,000	Due from Members	30,00,000
2. Reserve Fund		**4. Interest Receivable**	
& Other Funds		On Investments 2,000	
(a) Reserve Fund	50,000	On Loans 8,000	10,000
(b) Dividend Equalization		**5. OtherAssets**	
Reserve	18,000	**Furniture**	
(c) Co-operative		Balance 6,000	
Development Fund	2,050	Addition 1,000	
3. Deposit		7,000	
(a) Member Deposits	22,47,750	Less: Depreciation 700	6,300
(b) Staff Provident Fund	20,000	Salary Advance	500
(c) Interest Due on Deposit	5,000		
4. Other Liabilities			
Outstanding Expenses:			
Audit Fees 3,000			
Salaries 300	3,300		
Unpaid Dividend	2,100		
Education Fund	500		

5. Profit & Los A/c **Balance from** (a) Last Year 31,000 (b) Net profit for yea56,800	87,800		
Total	**31,86,500**	**Total**	**31,86,500**

Prudence Co-operative Credit Society Ltd.,

Profit & Loss Appropriation (Memorandum) Account

Dr. for the year ended 31st March, 2005. **Cr.**

Particulars	₹	Particulars	₹
Reserve Fund	14,200	Balance from 97-98	31,000
(25% of 56,800)			
Dividend at 5%		Net Profit for 98-99	56,800
on Paid up Capital	37,500		
Co-operative Development			
Fund 5% (56,800-14,200)	2,130		
Dividend Equalization			
Fund	2,000		
Building Fund	10,000		
Balance c/f	21,970		
Total	**87,800**	**Total**	**87,800**

Illustration-5: Ajinkyatara Co-operative Society rendering Loans and Rationing Facilities on it's members. The Trial Balance of the society as on 31st March, 2006 is as follows:

Trial Balance

Particulars	Debit Balance ₹	Credit Balance ₹
Member Share Capital	---	14,100
Member's Deposit	---	30,000
Dead Stock	7,000	---
Stationery and Printing	750	---
Bank Share Purchased	5,000	---
Sahakari Sangh Share Purchased	2,000	---

Bank Loan (Simple)	---	31,000
Members Loans	83,250	---
Interest on Members Loans	---	53,150
Purchase of Rationing Grains	1,20,000	---
Sale of Rationing Grains	---	1,27,500
Office Rent	9,000	---
Salaries	10,550	---
Travelling Expenses	1,250	---
Freight	1,300	---
Coolie Charges	900	---
Bank Current A/c	33,500	---
Bank Interest	26,250	---
Reserve and Other Fund	---	45,100
Cash Balance	100	---
Total	**3,00,850**	**3,00,850**

Adjustments:

1. Closing Stock of Rationing Grains on 31-3-2006 was ₹ 35,000/-
2. Outstanding office Rent is ₹ 1,000/-
3. Provide for Audit Fees due ₹ 600/-
4. Provide Depreciation on Dead Stock at 5%.
5. Provide Bad debts Reserve ₹ 1,500/-

You are required to prepare, Trading, Profit & Loss Account for the year ending on 31-3-2006 and Balance Sheet as on date.

Solution:

Ajnkyatara Co-operative Society Ltd.

Trading Account

for the year ended 31st March, 2006

Particulars	₹	Particulars	₹
To Purchases of Rationing Grains	1,20,000	By Sales of Rationing Grains	1,27,500
To Freight	1,300	By Closing Stock of	

To Coolie Charges	900	Grains	35,000
To Gross Profit transferred to Profit & Loss A/c	40,300		
Total	1,62,500		1,62,500

Ajnkyatara Co-operative Society Ltd.
Profit & Loss Account
for the year ended 31st March, 2006

Particulars	₹	Particulars	₹
To Bank Interest	26,250	By Interest on Members Loans	53,150
To Salaries	10,550		
To Travelling Expenses	1,250	By Gross Profit transferred from Trading A/c	40,300
To OfficeRent 9,000 Add :Outstanding 1,000	10,000		
To Stationery &Printing	750		
To Provision for Audit Fees	600		
To Provision for Bad Debts	1,500		
To Depreciation on Dead Stock	350		
To Net Profit	42,200		
Total	**93,450**	**Total**	**93,450**

Ajnkyatara Co-operative Society Ltd.
Balance Sheet
as on 31st March, 2006

Liabilities	₹	Assets	₹
1. Share Capital	14,100	**1. Cash & Bank Balances**	
2. Reserve Fund & Other Funds	45,100	(c) Cash on Hand	100

Provision for Bad Debts	1,500	(d) Cash at Bank	33,500
3. Deposits		**2. Investments:**	
Member Deposits	30,000	Bank Shares	5,000
4. Current Liabilities		SahakariSangh Shares	2,000
Outstanding Office Rent	1,000	**3. Loans**	
Provisions for Audit Fees	600	(a) Member Loans	83,250
5. Bank Loan	31,000	**4. Current Assets**	
6. Profit & Loss A/c		Stock of RationingGrains	35,000
Net Profit	42,200	**5. Fixed Assets**	
		DeadStock 7000	
		Less:Dep. 350	6,650
Total	**1,65,500**	**Total**	**1,65,500**

2.3 Summary:

In Indian scenario, next to corporate sector, a cooperative society is the most important form of business organization. The financial performance of cooperatives is critical issue when the growth and sustainability of business organization in the form of cooperatives are concerned. Cooperative societies are expected to run with the principles such as 1) Voluntary and Open Membership, 2) Democratic Member Control, 3) Members' Economic Participation, 4) Autonomy and Independence, 5) Education, Training and Information, 6) Co-operation among Cooperatives and 7) Concern for Community.

There are different types of co-operative societies which are defined in The Maharashtra Co-Operative Societies Act 1960, mentioned as: 1) Agricultural Marketing Society, 2) Consumer's Society, 3) Co-operative Bank, 4) Housing Society, 5) Lift Irrigation Society, 6) Processing Society, 7) Producers' Society and 8) Resource Society.

In Maharashtra state, to prepare financial statements of cooperatives, we have to study the provisions of Maharashtra Cooperative Societies Act 1960 and the Maharashtra State Cooperative Societies Rules 1961. This chapter intends to inculcate familiarity with knowledge and skill of preparing main financial statements of cooperative organizations i.e. 1) Trading Account, 2) Profit and Loss Account, 3) Profit and Loss Appropriation Account and 4) Balance Sheet.

2.4 Term to Remember

1. **Voluntary Association:** Members join the co-operative society voluntarily, that is, by choice. A member can join the society as and when he likes, continue for as long as he likes, and leave the society at will.
2. **Limited Liability:** The liability of members of a co-operative society is limited to the extent of capital contributed by them. Unlike sole proprietors and partners the personal properties of members of the co-operative societies are free from any kind of risk because of business liabilities.
3. **Sources of Finance:** In a co-operative society capital is contributed by all the members. However, it can easily raise loans and secure grants from government after its registration.
4. **Statutory books:** Books mandatory according to the Co-operative societies Act.
5. **Non-Statutory books**: Books not mandatory according to Co-operative societies Act but prepared for convenience for working of the co-operative society.
6. **Non-Profit-Organisations (NPO's):** The World Bank defines NPOs as "private organizations that pursue activities to relieve suffering, promote the interests of the poor, protect the environment, provide basic social services, or undertake community development".

2.5 Answers to Check Your Progress:

Check your progress-1

(A) 1- (b), 2- (a)

(B) 1- True, 2- False, 3- True

Check your progress-2

(A) 1- (a), 2- (d)

(B) 1- True, 2- False, 3- True

2.6 Exercises:

1. What are the basic principles of co-operative?
2. Explain various types of co-operative societies.
3. Describe the process of preparing financial statements of co-operative societies.

4. Prepare final accounts for the year ended 31-3-2007 in respect of Shrikrishna Co-operative Credit Society Ltd., Sangli from the following trial balance and additional information.

Trial Balance

Particulars	**Dr. ₹**	**Cr.₹**
Cash in hand Cash at Banks	239.11	---
S.D.C.C. Bank Current A/c	51.07	---
Saving A/c	164.25	---
Shares in S.D.C.C.Bank	1,40,000.00	---
Fixed Deposits with S.D.C.C.Bank	73,800.00	---
Interest Received	---	2,57,989.60
Hire purchase Interest	---	62,204.00
Bank Interest	---	6,516.45
Dividend	---	9,615.00
Salaries	18,290.00	---
Meeting Expenses	587.50	---
Printing & Stationery	1,016.00	---
Annual General Meeting Expenses	633.40	---
Sundry Expenses	47.00	---
Share Capital	---	5,72,130.00
Reserve Fund	---	73,735.25
Education & Medical Help Fund	---	4,877.00
Building Fund	---	56,300.00
Share in Shetkari Sahakari Sangh	100.00	---
Loans to Members	17,71,558.50	---
Hire Purchase Loans	4,37,124.00	---
Deposits – Savings	---	44,960.00
Fixed	--	1,09,506.00
Recurring	---	1,900.30
Cash Credits	---	14,31,609.93
Unpaid Dividend	---	5,399.90
Interest on Deposits	5,617.00	---
Diwali presents to Members	13,507.80	---
Bonus to Employees	713.00	---
Bank Cash Credit Interest	1,65,194.70	---
Function Expenses	265.00	---
Education Fund Contribution	500.00	---

Fixed Deposits Interest	11,233.00	---
Interest Payable on Deposits	---	3,397.90
Education Fund Payable	---	500.00
Total	**26,40,641.33**	**26,40,641.33**

Adjustments: The Directors propose the following appropriations:

1. Reserve Fund 25% of Net Profit
2. Dividend to shareholders 12% of paid up Capital.
3. 10% of remaining balances of net profit to Education and Medical Help.
4. Balance to Building Fund.

5. From the following Trial Balance of Sangli Co-operative Purchases and Sales Society Ltd. as on 31.03.2018, prepare Trading and Profit and Loss Account for the year ended 31-03-2018 and Balance Sheet as on that date, after considering the adjustments given thereafter.

Trial Balance

Particulars	Dr. ₹	Cr. ₹
Share Capital		3,36,000
Reserve Fund		60,000
Creditors		40,000
Profit and Loss A/c. Balance 01-04-2017		1,76,000
Opening stock	3,92,000	
Furniture and Equipments	1,24,000	
Container Deposits	32,000	
Salaries	3,00,000	
Sundry Debtors	60,000	
Commission	88,000	
Rent and Taxes	60,000	
Postages	8,000	
Travelling and Conveyance	18,000	
Printing and Stationery	14,000	
Admission Fees		2,000
Purchases	63,40,000	
Coolie charges, Freight and Cartage	1,60,000	
Investments	2,40,000	
Sales		76,20,000

Cash in Hand	6,000	
Bank Balance	4,00,000	
Development Fund		8,000
Total	**82,42,000**	**82,42,000**

Adjustments:

1. Closing stock is valued at ₹ 4,40,000.
2. Outstanding Rent ₹ 4,000 and commission payable ₹ 20,000.
3. Rs.8,000 Salary was paid as advance as on 31-03-2018.
4. Accrued Income on Investment ₹ 20,000.
5. Provide 10% Depreciation on Furniture and Equipments.

6. The following is the Trial Balance of Prayatna Credit Co-operative Society Ltd. for the year ended 31st March,2005.

Trial Balance

Debit Balance	₹	**Credit Balance**	₹
Loans Due from Members	7,20,000	Share Capital	1,80,000
Contribution to Staff		Reserve Fund	12,000
Provident Fund	480	Members Deposits	5,39,460
Insurance Premium	240	Unpaid Dividend	504
Travelling & Conveyance	144	Dividend Equalization Fund	4,320
Printing & Stationery	96	Staff Provident Fund	4,800
Establishment of Executive		Profit & Loss App.A/c	7,440
Officer	1,200	Interest	42,720
Salary & Allowance	7,200	Renewal Fees	960
Interest Due on Loans	1,920	Sundry Income	72
Interest on Deposits	19,200	Co-op. Development Fund	492
Office Furniture	1,680	Education Fund	120
Fixed Deposit with			
Co-operative Bank	37,200		
Cash with Banks	3,360		
Cash in hand	168		
Total	**7,92,888**	**Total**	**7,92,888**

Adjustments:

1. Interest due on members deposits ₹ 1,000.
2. Interest accrued due but not received ₹ 480.
3. Salary outstanding on 31-3-2005 ₹ 120.
4. Outstanding Audit Fees ₹ 720.
5. Authorized Capital: 20,000 shares of ₹ 10 each. Directors propose to pay dividend at 2%.
6. Prepare Profit and Loss Account and Balance Sheet for the year ended 31st March, 2005.

7. Following are the final balances of Maharashtra Co-operative Credit Society Ltd., for the year ended 31st March, 2009. Prepare Profit & Loss A/c and a Balance Sheet in the prescribed forms.

Trial Balance

Last Year	Particulars	Current Year	
		₹	₹
4,62,740	Share Paid-up Capital		6,30,770
12,336	Reserve Fund		39,413
1,45,819	Building Fund		3,28,755
3,689	Depreciation Fund		6,906
	Relief Fund		33,552
7,842	Cash in hand	21,349	
676	K.D.C.C. Bank : Current (O/d)		8,820
345	K.D.C.C. Bank : Savings	345	
9,700	Reserve Fund Deposit	35,600	
1,70,050	Bank Share	2,80,050	
15,000	Fixed Deposit in Janata Co-op. Bank		
	Fixed Deposit in K.D.C.C. Bank	40,000	
	Call Deposits		60,000
3,15,240	Damdupp at Deposits		5,83,804
3,11,846	Time Deposits		6,82,214

9,19,909	Pigmi Deposits		20,18,349
4,116	Recurring Deposits		6,837
1,81,166	Savings Deposits		4,61,957
6,197	Non-operating Savings		17,392
76,000	Dhanvridhi Deposits		94,185
29,95,764	Loans against securities	64,17,854	
2,59,710	Unsecured Loans	4,41,208	
34,296	Loans against Gold Securities	1,35,307	
13,94,930	Loans against Deposits	3,98,747	
1,45,175	Loans taken K.D.C.C. Bank Cash Credit		28,62,005
3,87,953	Interest Received		8,83,654
2,199	On Loans		4,119
979	On Investments		6,642
229	Dividend		
3,828	Court Expenses		
500	Gifts	95	
287	Education Fund	500	
	Recovery Charges	1,013	
	Govt. Audit Fee	3,090	
	Board Subscription	10	
	Peon Dress	950	
	Profit & Loss (Loss)	1,163	
	Election Expenses	1,000	
	News Papers	246	
	Insurance	833	
	Interest	16,959	
7,378	State Co-operative Conference	150	
16,576	Printing & Stationery		12,411
1,130	Pigmi Commission		24,706
935	Advertiement		7,296

45	Profit & Loss(Profit)		4,626
60	Sundry Expenses		
	Notice Fee		22
692	Share Transfer Fee		5
	Recovery Expenses		5,347
	Postage & Telephone		104
131	Insurance Commission		3,132
3,000	Notice Fees		2,502
100	Local Audit Fee		--
1,850	Office Rent		100
	Share Suspense		2,622
6,220	Dividend		12,892
	Pigmi Commission		11,969
3	Interest on Deposits		34,581
732	Admission Fee Suspense		13
230	Advertisement		
	Professional Tax		201
179	Salary		481
30,246	Library	80	
446	Dead Stock & Furniture	54,563	
27,030	Equipment's	446	
95,500	Salary Advance	1,280	
1,839	Building Advance	1,25,000	
1,54,169	Interest Due		
800	Deposits from Members	1,41,947	
1,000	Telephone Deposits	800	
10,260	Sine Board Advance	1,000	
	Loan to Staff Members	13,330	
81,240	Interest Paid		
91,914	(a) On Deposits	1,58,945	
24,358	(b) On Bank Loans	2,98,957	

15,886	Advertisement	25,560	
1,200	Printing & Stationery	22,755	
35	Office Rent	1,200	
1,335	Locker Rent	35	
972	Insurance	795	
34,811	Lodging Charges		
67,629	Salary to Staff	66,751	
338	Pigmi Commission	1,22,521	
2,614	Travelling	5,424	
66	Office Expenses	5,262	
495	Sundry Expenses	1,626	
900	Postage & Telephone	1,929	
21	Annual General Meeting Expenses	2,493	
	Depreciation		
	Library, Dead Stock & Furniture	3,216	

8. From the following Trial Balance of Samyak Co-operative Society Ltd., as on 31st March, 2018, prepare Trading and Profit and Loss Account for the year ended 31st March, 2018 and Balance Sheet as on that date, after considering the adjustments given thereafter.

Trial Balance

Credit	₹	Debit	₹
Share Capital	2,00,000	Loans to members	7,00,000
Reserve Fund	18,000	Contribution to Provident Fund	480
Member's Deposits	5,40,000	Insurance	1,040
Unpaid Dividend	400	Conveyance	3,420
Staff Provident Fund	4,800	Printing and stationery	960
Profit and Loss 2017-18	7,000	Salary of M.D.	12,000

Interest	86,000	Staff Salary	27,200
Renewal Fees	800	Interest on loans	1,920
Sundry Income	640	Interest on deposits	19,200
Development Fund	4,000	Furniture	1,680
Education Fund	1,200	Fixed Deposits with other banks	60,000
		Cash	4,360
		Bank	30,580
	8,62,840		**8,62,840**

Adjustments:

1. Interest due on member deposits ₹ 2,000.
2. Interest due but not received ₹ 4,800.
3. Salary due ₹ 1,200.
4. Audit Fees Due ₹ 800.
5. Depreciate Furniture by 5%.
6. Directors propose to pay Dividend of 5%.
7. Transfer ₹100 to Education Fund and ₹ 2,000 to Dividend Equalisation Fund.
8. Appropriations out of Profits of the year 2012-2013 were approved as follow: Reserve Fund ₹ 2,000

   Dividend ₹ 2,000.

9. Visit any cooperative society to see their accounting process and discuss with respective authority that look after accounting in the concern cooperative.

10. Take interview of Cooperative auditor or Chartered Accountant in respect of cooperative accounting.

2.7 Reference for further study:

1. Maharashtra Cooperative Societies Act 1960
2. Maharshtra State Co-operative Societies Rule,1961

❑❑❑

Unit-3

Accounting for Lease (AS 19)

Structure of Unit

3.0 Objectives:

After studying this unit, you will be able to:

1. Understand lease financing concept
2. Explain types of lease and its uses
3. Find relationship between lessor and lessee.

3.1 Introduction

Leasing activity was initiated in India in 1973. The first leasing company of India, named First Leasing Company of India Ltd. was set up in that year by Farouk Irani, with industrialist A C Muthia. For several years, this company remained the only company in the country until 20th Century Finance Corporation was set up - this was around 1980.

A lease is a contract between two parties called the 'lessor' and the 'lessee' whereby the lessor conveys to the lessee in return for rent the right to use an asset for an agreed period of time. The ownership of the asset continues to rest with the lessor whereas the lessee enjoys the right of the use of the asset in consideration of the rent paid to the lessor. The provisions of the Indian Contract Act, 1872 apply to lease contracts and the relationship between the lessor and the lessee is that of a bailor and a bailee.

3.2 Presentation of Subject Matter:

Leasing is a possibility for business to expand their access to short- and medium-term financing. From an economic perspective, leasing can be defined as "a contract between two parties where one party (the lessor) provides an asset for usage to another party (the lessee) for a specified period of time, in return for specified payments". Leasing is referred to as asset based financing. As lessors retain ownership of the assets they lease throughout the life of the contract, these leased assets are therefore an inherent form of collateral in such contracts (compared to traditional bank lending which will either be unsecured or make use of different types of collateral and typically not physical assets such as equipment which are inherent in leases). Conventional bank lending focuses on the loan repayment by the borrower from two sources: a primary source, the cash flow generation, and a secondary source, credit enhancements and collateral (if any). Leasing is focused on the lessee's ability to generate cash flows from the business operations to service the lease payments, as the lessor retains legal ownership of the asset. Hence, Leasing equipment is, basically, renting it so that you can use it in your business. As such, you have to make periodical payments for the leased equipment.

3.2.1 Definition

"A lease is a contract outlining the terms under which one party agrees to rent property owned by another party. It guarantees the lessee, also known as the tenant, use of an asset and guarantees the lessor, the property owner or landlord, regular payments for a specified period in exchange" - James Chen

"A contract by which one conveys real estate, equipment, or facilities for a specified term and for a specified rent"- Merriam-Webster

"A special kind of contract between a property owner and a person wanting temporary enjoyment and exclusive use of the property, in exchange for rent paid to the property owner" – Duhaime's Law Dictionary

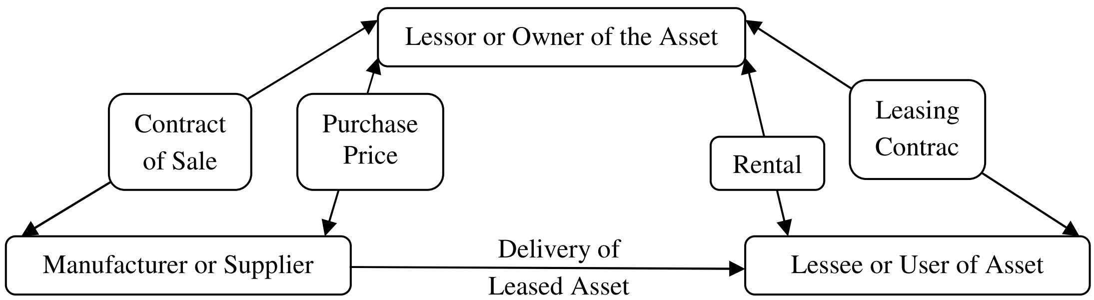
"Lease is a contract whereby the owner of an asset(Lessor) grants to another party (Lessee) the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent" - James C Van Horne

3.2.2 Lease Financing

Lease financing is one of the important sources of medium and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments. The owner of the asset is known as lessor and the user is called lessee.

The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

Lease finance is favoured by small business enterprises (SME), and individuals, where cash flow is the lifeblood of the firm. A monthly payment, even with interest attached, is often the better option than using cash to purchase capital assets. It allows the lessee to purchase an expensive item or capitalize the business over a period, thus alleviating the necessity of finding a significant amount of upfront cash.



3.2.3 Lease Agreement

All of us have had to make a lease agreement one or several times in life, for various reasons, say, for renting a house, for leasing out a property and so on. There is always a format available somewhere, and we get our hands on such copies (since thankfully, lease agreements do not come into copyright issues).

However, since specific additions to the lease agreements or special requests need to be filled only by the party who is making the agreement or their lawyer, it may be of interest to understand what lease agreements are, and how or why to make it.

A lease agreement, as we know, is a contract between two parties, (a lessee and the lessor here, the lessee being the one who is renting/leasing the property, and the lessor, the owner), wherein, specific conditions are mentioned about renting or leasing the property. It is a legal agreement which gives the lessee the right to occupy the property for the tenure mentioned on it, but does not give them the right to own it.

The lease agreement, therefore, is a very crucial document for both parties, the one who is lending it out and the one who is giving his property on rent. There are several issues wherein the lessor has signed an agreement and the lessee has misused the property or sublet it.

Similarly, in cities like Kolkata, where there are several old houses being sublet, there are cases pending for years together against the lessees who have refused to vacate the property Let to them by the lessor. And, there is also a case of increasing the rents or the percentage of increase one has to bear year after year or after a certain duration as mentioned by the lessor.

Hence, because of all the above mentioned issues, and much more that we see every day, it is essential to understand what needs to go into your lease agreement while renting/letting your property. The lease agreement is a legally binding document which is notarized and signed by both parties, and thus, makes it mandatory for them to follow the instructions in it.

3.2.3.1 Contents of a lease agreement:

Common contents of a lease agreement include:

- Names of the lessor and lessee or their agents.
- Description of the property.
- Amount of rent and due dates, grace period, late charges.
- Mode of rent payment.
- Methods to terminate the agreement prior to the expiration date and charges if any.
- Amount of security deposit and the account where it is held.
- Utilities furnished by the lessor and, if the lesser charges for such utilities, how the charge will be determined.

- Amenities and facilities on the premises which the lessee is entitled to use such as swimming pool, laundry or security systems.
- Rules and regulations such as pet rules, noise rules and penalty for violation.
- Identification of parking available, including designated parking spaces, if provided.
- How tenant repair requests are handled and procedures for emergency requests.

3.2.3.2 Terms commonly included in a lease agreement:

- **Duration:** Period for which the lease agreement will be in effect.
- **Rent:** The consideration or payment made by the lessee to the lessor in exchange for the property leased out.
- **Deposits:** The amount of deposit required (if any), the purpose of each deposit, and conditions for return or adjustment of deposit at the end of the lease period.
- **Terms of Use:** The purpose for which the property is to be used and terms and conditions regarding use of the property.
- **Utilities:** Which utilities are included in the rent, and which utilities the tenant is responsible for.
- **Insurance**: Whether the lessee is required to ensure the property – this is most often used in commercial rental agreements.
- **Repairs and Maintenance:** Party responsible for repairs and maintenance of the property – lessor or lessee.

3.2.4 Advantages and Disadvantages of Lease Financing

	Advantages	**Disadvantages**
To Lessor	➢ **Assured Regular Income:** Lessor gets lease rental by leasing an asset during the period of lease which is an assured and regular income. ➢ **Preservation of Ownership:** In case of finance	➢ **Unprofitable in Case of Inflation:** Lessor gets fixed amount of lease rental every year and they cannot increase this even if the cost of asset goes up. ➢ **Double Taxation:** ➢ **Sales tax may be charged**

	lease, the lessor transfers all the risk and rewards incidental to ownership to the lessee without the transfer of ownership of asset hence the ownership lies with the lessor. ➢ **Benefit of Tax:** As ownership lies with the lessor, tax benefit is enjoyed by the lessor by way of depreciation in respect of leased asset. ➢ **High Profitability:** The business of leasing is highly profitable since the rate of return based on lease rental, is much higher than the interest payable on financing the asset. ➢ **High Potentiality of Growth:** The demand for leasing is steadily increasing because it is one of the cost efficient forms of financing. Economic growth can be maintained even during the period of depression. Thus, the growth potentiality of leasing is much higher as compared to other forms of business. ➢ **Recovery of Investment:** In case of finance lease, the lessor can recover the total investment through lease rentals.	**twice:** First at the time of purchase of asset and second at the time of leasing the asset. ➢ **Greater Chance of Damage of Asset:** As ownership is not transferred, the lessee uses the asset carelessly and there is a great chance that asset cannot be useable after the expiry of primary period of lease.

To Lessee	➢ **Use of Capital Goods:** A business will not have to spend a lot of money for acquiring an asset but it can use an asset by paying small monthly or yearly rentals. ➢ **Tax Benefits:** A company is able to enjoy the tax advantage on lease payments as lease payments can be deducted as a business expense. ➢ **Cheaper:** Leasing is a source of financing which is cheaper than almost all other sources of financing. ➢ **Technical Assistance:** Lessee gets some sort of technical support from the lessor in respect of leased asset. ➢ **Inflation Friendly:** Leasing is inflation friendly, the lessee has to pay fixed amount of rentals each year even if the cost of the asset goes up. ➢ **Ownership:** After the expiry of primary period, lessor offers the lessee to purchase the assets— by paying a very small sum of money.	➢ **Compulsion:** Finance lease is non-cancellable and even if a company does not want to use the asset, lessee is required to pay the lease rentals. ➢ **Ownership:** The lessee will not become the owner of the asset at the end of lease agreement unless he decides to purchase it. ➢ **Costly:** Lease financing is more costly than other sources of financing because lessee has to pay lease rental as well as expenses incidental to the ownership of the asset. ➢ **Understatement of Asset:** As lessee is not the owner of the asset, such an asset cannot be shown in the balance sheet which leads to understatement of lessee’s asset.

3.2.5 Features of Lease Contract

1. The lease finance is a contract.
2. The parties to contract are lessor and lessee.
3. Equipment are bought by lessor at the request of lessee.
4. The lessor gives the right to use the asset to lessee.
5. The lease contract specifies the period of contract.
6. The lessee uses these equipment's.
7. The lessee, in consideration, pays the lease rentals to the lessor.
8. The lease decision is a financing decision for the lessee and an investment decision for the lessor.
9. The lessor is the owner of the assets and is entitled to the benefit of depreciation and other allied benefits e.g., under sections 32A and 32B of the Income-tax Act.
10. The lessee claims the rentals as expenses chargeable to his income.

3.2.6 Accounting Standard

3.2.6.1 AS 19 – Leases

This standard is primarily concerned with the accounting for leases by lessees and lessors and ensuring the appropriate accounting policies and disclosures in relation to finance lease and operating leases.

Applicability

Accounting standard 19 is applicable to enterprises in Level I, II and III but relaxation is given to Level II and Level III enterprises for certain disclosure requirements**.** This standard is not applicable to:

1. Leases for exploration or use of natural resources like Oil, Gas, Timber, Metal & other mineral rights.
2. Lease/License for items like motion picture films, video recordings, plays, manuscripts, patents, copyrights and
3. Lease for use of land.

It also does not apply to services which does not transfer the right to use the asset.

3.2.6.2 IND AS 116 – Leases

The Ministry of Corporate Affairs (MCA) notified Ind AS 116, the new leases accounting standard on 30th March 2019 with the effective date of its application from 1st April 2019. Ind AS -116 replaces the current guidance in Ind AS-17, 'Leases'. Ind AS 116 defines a lease as a contract, or part of a contract , that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. Ind AS 116 adds significant new, enhanced disclosure requirements for both lessors and lessees. On transition, lessees can choose between full retrospective application or a simplified approach that includes certain reliefs and does not require a restatement of comparatives. In addition, as a practical expedient entities are not required to reassess whether a contract is, or contains, a lease at the date of initial application (that is, such contracts are 'grandfathered').

3.2.6.3 Differences between AS 19 and IND AS 116

IND AS 116 is applicable from 1 April 2019 and entirely changes the classification model for leases. Most leases would be classified as finance leases under the standard.

	AS 19	**IND AS 116**
Classification as operating and finance leases	Leases that meet any of the five conditions are classified as finance leases. Others are operating leases.	Generally, all leases will be treated as finance leases in the books of the lessee as a 'Right to Use asset". Exceptions are: Short term leases. Leases of low value items. The accounting model changes substantially for lessee's though remains largely the same for lessors.
Concept of Right to Use	No specific concept of right to use.	Ind AS 116 focuses on right to use. The concept is that any asset over

		which an entity has right to use should be classified as a finance lease liability and right to use asset.
Separating components of a contract	No specific guidance.	A contract may include a lease component which needs to be identified and recorded separately as a lease. Typically, a company may enter into a contract for services which includes use of an asset, for example purchasing steam from a power plant in the company's premises or obtaining a customized vehicle (like those used by banks for transferring cash) along with driver. In such cases, the lease element is to be separated and recorded as a lease if the lessee can benefit from asset on its own and underlying asset is not highly inter-related with other parts of the contract.
Lease incentives	No specific guidance.	Lease incentives for example payments made by lessor to lessee is to be reduced from lease payments.
Initial direct costs on the lease	No specific guidance. Amortized over life of lease or charged off upfront by lessee.	To be recorded as part of the right to use asset and therefore amortized over life of the lease.
Disclosures	Detailed disclosures in relation to carrying value of assets on lease	Some disclosures required only by Ind AS: Expense on low value leases charged off as operating expense.

	and reconciliation of minimum lease payments to the present value of such payments (i.e. the finance lease liability). The differential is the interest to be paid over period of lease. Description of lessee's significant leasing arrangements.	Income from sub-leasing of right to use assets. Total cash outflow for leases. Additions to right to use assets

Check Your Progress-1

A) Choose correct Alternative given below

1. A person or organization that allows another person or organization to use something they own in return for regular payments is known as------------

   a. lease b. lessor c. lessee d. lease rent

2. A person or organization that makes regular payments in order to use something that another person or organization owns is known as------------

   a. lease payment b. lessor c. lessee d. lease contract

3. Leasing activity was initiated in India in the year---------

   a. 1973 b. 1975 c. 1980 d. 1983

B) Fill in the blanks

1. The first leasing company of India, named First Leasing Company of India Ltd. was set up in that year by------------------ Farouk Irani

2. Lessor gets lease rental by leasing an asset during the period of lease which is an assured and regular income is known as------------

3. The lease decision is a ------------------- decision for the lessee and an------------- decision for the lessor.

C) State the following statements are either True or False

1. The Ministry of Corporate Affairs (MCA) notified Ind AS 116, the new leases accounting standard on 30th March 2019 with the effective date of its application from 1st April 2019.
2. Ind AS 116 focuses on right to use.
3. The lessee claims the rentals as expenses chargeable to his income.

3.2.7 Types of Lease

Lease may be of the following types:

3.2.7.1 Finance Lease: Long-term non-cancelable lease contracts are known as financial leases. e.g. plant, machinery, land & building, ships, and aircraft's. In India, financial leases are very popular with high-cost and high technology equipment. Financial leases amortize the cost of the asset over the term of lease; they are, therefore, also called capital or full-payout lease. Most financial leases are direct leases. The lessor buys the asset identified by the lease from the manufacturer and signs a contract to lease it out to the lessee.

Examples of Finance Lease are:

1. Lease in which Assets is transferred to lessee at the end of lease term
2. Lease term in which lessee has the option to purchase the assets form lessor at the price which is lower than fair price on the date when option become exercisable
3. Lease term Covers complete economic life of the asset even if title is not transferred
4. Lease term in which present value of the minimum lease payments is equal to or substantially covers the fair value of the leased asset
5. Leased asset is of a specialized nature. Ex Ambulance (the lessee can use it without major modifications being made)

3.2.7.1.1 Types of Financial Lease:

- **Leveraged Lease**: Leveraged lease involves lessor, lessee and financier. Lessor (leasing company) provides equity equal to about 25% of the asset's cost while the remaining amount is provided by the financier (a bank or a financial institution), mainly as loan. Leveraged lease is a popular method of financing expensive assets.

- **Sale-and-Lease-Back:** In this type the lessee first sells asset owned by him to the lessor and then leases it back from the lessor. This provides liquidity as well as possible tax gains to the lessee.

- **Cross-Border Lease:** In case of cross-border or international lease, the lessor and the lessee are situated in two different countries. Because the lease transaction takes place between parties of two or more countries, it is called cross-border lease. It involves relationships and tax implications more complex than the domestic lease. When the lease transaction takes place between three parties manufacturer/vendor, lessor and lessee in three different countries, it is called foreign-to foreign lease.

3.2.7.1.2 Disclosure in case of Finance Lease:

1. Assets acquired on Lease should be shown separately
2. For each leased assets, show net carrying amount at the balance sheet date
3. Provide reconciliation between Minimum Lease Payment at balance sheet date and their present value
4. Disclose total of minimum lease payment at balance sheet date and their present value for:
    a) Not later than one year
    b) Later than one year but not later than five year
    c) Later than five years
5. Future minimum sublease payment expected to receive at balance sheet date
6. General description of lessee significant leasing arrangements

3.2.7.1.3 Accounting For Finance Lease:

A) In the Books of Lessee :

Following is the accounting treatment of finance Lease in the books of Lessee.

i) At the inception of lease, Lessee should show it as an asset and corresponding liability at lower of : a) Fair value of the leased asset b) PV of

MLP from the lessee point of view. (Present value to be calculated with discount rate equal to interest rate implicit in the lease. If implicit rate is not available, the discount rate is the lessee's incremental borrowing rate.)

ii) Lease Payments to be apportioned between :

   a) Principal amount : is reduced from the outstanding friability.

   b) Finance charges (Interest) : is allocated over lease term in such manner that it would produce a constant rate of interest on the remaining balance of liability.

iii) Charge depreciation on leased asset on the same lines as any other asset.

iv) Initial direct cost for finance lease is included in assets under lease.

v) Contingent rents, cost of service and taxes are recognized as expenses as and when incurred.

B) In the Books of Lessor:

Following is the accounting treatment of finance Lease in the books of Lessor.

i) Recognize asset given under finance lease as receivable at an amount equal to net investment in the lease and corresponding credit to sale asset.

   - Net Investment = Gross investment – Unearned Finance Income.
   - Gross investment = MLP + Unguaranteed Residual Value. (from Lessor point of view)
   - Unearned Finance = Gross Investment – PV of Gross Investment Income

ii) The lessor should allocate total finance income over the lease term in such a way so as to show a constant periodic return on the net investment of the lessor outstanding in respect of the finance lease.

iii) Lease payments relating to the accounting period, excluding cost of service, are reduced from both the principal and the unearned finance income.

Journal Entries in case of Finance Lease

	In the books of Lessee	In the books of Lessor
At Inception		
Signing of Contract	Leased asset A/c ------------ Dr To Rental obligation A/c (Being Value of asset taken under lease)	Rent Receivable A/c ------- Dr To Leased Asset A/c - (Being Value of asset Leased)
Rent paid	Rental obligation A/c ---- Dr To cash -	Cash A/c ------------------ Dr To Rent Receivables -
At the End of Every Year		
On payment of Rent & Interest	Rental obligation A/c ----- Dr Interest payable A/c ------ Dr To cash A/c	Cash A/c --------------------Dr To Rent Receivable A/c To Interest Receivable A/c
On payment of Insurance, Taxes etc.	Insurance A/c -------------- Dr Taxes A/c ------------- Dr To cash	Nil
Int. Dep. And Ins. Taxes transferred to P & L	P & L A/c ----------------- Dr To Interest A/c To Depreciation A/c To Insurance A/c To Taxes A/c	Nil
Charging Depreciation	Depreciation A/c ----------- Dr To provision for Dep. A/c	Nil
Interest due	Interest A/c -------------- Dr To Interest payable A/c	Interest Receivable A/c -- Dr To Interest A/c

Illustration 1

An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are ₹ 3,00,000/-. The amount will be paid in 3 installments and at the termination of lease the lessor will get back the equipment. The unguaranteed residual value at the end of 3^{rd} year is ₹ 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re. 1

due at the end of 3rd year at 10% IRR is 2.4868. The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

(i) State with reason whether the lease constitutes finance lease.

(ii) Calculate unearned finance income.

Solution:

(i) Present Value of Residual Value = ₹ 40,000 X 0.7513

= ₹ 30,052

Present Value of Lease Payment = ₹ 3,00,000 – ₹ 30,052

= ₹ 2,69,948.

The Present Value of Lease Payment being 89.98% [(2,69,948/3,00,000)*100] of the fair value. It being a substantial portion thereof, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income:

Annual Lease Payment = (2,69,948/2.4868)

= ₹ 1,08,552

Gross Investment in the lease [(₹ 1,08,552 X 3) + ₹ 40,000]	3,65,656
Less: Cost of the Equipment	3,00,000
Unearned Finance Income	65,656

Illustration 2

Tushar Ltd. takes a plant on lease on April 1st 2015 from Shivani Leasing Ltd. The following are the relevant details:

Inception of Lease	:	1st April 2015
Lease Term	:	5 years
Depreciation	:	@30% by WDV method
Fair Value	:	Rs.2,50,000/-
Residual Value	:	Zero
Lease Payment	:	₹ 79,944.50/- at the end of each year

Implicit Rate : 18%

You are required to give Journal Entries and ledger accounts in the books of Lessee and Lessor by adopting Finance Lease Method.

Solution:

Calculation of Interest

	Lease Payment	Interest (18%)	Principal	Balance
1st April 2015	-----	-----	-----	2,50,000.00
31st March 2016	79,944.50	45,000.00	34,944.50	2,15,055.50
31st March 2017	79,944.50	38,709.50	41,235.00	1,73,821.00
31st March 2018	79,944.50	31,287.50	48,657.00	1,25,164.00
31st March 2019	79,944.50	22,529.50	57,415.00	67,749.00
31st March 2020	79,944.50	12,194.50	67,750.00	0

Note:

Interest = Opening Balance*18%

e.g. Interest on 31st March 2016 = ₹ 2,50,000 * 18% = ₹ 45,000

Principal = Lease Payment – Interest

e.g. Principal on 31st March 2016 = ₹ 79,944.5 – ₹ 45,000 = ₹ 34,944.5

Calculation of Depreciation

Date	**WDV**	**Depreciation**
31st March 2016	2,50,000.00	75,000.00
31st March 2017	175000.00	52,500.00
31st March 2018	122500.00	36,750.00
31st March 2019	85750.00	25,725.00
31st March 2020	60025.00	18,007.50
Total		2,07,982.50

In the books of Tushar Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
1/04/2015	Plant A/c	Dr.	2,50,000.00	
	To Rent Obligation A/c			2,50,000.00
	(Being Value of Plant taken under lease)			
31/03/2016	Interest A/c	Dr.	45,000.00	
	To Interest Payable A/c			45,000.00
	(Being Interest due on lease)			
31/03/2016	Depreciation A/c	Dr.	75,000.00	
	To Provision For Depreciation A/c			75,000.00
	(Being charged Depreciation @ 30%)			
31/03/2016	Rent obligation A/c	Dr.	34,944.50	
	Interest Payable A/c	Dr.	45,000.00	
	To Bank A/c			79,944.50
	(Being paid Lease rent including interest)			
31/03/2016	P & L A/c	Dr.	1,20,000.00	
	To Interest A/c			45,000.00
	To Depreciation A/c			75,000.00
	(Being transferred Interest and Deprecation to P&L A/c)			
31/03/2017	Interest A/c	Dr.	38,709.50	
	To Interest Payable A/c			38,709.50
	(Being Interest due on lease)			
31/03/2017	Depreciation A/c	Dr.	52,500.00	
	To Provision For Depreciation A/c			52,500.00
	(Being charged Depreciation @ 30%)			

31/03/2017	Rent obligation A/c Dr.	41,235.00	
	Interest Payable A/c Dr.	38,709.50	
	To Bank A/c		79,944.50
	(Being paid Lease rent including interest)		
31/03/2017	P & L A/c Dr.	91,209.50	
	To Interest A/c		38,709.50
	To Depreciation A/c		52,500.00
	(Being transferred Interest and Deprecation to P&L A/c)		
31/03/2018	Interest A/c Dr.	31,287.50	
	To Interest Payable A/c		31,287.50
	(Being Interest due on lease)		
31/03/2018	Depreciation A/c Dr.	36,750.00	
	To Provision For Depreciation A/c		36,750.00
	(Being charged Depreciation @ 30%)		
31/03/2018	Rent obligation A/c Dr.	48,657.00	
	Interest Payable A/c Dr.	31,287.50	
	To Bank A/c		79,944.50
	(Being paid Lease rent including interest)		
31/03/2018	P & L A/c Dr.	68,037.50	
	To Interest A/c		31,287.50
	To Depreciation A/c		36,750.00
	(Being transferred Interest and Deprecation to P&L A/c)		
31/03/2019	Interest A/c Dr.	22,529.50	
	To Interest Payable A/c		22,529.50
	(Being Interest due on lease)		
31/03/2019	Depreciation A/c Dr.	25,725.00	
	To Provision For Depreciation A/c		25,725.00

	(Being charged Depreciation @ 30%)			
31/03/2019	Rent obligation A/c	Dr.	57,415.00	
	Interest Payable A/c	Dr.	22,529.50	
	To Bank A/c			79,944.50
	(Being paid Lease rent including interest)			
31/03/2019	P & L A/c	Dr.	48,254.50	
	To Interest A/c			22,529.50
	To Depreciation A/c			25,725.00
	(Being transferred Interest and Deprecation to P&L A/c)			
31/03/2020	Interest A/c	Dr.	12,194.50	
	To Interest Payable A/c			12,194.50
	(Being Interest due on lease)			
31/03/2020	Depreciation A/c	Dr.	18007.50	
	To Provision For Depreciation A/c			18007.50
	(Being charged Depreciation @ 30%)			
31/03/2020	Rent obligation A/c	Dr.	67,750.00	
	Interest Payable A/c	Dr.	12,194.50	
	To Bank A/c			79,944.50
	(Being paid Lease rent including interest)			
31/03/2020	P & L A/c	Dr.	30,202.00	
	To Interest A/c			12,194.50
	To Depreciation A/c			18007.50
	(Being transferred Interest and Deprecation to P&L A/c)			
31/03/2020	Provision for Dep. A/c	Dr.	2,07,982.50	
	To Plant A/c			2,07,982.50
			15,73,112.00	**15,73,112.00**

In the books of Shivani Leasing Ltd.
Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
1/04/2015	Plant A/c	Dr.	2,50,000.00	
	To Bank A/c			2,50,000.00
	(Being Purchase of asset for the purpose of lease)			
1/04/2015	Rent Received A/c	Dr.	2,50,000.00	
	To Plant A/c			2,50,000.00
	(Being Asset given on lease)			
31/03/2016	Interest Receivable A/c	Dr.	45,000.00	
	To Interest A/c			45,000.00
31/03/2016	Bank A/c	Dr.	79,944.50	
	To Rent Received A/c			34,944.50
	To Interest Receivable A/c			45,000.00
31/03/2017	Interest Receivable A/c	Dr.	38,709.50	
	To Interest A/c			38,709.50
31/03/2017	Bank A/c	Dr.	79,944.50	
	To Rent Received A/c			41,235.00
	To Interest Receivable A/c			38,709.50
31/03/2018	Interest Receivable A/c	Dr.	31,287.50	
	To Interest A/c			31,287.50
31/03/2018	Bank A/c	Dr.	79,944.50	
	To Rent Received A/c			48,657.00
	To Interest Receivable A/c			31,287.50
31/03/2019	Interest Receivable A/c	Dr.	22,529.50	
	To Interest A/c			22,529.50
31/03/2019	Bank A/c	Dr.	79,944.50	
	To Rent Received A/c			57,415.00
	To Interest Receivable A/c			22,529.50
31/03/2020	Interest Receivable A/c	Dr.	12,194.50	
	To Interest A/c			12,194.50

31/03/2020	Bank A/c Dr.	79,944.50	
	To Rent Received A/c		67,750.00
	To Interest Receivable A/c		12,194.50
		10,49,444.00	**10,49,444.00**

In the Books of Tushar Ltd.

Dr. **Lease Rent A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2016	To Bank A/c	79,944.50	31/03/2016	By Interest A/c	45,000.00
			31/03/2016	By Rent Obligation A/c	34,944.50
		79,944.50			**79,944.50**
31/03/2017	To Bank A/c	79,944.50	31/03/2017	By Interest A/c	38,709.50
			31/03/2017	By Rent Obligation A/c	41,2350
		79,944.50			**79,944.50**
31/03/2018	To Bank A/c	79,944.50	31/03/2018	By Interest A/c	31,287.50
			31/03/2018	By Rent Obligation A/c	48,657.00
		79,944.50			**79,944.50**
31/03/2019	To Bank A/c	79,944.50	31/03/2019	By Interest A/c	22,529.50
			31/03/2019	By Rent Obligation A/c	57,415.00
		79,944.50			**79,944.50**
31/03/2020	To Bank A/c	79,944.50	31/03/2020	By Interest A/c	12,194.50
			31/03/2020	By Rent Obligation A/c	67,750.00
		79,944.50			**79,944.5.00**

Dr. **Rent Obligation A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2016 31/03/2016	To Lease Rent A/c To Bal. c/d	34,944.50 2,15,055.50	1/04/2015	By Leased Asset A/c	2,50,000.00
		2,50,000.00			**2,50,000.00**
31/03/2017 31/03/2017	To Lease Rent A/c To Bal. c/d	41,235.00 1,73,821.00	1/04/2016	By Bal. b/d	2,15,055.50
		2,15,055.50			**2,15,055.50**
31/03/2018 31/03/2018	To Lease Rent A/c To Bal. c/d	48,657.00 1,25,164.00	1/04/2017	By Bal. b/d	1,73,821.00
		1,73,821.00			**1,73,821.00**
31/03/2019 31/03/2019	To Lease Rent A/c To Bal. c/d	57,415.00 67,749.00	1/04/2018	By Bal. b/d	1,25,164.00
		1,25,164.00			**1,25,164.00**
31/03/2020	To Lease Rent A/c	67,749.00	1/04/2019	By Bal. b/d	67,749.00
		67,749.00			**67,749.00**

Dr. **Interest A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/16	To Interest Payable A/c	45,000.00	31/03/16	By P & L A/c	45,000.00
		45,000.00			**45,000.00**
31/03/17	To Interest Payable A/c	38,709,5.00	31/03/17	By P & L A/c	38,709.50
		38,709,5.00			**38,709.50**
31/03/18	To Interest Payable A/c	31,287.50	31/03/18	By P & L A/c	31,287.50
		31,287.50			**31,287.50**

31/03/19	To Interest Payable A/c	22,529.50	31/03/19	By P & L A/c	22,529.50
		22,529.50			**22,529.50**
31/03/20	To Interest Payable A/c	12,194.50	31/03/20	By P & L A/c	12,194.50
		12,194.50			**12,194.50**

Dr. **Depreciation A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/16	To Prov. For Dep A/c	75,000.00	31/03/16	By P & L A/c	75,000.00
		75,000.00			**75,000.00**
31/03/17	To Prov. For Dep A/c	52,500.00	31/03/17	By P & L A/c	52,500.00
		52,500.00			**52,500.00**
31/03/18	To Prov. For Dep A/c	36,750.00	31/03/18	By P & L A/c	36,750.00
		36,750.00			**36,750.00**
31/03/19	To Prov. For Dep A/c	25,725.00	31/03/19	By P & L A/c	25,725.00
		25,725.00			**25,725.00**
31/03/20	To Prov. For Dep A/c	18,007.50	31/03/20	By P & L A/c	18,007.50
		18,007.50			**18,007.50**

In the Books of Shivani Leasing Ltd.

Dr. **Lease Rent A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2016	To Interest A/c To Rent Receivable A/c	45,000.00 34,944.50	31/03/2016	By Bank	79,944.50
		79,944.50			**79,944.50**
31/03/2017	To Interest A/c To Rent Receivable A/c	38,709.50 41,235.00	31/03/2017 31/03/2017	By Bank	79,944.50
		79,944.50			**79,944.50**
31/03/2018	To Interest A/c To Rent	31,287.50 48,657.00	31/03/2018 31/03/2018	By Bank	79,944.50

	Receivable A/c				
		79,944.50			**79,944.50**
31/03/2019	To Interest A/c To Rent Receivable A/c	22,529.50 57,415.00	31/03/2019 31/03/2019	By Bank	79,944.50
		79,944.50			**79,944.50**
31/03/2020	To Interest A/c To Rent Receivable A/c	12,194.50 67,750.00	31/03/2020 31/03/2020	By Bank	79,944.50
		79,944.50			**79,944.50**

Dr. **Rent Receivable A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
1/04/2015	To Lease Asset A/c	2,50,000.00	31/03/2016 31/03/2016	By Bank A/c By Bal. c/d	34,944.50 2,15,055.50
		2,50,000.00			**2,50,000.00**
31/03/2017 31/03/2017	To Bal. b/d To Bal. c/d	2,15,055.50	31/03/2016 31/03/2016	By Bank A/c By Bal. c/d	41,235.00 1,73,821.00
		2,15,055.50			**2,15,055.50**
31/03/2018 31/03/2018	To Bal. b/d To Bal. c/d	1,73,821.00	31/03/2016 31/03/2016	By Bank A/c By Bal. c/d	48,657.00 1,25,164.00
		1,73,821.00			**1,73,821.00**
31/03/2019 31/03/2019	To Bal. b/d To Bal. c/d	1,25,164.00	31/03/2016 31/03/2016	By Bank A/c By Bal. c/d	57,415.00 67,749.00
		1,25,164.00			**1,25,164.00**
31/03/2020	To Bal. b/d	67,749.00	31/03/2016	By Bank A/c	67,749.00
		67,749.00			**67,749.00**

Illustration 3

Om Ltd. takes a plant on lease on April 1st 2013 from Yash Leasing Ltd. The following are the relevant details:

Inception of Lease	:	1st Jan. 2013
Lease Term	:	5 years
Depreciation	:	@20% by WDV method
Fair Value	:	₹ 7,00,000/-
Residual Value	:	Zero
Lease Payment	:	₹ 2,08,821/- at the end of each year
Implicit Rate	:	15%

You are required to give Journal Entries and ledger accounts in the books of Lessee and Lessor by adopting Finance Lease Method.

Solution:

Calculation of Interest

	Lease Payment	**Interest (18%)**	**Principal**	**Balance**
1st April 2013	-----	-----	-----	7,00,000.00
31st March 2014	2,08,821.00	1,05,000.00	1,03,821.00	5,96,179.00
31st March 2015	2,08,821.00	89,426.85	1,19,394.20	4,76,784.90
31st March 2016	2,08,821.00	71,517.73	1,37,303.30	3,39,481.60
31st March 2017	2,08,821.00	50,922.24	1,57,898.80	1,81,582.80
31st March 2018	2,08,821.00	27,237.42	1,81,583.60	0

Note:

Interest = Opening Balance*18%

e.g. Interest on 31st March 2014 = ₹ 7,00,000 * 18% = ₹ 1,05,000

Principal = Lease Payment – Interest

e.g. Principal on 31st March 2014 = ₹ 2,08,821 – ₹ 1,05,000 = ₹ 1,03,821

Calculation of Depreciation

Date	WDV	Depreciation
31st March 2014	7,00,000	1,40,000
31st March 2015	5,60,000	1,12,000
31st March 2016	4,48,000	89,600
31st March 2017	3,58,400	71,680
31st March 2018	2,86,720	57,344
	Total	4,70,624

In the books of Om Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
1/04/2013	Plant A/c	Dr.	7,00,000.00	
	To Rent Obligation A/c			7,00,000.00
	(Being Value of Plant taken under lease)			
31/03/2014	Interest A/c	Dr.	1,05,000.00	
	To Interest Payable A/c			1,05,000.00
	(Being Interest due on lease)			
31/03/2014	Depreciation A/c	Dr.	1,40,000.00	
	To Provision For Depreciation A/c			1,40,000.00
	(Being charged Depreciation @ 30%)			
31/03/2014	Rent obligation A/c	Dr.	1,03,821.00	
	Interest Payable A/c	Dr.	1,05,000.00	
	To Bank A/c			2,08,821.00
	(Being paid Lease rent including interest)			

31/03/2014	P & L A/c Dr. To Interest A/c To Depreciation A/c (Being transferred Interest and Deprecation to P&L A/c)	2,45,000.00	 1,05,000.00 1,40,000.00
31/03/2015	Interest A/c Dr. To Interest Payable A/c (Being Interest due on lease)	89,426.85	 89,426.85
31/03/2015	Depreciation A/c Dr. To Provision For Depreciation A/c (Being charged Depreciation @ 30%)	1,12,000.00	 1,12,000.00
31/03/2015	Rent obligation A/c Dr. Interest Payable A/c Dr. To Bank A/c (Being paid Lease rent including interest)	1,19,394.20 89,426.85	 2,08,821.00
31/03/2015	P & L A/c Dr. To Interest A/c To Depreciation A/c (Being transferred Interest and Deprecation to P&L A/c)	2,01,426.85	 89,426.85 1,12,000
31/03/2016	Interest A/c Dr. To Interest Payable A/c (Being Interest due on lease)	71,517.73	 71,517.73
31/03/2016	Depreciation A/c Dr. To Provision For Depreciation A/c (Being charged Depreciation @ 30%)	89,600.00	 89,600.00
31/03/2016	Rent obligation A/c Dr. Interest Payable A/c Dr.	1,37,303.30 71,517.73	

	To Bank A/c (Being paid Lease rent including interest)			2,44,821.03
31/03/2016	P & L A/c To Interest A/c To Depreciation A/c (Being transferred Interest and Deprecation to P&L A/c)	Dr.	1,61,117.73	 71,517.73 89,600.00
31/03/2017	Interest A/c To Interest Payable A/c (Being Interest due on lease)	Dr.	50,922.24	 50,922.24
31/03/2017	Depreciation A/c To Provision For Depreciation A/c (Being charged Depreciation @ 30%)	Dr.	71,680.00	 71,680.00
31/03/2017	Rent obligation A/c Interest Payable A/c To Bank A/c (Being paid Lease rent including interest)	Dr. Dr.	1,57,898.80 50,922.24	 2,08,821.00
31/03/2017	P & L A/c To Interest A/c To Depreciation A/c (Being transferred Interest and Deprecation to P&L A/c)	Dr.	1,22,602.24	 50,922.24 71,680.00
31/03/2018	Interest A/c To Interest Payable A/c (Being Interest due on lease)	Dr.	27,237.42	 27,237.42
31/03/2018	Depreciation A/c To Provision For Depreciation A/c (Being charged Depreciation @ 30%)	Dr.	57,344.00	 57,344.00

31/03/2018	Rent obligation A/c Dr. Interest Payable A/c Dr. To Bank A/c (Being paid Lease rent including interest)	1,81,583.60 27,237.42	 2,08,821.00
31/03/2018	P & L A/c Dr. To Interest A/c To Depreciation A/c (Being transferred Interest and Deprecation to P&L A/c)	84,581.42	 27,237.42 57,344.00
31/03/2018	Provision for Dep. A/c Dr. To Plant A/c	4,70,624.00	 4,70,624.00
		10,44,186.00	**10,44,186.00**

In the books of Yash Leasing Ltd.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
1/04/2013	Plant A/c Dr. To Bank A/c (Being Purchase of asset for the purpose of lease)	7,00,000.00	 7,00,000.00
1/04/2013	Rent Received A/c Dr. To Plant A/c (Being Asset given on lease)	7,00,000.00	 7,00,000.00
31/03/2014	Interest Receivable A/c Dr. To Interest A/c	1,05,000.00	 1,05,000.00
31/03/2014	Bank A/c Dr. To Rent Received A/c To Interest Receivable A/c	2,08,821.00	 1,03,821.00 1,05,000.00
31/03/2015	Interest Receivable A/c Dr. To Interest A/c	89,426.85	 89,426.85
31/03/2015	Bank A/c Dr. To Rent Received A/c	2,08,821.00	 1,19,394.15

	To Interest Receivable A/c		89,426.85
31/03/2016	Interest Receivable A/c Dr.	71,517.73	
	To Interest A/c		71,517.73
31/03/2016	Bank A/c Dr.	2,08,821.00	
	To Rent Received A/c		1,37,303.27
	To Interest Receivable A/c		71,517.73
31/03/2017	Interest Receivable A/c Dr.	50,922.24	
	To Interest A/c		50,922.24
31/03/2017	Bank A/c Dr.	2,08,821.00	
	To Rent Received A/c		1,57,898.80
	To Interest Receivable A/c		50,922.24
31/03/2018	Interest Receivable A/c Dr.	27,237.42	
	To Interest A/c		27,237.42
31/03/2018	Bank A/c Dr.	2,08,821.00	1,81,583.60
	To Rent Received A/c		27,237.42
	To Interest Receivable A/c		
		27,88,209.00	**27,88,209.00**

In the Books of Om Ltd.

Dr. **Lease Rent A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2014	To Bank A/c	2,08,821.00	31/03/2014	By Interest A/c	1,05,000.00
			31/03/2014	By Rent Obligation A/c	1,03,821.00
		2,08,821.00			**2,08,821.00**
31/03/2015	To Bank A/c	2,08,821.00	31/03/2015	By Interest A/c	89,426.85
			31/03/2015	By Rent Obligation A/c	1,19,394.15
		2,08,821.00			**2,08,821**
31/03/2016	To Bank A/c	2,08,821.00	31/03/2016	By Interest A/c	71,517.73
			31/03/2016	By Rent Obligation A/c	1,37,303.27
		2,08,821.00			**2,08,821.00**

31/03/2017	To Bank A/c	2,08,821.00	31/03/2017 31/03/2017	By Interest A/c By Rent Obligation A/c	50,922.24 1,57,898.80
		2,08,821.00			**2,08,821.00**
31/03/2018	To Bank A/c	2,08,821.00	31/03/2018 31/03/2018	By Interest A/c By Rent Obligation A/c	27,237.42 1,81,583.60
		2,08,821.00			**2,08,821.00**

Dr. **Rent Obligation A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2014 31/03/2014	To Lease Rent A/c To Bal. c/d	1,03,821.00 5,96,179.00	1/04/2013	By Leased Asset A/c	7,00,000.00
		7,00,000.00			**7,00,000.00**
31/03/2015 31/03/2015	To Lease Rent A/c To Bal. c/d	1,19,394.20 4,76,784.90	1/04/2014	By Bal. b/d	5,96,179.00
		5,96,179.00			**5,96,179.00**
31/03/2016 31/03/2016	To Lease Rent A/c To Bal. c/d	1,37,303.30 3,39,481.60	1/04/2015	By Bal. b/d	4,76,784.90
		4,76,784.90			**4,76,784.90**
31/03/2017 31/03/2017	To Lease Rent A/c To Bal. c/d	1,57,898.80 1,81,582.80	1/04/2016	By Bal. b/d	3,39,481.60
		3,39,481.60			**3,39,481.60**
31/03/2018	To Lease Rent A/c	1,81,582.80	1/04/2017	By Bal. b/d	1,81,582.80
		1,81,582.80			**1,81,582.80**

Dr. **Interest A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/16	To Interest Payable A/c	1,05,000.00	31/03/16	By P & L A/c	1,05,000.00
		1,05,000.00			**1,05,000.00**
31/03/17	To Interest Payable A/c	89,426.85	31/03/17	By P & L A/c	89,426.85
		89,426.85			**89,426.85**
31/03/18	To Interest Payable A/c	71,517.73	31/03/18	By P & L A/c	71,517.73
		71,517.73			**71,517.73**
31/03/19	To Interest Payable A/c	50,922.24	31/03/19	By P & L A/c	50,922.24
		50,922.24			**50,922.24**
31/03/20	To Interest Payable A/c	27,237.42	31/03/20	By P & L A/c	27,237.42
		27,237.42			**27,237.42**

Dr. **Depreciation A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/16	To Prov. For Dep A/c	1,40,000	31/03/16	By P & L A/c	1,40,000
		1,40,000			**1,40,000**
31/03/17	To Prov. For Dep A/c	1,12,000	31/03/17	By P & L A/c	1,12,000
		1,12,000			**1,12,000**
31/03/18	To Prov. For Dep A/c	89,600	31/03/18	By P & L A/c	89,600
		89,600			**89,600**
31/03/19	To Prov. For Dep A/c	71,680	31/03/19	By P & L A/c	71,680
		71,680			**71,680**
31/03/20	To Prov. For Dep A/c	57,344	31/03/20	By P & L A/c	57,344
		57,344			**57,344**

In the Books of Yash Leasing Ltd.

Dr. **Lease Rent A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2014	To Interest A/c To Rent Receivable A/c	1,05,000.00 1,03,821.00	31/03/2014	By Bank	2,08,821.00
		2,08,821.00			**2,08,821.00**
31/03/2015	To Interest A/c To Rent Receivable A/c	89,426.85 1,19,394.20	31/03/2015	By Bank	2,08,821.00
		2,08,821.00			**2,08,821.00**
31/03/2016	To Interest A/c To Rent Receivable A/c	71,517.73 1,37,303.30	31/03/2016	By Bank	2,08,821.00
		2,08,821.00			**2,08,821.00**
31/03/2017	To Interest A/c To Rent Receivable A/c	50,922.24 1,57,898.80	31/03/2017	By Bank	2,08,821.00
		2,08,821.00			**2,08,821**
31/03/2018	To Interest A/c To Rent Receivable A/c	27,237.42 1,81,583.6	31/03/2018	By Bank	2,08,821.00
		2,08,821.00			**2,08,821.00**

Dr. **Rent Receivable A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
1/04/2013	To Lease Asset A/c	7,00,000.00	31/03/2014 31/03/2014	By Bank A/c By Bal. c/d	1,03,821.00 5,96,179.00
		7,00,000.00			**7,00,000.00**

31/03/2015	To Bal. b/d	5,96,179.00	31/03/2014 31/03/2014	By Bank A/c By Bal. c/d	1,19,394.20 4,76,784.90
		5,96,179.00			**5,96,179.00**
31/03/2016	To Bal. b/d	4,76,784.90	31/03/2014 31/03/2014	By Bank A/c By Bal. c/d	1,37,303.30 3,39,481.60
		4,76,784.90			**4,76,784.90**
31/03/2017	To Bal. b/d	3,39,481.60	31/03/2014 31/03/2014	By Bank A/c By Bal. c/d	1,57,898.80 1,81,582.80
		3,39,481.60			**3,39,481.60**
31/03/2018	To Bal. b/d	1,81,582.80	31/03/2014	By Bank A/c	1,81,582.80
		1,81,582.80			**1,81,582.80**

Illustration 4

Amardeep Ltd. leased a machinery to Susmita Ltd. on the following terms:

Fair Value of the Machinery	:	₹ 20 Lakh
Lease Term	:	5 years
Lease Rental per annum	:	₹ 5 Lakh
Guaranteed Residual Value	:	₹ 1 Lakh
Expected Residual Value	:	₹ 2 Lakh
Internal Rate of Return	:	15%

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the first year.

Solution:

Computation of Unearned Finance Income

According to AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease, and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

(a) **Gross Investment** in the lease is the aggregate of (i) minimum lease payments from the standpoint of the lessor, and (ii) any unguaranteed residual value accruing to the lessor.

Gross Investment = Minimum Lease Payment + Unguaranteed Residual Value

= (Total lease rent X Guaranteed Residual Value) + Unguaranteed Residual Value

= [(₹ 5,00,000 X 5 years) + ₹ 1,00,000] + ₹ 1,00,000

= Rs. 27,00,000

(b) Table showing present value of (i) Minimum Lease Payments (MLP) and (ii) Unguaranteed Residual Value (URV)

Year	MLP Inclusive URV (₹)	Discount Factor @ 15%	Present Value (₹)
1	5,00,000	0.8696	4,34,800
2	5,00,000	0.7561	3,78,050
3	5,00,000	0.6575	3,28,750
4	5,00,000	0.5718	2,85,900
5	5,00,000	0.4972	2,48,600
	1,00,000 (Guaranteed Residual Value)	0.4972	49,720
Total Present Value of Minimum Cash Payments			17,25,820 (i)
1,00,000		0.4972	49,720 (ii)
(Unguaranteed Residual Value) (i + ii)			17,75,540

Unearned Finance Income = (a) - (b)

= ₹ 27,00,000 - ₹ 17,75,540

= ₹ 9,24,460

Calculation of Interest

Year	Lease Payment	Finance Charges	Principal	Balance
0	-----	-----	-----	17,25,820
1	5,00,000	2,58,873	2,41,127	14,84,693
2	5,00,000	2,22,704	2,77,296	12,07,397
3	5,00,000	1,81,110	3,18,890	8,88,507
4	5,00,000	1,33,276	3,66,724	5,21,783
5	5,00,000	78,267	5,21,783	1,00,050*

*The difference between this figure and guaranteed residual value (Rs.1,00,000) is due to approximation in computing the interest rate implicit in the lease.

In the Books of Susmita Ltd.

Journal Entries

Particulars		Debit (₹)	Credit (₹)
At the inception of lease			
Machinery A/c	Dr.	17,25,820	
To Amardeep Ltd.			17,25,820
(Being recorded Lease of machinery at present value of MLP)			
At the end of the first year of lease			
Finance Charges A/c	Dr.	2,58,873	
To Amardeep Ltd. A/c			2,58,873
(Being Finance Charges for first year)			
Amardeep Ltd. A/c	Dr.	5,00,000	
To Bank A/c			5,00,000
(Being paid Lease rent to lessor)			
Depreciation A/c	Dr.	1,72,582	
To Machinery A/c			1,72,582
(Being provided Depreciation @10% by SLM)			
Profit and Loss A/c	Dr.	4,31,455	
To Depreciation A/c			1,72,582
To Finance Charges A/c			2,58,873
(Being transferred Depreciation and Finance Charges to P&L A/c)			
		30,88,730	**30,88,730**

Illustration 5

Amit Ltd. acquired equipment on lease from Bhagyashri Leasing Ltd. on 31st April 2017.The relevant information is as under –

Fair value of Equipment	:	₹ 10,00,000
Lease Term	:	3 years
Lease Rent	:	₹ 4,00,000 (at the end of the year)
Guaranteed Residual Value	:	₹ 50,000
Expected Residual value	:	₹ 80,000

Open the Rent Receivable A/c in the books of lessor Bhagyashri Leasing Ltd. Apportion unearned Finance Income & principal amount.

Solution:

As per AS-19 on Leases :

1.	Gross Investment	= MLP + GRV + URV = (400000X3 yrs)+50,000+30000 = ₹ 12,80,000
2.	Unearned Finance Income	= Gross Investment – PV of Gross Investment = ₹ 12,80,000 – ₹ 10,00,000 = ₹ 2,80,000
3.	Net Investment	= Gross Investment – unearned Finance Income = ₹ 12,80,000 – ₹ 2,80,000 = ₹ 10,00,000
4.	Implicit Rate of Return	= Net Investment/(Gross Investment/Lease Term) = 10,00,000/(12,80,000/3yrs) = 2.3437

On going through the annuity table given as Appendix 2 in the row for 3 years. The implicit rate of interest come to 14% (approx) on this basis, the unearned Finance Income of ₹ 2,80,000 can be apportioned.

Apportionment of Finance Income and Principal amount

Year	Lease Payment	Finance Charges	Principal	Balance
0	-----	-----	-----	10,00,000
1	4,00,000	1,40,000	2,60,000	7,40,000
2	4,00,000	1,03,600	2,96,400	4,43,600
3	4,00,000	36,400	3,63,600	80,000

In the Books of Bhagyashri Leasing Ltd.

Dr. **Lease Rent A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
31/03/2018	To Interest A/c	1,40,000	31/03/2018	By Bank	4,00,000
31/03/2018	To Rent Receivable A/c	2,60,000			
		4,00,000			**4,00,000**
31/03/2019	To Interest A/c	1,03,600	31/03/2019	By Bank	4,00,000
31/03/2019	To Rent Receivable A/c	2,96,400			
		4,00,000			**4,00,000**
31/03/2020	To Interest A/c	36,400	31/03/2020	By Bank	4,00,000
31/03/2020	To Rent Receivable A/c	3,63,600			
		4,00,000			**4,00,000**

Dr. **Rent Receivable A/c** **Cr.**

Date	Particular	₹	Date	Particular	₹
1/04/2017	To Lease Asset A/c	10,00,000	31/03/2018	By Bank A/c	2,60,000
			31/03/2018	By Bal. c/d	7,40,000
		10,00,000			**10,00,000**

31/03/2015	To Bal. b/d	7,40,000	31/03/2014 31/03/2014	By Bank A/c By Bal. c/d	2,96,400 4,43,600
		7,40,000			**7,40,000**
31/03/2016	To Bal. b/d	4,43,600	31/03/2014 31/03/2014	By Bank A/c By Bal. c/d	3,63,600 80,000
		4,43,600			**4,43,600**

3.2.7.2 Operating Lease:

Short-term, cancelable lease agreements are called operating lease. Convenience and instant services are the hallmarks of operating leases. Examples are: a tourist renting a car, lease contracts for computers, office equipment, car, trucks and hotel rooms. For assets such as computers or office equipment, an operating lease may run for 3 to 5 years. The lessor is generally responsible for maintenance and insurance. He may also provide other services, a single operating lease contract may not fully amortize the original cost of the asset; it covers a period considerably shorter than the useful life of the asset. Because of the short duration and the lessee's option to cancel the lease, the risk of obsolescence remains with the lessor. Naturally, the shorter the lease period and/or higher the risk of obsolescence, the higher will be the lease rentals.

Accounting in the books of Lessee in case of Finance Lease

1. At the inception of lease, lessee will recognize the lease as assets or liability at an amount equal to the fair value of leased assets
2. Apportion the lease payments into finance charge and reduction in outstanding liability
3. Allocate finance charge to the periods during lease term
4. Pass journal entry for depreciation

3.2.7.2.1 Types of Operating lease:

- **Closed and Open Ended Lease:** In the close ended lease, the asset gets transferred to the lessor at the end, and the risk of obsolescence, residual value etc. remain with the lessor being the legal owner of the asset. In the open-ended lease, the lessee has the option of purchase the asset at the end of lease.

- **Direct Lease:** It is a mix of operating and finance lease on a full payout basis and provides for the purchase option to the lessee.
- **Master Lease:** Master lease provides for a period longer than the asset's life and holds the lessor responsible for providing equipment in good operating condition during the lease period.
- **Percentage Lease:** Percentage lease provide for a fixed rent plus some per cent of the previous year's gross revenue to be paid to the lessor. This ensures protection against inflation.
- **Wet and dry Lease:** In the aircraft industry, when the lease involves financing as well as servicing and fuel, it is called wet lease. Dry lease provides only for financing.
- **Net Net Net Lease:** In the triple net lease, the lessee is obliged to the care of maintenance, taxes and insurance of the equipment.
- **Update Lease:**Update lease is intended to protect the lessee against the risk of obsolescence. The lessor agrees to replace obsolete asset with new one at specified rent.

Accounting in the books of Lessee in case of Operating Lease

Lease payment is recognized as an expense in the profit and loss account.

3.2.7.2.2 Disclosure in case of Operating Lease

1. Future lease payment for the following period
   a) Not later than one year
   b) Later than one year but not later than five years
   c) Later than five years
2. Total Expected future lease payment
3. Lease payment recognized in the statement of Profit and Loss for the period
4. General Description of Lessee significant leasing arrangements

3.2.7.2.3 Accounting in the books of Lessor in case of Finance Lease

1. Lessor to record assets in the books of account at an amount equal to net investment in Lease
2. Record finance income based on pattern reflecting constant periodic rate of return
3. Estimate unguaranteed residual value used in computing lessor gross investment in lease
4. If there is any reduction in estimated unguaranteed residual value then revise the income allocation over the remaining lease term. Reduction in respect to amount already recognized to be recognized immediately. Upward adjustment to be ignored
5. Initial direct cost associated with the lease to be recognized immediately in the profit and loss account or can be spread over the lease term

Accounting in the books of Lessor in case of Operating Lease

1. Lessor should record assets in balance sheet under fixed assets
2. Lease income to recognize in statement of profit and loss account
3. Cost incurred including depreciation to be recognized in statement of profit and loss account
4. Check for impairment and provide for in book as per GAAP
5. Depreciation in relation to leased assets must be consistent with the lessor's normal depreciation policy for similar assets.
6. Initial direct costs incurred by lessor in negotiating and arranging the lease should be expensed in the year in which they are incurred.

3.2.7.3 Distinction between Finance Lease and operating lease.

Comparative Factor	Operating Lease	Financial Lease
Duration	Short term	Long term (spread over the life of the asset)
Transfer of Ownership	Ownership may or may not be transferred after the lease	Normally, ownership is transferred after the lease

	term	term
Main Purpose	Short-term availability of an asset	Financing of the asset
Ownership Advantage	All advantages remain with lessor	Most of the advantages such as depreciation, investment allowance and subsidies are transferred to the lessee.
Total value of the lease	Small and for a portion of the life of the asset	Normally equal to the capital expenditure incurred on the asset
Associated services	A few services may be attached with the asset (such lease is called 'wet lease.' The lease is called 'dry' if it is without any services)	All associated services are provided to the lessee
Accounting treatment	The lease rent is treated as recurring expenditure by lessee and operating income by lessor	The lease sum is segregated into two portions, principal and interest. The entire principal amount is shown as an asset in lessee's balance sheet, whereas the interest portion is his/her recurring expense. Outstanding principal amount is shown as liability in the balance sheet of lessee. Lessor pays income tax only on his/her net revenue income.
Liquidity and taxability adjustments	The lease term being small, adjustments of liquidity and taxability are very limited	The entire lease may be so structured that the lessor and lessee should support each other.

Illustration 6

Natural Leasing Ltd. is the lessor of plant which it acquired at a cost of ₹ 7,50,000/- on 1st April 2017. This plant which has an estimated life of 10 years with no residual value was leased on the very same day for an initial period of 4 years, under operating lease providing for an annual rental of ₹ 1,05,640.

Show, how Natural Leasing Ltd. would treat this transaction in the financial statements prepared for the year ended 31st March 2020.

Solution:

Depreciation per year = Cost of Asset– Residual Value / Estimated Life

= (₹ 7,50,000 – Zero) / 10 years

= ₹ 75,000/year

Profit & Loss A/c
For the year ended 31st March 2020

Particulars	₹	Particulars	₹
To Depreciation on Leased Asset	75,000	By Lease Rental	1,05,640

Balance Sheet
As on 31st March 2020

Liabilities	₹	Assets	₹
		Plant 6,00,000 Less: Dep. 75,000	525000

Note: Book value of plant as on 31st March 2020 is (7,50,000 less two years depreciation)

Illustration 7

Mr. Rujul of Kolhapur takes an Oil Tanker on lease for a four-year period for which period he has secured a contract with Oil India to transport oil from Mumbai to Kolhapur. The contract was entered into on 1st April 2016 and the rentals agreed are Rs. 1,60,000, Rs. 1,50,000, Rs. 1,40,000 and Rs. 1,50,000 respectively. His other expenses and income from operating the tanker are given below:

	March 2017	March 2018	March 2019	March 2020
Diesel and Oil	50,000	55,000	60,000	45,000
Drivers Salaries	90,000	91,000	90,000	1,03,000
Administrative Overheads	48,000	49,000	51,000	74,000
Hire paid by Oil India	3,90,000	3,95,000	4,00,000	3,56,000

Show his Profit & Loss A/c for the four years and also how his Balance Sheet appears assuming that he started with a capital of Rs. 1,00,000/- cash. All payments and receipts are in cash.

Solution:

In the Books of Mr. Rujul of Kolhapur

Profit & Loss A/c *for the year ending 31st March*

	March 2017	March 2018	March 2019	March 2020
Hire paid by Oil India	3,90,000	3,95,000	4,00,000	3,56,000
Total (A)	**3,90,000**	**3,95,000**	**4,00,000**	**3,56,000**
Lease Rental (Avg=6,00,000/4)	1,50,000	1,50,000	1,50,000	1,50,000
Diesel and Oil	50,000	55,000	60,000	45,000
Drivers Salaries	90,000	91,000	90,000	1,03,000
Administrative Overheads	48,000	49,000	51,000	74,000
Total (B)	**3,38,000**	**3,45,000**	**3,51,000**	**3,72,000**
Net Income (Loss) [A –B]	52,000	50,000	49,000	(16,000)

Profit for the period

	March 2017	March 2018	March 2019	March 2020
Net Income (Loss)	52,000	50,000	49,000	(16,000)
Cumulative Profit	**52,000**	**1,02,000**	**1,51,000**	**1,35,000**

Balance Sheet As on 31st March

	March 2017	March 2018	March 2019	March 2020
Capital Profit (Cumulative)	1,00,000 52,000	1,00,000 1,02,000	1,00,000 1,51,000	1,00,000 1,35,000
	1,52,000	**1,02,000**	**2,51,000**	**2,35,000**

Illustration 8

Jadhav Ltd. Leased a machine to Shinde Ltd. The lease provides an annual rent of ₹ 1,44,300 at the beginning of the year commencing from 1st April, 2015 for a period of 4 years. The cost of machine is ₹ 10,00,000 and has an economic life of 10 years. Charge depreciation at 12% on WDV basis. Give Journal entries in the books of the Jadhav Ltd. and Shinde Ltd. Under Operating Lease.

Solution:

Calculation of Depreciation

Date	**WDV**	**Depreciation**
31st March 2016	10,00,000	1,20,000
31st March 2017	8,80,000	1,05,600
31st March 2018	7,74,400	92,928
31st March 2019	6,81,472	81,777
31st March 2020	5,99,695	71,963
	Total	4,72,268

In the Books of Jadhav Ltd.
Journal Entries

Date	**Particulars**	**Debit (₹)**	**Credit (₹)**
1/04/2015	Cash A/c Dr.	1,44,300	
	To Unearned Rent A/c		1,44,300
31/03/2016	Unearned Rent A/c Dr.	1,44,300	
	To Lease Rent A/c		1,44,300

31/03/2016	Depreciation A/c	Dr.	1,20,000	
	To Provision for Depreciation A/c			1,20,000
31/03/2016	Profit & Loss A/c	Dr.	1,20,000	
	To Depreciation A/c			1,20,000
1/04/2016	Cash A/c	Dr.	1,44,300	
	To Unearned Rent A/c			1,44,300
31/03/2017	Unearned Rent A/c	Dr.	1,44,300	
	To Lease Rent A/c			1,44,300
31/03/2017	Depreciation A/c	Dr.	1,05,600	
	To Provision for Depreciation A/c			1,05,600
31/03/2017	Profit & Loss A/c	Dr.	1,05,600	
	To Depreciation A/c			1,05,600
1/04/2017	Cash A/c	Dr.	1,44,300	
	To Unearned Rent A/c			1,44,300
31/03/2018	Unearned Rent A/c	Dr.	1,44,300	
	To Lease Rent A/c			1,44,300
31/03/2018	Depreciation A/c	Dr.	92,928	
	To Provision for Depreciation A/c			92,928
31/03/2018	Profit & Loss A/c	Dr.	92,928	
	To Depreciation A/c			92,928
1/04/2018	Cash A/c	Dr.	1,44,300	
	To Unearned Rent A/c			1,44,300
31/03/2019	Unearned Rent A/c	Dr.	1,44,300	
	To Lease Rent A/c			1,44,300
31/03/2019	Depreciation A/c	Dr.	81,777	
	To Provision for Depreciation A/c			81,777
31/03/2019	Profit & Loss A/c	Dr.	81,777	
	To Depreciation A/c			81,777
1/04/2019	Cash A/c	Dr.	1,44,300	
	To Unearned Rent A/c			1,44,300

31/03/2020	Unearned Rent A/c Dr.	1,44,300	
	To Lease Rent A/c		1,44,300
31/03/2020	Depreciation A/c Dr.	71,963	
	To Provision for Depreciation A/c		71,963
31/03/2020	Profit & Loss A/c Dr.	71,963	
	To Depreciation A/c		71,963
		23,87,536	**23,87,536**

In the Books of Shinde Ltd.

Journal Entries

Date	**Particulars**	**Debit (₹)**	**Credit (₹)**
1/04/2015	Prepaid Rent A/c Dr.	1,44,300	
	To Cash A/c		1,44,300
31/03/2016	Lease Rent A/c Dr.	1,44,300	
	To Prepaid Rent A/c		1,44,300
31/03/2016	Profit & Loss A/c Dr.	1,44,300	
	To Lease Rent A/c		1,44,300
1/04/2016	Prepaid Rent A/c Dr.	1,44,300	
	To Cash A/c		1,44,300
31/03/2017	Lease Rent A/c Dr.	1,44,300	
	To Prepaid Rent A/c		1,44,300
31/03/2017	Profit & Loss A/c Dr.	1,44,300	
	To Lease Rent A/c		1,44,300
1/04/2017	Prepaid Rent A/c Dr.	1,44,300	
	To Cash A/c		1,44,300
31/03/2018	Lease Rent A/c Dr.	1,44,300	
	To Prepaid Rent A/c		1,44,300
31/03/2018	Profit & Loss A/c Dr.	1,44,300	
	To Lease Rent A/c		1,44,300
1/04/2018	Prepaid Rent A/c Dr.	1,44,300	
	To Cash A/c		1,44,300
31/03/2019	Lease Rent A/c Dr.	1,44,300	
	To Prepaid Rent A/c		1,44,300
31/03/2019	Profit & Loss A/c Dr.	1,44,300	

	To Lease Rent A/c		1,44,300
1/04/2019	Prepaid Rent A/c Dr.	1,44,300	
	To Cash A/c		1,44,300
31/03/2020	Lease Rent A/c Dr.	1,44,300	
	To Prepaid Rent A/c		1,44,300
31/03/2020	Profit & Loss A/c Dr.	1,44,300	
	To Lease Rent A/c		1,44,300
		21,64,500	**21,64,500**

Illustration 9

Mangalmurty Leasing Ltd. is leases the lessor of 3D Printing Machine which it acquired at a cost of ₹ 4,20,000. This 3D Printing Machine which has an estimated life of 5 years, was leased on the very same day to Sukhakarta Ltd. for an initial period of 4 years, under operating lease. The depreciation could be charged in the proportion of output of prints per year. The other information is as under—

Estimated output from machine from 1st year to 5th year	:	30,000 Prints, 50,000 Prints, 60,000 Prints, 50,000 Prints and 20,000 Prints,
Annual Lease Payment	:	₹ 75,000, Rs. 90,000, ₹ 1,00,000 and ₹ 1,15,000 respectively

Give Journal entries in the books of Mangalmurty Leasing Ltd. (Lessor) and Sukhakarta Ltd.(Lessee)

Solution:

- The depreciable amount is ₹ 4,20,000 (Cost of 3D Printing Machine) should be allocated over useful life of 5 years in proportion of output (i.e. 3:5:6:5:2) as ₹ 30,000, ₹ 50,000, ₹ 60,000, ₹ 50,000 and ₹ 20,000 respectively. Hence, the amount of depreciation for the lease period is ₹ 60,000, 1,00,000, ₹ 1,20,000 and Rs. 1,00,000 respectively.

- Total lease payment ₹ 3,80,000/- should be recognized in proportion of out-put (i.e. 3:5:6:5). Hence, the amount of lease rent for the lease period is ₹ 60,000, 1,00,000, ₹ 1,20,000 and ₹ 1,00,000 respectively.

In the Books of Mangalmurty Leasing Ltd.
Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
1st Year	Cash A/c	Dr.	75,000	
	To Rent Receivable A/c			15,000
	To Lease Rent A/c			60,000
	Depreciation A/c	Dr.	60,000	
	To Provision for Depreciation A/c			60,000
	Lease Rent A/c	Dr.	15,000	
	To Profit & Loss A/c			15,000
	Profit & Loss A/c	Dr.	90,000	
	To Depreciation A/c			90,000
2nd Year	Cash A/c	Dr.	90,000	
	Rent Receivable	Dr.	10,000	
	To Lease Rent A/c			1,00,000
	Depreciation A/c	Dr.	1,00,000	
	To Provision for Depreciation A/c			1,00,000
	Profit & Loss A/c	Dr.	10,000	
	To Lease Rent A/c			10,000
	Profit & Loss A/c	Dr.	1,00,000	
	To Depreciation A/c			1,00,000
3rd Year	Cash A/c	Dr.	1,00,000	
	Rent Receivable	Dr.	20,000	
	To Lease Rent A/c			1,20,000
	Depreciation A/c	Dr.	1,20,000	
	To Provision for Depreciation A/c			1,20,000
	Profit & Loss A/c	Dr.	20,000	
	To Lease Rent A/c			20,000
	Profit & Loss A/c	Dr.	1,20,000	
	To Depreciation A/c			1,20,000
4th Year	Cash A/c	Dr.	1,15,000	
	To Rent Receivable A/c			15,000
	To Lease Rent A/c			1,00,000

	Depreciation A/c Dr.	1,00,000	
	To Provision for Depreciation A/c		1,00,000
	Lease Rent A/c Dr.	15,000	
	To Profit & Loss A/c		15,000
	Profit & Loss A/c Dr.	1,00,000	
	To Depreciation A/c		1,00,000
		12,60,000	**12,60,000**

In the Books of Sukhakarta Ltd.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
1st Year	Lease Rent A/c Dr.	60,000	
	Lease Rent Payable A/c Dr.	15,000	
	To Cash A/c		75,000
	Profit & Loss A/c Dr.	60,000	
	To Lease Rent A/c		60,000
2nd Year	Lease Rent A/c Dr.	1,00,000	
	To Cash A/c		90,000
	To Lease Rent Payable		10,000
	Profit & Loss A/c Dr.	1,00,000	
	To Lease Rent A/c		1,00,000
3rd Year	Lease Rent A/c Dr.	1,20,000	
	To Cash A/c		1,00,000
	To Lease Rent Payable		20,000
	Profit & Loss A/c Dr.	1,20,000	
	To Lease Rent A/c		1,20,000
4th Year	Lease Rent A/c Dr.	1,00,000	
	Lease Rent Payable A/c Dr.	15,000	
	To Cash A/c		1,15,000
	Profit & Loss A/c Dr.	1,00,000	
	To Lease Rent A/c		1,00,000
		7,90,000	**7,90,000**

Illustration 10

Mr. Avinash Leased Motor Car to Mr. Mayank For 4 years. The lease rent p.a. is ₹ 60,000 First three months are rent free period. The cost of car is ₹ 5,75,000 and useful life is 10 years with no residual value.

Pass Journal entries in the books of both parties under operating lease.

Solution:

In case of uneven lease payment, total rent payable should be divided evenly over each lease period

Year	Yearly Rent (₹)
1	45,000 (for 9 months)
2	60,000
3	60,000
4	60,000
Total	2,25,000

Total rent for the lease period i.e. for 4 years will be ₹ 2,25,000/-. Hence, for each year lease rental to be consider as ₹ 56,250/- per annum (₹ 2,25,000/4)

Annual Depreciation = (Cost of Car – Residual Value)/Estimated Life

= (₹ 5,75,000 – Zero)/10

= ₹ 57,500/-

In the Books of Mr. Avinash
Journal Entries

Date	**Particulars**		**Debit (₹)**	**Credit (₹)**
1^{st} Year	Cash A/c	Dr.	45,000	
	Rent Receivable A/c	Dr.	11,250	
	To Lease Rent A/c			56,250
	Depreciation A/c	Dr.	57,500	
	To Provision for Depreciation A/c			57,500
	Lease Rent A/c	Dr.	11,250	
	To Profit & Loss A/c			11,250

	Profit & Loss A/c	Dr.	57,500	
	To Depreciation A/c			57,500
2nd Year	Cash A/c	Dr.	60,000	
	To Lease Rent A/c			56,250
	To Rent Receivable A/c			3,750
	Depreciation A/c	Dr.	57,500	
	To Provision for Depreciation A/c			57,500
	Lease Rent A/c	Dr.	3,750	
	To Profit & Loss A/c			3,750
	Profit & Loss A/c	Dr.	57,500	
	To Depreciation A/c			57,500
3rd Year	Cash A/c	Dr.	60,000	
	To Lease Rent A/c			56,250
	To Rent Receivable A/c			3,750
	Depreciation A/c	Dr.	57,500	
	To Provision for Depreciation A/c			57,500
	Lease Rent A/c	Dr.	3,750	
	To Profit & Loss A/c			3,750
	Profit & Loss A/c	Dr.	57,500	
	To Depreciation A/c			57,500
4th Year	Cash A/c	Dr.	60,000	
	To Lease Rent A/c			56,250
	To Rent Receivable A/c			3,750
	Depreciation A/c	Dr.	57,500	
	To Provision for Depreciation A/c			57,500
	Lease Rent A/c	Dr.	3,750	
	To Profit & Loss A/c			3,750
	Profit & Loss A/c	Dr.	57,500	
	To Depreciation A/c			57,500
			7,18,750	**7,18,750**

In the Books of Mr. Mayank
Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
1st Year	Lease Rent A/c	Dr.	56,250	
	To Cash A/c			45,000
	To Rent Payable A/c			11,250
	Profit & Loss A/c	Dr.	56,250	
	To Lease Rent A/c			56,250
2nd Year	Lease Rent A/c	Dr.	56,250	
	Rent Payable A/c	Dr.	3,750	
	To Cash A/c			60,000
	Profit & Loss A/c	Dr.	56,250	
	To Lease Rent A/c			56,250
3rd Year	Lease Rent A/c	Dr.	56,250	
	Rent Payable A/c	Dr.	3,750	
	To Cash A/c			60,000
	Profit & Loss A/c	Dr.	56,250	
	To Lease Rent A/c			56,250
4th Year	Lease Rent A/c	Dr.	56,250	
	Rent Payable A/c	Dr.	3,750	
	To Cash A/c			60,000
	Profit & Loss A/c	Dr.	56,250	
	To Lease Rent A/c			56,250
			4,61,250	**4,61,250**

Check Your Progress-2

A) Choose Correct Alternative given below

1. Long-term non-cancelable lease contracts are known as ------------

   a. Operating lease b. lessor

   c. lessee d. financial leases

2. Lessor to record assets in the books of account at an amount equal to ----------------in Lease

   a. gross investment b. depreciation

c. net investment d. interest

3. The difference between the lessor's gross investment in the lease and its present value is termed as-----------------

   a. Unearned Finance Income b. Net Investment

   c. minimum rent d. None of the above

4. One difference between a financial lease and operating lease is that:

   a) there is a often a call option in a financial lease.

   b) there is often an option to buy in an operating lease.

   c) an operating lease is often cancellable by the lessee.

   d) a financial lease is often cancellable by the lessee.

5. The principal reason for the existence of leasing is that:

   a) companies, financial institutions, and individuals derive different benefits from owning assets.

   b) this is a type of financing unaffected by changes in tax law.

   c) intermediate-term loans are difficult to obtain.

   d) leasing is a renewable source of intermediate-term funds.

6. The type of lease that includes a third party, a lender, is called a(n):

   a) sale and leaseback. b) leveraged lease

   c) direct leasing arrangement. d) wet lease

7. One advantage of a financial lease is that:

   a) it has a shorter maturity than term loans.

   b) it never appears as a liability on the balance sheet.

   c) it eliminate the needs to make periodic payments.

   d) it provides a way to indirectly depreciate land.

8. A *direct lease*, a *sale and leaseback*, and a *leveraged lease* are all examples of

   a) financial leases. b) Operating leases.

   c) full-service leases

   d) "off-balance sheet" methods of financing.

B) Fill in the blanks

1. ---------------and ---------------are the hallmarks of operating leases.
2. The discount rate that, at the inception of the lease, causes the aggregate present value of the minimum lease payments to be equal to the fair value is called as----------------of interest in the lease.
3. In Operating lease, the lease rent is treated as ------------expenditure by lessee and -----------income by lessor

C) State the following statements are either True or False

1. The rate at which the lessor borrows his funds is called ‘Implicit Rate of Interest’
2. When the present value of minimum lease payments is greater than or substantially equal to the fair value of the asset, the lease is termed as ‘Finance Lease’
3. A leased asset for an operating lease should be depreciated on a basis consistent with the lessor’s normal depreciation policy for similar assets.
4. In an operating lease, the lessee should charge the lease rentals to the profit and loss account on cash bases.
5. In a sale and leaseback arrangement, the seller is the lessee and the buyer is the lessor.
6. In accounting for operating leases, the lessor, rather than the lessee, will recognize depreciation on the leased asset.
7. In addition to the criteria that must be met by the lessee, the lessor must meet additional conditions for classification as a non operating lease to satisfy the realization principle.
8. If the lessee is expected to take ownership of a leased asset at the end of the lease term, the lessor must use an estimated residual value when calculating the lease payments necessary to achieve a desired rate of return.

3.3 Summary:

Lease finance is a viable financing alternative whereby project costs are met by procuring assets and equipment on hire. Lease financing enables the use or services of assets, without locking up capital. Leasing is now playing a pivotal role not only in large ventures but also start-up enterprises. Leasing is becoming a preferred solution to resolve fixed asset requirements vs. purchasing the asset. While evaluating this investment, it is essential for the owner of the capital to understand whether leasing would yield better returns on capital or not. A famous quote by Donald B. Grant says, "Why own a cow when the milk is so cheap? All you really need is milk and not the cow." *The c*oncept of Lease is influenced by this quote. We can compare 'milk' with the 'rights to use an asset' and 'cow' with the 'asset' itself. Ultimately, a person who wants to manufacture a product using machinery can get to use that machinery under a leasing arrangement without owning it. A lease can be defined as an arrangement between the lessor (owner of the asset) and the lessee (user of the asset) whereby the lessor purchases an asset for the lessee and allows him to use it in exchange for periodical payments called lease rentals or minimum lease payments (MLP). Leasing is beneficial to both the parties for availing tax benefits or doing tax planning.

At the conclusion of the lease period, the asset goes back to the lessor (the owner) in an absence of any other provision in the contract regarding compulsory buying of the asset by the lessee (the user). There are four different things possible post-termination of the lease agreement.

To summarize, lease finance is appropriate for an individual or business which cannot raise money through other means of finance like debt or term loan because of the lack of funds. The business or lessee cannot even arrange the down payment money to raise debt. The lease works best for him. On the other hand, the lessor, who wants to invest his money efficiently, becomes the financier for the lessee and earns the interest. Financing of lease is usually done by banks and term lending institutions. Nationalized as well as non-nationalized banks and financial institutions act as financiers of lease transactions. Banks provide working capital credit to lessor and usually secure their financing by hypothecation of the charge over the assets so leased and also through an assignment of the lease rentals. Besides these institutions, there are a number of one-off financiers who may not specialize in the financing of leases but may be doing so for tax reasons.

3.4. Terms to Remember

1. **Lease:** A lease is a contract outlining the terms under which one party agrees to rent property owned by another party.
2. **Finance Lease:** A finance lease is a way of providing finance effectively. A leasing company (the lessor or owner) buys the asset for the user (usually called the hirer or lessee) and rents it to them for an agreed period.
3. **Operating Lease:** Operating lease is a contract wherein the owner, called the Lessor, permits the user, called the Lessee, to use of an asset for a particular period which is shorter than the economic life of the asset without any transfer of ownership rights.
4. **Lease Agreement:** A contract between a lessor and lessee that allows the lessee rights to the use of a property owned or managed by the lessor for a period of time. The agreement does not provide ownership rights to the lessee.
5. **Lessor:** A person or organization that allows another person or organization to use something they own in return for regular payments.
6. **Lessee**: A person or organization that makes regular payments in order to use something that another person or organization owns
7. **Duration:** Period for which the lease agreement will be in effect.
8. **Rent:** The consideration or payment made by the lessee to the lessor in exchange for the property leased out.
9. **Deposits:** The amount of deposit required (if any), the purpose of each deposit, and conditions for return or adjustment of deposit at the end of the lease period.
10. **Terms of Use:** The purpose for which the property is to be used and terms and conditions regarding use of the property.
11. **Economic Life: Either**
    (a) The period over which an asset is expected to be economically usable by one or more users; or
    (b) The number of production or similar units expected to be obtained from the asset by one or more users.

12. **Useful Life: Either**

(a) The period over which the leased asset is expected to be used by the lessee; or

(b) The number of production or similar units expected to be obtained from the use of the asset by the lessee.

13. **Residual Value:**

The estimated fair value of the asset at the end of the lease term.

14. **Guaranteed Residual Value:**

In the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.

15. **Unguaranteed Residual Value:** The amount by which the residual value of the asset exceeds its guaranteed residual value.

16. **Gross Investment in the Lease:**The aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.

17. **F*air value :*** *Fair*value is the amount for which an asset could be exchanged between a knowledgeable willing parties in an arm's length transaction.

18. **Minimum Lease Payments: The** minimum payment is known as the minimum lease payment. Minimum lease payments are rental payments over the lease term including the amount of any bargain purchase option, premium, and any guaranteed residual value, and excluding any rental relating to costs to be met by the lessor and any contingent rentals.

The payments over are lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) In the case of the lessee any residual value guaranteed by or on behalf of the lessee; or

(b) In the case of the lessor, any residual value guaranteed to the lessor

   (i) By or on behalf of the lessee; or

   (ii) By an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option

19. **Contingent Rent:** That portion of the lease payments that is not fixed in amount but is based on factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rate of interest)

20. **Non-Cancellable lease:** ***A*** lease that is cancellable only:

    a. upon the occurrence of some remote contingency; or

    b. with the permission of the lessor; or

    c. if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

    d. upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonable certain.

21. **Inception of the lease:** The earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

3.5 Answers to Check your Progress

Check your Progress- 1

A) Choose correct Alternative given below

1 – b   2 – c   3 - a

B) Fill in the blanks

1. Farouk Irani   2. Assured Regular Income

3. Financing, investment

C) State the following statements are either True or False

1 - True 2 - True 3- True

Check your Progress- 2

A) Choose correct Alternative given below

1 – d 2 – c 3 – a 4- c 5- a 6- b 7- d8- a

B) Fill in the blanks

1. Convenience, instant services 2. implicit rate

3. recurring, operating

C) State the following statements are either True or False

1 - False 2 - True 3- True 4- False 5- True

6 – True 7 – True 8 – False

3.6 Exercise

1. Answer in Short
   a) What is lease? Define the uses of lease.
   b) What is lease agreement? Elaborate the content of lease agreement.
   c) What is finance lease? Explain the various types of finance lease.
   d) What is operating lease? Explain the various types of operating lease.
2. Write Short Notes
   a) Lease Accounting
   b) Lease Rental
   c) Lease Period
   d) Sale and Lease Back
   e) Leverage Lease
3. Distinguish between operating and finance lease.
4. Distinguish between AS 19 and IND AS 116
5. Give in detail the advantages and disadvantages of lease financing.

6. What are the features of lease contract?

7. Superb Leasing Ltd. has leased a commercial vehicle of fair value Rs. 1,00,000/- on a four year lease with annual lease rental of Rs. 38,630/- payable at the end of the year. Compute the interest rate implicit in the lease.

   [Ans.: 20%]

8. Luminous Leasing Ltd. has leased Tractor of fair value of Rs. 1,20,000/- on a four year lease with annual lease rental of Rs. 36,550/- payable at the beginning of the year. Compute the interest rate implicit in the lease.

   [Ans.: 15%]

9. Super Lease Ltd. has leased a Machinery with fair value ₹ 4,00,000/- at an annual rental of ₹ 1,26,025/- payable in advance for 4 years

   Required:

   a. Calculate the total finance income over the life of the lease.

   b. Allocate the finance income at actuarial method to the accounting years over the life of the lease.

   c. Show how this transaction would appear in the Profit and Loss A/c and balance sheet of Super Lease Ltd. for all the years. The company provides depreciation on this assets at 30% as WDV basis.

10. Excellent Leasing Ltd. has leased a Xerox Machine costing ₹ 90,000/- for a four year term to Sunshine Ltd. for a four year period beginning on 1st April 2017. Lease rentals are payable in advance (at the beginning of each period) and agreed at ₹ 44,000/-, ₹ 32,000/-, 22,000/- and 11,000 respectively.

    Required:

    a. The interest rate implicit in the lease

    b. Allocation of finance income over the lease term

    c. Financial statements of the company for the first two years.

11. Show the leasing transaction in (12) will appear in the financial statement of Sunshine Ltd.

12. Proctor Leasing Ltd. leases a JCB machine costing ₹ 11,00,000/- on a five year lease to Rujul Ltd. at an annual lease rental ₹ 1,50,000/- payable at the end of each year. the lease commences on 1st April 2016.

    Required:

    a. Allocation of finance income over the lease term.

    b. Financial statements of the Leasing Company for the lease period.

13. Good Luck Leasing Ltd. entered into a leasing contract with Red Chilli Ltd to lease Crushing Plant. The plant cost ₹ 5,25,000/- and has an economic life of 10 years. The plant was purchased on 1st Jan. 2016 and is depreciated at 20% on WDV basis. The lease provides an annual rental of ₹ 77,500/- for a period of five years commencing from 1st April 2016. Show as to how this transaction would appear in the books of lessor and lessee.

14. Susmita Ltd. Leased a Beauty Parlor machine to Anita Ltd. The lease provides an annual rent of ₹ 39,300 at the beginning of the year commencing from 1st April, 2017 for a period of 4 years. The cost of machine is ₹ 2,00,000 and has an economic life of 6 years. Charge depreciation at 15% on WDV basis. Give Journal entries in the books of the Susmita Ltd. and Anita Ltd. Under Operating Lease.

15. Amardeep Leasing Ltd. is the lessor of Machine which it acquired at a cost of ₹ 5,00,000/-. This Machine which has an estimated life of 5 years, was leased on the very same day to Jadhav Ltd. for an initial period of 4 years, under operating lease. The depreciation could be charged in the proportion of output of units per year. The other information is as under—

Estimated output from machine from 1st year to 5th year	:	50,000 Units, 60,000 Units, 40,000 Units, 30,000 Units and 20,000 Units,
Annual Lease Payment	:	₹ 80,000, ₹ 1,00,000, ₹ 1,05,000 and ₹ 1,20,000 respectively

Give Journal entries in the books of Amardeep Leasing Ltd. (Lessor) and Jadhav Ltd. (Lessee)

16. Mr. Ravindra Leased Truck to Mr. Om For 4 years. The lease rent p.a. is Rs. 75,000 First six months are rent free period. The cost of Truck is Rs. 4,00,000/-

and useful life is 10 years with no residual value. Pass Journal entries in the books of both parties under operating lease.

3.7 Reference for Further Study:

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4. Bhattacharyya Asish K. (2006) Financial Accountancy, Prentice-Hall of India Pvt. Ltd. New Delhi.
5. Ghosh T P (2009). Financial Accounting for Managers, Taxman Publication (P.) Ltd. Admedabad.
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Unit-4
Accounts of Electrical Companies

Index

4.0 Objective :

After studying this unit, you will be able to-

1. Understand the main objectives of the Electricity Act, 2003.
2. Explain the meaning of certain key terms.
3. Understand some important accounting aspects relating to an electricity company.
4. Prepare the final accounts relating to an electricity company.

4.1 Introduction :

Power / Electricity is today a basic human need. It is a public utility industry because ample supplies of electricity at low rates are of vital interest to industry and the general public.

Prior to 10th June, 2003 the electricity supply industry in India was governed by three enactments namely -

- Indian Electricity Act, 1910
- The Electricity (Supply) Act, 1948
- The Electricity Regulatory Commission Act, 1998

With the policy of encouraging private sector participation in generation, transmission and distribution the objective of distancing the regulatory responsibilities from the government to the regulatory commissions and to harmonise and rationalise the provisions in the Indian Electricity Act, 1910 the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commission 1998, new comprehensive Electricity Act, 2003 was enacted.

4.2 Presentation of Subject Matter :

The electricity industry in India was guided by the Indian Electricity Act, 1910 and the Electricity (Supply) Act, 1948. The Indian Electricity Act, 1910 introduced a licensing system for the electricity industry and the Electricity (Supply) Act, 1948 introduced greater state involvement in the industry, facilitating regional coordination through state-owned, vertically integrated units called State Electricity Boards (SEBs) to develop a "Grid System". The SEBs were responsible for generation, transmission and distribution of electricity within each state of the Indian Union.

In the early 1990s, the power sector was liberalised by permitting private participation in the generation and transmission sectors and establishing regional load dispatch centres (RLDCs). In 1998, the Electricity Regulatory Commissions Act, 1998 (the ERC Act) established independent electricity regulatory commissions (ERC) at the central and state levels, with the objective of rationalising the electricity tariff regime and promoting and regulating the electricity industry. The ERC Act, which has been replaced by the Electricity Act, 2003 provided for the formation of State Electricity Regulatory Commissions (SERCs) in the respective states for the rationalisation of energy tariffs.

4.2.1 Historical Background of Legislative Initiatives

The Indian Electricity Act, 1910 provided basic framework for electric supply industry in India. It made provisions for growth of the sector through licensees. The Act covered the provisions for licence by State Government, provision for licence for supply of electricity in a specified area, legal framework for lying down of wires and other works, provisions laying down relationship between licensee and consumer.

The Electricity (Supply) Act, 1948 mandated creation of State Electricity Boards (SEBs) and need for the State to step in (through SEBs) to extend electrification (so far limited to cities) across the country. Later on this Act was amended to enable generation in Central sector and to bring in commercial viability in the functioning of SEBs -- especially section 59 was amended to make the earning of a minimum return of 3% on fixed assets a statutory requirement (w.e.f. 1.4.1985). Further amendment was made in 1991 to open generation to private sector and establishment of RLDCs and another amendment in 1998 was made to provide for private sector participation in transmission, and also provision relating to Transmission Utilities.

The Electricity Regulatory Commission Act, 1998 lays down the provision for setting up of Central / State Electricity Regulatory Commission with powers to determine tariffs. Further, it emphasized on the constitution of SERC optional for States and distancing of Government from tariff determination.

4.2.2 The Electricity Act, 2003

The Electricity Act, 2003 (the Electricity Act) is a central legislation relating to generation, transmission, distribution, trading and use of electricity, that seeks to replace the multiple legislations that governs the Indian power sector. The most significant reform initiative under the Electricity Act was the move towards a multi-buyer, multi-seller system as opposed to the existing structure which permitted only a single buyer to purchase power from power generators. In addition, the Electricity Act grants the ERCs freedom in determining tariffs, without being constrained by rate-of-return regulations. Under the Electricity Act, no licence is required for generation of electricity if the generating station complies with the technical standards relating to connectivity with the grid. The Electricity Act was amended in 2007 to exempt captive power generation plants from licensing requirements for supply to any licensee or consumer. The Electricity Act was amended in 2010 by notification dated 3 March 2010 to provide that any developer of a special economic zone notified under the Special Economic Zones Act, 2005 shall be deemed to be a licensee under the Electricity Act.

- **Objectives**

The objectives of the Act are "to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalization of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto".

The Electricity Act 2003 provides electricity market for private investments for increasing generation capacity and efficient network use in India. It encourages captive generation, non-discriminatory open access to transmission and distribution system and de-licensing generation

Under the Electricity Act 2003, activities like generation, transmission and distribution have been separately identified. Now, no person shall (a) transmit electricity; or (b) distribute electricity; or (c) undertake trading in electricity, unless he is authorised to do so by a license issued under section 14, or is exempt under section 13.

Thus the Electricity Act, 2003 (published in the Gazette of India, June 2, 2003) replaces the three existing legislations, namely, Indian Electricity Act, 1910, the Electricity (Supply) Act. 1948 and the Electricity Regulatory Commissions Act 1998

The objectives of the Electricity Act, 2003 are:

- consolidate the laws relating to generation, transmission, distribution, trading and use of electricity.
- taking measures conducive to development of electricity Industry.
- promoting competition therein.
- protecting interest of consumers.
- supply of electricity to all areas.

- rationalization of electricity tariff.
- ensuring transparent policies regarding subsidies.
- promotion of efficient and environmentally benign policies.
- Constitution of Central Electricity Authority, Central and State Regulatory Commissions and establishment of Appellate Tribunal and for matter connected therewith or incidental thereto.
- **The salient features of the Electricity Act, 2003 are:**
- The Central Government to prepare a National Electricity Policy in consultation with State Governments. It has been formulated.
- Thrust to complete the rural electrification and provide for management of rural electricity distribution by Panchayats, Cooperative Societies, non-Government organisations, franchiseest etc.
- Provision for licence free generation and distribution of electricity in the rural areas.
- Generation of electricity being delicensed and captive generation being freely permitted. Hydro projects would, however, need clearance from the Centra Electricity Authority.
- Electricity Transmission Utility at the Central as well as State level, to be a Government company with responsibility for planned and coordinated development of electricity transmission network.
- Provision for private licensees in electricity transmission and entry in distribution through an independent network.
- "Open access in electricity transmission from the outset.
- Open access in distribution to be introduced in phases with surcharge for current level of cross subsidy to be gradually phased out along with cross subsidies and obligation to supply. SERCs to frame regulations within one year regarding phasing of open access.
- Distribution licensees would be free to undertake generation and generating companies would be free to take up distribution businesses.

- The State Electricity Regulatory Commission is a mandatory requirement. 24 States had set up their State Electricity Regulatory Commissions up to March 31, 2006.
- Provision for payment of subsidy through budget.
- Trading of electricity is being recognised as a distinct activity. Regulatory commissions are authorised to fix ceilings on trading margin, if necessary.
- Provisions are to be made for reorganisation or continuance of SEBs.
- Metering of all electricity supplied is to be made mandatory.
- There is to be an Appellate Tribunal for Electricity to hear appeals against the decisions of Central Electricity Regulatory Commission and State Electricity Regulatory Commissions to bring in higher autonomy and transparency in the regulatory mechanism of the sector. The Tribunal has become operational from 21st July, 2005.
- Provisions regarding theft of electricity are being made more stringent.

Licensing: No licence required for power generation except for hydro power projects over a certain size but licence is required to (a) transmit electricity, or (b) distribute electricity or (c) to do trading in electricity.

The authorities under the Act are (a) Central Electricity Authority (CEA) (b) Central Electricity Regulatory Commission & (c) State Electricity Regulatory Commission.

Tariffs: Tariffs are fixed by the appropriate commissions considering various factors including safeguarding interest of consumer and at the same time recovery of cost of electricity and providing a reasonable return on investment.

For tariff determination under the Act two regulations have been issued Regulation 2004 & Regulation 2009.

4.2.3 Some Important Accounting Aspects :

A] Security Deposit-

Electricity Company can take suitable Security Deposit from consumers for supply of Electricity and/or for providing electric line, meter etc. This is refundable deposit.

Entry: Cash / Bank a/c Dr. --

To Security Deposit a/c --

This will be shown under non-current liability in Balance sheet.

Electricity company has to pay interest at Bank Rate or more (rate prevailing on 1st April of the year) on such deposit. Interest is accrued annually.

Entry: Interest Expense a/c Dr. --

To Interest Accrued on Security Deposit a/c --

This accrued interest will be adjusted against the consumers bill for the 1st quarter of next year.

Entry: Interest Accrued on Security Deposit a/c Dr. --

To Electricity Sale a/c --

Accrued interest will be shown under current liability in balance sheet.

Illustration.1. Security Deposit received from a Customer on 1.7.2010 Rs.1,00,000, RBI interest Rate on 1.4.10 was 8% & on 1.4.11 was 9%. Account this for the year 2010-11 & 2011-12

Solution 1] Accounting for Security Deposit & Interest on it

Journal Entries

Particulars		Debit	Credit
	Year 2010 – 11		
1.7.2010	Bank A/c Dr.	1,00,000	
	To Security Deposit		1,00,000
	(Security deposit received from consumers)		
31.3.2011	Interest A/c — Dr.	6,000	
	To Accrued interest A/c		6,000
	$\left\{1,00,000\ x\ 8\%\ x\ \frac{9}{12} = 6,000\right\}$		
	(Interest accrued on Security deposit from consumers)		

30.06.2011	**Year 2011-12** Accrued interest A/c To Electricity Sale A/c (Accrued Interest on security deposit adjusted against electricity bills of consumers)	Dr.	6,000	6,000
31.3.2012	Interest A/c To Accrued interest A/c $\left\{1{,}00{,}000 \; x \; 9\% \; x \; \frac{12}{12} = 9{,}000\right\}$ (Interest accrued on Security deposit from consumers)	Dr.	9,000	9,000
30.06.2012	**Year 2012-13** Accrued Interest A/c To Electricity Sale A/c (Accrued Interest on security deposit adjusted against electricity bills of consumers)	Dr.	9,000	9,000

B] Capital Service line contribution (Customers contribution for service line)

An Electricity company can collect such charges for providing electricity connection and/or transformers at new areas as per rules framed by State Electricity Regulatory Commission.

Entry: Cash / Bank A/c Dr. --

To Customers Contribution for service line --

This will be shown under capital reserve in Reserves & Surplus in the balance sheet.

This amount shall be amortised in profit and loss account in proportion to the depreciation providedon the concerned asset.

Entry: Customers Contribution for service line A/c Dr. --

To Profit & Loss A/c --

C] Accelerated Power Development and Reforms Program (APDRP):

Central government introduced this program to improve distribution network, reduce/avoid transmission & distribution losses, theft etc.

This has two components:

Investment Components: That is for capital expenditure purposes. It has grant & loan component.

In special category states, 100% of the project cost is provided, 90% in grant form and 10% in loan form.

In other states, 50% of the project cost is provided of which half (i.e. 25%) is grant and other half (i.e. 25%) is loan.

Incentive Component: This is provided to motivate states to reduce their cash losses (calculated with reference to base year of 2000-01). Upto 50% of cash loss reduction is provided and is in the form of grant.

Accounting for loan Component: Loan component will be accounted as usually and will be treated as long term borrowings. Interest will be recognized at the applicable rates and will be treated as revenue expense.

Accounting for Grant Component: Grant under APDRP received as incentive component for reduction in cash loss should be recognized in profit & loss account.

Entry: Bank A/c Dr. --

To Profit & Loss A/c (grant as incentive for reduction in cash losses) --

Grant received for capital expenditure shall be treated as capital receipt and should be shown under Capital Reserve in Reserves & Surplus in Balance sheet.

Entry : Bank A/c Dr. --

To Capital Grant under APDRP A/c

This grant should be amortised to profit & loss account in proportion to the depreciation charged on the respective assets.

Entry : Capital Grant under APDRP A/c Dr. --

To Profit & Loss A/c --

Note: In cash flow statement such grant & customers contribution for service line shall be shown under financing activity.

Illustration-2.

An Electricity company has incurred Capital Expenditure of Rs.100 lakhs having life of 10 years. This is partly financed as 40% of Cost contributed by consumer & 25% is grant from centralgovernment. Account this transactions & their amortization.

Solution 2] Amortisation of Consumers Contribution & Govt. grant for capital expenditure

Cost of Asset	100	Life: 10 year
(-) Salvage value	10	
Depreciable amount	90	

Depreciable p.a. $\left(\frac{90}{10}\right) = 9$

Consumers Contribution 40

Government grant 25

Write off / amortization of Consumers Contribution & Government grant in proportion to depreciation:

Consumers contribution $\frac{40}{10}$ = 4 Lakh p.a.

Government grant $\frac{25}{10}$ = 2.50 p.a.

Journal Entries

Particulars	**Debit**	**Credit**
Bank A/c ---------------- Dr.	65	
To Contribution from Consumer for service line A/c		40
To Government grant A/c		25
(For capital expenditure, 40% Contribution received from consumers and 25% grant from govt.)		
Plant & Machinery A/c ———— Dr.	100	
To Bank A/c		100
(Plant and machinery acquired)		

Every year – year 1 to 10 Depreciation A/c Dr. To Plant & Machinery / Depreciation Provision A/c (Depreciation charged)	 9	 9
Consumers Contribution A/c Dr. Government grant A/c Dr. To Profit & Loss A/c (Consumers contribution and Govt. grant amortised in proportion to thedepreciation charged on the concerned asset)	4 2.5	 6.5

D] Depreciation:

Regulation, 2009 provides following with regard to the depreciation:

(i) Rates shall be determined by Central Electricity Regulatory Commission.

(ii) This rates shall be followed for tariff as well as for accounting.

(iii) Depreciation will be by SLM (Straight Line Method)

(iv) Salvage Value of at least 10% will be considered i.e. maximum 90% of the cost will be writtenoff over the useful life of the asset.

(v) Depreciation will be charged on Historical Cost & not on Revalued value.

(vi) Depreciation will be charged on time proportion basis & will start when the asset is put to use.

(vii) If allows Optimized Depreciated Replacement Cost (ODRC) i.e. if asset is financed by loan component, then depreciation equal to the principle loan repayment in each year will be provided until the repayment of loan, remaining depreciable balance thereafter will be written off over remaining useful life on SLM.

(viii)Commission has considered 12 years repayment period of loan & accordingly has given rates. After repayment of loan the balance depreciable value shall be divided over remaining useful life.

Summarised / Grouped Depreciation Rates are as follows

A.	Land → Owned	0%
B.	Land → Leased	3.34%
C.	Building & Civil Engineering works	3.34%
D.	Plant & Machinery in generating stations, Cooling tower & circulating water systems, Hydraulic works, Transformers, substation equipments, Switchgear including Cable connections, Lightning arrestor, Batteries, overhead lines, Meters, AC plant-static, Street Light fittings, asset not covered anywhere else.	5.28%
E.	Office furniture, office Equipment, Internal wiring, Motors given on hire, Communication equipment	6.33%
F.	Self-propelled vehicles, AC plant-portable, Apparatus on hire other than motors	9.50%
G.	I.T. equipments	15.00%
H.	Temporary erections such as wooden structures	100.00 %

Debt Equity Ratio (For Tariff calculation)

As per Regulations Debt equity Ratio of 70:30 i.e. 70% Debt & 30% Equity Should be considered forfinancing Capital Expenditure.

Debt higher than 70% will be allowed. Higher equity can be allowed by Commission in certain cases.

In other cases equity above 30% shall be considered as notional loan & interest on that portion will be considered.

Return on Equity will be allowed at 14%.

Illustration.3. An Electricity Company has acquired plant & machinery costing Rs.20 lakhs having useful life of 15 years. Calculate Depreciation.

Solution 3] Calculation of Depreciation:

Cost of Assets	20 lakhs
Life	15 years

Salvage value 10% as per regulation. The same is considered.

Cost of Asset	20
– Salvage value	2
Depreciable amount	18
Life	15 years

Depreciation p.a. $\frac{18}{15}$ = 1.20 Lakhs

Illustration.4. An Electricity company has financed the project costing Rs.200 lakhs by 70% Debt & 30% Equity. Debt bearing 12% Interest is to be repaid in 10 equal annual installments. Life of Asset is 15 years. Considering that Electricity generation, distribution & other costs (excluding Depreciation & interest) are Rs.50 lakhs p.a. Calculate annual Revenue (Tariff) During the currency of loan & thereafter.

Solution 4] Tariff Calculation: Depreciation to create cash flow for loan repayment.

Cost of assets		200
Financed by: Debt	70%	140
Equity	30%	60

Loan repaid in 10 equal installment i.e. $\frac{40}{10}$ = 14 Lakhs p.a.

Cost of Asset	200
– Salvage Value 10%	20
Depreciable Value	180

Depreciation in 1st 10 years equal to the principle loan being repaid.

@14 x 10 years	140
Balance to be write off in year 11–15	40

Depreciation p. a. = $\frac{40}{5}$ ----- = 8 p.a. for year 11 to 15

Tariff (Revenues) Calculation

Particulars	During loan repayment term			Afterwards
	1st year	**2nd year**	**10th year**	**11th – 15th year**
Electricity generation, distribution & other costs	50.00	50.00	50.00	50.00
Interest on loan 1st year (140 x 12%) 2nd (140 – 14) x 12%, 3rd 14 x 12%	16.80	15.12	1.68	–
Depreciation	14.00	14.00	14.00	8.00
Return allowed on equity (60 x 14%)	8.40	8.40	8.40	8.40
Tariff / Revenues	89.20	87.52	74.08	66.40

4.2.3 Financial Statement of Electricity Company-:

The Electricity Act, 2003 which governs Electricity Companies doesn't prescribe any format for preparation and presentation of financial statement. Hence revised (New) schedule VI of Companies Act should be followed (Clarified by ICAI in its guidance note on revised schedule VI).

Illustration-5.

The trial balance of Samarpan Electric Supply Ltd. for the year ended 31st March, 2022 is as below:

Particulars	Dr. Rs. (000)	Cr. Rs. (000)
Share Capital :		
30,00,000 Equity Shares of Rs. 10 each		30,000
Patents and Trademarks	1,000	
14 % Debentures		12,000
11 % Term Loan		7,000
Land	6,200	
Building	17,000	
Power Plant	30,000	

Electrical Instruments	2,800	
Capital Reserves		3,600
Contingency Reserves		6,000
Transformers	8,200	
Net Revenue Account		3,400
Inventories	5,800	
Trade Receivables	3,200	
Contingency Reserve Investments	6,000	
Bank Balance	1,200	
Public Lamps	1,600	
Depreciation Fund		12,000
Trade Payables		3,000
Declared Dividend		6,000
	83,000	**83,000**

Prepare Balance Sheet of Samarpan Electric Supply Ltd. as on 31st March, 2022.

Solution-

Balance-Sheet of Samarpan Electricity Supply as on 31st March 2022

Particulars		Amount
Equity & Liabilities		
1) Shareholder Funds		
a) Share Capital	1	30,000
b) Reserves & Surplus	2	13,000
2) Non-Current Liabilities		
a) Long term Borrowing	3	19,000
3) Current Liabilities		
a) Trade Payables		3,000
b) Other Current Liabilities		6,000
Total		**71,000**
Assets		
1) Non-Current Assets		

a) Fixed Assets		
i) Tangible Assets	4	53,800
ii) Intangible Assets		1,000
b) Non-Current Investments		6,000
2) Current Assets		
a) Trade Receivables		3,200
b) Inventories		5,800
c) Cash & Cash equivalent		1,200
d) Other Current Assets		--
Total		**71000**

Notes to Account- **Rs. in (000)**

1. Share Capital		
Equity Share of Rs. 10 each		30,000
Total		**30,000**
2. Reserve & Surplus		
Capital & Reserves		3600
Contingency Reserves		6,000
Net Revenue account		3,400
Total		**13,000**
3. Long Term Borrowings		
Debentures		12,000
Term Loan		7,000
Total		**19,000**
4. Fixed Assets		
Tangible		
Land		6,200
Building		17,000
Plant & Machinery		

Power Plant	30,000	
Transformer	8,200	
Public Lamps	1,600	39,800
Electrical Instruments		2,800
Total		65,800
(-) Depreciation Fund		12,000
Total		**53,800**

Illustration-6.

The trial balance of Anuradha Electric Supply Ltd. for the year ended 31st March, 2018 is as below:

Particulars	Dr. Rs. (000)	Cr. Rs. (000)
Share Capital :		
Equity Shares of Rs. 10 each		6250.00
14% Perference Shares of Rs. 100 each		1875.00
Patents and Trademark	313.00	
15 % Debentures		3087.50
16 % Term Loan		1912.50
Land	1556.25	
Building	4391.75	
Plant and Machinery	7132.25	
Mains	565.50	
Meters	393.75	
Electrical Instruments	191.25	
Office Furniture	306.25	
Capital Reserves		627.50
Contingency Reserves		1503.75
Transformers	2055.00	
Net Revenue Account		668.75
Stock in Hand	1506.25	
Sundry Debtors	780.75	

Contingency Reserve Investments	1501.25	
Cash and Bank	406.75	
Public Lamps	380.00	
Depreciation Fund		3227.00
Sundry Creditors		815.50
Proposed Dividend		1512.50
	21,480.00	**21,480.00**

During 2017-18, Rs. ('000) 12.50 of 14% Preference Shares were redeemed at a premium of 10% out of proceeds of fresh issue of Equity Shares of necessary amounts at a premium of 10% . Prepare for the above period Balance Sheet as on 31st March, 2018 as per Schedule III of the Companies Act. 2013.

Balance-Sheet of Anuradha Electricity Supply as on 31st March 2018

Particulars		**Amount**
Equity & Liabilities		
1) Shareholder Funds		
a) Share Capital	1	8,125.00
b) Reserves & Surplus	2	2,800.00
2) Non-Current Liabilities		
a) Long term Borrowing	3	5,000.00
3) Current Liabilities		
a) Trade Payables		815.50
b) Other Current Liabilities		1,512.50
Total		**18,253.00**
Assets		
1) Non-Current Assets		
a) Fixed Assets		
i) Tangible Assets	4	13,745.00
ii) Intangible Assets	5	313.00
b) Non-Current Investments		1,501.25

2) Current Assets		
a) Trade Receivables		780.75
b) Inventories		1,506.25
c) Cash & Cash equivalent		406.75
d) Other Current Assets		--
Total		**18,253.00**

Notes to Account

1. Share Capital		
Equity Share Capital 10 each	6250	
+Issue	1250	7500.00
14% Preference Share of Rs. 100 each	1875	
(-) Redeem	(1250)	625.00
Total		**8125.00**
4. Tangible Fixed Assets		
Land		1556.25
Building		4391.75
Plant & Machinery		7132.25
Mains		565.50
Meters		393.75
Electrical Instrument		191.25
Office Furniture		306.25
Transformers		2055.00
Public Lamps		380.00
Total		16,972.00
(-) Depreciation		3227.00
Total		**13745.00**

Illustration.7

From the following balance as at 31st March, 2014, prepare the financial statements of Suhas Power and Light Co. Ltd.

Particulars	Rs.	Particulars	Rs.
Balance as on 1st April, 2013		Expenses of Management	14,400
- Land	1,80,000	Cost of Distribution	6,000
- Machinery	7,20,000	Depreciation	24,000
- Mains	2,40,000	Sales of Current	1,56,000
Expenditure during the year		Meter Rent	6,000
- Land	6,000	Interest on Debentures	12,000
- Machinery	6,000	Interim Dividend	24,000
- Mains	61,200	Net Revenue A/c as on 1.4.2013	34,200
Share Capital – Ordinary Shares	6,58,800	Sundry Debtors	
Debentures	2,40,000	- For energy supplied	48,000
Cost of Generation	42,000	- Other	600
Sundry Creditors	1,200	Cash Balance	6,000
Rent. Rates and Taxes	6,000	Depreciation Fund	3,00,000

Solution 7:

BALANCE SHEET (As per Revised Schedule VI)

Balance Sheet of Suhas Power and Light Co. Ltd.

	Particulars	Notes		Rs.
	1	3	4	5
I.	**CAPITAL AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital		6,58,800	
	Reserves and surplus	1	67,800	7,26,600
(2)	**Share application money pending allotment**			---
(3)	**Non-current liabilities**			

	Long-term borrowings			---
	Debenture			2,40,000
(4)	**Current liabilities**			
	Trade Payables			1,200
	TOTAL			**9,67,800**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets	2		9,13,200
(2)	**Current assets**			
	Trade receivables		48,000	
	Cash and cash equivalents		6,000	
	Other current assets		600	54,600
	TOTAL			**9,67,800**

Profit & Loss Account (As per Revised Schedule VI)

Suhas Power and Light Co. Ltd.

Profit and loss statement for the year ended 31.03.2014

	Particulars		**Rs.**
I.	Revenue from operations: Sales of current		1,56,000
II.	Other income: Meter rent		6,000
III.	**Total Revenue** (I+II)		1,62,000
IV.	**Expenses:**		
	Cost of Generation		42,000
	Finance costs: Interest on Debenture		12,000
	Depreciation and amortisation expenses		24,000
	Other expenses		
	Rent Rates Taxes	6,000	
	Expense of Management	14,400	
	Cost of distribution	6,000	26,400
	Total Expenses		1,04,400
V.	Profit before exceptional and extraordinary items and tax		57,600
VI.	Exceptional items		--
VII.	Profit before extraordinary items and tax		57,600

VIII.	Extraordinary Items	--
IX.	Profit before tax	57,600
X.	Tax expense:	--
XV.	Profit (Loss) for the period	57,600

Note No. 1: Reserve & Surplus:

	Profit & Loss Account (Net Revenue A/c)			**Rs.**
	Balance brought forward		34,200	
	Add: Profit for the year		57,600	
	Less: Interim Dividend		- 24,000	67,800

Note No. 2: Fixed Assets:

	Fixed Assets	Opening	Additions	Closing
	Land	1,80,000	6,000	1,86,000
	Machinery	7,20,000	6,000	7,26,000
	Mains	2,40,000	61,200	3,01,200
	Total			12,13,200
	Less: Depreciation Fund			3,00,000
	Closing WDV			9,13,200

Illustration.8.

The following balances are drawn from the books of TGF Electricity Supply Company for the year ended 31st March, 2014. Prepare financial statements.

Particulars	**Rs.**
Sale of Electricity : Domestic	75,20,000
Commercial	1,80,12,000
Miscellaneous Revenues : Meter Rent	1,88,000
Service Connection Fees	1,75,000
Public Lighting Maintenance	2,80,000
Other Revenues : Sale of Stores	50,000

Repair of Electrical Apparatus	40,000
Maintenance Expenses :	
- Salaries	78,40,000
- Operations and Maintenance of High Voltage Distribution	40,12,000
- Operation and Maintenance of Medium and Low Voltage Distribution	36,40,000
- Public Lighting	12,17,000
- Consumers' Servicing	50,000
- General Establishment Charges	2,85,000
Interest	12,10,000
Bad Debts	80,000
Managements Charges	4,80,000
Assest as on 1.4.2013 :	
Distribution Plant – High Voltage	1,80,50,000
Distribution Plant – Medium and Low Voltage	90,90,000
Public Lighting	40,00,000
General Equipment	50,00,000
Share Capital : 10,00,000 Equity Shares of Rs. 10 each	1,00,00,000
Government Grant	10,00,000
Consumer's Contribution for Service Line	50,00,000
Loan	2,40,00,000
Reserve	40,50,000
Capital Expenditure During 2014 : High Voltage Distribution Plant	14,00,000
Medium and Law Voltage Distribution Plant	15,00,000
Loan raised during 2013-14 : 10% Electricity Board	25,00,000
Other Assets and Liabilities as on 31.03.2014 :	
- Sundry Creditors	15,22,000
- Sundry Debtors	27,36,000
- Cash at Bank	62,97,000
- Investments	82,50,000
Provision for Depreciation (Opening)	8,00,000

Government grant and consumers contribution for service lines to be treated as Capital Reserves Charge Depreciation @ 5% on all assets on SLM basis on the average balance.

Solution 8 :

Balance Sheet (As per Revised Schedule VI)

Balance Sheet of TGF Electricity Supply Company

	Particulars	Notes		Rs.
	1	3	4	5
I.	**CAPITAL AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital		1,00,00,000	
	Reserves and surplus	1	1,55,49,000	2,55,49,000
(2)	**Share application money pending allotment**			--
(3)	**Non-current liabilities**			
	Long-term borrowings: Loans	2		2,65,00,000
(4)	**Current liabilities**			
	Trade Payables			15,22,000
	TOTAL			**535,71,000**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets	3	3,62,88,000	
	Non-current investment		82,50,000	4,45,38,000
(2)	**Current assets**			
	Trade receivables		27,36,000	
	Cash and cash equivalents		62,97,000	90,33,000
	TOTAL			**535,71,000**

Profit & Loss Account (As per Revised Schedule VI)

TGF Electricity Supply Company.

Profit and loss statement for the year ended 31.03.2014

	Particulars	**Notes**	**Rs.**
I.	Revenue from operations: Sales of current	4	2,55,32,000
II.	Other income:	5	7,33,000
III.	**Total Revenue** (I+II)		2,62,65,000
IV.	**Expenses:**		

	Cost of Generation & Operation, Maintenance		88,69,000
	Employee benefit cost		78,40,000
	Finance costs: Interest on Debenture		12,10,000
	Depreciation and amortisation expenses		19,52,000
	Other expenses	7	8,95,000
	Total Expenses		2,07,66,000
V.	Profit before exceptional and extraordinary items and tax		54,99,000
VI.	Exceptional items		--
VII.	Profit before extraordinary items and tax		54,99,000
VIII.	Extraordinary Items		--
IX.	Profit before tax		54,99,000
X.	Tax expense:		--
XV.	Profit (Loss) for the period		54,99,000

Note No. 1: Reserve & Surplus:

			Rs.
	Capital reserve: Govt. Grant		10,00,000
	: Consumers contribution for service line		50,00,000
	Reserves		40,50,000
	Profit & loss account		54,99,000
			1,55,49,000

Note No. 2: Long term Borrowings:

	Loans			**Rs.**
	Balance brought forward		2,40,00,000	
	Addition during the year		25,00,000	2,65,00,000

Note No. 3: Fixed Assets:

	Fixed Assets	Opening	Additions	Closing
	Distribution Plant- High voltage	1,80,50,000	14,00,000	1,94,50,000
	- Medium & low voltage	90,90,000	15,00,000	1,05,90,000
	Public lighting	40,00,000		40,00,000
	General equipment	50,00,000		50,00,000
	Total			3,90,40,000
	Less: Depreciation Provision: Opening		8,00,000	
	Current year @5% on 3,90,40,000		19,52,000	27,52,000
	Closing WDV			3,62,88,000

Note No. 4: Sales:

	Sale of Electricity			**Rs.**
	Domestic		75,20,000	
	Commercial		1,80,12,000	2,55,32,000

Note No. 5: Other Income:

	Misc. & Other revenue			**Rs.**
	Meter Rent		1,88,000	
	Service connection fees		1,75,000	
	Public lighting maintenance		2,80,000	
	Sales of stores		50,000	
	Repair of electrical apparatus		40,000	7,33,000

Note No. 6: Generation, Operation & Maintenance Expenses:

				Rs.
	Operation & Maintenance- High voltage dist.		40,12,000	
	- Medium & low voltage dist.		36,40,000	
	- Public lighting		12,17,000	88,69,000

Note No. 7: Other Expenses:

	Other expenses			Rs.
	Consumers servicing		50,000	
	General establishment charges		2,85,000	
	Bad debt		80,000	
	Management charges		4,80,000	8,95,000

Illustration.9.

The trial balance of NITIN Electric Supply Ltd. for the year ended 31st March, 2012 is as below.

Particulars	Dr.	Cr.
Share Capital		
Equity Shares of Rs. 10 each		250,00
14% Preference Shares of Rs. 100 each		75,00
Patents and trade mark	12,52	
15% Debentures		123,50
16% term loan		76,50
Land (additions during the year 10,25)	62,25	
Building (additions during the year 25,40)	175,67	
Plant & Machinery	285,29	
Mains	22,62	
Meters	15,75	
Electrical Instrument	7,65	
Office furniture	12,25	

Capital Reserve		25,10
Contingency Reserves		60,15
Transformers	82,20	
Net revenue account		26,75
Stock in hand	60,25	
Sundry debtors	31,23	
Contingency reserve investment	60,05	
Cash & bank	16,27	
Public Lamps	15,20	
Depreciation fund		129,08
Sundry creditors		32,62
Proposed dividend		60,50
Total	**859,20**	**859,20**

During 2011-12, ₹ ('000) 50,00 of 14% preference shares were redeemed at a premium of 10% out of proceeds of fresh issue of equity shares of necessary amounts at a premium of 10%.

Prepare Balance Sheet as on 31st March, 2012 as per the revised Schedule VI

Solution :

Balance-Sheet of NITIN Electric Supply Ltd. For the year ended March 31, 2012

			Particulars	Note No	₹ (000)
			Equity and Liabilities		
1			Shareholder's funds		
	a		Share capital	1	32,500
	b		Reserves and Surplus	2	11,200
2			Non-current liabilities		
	a		Long- term borrowings	3	20,000
3			Current liabilities		
	a		Trade payables		3,262

	b		Short- term provisions	4	6,050
			Total		**73,012**
			Assets		
1			Non- current assets		
	a		Fixed assets		
		i	Tangible assets	5	54,980
		ii	Intangible assets		1,252
	b		Other non-current assets	6	6,005
2			Current Assets		
	a		Inventories		6,025
	b		Trade receivables		3,123
	c		Cash and cash equivalents		1,627
			Total		**73,012**

Notes to Financial Statements-:

1.	**Share Capital**		**₹ (000)**
	Equity Share Capital		
	Authorised		
	25,00,000 Equity Shares of Rs.10 each	25,000	
	Issued & Subscribed		
	2,000,000 Equity Shares of Rs.10 each	20,000	
	5,00,000 Equity Shares of Rs.10 each issued during the year (A)	5,000	25,000
	Preference Share Capital		
	Authorized		
	1,25,000 14% Preference Shares of Rs.100 each	12,500	
	Issued & Subscribed		
	1,25,000 14% Preference Shares of Rs.100 each	12,500	
	50,000 Preference Shares of Rs.100 each redeemed during	(5,000)	7,500

	the year	(B)		
	Total (A+B)			**32,500**

2.	**Reserves and Surplus**	**₹ (000)**
	Capital Reserve	2,510
	Contingency Reserve	6,015
	Balance of net return A/c	2,675
	Total	**11,200**

3.	**Long-term borrowings**	**₹ (000)**
	Secured	
	15% Debentures	12,350
	16% Term Loan (Considered Secured)	7,650
	Total	**20,000**

4.	**Short-term provisions**	**₹ (000)**
	Proposed Dividend	6,050
	Total	**6,050**

5.	**Tangible Assets**		**₹ (000)**
	Land	5,200	
	Addition during the year	1,025	6,225
	Building	15,027	
	Addition during the year	2,540	17,567
	Plant & Machinery		
	Steam Power Plant	28,529	
	Transformers	8,220	
	Mains	2,262	
	Meters	1,575	
	Public Lamps	1,520	42,106

	General Equipments		
	Electrical Instruments	765	
	Office Furniture	1,225	1,990
	Less- Depreciation Fund		(12,908)
	Total		**54,980**

6.	**Other Non-Current Assets**	**₹ (000)**
	Contingency Reserve Investment (Assumed as non-current item)	**6,005**

Illustration 10

Following is the Trial Balance of UREKA Power Ltd as on 31 -March- 2012

Particular	Dr.	Cr.
	₹	₹
Share Capital authorized		
10,00,000 Equity Shares of ₹ 10 each		1,00,00,000
Issued, Subscribed and Paid up :		
2,36,225 Equity Shares of ₹ 10 each		23,62,250
Service Line contributions		
As per the last Balance Sheet		11,86,800
Contributions during the year		4,32,750
Grant in Aid under Accelerated Power Development and Reform Programme		
As per the last balance sheet		2,46,250
Contingency Reserve		
As per the last balance sheet		3,05,500
Tariff and Dividend Control Reserve		
As per the last Balance Sheet		57,950
General Reserve		
As per the last balance sheet		1,31,45,000
Secured Term Loans		
From Financial Institution		58,72,500

From Banks		82,20,050
Service Line and Security Deposits from Consumers		23,29,600
Term Loan from Government of India under Accelerated		
Power Development And Reform Programme		2,75,150
Short Term Loan from Financial Institution		8,75,000
Loan from Bank		54,800
<u>Closing balance of Non-current Assets</u>		
Land		
a. Freehold	6,69,800	
b. Leasehold	2,15,450	
Buildings	36,85,350	
Railway Skiing	11,700	
Plant and Machinery		
a. Steam Station	1,41,64,950	
b. Other including "Switchgears and Transformers"	1,02,89,450	
Transmission and		
Distribution Systems		
a. Overhead	21,21,450	
b. Underground	84,48,050	
Electrical Fittings and Apparatus	2,50,650	
Furniture, Fixture and Office Equipments	3,51,800	
Vehicles	1,07,400	
Intangible Assets		
Software	87,400	32,300
Capital Work-in-Process	26,88,550	
Contingency Reserve Investments (Quoted)		
ICICI Bonds 2011	3,05,500	
Other Investments Quoted	100	
Unquoted Investment in Subsidiary Companies	39,98,050	
Equity Shares AEC Cements & Constructions Limited	100	
Birla Sun Life Cash Plus	2,06,800	
Kotak Floater Short Term	3,10,250	
Interest Accrued on Investments	1,050	

Debts / Receivables		
Secured - Considered Good	9,91,650	
Unsecured - Considered Good	20,54,850	
Considered Doubtful	5,03,050	
Inventories (Coal, Oil Stores and Spares)	13,17,250	
Cash and Cheques on hand	15,800	
Balance with Schedules Banks		
In Current Account	3,77,850	
Fixed Deposits Account	42,37,350	
Balances with other banks in current Account	350	
Advances recoverable in cash or in kind or for value to be received	6,50,000	
Advances and Loans to Subsidiary Companies	68,850	
Balance with Government Authority	5,750	
Advance Tax and Tax Deducted at source (Net of Provision for taxation	94,400	
Provision for Gratuity and other fund		2,71,900
Provision for Leave Encashment		3,33,700
Provision for Taxation		96,100
Provision for Indirect tax		52,550
Proposed Dividend		12,04,850
Provision for Corporate Dividend Tax		2,10,750
Sundry Creditors		45,06,000
Due to Subsidiary Company		23,750
Investor Education and Protection Fund (unclaimed Dividends)		13,700
Consumers Benefit Account		60,050
Credit Balances of Consumers		1,63,550
Interest Accrued but not due on Loans and Security Deposits		1,04,550
Opening balance of Profit and Loss Account		18,93,450
Profit During the year before adjustment		1,39,00,200
	5,82,31,000	**5,82,31,000**

Service line contribution ₹92,250 has to be transferred to Statement of Profit and Loss.

1. Transfer from Accelerated Power Development and Reform Programme Rs.16150 to profit and loss account.
2. Provide for depreciation on tangible assets at the following rates of Appendix III

Particulars	***Rate of depreciation as per Appendix***
Land	
a. Freehold	0
b. Leasehold	3.34%
Buildings	3.34%
Railway Sidings	3.34%
Plant and Machinery	
a. Steam Station	5.28%
b. Others Including Switchgears and Transformers	5.28%
Transmission and Distributing Systems	
a. Overhead	5.28%
b. Underground	5.28%
Electrical Fittings and Apparatus	6.33%
Furniture, Fixture and office Equipments	6.33%
Vehicles	5.28%

3. Transfer to Contingency Reserve ₹ 5,000 and to General Reserve ₹20,00,000 from to statement to Profit and loss.
4. Loss on Contingency Reserve Investment Rs.8,050.
5. Debts include outstanding for a period exceeding six months.

   Secured

- Considered Good ₹ 43,400

  Unsecured

- Considered Good ₹ 66,250
- Considered Doubtful ₹ 1,24,850

Make a provision for debts considered doubtful.

Prepare Balance sheet as per Schedule VI and also mention the effect of adjustments on the profit in a working note.

Solution

Balance Sheet of UREKA Power Pvt. Ltd. As on 31th March, 2012

EQUITY AND LIABILITIES	Notes	₹
Shareholders Funds		
a. Share Capital	1	23,62,250
b. Reserves and surplus	2	28,633,055
Non – Current Liabilities		
a. Long Term Borrowings	3	1,52,97,500
b. Service Line and Security Deposits from Consumers		23,29,600
c. Long-term Provisions	4	6,05,600
Current Liabilities		
a. Short term Borrowings	5	23,750
b. Trade Payables	6	45,06,000
c. Other Current liabilities	7	15,46,700
d. Short Term Provisions	8	3,59,400
Total		**5,56,63,855**
ASSETS		
Non-current Assets		
a. Fixed Assets		
i) Tangible assets	9	3,82,92,305
ii) Intangible Assets (87,400-32,300)		55,100
iii) Capital Work in Progress		26,88,550
iv) Intangible assets under development		
b. Non-current investments	10	42,95,700
Current assets		
a. Current investments	11	5,17,050
b. Inventories (coal, Oil, Stores…)		13,17,250
c. Trade receivables	12	30,46,500
d. Cash and cash equivalents	13	46,31,350
e. Short-term loans and advances	14	8,19,000
f. Other current assets (Int. accrued)		1,050
Total		**5,56,63,855**

Note to Financial Statements:

1. Share Capital

Particulars	**Amount**
Authorised	
10,00,000 Equity shares of ₹ 10 each	1,00,00,000
Issued, subscribed and paid up:	
2,36,225 Equity shares of ₹ 10 each	23,62,250

2. Reserve and surplus

Particulars	**Amount**	**Amount**
Capital Reserves		
Service Line Contributions		
As pet last Balance Sheet	11,86,800	
Add. Contributions during the year	4,32,750	
	16,19,550	
Less Transfer to Profit and Loss account	(92,250)	15,27,300
Grant in Aid under Accelerated Power		
Development and Reform Programme	2,46,250	
As per last Balance sheet		
Received during the year		
	2,46,250	
Less : Transfer to Profit and Loss Account	(16,150)	2,30,100
Statutory Reserves		
Contingency Reserve		
As per last Balance sheet	3,05,500	
Less: Loss on Contingency Reserve Investments	(8,050)	
	2,97,450	
Add: Transfer from Profit and Loss Account	5,000	3,02,450
Tariff and Dividend Control Reserve		
As per last balance sheet		57,950
Other Reserve		
General Reserve		
As per last balance sheet	1,31,45,000	
Add: Transfer from Profit and Loss Account	20,00,000	1,51,45,000

Profit and Loss			
Opening balance of Statement of Profit and loss		1,89,3450	
Profit during the year before adjustment		1,39,00,200	
Less: Profit and loss adjustments			
Add: Service Line contribution	92,250		
Grant in Aid under Accelerated Power Development and Reform Program	16,150	1,08,400	
		1,59,02,050	
Less: Contingency reserve	5,000		
General reserve	20,00,000		
Bad-debt reserve	5,03,050		
Depreciation	20,23,745	(45,31,795)	1,13,70,255
			2,86,33,055

3. Long term borrowings

	Amount
Secured Term Loans	
From Financial Institutions	5,872,500
From Banks	8,220,050
(i)	**1,40,92,550**

In the absence of details of security, disclosure for the same has not been made.

Particulars	**Amount**
Term Loan from Government of India under Accelerated Power Development and Reform Program	2,75,150
Short Term Loan from Financial Institutions	8,75,000
Loan from Bank	54,800
(ii)	**12,04,950**
Total (i) + (ii)	**1,52,97,500**

4. Long-term provisions

Particulars	Amount
Provision for Gratuity and other funds Provision for Leave Encashment	2,71,900 3,33,700
	6,05,600

5. Short Term Borrowings

Particulars	Amount
Due to Subsidiary Company	**23,750**

6. Trade Payables

Particulars	Amount
Sundry Creditors	**4,506,000**

7. Other current Liabilities

Particulars	Amount
Investor Education and Protection Fund (Unclaimed Dividends) Consumers' Benefit Account Credit Balances of Consumers Interest Accrued but not due on Loans and Security Deposits Proposed Dividend	13,700 60,050 1,63,550 1,04,550 12,04,850
	15,46,700

It is assumed that there is no current maturity of long term loans.

8. Short Term Provisions

Particulars	Amount
Provision for Taxation	96,100
Provision for Indirect Tax	52,550
Provision for Corporate Dividend Tax	2,10,750
	3,59,400

9. Tangible Fixed Assets

Particulars	Closing Bal At cost	Provision for depreciation	Net block
Land			
(a) Freehold	6,69,800	0	6,69,800
(b) Leasehold @3.34%	2,15,450	7,196.03	2,08,254
Buildings @3.34%	36,85,350	1,23,090.69	35,62,259
Railway Siding @3.34%	11,700	390.78	11,309
Plant and Machinery	1,41,6	7,47,909.36	1,34,17,041
(a) Steam Station @5.28%	4,950	5,43,282.96	
(b) Others Including	1,02,89,450	1,12,0	97,46,167
"Switchgears and Transformers		12.56	20,09,43
@5.28%	21,	4,46,057.04	7
Transmission & Distributing	21,450	15,866.145	80,01,993
Systems (a) Overhead	84,48,050	22,268.94	2,34,784
@5.28%	2,50,650	5,670.72	3,29,531
(b) Underground @5.28%	3,51,800		
Electrical Fittings and	1,07,400		1,01,729
Apparatus@ 6.33%			
Furniture, Fixture and Office			
Equipments@ 6.33%			

Vehicles @ 5.28% **Total**	**4,03,16,050**	**2,023,745**	**38,292,305***

* Difference is due to approximation of decimal to nearest rupee.

10. Non-current investments

Particulars	**Amount**
Contingency Reserve Investments (Quoted)	
ICICI Bond - 2011 (3,05,500 – 8,050)	2,97,450
Other Investments Quoted	100
Unquoted Investment in Subsidiary Companies	39,98,050
Equity Shares AEC Cements & Constructions Limited	100
	42,95,700

11. Current Investments

Particulars	**Amount**
Unquoted	
Birla Sun Life Cash Plus	2,06,800
Kotak Floater Short Term	3,10,250
	5,17,050

12. Trade Receivables

Particulars	Amount	Amount
Debts outstanding for a period exceeding six months		
Secured - Considered Good		
Unsecured - Considered Good	43,400	
Considered Doubtful	66,250	
	1,24,850	
Other Debts		
Secured - Considered Good (9,91,650 – 43,400)	9,48,250	
Unsecured - Considered Good (20,54,850 – 66,250)	19,88,600	2,34,500
Considered Doubtful (5,03,050 – 1,24,850)	3,78,200	33,15,050
Less: Provision for Doubtful Debts		(5,03,050)
		30,46,500

13. Cash and Cash equivalents

Particulars	Amount
Cash and Cheques on hand	15,800
Balances with scheduled banks	3,77,850
In Current Accounts	42,37,350
Fixed Deposits Accounts	350
Balances with other Banks in Current Accounts	
	46,31,350

14. Short-term loans and advances

Particulars	Amount
Unsecured (Considered Good Unless Otherwise Stated)	6,50,000
Advances recoverable in cash or in kind or for value to be received	
Advances and Loans to Subsidiary Companies	68,850
Balance with Government Authority	5,750
Advance Tax and Tax deducted at source	94,400
	8,19,000

Check Your Progress

A] Fill in the blanks-:

1. Main purpose of the Electricity Act, 2003 is to …
   a) Reduce government subsidies and to make electricity companies self-sustainable.
   b) Bring private participation in this area.
   c) To distance State Electricity Boards from tariff determination.
   d) All of the above.
2. At present, electricity companies are governed by…
   a) Electricity Act, 1910
   b) Electricity (Supply) Act, 1948
   c) Electricity Regulatory Commissions Act, 1998
   d) Electricity Act, 2003
3. Electricity tariffs are fixed by…
   a) Electricity Act, 1910
   b) Electricity (Supply) Act, 1948
   c) Electricity Regulatory Commissions Act, 1998
   d) Appropriate Commission.
4. Security deposit from electricity consumers…

a) May be collected under section 43 of the Electricity Act 2003

b) May be collected under section 47 of the Electricity Act 2003

c) Is the same everywhere in India.

d) Cannot be collected.

5. Balance of security deposit from electricity consumers…

   a) is written off.

   b) is shown as a current liability.

   c) is shown as a non-current liability.

   d) is shown as a current asset.

6. Grant received under APDRP of Ministry of Power is accounted for…

   a) as a liability. b) as a reserve.

   c) as a capital reserve. d) as reduction in cost of fixed assets.

7. In case of electricity companies depreciation is charged as per…

   a) the rates prescribed by the central electricity regulatory Commission.

   b) the rates prescribed by the Companies Act.

   c) the rates prescribed by the Income Tax Act.

   d) the rates prescribed by the comptroller and Auditor General of India.

8. Interest on security deposit from electricity consumers…

   a) is not payable.

   b) is payable at bank rate or more as a prescribed.

   c) is payable only at a bank rate.

   d) may be paid at the rate lower than the bank rate.

B] State whether the following statements are True or False-:

1) The accounts of electricity companies must be prepared according to the format prescribed vide schedule VI to the Companies Act.

2) Shareholders Funds include share capital and Reserves & Surplus.

3) Security deposit is a refundable deposit.

4) Customers Contribution for Service Line will be showed under the capital reserve in "Reserves and Surplus" in the Balance Sheet.

4.3 Summary:

Electricity Act, 2003 provides for accounting of various transactions like security deposit received by Electricity Company, capital / service line contribution received, Grant & loan from APDRP, Depreciation and tariff etc. Responsibility for the development of the power industry is shared between the central government and the state governments. The Electricity Act, 2003 provides the overall legislative Framework for the sector.

4.4 Terms to Remember:

Tariffs -Tariffs are fixed by the appropriate commissions considering various factors including safeguarding interest of consumer and at the same time recovery of cost of electricity and providing a reasonable return on investment.

Security Deposit- Electricity Company can take suitable security deposit from consumers for supply of electricity and /or for providing electric line, meter etc. This is refundable deposit.

Capital Service line contribution (Customers Contribution for Service Line) - an electricity company can collect the charges for providing electricity connection and /or transformers at new areas as per rules framed by State Electricity regulatory Commission.

Accelerated Power Development and Reforms Program (APDRP)- Central Government introduced this program to improve distribution network, reduce or avoid transmission and distribution losses, theft etc.

4.5 Answers to Check your Progress:

A] Choose the Correct Alternative.

1-d. 2-d. 3-d. 4-b. 5-c. 6-c. 7-a. 8-b.

B] True or False

1-False. 2-True. 3-True. 4-True.

4.6 Exercise-:

1) What are the special features of the Electricity Act, 2003?

2) Explain the objectives of the Electricity Act, 2003.

3) How is an electricity company required to provide depreciation?

4) Write short notes on-:

a) Accelerated Power Development and Reforms Program (APDRP)

b) Security Deposit.

5) From the following balances as at 31st March, 2020, Prepare the Financial Statements of Swaraj Power and Light Co. Ltd.

Particulars	Rs.	Particulars	Rs.
Balance as on 1st April, 2019		Expenses of Management	7,200
- Land	90,000	Cost of Distribution	3,000
- Machinery	3,60,000	Depreciation	12,000
- Mains	1,20,000	Sales of Current	78,000
Expenditure during the year		Meter Rent	3,000
- Land	3,000	Interest on Debentures	6,000
- Machinery	3,000	Interim Dividend	12,000
- Mains	30,600	Net Revenue A/c as on 1.4.2019	17,100
Share Capital – Ordinary Shares	3,29,400	Sundry Debtors	
Debentures	1,20,000	- For energy supplied	24,000
Cost of Generation	21,000	- Other	300
Sundry Creditors	600	Cash Balance	3,000
Rent, Rates and Taxes	3,000	Depreciation Fund	1,50,000

6) The trial balance of Anand Electric Supply Ltd. for the year ended 31st March, 2019 is as below:

Particulars	Dr. Rs. (000)	Cr. Rs. (000)
Share Capital :		
60,00,000 Equity Shares of Rs. 10 each		60,000
Patents and Trademarks	2,000	
14 % Debentures		24,000
11 % Term Loan		14,000

Land	12,400	
Building	34,000	
Power Plant	60,000	
Electrical Instruments	5,600	
Capital Reserves		7,200
Contingency Reserves		12,000
Transformers	16,400	
Net Revenue Account		6,800
Inventories	11,600	
Trade Receivables	6,400	
Contingency Reserve Investments	12,000	
Bank Balance	2,400	
Public Lamps	3,200	
Depreciation Fund		24,000
Trade Payables		6,000
Declared Dividend		12,000
	1,66,000	**1,66,000**

Prepare Balance Sheet of Anand Electric Supply Ltd. as on 31st March, 2019.

4.7 Reference for further study:

1. Shukla M.C., Grewal T.S., Gupta S.C., (2007) Advanced Accounts, S.Chand & Company Ltd, New Delhi.

2. Gupta R.L., Radhaswamy M, (2011) Advanced Accountancy, Sultan Chand & Sons, New Delhi.

3. Maheshwari S.N, Maheshwari S.K., (2009) Advanced Accountancy, Vikas Publishing House Pvt.Ltd, Noida.

4. The Institute of Chartered Accountants of India, http//www.icai.org. Study Material.

5. Company Act 2013.

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