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PAPER – 5: ADVANCED ACCOUNTING

Question No. 1 is compulsory

Answer any five questions from the remaining six questions.

Wherever necessary, suitable assumption(s) may be made by the candidates.

Working notes should form part of the answer.

Question 1

Answer the following questions:

- (a) *A loan account remains out of order as on the date of Balance Sheet of a Bank. The account has been classified as doubtful assets (upto 1 year).*

Details of the accounts are :

<i>Outstanding</i>	<i>₹ 6,73,000</i>
<i>ECGC coverage</i>	<i>25% (Limited to ₹ 1,00,000)</i>
<i>Value of security held</i>	<i>₹ 1,50,000</i>

Compute the necessary provision to be made by a Bank as per applicable rates.

- (b) *ABC Ltd. came up with public issue of 3,00,000 Equity Shares of ₹ 10 each at ₹ 15 per share. P, Q and R took underwriting of the issue in ratio of 3 : 2: 1 with the provisions of firm underwriting of 20,000, 14,000 and 10,000 shares respectively.*

Applications were received for 2,40,000 shares excluding firm underwriting. The marked applications from public were received as under:

P - 60,000

Q - 50,000

R - 60,000

Compute the liability of each underwriter as regards the number of shares to be taken up assuming that the benefit of firm underwriting is not given to individual underwriters.

- (c) *A company acquired for its internal use a software costing ₹ 10 lakhs* on 28.01.2012 from the USA for US \$ 1,00,000. The exchange rate on that date was ₹ 52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:*

(i) Import Duty : 20%

(ii) Purchase Tax : 10%

(iii) Entry Tax : 5 % (Recoverable later from tax department)

** The first sentence of this question should be read as "A company acquired for its internal use a software on 28.01.2012 from the USA for US \$ 1,00,000."*

(iv) Installation expenses : ₹ 25,000

(v) Profession fees for Clearance from Customs : ₹ 20,000

Compute the cost of Software to be capitalized.

(d) Give Journal Entries in the books of Head Office to rectify or adjust the following:

(i) Goods sent to Branch ₹ 12,000 stolen during transit. Branch manager refused to accept any liability.

(ii) Branch paid ₹ 15,000 as salary to the officer of Head Office on his visit to the branch.

(iii) On 28th March, 2012, the H.O. dispatched goods to the Branch invoiced at ₹ 25,000 which was not received by Branch till 31st March, 2012.

(iv) A remittance of ₹ 10,000 sent by the branch on 30th March, 2012, received by the Head Office on 1st April, 2012.

(v) Head Office made payment of ₹ 25,000 for purchase of goods by Branch and wrongly debited its own purchase account. (4 × 5 = 20 Marks)

Answer

(a)

	₹
Doubtful Assets (upto 1 year)	6,73,000
Less: Value of security (excluding ECGC cover)	<u>(1,50,000)</u>
	5,23,000
Less: ECGC coverage (limited to ₹ 1,00,000)	<u>(1,00,000)</u>
Unsecured portion	<u>4,23,000</u>
Provision:	
for unsecured portion @100% on ₹ 4,23,000	4,23,000
for secured portion @ 25% on ₹ 1,50,000	<u>37,500</u>
Total provision to be made in the books of the bank	<u>4,60,500</u>

(b) Calculation of liability of each underwriter (in shares) assuming that the benefit of firm underwriting is not given to individual underwriters

(Number of shares)

	P	Q	R	Total
Gross Liability	1,50,000	1,00,000	50,000	3,00,000
Less: Marked applications				

(excluding firm underwriting)	(60,000)	(50,000)	(60,000)	(1,70,000)
Balance	90,000	50,000	(10,000)	1,30,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(6,000)	(4,000)	10,000	-
Balance	84,000	46,000	-	1,30,000
Less: Unmarked applications including firm underwriting (Refer W.N.)	(57,000)	(38,000)	(19,000)	(1,14,000)
Net Liability	27,000	8,000	(19,000)	16,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(11,400)	(7,600)	19,000	-
	15,600	400	-	16,000
Add: Firm underwriting	20,000	14,000	10,000	44,000
Total Liability	35,600	14,400	10,000	60,000

Working Note:

Applications received from public	2,40,000 shares
Add: Shares underwritten firm (20,000 + 14,000 + 10,000)	44,000 shares
Total applications	2,84,000 shares
Less: Marked applications (60,000 + 50,000 + 60,000)	(1,70,000 shares)
Unmarked applications including firm underwriting	1,14,000 shares

(c) Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	\$ 1,00,000
Less: Trade discount @ 5%	<u>(\$ 5,000)</u>
	<u>\$ 95,000</u>
Cost in ₹ (US \$ 95,000 x ₹ 52)	49,40,000
Add: Import duty on cost @ 20% (₹)	<u>9,88,000</u>

	59,28,000
Purchase tax @ 10% (₹)	5,92,800
Installation expenses (₹)	25,000
Profession fee for clearance from customs (₹)	<u>20,000</u>
Cost of the software to be capitalised (₹)	<u>65,65,800</u>

Note: Since entry tax has been mentioned as a recoverable / refundable tax, it is not included as part of the cost of the asset.

(d) In the books of Head Office

Journal Entries

	Particulars	Dr. Amount ₹	Cr. Amount ₹
(i)	Loss of goods due to theft during transit Dr. To Purchases account (Being goods lost on account of theft during transit)	12,000	12,000
(ii)	Salaries account Dr. To Branch account (Being salary paid by the branch for H.O. employee)	15,000	15,000
(iii)	No entry in the books of head office for goods sent to branch not received by branch till 31 st March 2012		
(iv)	Cash in transit account Dr. To Branch account (Being remittance by branch not received by 31 st March, 2012)	10,000	10,000
(v)	Branch account Dr. To Purchases account (Being rectification of entry for payment for goods purchased by branch wrongly debited to purchase account)	25,000	25,000

Note: In entry (i), it is assumed that refusal of branch manager (to accept liability of stolen goods) is accepted by the Head Office. Alternatively, Branch account will be credited on the basis of assumption that refusal of branch manager is not accepted by the Head Office.

Question 2

P, Q and R are partners sharing profits and losses in the ratio 3 : 2 : 1 after allowing interest on capital @ 9% p.a. Their Balance Sheet as at 31st March, 2012 are as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Plant & Machinery	1,08,000
P 50,000		Fixtures	20,000
Q 30,000		Stock	50,000
R <u>20,000</u>	1,00,000	Sundry Debtors	30,000
Reserve Fund	60,000		
Creditors	48,000		
	2,08,000		2,08,000

They applied for conversion of the firm into a Private Limited Company named PQR Pvt. Ltd. and the certificate was received on 01-04-2012. They decided to maintain same profit sharing ratio and to preserve the priority in regard to repayment of capital as far as possible. For that purpose, they decided to insert a clause of issuance of Preference shares in Memorandum of Association in addition to issuance of Equity shares of ₹10 each.

On 01-04-2012, the value of goodwill is to be determined on the basis of 2 years' purchase of the average profit from the business of the last 5 years. The particulars of profits are as under:

		₹
Year ended 31.03.2008	Profit	10,000
Year ended 31.03.2009	Loss	5,000
Year ended 31.03.2010	Profit	18,000
Year ended 31.03.2011	Profit	27,000
Year ended 31.03.2012	Profit	30,000

The loss for the year ended 31-03-2009 was on account of loss by strike to the extent of ₹10,000.

It was agreed that rest of the assets are valued on the basis of the Balance Sheet as at 31-03-2012 except Plant & Machinery which is valued at ₹1,02,000.

You are required to prepare (a) the Balance Sheet of the Company as at 01-04-2012, (b) Partners' Capital Accounts and (c) Statement showing the final settlement between the partners taking Q's capital as basis. (16 Marks)

Answer

(a) Balance Sheet of the PQR Pvt Ltd. as on 1-4-2012

	Note No.	₹
Equity and Liabilities		
<i>Shareholders funds</i>		
Share Capital	1	1,90,000
<i>Current liabilities</i>		
Trade Payables		<u>48,000</u>
Total		<u>2,38,000</u>
Assets		
<i>Non-current assets</i>		
Fixed Assets		
Tangible Assets	2	1,22,000
Intangible Assets	3	36,000
<i>Current assets</i>		
Inventories		50,000
Trade Receivables		<u>30,000</u>
Total		<u>2,38,000</u>

Notes to Accounts

	₹
1. Share Capital	
Equity share capital 18,000 fully paid shares of ₹ 10 each	1,80,000
Preference share capital (9% Preference Shares)	10,000
(All the shares have been issued for consideration other than cash)	<u> </u>
	<u>1,90,000</u>
2. Tangible assets	
Plant and Machinery	1,02,000
Fixtures	<u>20,000</u>
	<u>1,22,000</u>
3. Intangible asset	
Goodwill	36,000

(b) In the books of Partnership Firm

Partners' Capital Accounts

	P ₹	Q ₹	R ₹		P ₹	Q ₹	R ₹
To Plant and machinery A/c	3,000	2,000	1,000	By Balance b/d	50,000	30,000	20,000
To Equity shares in PQR Pvt. Ltd.	90,000	60,000	30,000	By Reserve fund	30,000	20,000	10,000
To 9% Preference shares in PQR Pvt. Ltd.	5,000		5,000	By Realization* A/c (Profit on sale of business)	18,000	12,000	6,000
	98,000	62,000	36,000		98,000	62,000	36,000

(c) Statement showing the final settlement between the Partners taking Q's capital as basis

	P ₹	Q ₹	R ₹	Total ₹
Value of Equity Shares to be allotted, taking Q's capital as basis P's Capital = $60,000 \times \frac{3}{2}$ R's Capital = $60,000 \times \frac{1}{2}$	90,000	60,000	30,000	
Total value of Equity Shares allotted to P, Q and R				1,80,000
9% Preference Shares to be allotted to P ₹ (95,000-90,000)	5,000			
9% Preference Shares to be allotted to R ₹ (35,000-30,000)			5,000	
Total Value of Preference Shares allotted to P and R				10,000
Total Purchase Consideration (W.N.2)				1,90,000

Taking Q's capital as basis, both P and R have ₹ 5,000 each as excess in their capital account balances. Since interest on capital is meant to compensate those whose capital is in excess of proportionate limits and since in the case of partners it is an appropriation of profit, it will be proper to give 9% preference shares to P and R for ₹ 5,000 each and the remaining amount of ₹ 1,80,000 in the form of Equity Shares to be divided among P, Q and R in the ratio 3:2:1. They will then share the company's profit in the ratio 3:2:1 after allowing preference dividend.

Note: The question requires that the profit sharing ratio should be maintained even after conversion of partnership firm into a company. Further, it also requires that priority in regard to repayment of capital should also be preserved. Therefore, it is also possible that 9% preference shares equivalent and proportionate to the capital balance of partners as on 31.3.2012 may be issued, so that such preference shares earn dividend equivalent to the interest on such capital @ 9%. Further, priority in regard to repayment of capital should be ensured to the extent of preference share capital and dividend thereon. Thereafter, to maintain the profit sharing ratio, equity share capital may be issued in the ratio of sharing profits and losses.

In that case, 1,00,000, 9% Preference shares will be issued to P, Q and R in the proportion of 5:3:2 and Equity shares will be issued to P, Q and R in the proportion of 3:2:1.

Working Notes:

1. Calculation of goodwill

	2007-08 ₹	2008-09 ₹	2009-10 ₹	2010-11 ₹	2011-12 ₹
Profits	10,000	(5,000)	18,000	27,000	30,000
Adjustment for abnormal loss in 2008-09	—	10,000	—	—	—
	10,000	5,000	18,000	27,000	30,000
Total Profit from 2007-08 to 2011-12					₹ 90,000
Average Profit (90,000 / 5)					18,000
Goodwill equal to 2 years' purchase					36,000

2. Computation of Purchase consideration

	₹
Assets:	
Goodwill	36,000
Plant and Machinery	1,02,000
Fixtures	20,000
Stock	50,000
Sundry Debtors	<u>30,000</u>
	2,38,000
Less: Liabilities:	
Creditors	<u>48,000</u>
Purchase Consideration	<u>1,90,000</u>

Question 3

(a) M Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2012 :

	₹ in '000	₹ in '000
<i>Equity & Liabilities</i>		
<i>Share Capital:</i>		
<i>Authorised Capital:</i>		5,000
<i>Issued and Subscribed Capital :</i>		
3,00,000 Equity shares of ₹ 10 each fully paid up	3,000	
20,000 9% Preference Shares of 100 each (issued two months back for the purpose of buy back)	2,000	5,000
<i>Reserve and Surplus:</i>		
Capital reserve	10	
Revenue reserve	4,000	
Securities premium	500	
Profit and Loss account	1,800	6,310
<i>Non-current liabilities - 10% Debentures</i>		400
<i>Current liabilities and provisions</i>		40
		11,750
<i>Assets</i>		
<i>Fixed Assets: Cost</i>	3,000	
<i>Less: Provision for depreciation</i>	250	2,750
<i>Non-current investments at cost</i>		5,000
<i>Current assets, loans and advances (including cash and bank balances)</i>		4,000
		11,750

- (1) The company passed a resolution to buy back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs.
- (2) The company redeemed the preference shares at a premium of 10% on 1st April, 2012.

- (3) Included in its investments were 'Investments in own debentures' costing ₹ 3 lakhs (face value ₹ 3.30 lakhs). These debentures were cancelled on 1st April, 2012.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2012. (12 Marks)

- (b) Define the term Finance Lease. State any three situations when a lease would be classified as finance lease. (4 Marks)

Answer

(a) In the books of M Ltd.

Journal Entries

			Dr.	Cr.
			₹ in '000	₹ in '000
1	Bank A/c Dr. Profit and Loss A/c Dr. To Investment A/c (Being investment sold for the purpose of buy-back)		2,500 500	3,000
2	Preference share capital A/c Dr. Premium on redemption of Preference Shares A/c Dr. To Preference shareholders A/c (Being redemption of preference share capital at premium of 10%)		2,000 200	2,200
3	Preference shareholders A/c Dr. To Bank A/c (Being payment made to preference shareholders)		2,200	2,200
4	Revenue Reserve A/c Dr. To Capital redemption reserve A/c (Refer Note) (Being creation of capital redemption reserve to the extent of nominal value of preference shares redeemed)		2,000	2,000
5	Equity share capital A/c Dr. Securities Premium A/c (Premium payable on buy-back) Dr. To Equity shares buy-back A/c (Being the amount due on buy-back)		600 300	900

6	Equity shares buy-back A/c To Bank A/c (Being payment made for buy-back)	Dr.	900	900
7	10% Debentures A/c To Own debentures A/c To Capital reserve A/c (Profit on cancellation) (Being own debentures cancelled at profit)	Dr.	330	300 30
8.	Securities Premium A/c To Premium on redemption of preference shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	Dr.	200	200

Balance Sheet of the M Ltd. as on 1st April, 2012

	Notes No.	₹ in '000
Equity and Liabilities		
1 Shareholders funds		
Share capital	1	2,400
Reserves and Surplus	2	5,340
2 Non-current liabilities		
Long term borrowings	3	70
3 Current liabilities		<u>40</u>
Total		<u>7,850</u>
Assets		
1 Non-current assets		
(a) Fixed assets		2,750
(b) Non-current investments	4	1,700
2 Current assets	5	<u>3,400</u>
Total		<u>7,850</u>

Notes to Accounts

		₹ in '000	₹ in '000
1.	Share Capital		
	Authorised share capital:		<u>5,000</u>

	Issued, subscribed and fully paid up share capital:			
	2,40,000 Equity shares of ₹ 10 each, fully paid up (60,000 equity shares had been bought back and cancelled during the year)			2,400
2.	Reserves and Surplus			
	Capital Reserves	10		
	Add: Profit on cancellation of debentures	<u>30</u>	40	
	Securities Premium	500		
	Less: Premium on redemption of preference shares	(200)		
	Premium on buy-back of equity shares	<u>(300)</u>	-	
	Revenue Reserve	4,000		
	Less: Transfer to Capital Redemption Reserve	<u>(2,000)</u>	2,000	
	Capital Redemption reserve		2,000	
	Surplus (Profit & Loss Account)	1,800		
	Less: Loss on sale of investment	<u>(500)</u>	<u>1,300</u>	5,340
3.	Long term borrowings			
	10% Debentures (400 - 330)			70
4.	Non-current investments			
	Balance as on 31.03.2012		5,000	
	Less: Investment sold		(3,000)	
	Own debentures cancelled		<u>(300)</u>	1,700
5	Current assets			
	Balance as on 31.03.2012		4,000	
	Add: Cash received on sale of investment		2,500	
	Less: Payment made to equity shareholders for buy back of shares		(900)	
	Payment made to preference shareholders		<u>(2,200)</u>	<u>3,400</u>

Note: In the given solution, it is assumed that buy-back of shares has been done out of the proceeds of issue of preference shares, therefore, no amount is transferred to capital redemption reserve for buy-back. However, if it is assumed that buy-back is from sale of investments and not from the proceeds of issue of preference shares, then, amount of revenue reserves transferred to capital redemption reserve will be ₹ 2,600 instead of ₹ 2,000.

- (b) As per AS 19 'Leases', a finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

As per para 8 of the standard, classification of lease into a finance lease or an operating lease depends on the substance of the transaction rather than its form. Three situations which would normally lead to a lease being classified as a finance lease are:

- (a) the lessor transfers ownership of the asset to the lessee by the end of the lease term;
- (b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred.

Question 4

Following are the summarized Balance Sheet of Companies K Ltd. and W Ltd., as at 31-12-2011 :

Liabilities	(` in '000)		Assets	(` in '000)	
	K Ltd.	W Ltd.		K Ltd.	W Ltd.
Share Capital :			Goodwill	20	-
Equity shares of ₹100 each	2,000	1,500	Other Fixed Assets	2,400	1,150
10% Preference shares of ₹100 each	700	400	Debtors	625	615
General Reserve	240	170	Stock	412	680
Profit and Loss Account		15	Cash at bank	38	155
12% Debentures of ₹ 100 each	600	200	Own Debenture (Nominal value of ₹ 2,00,000)	192	
Sundry Creditors	560	315	Discount on issue of debentures	2	
			Profit and Loss Account	411	
	4,100	2,600		4,100	2,600

On 01-04-2012, K Ltd. adopted the following scheme of reconstruction:

- (i) Each equity share shall be sub-divided into 10 equity shares of ₹ 10 each fully paid up. 50% of the equity share capital would be surrendered to the company.

- (ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 80% of the dividend claim and accept payment for the balance.
- (iii) Own debentures of ₹ 80,000 (nominal value) were sold at ₹ 98 cum interest and remaining own debentures were cancelled.
- (iv) Debenture holders of ₹ 3,00,000 agreed to accept one machinery of book value of ₹ 3,20,000 in full settlement.
- (v) Creditors, Debtors and stock were valued at ₹ 5,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively. Goodwill, discount on issue of debentures and Profit and Loss account (Dr.) are to be written off.
- (vi) The company paid ₹ 20,000 as penalty to avoid capital commitments of ₹ 4,00,000.

On 02.04.2012, a scheme of absorption was adopted. K Ltd. would take over W Ltd. The purchase consideration was fixed as below:

- (a) Equity shareholders of W Ltd. will be given 50 equity shares of ₹ 10 each fully paid up, in exchange for every 5 shares held in W Ltd.
- (b) Issue of 10% preference shares of ₹ 100 each in the ratio of 4 preference shares of K Ltd. for every 5 preference shares held in W Ltd.
- (c) Issue of 12% debentures of ₹ 100 each of K Ltd. for every 12% debenture in W Ltd.

Pass necessary Journal entries in the books of K Ltd. and draw the resultant Balance Sheet as at 2nd April, 2012. (16 Marks)

Answer

In the books of K Ltd.

Journal Entries

Particulars	Dr. Amount ₹	Cr. Amount ₹
01.04.2012		
1. Equity share capital A/c Dr. To Equity share capital A/c (Being sub-division of one share of ₹ 100 each into 10 shares of ₹ 10 each)	20,00,000	20,00,000
2. Equity share capital A/c Dr. To Capital reduction A/c (Being reduction of capital by 50%)	10,00,000	10,00,000

3.	Capital reduction A/c	Dr.	42,000	
	To Bank A/c			42,000
	(Being payment in cash of 20% of arrears of 3 years' preference dividend)			
4.	Bank A/c	Dr.	78,400	
	To Own debentures A/c			76,800
	[(1,92,000/2,00,000) x 80,000]			
	To Capital reduction A/c			1,600
	(Being profit on sale of own debentures transferred to capital reduction A/c)			
5.	12% Debentures A/c	Dr.	1,20,000	
	To Own debentures A/c			1,15,200
	[(1,92,000/2,00,000) x 1,20,000]			
	To Capital reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			
6.	12% Debentures A/c	Dr.	3,00,000	
	Capital reduction A/c	Dr.	20,000	
	To Machinery A/c			3,20,000
	(Being machinery of ₹ 3,20,000 taken up by the debenture holders for ₹ 3,00,000)			
7.	Creditors A/c	Dr.	60,000	
	To Capital reduction A/c			60,000
	(Being liabilities revalued)			
8.	Capital reduction A/c	Dr.	10,04,400	
	To Debtors A/c			25,000
	To Stock A/c			12,000
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	To Bank A/c			20,000
	To Capital reserve A/c			5,14,400
	(Being assets revalued and losses written off and penalty paid off through capital reduction account and the balance of capital reduction account transferred to capital reserve account)			

02.04.2012		
9.	Business Purchase A/c To Liquidators of W Ltd. (Being the purchase consideration payable to W Ltd.)	Dr. 18,20,000 18,20,000
10.	Fixed assets A/c Stock A/c Debtors A/c Cash at bank A/c To Sundry creditors A/c To 12% Debentures A/c of W Ltd. To Profit and Loss A/c To General reserve A/c To Capital reserve A/c (W.N.2) To Business purchase A/c (Being the takeover of all assets and liabilities of W Ltd. by K Ltd.)	Dr. 11,50,000 Dr. 6,80,000 Dr. 6,15,000 Dr. 1,55,000 3,15,000 2,00,000 15,000 1,70,000 80,000 18,20,000
11.	Liquidators of W Ltd. A/c To Equity share capital A/c To 10% Preference share capital A/c (Being the purchase consideration discharged)	Dr. 18,20,000 15,00,000 3,20,000
12.	12% Debentures of W Ltd. A/c To 12% Debentures A/c (Being K Ltd. issued their 12% Debentures against 12% Debentures of W Ltd.)	Dr. 2,00,000 2,00,000

Balance Sheet of K Ltd. as on 2nd April, 2012

Particulars	Notes No.	Amount (₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	35,20,000
(b) Reserves and Surplus	2	10,19,400

(2) Non-Current Liabilities		
(a) Long-term borrowings	3	3,80,000
(3) Current Liabilities		
(a) Trade payables	4	8,15,000
Total		57,34,400
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	5	32,30,000
(2) Current assets		
(a) Inventories	6	10,80,000
(b) Trade receivables	7	12,15,000
(c) Cash and cash equivalents	8	2,09,400
Total		57,34,400

Notes to Accounts

			₹
1	Share Capital		
	Equity Share Capital	20,00,000	
	Less: Surrender 50% equity capital	(10,00,000)	
	Add: Equity share capital issued to W Ltd.	<u>15,00,000</u>	25,00,000
	10% Preference share capital	7,00,000	
	Add: Preference share capital issued to W Ltd.	<u>3,20,000</u>	<u>10,20,000</u>
			35,20,000
2.	Reserves and Surplus		
	Profit and Loss A/c	15,000	
	General Reserve (2,40,000 + 1,70,000)	4,10,000	
	Capital Reserve (5,14,400 + 80,000)	<u>5,94,400</u>	10,19,400
3.	Long-term borrowings		
	12% Debentures	6,00,000	
	Less: Settled in consideration of machinery	(3,00,000)	
	Less: Cancelled debentures	(1,20,000)	

	Add: 12% Debentures issue to W Ltd.	<u>2,00,000</u>	3,80,000
4.	Trade payables of K Ltd.	5,60,000	
	Less: Reduction due to revaluation	(60,000)	
	Add: Trade payables of W Ltd.	<u>3,15,000</u>	8,15,000
5.	Tangible assets		
	Balance of Other fixed assets	24,00,000	
	Less: Machinery taken up by debenture holders	(3,20,000)	
	Add: Other fixed assets of W Ltd.	<u>11,50,000</u>	32,30,000
6.	Inventories	4,12,000	
	Less: Reduction due to revaluation	(12,000)	
	Add: Inventories of W Ltd.	<u>6,80,000</u>	10,80,000
7.	Trade receivables	6,25,000	
	Less: Reduction due to revaluation	(25,000)	
	Add: Trade receivables of W Ltd.	<u>6,15,000</u>	12,15,000
8.	Cash and cash equivalents	38,000	
	Less: Payment of arrear of preference dividend	(42,000)	
	Add: Profit on sale of own debentures	78,400	
	Less: Penalty paid	(20,000)	
	Add: Cash and cash equivalents of W Ltd.	<u>1,55,000</u>	2,09,400

Working Notes:

1. Purchase Consideration	₹
Equity share capital [(15,000 x 50/5) x ₹ 10]	15,00,000
10% Preference share capital [(4,000 x 4/5) x ₹ 100] =	<u>3,20,000</u>
	<u>18,20,000</u>

2. Capital Reserve

	₹
Share Capital of W Ltd. (Equity + Preference)	19,00,000

Less: Share Capital issued by K Ltd.	(18,20,000)
Capital reserve	<u>80,000</u>

Note: In the question, summarised balance sheets of K Ltd. and W Ltd. as on 31.12.2011 are given. However, the internal reconstruction and amalgamation took place on 1.4.2012 and 2.4.2012 respectively. Since, no information have been provided for the intervening period of 3 months (i.e. from 1.1.2012 to 31.3.2012), the above solution is given assuming this date of summarised balance sheets as 31.3.2012 instead of 31.12.2011. Alternatively, the solution may be given on the basis of 31.12.2011. In that case, the only difference will be that dividend on preference shares and interest on debentures for period of 3 months (i.e. from 1.1.2012 to 31.3.2012) will be considered at the time of internal reconstruction.

Question 5

(a) The following figures are extracted from the books of KLM Bank Ltd. as on 31-03-2012 :

	₹
Interest and discount received	38,00,160
Interest paid on deposits	22,95,360
Issued and subscribed capital	10,00,000
Salaries and allowances	2,50,000
Directors Fees and allowances	35,000
Rent and taxes paid	1,00,000
Postage and telegrams	65,340
Statutory reserve fund	8,00,000
Commission, exchange and brokerage	1,90,000
Rent received	72,000
Profit on sale of investment	2,25,800
Depreciation on assets	40,000
Statutory expenses	38,000
Preliminary expenses	30,000
Auditor's fee	12,000

The following further information is given:

- (1) A customer to whom a sum of ₹ 10 lakhs was advanced has become insolvent and it is expected only 55% can be recovered from his estate.
- (2) There was also other debts for which a provisions of ₹ 2,00,000 was found necessary.

(3) Rebate on bill discounted on 31-03-2011 was ₹ 15,000 and on 31-03-2012 was ₹ 20,000.

(4) Income tax of ₹ 2,00,000 is to be provided.

The directors desire to declare 5% dividend.

Prepare the Profit and Loss account of KLM Bank Ltd. for the year ended 31-03-2012 and also show, how the Profit and Loss account will appear in the Balance Sheet if the Profit and Loss account opening balance was NIL as on 31-03-2011. (8 Marks)

(b) Prepare the Fire Insurance Revenue A/c of Jasmine Fire Insurance Co. Ltd. as per IRDA regulations for the year ended 31st March, 2012 from the following details:

Particulars	Amount (₹)
Claims Paid	5,00,000
Legal Expenses regarding claims	10,000
Premiums received	12,50,000
Re-insurance premium paid	50,000
Commission	3,00,000
Expenses of Management	2,00,000
Provision against unexpired risk as on 1 st April, 2011	5,75,000
Claims unpaid on 1st April, 2011	50,000
Claims unpaid on 31st March, 2012	80,000

Provide for unexpired risk @ 50% less reinsurance.

(8 Marks)

Answer

(a) KLM Bank Limited

Profit and Loss Account for the year ended 31st March, 2012

		Schedule	Year ended 31.03.2012
			₹
I.	Income:		
	Interest earned	13	37,95,160
	Other income	14	<u>4,87,800</u>
	Total		<u>42,82,960</u>
II.	Expenditure		
	Interest expended	15	22,95,360

	Operating expenses	16	5,70,340
	Provisions and contingencies (4,50,000+2,00,000+2,00,000)		<u>8,50,000</u>
	Total		<u>37,15,700</u>
III.	Profits/Losses		
	Net profit for the year		5,67,260
	Profit brought forward		<u>Nil</u>
			<u>5,67,260</u>
IV.	Appropriations		
	Transfer to statutory reserve (25% of 5,67,260)		1,41,815
	Proposed dividend		50,000
	Balance carried over to balance sheet		<u>3,75,445</u>
			<u>5,67,260</u>
Profit & Loss Account balance of ₹ 3,75,445 will appear under the head 'Reserves and Surplus' in Schedule 2 of the Balance Sheet.			
			Year ended 31.3.2012 ₹
	Schedule 13 – Interest Earned		
I.	Interest/discount on advances/bills (Refer W.N.)		<u>37,95,160</u>
			<u>37,95,160</u>
	Schedule 14 – Other Income		
I.	Commission, exchange and brokerage		1,90,000
II.	Profit on sale of investment		2,25,800
III.	Rent received		<u>72,000</u>
			<u>4,87,800</u>
	Schedule 15 – Interest Expended		
I.	Interests paid on deposits		<u>22,95,360</u>
			<u>22,95,360</u>
	Schedule 16 – Operating Expenses		
I.	Payment to and provisions for employees (salaries & allowances)		2,50,000
II.	Rent, taxes paid		1,00,000
III.	Depreciation on assets		40,000

IV.	Director's fee, allowances and expenses	35,000
V.	Auditor's fee	12,000
VI.	Statutory (law) expenses	38,000
VII.	Postage and telegrams	65,340
VIII.	Preliminary expenses*	<u>30,000</u>
		<u>5,70,340</u>

Working Note:

	₹
Interest and discount received	38,00,160
Add: Rebate on bills discounted on 31.3.2011	15,000
Less: Rebate on bills discounted on 31.3.2012	<u>(20,000)</u>
	<u>37,95,160</u>

(b)

FORM B - RA

Name of the Insurer: Jasmine Fire Insurance Co. Ltd.

Registration No. and Date of Registration with the IRDA:

Revenue Account for the year ended 31st March, 2012

	Particulars	Schedule	Amount (₹)
(1)	Premium earned	1	11,75,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		<u>11,75,000</u>
(4)	Claims incurred	2	5,40,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	<u>2,00,000</u>
	Total (B)		<u>10,40,000</u>
	Operating Profit (A)- (B)		<u>1,35,000</u>

Schedule 1 : Premium earned (net)	₹
Premium received	12,50,000
Less: Re-insurance premium	<u>(50,000)</u>

* It is assumed that preliminary expenses have been fully written off during the year.

Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	<u>(25,000)</u>
	<u>11,75,000</u>
Schedule 2 : Claims Incurred	₹
Claims paid including legal expenses (5,00,000 + 10,000)	5,10,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	<u>(50,000)</u>
Total claims incurred	<u>5,40,000</u>
Schedule 3 : Commission	₹
Commission paid	<u>3,00,000</u>
	<u>3,00,000</u>
Schedule 4: Operating expenses	₹
Expenses of management	<u>2,00,000</u>
	<u>2,00,000</u>

Working Note:

Change in the provision for unexpired risk	₹
Unexpired risk reserve on 31 st March, 2012 =50% of net premium (i.e. 50% of ₹ 12,00,000)	6,00,000
Less : Unexpired risk reserve as on 1 st April 2011	<u>(5,75,000)</u>
Change in the provision for unexpired risk	<u>25,000</u>

Question 6

- (a) *Himalayas Ltd. had ₹10,00,000, 8% Debentures of ₹100 each as on 31st March, 2011. The company purchased in the open market following debentures for immediate cancellation:*

On 01-07-2011 – 1,000 debentures @ ₹97 (cum interest)

On 29-02-2012 – 1,800 debentures @ ₹99 (ex interest)

Debenture interest due date is 30th September and 31st March.

Give Journal Entries in the books of the company for the year ended 31 t March, 2012.

(8 Marks)

- (b) *Department A sells goods to Department B at a profit of 20% on cost and Department C at 15% profit on cost. Department B sells goods to A and C at a profit of 10% and 20%*

on sales respectively. Department C sells goods to A and B at 15% and 10% profit on cost respectively.

Departmental managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission, but before adjustment of unrealized profit are as under:

	₹
Department A	36,000
Department B	27,000
Department C	18,000

Stock lying at different departments at the end of the year are as below:

	Department A	Department B	Department C
	₹	₹	₹
Transfer from Department A	-	7,200	5,750
Transfer from Department B	19,000	-	15,000
Transfer from Department C	4,600	3,300	-

Find out correct departmental profits after charging manager's commission. (8 Marks)

Answer

(a) In the books of Himalayas Ltd.

Journal Entries

Date	Particulars	Dr. ₹	Cr. ₹
1.07.2011	Own Debentures A/c Dr. Debenture Interest Account A/c Dr. [1,000×100×8%× (3/12)] To Bank A/c (Being 1,000 Debentures purchased @ ₹ 97 cum interest for immediate cancellation)	95,000 2,000	97,000
1.07.2011	8% Debentures A/c Dr. To Own Debentures A/c To Capital reserve A/c (Profit on cancellation of debentures) (Being profit on cancellation of 1,000 Debentures transferred to capital reserve account)	1,00,000	95,000 5,000

30.09.2011	Debenture interest A/c $[9,000 \times 100 \times 8\% \times (1/2)]$ To Debenture holders A/c (Being interest accrued on 9,000 debentures and credited to debenture holders account)	Dr.	36,000	36,000
	Debentureholders A/c To Bank A/c (Being interest amount paid)	Dr.	36,000	36,000
29.02.2012	Own Debentures A/c Debenture Interest Account A/c $[1,800 \times 100 \times 8\% \times (5/12)]$ To Bank A/c (Purchase of 1,800 Debentures @ ₹ 99 ex interest for immediate cancellation)	Dr. Dr.	1,78,200 6,000	1,84,200
29.02.2012	8% Debentures A/c To Own Debentures A/c To Capital reserve A/c (Profit on cancellation of debentures) (Being profit on cancellation of 1,800 Debentures transferred to capital reserve account)	Dr.	1,80,000	1,78,200 1,800
31.03.2012	Debentures Interest A/c $[7,200 \times 100 \times 8\% \times (1/2)]$ To Debentureholders A/c (Being interest accrued on 7,200 debentures and credited to debenture holders account)	Dr.	28,800	28,800
31.3.2012	Debentureholders A/c To Bank A/c (Being amount paid)	Dr.	28,800	28,800
31.03.2012	Profit and Loss A/c To Debentures Interest A/c (Being interest on debentures for the year transferred to profit and loss account at the year end)	Dr.	72,800	72,800

(b) Calculation of correct Departmental Profit

	Department A	Department B	Department C
	₹	₹	₹
Profit after charging managers' commission but before adjustment for unrealized profit	36,000	27,000	18,000
Add back : Managers' commission (1/9)	<u>4,000</u>	<u>3,000</u>	<u>2,000</u>
	40,000	30,000	20,000
Less: Unrealised profit on stock (Working Note)	<u>(1,950)</u>	<u>(4,900)</u>	<u>(900)</u>
Profit before Manager's commission	38,050	25,100	19,100
Less: Commission for Department Manager @10%	<u>(3,805)</u>	<u>(2,510)</u>	<u>(1,910)</u>
Correct profit after charging manager 's commision	<u>34,245</u>	<u>22,590</u>	<u>17,190</u>

Working Note :

	Department A	Department B	Department C	Total
	₹	₹	₹	₹
Unrealised Profit on transfer to:				
Department A	—	$7,200 \times 20/120 = 1,200$	$5,750 \times 15/115 = 750$	1,950
Department B	$19,000 \times 10\% = 1,900$	—	$15,000 \times 20\% = 3,000$	4,900
Department C	$4,600 \times 15/115 = 600$	$3,300 \times 10/110 = 300$	—	900

Question 7

Answer any **four** of the following:

- (a) Annual lease rent = ₹40,000 at the end of each year

Lease period = 5 years

Guaranteed residual value = ₹ 14,000

Fair value at the inception (beginning) of lease = ₹1,50,000

Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.

Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

- (b) A new Plant X was acquired in exchange of old Plant B and on payment of ₹ 20,000. The carrying amount of the old Plant B was ₹ 1,75,000 (Historical cost less depreciation). The fair value of the Plant B on the date of exchange was ₹ 1,50,000.

Suggest the accounting entry in the books of the enterprise.

- (c) A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?
- (d) State the conditions of issuance of Sweat Equity Shares by Joint Stock Companies.
- (e) Give two examples on each of the following items:
- (i) Change in Accounting Policy
 - (ii) Change in Accounting Estimate
 - (iii) Extra Ordinary Items
 - (iv) Prior Period Items.

(4 × 4 = 16 Marks)

Answer

- (a) In the books of Lessee

Journal entry

		₹	₹
Asset A/c	Dr.	1,49,888	
To Lessor			1,49,888
(Being recognition of finance lease as an asset and a liability)			

Working Note:

Year	Lease Payments ₹	Discounting Factor (12.6%)	Present Value ₹
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.622	24,880
5	40,000	0.552	22,080
5	14,000 (GRV)	0.552	7,728
			1,49,888

- (b) When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. Accordingly, the value of Plant X will be

	₹
Exchange value of Plant B	1,50,000
Add: Additional cash paid	<u>20,000</u>
	<u>1,70,000</u>

Journal entries for acquisition of Plant X will be given as:

		₹	₹
1	Plant X A/c Dr. To Plant B A/c To Bank A/c (Being new plant X acquired in exchange of Plant B on additional payment of ₹ 20,000)	1,70,000	1,50,000 20,000
2	Profit and Loss A/c Dr. To Plant B A/c (Being loss on exchange of old Plant B transferred to Profit and Loss Account)	25,000	25,000

Note: Fair value of Plant B on the date of exchange has been considered for computation of cost of Plant X in the above answer. An alternative treatment is also possible when the assets exchanged are similar in nature. In such a case, new asset may be recorded at the net book value of the asset given up after making adjustments for balance receipt or payment of cash. Accordingly, the value of plant will be ₹ 1,95,000 (1,75,000+20,000) instead of ₹ 1,70,000 and the following entry will be made:

	₹	₹
Plant X A/c Dr. To Plant B A/c To Bank A/c (Being New plant X was acquired in the exchange of plant B on additional payment of ₹ 20,000)	1,95,000	1,75,000 20,000

- (c) As per para 14 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when
- (a) an enterprise has a present obligation as a result of a past event;
 - (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

If these conditions are not met, no provision should be recognised.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

- (d) A company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled-
- (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 (SEBI) 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.
- (e) (i) Examples of Changes in Accounting Policy:
- a. Change of depreciation method from WDV to SLM and vice-versa.
 - b. Change in cost formula in measuring the cost of inventories.
- (ii) Examples of Changes in Accounting Estimates:
- a. Change in estimate of provision for doubtful debts on sundry debtors.

- b. Change in estimate of useful life of fixed assets.
- (iii) Examples of Extraordinary items:
 - a. Loss due to earthquakes / fire / strike
 - b. Attachment of property of the enterprise by government
- (iv) Examples of Prior period items:
 - a. Applying incorrect rate of depreciation in one or more prior periods.
 - b. Omission to account for income or expenditure in one or more prior periods.