

PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

Buy-back of Shares

1. Anu Ltd. furnishes you with the following balance sheet as at 31st March, 2008:

(Rs. in crores)

Sources of Funds

Share Capital:

Authorised	100	
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Issued:

12% redeemable preference shares of Rs.100 each fully paid	75	
Equity shares of Rs.10 each fully paid	<u>25</u>	100

Reserves and surplus:

Capital reserve	15	
Securities Premium	25	
Revenue reserves	<u>260</u>	<u>300</u>
		<u>400</u>

Application of Funds

Fixed assets: cost	100	
Less: Provision for depreciation	<u>(100)</u>	nil
Investments at cost (Market value Rs.400 Cr.)		100
Current assets	340	
Less: Current liabilities	<u>40</u>	<u>300</u>
		<u>400</u>

The company redeemed preference shares on 1st April, 2008. It also bought back 50 lakh equity shares of Rs.10 each at Rs.50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

- (i) Pass journal entries to record the above.
- (ii) Prepare balance sheet as at 1.4.2008
- (iii) Calculate the value of a equity share on net assets basis.

Accounting for Electricity Companies

2. The following balances have been extracted from the books of Arpita electricity company at the end of an accounting year:

	Rs.
Share capital	1,00,00,000
Reserve fund invested in 8% Government securities, acquired at par	60,00,000
Contingencies reserve invested in 7% State Loan, at par	12,00,000
Loans from State Electricity Board	25,00,000
12% Debentures	20,00,000
Development reserve	8,00,000
Fixed Assets	2,50,00,000
Depreciation reserve on fixed assets	30,00,000
Consumers' deposits	40,00,000
Amount contributed by consumers towards cost of fixed assets	2,00,000
Intangible assets	8,00,000
Tariffs and dividend control reserve	10,00,000
Current assets (monthly average)	15,00,000

In the accounting year, the Company earned a profit of Rs. 28,00,000 after tax. Assuming that the bank rate is 10%, show how you will deal with the profits of the company.

Self-Balancing Ledgers

3. From the following information prepare a Total Debtors Account as appearing in the General ledgers in the Books of M/s Shukla and Company.

Debit balance as on 1.7.2007, Rs.87,200; Credit balance as on 1.7.2007 in Debtors Account Rs.600.

Transactions during 6 months ended on 31.12.2007:

Total sales were Rs.94,000 including cash sales of Rs.4,000. Debtors whose balances were in credit were paid off Rs.600. Payments received by cheques from Debtors Rs.60,000. Payments received by cash from Debtors Rs.48,000. Payment received by bills receivable Rs.26,000.

Bills receivable received from Debtors were dishonoured for Rs.6,000 and noting charges of Rs.60 were paid. Cheques received from customers were dishonoured for Rs.800.

Out of bills receivable received and included in Rs.26,000 above, bills of Rs 5,000 were endorsed to suppliers.

Bad debts written-off during the period were Rs.1,000. Discount allowed for prompt

payment were Rs.700 and bad debts written off in 2006 and now recovered from debtors amounted to Rs.900.

Interest debited for delay in payments were Rs.1,250. On 31.12.2007 provision for doubtful debts was created for Rs.2,100. M/s Trial & Co.'s account appeared in Debtors Ledger and also in Creditors Ledger. The balance in Creditors Ledger was Rs.900 and the same was transferred to Debtors Ledger. Goods of Rs.2,760 were rejected by the customers.

Accounting for Not-for-profit organizations

4. The following is the Income and Expenditure Account of the Gorakhpur Club for the year ended 31st March, 2008:

	Rs.		Rs.
To Salaries	15,750	By Subscriptions	55,000
To Stationery	1,250	By Donations	7,500
To Rates and Taxes	6,210	By Profit on Annual Meet	16,000
To Postage, Telephone etc.	2,520	By Sale of Souvenirs	5,250
To Sundry Expenses	8,210	By Profit on sale of Billiard Table	1,410
To Repairs and Maintenance	5,260		
To Table Tennis Balls	1,210		
To Printing of Souvenir	2,500		
To Affiliation Fee to Main Club till 31.3.2008	500		
To Electricity	6,250		
To Water Charges	1,210		
To Billiard Room Expenditure	2,460		
To Depreciation on Sundry Assets	1,560		
To Excess of Income over Expenditure	<u>30,270</u>		
	<u>85,160</u>		<u>85,160</u>

The following further information is available:

	1-4-2007	31-3-2008
	Rs.	Rs.
Sundry Assets	46,500	47,650
Outstanding Subscriptions	1,560	2,610
Advance Subscriptions	2,500	1,600

Expenses Outstanding:

Printing and Stationery	150	210
Telephone Bills	220	240
Electricity	125	225
Due towards purchase of Billiards Balls	-	165
Office Bearers' Fund	3,465	4,260

The Billiard Table was used for six months during the year and its book value was Rs. 10,240 as on 30th September, 2007.

Cash in hand at the beginning was Rs. 1,750.

The club is affiliated to the Main Club. It has paid one year's subscription in advance Rs.1,000. Out of the donation, a sum of Rs. 1,000 announced at the Annual Meet was duly taken into account but had not been received till 31st March, 2008.

All amounts received towards Office Bearers' Fund were credited to the Fund and the expenses amounting Rs. 2,785 were also charged to the Fund directly.

From the above particulars, prepare a Receipts and Payments Account for the year and draw the Balance Sheet as on 31st March, 2008.

Accounting for Incomplete Records

5. Avinash does not maintain his books of accounts under the double entry system but keeps slips of papers from which he makes up his annual accounts. He borrowed money from a bank to whom he has to render figures of profits every year. He gives the bank the following profit figures: 2003: Rs.20,000; 2004: Rs.32,000; 2005: Rs.35,000; 2006: Rs.48,000; 2007: Rs.55,000. The bank appoints you to audit the statements and verify whether the figures of profits reported are correct or not, for this purpose, the following figures are made available to you:
 - (a) Position as on 31st December, 2002 : Debtors Rs.20,000; Stock (at 95% of the cost) Rs.47,500; Cash and Bank Rs.12,600; Creditors Rs.6,000; Expenses due Rs.1,600.
 - (b) He borrowed Rs.5,000 from his wife on 30th September, 2002 on which he agreed to pay simple interest at 12% p.a. The loan was repaid alongwith interest on 31st December, 2004.
 - (c) In December, 2003, he advanced Rs.8,000 to A for purchase of a plot of land. The property was registered in March, 2005 after payment of balance consideration of Rs.32,000. Registration cost incurred were Rs.7,500.
 - (d) Avinash purchased jewellery for Rs.15,000 for his daughter in October, 2005. Marriage expenses incurred in January, 2006 were Rs.24,000.
 - (e) A new VCR was purchased in March, 2007 for Rs.18,000 and presented by him to his friend in November, 2007.
 - (f) His annual household expenses amounted to a minimum of Rs.24,000.

- (g) The position of assets and liabilities as on 31st December, 2007 was found to be: Bank overdraft (secured against property) Rs.12,000; Creditors Rs.10,000; Expenses payable Rs.600; Debtors (including Rs.600 due from a peon, declared insolvent) Rs.28,800; Stock (at 125% of cost to reflect market value) Rs.60,000 and Cash Rs.250.

It is found that the rate of profits has been uniform throughout the period and the proportion of sales during the year to total sales for the period was in the ratio of 3:4:4:6:8. Ascertain the annual profits and indicate differences, if any, with those reported by Avinash to the bank earlier.

Investment Accounting

6. Irfan carried out the following transactions in the shares of Sky Ltd.:
- (a) On 1st April, 2007 he purchased 20,000 equity shares of Re. 1 each fully paid up for Rs. 30,000.
 - (b) On 15th May 2007, Irfan sold 4,000 shares for Rs. 7,600.
 - (c) At a meeting on 15th June 2007, the company decided:
 - (i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2007, and
 - (ii) To give its members the right to apply for one share for every five shares held on 1st June 2007 at a price of Rs. 1.50 per share of which 75 paise is payable on or before 15th July 2007 and the balance, 75 paise per share, on or before 15th September, 2007.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2007.

- (a) Irfan received his bonus shares and took up 2000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30th September 2007.
- (b) On 15th March 2008, he received a dividend from Sky Ltd. of 15 per cent in respect of the year ended 31st Dec 2007.
- (c) On 30th March he received Rs. 14,000 from the sale of 10,000 shares.

You are required to record these transactions in the Investment Account in Irfan's books for the year ended 31st March 2008 transferring any profits or losses on these transactions to Profit and Loss account. Apply average basis.

Expenses and tax to be ignored.

Branch Accounting (Foreign Branch)

7. S & M Ltd., Bombay, have a branch in Sydney, Australia. At the end of 31st March, 2008, the following ledger balances have been extracted from the books of the Bombay Office

and the Sydney Office :

	Bombay (Rs. in thousands)		Sydney (Austr dollars in thousands)	
	Debit	Credit	Debit	Credit
Share Capital	—	2,000	—	—
Reserves & Surplus	—	1,000	—	—
Land	500	—	—	—
Buildings (Cost)	1,000	—	—	—
Buildings Depreciation Reserve	—	200	—	—
Plant & Machinery (Cost)	2,500	—	200	—
Plant & Machinery Depreciation Reserve	—	600	—	130
Debtors / Creditors	280	200	60	30
Stock (1.4.2007)	100	—	20	—
Branch Stock Reserve	—	4	—	—
Cash & Bank Balances	10	—	10	—
Purchases / Sales	240	520	20	123
Goods sent to Branch	—	100	5	—
Managing Director's salary	30	—	—	—
Wages & Salaries	75	—	45	—
Rent	—	—	12	—
Office Expenses	25	—	18	—
Commission Receipts	—	256	—	100
Branch / H.O. Current A/c	<u>120</u>	<u>—</u>	<u>—</u>	<u>7</u>
	<u>4,880</u>	<u>4,880</u>	<u>390</u>	<u>390</u>

The following information is also available :

(1) Stock as at 31.3.2008 :

Bombay Rs. 1,50,000

Sydney A \$ 3,125

(2) Head Office always sent goods to the Branch at cost plus 25%.

(3) Provision is to be made for doubtful debts at 5%.

(4) Depreciation is to be provided on buildings at 10% and on plant and machinery at 20% on written down values.

(5) The Managing Director is entitled to 2% commission on net profits.

(6) Income-tax is to be provided at 47.5%.

You are required :

(a) To convert the Branch Trial Balance into rupees;

use the following rates of exchange :

Opening rate A \$ = Rs. 20

Closing rate A \$ = Rs. 24

Average rate A \$ = Rs. 22

For Fixed Assets A \$ = Rs. 18.

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2008 showing to the extent possible H.O. results and Branch results separately. (Balance Sheet not required.)

Hire Purchase System

8. Suresh purchased seven trucks on hire purchase on 1st July, 2007. The cash price of each truck was Rs. 50,000. He was to pay 20% of the cash price at the time of delivery and the balance in five half-yearly instalments starting from 31st December, 2007 with interest at 5% p.a.

On Suresh's failure to pay the instalments due on 30th June, 2008, it was agreed that Suresh would return 3 trucks to the vendor and remaining four would be retained by him. The repossessed price of 3 trucks was Rs. 40,500. Suresh charged depreciation @20% p.a. After spending Rs. 1,000 on repairs, vendor sold away all three trucks for Rs. 40,000.

Show Trucks Account and Vendor's Account in the books of Suresh and Suresh Account and Goods Repossessed Account in the books of the vendor, assuming that their books are closed on 30th June every year.

Insurance Claim

9. A 'loss of profit' policy was taken for Rs. 80,000. Fire occurred on 15th March, 2008. Indemnity period was for three months. Net profit for 2007 year ending on 31st December was Rs. 56,000 and standing charges (all insured) amounted to Rs. 49,600. Determine insurance claim from the following details available from quarterly sales tax returns:

Sales	2005 (Rs.)	2006 (Rs.)	2007(Rs.)	2008(Rs.)
From 1 st January to 31 st March	1,20,000	1,30,000	1,42,000	1,30,000
From 1 st April to 30 th June	80,000	90,000	1,00,000	40,000
From 1 st July to 30 th September	1,00,000	1,10,000	1,20,000	1,00,000
From 1 st October to 31 st December	1,36,000	1,50,000	1,66,000	1,60,000

Sales from 16.3.2007 to 31.3.2007 were Rs. 28,000. Sales from 16.3.2008 to 31.3.2008 were Rs. Nil.

Sales from 16.6.2007 to 30.6.07 were Rs. 24,000. and sales from 16.2.2008 to 30.6.2008 were Rs. 6,000.

Partnership Accounts (Sale to a Company)

10. X, Y and Z have carried on business as drapers for twenty years and on 30th June, 2008, their balance sheet was as under:

Liabilities	Rs.	Rs.	Assets	Rs.
Bank overdraft		20,000	Premises	50,000
Creditors for supplies		30,000	Plant and Machinery	32,000
Creditors for expenses		18,000	Stock in trade	40,000
Capital accounts:			Sundry debtors	48,000
(Fixed)			Cash and bank balances	8,000
X	30,000			
Y	20,000			
Z	<u>20,000</u>	70,000		
Current accounts:				
X	16,000			
Z	<u>24,000</u>	<u>40,000</u>		
		<u>1,78,000</u>		<u>1,78,000</u>

The profits and losses were shared in the ratio of fixed capitals as on 30th June, 2008. The partners agreed that due to his old age, X would retire from the firm when its goodwill will be valued and proportionate share will be credited to X. It was also decided that premises appearing in the books at cost would be valued at its market value of Rs.80,000 and allotted to X in satisfaction of his dues. Any excess or deficit would be settled in cash. It was also agreed that stock in trade and debtors would be taken at 90% of the book value and an unrecorded liability of bonus of Rs.10,000 to staff should be brought into books. Goodwill of the firm was to be taken at Rs.70,000.

After X's retirement, the business was carried on by Y and Z sharing profits and losses equally and till 30th September, 2008, the firm had made a net profit of Rs.30,000 after crediting each partner's capital account with Rs.500 p.m. as salary. No drawings were made by the partners in the quarter.

Y and Z now find that they cannot continue the business and decide to sell it to a private limited company as and from 1st October, 2008. The company is to take over the entire business for a consideration of Rs.90,000 which the vendors agree to take 40% in 14% secured debentures and the balance in cash. To enable the company to pay the vendors and also leave it with a working capital of Rs.20,000 in addition to the working capital taken over by Y and Z, the company makes issue of equity shares of Rs.10 each at par.

Show the Balance Sheet of the company after the takeover of the business of Y and Z.

Accounting for Banking Companies

11. The following is an extract from the Trial Balance of a Dena Bank as at 31st March 2008:

	Rs.	Rs.
Bills Discounted	51,50,000	
Rebate on bills discounted not yet due, April 1, 2007		30,501
Discount received		1,45,500

An analysis of the bills discounted as shown above shows the following:

Date of Bills	Amount Rs.	Term Months	Rate of discount p.a. (%)
January 13	7,50,000	4	12
February 17	6,00,000	3	10
March 6	4,00,000	4	11
March 16	2,00,000	2	10

Find out the amount of discount received to be credited to Profit and Loss Account and pass appropriate Journal Entries for the same. Show how the relevant items will appear in the Dena Bank's Balance Sheet? For calculation take 1 year = 365 days.

Accounting for Insurance Companies

12. The following figures have been extracted from the books of New India Insurance Company Ltd. in respect of their Marine Business for 2007-2008:

				(Rs. in lakhs)	
Direct Business Income	50.00	Commission paid on Direct Business	5.00		
Reserve for unexpired risks as on 1.4.2007	60.00	Expenses of Management	5.00		
Claims outstanding as on 1.4.2007 (net)	20.00	Income tax deducted at source	3.00		
Bad Debts	10.00	Profit and Loss Account: (Cr.) balance as on 1.4.2007	10.00		
Income from investment and dividends (gross)	10.00	Other expenses	1.25		
Rent received from properties	5.00	Reinsurance premium receipts	5.00		

Investment in government securities as on 1.4.2007	100.00	Outstanding claims as on 31.3.2008 (net)	30.00
Investment in shares as on 1.4.2007	20.00	Direct claims paid (gross)	25.00
		Reinsurance claims paid	4.00

Prepare a Revenue Account and Profit and Loss Account for the year after taking into account the following further information:

- (a) All direct risks are reinsured for 20% of the risk.
- (b) Claim a Commission of 25% on reinsurance ceded.
- (c) Provide 25% Commission on reinsurance accepted
- (d) Market value of investments as on 31st march, 2008 is as follows:
 - (i) Government Securities Rs. 105 lakhs.
 - (ii) Shares Rs. 18 lakhs.
 Adjust separately for each of these two categories of investments.
- (e) Provide 65% for Income tax.

Cash-Flow Statement

13. The following are the changes in the account balance taken from the Balance Sheets of Bittu Ltd. at the beginning and end of the year:

	Changes in Rupees in debit or (credit)
Equity share capital 30,000 shares of Rs. 10 each issued and fully paid	0
Capital reserve	(49,200)
8% Debentures	(50,000)
Debenture discount	1,000
Freehold property at cost/revaluation	43,000
Plant and machinery at cost	60,000
Depreciation on plant and machinery	(14,400)
Debtors	50,000
Stock and work-in-progress	38,500
Creditors	(11,800)
Net profit for the year	(76,500)
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	(3,300)
Trade investments at cost	47,000
Bank	(64,300)
	0

You are informed that :

- (a) Capital reserve as at the end of the year represented realised profits on sale of one

freehold property together with surplus arising on the revaluation of balance of freehold properties.

- (b) During the year plant costing Rs. 18,000 against which depreciation provision of Rs.13,500 was lying was sold for Rs. 7,000.
- (c) During the middle of the year Rs. 50,000 debentures were issued for cash at a discount of Rs. 1,000.
- (d) The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.

You are required to prepare a statement which will explain, why bank borrowing has increased by Rs. 64,300 during the year end. Ignore taxation.

Underwriting of Shares

14. A joint stock company resolved to issue 10 lakh equity shares of Rs. 10 each at a premium of Re 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications. The issue was underwritten by X, Y and Z for a commission @ 2% of the issue price. 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively.

The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows: X - 1,19,500 shares; Y - 57,500 shares and Z – 10,500 shares.

Unmarked applications totalled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to:

- (i) Prepare a statement calculating underwriter's liability for shares.
 - (ii) Pass journal entries for all transactions including cash transactions.
15. Rs. 25,000 lent by A to P on 1st January, 2006 is repayable in 5 equal instalments commencing from 1st January, 2007. Calculate average due date and amount of interest at 10% p.a.
16. Given below is the balance sheet of S Ltd. as on 31st March, 2007:

(Amount in lakhs of rupees)

Equity share capital (in equity shares of Rs. 10 each)	4.00	Block of assets less depreciation to date	6.00
10% Preference share capital	3.00	Stock and debtors	5.30
General Reserve	1.00	Cash and bank	0.70

Profit and Loss account	1.00	
Creditors	<u>3.00</u>	<u> </u>
	<u>12.00</u>	<u>12.00</u>

A Ltd., another existing company holds 25% of equity share capital of S Ltd. purchased at Rs. 10 per share.

It was agreed that A Ltd. should take over the entire undertaking of S Ltd. on 30.9.2007 on which date the position of current assets (except cash and bank balances) and creditors was as follows:

Stock and debtors 4 lakhs

Creditors 2 lakhs

Profits earned for half year ended 30.9.2007 by S Ltd. was Rs. 70,500 after charging depreciation of Rs. 32,500 on block of assets. S Ltd. declared 10% dividend for 2006-2007 on 30.8.2007 and the same was paid within a week. Ignore corporate dividend tax.

Goodwill of S Ltd. was valued at Rs. 80,000 and block assets were valued at 10% over their book value as on 31.3.2007 for purpose of take over. Preference shareholders of S Ltd. will be allotted 10% preference shares of Rs. 10 each by A Ltd. Equity shareholders of S Ltd. will receive requisite number of equity shares of Rs. 10 each from A Ltd. valued at Rs. 10 per share.

- (a) Compute the purchase consideration for the taken over business.
- (b) Explain how the capital reserve or goodwill, if any, will appear in the balance sheet of A Ltd., after the amalgamation in the nature of purchase.

17. Answer the following questions (Give adequate working notes in support of your answer)
- (i) The economic life of an enterprise is artificially split into periodic intervals in accordance with the going concern assumptions. Is the statement true or false?
 - (ii) If payment is made on the average due date, it results in loss of interest to creditors. Is the statement true or false?
 - (iii) During the year 2007-2008, a medium size manufacturing company wrote down its inventories to net realisable value by Rs. 5,00,000. Is a separate disclosure necessary in final accounts?
 - (iv) A, B and C are partners with profit sharing ratio 5:3:2. A wants to retire, B and C agreed to continue at 2:1. Find the profit gaining ratio between B and C.
 - (v) If there appears a sports fund, the expenses incurred on sports activities will be taken to income and expenditure account. State whether the statement is true or false.
 - (vi) The company finds that the stock sheets of 31.3.2006 did not include two pages containing details of inventory worth Rs. 14.5 lakhs. State, how you will deal with this matter in the accounts of U Ltd. for the year ended 31st March, 2007 with

reference to AS 5.

- (vii) Following are the statements of interest on advances in respect of performing and non-performing assets of Madura Bank Ltd. Find out the income to be recognised for the year ended 31st March. 2008.

	(Rs. in lakhs)	
Performing Assets:	Interest earned	Interest received
Cash credit and overdrafts	1,800	1,060
Bills purchased and discounted	700	550
Non-performing Assets:		
Cash credit and overdrafts	450	70
Bills purchased and discounted	350	36

- (viii) Pass journal entries in year 1 in the case of the issue of debentures by ABC Co. Ltd.:

Issued Rs. 1,00,000, 11% debentures at 95% redeemable at the end of 10 years at 102%.

- (ix) In self balancing system, whenever a balance is transferred from an account in one ledger to that in another, only one entry is recorded through the respective ledger. State whether the statement is true or false.

- | | |
|---|-----------------|
| (x) Net profit for the current year | Rs. 1,00,00,000 |
| No. of equity shares outstanding | 50,00,000 |
| Basic earnings per share | Rs. 2.00 |
| No. of 12% convertible debentures of Rs. 100 each | 1,00,000 |
| Each debenture is convertible into 10 equity shares | |
| Interest expense for the current year | Rs. 12,00,000 |
| Tax relating to interest expense (30%) | Rs. 3,60,000 |
| Compute Diluted Earnings per Share. | |

18. Theory Questions

- What are the criteria that a joint stock company should fulfill to issue sweat equity shares?
- Write a short note on 'Double Accounts System of presentation of financial statements' by Electricity Supply Companies.
- A change in an accounting estimate requires the same treatment in the financial statements as that required for a prior period item. Comment
- In which order does the accounts of partnership in case of dissolution, is settled under piecemeal distribution of cash?

- (e) Who are 'B List Contributors' and when will their liabilities be crystallized?
 - (f) On what basis common expenditures are allocated among different departments?
 - (g) What are the reasons for increasing popularity of an ERP package in big organizations?
 - (h) Explain the implications of business entity concept for accounting purposes.
 - (i) Explain Garner v/s Murray rule applicable in the case of partnership firms. State, when is this rule not applicable.
 - (j) What do you mean by Epoque Method?
19. Theory questions based on Accounting Standards
- (a) Explain the provisions of AS 20 for restatement of shares.
 - (b) If a sale and lease back transaction results in an operating lease, what provisions will be applicable? Describe in line with AS 19.
 - (c) What criteria is applied for rating an enterprise as Level II enterprise for the purpose of compliance of Accounting Standards in India?
20. (a) Which borrowing costs are eligible for capitalisation as per AS 16? Describe in brief.
- (b) A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. Is it a liability?
 - (c) Explain the provisions of AS 26 relating to retirement and disposal of intangible assets.
21. (a) Describe with reference to Accounting Standards, the methods which may be used for recognising revenue on construction contracts.
- (b) Discuss the accounting principles relevant to the auditors relating to:
 - (i) Prior period items.
 - (ii) Change in accounting estimates.
 - (c) Summarise briefly the requirements of AS 1 relating to the disclosure of significant accounting policies.
22. Practical problems based on application of Accounting Standards
- (a) A raw material costing Rs. 150 has net realisable value (which can be the replacement cost) Rs. 130. The finished goods for which this raw material is used has other cost to incur Rs. 60. At what price raw material should be valued if finished goods has a net realisable value (i) Rs. 210 or above (ii) less than Rs. 190 and (iii) Rs. 200.
 - (b) Astha Ltd. paid an interim dividend of Rs. 1,00,000 during the financial year 2007-2008. Alongwith, it also paid Rs. 10,200 as corporate dividend tax, ABC Ltd., while

preparing cash flow statement for 2007-2008, classified dividend paid as financing activities and Corporate Dividend Tax paid as cash flow from operating activities. Do you agree with such treatment? Answer your question in framework of AS-3.

- (c) Heera Ltd. has two divisions. It provides depreciation for both divisions on straight line basis as per rates prescribed by Schedule XIV to the Companies Act. While finalizing the accounts for the year ended 31-3-2007, it however wants to change the method to Written Down Value method for one of its divisions since in the opinion of the management the assets of the said division suffer faster wear and tear. Please advise the company on the above and also whether the change should be prospective or retrospective.
- (d) A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 2007.

	(Rs. in lakhs)
Total Contract Price	1,000
Work Certified	500
Work not Certified	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 (Revised) issued by ICAI.

23. (a) A newly set up Private Ltd. manufacturing company has incurred following expenditures for the acquisition of plant & Machinery:
- Foreign tour expenses of directors for purchasing Plant & Machinery.
 - Technical staff's salary for erection of Plant & Machinery.
 - Non-technical staff's salary during the period of installation of Plant & Machinery
 - Other sundry expenses such as stationery, printing, postage, telegram and telephone and local conveyance charge etc.
- The company intends to capitalize the above expenses. Is the company justified? State with reasons.
- (b) Daya Ltd. acquired a machine on 1-1-2004 for Rs. 10,00,000. The useful life is 5 years. The company had applied on 1-4-2004, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy, was received in November 2007. The

company's Fixed Assets Account as at 31-3-2008 shows a credit balance as under:

Machine (original cost)	10,00,000
Accumulated depreciation (from 2004-2005 to 2006-2007 at straight line method)	<u>(6,00,000)</u>
	4,00,000
Less: Grant received	<u>(8,00,000)</u>
	(4,00,000)

How should the company deal with this asset in its account for 2007-08? Does it need to charge depreciation or negative depreciation for 2007-08? Can it credit Rs. 4,00,000 to capital reserve?

- (c) X Co. Ltd., has obtained an Institutional Loan of Rs. 680 lakhs for modernisation and renovation of its plant & machinery. Plant & machinery acquired under the modernisation scheme and installation completed on 31.3.2008 amounted to Rs. 520 lakhs, 30 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 130 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to Rs. 62 lakhs during 2007-2008.

You are required to state how the interest on the institutional loan is to be accounted for in the year 2007-2008.

24. (a) A Ltd. leased a machinery to B Ltd. on the following terms:

(Rs. in Lakhs)

Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
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.

- (b) A Ltd. has income from continuing ordinary operations of Rs. 2,40,000, a loss from discontinuing operations of Rs. 3,60,000 and accordingly a net loss of Rs. 1,20,000. The company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2008. Compute basic and diluted EPS.
- (c) An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.

25. (a) During 2004-05, Enterprise X gives a guarantee of certain borrowings of Enterprise Y, whose financial condition at that time is sound. During 2005-06, the financial condition of Enterprise Y deteriorates and at 30 September, 2005 Enterprise Y goes into liquidation. How it will be dealt with by 'X'?
- (b) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.
- (c) A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2007, when the exchange rate was Rs.43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2007 when the exchange rate was Rs.47 per US Dollar. However, on 31st March, 2007, the rate of exchange was Rs.48 per US Dollar. The company passed an entry on 31st March, 2007 adjusting the cost of raw materials consumed for the difference between Rs.47 and Rs.43 per US Dollar.
- In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.
- (d) A company signed an agreement with the Employees Union on 1.9.2007 for revision of wages with retrospective effect from 30.9.2006. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2007-08?

SUGGESTED ANSWERS/HINTS

1. (i) Journal entries in the books of Anu Ltd.

		Rs. in crores	
	Particulars	Debit	Credit
1 st April, 2008	12% Preference share capital A/c Dr.	75	
	To Preference shareholders A/c		75
	(Being preference share capital account transferred to shareholders account)		
	Preference shareholders A/c Dr.	75	
	To Bank A/c		75
	(Being payment made to shareholders)		
	Shares buy back A/c Dr.	25	
	To Bank A/c		25
	(Being 50 lakhs equity shares bought back @ Rs.50 per share)		

Equity share capital A/c (50 Lakhs x Rs.10)	Dr.	5	
Securities premium A/c (50 Lakhs x Rs.40)	Dr.	20	
To Shares buy back A/c			25
(Being cancellation of shares bought back)			
Revenue reserve A/c	Dr.	80	
To Capital Redemption Reserve A/c			80
(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

(ii)

Balance sheet of Anu Ltd as at 1.4.2008

Liabilities	(Rs. in crores)	Assets	(Rs. in crores)
Share Capital:		Fixed assets:	
Authorised	<u>100</u>	Cost	100
Issued, subscribed and paid up:		Less: Provision for depreciation	<u>(100)</u> Nil
200 lakhs equity shares of Rs.10 each	20		
		Investment at cost	100
		(Market value Rs.400 crores)	
Reserves and surplus:		Current assets as on 31.3.2008	340
Capital reserve	15	Less: Bank payment for redemption and buy back	<u>(100)</u> 240
Capital redemption reserve	80		
Securities premium	5		
(25-20)			
Revenue reserve			
(260-80)	<u>180</u>		
Current liabilities	<u>40</u>		
	<u>340</u>		<u>340</u>

(iii) Net asset value of equity shares

		(Rs. in crores)	
Particulars	Amount	Amount	
Assets:			
Fixed Assets	Nil		
Investments (at market value)	400		
Current assets	<u>240</u>	640	
Less: Liabilities:			
Current liabilities		<u>(40)</u>	
Net assets available for equity share holders		<u>600</u>	
Number of equity shares outstanding as on 1.4.2008		2 crores	
Value per equity share of Rs.10 each (600 ÷ 2)		Rs.300	
2. Calculation of Capital Base:	Rs.	Rs.	
Original cost of fixed assets	2,50,00,000		
Less: Amount contributed by the customers	<u>2,00,00,000</u>	2,48,00,000	
Intangible assets		8,00,000	
Investments against contingency reserve		12,00,000	
Monthly average of current assets		<u>15,00,000</u>	
Total (i)		2,83,00,000	
Less: Amount written off on account of depreciation	30,00,000		
Loan from State Electricity Board	25,00,000		
12% Debentures	20,00,000		
Consumers' deposits	40,00,000		
Development Reserve	8,00,000		
Balance of tariffs and dividend control reserve	<u>10,00,000</u>		
Total (ii)		<u>1,33,00,000</u>	
Capital Base (i)-(ii)		<u>1,50,00,000</u>	
Calculation of Reasonable Return:		Rs.	
Yield at standard rate i.e. 10% +2% on capital base (12% of Rs. 1,50,00,000)		18,00,000	
Add: Income from reserve fund investments (8% of Rs. 60,00,000)		4,80,000	
½ % of loans from State Electricity Board (½ % of Rs. 25,00,000)		12,500	
½ % of debentures (½ % of Rs. 20,00,000)		10,000	
½ % of development reserve (½ % of Rs. 8,00,000)		<u>4,000</u>	
Total		<u>23,06,500</u>	

Disposal of surplus:	Rs.
Profit after tax, given	28,00,000
Less: Reasonable return, as calculated above	<u>23,06,500</u>
Surplus	4,93,500
Less: 20% of reasonable return (20% of Rs. 23,06,500)	<u>4,61,300</u>
Amount to be credited to customers rebate reserve	<u>32,200</u>

Disposal of surplus of Rs. 4,61,300:

- (i) $\frac{1}{3}^{\text{rd}}$ of the surplus of the company subject to 5% of reasonable return is at the disposal of the company

$$\frac{1}{3}^{\text{rd}} \text{ of Rs. 4,61,300} = \text{Rs. 1,53,767}$$

$$5\% \text{ of Rs. 23,06,500} = \text{Rs. 1,15,325}$$

Lower of the two is at the disposal of the company Rs. 1,15,325

- (ii) $\frac{1}{2}$ of the balance is to be credited to Tariff and dividend control reserve

$$= \frac{1}{2} \text{ of Rs. } [4,61,300 - 1,15,325] = \text{Rs. 1,72,988}$$

- (iii) $\frac{1}{2}$ of the balance is to be credited to customers rebate reserve i.e. Rs. 1,72,987

Rs. 4,61,300

Final Distribution: Rs.

(i)	Refunded to customers (Rs 32,200 +Rs. 1,72,987)	2,05,187
(ii)	Transfer to tariff and dividend control reserve	1,72,988
(iii)	At the disposal of the company (Rs. 23,06,500+Rs. 1,15,325)	<u>24,21,825</u>
		<u>28,00,000</u>

3. In the General Ledger of M/s.Shukla & Company

Dr.		Total Debtors Account		Cr.	
Date	Particulars	Rs.	Date	Particulars	Rs.
1.7.2007	To Balance b/f	87,200	1.7.2007	By Balance b/f	600
1.7.2007 to 31.12.2007	To Sales (Rs.94,000- Rs.4,000)	90,000	1.7.2007 to 31.12.2007	By Bank	60,000
"	To Cash	600	"	By Cash	48,000
"	To Bills Receivable (dishonoured)	6,000	"	By Bills receivable	26,000
"	To Bank (noting charges)	60	"	By Bad debts	1,000
"	To Bank (cheque dishonoured)	800	"	By Discount allowed	700

"	To Interest	1,250	"	By Total Creditors A/c-Transfer	900
			"	By Sales Return	2,760
			"	By Balance c/d	<u>45,950</u>
		<u>1,85,910</u>			<u>1,85,910</u>

Notes: (1) Bad debts of 2006 recovered in 2007 will not appear in the Total Debtors Account. It should be credited to Profit and Loss Account.

(2) Bills Receivable of Rs.5,000 endorsed to suppliers has nothing to do with Total Debtors Account because at the time of endorsement Suppliers Account is debited and Bills Receivable Account is credited.

4. Receipts and Payments Account of Gorakhpur Club
for the year ended 31st March, 2008

	Rs.		Rs.
To Opening Balance	1,750	By Office Bearers' Fund	2,785
To Subscription (55,000+1,560+1,600-2,610-2,500)	53,050	By Affiliation Fee to the Main Club (500+ 500)	1,000
To Donations (7,500 -1,000)	6,500	By Salaries	15,750
To Office Bearers' Fund (4,260-3,465+2,785)	3,580	By Stationery (1,250+150-210)	1,190
To Sale of Souvenirs	5,250	By Rate and Taxes	6,210
To Sale of Billiard Table Cost	10,240	By Postage and Telephone (2,520+220-240)	2,500
Profit	<u>1,410</u>	By Sundry Expenses	8,210
To Profit on Annual Meet	16,000	By Repairs & Maintenance	5,260
		By Table Tennis Balls	1,210
		By Printing of Souvenirs	2,500
		By Electricity (6,250+125-225)	6,150
		By Water Charges	1,210
		By Billiard Room Expenses (2,460 -165)	2,295
		By Sundry Assets (47,650+1,560+10,240- 46,500)	12,950
		By Closing Balance (Bal. Fig.)	<u>28,560</u>
	<u>97,780</u>		<u>97,780</u>

Balance Sheet
as at 31st March, 2008

	Rs.	Rs.		Rs.
Capital Fund (W.N.1)	43,350		Sundry Assets less depreciation	47,650
Add: Excess of income over expenditure	<u>30,270</u>	73,620	Outstanding Subscription	2,610
Office Bearers' Fund		4,260	Prepaid Affiliation Fee	500
Outstanding Expenses (210+240+225+165)		840	Donations Receivable	1,000
Subscription in advance		<u>1,600</u>	Balance at Bank	<u>28,560</u>
		<u>80,320</u>		<u>80,320</u>

Working Notes:

- (1) Calculation of Capital Fund at the beginning of the year :

Balance Sheet
as at 31st March, 2007

Liabilities	Rs.	Assets	Rs.
Outstanding Expenses (150+220+125)	495	Sundry Assets	46,500
Office Bearers' Fund	3,465	Cash	1,750
Subscription received in advance	2,500	Outstanding Subscription	1,560
Capital Fund (Bal. Fig.)	<u>43,350</u>		
	<u>49,810</u>		<u>49,810</u>

- (2) It is assumed that cash balance is in addition to Sundry Assets.

5.

Balance Sheet of Avinash
as at 1.1.2003

Liabilities	Rs.	Assets	Rs.
Capital (Balancing figure)	69,850	Debtors	20,000
Loan from Mrs. Avinash	5,000	Stock (at cost Rs.47,500 ×100/95)	50,000
Add: Accrued interest	<u>150</u>	Cash and Bank	12,600
Creditors	6,000		
Outstanding Expenses	<u>1,600</u>		
	<u>82,600</u>		<u>82,600</u>

Balance Sheet of Avinash as on 31.12.2007

Liabilities	Rs.	Assets	Rs.
Capital (Balancing figure)	53,850	Debtors less bad debts	28,200
		Rs.(28,800-600)	
Creditors	10,000	Stock (at cost: Rs.60,000 × 100/125)	48,000
Outstanding Expenses	600	Cash	250
Bank overdraft	<u>12,000</u>		
	<u>76,450</u>		<u>76,450</u>

Statement Showing the total Profits from 1.1.2003 to 31.12.2007

Particulars	Rs.	Rs.
Capital as on 31.12.2007		53,850
Add: Drawings for the period:		
Household expenses (Rs.24,000 × 5)	1,20,000	
Purchase of a plot of land Rs.(8,000 + 32,000+7,500)	47,500	
Purchase of jewellery	15,000	
Marriage expenses incurred	24,000	
Purchase of a VCR	<u>18,000</u>	<u>2,24,500</u>
		2,78,350
Less: Capital as on 1.1.2003		<u>69,850</u>
Net Profit from 1.1.2003 to 31.12.2007		<u>2,08,500</u>

Statement showing the Difference of Annual Profits with Reported Profits
from 2003 to 2007

Year ending on 31.12.	Ratio of Apportionment	Annual Profit (Rs.)	Reported Profit (Rs.)	Difference (Rs.)
2003	3	25,020	20,000	5,020
2004	4	33,360	32,000	1,360
2005	4	33,360	35,000	(1,640)
2006	6	50,040	48,000	2,040
2007	<u>8</u>	<u>66,720</u>	<u>55,000</u>	<u>11,720</u>
	<u>25</u>	<u>2,08,500</u>	<u>1,90,000</u>	<u>18,500</u>

6.

In the books of Irfan

Investment Account (Shares in Sky Limited)

Date		Particulars	No. of Shares	Income Rs.	Amount Rs.	Date		Particulars	No. of Shares	Income Rs.	Amount Rs.
2007						2007					
April 1	To	Bank (Purchases)	20,000	-	30,000	May 15	By	Bank (Sale)	4,000	-	7,600
May 15	To	Profit & Loss A/c (W.N.1)	-	-	1,600	Sept. 30	By	Bank (Sale of Right of 1,200 shares @ 40 paise per share)	-	-	480
June 15	To	Bonus Issue	4,000	-	Nil	1995					
July 15	To	Bank @ 75 p. paid on 2,000 shares)	2,000	-	1,500	Mar. 15	By	Bank (Dividend @ 15% on Rs.16,000)		2,400	-
Sept. 15	To	Bank @ 75 p. paid on 2,000 shares)	-	-	1,500	Mar. 30	By	Bank (Sale)	10,000	-	14,000
2008	To	Profit & Loss A/c (W.N.2)			1,945		By	Balance c/d	12,000	-	14,465
Sept. 31	To	Profit & Loss A/c	-	2,400	-			$\left(\frac{12,000}{22,000} \times 26,520 \right)$			
			<u>26,000</u>	<u>2,400</u>	<u>36,545</u>				<u>26,000</u>	<u>2,400</u>	<u>36,545</u>

Working Notes:

(1)	Sale on 15-5-2007: Cost of 4,000 shares @ Rs.1.50	Rs.6,000	
	Sales price	<u>Rs.7,600</u>	
	Profit		Rs.1,600
(2)	Cost of 10,000 shares sold:		
	Cost of 22,000 shares (24,000 + 3,000)	Rs.27,000	
	Less: Amount received from rights	<u>Rs.480</u>	
	Cost of 22,000 shares		Rs.26,520
	$\therefore$ Cost of 10,000 shares $\left(\frac{\text{Rs.26,520}}{22,000 \text{ shares}} \times 10,000 \text{ shares} \right)$		Rs.12,055
	Profit on 10,000 shares (Rs.14,000 – Rs.12,055)		Rs.1,945

7. (a)

S & M Ltd.

Sydney Branch Trial Balance (in Rupees)

As on 31 st March, 2008

		Dr.	(Rs. '000) Cr.
	Conversion rate per A\$		
Plant & Machinery (cost)	Rs. 18	36,00	
Plant & Machinery Dep. Reserve	Rs. 18		23,40
Debtors / Creditors	Rs. 24	14,40	7,20
Stock (1.4.2007)	Rs. 20	4,00	
Cash & Bank Balances	Rs. 24	2,40	
Purchase / Sales	Rs. 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	Rs. 22	9,90	
Rent	Rs. 22	2,64	
Office expenses	Rs. 22	3,96	
Commission Receipts	Rs. 22		22,00
H.O. Current A/c			<u>1,20</u>
		<u>78,70</u>	<u>80,86</u>
Exchange loss (balancing figure)		<u>2,16</u>	
		<u>80,86</u>	<u>80,86</u>

(b)

Trading and Profit & Loss Account
for the year ended 31st March, 2008

				(Rs.'000)			
	H.O.	Branch	Total		H.O.	Branch	Total
To Opening Stock	1,00	4,00	5,00	By Sales	5,20	27,06	32,26
“ Purchases	2,40	4,40	6,80	“ Goods sent to	1,00	–	1,00
“ Goods received	–	1,00	1,00	Branch			
from Head Office				“ Closing Stock	1,50	75	2,25
“ Gross profit c/d	4,30	18,41	22,71				
	<u>7,70</u>	<u>27,81</u>	<u>35,51</u>		<u>7,70</u>	<u>27,81</u>	<u>35,51</u>
				By Gross profit b/d	4,30	18,41	22,71
To Wages & Salaries	75	9,90	10,65	By Commission			
“ Rent	–	2,64	2,64	receipts	2,56	22,00	24,56
“ Office expenses	25	3,96	4,21				
“ Provision for doubtful							
debts @ 5%	14	72	86				
“ Depreciation	4,60	2,52	7,12				
(W. N. 1)							
“ Balance c/d	1,12	20,67	21,79				
	<u>6,86</u>	<u>40,41</u>	<u>47,27</u>		<u>6,86</u>	<u>40,41</u>	<u>47,27</u>
				To Exchange loss			2,16
“ Branch Stock Reserve			11	By Balance b/d			21,79
(W. N. 2)							
“ Managing Director's							
remuneration :							
Salary	30						
Commission	<u>41</u>		71				
(W. N. 3)							
Provision for Income-tax			8,93				
(W. N. 4)							
“ Balance c/d			9,88				
			<u>21,79</u>				<u>21,79</u>

Working Notes :

(1) Calculation of Depreciation :

	(Rs '000)	
	H.O.	Branch
A. Building – Cost	10,00	–
Less : Dep. Reserve	<u>2,00</u>	–
	8,00	
Depreciation @ 10%	<u>80</u>	
B. Plant & Machinery Cost	25,00	36,00
Less : Dep. Reserve	<u>6,00</u>	<u>23,40</u>
	19,00	12,60
Depreciation @ 20%	<u>3,80</u>	<u>2,52</u>
Total Depreciation (A+B)	<u>4,60</u>	<u>2,52</u>

(2) Calculation of Branch Stock Reserve :

	Rs '000)
Closing stock	<u>75</u>
Reserve on closing stock ($75 \times 1/5$)	15
Less : Branch Stock Reserve (as on 1.4.2007)	<u>4</u>
Additional Reserve required	<u>11</u>

(3) Calculation of Managing Director's Commission :

Profit before adjustment	21,79
Add: Provision for doubtful debts	<u>86</u>
	22,65
Less: Branch stock reserve	11
Exchange loss	<u>2,16</u>
Profit u/s 349	<u>20,38*</u>
Commission @ 2%	41 (approx.)

(4) Calculation of provision for Income tax :

	(Rs ' 000)
Profit u/s 349 as computed above	20,38
Less : Provision for doubtful debts	86
MD's remuneration	<u>71</u>
Profit before tax	<u>18,81</u>
Provision for tax @ 47.5%	<u>8,93**</u> (approx.)

* For the purpose of calculating profit u/s 349 of the Companies Act, 1956, depreciation based on the rates given in Schedule XIV to the Companies Act, 1956 should be deducted. Depreciation rates as per Schedule XIV are not given in this question. Hence the adjustment for depreciation is ignored.

** Alternatively provision for tax may also be computed on Rs.19,67 thousand ignoring provision for doubtful debts.

Note : For the purpose of translation of financial statements of foreign operations, AS 11 (revised 2003) "The Effects of Changes in Foreign Exchange Rates" classifies the foreign operations as (i) integral foreign operations and (ii) non-integral foreign operations. The above answer has been given on the basis that the Sydney branch is an integral foreign operation of S&M Ltd.

8.

In the books of Suresh

Trucks Account

Dr.			Cr.		
Date	Particulars	Rs	Date	Particulars	Rs.
1.7.2007	To Vendor A/c (Rs. 50,000 x 7) (Cost of Trucks)	3,50,000	30.6.2008	By Depreciation A/c (20% of Rs. 3,50,000)	70,000
			30.6.2008	By Vendor A/c (Agreed value of trucks returned)	40,500
			30.6.2008	By Profit & Loss A/c (W.N.4)	79,500
			30.6.2008	By Balance c/d (W.N.5)	1,60,000
		<u>3,50,000</u>			<u>3,50,000</u>
1.7.2008	To Balance b/d	1,60,000			

Vendor's Account

Dr.			Cr.		
Date	Particulars	Rs.	Date	Particulars	Rs.
1.7.2007	To Bank A/c (Down Payment)	70,000	1.7.2007	By Trucks A/c (Rs. 70,000 x 5)	3,50,000
31.12.2007	To Bank A/c (W.N.3)	63,000	30.6.2008	By Interest A/c (W.N.1)	7,000
30.6.2008	To Trucks A/c	40,500	30.6.2008	By Interest A/c (W.N.2)	5,600
30.6.2008	To Balance c/d	<u>1,89,100</u>			
		<u>3,62,600</u>			<u>3,62,600</u>

Working Notes:

- (1) Interest is to be calculated @5% on Rs. (3,50,000-70,000) for 6 months = $5/100 \times 1/2 \times \text{Rs. } 2,80,000 = \text{Rs. } 7,000$

- (2) Interest is to be calculated @5% on Rs. (3,50,000-70,000 + 7,000 - 63,000) for 6 months = Rs. 5,600
- (3) Amount of 1st instalment = 1/5 Rs. (3,50,000-70,000) + Rs. 7,000 (interest) = Rs. 56,000 + Rs. 7,000 = Rs. 63,000
- (4) Book Value of three trucks returned
 Cash Price of 7 trucks = Rs. 50,000 x 7 = Rs. 3,50,000
 Less: Depreciation for 2007-08 @ 20% = Rs. 70,000
 Book Value of 7 Trucks on 30.6.2008 = Rs. 2,80,000
 Therefore, book value of 3 trucks = Rs. 2,80,000 / 7 x 3 = Rs. 1,20,000. Agreed value of 3 trucks = Rs. 40,500.
 Loss on surrender = Rs. 1,20,000 - Rs. 40,500 = Rs. 79,500
- (5) Book Value of 4 trucks = Rs. 2,80,000 / 7 x 4 = Rs. 1,60,000.

In the Books of Vendor

Suresh Account

Dr.			Cr.		
Date	Particulars	Rs	Date	Particulars	Rs.
1.7.2007	To H.P. Sales A/c	3,50,000	1.7.2007	By Bank A/c	70,000
31.12.2007	To Interest A/c	7,000	31.12.2007	By Bank A/c (Rs. 56,000 + Rs. 7,000)	63,000
30.6.2008	To Interest A/c	5,600	30.6.2008	By Goods Repossessed A/c	40,500
			30.6.2008	By Balance c/d	<u>1,89,100</u>
		<u>3,62,600</u>			<u>3,62,600</u>

Goods Repossessed Account

Dr.			Cr.		
Date	Particulars	Rs	Date	Particulars	Rs.
30.6.2008	To Rajesh A/c	40,500	30.6.2008	By Bank A/c	40,000
30.6.2008	To Bank A/c	1,000	30.6.2008	By Profit & Loss A/c (Loss)	<u>1,500</u>
		<u>41,500</u>			<u>41,500</u>

9. (1) Gross Profit Ratio

	Rs
Net Profit in 2007	56,000
Insured Standing Charges	<u>49,600</u>
Gross Profit	<u>1,05,600</u>

$$\begin{aligned}\text{Rate of Gross Profit} &= \frac{\text{Gross Profit}}{\text{Sales}} \times 100 \\ &= \frac{1,05,600}{5,28,000^*} \times 100 = 20\%\end{aligned}$$

*(Rs.1,42,000+Rs.1,00,000+Rs.1,20,000+Rs. 1,66,000)

(2) Short Sales

(a) Standard Sales (Adjusted)	Rs.
Indemnity Period: 16.3.2008 to 15.6.2008. Standard sales are to be calculated on the basis of sales of corresponding period of the previous year i.e. 16.3.2007 to 15.6.2007.	
(i) Sales for the period 16.3.2007 to 31.3.2007 (given)	28,000
(ii) Sales for the period 1.4.2007 to 15.6.2007 (W.N.1)	<u>76,000</u>
	1,04,000
Add: Upward trend in Sales 10% (W.N.2)	<u>10,400</u>
	<u>1,14,400</u>
(b) Actual sales of disorganised period from 16.3.2008 to 15.6.2008	Rs.
(i) Sales for the period 16.3.2008 to 31.3.2008	Nil
(ii) Sales for the period 1.4.2008 to 15.6.2008 (40,000-6,000)	<u>34,000</u>
	<u>34,000</u>
Short Sales = Standard Sales – Actual Sales	
= Rs. 1,14,400-Rs.34,000	80,400

$$\begin{aligned}\text{(3) Loss of Gross Profit} &= \text{Short Sales} \times \text{Gross Profit \%} \\ &= \text{Rs. } 80,400 \times 20\% \\ &= \text{Rs. } 16,080\end{aligned}$$

(4) Application of Average Clause

$$\text{Net Claim} = \frac{\text{Gross claim} \times \text{Policy value}}{\text{Gross profit on Annual turnover}}$$

$$\text{Rs } 16,080 \times \frac{\text{Rs. } 80,000}{\text{Rs. } 1,19,680} = \text{Rs. } 10,749 \text{ (Approx.)}$$

Working Notes:

- (1) Sales for the period 1.4.2007 to 30.6.2007 (given) 1,00,000
 Less: Sales for the period 16.6.2007 to 30.6.2007 (given) 24,000
 Sales for the period 1.4.2007 to 15.6.2007 76,000
- (2) Calculation of Upward Trend in Sales
- (a) Total Sales of 2006 = Rs. 4,80,000 less total sales of 2005 = Rs. 4,36,000. Increase of sales in 2006 over 2005 = Rs. 44,000
 Therefore, % of increase = Rs. 44,000 / Rs. 4,36,000 x 100 = 10.09%
- (b) Total Sales of 2007 = Rs. 5,28,000 less total sales of 2006 = Rs. 4,80,000. Increase of sales in 2007 over 2006 = Rs. 48,000
 Therefore, % of increase = Rs. 48,000 / Rs. 4,80,000 x 100 = 10%
- Average percentage of increase = $\left(\frac{10.09\% + 10\%}{2} \right) = 10\% \text{ (Approx.)}$
- (3) Annual Sales
- | | |
|---|-----------------|
| Sales from 16.3.2007 to 31.3.2007 | 28,000 |
| Sales from 1.4.2007 to 30.6.2007 | 1,00,000 |
| Sales from 1.7.2007 to 30.9.2007 | 1,20,000 |
| Sales from 1.10.2007 to 31.12.2007 | 1,66,000 |
| Sales from 1.1.2008 to 5.3.2008 | |
| (Rs. 30,000 – Nil between 16.3.2008 to 31.3.2008) | <u>1,30,000</u> |
| Sales for 12 months just before fire took place | 5,44,000 |
| Add: 10% increase (upward trend) | <u>54,400</u> |
| Adjusted sales of 12 months just before fire | <u>5,98,400</u> |
| Gross Profit on Annual Sales = Rs. 5,98,400 x 20% | <u>1,19,680</u> |

10.

...Limited

Balance sheet as at 1st October, 2008

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
Authorised	<u> ?</u>	Goodwill (W.N.6)	16,600
Issued and subscribed:		Plant and machinery	32,000
7,400 shares of Rs.10 each,		Current Assets:	
fully called and paid-up	74,000	Cash at bank	20,000
Secured Loans:		Remaining net working capital	
14% secured debentures	36,000	taken over	<u>41,400</u>
	<u>1,10,000</u>		<u>1,10,000</u>

Working Notes:

1.

Revaluation Account

	Rs.		Rs.
To Provision for bad debts account	4,800	By Premises	30,000
To Stock in trade	4,000		
To Bonus due to staff (unrecorded liability)	10,000		
To Profit transferred to:			
X's capital, (3/7)	4,800		
Y's capital, (2/7)	3,200		
Z's capital, (2/7)	<u>3,200</u>		
	<u>30,000</u>		<u>30,000</u>

2. X's share of goodwill = $\frac{3}{7} \times \text{Rs.}70,000 = \text{Rs.}30,000$; gaining ratio of remaining partners is 1:1.

Therefore, Y and Z will be debited with Rs.15,000 each.

3.

X's Capital Accounts

	Rs.		Rs.
To Premises	80,000	By Balance b/d	30,000
To Cash/Bank A/c	800	By X's Current Account (transfer)	16,000
		By Revaluation Accounts (profit)	4,800
		By Y's capital Account (goodwill)	15,000
		By Z's capital Account (goodwill)	<u>15,000</u>
	<u>80,800</u>		<u>80,800</u>

Dr.		Continuing Partners' Capital Accounts						Cr.	
		Y			Z			Y	Z
		Rs.		Rs.			Rs.	Rs.	
To	X's Capital Account (goodwill)	15,000		15,000	By	Balance b/d	20,000	20,000	
To	Balance c/d	8,200		32,200	By	Z's Current account		24,000	
					By	Revaluation Account (profit)	3,200	3,200	
		<u>23,200</u>		<u>47,200</u>			<u>23,200</u>	<u>47,200</u>	

4. Balance Sheet of Y and Z as on 30th June, 2008

Liabilities		Rs.	Assets	Rs.	Rs.
Y's Capital Account		8,200	Plant and Machinery		32,000
X's Capital Account		32,200	Stock-in-trade		36,000
Bank Overdraft		20,000	Sundry Debtors	48,000	
Creditors for Suppliers	30,000		Less: Provision for Bad Debts	4,800	43,200
for expenses	18,000		Cash and Bank balances		
for Bonus to staff	<u>10,000</u>	<u>58,000</u>	(8,000 - 800)		<u>7,200</u>
		<u>1,18,400</u>			<u>1,18,400</u>

Net Working Capital = Rs.(36,000 + 43,200 + 7,200 – 20,000 – 58,000) = Rs.8,400

5. Balance sheet of Y and Z as on 30th September, 2008

Liabilities		Rs.	Rs.	Assets	Rs.	Rs.
Y's Capital Account:				Plant and Machinery		32,000
Balance on 1.7.2008	8,200			Net Working Capital:		
Add: Salary	1,500			As on 1.7.2008	8,400	
Share in profits	<u>15,000</u>	24,700		Add: Partners' salary	3,000	
X's Capital Account:				Profit	<u>30,000</u>	41,400
Balance on 1.7.2008	32,200					
Add: Salary	1,500					
Share in profits	<u>15,000</u>	<u>48,700</u>				
		<u>73,400</u>				<u>73,400</u>

		Rs.	Rs.
6.	Consideration paid for business		90,000
	Less: Plant and machinery taken over	32,000	

	Net working capital	<u>41,400</u>	<u>73,400</u>
	Amount paid for goodwill		<u>16,600</u>
7.	Debentures to be issued = 40% of Rs.90,000		36,000
	Cash to be paid = Rs.90,000 – Rs.36,000		54,000
	Total cash required = Rs.54,000 + Rs.20,000		74,000
	Hence, the company will issue 7,400 shares of Rs.10 each.		

11. Calculation of Unexpired Discounts or Rebate on Bills Discounted

Date of Bill	Date of Maturity including three days of grace	No. of days after March 31	Amount Rs.	Rate of discount % p.a.	Total Annual Discount	Proportionate Discount for days after 31 st March
2008	2008					
Jan. 13	May 16	46	7,50,000	12	90,000	$11,342 \left(90,000 \times \frac{46}{365} \right)$
Feb. 17	May 20	50	6,00,000	10	60,000	$8,219 \left(60,000 \times \frac{50}{365} \right)$
March 6	July 9	100	4,00,000	11	44,000	$12,055 \left(44,000 \times \frac{100}{365} \right)$
March 16	May 19	49	2,00,000	10	20,000	$2,685 \left(20,000 \times \frac{49}{365} \right)$
						<u>34,301</u>

So, unexpired discounts on 31st March, 2008, Rs.34,301.

The amount to be credited to Profit and Loss Account is ascertained from the Discount Account as follows:

Discount Account						
2008			Rs.	2008		
March 31	To	Profit and Loss A/c (Bal. fig.) (transferred)	1,41,700	Mar. 31	By	Sundries
						1,45,500

March 31	To	Rebate on Bills Discounted (on 31.3.08)	March 31	By	Rebate on Bills Discounted (on 1.4.2007)
		<u>34,301</u>			<u>30,501</u>
		<u>1,76,001</u>			<u>1,76,001</u>

Journal Entries

2008					Rs.	Rs.
March 31	Rebate on Bills Discounted Account	Dr.	30,501			
	To Discount Account					30,501
	(Being unexpired discount brought forward from the previous year, credited to Discount Account)					
	Discount Account	Dr.	34,301			
	To Rebate on Bills Discounted Account					34,301
	(Being provision for unexpired discount required at the end of the year)					
	Discount Account	Dr.	1,41,700			
	To Profit and Loss Account					1,41,700
	(Being discount earned for the year 2007-2008 transferred to profit and loss account)					

Extracts of Balance Sheet

as at 31.3.2008

Liabilities	Rs.	Assets	Rs.
Other Liabilities:		Advances:	
Rebate on Bills Discounted	34,301	Bills Discounted	51,50,000

12. Form B - RA

Name of the Insurer: New India Insurance Company Ltd.

Registration No. and date of registration with the IRDA:

Revenue Account for the year ended 31st March, 2008

Particulars	Schedule	Current Year (Rs. in Lakhs)	Previous Year (Rs. in Lakhs)
1. Premium earned (net)	1	60.00	
2. Profit/Loss on sale/redemption of investments		-	
3. Others		-	
4. Interest, Dividend & Rent-Gross (10+5-3)		<u>12.00</u>	
Total (A)		<u>72.00</u>	

1.	Claims Incurred (Net)	2	34.00
2.	Commission	3	3.75
3.	Operating expenses related to insurance business	4	<u>16.25</u>
	Total (B)		<u>54.00</u>
	Operating Profit/(Loss) from Marine Business (C) = (A-B)		18.00
	Appropriations		
	Transfer to Shareholder's Account		-
	Transfer to Catastrophe Reserve		-
	Transfer to other Reserves (to be specified)		-
	Total (C)		<u>18.00</u>

Form B – PL

Name of the Insurer: New India Insurance Company Ltd.

Registration No. and date of registration with the IRDA:

Profit & Loss Account
for the year ended 31st March, 2008

Particulars	Schedule	Current Year (Rs. In Lakhs)	Previous Year (Rs. In Lakhs)
1. Operating Profit from marine insurance		18.00	
2. Income from investments		-	
3. Other Income		<u>-</u>	
Total (A)		<u>18.00</u>	
4. Provision (other than taxation)			
Diminution in the value of investment in shares	2.00		
Less: increment in the value of investment in govt. securities <u>(5.00)</u>		(3.00)	
5. Other expenses		<u>-</u>	
Total (B)		<u>(3.00)</u>	
Profit before tax A-B [i.e. 18 – (-3)]		21.00	
Less: Provision for taxation		<u>(10.65)</u>	
Total		10.35	

Appropriations	Nil
Balance of profit/loss bought forward from last year	<u>10.00</u>
Balance carried forward to Balance Sheet	<u>20.35</u>

Schedule 1

Premium Earned (Net)

Particulars	Current Year (Rs. in Lakhs)	Previous Year (Rs. in Lakhs)
Premium from direct business	50.00	
Add: Premium on re-insurance accepted	<u>5.00</u>	
	55.00	
Less: Premium on re-insurance ceded	<u>10.00</u>	
Net Premium	45.00	
Adjustment for change in reserve for unexpired risk [(opening) 60 – (Closing) 45]	<u>15.00</u>	
	<u>60.00</u>	

Schedule 2

Claims incurred (Net)

Particulars	Current Year (Rs. in Lakhs)	Previous Year (Rs. in Lakhs)
Claims paid		
Direct	25.00	
Add: Reinsurance accepted	<u>4.00</u>	
	29.00	
Less: Reinsurance ceded	<u>5.00</u>	
Net Claims paid	24.00	
Add: Claims outstanding at the end of the year	<u>30.00</u>	
	54.00	
Less: Claims outstanding at the beginning of the year	<u>20.00</u>	
Total claims incurred	<u>34.00</u>	

Schedule 3

Commission

Particulars	Current Year (Rs. in Lakhs)	Previous Year (Rs. in Lakhs)
Commission paid		
Direct	5.00	
Add: Re-insurance accepted	<u>1.25</u>	
	6.25	
Less: Commission on reinsurance ceded	<u>2.50</u>	
Net Commission	<u>3.75</u>	

Schedule 4

Operating Expenses

Particulars	Current Year (Rs. in Lakhs)	Previous Year (Rs. in Lakhs)
Expenses of Management	5.00	
Bad Debts	10.00	
Other expenses	<u>1.25</u>	
	<u>16.25</u>	

Working Note:

Provision for income tax:	Rs. in lakhs
Income (excluding revaluation)	18.00
Add: Tax deducted at source	<u>3.00</u>
	<u>21.00</u>
Provision @ 65% of Rs. 21.00 lakhs	13.65
Less: Tax deducted at source	<u>(3.00)</u>
	<u>10.65</u>

13.

Bittu Ltd
Cash Flow Statement for the year ended

	Rs.	Rs.
Cash flows from operating activities		
Net profit	76,500	
Adjustments for		

Depreciation (W.N.4)	27,900	
Profit on sale of plant (W.N.2)	(2,500)	
Accrued Interest on debentures for half year	<u>2,000</u>	
Operating profit before working capital changes	1,03,900	
Adjustments for:		
Increase in debtors less provision for doubtful debts	(46,700)	
Increase in stock and work-in-progress	(38,500)	
Increase in creditors	<u>11,800</u>	
Net cash from operating activities		30,500
Cash flows from investing activities		
Purchase of plant and machinery (W.N.1)	(78,000)	
Proceeds from sale of plant	7,000	
Proceeds from sale of freehold property (W.N.3)	6,200	
Increase in trade investments	<u>(47,000)</u>	
Net cash used in investing activities		(1,11,800)
Cash flows from financing activities		
Proceeds from issuance of debentures at discount	49,000	
Debenture interest paid	(2,000)	
Dividend paid in respect of earlier year	<u>(30,000)</u>	
Net cash from financing activities		<u>17,000</u>
Excess of outflows over inflows		(64,300)
Cash and cash equivalents at the beginning of the year		<u>Nil</u>
Cash and cash equivalents at the end of the year		<u>(64,300)</u>

Thus, the shortfall of Rs. 64,300 was made up through borrowings from bank.

Working Notes:

1. Acquisition of plant and machinery:	Rs.
Amount of increase, at cost	60,000
Add: Cost of plant disposed of	<u>18,000</u>
Cost of plant and machinery purchased	<u>78,000</u>

2. Profit on sale of plant = Rs. 7,000 - (Rs. 18,000 - Rs. 13,500)
= Rs. 7,000 - Rs. 4,500 = Rs. 2,500

3.	Proceeds from sale of freehold property:	
	Capital reserve	49,200
	Less: Increase in freehold property (given)	<u>43,000</u>
	Proceeds from sale	<u>6,200</u>
4.	Depreciation on Plant and Machinery provided for the year:	
	Increase in Provision for Depreciation (given)	14,400
	Add: Accumulated depreciation on plant sold	<u>13,500</u>
	Depreciation for the year	<u>27,900</u>
14.		
	Total number of shares issued	10,00,000 shares
	Less: Shares taken by the directors and others	<u>1,00,000 shares</u>
	Shares offered to general public	<u>9,00,000 shares</u>

Statement Showing the Liability of Underwriters

		(Number of shares)		
	X	Y	Z	
Gross liability (65%: 25%: 10%)	5,85,000	2,25,000	90,000	
Less: Marked applications	<u>1,19,500</u>	<u>57,500</u>	<u>10,500</u>	
	4,65,500	1,67,500	79,500	
Less: Unmarked applications in the ratio of gross liability	<u>4,55,000</u>	<u>1,75,000</u>	<u>70,000</u>	
Resultant Liability (or Surplus)	10,500	(7,500)	9,500	
Less: Surplus of Y allocated to X and Z in the ratio of 65:10	<u>6,500</u>	<u>7,500</u>	<u>1,000</u>	
Net Liability as per agreement	<u>4,000</u>	<u>Nil</u>	<u>8,500</u>	

In the Books of a Joint Stock Company

Journal Entries

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
	Bank A/c	Dr. 11,00,000	
	To Equity Share Capital A/c		10,00,000
	To Securities Premium A/c		1,00,000
	(Being the issue of 1,00,000 equity shares of Rs.10 each at a premium of Re.1 per share to the directors, their relatives and friends as per Board's Resolution No.....dated.....)		

Bank A/c	Dr.	97,62,500	
To Share Application A/c			97,62,500
(Being application money received on 8,87,500 shares @ Rs.11 each)			
X (4,000 shares x Rs.11)	Dr.	44,000	
Z (8,500 shares x Rs.11)	Dr.	93,500	
Share Application A/c	Dr.	97,62,500	
To Equity Share Capital A/c			90,00,000
To Securities Premium A/c			9,00,000
(Being allotment of shares to X – 4,000 and Z- 8,500, application money credited to Equity Share Capital Account and Securities Premium Account as per Board's Resolution No....dated....)			
Underwriting Commission A/c	Dr.	1,98,000	
To X (Note 1)			1,28,700
To Y (Note 1)			49,500
To Z (Note 2)			19,800
(Being the amount payable to X, Y and Z as underwriting commission @ 2% of the issue price)			
X	Dr.	84,700	
Y	Dr.	49,500	
To Bank A/c			1,34,200
(Being the amount paid to X and Y in respect of underwriting commission after adjusting amount payable on shares allotted)			
Bank A/c	Dr.	73,700	
To Z			73,700
(Being the balance money received from Z on shares allotted after adjusting underwriting commission)			

Working Note:

Statement showing the Amount Due from (Due to) Underwriters

Underwriters	X	Y	Z
Number of shares to be subscribed as per agreement	<u>4,000</u>	<u>Nil</u>	<u>8,500</u>
Amount payable @ Rs.11 per share (Rs.)	44,000	-	93,500
Less: Underwriting commission @ 2%			
X – on Rs.64,35,000	(1,28,700)	-	-
Y – on Rs.24,75,000	-	(49,500)	-
Z – on Rs.9,90,000	-	-	<u>(19,800)</u>
Amount paid/ (received)	<u>(84,700)</u>	<u>(49,500)</u>	<u>73,700</u>

15. Summation of number of years from the date of loan to the date of repayment of each instalment is as follows:

1st Instalment is paid after 1 year from the date of loan

2nd Instalment is paid after 2 years from the date of loan

3rd Instalment is paid after 3 years from the date of loan

4th Instalment is paid after 4 years from the date of loan

5th Instalment is paid after 5 years from the date of loan

Total 15 years

Number of instalments = 5

Average Due Date =

$$\text{Date of loan} + \frac{\text{Summation of number of years from the date of loan to the date of repayment of various instalments}}{\text{Number of instalments}}$$

$$= \text{January 1 2006} + \frac{15 \text{ years}}{5 \text{ Instalments}}$$

$$= \text{January 1 2006} + 3 \text{ years} = \text{January 1, 2009}$$

If loan was given on January 1, 2009, no interest would have been charged, but the loan was given on January 1, 2006. Therefore, interest for 3 years from the date of loan to the average due date will be charged.

$$\text{Interest} = \text{Rs. } 25,000 \times \frac{10}{100} \times 3 \text{ years} = \text{Rs. } 7,500$$

Amount of Loan	Rs. 25,000
Add : Interest payable	<u>Rs. 7,500</u>
Total amount payable in 5 instalments	<u>Rs. 32,500</u>

16. (a) Calculation of purchase consideration for the business taken over:

	Rs.
Assets taken over:	
Goodwill (as agreed)	80,000
Block of assets at 10% over their book value as on 31.3.2007	6,60,000
Stock and debtors	4,00,000
Cash and bank (W.N.1)	<u>1,33,000</u>
	12,73,000
Less: Liabilities taken over:	
Creditors	<u>2,00,000</u>
Purchase consideration (net assets)	<u>10,73,000</u>

Calculation of shares allotted against purchase consideration

	Rs.
Consideration	10,73,000
Less: Preference shares allotted to preference shareholders	<u>3,00,000</u>
	7,73,000
Less: 25% of Rs. 7,73,000 belonging to M Ltd.	<u>1,93,250</u>
Amount payable to other equity shareholders	<u>5,79,750</u>
Number of equity shares of Rs. 10 each to be issued	57,975 shares

- (b) Balance Sheet of A Ltd. as on 30th September, 2007 (Extract)

	Rs.	Rs.		
Reserve and Surplus:				
Capital Reserve (W.N.2)	93,250			
Less: Goodwill	<u>80,000</u>	13,250		

Working Notes:

1. Ascertainment of cash and bank balances as on 30th September, 2007
Balance Sheet as at 30th September, 2007

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Equity Share Capital		4,00,000	Block Assets	6,00,000	
10% preference share capital		3,00,000	Less: Depreciation	<u>32,500</u>	5,67,500
General Reserve		1,00,000	Stock and debtors		4,00,000
Profit and Loss account:			Cash and bank (Bal.fig.)		1,33,000
Balance b/d	1,00,000				
Add: Profit for 6 months		<u>70,500</u>			
		1,70,500			
Less: Dividends paid					
Preference 30,000					
Equity	<u>40,000</u>	<u>70,000</u>			
Creditors		<u>2,00,000</u>			
		<u>11,00,500</u>			<u>11,00,500</u>

2. Calculation of capital reserve resulting on amalgamation

	Rs.	Rs.
Net assets share to be allotted		10,73,000
Less: Preference shares to be allotted	3,00,000	
Equity shares to be allotted	5,79,750	
Cost of investments	<u>1,00,000</u>	<u>9,79,750</u>
Capital reserve		<u>93,250</u>

Alternatively, capital reserve may be calculated as follows:-

	Rs.
Value of investment, 25% of Rs.7,73,000	1,93,250
Less: Cost of investments	<u>1,00,000</u>
Capital reserve	<u>93,250</u>

17. (i) True- The economic life of an enterprise is artificially split into periodic intervals in accordance with the accounting period assumption or the periodicity concept. The going concern assumption assumes that an enterprise will continue in operation for indefinite period of time.
- (ii) False- Average due date is 'no loss no gain' date to either party. i.e. neither the debtor nor the creditor stands to lose or gain anything by way of interest.
- (iii) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Para 12 of AS 5 (Revised in 1997) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies states that :
- "When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."
- Circumstances which may give to separate disclosure of items of income and expense in accordance with para 12 of AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.
- (iv) B : $\frac{2}{3}$ less $\frac{3}{10} = \frac{11}{30}$
C: $\frac{1}{3}$ less $\frac{2}{10} = \frac{4}{30}$
Gaining ratio = B : C
 $11 : 4$
- (v) False- If there exists a specific sports fund, the expenditure incurred in carrying out the purpose of the fund i.e. incurred on sports activities will be deducted from that fund only.
- (vi) Paragraph 4 of Accounting Standard 5 on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".
- Rectification of error in stock valuation is a prior period item vide Para 4 of AS 5. Rs.14.5 lakhs must be added to the opening stock of 1/4/2002. It is also necessary to show Rs. 14.5 lakhs as a prior period adjustment in the Profit and loss Account below the line. Separate disclosure of this item as a prior period item is required as per Para 15 of AS 5.
- (vii) Interest on Performing Assets should be recognised on accrual basis, but interest on Non-performing Assets should be recognised on cash/realisation basis.

			Rs. in lakhs
Interest on cash credit and overdrafts	(1,800 + 70)	=	1,870
Interest on bills purchased and discounted	(700 + 36)	=	<u>736</u>
Total income to be recognised			<u>2,506</u>

(viii) ABC Co. Ltd.

Journal Entries

	Dr. (Rs.)	Cr. (Rs.)
Bank A/c	Dr. 95,000	
Discount on issue of debentures A/c	Dr. 5,000	
Loss on issue of debentures A/c	Dr. 2,000	
To 11% Debentures A/c		1,00,000
To Premium on Redemption of debentures A/c		2,000
(Issue of Rs. 1,00,000 11% debentures at a discount of 5% but redeemable at a premium of 2%)		

(ix) False- Whenever a balance is transferred from one account in one ledger to that in another, the entry is recorded through the journal. Also an additional entry is made in the control accounts for recording the corresponding effect.

(x) Adjusted net profit for the current year $(1,00,00,000 + 12,00,000 - 3,60,000) = \text{Rs. } 1,08,40,000$.

No. of equity shares resulting from conversion of debentures = 10,00,000 Shares.

No. of equity shares used to compute diluted EPS: $(50,00,000 + 10,00,000) = 60,00,000$ Shares

Diluted earnings per share = $(1,08,40,000 / 60,00,000) = \text{Rs. } 1.81$

18. (a) The Companies (Amendment) Act, 1999 introduced through section 79A a new type of equity shares called 'Sweat Equity Shares'. The expression 'sweat equity shares' means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions by whatever name called.

Notwithstanding anything contained in section 79, which deals with the power of a company to issue shares at a discount, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:-

- (i) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.

- (ii) the resolution specifies the number of shares, current market price, the consideration if any, and the class or classes of directors or employees to whom such equity shares are to be issued.
- (iii) not less than one year has, at the time of the issue, elapsed since the date on which the company was entitled to commence business.
- (iv) the sweat equity shares of company, whose equity shares are listed on a recognised stock exchange, are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf. But in the case of company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

All the limitations, restrictions and provisions relating to equity shares are applicable to sweat equity shares also.

- (b) Double accounts system is the name given to the system of preparing the final accounts of certain statutory companies formed by special Acts of parliament, usually public utility undertakings (for example Electricity Companies). The double accounts system is not a special method of keeping accounts, rather a special method of presenting accounts which are kept under the normal double entry system. Under this system, separate accounts in respect of capital and revenue are prepared in order to show clearly the capital receipts and the manner in which the amounts thereof have been invested. The final accounts prepared under the double accounts system normally consist of :

- (i) Revenue Account
- (ii) Net Revenue Account
- (iii) Capital Account (Receipts and Expenditure on capital account)
- (iv) General Balance Sheet.

The Double accounts system in its pure form does no longer exist but the statements submitted to State Governments by electricity companies generally follow the principle of double accounts system. It may be noted that for presenting accounts to the shareholders, electricity companies normally follow Schedule VI of the Companies Act, 1956.

- (c) 1. Prior Period Items are adjustments necessitated by errors or omissions in the previous periods and discovered in later time periods – e.g. if wages are not provided for in the previous periods.
- 2. They should be distinguished from Changes in Accounting Estimates, which are approximations and may be revised in future.
- 3. An estimate may have to be revised (1) if changes occur regarding the circumstances on which the estimate was based, or (2) as a result of new information, more experience, or subsequent developments.

4. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary or a prior period item.
- (d) In "Piecemeal Distribution of Cash", cash is utilized for settlement as and when it is available for distribution. The accounts are settled in the following order:
- (i) Secured Liabilities: Secured liabilities are paid out of the cash realized by sale of mortgaged asset. Portion of liability not covered by the amount realised is treated as unsecured liability. However, if assets other than the mortgaged asset are realized first, then secured liabilities are treated at par with unsecured liabilities till the realization of mortgaged asset.
 - (ii) Unsecured Liabilities: After settling secured liabilities, unsecured liabilities are settled. If the amount available is not sufficient to clear all unsecured liabilities, it is distributed rateably among all unsecured liabilities.
 - (iii) Partners' Loan: After settling outside liabilities, partners' loan are settled rateably.
 - (iv) Settlement of capital accounts of partners: The balance of capital accounts on the date of dissolution after adjustment for drawings, accumulated losses, reserves, accumulated profits etc. are settled by following anyone of the two methods given below:-
 - a. Proportionate Capital Method.
 - b. Maximum Loss Method.
- (e) The shareholders who transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.
- Their liability will crystalize only (i) when the existing assets available with the liquidator are not sufficient to cover the liabilities; (ii) when the existing shareholders fail to pay the amount due on the shares to the liquidator.
- (f) While preparing department accounts, common expenses should be allocated among the different departments on the basis of the following principles:
1. Common expenses, the benefit of which is shared by all the departments and which are capable of precise allocation (e.g., rent, lighting expenses etc.) are distributed among the departments concerned on some equitable basis considered suitable in the circumstances of the case. Rent is charged to different departments according to the floor area occupied by each department having regard to any favourable location specially allocated to a department. Lighting and heating expenses are distributed on the basis of consumption of energy by each department and so on.
 2. Common expenses which are not capable of accurate measurement are dealt with as follows:

- (i) Selling expenses, e.g. discount, bad debts, selling commission, etc. are charged on the basis of sales.
 - (ii) Administrative and other expenses, e.g. salaries of managers, directors, common advertisement expense, depreciation on assets, etc. are allocated equally among all the departments that have benefited thereby. Alternatively, no allocation may be made and such expenses may be charged to the combined profit and loss account.
- (g) Larger organisations often go for an ERP package where finance comes as a module. An ERP is an integrated software package that manages the business process across the entire enterprise.

Following advantages of using an ERP for maintaining accounts make ERP packages popular day by day:

1. Standardised processes and procedures : An ERP is a generalised package which covers most of the common functionalities of any specific module.
 2. Standardised reporting : Majority of the desired reports are available in an ERP package. These reports are standardised across industry and are generally acceptable to the users.
 3. Duplication of data entry is avoided as it is an integrated package.
 4. Greater information is available through the package.
- (h) The business entity concept has three major implications for accounting:
1. It limits the area to be covered by accounting records and reports. For example, personal transactions of the sole proprietor is not to be recorded in his business accounts as business expenses, they are simply treated as drawings.
 2. All transactions are recorded from the point of the entity itself and not from the point of other parties such as owners, managers or customers. For example, when a firm sells goods to customers, this is recorded as sales by the firm and not as purchases by the customers.
 3. The entity concept underlines the accounting concept of profits in which a sharp distinction is made between the expenses of operating the business and payment to the owners. All payments to the owners take the form of repayment of capital or loan, or a distribution of profits. They are not treated as business expenses.
- (i) Garner vs Murray rule requires-
1. That the solvent partners should bear the loss arising due to insolvency of a partner in their capital ratio after making adjustments for past accumulated reserves, profits or losses, drawings, interest on drawings/capitals, remuneration to partners etc, to the date of dissolution but before making adjustment for profit or loss on realization in case of fluctuating capital. In

case of fixed capital no such adjustments required.

2. That the solvent partners should bring in cash equal to their respective shares of the loss on realization.

This rule is not applicable when:

1. Only one partner is solvent.
2. All partners are insolvent.
3. The Partnership deed provides for a specific method to be followed in case of insolvency of a partner, then the conditions in the deed would prevail.

- (j) In Account Current, epoque method is the reverse of the product method. Interest is calculated from the commencement of the period of the account current to the date of each item. In calculating days for the purpose of interest both extreme dates, i.e., opening day of the account current and the date of the item are taken. Number of days thus ascertained, are multiplied by the respective amounts to get the products. No interest will be charged or credited on the opening balance because of its showing zero as number of days but interest on the closing balance (before calculating interest) must be charged for the whole period of the account current. Interest is then calculated for one day at the agreed rate for the balance of the products and is entered on the side showing shorter balance of products.

19. (a) According to para 44 of AS 20, 'If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

- (b) As per para 50 and 52 of AS 19, 'if a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the

difference between the carrying amount and fair value should be recognised immediately.'

- (c) Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:
 - (i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include 'other income'.
 - (ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.
 - (iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.
- 20. (a) To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period.

- (b) It is a present obligation as a result of past obligating event. The obligating event is the sale of the product which gives rise to an obligation because obligations also arise from normal business practices. An outflow of resources, embodying economic benefits in settlement is probable because a proportion of goods are returned for refund. For the best estimate of the cost of refunds, a provision should be recognized as per AS 29.
- (c) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at

its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

21. (a) As per AS 7, when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35 of the same standard.
- (b) (i) The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.
- (ii) The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:
 - (a) the period of the change, if the change affects the period only; or
 - (b) the period of the change and future periods, if the change affects both.

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.
- (c) For disclosure of significant accounting policies, AS 1 in its para nos. 24, 25, 26 and 27 requires, 'all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

If the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.'

22. (a) (i) The raw material price has declined to Rs. 130 but the cost of finished goods Rs. 210 including raw material cost Rs. 150 is fully realizable hence no need to write down inventory to Rs. 130 i.e. raw material will be valued at Rs. 150.
- (ii) If the net realizable value of finished goods say Rs. 190 or less, is less than its cost of Rs. 210 then raw material should be valued at Rs. 130.
- (iii) Although wordings of AS 2 does not say so clearly but if finished goods can be sold at Rs. 10 less than its expected total cost, then raw material can be valued at Rs.140 i.e. Rs. 10 less than its cost. That is, it need not be written down to Rs.130. This is in view of the purpose of writing down to net realizable in AS 2. According to AS 2, the practice of writing down inventories below cost to net realizable value is consistent with the view that assets should not be carried in excess of the amount that can be realized from its use since it is held for the purpose of that use. Hence the entire cost of Rs. 150 is not recovered by use in finished production. Only Rs. 140 is recoverable by use in production i.e. (Rs. 140+60= 200). Hence, the stock of raw materials should be valued at Rs. 140.

(b) Both dividend paid and Corporate Dividend Tax paid should be shown as financing activities as per AS 3.

(c) According to the Guidance Note on Accounting for Depreciation in Companies issued by ICAI, it is permissible for a company to adopt more than one method of depreciation simultaneously that is to say that-

1. Company may follow different methods for different types of assets; and
2. Company geographical locations can follow different methods.

Only condition is that same methods should be consistently adopted from year to year.

Change in the method of depreciation is a change in accounting policy. According to AS 6, such a change is permissible only when at least one of the following 3 conditions is satisfied:-

- (i) Such change is required by law.
- (ii) Such change is required by the Accounting Standards
- (iii) Such change will result in more appropriate presentation.

Here, from the facts given it appears that condition (iii) is satisfied i.e. change will lead to more appropriate presentation (since WDV method will better represent the pattern of faster wear & tear instead of SLM).

According to AS 6, change should be retrospective. Any difference arising thereon should be changed/ credited to P&L account in the year of change.

(d) (i)	Amount of foreseeable loss	(Rs in lakhs)
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	<u>1,000</u>
	Total foreseeable loss to be recognized as expense	<u>100</u>

According to para 35 of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	Contract work-in-progress i.e. cost incurred to date are Rs. 605 lakhs	(Rs in lakhs)
	Work certified	500
	Work not certified	<u>105</u>
		<u>605</u>

This is 55% ($605/1,100 \times 100$) of total costs of construction.

- (iii) Proportion of total contract value recognised as revenue as per para 21 of AS 7 (Revised).

55% of Rs. 1,000 lakhs = Rs. 550 lakhs

- (iv) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

$$= [605 + \text{Nil} - 100 - (400 + 140)] \text{ Rs. in lakhs}$$

$$= [605 - 100 - 540] \text{ Rs. in lakhs}$$

Amount due to customers = Rs. 35 lakhs

The amount of Rs. 35 lakhs will be shown in the balance sheet as liability.

- (v) The relevant disclosures under AS 7 (Revised) are given below:

	Rs. in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognized losses	(100)
Progress billings (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

23. (a) (i) Yes, as foreign tour expenses of directors for purchase of Plant and Machinery is for the acquisition of the asset, therefore it should be capitalised.
- (ii) Yes, salary of technical staff for erection of Plant and Machinery is the cost directly attributable for bringing the asset to its working conditions for its intended use. Therefore, it should be capitalised.
- (iii) No, as per para 9 of AS 10 only salary of technical staff can be said to as directly attributable to bring the asset to its working conditions for its intended use. Therefore, salary of non-technical staff cannot be capitalised.
- (iv) No, as per para 9.3 of AS 10, 'administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset.' Hence the same should not be capitalized.
- (b) In respect of depreciable assets, AS 12 does not permit the crediting of the grant or any part thereof to capital reserve. The company has only two options – reduce the grant from the cost of fixed assets or treat it as deferred income. It appears that company follows the first option. Out of the Rs. 8,00,000 that has been received, Rs. 4,00,000 is the balance in Machinery account and so Rs. 4,00,000 should be credited to the Machinery account. The balance Rs. 4,00,000 may be credited to profit & loss account as already the cost of the assets to the tune of Rs. 6,00,000 has been debited to profit and loss account in the earlier years and Rs. 4,00,000 transferred to profit & loss account would be partial recovery of that cost. There is no need to provide depreciation for 2007-08 or 2008-09 as the depreciable amount is now Nil.
- (c) Statement showing the treatment for total interest amount of Rs. 62 lakhs

Purpose	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
		Rs. in lakhs	Rs. in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset*	$\frac{62 \times 520}{680} = 47.41$	
Advance to suppliers for additional assets	Qualifying asset*	$\frac{62 \times 30}{680} = 2.74$	

* Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets. In that case, the entire amount of interest Rs. 62 lakhs will be recognized as expense in the profit and loss account for the year ended 31st March, 1998.

Working Capital	Not a qualifying asset	$\frac{62 \times 130}{680}$
		= <u>11.85</u>
	<u>50.15</u>	<u>11.85</u>

24. (a) Computation of Unearned Finance Income

- (i) Gross investment = Minimum lease payments + Unguaranteed residual value
 = (Total lease rent + Guaranteed residual value) + Unguaranteed residual value
 = [(Rs. 5,00,000 × 5 years) + Rs. 1,00,000] + Rs. 1,00,000
 = Rs. 27,00,000

- (ii) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV	Internal rate of return (Discount factor 15%)	Present Value	
	Rs.		Rs.	
1	5,00,000	.8696	4,34,800	
2	5,00,000	.7561	3,78,050	
3	5,00,000	.6575	3,28,750	
4	5,00,000	.5718	2,85,900	
5	5,00,000	.4972	2,48,600	
	1,00,000	.4972	49,720	
	(guaranteed residual value)		<u>17,25,820</u>	(1)
	1,00,000	.4972	49,720	(2)
	(unguaranteed residual value)		<u>17,75,540</u>	
		(1) + (2)		

Unearned Finance Income = Gross investment – PV of MLP
 = Rs. 27,00,000 – Rs. 17,75,540
 = Rs. 9,24,460

Journal Entries in the books of B Ltd.

	Rs.	Rs.
At the inception of lease		
Machinery account	Dr. 17,25,820*	
To A Ltd.'s account		17,25,820*
(Being lease of machinery recorded at present value of MLP)		
At the end of the first year of lease		
Finance charges account (Refer W. N.)	Dr. 2,58,873	
To A Ltd.'s account		2,58,873
(Being the finance charges for first year due)		
A Ltd.'s account	Dr. 5,00,000	
To Bank account		5,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of Rs. 2,41,127 and finance charge of Rs. 2,58,873)		
Depreciation account	Dr. 1,72,582	
To Machinery account		1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)		
Profit and loss account	Dr. 4,31,455	
To Depreciation account		1,72,582
To Finance charges account		2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)		

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

* As per para 11 of AS 19, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 20,00,000 is more than the present value amounting Rs. 17,25,820, the machinery has been recorded at Rs. 17,25,820 in the books of B Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

Year	Outstanding liability (opening balance) Rs.	Lease rent Rs.	Finance charge Rs.	Reduction in outstanding liability Rs.	Outstanding liability (closing balance) Rs.
1	17,25,820	5,00,000	2,58,873	2,41,127	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,296	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,276	3,66,724	5,21,783
5	5,21,783	5,00,000	<u>78,267</u>	<u>5,21,783</u>	1,00,050*
			<u>8,74,230</u>	<u>17,25,820</u>	

*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.

- (b) As per para 39 of AS 20, 'Potential Equity Shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.'

As income from continuing operations is the control figure as per para 40, Rs. 2,40,000 should be considered and not Rs. (1,20,000) for deciding whether the potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion decrease the net profit per share from continuing operations from Rs. 240 (i.e. Rs.2,40,000/ 1,000 shares) to Rs. 200 (i.e. Rs.2,40,000/1,200 shares). In view of the above, the basic loss per share would be Rs. 120 and diluted loss per share would be Rs. 100.

- (c) According to AS 26, the enterprise should amortise the right to generate power over sixty years, unless there is evidence that its useful life is shorter. But the enterprise should subject this right to impairment testing at each year end during its useful life since useful life is considered to be more than 10 years.

25. (a) (i) At 31 March, 2005

The giving of the guarantee, gives rise to a possible obligation.

No outflow of benefits is probable at 31 March, 2005 since financial position of Y is sound. Hence, no provision is recognised. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(ii) At 31 March, 2006

The obligating event is the giving of the guarantee, which gives rise to a legal obligation to make good enterprise Y's defaults.

At 31 March 2006, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, since enterprise Y has gone into liquidation.

A provision should be recognised for the best estimate of the obligation.

Note: This example deals with a single guarantee. If an enterprise has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable. Where an enterprise gives guarantees in exchange for a fee, revenue is recognised under AS 9, Revenue Recognition.

- (b) According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.
- (c) As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item, hence should be valued at the closing rate i.e, Rs.48 at 31st March, 2007 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs.5 (48-43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2007 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs.48 and Rs.47 per Us dollar. Hence, the accounting treatment adopted by the company is incorrect.
- (d) It is given that revision of wages took place on 1st September, 2007 with retrospective effect from 30.9.2006. Therefore wages payable for the half year from 1.10.2006 to 31.3.2007 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs. 7,50,000 (for 1½ years @ Rs. 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Students are hereby informed that Accounting Standards 1, 2, 3, 4, 5, 6, 7, 9, 10, 11, 12, 13, 14, 16, 19, 20, 26, 29 are applicable for November, 2008 examination at PCC level.