

MOCK TEST PAPER - 1

PCC : GROUP – I

PAPER – 1: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Accounting Standard 2 “Valuation of Inventories” states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on “Revenue Recognition” states, “at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at net-realizable value.”

Bedsheets do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry towel) should have been valued at lower of cost and net-realizable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

- (b) Adjusted Net profit for the current year

$$= 2,00,00,000 + 5,50,000 - 1,65,000 = ₹ 2,03,85,000$$

Number of equity shares resulting from conversion of debentures

$$= 50,000 \times 8 = 4,00,000 \text{ equity shares}$$

Total number of equity shares resulting from conversion of debentures

$$= 40,00,000 + 4,00,000 = 44,00,000 \text{ shares}$$

$$\text{Diluted Earnings per share} = \frac{₹ 2,03,85,000}{44,00,000} = ₹ 4.63 \text{ (Approximately)}$$

- (c) As per para 12.1 of AS 10 “Accounting for Fixed Assets” expenditure that increases the future benefits from the existing assets, is included in the gross book value.

Hence, in the given case, repairs of ₹ 2.50 lacs and partial replacement of the part of the machinery should be charged to Profit & Loss Account. ₹ 7 lacs incurred on a part of the machinery, which will increase the efficiency, should be capitalized.

- (d) As per AS 11 ‘The Effects of Changes in Foreign Exchange Rates’, all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2010 and corresponding creditor would be recorded at ₹ 4,50,000 (i.e. \$10,000 × ₹ 45).

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US \$10,000 on 31.3.2010 will be reported at ₹ 4,40,000 (i.e. \$10,000 × ₹ 44) and exchange profit of ₹ 10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2009-10.

On 7.7.2010, creditor of \$10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2010-11.

2. (a) Loss to be borne by Equity and Preference Shareholders

	₹
Profit and loss account (debit balance)	7,00,000
Goodwill	3,00,000
Plant & Machinery	3,00,000
Debtors	3,50,000
Amount to be written off	16,50,000
Less: 50% of Creditors	(3,50,000)
Recorded loss borne by the share holders	13,00,000
Add: Arrears of preference dividend of 2 years forgone by the preference shareholders	<u>1,40,000</u>
Total sacrifice by the shareholders of Weak Ltd.	<u>14,40,000</u>

(b)

	₹	₹
Total recorded loss of ₹13,00,000		
Preference shareholders' share of loss = 20% of ₹ 10,00,000	2,00,000	
Add: Arrears of preference dividend	<u>1,40,000</u>	3,40,000
Equity shareholders' share of loss (₹13,00,000 – ₹ 2,00,000) being more than 51% of equity share capital		<u>11,00,000</u>
		<u>14,40,000</u>

(c) New structure of share capital after reorganisation

Equity shares:	₹
20,000 equity shares of ₹45 each, fully paid up (₹ 20,00,000 – ₹11,00,000)	9,00,000
Preference shares:	
10,000, 9% preference shares of ₹80 each, fully paid up (₹ 10,00,000 – ₹ 2,00,000)	<u>8,00,000</u>
	<u>17,00,000</u>

(d) Working capital of the reorganized company

Current Assets:	₹	₹
Stock		3,00,000
Debtors		4,00,000
Cash		<u>1,50,000</u>
		8,50,000
Less: Current liabilities:		
Creditors	3,50,000	
Bank overdraft **	<u>75,000</u>	<u>4,25,000</u>
Working capital		<u>4,25,000</u>

**(e) Balance Sheet of Sumit Ltd. (and reduced)
as on 31st March, 2011**

Liabilities	₹	Assets	₹
Authorised, issued and paid up share capital		Fixed Assets	
20,000 equity shares of ₹45 each	9,00,000	Plant and Machinery	15,00,000
10,000, 9% preference shares of ₹80 each	8,00,000	Current Assets	
Unsecured loan		Stock	3,00,000
Term loan with Bank	2,25,000	Debtors	4,00,000
Current liabilities		Cash	1,50,000
Bank overdraft	75,000		
Creditors	<u>3,50,000</u>		
	<u>23,50,000</u>		<u>23,50,000</u>

** Current ratio shall be 2 : 1, i.e. total current liabilities shall be 50% of ₹8,50,000 (i.e. ₹3,00,000 + 4,00,000 + 1,50,000) = ₹4,25,000. Therefore, Bank overdraft = ₹75,000 (₹4,25,000 less creditors ₹3,50,000).

3. Realization Account as on 31.3.2011

Dr.				Cr.			
2011		₹	₹	2011		₹	₹
March 31	To Sundry assets:			March 31	By Provision for bad and doubtful debts		500
	Furniture and fixture	4,000			By Sundry creditors		15,500
	Trade mark	7,000			By Cash:		
	Debtors	16,000			Furniture and fixtures	1,000	
	Stock in trade	<u>10,000</u>	37,000		Trade mark	4,000	
					Debtors	11,000	
	To Cash (payment to creditors)		15,500		Stock in trade	8,000	
	To Cash (liability for bills discounted)		2,500		Surrender value of joint life policy	<u>3,000</u>	27,000
					By Partners' capital accounts: (loss on realisation)		
					A	3,600	
					B	3,600	
					C	2,400	
					D	<u>2,400</u>	<u>12,000</u>
			<u>55,000</u>				<u>55,000</u>

Cash Account

Dr.				Cr.		
2011		₹	2011		₹	
March 31	To Balance b/d	2,000	March 31	By Realisation A/c	15,500	
	To Realisation A/c	27,000		By Realisation A/c	2,500	
	To C's capital A/c	3,700		By A's loan A/c	10,000	
	To D's capital	8,400		By A's capital A/c	7,619	
				By B's capital A/c	<u>5,481</u>	
		<u>41,100</u>			<u>41,100</u>	

Partners' Capital Accounts

Dr.						Cr.					
		A	B	C	D			A	B	C	D
2011		₹	₹	₹	₹	2011		₹	₹	₹	₹
March 31	To Balance b/d	-	-	16,000	6,000	March 31	By Balance A/c	20,000	15,000		
	To Realisation A/c (loss)	3,600	3,600	2,400	2,400		By Cash A/c	-	-	3,700	8,400
	To C's Capital A/c (Loss of capital written off)	8,400	6,300	-	-		By A's Capital A/c	-	-	8,400	-
	To B's capital A/c (commission)	381	-	-	-		By B's Capital A/c	-	-	6,300	-
	To Cash A/c	7,619	5,481				By A's Capital A/c (commission)	-	381	-	-
		<u>20,000</u>	<u>15,381</u>	<u>18,400</u>	<u>8,400</u>			<u>20,000</u>	<u>15,381</u>	<u>18,400</u>	<u>8,400</u>

Working Notes:

- (1) There was a debit balance of ₹ 8,400 in D's capital account and D is a solvent partner, therefore he must bring cash for balance capital.
- (2) 'C' is insolvent therefore he is not able to bring cash. The deficiency in his account is borne by 'A' and 'B' in the ratio of 4:3 (capital ratio).
 Deficiency in 'C's account = ₹ 16,000 + ₹ 2,400 - ₹ 3,700 = ₹ 14,700
 Borne by A = $\frac{4}{7} \times ₹ 14,700 = ₹ 8,400$
 Borne by B = $\frac{3}{7} \times ₹ 14,700 = ₹ 6,300$
- (3) 'B' is entitled to get 5% commission on the amount finally paid to partner 'A' only. The calculation is as follows: $(₹ 20,000 - ₹ 3,600 - ₹ 8,400) \times \frac{5}{105} = ₹ 381$.
- (4) Mr. A's loan is paid off in cash.

**4. Income and Expenditure Account of Aman club
for the year ended 31st March, 2011**

<i>Expenditure</i>	<i>Amount (₹)</i>	<i>Income</i>	<i>Amount (₹)</i>
To Salaries (W.N.8)	1,28,000	By Subscriptions (W.N.2)	1,94,750
To Printing and stationery	70,000	By Entrance donation (W.N.3)	90,000
To Postage	40,000	By Interest (W.N.4)	60,000
To Telephone & fax	52,000	By Miscellaneous income	9,000
To Repairs and maintenance	48,000	By Profit from operations (W.N.6)	92,000
To Glass and table linen	12,000	By Excess of expenditure over income transferred to capital fund (deficit)	30,250
To Crockery and cutlery	14,000		
To Garden upkeep	8,000		
To Membership fee	4,000		
To Insurance (W.N.5)	6,000		
To Electricity charges (W.N.8)	43,000		
To Loss on sale of assets (10,000 – 8,000)	2,000		
To Depreciation (W.N.9)	<u>49,000</u>		
	<u>4,76,000</u>		<u>4,76,000</u>

Balance Sheet of Nanoo Club as on 31st March, 2011

<i>Liabilities</i>	<i>Amount (₹)</i>	<i>Assets</i>	<i>Amount (₹)</i>
Capital fund(W.N.10)	10,89,600	Fixed assets (W.N.9)	4,41,000
Gratuity fund	1,50,000	Stock	2,10,000
Sundry creditors (W.N.7)	92,000	Investments in 12% Government securities	5,00,000
Subscription received in advance	18,000	Subscription outstanding	7,000
Entrance donation refundable	20,000	Interest accrued (W.N.4)	2,000
Outstanding salary	8,000	Bank	2,24,600
Outstanding electricity charges	15,000	Cash	<u>8,000</u>
	<u>13,92,600</u>		<u>13,92,600</u>

Working Notes:

(1)

Opening Balance Sheet**as on 1st April, 2010**

<i>Liabilities</i>	<i>Amount (₹)</i>	<i>Assets</i>	<i>Amount (₹)</i>
Capital fund (Bal.Fig.)	10,29,850	Fixed assets	5,00,000
Sundry creditors	1,12,000	Stock	3,80,000
Subscription received in advance	15,000	Investment in 12% Government securities	5,00,000
Entrance donation received in advance (pending membership)	1,00,000	Subscription outstanding	12,000
Gratuity fund	1,50,000	Prepaid insurance	1,000
		Cash	10,000
		Bank	<u>3,850</u>
	<u>14,06,850</u>		<u>14,06,850</u>

(2) Subscription	₹
Subscription received during the year	2,02,750
Add: Outstanding subscription on 31.3.2011	7,000
Add: Received in advance as on 1.4.2010	<u>15,000</u>
	2,24,750
Less: Outstanding subscription as on 1.4.2010	(12,000)
Less: Received in advance as on 31.3.2011	<u>(18,000)</u>
	<u>1,94,750</u>
(3) Entrance Donation	₹
Entrance Donation received during the year	1,00,000
Add: Received in Advance as on 1.4.2010	<u>1,00,000</u>
	2,00,000
Less: Refundable to Ineligible Member	<u>20,000</u>
	1,80,000
Less: 50% Capitalized	<u>90,000</u>
	<u>90,000</u>

(4)	Interest received		₹
	Interest on ₹ 5,00,000 @ 12% p.a.		60,000
	Less: Interest received during the year		<u>58,000</u>
	Interest accrued as on 31.3.2011		<u>2,000</u>
	Interest credited to Income and Expenditure A/c		<u>60,000</u>
(5)	Insurance		₹
	Insurance paid during the year		5,000
	Add: Prepaid Insurance as on 1.4.2010		<u>1,000</u>
			<u>6,000</u>
(6)	Profit from Operations		₹
	<u>Cost of Goods sold</u>		
	Opening Stock as on 1.4.2010		3,80,000
	Add: Purchases		<u>15,00,000</u>
			18,80,000
	Less: Closing Stock		<u>2,10,000</u>
	Cost of Goods Sold (A)		<u>16,70,000</u>
	<u>Receipts from operations</u>		
	Receipts from Coffee Room		10,70,000
	Receipts from Wines & Sprits		5,10,000
	Receipts from Swimming Pool		80,000
	Receipts from Tennis Court		<u>1,02,000</u>
	Total of Receipts (B)		<u>17,62,000</u>
	Profit from Operations (B-A)		<u>92,000</u>
(7)	Sundry Creditors		₹
	Opening Balance as on 1.4.2010		1,12,000
	Add: Purchases made during the year		<u>15,00,000</u>
			16,12,000
	Less: Payment made during the year		<u>15,20,000</u>
	Closing Balance as on 31.3.2011		<u>92,000</u>
(8)	(a) Salary		₹
	Salary paid as on 31.3.2011	1,20,000	
	Add: Outstanding Salary as on 31.3.2011	<u>8,000</u>	<u>1,28,000</u>

(b)	Electricity charges	28,000	
Add:	Outstanding Electricity charges as on 31.3.2011	<u>15,000</u>	<u>43,000</u>
(9)	Fixed Assets		
	Fixed Assets as per Trial Balance		5,00,000
	Less: W.D.V. of Assets sold		<u>10,000</u>
			4,90,000
	Less: Depreciation @ 10% on ₹ 4,90,000		<u>49,000</u>
	Fixed Assets as on 31.3.2011		<u>4,41,000</u>
(10)	Capital fund		₹
	Capital fund as on 31.3.2010		10,29,850
	Add: Entrance donation capitalized		<u>90,000</u>
			11,19,850
	Less: Deficit		<u>30,250</u>
			<u>10,89,600</u>

5. (a)

Form B – RA (Prescribed by IRDA)

Name of the Insurer:

Agni Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA:

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Revenue Account for the year ended 31st March, 2011

	Particulars	Schedule	Current year ended on 31 st March, 2011 ₹
1.	Premiums earned (Net)	1	<u>8,40,000</u>
	Total (A)		<u>8,40,000</u>
1.	Claims incurred (Net)	3	8,00,000
2.	Commission		50,000
3.	Operating Expenses	4	<u>3,00,000</u>
	Total (B)		<u>11,50,000</u>
	Operating Profit/(Loss) from Fire Insurance Business [C =(A - B)]		(3,10,000)

Schedule 1**Premiums earned (Net)**

	₹
Premium received	15,00,000
Less: Premium on re-insurance paid	<u>1,00,000</u>
	14,00,000
Change in provision for unexpired risk (NIL-5,60,000)	<u>(5,60,000)</u>
Net Premium	<u>8,40,000</u>

Schedule 2

Reserve for unexpired risk @ 40% on net premium ₹ 14,00,000 $\times \frac{40}{100} = ₹ 5,60,000$

Schedule 3**Claims**

	₹
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2011	<u>1,00,000</u>
	<u>8,00,000</u>

Schedule 4**Operating expenses**

₹

Expenses of Management 3,00,000

(b)**Uncertain Bank Ltd.****Journal Entries**

		(Rupees in crores)	
		Dr. ₹	Cr. ₹
Rebate on bills discounted A/c	Dr.	9.00	
To Discount on bills A/c			9.00
(Being the transfer of opening balance in rebate on bills discounted account to discount on bills account)			
Bills purchased and discounted A/c	Dr.	4000.00	
To Discount on bills A/c			144.00
₹ 4,000 crores $\times \frac{18}{100} = \frac{73}{365}$			

To Clients A/c (Being the discounting of bills of exchange during the year)			3,856.00
Discount on bills A/c	Dr.	10.80	
To Rebate on bills discounted A/c (Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)			10.80
Discount on bills A/c	Dr.	142.20	
To Profit and loss A/c (Being the amount of income for the year from discounting of bills of exchange transferred to Profit and Loss A/c)			142.20

Ledger Accounts

(i) Discount on bills A/c

2011		₹	2010		₹
March 31	To Rebate on bills discounted A/c	10.80	April 1	By Rebate on bills discounted A/c	9.00
	To Profit and loss A/c	142.20	2010-11	By Bills purchased and discounted A/c	<u>144.00</u>
		<u>153.00</u>			<u>153.00</u>

(ii) Rebate on bills discounted A/c

2010		₹	2010		₹
April 1	To Discount on bills A/c	9.00	April 1	By Balance b/d	9.00
2011			2011		
March 31	To Balance c/d	<u>10.80</u>	March 31	By Discount on bills A/c	<u>10.80</u>
		<u>19.80</u>			<u>19.80</u>

6. (a) Liquidator's Final Statement of Account

	₹		₹
To Cash in hand	7,50,000	By Liquidator's remuneration (2% on 2,65,000*)	5,300
To Cash / bank (Amount received on call for 7,000 equity shares @ ₹ 6.53 per share)	45,710	By Preferential creditors	35,000
		By Unsecured creditors	2,30,000
		By Preference shareholders	5,00,000

* 35,000 + 2,30,000 = 2,65,000

		By Equity shareholders (Amount paid to holders of 3,000 equity shares @ ₹ 8.47 per equity share)	<u>25,410</u>
	<u>7,95,710</u>		<u>7,95,710</u>

Working Note:

Calculation of amount receivable from equity shareholders or payable to equity shareholders

	₹	₹
Cash in hand (Assets realized)		7,50,000
Less: Payments made:		
Liquidator's remuneration	5,300	
Preference creditors	35,000	
Unsecured creditors	2,30,000	
Preference shareholders	<u>5,00,000</u>	<u>7,70,300</u>
		20,300
Add: Amount payable to equity shareholders (paid up):		
3,000 equity share of ₹ 100 each ₹ 75 paid up	2,25,000	
7,000 equity share of ₹ 100 each ₹ 60 paid up	<u>4,20,000</u>	<u>6,45,000</u>
Total loss to be borne by equity shareholders		<u>6,65,300</u>
No. of equity shares		10,000 shares
Loss per equity share $\frac{6,65,300}{10,000} = ₹ 66.53$		
Amount receivable from 7,000 equity shareholders = 7,000 x 6.53 (i.e. 66.53 – 60) = ₹ 45,710		
Amount payable to 3,000 equity shareholders = 3,000 x 8.47 (i.e. 75 – 66.53) = ₹ 25,410		

(b)

In the books of Mr. Mohan
8% Bond Account

Date	Particulars	Nominal Value ₹	Income ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Income ₹	Cost ₹
2010 April 1	To Bank A/c (W.N.1)	12,00,000	40,000	9,26,000	2010 May 1	By Bank A/c (W.N.2)	--	48,000	---
2011 Mar. 31	To Profit & Loss A/c : Int. income		84,000		Oct. 1	By Bank A/c (W.N.4)	3,00,000	10,000	2,43,000
	Profit on Sale			11,500	Nov. 1	By Bank A/c (W.N.5)	---	36,000	---
		<u>12,00,000</u>	<u>1,24,000</u>	<u>9,37,500</u>	Mar. 31	By Balance c/d (W.N.7 & 8)	<u>9,00,000</u>	<u>30,000</u>	<u>6,94,500</u>
							<u>12,00,000</u>	<u>1,24,000</u>	<u>9,37,500</u>

Equity Shares in X Ltd.

	Particulars	Nominal Value ₹	Income ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Income ₹	Cost ₹
2010 April 12	To Bank A/c	10,00,000	-	40,00,000	2010 May 15	By Bank A/c	12,50,000	---	25,00,000
May 15	To Bonus Issue A/c (W.N.3)	15,00,000	---	---	Dec. 1	By Bank (Dividend) (W.N.6)	----	2,25,000	----
2011 Mar. 31	To Profit & Loss A/c: Dividend	---	2,25,000	----	2011 Mar. 31	By Balance c/d (W.N.9)	12,50,000	----	20,00,000
	Profit on Sale (W.N.10)	----	----	5,00,000					
		<u>25,00,000</u>	<u>2,25,000</u>	<u>45,00,000</u>			<u>25,00,000</u>	<u>2,25,000</u>	<u>45,00,000</u>

Working Notes:

1. Cum interest purchased cost of 8% Bond = $\frac{₹12,00,000}{100} \times 80.50 = ₹9,66,000$
 Less: Interest portion $\frac{₹12,00,000}{100} \times 8\% \times \frac{5}{12} = ₹40,000$
 Ex-interest cost ₹9,26,000
2. Half yearly interest on 8% bond as on 1st May, 2010
 = ₹12,00,000 x 8% x 6/12 = ₹48,000
3. Bonus issue of equity shares of X Ltd. = 1,00,000/2 x 3 x 10 = ₹15,00,000
4. Sales value = 3,00,000/100 x 81 = ₹2,43,000
5. Half yearly interest on 8% bond as on 1st November, 2010
 = (12,00,000 - 3,00,000) x 8% x 6/12 = ₹36,000
6. Dividend on equity shares of X Ltd.
 = (10,00,000 + 15,00,000 - 12,50,000) x 18% = ₹2,25,000
7. Accrued interest = 9,00,000 x 8% x 5/12 = 30,000
8. Closing balance of 8% bond 9,26,000/12,00,000 x 9,00,000 = 6,94,500
9. Closing balance of equity shares of X Ltd.
 [40,00,000/(10,00,000+15,00,000)] x 12,50,000 = ₹20,00,000
10. Profit on sale of equity shares of X Ltd.
 Sales value ₹25,00,000
 Less: Cost [40,00,000/(10,00,000+15,00,000)] x 12,50,000 ₹20,00,000
₹5,00,000

7. (a) (i) Amount of foreseeable loss (₹ in lakhs)

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

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

		(₹ in lakhs)
(ii)	Contract work-in-progress i.e. cost incurred to date are ₹605 lakhs	
	Work certified	500
	Work not certified	<u>105</u>
		<u>605</u>
	This is 55% $(605/1,100 \times 100)$ of total costs of construction.	

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

$$55\% \text{ of ₹1,000 lakhs} = ₹550 \text{ lakhs}$$

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

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

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

$$\text{Amount due to customers} = ₹35 \text{ lakhs}$$

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

- (b) The proposals will be evaluated and vendor will be selected considering the following criteria:
1. Quantum of services provided and whether the same matches with the requirements of the hospital.
 2. Reputation and background of the vendor.
 3. Comparative costs of the various propositions.
 4. Organizational set up of the vendor particularly technical staffing to obtain services without inordinate delay.
 5. Assurance of quality, confidentiality and secrecy.
 6. Data storage and processing facilities.
- (c) As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment^{*} amounts to at least substantially all of the fair value of leased asset. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not

^{*} In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

transferred. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor ₹ 3.36 lakhs (approx.)
(Year 1 to Year 5 Flows ₹ 3 lakhs each year)

Present Value of minimum lease payments ₹ 10.08 lakhs (approx.)

Thus present value of minimum lease payments is ₹ 10.08 lakhs and the fair value of the machine is ₹ 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

(d) In the books of N Co. Ltd.

Journal Entries

			₹	₹
1.10.2010	Employee compensation expense A/c Dr.	14,00,000		
	To Employee stock option outstanding A/c			14,00,000
	(Being the grant of 20,000 stock options to employees at ₹ 50 when market price is ₹ 120)			
10.12.10	Bank A/c Dr.	8,00,000		
to	Employee stock option outstanding A/c Dr.	11,20,000		
31.3.11	To Equity share capital A/c			1,60,000
	To Securities premium A/c			17,60,000
	(Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)			
31.3.11	Employee stock option outstanding A/c Dr.	2,80,000		
	To Employee compensation expense A/c			2,80,000
	(Being reverse entry passed for lapse of 4,000 stock options)			

31.3.11	Profit and Loss A/c	Dr.	11,20,000	
	To Employee compensation expense A/c			11,20,000
	(Being transfer of employee compensation transferred to Profit and Loss Account)			

- (e) As per AS 26 'Intangible Assets', the condition for recognition of a research and development asset has to be fulfilled when the expenditure was incurred. If the recognition conditions are not fulfilled the amount has to be charged to the profit and loss account. Once the amount is charged to the Profit and Loss account, such amount cannot be restated later as a Research and Development Asset when the condition for recognition get fulfilled. The Company therefore cannot capitalize ₹ 75,00,000 even as a prior period item.