GUIDELINE ANSWERS TO QUESTIONS OF IPCC EXAMINATION MAY-JUNE 2014

PAPER – 5 **ADVANCED ACCOUNTING**

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<u>About the Answers :</u>

1) The Answers given in are based on author's own opinion and may be unmatched with suggested answers issued by ICAI or any authority.
2) Required working notes are given with the answers for better understanding
3) For any problem relating to above answers you may contact at *<u>09176425830</u>*

SOLUTIONS TO PAPER -5 ADVANCED ACCOUNTING MAY 2014

Answer to Question No.1(a)

As per para 8 of AS-4 "Contingencies & Events Occruing after the Balance Sheet Date' adjustment to the assets and liablities are required for events occuring after the balance sheet date that provide additional information materially affecting thedetermination of the amounts relating to conditions existing at the balance sheet date.

A Debtor for Rs.5 Lakhs suffered heavy loss and became insolvent after the balance sheet date April 2014. The Loss was also not insured.

Accordingly FULL provision for bad debts amounting to Rs.5,00,000 should be made to cover the loss arising due to insolvency of a debtor, in the final accounts of Z Ltd. For the year ended 31st March, 2014.

Answer to Question No.1(b)

Treatment of Interest under AS 16 "Borrowing Costs"

S.No.	Particulars	Nature of Assets	Interest to be Capitalized	Interest to be Charged to P & L a/c
			(in Rupees)	(in Rupees)
1	Construction of Factory Building	*Qualifying Asset*	11,00,000 x 40/100 = 4,40,000	
2	Purchase of Machinery	*Not a Qualifying Asset*		11,00,000 x 35/100 = 3,85,000
3	Working Capital	*Not a Qualifying Asset*		11,00,000 x 25/100 = 2,75,000
	Total		Rs.4,40,000	Rs.6,60,000

During the year 2013-14 the Suhana Ltd had invested idle fund out of money raised from debentures in bank's fixed depsoit and earned interest of Rs.2,00,000

This is nothing but Temporary Investment Income

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Workings:

Construction of Factory Building	4,40,000
Less: Interest on Bank's Fixed Deposit	2,00,000
Total	2,40,000

Answer to Question No.1(c)

Interest rate implicit on Lease'

The Interest rate implict in the lease is the discount rate, that at the inception of the lease causes the aggregate present vslue of

(a) the minimum lease payments under a finance lease from the standpoint of the lesser and

(b) any unguaranteed residual value accriung to the lessor, to be equal to the fair value of the leased asset.

Calculation of 'Interest rate implicit on Lease'

Year	Lease Payments	DF (10%)	PV
1	80000	0.909	72720
2	80000	0.826	66080
3	80000	0.751	60080
4	80000	0.683	54640
5	80000	0.621	49680
5	40000	0.621	24840
5	24000	0.621	14904
			342944

Year	Lease Payments	DF (14%)	PV
1	80000	0.877	70160
2	80000	0.769	61520
3	80000	0.675	54000
4	80000	0.592	47360
5	80000	0.519	41520
5	40000	0.519	20760
5	24000	0.519	12456
			307776

Interest rate implicit on lease is computed below by interpolation:

Interest rate implicit on lease = $10\% + \frac{14\% - 10\%}{342944-307776} \times (342944-320000) = 14.88\%$

Answer to Question No.1(d)

(i) Computation of Basic Earning per share (EPS)	Year 2012-13	Year 2013-14
EPS for the year 2012-13 as given		
$\frac{\text{Net Profit of the year attributable to Equity Shareholders}}{\text{Weighted average number of Equity Shares outstanding the year}}$		
$= \frac{22,00,000}{10,00,000}$	2.2	

EPS for the year 2012-13 restated for rights issue

$$= \frac{22,00,000}{10,00,000 \text{ shares } \times 1.04} \qquad 2.12$$

EPS for the year 2013-14 including effects of rights issue

$$= \frac{30,00,000}{(10,00,000 \times 1.04 \times 4/12) + (12,00,000 \times 8/12)} \qquad 2.62 \text{ (approx)}$$

Workings Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Full value of O/s shares imemdiately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares o/s prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(\text{Rs.}32 \times 10,00,000 \text{ Shares}) + (\text{Rs.}25 \times 2,00,000 \text{ Shares})}{10,00,000 + 2,00,000} \qquad 30.83$$

2. Computation of adjusting factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-right value per share}}$$

$$= \frac{\text{Rs.}32}{\text{Rs.}30.83} \qquad 1.04 \text{ (approx)}$$

Answer to Question No.2

Statement Showing distribution of Cash

	Creditors		**Capitals**		
			P	**Q**	**R**
Balance due after loan (W.N.1)		16000	52000	43500	32000
January					
Balance available	9000				
Realisation less expenses					
and cash retained	10000				
Amount availabe and paid	19000	16000	-	-	3000
Balance due			52000	43500	29000
February					
Opening Balance	6000				
Expenses paid and					
balance carried forward	3000				
Available for distribution	3000				
Cash paid to 'Q' and Machinery					
given to 'R'			-	3000	9000
(Excess paid to 'R' Rs.)			52000	40500	20000
March					
Opening Balance	2000				
Amount realised less expenses	87300				
Amount paid to partners	89300		41689	32767	14844
			10311	7733	5156

Working Note:

(1) Highest relative Capital Basis

		P	**Q**	**R**
Scheme of payment for January				
Balance of Capital Accounts		65000	50500	32000
Less: Loans		(13000)	(7000)	-
	A	52000	43500	32000
Profit Sharing Ratio		4	3	2
Capital Profit Sharing Ratio		13000	14500	16000
Capital Profit Sharing Ratio, taking P's				
Capital as base	B	52000	39000	26000
Excess of R's Capital and Q's Capital	A-B	-	4500	6000
Profit Sharing Ratio			3	2
Capital Profit Sharing Ratio			1500	3000
Capital in profit sharing ratio taking				
Q's Capital as base			4500	3000
Excess of R's Capital over Q				3000

(2) Scheme of distribtuion of available cash:

		P	Q	R
Scheme of payment for March				
Balance of Capital Accounts	A	52000	40500	20000
Profit sharing ratio		4	3	2
Capital Profit Sharing Ratio		13000	13500	10000
Capital in profit sharing ratio taking				
Q's Capital as base	**B**	40000	30000	20000
Excess of Q's Capital and R's Capital	**A-B**	12000	10500	-
Profit sharing ratio		4	3	
Capital Profit Sharing Ratio		3000	3500	
Capital in profit sharing ratio taking		12000	9000	
P's Capital as base				
Excess of Q's Capital over P's Capital		-	1500	
Payment Rs.1500	**C**	-	(1500)	
Balance of Excess		12000	9000	
Payment Rs.21000	**D**	(12000)	(9000)	
Balance	**A-C-D**	40000	30000	20000
Payment (Rs.89300-Rs.22500) = Rs.66800	**D**	(29689)	(22267)	(14844)
Loss		10311	7733	5156
Total Payment Rs.89300	**A+C+D**	41689	32767	14844

Answer to Question No.3(a)

10% Debentures Account

Date	Particulars	Rs.	Date	Particulars	Rs.
31/03/2014	To Own Debentures A/c	300000	01/04/2013	By Balance b/d	2500000
	To Bank A/c	2200000			
		2500000			2500000

Debenture Redemption Sinking Fund Account

Date	Particulars	Rs.	Date	Particulars	Rs.
31.03.2014	To General Reserve (Balancing Figure)	2730000	01/04/2013	By Balance b/d	2400000
			31.03.2014	By Profit & Loss A/c	90000
			31.03.2014	By 8% Stock A/c (Profit W.N.5)	28000
			31.03.2014	By Interest on Sinking Fund A/c (W.N3)	206000
			31.03.2014	By Own Debentures A/c (W.N.4)	6000
		2730000			2730000

Working Notes:

1.Amount of Stock as on 01-04-2013

Sinking Fund Balance as on 01-04-2013	2400000
Less: Own Debentures	294000
	2106000

2. Sales value of 8% Stock

= Face value / Rs. Per stock

= 2200000 / 100 22000 per stock

Sales Value = 22000 stock x Rs.97 per stock

= 2134000

3. Interest credited to Sinking Fund

(i) Interest on 8% Stock (Rs.2200000 x 8%)	Rs.	176000
(ii) Interest on Own Debentures (3000 Debentures x Rs.100 x 10%)	Rs.	30000
		206000

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Own Debentures A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2013	To Balance b/d	294000	31.03.2014	By 10% Debentures A/c	300000
31.03.2014	To Sinking Fund A/c	6000			
		300000			300000

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8% Stock Account

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2013	To Balance b/d (Face Value Rs.2200000) (W.N.1)	2106000	31.03.2014	By Bank Account (W.N.2)	2134000
31.03.2014	To sinking Fund (Profit on Sales)	28000			
		2134000			2134000

Answer to Question No.3(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)

	L	**M**	**N**	**O**	**Total**
Gross Liability	80000	60000	40000	20000	200000
Less: Marked applications (exckuding firm underwriting)	(55000)	(40000)	(42000)	(8000)	(145000)
Balance	25000	20000	(2000)	12000	55000
Less: Surplus of N allocated to L,M,O in the ratio of 4 : 3 : 1	(1000)	(750)	2000	(250)	-
Balance	24000	19250	-	11750	55000
Less: Unmarked applications including firm underwriting (Refer Working Note 1)	(7200)	(5400)	(3600)	(1800)	(18000)
Net Liability	16800	13850	(3600)	9950	37000
Less: Surplus of N allocated to L,M,O in the ratio of 4 : 3 : 1	(1800)	(1350)	3600	(450)	-
	15000	12500	-	9500	37000
Add: Firm Underwriting	5000	4000	2000	2000	13000
Total Liability	20000	16500	2000	11500	50000

Working Note : 1

	Shares
Applications received from public	150000
Add: Shares Underwritten firm (5000+4000+2000+2000)	13000
Total Applications	163000
Less: Marked applications (55000+40000+42000+8000)	145000
Unmarked applications including firm underwriting	18000

Answer to Question No.4

Calculation of Purchase Consideration

	P Ltd	Q Ltd
Purchase Consideration		
Goodwill	50000	150000
Building at cost less depreciation	100000	190000
Plant & Machinery at cost less depreciation	25000	80000
Furniture & Fixtures	-	35000
Inventories	135000	50000
Trade Receivables	-	142000
Cash at Bank	-	58000
	310000	705000
Less: Liabilities		
8% Secured Debentures (110000x 110%)	121000	-
Trade Payables	-	140000
Net Assets taken over	189000	565000
To be satisfied by issue of Shares of PQ Ltd. @ Rs.10 each	18900	56500

Balance Sheet of PQ Ltd. As at 1st April 2014

		Particulars	*Note No*	*Amount*
		EQUITY AND LIABILITES		Rs.
1		Shareholders' Funds		
	(a)	Share Capital	1	754000
	(b)	Reserves & Surplus	2	11000
2		**Non-Current Liabilities**		
	(a)	Long-Term Borrowings	3	110000
3		**Current Liabilities**		
	(a)	Trade Payables		140000
		Total		1015000
		ASSETS		
1		**Non-Current Assets**		
	(a)	Fixed Assets		
	(i)	Tangible Assets	4	430000
	(ii)	Intangible Assets	5	200000
2		**Current Assets**		
	(a)	Inventories		185000
	(b)	Trade Receivables		142000
	(c)	Cash and Cash equivalents		58000
		Total		1015000

Notes to Accounts

		Rs.	Rs.
1 Share Capital			
Equity Share Capital			
75400 Shares of Rs.10 each			754000
2 Reserves & Surplus			
Securities Premium A/c (W.N.1)			11000
3 Long-Term Borrowings			
8% Secured Debentures			110000
4 Tangible Assets			
Building at cost less depreciation			
P Ltd	100000		
Q Ltd	190000		290000
Plant & Machinery at cost less depreciation			
P Ltd	25000		
Q Ltd	80000		105000
Furniture & Fixtures			
Q Ltd	35000		35000
			430000
5 Intangible Assets			
Goodwill			
P Ltd	50000		
Q Ltd	150000		200000

Journal Entries in the books of P Ltd.

			Dr	Cr
1	Realisation a/c	Dr	304000	
	To Building			100000
	To Plant & Machinery			25000
	To Inventories			135000
	To Trade Recivables			44000
	(Being Assets transferred to realisation account except bank)			
2	8% Secured Debentures a/c	Dr	110000	
	Trade Payables a/c	Dr	54000	
	To Realisation a/c			164000
	(Being all liabilities transferred to Realisation a/c)			
3	Equity Share Capital a/c	Dr	140000	
	Profit & Loss a/c	Dr	30000	
	To Realisation a/c			170000
	(Being Equity transferred to Equity Shareholders a/c)			
4	PQ Ltd a/c	Dr	189000	
	To Realisation a/c			189000
	(Being Purchase Consideration due)			

5	Bank a/c	Dr	44000	
	Realisation a/c			44000
	(Being Trade Receivables received fully)			
6	Realisation a/c	Dr	54000	
	To Bank a/c			54000
	(Being Trade Payables paid)			
7	Shares in PQ Ltd.a/c	Dr	189000	
	To PQ Ltd a/c			189000
	(Being Purchase consideration received in the form of Shares of PQ Ltd.)			
8	Realisation a/c	Dr	228000	
	To Equity Shareholders a/c			228000
	(Being Profit on Realisation account transferred to Shareholders account)			
9	Equity Shareholders a/c	Dr	209000	
	To Shares in PQ Ltd. a/c			189000
	To Bank a/c			20000
	(Being final payment made to shareholders)			

Working Note:

Calculation of Securities Premium Balance

Debentures issued by PQ Ltd. To P Ltd at 10 % premium

Therefore, Securities Premium Account will be credited with (Rs.110000 x 10%)

= Rs.11000

Answer to Question No.5(a)

Amount to be Capitalised

Cost of New Plant	25000000	
Add: Value of materials used		
from old plant	3800000	28800000
Less:Estimated current cost of		
replacing old plant (Note1)		28166667
Total		633333

Amount Chargeable to Revenue Account

Estimated current cost of replacing old plant (Note1)		28166667
Less: Sale proceeds of old plant	1500000	
Value of materilas used in plant	3800000	5300000
Total		22866667

Plant Account

To Balance b/d	7500000	By Balance c/d	15450000
To Bank A/c (Rs.7950000-3800000	4150000		
To Replacement Account	3800000		
	15450000		15450000

Replacement Account

To Bank A/c	28166667	By Bank a/c (sale proceeds)	1500000
(Current cost of replacement)		By Plant a/c (materials used)	3800000
		By Revenue a/c (transfer)	22866667
	28166667		28166667

Working Note (1) Calculation of Estimated Current Cost of Replacing Old Plant

Elements of Cost	Ratio	Cost of Existing Plant	Increase in % of cost	Current Cost
Materials	4/10	3000000	250%	10500000
Labour	4/10	3000000	200%	9000000
			Prime Cost	19500000
Overheads 4/13 of Total Cost or 4/9 of Prime Cost (since the ratio of cost = 5 : 4 : 4)				8666667
			Total	28166667

Answer to Question No.5(b)

Schedule 1

Premium Earned (Net)		Direct	Reinsurance	
Premium Received		9200000	786000	
Add: Receivable on 31.03.2014		394000	33000	
		9594000	819000	
Less: Receivable on 01.04.2013		459000	37000	
		9135000	782000	
Total Premium Income = 9135000 + 782000				9917000
Premium Paid	636000			
Add: Premium Payable as on 31.03.2014	20000			
	656000			
Less: Premium Payable as on 01.04.2013	28000			628000
Total Premium Earned (Net)				9289000

Schedule 2

Claims incurred (Net)			
Claims Paid	Direct		7300000
	Reinsurance		580000
Re-insurance Claims received			(210000)
Claims Outstanding as on 31.03.2014			
	Direct	101000	
	Reinsurance	12000	
		113000	
Less: Recoverable for Re-insurers as on 31.03.2014		39000	
		74000	74000
Claims Outstanding as on 01.04.2013			
	Direct	94000	
	Reinsurance	16000	
		110000	
Less: Recoverable for Re-insurers as on 01.04.2013		42000	
		68000	68000
Total Claim Incurred (Net)			7676000

Answer to Question No.6(a)

Journal Entries in the books of Independent Branch

	Particulars		Dr Amount	Cr Amount
(i)	Head Office	Dr	2,800	
	To Income			2,800
	(Being Income allocated to branch by H.O)			
(ii)	Provision for Doubtful Debts	Dr	1,000	
	To Head Office account			1,000
	(Being Provision for Doubtful Debts provided)			
(iii)	Head Office account	Dr	3,000	
	To Salaries account			3,000
	(Being the rectification of Salary paid on behalf of H.O)			
(iv)	Head Office account	Dr	5,000	
	To Cash / Bank Account			5,000
	(Being the expenditure on account of other branches recorded in books)			
(v)	No entry in branch books			
(vi)	Expenses account	Dr	75,000	
	To Head Office account			75,000
	(Being the allocated expenditure by the head office recorded in branch books)			
(vii)	Head Office account	Dr	30,000	
	To Debtors account			30,000
	(Being the adjustment of collection from branch debtors)			
(viii)	Goods in transit account	Dr	10,000	
	To Head Office account			10,000
	(Being Goods dispatched by H.O. but not yet received)			

Answer to Question No.6(b)

Particulars	P	S	Q
	Departments		
	Rs.	Rs.	Rs.
Profit	90000	60000	45000
Add: Managerial Commission (1/9)	10000	6667	5000
	100000	66667	50000
Less: Unrealised profit on stock (W.N.1)	5426	21000	2727
	94574	45667	47273
Less: Managers' Commission @ 10%	9457	4567	4727
	85117	41100	42546

Working Notes:

Value of Unrealised profit

Transfer by department P to		
S department (18,000 x 25/125)	3600	
Q department (14,000 x 15/115)	1826	5426
Transfer by department S to		
P department (48,000 x 20/100)	9600	
Q department (38,000 x 30/100)	11400	21000
Transfer by department Q to		
P department (12,000 x 20/120)	2000	
S department (8,000 x 10/110)	727	2727

Answer to Question No.7(a)

Calculation of necessary provision :

Particulars	Loan Amount
Balance Outstainding	724000
Less: Realisable of value of security	175000
Unsecured Balance	549000
Less: ECGC Cover @ 30% = Rs.164700	
(subject to maximum of 150000)	150000
Net Unsecured Balance	399000
Required Provision:	
100% for Unsecured Portion	399000
Add: 40% of secured portion on Rs.175000	
(Doubtful upto 3 years)	70000
Total Provision Required	469000

Answer to Question No.7(b)

S.No	Particulars	Head under which items be classified in Balance Sheet
(i)	Share application money received in excess of issued share capital	Other Current Liabilities
(ii)	Share option outstanding account	Reserves & Surplus
(iii)	Unpaid matured debenture and interest accrued thereon	Other Current Liabilities
(iv)	Uncalled liability on shares and other partly paid investments	Contingent Liabilities & Commitments
(v)	Calls unpaid	Share Capital
(vi)	Intangible Assets under development	Fixed Assets
(vii)	Money received against share warrant	Shareholder's Funds
(viii)	Long term maturity of finance lease obligation	Long Term Borrowings

Answer to Question No.7 (c)

Treatment of Refund of Government Grants in line with AS 12

(i) When Government Grant is related to revenue:

The amount of refund should be adjusted against any unamortised "deffered Govt grants" if any. Remaining balance amount of refund should be charged to Profit and Loss account as extra ordinary item.

(ii) When Government Grant is related to specific fixed assets:

When the grant was received it was deducted from gross value of assets

Refund amount should be recorded by increasing the book value of the asset. Depreciation on the revised book value should be provided prospectively over the residual life of the asset.

When the grant was received it was traeted as Deffered Income

Refundable amount should be adjusted with unamortised deffered income

When the grant was received it was credited to Capital Reserve

Refundable amount should be adjusted with the capital reserve

(iii) When Government Grant is related to Promoters Contribution:

Refundable amount should be reduced from the capital reserve

Answer to Question No.7(d)

A partner who, on admission pays a premium to other partner with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund if the firm is dissolved before the term has expired.

(i) Firstly the assets of the firm, including goodwill are realized. Then the amount realized is applied first towards repayment of liabilities to outsiders and loan taken from partners; afterwards the capital contributed by partners is repaid and, if there is still surplus, it is distributed amon the partners in their profir sharing ratio.

(ii) No claim in this respect arises if:

a) the firm is dissolved due to the death of a partner,

b) the dissolution is mainly due to the partner's (claiming refund) own misconduct;

c) the dissolution is with regard to agreement containing no provision for the return of the premium or any part of it.

Answer to Question No.7(e)

Conditions to be fulfilled by a Joint Stock Cpmpany to buy back its equity shares.

i) The buy-back is authorized by its articles.

ii) A Special resolution has been passed in general meeting of the company authorising buy-back

iii) All the Shares for buuy-back are fully paid up.

iv) 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 paid up equity capital in that financial year.