

INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-5 : FINANCIAL ACCOUNTING

Q1. State with reasons whether the following are Capital Expenditure or Revenue Expenditure:

- (i) Expenses incurred in connection with obtaining a licence for starting the factory were Rs 10,000.
- (ii) Rs 1,000 paid for removal of stock to a new site.
- (iii) Rings and Pistons of an engine were changed at a cost of Rs 5,000 to get full efficiency.
- (iv) Rs 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.
- (v) Rs 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
- (vi) A factory shed was constructed at a cost of Rs 1,00,000. A sum of Rs 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Answer 1.

- (i) Rs. 10,000 incurred in connection with obtaining a license for starting the factory is a *Capital Expenditure*. It is incurred for acquiring a right to carry on business for a long period.
- (ii) Rs. 1,000 incurred for removal of stock to a new site is treated as a *Revenue Expenditure* because it is not enhancing the value of the asset and it is also required for starting the business on the new site.
- (iii) Rs. 5,000 incurred for changing Rings and Pistons of an engine is a *Revenue Expenditure* because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.
- (iv) Rs. 2,000 incurred for defending the title to the firm's assets is a *Revenue Expenditure*.
- (v) Rs. 10,000 incurred on advertising is to be treated as a *Deferred Revenue Expenditure* because the benefit of advertisement is available for 4 years, Rs. 2,500 is to be written off every year.
- (vi) Cost of construction of Factory shed of Rs. 1,00,000 is a *Capital Expenditure*, similarly cost of construction of small huts for storing building materials is also a *Capital Expenditure*.

Q2. The financial year of Mr. Chalaman ends on 31st March, 2008 but the stock in hand was physically verified only on 8th April, 2008. You are required to determine the value of Closing Stock (at cost) as at 31st March, 2008 from the following information.

- (i) The stock (valued at cost) as verified on 8th April, 2008 was Rs. 15,000.
- (ii) Sales have been entered in the Sales Day Book only after the despatch of goods and sales returns only on receipt of goods.

- (iii) Purchases have been entered in the Purchase Day Book on receipt of the purchase invoice irrespective of the date of receipt of the goods.
- (iv) Sales as per the sales day book for the period 1st April, 2008 to 8th April, 2008 (before the actual verification) amounted to Rs. 6,000 of which goods of a sale value of Rs. 1,000 had not been delivered at the time of verification.
- (v) Purchases as per the purchase day book for the period 1st April, 2008 to 8th April, 2008 (before the actual verification) amounted to Rs. 6,000 of which purchases valued Rs. 1,500 had not been received at the date of verification and purchases of Rs. 2,000 had been received prior to 31st March, 2008.
- (vi) In respect of goods costing Rs. 5,000 received prior to 31st March, 2008, invoices had not been received up to the date of verification of stocks.
- (vii) The gross profit is 20% on sales.

Solution:

Mr. Chalaman

Statement showing Value of Stock on 31.3.2008

Particulars	Amount Rs.	Amount Rs.
Stock as on 8.4.08	15,000	
<i>Add :</i>		
(a) Cost of Goods Sold and sent Out between 1.4.08 and 8.4.08		
Sales in this period	6,000	
<i>Less :</i> Goods sold but not delivered (at Selling Price)	<u>1,000</u>	
	5,000	
<i>Less :</i> Gross Profit included [20% of 5,000]	<u>1,000</u>	4,000
		19,000
<i>Less :</i>		
(a) Goods purchased and received between 1.4.08 and 8.4.08 :		
Purchases in this period	6,000	
<i>Less :</i> Goods not received till 8.4.08	<u>1,500</u>	4,500
(b) Goods received before 31 .3.08 for which the invoice is yet to be received		5,000
Stock on 31.3.2008		9,500

- Q3. (a) State the essential features of Accounting Principles.**
(b) Explain the Convention of Materiality.
(c) State the situations where the principle of conservatism is applicable.

Answer:

- (a) **Essential Features of Accounting Principles**

Accounting principles are acceptable when they, in general, satisfy the following three basic norms

- (i) usefulness,
- (ii) objectivity, and
- (iii) feasibility.

Accounting principles satisfy the first basic feature of usefulness as much as because of these, the accounting records become more meaningful and useful to the reader. In other words, an accounting rule, which does not increase the utility of the records to its readers, is not accepted as an accounting principle.

Accounting principles is that which is objective in nature. It is said to be objective when it is solidly supported by facts. It is objective when it cannot be influenced by the personal bias and whims.

Accounting principles should be such as are practicable. It will be seen that assets in the accounts are recorded at cost less depreciation as against at market price. This accounting principle is practicable and feasible because it does not entail the difficult work of ascertaining the market price of that asset. It does not make it obligatory for the accountant to record all fluctuation in the price of that asset.

- (b) **Materiality** is primarily related to the qualitative characteristic 'relevance'. If an item is not material, then it is not relevant. Para 17 of AS 1 states that financial statements should disclose all material items. Material items are those the knowledge of which might influence the decisions of the user of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omission or misstatement. From a positive perspective, materiality has to do with the significance of an the item or event to warrant attention in the accounting process. From a negative view point, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful. The Financial Accounting Standards Board, USA expresses the opinion that "no general standards of materiality can be formulated to take into account all the considerations that enter into an experienced human judgement". Individual judgements are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. The Companies Act, 1956 also recognises the need for separate disclosure of material items. Part II of Schedule VI states that any item of expense which exceeds 1 % of the total revenue of the company or Rs. 5,000, whichever is higher, should be shown as a separate and distinct item against an appropriate head in the profit and loss account.
- (c) **'Conservatism convention'** states that the accountants should not anticipate income and should provide for all possible losses. The underlying principle is that revenues should only be recognised when there is reasonable certainty about their realisation. At the same time provision must be made for all possible liabilities, whether the amount is known with certainty or is based on estimates. Faced with the choice between two methods of valuing an asset, the method which leads to lesser value must be selected. To illustrate, inventories are recorded at the cost or market value, whichever is less or if there is a possibility that a debt may not be realised, a specific amount is set aside from profits as a provision for doubtful debts.

Q4. On 1.4.2003 Mayami got a mining lease and from that date a part of the mine was sub-leased to Pathan. The terms of payment and the production of 5 years are as below.

Particulars	Lessee	Sub-Lessee
Royalty (Rs/Tonne)	2.00	3.00
Dead Rent per anum(Rs)	15,000	10,000
Short working recoverable(Years)	3	2
Production (Year ended....31.3.)		
2004	1,000	1,000
2005	3,000	2,000
2006	12,000	5,000
2007	9,000	2,000(strike)
2008	5,000	12,000

In case of strike, royalty earned will discharge all liabilities for the year only.

Show ledger accounts in the books of Mayami.

Solution :

In the Books of Mayami
Statement showing Royalties Payable

Year Ended 31.3	Output (Tons)	Actual Royalties Rs.	Min. Rent Rs.	Excess Workings Rs.	Short Workings				Amount Payable Rs.
					Occurred Rs.	Recouped Rs.	Written off Rs.	C/F Rs.	
2004	2,000	4,000	15,000	0	11,000	0	0	11,000	15,000
2005	5,000	10,000	15,000	0	5,000	0	0	16,000	15,000
2006	17,000	34,000	15,000	19,000	0	16,000	0	0	18,000
2007	11,000	22,000	15,000	7,000	0	0	0	0	22,000
2008	17,000	34,000	15,000	19,000	0	0	0	0	34,000

Statement Showing Royalties Receivable

Year Ended 31.3	Output (Tons)	Actual Royalties Rs.	Min. Rent Rs.	Excess Workings Rs.	Short Workings				Amount Payable Rs.
					Occurred Rs.	Recouped Rs.	Written off Rs.	C/F Rs.	
2004	1,000	3,000	10,000	0	7,000	0	0	7,000	10,000
2005	2,000	6,000	10,000	0	4,000	0	0	0	11,000
2006	5,000	15,000	10,000	5,000	0	5,000	2,000	0	4,000
2007	2,000	6,000	6,000	0	0	0	4,000	0	-
2008	12,000	36,000	10,000	26,000	0	0	0	0	36,000

Dr. **Short working Suspense Account** Cr.

Date	Particulars	Amt (Rs)	Date	Particulars	Amt (Rs)
31.03.06	To Balance c/d	7,000	31.03.02	By Pathan A/c	7,000
		<u>7,000</u>			<u>7,000</u>
31.03.03	To Balance c/d	11,000	1.04.02	By Balance b/d	7,000
31.3.06	To Pathan A/c	5,000	31.03.03	By Pathan A/c	4,000
	To P & L A/c	2,000	1.4.05	By Balance b/d	11,000
	To Balance c/d	4,000			
		<u>11,000</u>			<u>11,000</u>
31.03.07	To P & L A/c	4,000	1.4.06	By Balance b/d	4,000
		<u>4,000</u>			<u>4,000</u>

Dr. **ROYALTY RECEIVABLE ACCOUNT** Cr

Date	Particulars	Amt (Rs)	Date	Particulars	Amt (Rs)
31.03.04	To Royalties Payable A/c (1000 *2)	2000	31.03.04	By Pathan A/c (1000 *3)	3,000
	To Profit & Loss A/c	1,000			
		<u>3,000</u>			<u>3,000</u>
31.03.05	To Royalties Payable A/c (2000 *2)	4000	31.03.05	By Pathan A/c (2000 *3)	6,000
	To Profit & Loss A/c	2,000			
		<u>6,000</u>			<u>6,000</u>
31.03.06	To Royalties Payable A/c (5000 *2)	10000	31.03.06	By Pathan A/c (5000 *3)	15,000
	To Profit & Loss A/c	5,000			
		<u>15,000</u>			<u>15,000</u>
31.03.07	To Royalties Payable A/c (2000 *2)	4000	31.03.07	By Pathan A/c (2000 *3)	6,000
	To Profit & Loss A/c	2,000			
		<u>6,000</u>			<u>6,000</u>
31.03.08	To Royalties Payable A/c (12000 *2)	24000	31.03.08	By Pathan A/c (12000 *3)	36,000
	To Profit & Loss A/c	12,000			
		<u>36,000</u>			<u>36,000</u>

Dr

ROYALTY PAYABLE ACCOUNT

Cr

Date	Particulars	Amt (Rs)	Date	Particulars	Amt (Rs)
31.03.04	To Landlord A/c	4,000	31.03.04	By R/R A/c	2,000
		4,000		By P & L A/c	2,000
31.3.05	To Landlord A/c	10,000	31.3.05	By R/R A/c	4,000
		10,000		By P/L A/c	6,000
31.3.06	To Landlord A/c	34,000	31.3.06	By R/R A/c	10,000
		34,000		By P/L A/c	24,000
31.3.07	To Landlord A/c	22,000	31.3.07	By R/R A/c	4,000
		22,000		By P/L A/c	18,000
31.3.08	To Landlord A/c	34,000	31.3.08	By R/R A/c	24,000
		34,000		By P/L A/c	10,000
					34,000

Pathan's A/c

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
31.03.04	To R/R A/c	3,000	31.03.04	By Bank A/c	10,000
	To S/W Suspense A/c	7,000			10,000
31.03.05	To R/R A/c	6,000	31.03.04	By Bank A/c	10,000
	To S/W Suspense A/c	4,000			10,000
31.03.06	To R/R A/c	15,000	31.03.04	By Bank A/c	15,000
		15,000			15,000
31.03.07	To R/R A/c	6,000	31.03.04	By Bank A/c	6,000
		6,000			6,000
31.03.08	To R/R A/c	36,000	31.03.04	By Bank A/c	36,000
		36,000			36,000

Land Lord's A/c

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
31.03.04	To Bank A/c	15,000	31.03.04	By Royalty Payable A/c	4,000
				By S/W A/c	11,000
		15,000			15,000
31.03.05	To Bank A/c	15,000	31.03.05	By Royalty Payable A/c	10,000
				By S/W A/c	5,000
		15,000			15,000
31.03.06	To Bank A/c	18,000	31.03.04	By Royalty Payable A/c	34,000
	To S/W A/c	16,000			34,000
		34,000			
31.03.07	To Bank A/c	22,000	31.03.07	By Royalty Payable A/c	22,000
31.03.08	To Bank A/c	34,000	31.03.08	By Royalty Payable A/c	34,000

Q5. The hire purchases department of Zapak Ltd provides you the following information for the year ending on 30th September 2008 :

Purchase cost per unit	Rs 3,000
Cash sales price per unit	Rs 4,000
Cash down payment per unit	Rs 400
Monthly payment per unit	Rs 350
Number of instalments per unit	12
Number of units sold on hire purchase basis	120
Number of instalments collected	420
Nuber of instalments due but not yet collected	58

Required : Calculate the following :

(a) Number of instalments fallen due during the year, (b) Number of instalments not yet due on 30. 9. 2008, (c) Amount of instalment not yet due, (d) Amount of istalment due but not yet collected, (e) Amount fallen due during the year, (f) Cash collected during the year, (g) Hire Purchase price per unit, (h) Total hire purchase price of units sold, (i) Total cost price of units sold on hire purchase, (j) % of profit margin on H.P. Sales, (k) Profit included in total hire purchases price, (l) Profit included in the amount of instalments not yet due, (m) Gross Profit.

Also Prepare Hire Purchase Stock Account, Hire Purchases Debtors Account and Hire Purchase Adjustment Account.

Solution :**Step 1: Prepare the Analysis of No. of Instalments**

$$\begin{aligned}\text{Total No. of Instalments} &= \text{No. of Units sold} \times \text{Total No. of Instalments Payable} \\ &= 120 \times 12 = 1440\end{aligned}$$

Again, Total No. of instalments = Instalment Due + Instalments not Due

$$\text{Where, Instalments Due} = \text{Instalments Received} + \text{Instalments not received} = 420 + 58 = 478$$

$$\begin{aligned}\text{Instalments Not Due} &= \text{Total No of Instalments} - \text{Instalments Due} \\ &= 1440 - 478 = 962 \text{ (Balancing Figure)}\end{aligned}$$

Step 2 : Prepare the Analysis of Total Hire Purchase Price

$$\begin{aligned}\text{Total Hire Purchase Price} &= \text{No. of Units sold} \times \text{H.P. Selling price per unit} \\ &= 120 \times 4,600 = \text{Rs } 5,52,000\end{aligned}$$

Again, **Total Hire Purchase Price = Down Payment received + Instalments Receivable**

$$\begin{aligned}\text{Down Payment Received} &= \text{No. of units sold} \times \text{Down Payment per unit} \\ &= 120 \times \text{Rs } 400 = \text{Rs } 48,000\end{aligned}$$

$$\text{Instalments Receivable} = 1,440 \times \text{Rs.} 350 = \text{Rs.} 5,04,000$$

Again, **Instalments Receivable = Instalments Due + Instalments not Due**

$$\text{Where, Instalments Due} = 478 \times \text{Rs } 350 = \text{Rs } 1,67,300$$

$$\text{Instalments Not Due} = 962 \times \text{Rs } 350 = \text{Rs.} 3,36,700$$

Again, **Instalments Due = Instalments due & received + Instalments due but not received**

$$\text{Where, Instalments due \& received} = 420 \times 350 = 1,47,000$$

$$\text{Instalments due but not received} = 58 \times \text{Rs } 350 = \text{Rs } 20,300$$

Let us answer the given questions on the basis of above :

- (a) Number of Instalments fallen due = 478
- (b) Number of Instalments not yet due = 962
- (c) Amount of Instalments not yet due = Rs 3,36,700
- (d) Amount of Instalments due but not yet collected = Rs 20,300
- (e) Total Amount fallen due = Down Payment + Instalments due
 $= \text{Rs } 48,000 + \text{Rs } 1,67,300 = \text{Rs } 2,15,300$
- (f) Total Cash Collected = Down Payment + Instalments due and received
 $= \text{Rs } 48,000 + \text{Rs } 1,47,000 = \text{Rs } 1,95,000$
- (g) Hire Purchase Price per unit = Down Payment/Unit + Amount of Instalment/Unit
 $= \text{Rs } 400 + (\text{Rs } 350 \times 12) = \text{Rs } 4,600$

- (h) Total Hire Purchase Price = Rs 5,52,000
- (i) Total Cost Price of Units sold on H.P. = No. of Units sold Cost per unit
 $= 120 \times \text{Rs } 3,000 = \text{Rs } 3,60,000$
- (j) % of Profit Margin on H.P. Sales = $\{[(\text{H. P. Price} - \text{Cost Price}) / \text{H. P. Price}] \times (100)\}$
 $= \{[(4,600 - 3,000) / 4,600] \times (100)\}$
 $= 34.78\%$
- (k) Profit included in Total Hire Purchase P = $\{[(4,600 - 3,000) / 4,600] \times (5,52,000)\}$
- (l) Profit included in the Total Amount of Instalments not yet due
 $= \{[(4,600 - 3,000) / 4,600] \times (3,36,700)\}$
 $= 1,17,113$
- (m) Gross Profit on Hire Purchase Sales = % of Profit Margin $\times$ Total Amount fallen due
 $= \{[(4,600 - 3,000) / 4,600] \times (2,15,300)\}$
 $= 74,887$

Dr. Cr.
(i) Hire Purchase Stock Account

Particulars	Rs	Particulars	Rs
To Balance b/d	—	By Hire Purchase Debtors A/c	2,15,300
To Goods Sold on Hire Purchase A/c	5,52,000	By Balance c/d	3,36,700
	5,52,000		5,52,000

Dr. Cr.
(ii) Hire Purchase Debtors Account

Particulars	Rs	Particulars	Rs
To Balance b/d	—	By Bank A/c	1,95,000
To Hire Purchase Stock A/c	2,15,300	By Balance c/d	20,300
	2,15,300		2,15,300

Dr. Cr.
(iii) Hire Purchase Adjustment Account

Particulars	Rs	Particulars	Rs
To Hire Purchase Stock Reserve A/c [3,36,700 $\times$ 1,600/4,600]	1,17,113	By Goods Sold on Hire Purchase A/c	1,92,000
To Profit t/f to Profit & Loss A/c	74,887	[5,52,000 $\times$ 1,600/4,600]	
	1,92,000		1,92,000

Q6. Mr. Gulab sells goods on hire purchase basis. He fixes hire purchase price at 33^{1/3}% profit on invoice price of the goods. The following are the figures relating to his hire purchase business for the year ending on 31st March 2008 :

	01.04.2007	31.03.2008
	Rs.	Rs.
Hire Purchase Stock	60,000	?
Hire Purchase Debtors	1,500	?
Shop Stock	50,000	75,000

Goods purchased during the year Rs 3,27,000, Cash received from customers during the year Rs 4,62,000. Total amount of instalments that fell due during the year Rs 4,63,500.

One customer to whom goods had been sold for Rs 6,000 paid only 5 instalments of Rs 500 each. On his failure to pay the monthly instalment of Rs 500 each on 4th March 2008, the goods were repossessed on 27th March 2008 after due legal notice.

Required : Prepare the Hire Purchase Trading Account.

Solution :

Dr.	Hire Purchase Trading Account		Cr.
Particulars	Rs	Particulars	Rs
To Opening Balances:		By Hire Purchase Stock Reserve	
Hire Purchase Stock	60,000	[60,000 × 50/150]	20,000
Hire Purchase Debtors	1,500	By Bank A/c	4,62,000
To Goods Sold on Hire Purchase	4,53,000	By Goods Sold on Hire	
To Hire Purchase Stock Reserve A/c	15,500	Purchase A/c	1,51,000
[46,500 × 50/150]		[4,53,000 x 50/150]	
To Profit t/f to General		By Goods Repossessed A/c	2,333
P & L A/c	1,54,333	[At Revalued Figure]	
		By Closing Balances :	
		Hire Purchase Stock	46,500
		Hire Purchase Debtors	2,500
	6,84,333		6,84,333

Working Notes :

Dr.	(i) Shop Stock Account		Cr.
Particulars	Rs	Particulars	Rs
To Balance b/d	50,000	By Goods Sold on Hire Purchase A/c	3,02,000
To Purchases	3,27,000	By Balance c/d	75,000
		[Excluding Goods Repossessed]	
	3,77,000		3,77,000

Dr. **(ii) Goods Sold on Hire Purchase Account** Cr.

Particulars	Rs	Particulars	Rs
To Stop Stock A/c	3,02,000	By Hire Purchase Trading A/c	4,53,000
To Hire Purchase Trading A/c	1,51,000		
	4,53,000		4,53,000

Dr. **(iii) Memorandum Hire Purchase Stock Account** Cr.

Particulars	Rs	Particulars	Rs
To Balance b/d	60,000	By Hire Purchase Debtors A/c	4,63,500
To Goods Sold on Hire Purchase	4,53,000	By Goods Repossessed A/c	3,000
		By Balance c/d	46,500
	4,65,000		4,65,000

Dr. **(iv) Memorandum Hire Purchase Debtors Account** Cr.

Particulars	Rs	Particulars	Rs
To Balance b/d	1,500	By Bank A/c	4,62,000
To Hire Purchase Stock A/c	4,63,500	By Goods Repossessed A/c	500
		By Balance c/d	2,500
	4,65,000		4,65,000

Working Note :

Calculation of the value of Goods Repossessed.

$$= (\text{Cost Price} / \text{Hire Purchase Price}) \times \text{Unpaid amount (whether due or not)}$$

$$= \text{Rs.} \left(\frac{4,000}{6,000} \right) \times 3,500 = \text{Rs. } 2,333$$

Q7. The Dreamers' Club makes up its accounts to 31st December in each year. On 31st December, 2008 the cashier of the club absconded leaving behind no information or cash. An examination of the records showed that the books had not been written up for a considerable time and it was decided to reconstruct the figures from 1.1.2008.

A summary of the Bank Account for the year showed that :

Receipts	Amount Rs.	Payments	Amount Rs.
Balance on 1.1.2008	420	Rent & Rates	460
Bank Deposits	42,610	Insurance	40
		Light & Heat	156
		Bar Purchases	35,067
		Telephone	59
		Cash Withdrawn	5,848
		Balance as on 31.12.08	1,400
	43,030		43,030

The following information is also obtained :

- I. The Barman places takings in the bank night safe on his way home for crediting to the club account. The bartakings totalled Rs. 44,610 for the year. The treasurer had no access to bar takings.
2. The receipt counterfoils for members subscriptions totaled Rs. 3,050 for the year.
3. A summary of expenditure for petty cash and wages revealed Glasses, crockery main tenance— Rs. 1,310; Wages—Rs. 2,650; Sundry Expenses—Rs. 475
4. Outstanding or Prepaid Amounts were :

	31.12.07	31.12.08
Prepaid Rates	Rs. 26	Rs. 28
Outstanding Expenses	Rs. 64	Rs. 100

The Bar Stock on 1.1.2008 was Rs. 3,607 and 31.12.08 Rs. 2,916. Opening Cash with the Cashier at the beginning of the year 2008 was Rs. 35 only.

Prepare an Income & Expenditure Account of the club for the year ended 31.12.2008.

Working Notes:

1. Cash Defalcation by Cashier :

Cash Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/f	35	By Bank (44,610 – 42,610)	2,000
To Subscriptions	3,050	By Glasses, crockery etc.	1,310
To Bank	5,848	By Wages	2,650
		By Sundry Expenses	475
		By Defalcation of cash	2,498
	8,933		8,933

2. Rent & Rates

Paid from Bank	460
+ Prepaid as on 31.12.07 (relating to current year)	26
	486
– Prepaid Rates as on 31.12.08 (relating to next year)	28
	<u>458</u>

2. Bar Trading A/c for the year ended 31.12.08

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	3,607	By Bar takings	44,610
To Purchases	35,067	By Closing Stock	2,916
To Income & Expenditure A/c	8,852		
	47,526		47,526

Dreamers' Club**Dr. Income and Expenditure Account for the year ended 31.12.2008 Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Rent & Rates	458	By Subscriptions	3,050
To Insurance	40	By Bar Trading A/c (Profit from Bar)	8.852
To Light & Heat	156		
To Telephone Charges	59		
To Glass & Crockery Maintenance	1,310		
To Wages	2,650		
To Expenses 475			
Add : Outstanding for 08 100			
Less : Outstanding for 07 64	511		
To Defalcation of Cash	2,498		
To Surplus (Excess of Income over expenditure)	4,220		
	11,920		11,920

Q8. The Accountant of City Club furnished the following information about the Receipts and Payments of the club for the year ended 31st March, 2009 :

Receipts	Rs.	Payments	Rs.
To Subscriptions	62,130	By Premises	30,000
" Fair Receipts	7,200	" Rent	2,400
" Variety show Receipts (net)	12,810	" Rates and Stationery	3,780
" Interest	690	" Printing & Stationery	1,410
" Bar Collections	22,350	" Sundry Expenses	5,350
		" Wages	2,520
		" Fair Expenses	7,170
		" Honorarium to Secretary	11,000
		" Bar Purchases (Payment)	17,310
		" Repairs	960
		" New Car (less proceeds of old car Rs.9,000)	37,800

The following additional information could be obtained :

	1.4.08	1.3.09
	(Rs.)	(Rs.)
Cash in hand	450	NIL
Bank Balance as per Cash Book	24,420	10,350
Cheque issued for Sundry Expenses not presented to the bank (entry has been duly made in the Cash book)	270	90
Subscriptions Due	3,600	2,940
Premises at cost	87,000	117,000
Provision for Depreciation on Premises	56,400	
Car at cost	36,570	46,800
Accumulated Depreciation on Car	30,870	
Bar Stock	2,130	2,610
Creditors for Bar Purchases	1,770	1,290

Annual Honorarium to Secretary is Rs. 12,000 Depreciation on Premises is to be provided at 5% on written down value. Depreciation on new car is to be provided at 20%.

You are required to prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31.3.09.

Solution :

Working Notes :

	Rs.
(1) Depreciation on New Car :	
Net Amount	37,800
Add : Sale proceeds of Old Car	<u>9,000</u>
Actual Cost	46,800
Less : Depreciation @ 20%	<u>9,360</u>
	<u>37,440</u>
(2) Profit on sale of Old Car :	
Sale proceeds	9000
Less: Written Down Value : Cost - 36,570	
Provision for Depreciation - 30,870	<u>5700</u>
Profit on Sale	<u>3300</u>

- (3) Cheques issued for Sundry Expenses not presented to the Bank need not be considered as Bank Balance as per Cash Book is given and the entry for the expenses have been duly made in the Cash Book.

(4) Calculation of Bar Purchases

Dr.		Creditors for Bar Purchases Account		Cr.
Particulars	Rs.	Particulars	Rs.	
31.3.09 To cash Payment for Bar Purchases	17,310	1.4.08 By Balance b/d	1,770	
31.3.09 To Balance c/d	1,290	31.3.09 By Purchases (Balance Figure)	16,830	
	18,600		18,600	

(5)

Dr.		Bar Trading Account for the year ended 31.03.09		Cr.
Particulars	Rs.	Particulars	Rs.	
To Opening Stock	2,130	By Bar collections	22,350	
To Bar Purchases	16,830	By Close stock	2,610	
To Income & Expenditure A/c profit from Bar transfered	6,000			
	24,960		24,960	

City Club

Receipts & Payments Account for the year ended 31.3.09

Receipts	Rs.	Payments	Rs.
To Balance b/d :		By Premises	30,000
" Cash in hand	450	" Rent	2,400
" Cash at Bank	24,420	" Rates & Taxes	3,780
" Subscriptions	62,130	" Printing & Stationery	1,410
		" Sundry Expenses	5,350
" Fair Receipts	7,200	" Wages	2,520
" Variety Show Receipts (Net)	12,810	" Fair Expenses	7,170
" Interest	690	" Honorarium to Secretary	11,000
" Bar Collections	22,350	" Payments for Bar Purchases	17,310
" Sale Proceeds of Old Car	9,000	" Repairs	960
		" Cost of New Car	46,800
		" Balance c/d : Cash at Bank	10,350
	1,39,050		1,39,050

City Club**Dr. Income and Expenditure Account for the year ended 31st March, 2009 Cr.**

Expenditure	Rs.	Rs.	Income	Rs.	Rs.
To Rent		2,400	By Subscription	62,130	
Rates & Taxes		3,780	Add : Amount Due		
			On 31.3.09	2,940	
" Printing & Stationery		1,410		65,070	
" Wages		2,520	Less: Amount Due		
" Honorarium to Secy.	11 000		On 31.3.08	3,600	61470
" Add: O/S on 31.3.09	<u>1000</u>	12,000	" Profit on Sale of		
" Sundry Expenses		5,350	Old Car [Note 1]		3300
" Repairs		960	" Profit from Bar		
" Depreciation :			[Note 5]		6000
On Car [Note 1]	9360		" Variety Show		
On Premises					
[5% of 60600]	<u>3030</u>	12,390	Receipts (net)		12810
" Surplus (Excess of			" Income from Fair :		
Incomes over			Receipts	7200	
Expenditure, transfer		43,490	Less : Expenses	7170	30
to Capital Fund)			" Interest		690
		<u>84,300</u>			<u>84,300</u>

Baisakhi and Srabarni are partners sharing profits and losses in proportion to their capitals. Their Balance Sheet as on 31st March, 2009 is given below :

Liabilities	Rs.	Assets	Rs.
Creditors	15,000	Freehold Premises	10,000
General Reserve	2,100	Machinery	3,500
Capitals :		Furniture	1,750
Baisakhi	20,000	Office Equipments	550
Srabani	15,000	Stock	14,100
		Bill Receivable	3,060
		Debtors	17,500
		Bank	1,590
		Cash	50
	<u>52,100</u>		<u>52,100</u>

On 1st April, 2009 they admit Poushali on the following conditions:

- (i) Poushali should bring in Rs. 10,000 as capital and to pay Rs. 3,500 for goodwill as she will get 1/4th share in profits.
- (ii) A provision of 2% to be raised against debtors, stock to be reduced by 5%, Freehold Premises to be revalued at Rs. 12,650, Machinery at Rs. 2,800, Furniture at Rs. 1,540 and Office equipments at Rs. 495.
- (iii) Partners agreed that the values of assets and liabilities should remain unaltered.

Show the necessary accounts and prepare the opening Balance Sheet of the new firm.

Points to be noted :

1. The Partners have decided not to alter the book values of the assets and liabilities. The effects of revaluation may be ascertained either by preparing a Memorandum Revaluation Account as follows.

(a) Calculation of Profit/Loss on Revaluation

Dr.	Memorandum Revaluation Account		Cr.
	Rs.		Rs.
To PBDD (@ 2% of 17,500)	350	By Freehold Premises	2,650
To Stock	705		
To Machinery	700		
To Furniture	210		
To Office Equipments	55		
To Partners Capital A/c's			
Baisakhi : (4/7)	360		
Sarhani : (3/7)	270		
	2,650		2,650
To Reversal of Items b/d	2650	By Reversal of Items b/d	2,020
		By Partners Capital A/c (In New Ratio)	
		[Loss on Revaluation]	
		Baisakhi 270	
		Sharhani 203	
		Poushali 157	630
	2,650		2,650

- (b) As General Reserve is to remain unaltered, similar adjustment will be required to be shared among old partners in old ratio and then written back among all partner's in new ratio

2. Calculation of net effects on Capital Accounts

New Profit Sharing Ratio : 12 : 9 : 7

Dr.

Capital Accounts

Cr.

Date	Particulars	Baisakhi Amount Rs.	Srabani Amount Rs.	Poushli Amount Rs.	Date	Particulars	Baisakhi Amount Rs.	Srabani Amount Rs.	Poushali Amount Rs.
31.3.08	To Gen. Res.	900	675	525	1.4.07	By Balance b/d	20000	15000	
	To M. Rev. A/c	270	203	157		By Gen. Reserve	1,200	900	—
					31.3.08	By Bank A/c	—	—	10000
						By M.Rev. A/c	360	270	—
						By Bank A/c	2000	1500	—
						(Premium) at 4:3			
	" Balance c/d	22,390		16,792	9,318				
		23,560	17,670	10,000			23,560	17,670	10,000

Balance Sheet as on 1.4.2008

Liabilities	Rs.	Assets	Rs.
Capitals :		Freehold Premises	10,000
Baisakhi	22,390	Machinery	3,500
Srabani	16,792	Furniture	1,750
Poushali	<u>9,318</u>		48,500
General Reserve	2,100	Office Equipment	550
Sundry Creditors	15,000	Stock	14,100
		Bills Receivable	3,060
		Debtors	17,500
		Bank	
		[1,590 + 10,000 + 3,500]	15,090
		Cash	50
	65,600		65,600

Q10. Kalyani and Ranu commenced business on 1st July, 2006 as partners with capitals of Rs. 1,80,000 and Rs. 1,20,000 respectively. The capitals would remain fixed and carry interest at 10% p.a. profit and losses were to be shared in proportion to their capitals.

They appointed Anita as their Manager on 1st July, 2006 at a salary of Rs. 9,600 per annum plus a bonus of 5% of the net profits after charging such bonus and interest as a partner from the commencement of the business. She had to deposit Rs. 80,000 as security, carrying an interest @ 12%p.a. It was agreed that she would be entitled to one-fifth share of the profits and her security deposit would be treated as her capital carrying interest @ 10% p.a. It was further agreed that this new arrangement should not result in Anita's share for any of these years being less than what she had already received under the original agreement and terms of her appointment.

The profits before charging Anita's bonus and interest on Capital of the partners or giving effect to the new arrangement were – (a) for the year 2006-07 - Rs. 60,000; (b) for the year 2007 – 08 – Rs. 1,20,000; (c) for the year 2008-09 – Rs. 1,60,000

Show by a single journal entry to give effect to the new arrangement with explanatory computation.

Points to be noted :

1. As a Manager, Anita received (a) bonus @ 5% on Net Profits after charging such bonus and interest on capital at 10% p.a. to Kalyani and Ranu (b) Salary Rs. 9,600 p.a. (c) Interest on security deposit at 12% p.a.
2. As a Partner Anita is entitled to (a) Interest on Capital at 10% p.a. (b) $\frac{1}{5}$ th of profit after providing interest on capital at 10% p.a. to all partners including herself.
3. If total dues of Anita under (2) above is more than that under (1) above, she should get the difference. But if such dues under (1) above is more, she would not refund the excess already received.

Solution :

(1) **Workings :** Calculation of Anita's Dues as Manager

	2006-07 Rs.	2007-08 Rs.	2008-09 Rs.
Salary	9,600	9,600	9,600
Interest on Security Deposit : 12% of 80,000	9,600	9,600	9,600
Bonus $\frac{5}{105}$ of profit after charging interest on capitals of Kalyani and Ranu			
2006-07 = $\frac{5}{105}$ of (60,000 - 10% of 3,00,000)	1,429		
2007-08 = $\frac{5}{105}$ of 1,20,000 – 10% of 3,00,000)		4,286	
2008-09 = $\frac{5}{105}$ of 1,60,000 – 10% of 3,00,000)			6,190
	<u>20,629</u>	<u>23,486</u>	<u>25,390</u>

(2) Calculation of Distributable profit under the new arrangement

	2006-07 Rs.	2007-08 Rs.	2008-09 Rs.
Net profits given (after charging interest on security deposit and Anita's salary but before charging interest on capitals)	60,000	1,20,000	1,60,000
Add : Anita's Salary and Interest on Deposit no more payable [9,600 + 9,600]	<u>19,200</u>	<u>19,200</u>	<u>19,200</u>
	79,200	1,39,200	1,79,200
Less : Interest on Capitals to all partners @ 10% of [1,80,000 + 1,20,000 + 80,000]	<u>38,000</u>	<u>38,000</u>	<u>38,000</u>
Distributable Profits	41,200	1,01,200	1,41,200
Anita's Share of Profit = $\frac{1}{5}$ th of Distributable Profit	8,240	20,240	28,240

(3) – Difference in Payments to Anita

	2006-07 Rs.	2007-08 Rs.	2008-09 Rs.
A. Anita's Dues as Partner :			
Interest on Capital @ 10% of 80,000	8,000	8,000	8,000
Share of Profit [as per workings 2]	8,240	20,240	28,240
	16,240	28,240	36,240
B. Anita's Dues as manager [as per workings 1]	20,629	23,486	25,390
Difference Payable to Anita	—	4,754	10,850
Total			<u>15,604</u>

Journal

Date	Particulars	L.F	Dr.	Cr.
			Amount Rs.	Amount Rs.
	Kalyani's Current A/c [3/5 of 15,604] Dr.		9,362	
	Ranu's Current A/c [2/5 of 15,604] Dr.		6,242	
	To Anita's Current A/c			
	[Adjustments made through Partners' Current A/cs to the to new arrangement regarding profits]			15,604

Q11. The following was the Balance Sheet of A, B and C who shared profits in the ratio of 1 : 2 : 2 as on 31st December, 2008.

Sundry Creditors	10,000	Goodwill	15,000
Capital A/c:		Debtors	10,000
A 10,000		Machinery	20,000
B 20,000		Buildings	30,000
C <u>20,000</u>	50,000	Stock	10,000
General Reserve	5,000	Cash at Bank	5,000
Investment Fluctuation Fund	3,000	Investments	10,000
Bad Debts Reserve	2,000		
Bank Loan	30,000		
	<u>1,00,000</u>		<u>1,00,000</u>

C died on 31st March, 2009. His account is to be settled under the following terms :

Goodwill is to be calculated at the rate of 2 years purchase on the basis of the average of 5 years profit or loss. Profit for January to March' 09 is to be calculated proportionately on the average profit of 3 years. The profits were : 2004 Rs. 3,000, 2005 Rs. 7,000, 2006 Rs. 10,000, 2007 Rs. 14,000, 2008 loss Rs. 12,000. During 2008 a Moped costing Rs. 4,000 was purchased and

debited to Travelling Expenses Account on which depreciation is to be calculated @ 25%/. Other values agreed on assets are : Stock Rs. 12,000, Building Rs, 35,000, Machinery Rs,. 25,000 and Investments Rs. 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal entries and Ledger Accounts of the Partners.

Solution :

1. Adjusted profit for 2008

Profit	(12,000)
Add : Cost of Moped	
Wrongly treated as Travelling Expense	4,000
Less : Depreciation not charged on Moped @25%	
on Rs. 4,000	(1,000)
Adjusted Profit	(9,000)

2. Valuation of Goodwill

Total Profit/Loss for the last 5 years = 3,000 + 7,000 + 10,000 + 14,000 – 9,000 = Rs. 25,000

Average Profit = Rs. 25,000/5 = Rs. 5,000; Goodwill = 2 × Rs. 5,000 = Rs. 10,000

But Goodwill is appearing at Balance Sheet at Rs. 15,000. Over valuation of Goodwill Rs. 5,000 should be written off among A, B & C as 1 : 2 : 2. The balance of Goodwill between A & B in the ratio 1:2

3. Share of Profit of Deceased Partner till his date of death

Average Profit of the last 3 years [2006, 2007 & 2008] = (10,000 + 14,000 – 9,000)/3 = Rs. 5,000

Estimated Profit for 3 months [Jan to March, '09] = Rs. 5,000 × 3/12 = Rs. 1,250

C's share of profit = Rs. 1,250 × 2/5 = Rs. 500

Solution :

In the Books of A, B & C

Journal Entries

Date	Particulars	Amount Rs.	Amount Rs.
	Stock A/c Dr.	2,000	
	Buildings A/c Dr.	5,000	
	Machinery A/c Dr.	5,000	
	Moped A/c [4,000 – Depr. 1,000] Dr.	3,000	
	To Revaluation A/c		15,000
	[Values of assets increased on revaluation]		

Date	Particulars	Amount Rs.	Amount Rs.
	General Reserve A/c Dr. 5,000 Investment Fluctuation Fund A/c Dr. 3,000 Bad Debts Reserve A/c Dr. 2,000 To A's Capital A/c 2,000 To B's Capital A/c 4,000 To C's Capital A/c 4,000 [Transfer of Reserves etc. to Partners]		
	Capitals in 1 : 2 : 2] Revaluation A/c Dr. 2,000 To Investment A/c 2,000 [Value of investments reduced]		
	Revaluation A/c Dr. 13,000 To A's Capital A/c 2,600 To B's Capital A/c 5,200 To C's Capital A/c 5,200 (Being profit on revaluation shared in 1 : 2 : 2)		
	A's Capital A/c Dr. 1,000 B's Capital A/c Dr. 2,000 C's Capital A/c Dr. 2,000 To Goodwill A/c 5,000 [Value of Goodwill reduced]		
	Profit & Loss Suspense A/c Dr. 500 To C's Capital A/c 500 [Estimated share of Profit till his date of death transferred to the deceased partner's Capital]		
	C's Capital A/c Dr. 27,700 To C's Executors A/c 27,700 [Total dues to the deceased partner transferred to his Executor's A/c]		

A, B & C
Capital Accounts

Date 2008	Particulars	A Rs.	B Rs.	C Rs.	Date 2008	Particulars	A Rs.	B Rs.	C Rs.
31.3	To Goodwill A/c	1,000	2,000	2,000	31.3.	By Balance b/d	10,000	20,000	20,000
	To Goodwill A/c	3,333	6,667			" Revaluation A/c	2,600	5,200	5,200
	To C's Executors A/c (Balance transferred)	—	—	27,700		" Sundry Reserves A/c	2,000	4,000	4,000
	To Balance c/d	10,267	20,533			" P & L Suspense A/c	—	—	500
		14,600	29,200	29,700					
		14,600	29,200	29,700			14,600	29,200	29,700

A and B
Balance Sheet as at 31.3.2009

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital A/cs:			Buildings		35,000
A	10,267		Machinery		25,000
B	20,533	30,800	Moped		3,000
C's Executor's A/c		27,700	Investments		8,000
Bank Loan		30,000	Stock		12,000
Sundry Creditors		10,000	Debtors		10,000
			Bank		5,000
			P & L Suspense A/c		500
		98,500			98,500

Q12. A partnership firm was dissolved on 30th June, 2009. Its Balance Sheet on the date of dissolution was as follows :

Liabilities	Rs.	Assets	Rs.
<i>Capitals :</i>		Cash	5,400
Atrik	38,000	Sundry Assets	94,600
Mohit	24,000		
Rupa	18,000		
Loan A/c — Mohit	5,000		
Sundry Creditors	15,000		
	1,00,000		1,00,000

The assets were realised in instalments and the payments were made on the proportionate capital basis. Creditors were paid Rs. 14,500 in full settlement of their account. Expenses of realisation were estimated to be Rs. 2,700 but actual amount spent on this account was Rs. 2,000. This

amount was paid on 15th September. Draw up a Memorandum of distribution of Cash, which was realised as follows :

On 5th July	Rs. 12,600
On 30th August	Rs. 30,000
On 15th September	Rs. 40,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Give working notes.

Solution :

**Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)**

Particulars	Creditors Rs.	Mohit's Loan Rs.	Atrik Rs.	Mohit Rs.	Rupa Rs.
A Balance Due	15,000	5,000	33,000	24,000	18,000
B Cash paid (Rs. 5,400 – Rs. 2,700)	2,700	—	—	—	—
C Balance unpaid (A - B)	12,300	5,000	38,000	24,000	18,000
D 1st Instalment of Rs. 12,600	11,800	800	—	—	—
E Balance unpaid (C - D)	500	4,200	38,000	24,000	18,000
F Less : Written-off	500				
G 2nd instalment of Rs. 30,000		4,200	16,320	2,320	7,160
H Balance unpaid (E-F-G)			21,680	21,680	10,840
I 3rd Instalment (Rs. 40,000 + Rs. 700)			16,280	16,280	8,140
J Unpaid Balance (H-I) = Loss on Realisation			5,400	5,400	2,700

Working Notes :

(i) Statement showing the Calculation of Highest Relative Capitals

Particulars	Atrik Rs.	Mohit Rs.	Rupa Rs.
A Actual Capitals	38,000	24,000	18,000
B Profit-sharing ratio	2	2	1
C Actual Capitals ÷ Profit Sharing Ratio	19,000	12,000	18,000
D Proportionate Capitals taking Shyam's	24,000	24,000	12,000
E Surplus Capital [A-D]	14,000	Nil	6,000
F Surplus Capital ÷ Profit Sharing Ratio	7,000	—	6,000
G Proportionate capitals taking Mohan's Capital as the basis	12,000	—	6,000
H Revised Surplus Capital (E - G)	2,000	—	—

(ii) Distribution of Second Instalment of Rs. 30,000

		Creditors	Atrik	Mohit	Rupa
First	Rs. 4,200	4,200	—	—	—
Next	Rs. 2,000 (Absolute Surplus)		2,000	—	—
Next	Rs. 18,000 (Balance of Surplus)		12,000	—	6,000
Balance	Rs. 5,800 (2 : 2 : 1)		2,320	2,320	1,160
Total	30,000	4,200	16,320	2,320	7,160

Q13. Rahul, Roshan and Rohan were in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. The partnership was dissolved on 30th June, 2008 when the position was as follows :

Liabilities	Rs.	Assets	Rs.
Capitals :		Cash in hand	28,000
Rahul	1,40,000	Sundry Debtors	2,94,000
Roshan	70,000	Stock in trade	1,12,000
Rohan	14,000		
Creditors	2,10,000		
	4,34,000		4,34,000

There was a bill for Rs. 10,000, due on 30th November, 2008, under discount. It was agreed that the net realisations should be distributed in their due order (at end of each month) but as safely as possible. The realisations and expenses were as under :

Date	Stock & Debtors Rs.	Expenses Rs.
31st July	84,000	7,000
31st August	1,26,000	5,400
30th September	70,000	4,900
31st October	77,000	3,500
30th November	35,500	3,500

The Stock was completely disposed off and amounts due from debtors were realised, the balance being irrecoverable. The acceptor of the bill under discount met the bill on the due date. Prepare a Statement showing the piecemeal distribution of cash according to Maximum Loss Method.

Solution :

**Statement showing the Distribution of Cash
(According to Maximum Loss Method)**

Particulars	Creditors Rs.	Rahul Rs.	Roshan Rs.	Rohan Rs.
A Balance Due	2,10,000	1,40,000	70,000	14,000
B Cash on hand on 30th June paid to creditors	28,000	—	—	—
C Balance outstanding (A - B)	1,82,000	1,40,000	70,000	14,000
D Cash paid on 31st July	77,000	—	—	—
E Balance outstanding (C - D)	1,05,000	1,40,000	70,000	14,000
F Rs 1,05,000 paid to creditors on 31st August	1,05,000	—	—	—
G Balance outstanding (E - F)		1,40,000	70,000	14,000
Balance available for distribution (Rs. 1,20,600 - Rs. 1,05,000 - Rs. 10,000) = Rs. 5,600				
Less : Maximum loss (Rs. 2,24,000 - Rs. 5,600) in ratio of 3 : 2 : 1		(1,09,200)	(72,800)	(36,400)
Balance		30,800	(2,800)	(22,400)
Deficiency of Roshan and Rohan's capital charged to Rahul		(25,200)	2,800	22,400
H Cash paid on 31st August		5,600	—	—
I Balance outstanding (G - H)		1,34,400	70,000	14,000
Less : Maximum Loss (Rs. 2,18,400 – Rs. 65,100)		(76,650)	51,100	(25,550)
Balance		57,750	18,900	(11,550)
Deficiency of Rohan's capital charged to Rahul and Roshan (2 : 1)		(7,700)	(3,850)	11,550
J Cash paid on 30th September		50,050	15,050	—
K Balance outstanding (I - J)		84,350	54,950	14,000
Less : Maximum loss (Rs 1,53,300 – Rs. 73,500)		(39,900)	(26,600)	(13,300)
L Cash paid on 31st October		44,450	28,350	700
M Balance outstanding (K - L)		39,900	26,600	13,300
Less : Maximum loss (Rs 79,800 – Rs. 42,000*)		(18,900)	(12,600)	(6,300)
N Cash paid on 30th November		21,000	14,000	7,000
O Unpaid Balance (M - N)		18,900	12,600	6,300

***Note :** Cash available on 30th November = (Rs 35,500 – Rs. 3,500) + Rs. 10,000 (Reserved for Discounted B/R, now no longer required) = Rs. 42,000.

Q14. Mr. B and Mr. E are partners sharing Profits and Losses in the ratio of 3:2. On 30th September, 2008 they admit Mr. C as a partner, and the new profit ratio is 2:2:1. C brought in Fixtures Rs. 3,000 and cash Rs. 10,000, the goodwill being (i) B and E Rs. 20,000 and (ii) C Rs. 10,000 but neither figure is to be brought into the books.

On 31st March, 2009, the partnership is dissolved, B retiring and the other two partners forming a company called BC Limited with equal capitals, taking over all remaining assets and liabilities, goodwill being agreed at Rs. 40,000 and brought into books of the company. B agrees to take over the business car at Rs. 3,700: Plant was sold for Rs. 3,000 being in excess of requirements. The profit of the two preceding years were Rs. 17,200 and Rs. 19,000 respectively and it was agreed that for the half year ended 30th September, 2008 the net profit was to be taken as equal to the average of the two preceding years and the current year.

No entries has been made when C entered, except cash. No new book being opened by BC Company Ltd., B agreed to have Rs. 50,000 as loan to the company, secured by 12% Debentures. The following is the Trial Balance as on 31st March, 2009.

	Debit Rs.	Credit Rs.
Capital Accounts:		
B		35,000
E		20,000
C		10,000
Drawing Accounts:		
B	6,000	
E	5,000	
C	2,800	
Debtors & Creditors	31,000	12,000
Plant (Book value of plant sold Rs. 4,000)	23,000	
Fixtures	7,000	
Motor Car	2,700	
Stock on 31st March, 09	13,000	
Bank	16,300	
P & L A/c for the year		29,800
	1,06,800	1,06,800

Prepare :

- (1) Goodwill Adjustment Account
- (2) Capital Accounts of Partner
- (3) Profit and Loss Appropriation Account
- (4) Balance Sheet of BC Ltd. as on 31st March, 2009

Solution:

(1)

Goodwill Adjustment Account

	Rs.		Rs.
2008		2008	
30th Sept.		30th Sept.	
To Partners' Capital A/c		By Partners' Capital A/c	
(Goodwill raised)		(Goodwill written off) (W.N. 1)	
B	12,000	B	12,000
E	8,000	E	12,000
C	10,000	C	6,000
2009		2009	
31st March		31st March	
To Partners' Capital A/cs		By Goodwill A/c	
(goodwill raised)		(Goodwill raised in the	
B	16,000	books transferred)	40,000
E	16,000		
C	8,000		
	70,000		70,000

(2)

Partners' Capital Accounts

2009 31st March	B	E	C	2009 31st March	B	E	C
To Drawings	6,000	5,000	2,800	By Balance b/d	35,000	20,000	10,000
To Motor Car	3,700	–	–	By Fixtures (not recorded earlier)	–	–	3,000
To 12% Debentures	50,000	–	–	By Profit upto 30th Sept '08 (W.N.2)	13,200	8,800	
To Goodwill Adjust- ment Account	12,000	12,000	6,000	By Profit for 6 months ended 31 st March 2009	3,120	3,120	1,560
To Bank Account	7,620			By Goodwill Adjustment A/c	12,000	8,000	10,000
To Bank Account (WN 3)	–	7,580	–	By Goodwill Adjustment A/c	16,000	16,000	8,000
To Share Capital	–	31,340	31,340	By Bank A/c (W.N.3)	–	–	7,580
	79,320	55,920	40,140		79,320	55,920	40,140

(3) Profit & Loss Appropriation Account for the year ended 31st March, 2009

	Rs.		Rs.
To Partners' Capital Account (Distribution of Profit)		By Profit & Loss A/c (Net profit transferred)	29,800
B	16,320		
E	11,920		
C	1,560		
	29,800		29,800

**(4) Balance Sheet of BC Ltd.
As on 31st March, 2009**

Liabilities	Rs.	Assets	Rs.
Share Capital	62,680	Fixed Assets :	
Secured Loan :		Goodwill	40,000
12% Debentures	50,000	Plant	19,000
Current Liabilities & Provisions:		Fixtures	10,000
Creditors	12,000	Current Assets, Loans & Advances :	
		Stock	13,000
		Debtors	31,000
		Cash at bank (W.N.4)	11,680
	1,24,680		1,24,680

Working Notes :**(1) Goodwill Adjustment as on 30th September, 2008**

	Total Rs.	B Rs.	E Rs.	C Rs.
Goodwill raised -				
B and E (3:2)	20,000	12,000	8,000	–
C	10,000			10,000
	30,000			
Goodwill written off in the new profit sharing ratio (2:2:1)	<u>30,000</u>	<u>12,000</u>	<u>12,000</u>	<u>6,000</u>

(2) Calculation of half yearly profit :	Rs.	Rs.
Profit of the preceding two years (Rs. 17,200 + Rs. 19,000)		36,200
Current year's profit		29,800
		66,000
Profit for six months ended 30th September, 2008 ($\frac{1}{3} \times 66,000$)		22,000
Profit for next six months ended 31st March, 2009 (Rs. 29,800 – Rs. 22,000)		7,800

(3) Share Capital of BC Ltd:

Total Capital of the firm before conversion -

E	38,920	
C	23,760	62,680

E and C should have equal share in BC Ltd.

C should bring in cash ($\times 62,680 - 23,760$) 7,580E should withdraw cash ($38,920 - \frac{1}{2} \times 62,680$) 7,580**Bank Account**

(4)	Rs.		Rs.
To Balance b/d	16,300	By B's Capital Account	7,620
To Plant Account		By E's Capital	
(Sale of Plant)	3,000	(Amount withdrawn)	7,580
To Cs capital A/c		By Balance c/d	11,680
(Amount brought in)	7,580		
	<u>26,880</u>		<u>26,880</u>

(5) Profit and loss on sale and takeover of assets :	Rs.
Profit on Motor car taken over (Rs. 3,700 – Rs. 2,700)	1,000
Loss on sale of plant (Rs. 4,000 – Rs. 3,000)	1,000
Net effect	Nil

Q15. (a) State the Conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares.

Answer 15. (a)

As per section 77A of the Companies Act, 1956 a joint stock company has to fulfill the following conditions to buy-back its own equity shares:

- The buy-back is authorised by its articles.
- A special resolution* has been passed in general meeting of the company authorising the buy-back.

- (iii) The buy-back does not exceed 25% of the total paid up capital and free reserves of the company. Provided the buy-back must not exceed 25% of its total paid up equity capital in that financial year.
- (iv) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.
- (v) All the shares for buy-back are fully paid up.
- (vi) The buy-back is made out of the free reserves (which include securities premium) or out of the proceeds of a fresh issue of any shares or other specified securities.
- (vii) The buy-back is completed within 12 months of the passing of the special resolution or a resolution passed by the Board.
- (vii) The buy-back of the shares listed on any recognised stock exchange is in accordance with the regulations made by the SEBI in this behalf.
- (ix) Before making such buy-back, a listed company has to file with the Registrar and the SEBI a declaration of solvency in the prescribed form.

Q15. (b) Sweat equity shares and conditions, which must be fulfilled by a Joint Stock Company to issue these shares.

Answer 15. (b)

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.

Q16. (a) Discuss the payment of dividend on partly paid shares.**Answer 16. (a)**

In the case of partly paid-up shares, the dividend is payable either on the nominal, called-up or the paid-up amount of shares, depending on the provisions in this regard that there may be in the articles of the company. In the absence of any such provisions, Table A should be applicable. In such a case the amount of dividend payable will be calculated on the amount paid-up on the shares, and while doing so, the dates on which the amounts were paid must be taken into account. Calls paid in advance do not rank for payment of dividend. A company may if so authorised by its articles, pay a dividend in proportion to the amount paid on each share, where a larger amount is paid on some shares than on others (Section 93 of the Companies Act, 1956). But where the articles are silent and Table A has been excluded, the amount of dividend payable will have to be calculated on the nominal amount of shares. It should, however, be noted that according to Clause 88 of Table A dividends are to be declared and paid according to the amounts paid or credited as paid on the shares in respect whereof the dividend is paid, but if and so long as nothing is paid upon any of the shares of the company, dividends may be declared and paid according to the nominal amount of the shares.

Q16. (b) State the guidelines of SEBI regarding issue of convertible debentures for disclosure and investor protection.**Answer 16. (b)**

SEBI guidelines regarding issue of convertible debentures for disclosure and investor protection are as follows :

- (i) Issue of Fully Convertible Debentures (FCDs) having a conversion period of more than 36 months will not be permissible, unless conversion is made optional with "put" and "call" option.
- (ii) No company shall make a public issue or rights issue of debts instruments (whether convertible or not), unless credit rating of not less than investment grade is obtained from not less than two registered credit rating agencies and disclosed in the offer document. All the credit ratings including the unaccepted credit ratings shall be disclosed.
- (iii) All the credit ratings obtained during the 3 years preceding the public or rights issue of convertible debentures for any listed security of the issuer company shall be disclosed in the offer document.
- (iv) No company shall issue a prospectus or a letter of offer to the public for subscription of its debentures without the appointment of a debenture trustees or creation of Debenture Redemption Reserve, in accordance with the provisions of the Companies Act, 1956. The names of the debenture trustees shall be stated in the Offer Document and also in all the subsequent periodical communication. Also a trust deed shall be executed within 3 months of the closure of the issue.
- (v) The merchant banker shall ensure that the security created is adequate to ensure 100% asset cover for the debentures and is free from any encumbrances and also the necessary permissions to mortgage the assets or No objection certificate for a second or *pari passu* charged in cases where assets are encumbered have been obtained.
- (vi) Premium amount on conversion and time of conversion, shall be predetermined by the issuer company and stated in the prospectus. Interest rates for the above debentures will also be freely determined by the issuer company.

- (vii) Any conversion in part or whole of the debentures will be optional in the hands of the debentureholders, if the conversion takes place at or after 18 months from the date of allotment, but before 36 months.
- (viii) Premium amount at the time of conversion for the Partly Convertible Debentures (PCD) shall be predetermined and stated in the prospectus. Redemption amount, period of maturity, yield on redemption for the PCDs or NCDs shall also be indicated in the prospectus.
- (ix) In case, the non-convertible portions of PCDs or NCDs are to be rolled over with or without change in the interest rate, a compulsory option should be given to those debentureholders who want to withdraw and encash from the debenture programme. Roll over shall be done only in cases where debentureholders have sent their positive consent and not on the basis of the non-receipt of their negative reply.
- (x) Before roll over of any NCDs or non-convertible portion of the PCDs, at least two credit ratings of not less than investment grade shall be obtained within a period of six months prior to the due date of redemption and communicated to debentureholders before roll over and fresh trust deed shall be made.
- (xi) Letter of information regarding roll over shall be vetted by SEBI with regard to the credit ratings, debentureholder's resolution, option for conversion and such other items which SEBI may prescribe from time to time.
- (xii) The disclosures relating to raising of debentures will contain, amongst other things, the existing and future equity and long term debt ratio, servicing behaviour on existing debentures, payment of due interest on due dates on long term loans and debentures, certificate from a financial institution or bankers about their no objection for a second or pari passu charge created in favour of the trustees to the proposed debenture issues.
- (xiii) SEBI may prescribe additional disclosure requirement from time to time, after due notice.

Q17. The Balance sheet of XYZ Ltd. as at 31st December, 2008 inter alia includes the following :

		Rs.
50,000	8% Preference shares of Rs. 100 each Rs. 70 paid up	35,00,000
1,00,00	Equity shares of Rs. 100 each fully paid up	1,00,00,000
	Securities premium	5,00,000
	Capital redemption reserve	20,00,000
	General reserve	50,00,000

Under the terms of their issue, the preference shares are redeemable on March 31, 2009 at a premium of 5%. In order to finance the redemption, the company makes a right issue of 50,000 equity shares of Rs. 100 each at Rs. 20 being payable on application, Rs. 35 (including premium) on allotment and the balance on January 1, 2010. The issue was fully subscribed and allotment made on March 1, 2009. The monies due on allotment were received by March 30, 1999.

The preference shares were redeemed after fulfilling the necessary conditions of Section 80 of the Companies Act, 1956. The company decided to make the minimum utilisation of general reserve.

You are asked to pass the necessary journal entries and show the relevant extracts from the Balance Sheet as on March 31, 2009 with the corresponding figures as on 31st December, 2008.

Solution:

XYZ Ltd.
Journal Entries

		Dr. Rs. '000	Cr. Rs. '000
8% Preference Share Final Call Account	Dr.	15,00	
To 8% Preference Share Capital Account			15,00
(Being the final call made on 50,000 preference shares @ Rs. 30 each to make them fully paid up)			
Bank Account	Dr.	15,00	
To 8% Preference Share Final Call Account			15,00
(Being the final call amount received on 50,000 preference shares @ Rs. 30 each)			
Bank Account	Dr.	10,00	
To Equity Share Application Account			10,00
(Being the application money received on 50,000 equity shares @ Rs. 20 per share)			
Equity Share Application Account	Dr.	10,00	
To Equity Share Capital Account			10,00
(Being the application money on 50,000 equity shares transferred to equity share capital account vide Board's resolution dated...)			
Equity Share Allotment Account	Dr.	17,50	
To Equity Share Capital Account			12,50
To Securities Premium Account			5,00
(Being the amount due on 50,000 equity shares @ Rs. 35 per share [including premium Rs.] 10 vide Board's resolution dated...)			
Bank Account	Dr.	17,50	
To Equity Share Allotment Account			17,50
(Being the allotment money received on 50,000 equity shares @ Rs. 35 per share)			
8% Preference Share Capital Account	Dr.	50,00	
Premium on Redemption of Preference Shares Account	Dr.	2,50	
To Preference Shareholders Account			52,50
(Being the amount payable to preference share holders on redemption)			

		Dr. Rs. '000	Cr. Rs. '000
Preference Shareholders Account	Dr.	52,50	
To Bank Account			52,50
(Being the payment made to preference shareholders)			
Securities Premium Account	Dr.	2,50	
To Premium on Redemption of Preference Shares Account			2,50
(Being the premium payable on redemption of preference shares charged to share premium account)			
General Reserve	Dr.	27,50	
To Capital Redemption Reserve			27,50
(Being the amount transferred to capital redemption reserve on redemption of preference shares for the balance not covered by proceeds of fresh issue of shares)			

Balance Sheet of XYZ Limited
As at 31st March, 1999 (after redemption of preference shares)
(Relevant extracts)

	Amount Rs. ('000) As on 31.3.99	Amount Rs. ('000) As on 31.12.98
1. Sources of funds		
Shareholders' funds :		
(a) Share Capital		
Issued, subscribed and paid-up		
1,00,000 equity shares of Rs. 100 each, fully paid up	1,00,00	1,00,00
50,000 equity shares of Rs. 100 each,		
Rs. 45 called up and paid up	22,50	—
50,000, 8% Redeemable preference shares of		
Rs. 100 each, Rs. 70 called-up and paid-up		
(redeemed on 31st March, 1999)	—	35,00
	1,22,50	1,35,00
(b) Reserves and Surplus :		
Capital redemption reserve	47,50	20,00
Securities premium account	7,50	5,00
General reserve	22,50	50,00
	77,50	75,00

The cash and bank balance will be decreased by Rs. 10,00,000 on 31.3.09 as compared to the balance on 31.12.08.

Working Notes :	Rs. '000
(i) Transfer to Capital Redemption Reserve	
Nominal value of preference shares redeemed (Rs. 100 × 50,000)	50,00
Less : Proceeds of fresh equity issue [(Rs. 20 + 25) × 50,000]	22,50
Transfer to capital redemption reserve	27,50
(ii) Capital Redemption Reserve as on 31.3.09	
Balance as on 31.12.08	20,00
Add : Transfer from general reserve	27,50
Balance as on 31.3.09	47,50
(iii) General reserve as on 31.3.09	
Balance as on 31.12.08	50,00
Less : Transfer to capital redemption reserve	27,50
Balance as on 31.3.09	22,50
(iv) Securities premium as on 31.3.09	
Balance as on 31.12.08	5.00
Add : Amount received @ Rs. 10 per share on fresh issue of 50,000 equity shares	5.00
Less : Premium on redemption of preference shares	2.50
Balance as on 31.3.09	7.50
(v) Change in cash and bank balance	
Receipts : (31.12.08 - 31.3.09)	
Application money on 50,000 equity shares @ Rs. 20 per share	10.00
Allotment money on 50,000 equity shares @ Rs. 35 per share	17.50
Final call on 50,000, 8% Preference shares @ Rs. 30 per share	15.00
	42.50
Payments :	
Amount paid to preference shareholders on redemption	52.50
Reduction in cash and bank balance	10.00

Q18. (a) From the following particulars of Ganga Limited, you are required to calculate the managerial remuneration in the following situation.

- (i) There is only one whole time director.
- (ii) There are two whole time directors.
- (iii) There are two whole time directors, a part time director and a Manager.

	Rs.
Net profit before provision for income-tax and managerial remuneration, but after depreciation and provision for repairs	8,70,410
Depreciation provided in the books	3,10,000
Provision for repairs of machinery during the year	25,000
Depreciation allowable under Schedule XIV	2,60,000
Actual expenditure incurred on repairs during the year	15,000

Solution:

Sections 198 and 309 of the Companies Act, 1956 prescribe the maximum percentage of profit that can be paid as managerial remuneration. For this purpose, profit is to be calculated in the manner as specified in Section 349.

Calculation of net profit u/s 349 of the Companies Act, 1956

	Rs.	Rs.
Net profit before provision for income-tax and managerial remuneration, but after depreciation and provision for repairs		8,70,410
<i>Add back :</i> Depreciation provided in the books	3,10,000	
Provision for repairs of machinery	25,000	
		12,05,410
<i>Less :</i> Depreciation allowable under Schedule XIV	2,60,000	
Actual expenditure incurred on repairs	15,000	
Profit under section 349		9,30,410

Calculation of managerial remuneration

- (i) There is only one whole time director
 Managerial remuneration = 5% of Rs. 9,30,410
 = Rs. 46,520.50
- (ii) There are two whole time directors
 Managerial remuneration = 10% of Rs. 9,30,410
 = Rs. 93,041
- (iii) There are two whole time directors, a part time director and a manager
 Managerial remuneration = 11% of Rs. 9,30,410
 = Rs. 1,02,345.10

Q18. (b) The trial balance of Complex Ltd. as at 31st March, 2009 shows the following items :

	Dr. Rs.	Cr. Rs.
Advance payment of income-tax	2,20,000	—
Provision for income-tax for the year ended 31.3.08	—	1,20,000

The following further informations are given :

- (i) Advance payment of income-tax includes Rs. 1,40,000 for 2007-08.
- (ii) Actual tax liability for 2007-08 amounts to Rs. 1,52,000 and no effect for the same has so far been given in accounts.
- (iii) Provision for income-tax has to be made for 2008-09 for Rs. 1,60,000.

You are required to prepare (a) provision for income-tax account, (b) advance payment of income-tax account, (c) liabilities for taxation account and also show, how the relevant items will appear in the profit and loss account and balance sheet of the Company.

Solution:

Complex Ltd.

(a) **Provision for Income Tax (2007-08) Account**

Dr.	Rs.		Cr.	Rs.
31.3.09 To Advance Payment of Income-tax A/c	1,40,000	1.4.08 By Balance b/d		1,20,000
To Liability for Taxation A/c	12,000	31.3.09 By Profit and Loss A/c		32,000
	1,52,000			1,52,000

Provision for Income-tax (2008-09) Account

	Rs.			Rs.
31.3.09 To Balance c/d	1,60,000	31.3.09 By Profit and Loss A/c		1,60,000
	1,60,000			1,60,000

(b) **Advance Payment of Income Tax Account**

	Rs.			Rs.
31.3.09 To Balance b/d	2,20,000	31.3.09 By Provision for Income-tax (2007-08) A/c		1,40,000
		By Balance c/d		80,000
	2,20,000			2,20,000

(c) **Liability for Taxation Account**

	Rs.			Rs.
31.3.09 To Balance c/d	12,000	31.3.09 By Provision for Income-tax A/c		12,000
	12,000			12,000

Profit and Loss Account
for the year ended 31st March, 2009 (Extracts)

	Rs.	Rs.
Profit before Taxation		
Less : Taxation for the year	1,60,000	
Taxation adjustment of previous year	32,000	1,92,000
Net Profit		

Balance Sheet of Complex Ltd.
As at 31st March, 2009 (Extracts)

Liabilities	Rs.	Assets	Rs.
Current Liabilities and Provisions		Current Assets, Loans and Advances	
A. Current Liabilities		B. Loans and Advances	
Liability for Taxation (1996-97)	12,000	Advance payment of	
B. Provisions		Income-tax	80,000
Provision for Income-tax	1,60,000		

Q19. Fruit Juice Ltd., Mumbai has factories at Ratnagiri (alphonso mango pulp) and Nagpur (Orange juice). During the year ended 31st March, 2009, the following locationwise revenue statements were furnished by the two factories (from which the total column has been compiled) :

	Ratnagiri Rs.	Nagpur Rs.	Total Rs.
Opening stock :			
Work in process	24,000	12,000	36,000
Finished goods	8,000	2,000	10,000
	32,000	14,000	46,000
Raw material consumption	25,00,000	10,00,000	35,00,000
Employee cost	5,00,000	6,00,000	11,00,000
Power and Fuel	1,00,000	50,000	1,50,000
Consumable stores	15,000	7,000	22,000
Rates and taxes	14,000	9,000	23,000
Repairs to factory :			
Building	4,000	5,000	9,000
Machinery	80,000	50,000	1,30,000
Other assets	3,000	1,000	4,000
Other expenses	65,000	55,000	1,20,000
Depreciation	1,00,000	90,000	1,90,000
	34,13,000	18,81,000	52,94,000
Less : Closing stock			
Work in process	28,000	13,000	41,000
Finished goods	5,000	8,000	13,000
	33,000	21,000	54,000
Cost of goods transferred to marketing division	33,80,000	18,60,000	52,40,000

The marketing division furnishes you with the following information of its productwise revenue statement for the year ended 31st March, 2009 (from which the total column has been compiled) :

	Mango pulp	Orange juice	Total
Opening stock :	12,000	5,000	17,000
Receipt during the year out of :			
Last year's despatch from factory	10,000	5,000	15,000
Current year's despatch from factory	33,65,000	18,50,000	52,30,000
	33,75,000	18,55,000	52,30,000
Transport "in" cost from factory	50,000	60,000	1,10,000
	34,37,000	19,20,000	53,57,000
Less : Closing stock	7,000	10,000	17,000
	34,30,000	19,10,000	53,40,000
Sales commission	5,00,000	2,50,000	7,50,000
Sales tax	4,00,000	1,25,000	5,25,000
Profit	6,70,000	2,15,000	8,85,000
Sales	50,00,000	25,00,000	75,00,000

You are asked to prepare sectional and consolidated revenue statement for the year ended 31st March, 2009 for consideration of the board of directors and presentation to the members of Fruit Juice Ltd. Also work out the percentage of net profit to sales. Show your working, if any.

Solution:

**Revenue Statement of Fruit Juice Ltd. (Sectional and Consolidated)
for the year ended 31st March, 2009**

	Mango Pulp Rs. '000	Orange Juice Rs. '000	Total Rs. '000
Sales	5,000	2,500	7,500
Add : Excess of closing inventory over opening inventory (Working note 1)	1	17	18
Gross revenue	5,001	2,517	7,518
Less : Manufacturing and other expenses (Working note 2)	4,231	2,212	6,443
Profit before depreciation	770	305	1,075
Less : Depreciation	100	90	190
Net Profit	670	215	885
	Mango Pulp	Orange Juice	Total
Percentage of net profit to sales	13.4%	8.6%	11.8%

Working Notes :

(1) Excess of closing inventory over opening inventory

(a)	Mango Pulp Rs. '000	Orange Juice Rs. '000	Total Rs. '000
Opening Stock			
Finished goods :			
At factory	8	2	10
In transit (received during the year by marketing division)	10	5	15
With marketing division	12	5	17
	30	12	42
Work in process	24	12	36
Total	54	24	78

(b)	Mango Pulp Rs. '000	Orange Juice Rs. '000	Total Rs. '000
Closing Stock			
Finished goods :			
At factory	5	8	13
In transit*	15	10	25
With marketing division	7	10	17
	27	28	55
Work in process	28	13	41
	55	41	96
(c) Closing Stock	55	41	96
Less : Opening stock	54	24	78
Excess of closing stock over opening stock	1	17	18
* Goods sent by factory	3,380	1,860	5,240
Less : Received by marketing division	3,365	1,850	5,215
Finished goods in transit	15	10	25

(2) Manufacturing and other costs

	Mango Pulp Rs. '000	Orange Juice Rs. '000	Total Rs. '000
Manufacturing costs:			
Raw Material consumption	2,500	1,000	3,500
Employee cost	500	600	1,100
Power and fuel	100	50	150
Consumable stores	15	7	22
Rates and taxes	14	9	23

Repairs : Building	4	5	9
Machinery	80	50	130
Other assets	3	1	4
Other costs :			
Transport	50	60	110
Sales commission	500	250	750
Sales tax	400	125	525
Other expenses	65	55	120
	4,231	2,212	6,443

- Q20. (i) A major fire has damaged the assets in a factory of a limited company on 2nd April-two days after the year end closure of account. The loss is estimated at Rs. 20 crores out of which Rs. 12 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.**
- (ii) There is a sales tax demand of Rs. 2.50 crores against a company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The grounds of appeal deal with points covering Rs. 2 crores of the demand. State how the matter will have to be dealt with in the final accounts for the year.**

Answer :

- (i) The loss due to break out of fire is an example of event occurring after the balance sheet date that does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of the balance sheet and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS-4 states that disclosure is generally made of events in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise at the balance sheet date. In the given case, the loss of assets in a factory is considered to be an event affecting the substratum of the enterprise after the balance sheet date. Hence, as recommended in paragraph 15 of AS-4, disclosure of the event should be made in the report of the approving authority that represent material changes and commitments affecting the financial position of the enterprise.
- (ii) The undisputed part of sales tax liability of Rs. 0.50 crore should be considered as actual liability and adequately provided for. The Institute of Chartered Accountants of India has issued Accounting standard 29 on "Provisions Contingent Liabilities and Contingent Assets" (comes into effect in respect of accounting periods commencing on or after 1.4.2004). According to the standard, an enterprise should not recognise a contingent liability but should disclose it, as required by paragraph 68, unless the possibility of an outflow of resources embodying economic benefits is remote. Accordingly the company should disclose the disputed part of sales tax liability of Rs. 2 crore as contingent liability in their financial statements of the year. However, the above disclosed contingent liability should be reviewed continuously and if it becomes probable that an outflow of future economic benefit will be required , then recognise the contingent liability as a provision.
- Q21. Jagannath Ltd. had made a rights issue of shares in 2006. In the offer document to its members, it had projected a surplus of Rs. 40 crores during the accounting year to end on 31st March, 2009. The draft results for the year, prepared on the hitherto followed accounting**

policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided on the following :

- (i) Value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation of inventory at prime cost (Rs. 30 crores).
- (ii) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at Rs. 27 crores is lower than the amount of Rs. 45 crores which would have been provided had the old method been followed, by Rs. 18 crores.
- (iii) Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to Rs. 600 crores.
- (iv) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being Rs. 10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2008-09

Answer :

As per AS 1 "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. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts :

- (i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognisance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end inventory has been valued at Rs. 50 crores and the profit for the year is increased by Rs. 20 crores.
- (ii) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at Rs. 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by Rs. 18 crores. To that extent, the profit for the year is increased.
- (iii) So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by Rs. 12 crores than would have been the case if the old policy were to continue.

- (iv) The company has decided to provide Rs. 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. the provision so made has reduced the profit disclosed in the accounts by Rs. 10 crores.

- Q22. (a) When Capitalisation of borrowing cost should cease as per Accounting Standard 16?**
(b) Define a "Business Segment" and a "Geographical Segment" as per Accounting Standard 17.
(c) Briefly describe, how do you calculate "Diluted Earnings per Share" as per Accounting Standard 20.
(d) Briefly describe the disclosure requirements for "Deferred Tax Assets" and "Deferred Tax Liabilities" as per Accounting Standard 22.
(e) Write short note on Sale and Lease Back Transactions as per Accounting Standard 19.

Answer :

- (a) Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

- (b) **A Business Segment:** A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:
- (a) the nature of the products or services;
 - (b) the nature of the production processes;
 - (c) the type or class of customers for the products or services;
 - (d) the methods used to distribute the products or provide the services and
 - (e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

A geographical segment: A geographical segment is a distinguishable component of an enterprise that is engaged in providing product or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include :

- (a) similarity of economic and political conditions;
- (b) relationships between operations in different geographical areas;
- (c) proximity of operations;

- (d) special risks associated with operations in a particular area;
 - (e) exchange control regulations; and
 - (f) the underlying currency risks.
- (c) For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.
- The amount of net profit or loss for the period attributable to equity shareholders should be adjusted, after taking into account any attributable change in tax expense for the period.
- The number of equity shares should be the aggregate of the weighted average number of equity shares (as per paragraphs 15 and 22 of AS 20) and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.
- An enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.
- (d) (i) An enterprise should offset deferred tax assets and deferred tax liabilities if:
- (a) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax, and
 - (b) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.
- (ii) Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.
- (iii) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

Q23. (a) X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2008. Till March, 2009, 75% of the stocks were sold. The company wants to disclose closing stock at Rs.10 lakhs. The expected sale value is Rs.11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2009.

(b) Explain the 'Accounting of Revaluation of Assets' with reference to AS 10.

(c) Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2009, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at Rs.9 lakhs. Decide whether the income by way of interest from dealers is eligible for recognition as per AS 9.

- (d) **AB Ltd. launched a project for producing product X in October, 2007. The Company incurred Rs. 20 lakhs towards Research and Development expenses upto 31st March, 2009. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.**

Advise the Company as per the applicable Accounting Standard.

Answer :

- (a) As per Para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost and net realizable value.

In this case, the cost of inventory is Rs. 10 lakhs. The net realizable value is 11,00,000 × 90% = Rs. 9,90,000. So, the stock should be valued at Rs. 9,90,000.

- (b) As per Para 30 of AS 10 "Accounting for Fixed Assets", an increase in net book value arising on revaluation of fixed assets should be credited to owner's interests under the head of 'revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed assets is charged directly to profit and loss statement except that to the extent such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized, it may be charged directly to that account.

- (c) As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments made by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

- (d) As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting Rs. 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2009.

- Q24. A head office sends goods to its branch at 20% less than the list price. Goods are sold to customers at cost plus 100%. From the following particulars, ascertain the profit made at the head office :**

	Head Office Rs.	Branch Rs.
Purchases	2,00,000	—
Goods sent to/Received by Branch (Invoice Price)	80,000	—
Sales to Customers	1,70,000	80,000

Solution :

Dr. **Branch Trading Profit and Loss Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Goods Sent to Branch A/c	80,000	By Sales	80,000
To Retail Profit t/f to Branch P & L A/c (b.f.)	16,000	By Closing Stock [See working note (ii)]	16,000
	96,000		96,000
To Net Profit subject to other Branch Expenses	16,000	By Gross Profit b/d	16,000
	16,000		16,000

Dr. **Branch Stock Reserve Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Balance c/d	6,000	By H.O. P & L A/c (Provision for Unrealised Profit on Closing Stock) (Rs. 16,000 × 60/160)	6,000
	6,000		6,000

Dr. **H. O. Trading and Profit & Loss Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Purchases	2,00,000	By Sales @ Rs. 200	1,70,000
To Gross Profit t/f to P & L A/c	1,15,000	By Goods sent to whole sale Branch @ Rs. 160	80,000
		By Closing Stock [See Working Note (iii)]	65,000
	3,15,000		3,15,000
To Stock Reserve on Branch Stock (16,000 × 60/160)	6,000	By Gross Profit b/d	1,15,000
To Net Profit	1,25,000	By Branch P & L A/c	16,000
	1,31,000		1,31,000

Working Notes :

(i) Calculation of Cost-price relationship	Rs.
Cost Price	100
Add : Wholesale Profit (balancing figure)	60
Wholesale Price	160
Add : Retail Profit (20% of Rs. 200)	40
List Price	200

- (ii) Closing Stock at Branch = Opening Stock (at W.P.) + Goods sent (at W.P.) — Wholesale price of goods sold
 = Nil + Rs. 80,000 — (80,000 × 160/160) = 16,000
- (iii) Closing Stock at H.O. = Opening Stock (at cost) + Purchases (at cost) — Cost of Goods sent to branch — Cost of Goods sold at H.O.
 Nil + Rs. 2,00,000 — (Rs. 80,000 × 100/160) —
 (Rs. 1,70,000 × 100/200) = Rs. 65,000

Q25. Journalise the following transactions in the books of Head Office. Delhi Branch and Agra Branch :

(a) Goods worth Rs. 50,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office. (b) Delhi Branch draws a bill receivable for Rs 40,000 on Agra Branch which sends its acceptance. (c) Delhi Branch received Rs 10,000 from Agra Branch. (d) Goods worth Rs. 20,000 were returned by a customer of Agra Branch to Delhi Branch. (e) Agra Branch collected Rs 20,000 from a customer of Delhi Branch.

Solution :

Journal of Head Office

Particulars	L. F.	Dr. (Rs)	Cr. (Rs)
(a) Agra Branch A/c To Delhi Branch A/c (Being the goods supplied by Delhi Branch to Agra Branch)	Dr.	50,000	50,000
(b) Delhi Branch A/c To Agra Branch A/c (Being a B/R drawn by Delhi upon Agra Branch)	Dr.	40,000	40,000
(c) Delhi Branch A/c To Agra Branch A/c (Being Cash sent by Agra Branch to Delhi Branch)	Dr.	10,000	10,000
(d) Delhi Branch A/c To Agra Branch A/c (Being the goods returned by customer of Agra Branch to Delhi Branch)	Dr.		20,000 20,000
(e) Agra Branch A/c To Delhi Branch A/c (Being the Cash collected by Agra Branch from a customer of Delhi Branch)	Dr.	20,000	20,000

Journal of Agra Branch

Particulars	L. F.	Dr. (Rs)	Cr. (Rs)
(a) Goods Received from Branch A/c To Head Office A/c (Being goods received from Delhi Branch)	Dr.	50,000	50,000
(b) Head Office A/c To B/P A/c (Being a B/P accepted for Delhi Branch)	Dr.	40,000	40,000
(c) Head Office A/c To Cash A/c (Being cash sent to Delhi Branch)	Dr.	10,000	10,000
(d) Head Office A/c To Debtors A/c (Being goods returned by customer to Delhi Branch)	Dr.	20,000	20,000
(e) Cash A/c To Head Office A/c (Being cash received from a customer of Delhi Branch)	Dr.	20,000	20,000

Journal of Delhi Branch

Particulars	L. F.	Dr. (Rs)	Cr. (Rs)
(a) H.O. A/c To Goods sent to Branch A/c (Being the goods supplied to Agra Branch)	Dr.	50,000	50,000
(b) Bills Receivable A/c To H.O. A/c (Being the acceptance of a B/R received from Agra Branch)	Dr.	40,000	40,000
(c) Cash A/c To H.O. A/c (Being the cash received from Agra Branch)	Dr.	10,000	10,000
(d) Goods Sent to Branch A/c To H.O. A/c (Being the goods received from a customer of Agra Branch)	Dr.	20,000	20,000
(e) H.O. A/c To Debtors A/c (Being the cash collected by Agra Branch from our customer)	Dr.	20,000	20,000

Q26. Z Ltd., has 3 departments, X, Y, Z. The following information is provided :

	X	Y	Z
	Rs.	Rs.	Rs.
Opening Stock	3,000	4,000	6,000
Consumption of direct materials	8,000	12,000	—
Wages	5,000	10,000	—
Closing Stock	4,000	14,000	8,000
Sales	—	—	34,000

Stock of each department is valued at cost to the department connected. Stocks of X department are transferred to Y at a margin of 50% above departmental cost. Stocks of Y department are transferred to Z department at a margin of 10% above departmental cost. Other expenses were : Salaries Rs. 2,000, Printing & Stationery Rs. 1,000, Rent Rs. 6,000, Interest paid Rs. 4,000, Depreciation Rs. 3,000, Allocate expenses in the ratio of departmental gross profit. Opening figures of reserve for unrealised profits on departmental stocks were : Department Y Rs. 1,000 ; Department Z Rs. 2,000.

Required : Prepare Departmental Trading and Profit & Loss Accounts for the year ended March 31, 2009.

Solution :

Departmental Trading and Profit & Loss Accounts

Dr.					Cr.				
<i>for the year ended 31st March, 2009</i>									
Particulars	X Rs.	Y Rs.	Z Rs.	Total Rs.	Particulars	X Rs.	Y Rs.	Z Rs.	Total Rs.
To Opening Stock :	3,000	4,000	6,000	13,000	By Internal b/d	18,000	33,000	—	51,000
To Direct Material considered	8,000	12,000	—	20,000	By Sales	—	—	34,000	34,000
To Wages	5,000	10,000	—	15,000	By Closing Stock	4,000	14,000	8,000	26,000
To Internal Transfer	—	18,000	33,000	51,000					
To Gross Profit c/d	6,000	3,000	3,000	12,000					
	<u>22,000</u>	<u>47,000</u>	<u>42,000</u>	<u>1,11,000</u>		<u>22,000</u>	<u>47,000</u>	<u>42,000</u>	<u>1,11,000</u>
To Salaries	1,000	500	500	2,000	By Gross Profit b/d	6,000	3,000	3,000	12,000
To Printing & Stationery	500	250	250	1,000	By Net Loss c/d	2,000	1,000	1,000	4,000
To Rent	3,000	1,500	1,500	6,000					
To Depreciation	1,500	750	750	3,000					
To Interest paid	2,000	1,000	1,000	4,000					
	<u>8,000</u>	<u>4,000</u>	<u>4,000</u>	<u>16,000</u>		<u>8,000</u>	<u>4,000</u>	<u>4,000</u>	<u>16,000</u>
To Net Loss b/d				4,000	By Provision for unrealised profit on Opening Stock				3,000
To Provision for unrealised profit on Closing Stock				3,918	By Balance transferred to P & L A/c				4,918
				<u>7,918</u>					<u>7,918</u>

Working Notes :

- (i) FIFO method for stock issue has been assumed. Alternatively this question could have been solved by assuming other methods for stock issue like LIFO Basis, Weighted Average basis, etc.

(ii) <i>Calculation of unrealised profit on Closing Stock of Deptt. Y</i>	Rs.
Current cost incurred by Dept. Y (Rs. 12,000 + Rs. 10,000 + Rs. 18,000)	40,000
Profit included in Above (Rs. 18,000 × 50/150)	6,000
Profit included in Closing Stock of Rs. 14,000 (Rs. 6,000 × Rs. 14,000/Rs. 40,000)	2,100
(iii) <i>Calculation of unrealised profit on Closing Stock of Dept C</i>	Rs.
Current Cost incurred by Dept. Z	33,000
Profit of Dept. B included in above (Rs. 33,000 × 10/110)	3,000
Cost element of Dept. Y included in current cost (Rs. 33,000 – 3,000)	30,000
Profit of Dept. a included in above cost (Rs. 6,000 × Rs. 30,000/Rs. 40,000)	4,500
Total Profit included in current cost of Dept. Z (Rs. 3,000 + Rs. 4,500)	7,500
Unrealised profit included in closing stock of Rs. 8,000 (Rs. 7,500 × Rs. 8,000/Rs. 33,000)	1,818
(iv) Total unrealised profit (Rs. 2,1000 + Rs. 1,818)	3,918

Q27. X Ltd., has a factory with two manufacturing Departments 'X' and 'Y'. Part of the output of Department X is transferred to Department Y for further processing and the balance is directly transferred to selling Department. The entire production of Department Y is directly transferred to the selling Department. Inter departmental stock transfers are made as follows :

X Department to Y Department at 33-1/3% over Departmental Cost.

X Department to selling department at 50% over Departmental Cost.

Y Department to selling department at 25% over Departmental Cost.

The following information is given for the year ended 31st March, 2008.

Particulars	Dept. X		Dept. Y		Selling Dept.	
	Units	Rs.	Units	Rs.	Units	Rs.
Opening Stock of Finished Goods	60	60,000	20	40,000	50	1,28,000
Opening Stock of Raw Materials	—	—	—	—	—	—
Raw material Consumed	—	1,82,000	—	20,000	—	—
Labour Charges	—	70,000	—	32,000	—	—
Sales	—	—	—	—	120	4,80,000
Closing Stock of Finished Goods	40	—	50	—	60	—

Out of the total transfer by X Department, 30 units were transferred to selling department, while the remaining to Department Y. The per unit material and labour consumption in X Department on production to be transferred directly to selling department is 300 per cent of the labour and material consumption on units transferred to Y Department. General Administration expenses Rs. 80,000.

Required : Prepare Departmental Profit and Loss Account and General Profit and Loss Account for the year ended 31.3.2009.

Solution :

Departmental Profit and Loss Account

Dr. for the year ended 31st March, 2009 Cr.

Particulars	X Dept.		Y Dept.		Selling Dept.		Particulars	X Dept.		Y Dept.		Sell Dept.	
	Qty.	Rs.	Qty.	Rs.	Qty.	Rs.		Qty.	Rs.	Qty.	Rs.	Qty.	Rs.
To Opening stock	60	60,000	20	40,000	50	1,28,000	By Stock	160	3,70,000	100	2,50,000	—	—
To Raw Material consumed		1,82,000	—	20,000	—	—	By Sales	—	—	—	—	120	4,80,000
To Units produced	140	—	—	—	—	—	By Closing Stock	40	48,000	50	1,00,000	60	1,80,000
To Labour Charges		70,000	—	32,000	—	—							
To Stock Transferred From X Dept.			130	2,08,000	30	1,62,00							
To Stock Transferred From Y Dept.					100	2,50,000							
To Departmental Profit t/f to General P & L A/C		1,06,000	—	50,000	—	1,20,000							
	200	4,18,000	150	3,50,000	180	6,60,000		200	4,18,000	150	3,50,000	180	6,60,000

General Profit and Loss Account

Dr. for the year ended 31st March, 2008 Cr.

Particulars	Rs.	Particulars	Rs.
To General Adm. Expenses	80,000	By Profit transferred from :	
To Stock Reserve for Closing Stock on Dept. Y	12,000	X Dept.	1,06,000
on Selling Dept.	18,175	Y Dept.	50,000
To Net profit	1,65,825	Selling Dept.	1,20,000
	2,76,000		2,76,000

Working Notes :**(a) Selling Department**

Particulars	Units	Particulars	Units
Opening Stock	50	Sales	120
T/f from X Dept.	30	Closing Stock	60
T/f from Y Dept. (Balancing figure)	100		
	180		180

(b) Y Department

Particulars	Units	Particulars	Units
Opening Stock	20	T/f to Selling Dept.	100
T/f from X Dept.	130	Closing Stock	50
	150		150

(c) X Department

Particulars	Units	Particulars	Units
Opening Stock	60	T/f to Selling Dept.	30
Production (Balancing figure)	140	T/f to Y Dept.	130
		Closing Stock	40
	200		200

- (d) Total Equivalent units produced in X Dept. in terms of those t/f to Y Dept.
 = Equivalent units of those t/f to Sell Dept. + t/f to Y Dept. + Closing Stock.
 = $(30 \times 300/100) + 130 + 40 = 260$

- (e) Calculation of Transfer Prices and Closing Stock.

	X Dept. Rs.	Y Dept. Rs.	Selling Dept. Rs.
A Cost of Opening Stock	60,000	40,000	1,28,000
B Add : Cost of Raw Materials Consumed	1,82,000	20,000	—
C Add : Labour Charges	70,000	32,000	—
D Add : T/f from X Dept.	—	2,08,000	1,62,000
E Add : T/f from Y Dept.	—	—	2,50,000
F Total Cost (A + B + C + D + E)	3,12,000	3,00,000	5,40,000
G Equivalent Units	260	150	180
H Average Cost per Equivalent Unit (F/G)	1,200	2,000	3,000

	X Dept. Rs.	Y Dept. Rs.	Selling Dept. Rs.
I Transfer Price of 130 Units t/f to Dept. Y			
(a) Cost of 130 Units ($130 \times \text{Rs. } 1,200$)	1,56,000		
(b) Add : Profit element @ 33-1/3 %	52,000		
	2,08,000		
J Transfer Price of Units t/f to Selling Dept.			
(a) Cost of Units t/f	1,08,000		
(b) Add : Profit element	54,000	50,000	
	1,62,000	2,50,000	
K Closing Stock	48,000	1,00,000	1,80,000
	($40 \times \text{Rs. } 1,200$)	($50 \times \text{Rs. } 2,000$)	($60 \times \text{Rs. } 3,000$)

(f) *Unrealised Profit on Increase in Closing Stock of Y Dept.* (Rs. 1,00,000 – Rs. 40,000)

A Current Cost incurred by Dept. Y

$$= \text{Rs. } 20,000 + \text{Rs. } 32,000 + \text{Rs. } 2,08,000 = \text{Rs. } 2,60,000$$

B Profit charged by Dept. X included in above ($\text{Rs. } 2,08,000 \times 1/4$) = Rs. 52,000

C Profit included in Increase in Closing Stock.

$$= (\text{Rs. } 52,000 \times \text{Rs. } 60,000 / \text{Rs. } 2,60,000) = \text{Rs. } 12,000$$

(g) *Profit Included in output transferred by Y Deptt. to Selling Dept.*

A Transfer Price = Rs. 2,50,000

B Profit of Dept. Y included in Above ($\text{Rs. } 2,50,000 \times 25/125$) = Rs. 50,000

C Cost Element of Dept. X in Transfer Price ($\text{Rs. } 2,50,000 - \text{Rs. } 50,000$) = Rs. 2,00,000

D Profit of Dept. X included in above

$$(\text{Rs. } 2,00,000 \times \text{Rs. } 52,000 / \text{Rs. } 2,60,000) = \text{Rs. } 40,000$$

E Total Profit Included in Transfer price ($\text{Rs. } 50,000 + \text{Rs. } 40,000$) = Rs. 90,000

(h) *Profit Included in output transferred by X Dept. to Selling Dept.*

$$= (\text{Rs. } 1,62,000 \times 50/150) = \text{Rs. } 54,000$$

(i) *Total Profit included in output transferred to Selling Dept.*

$$= \text{Rs. } 90,000 + \text{Rs. } 54,000 = \text{Rs. } 1,44,000$$

(j) *Total Transfer Price for the Transfer made by X Dept. and Y Dept.*

$$= \text{Rs. } 1,62,000 + \text{Rs. } 2,50,000 = \text{Rs. } 4,12,000$$

(k) *Unrealised Profit included in increas in Closing Stock of Sell Dept.*

$$= \text{Rs. } 1,44,000 \times \text{Rs. } 52,000 / \text{Rs. } 4,12,000 = \text{Rs. } 18,175$$

Q28. (a) From the following information find out the amount of provisions required to be made in the Profit & Loss Account of a commercial bank for the year ended 31st March, 2009 :

- (i) Packing credit outstanding from Food Processors Rs. 60 lakhs against which the bank holds securities worth Rs. 15 lakhs. 40% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.

(ii) Other advances :

Assets classification	Rs. in lakhs
Standard	3,000
Sub-standard	2,200
Doubtful :	
For one year	900
For two years	600
For three years	400
For more than 3 years	300
Loss assets	600

Solution :

(i)	(Rs. in lakhs)	
	Rs.	Rs.
Amount outstanding (packing credit)	60	
Less : Realisable value of securities	15	
	45	
Less : ECGC cover (40%)	18	
Balance	27	
Required provision :		
Provision for unsecured portion (100%)		27.0
Provision for secured portion (100%) *		<u>15.0</u>
		<u>42.0</u>

(ii) Other advances :

Assets	Amount Rs.	(Rs. in lakhs)	
		% of provision	Provision Rs.
Standard	3,000	0.40*	12
Sub-standard	2,200	10	220
Doubtful :			
For one year	900	20	180
For two years	600	30	180
For three years	400	30	120
For more than three years	300	100*	300
Loss	600	100	600
Required provision			1612

Note : Doubtful advances have been taken as fully secured. However, in case, the students assume that no security cover is available for these advances, provision will be made for 100%.

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2009 is required.

Q29. (b) Bidisha Bank Ltd. had extended the following credit lines to a Small Scale Industry which had not paid any interest since March, 2009

	Term Loan	Export Credit
Balance outstanding on 31.3.2001	Rs. 70 Lacs	Rs. 60. Lacs
DICGC/ECGC Cover	50%	40%
Securities held	Rs. 30 Lacs	Rs. 25 Lacs
Realisable value of securities	Rs. 20 Lacs	Rs. 15 Lacs

Compute the necessary provisions to be made for the year ended 31st March, 2009.

Answer :

	Term Loan Rs. in Lacs	Export Credit Rs. in Lacs
Balance outstanding	70.00	60.00
Less : Realisable value of securities	20.00	15.00
	50.00	45.00
Less : DICGC/ECGC Cover	25.00	18.00
Net unsecured balance	<u>25.00</u>	<u>27.00</u>
Provision in respect of secured portion (100%) *		20.00
15.00		
Provision for unsecured portion (100%)	25.00	27.00
Provision required	<u>45.00</u>	<u>42.00</u>

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st March 2009 is required.

Q30. (a) Indian Insurance Co. Ltd. furnishes you with the following information :

- (i) On 31.12.2008 it had reserve for unexpired risk to the tune of Rs. 40 crores. It comprised of Rs. 15 crores in respect of marine insurance business : Rs. 20 crores in respect of fire insurance business and Rs. 5 crores in respect of miscellaneous insurance business.
- (ii) It is the practice of Indian Insurance Co. Ltd. to create reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.

(iii) During 2008, the following business was conducted :

	Marine Rs.	Fire (Rs. in crores) Rs.	Miscellaneous Rs.
Premia collected from :			
(a) Insureds in respect of policies issued	18	43	12
(b) Other insurance companies in respect of risks undertaken	7	5	4
Premia paid/payable to other insurance companies on business ceded	6.7	4.3	7

Indian Insurance Co. Ltd. asks you to :

- (a) Pass journal entries relating to "Unexpired risks reserve".
 (b) Show in columnar form "Unexpired risks reserve" a/c for 2008

Answer : (a) Journal of Indian Insurance Co. Ltd.

		(Rupees in crores)	
		Dr. Rs	Cr. Rs.
2008 Dec. 31	Marine Revenue A/c Dr. 3.30 To Unexpired Risks Reserve A/c (Being the difference between closing provision of Rs. 18.30 crores (18 + 7 – 6.7) and opening provision of Rs. 15 crores charged to marine revenue account)	3.30	3.30
	Fire Revenue A/c Dr. 1.85 To Unexpired Risks Reserve A/c (Being the difference between closing provision of Rs. 21.85 crores [(43 + 5 – 4.3)/2] and opening provision of Rs. 20 crores charged to fire revenue account)	1.85	1.85
	Unexpired Risks Reserve A/c Dr. 0.50 To Miscellaneous Revenue A/c (Being the excess of opening balance of Rs. 5 crores over the required closing balance of Rs. 4.5 crores [(12 + 4 – 7)/2] credited to miscellaneous revenue account).	0.50	0.50

(b)

Unexpired Risks Reserve A/c**(Rs in crores)**

	Marine	Fire	Miscel- laneous			Marine	Fire	Miscel- laneous
	Rs.	Rs.	Rs.	1997		Rs.	Rs.	Rs.
1997								
Dec. 31 To Revenue A/c	–	–	0.50	Jan 1	By Balance b/d	15.00	20.00	5.00
To Balance c/d	18.30	21.85	4.50	Dec. 31	By Revenue A/c	3.30	1.85	–
	18.30	21.85	5.00			18.30	21.85	5.00

Note : Alternatively, the opening balances of unexpired risk reserves may be reversed in the beginning of year by transfer to Revenue account and fresh reserve of full required amount may be created at the end of the year which will be carried forward as closing balances.

Q30. (b) From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2009 :

	Direct Business Rs.	Re-Insurance Rs.
Claim paid during the year	46,70,000	7,00,000
Claim Payable— 1st April, 2008	7,63,000	87,000
31st March, 2009	8,12,000	53,000
Claims received	–	2,30,000
Claims Receivable— 1st April, 2008	–	65,000
31st March, 2009	–	1,13,000
Expenses of Management (includes Rs. 35,000 Surveyor's fee and Rs. 45,000 Legal expenses for settlement of claims)	2,30,000	–

Solution :**General Insurance Company****(Abstract showing the amount of claims)**

	Rs. '000	Rs. '000
Claims less Re-insurance :		
Paid during the year	52,20	
Add : Outstanding claims at the end of the year	7,52	
	59,72	
Less : Outstanding claims at the beginning of the year	7,85	51,87

Working Notes :

	Rs. '000	Rs. '000
1. Claims paid during the year		
Direct business	46,70	
Reinsurance	7,00	53,70
Add : Surveyor's fee	35	
Legal expenses	45	80
		54,50
Less : Claims received from re-insurers		2,30
		<u>52,20</u>
2. Claims outstanding on 31st March, 2009		
Direct business	8,12	
Reinsurance	53	8,65
Less : Claims receivable from re-insurers		1,13
		<u>7,52</u>
3. Claims outstanding on 1st April, 2008		
Direct business	763	
Reinsurance	87	8,50
Less : Claims receivable from re-insurers		65
		<u>7,85</u>

Q30. (c) Heaven Life Insurance Co. furnishes you the following information:

	Rs.	
Life Insurance fund on 31.3.2009	52,00,000	
Net liability on 31.3.2009 as per actuarial valuation	40,00,000	
Interim bonus paid to policyholders during intervaluation period		3,00,000
You are required to prepare:		
(i) Valuation Balance Sheet;		
(ii) Statement of Net Profit for the valuation period; and		
(iii) Amount due to the policyholders.		

Solution :

(i) **Heaven Life Insurance Co.**
Valuation Balance Sheet as at 31st March, 2009

	Rs.		Rs.
To Net Liability as per actuarial valuation	40,00,000	By Life Assurance Fund	52,00,000
To Surplus	12,00,000		
	<u>52,00,000</u>		<u>52,00,000</u>

(ii) **Statement showing Net Profit for the valuation period**

	Rs.
Surplus as per Balance Sheet (i.e., Valuation Balance Sheet)	12,00,000
Add: Interim bonus paid	<u>3,00,000</u>
	<u>15,00,000</u>

(iii)	Amount due to policyholders	Rs.
95% of net profit due to policyholders (95% of Rs. 15,00,000)		14,25,000
Less : Interim bonus already paid		<u>3,00,000</u>
Amount due to policyholders		<u>11,25,000</u>

Q31. State the main features of "Double Accounts" system of presentation of financial information in the case of public utility concern.

Answer :

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 Revenue account is analogous to the Profit & Loss Account of a company with some exceptions. The Net Revenue Account resembles with appropriation portion of the Profit & Loss Account of a company. The Balance Sheet is presented in two parts namely Capital Account and General Balance Sheet. The Capital Account shows the total amount of capital raised and its sources and also the manner and extent to which this capital has been applied in the acquisition of fixed assets for the purpose of carrying on the business. The General balance sheet includes the other items.

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.

Q32. Electric Supply Ltd. rebuilt and re-equipped one of their Mains at a Cash Cost of Rs. 40,00,000. The old Mains thus superseded cost Rs. 15,00,000. The capacity of the new Main is double that of the old Main.

Rs. 70,000 was realised from sale of old materials. Four old motors valued at Rs. 2,00,000 salvaged from the old Main were used in the reconstruction. The cost of Labour and Materials is respectively 30% and 25% higher now than when the old Main was built. The proportion of Labour to Materials in the Main then and now is 2 : 3.

Show the Journal entries for recording the above transactions, if accounts are maintained under Double Account System.

Solution:**Electric Supply Ltd.****Journal Entries**

		Dr. Rs.	Cr. Rs.
New Main Account	Dr.	20,95,000	
Replacement Account	Dr.	19,05,000	
To Bank Account			40,00,000
(Being current cost of replacement charged to replacement account and the balance amount capitalised)			
New Main Account	Dr.	2,00,000	
To Replacement Account			2,00,000
(Being the value of motors salvaged from old main used in the reconstruction of main)			
Bank Account	Dr.	70,000	
To Replacement Account			70,000
(Being the amount realised from sale of old materials credited to replacement account)			
Revenue Account	Dr.	16,35,000	
To Replacement Account			16,35,000
(Being the net current cost of replacement transferred to revenue account)			

Working Notes :

1. Current cost of replacement:

	Cost of existing main Rs.	Increase in cost Rate	Amount Rs.	Current cost Rs.
Materials ($3/5 \times$ Rs. 15 lacs)	9,00,000	25%	2,25,000	11,25,000
Labour ($2/5 \times$ Rs. 15 lacs)	6,00,000	30%	1,80,000	7,80,000
Estimated current cost for replacement of present main (amount to be charged to replacement account)				19,05,000

2. Additional cost of reconstruction of main (to be capitalised)

Cash cost of re-building new main	40,00,000
Less: Estimated current cost for replacement of existing old main	19,05,000
Additional cost in new main to be capitalised (excluding old motors used)	<u>20,95,000</u>

3. Replacement Account

Dr.		Cr.	
To Bank A/c	19,05,000	By New Main A/c	2,00,000
		By Bank A/c	70,000
		By Replacement A/c	
		(Balancing figure)	16,35,000
	19,05,000		19,05,000

Reasonable returns in electricity supply companies.

Answer :

The law seeks to prevent an electricity undertaking from earning too high a profit. For this purpose, "reasonable return" has been defined as consisting of :

- An yield at the standard rate which is Reserve Bank rate plus two percent on the capital base as defined below;
- Income derived from investment except investment made against Contingencies Reserve;
- An amount equal to 1/2% on loans advanced by the Electricity Board;
- An amount equal to 1/2% on the amounts borrowed from organisations or institutions approved by the State Government;
- An amount equal to 1/2% on the amount raised by the issue of debentures;
- An amount equal to 1/2% on balance of Development Reserve; and
- Such other amounts as may be allowed by the Central Government having regard to the prevailing tax structure in the country.

The term "Capital Base" used above, can be defined as:

- the original cost of fixed assets available for use and necessary for the purpose of the undertaking less contributions, if any made by the consumers for construction of service lines and also amounts written off;
- the cost of intangible assets;
- the original cost of work in progress;
- the amount of investments compulsorily made against contingencies reserve; and
- the monthly average of the stores, materials, supplies and cash and bank balances held at the end of each month of the year of account not exceeding in the aggregate an amount equal to one quarter of the expenditure.

Less:

- the amount written off or set aside on account of depreciation of fixed assets and amounts written off in respect of intangible assets in the books of the undertaking;
- the amount of any loans advanced by the Board;
- the amount of any loans borrowed from organisations or institutions approved by the State Government;
- the amount of any debentures issued by the licensee;

- (v) the amount of security deposits held in cash;
- (vi) the amount standing to the credit of the Tariffs and Dividends Control Reserve;
- (vii) the amount set apart for the development reserve; and
- (viii) the amount carried forward in the accounts of the licensee for distribution to the consumers.

Q33. From the following information, prepare a summarised Balance Sheet as at 31st March, 2009 :

Working Capital	Rs. 2,40,000
Bank overdraft	Rs. 40,000
Fixed Assets to Proprietary ratio	0.75
Reserves and Surplus	Rs. 1,60,000
Current ratio	2.5
Liquid ratio	1.5

Working notes :

1. Current assets and Current liabilities computation :

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{2.5}{1} \quad \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{2.5}{1} \text{ or}$$

$$\frac{\text{Current assets}}{2.5} = \frac{\text{Current liabilities}}{1} = k \text{ (say)}$$

$$\text{Or Current assets} = 2.5 k \text{ and Current liabilities} = k$$

$$\text{Or Working capital} = (\text{Current assets} - \text{Current liabilities})$$

$$\text{Or Rs. 2,40,000} = k (2.5 - 1) = 1.5 k$$

$$\text{Or } k = \text{Rs. 1,60,000}$$

$$\therefore \text{Current liabilities} = \text{Rs. 1,60,000}$$

$$\text{Current assets} = \text{Rs. 1,60,000} \times 2.5 = \text{Rs. 4,00,000}$$

2. Computation of stock

$$\text{Liquid ratio} = \frac{\text{Liquid assets}}{\text{Current liabilities}}$$

$$\text{Or } 1.5 = \frac{\text{Current assets} - \text{Stock}}{\text{Rs. 1,60,000}}$$

$$\text{Or } 1.5 \times \text{Rs. 1,60,000} = \text{Rs. 4,00,000} - \text{Stock}$$

$$\text{Or Stock} = \text{Rs. 1,60,000}$$

3. Computation of Proprietary fund; Fixed assets; Capital and Sundry creditors

$$\text{Proprietary ratio} = \frac{\text{Fixed assets}}{\text{Proprietary fund}} = 0.75$$

$$\text{Fixed assets} = 0.75 \text{ Proprietary fund}$$

$$\text{and Net working capital} = 0.25 \text{ Proprietary fund}$$

$$\text{Or Rs. 2,40,000/0.25} = \text{Proprietary fund}$$

$$\text{Or Proprietary fund} = \text{Rs. 9,60,000}$$

$$\begin{aligned} \text{and Fixed assets} &= 0.75 \text{ proprietary fund} \\ &= 0.75 \times \text{Rs. 9,60,000} \\ &= \text{Rs. 7,20,000} \end{aligned}$$

$$\begin{aligned} \text{Capital} &= \text{Proprietary fund} - \text{Reserves \& Surplus} \\ &= \text{Rs. 9,60,000} - \text{Rs. 1,60,000} \\ &= \text{Rs. 8,00,000} \end{aligned}$$

$$\begin{aligned} \text{Sundry creditors} &= (\text{Current liabilities} - \text{Bank overdraft}) \\ &= (\text{Rs. 1,60,000} - \text{Rs. 40,000}) \\ &= \text{Rs. 1,20,000} \end{aligned}$$

Balance Sheet

	Rs.		Rs.
Capital	8,00,000	Fixed assets	7,20,000
Reserves & Surplus	1,60,000	Stock	1,60,000
Bank overdraft	40,000	Current assets	2,40,000
Sundry creditors	1,20,000		
	<u>11,20,000</u>		<u>11,20,000</u>

Q33. (b) Discuss any three ratios computed for investment analysis.

Answer:

Three ratios computed for investment analysis are as follows;

$$(i) \text{ Earning per share} = \frac{\text{Profit after tax}}{\text{Number of equity shares outstanding}}$$

$$\begin{aligned}
 \text{(ii) Dividend yield ratio} &= \frac{\text{Equity dividend per share} \times 100}{\text{Market price per share}} \\
 \text{(iii) Return on capital employed} &= \frac{\text{Net profit after tax but before interest}}{\text{Net capital employed}}
 \end{aligned}$$

Q33. (c) Discuss the financial ratios for evaluating company performance on operating efficiency and liquidity position aspects.

Answer :

Financial ratios for evaluating performance on operational efficiency and liquidity position aspects are discussed as:

Operating Efficiency : Ratio analysis throws light on the degree of efficiency in the management and utilization of its assets. The various activity ratios (such as turnover ratios) measure this kind of operational efficiency. These ratios are employed to evaluate the efficiency with which the firm manages and utilises its assets. These ratios usually indicate the frequency of sales with respect to its assets. These assets may be capital assets or working capital or average inventory. In fact, the solvency of a firm is, in the ultimate analysis, dependent upon the sales revenues generated by use of its assets – total as well as its components.

Liquidity Position : With the help of ratio analysis, one can draw conclusions regarding liquidity position of a firm. The liquidity position of a firm would be satisfactory, if it is able to meet its current obligations when they become due. Inability to pay-off short-term liabilities affects its credibility as well as its credit rating. Continuous default on the part of the business leads to commercial bankruptcy. Eventually such commercial bankruptcy may lead to its sickness and dissolution. Liquidity ratios are current ratio, liquid ratio and cash to current liability ratio. These ratios are particularly useful in credit analysis by banks and other suppliers of short-term loans.

Q34. (a) Completed Contract Method.

Answer :

It is a revenue recognition method for long term construction contracts under which revenue is recognized only when the contract is completed or substantially completed; i.e., when only minor work is expected to complete the contract other than warranty obligations. Costs and progress payments received are accumulated during the course of contract but revenue is not recognized until the contract activity is substantially completed.

However, it is necessary to create provision for anticipated losses for the unfinished contract work although revenue is recognized only when the contract is substantially completed.

The principal advantage of this method is that it is based on results as determined when the contract is completed or substantially completed rather than on estimates which may require subsequent adjustments as a result of unforeseen cost and possible losses. If this method is followed, the risk of recognizing profit which is not really earned is greatly minimised.

The disadvantage is that periodic reported income does not reflect the level of activity on contracts during the period.

Q34. (b) Discuss the Computer Software Accounting.**Answer:**

In case computer software is acquired for sale in the ordinary course of business, it is treated as inventory and AS-2, Valuation of Inventories, is applicable which has been discussed in Section I of the book. If it is meant for internal use, AS-26 is applicable.

Computer software for internal use can be either:

- (i) acquired, or
- (ii) internally generated.

SOFTWARE ACQUIRED FOR INTERNAL USE

The cost of a software acquired for internal use should be recognized as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of the Accounting Standard-26* of the Institute of Chartered Accountants of India which are given below:

“ The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the following definition and criteria”