



## Engineering Equipment and Electronics

Engineering Equipment and Electronics (EEE) had a good year in 2002. Their results had exceeded the past year and now it was time for the finalisation of year-end accounts. The balance sheet of EEE as on 31<sup>st</sup> December 2001 is given in Exhibit 1. The details of the transactions for the year were as follows.

1. Income from sales and services was Rs.11,757,576<sup>1</sup>. During the year EEE decided to reduce the credit period from an average of 60 days to 15 days. This had ensured good collections and reduced bad debts. In fact the company had been able to reduce its overall receivables by being efficient on collections. The total amounts collected from sundry debtors during the year was Rs.16,558,500.
2. A part of the services rendered by EEE was certified unsatisfactory by one of the clients. EEE had already received a payment of \$1,500 for this service. At the time of the receipt the conversion rate was Rs.47.50 a dollar. EEE had to reimburse this amount. When EEE sent in the reimbursement, the per dollar rate had fallen to Rs.46.75. This amount had not been adjusted in the above sales figure.
3. In addition to sales and services, the company had some other income, which included:

Item	Gross	TDS	Net
Interest Income for the year	92,695	9,708	82,987
Dividend received	11,753	867	10,886
Miscellaneous income	118,167		118,167

4. During the year, the company sold off some assets listed under the head "Other Fixed Assets". The historic cost of other fixed assets that were sold was Rs.32,500. Accumulated depreciation on these were Rs.18,250. The profit on the sale of these assets were Rs.2,871.
5. The air handling business was not seen to be adding to the core operations. The company therefore decided to sell the entire assets of this business line to Asiatic Engineers. The cash realization on the sale of the air handling business was Rs.137,000. The income tax department had indicated that if the EEE invested the entire proceeds of the sale in a special bond issued by the Government, then no income tax would be charged on the profit earned from the sale of this business. EEE invested the proceeds in the special Government bonds. (Interest on these investments is included in the interest income above). In addition, Asiatic Engineers had agreed to reimburse any operating losses incurred by the air handling division in 2002, till the assets were transferred. The transfer involved a period of four months during which EEE claimed that it incurred an operating loss amounting to Rs.22,667. Asiatic Engineers reimbursed this amount to EEE.
6. Opening balance of creditors and other acceptances included amounts payable for purchase of raw material and expenses incurred on Capital Work in Progress in 2001. In 2002, the total purchase of raw material (on credit) was Rs.7,746,779. There was no purchase of stores,

Prepared by Professor M S Sriram, based on published annual reports. Some items have been reclassified for purposes of clarity and simplicity.

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<sup>1</sup> All figures in the case are in thousands.

spares, components and finished goods. The total payment made to the creditors during the year was Rs.8,520,200. This included a payment towards final settlement of dues to Engineers Europe. In 2001 EEE had imported some components from Engineers Europe, to be used in the construction work and was accounted under "Capital Work in Progress". The billing by Engineers Europe, was in Euros. At the conversion rate prevailing then the rupee equivalent of the billing was Rs.22,685. However due to the fall in the exchange rates the liability was fully settled at Rs. 20,000 during the year, thereby resulting in a savings on Rs.2,685.

7. In 2002, EEE spent Rs.2,680 on Capital-Work in Progress. This was paid in cash. The work was completed and the Capital Work in Progress was transferred to Fixed Assets.
8. The year ending inventory was as follows:

Raw Materials	31,741
Components, stores and spares	612,890
Work in process	389,298
Finished goods	84,061

9. The other expenses for during the year were as follows:

Power Fuel and Water paid	122,060
Excise Duty paid	25,620
Excise Duty payable	580
Repairs – Plant and Machinery paid	150,050
Personnel Expenses paid	1,207,900
Other administrative expenses paid	1,500,630
Interest Paid, net of Tax Deducted at Source (TDS)	6,000
Tax Deducted at Source on Interest, paid to IT Dept	600

10. Depreciation on Other Fixed Assets for the year was Rs.186,104. Of this Rs.2,881 was to be charged to Revaluation Reserve in respect of assets that were revalued a few of years ago.

11. The company had to account for the following items.

Excess provision for doubtful debts to be written back	27,900
Bad Debts to be written off	160,000
Loss of value of investments to be written off	25,680

12. Income Tax was to be calculated at 35% on the income. As per the income tax laws, provision for doubtful debts were not allowable as an expense. Similarly write back of provision was also not to be considered in calculations. However, write off of bad debts was an allowable expense. Necessary adjustments were to be made for profit on sale of air handling unit. The company had made payments towards advance tax to the tune of Rs.100,000. (The tax deducted at source by other parties was not included in the above amount).

13. The preference shares were redeemed in full during the year.

14. The board decided to provide for dividends on equity shares for the year at 150%. The proposed dividend for last year was fully paid in cash. However, due to a change in the policy on taxation of dividend pay out, the company was not liable to pay dividend tax of Rs. 21,150 included in the provisions last year. This amount was to be written back.

15. An amount equivalent to redemption of Preference Shares was transferred to Capital Redemption Reserve Account. The rest of the retained earnings were to be added to the balance in profit and loss account.

## Exhibit 1

<b>Engineering Equipment and Electronics</b>			
Balance Sheet as on 31 December 2001			
<b>Sources of Funds</b>		Amount (Rs in thousands)	
<b>SHARE CAPITAL</b>			
Equity Shares (Rs.10 each, fully paid up)		423,000	
Preference Shares (Rs.100 each, fully paid up)		75,000	498,000
<b>RESERVES AND SURPLUS</b>			
General Reserve Account		3,560,581	
Revaluation Reserve		173,264	
Profit and Loss Account		245,630	3,979,475
<b>LOAN FUNDS</b>			
			107,967
<b>Total</b>			<b>4,585,442</b>
<b>Application of Funds</b>			
<b>FIXED ASSETS</b>			
Air Handling Unit (Gross Block)	137,803		
Less Accumulated Depreciation	93,627	44,176	
Gross Block of other assets	2,824,827		
Less Accumulated Depreciation	1,306,790	1,518,037	1562213
<b>CAPITAL WORK IN PROGRESS</b>			
			11,624
<b>INVESTMENTS</b>			
			127,778
<b>CURRENT ASSETS, LOANS AND ADVANCES</b>			
Raw material inventory	62,009		
Components, Stores and spares	614,542		
Work-in-process	462,858		
Finished goods	65,049	1,204,458	
Sundry debtors, loans and advances	5,087,434		
Less provision for doubtful debts	216,779	4,870,655	
Cash and bank balances		1,425,155	
Other Current Assets		56,781	
Advance Income tax		188,314	
Total Current Assets		7,745,363	
<b>LESS: CURRENT LIABILITIES AND PROVISIONS</b>			
Creditors and Other Acceptances	4,489,815		
Other liabilities	139,071		
Provision for Dividend and Dividend Tax	232,650	4,861,536	2,883,827
<b>Total</b>			<b>4,585,442</b>