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Solved Ans. Ipcc Cost & FM _ May.11

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C.A. CPT, PCC, IPCC & FINAL

***Solved Ans Prepared by : C.A Arvind Kumar Jain
and Team Members***

(Disclaimer : Questions asked in the exam may have wrong/inadequate information and/or ambiguous language. In that case the answers provided by institute may differ from this Ideal Answers. If you find any errors, please email the same.)

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Qn.1 (a) Working Note – 1
Calculation of EBIT under different situations

Particulars	Situation A	Situation B
Sales (Qty)	6000 Units =====	6000 Units =====
Sales Value (Rs.)	1,80,000	1,80,000
Less: Variable Cost (Rs.)	<u>1,20,000</u>	<u>1,20,000</u>
Contribution (Rs.)	60,000	60,000
Less: Fixed Cost (Rs.)	<u>20,000</u>	<u>25,000</u>
EBIT (Rs.)	<u>40,000</u>	<u>35,000</u>

Working Note – 2 Calculation of EBT under different financial

Plans	Financial Plan XY		Financial Plan XM	
Particulars	Situation A	Situation B	Situation A	Situation B
EBIT	40000	35000	40000	35000
Less: Interest on Debt (12%)	<u>4800</u>	<u>4800</u>	<u>1200</u>	<u>1200</u>
EBT	35200	30200	38800	33800

Solution :
Operating Leverage

Contribution	60000	60000	60000	60000
= -----	-----	-----	-----	-----
EBIT	40000	35000	40000	35000
	= 1.50	= 1.714	= 1.50	= 1.714

Financial Leverage

EBIT	40000	35000	40000	35000
= -----	-----	-----	-----	-----
EBT	35200	30200	38800	33800
	= 1.136	= 1.159	= 1.031	= 1.714

2000 units

Qn.1(b) Time allowed = ----- = 50 hours

40 units

Time worked

1.4.11	=	9 hours
2.4.11	=	9 hours
3.4.11	=	9 hours
4.4.11	=	9 hours
5.4.11	=	<u>4 hours</u>

40 hours

Time Saved = 10 hours

Remuneration of worker x under

(a) Halsey plan = Time wages rate + Bonus

$$= (40 \text{ bonus} \times 25/-) + (10 \text{ hrs} \times 50\% \times 25/-)$$

$$= 1000/- + 125/- = 1125/-$$

(b) Rowan plan = Time wages rate + Bonus

$$= (40 \text{ hrs} \times 25/-) + \left(\frac{40}{50} \times 10 \times 25/- \right)$$

$$= 1000/- + 200/- = 1200/-$$

Qn.1(c) Store Ledger Account of xy Company Ltd.

Date	Particulars	Receipt			Issue			Balance		
		Qty	Rate	Amt.	Qty	Rate	Amt.	Qty	Rate	Amt.
April 2011										
1	Opening balance							200	10	2000
5	Receipt	250	8/-	2000	-	-	-	200	10	2000
								250	8	2000
8	Receipt	150	8.5/-	1275	-	-	-	200	10	2000
								250	8	2000
								150	8.5	1275
10	Issue	-	-	-	100	8.5	850	200	10	2000
								250	8	2000
								50	8.5	425
15	Receipt	50	10/-	500	-	-	-	200	10	2000
								250	8	2000
								50	8.50	425
								50	10	500
20	Shortage	-	-	-	10	10	100	190	10	1900
								250	8	2000
								50	8.50	425
								50	10	500
21	Receipt	60	9/-	540	-	-	-	190	10	1900
								250	8	2000
								50	8.50	425
								50	10	500
								60	9	540
23	Issue	-	-	-	190	10	1900	40	8	320
					210	8	1680	50	8.50	425
								50	10	500
								60	9	540
				4315			4530			1785/-

Qn. 1(d) FACTORING : Factoring is a new financial service that is presently being developed in India. It is not just a single service, rather a portfolio of complementary financial service available to clients i.e. sellers. The sellers are free to avail of any of the combination of services offered by the factoring organisations according to their individual requirements .

Generally, Factoring involves provision of specialised services relating to credit investigation, sales ledger management, purchase and collection of debts, credit protection as well as provision of finance against receivables and risk bearing. In factoring, accounting receivables are generally sold to a financial institution (a subsidiary of commercial bank- called " Factor") who charges commission and bears the credit risks associated with the accounts receivables purchased by it.

Its operation is very simple. Clients enter into an agreement with "Factor" working out a factoring arrangement according to his requirements. The factor then takes the responsibility of monitoring, follow up, collection and risk taking and provision of advance. The factor generally fixed up a limit customer-wise for the client (seller).

In factoring as soon as the seller receives an order from a buyer a credit approval slip is written and immediately sent to factoring company for a credit check. If the factor do not approve the sale, the seller generally refuses to fulfill the order.

Benefits of Factoring: Following are the benefits of factoring:-

- Factoring eliminates the need for cash discounts.
- Suppliers of goods and services can concentrate on their marketing activities without worry for collection of receivables.
- Due to specialisation, a factor can effect prompt and timely payments.
- The dealer is saved of the cost of carrying debtors and maintaining collection department. It increases his return.
- Factoring improves the liquidity of a firm.

Qn. 2(a)

	Machines		
	A	B	C
Depreciation	7500	7500	5000
Spare parts	4600	5750	2875
	(4000 x 1.15)	(4000 x 1.15 x 1.25)	(2000 x 1.15 x 1.25)
Power (To be dividend in the ratio of K.W. Rating)	15000	10000	15000
Consumable Stores	3000	2500	2500
Insurance of Machine	3000	3000	2000
(In the ratio of Depreciation)			
Indirect Labour (20000 x 1.20)	6000	9000	9000
(In the ratio of D. Labour hrs.)			
Building Maintt. Expenses Seg.	8000	8000	4000
(In the ratio of Floor space)			
Annual Interest on capital outlay	20000	20000	10000
Rent & Rates (10000 x 12)	48000	48000	24000
(In the ratio of Floor Space)			
Foreman Salary (20000 x 12 x 1.20)(1:1:1)	96000	96000	96000
Attendant Salary (5000 x 12 x 1.20) (1:1:1)	<u>24000</u>	<u>24000</u>	<u>24000</u>
Total overhead	235100	233750	194375
Productive Machine Hours W.N. 1	1947	1947	1947
Machine Hour rate	120.75/-	120.06/-	99.83/-

W.N. 1 Calculation of Productive machine hours worked during the year

Total No. of days in one year	365
Less: Sundays	52
Less: Holidays	<u>12</u>
Working days	<u>301</u>
(a) Normal working days	251
(b) Saturdays	50
(c) Normal working hours per day	8 hrs
(d) Working hours on Saturdays	4 hrs
(e) Total Machine Hours available (a x c) + (b x d)	2208 hrs
(f) 10% idle time	221 hrs
(g) Productive Hours	1987 hrs
(h) Breakdown time (2% of g)	40 hrs
(i) Actual Productive time per machine p.a.	1947 hrs

Qn. 2(b) Statement Showing net Profit under the two different credit policy

Particulars	Present Policy	Proposed Policy
Credit Period	One months	Two months
	(Rs.)	(Rs.)
Sales value @ 21/- p.u.	18,90,000	23,62,500
	(90000 x 21/-)	(90000 x 1.25 x 21/-)
Less: Variable cost @ 14/- p.u.	1260000	1575000
	(90000 x 14/-)	(112500 x 14/-)
Contribution	630000/-	787500/-
Less: Fixed Cost	360000/-	360000/-
	(90000 x 4/-)	
Less: Interest on blocked capital	54000/-	129000/-
	$\left(1620000 \times \frac{40}{100} \times \frac{1}{12}\right)$	$\left(1935000 \times \frac{40}{100} \times \frac{2}{12}\right)$
Net Profit	216000/-	298500/-

Since the profit is higher in case of proposed policy, therefore the board may adopt the new credit policy.

Qn. 3 Calculation of Estimated working capital of MNP Company Ltd. for the next year

Particulars	Rs.
Stock	
Raw Material (90000 x 1/12)	75000
Finished Goods (2940000 x 1/12)	24500
Debtors	
Domestic 2400000 x 80% x 1/12 =	160000
Export 1080000 x $\frac{100}{90}$ x 80% x $\frac{1}{12}$ =	<u>240000</u>
	400000
Prepaid Expenses	
Sales Promotion Exps. 150000 x $\frac{1}{4}$ =	37500
Advance Income tax (22500 x $\frac{3}{4}$) =	168750
Cash in hand	<u>250000</u>
Current Assets	1176250
Less: Current Liabilities	
Creditors for Raw Material (900000 x 2/12)	150000
Creditors for Expenses	
Wages $\left(720000 \times \frac{5}{12} \right)$	30000
Manufacturing Expenses $\left(1080000 \times \frac{1}{12} \right)$	90000
Administration Expenses $\left(240000 \times \frac{1}{12} \right)$	20000
Overdrawn limit	<u>75000</u>
Working Capital	<u>365000</u>
Add: Margin for contingencies @ 12%	811250
Estimated W.C. desired =	<u>97350</u>
	<u>908600</u>

Qn. 4 CASH FLOW STATEMENT OF XYZ LTD. FOR THE YEAR ENDED ON 31.3.2011

	Rs.	
Cash flow from operating activities		
Net Increase in P&L a/c	45000	
Less: Transfer from General reserve	80000	
Add: Depreciation on P & M	80000	
Add: Transfer to CRR	100000	
Add: Proposed dividend	170000	
Add: Preliminary Exps. W/o	210000	
Operating Profit before working capital changes	<u>20000</u>	
Less: Increase in Current Assets	545000	
Add: Increase in Current Liabilities	206000	
Cash generated from operations	<u>260000</u>	
Less: Income tax paid	599000	
	<u>140000</u>	459000
Cashflow from Investing activities		
PQM Purchased	(95000)	
Investment Purchased	<u>(80000)</u>	(175000)
Cashflow from Financing activities		
Redemption of Pref. Share Capital	(2,20,000)	
Issue of Equity share Capital	1,10,000	
Dividend Paid	<u>(1,60,000)</u>	<u>(270000)</u>
Net Increase in cash & Cash Equivalent		14000
Add: Opening Cash & Cash Equivalent		<u>150000</u>
Closing Cash & Cash Equivalent		164000

W.N.1

Proposed dividend A/c

Particulars	Rs.	Particulars	Rs.
To Cash A/c	160000	By balance b/d	160000

To balance c/d	210000	By P & L a/c	210000
	370000		370000

W.N.2

Provision for taxation

Particulars	Rs.	Particulars	Rs.
To Cash A/c	140000	By balance b/d	150000
To balance c/d	180000	By P & L a/c (B/F)	170000
	320000		320000

W.N.3

Share Premium A/c

Particulars	Rs.	Particulars	Rs.
To Premium on redemption of pref. shares	20000	By balance b/d	40000
To balance c/d	30000	By Bank a/c	10000
	50000		50000

W.N.4

P & M a/c

Particulars	Rs.	Particulars	Rs.
To balance b/d	700000	By Depreciation a/c	80000
To Cash a/c	95000	By balance c/d	820000
To Business Purchase A/c	105000		
	900000		900000

W.N. 5

Business Purchase A/c

Particulars	Rs.	Particulars	Rs.
To ESC A/c	160000	By Stock	25000
		By P & M	105000
		By Goodwill A/c	30000
	160000		160000

w.n. 6

ESC A/c

Particulars	Rs.	Particulars	Rs.
To balance c/d	660000	By balance b/d	400000
		By Business Purchases	160000
		By Cash A/c	100000
	660000		660000

Qn. 5(a)

SLC A/c

Particulars	Rs.	Particulars	Rs.
To balance b/d	1260000	By WIP Control A/c	672000
To CLC a/c	6720000	By Overhead Control A/c (R & M)	840000
To Wip control a/c	3360000	By Overhead Control A/c (Shortage)	252000
		By balance c/d	3528000
	11340000		11340000

WIP Control A/c

Particulars	Rs.	Particulars	Rs.
To balance b/d	2520000	By SLC a/c	3360000
To SLC a/c	6720000	By Costing P&L A/c [COGS]	15888000
To Wages control a/c	2520000	By balance c/d	1520000
To Overhead Control a/c	9008000		
	20768000		20768000

Costing P & L a/c

Particulars	Rs.	Particulars	Rs.
To WIP Control a/c	15888000	By CLC a/c [Sales]	17794560
To Overhead control a/c	<u>2054000</u>	By CLC a/c (Net Loss)	<u>147440</u>
	17942000		17942000

Overhead Control a/c

Particulars	Rs.	Particulars	Rs.
To CLC a/c	9550000	By WIP Control a/c	9008000
To SLC a/c	840000	By Costing P & L a/c (B/F)	2054000
To SLC a/c	252000		
To Wages control a/c	<u>420000</u>		
	11062000		<u>11062000</u>

P & L a/c

Particulars	Rs.	Particulars	Rs.
To Opening Stock		By Sales	17794560
Raw Material	1260000	By Closing Stock	
W/P	2520000	Raw Material	3528000
To Wages incurred	2940000	WIP	1520000
To Overhead incurred	9550000	By Income from Investments	400000
To Loss on Sale of F.A.	840000	By Net Loss (B/F)	587440
To Purchased of RM	<u>6720000</u>		
	23830000		<u>23830000</u>

Reconciliation Statement between Costing Profit and Financial Profit

Loss as per cost records	147440
Add: Loss on sale of F.A.	840000
Less: Income From Investments	<u>400000</u>
Loss as per Financial records	<u>587440</u>

Qn. 5(b) Debt securitization is a method of recycling of funds.

It is a process whereby loans and other receivables are under written and sold in form of asset.

It is thus a process of transforming the assets of a lending institution into negotiable instrument for generation of funds.

Process of debt securitisation : The process of debt securitisation is as follows:-

1. The loans are segregated into relatively homogeneous pools.
2. The basis of pool is the type of credit, maturity pattern, interest rate, risk etc.
3. The asset pools are then transferred to a trustee.
4. The trustee the issues securities which are purchased by investors.
5. Such securities (asset pool) are sold on the undertaking without recourse to seller.

Qn. 6(a) Capital Employed

Proposal

Particulars	P	Q	R
Equity Share Capital	2000000	1000000	1000000
Retained Earnings	2000000	1000000	1000000
Debt	-	2000000	-
Preference Share Capital	-	-	2000000
	<u>4000000</u>	<u>4000000</u>	<u>4000000</u>

Calculation of EPS

Particulars	P	Q	R
Expected EBIT	1800000	1800000	1800000
Less: Interest @ 10% on Debt	<u>-</u>	<u>200000</u>	<u>-</u>
EBT	1800000	1600000	1800000

Less: Tax @ 5%	<u>900000</u>	<u>800000</u>	<u>900000</u>
EAT	900000	800000	900000
Less: Preference dividend @ 10%	<u>-</u>	<u>-</u>	<u>200000</u>
Earnings available for Equity shareholders	900000	800000	700000
No. of Equity shares	200000	100000	100000
EPS	4.5/-	8/-	7/-

Financial Break Even Point : It is that level of EBIT at which earning available for Equity shareholders will be Zero.

Particulars	P	Q	R
Earnings available to Equity shareholders	NIL	NIL	NIL
Add: Preference dividend	<u>-</u>	<u>-</u>	<u>200000</u>
	-	-	200000
Add: Tax @ 50% on EBT	<u>-</u>	<u>-</u>	<u>200000</u>
	-	-	400000
Add: Interest	<u>-</u>	<u>200000</u>	<u>-</u>
EBIT	NIL	200000	400000

Indifference Point

Between Plan P & Q

$$(EBIT - I_1) (1 - t) - \text{Preference dividend} = (EBIT - I_2) (1 - t) - \text{Preference dividend}$$

$$\frac{(EBIT - \text{NIL}) (1 - .50) - \text{NIL}}{200000} = \frac{(EBIT - 200000) (1 - .50) - \text{NIL}}{100000}$$

$$\frac{.50 EBIT}{2} = \frac{.50 EBIT - 100000}{1}$$

$$.50 EBIT = EBIT - 200000$$

$$EBIT = \frac{200000}{0.50} = 400000/-$$

Between P & R

$$\frac{(EBIT - \text{NIL}) (1 - .50) - \text{NIL}}{200000} = \frac{(EBIT - \text{NIL}) (1 - .50) - 200000}{100000}$$

$$\frac{0.50 EBIT}{2} = \frac{.50 EBIT - 200000}{1}$$

$$.50 EBIT = EBIT - 400000$$

$$EBIT = \frac{400000}{0.50} = 800000/-$$

Between Q & R

$$\frac{(EBIT - 200000) (1 - .50) - \text{NIL}}{100000} = \frac{(EBIT - \text{NIL}) (1 - .50) - 200000}{100000}$$

$$\cancel{.50 EBIT - 100000} = \cancel{.50 EBIT - 200000}$$

∴ Indifference point is not possible in this plan.

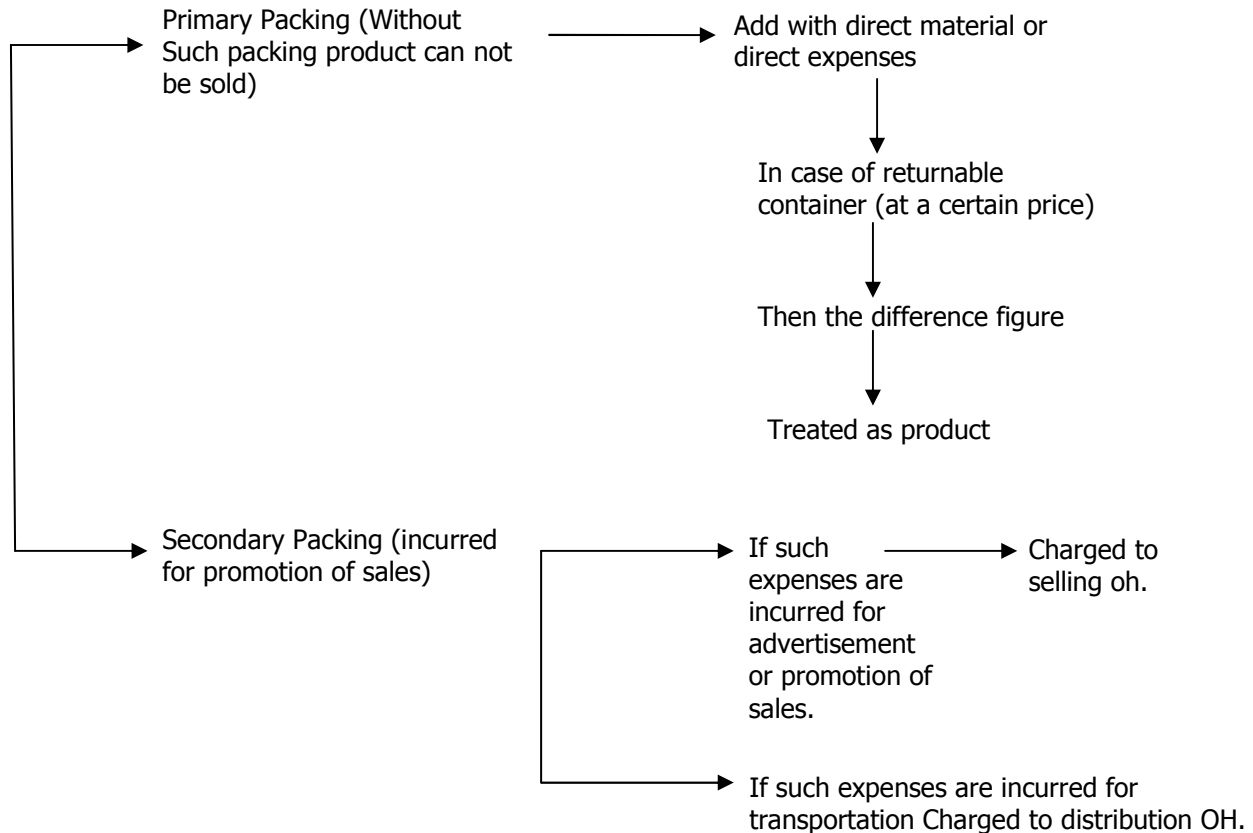
Plan Q is best among others because EPS is maximum in this case.

Qn. 6. (b) Distinction between Cost Unit and Cost Centre: The terms cost unit is defined as a unit of quantity of product, service or time (or a combination of these) in relation to which costs may be ascertained or expressed.

The term cost centre is defined as a location, person or an item of equipment or a group of these for which costs may be ascertained and used for the purposes of cost control. Cost centres can be personal cost centres, impersonal cost centres, operation cost centres and process cost centres.

Thus each sub-unit of an organisation is known as a cost centre, if cost can be ascertained for it. In order to recover the cost incurred by a cost centre, it is necessary to express it as the cost of output. The unit of output in which cost incurred by cost centre is expressed is known as cost unit.

Qn. 7(a) (i) Packing Cost:



Qn 7. (a) (ii) Fringe Benefits: If any fringe benefits are incurred for factory workers, it should be treated as factory OH or production OH and apportioned among all the production or service departments on the basis of no. of workers in each deptt.

Fringe benefits relating to office, selling and distribution staff should be treated as office and administration OH and selling and distribution OH and recovered accordingly.

Qn. 7. (b) (i) Operating Ratio : A ratio that shows the efficiency of a company's management by comparing operating expense to net sales is classed **Operating Ratio**. It is calculated as follows :
$$\frac{\text{Operating expenses}}{\text{Net Sales}}$$

The smaller the ratio, the greater the organization's ability to generate profit if revenues decrease. When using this ratio, however, investors should be aware that it doesn't take debt repayment or expansion into account.

Qn. 7. (b) (ii) Price Earnings ratio : The price earnings ratio indicates the expectation of equity investors about the earnings of the firm. It relates earnings to market price and is generally taken as a summary measure of growth potential of an investment, risk characteristics, shareholders orientation, corporate image and degree of liquidity. It is calculated as :

$$\text{P.E. Ratio} = \frac{\text{Market price per shares}}{\text{Earnings per share}}$$

Qn. 7. (c) Causes of labour turnover: The main causes of labour turnover in an organisation/industry can be broadly classified under the following three heads: (a) Personal Causes (b) Unavoidable causes and (c) Avoidable causes.

Personal causes are those which induce or compel workers to leave their jobs. Such causes include the following : (i) change of jobs for betterment (ii) Premature retirement due to ill health or old age (iii) Domestic problems and family responsibilities (iv) discontentment over the jobs and working environment.

In all the above cases the employee leaves the organisation at his will and, therefore it is difficult to suggest any possible remedy in the first three cases. But the last one can be overcome by creating conditions leading to a healthy working environment. For this, officers should play a positive role and make sure that their subordinates work under healthy working conditions.

Unavoidable causes are those under which it becomes obligatory on the part of management to ask some or more of their employees to leave the organisation. Such causes are summed up as listed below : (i) Seasonal nature of the business (ii) Shortage of raw material, Power, Slack market for the product etc. (iii) Change in the plant location (iv) Disability, making a worker unfit for work; (v) disciplinary measures (vi) Marriage [generally in the case of women]

Avoidable causes are those which require the attention of management and on a continuous basis so as to keep the labour turnover ratio as low as possible. The main causes under this case are indicated below: 1) Dissatisfaction with job, remuneration, hours of work, working conditions, etc. 2) Bad relationship with management, supervisor's or fellow workers; 3) Lack of training facilities and promotional avenues; 4) Lack of recreational and medical facilities; 5) Low wages and allowances.

Qn. 7. (d) CASH MANAGEMENT MODELS: This helps in deciding optimum cash balance. These models can be put in two categories :

- (i) Inventory type models (William J. Baumol's EOQ model) and
- (ii) Stochastic model (Miller Orr Management Model)

(i) **J Baumol's EOQ Model:** The EOQ model for optimum cash balance was suggested by William J. Baumol in the year 1952 :

Aim of the model : This model tries to balance the income foregone on cash held by the firm against the transaction cost of converting cash into marketable securities or vice-versa.

The Model: The optimum cash level is that level of cash where the carrying cost and the transaction cost are the minimum. **Where;**

Carrying cost denotes -cost of holding cash i.e. the interest foregone on marketable securities.

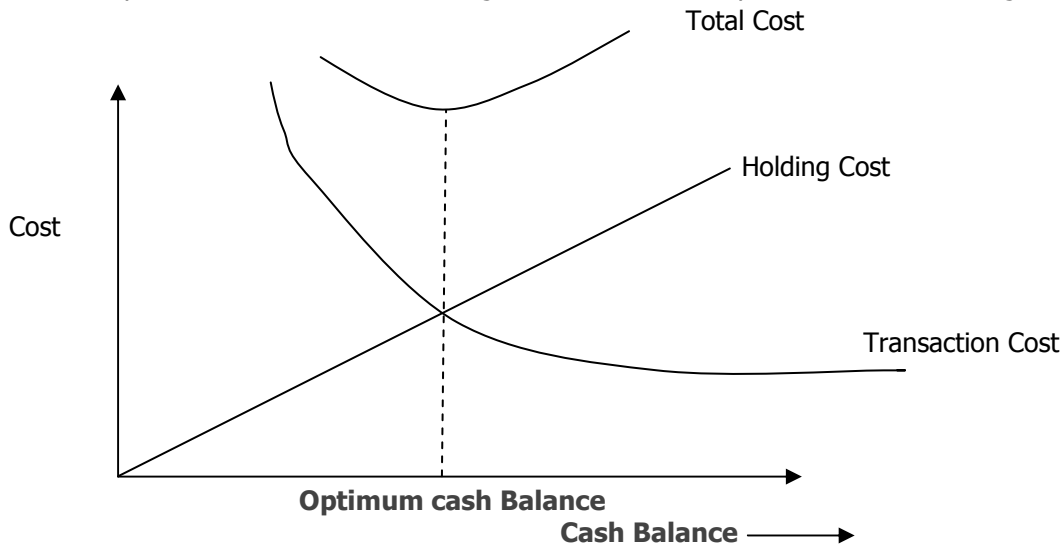
Transaction cost denotes -cost involved in converting marketable securities into cash.

Explanation of the Model: Every firm has to deal with holding cost and transaction cost.

A firm tries to keep its cash balance to a minimum. As the cash depletes, it replenishes it by selling the marketable securities, but this increases the transaction cost.

Therefore the optimum cash balance is found by controlling the holding cost and transaction cost so as to minimise the total cost. **This is done in the following way :** The cash is recovered by selling the marketable securities in such a way that the transaction cost is optimally balanced with holding cost of cash.

The optimum cash balance according to this model is the point where the holding cost and transaction cost are equal.



Formula : According to this model the formula for determining optimum cash balance i.e.

$$C = \sqrt{\frac{2 u \times P}{S}}$$

Where C = Optimum cash balance

u = Annual or monthly cash disbursement

P = Fixed cost per transaction

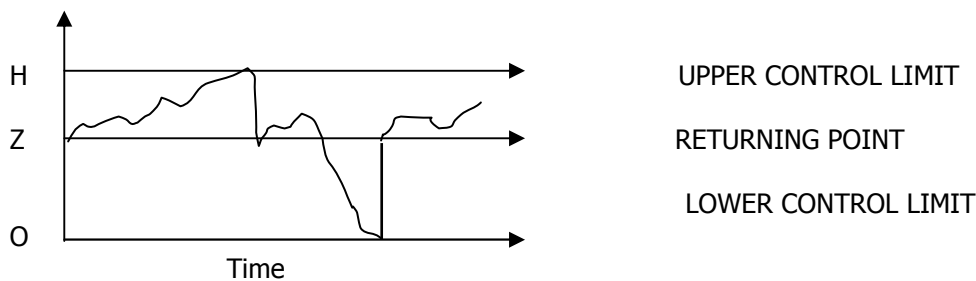
S = Opportunity cost of one rupee p.a. or p.m.

Assumptions : The model assumes that the firm uses cash at a known rate per period and that this rate of use is constant.

Limitations :

1. The cash out flows in a firm is not constant and hence the basic assumption of constant rate of use of cash is wrong.
2. The transaction cost is very difficult to be measured.

(ii) **Miller Orr Management Model:**



Merton miller and daniel orr's management model helps to determine the optimum level of cash balance when the demand for cash is stochastic and not known in advance. The model is designed to determine the time and size of transfers between an investment account and cash account " Upper limit(h) " returning point(z) ; and lower limit (o), is drafted. When cash balance reaches the upper limit, a transfer of cash equal to h-z is effected to marketable securities; When it touch the lower limit a transfer from marketable securities to cash is made. During the period when cash balance stays between these high and low limits, no transaction between cash and marketable securities is made. The high and low limit of cash balances are set on the basis of fixed costs associated with securities transaction, the opportunity cost of holding cash and the degree of likely fluctuation in cash balances.

Qn. 7. (e) Process of estimating profit/loss on incomplete contracts : In case of completed contracts all the profit that arise from the contract can be transferred to Profit and Loss Account. But in case of incomplete contracts, only a portion of the profit is taken to the Profit and Loss Account depending on the extent of work completed on the contract because some provision is to be made for meeting contingencies and unforeseen loss. There are no hard and fast rules in calculation of profit to be taken to Profit and Loss Account. But in general, the following principles are followed :

- (a) If loss is arrived on incomplete contracts, the entire loss is debited to Profit and Loss Account.
- (b) Profit should be considered only in respect of work certified. The uncertified work should be valued at cost.
- (c) If the amount of work certified is less than 25% of the contract price, then no profit should be taken to Profit and Loss Account, and the entire amount is kept as 'reserve' for meeting contingencies.
- (d) If the amount of work certified is more than 25% but less than 50% of the contract price, then following amount should be taken to the Profit and Loss Account :

$$\text{Notional profit} \times \frac{1}{3} \times \frac{\text{Cash received}}{\text{Work certified}}$$

The balance will remain as 'reserve' for meeting contingencies.

- (e) If the amount of work certified is 50% or more but less then 90% of the contract price, then the formula will be as follows :

$$\text{Notional profit} \times \frac{2}{3} \times \frac{\text{Cash received}}{\text{Work certified}}$$

The balance will remain as 'reserve' for meeting contingencies.

Qn. (f) Profit on Contracts Nearing Completion : If the contract is nearing completion, the total cost of completing the contract may be estimated if possible and then ascertain the **estimated total profit**. The amount of profit to be transferred to the Profit and Loss Account is calculated by applying the following formula :

$$\text{Estimated profit} \times \frac{\text{Cash received} - \text{Work-certified}}{\text{Work-certified}} \times \frac{\text{Contract price}}{\text{Contract price}}$$

The balance amount of profit not transferred to Profit and Loss Account but kept as 'reserve' for meeting contingencies is shown in the Balance sheet 'assets side' by deducting from the amount of 'work-in-progress'. It is carried down as a credit balance in the Contract Account itself, the work-in-progress being represented by the debit balance in the Contract Account.