SUGGESTED ANSWERS

TO

QUESTIONS

SET AT THE

INSTITUTE'S EXAMINATIONS

NOVEMBER, 1994 – NOVEMBER, 2008

A COMPILATION

PROFESSIONAL EDUCATION (COURSE – II)

PAPER – 1 : ACCOUNTING

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
NOIDA

CONTENTS

1

FUNDAMENTALS OF ACCOUNTING

(A) Write short notes on:

Question 1

What are the main characteristics of a bank's book-keeping system?

(5 marks) (Intermediate–Nov. 1997)

Answer

Main characteristics of a bank's book-keeping system are:

(i) **Voucher posting:** Entries in the personal ledgers are made directly from vouchers instead of being posted from the books of prime entry.

(ii) **Voucher summary sheets:** The vouchers entered into different personal ledgers each day are summarised on summary sheets. The totals of these summary sheets are posted to the control accounts in the general ledger.

(iii) **Daily trial balance:** The general ledger trial balance is extracted and agreed every day.

(iv) **Continuous checks:** All entries in the detailed personal ledgers and summary sheets are checked by persons other than those who have made the entries. This checking is done every day. As a result most clerical mistakes are detected before another day begins.

(v) **Control accounts:** A trial balance of the detailed personal ledgers is prepared periodically, usually every two weeks. It is agreed with general ledger control accounts.

(vi) **Double voucher system:** Two vouchers are prepared for every transaction not involving cash - one debit voucher and another credit voucher.

Question 2

What are the advantages of maintaining subsidiary books by a trading—manufacturing organisation? *(5 marks) (Intermediate–Nov. 1997)*

Answer

Advantages of maintaining subsidiary books by a trading/manufacturing organization are:

(i) **Division of work:** In place of one journal, there are many subsidiary books. The accounting work can be divided amongst a number of people.

(ii) **Specialisation and efficiency:** As a person is handling only one type of work, he acquires full knowledge and becomes efficient in handling the work. Accounting work is done efficiently.

(iii) **Saving of time:** Various accounting processes can be undertaken simultaneously because of the use of a number of books. This results in quicker completion of work.

(iv) **Availability of information:** Since a separate register is kept for each class of transactions, the information relating to each class of transaction is available at one place.

Additional information for sales tax, excise, octroi etc., can also be compiled from the appropriate columns in the purchases and sales registers.

(v) **Facility in checking:** When the trial balance does not agree, the location of errors is facilitated by the existence of separate books. Similarly audit of the various books of prime entry can be conducted simultaneously by a team of audit staff.

Question 3

Define in one sentence each :

(i) Expense, (ii) Equity, (iii) Liability, (iv) Asset and (v) Income

(5 Marks) (Intermediate–Nov. 1997)

Answer

(i) **Expense:** It is a cost incurred during an accounting period in order to earn revenue.

(ii) **Equity:** It is the "residual interest" of the owners of an enterprise in the assets of the enterprise which remain after providing for the liabilities of the enterprise.

(iii) **Liability:** It is a present obligation of the factors arising from past events the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

(iv) **Asset:** An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

(v) **Income:** Income is increase in economic benefits during the accounting period in the form of inflows of assets or decrease of liabilities that result in increase in equity other than those relating to fresh contribution from equity participants.

(B) Practical Questions:

Question 1

A business maintains accounts on self-balancing system for customers and suppliers. You are required to pass journal entries for "Control Account" purposes in respect of the following transactions for September, 1997 : (10 marks) (Intermediate–Nov. 1997)

Answer

(a) Bills of exchange for Rs. 3,00,000 drawn on customers against credit sales;

(b) Bills of exchange for Rs. 2,50,000 accepted by customers earlier now endorsed to suppliers;

(c) An endorsed bill of exchange for Rs. 13,000 dishonoured; noting charges Rs. 150 incurred by holder in due course; endorsement was not "sans recourse";

(d) An acceptor of a bill of exchange of Rs. 12,000 retires the bill by paying Rs. 11,800. This bill was already endorsed to the supplier. The business contacts and pays the supplier by cheque on the due date.

Answer

Journal for September, 1997

			Debit (Rs.)	Credit (Rs.)
1.	General ledger control a/c (in customers ledger)	Dr.	3,00,000	
	To Customers' ledger control a/c (in general ledger)			3,00,000
	(Being self-balancing control A/c entry for bills of exchange drawn on and accepted by customers)			
2.	Suppliers ledger control a/c (in general ledger)	Dr.	2,50,000	
	To General ledger control a/c (in suppliers' ledger)			2,50,000
	(Being self-balancing control entry for bills of exchange accepted by customers now endorsed to suppliers)			
3.	Customers ledger control a/c (in general ledger)	Dr.	13,150	
	General ledger control a/c (in supplier's ledger)	Dr.	13,150	
	To General ledger control a/c (in customers' ledger)			13,150
	To Suppliers' ledger control a/c (in general ledger)			13,150
	(Being entry to record dishonour of an endorsed bill of exchange, along with noting charges of Rs. 150)			
4.(i)	General ledger control a/c (in customer's ledger)	Dr.	12,000	
	To Customers' ledger control a/c (in general ledger)			12,000
	(Being retirement by a customer of an endorsed bill of exchange)			

(ii)	Supplier's ledger control a/c (in general edger)	Dr.	12,000	
	To General ledger control a/c (in suppliers ledger)			12,000
	(Being payment made to supplier on due date)			
(iii)	Customers' ledger control a/c (in general edger)	Dr.	12,000	
	General ledger control a/c (in suppliers' ledger)	Dr.	12,000	
	To Suppliers' ledger control a/c (in general ledger)			12,000
	To General ledger control a/c (in customers' ledger)			12,000
	(Being transfer of balance from customers' account to suppliers' account)			

Question 2

On 31st March, 1998 Ramji Dayalji P. Ltd., a trading organisation owned inventory costing Rs. 3 lakhs of which inventory valued Rs. 1 lakh was with consignees. It also has in its possession inventory valued at Rs. 10 lakhs belonging to its own principals.

During the year ended 31st March, 1999 Ramji Dayalji P. Ltd. :

(a) purchased inventory worth Rs. 50 lakhs of which 80% was despatched to its consignees, the transportation cost being 5% of the value of goods sent;

(b) received from its principals inventory of Rs. 150 lakhs;

(c) sold 90% of own goods received and lying with itself at 20% margin on sales;

(d) sold on behalf of principals 95% of goods available at 120% of the value thereof. Ramji Dayalji P. Ltd is entitled to commission at 10% of such sales.

The consignees sold at 125% of their per unit landed cost (consignees spending nil) 95% of goods available with them and were entitled to commission at 10% of sales.

You are asked to work out the various figures for recording in the revenue statement of Ramji Dayalji P. Ltd. for the year ended 31st March, 1999. Prepare the revenue statement.

(10 marks) (Intermediate May 1999)

Answer

Revenue Statement of Ramji Dayalji P. Ltd.

for the year ended 31st March, 1999

		Rs.
Sales		64,56,250
Excess of closing inventory	3,35,000	
over opening inventory	3,00,000	35,000

Commission income (from consignors)		18,24,000
Gross revenues		83,15,250
Less : Purchases	50,00,000	
Transportation cost	2,00,000	
Commission to consignees	5,10,625	57,10,625
Net Profit		26,04,625

Working Notes :

(i) *Valuation of inventory as on 31.3.99*

	Ramji Dayalji P.Ltd.	*Consignees*	*Total*
	Rs.	*Rs.*	*Rs.*
Opening stock	2,00,000	1,00,000	3,00,000
Purchses	10,00,000	40,00,000	50,00,000
Transportation cost	-	2,00,000	2,00,000
	12,00,000	43,00,000	55,00,000
Cost of goods sold	10,80,000	40,85,000	51,65,000
Closing stock	1,20,000	2,15,000	3,35,000

(ii) *Sales of goods*

	Ramji Dayalji P. Ltd.	*Consignees*	*Total*
	Rs.	*Rs.*	*Rs.*
Cost of goods sold	10,80,000	40,85,000	51,65,000
Add : Profit margin (25% on cost)	2,70,000	10,21,250	12,91,250
	13,50,000	51,06,250	64,56,250

(iii) *Commission payable to consignees*

	Rs.
Sales made by consignees	51,06,250
Commission (10% on sales)	5,10,625

(iv) *Sales for principals*

	Rs.
Opening stock belonging to principals	10,00,000
Add : Goods received during the year	1,50,00,000
Total goods available	1,60,00,000
Cost of goods sold (95%)	1,52,00,000

Add : Profit margin (20% on Rs. 1,52,00,000)	30,40,000
Sales	1,82,40,000
Commission (10% on sales)	18,24,000

2
ACCOUNTING THEORY

(A) Write short notes on:

Question 1

Materiality *(3 Marks) (Intermediate–Nov. 1994)*

Answer

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.

Questions 2

Indicate any three areas in respect of which different accounting policies may adopted by different enterprises. Also indicate the requirements with regard to disclosure of accounting policies. *(7 Marks) (Intermediate—May 1995)*

Answer

Areas in which different accounting policies may be adopted : The following are three areas in which different accounting policies may be adopted by different enterprises:

(i) Methods of depreciation, depletion and amortisation.

(ii) Valuation of inventories.

(iii) Valuation of Fixed Assets.

(The above three areas are not exhaustive. There are other areas also)

Disclosure requirements of accounting policies : The disclosure requirements as prescribed in Accounting Standard 1 (AS 1) 'Disclosure of Accounting Policies' are as follows :

(i) All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed at one place and they should form part of the financial statements.

(ii) Any change in the accounting policies which has a material effect in the current period should be disclosed alongwith the amount, to the extent ascertainable, by which any item in the financial statement is affected. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. However, if a change in accounting policies is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is made.

(iii) If the fundamental accounting assumptions viz. Going concern, Consistency and Accrual are followed in the preparation of financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

Question 3

Entity concept. *(5 Marks) (Intermediate–Nov. 1995)*

Answer

The American Accounting Association defines the accounting entity as "an area of economic interest of a particular individual or group". The accounting entity may be the business unit itself (i.e. sole proprietorship firm, partnership firm, company or government business undertaking), or defined part of a business (i.e. a department) or an amalgamation of related businesses (i.e. a holding company) depending on the users needs. It can also be a non-business group, i.e. person, club, religious bodies or government, which engages in economic activities.

The entity concept has three major implications for accounting:

1. It limits the area to be covered by accounting records and reports. For example, personal transactions of the sole proprietor is not to be recorded in his business accounts as business expenses, they are simply treated as drawings.
2. All transactions are recorded from the point of the entity itself and not from the point of other parties such as owners, managers or customers. For example, when a firm sells goods to customers, this is recorded as sales by the firm and not as purchases by the customers.
3. The entity concept underlines the accounting concept of profits in which a sharp distinction is made between the expenses of operating the business and payment to the owners. All payments to the owners take the form of repayment of capital or loan, or a distribution of profits. They are not treated as business expenses.

Question 4

Elucidate "accounting convention of conservatism." *(5 Marks) (Intermediate–of Nov. 1999)*

Answer

'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.

Question 5

Under what circumstances can an enterprise change its accounting policy?

(4 Marks) (PE-II – Nov. 2005)

Answer

A change in accounting policy is made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.

3

DEPARTMENTAL AND BRANCH ACCOUNTS

UNIT 1 : DEPARTMENTAL ACCOUNTS

(A) Write short notes on:

Question 1

Basis of allocation of common expenditure among different departments.

(4 marks) (Intermediate–Nov. 1998)

Answer

While preparing department accounts, expenses should be allocated among the different departments on the basis of the following principles :

1. Expenses incurred specially for each department are charged directly thereto e.g., insurance charges of stock held by a department.
2. Common expenses, the benefit of which is shared by all the dpeartments and which are capable of precise allocation, (e.g., rent, lighting expenses etc.) are distributed among the departments concerned on some equitable basis considered suitable in the circumstances of the case. Rent is charged to different departments according to the floor area occupied by each department, having regard to any favourable location specially allocated to a department. Lighting and heating expenses are distributed on the basis of consumption of energy by each department and so on.
3. Common expenses which are not capable of accurate measurement are dealt with as follows:
   (i) Selling expenses, e.g., discount, bad debts, selling commission, etc. are charged on the basis of sales.
   (ii) Administrative and other expenses, e.g., salaries of managers, directors, common advertisement expenses, depreciation on assets, etc., are allocated equally among all the departments that have benefited thereby. Alternatively, no allocation may be made and such expenses may be charged to the combined profit and loss account.

(B) Practical Questions:

Question 1

Department X sells goods to Department Y at a profit of 25% on cost and to Department Z at 10% profit on cost. Department Y sells goods to X and Z at a profit of 15% and 20% on sales, *respectively. Department Z charges 20% and 25% profit on cost to Department X and Y, respectively.*

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

	Rs.
Department X	*36,000*
Department Y	*27,000*
Department Z	*18,000*

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

	Dept. X Rs.	*Dept. Y Rs.*	*Dept. Z Rs.*
Transfer from Department X	—	*15,000*	*11,000*
Transfer from Department Y	*14,000*	—	*12,000*
Transfer from Department Z	*6,000*	*5,000*	—

Find out the correct departmental Profits after charging Managers' commission

(8 marks)(Intermediate–Nov. 2001)

Answer

Calculation of correct Profit

	Department X Rs.	*Department Y Rs.*	*Department Z Rs.*
Profit after charging managers' commission	36,000	27,000	18,000
Add back : Managers' commission (1/9)	4,000	3,000	2,000
	40,000	30,000	20,000
Less : Unrealised profit on stock (Working Note)	4,000	4,500	2,000
Profit before Manager's commission	36,000	25,500	18,000
Less : Commission for Department Manager @10%	3,600	2,550	1,800
	32,400	22,950	16,200

Working Note :

Stock lying with

	Dept. X Rs.	*Dept. Y Rs.*	*Dept. Z Rs.*	*Total Rs.*
Unrealised Profit of :				
Department X		1/5×15,000 =3,000	1/11×11,000 =1,000	4,000
Department Y	0.15×14,000 =2,100		0.20×12,000 =2,400	4,500
Department Z	1/6×6,000 =1,000	1/5×5,000 =1,000		2,000

Question 2

FGH Ltd. has three departments I.J.K. The following information is provided for the year ended 31.3.2004:

	I	J	K
	Rs.	*Rs.*	*Rs.*
Opening stock	*5,000*	*8,000*	*19,000*
Opening reserve for unrealised profit	—	*2,000*	*3,000*
Materials consumed	*16,000*	*20,000*	—
Direct labour	*9,000*	*10,000*	—
Closing stock	*5,000*	*20,000*	*5,000*
Sales	—	—	*80,000*
Area occupied (sq. mtr.)	*2,500*	*1,500*	*1,000*
No. of employees	*30*	*20*	*10*

Stocks of each department are valued at costs to the department concerned. Stocks of I are transferred to J at cost plus 20% and stocks of J are transferred to K at a gross profit of 20% on sales. Other common expenses are salaries and staff welfare Rs. 18,000, rent Rs. 6,000.

Prepare Departmental Trading, Profit and Loss Account for the year ending 31.3.2004.

(10 marks) (PE-II–Nov. 2004)

Answer

FGH Ltd.
Departmental Trading and Profit and Loss Account
for the year ended 31st March, 2004

		I	J	K	Total			I	J	K	Total
		Rs.	Rs.	Rs.	Rs.			Rs.	Rs.	Rs.	Rs.
To	Opening stock	5,000	8,000	19,000	32,000	By	Sales			80,000	80,000
To	Material consumed	16,000	20,000		36,000	By	Inter-departmental transfer	30,000	60,000		90,000
To	Direct labour	9,000	10,000		19,000	By	Closing stock	5,000	20,000	5,000	30,000
To	Inter-departmental transfer		30,000	60,000	90,000						
To	Gross profit	5,000	12,000	6,000	23,000						
		35,000	80,000	85,000	2,00,000			35,000	80,000	85,000	2,00,000
To	Salaries and staff welfare	9,000	6,000	3,000	18,000	By	Gross profit b/d	5,000	12,000	6,000	23,000
To	Rent	3,000	1,800	1,200	6,000	By	Net loss	7,000			7,000
To	Net profit		4,200	1,800	6,000						
		12,000	12,000	6,000	30,000			12,000	12,000	6,000	30,000
To	Net loss (I)				7,000	By	Stock reserve b/d (J + K)				5,000
To	Stock reserve (J+K) (Refer W.N.)				3,000	By	Net profit (J + K)				6,000
To	Balance transferred to Profit and loss account				1,000						
					11,000						11,000

Working Note:

Calculation of unrealized profit on closing stock

	Rs.
Stock reserve of J department	
Cost	30,000
Transfer from I department	30,000
	60,000
Stock of J department	20,000

Proportion of stock of I department = $\text{Rs. } 20{,}000 \times \dfrac{\text{Rs.}30{,}000}{\text{Rs.}60{,}000}$ = Rs.10,000

Stock reserve =$\text{Rs.}10{,}000 \times \dfrac{20}{120}$ = Rs.1667 (approx.)

Stock reserve of K department	*Rs.*
Stock transferred from J department	5,000
Less: Profit (stock reserve) 5,000 × 20%	1,000
Cost to J department	4,000

Proportion of stock of I department =$\text{Rs. } 4{,}000 \times \dfrac{\text{Rs.}30{,}000}{\text{Rs.}60{,}000} =$ Rs.2,000

$\text{Stock reserve} = \text{Rs.}2{,}000 \times \dfrac{20}{120} =$ Rs.333 (approx.)

Total stock reserve = Rs.1,000 + Rs.333 = Rs.1,333

UNIT– 2 : BRANCH ACCOUNTS

(INCLUDING INDEPENDENT BRANCHES AND FOREIGN BRANCHES)

Question 1

S & M Ltd., Bombay, have a branch in Sydney, Australia. At the end of 31st March, 1995, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office :

	Bombay (Rs. thousands)		Sydney (Austr dollars thousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.94)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available :

(1) *Stock as at 31.3.95 :*
Bombay Rs. 1,50,000
Sydney A $ 3,125

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

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

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

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

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

You are required :

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

(use the following rates of exchange :

Opening rate	*A \$ = Rs. 20*
Closing rate	*A \$ = Rs. 24*
Average rate	*A \$ = Rs. 22*
For Fixed Assets	*A \$ = Rs. 18).*

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 1995 showing to the extent possible H.O. results and Branch results separately. (Balance Sheet not required.)

(20 marks) (Intermediate May 1995)

Answer

(a)

S & M Ltd.

Sydney Branch Trial Balance (in Rupees)

As on 31 st March, 1995

(Rs. '000)

	Conversion rate per A\$	*Dr.*	*Cr.*
Plant & Machinery (cost)	Rs 18	36,00	
Plant & Machinery Dep. Reserve	Rs. 18		23,40
Debtors / Creditors	Rs. 24	14,40	7,20
Stock (1.4.94)	Rs. 20	4,00	
Cash & Bank Balances	Rs. 24	2,40	
Purchase / Sales	Rs. 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	Rs. 22	9,90	
Rent	Rs. 22	2,64	
Office expenses	Rs. 22	3,96	
Commission Receipts	Rs. 22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

(b)

Trading and Profit & Loss Account
for the year ended 31st March, 1995

(Rs.'000)

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

Working Notes :

(1) **Calculation of Depreciation :**

(Rs '000)

		H.O.	*Branch*
A.	Building – Cost	10,00	–
	Less : Dep. Reserve	2,00	–
		8,00	

	Depreciation @ 10%		80
B.	Plant & Machinery Cost	25,00	36,00
	Less : Dep. Reserve	6,00	23,40
		19,00	12,60
	Depreciation @ 20%	3,80	2,52
	Total Depreciation (A+B)	4,60	2,52
			(Rs '000)
(2)	**Calculation of Branch Stock Reserve :**		
	Closing stock		75
	Reserve on closing stock (75 × 1/5)		15
	Less : Branch Stock Reserve (as on 1.4.94)		4
	Additional Reserve required		11

			(Rs' 000)	
(3)	**Calculation of Managing Director's Commission :**			
	Profit before adjustment		21,79	
	Add: Provision for doubtful debts		86	
			22,65	
	Less: Branch stock reserve	11		
	Exchange loss	2,16	2,27	
	Profit u/s 349		20,38*	
	Commission @ 2%		41	(approx.)
(4)	**Calculation of provision for Income tax :**		*(Rs ' 000)*	
	Profit u/s 349 as computed above		20,38	
	Less : Provision for doubtful debts	86		
	MD's remuneration	71	1,57	
	Profit before tax		18,81	
	Provision for tax @ 47.5%		8,93**	(approx.)

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

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

**Alternatively provision for tax may also be computed on Rs. (000) 19,67 ignoring provision for doubtful debts.

Question 2

Head Office passes adjustment entry at the end of each month to adjust the position arising out of inter–branch transactions during the month. From the following inter–branch transactions in January, 1996, make the entry in the books of Head Office :

(a) Bombay Branch

(1) Received Goods : Rs. 6,000 from Calcutta Branch, Rs, 4,000 from Patna Branch.

(2) Sent Goods to Rs. 10,000 to Patna, Rs, 8,000 to Calcutta.

(3) Received B/R : Rs. 6,000 from Patna.

(4) Sent Acceptance : Rs. 4,000 to Calcutta, Rs. 2,000 to Patna.

(b) Madras Branch (Apart from the above)

(5) Received Goods : Rs. 10,000 from Calcutta, Rs. 4,000 from Bombay.

(6) Cash Sent : Rs. 2,000 to Calcutta, Rs. 6,000 to Bombay.

(c) Calcutta Branch (Apart from the above)

(7) Sent Goods to Patna : Rs. 6,000.

(8) Paid B/P : Rs. 4,000 to Patna, Rs. 4,000 cash to Patna.

(15 marks) (Intermediate–May 1996)

Answer

In the Books of Head Office

Journal

Date	*Particulars*		*Dr.* *Rs.*	*Cr.* *Rs.*
1996				
Jan 31	Madras Branch A/c	Dr.	6,000	
	Patna Branch A/c	Dr.	16,000	
	To Bombay Branch A/c			6,000
	To Calcutta Branch A/c			16,000
	(Being adjustment entry passed by head office in respect of inter–branch transactions during the month.)			

Working Note :

	Inter – branch transactions			
	Bombay	*Madras*	*Calcutta*	*Patna*
	Rs.	*Rs.*	*Rs.*	*Rs.*
(a) *Bombay Branch*				
(1) Received Goods	10,000 (Dr.)		6,000 (Cr.)	4,000 (Cr.)
(2) Sent Goods	18,000 (Cr.)		8,000 (Dr.)	10,000 (Dr.)
(3) Received B/R	6,000 (Dr.)			6,000 (Cr.)

	(4) Sent Acceptance	6,000 (Cr.)		4,000 (Dr.)	2,000 (Dr.)
(b)	*Madras Branch*				
	(5) Received Goods	4,000 (Cr.)	14,000 (Dr.)	10,000 (Cr.)	
	(6) Cash Sent	6,000 (Dr.)	8,000 (Cr.)	2,000 (Dr.)	
(c)	*Calcutta Branch*				
	(7) Sent Goods			6,000 (Cr.)	6,000 (Dr.)
	(8) Paid B/P and Cash			8,000 (Cr.)	8,000 (Dr.)
		6,000 (Cr.)	6,000 (Dr.)	16,000 (Cr.)	16,000 (Dr.)

Question 3

Rahul Limited operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.97 :

	Rs.
Stock at the outlet 1.4.96	*30,000*
Goods invoiced to the outlet during the year	*3,24,000*
Gross profit made by the outlet	*60,000*
Goods lost by fire	*?*
Expenses of the outlet for the year	*20,000*
Stock at the outlet 31.3.97	*36,000*

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.97 :

(a) Outlet Stock Account.

(b) Outlet Profit & Loss Account.

(c) Stock Reserve Account. *(10 marks) (Intermediate–May 1997)*

Answer

Outlet Stock Account

1.4.96	*Rs.*		*Rs.*
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent to outlet	3,24,000	By Goods lost by fire	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

To Expenses	20,000	By Gross Profit b/d	60,000
To Goods lost by fire (W.N. 2)	18,000		

To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d	7,200	By HO P&L A/c (W.N. 3) (Stock Res. required)	7,200
	13,200		13,200

Working Notes :

			Rs.
(1)	Wholesale Price	100+25 =	125
	Retail Price	125 + 20% =	150
	Gross Profit at the outlet		
	Wholesale Price – Retail Price (150 – 125)		25

Retail sales value = 60,000 × $\frac{150}{25}$ = Rs. 3,60,000

(2) Goods lost by fire

Op. Stock + Goods Sent + Gross Profit – Sales – Closing Stock

30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = Rs. 18,000

(3) Stock Reserve

Opening Stock = 30,000 × $\frac{25}{125}$ = Rs. 6,000

Closing Stock = 36,000 × $\frac{25}{125}$ = Rs. 7,200

Question 4

T of Calcutta has a branch at Dibrugarh. The branch does not maintain separate books of accounts. The branch has the following assets and liabilities on 31st August, 1997 and 30th September, 1997 :

	31st August, 1997	*30th September, 1997*
	Rs.	*Rs.*
Stock of tea	*1,80,000*	*1,50,000*
Advance to suppliers	*5,00,000*	*4,50,000*
Bank Balance	*75,000*	*1,00,000*
Prepaid expenses	*10,000*	*12,000*
Outstanding expenses	*13,000*	*11,000*
Creditors for purchases	*3,00,000*	*to be ascertained*

During the month, Dibrugarh branch :

(a) received by electronic mail transfer Rs. 10,00,000 from Calcutta head office;

(b) purchased tea worth Rs. 12,00,000;

(c) sent tea costing Rs. 12,30,000 to Calcutta, freight of Rs. 80,000 being payable at the destination by the receiver;

(d) spent Rs. 25,000 on office expenses;

(e) paid Rs. 3,00,000 as advance to suppliers;

(f) paid Rs. 6,50,000 to suppliers in settlement of outstanding dues.

In addition, T informs you that the Calcutta office had directly paid Rs. 3,50,000 to Dibrugarh suppliers by cheques drawn on bank accounts in Calcutta during the month.

T informs you that for the purpose of accounting, Dibrugarh branch is not treated as an outsider. He wants you to write the detailed accounts relating to the transactions of the Dibrugarh branch as would appear in the books of Calcutta Head Office. (10 marks) (Intermediate–Nov. 1997)

Answer

Dibrugarh Tea Stock Account

Dr.					*Cr.*
1997 Sept.		*Rs.*	*1997 Sept.*		*Rs.*
1	To Opening balance	1,80,000	30	By Tea in transit to Calcutta	12,30,000
30	To Purchases	12,00,000	30	By Closing stock	1,50,000
		13,80,000			13,80,000

Advance to Dibrugarh Supplier's Account

Dr.					*Cr.*
1997 Sept.		*Rs.*	*1997 Sept.*		*Rs.*
1	To Opening balance	5,00,000	30	By Suppliers – adjustment	3,50,000
30	To Dibrugarh bank	3,00,000	30	By Closing balance	4,50,000
		8,00,000			8,00,000

Dibrugarh Supplier's Account

Dr.					*Cr.*
1997		*Rs.*	*1997*		*Rs.*
Sept.			*Sept.*		
30	To Advance to Suppliers		1	By Opening balance	3,00,000
	– Dibrugarh	3,50,000	30	By Tea stock	12,00,000
30	To Dibrugarh bank	6,50,000		(Purchases)	
30	To Calcutta Bank	3,50,000			
30	To Balance c/d	1,50,000			
		15,00,000			15,00,000

Dibrugarh Bank Account

Dr.					*Cr.*
1997		*Rs.*	*1997*		*Rs.*
Sept	.		*Sept.*		
1	To Balance b/d	75,000	30	By Advance to	
	To Calcutta Bank A/c	10,00,000		Suppliers	3,00,000
			30	By Suppliers	6,50,000
			30	By Expenses	25,000
			30	By Balance c/d	1,00,000
		10,75,000			10,75,000

Dibrugarh Branch Expenses Account

Dr.					*Cr.*
1997		*Rs.*	*1997*		*Rs.*
Sept			*Sept.*		
1	To Prepaid expenses	10,000	1	By Outstanding expenses	13,000
30	To Dibrugarh Bank	25,000	30	By Prepaid expenses	12,000
30	To Oustanding expenses	11,000	30	By Branch Profit and loss	21,000
		46,000			46,000

Question 5

Carlin & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trial balance as on 31st March, 1999 and the additional information given thereafter :

	Dr.	*Cr.*
	Rupees in thousands	
Stock on 1st April, 1998	*300*	*–*
Purchases and sales	*800*	*1,200*
Sundry Debtors and creditors	*400*	*300*
Bills of exchange	*120*	*240*
Wages and salaries	*560*	*–*
Rent, rates and taxes	*360*	*–*
Sundry charges	*160*	*–*
Computers	*240*	*–*
Bank balance	*420*	*–*
New York office a/c	*–*	*1,620*
	3,360	*3,360*

Additional information :

(a) Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.

(b) Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st March, 1999.

(c) The rates of exchange may be taken as follows :

(i) on 1.4.1998 @ Rs. 40 per US $

(ii) on 31.3.1999 @ Rs. 42 per US $

(iii) average exchange rate for the year @ Rs. 41 per US $

(iv) conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 1999 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.1999 in New York books and there were no items pending reconciliation. *(10 marks) (Intermediate–May 1999)*

Answer

Carlin & Co. Ltd.
Mumbai Branch Trial Balance in (US $)
as on 31st March, 1999

	Conversion rate per US $ (Rs.)	Dr. US $	Cr. US $
Stock on 1.4.98	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

Trading and Profit & Loss Account
for the year ended 31st March, 1999

	US $		*US $*
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on computers (US $ 6,000 × 0.6)	3,600.00		
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch
as on 31st March, 1999

Liabilities		*US $*	*Assets*	*US $*	*US $*
New York Office A/c	39,609.18		Computers	6,000.00	
Less : Net Loss	17,685.38	21,923.80	*Less* :Depreciation	3,600.00	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		2,857.14
		34,780.95			34,780.95

Note : The above answer has been given on the basis that the Mumbai branch is an integral foreign operation of carlin & Co.

Question 6

An Indian company has a branch at Washington. Its Trial Balance as at 30th September, 1998 is as follows:

	Dr.	*Cr.*
	US $	*US $*
Plant and machinery	*1,20,000*	–
Furniture and fixtures	*8,000*	–
Stock, Oct. 1, 1997	*56,000*	–
Purchases	*2,40,000*	–
Sales	–	*4,16,000*
Goods from Indian Co. (H.O.)	*80,000*	–
Wages	*2,000*	–
Carriage inward	*1,000*	–
Salaries	*6,000*	–
Rent, rates and taxes	*2,000*	–
Insurance	*1,000*	–
Trade expenses	*1,000*	–
Head Office A/c	–	*1,14,000*
Trade debtors	*24,000*	–
Trade creditors	–	*17,000*
Cash at bank	*5,000*	–
Cash in hand	*1,000*	–
	5,47,000	*5,47,000*

The following further information is given :

(1) Wages outstanding – $ 1,000.

(2) Depreciate Plant and Machinery and Furniture and Fixtures @ 10 % p.a.

(3) The Head Office sent goods to Branch for Rs. 39,40,000.

(4) The Head Office shows an amount of Rs. 43,00,000 due from Branch.

(5) Stock on 30th September, 1998 – $ 52,000.

(6) There were no in transit items either at the start or at the end of the year.

(7) On September 1, 1996, when the fixed assets were purchased, the rate of exchange was Rs. 38 to one $.

On October 1, 1997, the rate was Rs. 39 to one $.

On September 30, 1998, the rate was Rs. 41 to one $.

Average rate during the year was Rs. 40 to one $.

You are asked to prepare :

(a) Trial balance incorporating adjustments given under 1 to 4 above, coverting dollars into rupees.

(b) Trading and Profit and Loss Account for the year ended 30th September, 1998 and Balance Sheet as on that date depicting the profitability and net position of the Branch as would appear in India for the purpose of incorporating in the main Balance Sheet. (16 marks) (Intermediate–Nov. 1999)

Answer

(a) **In the books of Indian Company**
Washington Branch Trial Balnce (in Rupees)
as on 30th September, 1998

(Rs. '000)

	Dr. *US $*	*Cr.* *US $*	*Conversion rate*	*Dr.* *Rs.*	*Cr.* *Rs.*
Plant and Machinery	1,08,000		41	44,28,000	
Depreciation on plant and machinery	12,000		41	4,92,000	
Furniture and fixtures	7,200		41	2,95,200	
Depreciation on furniture and fixtures	800		41	32,800	
Stock, Oct. 1, 1997	56,000		39	21,84,000	
Purchases	2,40,000		40	96,00,000	
Sales		4,16,000	40		1,66,40,000
Goods from Indian Co. (H.O.)	80,000			39,40,000	
Wages	3,000		40	1,20,000	
Outstanding wages	1,000		41		41,000

Carriage inward	1,000		40	40,000	
Salaries	6,000		40	2,40,000	
Rent, rates and taxes	2,000		40	80,000	
Insurance	1,000		40	40,000	
Trade expenses	1,000		40	40,000	
Head Office A/c		1,14,000			43,00,000
Trade debtors	24,000		41	9,84,000	
Trade creditors		17,000	41		6,97,000
Cash at bank	5,000		41	2,05,000	
Cash in hand	1,000		41	41,000	
Exchange gain					10,84,000
(balancing figure)				2,27,62,000	2,27,62,000

(b) **Washington Branch Trading and Profit and Loss Account for the year ended 30th September, 1998**

Dr.			*Cr.*
	Rs.		*Rs.*
To Opening stock	21,84,000	By Sales	1,66,40,000
To Purchases	96,00,000	By Closing stock	21,32,000
To Goods from Head Office	39,40,000	(52,000 US \$ × 41)	
To Wages	1,20,000		
To Carriage inward	40,000		
To Gross profit c/d	28,88,000		
	1,87,72,000		1,87,72,000
To Salaries	2,40,000	By Gross profit b/d	28,88,000
To Rent, rates and taxes	80,000		
To Insurance	40,000		
To Trade expenses	40,000		
To Depreciation on plant and machinery	4,92,000		
To Depreciation on furniture and fixtures	32,800		
To Net Profit c/d	19,63,200		
	28,88,000		28,88,000

Balance Sheet of Washington Branch
as on 30th September, 1998

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Head Office A/c	43,00,000		Plant and machinery	49,20,000	
Add : Net profit	19,63,200	62,63,200	*Less* : Depreciation	4,92,000	44,28,000
Foreign currency			Furniture and fixtures	3,28,000	
Translation reserve		10,84,000	*Less* : Depreciation	32,800	2,95,200
Trade creditors		6,97,000	Closing stock		21,32,000
Outstanding wages		41,000	Trade debtors		9,84,000
			Cash in hand		41,000
			Cash at bank		2,05,000
		80,85,200			80,85,200

Note : (1) Depreciation has been calculated at the given depreciation rate of 10% on WDV basis.

(2) The above solution has been given assuming that the Washington branch is a non-integral foreign operation of the Indian Company.

Question 7

Widespread Ltd. invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding Rs. 10,000 necessary for meeting immediate requirements of cash. On 31st March, 2000 the assets at the branch were as follows :

	Rs. ('000)
Cash in Hand	*10*
Trade Debtors	*384*
Stock, at Invoice Price	*1,080*
Furniture and Fittings	*500*

During the accounting year ended 31st March, 2001 the invoice price of goods dispatched by the head office to the branch amounted to Rs. 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at Rs. 72,000. Other transactions at the branch during the year were as follows :

	Rs. ('000)
Cash Sales	*9,700*
Credit Sales	*3,140*
Cash collected by Branch from Credit Customers	*2,842*
Cash Discount allowed to Debtors	*58*
Returns by Customers	*102*
Bad Debts written off	*37*
Expenses paid by Branch	*842*

On 1st January, 2001 the branch purchased new furniture for Rs.1 lakh for which payment was made by head office through a cheque.

On 31st March, 2001 branch expenses amounting to Rs. 6,000 were outstanding and cash in hand was again Rs. 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 2001.

(16 marks) (Intermediate–May 2001)

Answer

In the Head Office Books
Branch Account
for the year ended 31st March, 2001

Dr.			*Cr.*
	Rs. '000		*Rs.'000*
To Balance b/d		By Balance b/d	
Cash in hand	10	Stock reserve Rs. 1,080 × $\frac{1}{6}$	180
Trade debtors	384	By Goods sent to branch A/c	72
Stock	1,080	(Returns to H.O.)	
Furniture and fittings	500	By Goods sent to branch A/c	2,188
To Goods sent to branch A/c	13,200	(Loading on net goods sent	
To Bank A/c (Payment for furniture)	100	to branch –(Rs. 13,128 × $\frac{1}{6}$)	
To Balance c/d		By Bank A/c	
Stock reserve (Rs.1,470 × $\frac{1}{6}$)	245	(Remittance from	
		branch to H.O.)	11,700
Outstanding expenses	6	By Balance c/d	
To Profit and loss A/c	1,096	Cash in hand	10
(Net Profit)		Trade debtors	485
		Stock	1,470
		Furniture and fittings	516
	16,621		16,621

Working notes :

1. Invoice price and cost

Let cost be	100
So, invoice price	120
Loading	20

Loading : Invoice price = 20 : 120 = 1 : 6

2. Invoice price of closing stock in branch

Branch Stock Account

	Rs. '000		Rs. '000
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. Closing balance of branch debtors

Branch Debtors Account

	Rs. '000		Rs. '000
To Balance b/d	384	By Branch branch	2,842
To branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses (Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. Closing balance of furniture and fittings

Branch Furniture and Fittings Account

	Rs. '000		Rs. '000
To Balance b/d	500	By Depreciation (80+4)	84
To Bank	100	By Balance c/d	516
	600		600

5. Remittance by branch to head office

Branch Cash Account

	Rs. '000		Rs. '000
To Balance b/d	10	By Branch expenses	842
To Branch stock	9,700	By Remittances to H.O.	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

Question 8

On 31st March, 2000 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Debit Balances	*Rs. in lacs*
Furniture and Equipment	*18*
Depreciation on furniture	*2*
Salaries	*25*
Rent	*10*
Advertising	*6*
Telephone, Postage and Stationery	*3*
Sundry Office Expenses	*1*
Stock on 1st April, 1999	*60*
Goods Received from Head Office	*288*
Debtors	*20*
Cash at bank and in hand	*8*
Carriage Inwards	*7*
	448
Credit Balances	
Outstanding Expenses	*3*
Goods Returned to Head Office	*5*
Sales	*360*
Head Office	*80*
	448

Additional Information :

Stock on 31st March, 2000 was valued at Rs. 62 lacs. On 29th March, 2000 the Head Office despatched goods costing Rs. 10 lacs to its branch. Branch did not receive these goods before 1st April, 2000. Hence, the figure of goods received from Head Office does not include these goods. Also the head office has charged the branch Rs. 1 lac for centralised services for which the branch has not passed the entry.

You are required to :

(i) Pass Journal Entries in the books of the Branch to make the necessary adjustments

(ii) Prepare Final Accounts of the Branch including Balance Sheet, and

(iii) Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance. (16 marks) (Intermediate–May 2002)

Answer

(i)

Books of Branch

Journal Entries

(Rs. in lacs)

		Dr.	*Cr.*
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 2000)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii)

Trading and Profit & Loss Account of the Branch for the year ended 31st March, 2000

		Rs. in lacs		*Rs. in lacs*
To Opening Stock		60	By Sales	360
To Goods received from			By Closing Stock	62
Head Office	288			
Less : Returns	5	283		
To Carriage Inwards		7		
To Gross Profit c/d		72		
		422		422
To Salaries		25	By Gross Profit b/d	72
To Depreciation on Furniture		2		
To Rent		10		
To Advertising		6		
To Telephone, Postage & Stationery		3		
To Sundry Office Expenses		1		
To Head Office Expenses		1		
To Net Profit Transferred to Head Office A/c		24		
		72		72

Balance Sheet as on 31st March, 2000

Liabilities	*Rs. in lacs*	*Assets*		*Rs. in lacs*
Head Office	80	Furniture & Equipment	20	
Add : Goods in transit	10	*Less :* Depreciation	2	18

Head Office			Stock in hand	62
Expenses	1		Goods in Transit	10
Net Profit	24		Debtors	20
		115	Cash at bank and in hand	8
Outstanding Expenses		3		
		118		118

(iii)

Books of Head Office

Journal Entries

		Rs.	*Rs.*
		Dr.	*Dr.*
Branch Trading Account	Dr.	355	
To Branch Account			355
(The total of the following items in branch trial balance debited to branch trading account			
Rs. in lacs			
Opening Stock 60			
Goods received from Head Ofice 288			
Carriage Inwards 7)			
Branch Account	Dr.	427	
To Branch Trading Account			427
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amounts being as follows:			
Rs. in lacs			
Sales 360			
Closing Stock 62			
Goods returned to Head Office 5)			
Branch Trading Account	Dr.	72	
T0 Branch Profit and Loss Account			72
(Gross profit earned by branch credited to Branch Profit and Loss Account)			
Branch Profit and Loss Account	Dr.	48	
To Branch Account			48
(Total of the following branch expenses debited to Branch Profit & Loss Account			
Rs. in lacs			
Salaries 25			

Rent	10			
Advertising	6			
Telephone, Postage & Stationery	3			
Sundry Office Expenses	1			
Head Office Expenses	1			
Depreciation on furniture & Equipment	2			
Branch Profit & Loss Account		Dr.	24	
To Profit and Loss Account				24
(Net profit at branch credited to (general) Profit & Loss A/c)				
Branch Furniture & Equipment		Dr.	18	
Branch Stock		Dr.	62	
Branch Debtors		Dr.	20	
Branch Cash at Bank and in Hand		Dr.	8	
Goods in Transit		Dr.	10	
To Branch				118
(Incorporation of different assets at the branch in H.O. books)				
Branch		Dr.	3	
To Branch Outstanding Expenses				3
(Incorporation of Branch Outstanding Expenses in H.O. books)				

Question 9

Show adjustment Journal entry in the books of Head Office at the end of April, 2003 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch accounts in its books.

A. *Delhi Branch:*

(1) *Received goods from Mumbai – Rs. 35,000 and Rs. 15,000 from Kolkata.*
(2) *Sent goods to Chennai – Rs. 25,000, Kolkata – Rs. 20,000.*
(3) *Bill Receivable received – Rs. 20,000 from Chennai.*
(4) *Acceptances sent to Mumbai – Rs. 25,000, Kolkata – Rs. 10,000.*

B. *Mumbai Branch (apart from the above) :*

(5) *Received goods from Kolkata – Rs. 15,000, Delhi – Rs. 20,000.*
(6) *Cash sent to Delhi – Rs. 15,000, Kolkata – Rs. 7,000.*

C. Chennai Branch (apart from the above) :

(7) Received goods from Kolkata – Rs. 30,000.

(8) Acceptances and Cash sent to Kolkata – Rs. 20,000 and Rs. 10,000 respectively.

D. Kolkata Branch (apart from the above) :

(9) Sent goods to Chennai – Rs. 35,000.

(10) Paid cash to Chennai – Rs. 15,000.

(11) Acceptances sent to Chennai – Rs. 15,000. (8 marks) (PE-II–May 2003)

Answer

(a) Journal entry in the books of Head Office

Date	*Particulars*		*Dr.* *Rs.*	*Cr.* *Rs.*
30th April, 2003	Mumbai Branch Account	Dr.	3,000	
	Chennai Branch Account	Dr.	70,000	
	To Delhi Branch Account			15,000
	To Kolkata Branch Account			58,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 2003.			

Working Note:

Inter – Branch transactions

		Delhi *Rs.*	*Mumbai* *Rs.*	*Chennai* *Rs.*	*Kolkata* *Rs.*
A.	Delhi Branch				
(1)	Received goods	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
(2)	Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
(3)	Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
(4)	Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)
B.	Mumbai Branch				
(5)	Received goods	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)
(6)	Sent cash	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
C.	Chennai Branch				
(7)	Received goods			30,000 (Dr.)	30,000 (Cr.)
(8)	Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D.	Kolkata Branch				
(9)	Sent goods			35,000 (Dr.)	35,000 (Cr.)

(10)	Sent cash			15,000 (Dr.)	15,000 (Cr.)
(11)	Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
		15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Question 10

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses Rs. 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for Rs. 1,500.

(iii) Branch paid Rs. 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected Rs. 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of Rs. 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of Rs. 3,000 on behalf of Branch B.

(6 marks) (PE-II–Nov. 2004)

Books of Branch A
Journal Entries

	Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
(i)	Expenses account	Dr.	3,500	
	To Head office account			3,500
	(Being the allocated expenditure by the head office recorded in branch books)			
(ii)	Depreciation account	Dr.	1,500	
	To Head office account			1,500
	(Being the depreciation provided)			
(iii)	Head office account	Dr.	2,000	
	To Salaries account			2,000
	(Being the rectification of salary paid on behalf of H.O.)			
(iv)	Head office account	Dr.	10,000	
	To Debtors account			10,000
	(Being the adjustment of collection from branch debtors)			
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account			3,000
	(Being the expenditure on account of Branch B, recorded in books)			

Question 11

M/s Shah & Co. commenced business on 1.4.2004 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office, where the goods were processed before sale. There was no loss or wastage in processing.

Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales, whether by Head Office or by the Branch, were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2005.

	Head Office		Branch	
	Dr.	Cr.	Dr.	Cr.
	Rs.	Rs.	Rs.	Rs.
Capital		3,10,000		
Drawings	55,000			
Purchases	19,69,500			
Cost of processing	50,500			
Sales		12,80,000		8,20,000
Goods sent to Branch		9,24,000		
Administrative expenses	1,39,000		15,000	
Selling expenses	50,000		6,200	
Debtors	3,09,600		1,13,600	
Branch Current account	3,89,800			
Creditors		6,01,400		10,800
Bank Balance	1,52,000		77,500	
Head Office Current account				2,61,500
Goods received from H.O.			8,80,000	
	31,15,400	31,15,400	10,92,300	10,92,300

Following further information is provided:

(i) Goods sent by Head Office to the Branch in March, 2005 of Rs. 44,000 were not received by the Branch till 2.4.2005.

(ii) A remittance of Rs. 84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2005.

(iii) Stock taking at the Branch disclosed a shortage of Rs. 20,000 (at selling price to the branch).

(iv) Cost of unprocessed goods at Head Office on 31.3.2005 was Rs. 1,00,000.

Prepare Trading and Profit and Loss account in columnar form and Balance Sheet of the business as a whole as at 31.3.2005. *(16 Marks) (PE-II – Nov. 2006)*

Answer

In the Books of Shah & Co.

Trading and Profit and Loss Account for the year ended 31st March, 2005

	Particulars	*H.O.*	*Branch*	*Total*			*H.O.*	*Branch*	*Total*
		Rs.	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*
To	Purchases	19,69,500	–	19,69,500	By	Sales	12,80,000	8,20,000	21,00,000
To	Cost of processing	50,500	–	50,500	By	Goods sent to Branch	9,24,000	–	–
To	Goods received				By	Stock shortage	–	16,000	14,545
	from H.O.	–	8,80,000	–	By	Goods in transit			44,000
To	Gross profit c/d	3,40,000	1,64,000	5,02,545	By	Closing stock:			
						Processed goods	56,000	2,08,000	2,64,000
						Unprocessed goods	1,00,000	–	1,00,000
		23,60,000	10,44,000	25,22,545			23,60,000	10,44,000	25,22,545
To	Admn. Expenses	1,39,000	15,000	1,54,000	By	Gross profit b/d	3,40,000	1,64,000	5,02,545
To	Selling Expenses	50,000	6,200	56,200					
To	Stock shortage	–	16,000	14,545					
To	Stock reserve	22,909	–	22,909					
To	Net profit	1,28,091	1,26,800	2,54,891					
		3,40,000	1,64,000	5,02,545			3,40,000	1,64,000	5,02,545

Balance Sheet as at 31st March, 2005

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital	3,10,000		Debtors		
Add: Net profit	2,54,891		H.O.		3,09,600
	5,64,891		Branch		1,13,600
Less: Drawings	55,000	5,09,891	Closing stock:		
Creditors:			Processed goods		
H.O.	6,01,400		H.O.	56,000	
Branch	10,800	6,12,200	Branch	2,08,000	
				2,64,000	
			Less: Stock reserve	18,909	2,45,091
			Unprocessed goods		1,00,000
			Bank Balance		
			H.O.		1,52,000
			Branch		77,500
			Goods in transit	44,000	
			Less: Stock reserve	4,000	40,000
			Cash in transit		84,300
		11,22,091			11,22,091

Working Notes:

1. **Calculation of closing stock:**

Stock at Head Office:

Cost of goods processed Rs. (19,69,500 + 50,500 – 1,00,000)		19,20,000
Less: Cost of goods sent to Branch		
$9,24,000 \times \frac{100}{110}$	8,40,000	
Cost of goods sold $12,80,000 \times \frac{100}{125}$	10,24,000	18,64,000
Stock of processed goods with H.O.		56,000

Stock at Branch:

Goods received from H.O. (at invoice price)			8,80,000
Less: Invoice value of goods sold			
$8{,}20{,}000 \times \frac{100}{125}$		6,56,000	
Invoice value of stock shortage	$20{,}000 \times \frac{100}{125}$	16,000	6,72,000
Stock at Branch at invoice price			2,08,000
Less: Stock Reserve $2{,}08{,}000 \times \frac{10}{110}$			18,909
Stock of processed goods with Branch (at cost)			1,89,091

2. Stock Reserve:

Unrealised profit on Branch stock $\left(2{,}08{,}000 \times \frac{10}{110}\right)$	18,909
Unrealised profit on goods in transit $\left(44{,}000 \times \frac{10}{110}\right)$	4,000
	22,909

Question 12

Concept & Co., with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33 1/3%. The following information is given in respect of the branch for the year ended 31st March, 2006:

	Rs.
Goods sent to Branch (Invoice price)	*4,80,000*
Stock at Branch on 1.4.2005 (Invoice price)	*24,000*
Cash sales	*1,80,000*
Return of goods by customers to the Branch	*6,000*
Branch expenses (paid in cash)	*53,500*
Branch debtors balance on 1.4.2005	*30,000*
Discount allowed	*1,000*
Bad debts	*1,500*
Collection from Debtors	*2,70,000*
Branch debtors cheques returned dishonoured	*5,000*
Stock at Branch on 31.3.2006 (Invoice price)	*48,000*
Branch debtors balance on 31.3.2006	*36,500*

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of *the Head Office:*

(i) Nagpur Branch Stock Account

(ii) Nagpur Branch Debtors Account

(iii) Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any.

(16 Marks) (PE-II – May 2006)

Answer

In the books of head office

Nagpur Branch Stock Account

	Rs.			Rs.
1.4.2005 To Balance b/d	24,000	31.3.06 By Bank A/c (Cash Sales)		1,80,000
31.3.2006 To Goods sent to Branch A/c	4,80,000	By Branch Debtors (Credit Sales)		2,80,000
To Branch Debtors	6,000	By Stock shortage:		
		Branch P&L A/c	1,500*	
		Branch Adjustment A/c (Loading)	500	2,000
		By Balance c/d		48,000
	5,10,000			5,10,000

Nagpur Branch Debtors Account

1.4.2005 To Balance b/d	30,000	31.3.2006 By Bank A/c (Collection)	2,70,000
31.3.2006 To Bank A/c (dishonour of cheques)	5,000	By Branch Stock A/c	6,000
To Branch Stock A/c	2,80,000*	By Bad debts	1,500
		By Discount allowed	1,000
		By Balance c/d	36,500
	3,15,000		3,15,000

Nagpur Branch Adjustment Account

To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	1,13,500		
	1,26,000		1,26,000

To Branch Stock A/c		By Gross Profit b/d	1,13,500
(Cost of loss)	1,500		
To Branch Expenses	56,000		
To Net Profit			
(Transferred to General P & L A/c)	56,000		
	1,13,500		1,13,500

*Balancing figure.

Working Notes:

1. Credit Sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is taken as credit sales

2. Loading is 33 $\frac{1}{3}$ % or Cost; i.e. 25% of invoice value

   Loading on opening stock = 24,000 × 25% = 6,000

3. Loading on goods sent = 4,80,000 × 25% = Rs.1,20,000

4. Loading on Closing Stock = Rs.48,000 × 25% = Rs.12,000

5. Total Branch Expenses = Cash expenses + Bad debt + Discount allowed

   = Rs.53,500 + Rs.1,500 + Rs.1,000 = Rs.56,000

6. Gross Profit

   Total sales (at invoice price) - Goods returned by customers (at invoice price) x $\frac{33.33}{100+33.33}$

   {(Rs. 1,80,000+ Rs. 2,80,000)- Rs. 6,000} x $\frac{33.33}{133.33}$ = Rs. 1,13,500

Question 13

Red and Co. of Mumbai started a branch at Bangalore on 1.4.2006 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2007:

	Rs.
Cost of goods sent to branch	*1,00,000*
Goods received by branch till 31.3.2007 at Invoice price	*1,08,000*
Credit sales for the year	*1,16,000*
Closing debtors on 31.3.2007	*41,600*
Bad debts written off during the year	*400*
Cash remitted to H.O.	*86,000*
Closing cash on hand at branch on 31.3.2007	*4,000*
Cash remitted by H.O. to branch during the year	*6,000*

Closing stock in hand at branch at invoice price	*12,000*
Expenses incurred at branch	*24,000*

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment A/c for ascertaining gross profit and Branch Profit and Loss A/c for ascertaining Branch profit. *(16 Marks) (PE II- May, 2007)*

Answer

Branch Debtors A/c

Dr.					*Cr.*
		Rs.			*Rs.*
To	Branch Stock A/c	1,16,000	By	Branch Cash A/c (balancing figure)	74,000
			By	Bad Debts (written off)	400
			By	Balance c/d	41,600
		1,16,000			1,16,000

Goods Sent to Branch A/c

To	Branch Adjustment A/c $1,00,000 \times \frac{20}{100}$	20,000	By	Branch Stock A/c	1,20,000
To	Purchases/ Trading A/c	1,00,000			
		1,20,000			1,20,000

Branch Cash A/c

To	Branch Debtors A/c	74,000	By	Branch Expenses A/c	24,000
To	H.O. A/c (cash remittance)	6,000	By	H.O. (cash remittance)	86,000
To	Branch Stock A/c - Cash Sales (balancing figure)	34,000	By	Balance c/d	4,000
		1,14,000			1,14,000

Branch Stock A/c

To	Goods sent to Branch A/c	1,20,000	By	Branch Debtors A/c	1,16,000
To	Branch Adjustment A/c	54,000	By	Branch Cash A/c (Sales)	34,000
	(Excess profit over normal loading - balancing figure)		By	Goods in Transit (1,20,000-1,08,000)	12,000
			By	Balance c/d	12,000
		1,74,000			1,74,000

Branch Expenses A/c

To	Branch Cash A/c	24,000	By	Branch P&L A/c	24,000

Branch Adjustment A/c

To	Stock Reserve A/c	2,000	By	Goods sent to Branch A/c	20,000
To	Goods in transit Reserve A/c	2,000	By	Branch Stock A/c	54,000
To	Branch P&L A/c (Balancing figure)	70,000			
		74,000			74,000

Branch P & L A/c

To	Branch Expenses A/c	24,000	By	Branch Adjustment A/c	70,000
To	Bad Debts	400			
To	Net Profit (transferred to General P&L A/c)	45,600			
		70,000			70,000

Working Notes:

1. Loading is 20% of cost i.e. 16.67% (1/6th) of invoice value.

   Loading on closing stock = Rs. 1/6th of Rs.12,000 =Rs. 2,000.

2. Loading on goods sent to branch = 1/6th of Rs.1,20,000 = Rs. 20,000.

3. Loading on goods in transit = 1/6th of Rs. 12,000 = Rs. 2,000.

Question 14

The Washington branch of XYZ Limited, Mumbai sent the following trial balance as on 31st December, 2007:

	$	$
Head office A/c	_	*22,800*
Sales	_	*84,000*
Debtors and creditors	*4,800*	*3,400*
Machinery	*24,000*	_
Cash at bank	*1,200*	_
Stock, 1 January, 2007	*11,200*	_
Goods from H.O.	*64,000*	_
Expenses	*5,000*	_
	1,10,200	*1,10,200*

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

		Rs.			Rs.
To	*Balance b/d*	*8,10,000*	*By*	*Cash*	*28,76,000*
To	*Goods sent to branch*	*29,26,000*	*By*	*Balance c/d*	*8,60,000*
		37,36,000			*37,36,000*

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired on 31st January, 2002, when $ 1.00 = Rs.40.

Rates of exchange were:

1st January, 2007	*$ 1.00*	=	*Rs.46*
31st December, 2007	*$ 1.00*	=	*Rs.48*
Average	*$ 1.00*	=	*Rs.47*

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

(16 Marks) (PE II- May, 2008)

Answer

(i) **In the Books of Head Office**

Branch Trading and Profit & Loss A/c (in Dollars)

for the year ended 31st December, 2007

	Particulars	*$*		*Particulars*	*$*
To	Opening stock	11,200	By	Sales	84,000
To	Goods from H.O.	64,000	By	Closing stock (W.N.2)	8,000
To	Gross profit c/d	16,800			
		92,000			92,000
To	Expenses	5,000	By	Gross profit b/d	16,800
To	Depreciation	2,400			
To	Manager's commission (W.N.1)	470			
To	Net profit c/d	8,930			
		16,800			16,800

(ii) **(a)** **Converted Branch Trial Balance (into Indian Currency)**

Particulars	*Rate per $*	*Dr. (Rs.)*	*Cr. (Rs.)*
Machinery	40	9,60,000	_
Stock January 1, 2007	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate		47,000	_
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		Rs.3,84,000

(b) **Branch Trading and Profit & Loss A/c**

for the year ended 31st December, 2007

		Rs.			Rs.
To	Opening stock	5,15,200	By	Sales	39,48,000
To	Goods from head office	29,26,000	By	Closing stock (W.N.2)	3,84,000
To	Gross profit c/d	8,90,800			
		43,32,000			43,32,000
To	Expenses	2,35,000	By	Gross profit b/d	8,90,800
To	Depreciation @ 10% on Rs.9,60,000	96,000			
To	Exchange difference	47,000			
To	Manager's commission (W.N.1)	22,560			
To	Net Profit c/d	4,90,240			
		8,90,800			8,90,800

(c) **Branch Account**

		Rs.				Rs.
To	Balance b/d	8,60,000	By	Machinery	9,60,000	
To	Net profit	4,90,240		*Less:* Depreciation	96,000	8,64,000
To	Creditors	1,63,200	By	Closing stock		3,84,000
To	Outstanding commission	22,560	By	Debtors		2,30,400
			By	Cash at bank		57,600
		15,36,000				15,36,000

Working Notes:

1. **Calculation of manager's commission @ 5% on profit**

   i.e. 5% of $[16,800 – (5,000 + 2,400)]

   Or 5% × $9,400 = $ 470

   Manager's commission in Rupees = $ 470 × Rs.48 = Rs. 22,560

2. Calculation of closing stock

	$
Opening stock	11,200
Add: Goods from head office	64,000
	75,200
Less: Cost of goods sold (at invoice price)	
i.e. $\frac{100}{125} \times 84,000$	67,200
Closing stock	8,000

Closing stock in Rupees = $8,000 x Rs.48 = Rs.3,84,000.

4

ACCOUNTING FOR SOME SPECIAL TRANSACTIONS

UNIT 1 & 2 : HIRE PURCHASE AND INSTALMENT PAYMENT SYSTEM AND ACCOUNTING FOR LEASES

Question 1

Krishna Agencies started business on 1st April, 1994. During the year ended 31st March, 1995, they sold under-mentioned durables under two schemes — Cash Price Scheme (CPS) and Hire-Purchase Scheme (HPS).

Under the CPS they priced the goods at cost plus 25% and collected it on delivery.

Under the HPS the buyers were required to sign a Hire-purchase Agreement undertaking to pay for the value of the goods including finance charges in 30 instalments, the value being calculated at Cash Price plus 50%.

The following are the details available at the end of 31st March, 1995 with regard to the products :

Product	Nos. purchased	Nos. sold under CPS	Nos. sold under HPS	Cost per unit Rs.	No. of instalments due during the year	No. of instalments received during the year
TV sets	90	20	60	16,000	1,080	1,000
Washing Machines	70	20	40	12,000	840	800

The following were the expenses during the year :

	Rs.
Rent	1,20,000
Salaries	1,44,000
Commission to Salesmen	12,000
Office Expenses	1,20,000

From the above information, you are required to prepare :

(a) Hire-purchase Trading Account, and

(b) Trading and Profit & Loss Account. *(20 marks) (Intermediate–May 1995)*

Answer

In the books of Krishna Agencies
Hire-Purchase Trading Account
for the year ended 31st March, 1995

	Rs.	Rs.		Rs.	Rs.
To Goods sold on H.P. A/c:			By Bank A/c cash received		
TVs			TVs		
(60×Rs. 30,000)	18,00,000		(1,000×Rs. 1,000)	10,00,000	
Washing Machines			Washing Machines		
(40 × Rs. 22,500)	9,00,000	27,00,000	(800 ×Rs. 750)	6,00,000	16,00,000
To H.P. Stock Reserve			By Instalment Due A/c:		
Rs. 9,90,000×$\frac{87.5}{187.5}$		4,62,000	TVs		
			(80×Rs.1,000)	80,000	
To Profit & Loss A/c		7,98,000	Washing Machines		
(H.P. profit transferred)			(40×Rs. 750)	30,000	1,10,000
			By Goods sold on HP A/c: (Cancellation of loading)		
			Rs. 27,00,000 ×$\frac{87.5}{187.5}$		12,60,000
			By H.P. Stock (W.N 2)		9,90,000
		39,60,000			39,60,000

Trading and Profit & Loss Account
for the year ended 31st March, 1995

	Rs.	Rs.		Rs.	Rs.
To Purchases:			By Sales:		
TVs			TVs		
(90×Rs. 16,000)	14,40,000		(20×Rs. 20,000)	4,00,000	
Washing Machines			Washing Machines		
(70 × Rs. 12,000)	8,40,000	22,80,000	(20 ×Rs. 15,000)	3,00,000	7,00,000
To Gross profit c/d		1,40,000	By Goods sold on H.P. A/c		14,40,000
			(27,00,000–12,60,000)		
			By Shop Stock (W. N 3)		2,80,000
		24,20,000			24,20,000
To Salaries		1,44,000	By Gross profit b/d		1,40,000

To Rent	1,20,000	By H.P. Trading a/c	
To Commission	12,000	(H.P. Profit)	7,98,000
To Office expenses	1,20,000		
To Net Profit	5,42,000		
	9,38,000		9,38,000

Working Notes:

(1) *Calculation of per unit cash price, H.P. price and Instalment Amount :*

Product	*Cost Rs.*	*Cash Price Rs. (Cost × 1.25)*	*H.P. price Rs. (Cash Price× 1.50)*	*Instalment Amount (Rs.) (H.P. price/No. of instalments)*
TV sets	16,000	20,000	30,000	1,000
Washing Machines	12,000	15,000	22,500	750

(2) *Calculation of H.P. Stock as on 31st March, 1995 :*

Product	*Total No. of Instalments (Nos.)*	*Instalments Due in 1994-95 (Nos.)*	*Instalments not due in 1994-95 (Nos.)*	*Amount Rs.*
TV sets	1800	1080	720	7,20,000
Washing Machines	1,200	840	360	2,70,000
				9,90,000

(3) *Calculation of Shop Stock as on 31st March, 1995 :*

Product	*Purchased (Nos.)*	*Sold (Nos.)*	*Balance (Nos.)*	*Amount Rs.*
TV sets	90	80	10	1,60,000
Washing Machines	70	60	10	1,20,000
				2,80,000

Question 2

ABC Associates entered into a financial lease agreement on 1.4.1995 with Flexible Leasing Ltd. for lease of a car. The price of the car was Rs. 2,00,000 and the quarterly lease rentals were agreed at Rs. 90 per thousand payable at the beginning of every quarter. ABC Associates kept up their payments but by 25.3.1996 they approached and obtained the *consent of the leasing company for treating the arrangement as one of Hire-purchase from the beginning on the following terms :*

Period: 3 years

Quarterly hire : Rs. 30,000 payable at the beginning of the quarter.

It was agreed that the lease rentals paid will be treated as hire monies and that the balance due upto 31.3.1996 will be settled by ABC Associates on that date with interest at 18% p.a. on various instalments due during the year. The rate of depreciation on the car is 25%.

Show the following accounts in the books of ABC Associates for the year 1995-96:

Flexible Leasing Ltd.'s A/c and Interest Suspense A/c.

Calculations are to be rounded off to the nearest rupee (15 Marks)(Intermediate–May 1996)

Answer

Books of ABC Associates
Flexible Leasing Limited Account

Dr.					*Cr.*
		Rs.			*Rs.*
1996			1996		
March 25	To Lease rental A/c	72,000	March 25	By Car on Hire Purchase A/c	2,00,000
March 31	To Bank	53,400	March 25	By Interest Suspense A/c	1,60,000
March 31	To Balance c/d	2,40,000		By Interest A/c	5,400
		3,65,400			3,65,400

Interest Suspense Account

Dr.					*Cr.*
		Rs.			*Rs.*
1996			1996		
March 25	To Flexible Leasing Ltd. A/c	1,60,000	March, 31	By Interest on Hire purchase A/c	72,727
			March, 31	By Balance c/d	87,273
		1,60,000			1,60,000

Working Notes :

(i) Calculation of balance payable on 31st March, 1996 and the Amount of Interest

Calculation of Difference Payable on 31.3.1996 and Interest

Date	Quarterly Hire Charges (Rs.)	Quarterly Lease Rentals Paid (Rs.)	Difference Payable (Rs.)	Interest (18% p.a.) From	To	Amount of Interest (Rs.)
1.4.95	30,000	18,000	12,000	1.4.95	31.3.96	2,160
1.7.95	30,000	18,000	12,000	1.7.95	31.3.96	1,620
1.10.95	30,000	18,000	12,000	1.10.95	31.3.96	1,080
1.1.96	30,000	18,000	12,000	1.1.96	31.3.96	540
		72,000	48,000			5,400

Amount payable on 31st March, 1996 :

	Rs.
Balance due	48,000
Interest due	5,400
	53,400

(1) Ascertainment of Total Amount of Interest on Hire Purchase

	Rs.
Hire Purchase Price of the car	
(Rs. 30,000 × 12 installments)	3,60,000
Less : Cash Price	2,00,000
Total Amount of Interest	1,60,000

(2) Calculation of Interest on Hire Purchase Attributable to the year 1995-1996.

Date	*Interest Calculation*	*Interest* *Rs.*
1.4.95	—	—
1.7.95	$1,60,000 \times \frac{11}{66}$	26,667
1.10.95	$1,60,000 \times \frac{10}{66}$	24,242

1.1.96	$1{,}60{,}000 \times \frac{9}{66}$	21,818
		72,727

Question 3

Omega Corporation sells computers on hire purchase basis at cost plus 25%. Terms of sales are Rs. 10,000 as down payment and 8 monthly instalments of Rs. 5,000 for each computer. From the following particulars prepare Hire Purchase Trading Account for the year 1999.

As on 1st January, 1999 last instalment on 30 computers was outstanding as these were not due up to the end of the previous year.

During 1999 the firm sold 240 computers. As on 31st December, 1999 the position of instalments outstanding were as under :

Instalments due but not collected :

2 instalments on 2 computers and last instalment on 6 computers.

Instalments not yet due :

8 instalments on 50 computers, 6 instalments on 30 and last instalment on 20 computers.

Two computers on which 6 instalments were due and one instalment not yet due on 31.12.99 had to be repossessed. Repossessed stock is valued at 50% of cost. All other instalments have been received. (10 marks) (Intermediate–May 2000)

Answer

In the books of Omega Corporation
Hire Purchase Trading Account
for the year ended on 31st Dec., 1999

Dr.				*Cr*
	Rs.	*Rs.*		*Rs.*
To Hire Purchase Stock (30×Rs. 5,000)		1,50,000	By Hire Purchase Sales (W.N. 2)	91,40,000
To Goods Sold on Hire Purchase (240×Rs. 50,000)		1,20,00,000	By Stock Reserve (Rs. 1,50,000×20%)	30,000
To Bad Debts		12,000	By Goods sold on Hire Purchase (Rs. 1,20,00,000× 20%)	24,00,000
To Loss on Re-possession	16,000		By Hire Purchase Stock [(8×50+6×30+1×20)× Rs. 5,000]	30,00,000
Less : Instalments not yet due	8,000	8,000		
To Stock Reserve (30,00,000 ×20%)		6,00,000		

To Profit & Loss A/c (Transfer of Profit)	18,00,000		
	1,45,70,000		1,45,70,000

Alternatively, hire purchase trading account can be prepared in the following manner :

Hire Purchase Trading Account
for the year ended on 31st Dec., 1999

	Rs.		Rs.
To Hire Purchase Stock (30×Rs. 5,000)	1,50,000	By Cash (W.N.1)	90,30,000
To Goods Sold on Hire Purchase (240×Rs. 50,000)	1,20,00,000	By Stock Reserve (Rs. 1,50,000×20%)	30,000
To Stock Reserve (Rs. 30,00,000 × 20%)	6,00,000	By Goods Sold on Hire Purchase (Rs. 1,20,00,000×20%)	24,00,000
To Profit & Loss A/c (Transfer of Profit)	18,00,000	By Goods Repossessed (2×Rs. 40,000×50%)	40,000
		By Instalments Due [(2×2+1×6)×Rs. 5,000]	50,000
		By Hire Purchase Stock [8×50+6×30+1×20)×Rs. 5,000]	30,00,000
	1,45,50,000		1,45,50,000

Working Notes :

		Rs.
(1)	*Cash collected:*	
	Cash down payment (240 × Rs. 10,000)	24,00,000
	Add : Instalments collected :	
	Last instalments on 30 computers outstanding on 1.4.99	1,50,000
	Instalments due and collected on 240 computers sold during the year :	
	Total instalments on 240 computers (8 × 240 × Rs. 5,000)	96,00,000
	Less : Instalments due but not collected [(2 × 2 + 1 × 6 + 6 × 2) × Rs. 5,000]	1,10,000

	Instalments not due on 31.12.99 [(8 × 50 + 6 × 30 + 1 × 20 + 1 × 2) × Rs. 5,000]	30,10,000	31,20,000	64,80,000
				90,30,000
(2)	*Hire purchase sales:*			
	Cash collected			90,30,000
	Add : Instalments due but not collected			
	[(2 × 2 + 1 × 6 + 6 × 2) × Rs. 5,000]			1,10,000
				91,40,000
(3)	*Loss on repossessed computers:*			
	Cost of instalments due but not collected			
	(6 × 2 × Rs. 4,000)			48,000
	Cost of Instalments not yet due			
	(1 × 2 × Rs. 4,000)			8,000
				56,000
	Less : Estimated value of repossessed computers			
	(2 × Rs. 40,000 × 50%)			40,000
	Loss			16,000
(4)	*Bad debts (in respect of repossessed computers):*			
	Instalments due but not collected			
	(6 × 2 × Rs. 5,000)			60,000
	Cost of installments not due on 31.12.99			
	(1 × 2 × Rs. 5,000 × 80%)			8,000
				68,000
	Less : Cost of instalments due but not collected			
	(6 × 2 × Rs. 4,000)			48,000
	Cost of instalments not yet due			
	(1 × 2 × Rs. 4,000)		8,000	56,000
	Bad debts			12,000

Question 4

Welwash (Pvt.) Ltd. sells washing machines for outright cash as well as on hire-purchase basis. The cost of a washing machine to the company is Rs. 10,500. The company has fixed *cash price of the machine at Rs. 12,300 and hire-purchase price, at Rs. 13,500 payable as to Rs. 1,500 down and the balance in 24 equal monthly instalments of Rs. 500 each.*

On Ist April, 2000 the company had 26 washing machines lying in its showroom. On that date 3 instalments had fallen due, but not yet received and 675 instalments were yet ot fall due in respect of machines lying with the hire purchase customers.

During the year ended 31st March, 2001 the company sold 130 machines on cash basis and 80 machines on hire-purchase basis. After paying five monthly instalments, one customer failed to pay subsequent instalments and the company had to repossess the washing machine. After spending Rs. 1,000 on it, the company resold it for Rs. 11,500.

On 31st March, 2001 there were 21 washing machines in stock, 810 instalments were yet to fall due and 5 instalments had fallen due, but not yet received in respect of washing machines lying with the hire-purchase customers. Total selling expenses and office expenses including depreciation on fixed assets totalled Rs. 1,60,000 for the year.

You are required to prepare for the Accounting Year ended 31st March, 2001:

(1) Hire purchase Trading Account, and

(2) Trading and Profit and Loss Account showing net profit earned by the company after making provision for income-tax @ 35%. (16 marks)(Intermediate–Nov. 2001)

Answe

In the books of Welwash (Pvt.) Ltd.
Hire Purchase Trading Account
for the year ended on 31st March, 2001

Dr.			*Cr*
	Rs.		*Rs.*
To Hire Purchase Stock (Rs. 500 × 675)	3,37,500	By Cash (W.N. 1)	10,02,000
To Instalments due Rs. (500 × 3)	1,500	By Stock Reserve $\left(\text{Rs.}3,37,500 \times \frac{3,000}{13,500}\right)$	75,000
To Goods sold on Hire Purchase (Rs. 13,500×80)	10,80,000	By Goods Repossessed (Rs. 13,500–Rs. 1,500–Rs. 2,500)	9,500
To Stock Reserve $\left(\text{Rs.}4,05,000 \times \frac{3,000}{13,500}\right)$	90,000	By Goods sold on Hire Purchase $\left(\text{Rs.}10,80,000 \times \frac{3,000}{13,500}\right)$	2,40,000
To Profit and Loss A/c (Transfer of profit)	2,25,000	By Hire Purchase Stock (Rs. 500 × 810)	4,05,000
		By Instalments due (Rs. 500 × 5)	2,500
	17,34,000		17,34,000

Trading and Profit and Loss Account
for the year ended on 31st March, 2001

	Rs.		Rs.
To Opening Stock	2,73,000	By Sales (Rs. 12,300×130)	15,99,000
(Rs.10,500×26)			
To Purchases		By Goods sold on Hire Purchase	
Rs. 10,500×(130+80+21–26)	21,52,500	(Rs. 10,80,000–Rs. 2,40,000)	8,40,000
To Gross Profit	2,34,000	By Closing Stock (Rs. 10,500×21)	2,20,500
	26,59,500		26,59,500
To Sundry Expenses	1,60,000	By Gross Profit	2,34,000
To Provision for Income Tax		By Hire Purchase Trading A/c	2,25,000
(35% of Rs. 3,00,000)	1,05,000	By Goods Repossessed	
To Net Profit for the year	1,95,000	(Rs. 11,500–Rs.1,000–Rs. 9,500)	1,000
	4,60,000		4,60,000

Working Notes :

(1) *Cash collected during the year*

			Rs.
Hire purchase stock on 1.4.2000			3,37,500
Instalments due on 1.4.2000			1,500
Hire purchase price of goods sold during the year			10,80,000
			14,19,000
		Rs.	
Less :	Repossessed goods	9,500	
	Hire purchase stock on 31.3.2001	4,05,000	
	Instalments due on 31.3.2001	2,500	4,17,000
Cash collected during the year			10,02,000

(2) *Washing machines purchased during the year*

	No.	No.
Closing balance	21	
Add : Cash Sales	130	

Sales on hire purchase basis	80	231
Less : Opening stock		26
Purchase during the year		205

Purchases 205 × Rs. 10,500 = Rs. 21,52,500

Question 5

A acquired on 1st January, 2003 a machine under a Hire-Purchase agreement which provides for 5 half-yearly instalments of Rs. 6,000 each, the first instalment being due on 1st July, 2003. Assuming that the applicable rate of interest is 10 per cent per annum, calculate the cash value of the machine. All working should form part of the answer.

(8 marks) (PE-II – May 2003)

Answer

Statement showing cash value of the machine acquired on hire-purchase basis

	Instalment Amount	*Interest @ 5% half yearly (10% p.a.) = 5/105 = 1/21) (in each instalment)*	*Principal Amount (in each instalment)*
	Rs.	Rs.	Rs.
5th Instalment	6,000	286	5,714
Less: Interest	– 286		
	5,714		
Add: 4th Instalment	6,000		
	11,714	558	5,442
Less: Interest	558		(11,156–5,714)
	11,156		
Add: 3rd instalment	6,000		
	17,156	817	5,183
Less: Interest	817		(16,339–11,156)
	16,339		
Add: 2nd instalment	6,000		
	22,339	1,063	4,937
Less: Interest	1,063		(21,276–16,339)
	21,276		

Add: 1st instalment	6,000		
	27,276	1,299	4,701
Less: Interest	1,299	____	(25,977–21,276)
	25,977	4,023	25,977

The cash purchase price of machinery is Rs. 25,977.

Question 6

Sameera Corporation sells Computers on Hire-purchase basis at cost plus 25%. Terms of sales are 5,000/- as Down payment and 10 monthly instalments of Rs. 2,500/- for each Computer. From the following particulars, prepare Hire-purchase Trading A/c for the year 2002-2003:

As on 1st April, 2002, last instalment on 20 Computers were outstanding as these were not due upto the end of the previous year. During 2002—03, the firm sold 120 Computers. As on 31st March, 2003 the position of instalments outstanding were as under:

Instalments due but not collected	*4 Instalments on 4 Computers and Last instalment on 9 Computers*
Instalments not yet due	*6 Instalments on 50 Computers, 4 Instalments on 20 and Last Instalment on 40 Computers*

Two Computers on which 8 Instalments were due and one Instalment not yet due on 31.03.2003, had to be repossessed. Repossessed stock is valued at 50% of cost. All other Instalments have been received. *(14 marks) (PE-II – May 2004)*

Answer

In the books of Sameera Corporation
Hire Purchase Trading Account
for the year ended 31st March, 2003

Dr.			*Amount* Rs.			*Cr.* *Amount* Rs.
To	Hire Purchase Stock (20 × Rs. 2,500)		50,000	By	Hire Purchase Sales (W.N. 2)	25,95,000
To	Goods sold on Hire Purchase (120×Rs.30,000)		36,00,000	By	Stock Reserve (Rs. 50,000 × 20%)	10,000
To	Bad Debts (W.N. 4)		8,000	By	Goods sold on Hire Purchase (Rs. 36,00,000 × 20%)	7,20,000
To	Loss on Repossession	12,000				
	Less: Instalments not yet due	4,000	8,000	By	Hire Purchase Stock [(6×50+4×20+ 1×40) × Rs. 2,500]	10,50,000
To	Stock Reserve (Rs.10,50,000 × 20%)		2,10,000			

To	Profit and Loss Account (Transfer of Profit)	4,99,000		
		43,75,000		43,75,000

Alternatively the Hire Purchase Trading A/c can be prepared in the following manner:

Hire Purchase Trading Account
for the year ended 31st March, 2003

		Amount Rs.			*Amount Rs.*
To	Hire Purchase Stock (20 × Rs. 2,500)	50,000	By	Cash Account (W.N. 1)	24,92,500
To	Goods sold on Hire Purchase (120×Rs.30,000)	36,00,000	By	Stock Reserve (Rs. 50,000 × 20%)	10,000
To	Stock Reserve (Rs.10,50,000 × 20%)	2,10,000	By	Goods sold on Hire Purchase (Rs. 36,00,000 × 20%)	7,20,000
To	Profit and Loss Account (Transfer of Profit)	4,99,000	By	Goods Repossessed (2 × Rs. 24,000 × 50%)	24,000
			By	Instalments due [(4 × 4 + 1 × 9) × Rs. 2,500]	62,500
			By	Hire Purchase Stock [(6 × 50 + 4 × 20 + 1 × 40) × Rs. 2,500]	10,50,000
		43,59,000			43,59,000

Question 7

ABC Ltd. sells goods on Hire-purchase by adding 50% above cost. From the following particulars, prepare Hire-purchase Trading account to reveal the profit for the year ended 31.3.2005:

		Rs.
1.4.2004	*Instalments due but not collected*	*10,000*
1.4.2004	*Stock at shop (at cost)*	*36,000*
1.4.2004	*Instalment not yet due*	*18,000*
31.3.2005	*Stock at shop*	*40,000*
31.3.2005	*Instalments due but not collected*	*18,000*
Other details:		
Total instalments became due		*1,32,000*
Goods purchased		*1,20,000*
Cash received from customers		*1,21,000*

Goods on which due instalments could not be collected were repossessed and valued at 30% below original cost. The vendor spent Rs. 500 on getting goods overhauled and then sold for Rs. 2,800. *(16 marks) (PE-II – May 2005)*

Answer

In the Books of ABC Ltd.
Hire Purchase Trading Account
for the year ended 31st March, 2005

Dr.			*Rs.*			*Cr.*	*Rs.*
1.1.2004	To	Hire purchase stock	18,000	1.1.2004	By	Stock reserve (1/3 of Rs. 18,000)	6,000
1.1.2004 to 31.3.2005	To	Goods sold on hire Purchase	1,74,000	1.1.2004 to 31.3.2005	By	Hire purchase sales	1,32,000
	To	Loss on repossession of goods (W.N. 5)	1,600		By	Goods sold on hire purchase (1/3 of Rs. 1,74,000)	58,000
31.3.2005	To	Stock reserve	20,000		By	Profit on sale of repossessed goods (W.N. 4)	900
	To	Profit and loss account (Transfer of profit)	43,300	31.3.2005	By	Hire purchase stock (W.N. 3)	60,000
			2,56,900				2,56,900

Alternatively, Hire Purchase Trading Account can be prepared in the following manner:

Hire Purchase Trading Account
for the year ended 31st March, 2005

Dr.			*Rs.*			*Cr.*	*Rs.*
1.1.2004	To	Hire purchase stock	18,000	1.1.2004	By	Stock reserve (1/3 of Rs. 18,000)	6,000
1.1.2004	To	Hire purchase debtors	10,000				
to 31.3.2005	To	Goods sold on hire purchase	1,74,000	1.1.2004 to 31.3.2005	By	Cash (Rs. 1,21,000 + Rs. 2,800)	1,23,800
	To	Cash (Overhauling charges)	500		By	Goods sold on hire purchase (1/3 of Rs. 1,74,000)	58,000
31.3.2005	To	Stock reserve	20,000				
	To	Profit and loss account (Transfer of profit)	43,300	31.3.2005	By	Hire purchase stock	60,000
					By	Hire purchase debtors	18,000
			2,65,800				2,65,800

Working Notes:

1. Memorandum Instalment due but not collected (hire purchase debtors) account

Dr.		*Rs.*		*Cr.*	*Rs.*
To	Balance b/d	10,000	By	Cash	1,21,000
To	Hire purchase sales	1,32,000	By	Repossessed stock (Balancing figure)	3,000
			By	Balance c/d	18,000
		1,42,000			1,42,000

2. Memorandum shop stock account

Dr.		*Rs.*		*Cr.*	*Rs.*
To	Balance b/d	36,000	By	Goods sold on hire purchase (Balancing figure)	1,16,000
To	Purchases	1,20,000			
			By	Balance c/d	40,000
		1,56,000			1,56,000

3. Memorandum Instalment not yet due (hire purchase stock) account

Dr.		*Rs.*		*Cr.*	*Rs.*
To	Balance b/d	18,000	By	Hire purchase Sales	1,32,000
To	Goods sold on hire purchase [1,16,000 + (1,16,000 × 50%)]	1,74,000	By	Balance c/d (Balancing figure)	60,000
		1,92,000			1,92,000

4. Goods Repossessed account

Dr.		*Rs.*		*Cr.*	*Rs.*
To	Hire purchase debtors	3,000	By	Hire purchase trading account (W.N. 5)	1,600
			By	Balance c/d (W.N. 5)	1,400
		3,000			3,000
To	Balance b/d	1,400	By	Cash account	2,800
To	Cash account (expenses)	500			
To	Profit on sale	900			
		2,800			2,800

5.

	Rs.
Original cost of goods repossessed $\left(\text{Rs. } 3{,}000 \times \frac{100}{150}\right)$	2,000
Instalments due but not received	3,000
Valuation of repossessed goods (70% of Rs. 2,000)	1,400
Loss on repossession	1,600

Question 8

Computer point sells computers on Hire-purchase basis at cost plus 25%. Terms of sale are Rs.5,000 down payment and eight monthly instalments of Rs.2,500 for each computer.
The following transactions took place during the financial year 2006-07:

Number of instalments not yet due as on 1.4.2006	*= 25*
Number of instalments due but not collected as on 1.4.2006	*= 5*

During the financial year 240 computers were sold. Out of the above sold computers during the year the outstanding position were as follows as on 31.3.2007:
Instalments not yet due:

(i) Eight instalments on 50 computers.

(ii) Six instalments on 30 computers.

(iii) Two instalments on 10 computers.

Instalments due but not collected:

Two instalments on 5 computers during the year. Two computers on which five instalments were due and two instalments not yet due were repossessed out of sales effected during current year. Repossessed stock is valued at 50% of cost. All instalments have been received. You are asked to prepare Hire-Purchase Trading Account for the year ending on 31.3.2007.

(PE II- Nov. 2007)(16 Marks)

Answer

Dr. **Hire Purchase Trading Account for the year ended 31.3.2007** *Cr.*

		Rs.			*Rs.*
To	Hire purchase stock (25 x Rs. 2,500)	62,500	By	Stock reserve ($62{,}500 \times \frac{25}{125}$)	12,500
To	Hire purchase debtors (5 x Rs. 2,500)	12,500	By	Goods sold on hire purchase A/c – Loading ($60{,}00{,}000 \times \frac{25}{125}$)	12,00,000
To	Goods sold on hire purchase (240 computers x Rs.25,000*)	60,00,000	By	Cash A/c (W.N.1)	45,15,000

* Hire purchase price of a computer = Rs. 5,000 + (Rs. 2,500 x 8) = Rs. 25,000.

To	Stock reserve (Rs.15,00,000 $\times \frac{25}{125}$)	3,00,000	By	Repossessed goods (W.N.2)	20,000
To	Profit transferred to P & L A/c	8,97,500	By	Hire purchase debtors (2 x 5 x Rs.2,500)	25,000
			By	Hire purchase stock [(8x50)+(6x30)+(2x10) x Rs.2,500]	15,00,000
		72,72,500			72,72,500

Working Notes:

1. Calculation of cash collected during the year

		Rs.
Down payment received on 240 computers sold during the year (240 x Rs.5,000)		12,00,000
Number of Instalments due and collected:	No. of instalments	
Total Instalments (8 instalments x 240 computers)	1,920	
Add: Opening hire purchase debtors	25	
Add: Opening hire purchase stock	5	
	1950	
Less: Closing hire purchase debtors (2 x 5)	10	
	1,940	
*Less:*Closing hire purchase stock		
8 x 50 = 400		
6 x 30 = 180		
2 x 10 = 20	600	
	1,340	
*Less:*Repossessed computer (5 x 2 + 2 x 2)	14	
Total number of instalments received during the year	1,326	
Total amount of instalments received (1,326 instalments x Rs.2,500)		33,15,000
Instalments collected during the year		45,15,000

2. Value of repossessed computers

Hire purchase price of two repossessed computers = [Rs.5,000 + (8 x Rs. 2,500)] x 2 computers

= Rs.50,000

Cost price of the repossessed computers $= \frac{\text{Rs.}50{,}000}{125} \times 100$ = Rs. 40,000

Value of repossessed computers = Rs.40,000 x 50% = Rs.20,000

Alternatively Hire Purchase Trading Account can also be prepared in the following manner:

Dr. *Hire Purchase Trading Account for the year ended 31.3.2007* **Cr.**

			Rs.			*Rs.*
To	Hire purchase stock (25 x Rs. 2,500)		62,500	By	Stock reserve ($62{,}500 \times \frac{25}{125}$)	12,500
To	Hire purchase debtors (5 x Rs. 2,500)		12,500	By	Hire purchase sales A/c (W.N.1)	45,65,000
To	Goods sold on hire purchase (240 computers x Rs.25,000)		60,00,000	By	Goods sold on hire purchase A/c – Loading ($60{,}00{,}000 \times \frac{25}{125}$)	12,00,000
To	Bad debts (W.N.3)		5,000	By	Hire purchase stock [(8x50)+(6x30)+(2x10) x Rs.2,500]	15,00,000
To	Loss on goods repossessed (W.N.2)	8,000				
	Less : Cost of instalments not due	8,000	Nil			
To	Stock reserve $15{,}00{,}000 \times \frac{25}{125}$		3,00,000			
To	Profit transferred to P & L A/c		8,97,500			
			72,77,500			72,77,500

Working Notes:

1. Calculation of hire purchase sales *Rs.*

Cash collected (As per the working note 1 of the Alternate solution given above)	45,15,000
Add: Instalments due but not collected (including repossessed computers) (2 x Rs.2,500 x 5) + (5 x Rs.2,500 x 2)	5,00,000
	45,65,000

2. Calculation of loss on repossessed computers

Cost of instalments due but not collected $\frac{(2 \text{ x } 2{,}500 \text{ x } 5)}{125} \times 100$	20,000
Add: Cost of instalments not yet due $\frac{(2 \text{ x } 2{,}500 \text{ x } 2)}{125} \times 100$	8,000
	28,000
Less : Value of repossessed computers $\left[\frac{(2 \text{ x } 25{,}000)}{125} \times 100\right] \times 50\%$	20,000
Loss on repossessed computers	8,000

3. Bad debts (in respect of repossessed computers)

Instalments due but not collected (5 x Rs.2,500 x 2)		25,000
Add: Cost of installments not due $\frac{(2 \times \text{Rs. } 2{,}500 \text{ x } 2)}{125} \times 100$		8,000
		33,000
Less : Cost of instalments due but not collected $\frac{(5 \text{ x Rs.} 2{,}500 \text{ x } 2)}{125} \times 100$	20,000	
Cost of instalments not yet due $\frac{(2 \times \text{Rs. } 2{,}500 \text{ x } 2)}{125} \times 100$	8,000	28,000
Bad debts on repossessed computers		5,000

Question 9

Easy buy Corporation sells goods on hire-purchase basis. The hire-purchase price is cost plus 60%.

It furnishes you the following information:

	Rs.
Hire Purchase stock on 1.4.2007	*2,40,000*
Installments due on 1.4.2007	*45,000*
Goods sold on hire purchase from 1.4.2007 to 31.3.2008	*9,60,000*
Cash collected from HP debtors during 1.4.2007 to 31.3.2008	*3,00,000*
Stock with customers at hire-purchase price on 31.3.2008	*6,40,000*

You are required to prepare Hire Purchase Trading Account for the year ended 31st March, 2008 *(8 Marks) (PE II- Nov. 2008)*

Answer

Hire Purchase Trading Account

For the year ended 31.3.2008

		Rs.			Rs.
To	Hire purchase stock (Opening)	2,40,000	By	Hire purchase stock reserve (Opening)	90,000
To	Instalments due (Opening)	45,000	By	Bank (Collections)	3,00,000
To	Goods sold on hire purchase	9,60,000	By	Goods sold on hire purchase (Loading)	3,60,000
To	Hire purchase stock reserve (Closing)	2,40,000	By	Hire purchase stock (Closing)	6,40,000
To	Profit and loss A/c	2,10,000	By	Instalments due (Closing)	3,05,000
		16,95,000			16,95,000

Working Notes:

Memorandum Hire Purchase Stock A/c

	Rs.		Rs.
To Balance b/d	2,40,000	By Hire Purchase debtors A/c (Balancing Figure)	5,60,000
To Goods sold on hire purchase	9,60,000	By balance c/d	6,40,000
	12,00,000		12,00,000

Memorandum Hire Purchase Debtors A/c

	Rs.		Rs.
To Balance b/d	45,000	By Cash/Bank A/c	3,00,000
To Hire purchase stock A/c	5,60,000	By balance c/d (Balancing Figure)	3,05,000
	6,05,000		6,05,000

UNIT 3 : INVESTMENT ACCOUNTS

Question 1

On 1.4.96, Sundar had 25,000 equity shares of 'X' Ltd.at a book value of Rs. 15 per share (Face value Rs.10). On 20.6.96, he purchased another 5,000 shares of the company at Rs. 16 per share. The directors of 'X'Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The tems of the issue are as follows:

Bonus basis 1:6 (Date 16.8.96).

Rights basis 3:7 (Date 31.8.96) Price Rs. 15 per share.

Due date for payment 30.9.96.

Shareholders can transfer their rights in full or in part. Accordingly Sundar sold 33.33% of his entitlement to Sekhar for a consideration of Rs. 2 per share.

Dividends: Dividends for the year ended 31.3.96 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.96. Dividends for shares acquired by him on 20.6.96 are to be adjusted against the cost of purchase.

On 15.11.96, Sundar sold 25,000 equity shares at a premium of Rs. 5 per share.

You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.96 and shares are valued at average cost. *(15 Marks), (Intermediate–May 1997)*

Answer

Books of Sundar

Investment Account

Equity Shares in X Ltd.

		No.	Amount Rs.			No.	Amount Rs.
1.4.96	To Bal b/d	25,000	3,75,000	30.9.96	By Bank (Sale of Rights)		10,000
20.6.96	To Bank	5,000	80,000	31.10.96	By Bank (dividend on shares acquired on 20/6/96)		10,000
16.8.96	To Bonus	5,000	—				
30.9.96	To Bank (Rights Shares)	10,000	1,50,000				

				15.11.96	By Bank		
					(Sale of shares)	25,000	3,75,000
15.11.96	To Profit		50,000	31.12.96	By Bal. c/d	20,000	2,60,000
	transferred	45,000	6,55,000			45,000	6,55,000

Profit & Loss A/c

To Balance c/d	1,00,000	By Profit transferred	50,000
		By Dividend	50,000
	1,00,000		1,00,000

Working Notes:

(1) Bonus Shares = $\frac{(25{,}000+5{,}000)}{6} = 5{,}000$ shares

(2) Right Shares = $\frac{25{,}000+5{,}000+5{,}000}{7} \times 3$ = 15,000 shares

(3) Rights shares renounced = 15,000×1/3 = 5,000 shares

(4) Dividend received = 25,000×10×20% = Rs. 50,000

Dividend on shares purchased on 20.6.96 = 5,000×10×20% = Rs.10,000 is adjusted to Investment A/c

(5) Cost of shares on 31.12.96

$$\frac{(3{,}75{,}000+80{,}000+1{,}50{,}000-10{,}000-10{,}000)}{45{,}000} \times 20{,}000 \quad = \text{Rs.}\,2{,}60{,}000$$

Question 2

On 1.4.2002, Mr. Krishna Murty purchased 1,000 equity shares of Rs. 100 each in TELCO Ltd. @ Rs. 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per Rs. 100 as cost of shares transfer stamps. On 31.1.2003 Bonus was declared in the ratio of 1 : 2. Before and after the record date of bonus shares, the shares were quoted at Rs. 175 per share and Rs. 90 per share respectively. On 31.3.2003 Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower. *(10 marks) (PE-II – Nov. 2003)*

Answer

In the books of Mr. Krishna Investment Account
for the year ended 31st March, 2003

(Scrip: Equity Shares of TELCO Ltd.)

Dr.									*Cr.*
Date		*Particulars*	*Nominal Value (Rs.)*	*Cost (Rs.)*	*Date*		**Particulars**	*Nominal Value (Rs.)*	*Cost (Rs.)*
1.4.2002	To	Bank A/c	1,00,000	1,23,000	31.3.2003	By	Bank A/c	50,000	44,100
31.1.2003	To	Bonus shares	50,000	–	31.3.2003	By	Balance c/d	1,00,000	82,000
31.3.2003	To	Profit & loss A/c	–	3,100					
			1,50,000	1,26,100				1,50,000	1,26,100

Working Notes:

(i) Cost of equity shares purchased on 1.4.2002 = 1,000 × Rs. 120 + 2% of Rs. 1,20,000 + ½% of Rs. 1,20,000 = Rs. 1,23,000

(ii) Sale proceeds of equity shares sold on 31st March, 2003 = 500 × Rs. 90 – 2% of Rs. 45,000 = Rs. 44,100.

(iii) Profit on sale of bonus shares on 31st March, 2003

= Sales proceeds – Average cost

Sales proceeds = Rs. 44,100

Average cost = Rs. (1,23,000 × 50,000)/1,50,000

= Rs. 41,000

Profit = Rs. 44,100 – Rs. 41,000 = Rs. 3,100.

(iv) Valuation of equity shares on 31st March, 2003

Cost = (Rs. 1,23,000 × 1,00,000)/1,50,000 = Rs. 82,000)

Market Value = 1,000 shares × Rs. 90 = Rs. 90,000

Closing balance has been valued at Rs. 82,000 being lower than the market value.

UNIT 4 : CONTRACT ACCOUNTS

Question 1

Completed Contract Method.

(5 marks) (Intermediate–Nov. 1995)

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.

Question 2

Describe with reference to Accounting Standard 7 on Accounting for construction contracts, the methods which may be used for recognizing revenue on construction contracts.

(4 marks) (Intermediate–Nov. 2001)

Answer

As per Accounting Standard 7 on Accounting for Construction Contracts, two methods of accounting commonly followed by contractors for recognizing revenue on construction contracts are the percentage of completion method and the completed contract method.

Under the percentage of completion method, revenue is recognized as the contract activity progresses based on the stage of completion reached. The costs incurred in reaching the stage of completion are matched with this revenue, resulting in the reporting of results which can be attributed to the proportion of work completed. Although (as per the principle of 'prudence') revenue is recognized only when realized, under this method, the revenue is recognized as the activity progresses even though in certain circumstances it may not be realized.

Under the completed contract method, revenue is recognized only when the contract is completed or substantially completed; that is, when only minor work is expected other than warranty obligation. Costs and progress payments received are accumulated during the course of the contract but revenue is not recognized until the contract activity is substantially completed.

Under both methods, provision is made for losses for the stage of completion reached on the contract. In addition, provision is usually made for losses on the remainder of the contract.

It may be necessary for accounting purposes to combine contracts made with a single customer or to combine contracts made with several customers if the contracts are negotiated as a package or if the contracts are for a single project. Conversely, if a contract covers number of projects and if the costs and revenues of such individual projects can be identified within the terms of the overall contract, each such project may be treated as equivalent to a separate contract.

5

INTRODUCTION TO GOVERNMENT ACCOUNTS AND ACCOUNTING FOR AGRICULTURAL FARMS

UNIT 1 : INTRODUCTION TO GOVERNMENT ACCOUNTS

(A) Write short notes on:

Question 1

Principles of Government Accounting *(5 marks) [Intermediate–Nov. 1995]*

Answer

Government expenditure in India is classified into a five Tier-system:

(i) Sectors (ii) Major heads (iii) Minor heads (iv) Sub-heads (v) Detailed heads of accounts.

The Government's main interest is to forecast with possible accuracy what is expected to be received or paid during the year and whether the former together with the balance of the past year is sufficient to cover the latter. Similarly in the complete accounts of the year, it is concerned to see to what extent its forecast was justified by facts and whether it has surplus or deficit balance as a result of year's transactions.

Government accounts are designed to determine how much money it has to mobilise in order to maintain its necessary activities at the proper standard of efficiency. On the basis of budgets and accounts, government determines (a) whether to curtail or expand its activities and (b) whether it can and should increase or decrease taxation accordingly.

The accounts are kept on single entry. However, a portion of the accounts are kept on double entry system. A statement of its estimated annual receipts and expenditure is prepared by each government and presented to its legislature. A Union Territory presents statement to their legislature with the previous approval of the President. This annual statement is commonly known as Budget. In the statement, the sums required to meet expenditure charged upon the Consolidated Fund of India or the Consolidated Fund of State, or the Consolidated Fund of Union Territory and the sums required to meet other expenditure are shown separately. The budget shows receipts and payments of the government under three heads :

1. Consolidated Fund
2. Contingency Fund
3. Public Account

The budget comprises of (i) Revenue Budget and (ii) Capital budget.

Question 2

Consolidated Fund *(5 marks) [Intermediate Nov. 1996]*

Answer

In India Government accounts are kept in three main parts, i.e., consolidated fund, contingency fund and public account.

Revenue of the Government arising out of taxation, other receipts classified as revenue, certain capital receipts by way of deposits, advances and expenditure therefrom are classified and accounted under "Consolidated fund".

Accounting for the Central Government and State Government is done separately i.e., consolidated fund of India for the Central Government and a separate consolidated fund for each state and Union Territory. The two main sub-divisions under the consolidated fund are Revenue A/c and Capital A/c.

Question 3

Proprietary ratio. *(5 marks) [Intermediate –May 1997]*

Answer

Proprietary ratio is calculated to judge the owner's contribution to total fund application/assets.

$$\text{Proprietary ratio} = \frac{\text{Proprietary Fund}}{\text{Total Assets}}$$

Proprietary Fund includes both share capital equity, preference capital and reserves and surplus minus losses. However, for this purpose only free reserves should be counted. The ratio indicates the share of proprietary fund against each rupee of investment. This ratio also helps to analyse the strength of the company.

A high proprietary ratio will indicate less utilization of external funds. It will also indicate the high internal funds utilization of the company. The optimum proprietary ratio to be maintained by a company will depend on the industry to which it belongs.

Question 4

Peculiarity of Government Accounting. *(5 marks) [Intermediate–May 1999]*

Answer

The main objective of government accounting is to forecast with possible accuracy what is expected to be received or paid during the year and whether the former together with the balance of past year is sufficient to cover the latter. Similarly in the complete accounts of the year, Government is concerned to see to what extent the forecast was justified by facts and whether it has surplus or deficit balance as a result of year's transactions.

Accordingly, government accounts are designed to determine how much money it has to mobilize in order to maintain its necessary activities at the proper standard of efficiency. On the basis of budgets and accounts, government determines (a) whether to curtail or expand its activities and, (b) whether it can and should increase or decrease taxation accordingly. Government expenditure in India is classified into a five tier-system : (i) Sectors (ii) Major heads (iii) Minor heads, (iv) Sub-heads, (v) Detailed heads of accounts.

The mass of government accounts is kept on single entry. There is, however, a portion of the accounts which is kept on double entry system. A statement of its estimated annual receipts and expenditures is prepared by each government and presented to its legislature. A Union Territory presents statement to its legislature with the previous approval of the President. This annual statement is commonly known as budget. In this statement, the sums required to meet the expenditure charged upon the Consolidated Fund of India or of State or of Union Territory and the sums required to meet other expenditure are shown separately. The budget shows receipts and payments of the government under three heads :

1. Consolidated Fund
2. Contingency Fund
3. Public Account.

The budget comprises of revenue budget and capital budget. Thus one of the most distinctive features of the system of government accounts in India is the minute elaboration with which the financial transactions of government under both receipts and payments, are differentiated and classified.

Question 5

Whether government accounting is totally different from commercial accounting ? State your opinion with reasons. *(5 marks) [Intermediate –Nov. 1999]*

Answer

The primary objective of commercial accounting is to ascertain the gain or loss of an enterprise for a given period and to find out the position of assets and liabilities at the end of the accounting period. Against this, government accounts are designed to enable government to determine how much money it needs to mobilize in order to maintain its necessary activities at the proper standard of efficiency. It is thus clear that the purpose of government accounting is totally different from that of commercial accounting. The other broad differences between government accounting and commercial accounting can be enumerated as follows :

1. *Financial Statements* : Every commercial enterprise prepares a profit and loss account and a Balance Sheet. But in case of government accounting, following two statements are generally prepared:
   - *(i)* Government account — to show the net result of all incomes and expenditure including expenditure on capital account ;
   - *(ii)* Statement of balancing accounts — to show whether the government owes or has to receive money.
2. *Method of accounting :* Government accounts are maintained on cash basis as against commercial accounting in which accounts are normally maintained on mercantile basis.

3. *System of accounting :* In commercial accounting, double entry system of book keeping is followed. On the other hand, mass of the government accounts are kept on single entry. There is, however, a portion of accounts which is maintained on double entry basis.

4. *Classification of accounts :* In commercial accounting, accounts are broadly classified into (i) personal (ii) real, and (iii) nominal accounts. Government accounts are kept in three parts : Part 1 – Consolidated fund ; Part II – Contingency fund ; and Part III – Public account.

5. *Classification of financial transactions :* One of the most distinctive features of the system of government accounts in India is the minute elaboration with which the financial transactions of government under both receipts and payments, are differentiated and classified. Government expenditure in India is classified into a five tier system : Sectors, Major heads, Minor heads, Sub-heads and Detailed heads of accounts. In case of commercial accounting, no such elaborate details are provided.

Question 6

Briefly explain "Treasury system" and the functions entrusted to Treasury in Government Accounting. (4 marks) (Intermediate–May 2000 & Nov. 2000, PE-II–Nov. 2003, Nov. 2007)

Answer

Under the treasury system, district treasury is the basic unit and the focal point for the primary record of financial transactions of government in the district with sub-treasuries under it at the Taluks and Tehsils level.

The Treasuries are of two kinds - (1) Banking (ii) Non-banking. A bank treasury means a treasury, the cash business of which is conducted by the Reserve Bank of India or its branches or agencies authorised to conduct Government business and non-banking treasury means a treasury, the cash business of which is conducted by itself.

The functions entrusted to the treasury are as follows:

(i) Receipt of money from the public and departmental officers for credit to government.

(ii) Payment of claims against Government on bills or cheques or other instruments presented by departmental drawing and disbursing officers or pensioners or others authorised to do so.

(iii) Keeping initial and subsidiary accounts of the receipts and payments occurring at them and rendering statements of such transactions to the Accountant General for detailed compilation and consolidation.

(iv) Acting as a banker in respect of funds of local bodies, Zilla Parishads, Panchayat Institutions etc. who keep their funds with the treasuries.

(v) Custody of opium and other valuables because of the strong room facility provided at the treasury.

(vi) Custody of cash balances of the State Government and conducting cash business of Government at non-banking treasuries.

Question 7

Treasury System used for the primary record of Financial Transactions of the Government.

(4 marks) [Intermediate –May 2001]

Answer

In the treasury system, there are treasuries which receive and pay money on behalf of the government. Under this system, district treasury is the basic unit and the local point for the primary record of financial transactions of government in the district with sub-treasuries under it at the taluks/tahsils in the district. The system was evolved more than a century ago Treasuries are of two kinds – (i) banking and (ii) non-banking. The cash business of a bank treasury is conducted by the Reserve Bank of India or its branches or authorized agencies. A non-banking treasury conducts the cash business itself.

Apart from receiving and paying cash on behalf of government, treasury keeps initials and subsidiary accounts of receipts and payments occurring at it and renders statements of transactions to the Accountants General for detailed compilation and consolidation. It acts as a banker in respect of funds of local bodies, zila parishads etc. Treasury also keeps custody of opium and other valuables belonging to the government in its strong room.

Question 8

What are the main principles of allocation between Capital and Revenue accounts on a Capital scheme? *(4 Marks) (PE-II – May 2005)*

Answer

The following are the main principles governing the allocation of expenditure on a capital scheme between capital and revenue accounts:

(i) Capital account should bear all charges for the first construction and equipment of a project as well as charges for intermediate maintenance of the work while not yet opened for service. It would also bear charges for such further additions and improvements as may be sanctioned under rules made by competent authority.

(ii) Subject to (iii) below, revenue account should bear all subsequent changes for maintenance and all working expenses. These embrace all expenditure on the working and upkeep of the project and also on such renewals and replacements and such additions, improvements or extensions as prescribed by Government.

(iii) In the case of works of renewal and replacement which partake both of a capital and revenue nature, the allocation of expenditure should be regulated by the broad principle that revenue should pay or provide a fund for the adequate replacement of all wastage or depreciation of property originally provided out of capital grants and that only the cost of genuine improvements, whether determined by prescribed rules or formulae or under special orders of Government, should be debited to capital account. Where under special orders of Government, a Depreciation or Renewals Reserve Fund is established for renewing assets of any commercial department or undertaking, the distribution of expenditure on renewals, and replacements between capital account and the fund should be so regulated as to guard against over-capitalisation on the one hand and excessive withdrawals from the fund on the other.

(iv) Expenditure on account of reparation of damage caused by extraordinary calamities such as flood, fire, earthquake, enemy action, should be charged to capital account or to revenue account or divided between them in such a way as may be determined by Government according to the circumstance of each case.

(v) Capital receipts in so far as they relate to expenditure previously debited to capital heads, accruing during the process of construction of a project, should be utilised in reduction of capital expenditure. Thereafter, their treatment in the accounts will depend on circumstances, but except under a special rule or order of Government, they should not be credited to the revenue account of the department or undertaking.

Question 9

Write short note on "Appropriation Act" with reference to Government Accounts.

(4 Marks) (PE-II – Nov. 2006)

Answer

After the demand is passed by the legislature, appropriation bill is introduced to provide for the appropriation out of the Consolidated Fund of India or the State or the Union Territory having separate legislature for all moneys required to meet (a) the grants made by the legislature; (b) the expenditure charged on consolidated fund but not exceeding in any case the amount shown in the statement previously laid before the legislature. No money can be withdrawn from the consolidated fund until the appropriation bill is passed. The sum is authorized in the Appropriation Act or intended to cover all the changes including the liability of past years to be paid during a financial year or to be adjusted in accounts of the year. Any unspent balance lapses and is not available for utilisation in the following year.

Question 10

How the Government expenditure in India is classified? *(2 Marks) (PE II-May, 2008)*

Answer

Government expenditure in India is classified into a five tier system:

(i) Sectors
(ii) Major Heads
(iii) Minor Heads
(iv) Sub-Heads
(v) Detailed Heads of Accounts

UNIT 2 : ACCOUNTING FOR AGRICULTURAL FARMS

(A) Write short notes on:

Question 1

Use of Accounting information in agricultural farms.

(5 marks) [Intermediate–May 1996 and PE-II May 2006]

Answer

A properly designed accounting system can be used for extracting the following information:

1. Crop-wise performance and overall performance of the agricultural enterprise.
2. Comprehensive information regarding yield, revenue, input and cost of the enterprise.
3. Financial state of affairs i.e. assets and liabilities of the farm at a particular point of time.
4. Profit/Loss of the farm during a year.
5. Data base for other decisions, namely (a) acquire assets or hire services for ploughing, irrigation, weeding, threshing etc.; (b) replacement of draught animal, machinery and farming technique; (c) selection of crop-mix; (d) choosing farm size; (e) farm diversification, for example adding crop and non-farming activities like processing of agricultural products; (f) divestment decisions whether to discontinue agricultural operations.
6. Supporting data to the lenders including banks and co-operative societies to assess farm's financial requirements as well as debt servicing ability.
7. Reliable data for farm management survey.
8. Reliable data for assessment of agricultural income tax.

Question 2

Explain, why Accounting in Agricultural operation is not popular. Mention a few peculiar features of Farm Accounting. (7 marks) (Intermediate–Nov. 1996 & PE-II–Nov. 2004)

Answer

The features of farm accounting are as follows:

(i) Agricultural sector in India is unorganized and dominated by small farmers. Most agricultural farms are family oriented and part of the farms produce is consumed by the family members. Level of the education of the average farmers appears to be the principal barrier for adaptation of agricultural accounting system. Farmers are not aware of the technique of using accounting data for the purpose of management decision and usefulness of data base management.

(ii) The family takes part in management and provides labour for the farm. Farmers cannot afford the additional expenses involved in hiring a person to maintain accounts.

(iii) Agriculture is in some cases a seasonal occupation and many farmers have other occupations also. Farming operations are uncertain due to natural calamities.

(iv) There are many divisions in farm accounting. Finished product of one division can become the raw material for another.

(v) Tax authorities do not rigorously insist on maintenance of books of account. Collection of statistics by the government is also not adequate.

Question 3

Compilation of accounting information for agricultural farm. (5 marks) (Q. 1 (i) (b) of May 1999)

Answer

Agricultural activities are carried on mostly in an unorganized manner. The farmer has no office and also does not find time for day by day record keeping. The transactions and events are also not supported by vouchers or other documents in most of the cases. So it is desirable to maintain a Diary to record happenings of the day. This Diary becomes the source document for record keeping.

Seven registers are required for running the accounting system.

1. *Cash Book:* to record cash transactions.
2. *Fixed Assets Register:* to record details of fixed assets – description of assets, cost of purchases/construction/generation, disposal, depreciation and balance.
3. *Loan Register:* to record borrowings from bank, cooperatives and other agencies trade creditors along with interest paid or payable.
4. *Stock Register:* to record details of input, output and by product – receipts, utilization, wastage and balance.
5. *Debtors and Creditors Register:* to record credit transactions classified by parties involved.
6. *Register for National Transactions:* to record transactions between farm and farm household.
7. *Cost Analysis Register:* to record cropwise input and output inclusive of apportionment of common costs and finding out crop profit.

Question 4

Common costs incurred in agricultural farm and the basis of their apportionment.

(5 marks (6 (b) of Nov. 2000)

Answer

Seed, fertilizer, manure, pesticides, direct wages—notional and actual, land rental—notional and actual can be identified crop-wise. But other costs like irrigation, services of agricultural machinery, implements or animal power, depreciation, interest etc. cannot be classified simply by nomenclature. These costs which can't be identified cropwise are common costs of the agricultural farms. Common costs should be apportioned among the crop enterprises on the basis of usage, wherever use of assets can be quantified. In other cases length of crop season can be used. An illustrative list of the common costs and apportionment bases is given below:

Apportionment bases of common costs in agriculture

Cost element	*Apportionment basis*
Maintenance of Draught Animal and Depreciation	Animal Base
Maintenance of Agricultural Machinery, Implements and Depreciation	Machine Hours
Maintenance of Farm Shed and Depreciation	Length of crop season
Interest on Fixed Capital	Length of crop season
Interest on Working Capital	Working Capital Investment for various crops

Question 5

What are the information that are extracted from the well designed accounting system in Agricultural Farm? (4 Marks) (PE II- May, 2007)

Answer

A well designed accounting system can be used for extracting the following information:

1. Crop-wise performance and overall performance of the agricultural enterprise.
2. Comprehensive information regarding yield, revenue, input and cost of the enterprise.
3. Financial state of affairs i.e. assets and liabilities of the farm at a particular point of time.
4. Profit/Loss of the farm during a year.
5. Data base for other decisions, namely (a) acquire assets or hire services for ploughing, irrigation, weeding, threshing etc.; (b) replacement of draught animal, machinery and farming technique; (c) selection of crop-mix; (d) choosing farm size; (e) farm diversification, for example adding crop and non-farming activities like processing of agricultural products; (f) divestment decisions whether to discontinue agricultural operations.
6. Supporting data to the lenders including banks and co-operative societies to assess farm's financial requirements as well as debt servicing ability.
7. Reliable data for farm management survey.
8. Reliable data for assessment of agricultural income tax.

Question 6

List out major cost elements and revenue elements of an Agricultural farm.

(4 marks)(PE II, Nov. 2007)

Answer

In an agricultural farm, major cost elements are:

Seed, Fertilizer, Pesticides, Irrigation, Wages, Running and Maintenance cost of Agricultural Machinery and Implements, Maintenance cost of drought animals, depreciation of fixed assets, Interest on borrowed capital, Notional Rental on owned Land, Notional interest on owner's capital, Notional Wages of Family Workers.

In an agricultural farm, revenue consists of sale of main products and by-products, value of family consumption of crops and by-products, value of crops and by-products transferred to allied enterprise run by the family (example, use of paddy straw as food of milch animal), value of output exchanged for input.

Question 7

Give names of books required to be maintained in agriculture farm accounting.

(4 Marks) (PE II-May, 2008)

Answer

The following seven books/registers are required in agriculture farm accounting:

i. Cash book

ii. Fixed assets register

iii. Loan register

iv. Stock register

v. Debtors and creditors register

vi. Register for notional transactions

vii. Cost analysis register

Question 8

Draw a list of direct crop costs and another of common costs in agricultural farming.

(4 Marks) (PE II- Nov. 2008)

Answer

Direct crop costs in agricultural farming are as follows:

- Seeds
- Fertilizer and manure

- Pesticides and insecticides
- Wages – notional and actual
- Hire charges of animal power
- Machinery and implements
- Running cost of owned machinery and implements.
- Land Rental – notional and actual.

Common costs in agricultural farming are as follows:

- Maintenance of draught.
- Animal, machinery and implements.
- Maintenance of farm shed
- Depreciation
- Interest on borrowed capital
- Notional interest on own capital.

6

ADVANCED PARTNERSHIP ACCOUNTS

UNIT 1 : INTRODUCTION TO PARTNERSHIP ACCOUNTS

Question 1

X, Y Ltd. and Z Ltd. are partners of X & Co. The partnership deed provided that :

(a) The working partner Mr. X is to be remunerated at 15% of the net profits after charging his remuneration, but before charging interest on capital and provision for taxation;

(b) Interest is to be provided on capital at 15% per annum;

(c) Balance profits after making provision for taxation, is to be shared in the ratio of 1 : 2 : 2 by the three partners.

During the year ended 31st March, 1997 :

(i) the net profit before tax and before making any payment to partners amounted to Rs. 6,90,000;

(ii) interest on capitals at 15% per annum amounted to :

Rs. 60,000 for X; Rs. 1,50,000 for Y Ltd. and Rs. 1,80,000 for Z Ltd. The capitals have remained unchanged during the year;

(iii) provision for tax is to be at 40% of "total income" of the firm. The toal income has been computed at Rs. 1,95,000.

You are asked by :

(a) the firm to pass closing entries in relation to the above;

(b) Y Ltd. to pass journal entries in its books pertaining to its income from the firm and show the investment in partnership account as it would appear in its ledger;

(c) Z Ltd. to show, how the above information will appear in its financial statements for the year;

(d) Shri X to show the working, if any, in relation to the above.

(20 marks) (Intermediate–Nov. 1997)

Answer

Journal of partnership firm of Shri X, Y Ltd. and Z Ltd.
Closing entries on 31st March, 1997

		Dr. Rs.	Cr. Rs.
Profit and loss account	Dr.	78,000	
To Provision for taxation for A.Y.1997-98			78,000
(Being provision made for taxation at 40% on total income of Rs. 1,95,000)			
Profit and loss appropriation account	Dr.	4,80,000	
To Remuneration to X, the working partner			90,000
To Interest on capitals :			
X			60,000
Y Ltd.			1,50,000
Z Ltd.			1,80,000
(Being interest on capitals provided at 15% per annum and remuneration to working partner X at 15% of net profit after charging his remuneration but before providing for tax and interest on capitals – now recorded)			
Profit and loss appropriation account (Rs. 6,90,000 - Rs.78,000 - Rs.4,80,000)	Dr.	1,32,000	
To Capital Accounts :			
X			26,400
Y Ltd.			52,800
Z Ltd.			52,800
(Being balance profits credited to partners' capital accounts in the ratio of 1 : 2 : 2)			

(b) Journal entries in the books of Y Ltd.

1997			Dr.	Cr.
March 31			Rs.	Rs.
	Investment in partnership with Shri X and Z Ltd.	Dr.	2,02,800	
	To Interest on capital (taxable)			1,50,000
	To Share to profits (non-taxable)			52,800
	(Being entry to record interest income at 15% p.a. on capital of Rs. 10,00,000 and 2/5th share of profit in the firm)			

Interest on capital	Dr.	1,50,000	
Share of profits	Dr.	52,800	
To Profit and Loss A/c			2,02,800
(Being incomes transferred to profit and loss account)			

Ledger

Investment in partnership with Shri X and Z Ltd.

1996		Dr. Rs.	Cr. Rs.	Balance Rs.
April 1	To Balance b/d	10,00,000		Dr.10,00,000
1997				
March 31	To Interest income from the firm	1,50,000		Dr. 11,50,000
	To Share of profits in the firm	52,800		Dr. 12,02,800
	By Balance c/d		12,02,800	
		12,02,800	12,02,800	

(c) Extracts from the financial statements of Z Ltd.

Revenue statement for the year ended 31st March, 1997

	1996-97 Rs.	1995-96 Rs.
Operating income:		
Income from partnership :		
Interest on capital invested	1,80,000	
Share of profit	52,800	
	2,32,800	

Extracts from schedule of investments attached to and forming part of the balance sheet as at 31st March, 1997.

	31.3.1997 Rs.	*31.3.1996 Rs.*
Investment in partnership with Shri X and Y Ltd.	*14,32,800*	*12,00,000*

Partners	*Capitals as on 31st March 1997 Rs.*	*1996 Rs.*	*Share of profit 1996-97*	*1995-96*
X	5,76,400	*4,00,000*	*1/5*	*1/5*
Y Ltd.	12,02,800	10,00,000	2/5	2/5
Z Ltd.	14,32,800	12,00,000	2/5	2/5

Working for capitals :	*X*	*Y Ltd.*	*Z Ltd.*
	Rs.	*Rs.*	*Rs.*
Opening capital	4,00,000	10,00,000	12,00,000
Remuneration credited	90,000	—	—
Interest on capital	60,000	1,50,000	1,80,000
Share in profits	26,400	52,800	52,800
	5,76,400	12,02,800	14,32,800

(d) Working for remuneration to X, the working partner

$$\frac{\text{Rs.}6{,}90{,}000 \times 15}{115} = \text{Rs.}90{,}000$$

Working for capitals of partners (opening of current year and closing of last year)

X = $\text{Rs.}60{,}000 \times \frac{100}{15}$ = Rs. 4,00,000

Y Ltd. = $\text{Rs.}1{,}50{,}000 \times \frac{100}{15}$ = Rs. 10,00,000

Z Ltd. = $\text{Rs.}1{,}80{,}000 \times \frac{100}{15}$ = Rs. 12,00,000

Question 2

Avinash, Basuda Ltd. and Chinmoy Ltd. were in partnership sharing profits and losses in the ratio of 9 : 4 : 2. Basuda Ltd. retired from the partnership on 31st March, 1998, when the firm's balance sheet was as under :

Rs. in thousand

		Rs.		*Rs.*
Sundry creditors		*600*	*Cash and bank*	*284*
Capital accounts :			*Sundry debtors*	*400*
Avinash	*2,700*		*Stock*	*800*
Basuda Ltd.	*1,200*		*Furniture*	*266*
Chinmoy Ltd.	*600*	*4,500*	*Plant*	*850*
			Land and building	*2,500*
		5,100		*5,100*

Basuda Ltd.'s share in goodwill and capital was acquired by Avinash and Chinmoy Ltd. in the ratio of 1 : 3, the continuing partners bringing in the necessary finance to pay off Basuda Ltd. The partnership deed provides that on retirement or admission of a partner, the goodwill of the firm is to be valued at three times the average annual profits of the firm for the four years ended on the date of retirement or admission. The profits of the firm during the four years *ended 31st March, 1998 in thousands of rupees were :*

	Rs.
1994-95	*450*
1995-96	*250*
1996-97	*600*
1997-98	*700*

The deed further provided that goodwill account is not to appear in the books of accounts at all. The continuing partners agreed that with effect from 1st April, 1998, Ghanashyam, son of Avinash is to be admitted as a partner with 25% share of profit.

Avinash gifts to Ghanashyam, by transfer from his capital account, an amount sufficient to cover up 12.5% of capital and goodwill requirement. The balance 12.5% of capital and goodwill requirement is purchased by Ghanashyam from Avinash and Chinmoy Ltd. in the ratio of 2 : 1.

The firm asks to you :

(i) Prepare a statement showing the continuing partners' shares;

(ii) Pass journal entries including for bank transactions; and

(iii) Prepare the balance sheet of the firm after Ghanashyam's admission

(20 marks) (Intermediate–May 1998)

Answer

(i) Statement showing the partners' shares

	Avinash	*Basuda Ltd.*	*Chinmoy Ltd.*	*Ghanashyam*
Ratio before retirement of Basuda Ltd.	$\frac{9}{15}$	$\frac{4}{15}$	$\frac{2}{15}$	
Adjustment on retirement	$(+)\frac{1}{15}$	—	$(+)\frac{3}{15}$	
New ratio before admission of Ghanashyam	$\frac{10}{15}$		$\frac{5}{15}$	
On admission of Ghanashyam :				
Gift by Avinash (12.5/100)	$(-)\frac{1}{8}$			$\frac{1}{8}$
Purchase from Avinash & Chinmoy Ltd.*	$(-)\frac{2}{24}$		$(-)\frac{1}{24}$	$(+)\frac{3}{24}$
New ratio	$\frac{11}{24}$		$\frac{7}{24}$	$\frac{6}{24}$

* Purchase from Avinash = 2/3 × 1/8 = 2/24

Purchase from Chinmoy Ltd. = 1/3 × 1/8 = 1/24

(ii) **Journal Entries**

			Dr. *Rs.*	*Cr.* *Rs.*
1.	Avinash's capital A/c	Dr.	1,00,000	
	Chinmoy Ltd's capital A/c	Dr.	3,00,000	
	To Basuda Ltd.'s capital A/c			4,00,000
	(Being purchase by Avinash and Chinmoy Ltd. of goodwill from Basuda Ltd.)			
2.	Avinash's capital A/c	Dr.	7,50,000	
	To Ghansahyam's capital A/c			7,50,000
	(Being gift made by Avinash to Ghansahyam)			
3.	Bank A/c	Dr.	31,00,000	
	To Avinash's capital A/c			7,75,000
	To Chinmoy Ltd's capital A/c			13,87,500
	To Ghanasahyam's capital A/c			9,37,500
	(Being capital brought in by the partners)			
4.	Basuda Ltd's capital A/c	Dr.	16,00,000	
	To Bank A/c			16,00,000
	(Being final payment made to Basuda Ltd. on retirement)			
5.	Ghanashyam's capital A/c	Dr.	1,87,500	
	To Avinash's capital A/c			1,25,000
	To Chinmoy Ltd's Capital A/c			62,500
	(Being goodwill adjusted on admission)			

(iii) **Balance Sheet as on 1st April, 1998**

Liabilities		*Amount* *Rs.*	*Assets*	*Amount* *Rs.*
Sundry creditors		6,00,000	Cash and bank	17,84,000
Capital accounts :			Sundry debtors	4,00,000
Avinash	27,50,000		Stock	8,00,000
Chinmoy Ltd.	17,50,000		Furniture	2,66,000
Ghanashyam	15,00,000		Plant	8,50,000
		60,00,000	Land and building	25,00,000
		66,00,000		66,00,000

Working Notes :

(Rs. in thousand)

(1) *Adjustment of Goodwill on Retirement*

Value of Goodwill = (450 + 250 + 600 + 700) × ¾ = 1,500

Share of Basuda Ltd. = 1,500 × 4/15 = 400

Adjustment through partners' capital accounts

Avinash : $\frac{1}{4} \times 400 = 100\,(\text{Dr.})$

Basuda Ltd. : $\frac{4}{15} \times 1{,}500 = 400\,(\text{Cr.})$

Chinmoy Ltd. : $\frac{3}{4} \times 400 = 300\,(\text{Dr.})$

(2) *Closing Balances of Capital Accounts*

Basuda Ltd.'s share of capital and goodwill = 1,200 + 400 = 1,600

This represents 4/15th share of capital and goodwill requirement of the firm.

Thus, total capital and goodwill requirement = $1{,}600 \times \frac{15}{4} = 6{,}000$

Hence, closing capital balances (in new profit sharing ratio of 11 : 7 : 6) should be

Avinash : $\frac{11}{24} \times 6{,}000 = 2{,}750$

Chinmoy Ltd. : $\frac{7}{24} \times 6{,}000 = 1{,}750$

Ghanashyam : $\frac{6}{24} \times 6{,}000 = 1{,}500$

Gift by Avinash to Ghanashyam : $\frac{1}{2} \times 1{,}500 = 750$

(Debit to Avinash's capital A/c and credit to Ghanashyam's capital A/c)

(2) *Adjustment of Goodwill on Admission*

Goodwill of the firm = 1,500

Ghanashyam's share of goodwill= $\frac{1}{4} \times 1{,}500$

= 375

(a) Gift by Avinash $= \frac{1}{2} \times 375$

$= 187.5$

(Included in the gift of 750 – see W.N. 2)

(b) Purchase from Avinash and Chinmoy Ltd. = 187.5

(in 2 : 1 ratio)

Thus, adjustment of goodwill purchased through capital accounts

Avinash : $\frac{2}{3} \times 187.5 = 125\,(\text{Cr.})$

Chinmoy Ltd. : $\frac{1}{3} \times 187.5 = 62.5\,(\text{Cr.})$

Ghanashyam : $\frac{1}{2} \times 375 = 187.5\,(\text{Dr.})$

(3) Amount brought in by Partners

Partners' Capital Accounts

	Avinash	*Basuda Ltd.*	*Chinmoy Ltd.*	*Ghana-shyam*		*Avinash*	*Basuda Ltd.*	*Chinmoy Ltd.*	*Ghana-shyam*
	Rs.	*Rs.*	*Rs.*	*Rs.*		*Rs.*	*Rs.*	*Rs.*	*Rs.*
To Basuda Ltd.	100	—	300	—	By Balance b/d	2,700	1,200	600	—
To Ghanashyam	750	—	—	—	By Avinash and Chinmoy Ltd.	—	400	—	—
To Avinash and Chinmoy Ld.	—	—	—	187.5					
To Cash and Bank	—	1,600	—	—	By Cash and Bank (Bal. figure)	775	—	1,387.5	937.5
To Balancd c/d	2,750	—	1,750	1,500	By Avinash	—	—	—	750
					By Ghanashyam	125	—	62.5	—
	3,600	1,600	2,050	1,687.5		3,600	1,600	2,050	1,687.5

(4) Cash and Bank

Amount given	284
Amount brought in by partners	3,100
	3,384
Less : Payment to Basuda Ltd.	1,600
	1,784

Net increase = Rs. 1,500

(Equivalent to the value of goodwill)

Question 3

A, B and C were partners of a firm sharing profits and losses in the ratio of 3 : 4 : 3. The Balance Sheet of the firm, as at 31st March, 1998 was as under :

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Accounts :			Fixed Assets		1,00,000
A	48,000		Current Assets :		
B	64,000		Stock	30,000	
C	48,000	1,60,000	Debtors	60,000	
Reserve		20,000	Cash and Bank	30,000	1,20,000
Creditors		40,000			
		2,20,000			2,20,000

The firm had taken a Joint Life Policy for Rs. 1,00,000; the premium periodically paid was charged to Profit and Loss Account. Partner C died on 30th September, 1998. It was agreed between the surviving partners and the legal representatives of C that :

(i) Goodwill of the firm will be taken at Rs. 60,000.

(ii) Fixed Assets will be written down by Rs. 20,000.

(iii) In lieu of profits, C should be paid at the rate of 25% per annum on his capital as on 31st March, 1998.

Policy money was received and the legal heirs were paid off. The profits for the year ended 31st March, 1999, after charging depreciation of Rs. 10,000 (depreciation upto 30th September was agreed to be Rs. 6,000) were Rs. 48,000.

Partners' Drawings Accounts showed balances as under :

A Rs. 18,000 (drawn evenly over the year)

B Rs. 24,000 (drawn evenly over the year)

C (up-to-date of death) Rs. 20,000

On the basis of the above figures, please indicate the entitlement of the legal heirs of C, assuming that they had not been paid anything other then the share in the Joint Life Policy.

(13 marks) (Intermediate–Nov. 2000)

Answer

Computation of entitlement of legal heirs of C

(1) Profits for the half year ended 31st March, 1999

	Rs.
Profits for the year ended 31st March, 1999 (after depreciation)	48,000
Add : Depreciation	10,000
Profits before depreciation	58,000

Profits for the first half (assumed : evenly spread)	29,000
Less : Depreciation for the first half	6,000
Profits for the first half year (after depreciation)	23,000
Profits for the second half (i.e., 1st October, 1998 to 31st March, 1999)	29,000
Less : Depreciation for the second half	4,000
Profits for the second half year (after depreciation)	25,000

(2) Capital Accounts of Partners as on 30th September, 1998

Dr.	A	B	C		A	B	C Cr.
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Fixed Assets (loss on revaluation)	6,000	8,000	6,000	By Balance b/d	48,000	64,000	48,000
To Drawings	9,000	12,000	20,000	By Reserve	6,000	8,000	6,000
To C Executor's A/c			52,000	By Goodwill	18,000	24,000	18,000
To Balance c/d	57,000	76,000	–	By P & L Appropriation A/c (Interest on Rs. 48,000 @ 25% for 6 months)	—	—	6,000
	72,000	96,000	78,000		72,000	96,000	78,000

(3) Application of Section 37 of the Partnership Act

Legal heirs of C have not been paid anything other than the share in joint life policy. The amount due to the deceased partner carries interest at the mutually agreed upon rate. In the absence of any agreement, the representatives of the deceased partner can receive at their option interest at the rate of 6% per annum or the share of profit earned for the amount due to the deceased partner.

Thus, the representatives of C can opt for

Either,

(i) Interest on Rs. 52,000 for 6 months @ 6% p.a. = Rs. 1,560

Or

(ii) Profit earned out of unsettled capital (in the second half year ended 31st March, 1999)

$$\text{Rs. } 25{,}000 \times \frac{52{,}000}{57{,}000 + 76{,}000 + 52{,}000} = \text{Rs. } 7{,}027 \text{ (approx.)}$$

In the above case, it would be rational to assume that the legal heirs would opt for Rs. 7,027.

(4) Amount due to legal heirs of C

	Rs.
Balance in C's Executor's account	52,000
Amount of profit earned out of unsettled capital [calculated in (3)]	7,027
Amount due	59,027

Question 4

A, B and C were partners, sharing Profits and Losses in the ratio of 5 : 3 : 2 respectively. On 31st March, 2000 their Balance Sheet stood as follows :

Liabilities	*Rs.*	*Assets*	*Rs.*
A's capital	*7,79,000*	*Plant and Machinery*	*13,62,000*
B's capital	*7,07,800*	*Furniture and Fittings*	*2,36,000*
C's capital	*6,86,200*	*Stock*	*7,02,000*
Creditors	*4,91,000*	*Debtors*	*1,91,000*
		Cash at Bank	*1,73,000*
	26,64,000		*26,64,000*

On 31st July, 2000 A died. According to partnership deed, on the death of a partner, the capital account of the deceased partner was to be credited with :

(i) his share of profit for the relevant part of the year of death calculated on the basis of profit earned during the immediately preceding accounting year, and

(ii) his share of goodwill

Goodwill was to be valued at two years' purchase of the average profits of immediately preceding three accounting years. The profits, as per books of account were as follows :

	Rs.
For accounting year ended 31st March, 1998	*3,29,000*
For accounting year ended 31st March, 1999	*3,46,000*
For accounting year ended 31st March, 2000	*3,78,000*

However, while going through the books of account on A's death, it came to light that Rs. 30,000 worth of wages were spent on installation of a new machinery, but the same was not capitalized; the machinery was put into operation on 1st October, 1999. Depreciation was provided on the machinery @ 20% per annum.

On 1st October, 2000 A's son D was admitted into partnership with immediate effect on the following terms :

(a) D would get one-fourth share in the profit of the firm, while the relative profit sharing ratio between B and C would remain unchanged.

(b) The final balance of A's capital account would be credited to D's capital account

(c) An adjustment would be made in the Capital Accounts for D's share of goodwill. The basis of valuation of firm's goodwill would be the same as was adopted at the time of the death of his father.

On 31st March, 2001 the Profit and Loss Account of the firm showed that the firm had earned a profit of Rs. 4,16,000 for the year. The respective drawings accounts showed that while B and C had withdrawn Rs. 60,000 each during the year, D's drawings totalled Rs. 30,000. The Drawings Accounts are closed at the end of the year by transfer to respective capital accounts.

You are required to :

(i) Prepare a statement showing distribution of profits for the accounting year ended 31st March, 2001; and

(ii) Pass journal entries for all the transactions relating to death of the partner. D's admission into partnership, and at the end of the year relating to transfer of Drawings Accounts and distribution of profit for the year. (20 marks) (Intermediate–May 2001)

Answer

(i) Statement Showing distribution of profits for the accounting year ended 31st March, 2001

		Rs.	Rs.
Net profit for the year ended 31.03.2001			4,16,000
	A's share		
	(Profit distributed to deceased partner A & his executor)		
(a)	Profit for 4 months (1.4.2000 – 31.7.2000) (W.N.1)	67,500	
(b)	Application of Sec. 37 (1.8.2000 – 30.9.2000) (W. N. 5)	28,021	95,521
	B's share		
(a)	Profit for 4 months (1.4.2000 – 31.7.2000) (W. N. 3)	42,700	
(b)	Profit for 2 months (1.8.2000 – 30.9.2000) (W. N. 6)	24,787	
(c)	Profit for 6 months (1.10.2000 – 31.3.2001) (W. N. 10)	93,600	1,61,087
	C's share		
(a)	Profit for 4 months (1.4.2000 – 31.7.2000) (W. N. 3)	28,467	
(b)	Profit for 2 months (1.8.2000 – 30.9.2000) (W. N. 6)	16,525	
(c)	Profit for 6 months (1.10.2000 – 31.3.2001) (W. N. 10)	62,400	1,07,392
	D's share		
(a)	Profit for 6 months (1.10.2000 – 31.3.2001) (W. N. 10)	52,000	52,000
			4,16,000

(ii) **Journal Entries**

Year			*Dr.*	*Cr.*
2000			*Rs.*	*Rs.*
July 31	Machinery A/c	Dr	27,000	
	To A's Capital A/c			13,500
	To B's Capital A/c			8,100
	To C's Capital A/c			5,400
	(Wages spent on installation of new machinery capitalised and credited to partners' capital accounts after providing depreciation for six months ended 31st March, 2000)			
	Profit and Loss Suspense A/c	Dr.	67,500	
	To A's Capital A/c			67,500
	(A's share of profit for four months as calculated in W. N. 1 credited to his capital account)			
	Goodwill A/c	Dr.	7,20,000	
	To A's Capital A/c			3,60,000
	To B's Capital A/c			2,16,000
	To C's Capital A/c			1,44,000
	(Goodwill raised in the books and credited to partners in the old profit sharing ratio 5 : 3 : 2)			
	A's Capital A/c	Dr.	12,20,000	
	To A's Executor's A/c			12,20,000
	(Balance due to A transferred to his executor's account)			
	Profit & Loss Suspense A/c	Dr.	28,021	
	To A's Executor's A/c			28,021
	(Profit earned out of the unsettled capital credited to A's executor's account as per W. N. 5)			
Oct. 1	A's Executor's A/c	Dr.	12,48,021	
	To D's Capital A/c			12,48,021
	(Final balance of A's executor's account transferred to D's capital account)			

	B's Capital A/c	Dr.	3,24,000	
	C's Capital A/c	Dr.	2,16,000	
	D's Capital A/c	Dr.	1,80,000	
	To Goodwill			7,20,000
	(Goodwill written off and debited to partners in the new profit sharing ratio 9 : 6 : 5)			
March 31	B's Capital A/c	Dr.	60,000	
	C's Capital A/c	Dr.	60,000	
	D's Capital A/c	Dr.	30,000	
	To B's Drawings A/c			60,000
	To C's Drawings A/c			60,000
	To D's Drawings A/c			30,000
	(Drawings debited to partners' capital accounts)			
March 31	Profit and Loss Appropriation A/c	Dr.	4,16,000	
	To Profit and loss suspense A/c (Rs. 67,500 + 28,021)			95,521
	To B's Capital A/c			1,61,087
	To C's Capital A/c			1,07,392
	To D's Capital A/c			52,000
	(Division of profits as shown in statement of distribution of profits and balance of profit & loss suspense account transferred to profit and loss appropriation account)			

Working Notes :

(1) Computation of A's share in profit for the period 1.4.2000 – 31.7.2000

A's share in profit for the period of 1st April, 2000 to 31st July, 2000 is to be calculated on the basis of profit earned during the immediately previous accounting year i.e. year ended on 31st March, 2000

	Rs.
Profit for the year ended 31st March, 2000	3,78,000
Add : Capital expenditure of wages spent on installation of new machinery, treated as revenue expenditure	30,000
	4,08,000

Less : Depreciation on Rs. 30,000 (being the value of machinery @ 20% p.a. for 6 months)	3,000
Correct profit for the year ended 31st March, 2000	4,05,000

Profit for 4 months on the basis of last year's profit = Rs. 4,05,000× $\frac{4}{12} = 1{,}35{,}000$

A's share in profit = 1,35,000 × $\frac{5}{10} = 67{,}500$

(2) Valuation of Goodwill

	Rs.
Profit for the year ended 31st March, 1998	3,29,000
Profit for the year ended 31st March, 1999	3,46,000
Profit for the year ended 31st March, 2000	4,05,000
Total Profit	10,80,000

Average Profit = Rs. $\frac{10{,}80{,}000}{3} = \text{Rs.}\,3{,}60{,}000$

Goodwill (two years' purchase) = Rs. 3,60,000 × 2 = Rs. 7,20,000

(3) Distribution of profit for 4 months ended 31st July, 2000

	Rs.
Net Profit (Rs. 4,16,000 × $\frac{4}{12}$)	1,38,667
A's share (W. N. 1)	67,500
B's share (Rs. 71,167 × $\frac{3}{5}$)	42,700
C's share (Rs. 71,167 × $\frac{2}{5}$)	28,467

(4) Partners' Capital Accounts as on 31st July, 2000

	A Rs.	B Rs.	C Rs.		A Rs.	B Rs.	C Rs.
To Drawings		20,000	20,000	By Balance b/d	7,79,000	7,07,800	6,86,200
To A's Executor's A/c	12,20,000	9,54,600	8,44,067	By Plant & Machinery	13,500	8,100	5,400
To Balance c/d		–	–	By Goodwill	3,60,000	2,16,000	1,44,000
				By Share in Profit (W. N. 3)	67,500	42,700	28,467
	12,20,000	9,74,600	8,64,067		12,20,000	9,74,600	8,64,067

(5) Application of section 37 of the Partnership Act

Either

(i) Interest of Rs. 12,20,000 × $\frac{6}{100} \times \frac{2}{12}$ = Rs. 12,200

Or

(ii) Profit earned out of unsettled capital

$$\text{Rs. } 4,16,000 \times \frac{2}{12} \times \frac{\text{Rs. } 12,20,000}{\text{Rs. } (12,20,000 + 9,54,600 + 8,44,067)} = \text{Rs. } 28,021 \text{ (approx.)}$$

In the absence of specific agreement amongst partners on the above subject matter, the representatives of the deceased partner can receive at their option, interest at the rate of 6% p.a. or share of profit earned for the amount due to the deceased partner.

In the above case, it would be rational to assume that A's representatives would opt for Rs. 28,021.

(6) Distribution of profit for 2 months ended 31st Oct, 2000

		Rs.
Net profit	(Rs. 4,16,000 × $\frac{2}{12}$)	69,333
A's executor's share (W. N. 5)		28,021
B's share	(Rs. 41,312 × $\frac{3}{5}$)	24,787
C's share	(Rs. 41,312 × $\frac{2}{5}$)	16,525

(7) A's Executor's Account

	Rs.		*Rs.*
To D's Capital A/c	12,48,021	By A's capital A/c	12,20,000
		By Share in profit (W. N. 6)	28,021
	12,48,021		12,48,021

(8) Partner's Capital Accounts (1st August, 2000 to 30th Sept., 2000)

Dr.	*B*	*C*		*B*	*C*
	Rs.	*Rs.*		*Rs.*	*Rs.*
To Drawings	10,000	10,000	By Balancd b/d	9,54,600	8,44,067
To Balance c/d	9,69,387	8,50,592	By P & L A/c	24,787	16,525
	9,79,387	8,60,592		9,79,387	8,60,592

(9) Computation of new profit sharing ratio between B, C & D

D is admitted for ¼ share

B's new ratio	= 3/4 × 3/5	= 9/20
C's new ratio	= 3/4 × 2/5	= 6/20
D's new ratio	= 5/20	
New profit sharing ratio	= 9 : 6 : 5	

(10) Distribution of profit for 6 months ended 31st March, 2001

	Rs.
Net profit (Rs. 4,16,000 × $\frac{6}{12}$)	2,08,000
B's share (Rs. 2,08,000 × $\frac{9}{20}$)	93,600
C's share (Rs. 2,08,000 × $\frac{6}{20}$)	62,400
D's share (Rs. 2,08,000 × $\frac{5}{20}$)	52,000

(11) Partner's Capital Accounts as on 31st March, 2001

	B	C	D		B	C	D
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Goodwill	3,24,000	2,16,000	1,80,000	By Balance b/d	9,69,387	8,50,592	
To Drawings	30,000	30,000	30,000	By A's Executor's A/c			12,48,021
To Balance c/d	7,08,987	6,66,992	10,90,021	By Share of profit (W. N. 10)	93,600	62,400	52,000
	10,62,987	9,12,992	13,00,021		10,62,987	9,12,992	13,00,021

Notes:

1. It is assumed that profit was earned uniformly throughout the year. Although notional profit was calculated for the first four months, it is to be transferred from the current year's profit (as calculated in working note 3). The question requires that A's share of profit for this period is to be calculated on the basis of profit earned during year ended 31st March. 2000. The balance amount after calculating his share has been credited to B and C in ratio 3 : 2.
2. It is assumed that drawings were made evenly throughout the year. However, single entry has been given at year end in the main solution relating to transfer of drawings and distribution of profit but the Partners' capital accounts shown in the working notes include the entries of drawings and distribution of profit of respective dates within the year.

Question 5

M/s Neptune & Co.'s Balance Sheet as at 31st March, 2001:

Liabilities		Rs.	Assets		Rs.
Bank overdraft (State Bank)		54,000	Cash at Bank of India		800
Sundry Creditors		1,56,000	Sundry Debtors		2,80,000
Capital Accounts :			Stock		1,00,000
Mr. A			Motor Cars cost as per last B/S	1,60,000	
Balance as per last B/S	4,02,000		Less : Depreciation till date	54,000	1,06,000
Add : Profits for the year	95,400		Machinery :		
	4,97,400		Cost as per last B/S	3,00,000	
Less : Drawings	40,000	4,57,400	Less : Depreciation till date	1,40,000	1,60,000
Mr. B			Land and Building		2,40,000
Balance as per last B/s	2,00,000				
Add : Profit for the year	95,400				
	2,95,400				
Less : Drawings	76,000	2,19,400			
		8,86,800			8,86,800

You have examined the foregoing Draft of the Balance Sheet and have ascertained that the following adjustments are required to be carried out :

(i) Land and Buildings are shown at cost less Rs. 60,000 being the proceeds of the sale during the year of premises costing Rs. 70,000.

(ii) Machinery having a net book value of Rs. 4,300 had been scrapped during the year. The original cost was Rs. 12,300.

(iii) Rs. 2,000 paid for the Licence fees for the year ending 30th September, 2001 had been written off.

(iv) Debts amounting to Rs. 10,420 were considered to be bad and further debts amounting to Rs. 5,400 were considered doubtful and required 100% provision. Provision for doubtful debts had previously been made for Rs. 10,000.

(v) An item in the Inventory was valued at Rs. 37,400, but had a realisable value of Rs. 26,000 only. Scrap Material having a value of Rs. 6,600 had been omitted from the stock valuation.

(vi) The cashier had misappropriated Rs. 700.

(vii) The cash-book for the year ending 31st March, 2001 included payments amounting to Rs. 6,924, the cheques having been made out, but not despatched to suppliers until April 2001.

(viii) Interest is to be allowed on the Partners' opening Capital Account balances less drawings during the year at 9%.

You are required to prepare :

(a) Profit & Loss Adjustment Account for the year.

(b) Capital Accounts of the Partners. *(16 marks) (Intermediate–Nov. 2001)*

Answer

(a)

M/s Neptune & Co.
Profit and Loss Adjustment Account
for the year ended 31st March, 2001

		Rs.			*Rs.*
To Land & Building (Loss on sale		10,000	By Partner's Capital Accounts :		
To Machinery (Loss on scrapping)4,300			Mr. A	95,400	
To Provision for Doubtful Debts (Working note)		5,820	Mr. B	95,400	1,90,800
To Stock Adjustment (Fall in the Market value)		11,400	By Prepaid expenses (Licence fee)		1,000
To Cas (Misappropriated)		700	By Stock Adjustment (items omitted)		6,600
To Interest on Capital					
Mr. A	32,580				
Mr. B	11,160	43,740			
To Profit transferred to Capital Accounts:					
Mr. A	61,220				
Mr. B	61,220	1,22,440			
	1,98,400				1,98,400

(b)

Partners' Capital Accounts
As on 31st March, 2001

	Mr. A	*Mr. B*		*Mr. A*	*Mr. B*
31.3.2001	*Rs.*	*Rs.*	*31.3.2000*	*Rs.*	*Rs.*
To Drawings	40,000	76,000	By Balance b/d	4,02,000	2,00,000
To Profit & Loss			31.3.2001		
Adjustment Account	95,400	95,400	By Profit & Loss A/c	95,400	95,400
To Balance c/d	4,55,800	1,96,380	By Profit & Loss		
			Adjustment A/c:		
			Interest on capital	32,580	11,160
			Profit for the year	61,220	61,220
5,91,200	3,67,780		5,91,200	3,67,780	

Working Notes :

(1) Provision for doubtful debts charged to profit and loss adjustment account

Provision for Doubtful Debts Accounts

	Rs.		Rs.
To Bad Debts	10,420	By Balance b/d	10,000
To Balance c/d (required)	5,400	By Profit & Loss Adjustment A/c	
		(balancing figure)	5,820
	15,820		15,820

(2) Interest on Capitals

Mr. A Rs. 3,62,000 × 9% p.a. = Rs. 32,580

Mr. B Rs. 1,24,000 × 9% p.a. = Rs. 11,160

Note : Misappropriation by cashier may be debited to cashier also. In that case, Rs. 700 will not be debited to Profit and Loss Adjustment Account and profit transferred to partners will be Rs. 1,23,140.

Question 6

Manish, Jatin and Paresh were partners sharing Profits/ Losses in the ratio of Manish 40 percent, Jatin 35 percent, and Paresh 25 percent. The draft Balance Sheet of the partnership as on 31st December, 2001 was as follows :

		Rs.			Rs.
Sundry Creditors		*30,000*	*Cash on hand and at Bank*		*67,000*
Bills payable		*8,000*	*Stock*		*42,000*
Loan from Jatin		*30,000*	*Sundry Debtors*	*34,000*	
Current Accounts :			*Less : Provision for*		
Manish	*12,000*		*Doubtful Debts*	*6,000*	*28,000*
Jatin	*8,000*		*Plant and Machinery*		
Paresh	*6,000*	*26,000*	*(at cost)*	*80,000*	
Capital Accounts :			*Less : Depreciation*	*28,000*	*52,000*
Manish	*90,000*		*Premises (at cost)*		*75,000*
Jatin	*50,000*				
Paresh	*30,000*	*1,70,000*			
		2,64,000			*2,64,000*

Jatin retired on 31st December, 2001. Manish and Paresh continued in partnership sharing Profits/ Losses in the ratio of Manish 60 percent and Paresh 40 percent. 50 percent of Jatin's Loan was repaid on 1.1.2002 and it was agreed that of the amount then remaining due to him a sum of Rs. 80,000 should remain as loan to partnership and the balance to be carried *forward as ordinary trading liability. The following adjustments were agreed to be made to the above mentioned Balance Sheet:*

(i) Rs. 10,000 should be written off from the premises.

(ii) Plant and Machinery was revalued at Rs. 58,000.

(iii) Provision for doubtful debts to be increased by Rs. 1,200

(iv) Rs. 5,000 due to creditors for expenses had been omitted from the books of account.

(v) Rs. 4,000 to be written off on stocks.

(vi) Provide Rs. 1,200 for professional charges in connection with revaluation.

As per the deed of partnership, in the event of the retirement of a partner, goodwill was to be valued at an amount equal to one year's purchase of the average profits of the preceding three years on the date of retirement. Before determining the said average profits a notional amount of Rs. 80,000 should be charged for remuneration to partners. The necessary profits before charging such remuneration were:

Year ending 30.12.1999	*Rs. 1,44,000*	
Year ending 31.12.2000	*Rs. 1,68,000*	
Year ending 31.12.2001	*Rs. 1,88,200*	*(As per draft accounts)*

It was agreed that, for the purpose of valuing goodwill, the amount of profit for the year 2001 be recomputed after charging the loss on revaluation in respect of premises and stock, the unprovided expenses (except professional expenses) and increase in the provision for doubtful debts. The continuing partners decided to eliminate goodwill account from their books.

You are required to prepare:

(i) Revaluation Account:

(ii) Capital Accounts (merging current accounts therein):

(iii) Jatin's Accounts showing balance due to him; and

(iv) Balance Sheet of Manish and Paresh as at 1st January, 2002.

(16 marks) (Intermediate–May 2002)

Answer

(i) Revaluation Account

	Rs			*Rs.*
To Premises	10,000	By Plant and Machinery		6,000
To Provision for Doubtful Debts	1,200	By Loss on revaluation transferred		
To Outstanding Expenses	5,000	to Capital Accounts:		
To Stocks	4,000	Manish (40%)	6,160	
To Provision for Professional Charges1,200		Jatin (35%)	5,390	
		Paresh (25%)	3,850	15,400
	21,400			21,400

(ii) **Capital Accounts of Partners**

	Manish	Jatin	Paresh		Manish	Jatin	Paresh
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Revalutation A/c (loss)	6,160	5,390	3,850	By Balance b/d	90,000	50,000	30,000
To Goodwill (written off in new Profit sharing ratio)	48,000	–	32,000	By Current A/c	12,000	8,000	6,000
To Personal A/c (Balance transferred)		80,610	–	By Goodwill (old profit sharing)	32,000	28,000	20,000
To Balance c/d	79,840		20,150				
	1,34,000	86,000	56,000		1,34,000	86,000	56,000

(iii) **Jatin's Personal Account**

	Rs.		Rs.
To Bank Account (50% of old loan)	15,000	By Capital Accounts (Balance transferred)	80,610
To Loan Account (transferred)	80,000	By Loan Account (old loan)	30,000
To Balance c/d	15,610		
	1,10,610		1,10,610

(iv) **Balance Sheet of Manish and Paresh as on 1st January, 2002**

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Accounts			Fixed Assets		
Manish	79,840		Plant and Machinery	86,000	
Paresh	20,150	99,990	Less: Depreciation	28,000	58,000
Jatin's Loan A/c		80,000	Premises	75,000	
Current Liabilities			Less: Written off	10,000	65,000
and Provisions			Current Assets		
Bills Payable	8,000		Cash in hand & at Bank		
Sundry Creditors	35,000		(67,000–15,000)		52,000
(30,000+5,000)			Sundry Debtors	34,000	
Jatin's dues	15,610		Less: Provision for		
Provision for			doubtful debts	7,200	26,800
Professional charges	1,200	59,810	Stock in trade		38,000
		2,39,800			2,39,800

Working Notes :

(1) Profit for the Year ending 31st December, 2001

		Rs.
As per draft accounts		1,88,200
Less: Premises written off	10,000	
Provision for Doubtful debts	1,200	
Outstanding Expenses	5,000	
Stock	4,000	20,200
		1,68,000

(2) Valuation of Goodwill

	Rs.
Profit for the year ending 31st Dec.2001 (adjusted)	1,68,000
Profit for the year ending 31st Dec. 2000	1,68,000
Profit for the year ending 31st Dec. 1999	1,44,000
	4,80,000
Average Profits before partners' salaries	1,60,000
Less: Partners's Salaries (notional)	80,000
Super Profit and Goodwill (one year's purchase)	80,000

Question 7

Ram, Rahim and Robert are partners, sharing Profits and Losses in the ratio of 5 : 3 : 2. It was decided that Robert would retire on 31.3.2005 and in his place Richard would be admitted as a partner with new profit sharing ratio between Ram, Rahim and Richard at 3 : 2 : 1.

Balance Sheet of Ram, Rahim and Robert as at 31.3.2005:

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		*Cash in hand*	*20,000*
Ram	*1,00,000*	*Cash in Bank*	*1,00,000*
Rahim	*1,50,000*	*Sundry Debtors*	*5,00,000*
Robert	*2,00,000*	*Stock in Trade*	*2,00,000*
General Reserve	*2,00,000*	*Plant & Machinery*	*3,00,000*
Sundry Creditors	*8,00,000*	*Land & Building*	*5,30,000*
Loan from Richard	*2,00,000*		
	16,50,000		*16,50,000*

Retirement of Robert and admission of Richard is on the following terms:

(a) Plant & Machinery to be depreciated by Rs. 30,000.

(b) Land and Building to be valued at Rs. 6,00,000.

(c) Stock to be valued at 95% of book value.

(d) Provision for doubtful debts @ 10% to be provided on debtors.

(e) General Reserve to be apportioned amongst Ram, Rahim and Robert.

(f) The firm's goodwill to be valued at 2 years purchase of the average profits of the last 3 years. The relevant figures are:

Year ended 31.3.2002 – Profit Rs. 50,000

Year ended 31.3.2003 – Profit Rs. 60,000

Year ended 31.3.2004 – Profit Rs. 55,000

(g) Out of the amount due to Robert Rs. 2,00,000 would be retained as loan by the firm and the balance will be settled immediately.

(h) Richard's capital should be equal to 50% of the combined capital of Ram and Rahim.

Prepare:

(i) Capital accounts of the partners; and

(ii) Balance Sheet of the reconstituted firm. *(16 Marks) (PE-II – Nov. 2005)*

Answer

Partners' Capital Accounts

Dr.											*Cr.*
		Ram	*Rahim*	*Robert*	*Richard*			*Ram*	*Rahim*	*Robert*	*Richard*
		Rs.	*Rs.*	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*	*Rs.*
To	Revaluation A/c (W.N. 1)	10,000	6,000	4,000	–	By	Balance b/d	1,00,000	1,50,000	2,00,000	–
To	Loan from Robert A/c			2,00,000		By	General reserve	1,00,000	60,000	40,000	–
To	Bank			58,000		By	Goodwill (W.N. 2)	55,000	33,000	22,000	–
To	Balance c/d	2,45,000	2,37,000	–	–						
		2,55,000	2,43,000	2,62,000	–			2,55,000	2,43,000	2,62,000	–
To	Goodwill*	55,000	36,667	–	18,333	By	Balance b/d	2,45,000	2,37,000	–	–
						By	Loan A/c – transfer	–	–	–	2,00,000
To	Balance c/d	1,90,000	2,00,333	–	1,95,167	By	Bank	–	–	–	13,500
		2,45,000	2,37,000	–	2,13,500			2,45,000	2,37,000	–	2,13,500

* As per para 36 of AS 10, 'Accounting for Fixed Assets', goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, the goodwill raised at the time of retirement of Robert is to be written off in new ratio among remaining partners including new partner – Richard.

Balance Sheet as at 31.3.2005
after the admission of Richard

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		Land and Building	6,00,000
Ram	1,90,000	Plant and Machinery	2,70,000
Rahim	2,00,333	Stock	1,90,000
Richard	1,95,167	Debtors	4,50,000
Sundry Creditors	8,00,000	Cash at Bank (W.N. 3)	55,500
Loan from Robert	2,00,000	Cash in hand	20,000
	15,85,500		15,85,500

Working Notes:

(1) **Revaluation Account**

		Rs.				Rs.
To	Plant and Machinery	30,000	By	Land and Building		70,000
To	Stock	10,000	By	Partners Capital A/cs:		
To	Debtors	50,000		Ram	10,000	
				Rahim	6,000	
				Robert	4,000	20,000
		90,000				90,000

(2) **Calculation of Goodwill:**

Profit for the year ended 31.3.2002		50,000
Profit for the year ended 31.3.2003		60,000
Profit for the year ended 31.3.2004		55,000
	1,65,000	

$$\text{Average profit} = \frac{1,65,000}{3} = \text{Rs. } 55,000$$

Goodwill = Rs. 55,000 × 2 years = Rs. 1,10,000.

(3) **Bank Account**

		Rs.			Rs.
To	Balance b/d	1,00,000	By	Robert's Capital A/c	58,000
To	Richard's Capital A/c	13,500	By	Balance c/d	55,500
		1,13,500			1,13,500

Question 8

The following was the Balance Sheet of 'A' and 'B', who were sharing profits and losses in the ratio of 2:1 on 31.12.2006:

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Plant and machinery	12,00,000
A	10,00,000	Building	9,00,000
B	5,00,000	Sundry debtors	3,00,000
Reserve fund	9,00,000	Stock	4,00,000
Sundry creditors	4,00,000	Cash	1,00,000
Bills payable	1,00,000		
	29,00,000		29,00,000

They agreed to admit 'C' into the partnership on the following terms:

(i) The goodwill of the firm was fixed at Rs.1,05,000.

(ii) That the value of stock and plant and machinery were to be reduced by 10%.

(iii) That a provision of 5% was to be created for doubtful debts.

(iv) That the building account was to be appreciated by 20%.

(v) There was an unrecorded liability of Rs.10,000.

(vi) Investments worth Rs.20,000 (Not mentioned in the Balance Sheet) were taken into account.

(vii) That the value of reserve fund, the values of liabilities and the values of assets other than cash are not to be altered.

(viii) 'C' was to be given one-fourth share in the profit and was to bring capital equal to his share of profit after all adjustments.

Prepare Memorandum Revaluation Account, Capital account of the partners and the Balance Sheet of the newly reconstituted firm. (16 Marks) (PE II, Nov. 2007)

Answer

Memorandum Revaluation Account

		Rs.			Rs.
To	Stock	40,000	By	Building	1,80,000
To	Plant & machinery	1,20,000	By	Investments	20,000
To	Provision for doubtful debts	15,000			
To	Unrecorded liability	10,000			
To	Profit transferred to Partners' Capital A/cs (in old ratio)				

	A = 10,000				
	B = 5,000	15,000			
		2,00,000			2,00,000
To	Building	1,80,000	By	Stock	40,000
To	Investments	20,000	By	Plant & machinery	1,20,000
			By	Provision for doubtful debts	15,000
			By	Unrecorded liability	10,000
			By	Loss transferred to Partners' Capital A/cs (in new ratio)	
				A = 7,500	
				B = 3,750	
				C = 3,750	15,000
		2,00,000			2,00,000

Partners' Capital Accounts

		A	B	C			A	B	C
To	Loss on Revaluation	7,500	3,750	3,750	By	Balance b/d	10,00,000	5,00,000	-
To	Reserve Fund	4,50,000	2,25,000	2,25,000	By	Reserve Fund	6,00,000	3,00,000	-
To	A (W.N.3)	-	-	17,500	By	C (W.N.3)	17,500	8,750	-
To	B (W.N.3)	-	-	8,750	By	Profit on Revaluation	10,000	5,000	
To	Balance c/d (Refer W.N.2)	11,70,000	5,85,000	5,85,000	By	Cash (Bal. Fig.)			8,40,000
		16,27,500	8,13,750	8,40,000			16,27,500	8,13,750	8,40,000

Balance Sheet of newly reconstituted firm as on 31.12.2006

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts		Plant & Machinery	12,00,000
A	11,70,000	Building	9,00,000
B	5,85,000	Sundry Debtors	3,00,000
C	5,85,000	Stock	4,00,000
Reserve Fund	9,00,000	Cash (1,00,000 + 8,40,000)	9,40,000
Sundry Creditors	4,00,000		
Bills Payable	1,00,000		
	37,40,000		37,40,000

Working Notes:

1. **Calculation of new profit and loss sharing ratio**

   C will get 1/4 th share in the new profit sharing ratio.

   Therefore, remaining share will be 1-1/4 =3/4

Share of A will be 3/4 x 2/3 = 2/4 i.e. 1/2

Share of B will be 3/4 x 1/3 = 1/4

New ratio will be

A : B : C

1/2 : 1/4 : 1/4

2 : 1: 1

2. Calculation of closing capital of C

Closing capitals of A & B after all adjustments are:

A = Rs.11,70,000

B = Rs. 5,85,000

Since B's capital is less than A's capital, therefore B's capital is taken as base.

Hence, C's closing capital should be Rs.5,85,000 i.e. at par with B (as per new profit and loss sharing ratio)

3. Adjustment entry for goodwill*

Partners	*Goodwill as per old ratio*	*Goodwill as per new ratio*	*Effect*	
A	70,000	52,500	+ 17,500	-
B	35,000	26,250	+ 8,750	-
C	-	26,250	-	-26,250
	1,05,000	1,05,000	26,250	26,250

Adjustment entry will be:

C's Capital A/c	Dr.	26,250	
To A's Capital A/c			17,500
To B's Capital A/c			8,750

* As per para 36 of AS 10, 'Accounting for fixed Assets,' goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, the goodwill raised at the time of admission of C is to be written off in new ratio among all partners including new partner, C.

UNIT 2 : DISSOLUTION OF FIRMS

(A) Practical Questions:

Question 1

The firm of Kapil and Dev has four partners and as of 31st March, 1995, its Balance Sheet stood as follows:

Balance Sheet as on 31st March, 1995

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital A/cs:		Land	50,000
F. Kapil	2,00,000	Building	2,50,000
S. Kapil	2,00,000	Office equipment	1,25,000
R. Dev	1,00,000	Computers	70,000
Current A/cs		Debtors	4,00,000
F. Kapil	50,000	Stocks	3,00,000
S. Kapil	1,50,000	Cash at Bank	75,000
R. Dev	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current A/c :	
Current Liabilities	70,000	B. Dev	87,400
	13,80,000		13,80,000

The partners have been sharing profits and losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 1.4.1995 on the basis of the following understanding :

(a) The following assets are to be adjusted to the extent indicated with respect to the book values :

Land	*200%*
Building	*120%*
Computers	*70%*
Debtors	*95%*
Stocks	*90%*

(b) In the case of the loan, the lender's are to be paid at their insistence a prepayment premium of 1%.

(c) B. Dev is insolvent and no amount is recoverable from him. His father, R.Dev, however, agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.

Assuming that the realisation of the assets and discharge of liabilities is carried out immediately, show the Cash A/c, Realisation Account and the Partners' Accounts.

(20 marks) (Intermediate – May 1995)

Answer

In the books of M/s. Kapil and Dev

Cash Account (Bank Column)

	Rs.			Rs.
To Balance b/d	75,000	By Realisation A/c-		
To Realisation A/c		(Payment of sundry liabilities)		5,75,000
(Realisation of Sundry assets)	12,46,600	By Partners' Capital A/cs:		
		F. Kapil	2,42,600	
		S. Kapil	3,42,600	
		R. Dev	1,61,400	7,46,600
	13,21,600			13,21,600

Realisation Account

		Rs.			Rs.
To Land		50,000	By Current Liabilities		70,000
To Building		2,50,000	By Loan from NBFC		5,00,000
To Office equipments		1,25,000	By Cash A/c:		
To Computers		70,000	Land	1,00,000	
To Debtors		4,00,000	Building	3,00,000	
To Stocks		3,00,000	Office Equip.	1,25,000	
To Other Current Assets		22,600	Computers	49,000	
To Cash A/c:			Debtors	3,80,000	
Current liabilities	70,000		Stocks	2,70,000	
Loan from NBFC	5,05,000	5,75,000	Other Current Assets	22,600	12,46,600
To Partners' Current A/cs:					
Profit on realisation:					
F. Kapil	9,600				
S. Kapil	9,600				
R. Dev	2,400				
B. Dev	2,400	24,000			
		18,16,600			18,16,600

Partners' Capital Accounts

	F. Kapil	S. Kapil	R. Dev.	B. Dev.		F. Kapil	S. Kapil	R. Dev.	B. Dev.
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Partners' Current A/cs Transfer	–	–		85,000	By Balance b/d	2,00,000	2,00,000	1,00,000	–
To B.Dev A/c 50% of deficiency	–	–	42,500	–	By Partners' Current A/c transfer	59,600	1,59,600	1,12,400	–
To B.Dev A/c balance of deficiency borne by in capital ratio other partners (2:2:1)	17,000	17,000	8,500	–	By R.Dev A/c –50% of deficiency	–	–	–	42,500
					By F.Kapil A/c	–	–	–	17,000
					By S.Kapil A/c	–	–	–	17,000
					By S. Kapil A/c	–	–	–	17,000
					By R. Dev A/c	–	–	–	8,500
To Cash A/c- final Settlement	2,42,600	3,42,600	1,61,400	–	(as per contra)				
	2,59,600	3,59,600	2,12,400	85,000		2,59,600	3,59,600	2,12,400	85,000

Partners' Current Accounts

	F. Kapil	S. Kapil	R. Dev.	B. Dev.		F. Kapil	S. Kapil	R. Dev.	B. Dev.
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Balance b/d	–	–	–	87,400	By Balance b/d	50,000	1,50,000	1,10,000	–
To Partners' Capital A/c (transfer)	59,600	1,59,600	1,12,400	–	By Realisation A/c	9,600	9,600	2,400	2,400
					By Partners' Capital A/c (transfer)	–	–	–	85,000
	59,600	1,59,600	1,12,400	87,400		59,600	1,59,600	1,12,600	87,400

Note: In the absence of specific information, it is assumed that the assets are realised at the agreed values.

Question 2

The firm of LMS was dissolved on 31.3.95, at which date its Balance Sheet stood as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	2,00,000	Fixed Assets	45,00,000
Bank Loan	5,00,000	Cash and Bank	2,00,000
L's Loan	10,00,000		
Capital			
L	15,00,000		
M	10,00,000		
S	5,00,000		
Total	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at Rs. 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are:

S.No.	Amount in Rs.
1	5,00,000
2	15,00,000
3	15,00,000
4	30,00,000
5	30,00,000

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings. *(15 Marks) (Intermediate–Nov. 1995)*

Answer

In the Books of M/s LMS

Statement of Piecemeal Distribution (Under Higher Relative Capital method)

Particulars	Amount available	Creditors	Bank Loan	L's loan	Capital A/cs L	M	S
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Balance due		2,00,000	5,00,000	10,00,000	15,00,000	10,00,000	5,00,000
1st Instalment (including cash and bank balances)	5,00,000						

Less: Liquidator's Expenses and fees	1,00,000						
	4,00,000						
Less: Payment to Creditors and repayment of Bank Loan in the ratio of 2:5	(4,00,000)	(1,14,286)	(2,85,714)	–	–	–	–
Balance Due	–	85,714	2,14,286	10,00,000	15,00,000	10,00,000	5,00,000
2nd Instalment	15,00,000						
Less: Payment to Creditors and repayment of bank loan in full settlement	(3,00,000)	(85,714)	(2,14,286)	–	–	–	–
	12,00,000	–	–				
Less: Repayment of L's Loan	(10,00,000)			(10,00,000)	–	–	–
	2,00,000						
Less: Payment to Mr. L towards relative higher capital (W.N. 1)	(2,00,000)				(2,00,000)	–	—
					13,00,000	10,00,000	5,00,000
Balance Due							
3rd Instalment	15,00,000						
Less: Payment to Mr. L towards higher relative capital (W.N. 2)	(3,00,000)				(3,00,000)		
	12,00,000				10,00,000		
Less: Payment to Mr. L & Mr. M towards excess capital (W.N. 1&2)	(10,00,000)				(5,00,000)	(5,00,000)	
	2,00,000				5,00,000	5,00,000	
Less: Payment to all the partners equally	(2,00,000)				(66,667)	(66,667)	(66,666)
					4,33,333	4,33,333	4,33,334
Balance due							
4th Instalment	30,00,000						
Less: Payment to all the partners equally	(30,00,000)				(10,00,000)	(10,00,000)	(10,00,000)

Realisation profit credited to Partners		5,66,667	5,66,667	5,66,666
5th Instalment	30,00,000			
Less: payment to all partners equally	(30,00,000)	10,00,000	10,00,000	10,00,000
Realisation profit credited to partners		15,66,667	15,66,667	15,66,666

Working Notes:

(i) Scheme of payment of surplus amount of Rs. 2,00,000 out of second Instalment:

	Capital A/cs L Rs.	M Rs.	S Rs.
Balance (i)	15,00,000	10,00,000	5,00,000
Profit sharing ratio (ii)	1	1	1
Capital taking S's Capital (iii)	5,00,000	5,00,000	5,00,000
Excess Capital (iv) = (i) – (iii)	10,00,000	5,00,000	
Profit Sharing Ratio	1	1	
Excess capital taking M's Excess Capital as base (v)	5,00,000	5,00,000	
Higher Relative Excess (iv) – (iv)	5,00,000		

So Mr. L should get Rs. 5,00,000 first which will bring down his capital account balance from Rs. 15,00,000 to Rs. 10,00,000. Accordingly, surplus amounting to Rs. 2,00,000 will be paid to Mr. L towards higher relative capital.

(ii) Scheme of payment of Rs. 15,00,000 realised in 3rd Instalment:

- Payment of Rs. 3,00,000 will be made to Mr. L to discharge higher relative capital. This makes the higher capital of both Mr. L and Mr. M Rs. 5,00,000 as compared to capital of Mr. S.
- Payment of Rs. 5,00,000 each of Mr. L & Mr. M to discharge the higher capital.
- Balance Rs. 2,00,000 equally to L, M and S, i.e., Rs. 66,667 Rs. 66,667 and Rs. 66,666 respectively.

Question 3

Ajay, Vijaya, Ram and Shyam are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 1996 :

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		3,00,000	Sundry Debtors	3,50,000
Capital A/cs :			Less: Doubtful Debts	50,000
Ajay	7,00,000			3,00,000
Shyam	3,00,000		Cash in hand	1,40,000
		10,00,000	Stocks	2,00,000
			Other Assets	3,10,000
			Capital A/cs:	
			Vijay	2,00,000
			Ram	1,50,000
		13,00,000		13,00,000

On 31st March, 1996, the firm is dissolved and the following points are agreed upon:

Ajay is to takeover sundry debtors at 80% of book value

Shyam is to takeover the stocks at 95% of the value and

Ram is to discharge sundry creditors.

Other assets realise Rs. 3,00,000 and the expenses of realisation come to Rs. 30,000.

Vijay is found insolvent and Rs. 21,900 is realised from his estate.

Prepare Realisation Account and Capital Accounts of the partners. Show also the Cash A/c.

The loss arising out of capital deficiency may be distributed following the decision in Garner vs Murray. *(15 marks) (Intermediate–Nov. 1996)*

Answer

Realisation A/c

Dr.			Cr.
	Rs.		Rs.
To Sundry Debtors	3,50,000	By Sundry Creditors	3,00,000
To Stock	2,00,000	By Provision for Doubtful	
To Other assets	3,10,000	Debts	50,000
To Ram's Capital A/c:		By Ajay's Capital A/c	
(Creditors)	3,00,000	(Debtors)	2,80,000

	Rs.		Rs.
To Cash (Expenses on realization)	30,000	By Shyam's Capital A/c (stock)	1,90,000
		By Cash (Other assets)	3,00,000
		By Ajay's Capital A/c	28,000
		By Vijay's Capital A/c	7,000
		By Ram's Capital A/c	14,000
		By Shyam's Capital A/c (Loss on realisation)	21,000
	11,90,000		11,90,000

Capital A/cs

Dr.	Ajay Rs.	Vijay Rs.	Ram Rs.	Shyam Rs.		Ajay Rs.	Vijay Rs.	Ram Rs.	Shyam Rs. Cr.
To Balance b/f	–	2,00,000	1,50,000	–	By Balance b/f	7,00,000	–	–	3,00,000
To Realisation (Debtors)	2,80,000	–	–	–	By Realisation (Creditors)	–	–	3,00,000	–
To Realisation (Stock)	–	–	–	1,90,000	By Balance c/d	–	2,07,000	–	–
To Realisation (loss)	28,000	7,000	14,000	21,000					
To Balance c/d	3,92,000	–	1,36,000	89,000					
	7,00,000	2,07,000	3,00,000	3,00,000		7,00,000	2,07,000	3,00,000	3,00,000
To Balance b/d	–	2,07,000	–	–	By Balance b/d	3,92,000	–	1,36,000	89,000
To Vijay's A/c	1,29,570	–	–	55,530	By Cash	–	21,900		
To Cash	2,62,430	–	1,36,000	33,470	By Ajay	–	1,29,570		
					By Shyam	–	55,530	–	–
	3,92,000	2,07,000	1,36,000	89,000		3,92,000	2,07,000	1,36,000	89,000

Cash A/c

Dr.	Rs.			Cr. Rs.
To Balance b/d	1,40,000	By Realisation A/c (expenses)		30,000
To Realisation A/c	3,00,000	By Capital A/c		
To Vijay's Capital A/c	21,900	Ajay	2,62,430	
		Ram	1,36,000	
		Shyam	33,470	
				4,31,900
	4,61,900			4,61,900

Note:

1. Since creditors are taken over by Ram as per Balance Sheet figures, a direct entry for the same in Ram's Capital A/c is also correct.
2. Ajay takes over Debtors at 80% of Rs. 3,50,000 i.e. Rs. 2,80,000.
3. Vijay's deficiency will be borne by Ajay and Shyam in the ratio of 7 : 3 i.e. on opening capitals of Rs. 7,00,000 and Rs. 3,00,000. Ram will not bear any portion of the loss since at the time of dissolution he had a debit balance in his capital account.

Question 4

Ram, Rahim and Auntony were in partnership sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively. They decided to dissolve the partnership firm on 31.3.1998, when the Balance Sheet of the firm appeared as under :

Balance Sheet of the firm as on 31.3.1998

Liabilities		*Rs.*	*Assets*	*Rs.*
Sundry Creditors		*5,67,000*	*Goodwill A/c*	*4,56,300*
Bank Overdraft		*6,06,450*	*Plant and Machinery*	*6,07,500*
Joint Life Policy Reserve		*2,65,500*	*Furniture*	*64,650*
Loan from Mrs. Ram		*1,50,000*	*Stock*	*2,36,700*
Capital Accounts:			*Sundry Debtors*	*5,34,000*
Ram	*4,20,000*		*Joint Life Policy*	*2,65,500*
Rahim	*2,25,000*		*Commission Receivable*	*1,40,550*
Auntony	*1,20,000*	*7,65,000*	*Cash in Hand*	*48,750*
		23,53,950		*23,53,950*

The following details are relevant for dissolution :

(i) *The joint life policy was surrendered for Rs. 2,32,500.*

(ii) *Ram took over goodwill and plant and machinery for Rs. 9,00,000.*

(iii) *Ram also agreed to discharge bank overdraft and loan from Mrs. Ram.*

(iv) *Furniture and stocks were divided equally between Ram and Rahim at an agreed valuation of Rs. 3,60,000.*

(vi) *Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.*

(vi) *Commission receivable was received in toto in time.*

(vii) *A bill discounted was subsequently returned dishonoured and proved valueless Rs. 30,750 (including Rs. 500 noting charges).*

(viii) *Ram paid the expenses of dissolution amounting to Rs. 18,000.*

(ix) Auntony agreed to receive Rs. 1,50,000 in full satisfaction of his rights, title and interest in the firm.

You are required to show accounts relating to closing of books on dissolution of the firm.

(15 Marks) (Intermediate–Nov. 1998)

Answer

Realisation Account

		Rs.			Rs.
To Goodwill A/c		4,56,300	By Sundry Creditors A/c		5,67,000
To Plant & Machinery A/c		6,07,500	By Joint Life Policy Reserve A/c		2,65,500
To Furniture A/c		64,650	By Cash A/c :		
To Stock A/c		2,36,700	Joint Life Policy		2,32,500
To Sundry Debtors A/c		5,34,000	By Ram's Capital A/c:		
To Joint Life Policy A/c		2,65,500	Goodwill, Plant and		
To Ram's Capital A/c:			Machinery	9,00,000	
Dissolution Expenses		18,000	Furniture, Stocks	1,80,000	10,80,000
To Cash A/c :					
Bill dishonoured		30,750	By Rahim's Capital A/c:		
To Partner's Capital Accounts:			Furnitures stocks		
(Profit on realisation)					1,80,000
Ram	55,800				
Rahim	37,200				
Auntony	18,600	1,11,600			
		23,25,000			23,25,000

Capital Accounts

	Ram Rs.	Rahim Rs.	Auntony Rs		Ram Rs.	Rahim Rs.	Auntony Rs.
To Realisation A/c:				By Balance b/d	4,20,000	2,25,000	1,20,000
Goodwill, Plant				By Bank Overdraft A/c	6,06,450	–	–
and Machinery	9,00,000	–	–	By Loan from			
Furniture, Stocks	1,80,000	1,80,000		Mrs. Ram A/c	1,50,000	–	–
To Auntony's Capital A/c	6,840	4,560	–	By Realisation A/c:			
To Cash A/c			1,50,000	Dissolutin Expenses	18,000	–	–

To Cash A/c	1,63,410	77,640	–	By Realisation A/c:			
(Balancing figure)				Profit on realisation	55,800	37,200	18,600
				By Partners' Capital A/cs:	–	–	–
				Ram	–	–	6,840
				Rahim	–	–	4,560
				(Note 2)			
	12,50,250	2,62,200	1,50,000		12,50,250	2,62,200	1,50,000

Cash Account

	Rs.		Rs.
To Balance b/d	48,750	By Realisation A/c:	
To Realisation A/c:		Bill dishonoured	30,750
Joint Life Policy	2,32,500	By Partners' Capital Accounts:	
To Commission Receivable A/c	1,40,550	Ram	1,63,410
		Rahim	77,640
		Auntony	1,50,000
	4,21,800		4,21,800

Notes:

(1) No entry is required regarding assignment of sundry debtors to sundry creditors in full satisfaction of their claims.

(2) The amount of excess payments to Auntony (Rs. 1,50,000 less Rs. 1,38,600 i.e., Rs. 11,400) has been debited to Ram and Rahim in the ratio of 3:2.

Question 5

A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were Rs. 9,600, Rs. 6,000 and Rs. 8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	Rs.		Rs.
Liability for interest on		*Investments*	*1,000*
loans from :		*Furniture*	*2,000*
Spouses of partners	*2,000*	*Machinery*	*1,200*
Partners	*1,000*	*Stock*	*4,000*

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure. *(10 marks) (Intermediate–Nov. 1999)*

Answer

Statement of Distribution of Cash

	Realisation	Interest on loans from partners' spouses	Interest on loans from partners	Partners' Capitals A	B	C	Total
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Balances due		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	(1,000)	(1,000)				
		1,000	–				
(ii) Sale of furniture	2,000	(1,000)	(1,000)				
		–	–				
(iii) Sale of machinery	1,200						
Maximum possible loss Rs. 22,800 (total of capitals Rs. 24,000 less cash available Rs. 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2				(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit				(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C				1,800	840	(2,640)	–
Amount paid				–	–	1,200	1,200
Balances in capital acounts				9,600	6,000	7,200	22,800
(iv) Sale of stock	4,000						
Maximum possible loss Rs. 18,800 (Rs. 22,800 – Rs. 4,000) Allocated to partners in the ratio 5 : 3 : 2				(9,400)	(5,640)	(3,760)	(18,800)
Amounts at credit and cash paid				200	360	3,440	(4,000)
Balances in capital accounts left unpaid—Loss				9,400	5,640	3,760	18,8000

Question 6

Neptune, Jupiter, Venus and Pluto had been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2003:

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Account:			Premises		1,20,000
Neptune	1,00,000		Furniture		40,000
Jupiter	60,000	1,60,000	Stock		1,00,000
General Reserve		56,000	Debtors		40,000

Capital Reserve	*14,000*	*Cash*		*8,000*
Sundry Creditors	*20,000*	*Capital Overdrawn:*		
Mortgage Loan	*80,000*	*Venus*	*10,000*	
		Pluto	*12,000*	*22,000*
	3,30,000			*3,30,000*

(i) The assets were realised as under:

	Rs.
Debtors	*24,000*
Stock	*60,000*
Furniture	*16,000*
Premises	*90,000*

(ii) Expenses of dissolution amounted to Rs. 4,000.

(iii) Further Creditors of Rs. 12,000 had to be met.

(iv) General Reserve unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and the Cash Account assuming that Venus became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner vs Murray. (16 marks) (PE – II – Nov. 2003)

Answer

Realisation Account

		Rs.			*Rs.*	*Rs.*
To	Sundry assets A/c (transfer):		By	Sundry creditors A/c		20,000
	Premises	1,20,000	By	Cash A/c (assets realised):		
	Furniture	40,000		Premises	90,000	
	Stock	1,00,000		Furniture	16,000	
	Sundry Debtors	40,000		Stock	60,000	
To	Cash A/c (creditors paid)	32,000		Debtors	24,000	1,90,000
To	Cash A/c (expenses)	4,000	By	Loss transferred to Capital Accounts:		

		Neptune	54,000	
		Jupiter	36,000	
		Venus	18,000	
		Pluto	18,000	1,26,000
	3,36,000			3,36,000

Cash Account

			Rs.			Rs.
To	Balance b/d		8,000	By	Realisation A/c (creditors)	32,000
To	Realisation A/c			By	Realisation A/c (expenses)	4,000
	(assets realised)		1,90,000	By	Mortgage loan	80,000
To	Capital A/c			By	Neptune's Capital A/c	1,18,857
	(realisation loss			By	Jupiter's Capital A/c	73,143
	made good):					
	Neptune	54,000				
	Jupiter	36,000				
	Pluto	18,000	1,08,000			
To	Pluto's Capital A/c		2,000			
			3,08,000			3,08,000

Partners' Capital Accounts

	Particulars	*Neptune*	*Jupiter*	*Venus*	*Pluto*		*Particulars*	*Neptune*	*Jupiter*	*Venus*	*Pluto*
		Rs.	*Rs.*	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*	*Rs.*
To	Balance b/d	–	–	10,000	12,000	By	Balance b/d	1,00,000	60,000	–	–
To	Realisastion A/c (loss)	54,000	36,000	18,000	18,000	By	General reserve A/c (3 : 2 : 1 :1)	24,000	16,000	8,000	8,000
To	Venus's Capital A/c (loss)	11,143	6,857	–	–	By	Capital reserve A/c (3 : 2 : 1 :1)	6,000	4,000	2,000	2,000
To	Cash A/c	1,18,857	73,143	–	–	By	Cash A/c (loss on realization)	54,000	36,000	–	18,000
						By	Neptune's Capital A/c	–	–	11,143	–
						By	Jupiter's Capital A/c	–	–	6,857	–
						By	Cash A/c	–	–	–	2,000
		1,84,000	1,16,000	28,000	30,000			1,84,000	1,16,000	28,000	30,000

Question 7

X, Y and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4 : 3 : 2. Following is the Balance sheet of the firm as at 31st March, 2008:

Balance Sheet as at 31st March, 2008

Liabilities	*Rs.*	*Assets*	*Rs.*
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above said date. It was found that a credit purchase of Rs. 20,000 in January, 2008 had not been recorded in the books of the firm.

Fixed assets realized Rs. 5,20,000 and book debts Rs. 4,40,000.

Stocks were valued at Rs. 2,50,000 and it was taken over by partner Y.

Creditors allowed discount of 5% and the expenses of realization amounted to Rs. 6,000.

You are required to prepare:

(i) Realisation account;

(ii) Partners capital account; and

(iii) Cash account. *(8 Marks) (PE-II Nov. 2008)*

Answer

(i) Realisation Account

		Rs.			Rs.
To	Fixed assets	5,00,000	By	Creditors	3,20,000
To	Stock in trade	3,00,000	By	Cash (5,20,000+4,40,000)	9,60,000
To	Debtors	5,00,000	By	Y (Stock taken over)	2,50,000
To	Cash - Expenses	6,000	By	Loss transferred to partners' capital accounts	
To	Cash -Creditors (3,40,000x 95%)	3,23,000		X	44,000
				Y	33,000
				Z	22,000
		16,29,000			16,29,000

(ii) **Partners' Capital Accounts**

		X	Y	Z			X	Y	Z
		Rs.	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*
To	Realisation Account	44,000	33,000	22,000	By	Balance b/d	4,00,000	3,00,000	2,00,000
To	Realisation Account	-	2,50,000	-	By	General reserve	40,000	30,000	20,000
To	Cash	3,96,000	47,000	1,98,000					
		4,40,000	3,30,000	2,20,000			4,40,000	3,30,000	2,20,000

(iii) **Cash Account**

		Rs.			Rs.
To	Balance b/d	10,000	By	Realisation A/c (Expenses)	6,000
To	Realisation A/c (Fixed assets and book debts realized)	9,60,000	By	Realisation A/c (Creditors)	3,23,000
			By	X	3,96,000
			By	Y	47,000
			By	Z	1,98,000
		9,70,000			9,70,000

Unit 3 : AMALGAMATION, CONVERSION AND SALE OF PARTNERSHIP FIRMS

(A) Practical Questions:

Question 1

Mr. B and Mr. E are partners sharing Profits and Losses in the ratio of 3:2. On 30th September, 1993 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, 1994, 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, 1993 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, 1994.

	Debit	Credit
	Rs.	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, 94	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,1994 *(20 Marks) (Intermediate–Nov. 1994)*

Answer

Goodwill Adjustment Account

	Rs.		Rs.
1993		1993	
30th Sept. To Partners' Capital A/c		30th Sept. 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
1994		1994	
31st March To Partners' Capital A/cs		31st March 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

1994	*B*	*E*	*C*	*1994*	*B*	*E*	*C*
31st March				31st March			
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			
To Goodwill Adjust				30th Sept 93 (W.N.2)	13,200	8,800	
ment Account	12,000	12,000	6,000	By Profit for 6 months			
To Bank Account	7,620			ended 31st March 1994	3,120	3,120	1,560
To Bank Account(WN 3)	–	7,580	–	By Goodwill			
To Share Capital	–	31,340	31,340	Adjustment A/c	12,000	8,000	10,000
				By Goodwill			
				Adjustment A/c	16,000	16,000	8,000
				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, 1994

	Rs.		Rs.
To Partners' Capital Account		By Profit & Loss A/c	
(Distribution of Profit)		(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, 1994

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, 1993*

	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)	30,000	12,000	12,000	6,000

(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, 1993 (× 66,000)		22,000
Profit for next six months ended 31st March, 1994 (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 have equal share in BC Ltd.

C should bring in cash ($\frac{1}{2}$ × 62,680 – 23,760)	7,580
E should withdraw cash (38,920 – $\frac{1}{2}$ × 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		
	26,880		26,880

(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
Not effect	Nil

Question 2

A, B and C were partners in business, sharing profits & losses in the ratio 2:1:1. Their Balance Sheet as at 31.3.97 is as follows:

Balance Sheet as at 31.3.97

(Figures in Rs.'000)

Liabilities		*Rs.*	*Assets*		*Rs.*
Fixed Capital:			*Fixed Assets*		*300*
A	*200*		*Investments*		*50*
B	*100*		*Current Assets:*		
C	*100*	*400*	*Stock*	*100*	
Current Accounts:			*Debtors*	*60*	
A	*40*		*Cash & Bank*	*150*	*310*
B	*20*	*60*			
Unsecured Loans		*200*			
		660			*660*

On 1.4.97, it is agreed among the partners that BC (P) Ltd. a newly formed company with B and C having each taken up 100 shares of Rs. 10 each will take over the firm as a going concern including goodwill but excluding cash & bank balances. The following points are also agreed upon:

(a) Goodwill will be valued at 3 years purchase of super profits.

(b) The actual profit for the purpose of goodwill valuation will be Rs. 1,00,000.

(c) Normal rate of return will be 15% on fixed capital.

(d) All other assets and liabilities will be taken over at book values.

(e) The purchase consideration will be payable partly in shares of Rs. 10 each and partly in cash. Payment in cash being to meet the requirement to discharge A, who has agreed to retire.

(f) B and C are to acquire equal interest in the new company.

(g) Expenses of liquidation Rs. 40,000.

You are required to prepare the necessary Ledger Accounts.

(15 marks) (Intermediate–May 1997)

Answer

	Rs.
Capital employed on 31.3.97 (Fixed capital)	4,00,000
Calculation of Goodwill :	
Weighted average of actual profits	1,00,000
Less: Normal profits at 15% of Rs. 4,00,000	60,000
Super profits	40,000
Goodwill at 3 years' purchase, i.e. 40,000 × 3	1,20,000
Calculation of Purchase Consideration :	
Total assets as per Balance Sheet	6,60,000
Less: Cash & Bank balances	1,50,000
	5,10,000
Add: Goodwill	1,20,000
	6,30,000
Less: Unsecured loans	2,00,000
Purchase Consideration	4,30,000

Realisation Account

	Rs.			Rs.
To Sundry Assets	5,10,000	By Unsecured loans		2,00,000
To Goodwill	1,20,000	By BC (P) Ltd.		4,30,000
To Bank : expenses	40,000	By Capital A/c:		
		A	20,000	
		B	10,000	
		C	10,000	40,000
	6,70,000			6,70,000

Partners' Capital Accounts

	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Realisation	20,000	10,000	10,000	By Bal. c/d	2,00,000	1,00,000	1,00,000
To Cash	2,80,000	–	–	By Cur. A/c	40,000	20,000	
To C (Cap. adj)	–	10,000	–	By Goodwill	60,000	30,000	30,000
To Shares in BC (P) Ltd.)	–	1,30,000	1,30,000	By B (Cap. adj)	–	–	10,000
	3,00,000	1,50,000	1,40,000		3,00,000	1,50,000	1,40,000

Cash & Bank A/c

	Rs.		Rs.
To Balance b/d	1,50,000	By Realisation A/c – expenses	40,000
To BC (P) Ltd. (Balancing Figure)	1,70,000	By A's Capital A/c	2,80,000
	3,20,000		3,20,000

BC (P) Ltd.

To Realisation	4,30,000	By Cash	1,70,000
		By Equity Shares (Balancing Figure) (26,000 shares of Rs. 10 each)	2,60,000
	4,30,000		4,30,000

Proportion of equity capital B:C = 1:1

No. of shares = $\frac{26,000}{2}$ = 13,000 shares each.

Question 3

Alpha Manufacturing P. Ltd. is a company manufacturing articles. Beeta marketing P. Ltd. is a company engaged in markting activities. The two companies enter into a partnership on the following terms:

(a) Alpha Manufacturing P. Ltd. is to supply goods on credit of two months to the partnership firm. The partnership is to discharge the due to Alpha Manufacturing P. Ltd. along with interest at 12% per annum regularly on due dates.

(b) Beeta Marketing P. Ltd. is to sell the goods.

(c) Expenses of sales are to be met out of the partnership funds. Alpha Manufacturing P. Ltd. and Beeta Marketing P. Ltd. are to introduce capital of Rs. five lakhs each for meeting the above expenses and as working capital. Interest at 15% per annum is payable on partners' capital—payment being made every month. Accordingly the capitals are introduced on 1st April, 1999.

(d) Profits and losses are to be dealt with as follows:

(i) 10% of the profits, if any, are to be credited to reserves for strengthening the working capital base;

(ii) balance profits are to be shared equally by credit to current accounts;

(iii) losses, if any, are to be borne equally by debit to capital accounts.

(e) The firm name is to be AB Traders.

During the year ended 31st March, 2000 the following were the transactions:

(a) Purchases Rs. 150 lakhs of which Rs. 30 lakhs were in the first quarter; Rs. 90 lakhs were in the next six months; the balance Rs. 30 lakhs were in the last quarter. The purchases are evenly spread through the respective periods.

(b) Sales were Rs. 200 lakhs.

(c) Sales expenses were Rs. 10 lakhs and were paid in full.

(d) Discount allowed to customers amounted to Rs. 4 lakhs. On 31st March, 2000, amounts due from customers were Rs. 45 lakhs and unsold inventory was worth Rs. 15 lakhs.

You are required to prepare final accounts of the firm.

(15 marks) (Intermediate–May 2000)

Answer

AB Traders
Trading and Profit and Loss Account
for the year ended on 31st March, 2000

(Rs. in Lakhs)

	Rs.		*Rs.*
To Purchases	150.00	By Sales	200.00
To Gross profit c/d	65.00	By Closing stock	15.00
	215.00		215.00
To Interest to supplier (W.N.1)	2.80	By Gross profit b/d	65.00
To Sales expenses	10.00		
To Discount	4.00		
To Net profit	48.20		
	65.00		65.00

Profit and Loss Appropriation Account

To Reserves	4.82	By Net profit	48.20
To Interest on capitals			
(15% on Rs. 10 lakhs)	1.50		
To Net profit transferred to			
capital accounts:			
Alpha Manufacturing P. Ltd.	20.94		
Beeta Marketing P. Ltd.	20.94		
	48.20		48.20

Balance Sheet of AB Traders
as at 31st March, 2000

(Rs. in lakhs)

	Rs.		*Rs.*
Capital accounts:		Closing inventory	15.00
Alpha Manufacturing P. Ltd.	5.00	Customers' dues	45.00
Beeta Marketing P. Ltd.	5.00	Bank balance	16.90
Current accounts:			
Alpha Manufacturing P. Ltd.	20.94		
Beeta Marketing P. Ltd.	20.94		

Reserves	4.82		
Liability for goods			
(Alpha Manufacturing P. Ltd.)	20.00		
Interest Accrued	0.20		
	76.90		76.90

Working Notes: *(Rs. in lakhs)*

1. Interest to supplier (Alpha Manufacturing P. Ltd.)

Assuming that purchases are made evenly in the middle of each month of the quarter, the schedule of payment of dues for the purchases of last quarter is given below:

Year 2000	*Purchases Rs.*	*Due date of payment*	*Period of interest accrual (upto financial year' end)*
Jan. 15	10	15th March	2 months
Feb. 15	10	15th April	$1\frac{1}{2}$ months
March 15	10	15th May	15 days

	Rs.
Interest on Rs. 130 lakhs (30 + 90 + 10) for two months	2.60
Interest on Rs. 10 lakhs for one and half months	0.15
Interest on Rs. 10 lakhs for 15 days	0.05
	2.80

Interest accrued on 31st March, 2000 = 0.15 + 0.05 = 0.20

Customers' Account

	Rs.		*Rs.*
To Sales A/c	200.00	By Discount A/c	4.00
		By Bank A/c (balancing figure)	151.00
		By Balance c/d	45.00
	200.00		200.00

Bank Accounts

	Rs.		*Rs.*
To Capital A/cs :		By Sales expenses A/c	10.00
Alpha Manufacturing P. Ltd.	5.00	By Alpha Manufacturing P. Ltd.	
Beeta Marketing P. Ltd.	5.00	(payment for purchases)	130.00

To Customers A/c	151.00	By Interest A/c	2.60
		By Interest on partners' capitals:	
		Alpha Manufacturing P. Ltd.	0.75
		Beeta Marketing P. Ltd.	0.75
		By Balance c/d	16.90
	161.00		161.00

Partners' Current Accounts

	Alpha Pvt. Ltd. Rs.	*Beeta Pvt. Ltd. Rs.*		*Alpha Pvt. Ltd. Rs.*	*Beeta Pvt. Ltd. Rs.*
To Bank A/c	0.75	0.75	By P & L Appropriation A/c (Interest on capital)	0.75	0.75
To Balance c/d	20.94	20.94	By P & L Appropriation A/c (Share of profit)	20.94	20.94
	21.69	21.69		21.69	21.69

Question 4

Avinash, Rohit and Madwesh were carrying on business in partnership sharing Profits and Losses in the ratio of 5 : 4 : 3 respectively. The Trial Balance of the firm as on 31st March, 2002 was the following:

Particulars	*Dr. (Rs.)*	*Cr. (Rs.)*
Plant and Machinery @ cost	*1,05,000*	–
Stock	*60,200*	–
Sundry Debtors	*85,000*	–
Sundry Creditors	–	*1,05,200*
Capital A/cs:		
Avinash	–	*70,000*
Rohit	–	*50,000*
Madwesh	–	*30,000*
Drawings A/cs:		
Avinash	*30,000*	–

Rohit	*25,000*	–
Madwesh	*20,000*	–
Depreciation on Plant and Machinery	–	*35,000*
Trading Profit for the year	–	*1,29,800*
Cash at Bank	*94,800*	–
	4,20,000	*4,20,000*

Additional Information:

(a) Interest on Capital Accounts at 10% on the amount standing to the credit of partners' capital accounts at the beginning of the year was not provided before preparing the above Trial Balance.

(b) On 31st March, 2002 they formed a Private Ltd. Company Anagha (P) Ltd. to take over the partnership business.

(c) You are further informed as under:

(i) Plant and Machinery is to be transferred at Rs. 80,000.

(ii) Equity Shares of Rs. 10 each of the company are to be issued to the partners at par in such numbers to ensure that by reason of their share holdings alone, they will have the same rights of sharing Profits and Losses as they had in the partnership. Balance, if any in their Capital Accounts, will be settled by giving 7½% Preference Shares at par.

(iii) Before transferring the business, the partners withdrew by cash from partnership the following amounts over and above the drawings as shown in the Trial Balance:

(a)	*Avinash*	*Rs. 20,000*
(b)	*Rohit*	*Rs. 10,600*
(c)	*Madwesh*	*Rs. 14,200*

(iv) All Assets and Liabilities except Plant and Machinery and the Bank Balance are to be transferred at their value in the books of the partnership as at 31st March, 2002.

(v) You are required to prepare:

(a) Profit and Loss Adjustment Account for the year ending 31st March, 2002.
(b) Capital Accounts showing all the adjustments required to dissolve the partnership
(c) A statement showing the number of shares of each class to be issued by the company to each of the partners to settle their accounts.
(d) Prepare Balance Sheet of the company Anagha (P) Ltd. as on 31.03.2002 after take over of the business. *(16 marks) (PE-II – Nov. 2002)*

Answer

(a) **In the Books of Avinash, Rohit & Madwesh**

Profit and Loss Adjustment Account for the year ending 31st March, 2002

			Rs.	*Rs.*			*Rs.*
To	Interest on Capital	Avinash	7,000		By	Balance b/d	1,29,800
		Rohit	5,000				
		Madwesh	3,000	15,000	By	Plant and Machinery	10,000
To	Capital Accounts	Avinash	52,000				
		Rohit	41,600				
		Madwesh	31,200	1,24,800			
				1,39,800			1,39,800

(b) **Partners' Capital Accounts**

		Avinash	Rohit	Madwesh			Avinash	Rohit	Madwesh
To	Drawings as per Trial Balance	30,000	25,000	20,000	By	Balance b/d	70,000	50,000	30,000
					By	Profit and Loss			
To	Additional Drawings	20,000	10,600	14,200		Adjustment A/c	52,000	41,600	31,200
To	Balance c/d	79,000	61,000	30,000	By	Interest on Capital	7,000	5,000	3,000
		1,29,000	96,600	64,200			1,29,000	96,600	64,200
To	Equity Shares	50,000	40,000	30,000	By	Balance b/d	79,000	61,000	30,000
To	Preference Shares	29,000	21,000	–					
		79,000	61,000	30,000			79,000	61,000	30,000

(c) **Statement showing the number and classes of shares issued to the partners**

Particulars	Avinash	Rohit	Madwesh
Closing Capital Balance	79,000	61,000	30,000
(After Adjustments)			
Taking Madwesh's Capital as base for ensuring same rights of share holding-Equity Shares	50,000	40,000	30,000

of Rs. 10 each to be issued			
Balance to be settled by issue of 7½% Preference Shares	29,000	21,000	–

(d) Balance Sheet of Anagha (P) Ltd. as on 31st March, 2002 (after takeover of the business)

Shares Capital:	*Rs.*	*Fixed Assets:*	*Rs.*
12,000 Equity Shares of 10 each at par (Issued for consideration other than cash)	1,20,000	Plant and Machinery	80,000
		Current Assets:	
		Stock	60,200
7½% Preference Shares		Debtors	85,000
(Issued for consideration other than cash)	50,000	Cash at Bank	50,000
Current Liabilities and Provisions:			
Sundry Creditors	1,05,200		
	2,75,200		2,75,200

Working Note:

Purchase Consideration	
Plant and Machinery	80,000
Stock:	60,200
Debtors	85,000
Cash at Bank (94,800 – 44,800)	50,000
	2,75,200
Less: Sundry Creditors	1,05,200
	1,70,000

Question 5

Ram, Rahim and Robert are partners of the firm 'RR Traders' for the past 5 years. The partners decided to dissolve the firm consequent to insolvency of partner Robert in October, 2002. The Balance Sheet of the firm as on 31.10.2002 is furnished below. They share profits and losses equally:

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		*Land and Building*	*5,00,000*
Ram	*4,50,000*	*Plant and Machinery*	*2,00,000*
Rahim	*4,50,000*	*Furniture and Fittings*	*50,000*

Robert	*2,00,000*	*Stock in Trade*	*3,00,000*
General Reserve	*2,10,000*	*Debtors*	*5,00,000*
Creditors	*2,90,000*	*Cash at Hand/Bank*	*50,000*
	16,00,000		*16,00,000*

The partners Ram and Rahim decided to form a new firm 'RR Enterprises' and takeover all the assets and liabilities of the firm at values given below:

Land and Building	*Rs. 3,50,000*
Plant and Machinery	*Rs. 1,50,000*
Furniture and Fittings	*Rs. 20,000*
Stock in trade	*Rs. 2,00,000*

Debtors include Rs. 3,00,000 due from SK & Co. owned by Robert. (Nothing is recoverable from the said concern).

Other debtors can be recovered fully.

Prepare:

(i) Realisation account, Partners' capital accounts in the books of RR Traders; and

(ii) The Balance Sheet of RR Enterprises (immediately after commencement).

(16 marks) (PE-II – May 2003)

Answer

(i) **In the Books of RR Traders**

Realisation Account

		Rs.			*Rs.*
To	Sundry assets:		By	Creditors	2,90,000
	Land and building	5,00,000	By	RR Enterprises (W.N. 1)	9,70,000
	Plant and machinery	2,00,000			
	Furniture and fittings	50,000	By	Loss transferred to partners' capital accounts	
	Stock	3,00,000			
	Debtors	2,00,000		Ram 1,10,000	
	Cash at hand/bank	50,000		Rahim 1,10,000	
To	RR Enterprises (liability taken over)	2,90,000		Robert 1,10,000	3,30,000
		15,90,000			15,90,000

Partners' Capital Accounts

		Ram	Rahim	Robert			Ram	Rahim	Robert
		Rs.	Rs.	Rs.			Rs.	Rs.	Rs.
To	Sundry debtors			3,00,000	By	Balance b/d	4,50,000	4,50,000	2,00,000
To	Realisation account	1,10,000	1,10,000	1,10,000	By	General reserve	70,000	70,000	70,000
To	Robert's account (deficiency borne by solvent partners)	70,000	70,000	—	By	Cash	1,10,000*	1,10,000*	—
					By	Ram and Rahim (deficiency borne by solvent partners)			
To	Balance c/d	4,50,000	4,50,000	—			—	—	1,40,000
		6,30,000	6,30,000	4,10,000			6,30,000	6,30,000	4,10,000

* Solvent partners bring cash to the extent of loss arising upon realisation of assets of the firm as per Garner vs Murray Rule.

(ii) **Balance Sheet of RR Enterprises**

as on 31.10.2002

(immediately after commencement)

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		Land and building	3,50,000
Ram	4,50,000	Plant and machinery	1,50,000
Rahim	4,50,000	Furniture and fittings	20,000
Creditors	2,90,000	Stock in trade	2,00,000
		Debtors	2,00,000
		Cash at hand/bank (W.N. 2)	2,70,000
	11,90,000		11,90,000

Working Notes:

1. Agreed value of assets taken over by RR Enterprises

	Rs.
Land and building	3,50,000
Plant and machinery	1,50,000

Furniture and fittings	20,000
Stock in trade	2,00,000
Debtors (5,00,000 – 3,00,000)	2,00,000
Cash at hand/bank	50,000
	9,70,000

2. Cash in hand/bank balance of RR Enterprises as on 31.10.*2002.*

	Rs.
Opening Balance	50,000
Add: Ram's and Rahim's contribution	2,20,000
(Rs.1,10,000 + Rs.1,10,000)	
	2,70,000

Question 6

Riu, Inu and Sinu were running Partnership business sharing Profits and Losses in 2 :2 : 1 ratio. Their Balance Sheet as on 31st March, 2003 stood as follows:

Balance Sheet as on 31st March, 2003

(Figures in Rs.'000)

Liabilities	*Amount Rs.*	*Amount Rs.*	*Assets*	*Amount Rs.*	*Amount Rs.*
Fixed Capital:			*Fixed Assets*		*400.00*
Riu	*300.00*		*Investments*		*50.00*
Inu	*200.00*		*Current Assets:*		
Sinu	*100.00*	*600.00*	*Stock*	*100.00*	
Current Accounts:			*Debtors*	*275.00*	
Riu	*60.00*		*Cash & Bank*	*125.00*	*500.00*
Sinu	*40.00*	*100.00*			
Unsecured Loans		*100.00*			
Current Liabilities		*150.00*			
		950.00			*950.00*

On 01.04.2003, they agreed to form a new company RIS (P) Ltd. with Inu and Sinu each taking up 200 shares of Rs. 10 each, which shall take over the firm as a going concern including Goodwill, but excluding Cash and Bank Balances. The following are also agreed upon:

(a) Goodwill will be valued at 3 year's purchase of superprofits.

(b) *The actual profit for the purpose of Goodwill valuation will be Rs. 2,00,000.*

(c) *The normal rate of return will be 18% per annum on Fixed Capital.*

(d) *All other Assets and Liabilities will be taken over at Book values.*

(e) *The Purchase Consideration will be payable partly in Shares of Rs. 10 each and partly in cash. Payment in cash being to meet the requirement to discharge Riu, who has agreed to retire.*

(f) *Inu and Sinu are to acquire interest in the new company at the ratio 3 : 2.*

(g) *Realisation expenses amounted to Rs. 51,000.*

You are required to prepare Realisation Account, Cash and Bank Account, RIS (P) Limited Account and Capital Account of Partners. (16 marks) (PE – II – May 2004)

Answer

Realisation Account

			Rs.			Rs.
To	Sundry Assets			By	Unsecured Loans	1,00,000
	Fixed Assets	4,00,000		By	Current Liabilities	1,50,000
	Investments	50,000		By	RIS(P) Ltd. (WN – 2)	8,51,000
	Stock	1,00,000		By	Capital Accounts:	
	Debtors	2,75,000	8,25,000		Riu	20,400
To	Goodwill (WN –1)		2,76,000		Inu	20,400
To	Bank A/c (Realisation Expenses)		51,000		Sinu	10,200
			11,52,000			11,52,000

Cash and Bank Account

		Rs.			Rs.
To	Balance b/d	1,25,000	By	Realisation A/c – Expenses	51,000
To	R.I.S (P) Ltd. (Balancing figure)	3,76,000	By	Riu's Capital A/c	4,50,000
		5,01,000			5,01,000

RIS (P) Ltd.

		Rs.			Rs.
To	Realisation A/c	8,51,000	By	Cash A/c	3,76,000
			By	Equity Shares in RIS (P) Ltd. A/c (Balancing figure)	4,75,000
		8,51,000			8,51,000

Partners' Capital Accounts

		Riu	Inu	Sinu			Riu	Inu	Sinu
		Rs.	Rs.	Rs.			Rs.	Rs.	Rs.
To	Realisation A/c	20,400	20,400	10,200	By	Balance b/d	3,00,000	2,00,000	1,00,000
To	Cash A/c	4,50,000	–	–	By	Current A/c	60,000	–	40,000
To	Sinu's A/c (Capital Adjustment)	–	5,000	–	By	Goodwill A/c	1,10,400	1,10,400	55,200
					By	Inu's A/c (Capital Adjustment)	–	–	5,000
To	Equity Shares in RIS(P) Ltd.	–	2,85,000	1,90,000					
		4,70,400	3,10,400	2,00,200			4,70,400	3,10,400	2,00,200

Working Notes:

(1) Calculation of Goodwill

	Rs.
Actual profits	2,00,000
Less: Normal Rate of Return @ 18% of fixed capital worth Rs. 6,00,000	1,08,000
Super Profits	92,000
Goodwill valued at 3 years' purchase	2,76,000

(2) Calculation of Purchase Consideration

	Rs.
Total value of assets as per Balance Sheet	9,50,000
Less: Cash and Bank Balances	1,25,000
	8,25,000
Add: Goodwill	2,76,000
	11,01,000
Less: Liabilities taken over	
Unsecured Loan	1,00,000
Current Liabilities	1,50,000
Purchase Consideration	8,51,000

(3) Sharing of Shares in New Company received as Purchase Consideration

Equity shares of RIS (P) Ltd. have been given to Inu and Sinu in the ratio 3 : 2.

Question 7

Firm X & Co. consists of partners A and B sharing Profits and Losses in the ratio of 3 : 2. The firm Y & Co. consists of partners B and C sharing Profits and Losses in the ratio of 5 : 3.

On 31st March, 2006 it was decided to amalgamate both the firms and form a new firm XY & Co., wherein A, B and C would be partners sharing Profits and Losses in the ratio of 4:5:1.

Balance Sheet as at 31.3.2006

Liabilities	*X & Co.,*	*Y & Co.*	*Assets*	*X & Co.*	*Y & Co.*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Capital:			*Cash in hand/bank*	*40,000*	*30,000*
A	*1,50,000*	*---*	*Debtors*	*60,000*	*80,000*
B	*1,00,000*	*75,000*	*Stock*	*50,000*	*20,000*
C	*---*	*50,000*	*Vehicles*	*---*	*90,000*
Reserve	*50,000*	*40,000*	*Machinery*	*1,20,000*	*---*
Creditors	*1,20,000*	*55,000*	*Building*	*1,50,000*	*---*
	4,20,000	*2,20,000*		*4,20,000*	*2,20,000*

The following were the terms of amalgamation:

(i) Goodwill of X & Co., was valued at Rs.75,000. Goodwill of Y & Co. was valued at Rs.40,000. Goodwill account not to be opened in the books of the new firm but adjusted through the Capital accounts of the partners.

(ii) Building, Machinery and Vehicles are to be taken over at Rs.2,00,000, Rs.1,00,000 and Rs.74,000 respectively.

(iii) Provision for doubtful debts at Rs.5,000 in respect of X & Co. and Rs.4,000 in respect of Y & Co. are to be provided.

You are required to:

(i) Show, how the Goodwill value is adjusted amongst the partners.

(ii) Prepare the Balance Sheet of XY & Co. as at 31.3.2006 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency to be kept in the respective Partners' Current account. *(16 Marks) (PE-II – May 2006)*

Answer

(i) Adjustment for raising and writing off of goodwill

	Raised in old profit sharing ratio		*Total*	*Written off in new ratio*	*Difference*
	X & Co.	*Y & Co.*			
	3:2	*5:3*			
	Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*
A.	45,000	---	45,000 Cr.	46,000 Dr.	1,000 Dr.
B.	30,000	25,000	55,000 Cr.	57,500 Dr.	2,500 Dr.
C	---	15,000	15,000 Cr.	11,500 Dr.	3,500 Cr.
	75,000	40,000	1,15,000	1,15,000	Nil

(ii) **Balance Sheet of X Y & Co.(New firm) as on 31.3.2006**

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		Vehicle	74,000
A	1,72,000	Machinery	1,00,000
B	2,15,000	Building	2,00,000
C	43,000	Stock	70,000
Current Accounts:		Debtors	1,31,000
A	22,000	Cash & Bank	70,000
C	18,000		
Creditors	1,75,000		
	6,45,000		6,45,000

Working Notes:

1. **Balance of Capital Accounts at the time of amalgamation of firms**

X & Co. Profit and loss sharing ratio 3:2	*A's Capital* Rs..	*B's Capital* Rs.
Balance as per Balance Sheet	1,50,000	1,00,000
Add: Reserves	30,000	20,000
Revaluation profit (Building)	30,000	20,000
Less: Revaluation loss (Machinery)	(12,000)	(8,000)
Provision for doubtful debt.	(3,000)	(2,000)
	1,95,000	1,30,000

Y & Co. Profit and loss sharing ratio 5:3	*B's Capital* Rs.	*C's Capital* Rs.
Balance as per Balance sheet	75,000	50,000
Add: Reserves	25,000	15,000
Less: Revaluation (vehicle)	(10,000)	(6,000)
Provision for doubtful debts	(2,500)	(1,500)
	87,500	57,500

2. **Balance of Capital Accounts in the balance sheet of the new firm as on 31.3.2006**

		A Rs.	*B* Rs.	*C* Rs.
Balance b/d:	X & Co.	1,95,000	1,30,000	--
	Y & Co.	--	87,500	57,500
		1,95,000	2,17,500	57,500

Adjustment for goodwill	(1,000)	(2,500)	3,500
	1,94,000	2,15,000	61,000
Total capital Rs. 4,30,000 (B's capital* i.e. Rs.2,15,000 x 2) to be contributed in 4:5:1 ratio.	1,72,000	2,15,000	43,000
Transfer to Current Account	22,000	---	18,000

Question 8

'X' and 'Y' carrying on business in partnership sharing Profit and Losses equally, wished to dissolve the firm and sell the business to 'X' Limited Company on 31-3-2006, when the firm's position was as follows:

Liabilities	*Rs.*	*Assets*	*Rs.*
X's Capital	*1,50,000*	*Land and Building*	*1,00,000*
Y's Capital	*1,00,000*	*Furniture*	*40,000*
Sundry Creditors	*60,000*	*Stock*	*1,00,000*
		Debtors	*66,000*
		Cash	*4,000*
	3,10,000		*3,10,000*

The arrangement with X Limited Company was as follows:

(i) Land and Building was purchased at 20% more than the book value.

(ii) Furniture and stock were purchased at book values less 15%.

(iii) The goodwill of the firm was valued at Rs.40,000.

(iv) The firm's debtors, cash and creditors were not to be taken over, but the company agreed to collect the book debts of the firm and discharge the creditors of the firm as an agent, for which services, the company was to be paid 5% on all collections from the firm's debtors and 3% on cash paid to firm's creditors.

(v) The purchase price was to be discharged by the company in fully paid equity shares of Rs.10 each at a premium of Rs.2 per share.

The company collected all the amounts from debtors. The creditors were paid off less by Rs.1,000 allowed by them as discount. The company paid the balance due to the vendors in cash.

Prepare the Realisation account, the Capital accounts of the partners and the Cash account in the books of partnership firm. (16 Marks) (PE-II – Nov. 2006)

* B's Capital Rs.21,500 being one-half of the total capital of the firm.

Answer

Realisation Account

		Rs.				Rs.
To	Land & Building	1,00,000	By	Sundry Creditors		60,000
To	Furniture	40,000	By	X Ltd. Co. - Purchase consideration – (W.N.1)		2,79,000
To	Stock	1,00,000	By	X Ltd. Company – Sundry Debtors	66,000	
To	Debtors	66,000		*Less*: Commission 5% on 66,000	3,300	62,700
To	X Ltd. Co. - Sundry Creditors	59,000				
To	X Ltd. Co. – Commission 3% on 59,000	1,770				
To	Profits transferred to A's Capital A/c 17,465 B's Capital A/c 17,465	34,930				
		4,01,700				4,01,700

Capital Accounts

		A	B			A	B
		Rs.	Rs.			Rs.	Rs.
To	Shares in X Ltd. Co.–(W.N.2)	1,63,980	1,15,020	By	Balance b/d	1,50,000	1,00,000
To	Cash – Final Payment	3,485	2,445	By	Realisation A/c - Profit	17,465	17,465
		1,67,465	1,17,465			1,67,465	1,17,465

Cash Account

		Rs.			Rs.
To	Balance b/d	4,000	By	A's Capital A/c- Final payment	3,485
To	X Ltd. Co. (Amount realized from Debtors less amount paid to creditors) –(W.N.3)	1,930	By	B's Capital A/c- Final Payment	2,445
		5,930			5,930

Working Notes:

1 Calculation of Purchase consideration:

	Rs.
Land & Building	1,20,000
Furniture	34,000
Stock	85,000
Goodwill	40,000
	2,79,000

2. The shares received from the company have been distributed between the two partners A & B in the ratio of their final claims i.e., 1,67,465: 1,17,465*.

No. of shares received from the company = $\frac{2,79,000}{12} = 23,250$

A gets $\frac{23,250 \times 1,67,465}{2,84,930} = 13,665$ shares valued at 13,665 x 12 = Rs.1,63,980. B gets the remaining 9,585 shares, valued at Rs.1,15,020 (9,585 $\times$ 12)

3. Calculation of net amount received from X Ltd on account of amount realized from debtors less amount paid to creditors.

		Rs.
	Amount realized from Debtors	66,000
Less:	Commission for realization from debtors (5% on 66,000)	3,300
		62,700
Less:	Amount paid to creditors	59,000
		3,700
Less:	Commission for cash paid to creditors (3% on 59,000)	1,770
Net amount received		1,930

* In the above situation, shares received from X Ltd. Company have been distributed between two partners A and B in the ratio of their final claims. Alternatively, shares received from X Ltd. can be distributed among the partners in their profit sharing ratio i.e. Rs. 2,79,000 x ½ =Rs. 1,39,500 each. In that case, firm will pay cash amounting Rs. 27,965 to A and will receive cash Rs.22,035 from B.

Question 9

A, B and C carried on business in partnership, sharing Profits and Losses in the ratio of 1:2:3. They decided to form a private limited company, AB (P) Ltd. and C is not interested to take over the shares in AB (P) Ltd. The authorized share capital of the company is Rs.12,00,000 divided into 12,000 ordinary shares of Rs.100 each.

The company was incorporated and took over goodwill as valued and certain assets of the partnership firm on 31.3.2006. The Balance Sheet of the partnership firm on that date was as follows:

Liabilities		Rs.	Assets	Rs.
Capital Accounts:			Fixed Assets:	
A		1,00,000	Machinery	1,20,000
B		2,00,000	Land	1,74,000
C		3,00,000	Motorcycles	30,000
Current Accounts:			Furniture & fittings	11,000
A		39,420	Current Assets:	
B		60,580	Stock	2,35,000
A's Loan A/c	28,000		Debtors	43,000
(+) Interest accrued	2,000	30,000	Cash in hand	87,000
Current Liability:			C's overdrawn	1,00,000
Creditors		70,000		
		8,00,000		8,00,000

C, who retired was presented by the other partners (A and B) with one motorcycle valued in the books of the firm Rs.9,000. The remaining motorcycles were sold in the open market for Rs.13,000. C also received certain furniture for which he was charged Rs.2,000. The debtors which were all considered good, were taken over by C for Rs.40,000. A and B were charged in their profit sharing ratio for the book value of Motorcycle presented by them to C.

It was agreed that C who is not willing to take the shares in AB (P) Ltd. was discharged first by providing necessary cash. A and B should bring cash, if necessary.

AB (P) Ltd. took over the remaining furniture and fittings at a price of Rs.13,000, the machinery for Rs.1,25,000, the stock at an agreed value of Rs.2,00,000 and the land at its book value. The value of the goodwill of the partnership firm was agreed at Rs.88,000. The creditors of the firm were settled by the firm for Rs.70,000. A's loan account together with interest accrued was transferred to his capital account.

The purchase consideration was discharged by the company by the issue of equal number of fully paid up equity shares at par to A and B.

Prepare Realisation A/c, Capital A/cs of the partners and Cash A/c. Also draw the Balance Sheet of AB (P) Ltd. *(20 Marks) (PE-II – May, 2007))*

Answer

Realization Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Machinery	1,20,000	By	Creditors	70,000
To	Land	1,74,000	By	AB (P) Ltd. – Purchase consideration (Refer Working Note)	6,00,000
To	Motor Cycles	30,000	By	A's Capital A/c	3,000
To	Furniture & Fittings	11,000	By	B's Capital A/c	6,000
To	Stock	2,35,000	By	C's Capital A/c (2,000 + 40,000)	42,000
To	Debtors	43,000	By	Cash A/c (Sale of Motor Cycle)	13,000
To	Cash (payment to creditors)	70,000			
To	Profit transferred to				
	A's Capital A/c	8,500			
	B's Capital A/c	17,000			
	C's Capital A/c	25,500			
		7,34,000			7,34,000

Partners' Capital Accounts

Dr									*Cr.*
		A	*B*	*C*			*A*	*B*	*C*
		Rs.	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*
To	Current A/c	-	-	1,00,000	By	Balance b/d	1,00,000	2,00,000	3,00,000
To	Realisation A/c (Assets taken over)	3,000	6,000	42,000	By	Current A/c	39,420	60,580	-
To	Equity shares in AB (P) Ltd.	3,00,000	3,00,000	-	By	A's Loan A/c	30,000	-	-
To	Cash A/c	-	-	1,83,500	By	Realization	8,500	17,000	25,500

				A/c (Profit)			
			By	Cash A/c	1,25,080	28,420	
3,03,000	3,06,000	3,25,500			3,03,000	3,06,000	3,25,500

Cash Account

Dr.		Rs.		Cr.	Rs.
To	Balance b/d	87,000	By	Realisation A/c	70,000
To	Realisation A/c	13,000	By	C's Capital A/c	1,83,500
To	A's Capital A/c	1,25,080			
To	B's Capital A/c	28,420			
		2,53,500			2,53,500

Balance Sheet of AB (P) Ltd.

Liabilities	*Rs.*	*Assets*	*Rs.*
Authorised Share Capital:		*Fixed Assets:*	
12,000 Equity Shares of Rs.100 each	12,00,000	Goodwill	88,000
		Land	1,74,000
Issued, Subscribed & Paid up:		Machinery	1,25,000
6,000 equity shares of Rs.100 each fully paid up (shares were issued for consideration otherwise than for cash)	6,00,000	Furniture & Fittings	13,000
		Current Assets:	
		Stock	2,00,000
	6,00,000		6,00,000

Working Note:

Calculation of Purchase Consideration

Assets taken over by AB (P) Ltd.	*Rs.*
Machinery	1,25,000
Furniture & Fittings	13,000
Land	1,74,000
Stock	2,00,000
Goodwill	88,000
Purchase Consideration	6,00,000

Purchase consideration is discharged by the issue of equal number of equity shares of Rs.100 each (3,000 shares) at par to A & B.

Question 10

S and T were carrying on business as equal partners. Their Balance Sheet as on 31st March, 2007 stood as follows:

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital accounts:			*Stock*	*2,70,000*
S	*6,40,000*		*Debtors*	*3,65,000*
T	*6,60,000*	*13,00,000*	*Furniture*	*75,000*
Creditors		*3,27,500*	*Joint life policy*	*47,500*
Bank overdraft		*1,50,000*	*Plant*	*1,72,500*
Bills payable		*62,500*	*Building*	*9,10,000*
		18,40,000		*18,40,000*

The operations of the business was carried on till 30th September, 2007. S and T both withdrew in equal amounts, half the amount of profits made during the current period of 6 months after 10% p.a. had been written off on building and plant and 5% p.a. written off on furniture. During the current period of 6 months, creditors were reduced by Rs.50,000, Bills payables by Rs.11,500 and bank overdraft by Rs.75,000. The Joint life policy was surrendered for Rs.47,500 on 30th September, 2007. Stock was valued at Rs.3,17,000 and debtors at Rs.3,25,000 on 30th September, 2007. The other items remained the same as they were on 31st March, 2007.

On 30th September, 2007 the firm sold its business to ST Ltd. The goodwill was estimated at Rs.5,40,000 and the remaining assets were valued on the basis of the balance sheet as on 30th September, 2007. The ST Ltd. paid the purchase consideration in equity shares of Rs.10 each. You are required to prepare a Realisation account and Capital accounts of the partners.

(16 Marks) (PE II- May, 2008)

Answer

Realisation Account

Particulars			*Rs.*	*Particulars*		*Rs.*
To	Sundry assets:			By	Creditors	2,77,500
	Stock		3,17,000	By	Bills payables	51,000
	Debtors		3,25,000	By	Bank overdraft	75,000
	Plant		1,63,875	By	Shares in ST Ltd. (W.N. 3)	18,80,000
	Building		8,64,500			
	Furniture		73,125			
To	Profit:					
	S	2,70,000				

T	2,70,000	5,40,000		
		22,83,500		22,83,500

Partners' Capital Accounts

Date	*Particulars*		*S*	*T*	*Date*	*Particulars*		*S*	*T*
2008					2008				
April 1	To	Cash – Drawings (W.N. 2)	20,000	20,000	April 1	By	Balance b/d	6,40,000	6,60,000
Sept. 30	To	Shares in ST Ltd.	9,30,000	9,50,000	Sept. 30	By	Profit (W.N.2)	40,000	40,000
						By	Realisation A/c (Profit)	2,70,000	2,70,000
			9,50,000	9,70,000				9,50,000	9,70,000

Working Notes:

(1) **Ascertainment of total capital**

Balance Sheet

as at 30th September, 2007

Liabilities	*Rs.*	*Assets*		*Rs.*
Sundry creditors	2,77,500	Building	9,10,000	
Bills payable	51,000	*Less:* Depreciation	45,500	8,64,500
Bank overdraft	75,000	Plant	1,72,500	
Total capital (bal. fig.)	13,40,000	*Less:* Depreciation	8,625	1,63,875
		Furniture	75,000	
		Less: Depreciation	1,875	73,125
		Stock		3,17,000
		Debtors		3,25,000
	17,43,500			17,43,500

(2) **Profit earned during six months to 30 September, 2007**

		Rs.
Total capital (of S and T) on 30th September, 2007 (W.N.1)		13,40,000
Capital on 1st April, 2007		
S	6,40,000	
T	6,60,000	13,00,000
Net increase (after drawings)		40,000

Since drawings are half of profits therefore, actual profit earned is Rs.40,000 x 2 = Rs.80,000 (shared equally by partners S and T).

Half of the profits, has been withdrawn by both the partners equally i.e. drawings Rs. 40,000 (Rs.80,000 x ½) withdrawn by S and T in 1:1 (i.e. Rs.20,000 each).

(3) **Purchase consideration:**

	Rs.
Total assets (W.N.1)	17,43,500
Add: Goodwill	5,40,000
	22,83,500
Less: Liabilities (2,77,500 + 51,000 + 75,000)	4,03,500
Purchase consideration	18,80,000

Note: The above solution is given on the basis that reduction in bank overdraft is after surrender of Joint life policy.

7

INSOLVENCY ACCOUNTS OF NON-CORPORATE ENTITIES

(A) Write short notes on:

Question 1

List the preferential creditors, who are eligible for preferential payment upon insolvency of an individual *(4x4=16 Marks) (PE-II – May 2006)*

Answer

Preferential creditors get preference over other unsecured creditors. Hence, they are known as preferential creditors. By law, the following are the preferential creditors:

(i) all debts due to Government or any local authority.

(ii) Salary and wages to staff in respect of the services rendered to the insolvent during 4 months preceding the date of presentation of insolvency petition, subject to the following limits:

(a) Under the Presidency Towns Insolvency Act – Rs.300 for such clerk and Rs.100 each for each such servant or labourer.

(b) Under the Provincial Insolvency Act Rs.20 for each such clerk, servant or labourer.

(iii) One month's rent due to the landlord is preferential under the Presidency Towns Insolvency Act. Rent is not at all preferential as per the provincial Insolvency Act .

(B) Practical Questions:

Question 1

Ram commenced business on 1.7.1997 with a capital of Rs. 2,00,000. On 31st March, 2003 an adjudication order for insolvency was made against him. Following are the other details available relating to his business as on 31.3.2003:

	Rs.
Sundry Creditors	*1,50,000*
Mortgage Loan (of building)	*1,00,000*
Godown Rent (2 months)	*5,000*
Wages due	*8,000*
Mrs. Ram loan (given out of her own source)	*25,000*

Cost of Building (estimated to realise Rs. 1,00,000)	*1,60,000*
Debtors (includes bad of Rs. 10,000)	*90,000*
Stock in trade (Realisation value 10,000)	*15,000*
Cash in Hand/Bank	*10,000*

He maintained books upto 31.3.2000 and profit upto 31.3.2000 was Rs. 1,40,000. He did not maintain books from 1.4.2000 onwards. He has been drawing Rs. 4,000 per month and goods worth Rs. 1,500 per month uniformly from April, 2000 onwards.

Prepare statement of affairs and deficiency account. *(16 marks) (PE-II–May 2003)*

Answer

Statement of Affairs as on 31.3.2003

Rs.		Rs.	Rs.		Rs.	Rs.
1,80,000	Unsecured creditors As per list A		1,80,000	Property as per list E		
				Cash in hand	10,000	10,000
1,00,000	Creditors fully secured as per list B	1,00,000		Stock in hand	15,000	10,000
				Books debts as per list F		
	Estimated value of			Good	80,000	80,000
	Security	1,00,000	Nil	Bad	10,000	Nil
Nil	Creditors partly secured as per list C		Nil			1,00,000
				Deduct creditors for		
8,000	Creditors for taxes, wages etc. being payable in full as per list D	8,000		wages as per list D		8,000
						92,000
				Deficiency as explained in		
	Deducted as per contra	8,000		list H		88,000
2,88,000			1,80,000			1,80,000

Deficiency Account (List H)

	Rs.		Rs.
Excess of assets over liabilities on 1.7.1997	2,00,000	Net loss arising from carrying on of business from 1.4.2000 to the date of adjudication (W.N. 2)	1,55,000
Net profit upto 31.3.2000	1,40,000		
Deficiency	88,000	Loss on realisation of	

		Building	60,000
		Stock in trade	5,000
		Debtors	10,000
		Drawings for household expenses since 1.4.2000	1,98,000
	4,28,000		4,28,000

Working Notes:

(1) The unsecured creditors in this case will be as follows:

	Rs.
Sundry Creditors	1,50,000
Godown Rent	5,000
Mrs. Ram loan	25,000
(Since loan was given out of her own sources)	
	1,80,000

(2) Since accounts were not prepared for the period of 1.4.2000 to 31.3.2003 it is necessary to ascertain the profit or loss incurred in these three years. Hence, the following trial balance has been prepared with the given book figures.

Trial Balance

Dr.		*Rs.*			*Cr.* *Rs.*
Building		1,60,000	Capital introduced	2,00,000	
Book debt			Add: Profit upto 30.3.2000	1,40,000	
Good	80,000			3,40,000	
Bad	10,000	90,000			
Stock in trade		15,000	Less: Drawings for		
Cash in hand/bank		10,000	(Rs. 5,500 × 36 months)	1,98,000	1,42,000
Loss (balancing figure)		1,55,000	Creditors		1,50,000
			Mortgage on building		1,00,000
			Godown rent		5,000
			Wages due		8,000
			Mrs. Ram's loan		25,000
		4,30,000			4,30,000

Question 2

Mr. Shankar of Mumbai finding himself unable to meet his creditors, has to prepare a Statement of Affairs, for which the following particulars are available on the date of his adjudication as Insolvent as on 31.03.2003:

Leasehold property Rs. 2,00,000, estimated to realise, Rs. 1,90,000.

Plant & Machinery Rs. 80,000, estimated to realise Rs. 60,000.

Stock in Trade Rs. 40,000, estimated to realise Rs. 28,000.

Bookdebts: Good Rs. 1,20,000, Doubtful Rs. 10,000, estimated to realise 50%, Bad Rs. 28,000, Bills in Hand Rs. 7,500.

Life Policy for Rs. 50,000, whose Surrender value is Rs. 10,000 held by the insurance company against a loan of Rs. 4,000.

Household Furniture Rs. 7,200, Household Debts Rs. 5,800.

Bills Discounted Rs. 12,000, Rs. 4,000 likely to be dishonoured.

Loan on Mortgage of Leasehold Rs. 1,00,000, Cash in Hand Rs. 200.

Bank Overdraft secured by Personal Guarantee of Shankar's Brother, and Second Mortgage on Leasehold Rs. 1,00,000.

Unsecured Creditors Rs. 3,00,000. Loan from Naresh Rs. 5,000 secured by a Second charge on Life Policy. Ground Rent on Household for three months accrued Rs. 750.

He could not pay his office clerks (two persons) salaries for six months Rs. 3,000 and also Rates & Taxes amounting to Rs. 3,000 due to Government.

Prepare Statement of Affairs of Mr. Shankar as on 31.03.2003. (16 marks) (PE-II–May 2004)

Answer

Statement of Affairs of Mr. Shankar as on 31.3.2003

Gross Liabilities	*Liabilities (as stated and estimated by Debtor)*		*Expected to Rank*	*Assets (as stated and estimated by Debtor)*	*Book Value*	*Estimated to Produce*
Rs.		*Rs.*	*Rs.*		*Rs.*	*Rs.*
	Unsecured Creditors			Properties as per List E		
3,20,700	as per List A		3,12,700	viz.,		
	Creditors fully			(a) Cash	200	200
1,09,000	secured as per list B	1,09,000		(b) Stock in trade	40,000	28,000
	Estimated value of			(c) Plant & Machinery	80,000	60,000
	Securities	<u>2,00,000</u>		(d) Furniture	7,200	7,200
	Surplus	91,000		Book Debts as per List F		

	Less: Amount thereof			Good	1,20,000	1,20,000
	carried to List C	90,000		Doubtful	10,000	5,000
	Balance thereof to			Bad	28,000	–
	contra	1,000		Bills of Exchange as per		
	Creditors partly			List G	7,500	
1,00,000	secured as per List C	1,00,000		Estimated to realize		7,500
	Less: Estimated			Surplus from Securities in		
	value of Securities	90,000	10,000	the hands of creditors		
	Preferential Creditors			fully secured (as per		
	(Creditors for			contra)		1,000
	Salaries and Wages,				2,92,900	2,28,900
	Rent etc.) payable in			Deduct Preferential		
3,850	full as per List D	3,850		Creditors (as		
	Deducted as per			per Contra)		3,850
	contra	3,850				2,25,050
				Deficiency as explained		
				in List H		97,650
5,33,550			3,22,700			3,22,700

Working Notes:

1. Unsecured Creditors as per List A

	Rs.
Household Debts	5,800
Bills Discounted likely to be dishonoured	4,000
Unsecured Creditors	3,00,000
Two months rent (one month rent is preferential)	500
Clerk's Salary (in excess of 300/- per clerk) (3,000 – 600)	2,400
Unsecured Creditors	3,12,700

The gross liabilities of unsecured creditors includes full amount of discounted bills.

2. Fully Secured Creditors as per List B

	Amount	*Security*
	Rs.	*Rs.*
Loan from Insurance Company	4,000	10,000
Naresh	5,000	
Loan on Mortgage of Leasehold	1,00,000	1,90,000
	1,09,000	2,00,000

Note: Since the Surrender Value is Rs. 10,000, both the Insurance Company and Naresh can be fully covered leaving a surplus of Rs. 1,000.

3. Partly Secured Creditors as per List C

The bank will be partly secured because after meeting the first charge on Leasehold, Rs. 90,000 will be left which is insufficient to meet Bank overdraft fully. The personal Guarantee of Shankar's brother cannot be considered for preparing Shankar's statement of affairs.

4. Preferential Creditors as per List D

	Rs.
One month's rent	250
Salaries of two clerks (Rs. 300 $\times$ 2)	600
Rates and Taxes	3,000
Preferential Creditors	3,850

Note: As shankar is a resident of Mumbai, the Presidency Towns Insolvency Act, 1909 will apply to him, and accordingly Preferential Creditors shall be calculated.

Question 3

Following is the Balance Sheet of Mr. Brown as at 31st March, 2005. He has filed a petition in the court for being declared as insolvent:

Liabilities	*Rs.*	*Assets*		*Rs.*
Capital	*18,000*	*Goodwill*		*5,000*
Bank loan (secured by first		*Machinery*		*20,000*
charge on building)	*80,000*	*Building*		*1,15,000*
Loan from Finance Co.,	*30,000*	*Investment in shares*		*5,000*
(secured by second charge		*Furniture*		*7,000*
on building)		*Stock*		*9,000*
Sundry creditors	*59,000*	*Debtors:*		
Sales tax payable	*8,000*	*Good*	*14,000*	

Loan from wife	*5,000*	*Doubtful*	*8,000*	
		Bad	*2,000*	*24,000*
		Cash and bank		*15,000*
	2,00,000			*2,00,000*

Mr. Brown estimated that except the following, all tangible assets are realisable:

(i) A machinery Rs. 5,000 included in the Balance Sheet has no value.

(ii) Debtors (unrealisable) Rs. 7,600.

(iii) Non-moving stock Rs. 3,000.

(iv) Useless furniture Rs. 4,000.

(v) Investment has no value.

Further Information:

(i) Building expected to realise Rs. 1,20,000.

(ii) Loan was given by his wife from her personal sources.

(iii) A bill discounted for Rs. 10,000 is likely to be dishonoured.

(iv) One creditor forgoes his claim for Rs. 4,000.

(v) Mr. Brown started his business on 1.4.2001. His household expenses upto 31.3.2005 is Rs. 48,000. His private Life Insurance Policy matured for Rs. 30,000 on 31.3.2005.

He made profit of Rs. 40,000 upto 31.3.2003.

He incurred loss of Rs. 50,000 from 1.4.2003 to 31.3.2005.

Also, he suffered speculation loss of Rs. 10,000 in the year ended 31.3.2005.

Based on the above information, prepare Statement of Affairs of Mr. Brown as on 31.3.2005 and Deficiency Account. (16 marks) (PE-II – May 2005)

Answer

Statement of Affairs of Mr. Brown as on 31st March, 2005

Dr. Gross Liabilities	Liabilities (as stated and estimated by debtor)		Expected to Rank	Assets (as stated and estimated by debtor)	Book Value	Estimated to produce *Cr.*
Rs.		Rs.	Rs.		Rs.	Rs.
74,000	Unsecured creditors as per List A		70,000	Properties as per List E		
80,000	Creditors fully secured as per List B	80,000		Cash and Bank	15,000	15,000
				Stock	9,000	6,000
	Less: Estimated value of			Machinery	20,000	15,000

	securities	1,20,000		Furniture	7,000	3,000
	Surplus	40,000		Goodwill	5,000	–
	Less: Amount carried to			Investment in shares	5,000	–
	List C	30,000		Book debts as per List F		
	Balance thereof to contra	10,000	–	Good	14,000	14,000
30,000	Creditors partly secured as per List C	30,000		Doubtful	8,000	2,400
	Less: Surplus carried from			Bad	2,000	–
					85,000	55,400
	List B	30,000		Surplus from securities in		
	Balance	–	–	the hands of fully		
8,000	Preferential creditors			secured creditors		
	payable in full as per List D			(as per contra)		10,000
						65,400
	Sales tax payable	8,000		*Less*: Preferential		
	Less: Deducted as per contra	8,000	–	creditors as per contra		8,000
						57,400
				Add: Deficiency as		
				explained in List H		12,600
1,92,000			70,000			70,000

Deficiency Account (List H)

	Rs.		*Rs.*	*Rs.*
Excess of assets over		Net loss arising from business		
liabilities as on 01.04.2001	56,000	since 01.04.2003		50,000
(Balancing figure)		Bad debts as per list F		7,600
Net profit arising from		Drawings for household expenses		48,000
business upto 31.03.2003	40,000	Loss on realisation of :		
Profit on realisation of:		Furniture	4,000	
Building	5,000	Machinery	5,000	
Life policy matured	30,000	Stock	3,000	
Creditors forgone claims	4,000	Goodwill	5,000	
Deficiency as per		Investment	5,000	22,000
Statement of Affairs	12,600	Loss on dishonour of bill		10,000
		Speculation losses		10,000
	1,47,600			1,47,600

Question 4

Mr. A is insolvent. He supplies to you the following information as on 31.3.2006:

	Rs.
Cash in hand	*10,000*
Creditors for goods	*10,00,000*
Taxes due to Government	*35,000*
Bank loan secured by lien on stock	*1,50,000*
Furniture (expected to realize Rs 50,000)	*75,000*
Stock (expected to realize 50%)	*6,00,000*
Book debts (good)	*4,50,000*
Book debts (doubtful) expected to realize 40%	*5,50,000*
Bills discounted (Rs.40,000 bad)	*1,40,000*
Loan from Nathan secured by second charge on stock	*2,00,000*
Bills receivable (Rs.40,000 bad)	*1,00,000*

Mr. A started business four years ago with a capital of Rs.4,50,000. He drew Rs.75,000 each year for private purposes, but did not maintain proper books of accounts. Mrs. A gave up her jewellery valued Rs.1,00,000 to the receiver.

Prepare Statement of Affairs of Mr. A as on 31.3.2006 and Deficiency Account as on that date.

(16 Marks) (PE II- May, 2007)

Answer

Statement of Affairs of Mr. 'A' as on 31.3.2006

Gross Liabilities	*Liabilities*		*Expected to Rank*	*Property & Assets*	*Book Value*	*Expected to produce*
Rs.		*Rs.*			*Rs.*	*Rs.*
11,40,000	Unsecured creditors as per list A		10,40,000	Properties as per list E :		
1,50,000	Fully Secured Creditors			Cash in Hand	10,000	10,000
	as per List B (Bank Loan)	1,50,000		Furniture	75,000	50,000
	Less: Estimated value of stock	3,00,000		Jewellery from wife	-	1,00,000
		1,50,000		Book debts as per List F:		
	Surplus transferred to List C	1,50,000	-			
2,00,000	Partly secured creditors as per List C (Loan from Nathan)	2,00,000		Good	4,50,000	4,50,000
	Surplus transferred from List B	1,50,000	50,000	Doubtful	5,50,000	2,20,000
35,000	Preferential creditors as per list D (Taxes due to Government)	35,000		Bills Receivable as per List G	1,00,000	60,000
	Deducted as per contra	35,000	-		11,85,000	8,90,000
				Less: Preferential		

		creditors as per contra	35,000
			8,55,000
		Deficiency as explained in List H	2,35,000
15,25,000	10,90,000		10,90,000

Deficiency Account (List H)

	Rs.		Rs.	Rs.
Excess of Assets over Liabilities	4,50,000	Bad debts as per List F		3,30,000
Accumulated Profit up to 31st March, 2006 (Refer Working Note 2)	2,50,000	Drawings (75,000x4)		3,00,000
		Other Losses:		
Profit from other sources: Jewellery from wife	1,00,000	Loss on realization of Furniture	25,000	
Deficiency as per Statement of Affairs	2,35,000	Stock	3,00,000	
		Bills receivable	40,000	3,65,000
		Loss on Bills Discounted		40,000
	10,35,000			10,35,000

Working Notes:

1. **Calculation of unsecured creditors as per List A**

	Gross	*Expected to Rank*
	Rs.	*Rs.*
Creditors for Goods	10,00,000	10,00,000
Liabilities for Bills Discounted	1,40,000	40,000
	11,40,000	10,40,000

2. **Calculation of Accumulated Profit/Loss**

Trial Balance

Debit	*Rs.*	Credit	*Rs.*
Cash	10,000	Creditors	10,00,000
Furniture	75,000	Taxes due to Government	35,000
Stock	6,00,000	Bank Loan	1,50,000
Debtors (4,50,000 + 5,50,000)	10,00,000	Loan from Nathan	2,00,000
Bills Receivable	1,00,000	Capital	4,50,000
Drawings (75,000 x 4)	3,00,000	Accumulated Profit (b/f)	2,50,000
	20,85,000		20,85,000

8

COMPANY ACCOUNTS - I

UNITS 1 – 4 : ISSUE, REDEMPTION AND CONVERSION OF SHARES AND DEBENTURES

(A) Write short notes on :

Question 1

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

(4 marks) (Intermediate–Nov. 2001)

Answer

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:

(a) The buy-back is authorised by its articles.

(b) A special resolution* has been passed in general meeting of the company authorising the buy-back.

(c) 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.

(d) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.

(e) All the shares for buy-back are fully paid up.

(f) 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.

(g) The buy-back is completed within 12 months of the passing of the special resolution or a resolution passed by the Board.

(h) 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.

(i) 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.

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* If the buy-back by the company is or less than 10% of the total paid-up equity capital and free reserves of the company then it can be authorised by the Board by means of resolution passed at its meeting and no special resolution will be required.

Questions 2

Sweat equity shares and conditions, which must be fulfilled by a Joint Stock Company to issue these shares. *(4 marks)(Intermediate–Nov. 2001)*

Answer

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.

Question 3

Dividend on partly paid shares. *(4 marks) (Intermediate May 2002)*

Answer

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.

Question 4

State the guidelines of SEBI regarding issue of convertible debentures for disclosure and investor protection. (8 marks) (Intermediate–Nov. 1998)

Answer

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.

(B) Practical Questions:

Question 1

The following is the Balance Sheet of Trinity Ltd. as at 31.3.1995 :

Trinity Ltd.

Balance Sheet as at 31st March, 1995

Liabilities		*Rs.*	*Assets*	*Rs.*
Share Capital			*Fixed Assets*	
Authorised			*Gross Block*	*3,00,000*
10,000 10% Redeemable Preference			*Less : Depreciation*	*1,00,000*
Shares of Rs. 10 each		*1,00,000*		*2,00,000*
90,000 Equity Shares of Rs. 10 each		*9,00,000*	*Investments*	*1,00,000*
		10,00,000	*Current Assets and Loans*	
			and Advances	
Issued, Subscribed and Paid-up Capital				
10,000 10% Redeemable Preference			*Inventory*	*25,000*
Shares of Rs. 10 each		*1,00,000*	*Debtors*	*25,000*
10,000 Equity Shares of Rs. 10 each		*1,00,000*	*Cash and Bank Balances*	*50,000*
	(A)	*2,00,000*	*Misc. Expenditure to the extent*	
Reserves and Surplus			*not written of*	*20,000*
General Reserve		*1,20,000*		
Securities Premium		*70,000*		

Profit and Loss A/c		*18,500*		
	(B)	*2,08,500*		
Current Liabilities and Provisions	*(C)*	*11,500*		
Total	*(A + B + C)*	*4,20,000*	*Total*	*4,20,000*

For the year ended 31.3.1996, the company made a net profit of Rs. 15,000 after providing Rs. 20,000 depreciation and writing off the miscellaneous expenditure of Rs. 20,000.

The following additional information is available with regard to company's operation :

1. *The preference dividend for the year ended 31.3.1996 was paid before 31.3.1996.*
2. *Except cash and bank balances other current assets and current liabilities as on 31.3.1996, was the same as on 31.3.1995.*
3. *The company redeemed the preference shares at a premium of 10%.*
4. *The company issued bonus shares in the ratio of one share for every equity share held as on 31.3.1996.*
5. *To meet the cash requirements of redemption, the company sold a portion of the investments, so as to leave a minimum balance of Rs. 30,000 after such redemption.*
6. *Investments were sold at 90% of cost on 31.3.1996.*

   You are required to

   (a) Prepare necessary journal entries to record redemption and issue of bonus shares.

   (b) Prepare the cash and bank account.

   (c) Prepare the Balance Sheet as at 31st March, 1996 incorporating the above transactions.

(20 marks) (Intermediate–Nov. 1996)

Answer

Journal Entries in the Books of Trinity Ltd.

		Dr. Rs.	Cr. Rs.
Securities Premium A/c	Dr.	10,000	
To Premium on Redemption of Preference shares			10,000
(Being amount of premium payable on redemption of preference shares)			
10% Redeemable Preference Capital	Dr.	10,00,000	
Premium on redemption of Preference Shares	Dr.	10,000	
To Preference Shareholders			1,10,000
(Being the amount payable to preference shareholders on redemption)			

General Reserve A/c	Dr.	1,00,000	
To Capital Redemption Reserve			1,00,000
(Being transfer to the latter account on redemption of shares)			
Bank A/c	Dr.	45,000	
Profit and Loss A/c	Dr.	5,000	
To Investments			50,000
(Being amount realised on sale of Investments and loss thereon adjusted)			
Preference shareholders A/c	Dr.	1,10,000	
To Bank			1,10,000
(Being payment made to preference shareholders)			
Capital Redemption Reserve A/c	Dr.	1,00,000	
To Bonus to Shareholders			1,00,000
(Amount adjusted for issuing bonus share in the ratio of 1 : 1.)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital			1,00,000
(Balance on former account transferred to latter)			

(b) **Cash and Bank A/c**

Dr.		*Rs.*		*Cr.* *Rs.*
To Balance b/d		50,000	By Preference Dividend	10,000
To Cash from operations:			By Preference shareholders	1,10,000
Profit	15,000		By Balance c/d	30,000
Add : Depreciation	20,000			
Add : Miscellaneous Expenditure written off	20,000	55,000		
To Investments		45,000		
		1,50,000		1,50,000

(c) **Balance Sheet of Trinity Limited as at 31st March, 1996 (after redemption)**

Liabilities		*Rs.*	*Assets*			*Rs.*
Share Capital			Fixed Assets			
Authorised Capital		10,00,000	Gross Block		3,00,000	
Issued, Subscribed and Paid-up			*Less* : Depreciation			
Capital			upto 31.3.95	1,00,000		
20,000 Equity Share						
of Rs. 10 each fully paid		2,00,000	For the year	20,000	1,20,000	1,80,000
(10,000 shares have been						
allotted as Bonus Shares			Investments			
by capitalising capital			(Market Value Rs. 45,000)			50,000
Redemption Reserve)			Current Assets, Loans and Advances			
Reserves and Surplus						
General Reserve	20,000		Inventory		25,000	
Securities Premium	60,000		Debtors		25,000	
Profit and Loss A/c	18,500	98,500	Cash and Bank Balance		30,000	80,000
Current Liabilities and Provisions						
Sundry Creditors		11,500				
		3,10,000				3,10,000

Working Notes:

(i) Profit and Loss Account for the year ending 31st March, 1996

		Rs.
Balance as on 1.4.1995		18,500
Add : Profit for the year		15,000
		33,500
Less : Preference Dividend	10,000	
Loss on sale of investments	5,000	15,000
Balance as on 31.3.1996		18,500

(ii)

General Reserve	1,20,000
Less : Transfer to Capital Redemption Reserve	1,00,000
Balance as on 31.3.1996	20,000

(iii)	Securities Premium	70,000
	Less : Premium on Redemption of Preference shares	10,000
	Balance as on 31.3.1996	60,000
(iv)	Capital Redemption Reserve	1,00,000
	Less : Transfer for Bonus Shares	1,00,000
	Balance as on 31.3.1996	NIL
(v)	Sale of Investments:	
	Cost of Investments	50,000
	Less : Cash Received	45,000
	Loss on Sale of Investments	5,000
	Total Investments:	1,00,000
	Less : Cost of Investments sold	50,000
	Cost of Investments on hand	50,000
	Market value (90% of Rs. 50,000)	45,000

Question 2

The balance sheet of XYZ Ltd. as at 31st December, 1998 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, 1999 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, 2000. The issue was fully subscribed and allotment made on March 1, 1999. 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 jounal entries and show the relevant extracts from the Balance Sheet as on March 31, 1999 with the corresponding figures as on 31st December, 1998.

(14 marks) (Intermediate–Nov. 1999)

Answer

XYZ Ltd.
Journal Entries

		Dr.	*Cr.*
		Rs. '000	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)			
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 31.3.99 as compared to the balance on 31.12.98.

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 31.3.99	
	Balance as on 31.12.98	20,00
	Add : Transfer from general reserve	27,50
	Balance as on 31.3.99	47,50
(iii)	General reserve as on 31.3.99	
	Balance as on 31.12.98	50,00
	Less : Transfer to capital redemption reserve	27,50
	Balance as on 31.3.99	22,50
(iv)	Securities premium as on 31.3.99	
	Balance as on 31.12.98	5,00
	Add : Amount received @ Rs. 10 per share on fresh issue of 50,000 equity shares	5,00
		10,00
	Less : Premium on redemption of preference shares	2,50
	Balance as on 31.3.99	7,50
(v)	Change in cash and bank balance	
	Receipts : (31.12.98 - 31.3.99)	

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

Question 3

Provisional Balance Sheet of P Ltd. as at 31st March, 2001 was as under:

Balance Sheet as at 31st March, 2001

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*
Share Capital			*Fixed Assets (at cost less*	
50,000 equity shares of Rs. 10			*depreciation)*	*7,00,000*
each, Rs. 7 per share called up	*3,50,000*		*Cash & Bank balances*	*2,00,000*
Less : Calls in arrear on 10,000			*Other Current assets*	*6,00,000*
shares @ Rs. 2 per share	*20,000*			
	3,30,000			
Add : Calls in advance on				
40,000 shares @				
Rs. 3 per share	*1,20,000*	*4,50,000*		
20,000, 10% Redeemable preference				
shares of Rs. 10 each, fully paid up		*2,00,000*		
Reserves & Surplus :				
General Reserve		*3,00,000*		
Profit & Loss Account		*2,70,000*		
Current Liabilities		*2,80,000*		
		15,00,000		*15,00,000*

Calls in arrear are outstanding for 6 months. Calls in advance were also received 6 months back. Interest @ 10% p.a. on calls in advance and 12% p.a. on calls in arrear are allowed/charged.

The Board of Directors have recommended that:

(i) Dividend for the year 2000-01 be allowed @ 20% on equity shares.

(ii) Money on calls in advance be refunded and partly paid equity shares be converted as fully paid up by declaring bonus dividend to shareholders.

(iii) The preference shares, which are redeemable at a premium of 10% any time after 31st March, 2001 may be redeemed by issue of 10% Debentures of Rs. 100 in cash.

Show Journal Entries to give effect to the above proposals including payment and receipt of cash and redraft the Profit and Loss Account and Balance Sheet of P Ltd.

(20 marks) (Intermediate–Nov. 2001)

Answer

Journal Entries

P Ltd.

		Dr. *Rs.*	*Cr.* *Rs.*
Interest on Calls in Arrear A/c	Dr.	1,200	
To Profit & Loss A/c			1,200
(Being interest @ 12 % p.a. on Rs. 20,000 for 6 months credited to Profit and Loss Account)			
Bank A/c	Dr.	21,200	
To Calls in Arrear A/c			20,000
To Interest on Calls in Arrear A/c			1,200
(Being interest on calls in arrear received)			
Profit & Loss A/c	Dr.	6,000	
To Interest on Calls in Advance A/c			6,000
(Being interest @ 10% on Rs. 1,20,000 for 6 months allowed on calls in advance)			
Profit & Loss A/c	Dr.	90,000	
To Preference Dividend			20,000
To Equity Dividend			70,000
(Being dividend @ 10% on Preference share capital & 20% on Equity share capital proposed)			
Profit & Loss A/c	Dr.	1,50,000	
To Bonus to Equity Shareholders A/c			1,50,000
(Being bonus dividend declared)			
Share Final Call A/c	Dr.	1,50,000	
To Equity Share Capital A/c			1,50,000
(Being final call made @ Rs. 3 on 50,000 shares)			

Bonus to Equity shareholders A/c	Dr.	1,50,000	
To Share Final Call A/c			1,50,000
(Being adjustment of bonus dividend against final call)			
Calls in Advance A/c	Dr.	1,20,000	
Interest on Calls in Advance A/c	Dr.	6,000	
To Bank A/c			1,26,000
(Being amount of calls in advance along with interest refuned)			
Bank A/c	Dr.	2,20,000	
To 10% Debentures A/c			2,20,000
(Being 2,200 Debentures of Rs.100 each issued in cash)			
Profit & Loss A/c	Dr.	20,000	
To Premium on Redemption of Preference shares A/c			20,000
(Being premium payable on redemption)			
Profit & Loss A/c	Dr.	5,200	
General Reserve A/c	Dr.	1,94,800	
To Capital Redemption Reserve A/c			2,00,000
(Transfer to capital redemption reserve)			
Preference Share Capital A/c	Dr.	2,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	20,000	
To Preference Shareholders A/c			2,20,000
(Amount due on redemption of preference shares)			
Preference Shareholders A/c	Dr.	2,20,000	
To Bank A/c			2,20,000
(Amount paid to preference shareholders)			

Profit & Loss Account of P Ltd.
for the year ended 31st March, 2001

	Rs.		*Rs.*
To Interest on calls in advance	6,000	By Balance b/d	2,70,000
To Balance c/d	2,65,200	By Interest on calls in arrear	1,200
	2,71,200		2,71,200
To Premium on redemption	20,000	By Balance b/d	2,65,200

To Preference Dividend	20,000	
To Equity Dividend	70,000	
To Bonus Dividend	1,50,000	
To Capital Redemption Reserve	5,200	
	2,65,200	2,65,200

Balance Sheet of P Ltd.
as on 31st March 2001

Liabilities		*Rs.*	*Assets*	*Rs.*
Share Capital:			Fixed Assets	7,00,000
50,000 equity shares of Rs. 10 each			(Cost less depreciation)	
fully paid up		5,00,000		
(Of the above equity shares			Cash & Bank balance (W.N.)	95,200
Rs. 3 per share has not been				
received in cash but has been capitalised			Other Current Assets	6,00,000
by issuing				
bonus dividend)				
Reserves & Surplus:				
Capital Redemption Reserve		2,00,000		
General Reserve	3,00,000			
Less: utilised for redemption				
of preference share	1,94,800	1,05,200		
Profit & Loss Account		—		
10% Debentures		2,20,000		
Current liabilities		2,80,000		
Proposed dividend		90,000		
		13,95,200		13,95,200

Working Note :

Cash and Bank balance as on 31st March, 2001

		Rs.
Cash and bank balance (given)		2,00,000
Add:	Recovery of calls in arrear and interest thereon	21,200
	Proceeds from issue of 10% Debentures	2,20,000
		4,41,200
Less:	Payment of calls in advance and interest thereon	1,26,000
	Redemption of preference shares	2,20,000
		95,200

Note : In the absence of information, it has been assumed that the amount of calls in arrear has been received in the given solution. It has been assumed that 20% dividend on equity shares has been proposed before the equity shares are made fully paid by way of bonus dividend.

Question 4

The financial position of P Limited at 31st December, 2001 was as follows:

Liabilities	*Rs.*	*Assets*	*Rs.*
Authorised, Issued and Subscribed Capital		*Assets*	*8,40,000*
		Cash and Bank	*3,00,000*
40,000, 5 % Redeemable Preference shares of			
Rs. 10 each, fully paid	*4,00,000*		
20,000 Equity shares of Rs. 10 each, fully paid	*2,00,000*		
Securities Premium Account	*50,000*		
Profit and Loss Account	*2,80,000*		
Sundry Liabilities	*2,10,000*		
	11,40,000		*11,40,000*

As per the terms of issue of the Preference Shares these were redeemable at a premium of 5 % on 1st February, 2002 and it was decided to arrange this as far as possible out of the company's resources subject to leaving a balance of Rs. 50,000 in the credit of the Profit and Loss Account. It was also decided to raise the balance amount by issue of 17,000 Equity Shares of Rs. 10 each at a premium of Rs. 2.50 per share.

You are required to prepare the necessary Ledger Accounts giving effect to the above arrangments in the company's books. Journal Entries are not required. *(6 marks) (Intermediate–May 2002)*

Answer

5% Redeemable Preference Share Capital Account

2002		*Rs.*	*2000*		*Rs.*
Feb. 1	To Preference Share holders A/c	4,00,000	Jan. 1	By Balance b/d	4,00,000
		4,00,000			4,00,000

Preference Shareholders Account

2002		*Rs.*	*2002*		*Rs.*
Feb. 1	To Bank A/c	4,20,000	Feb. 1	By 5% Redeemable Preference Share Capital A/c	4,00,000
				By Premium on Redemption A/c	20,000
		4,20,000			4,20,000

Premium on Redemption Account

2002			Rs	2002			Rs.
Feb. 1	To	Preference Share-holders A/c	20,000	Feb. 1	By	Securities Premium A/c	20,000

Equity Shares Application and Allotment Account

2002			Rs.	2002			Rs.
Feb. 1	To	Equity Share Capital A/c	1,70,000	Feb. 1	By	Bank A/c	2,12,500
	To	Securities Premium A/c	42,500				
			2,12,500				2,12,500

Capital Redemption Reserve Account

2002			Rs.	2002			Rs.
Feb. 1	To	Balance c/d	2,30,000	Feb. 1	By	Profit and Loss A/c	2,30,000
			2,30,000				2,30,000

Equity Share Capital Account

2002			Rs.	2002			Rs.
Feb. 1	To	Balance	3,70,000	Jan. 1	By	Balance b/d	2,00,000
				Feb. 1	By	Equity shares application and allotment A/c	1,70,000
			3,70,000				3,70,000

Securities Premium Account

2002			Rs.	2002			Rs.
Feb. 1	To	Premium on Redemption A/c	20,000	Jan. 1	By	Balance b/d	50,000
	To	Balance c/d	72,500	Feb. 1	By	Equity Shares Application and Allotment A/c	42,500
			92,500				92,500

Profit and Loss Account

2002			Rs.	2002			Rs.
Feb. 1	To	Capital Redemption Reserve A/c	2,30,000	Jan. 1	By	Balance b/d	2,80,000
	To	Balance c/d	50,000				
			2,80,000				2,80,000

Cash and Bank Account

2002			*Rs.*	*2002*			*Rs.*
Jan. 1	To	Balance b/d	3,00,000	Feb. 1	By	Preference Share Holders A/c	4,20,000
Feb. 1	To	Equity Share Application and Allotment A/c	2,12,500		By	Balance c/d	92,500
			5,12,500				5,12,500

Note: No dividend has been paid on preference shares in the above solution. Alternatively, dividend may be paid at the rate of 5% for one month because the redemption takes place on 1st February, 2002 assuming that the articles of the company and terms of contract of company with the preference shareholders provide for such dividend.

Question 5

Libra Limited recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued 2,00,000; face value and issue price Rs.100 per debenture.

(b) Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue.

(c) Date of closure of subscription lists 1.5.1994, date of allotment 1.6.1994, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion Rs. 60 (Face Value Rs. 10).

(d) Underwriting Commission 2%.

(e) No. of debentures applied for 1,50,000.

(f) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 1995 (including cash and bank entries).

(15 marks) (Intermediate–May 1995)

Answer

In the books of Libra Ltd.
Journal Entries

Date	*Particulars*		*Amount Dr. Rs.*	*Amount Cr. Rs.*
1.5.94	Bank A/c	Dr.	1,50,00,000	
	To Debenture Application A/c			1,50,00,000
	(Application money received on 1,50,000 debentures @ Rs. 100 each)			

1.6.94	Debenture Application A/c	Dr.	1,50,00,000	
	Underwriters A/c	Dr.	50,00,000	
	To 15% Debentures A/c			2,00,00,000
	(Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)			
	Underwriting Commission	Dr.	4,00,000	
	To Underwriters A/c			4,00,000
	(Commission payable to underwriters @ 2% on Rs. 2,00,00,000)			
	Bank A/c	Dr.	46,00,000	
	To Underwriters A/c			46,00,000
	(Amount received from underwriters in settlement of account)			
30.9.94	Debenture Interest A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Interest paid on debentures for 4 months @ 15% on Rs. 2,00,00,000)			
30.10.94	15% Debentures A/c	Dr.	1,20,00,000	
	To Equity Share Capital A/c			20,00,000
	To Securities Premium A/c			1,00,00,0000
	(Conversion of 60% of debentures into shares of Rs. 60 each with a face value of Rs. 10)			
31.3.95	Debenture Interest A/c	Dr.	7,50,000	
	To Bank A/c			7,50,000
	(Interest paid on debentures for the half year)			

Working Note :

Calculation of Debenture Interest for the half year ended 31st March, 1995

On Rs. 80,00,000 for 6 months @ 15%	= Rs. 6,00,000
On Rs. 1,20,00,000 for 1 months @ 15%	= Rs. 1,50,000
	Rs. 7,50,000

Question 6

Progressive Ltd. issued Rs. 10,00,000, 6% Debenture Stock at par on 21.1.1984, Interest was payable on 30th June and 31st December, in each year.

Under the terms of the Debentures Trust the owned stock is redeemable at par. The trust deed obliges the Company to pay to the trustees on 31st December, 1995 and annually thereafter the sum of Rs. 1,00,000 to be utilised for the redemption and cancellation of an equivalent amount of stock, which is to be selected by drawing lots.

Alternatively, the Company is empowered as from 1st January, 1995 to purchase its own debentures on the open market. These Debentures must be surrendered to the Trustees for cancellation and any adjustments for accrued interest recorded in the books of account. If in any year the nominal amount of the stock surrendered under this alternative does not amount to Rs. 1,00,000 then the shortfall is to be paid by the Company to the Trustees in cash on 31st December.

The following purchases of stock were made by the Company:

		Nominal value of stock purchased Rs.	Purchase price per Rs. 100 of stock Rs.	
(1)	*30th September, 1995*	*1,20,000*	*98*	
(2)	*31st May, 1996*	*75,000*	*95*	*(Ex-interest)*
(3)	*31st July, 1997*	*1,15,000*	*92*	

The Company fulfilled all its obligations under the trust deed.

Prepare the following Ledger Accounts :

(a) Debenture Stock A/c

(b) Debenture Redemption A/c

(c) Debenture Interest A/c

***Note :** Ignore costs and taxation* *(15 Marks) (Intermediate–Nov. 1998)*

Answer

In the Books of Progressive Ltd.

Debenture Stock Account

1995		*Rs.*	*1995*		*Rs.*
Sept. 30	To Debenture Redemption A/c	1,20,000	Jan. 1	By Balance b/d	10,00,000
Dec. 31	To Balance c/d	8,80,000			
		10,00,000			10,00,000
1996		*Rs.*	*1996*		*Rs.*
May 31	To Debenture Redemption A/c	75,000	Jan. 1	By Balance b/d	8,80,000
Dec.31	To Debenture				

		Redemption A/c	25,000				
	To	Balance c/d	7,80,000				
			8,80,000				8,80,000
1997			*Rs.*	*1997*			*Rs.*
July 31	To	Debenture Redemption A/c	1,15,000	Jan. 1	By	Balance b/d	7,80,000
Dec.31	To	Balance c/d	6,65,000				
			7,80,000				7,80,000

Debenture Redemption Account

1995			*Rs.*	*1995*		*Rs.*
Sept. 30	To	Bank A/c (Rs. 1,20,000×0.98 – Rs. 1,800)	1,15,800	Sept.30	By Debenture Stock A/c	1,20,000
	To	Capital Reserve A/c	4,200			
			1,20,000			1,20,000
1996			*Rs.*	*1996*		*Rs.*
May 30	To	Bank A/c (Rs. 75,000 × 0.95)	71,250	May 31	By Debenture Stock A/c	75,000
				Dec. 31	By Debenture Stock A/c	25,000
	To	Capital Reserve A/c (Profit on cancellation)	3,750			
Dec.31	To	Bank A/c (Shortfall=Rs.1,00,000 – Rs. 75,000)	25,000			
			1,00,000			1,00,000
1997			*Rs.*	*1997*		*Rs.*
July 31	To	Bank A/c (Rs. 1,15,000 ×.92 – Rs. 575)	1,05,225	July 31	By Debenture Stock A/c	1,15,000
	To	Capital Reserve A/c (Profit on cancellation)	9,775			
			1,15,000			1,15,000

Debenture Interest Account

1995		*Rs.*	*1995*		*Rs.*
June 30	To Bank A/c	30,000	Dec. 31	By Profit and Loss A/c	58,200
Sept. 30	To Bank A/c	1,800			
Dec. 31	To Bank A/c	26,400			
		58,200			58,200
1996		*Rs.*	*1996*		*Rs.*
May 31	To Bank A/c	1,875	Dec. 31	By Profit and Loss A/c	50,175
June 31	To Bank A/c	24,150			
Dec. 31	To Bank A/c	24,150			
		50,175			50,175
1997		*Rs.*	*1997*		*Rs.*
June 30	To Bank A/c	23,400	Dec. 31	By Profit and Loss A/c	43,925
July 31	To Bank A/c	575			
Dec. 31	To Bank A/c	19,950			
		43,925			43,925

Working Notes :

Interest paid on Debentures @6% per annum:

Date	*Amount of Debentures* *Rs.*	*Period*	*Interest* *Rs.*
1995			
June 30	10,00,000	6 months	30,000
Sept. 30	1,20,000	3 months	1,800
Dec. 31	8,80,000	6 months	26,400
1996			
May 31	75,000	5 months	1,875
June 30	8,05,000	6 months	24,150
Dec. 31	8,05,000	6 months	24,150
1997			
June 30	7,80,000	6 months	23,400
July 31	1,15,000	1 month	575
Dec. 31	6,65,000	6 months	19,950

Notes : (1) It has been assumed that debentures are purchased for immediate cancellation.
(2) The purchases of 30th September, 1995 and 31st July, 1997 have been taken on cum-interest basis

Question 7

Pass journal entries in year 1 in the case of the issue of debentures by ABC Co. Ltd.:
Issued Rs. 1,00,000, 11% debentures at 95% redeemable at the end of 10 years.
(i) at 102%, and (ii) at 98% *(5 marks) (Intermediate–May 2000)*

Answer

ABC Co. Ltd.
Journal Entries

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

Question 8

On 1st April, 2007, in MK Ltd's ledger 9% debentures appeared with a opening balance of Rs. 50,00,000 divided into 50,000 fully paid debentures of Rs. 100 each issued at par.

Interest on debentures was paid half-yearly on 30th of September and 31st March every year.

On 31.5.2007, the company purchased 8,000 debentures of its own @ Rs. 98 (ex-interest) per debenture.

On 31.12.2007 it cancelled 5,000 debentures out of 8,000 debentures acquired on 31.5.2007.

On 31.1.2008 it resold 2,000 of its own debentures in the market @ Rs. 101 (ex-interest) per debenture.

You are required to prepare:

(i) Own debentures account;

(ii) Interest on debentures account; and

(iii) Interest on own debentures account. *(8 Marks) (PE II-Nov. 2008)*

Answer

MK Ltd.'s Ledger

(i) Own Debentures Account

			Rs.				*Rs.*
31.5.07	To	Bank	7,84,000	31.12.07	By	9% Debentures A/c	5,00,000
31.12.07	To	Capital Reserve (Profit on cancellation)	10,000	31.1.08	By	Bank- Resale of 2,000 debentures	2,02,000
31.1.08	To	Profit and Loss A/c (Profit on resale)	6,000	31.3.08	By	Balance c/d	98,000
			8,00,000				8,00,000

(ii) Interest on Debentures Account

			Rs.				*Rs.*
31.5.07	To	Bank (Interest for 2 months on 8,000 debentures)	12,000	31.3.08	By	Profit and Loss A/c	4,38,750
30.9.07	To	Interest on own debentures (Interest for 4 months on 8,000 debentures)	24,000				
30.9.07	To	Bank (Interest for 6 months on 42,000 debentures)	1,89,000				
31.12.07	To	Interest on own debentures (Interest for 3 months on 5,000 debentures)	11,250				
31.3.08	To	Interest on own debentures (Interest for 6 months on 1,000 debentures)	4,500				
31.3.08	To	Bank (Interest for 6 months on 44,000 debentures)	1,98,000				
			4,38,750				4,38,750

(iii) Interest on Own Debentures Account

			Rs.				Rs.
31.3.08	To	Profit and Loss A/c	45,750	30.9.07	By	Interest on Debentures A/c	24,000
				31.12.07	By	Interest on Debentures A/c	11,250
				31.01.08	By	Bank (interest for 4 months on 2,000 debentures)	6,000
				31.03.08	By	Interest on Debentures	4,500
			45,750				45,750

Working Note:

			Rs.
31.5.07	Acquired 8,000 Debentures @ 98 per debenture (ex-interest)		
	Purchase price of debenture 8,000 × Rs. 98	=	7,84,000
	Interest for 2 months Rs. 8,00,000 × 9% × $\frac{2}{12}$	=	12,000
30.9.07	Interest on own debentures		
	[Rs. 8,00,000 × 9% × ½] less Rs.12,000	=	24,000
	Interest on other debentures		
	Rs. 42,00,000 × 9% × ½	=	1,89,000
31.12.07	Cancellation of 5,000 own debentures		
	Face value Rs.100 less acquired at Rs.98 = 2 × 5000	=	10,000
31.1.08	Resale of 2,000 Debentures sold for 101 (ex-interest) acquired for Rs. 98 (ex-interest)		
	2,000 × Rs.3 per Debenture	=	6,000
31.12.07	Interest on cancelled 5,000 debentures		
	5,000 × Rs.100 × 9% × $\frac{1}{4}$	=	11,250
31.3.08	Interest on 1,000 own debentures		
	Rs. 1,00,000 × 9% × ½	=	4,500

UNIT 5 : FINAL ACCOUNTS OF COMPANIES

Question 1

The Balance Sheet of A Ltd. as at 31.3.1995 is as follows:

Balance Sheet as at 31.3.1995

Liabilities	*Rs.*	*Assets*	*Rs.*
Authorised Share Capital		*Sundry Assets*	*17,00,000*
1,50,000 Equity Shares of Rs. 10 each	*15,00,000*		
Issued, Subscribed and Paid-up			
80,000 Equity Shares of			
Rs. 7.50 each called-up and paid-up	*6,00,000*		
Reserves and surplus			
Capital Redemption Reserve	*1,50,000*		
Plant Revaluation Reserve	*20,000*		
Securities Premium Account	*1,50,000*		
Development Rebate Reserve	*2,30,000*		
Investment Allowance Reserve	*2,50,000*		
General Reserve	*3,00,000*		
	17,00,000		*17,00,000*

The company wanted to issue bonus shares to its share holders at the rate of one share for every two shares held. Necessary resolutions were passed; requisite legal requirements were complied with:

(a) You are required to give effect to the proposal by passing journal entries in the books of A Ltd.

(b) Show the amended Balance Sheet. *(20 marks) (Intermediate–Nov. 1995)*

Answer

In the Books of A Ltd.

Journal Entries

			Rs.	Rs.
(i)	Share Final Call A/c	Dr.	2,00,000	
	To Share Capital A/c			2,00,000
	(Being the final call of Rs. 2.50 each on 80,000 equity shares made)			
(ii)	Bank A/c	Dr.	2,00,000	
	To Share Final Call A/c			2,00,000
	(Being the amount due on final call received)			

(iii)	General Reserves	Dr.	3,00,000	
	Securities Premium A.c	Dr.	1,00,000	
	To Bonus to Share holders A/c			4,00,000
	(Being the appropriation made as above to facilitate issue of fully paid up bonus shares at the rate of one share for every two shares held)			
(iv)	Bonus to Shareholders A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being the issuance of 40,000 fully paid up shares of Rs. 10 each by way of bonus)			

(b) **Balance Sheet (after bonus issue)**

Liabilities	*Amount*	*Assets*	*Amount*
Authorised Share Capital		Bank	2,00,000
1,50,000 equity shares of Rs. 10 each	15,00,000	Sundry Assets	17,00,000
Issued and Subscribed			
1,20,000 Equity Shares of Rs. 10 each fully paid	12,00,000		
Of the above, 40,000 equity shares are allotted as fully paid up by way of bonus shares			
Reserves and Surplus			
Capital Redemption Reserve	1,50,000		
Securities Premium	50,000		
Development Rebate Reserve	2,30,000		
Investment Allowance Reserve	2,50,000		
Plant Revaluation Reserve	20,000		
	19,00,000		19,00,000

Question 2

The following is the Trial Balance of Subhash Limited as on 31.3.97 :

(Figures in Rs. '000)

Debit	*Rs.*	*Credit*	*Rs.*
Land at cost	*110*	*Equity Capital (Shares of Rs. 10 each)*	*150*
Plant & Machinery at cost	*385*	*10% Debentures*	*100*

Debtors	*48*	*General Reserve*	*65*
Stock (31.3.97)	*43*	*Profit & Loss A/c*	*36*
Bank	*10*	*Securities Premium*	*20*
Adjusted Purchases	*160*	*Sales*	*350*
Factory Expenses	*30*	*Creditors*	*26*
Administration Expenses	*15*	*Provision for Depreciation*	*86*
Selling Expenses	*15*	*Suspense Account*	*2*
Debenture Interest	*10*		
Interim Dividend Paid	*9*		
	835		*835*

Additional Information :

(a) *On 31.3.97, the company issued bonus shares to the shareholders on 1 : 3 basis. No entry relating to this has yet been made.*

(b) *The authorised share capital of the company is 25,000 shares of Rs. 10 each.*

(c) *The company on the advice of independent valuer wish to revalue the land at Rs. 1,80,000.*

(d) *Proposed final dividend 10%.*

(e) *Suspense account of Rs. 2,000 represents cash received for the sale of some of the machinery on 1.4.96. The cost of the machinery was Rs. 5,000 and the accumulated depreciation thereon being Rs. 4,000.*

(f) *Depreciation is to be provided on plant and machinery at 10% on cost.*

You are required to prepare Subhash Limited's Profit & Loss account for the year ended 31.3.97 and a balance sheet on that date in vertical form as per the provisions of Schedule VI of the Companies Act, 1956.

Your answer to include detailed schedules only for the following :

(1) Share Capital

(2) Reserves & Surplus

(3) Fixed Assets

Ignore previous years' figures & taxation. *(20 marks) (Intermediate–May 1997)*

Answer

Subash Limited

Balance Sheet as at 31.3.97

1 **Sources of funds**

	Schedule No.		(Rs. '000)
(1) Shareholders funds			
(a) Capital	1	200	
(b) Reserves & Surplus	2	200	400
(2) Loan funds			

	10% Debentures				100
		Total			500
II	Application of funds				
	(1) Fixed Assets:	3			
	Land			180	
	Gross Block (385 - 5)		380		
	Less: Depreciation				
	(86 + 38 - 4)		120	260	440
	(2) Current assets:				
	Stock		43		
	Debtors		48		
	Cash		10	101	
	Less: Current Liabilities:				
	Creditors		26		
	Proposed dividend		15	41	60
		Total			500

Subash Limited

Profit & Loss Account for the year ended 31.3.97

			(Rs. '000)
Sales			350
Other income (profit on sale of machinery)			1
Total income			351
Less : Expenses:			
Purchases		160	
Factory expenses		30	
Administration expenses		15	
Selling expenses		15	
Depreciation		38	
Interest on Debentures		10	268
			83
Net Profit before dividend			
Dividend : Interim	9		
Final	15		24
Balance carried to balance sheet			59

Working Notes :

Bonus issue proportion = 1:3

No. of shares = 15,000 × 1/3 = 5,000 shares

			Debit (Rs.)	Credit (Rs.)
(1)	General Reserve Account	Dr.	Rs. 50,000	
	To Equity Share Capital Account			Rs. 50,000
	(Being reserves capitalised)			
(2)	Land Account	Dr.	Rs. 70,000	
	To Revaluation Reserve Account			Rs. 70,000
	(Being land revalued)			

Schedules

SCHEDULE 1	Rs.
Share Capital	
Authorised	
25,000 Shares of Rs. 10 each	2,50,000
Issued, subscribed & fully paid-up	
20,000 shares of Rs. 10 each	2,00,000
[of the above, 5,000 shares are alloted as fully paid by way of Bonus Shares. Bonus Shares were issued by utilising the general reserve]	

SCHEDULE 2

Reserves and Surplus

	Rs.
Share Premium Account	20,000
Revaluation reserve	70,000
General reserve (65,000 – 50,000)	15,000
Balance in profit & loss A/c (36,000 + 59,000)	95,000
	2,00,000

SCHEDULE 3

Fixed Assets	As on 1/4/1996	Additions	Deductions	Depreciation	Net Block
	Rs.	Rs.	Rs.	Rs.	Rs.
Land	1,10,000	70,000	-	-	1,80,000
Plant & Machinery	3,85,000	-	5,000	1,20,000	2,60,000
Total	4,95,000	70,000	5,000	1,20,000	4,40,000

Land was revalued upward by Rs. 70,000 during the year.

Question 3

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 ar 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*

(6 marks) (Intermediate–Nov. 1998)

Answer

Sections 198 and 309 of the Comapnies 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
Add back : Depreciation provided in the books	3,10,000	
Provision for repairs of machinery	25,000	3,35,000
		12,05,410
Less : Depreciation allowable under Schedule XIV	2,60,000	
Actual expenditure incurred on repairs	15,000	2,75,000
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

Question 4

The trial balance of Complex Ltd. as at 31st March, 1998 shows the following items :

	Dr.	*Cr.*
	Rs.	*Rs.*
Advance payment of income-tax	*2,20,000*	-
Provision for income-tax for the year ended 31.3.97	-	*1,20,000*

The following further informations are given :

(i) Advance payment of income-tax includes Rs. 1,40,000 for 1996-97.

(ii) Actual tax liability for 1996-97 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 1997-98 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.

(10 marks) (Intermediate–Nov. 1998)

Answer

Complex Ltd.

(a) **Provision for Income Tax (1996-97) Account**

Dr.					*Cr.*
		Rs.			*Rs.*
31.3.98	To Advance Payment of Income-tax A/c	1,40,000	1.4.97	By Balance b/d	1,20,000
	To Liability for Taxation A/c	12,000	31.3.98	By Profit and Loss A/c	32,000
		1,52,000			1,52,000

Provision for Income-tax (1997-98) Account

		Rs.			Rs.
31.3.98	To Balance c/d	1,60,000	31.3.98	By Profit and Loss A/c	1,60,000
		1,60,000			1,60,000

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

		Rs.			Rs.
31.3.98	To Balance b/d	2,20,000	31.3.98	By Provision for Income-tax (1996-97) A/c	1,40,000
				By Balance c/d	80,000
		2,20,000			2,20,000

(c) **Liability for Taxation Account**

		Rs.			Rs.
31.3.98	To Balance c/d	12,000	31.3.98	By Provision for Income-tax A/c	12,000
		12,000			12,000

Profit and Loss Account
for the year ended 31st March, 1998 (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, 1998 (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 Income-tax	80,000
B. Provisions			
Provision for Income-tax	1,60,000		

Question 5

Fruit Juice Ltd., Mumbai has factories at Ratnagiri (alphonso mango pulp) and Nagpur (Orange juice).

During the year ended 31st March, 1999, the following locationwise revenue statements were furnished by the two factories (from which the total column has been compiled) :

	Ratnagiri	Nagpur	Total
	Rs.	Rs.	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, 1999 (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, 1999 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. *(16 marks) (Intermediate May 1999)*

Answer

Revenue Statement of Fruit Juice Ltd. (Sectional and Consolidated)

for the year ended 31st March, 1999

	Mango Pulp	Orange Juice	Total
	Rs. '000	Rs. '000	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	Orange Juice	Total
	Rs. '000	*Rs. '000*	*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*	*Orange Juice*	*Total*
	Rs. '000	*Rs. '000*	*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	*Orange Juice*	*Total*
	Rs. '000	*Rs. '000*	*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

UNIT 6 : PROBLEMS BASED ON ACCOUNTING STANDARDS AND GUIDANCE NOTES

Question 1

Events Occurring after the Balance Sheet Date and their disclosure requirements.

(5 marks) (Intermediate–Nov. 1994, May 97 and May 1998)

Answer

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company and in the case of any other entity by the corresponding approving authority.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate. However, assets and liabilities should not be adjusted for but disclosure should be made in the report of the approving authority of events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

(ii) Disclosure regarding events occurring after the balance sheet date :

   (a) The nature of the event;

   (b) An estimate of the financial effect, or a statement that such an estimate cannot be made.

Question 2

Prior-Period items. *(2 marks) (Intermediate–Nov. 1994, May 1996 and May 1998)*

Answer

When income or expenses arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods, the said incomes or expenses have to be classified as prior period items. The errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts or oversight.

Question 3

Pre–incorporation expenses. *(5 marks) (Intermediate–May 1996)*

Answer

Pre–incorporation expenses denote expenses incurred by the promoters for the purposes of the company before its incorporation.

Broadly, these include expenses in connection with:

(a) preliminary analysis of the conceived idea,

(b) detailed investigation in terms of technical feasibility and commercial viability to establish the soundness of the proposition,

(c) preparation of 'project report' or 'feasibility report' and its verification through independent appraisal authority (before giving final approval to the proposition) and

(d) organisation of funds, property and managerial ability and assembling of other business elements.

These expenses should be properly capitalised and shown in the balance sheet under the heading "Miscellaneous Expenditure". There is no legal requirement to write–off these expenses to profit and loss account within any specified period of time nor is there any rigid accounting convention in regard to this matter. However, good corporate practice recognises the need to write off these expenses to profit and loss account whtin a period of 3 to 5 years.

Question 4

Provisions contained in the Accounting Standard in respect of Revaluation of fixed assets.

(10 marks) (Intermediate–Nov. 1996)

Answer

(i) Revaluation of fixed Assts

According to Accounting Standard 10 on "Accounting for Fixed Assets"

(a) When fixed assets are revalued in financial statements, the basis of selection should be an entire class of assets or the selection should be done on a systematic basis. The basis of selection should be disclosed.

(b) The revaluation of any class of assets should not result in the net book value of that class being greater than the recoverable amount of that class of assets.

(c) The accumulated depreciation should not be credited to profit and loss account.

(d) The net increase in book value should be credited to a revaluation reserve account.

(e) On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value should be charged or credited to the profit and loss account except that to the extent to which such a loss is related to an increase and which has not been subsequently reversed or utilised may be charged directly to that account.

Questiion 5

The difference between actual expense or income and the estimated expense or income as accounted for in earlier years' accounts, does not necessarily constitue the item to be a prior period item comment. *(2 marks) (Intermediate–May 1998)*

Answer

The statement given in the question is correct and is in accordance with the Accounting Standard (AS) 5 (Revised) "Net Profit or Loss for the Period. Prior Period Items and Changes in Accounting Policies''.

The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustments within the definition of an extraordinary item or a prior period item.

Question 6

When can revenue be recognised in the case of transaction of sale of goods?

(2 marks) (Intermediate–May 1998)

Answer

As per AS 9 Revenue Recognition, revenue from sales transactions should be recognised when the following requirements as to performance are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection :

(i) The seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of goods.

Question 7

Valuation of fixed assets in special cases. *(3 marks) (Intermediate–Nov. 1998)*

Answer

Para 15 of Accounting Standard 10 on "Accounting for Fixed Assets" states the following provisions regarding valuation of fixed assets in special cases :

1. In the case of fixed assets acquired on hire purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate arration to indicate that the enterprise does not have full ownership thereof.

2. Where an enterprise owns fixed assets jointly with others (otherwise than as a partner in a firm), the extent of its share in such assets, and the proportion in the original cost, accumulated depreciaiton and written down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register.

3. Where several assets are purchased for a consolidated price, the consideration is apportioned to the various assets on a fair basis as determined by competent valuers.

Question 8

What are the main features of the Cash Flow Statement? Explain with special reference to AS 3? (5 marks) (Intermediate–Nov. 1999)

Answer

According to AS 3 (Revised) on "Cash Flow Statements", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of non–cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

As per para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities. This statement also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

AS 3 (revised) is recommendatory at present but for companies listed on stock exchanges, its compliance is mandatory due to the listing agreement which provides for the listed companies to furnish cash flow statement in their Annual Reports.

Question 9

Extraordinary Items to be disclosed as per the Accounting Standard.

(3 marks) (Intermediate–Nov. 1994)

Answer

Extraordinary items are gains or losses which arise from events or transactions that are distinct from the ordinary activities of the business and which are both material and expected not to recur in future frequently. These would also include material adjustments necessitated by circumstances, which though related to previous periods are determined in the current period. Some examples of extraordinary items may be the sale of a signficant part of the business, the sale of an investment not acquired with the intention of resale etc. The nature and amount of each extraordinary item are separately disclosed so that users of financial statements can evaluate the relative significance of such items and their effect on the current operating results. It may be noted that income or expenses arising from the ordinary activities of the enterprise, though abnormal in amount or infrequent in occurrence, do not qualify as extraordinary.

Question 10

(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.*

(8 marks) (Intermediate–May 1995)

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 conditiont 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 continuosly and if it becomes probable that an outflow of future economic benefit will be required , then recognise the contingent liability as a provision.

Question 11

Jagannath Ltd. had made a rights issue of shares in 1996. 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, 1998. 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 cores.

(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 1997-1998 (6 Marks) (Intermediate–May 1998)

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.

Question 12

Media Advertisers obtained advertisement rights for One Day World Cup Cricket Tournament to be held in May/June, 1999 for Rs. 250 lakhs.

By 31st March, 1999 they have paid Rs. 150 lakhs to secure these advertisement rights. The balance Rs. 100 lakhs was paid in April, 1999.

By 31st March, 1999 they procured advertisement for 70% of the available time for Rs. 350 lakhs. The advertisers paid 60% of the amount by that date. The balance 40% was received in April, 1999.

Advertisements for the balance 30% time were procured in April, 1999 for Rs. 150 lakhs. The advertisers paid the full amount while booking the advertisement.

25% of the advertisement time is expected to be available in May, 1999 and the balance 75% in June, 1999.

You are asked to :

(i) Pass journal entries in relation to the above.

(ii) Show in columnar form as to how the items will appear in the monthly financial statements for March, April, May and June 1999.

Give reasons for your treatment. *(12 marks) (Intermediate–May 1999)*

Answer

In the books of Media Advertisers

Journal Entries

			Dr. *Rs. in lakhs*	*Cr.* *Rs. in lakhs*
1999				
March	Advance for advertisement rights (purchase) A/c	Dr.	150.00	
	To Bank A/c			150.00
	(Being advance paid for obtaining advertisement rights)			
	Bank A/c	Dr.	210.00	
	To Advance for advertisement time (sale) A/c			210.00
	(Being advance received from advertisers amounting to 60% of Rs. 350 lakhs for booking 70% advertisement time)			
April	Advance for advertisement rights (purchase) A/c	Dr.	100.00	
	To Bank A/c			100.00
	(Being balance advance i.e., Rs. 250 lakhs less Rs. 150 lakhs paid)			
	Bank A/c	Dr.	140.00	
	To Advance for advertisement time (sale) A/c			140.00
	(Being balance advance i.e., Rs. 350 lakhs less Rs. 210 lakhs received from advertisers)			
	Bank A/c	Dr.	150.00	
	To Advance for advertisement time (sale) A/c			150.00
	(Being advance received from advertisers in respect of booking of balance 30% time)			
May	Advertisement rights (purchase) A/c	Dr.	62.50	
	To Advance for advertisement rights (purchase) A/c			62.50
	(Being cost of advertisement rights used in May i.e., 25% of Rs. 250 lakhs, adjusted against advance paid)			

	Advance for advertisement time (sale) A/c	Dr.	125.00	
	To Advertisement time (sale) A/c			125.00
	(Being sale price of advertisement time in May i.e., 25% of Rs. 500 lakhs adjusted, against advance received from advertisers)			
	Profit and Loss A/c	Dr.	62.50	
	To Advertisement rights (purchase) A/c			62.50
	(Being cost of advertisement rights debited to Profit and Loss Account in May)			
	Advertisement time (sale) A/c	Dr.	125.00	
	To Profit and Loss A/c			125.00
	(Being revenue recognised in Profit and Loss Account in May)			
June	Advertisement rights (purchase) A/c	Dr.	187.50	
	To Advance for advertisement rights (purchase) A/c			187.50
	(Being cost of advertisement rights used in June, i.e., 75% of Rs. 250 lakhs, adjusted against advance paid)			
	Advance for advertisement time (sale) A/c	Dr.	375.00	
	To Advertisement time (sale) A/c			375.00
	(Being sale price of advertisement time availed in June i.e., 75% of Rs. 500 lakhs, adjusted against advance received from advertisers)			
June	Profit and Loss A/c	Dr.	187.50	
	To Advertisement rights (purchase) A/c			187.50
	(Being cost of advertisement rights used in June, debited to Profit and Loss Account in June)			
	Advertisement time (sale) A/c	Dr.	375.00	
	To Profit and Loss Account			375.00
	(Being revenue recognised in June)			

(ii) **Monthly financial statements**

(1) Revenue statement (Rs. in lakhs)

	March	April	May	June
	Rs.	*Rs.*	*Rs.*	*Rs.*
Sale of advertisement time	–	–	125.00	375.00
Less: Purchase of advertisement rights	–	–	62.50	187.50
Netprofit	–	–	62.50	187.50

(2) Balance sheet as at	*31.3.99*	*30.4.99*	*31.5.99*	*30.6.99*
Sources of funds:				
Net profit	–	–	62.50	250.00
Application of funds:				
Current assets, loans and advances:				
Advance for advertisement rights	150.00	250.00	187.50	–
Bank Balance	60.00	250.00	250.00	250.00
	210.00	500.00	437.50	250.00
Less: Current liabilities				
Advance for advertisement time				
(received from advertisers)	210.00	500.00	375.00	–
Net current assets	–	–	62.50	250.00

As per para 7.1 of AS 9 on Revenue Recognition, under proportionate completion method, revenue from service transactions is recognised proportionately by reference to the performance of each act where performance consists of the execution of more than one act. Therefore, income from advertisement is recognised in May, 1999 (25%) and June, 1999 (75%) in the proportion of availability of the advertisement time.

Question 13

(a) *Describe the factors for determination of "Reportable Segments" as per AS-17.*

(b) *Briefly describe the disclosure requirements for related party transactions as per Accounting Standard 18.*

(c) *State the different types of Leases contemplated in Accounting Standard 19 and discuss briefly.* *(12 marks) (Intermediate–May 2002)*

Answer

(a) Paragraphs 27 to 29 of AS 17 on Segment Reporting deals with reportable segments.

Paragraph 27 requires that a business segment or geographical segment should be identified as a reportable segment if :

(i) its revenue from sales to external customers and from transactions with other segments is 10 percent or more of the total revenue, external and internal, of all segments; or

(ii) its segment result, whether profit or loss, is 10 percent or more of-

(a) the combined result of all segments in profit, or

(b) the combined result of all segments in loss, whichever is greater in absolute amount; or

(iii) its segment assets are 10 percent or more of the total assets of all segments.

A business segment or a geographical segment which is not a reportable segment as per paragraph 27, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

If total external revenue attributable to reportable segments constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 percent thresholds specified in paragraph 27 of the standard, until at least 75 percent of the total enterprise revenue is included in reportable segments.

(b) Paragraph 23 of AS 18 on Related Party Disclosures requires that if there have been transactions between related parties, during the existence of the a related party relationship, the reporting enterprise should disclose the following :

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

Point (v) requires disclosure of 'any other elements of the related party transactions necessary for an understanding of the financial statements. An example of such a disclosure would be an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

(c) Accounting Standard 19 has divided the lease into two types viz. (i) Finance Lease and (ii) Operating Lease.

Finance Lease : A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. title may or may not eventually be transferred. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of the minimum lease payments from the standpoint of the lessee.

Operating Lease : A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership. Lease payments under an operating lease should be recognised 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.

Question 14

(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.

(20 marks) (PE-II – Nov. 2002)

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.

(iv) The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

(e) **Sale and leaseback transactions:** As per AS 19 on 'Leases', a sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the asset back to the vendor. The lease payments and the sale price are usually interdependent, as they are negotiated as a package. The accounting treatment of a sale and lease back transaction depends upon the type of lease involved.

If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sale proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

If sale and leaseback transaction results in a operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

Question 15

(a) X Co. Ltd. charged depreciation on its asset on SLM basis. For the year ended 31.3.2003 it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to Rs. 20 lakhs being additional charge.

Decide how it must be disclosed in Profit and loss account. Also, discuss, when such changes in method of depreciation can be adopted by an enterprise as per AS–6.

(b) Decide when research and development cost of a project can be deferred to future periods as per AS 26.

(c) You are an accountant preparing accounts of A Ltd. as on 31.3.2003. After year end the following events have taken place in April, 2003:

(i) A fire broke out in the premises damaging, uninsured stock worth Rs. 10 lakhs (Salvage value Rs. 2 lakhs).

(ii) A suit against the company's advertisement was filed by a party claiming damage of Rs. 20 lakhs.

(iii) Dividend proposed @ 20% on share capital of Rs. 100 lakhs.

Describe, how above will be dealt with in the account of the company for the year ended on 31.3.2003.

(d) How the government grants related to specific fixed assets should be presented in the Balance Sheet as per AS–12?

(e) Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS–14.

(f) Mention the prescribed accounting treatment in respect of gratuity benefits payable to employees as per AS–15. *(24 marks) (PE-II – May 2003)*

Answer

(a) The company should disclose the change in method of depreciation adopted for the accounting year. The impact on depreciation charge due to change in method must be quantified and reported by the enterprise.

Following aspects may be noted in this regard as per AS 6 on Depreciation Accounting.

(a) The depreciation method selected should be applied consistently from period to period.

(b) A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise.

(c) When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed.

(d) In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss.

(e) In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

(b) As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research should be recognized. The expenditure incurred on development phase can be deferred to the subsequent years if the company can demonstrate all of the following conditions (as specified in para 44 of AS 26 'Intangible Assets'):

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

(c) Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to para 15 of AS 4 on Contingencies and Events occurring after the Balance Sheet date. Hence, fire accident and loss thereof must be disclosed.

Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements. Thus, dividends which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted as per para 14 of AS 4.

(d) Paragraphs 8 and 14 of AS 12 on Accounting for Government Grants deal with presentation of government grants related to specific fixed assets.

Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in proportion in which depreciation on those assets is charged. Grants related to non-depreciable assets should be credited to capital reserve under this method. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income balance should be separately disclosed in the financial statements.

(e) The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 on Accounting for Amalgamation.

For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:

(a) names and general nature of business of the amalgamating companies;

(b) the effective date of amalgamation for accounting purpose;

(c) the method of accounting used to reflect the amalgamation; and

(d) particulars of the scheme sanctioned under a statute.

For amalgamations accounted under the pooling of interests method, the following additional disclosures should be made in the first financial statements following the amalgamation:

(a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations, accounted under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation;

(a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

(f) Accounting treatment in respect of gratuity benefits payable to employees has been prescribed under paragraph 28 of AS 15 on Accounting for Retirement Benefits in the Financial Statements of Employers.

Accounting treatment in respect of gratuity benefit and other defined benefit schemes will depend on the type of arrangement, which the employer has chosen to make.

(i) If the employer has chosen to make payment for retirement benefits out of his own funds, an appropriate charge to the statement of profit and loss for the year should be made through a provision for the accruing liability. The accruing liability should be calculated according to actuarial valuation. However, those enterprises which employ only a few persons may calculate the accrued liability by reference to any other rational method e.g., a method based on the assumption that such benefits are payable to all employees at the end of the accounting year.

(ii) In case the liability for retirement benefits is funded through creation of a trust, the cost incurred for the year should be determined actuarially. Such actuarial valuation should normally be conducted at least once in every three years. However, where actuarial valuation are not conducted annually, the actuary's report should specify the contributions to be made by the employer on annual basis during the inter-valuation period. This annual contribution (which is in addition to the contribution that may be required to finance unfunded past service cost) reflects proper accrual of retirement benefit cost for each of the years during the inter-valuation period and should be charged to the statement of profit or loss each year. Where the contribution paid during a year is lower than the amount required to be contributed during the year to meet the accrued liability as certified by the actuary, the shortfall should be charged to the statement of profit or loss for the year. Where the contribution paid during a year is in excess of the amount required to be contributed during the year to meet the accrued liability as certified by the actuary, the excess should be treated as a pre-payment.

(ii) In case the liability for retirement benefits is funded through a scheme administered by an insurer, an actuarial certificate or a confirmation from the insurer should be obtained that the contribution payable to the insurer is the appropriate accrual of the liability for the year. Where the contribution paid during a year is lower than the amount required to be contributed during the year to meet the accrued liability as certified by the actuary or confirmed by the insurer, as the case may be, the shortfall should be charged to the statement of profit or loss for the year. Where the contribution paid during a year is in excess of the amount required to be contributed during the year to meet the accrued liability as certified by the actuary or confirmed by the insurer, as the case may be, the excess should be treated as a pre-payment.

Question 16

(a) *How is software acquired for internal use accounted for under AS-26?*

(b) *What are the principles for recognition of deferred taxes under AS-22?*

(c) *Define related party transaction under AS-18.*

(d) *A Limited company charged depreciation on its assets on the basis of W.D.V. method from the date of assets coming to use till date amounts to Rs. 32.23 lakhs. Now the company decides to switch over to Straight Line method of providing for depreciation. The amount of depreciation computed on the basis of S.L.M. from the date of assets coming to use till the date of change of method amounts to Rs. 20 lakhs.*

Discuss as per AS-6, when such changes in method of can be adopted by the company and what would be the accounting treatment and disclosure requirement.

(e) *X Limited has recognized Rs. 10 lakhs on accrual basis income from dividend on units of mutual funds of the face value of Rs. 50 lakhs held by it as at the end of the financial* *year 31st March, 2003. The dividends on mutual funds were declared at the rate of 20% on 15th June, 2003. The dividend was proposed on 10th April, 2003 by the declaring company. Whether the treatment is as per the relevant Accounting Standard? You are asked to answer with reference to provisions of Accounting Standard.*

(20 marks) (PE-II – Nov. 2003)

Answer

(a) Paragraphs 10 and 11 of Appendix A to the Accounting Standard 26 on Intangible Assets, lays down the following procedure for accounting of software acquired for internal use:-

- The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this statement.
- The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use.

Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement which deal with the method of accounting for 'Separate Acquisitions', 'Acquisitions as a part of Amalgamations', Acquisitions by way of Government Grant', and 'Exchanges of Assets', need to be considered, as appropriate.

Recognition criteria as per paragraphs 20 and 21 of the standard are stated below:-

- An intangible asset should be recognised if, and only if:
  (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
  (b) the cost of the asset can be measured reliably.
- An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

(b) Taxable income is calculated in accordance with tax laws. In some circumstances the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. This results in a difference between the taxable and the accounting income. Such differences are classified into Permanent and Timing differences. The tax effect of the timing differences is known as Deferred Tax and is included as tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.

Prudence would dictate that deferred tax liabilities are provided for without exception, even in situations where an enterprise is incurring losses. Deferred tax assets should be recognized and carried forward only to the extent that there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realized. Reasonable certainty can be demonstrated by providing robust and realistic estimates of profits for the future. A company with a track record of losses with no immediate visibility of a turnaround should not recognise a deferred tax asset as a matter of prudence. In the case of an unabsorbed depreciation and carry forward losses under the tax laws, the recognition principles are more stricter, i.e. deferred tax asset should be recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available.

In that situation there has to be convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. This is a matter of judgement and the conclusion would depend on facts and circumstances of each case.

(c) Accounting Standard 18 on Related Party Disclosures defines a related party transaction as transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Related parties have been defined by the standard in the following words. “Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.”

Further, paragraph 24 of the Standard gives certain examples of related party transactions in respect of which disclosures may be made by a reporting enterprise. Those examples are listed below:-

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of fixed assets;

(c) rendering or receiving of services;

(d) agency arrangements;

(e) leasing or hire purchase arrangements;

(f) transfer of research and development;

(g) license agreements;

(h) finance (including loans and equity contributions in cash or in kind);

(i) guarantees and collaterals; and

(j) management contracts including for deputation of employees.

(d) Paragraph 21 of Accounting Standard 6 on Depreciation Accounting says, "The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise."

The paragraph also mentions the procedure to be followed when such a change in the method of depreciation is made by an enterprise. As per the said paragraph, depreciation should be recalculated in accordance with the new method from the date of the asset coming to use. The difference in the amount, being deficiency or surplus from retrospective recomputation should be adjusted in the profit and loss account in the year such change is effected. Since such a change amounts to a change in the accounting policy, it should be properly quantified and disclosed. In the question given, the surplus arising out of retrospective recomputation of depreciation as per the straight line method is Rs. 12.23 lakhs (Rs. 32.23 lakhs – Rs. 20 lakhs). This should be written back to Profit and Loss Account and should be disclosed accordingly.

(e) Paragraph 8.4 and 13 of Accounting Standard 9 on Revenue Recognition states that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

In the given case, the dividend is proposed on 10th April, 2003, while it is declared on 15th June, 2003. Hence, the right to receive payment is established on 15th June, 2003. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognised by X Ltd. in the financial year ended 31st March, 2004.

The recognition of Rs. 10 lakhs on accrual basis in the financial year 2002-2003 is not as per AS 9 'Revenue Recognition'.

(i) Acting as a banker in respect of funds of local bodies, Zilla Parishads, Panchayat Institutions etc. who keep their funds with the treasuries.

(ii) Custody of opium and other valuables because of the strong room facility provided at the treasury.

(iii) Custody of cash balances of the State Government and conducting cash business of Government at non-banking treasuries.

Question 17

(a) X Ltd. received a grant of Rs. 2 crores from the Central Government for the purpose of a special Machinery during 1998-99. The cost of Machinery was Rs. 20 crores and had a useful life of 9 years. During 2002-03, the grant has become refundable due to non-fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. State with reasons, the accounting treatment to be followed in the year 2002-03.

(b) The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2002-03. The Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

Items	*Historical Cost (Rs. in lakhs)*	*Net Realisable Value (Rs. in lakhs)*
A	*40*	*28*
B	*32*	*32*
C	*16*	*24*

What will be the value of Closing Stock?

(c) *During the current year 2002–2003, X Limited made the following expenditure relating to its plant building:*

	Rs. in lakhs
Routine Repairs	*4*
Repairing	*1*
Partial replacement of roof tiles	*0.5*
Substantial improvements to the electrical wiring system which will increase efficiency	*10*

What amount should be capitalized?

(d) *A plant was depreciated under two different methods as under:*

Year	*SLM (Rs. in lakhs)*	*W.D.V. (Rs. in lakhs)*
1	*7.80*	*21.38*
2	*7.80*	*15.80*
3	*7.80*	*11.68*
4	*7.80*	*8.64*
	31.20	*57.50*
5	*7.80*	*6.38*

What should be the amount of resultant surplus/deficiency, if the company decides to switch over from W.D.V. method to SLM method for first four years? Also state, how will you treat the same in Accounts.

(e) *Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.* *(20 marks) (PE-II – May 2004)*

Answer

(a) As per para 11.3 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset. Depreciation on the revised book value is provided prospectively over the residual useful life of the asset. In the given case, book value of machinery will be increased by Rs. 2 crores in the year 2002-2003. The computations for the depreciation on machinery can be given as:

Cost of machinery	Rs. 20 crores
Less: Grant received	Rs. 2 crores
Cost of machinery	Rs. 18 crores
Useful life of machinery	9 years
Depreciation per year as per straight line method	Rs. 18 crores/9
(assuming residual value to be zero)	= Rs. 2 crores
Total depreciation for 4 years (1998-99 to 2001-2002)	Rs. 8 crores
Book value (in year 2002-2003)	Rs. 10 crores
Add: Grant refunded	Rs. 2 crores
Revised book value	Rs. 12 crores
Remaining useful life	5 years
Revised annual depreciation	Rs. 12 crores/5
	= 2.4 crores

Thus, book value of machinery will be Rs. 12 crores in the year 2002-2003 and the depreciation amounting Rs. 2.4 crores will be charged on machinery. Annual depreciation of Rs. 2.4 crores will be charged in the next four years.

(b) As per para 5 of AS 2 on Valuation of Inventories, inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis in the given case.

Items	*Historical Cost (Rs. in lakhs)*	*Net Realisable Value (Rs. in lakhs)*	*Valuation of closing stock (Rs. in lakhs)*
A	40	28	28
B	32	32	32
C	16	24	16
	88	84	76

Hence, closing stock will be valued at Rs. 76 lakhs.

(c) As per para 12.1 of AS 10 on Accounting for Fixed Assets, expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. Hence, in the given case, Repairs amounting Rs. 5 lakhs and Partial replacement of roof tiles should be charged to profit and loss statement. Rs. 10 lakhs incurred for substantial improvement to the electrical writing system which will increase efficiency should be capitalized.

(d) As per para 21 of AS 6 on Depreciation Accounting, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In the given case, there is a surplus of Rs. 26.30 lakhs on account of change in method of depreciation, which will be credited to Profit and Loss Account. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

(e) As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

(i) The Pooling of Interest Method

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

(ii) The Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

Question 18

(a) On 20.4.2003 JLC Ltd. obtained a loan from the Bank for Rs. 50 lakhs to be utilised as under:

	Rs.
Construction of a shed	*20 lakhs*
Purchase of machinery	*15 lakhs*
Working capital	*10 lakhs*
Advance for purchase of truck	*5 lakhs*

In March, 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2004 was Rs. 9 lakhs. Show the treatment of interest under AS 16.

(b) *A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2003-2004.*

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2004. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

(c) *Explain the treatment of cost arising from alteration in retirement benefit cost as per AS 15.* *(12 marks) (PE-II – Nov. 2004)*

Answer

(a) As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time (usually 12 months or more) to get ready for its intended use or sale. If an asset is ready for its intended use or sale at the time of its acquisition then it is not treated as a qualifying asst for the purposes of AS 16.

Treatment of interest as per AS 16

	Particulars	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
(1)	Construction of a shed	Qualifying asset	$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 20 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 3.60 lakhs	
(2)	Purchase of machinery	Not a qualifying asset*		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 15 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 2.70 lakhs.
(3)	Working capital	Not qualifying asset		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 10 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 1.80 lakhs
(4)	Advance for purchase of truck	Not a qualifying asset		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 5 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 0.90 lakhs
	Total		Rs.3.60 lakhs	Rs.5.40 lakhs

* On the basis that machinery is ready for its intended use at the time of its acquisition/purchase.

(b) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2003-2004. Subsequently in 2004 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

(c) Alteration in the retirement benefit cost may arise from introduction of a retirement benefit scheme for existing employees or because of making of improvements to an existing scheme. As per AS 15 any alternation in retirement benefit cost arising from changes in the actuarial method used or assumptions adopted should be charged or credited to the statement of profit or loss as they arise in accordance with AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". Additionally, a change in the actuarial method should be treated as a change in accounting policy and disclosed in accordance with AS 5. The cost of additional benefits provided to retired employees due to amendments in the retirement benefit scheme should also be treated in the same manner (i.e. charged to profit and loss statement of the year).

Question 19

(a) *A major fire has damaged assets in a factory of X Co. Ltd. on 8.4.2004, 8 days after the year end closing of accounts. The loss is estimated to be Rs. 16 crores (after estimating the recoverable amount of Rs. 24 crores from the Insurance Company).*

If the company had no insurance cover, the loss due to fire would be Rs. 40 crores.

Explain, how the loss should be treated in the Final accounts of the year ended 31.3.2004.

(b) *A Company had deferred research and development cost of Rs. 150 lakhs. Sales expected in the subsequent years are as under:*

Years	*Sales (Rs. in lakhs)*
I	*400*
II	*300*

III	*200*
IV	*100*

You are asked to suggest how should Research and Development cost be charged to Profit and Loss account.

If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

(c) In April, 2004 a Limited Company issued 1,20,000 equity shares of Rs. 100 each. Rs. 50 per share was called up on that date which was paid by all shareholders. The remaining Rs. 50 was called up on 1.9.2004. All shareholders paid the sum in September, 2004, except one shareholder having 24,000 shares. The net profit for the year ended 31.3.2005 is Rs. 2,64,000 after dividend on preference shares and dividend distribution tax of Rs. 64,000.

Compute basic EPS for the year ended 31.3.2005 as per Accounting Standard 20.

(d) (i) Mr. Raj a relative of key Management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2004 to 30.6.2004. On 1.7.2004 he left the service.

Should the relative be identified as at the closing date i.e. on 31.3.2005 for the purposes of AS 18?

(ii) X Ltd. sold goods to its associate Company for the 1st quarter ending 30.6.2004. After that, the related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year has to be disclosed as related party transaction.

(e) On 1.4.2001 ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of a machinery costing Rs. 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2004 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd.?

(4 marks each) (PE-II – May 2005

Answer

(a) The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.3.2004. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March, 2004. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the Balance Sheet. In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

(b) (i) Based on sales, research and development cost to be allocated as follows:

Year	*Research and Development cost allocation (Rs. in lakhs)*
I	$\frac{400}{1,000} \times 150 = 60$
II	$\frac{300}{1,000} \times 150 = 45$
III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining Rs. 45 lakhs [150 – (60 + 45)] as an expense immediately.

Note: As per para 41 of AS 26 on Intangible Assets, expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. It has been assumed in the above solution that the entire cost of Rs. 150 lakhs is development cost. Therefore, the expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all the conditions specified in para 44 of AS 26. An intangible asset should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Hence the remaining unamortised amount of Rs. 45,00,000 has been written off as an expense at the end of third year.

(c) Basic earnings per share (EPS) = $\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$

$$= \frac{\text{Rs. }2,64,000}{88,000 \text{ shares (as calculated in working note)}} = \text{Rs. }3$$

Working Note:

Calculation of weighted average number of equity shares

	Number of shares	*Nominal value of shares*	*Amount paid*
1st April, 2004	1,20,000	100	50
1st September, 2004	96,000	100	100
	24,000	100	50

As per para 19 of AS 20 on Earnings per share, Partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividends to the extent of amount paid, weighted average number of shares will be calculated as:

		Shares
$1,20,000 \times \frac{1}{2} \times \frac{5}{12}$	=	25,000
$96,000 \times \frac{7}{12}$	=	56,000
$24,000 \times \frac{1}{2} \times \frac{7}{12}$	=	7,000
		88,000 shares

(d) (i) According to para 10 of AS 18 on Related Party Disclosures, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence, Mr. Raj, a relative of key management personnel should be identified as relative as at the closing date i.e. on 31.3.2005.

(ii) As per para 23 of AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2004 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

(e) According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. The accounting treatment in both the alternatives can be given as follows:

Alternative 1:

		Rs. (in lakhs)
1st April, 2001	Acquisition cost of machinery (Rs. 1,500 – 300)	1,200.00
31st March, 2002	*Less*: Depreciation @ 20%	240.00
	Book value	960.00
31st March, 2003	*Less*: Depreciation @ 20%	192.00
	Book value	768.00
31st March, 2004	*Less*: Depreciation @ 20%	153.60

1st April, 2004	Book value	614.40
May, 2004	*Add*: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset i.e. years ended 31st March, 2005 and 31st March, 2006.

Alternative 2:

ABC Ltd. can also debit the refund amount of Rs. 300 lakhs in capital reserve of the company.

Question 20

(a) *ABC Ltd. could not recover Rs. 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.*

The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of Rs. 10 lakhs in the books of account for the year ended 31st March, 2005?

(b) *X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2004. The wage revision is with retrospective effect from 1.4.2000. The arrear wages upto 31.3.2004 amounts to Rs. 80 lakhs. Arrear wages for the period from 1.4.2004 to 30.06.2004 (being the date of agreement) amounts to Rs. 7 lakhs.*

Decide whether a separate disclosure of arrear wages is required.

(c) *An intangible asset appears in Balance Sheet of A Co. Ltd. at Rs. 16 lakhs as on 31.3.2004. The asset was acquired for Rs. 40 lakhs in April, 1991. The Company has been amortising the asset value on straight line basis. The policy is to amortise for 20 years.*

Do you advise the Company to amortise the entire asset value in the books of the company as on 31.3.2004?

(d) *Ram Co. (P) Ltd. furnishes you the following information for the year ended 31.3.2005:*

Depreciation for the year ended 31.3.2005 (under straight line method)	*Rs. 100 lakhs*
Depreciation for the year ended 31.3.2005 (under written down value method)	*Rs. 200 lakhs*
Excess of depreciation for the earlier years calculated under written down value method over straight line method	*Rs. 500 lakhs*

The Company wants to change its method of claiming depreciation from straight line method to written down value method.

Decide, how the depreciation should be disclosed in the Financial Statement for the year ended 31.3.2005.

(e) How refund of revenue grant received from the Government is disclosed in the Financial Statements? (4 Marks each) (PE-II – Nov. 2005)

Answer

(a) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of Rs. 10 lakhs according to para 8 of AS 4.

(b) It is given that revision of wages took place in June, 2004 with retrospective effect from 1.4.2000. The arrear wages payable for the period from 1.4.2000 to 30.6.2004 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs. 87 lakhs (from 1.4.2000 to 30.6.2004) should be included in current year's wages.

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

However, wages payable for the current year (from 1.4.2004 to 30.6.2004) amounting Rs. 7 lakhs is not a prior period item, hence need not be disclosed separately. This may be shown as current year wages.

(c) AS 26 'Intangible Assets', came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature. Para 67 of the standard provides that if there is persuasive evidence that the life of the intangible asset is 20 years, then no adjustment is required at 1.4.2003. However, para 63 of the standard states that if it cannot be demonstrated that the life of the intangible asset is greater than 10 years, then

AS 26 would require the asset to be amortised over not more than 10 years. Since, in the given case, the amortisation period determined by applying para 63 has already expired as on 1.4.2003, the carrying amount of Rs. 16 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1.4.2003.

(d) As per para 21 of AS 26 'Intangible Assets', when a change in the method of depreciation is made, depreciation should be calculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation should be adjusted in the accounts in the year in which the method of depreciation is changed. The deficiency should be charged to profit and loss account. Similarly, any surplus should be credited in the statement of profit and loss. Such change is a change in the accounting policy, and its effect should be quantified and disclosed.

In the given case, the deficiency of Rs. 500 lakhs would be charged to the profit and loss account of 31.3.2005. In the notes to account, the fact of change in method of depreciation should be elaborated along with the effect of Rs. 500 lakhs. The current depreciation charge of 200 lakhs determined in accordance with the written down value method should be debited to the profit and loss account.

(e) The amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

Question 21

(a) *X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2005. Till March, 2006, 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 31.3.2006.*

(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 31.3.2006, 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, 2004. The Company incurred Rs.20 lakhs towards Research and Development expenses upto 31st March, 2006. 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.

(4 Marks each) (PE-II May 2006)

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 $\times$ 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 make 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, 2006.

Question 22

(a) What are the costs that are to be included in Research and Development costs as per AS 8.

(b) The Company reviewed an actuarial valuation for the first time for its Pension Scheme, which revalued a surplus of Rs.12 lacs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs.4 lacs instead of Rs.10 lacs. The average remaining life of the employees, if estimated to be 6 years, you are required to advise the Company considering the accounting standards 5 and 15.

(c) X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at Rs.10 lacs to another company for Rs.15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.

(d) Define related party transaction under AS 18. (4 Marks each) (PE-II- Nov. 2006)

Answer

(a) According to paras 41 and 43 of AS 26*, **"**No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Examples of research costs are:

- Costs of activities aimed at obtaining new knowledge;
- Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- Costs of the search for alternatives for materials, devices, products, processes, systems or services; and
- Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

According to paras 45 and 46 of AS 26, "In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

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* AS 8 stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. Therefore the above answer has been given as per AS 26.

Examples of development activities/costs are:

- Costs of the design, construction and testing of pre-production or pre-use prototypes and models;
- Costs of the design of tools, jigs, moulds and dies involving new technology;
- Costs of the design, construction ad operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

(b) According to para 92 of AS 15 (Revised 2005) on "Employee Benefits", any actuarial gains and losses should be recognized immediately in the statement of profit and loss account as income or expense.

In the given case, the amount of surplus from pension scheme of Rs. 12 lacs is an actuarial gain, which should be recognized as income in the profit and loss account of the current year and not to be adjusted from the amount of annual contribution.

The surplus arising due to review of actuarial valuation of pension scheme by a company should be treated as a change in accounting policy and disclosed in accordance with AS 5(Revised).

(c) According to para 13 of AS 4 "Contingences and Events occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In this case the sale of immovable property was carried out before the closure of the books of Accounts. This is clearly an event occurring after the balance sheet date. Agreement to sell was effected before the balance sheet date and the registration was done after the balance sheet date. So the adjustment for the sale of immovable property is necessary in the books of account for the year ended 31st March, 2006.

(d) According to AS 18, "Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions."

A related party transaction involves a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Following are the examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- Purchases or sales of goods (finished or unfinished);
- Purchases or sales of fixed assets;
- Rendering or receiving of services;

- Agency arrangements;
- Leasing or hire purchase arrangements;
- Transfer of research and development;
- Licence agreements;
- Finance (including loans and equity contributions in cash or in kind);
- Guarantees and collateral etc.
- Management contracts including for deputation of employees.

Question 23

(a) What are the disclosure requirements of AS-7 (Revised)?

(b) How would you treat the Government grant received relating to a depreciable asset under the following cases as per AS-12?

Case i: Gross value of asset Rs.2 crores and Grant received Rs.20 lakhs only.

Case ii: Gross value of asset Rs.2 crores and Grant received Rs.2 crores.

(c) Explain the concept of actuarial valuation.

(d) What are the information that are to be disclosed in the financial statements as per AS-10? (4x4= 16 Marks) (PE II- May, 2007)

Answer

(a) According to paragraphs 38, 39 and 41 of AS 7, an enterprise should disclose:

(a) the amount of contract revenue recognized as revenue in the period;

(b) the methods used to determine the contract revenue recognized in the period; and

(c) the methods used to determine the stage of completion of contracts in progress.

In case of contract still in progress the following disclosures are required at the reporting date:

(a) the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; and

(c) the amount of retentions.

An enterprise should also present:

(a) the gross amount due from customers for contract work as an asset; and

(b) the gross amount due to customers for contract work as a liability.

(b) In accordance with AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value.

Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged.

Case i

Grant received amounting Rs.20 lakhs is required to be deducted from Rs.2 crores. The balance of Rs.1.80 crores to be shown as an assest in the Balance Sheet and depreciation should also be charged on Rs.1.80 crores.

Case ii

As the grant is received for the entire cost of the asset, the asset shall be recorded at a nominal value of Rs.100 in the Balance sheet so that the existence of the amount is reflected. No depreciation is to be charged in this case.

Note: Alternatively, in both the cases government grant may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(c) Actuarial valuation is the process used by an actuary* to estimate the present value of benefits to be paid under a retirement scheme and the present values of the scheme assets and, sometimes, of future contributions. In the case of defined benefit scheme the cost of retirement benefits, to be charged to Profit and Loss Account on year to year basis, is determined on actuarial basis. According to paragraph 65 of AS 15 (revised 2005), an enterprise should use the Projected Unit Credit**method to determine the present value of its defined benefit obligations and the related current service cost and, wherever applicable, past service cost.

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* Actuary is an expert person who can calculate the liability where the factors affecting the calculation of liability are uncertain and cannot be determined in ordinary course.

** Projected Unit Credit method (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build the final obligation.

(d) As per AS 10, the following information should be disclosed in the financial statements :

(i) gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements ;

(ii) expenditure incurred on account of fixed assets in the course of construction or acquisition ; and

(iii) revalued amount substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

Question 24

(a) Explain the treatment of Refund of Government Grants as per AS-12.

(b) The Company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2006 has included such charges in the valuation of closing stock. This being in the nature of interest, X Ltd. decided to exclude such charges from closing stock for the year 2006-07. This would result in decrease in profit by Rs.5 lakhs. Comment.

(c) The Board of Directors of X Ltd. decided on 31.3.2007 to increase sale price of certain items of goods sold retrospectively from 1st January, 2007. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2007 to 31.3.2007. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

(d) Briefly explain disclosure requirements for Investments as per AS-13.

(4x4 = 16 Marks)(PE II-Nov. 2007)

Answer

(a) As per para 11 of AS 12 'Accounting for Government Grants', government grant that becomes refundable is treated as an extraordinary item.

The amount refundable in respect of a government grant related to revenue is first applied against any unamortised deferred credit remaining in respect of the grant.

The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable.

Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

(b) As per para 12 of AS 2 (revised), interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are therefore, usually not included in the cost of inventories. However, X Ltd. was in practice to charge the cost for delay in cotton clearing in the closing stock. As X Ltd. decided to change this valuation procedure of closing stock, this treatment will be considered as a change in accounting policy and such fact to be disclosed as per AS 1. Therefore, any change in amount mentioned in financial statement, which will affect the financial position of the company should be disclosed properly as per AS 1, AS 2 and AS 5.

Also a note should be given in the annual accounts that, had the company followed earlier system of valuation of closing stock, the profit before tax would have been higher by Rs. 5 lakhs.

(c) As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2006-07, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

(d) The disclosure requirements as per para 35 of AS 13 are as follows:

(i) Accounting policies followed for valuation of investments.

(ii) Classification of investment into current and long term in addition to classification as per Schedule VI of Companies Act in case of company.

(iii) The amount included in profit and loss statements for

(a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;

(b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;

(c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises.

Question 25

*Answer any **four** of the following:*

(i) (a) X Ltd. purchased debentures of Rs.10 lacs of Y Ltd., which are traded in stock exchange. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 2008?

(b) Mr. Raj a relative of key management personnel received remuneration of Rs.2,50,000 for his services in the company for the period from 1.4.2007 to 30.6.2007. On 1.7.2007, he left the service.

Should the relative be identified as a related party at the closing date i.e., on 31.3.2008 for the purpose of AS 18?

(ii) A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	Rs.
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

(iii) (a) Wye Ltd. received Rs.50 lacs from the Central Government as subsidy for setting up an industry in backward area. How will you treat it in accounts?

(b) How Government grant relating to Specific Fixed Assets is treated in the books as per AS 12?

(iv) A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.

(v) In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is Rs.1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

(4 x 4= 16 Marks)(PEII-May, 2008)

Answer

(i) (a) As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments[1]. If investment, of Rs.10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

However, if investment of Rs.10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

(b) According to para 10 of AS 18 on 'Related Party Disclosures', parties are considered to be related if *at any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Here, Mr. Raj, who received remuneration of Rs.2,50,000 from the company, is the relative of the key management personnel of that company. And as per para 3 clause (d) of the Standard, 'key management personnel and relatives of such personnel' are said to be in related party relationships. Hence, Mr. Raj, a relative of key management personnel ,should be identified as related party at the closing date i.e. on 31.3.2008.

(ii) As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

(iii) (a) As per para 10 of AS 12 on 'Accounting for Government Grants', subsidy of Rs.50 lacs from the Central government, for setting up an industry in backward area is a government grant in the nature of promoter's contribution. Such grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

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[1] As per para 6 of AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition.

(b) According to para 8 of AS 12 on 'Accounting for Government Grants', two methods of presentation, in financial statements, of grants related to specific fixed assets are regarded as acceptable alternatives.

- Under one method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.
- Under the other method, grant related to depreciable asset is treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the assets. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account.

(iv) **Computation of earnings per share**

	Earnings	**Shares**	**Earnings per share**
Net profit for the year 2007-08	Rs.15,00,000		
Weighted average number of shares outstanding during year 2007-08		6,00,000	
Basic earnings per share			Rs. 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00	*	(60,000)	
Diluted earnings per share	Rs. 15,00,000	6,40,000	Rs. 2.34 (approx.)

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of the computation to have been issued for no consideration.

(v) As per para 13 of AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT.

The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to Rs.50,000 (50 MT × Rs.1,000) will be charged to the profit and loss statement.

Question 26

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2008:

Cash Flow Abstract

Inflows	***Rs.***	***Outflows***	***Rs.***
Opening balance:		*Payment to creditors*	*90,000*
Cash	*10,000*	*Salaries and wages*	*25,000*
Bank	*70,000*	*Payment of overheads*	*15,000*
Share capital – shares issued	*5,00,000*	*Fixed assets acquired*	*4,00,000*
Collection from Debtors	*3,50,000*	*Debentures redeemed*	*50,000*
Sale of fixed assets	*70,000*	*Bank loan repaid*	*2,50,000*
		Taxation	*55,000*
		Dividends	*1,00,000*
		Closing balance:	
		Cash	*5,000*
		bank	*10,000*
	10,00,000		*10,00,000*

Prepare Cash Flow Statement for the year ended 31st March, 2008 in accordance with Accounting standard – 3.

(8 Marks) (PE II- Nov. 2008)

Answer

Cash Flow Statement

for the year ended 31.3.2008

	Rs.	*Rs.*
Cash flow from operating activities		
Cash received from customers	3,50,000	
Cash paid to suppliers	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(55,000)	
Net cash from operating activities		1,65,000

Cash flow from investing activities		
Payment for purchase of fixed assets	(4,00,000)	
Proceeds from sale of fixed assets	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	
Dividends paid	(1,00,000)	
Net cash from financing activities		1,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 27

(a) *B Ltd. undertook a construction contract for Rs. 50 crores in April, 2007. the cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.*

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2008?

(b) *List any five related party transactions, which require disclosure as per AS 18.*

(c) *A Government grant of Rs. 25 lakhs received 3 years ago in respect of a machinery which costs Rs. 200 lakhs, became refundable in March, 2008.*

(i) *How the receipt of grant would have been recorded in the books of the recipient?*

(ii) *How the refund of grant would be reflected in the books, at the time of its refund?*

(d) *List the conditions to be fulfilled as per Accounting Standard 14 (AS 14) for an amalgamation to be in the nature of merger, in the case of companies.*

(e) *Discuss the treatment of exchange loss relating to fixed assets as per AS 11 vis – a – vis the Schedule VI disclosure under the Companies Act, 1956.*

(4 x 5 = 20 Marks) (PE II- Nov. 2008)

Answer

(a) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

(b) Five examples of related party transactions for which disclosure is required according to AS 18 are:

(i) Purchase and/or sales of goods (finished or unfinished)

(ii) Purchase or sale of fixed assets.

(iii) Rendering or receiving of services.

(iv) Agency arrangements.

(v) Leasing or hire purchase arrangements.

(c) The grant is shown as a deduction from the gross value of the asset. Depreciation on machinery would be charged on the reduced value of Rs.175 lakhs. Alternatively, the grant may be treated as deferred income which should be credited to profit and loss statement on a systematic and rational basis over the useful life of the asset.

As per para 21 of AS 12, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

(d) An amalgamation should be considered to be an amalgamation in the nature of merger if the following conditions are satisfied:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(e) Schedule VI to The Companies Act, 1956 provides that any increase or decrease in liability due to change in the rate of exchange relating to any fixed asset should be added to or deducted from the cost of the asset. The amount arrived at should be taken to be the cost of the fixed asset.

AS 11 (revised), however, does not require adjustment of exchange difference in the carrying amount of fixed assets. The exchange difference is required to be recognised in the statement of profit or loss since it is felt that this treatment is conceptually preferable to that required in Schedule VI and is in consonance with the international position in this regard.

The provisions of AS 11 will prevail over Schedule VI of the Companies Act. National Advisory Committee on Accounting Standards (NACAS) has notified AS 11 for preparation of financial statements of companies. ICAI has come up with the announcement in this regard, stating that after the notification of AS 11 by NACAS, AS 11 will overrule Schedule VI of the Companies Act.

9

COMPANY ACCOUNTS - II

UNIT 1 : UNDERWRITING OF SHARES AND DEBENTURES

(A) Write short notes on:

Question 1

“Firm” underwriting. Also give the accounting entries relating to firm underwriting in the books of: (i) the company, (ii) the underwriter *(5 Marks) (Intermediate–Nov. 1999)*

Answer

‘Firm’ underwriting signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter’s liability is determined without taking into account the number of shares taken up ‘firm’ by him, i.e. the underwriter is obliged to take up :

1. the number of shares he has applied for ‘firm’; and
2. the number of shares he is obliged to take up on the basis of the underwriting agreement.

For example, A underwrites 60% of an issue of 10,000 shares of Rs. 10 each of XY Co. Ltd. and also applies for 1,000 shares, ‘firm’. The underwriting commission is agreed to at the rate of 2.5 percent. In case there are marked applications for 4,800 shares, he will have to take up 2,200 shares, i.e. 1,000 shares for which he applied ‘firm’ and 1,200 shares to meet his liability of underwriting contract. If, on the other hand, the underwriting contract has provided that an abatement would be allowed in respect of shares taken up ‘firm’, the liability of A in the above-mentioned case would only be for 1,200 shares in total. The accounting entries in relation to firm underwriting of 1,000 shares in the above example are given below :

Entries in the books of XY Co. Ltd. (Company)

		Dr. *Rs.*	*Cr.* *Rs.*
1. A’s Account	Dr.	10,000	
To Equity Share Capital Account			10,000
(Being allotment of underwritten equity shares in pursuance of firm underwriting contract, vide Board’s resolution)			

2. Underwriting Commission on Issue of Shares Account	Dr.	250	
To A's Account			250
(Being underwriting commission due to the underwriter under the firm underwriting contract...)			
3. Bank Account	Dr.	9,750	
To A's Account			9,750
(Being money received in full settlement of account from underwriter)			

Entries in the books of A (Underwriter)

		Dr. *Rs.*	*Cr.* *Rs.*
1. Underwriting Account	Dr.	10,000	
To XY Co. Ltd. Account			10,000
(Being the liability to take up necessary number of shares of the company in pursuance of firm underwriting contract recorded)			
2. XY Co. Ltd. Account	Dr.	250	
To Underwriting Account			250
(Being underwriting commission income credited to underwriting account)			
3. XY Co. Ltd. Account	Dr.	9,750	
To Bank Account			9,750
(Being balance money paid to the company in full settlement of account)			

Question 2

Write a short note on Firm underwriting and Partial underwriting along with firm underwriting.

(4 marks) (PE – II–May 2004)

Answer

In firm underwriting the underwriter agrees to subscribe upto a certain number of shares/debentures irrespective of the nature of public response to issue of securities. He gets these securities even if the issue is fully subscribed or over-subscribed. These securities are taken by the underwriter in addition to his liability for securities not subscribed by the public. Under partial underwriting along with firm underwriting, unless otherwise agreed, individual underwriter does not get the benefit of firm underwriting in determination of number of shares/debentures to be taken up by him.

(B) Practical Questions:

Question 1

Noman Ltd. issued 80,000 Equity Shares which were underwritten as follows:

Mr. A	*48,000 Equity Shares*
Messrs B & Co.	*20,000 Equity Shares*
Messrs C Corp.	*12,000 Eqiuty Shares*

The above mentioned underwriters made applications for 'firm' underwritings as follows:

Mr. A	*6,400 Equity Shares*
Messrs B & Co.	*8,000 Equity Shares*
Messrs C Corp.	*2,400 Equity Shares*

The total applications excluding 'firm' underwriting, but including marked applications were for 40,000 Equity Shares.

The marked Applications were as under:

Mr. A	*8,000 Equity Shares*
Messrs B & Co.	*10,000 Equity Shares*
Messrs C Corp.	*4,000 Equity Shares*

(The underwriting contracts provide that underwriters be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten)

You are required to show the allocation of liability. Workings will be considered as a part of your answer. *(12 Marks) (Intermediate–Nov. 1997)*

Answer

Noman Ltd.
Statement showing Liability of Underwriters

	Mr. A	*M/s. B & Co.*	*C Corpn.*	*Total*
Gross Liability (No. of shares)	48,000	20,000	12,000	80,000
Unmarked Applications* (Ratio 48:20:12)	10,800	4,500	2,700	18,000
	37,200	15,500	9,300	62,000
Marked Applications	8,000	10,000	4,000	22,000
	29,200	5,500	5,300	40,000
Firm underwriting	6,400	8,000	2,400	16,800
Balance to be taken under the contract	22,800	-2,500	2,900	23,200

Credit for excess of				
B & Co. (ratio 48 : 12)	2,000	2,500	500	
Net Liability	20,800		2,400	
Add: Firm Underwriting	6,400	8,000	2,400	16,800
Total Liability	27,200	8,000	4,800	40,000

Working Note :

* Total Applications	40,000	Shares
Marked Applications	22,000	Shares
Unmarked applications	18,000	Shares

Question 2

A joint stock company resolved to issue 10 lakh equity shares of Rs. 10 each at a premium of Re. 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows :

X 30,000 shares, Y 20,000 shares and Z 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares.

Unmarked applications totalled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to :

(i) Prepare a statements calculating underwriters' liability for shares other than shares underwritten firm.

(ii) Pass journal entries for all the transactions including cash transactions.

(16 marks) (Intermediate–May 2001)

Answer

(i) Statement showing underwriters' liability for shares other than shares underwritten firm

	X	*Y*	*Z*	*Total*
Gross liability	5,85,000	2,25,000	90,000	9,00,000
(9,00,000 shares in the ratio of 65 : 25 : 10)				
Less : Marked applications	1,19,500	57,500	10,500	1,87,500
	4,65,500	1,67,500	79,500	7,12,000

Less : Allocation of unmarked applications (including firm underwriting i.e. 7,00,000) in the ratio 65 : 25 : 10	4,55,000	1,75,000	70,000	7,00,000
	10,500	(7,500)	9,500	12,500
Surplus of Y allocated to X and Z in the ratio 65 : 10	(6,500)	7,500	(1,000)	–
	4,000	–	8,500	12,500
	Rs.	*Rs.*	*Rs.*	
Liability amount @ Rs. 11	44,000	–	93,500	
Underwriting commission payable (Gross liability × Rs. 11 × 2%)	1,28,700	49,500	19,800	
Net Amount payable	84,700	49,500		
Net Amount receivable			73,700	

(ii) **Journal Entries**

		Dr.	*Cr.*
Bank A/c	Dr.	11,00,000	
To Equity Shares Application A/c			11,00,000
(Being application money received on 1 lakh equity shares @ Rs. 11 per share)			
Bank A/c	Dr.	97,62,500	
To Equity Share Application A/c			97,62,500
(Application money received on 8,87,500 equity shares @ Rs. 11 per share from general public and underwriters for shares underwritten firm)			
Equity Share Application A/c	Dr.	1,08,62,500	
X' s A/c	Dr.	44,000	
Z' s A/c	Dr.	93,500	
To Equity Share Capital A/c			1,00,00,000
To Securities Premium A/c			10,00,000
(Allotment of 10 lakh equity shares of Rs. 10 each at a premium of Re. 1 per share)			

Underwriting commission A/c	Dr.	1,98,000	
To X's A/c			1,28,700
To Y's A/c			49,500
To Z's A/c			19,800
(Amount of underwriting commission payable to X, Y and Z @2% on the amount of shares underwritten)			
Bank A/c	Dr.	73,700	
To Z's A/c			73,700
(Amount received from Z in final settlement)			
X's A/c	Dr.	84,700	
Y's A/c	Dr.	49,500	
To Bank A/c			1,34,200
(Amount paid to X and Y in final settlement)			

Question 3

Scorpio Ltd. came out with an issue of 45,00,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co; B & Co. and C & Co.

Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below:

A & Co.		*7,25,000 shares*
B & Co.		*8,40,000 shares*
C & Co.		*13,10,000 shares*
	Total	*28,75,000 shares*

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid alongwith application. You are required to:

(a) Compute the underwriters liability (number of shares)

(b) Compute the amounts payable or due to underwriters; and

(c) Pass necessary journal entries in the books of Scorpio Ltd. relating to underwriting.

(16 Marks) (PE-II – Nov. 2005)

Answer

(a) Computation of liabilities of underwriters (No. of shares):

	A & Co.	B & Co.	C & Co.
Gross liability	12,00,000	12,00,000	12,00,000
Less: Firm underwriting	1,00,000	1,00,000	1,00,000
	11,00,000	11,00,000	11,00,000
Less: Marked applications	7,25,000	8,40,000	13,10,000
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked applications distributed to A & Co. and B & Co. in equal ratio	1,12,500	1,12,500	Nil
	2,62,500	1,47,500	(2,10,000)
Less: Surplus of C & Co. distributed to A & Co. and B & Co. in equal ratio	1,05,000	1,05,000	2,10,000
Net liability (excluding firm underwriting)	1,57,500	42,500	Nil
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (No. of shares)	2,57,500	1,42,500	1,00,000

(b) Computation of amounts payable by underwriters:

Liability towards shares to be subscribed @ 12 per share	30,90,000	17,10,000	12,00,000
Less: Commission (5% on 12 lakhs shares @ 10 each)	6,00,000	6,00,000	6,00,000
Net amount to be paid by underwriters	24,90,000	11,10,000	6,00,000

(c)

In the Books of Scorpio Ltd.

Journal Entries

Particulars		*Dr.* *Rs.*	*Cr.* *Rs.*
Underwriting commission A/c	Dr.	18,00,000	
To A & Co. A/c			6,00,000
To B & Co. A/c			6,00,000
To C & Co. A/c			6,00,000
(Being underwriting commission on the shares underwritten)			

A & Co. A/c	Dr.	30,90,000	
B & Co. A/c	Dr.	17,10,000	
C & Co. A/c	Dr.	12,00,000	
To Equity share capital A/c			50,00,000
To Share premium A/c			10,00,000
(Being shares including firm underwritten shares allotted to underwriters)			
Bank A/c	Dr.	42,00,000	
To A & Co. A/c			24,90,000
To B & Co. A/c			11,10,000
To C & Co. A/c			6,00,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)			

Question 4

Gemini Ltd. came up with public issue of 30,00,000 Equity shares of Rs. 10 each at Rs. 15 per share. A, B and C took underwriting of the issue in 3 : 2 : 1 ratio.

Applications were received for 27,00,000 shares.

The marked applications were received as under:

A	8,00,000 shares
B	7,00,000 shares
C	6,00,000 shares

Commission payable to underwriters is at 5% on the face value of shares.

(i) Compute the liability of each underwriter as regards the number of shares to be taken up.

(ii) Pass journal entries in the books of Gemini Ltd. to record the transactions relating to underwriters. *(8 Marks)(PE II- Nov. 2008)*

Answer

(i) **Computation of liability of underwriters in respect of shares**

(In shares)

	A	*B*	*C*
Gross liability	15,00,000	10,00,000	5,00,000
Less: Unmarked applications	3,00,000	2,00,000	1,00,000
	12,00,000	8,00,000	4,00,000

Less: Marked applications	8,00,000	7,00,000	6,00,000
	4,00,000	1,00,000	(2,00,000)
Surplus of C distributed to A & B in 3:2 ratio	1,20,000	80,000	2,00,000
Net liability	2,80,000	20,000	Nil

(ii) Journal Entries in the books of Gemini Ltd.

		Rs.	*Rs.*
A's Account	Dr.	42,00,000	
B's Account	Dr.	3,00,000	
To Share Capital Account			30,00,000
To Securities Premium Account			15,00,000
(Being the shares to be taken up by the underwriters)			
Underwriting Commission Account	Dr.	15,00,000	
To A's Account			7,50,000
To B's Account			5,00,000
To C's Account			2,50,000
(Being the underwriting commission due to the underwriters)			
Bank Account	Dr.	34,50,000	
To A's Account			34,50,000
(Being the amount received from underwriter A for the shares taken up by him after adjustment of his commission)			
B's Account	Dr.	2,00,000	
To Bank Account			2,00,000
(Being the amount paid to underwriter B after adjustment of the shares taken by him against underwriting commission due to him)			
C's Account	Dr.	2,50,000	
To Bank Account			2,50,000
(Being the underwriting commission paid to C)			

UNIT 2 AND 3 : ACCOUNTING FOR BUSINESS ACQUISITIONS AND ACCOUNTING REPORTS

(A) Practical Questions:

Question 1

P Ltd. was incorporated on 1.4.99 with an authorised capital of Rs. 5,00,000 divided into equity shares of Rs. 10 each. It tookover the business of P on the basis of following valuation :

	Rs.
Goodwill	20,000
Plant	80,000
Stock	15,000
Debtors	30,000
Cash	5,000
Creditors	8,000

(a) Purchase consideration was satisfied by issue of equity shares of Rs. 10 at par.

(b) Preliminary expenses paid by the company Rs. 8,000.

(c) 20,000 shares were issued to Public at Rs. 12 each. The shares were fully subscribed and paid up. In addition to the above, the following further balances arise in the books as on 31.3.2000:

	Rs.		Rs.
Purchases	3,00,000	Branch Suspense (Cr.)	14,000
Sales	5,20,000	Bank	1,30,000
Salaries	60,000	Ramprakash (Suspense) (Dr.)	30,000
Other Expenses	20,000	Gulati (Suspense) (Cr.)	25,000
Debtors	92,000	Closing stock	20,000
Building	1,75,000	Creditors	18,000

The following information is also to be considered :

(1) Ramprakash Suspense A/c represents Rs. 30,000 paid to him for a joint venture business. In addition to the above, Ramprakash spent personally Rs. 20,000 for purchase of goods and Rs. 2,500 for expenses. Sales made by him were Rs. 70,000 and the balance stock was taken over by him at an agreed valuation of Rs. 2,500. Ramprakash is to get 2/5 of the profit.

(2) Gulati's Suspense represents advance made by him against a consignment of 10 TV sets, costing Rs. 10,000 each to be priced 35% over cost. Gulati is to get 15% commission on sales. Gulati has incurred Rs. 5,000 as transportation charges and has sold 8 TV sets. No entry was passed on sending the goods.

(3) Sales include the following :

(a) Goods sold on "Sale or Return" basis—Cost Rs. 30,000 on which 25% profit was charged. The goods have not yet been accepted by the customer.

(b) Hire-purchase sales Rs. 50,000; prices being determined by adding $33\frac{1}{3}\%$ *on cost price. 30% of instalments have not yet fallen due.*

(c) Goods sent to branch Rs. 30,000 (Invoice Price) at 25% profit on Cost price. Remittance received from branch has been credited to Branch Suspense Account. Branch returns disclose that branch had Rs. 10,000 closing stock (invoice price), Rs. 500 in cash and Rs. 7,500 in debtors.

(4) Bank balance given above is not in agreement with the balance as per bank statement. Cheques deposited Rs. 10,000 and cheques issued for Rs. 8,000 have not been recorded in the bank statement; Rs. 15,000 cheque dishonoured by a party and bank charges of Rs. 700 have not yet been entered in cash-book.

(5) Provide 5% depreciation on building, 40% for taxation and 15% dividend. Transfer Rs. 20,000 to General Reserve.

(6) All purchases and sales transactions were on credit.

Prepare Balance Sheet as at 31st March, 2000 and Profit & Loss Account for the year ended 31st March, 2000. (20 marks) (Intermediate–Nov. 2000)

Answer

Profit and Loss Account of P Ltd.

for the year ended as at 31st March, 2000

	Rs.			*Rs.*
To Stock (taken over)	15,000	By Sales		4,37,500
To Purchases	3,00,000	By Goods sent to branch		24,000
To Gross profit c/d	3,34,000	By Goods sent on hire purchase		37,500
		By Goods sent on consignment		1,00,000
		By Closing stock	20,000	
		Add : Goods sent on		
		sale or return basis	30,000	50,000
	6,49,000			6,49,000
To Salaries	60,000	By Gross profit b/d		3,34,000
To Expenses	20,000	By Profit on:		
To Bank charges	700	Joint venture		12,000
To Depreciation on building		Hire purchase		8,750

(5% on Rs. 1,75,000)	8,750	Consignment	7,800
To Provision for taxation	1,11,640	Branch	6,000
(40% of Rs. 2,79,100)			
To Net profit c/d	1,67,460		
	3,68,550		3,68,550
To Proposed dividend	51,300	By Net profit b/d	1,67,460
To General Reserve	20,000		
To Net profit c/d	96,160		
	1,67,460		1,67,460

Balance Sheet of P Ltd.
as at 31st March, 2000

	Rs.			Rs.
Share capital		*Fixed Assets*		
Authorised		Goodwill		20,000
50,000 Equity shares of		Building	1,75,000	
Rs. 10 each, fully paid up	5,00,000	*Less:* Depreciation	8,750	1,66,250
Issued & subscribed:		Plant		80,000
34,200 Equity shares of		*Current assets loans and advances*		
Rs. 10 each, fully paid up	3,42,000	*Current assets :*		
(Out of these shares, 14,200		Closing stock		
shares have been allotted as		Stock in hand	20,000	
fully paid up for consideration		Goods sent on		
other than cash)		approval basis	30,000	
Reserves and surplus:		Hire purchase stock	11,250	
Securities premium	40,000	Consignment stock	21,000	
General reserve	20,000	Branch stock	8,000	90,250
Profit and loss account	96,160	Sundry debtors	24,500	
Current liabilities and Provisions		*Add :* Branch debtors	7,500	32,000
Current liabilities :		Bank		1,14,300
Sundry creditors	18,000	Cash in hand	64,000	
Provisions :		Cash at branch	500	64,500

Provision for taxation	1,11,640	Gulati's account	61,800
Proposed dividend	51,300	Ramprakash's account	42,000
		Miscellaneous expenditure	
		Preliminary expenses	8,000
	6,79,100		6,79,100

Working Notes :

(1) **Sales Account**

		Rs.		Rs.
To Sundry Debtors A/c-			By Balance b/d (given)	5,20,000
Goods sold on sale or return basis $\left[30,000 \times \frac{125}{100}\right]$		37,500		
To Sundry Debtors A/c				
Hire purchase sales	15,000			
To Sundry Debtors A/c-				
Goods sent to branch,	30,000			
To Profit & Loss A/c	4,37,500			
	5,20,000			5,20,000

(2) **Memorandum Debtors Account**

	Rs.		Rs.
To P (Debtors taken over)	30,000	By Cash	4,78,000
To Sales	4,37,500	By Balance c/d	24,500
To Hire purchase sales	35,000		
	5,02,500		5,02,500

(3) **Sundry Debtors Account**

	Rs.		Rs.
To Balance b/d	92,000	By Sales A/c	
To Bank A/c (cheque dishonoured)	15,000	(Goods sold on sale or return basis)	37,500
		By Sales A/c-	
		H.P. Sales	15,000
		Goods sent to branch	30,000
		By Balance c/d	24,500
	1,07,000		1,07,000

(4) **Branch Account**

	Rs.		Rs.
To Goods sent to Branch A/c	24,000	By Branch Suspense A/c	14,000
To Profit & Loss A/c	6,000	By Balance c/d-	
		Stock $\left[10{,}000 \times \frac{100}{125}\right]$	8,000
		Cash	500
		Debtors	7,500
	30,000		30,000

(5) **H.P. Trading Account**

	Rs.		Rs.
To Goods sent on H.P.		By H.P. Sales	35,000
$\left[50{,}000 \times \frac{3}{4}\right]$	37, 500	By H.P. Stock	11,250
To Profit on H.P.			
$\left[35{,}000 \times \frac{1}{4}\right]$	8,750		
	46,250		46,250

(6) **Memorandum Joint Venture Account**

	Rs.		Rs.
To Ram Prakash Suspense A/c	30,000	By Ram Prakash A/c-	
To Ram Prakash A/c (Purchases)	20,000	Sales	70,000
To Ram Prakash A/c (Expenses)	2,500	Stock taken over	2,500
To Share of Profits-			
P & L A/c (3/5)	12,000		
Ram Prakash (2/5)	8,000		
	72,500		72,500

(7) **Ram Prakash's Account**

	Rs.		Rs.
To Mem. Joint Venture A/c-		By Mem. Joint Venture A/c-	
Sales	70,000	Purchases	20,000
Stock taken over	2,500	Expenses	2,500
		Profits share	8,000
		By Balance c/d	42,000
	72,500		72,500

(8) **Consignment Account**

	Rs.		Rs.
To Goods sent on consignment A/c (10 × 10,000)	1,00,000	By Gulati A/c (Sales)	1,08,000
To Gulati A/c (Expenses)	5,000	By Consignment Stock (2 × 10,000) = 20,000	
To Gulati A/c (Commission) (1,08,000 × 15%)	16,200	*Add :* Expenses $\left[5{,}000 \times \frac{2{,}000}{10{,}000}\right]$ = 1,000	21,000
To Profit & Loss A/c	7,800		
	1,29,000		1,29,000

(9) **Gulati's Account**

	Rs.		Rs.
To Consignment A/c $\left[8 \times 10{,}000 \times \frac{135}{100}\right]$	1,08,000	By Gulati Suspense A/c	25,000
		By Consignment A/c-	
		Expenses	5,000
		Commission	16,200
		By Balance c/d	61,800
	1,08,000		1,08,000

(10) **Sundry Creditors Account**

	Rs.		Rs.
To Cash A/c	2,90,000	By P (Creditors taken over)	8,000
To Balance c/d	18,000	By Purchases A/c	3,00,000
	3,08,000		3,08,000

(11) **Cash and Bank Account**

	Rs.		Rs.
To P A/c (Cash taken over)	5,000	By Creditors A/c	2,90,000
To Memorandum Debtors A/c	4,78,000	By Salaries A/c	60,000
To Sundry Debtors A/c	15,000	By Other Expenses A/c	20,000
To Share Capital A/c	2,00,000	By Ram Prakash Suspense A/c	30,000
To Securities Premium A/c	40,000	By Building A/c	1,75,000
To Gulati Suspense A/c	25,000	By Preliminary Expenses A/c	8,000
To Branch Suspense A/c	14,000	By Balance c/d-	

		Bank (given)	1,30,000
		Cash (balance)	64,000
	7,77,000		7,77,000

(12) **Bank Account**

	Rs.		Rs.
To Balance b/d	1,30,000	By Bank ChargesA/c	700
		By Sundry Debtors A/c (Cheque dishonoured)	15,000
		By Balance c/d	1,14,300
	1,30,000		1,30,000

(13) **Calculation of purchase consideration**

	Rs.	Rs.
Assets taken over :		
Goodwill	20,000	
Plant	80,000	
Stock	15,000	
Debtors	30,000	
Cash	5,000	1,50,000
Less : Creditors		8,000
Net assets taken over		1,42,000

Purchase consideration will be discharged by issue of 14,200 equity shares of Rs. 10 each.

Notes :

1. The rate of depreciation for Plant has not been given in the question, therefore, no depreciation has been provided on Plant. Students may assume any suitable rate of depreciation and provide for accordingly.
2. Sundry Debtors Account and Memorandum Debtors Account can be combined also.
3. The provision for corporate dividend tax has been ignored.

Question 2

Megabyte Ltd. was incorporated on 1st April, 1999 to take over the running business of Mr. X.

The purchase consideration was satisfied by allotment of:

(i) 20,000 equity shares of Rs. 10 each at par.

(ii) 10,000 10% Redeemable Preference shares of Rs. 10 each at par, redeemable on 31.3.2006.

(iii) Rs. 50,000 paid in cash.

The company issued a prospectus for raising capital by issue of 30,000 equity shares of Rs. 10 each, at par and 15,000, 10% Redeemable preference shares of Rs. 10 each, at par. The entire amount in respect of the issue was received by 30th June, 1999 except final call of Rs. 2.50 per share on 1,000 shares issued to Mr. Y, a director. Underwriting Commission @ 2% on equity shares and @ 3% on preference shares were paid to a merchant banker.

The preliminary expenses were estimated at Rs. 50,000 in the prospectus but the actual expenses incurred were as under :

	Rs.	
Solicitor's fee	*10,000*	
Printing of memorandum	*15,000*	*(of which Rs. 5,000 remained unpaid)*
Stamping and registration	*20,000*	
Advertisement expenses	*30,000*	

The company purchased a plot of land for Rs. 75,000. Further, it advanced Rs. 1,00,000 for construction of office building and Rs. 1,50,000 to a supplier, being 40% of contract price for supply of machinery. A part of the investments taken over from Mr. X was sold for Rs. 50,000 (Rs. 5,000 in excess of their book value).

Prepare a Receipts and Payments Account and other relevant financial information to be included in the Statutory Report pursuant to Section 165 of the Companies Act, 1956 in respect of Megabyte Ltd. made upto 30th June, 1999. (15 marks) (Intermediate–May 2000)

Answer

Extracts from the Statuory Report of Megabyte Ltd.
(Pursuant to Section 165)
Receipts and Payments Account upto 30th June, 1999

Receipts	*Rs.*	*Payments*			*Rs.*
Shares:		Vendor (Mr. X)			50,000
Equity shares		Preliminary expenses:			
(Rs. 3,00,000 – Rs. 2,500)	2,97,500	Underwriting commission			
10% Redeemable preference		Equity shares	6,000		
shares	1,50,000	Preference shares	4,500	10,500	
Investments	50,000	Solicitor's fees		10,000	
		Printing of memorandum		10,000	
		Stamping and registration		20,000	
		Advertisement		30,000	80,500
		Capital expenditure:			
		Land			75,000
		Building (advance)			1,00,000
		Machinery (advance)			1,50,000
		Balance			42,000
	4,97,500				4,97,500

Financial information for inclusion in the Statutory Report

1. Shares allotted

(a) Allotted subject to payment thereof in cash

	No. of shares	*Nominal value of each share*	*Amount received upto 30.6.1999*
		Rs.	*Rs.*
Equity shares	30,000	10	2,97,500
10% Redeemable preference shares	15,000	10	1,50,000

(b) Allotted as fully paid-up otherwise than in cash (to vendor, Mr. X for purchase of his running business)

Equity shares	20,000	10	2,00,000
10% Redeemable preference shares	10,000	10	1,00,000

2. Preliminary expenses

	Preliminary expenses actually incurred up to 30.6.1999
	Rs.
Solicitor's fee	10,000
Printing of memorandum	15,000
Stamping and registration	20,000
Advertisement expenses	30,000
	75,000

Preliminary expenses as estimated in the prospectus was Rs. 50,000.

3. Particulars of contracts

The company has advanced Rs. 1,00,000 for construction of office building.

The company has entered into a contract for supply of machinery costing Rs. 3,75,000 against which a sum of Rs. 1,50,000 has been advanced, being 40% of contract price.

4. The arrears due on calls from directors

Name of director	*Amount due*
	Rs.
Mr. Y	2,500

Question 3

Emergent Ltd. was incorporated on 1st April, 2002 to take over the running business of Mr. A.

The purchase consideration was satisfied by allotment of:

(i) 15,000 equity shares of Rs. 10 each issued at a premium of Rs. 2 per share.

(ii) 12,000 10% Redeemable preference shares of Rs. 10 each at par, redeemable on 31.3.2007.

(iii) Rs. 70,000 paid in cash.

The company issued a Prospectus for issuing 50,000 equity shares of Rs. 10 each, at a premium of Rs. 2 per share and 20,000 10% Redeemable Preference shares of Rs. 10 each, at par. The entire amount in respect of the issue was received by 30th June, 2002 except final call of Rs. 3 per share on 2,500 shares issued to Mr. X, a director. Underwriting commission @ 2.5% on nominal value of equity shares and @ 3% on preference shares were paid to a merchant banker.

The preliminary expenses were estimated at Rs. 75,000 in the prospectus but the actual expenses incurred was as under:

	Rs.
Solicitor's fee	*– 15,000*
Printing of memorandum	*– 20,000 (Rs. 10,000 remaining unpaid)*
Stamping and registration	*– 25,000*
Advertisement expenses	*– 30,000*

The company purchased a plot of land for Rs. 1,00,000. Further, it advanced Rs. 2,50,000 for construction of office building and Rs. 3,50,000 to a supplier, being 35% of contract price for supply of machinery. A part of the investments taken over from Mr. A was sold for Rs. 80,000 (Rs. 5,000 in excess of their book value).

Prepare a Receipts and Payments Account and other relevant financial information to be included in the Statutory Report pursuant to Section 165 of the Companies Act, 1956 in respect of Emergent Ltd. made up to 30th June, 2002. (16 marks) (PE-II–May 2003)

Answer

Extracts from the Statutory Report of Emergent Ltd.
(Pursuant to Section 165 of the Companies Act)
Receipts and Payments Account up to 30th June, 2002

Receipts	*Rs.*	*Payments*	*Rs.*	*Rs.*	*Rs.*
Shares:		Vendor (Mr. A)			70,000
Equity Shares	5,92,500	Preliminary expenses:			
(Rs. 6,00,000 – Rs. 7,500)		Underwriting commission –			

10% Redeemable preference shares	2,00,000	Equity Shares	12,500		
		Preference Shares	6,000	18,500	
Investments	80,000	Solicitor's fee		15,000	
		Printing of memorandum		10,000	
		Stamping and registration		25,000	
		Advertisement expenses		30,000	98,500
		Capital Expenditure:			
		Land			1,00,000
		Building (advance)			2,50,000
		Machinery (advance)			3,50,000
		Cash and bank balance			4,000
	8,72,500				8,72,500

Financial information for inclusion in the Statutory Report

1. Shares allotted

(a) Allotted subject to payment thereof in cash.

	No. of shares	*Nominal value of each share Rs.*	*Premium Rs.*	*Amount received upto 30.06.2002 Rs.*
Equity shares	50,000	10	2	5,92,500
10% Redeemable preference shares	20,000	10		2,00,000

(b) Allotted as fully paid-up otherwise than in cash (to vendor Mr. A for purchase of running business)

Equity shares	15,000	10	2	1,80,000
10% Redeemable preference shares	12,000	10		1,20,000

2. Preliminary expenses actually incurred upto 30.06.2002

	Rs.
Solicitor's fee	15,000
Printing of Memorandum	20,000
Stamping and Registration	25,000
Advertisement expenses	30,000
	90,000

Preliminary expenses as estimated in the Prospectus – Rs. 75,000.

3. Particulars of contracts

   The company has advanced Rs. 2,50,000 for construction of office building.

   The company has entered into a contract for supply of machinery costing Rs. 10,00,000 against which a sum of Rs. 3,50,000 has been advanced, being 35% of contract price.

4. The arrears due on calls from directors

Name of director	Amount due (Rs.)
Mr. X	7,500

UNIT 4 : AMALGAMATION AND RECONSTRUCTION

(A) Write short notes on :

Question 1

Amalgamation and Absorption of companies—a comparison.(3 marks)(Intermediate–Nov. 1994)

Answer

In accounting parlance, amalgamation means merger of two or more companies into one new or existing company. Absorption, on the other hand, refers to acqusition of business of one company by another company. But it may be noted that the Companies Act, 1956 does not make any distinction between amalgamation and absorption. Infact, the Companies Act, 1956 does not properly define the terms amalgamation and absorption. But Sections 394 and 396 of the Act prescribe the procedure for amalgamation. The Income-tax Act, 1961, however, defines the term amalgamation to mean "the merger of one or more companies with another company or the merger of two or more companies to form one company". Therefore, it seems that legally there is no difference between amalgamation and absorption of companies. According to the Accounting Standard 14, "Accounting for Amalgamations", amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine pooling not merely of the assets and liabilities of the two companies but also of the shareholders' interests and of the businesses of these companies. Such amalgamations are kn54own as "amalgamation in the nature of merger". The second type of amalgamations are those which are in effect a mode by which one company acquires another company and as a consequence the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company or the business of the company which is acquired is not intended to be continued. Such amalgamations are known as "amalgamation in the nature of purchase." Therefore, it can be said that amalgamations include absorption.

Question 2

Pooling of interests method of amalgamation. (5 marks)(Intermediate–May 1997

Answer

Pooling of interests method of accounting for amalgamation records amalgamation transactions as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only the minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

Under the pooling of interests methods the assets, liabilities and reserves of the transferor company will be taken over by the transferee company at existing carrying amounts unless any adjustment is required due to difference in accounting policies. As a result, the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) by the transferee company and the amount of share capital of transferor company should be adjusted in reserves. At the time of amalgamation, if the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation.

Question 3

What are the conditions, which, according to AS 14 on Accounting for Amalgamations, must be satisfied for an amalgamation in the nature of merger?

(4 Marks) (Intermediate–May 2001 and PE-II – Nov. 2006)

Answer

According to AS 14 on Accounting for Amalgamations; the following conditions must be satisfied for an *amalgamation in the nature of merger :*

(i) All the assets and liabilties of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(vi) All reserves & surplus of the transferor company shall be preserved by the transferee company.

If any one of the condition is not satisfied in a process of amalgamation, it cannot be treated as amalgamation in the nature of merger.

Question 4

Distinguish between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation. *(4 marks) (Intermediate–May 2002)*

Answer

The following are the points of distinction between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation :

(i) The pooling of interests method is applied in case of an amalgamation in the nature of merger whereas purchase method is applied in the case of an amalgamation in the nature of purchase.

(ii) In the pooling of interests method all the reserves of the transferor company are also recorded by the transferee company in its books of account while in the purchase method the transferee company records in its books of account only the assets and liabilities taken over, the reserves, except the statutory reserves, of the transferor company are not aggregated with those of the transferee company.

(iii) Under the pooling of interests method, the difference between the consideration paid and the share capital of the transferor company is adjusted in the general reserve or other reserves of the transferee company. Under the purchase method, the difference between the consideration and net assets taken over is treated by the transferee company as goodwill or capital reserve.

(iv) Under the pooling of interests method, the statutory reserves are recorded by the transferee company like all other reserves without opening amalgamation adjustment account. In the purchase method, while incorporating statutory reserves the transferee company has to open amalgamation adjustment account debiting it with the amount of the statutory reserves being incorporated.

(B) Practical Questions:

Question 1

The paid-up capital of Toy Ltd. amounted to Rs. 2,50,000 consisting of 25,000 equity shares of Rs. 10 each.

Due to losses incurred by the company continuously, the directors of the company prepared a scheme for reconstruction which was duly approved by the court. The terms of reconstruction were as under:

(i) In lieu of their present holdings, the shareholders are to receive:

(a) Fully paid equity shares equal to 2/5th of their holding.

(b) 5% preference shares fully paid-up to the extent of 20% of the above new equity shares.

(c) 3,000 6% second debentures of Rs. 10 each.

(ii) An issue of 2,500 5% first debentures of Rs. 10 each was made and fully subscribed in cash.

(iii) The assets were reduced as follows:

(a) Goodwill from Rs. 1,50,000 to Rs. 75,000.

(b) Machinery from Rs. 50,000 to Rs. 37,500.

(c) Leasehold premises from Rs. 75,000 to Rs. 62,500.

Show the journal entries to give effect to the above scheme of recontrsuction.

(10 marks) (Intermediate–Nov. 1995)

Answer

Journal Entires

		Rs.	Rs.
Share Capital A/c (old)	Dr.	2,50,000	
To Equity Share Capital A/c			
($\frac{2}{5}$ of Rs. 2,50,000)			1,00,000
To 5% Preference Share Capital A/c			

$(\frac{20}{100}$ × Rs. 1,00,000)			20,000
To 6% Second Debntures A/c			30,000
To Capital Reduction A/c			1,00,000
(Conversion of 25,000 Equity Shares and balance being transferred to Capital Reduction A/c in accordance with the Scheme of internal reconstruction as per Special Resolution dated..........as confirmed by the Court Order dated........)			
Bank A/c	Dr.	25,000	
To 5% First Debenture A/c			25,000
(Issue of Rs. 25,000 5% First Debentures for cash as per scheme of internal reconstruction)			
Capital Reduction A/c	Dr.	1,00,000	
To Goodwill A/c			75,000
To Plant & Machinery A/c			12,500
To Leasehold premises A/c			12,500
(Sundry Assets written down as per scheme of internal reconstruction			

Question 2

Star and Moon had been carrying on business independently. They agreed to amalgamate and form a new company Neptune Ltd. with an authorised share capital of Rs. 2,00,000 divided into 40,000 equity shares of Rs. 5 each.

On 31st December, 1995, the respective Balance Sheets of Star and Moon were as follows :

	Star	*Moon*
	Rs.	*Rs.*
Fixed Assets	*3,17,500*	*1,82,500*
Current Assets	*1,63,500*	*83,875*
	4,81,000	*2,66,375*
Less: Current Liabilities	*2,98,500*	*90,125*
Representing Capital	*1,82,500*	*1,76,250*

Additional Information :

(a) Revalued figures of Fixed and Current Assets were as follows :

	Star	*Moon*
	Rs.	*Rs.*
Fixed Assets	*3,55,000*	*1,95,000*
Current Assets	*1,49,750*	*78,875*

(b) The debtors and creditors—include Rs. 21,675 owed by Star to Moon.

The purchase consideration is satisfied by issue of the following shares and debentures :

(i) 30,000 equity shares of Neptune Ltd., to Star and Moon in the porportion to the profitability of their respective business based on the average net profit during the last three years which were as follows :

	Star	*Moon*
1993 Profit	*2,24,788*	*1,36,950*
1994 (Loss)/Profit	*(1,250)*	*1,71,050*
1995 Profit	*1,88,962*	*1,79,500*

(ii) 15% debentures in Neptune Ltd., at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 1995 after revaluation of assets.

You are requested to :

(1) Compute the amount of debentures and shares to be issued to Star and Moon.

(2) A Balance Sheet of Neptune Ltd., showing the position immediately after amalgamation.

(20 marks) (Intermediate–May 1996)

Answer

(1) **Computation of Amount of Debentures and Shares to be issued:**

		Star Rs.	*Moon* Rs.
(i) *Average Net Profit*			
$\frac{2,24,788 - 1,250 + 1,88,962}{3}$	=	1,37,500	
$\frac{1,36,950 - 1,71,050 + 1,79,500}{3}$	=		1,62,500
(ii) *Equity Shares Issued*			
(a) Ratio of distribution			
Star : Moon			
1,375 : 1,625			
(b) Number			
Star : 13,750			
Moon : 16,250			
30,000			
(c) Amount			
13,750 shares of Rs. 5 each	=	68,750	
16,250 shares of Rs. 5 each	=		81,250
(iii) *Capital Employed (after revaluation of assets)*			
Fixed Assets		3,55,000	1,95,000
Current Assets		1,49,750	78,875

		5,04,750	2,73,875
Less: Current Liabilities		2,98,500	90,125
		2,06,250	1,83,750

(iv) *Debentures Issued*

8% Return on capital employed		16,500	14,700
15% Debentures to be issued to provide equivalent income :			
Star : $16,500 \times \frac{100}{15}$	=	1,10,000	
Moon : $14,700 \times \frac{100}{15}$	=		98,000

(2) **Balance Sheet of Neptune Ltd.**

As at 31st December, 1995

Liabilities	*Amount* *Rs.*	*Assets*	*Amount* *Rs.*
Share Capital:		Fixed Assets	5,50,000
Authorised		Current Assets	2,06,950
40,000 Equity Shares of Rs. 5 each	2,00,000		
Issued and Subscribed			
30,000 Equity Shares of Rs. 5 each (all the above shares are allotted as fully paid-up pursuant to a contract without payments being received in cash)	1,50,000		
Reserves and Surplus			
Capital Reserve	32,000		
Secured Loans			
15% Debentures	2,08,000		
Unsecured Loans	–		
Current Liabilities and Provisisons			
Current Liabilties	3,66,950		
Provisions	–		
	7,56,950		7,56,950

Working Notes :

		Star	Moon	Total
		Rs.	Rs.	Rs.
(1)	*Purchase Consideration*			
	Equity Shares Issued	68,750	81,250	1,50,000
	15% Debentures Issued	1,10,000	98,000	2,08,000
		1,78,750	1,79,250	3,58,000
(2)	*Capital Reserve*			
	(a) Net Assets Taken Over			
	Fixed Assets	3,55,000	1,95,000	5,50,000
	Current Assets	1,49,750	57,200*	2,06,950
		5,04,750	2,52,200	7,56,950
	Less : Current Liabilities	2,76,825**	90,125	3,66,950
		2,27,925	1,62,075	3,90,000
	(b) Purchase Consideration	1,78,750	1,79,250	3,58,000
	(c) Capital Reserve [(a) - (b)]	49,175		
	(d) Goodwill [(b) - (a)]		17,175	
	(e) Capital Reserve [Final Figure(c) - (d)]			32,000

* 78, 875 - 21,675

** 2,98,500 - 21,675

Question 3

The following are the Balance Sheets of Yes Ltd. and No Ltd. as on 31st October, 1999 :

	Yes Ltd.	No Ltd.
	Rs.	Rs.
	(in crores)	(in crores)
Sources of funds:		
Share capital:		
Authorised	25	5
Issued and Subscribed :		
Equity Shares of Rs. 10 each fully paid	12	5
Reserves and surplus	88	10
Shareholders funds	100	15

Unsecured loan from Yes Ltd.		*—*		*10*
		100		*25*
Funds employed in :				
Fixed assets: Cost		*70*		*30*
Less: Depreciation		*50*		*24*
		20		*6*
Written down value				
Investments at cost:				
30 lakhs equity shares of Rs. 10 each of No Ltd.		*3*		
Long-term loan to No. Ltd.		*10*		
Current assets	*100*		*34*	
Less : Current liabilities	*33*	*67*	*15*	*19*
		100		*25*

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity share of Yes Ltd. issued at a premium of Rs. 2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.

You are asked to pass journal entires in the books of the two companies to give effect to the above. *(16 marks) (Intermediate–Nov. 1999)*

Answer

Journal entries in the books of No Ltd.

(Rupees in crores)

		Dr. Rs.	Cr. Rs.
Realisation Account	Dr.	64.00	
To Fixed Assets Account			30.00
To Current Assets Account			34.00
(Being the assets taken over by Yes Ltd. transferred to Realisation Account)			
Provision for depreciation Account	Dr.	24.00	
Current Liabilities Account	Dr.	15.00	
Unsecured Loan from Yes Ltd. Account	Dr.	10.00	
To Realisation Account			49.00
(Being the transfer of liabilities and provision to Realisation Account)			

Yes Ltd.	Dr.	1.2	
To Realisation Account			1.2
(Being the amount of consideration due from Yes Ltd. credited to Realisation Account)			
Equity Shareholders Account	Dr.	13.80	
To Realisation Account			13.80
(Being the the loss on realisation transferred to equity shareholders account)			
Equity Share Capital Account	Dr.	5.00	
Reserves and Surplus Account	Dr.	10.00	
To Equity Shareholders Account			15.00
(Being the amount of share capital, reserves and surplus credited to equity shareholders account)			
Equity Shareholders (Yes Ltd.) Account	Dr.	0.72	
To Yes Ltd.			0.72
(Being the 3/5th of the consideration due from Yes Ltd. adjusted against the amount due to Yes Ltd. for shares held by it)			
Equity shares of Yes Ltd.	Dr.	0.48	
To Yes Ltd.			0.48
(Being the receipt of 4 lakhs equity shares of Rs. 10 each at Rs. 12 per share for allotment to outside shareholders			
Equity Shareholders Account	Dr.	0.48	
To Equity Shares of Yes Ltd.			0.48
(Being the distribution of equity shares received from Yes Ltd. to shareholders)			

Journal Entries in the Books of Yes Ltd.

(Rupees in crores)

		Dr. Rs.	Cr. Rs.
Business Purchase Account	Dr.	1.2	
To Liquidator of No Ltd. Account			1.2
(Being the amount of purchase consideration agreed under approved scheme of amalgamation- W.N. 1)			
Fixed Assets	Dr.	6.00	
Current Assets	Dr.	34.00	
To Current Liabilities			15.00
To Unsecured Loan (from Yes Ltd.)			10.00
To Business Purchase Account			1.20
To Capital Reserve			13.80
(Being the assets and liabilities taken over and the surplus transferred to capital reserve)			
Liquidator of No Ltd.	Dr.	0.72	
Capital Reserve	Dr.	2.28	
To Investments in Equity Shares of No Ltd.			3.00
(Being the investments in the equity shares of No Ltd. cancelled and the resultant loss recorded)			
Liquidator of No Ltd.	Dr.	0.48	
To Equity Share Capital Account			0.40
To Securities Premium Account			0.08
(Being the allotment to outside shareholders of No Ltd. 4 lakhs equity shares of Rs. 10 each at a premium of Rs. 2 per share)			

Unsecured Loan (from Yes Ltd.)	Dr.	10.00	
To Loan to No. Ltd.			10.00
(Being the cancellation of unsecured loan given to No Ltd.)			

Working Note:

Purchase Consideration	*Rs. in crores*
$\frac{50\text{ lakhs}}{5}$ × Rs. 12	
i.e., 10 lakhs equity shares at Rs. 12 per share	1.20
Less: Belonging to Yes Ltd. $\left[\frac{3}{5}\times 1.20\right]$	0.72
Payable to other equity shareholders	0.48

Number of equity shars of Rs. 10 each to be issued $\left[\frac{48\text{ lakhs}}{12}\right]$ = 4 lakhs

Question 4

Super Express Ltd. and Fast Express Ltd. were in competing business. They decided to form a new company named Super Fast Express Ltd. The balance sheets of both the companies were as under :

Super Express Ltd.
Balance Sheet as at 31st December, 1999

	Rs.		Rs.
20,000 Equity shares of		Buildings	10,00,000
Rs. 100 each	20,00,000	Machinery	4,00,000
Provident fund	1,00,000	Stock	3,00,000
Sundry creditors	60,000	Sundry debtors	2,40,000
Insurance reserve	1,00,000	Cash at bank	2,20,000
		Cash in hand	1,00,000
	22,60,000		22,60,000

Fast Express Ltd.
Balance Sheet as at 31st December, 1999

	Rs.		Rs.
10,000 Equity shares of		Goodwill	1,00,000
Rs. 100 each	10,00,000	Buildings	6,00,000
Employees profit sharing		Machinery	5,00,000
account	60,000	Stock	40,000
Sundry creditors	40,000	Sundry debtors	40,000

Reserve account	*1,00,000*	*Cash at bank*	*10,000*
Surplus	*1,00,000*	*Cash in hand*	*10,000*
	13,00,000		*13,00,000*

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of Rs. 100 each in lieu of purchase consideration.

Prepare opening balance sheet of Super Fast Express Ltd. (8 marks) (Intermediate–May 2000)

Answer

Balance Sheet of Super Fast Express Ltd

as at 1st Jan., 2000

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital:		Goodwill	1,00,000
30,000 Equity shares of Rs. 100 each	30,00,000	Buildings	16,00,000
Reserve account	1,00,000	Machinery	9,00,000
Surplus	1,00,000	Stock	3,40,000
Insurance reserve	1,00,000	Sundry debtors	2,80,000
Employees profit sharing account	60,000	Cash at bank	2,30,000
Provident fund	1,00,000	Cash in hand	1,10,000
Sundry creditors	1,00,000		
	35,60,000		35,60,000

The above solution is based on pooling of interests method.

Alternative solution under the purchase method is given below :

Balance Sheet of Super Fast Express Ltd.

as at 1st Jan., 2000

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital:		Buildings	16,00,000
32,000 Equity shares of		Machinery	9,00,000
Rs. 100 each	32,00,000	Stock	3,40,000
Provident fund	1,00,000	Sundry debtors	2,80,000
Employees profit sharing account	60,000	Cash at bank	2,30,000
Sundry creditors	1,00,000	Cash in hand	1,10,000
	34,60,000		34,60,000

Working Notes :

Calculation of Purchase Consideration

	Super Express Ltd.	Fast Express Ltd.
Total assets on 31.12.99 (excluding goodwill)	22,60,000	12,00,000
Less: Provident fund	1,00,000	–
Employees profit sharing account	–	60,000
Sundry creditors	60,000	40,000
Net assets taken over	21,00,000	11,00,000

Question 5

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the Company on 31.3.2000 before reconstruction :

Balance Sheet of Green Limited as at 31.3.2000

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital:		*Fixed Assets:*	
Authorised:		*Goodwill*	*20,00,000*
1,50,000 Equity Shares of Rs. 50 each	*75,00,000*	*Building*	*10,00,000*
Subscribed and Paid up Capital:		*Plant*	*10,00,000*
50,000 Equity Shares of Rs. 50 each	*25,00,000*	*Computers*	*25,00,000*
1,00,000 Equity Shares of Rs. 50 each,		*Investments*	*Nil*
Rs. 40 per share paid up	*40,00,000*	*Current Assets*	*Nil*
Secured Loans:		*Profit and Loss A/c—Loss*	*20,00,000*
12% First Debentures	*5,00,000*		
12% Second Debentures	*10,00,000*		
Current Liabilities:			
Sundry Creditors	*5,00,000*		
	85,00,000		*85,00,000*

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X	*Mr. Y*
	Rs.	*Rs.*
12% First Debentures	*3,00,000*	*2,00,000*
12% Second Debentures	*7,00,000*	*3,00,000*
Sundry Creditors	*2,00,000*	*1,00,000*
	12,00,000	*6,00,000*

Fully paid up Rs. 50 shares	*3,00,000*	*2,00,000*
Parly paid up shares (Rs. 40 paid up)	*5,00,000*	*5,00,000*

The following Scheme of Reconstruction is approved by all parties interested and also by the Court:

(a) Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of Rs. 20 each.

(b) Mr. X is to cancel Rs. 7,00,000 of his total debt (other than share amount) and to pay Rs. 2 lakhs to the company and to receive new 14% First Debentures for the balance amount.

(c) Mr. Y is to cancel Rs. 3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.

(d) The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entires to record the same and also show the Balance Sheet of the reconstructed company. (10 marks) (Intermediate–Nov. 2000)

Answer

Green Limited

Journal Entries

		Dr.	Cr.
		Rs.	Rs.
Bank Account	Dr.	10,00,000	
To Equity Share Capital Account			10,00,000
(Balance of Rs. 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)			
Equity Share Capital Account (Rs. 50)	Dr.	75,00,000	
To Equity Share Capital Account (Rs. 20)			30,00,000
To Capital Reduction Account			45,00,000
(Reduction of equity shares of Rs. 50 each to shares of Rs. 20 each as per reconstruction scheme)			
12% First Debentures Account	Dr.	3,00,000	
12% Second Debentures Account	Dr.	7,00,000	
Sundry Creditors Account	Dr.	2,00,000	
To X			12,00,000
(The total amount due to X, transferred to his account)			

Bank Account	Dr.	2,00,000	
To X			2,00,000
(The amount paid by X under the reconstruction scheme)			
12% First Debentures Account	Dr.	2,00,000	
12% Second Debentures Account	Dr.	3,00,000	
Sundry Creditors Account	Dr.	1,00,000	
To Y			6,00,000
(The total amount due to Y, transferred to his account)			
X	Dr.	14,00,000	
To 14% First Debentures Account			7,00,000
To Capital Reduction Account			7,00,000
(The cancellation of Rs. 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)			
Capital Reduction Account	Dr.	55,00,000	
To Goodwill Account			20,00,000
To Profit and Loss Account			20,00,000
To Computers Account			15,00,000
(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss accout, and computers—Working Note)			

Balance Sheet of Green Limited (and reduced)
as on 31st March, 2000

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital:		Fixed Assets:	
Subscribed and Paid up Capital		Building	10,00,000
1,50,000 Equity shares of		Plant	10,00,000
Rs. 20 each	30,00,000	Computers	10,00,000

Secured Loans:		Current Assets:	
14% First Debentures	10,00,000	Cash and Bank Balance	12,00,000
Current Liabilities:			
Sundry Creditors	2,00,000		
	42,00,000		42,00,000

Working Note:

Capital Reduction Account

	Rs.		*Rs.*
To Goodwill A/c	20,00,000	By Equity Share Capital A/c	45,00,000
To P & L A/c	20,00,000	By X	7,00,000
To Computers (Bal. Fig.)	15,00,000	By Y	3,00,000
	55,00,000		55,00,000

Question 6

The following were the Balance Sheets of P Ltd. and V Ltd. as at 31st March, 2001 :

Liabilities	*P Ltd. (Rs. in lakhs)*	*V Ltd. (Rs. in lakhs)*
Equity Share Capital (Fully paid shares of Rs. 10 each)	*15,000*	*6,000*
Securities Premium	*3,000*	*–*
Foreign Project Reserve	*–*	*310*
General Reserve	*9,500*	*3,200*
Profit and Loss Account	*2,870*	*825*
12% Debentures	*–*	*1,000*
Bills Payable	*120*	
Sundry Creditors	*1,080*	*463*
Sundry Provisions	*1,830*	*702*
	33,400	*12,500*

Assets	*P Ltd. (Rs. in lakhs)*	*V Ltd. (Rs. in lakhs)*
Land and Buildings	*6,000*	*–*
Plant and Machinery	*14,000*	*5,000*
Furniture, Fixtures and Fittings	*2,304*	*1,700*
Stock	*7,862*	*4,041*
Debtors	*2,120*	*1,020*
Cash at Bank	*1,114*	*609*
Bills Receivable	*—*	*80*
Cost of Issue of Debentures	*—*	*50*
	33,400	*12,500*

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.

On 1st April 2001, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P Ltd. would allot three fully paid equity shares of Rs. 10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Expenses of amalgamation amounting to Rs. 1 lakh were borne by P Ltd.

You are required to :

(i) Pass journal entries in the books of P Ltd. and

(ii) Prepare P Ltd.'s Balance Sheet immediately after the merger.

(16 marks) (Intermediate–May 2001)

Answer

Books of P Ltd.
Journal Entries

		Dr.	Cr.
		(Rs. in Lacs)	*(Rs. in Lacs)*
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd.			9,000
(Being business of V Ltd. taken over for consideration settled as per agreement)			
Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1,700	
Stock	Dr.	4,041	
Debtors	Dr.	1,020	
Cash at Bank	Dr.	609	
Bills Receivable	Dr.	80	
To Foreign Project Reserve			310
To General Reserve (3,200 - 3,000)			200
To Profit and Loss A/c (825 - 50)			775
To 12% Debentures			1,000
To Sundry Creditors			463
To Sundry Provisions			702
To Business Purchase			9,000
(Being assets & liabilities taken over from V Ltd.)			

Liquidator of V Ltd. A/c	Dr.	9,000	
To Equity Share Capital A/c			9,000
(Purchase consideration discharged in the form of equity shares)			
General Reserve A/c	Dr.	1	
To Bank A/c			1
(Liquidation expenses paid by P Ltd.)			
12% Debentures A/c	Dr.	1,000	
To 13% Debentures A/c			1,000
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	80	
To Bills Receivable A/c			80
(Cancellation of mutual owing on account of bills)			

Balance Sheet of P Ltd. as at 1st April, 2001 (after merger)

Liabilities	*Rs. (in lakhs)*	*Assets*	*Rs. (in lakhs)*
Share Capital		**Fixed Assets**	
Authorised, issued and subscribed :		Land and buildings	6,000
24 crore equity shares of Rs. 10		Plant and Machinery	19,000
each, fully called and paid-up	24,000	Furniture, fixtures and fittings	4,004
(Of the above shares, 9 crore shares		**Current Assets, Loans and Advances**	
have been issued for consideration		(a) Current Assets	
other than cash)		Stock	11,903
Reserves and Surplus		Debtors	3,140
Securities Premium	3,000	Cash at Bank	1,722
Foreign Project Reserve	310	(b) Loan and advances	Nil
General Reserve	9,699		
Profit and Loss Account	3,645		
Secured Loan			
13% Debentures	1,000		

Current Liabilities and provisions

(a)	Current Liabilities		
	Bills Payable	40	
	Sundry Creditors	1,543	
(b)	Provisions		
	Sundry Provisions	2,532	
		45,769	45,769

Working Notes :

1. Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = Rs. 6,000 lacs × $\frac{3}{2}$ = Rs. 9,000 lacs.

Note : The question is silent regarding the treatment of fictitious assets and therefore they are not transferred to the amalgamated company. Thus the cost of issue of debentures shown in the balance sheet of the V Ltd. company is not transferred to the P Ltd. company.

Question 7

The following are the summarised Balance Sheets of X Ltd. and Y Ltd :

	X Ltd.	*Y Ltd.*
	Rs.	*Rs.*
Liabilities :		
Share Capital	*1,00,000*	*50,000*
Profit & Loss A/c	*10,000*	–
Creditors	*25,000*	*5,000*
Loan X Ltd.	—	*15,000*
	1,35,000	*70,000*
Assets :		
Sundry Assets	*1,20,000*	*60,000*
Loan Y Ltd.	*15,000*	–
Profit & Loss A/c	—	*10,000*
	1,35,000	*70,000*

A new company XY Ltd. is formed to acquire the sundry assets and creditors of X Ltd. and Y Ltd. and for this purpose, the sundry assets of X Ltd. are revalued at Rs. 1,00,000. The debt due to X Ltd. is also to be discharged in shares of XY Ltd.

Show the Ledger Accounts to close the books of X Ltd. *(8 marks) (Intermediate–Nov. 2001)*

Answer

Books of X Ltd.

Realisation Account

	Rs.		Rs.
To Sundry Assets	1,20,000	By Creditors	25,000
		By XY Ltd. (Purchase consideration)	75,000
		By Shareholders (Loss on realisation)	20,000
	1,20,000		1,20,000

Shareholders Account

	Rs.		Rs.
To Realisation Account (Loss)	20,000	By Share Capital	1,00,000
To Shares in XY Ltd.	90,000	By Profit and Loss Account	10,000
	1,10,000		1,10,000

Loan Y Ltd.

	Rs.		Rs.
To Balance b/d	15,000	By Shares in XY Ltd.	15,000

Shares in XY Ltd.

	Rs.		Rs.
To XY Ltd.	75,000	By Shareholders	90,000
To Loan Y Ltd.	15,000		
	90,000		90,000

XY Ltd.

	Rs.		Rs.
To Realisation Account	75,000	By Shares in XY Ltd.	75,000

Question 8

The following is the Balance Sheet of Rocky Ltd. as at March 31, 2002:

Liabilities	*Rs. in lacs*
Fully paid equity shares of Rs. 10 each	*500*
Capital Reserve	*6*
12% Debentures	*400*
Debenture Interest Outstanding	*48*
Trade Creditors	*165*
Directors' Remuneration Outstanding	*10*

Other Outstanding Expenses	*11*
Provisions	*33*
	1,173
Assets	
Goodwill	*15*
Land and Building	*184*
Plant and Machinery	*286*
Furniture and Fixtures	*41*
Stock	*142*
Debtors	*80*
Cash at Bank	*27*
Discount on Issue of Debentures	*8*
Profits and Loss Account	*390*
	1,173

The following scheme of internal reconstruction was framed, approved by the Court, all the concerned parties and implemented:

(i) *All the equity shares be converted into the same number of fully-paid equity shares of Rs. 2.50 each.*

(ii) *Directors agree to forego their outstanding remuneration.*

(iii) *The debentureholders also agree to forego outstanding interest in return of their 12% debentures being converted into 13% debentures.*

(iv) *The existing shareholders agree to subscribe for cash, fully paid equity shares of Rs. 2.50 each for Rs. 125 lacs.*

(v) *Trade creditors are given the option of either to accept fully-paid equity shares of Rs. 2.50 each for the amount due to them or to accept 80% of the amount due in cash. Creditors for Rs. 65 lacs accept equity shares whereas those for Rs. 100 lacs accept Rs. 80 lacs in cash in full settlement.*

(vi) *The Assets are revalued as under :*

	Rs. in lacs
Land and building	*230*
Plant and Machinery	*220*
Stock	*120*
Debtors	*76*

Pass Journal Entries for all the above mentioned transactions and draft the company's Balance Sheet immediately after the reconstruction. *(20 marks) (Intermediate–May 2002)*

Answer

Journal Entries

		Dr.	Cr.
			Rs. in lacs
		Dr.	*Cr.*
Equity Share Capital (Rs. 10 each) A/c	Dr.	500	
To Equity Share Capital (Rs. 2.50 each) A/c			125
To Reconstruction A/c			375
(Conversion of all the equity shares into the same number of fully paid equity shares of Rs. 2.50 each as per scheme of reconstruction)			
Director's Remuneration Outstanding A/c	Dr.	10	
To Reconstruction A/c			10
(Outstanding remuneration foregone by the directors as per scheme of reconstruction)			
12% Debentures A/c	Dr.	400	
Debenture Interest Outstanding A/c	Dr.	48	
To 13% Debentures A/c			400
To Reconstruction A/c			48
(Conversion of 12% debentures into 13% debentures, Debentureholders forgoing outstanding debenture interest)			
Bank	Dr.	125	
To Equity Share Application A/c			125
(Application money received for equity shares)			
Equity Share Application A/c	Dr.	125	
To Equity Share Capital (Rs. 2.50 each) A/c			125
(Application money transferred to share cpital)			
Trade Creditors	Dr.	165	
To Equity Share Capital (Rs. 2.50 each) A/c			65
To Bank A/c			80
To Reconstruction A/c			20
(Trade creditors for Rs. 64 lakhs accepting shares for full amount and those for Rs. 100 lakhs accepting cash equal to 80% of claim in full settlement)			
Capital Reserve	Dr.	6	
To Reconstruction A/c			6
(Capital Reserve being used for purpose of reconstruction)			

Land and Building	Dr.	46	
To Reconstruction A/c			46
(Appreciation made in the value of land and building as per scheme of reconstruction)			
Reconstruction A/c	Dr.	505	
To Goodwill			15
To Plant and Machinery			66
To Stock			22
To Debtors			4
To Discount on issue of Debentures			8
To Profit and Loss Account			390
(Writing off losses and reduction in the values of assets as per scheme of reconstruction—W.N. 1)			

Balance Sheet of Rocky Ltd. (and Reduced) as on 31st March, 2002

Liabilities	*Rs. in lacs*
1,26,000 Fully paid equity shares of Rs. 2.50 each (W.N. 2)	315
(26,000 shares have been issued for consideration other than cash)	
13% Debentures	400
Outstanding Expenses	11
Provisions	33
	759

Assets	*Rs. in lack*	*Rs. in lacs*
Goodwill	15	
Less : Amount written off under scheme of reconstruction dated...........	15	Nil
Land and Building	184	
Add : Amount of appreciation made under scheme of reconstruction dated..........	46	230
Plant and Machinery	286	
Less: Amount written off under scheme of reconstruction dated.........	66	220
Furniture and Fixtures		41
Stock		120
Debtors	80	

Less: Provision for Bad Debts	4	76
Cash at bank		72
		759

Note : Goodwill has been written off under reconstruction scheme in the solution given above.

Working Notes:

1.

(Rs. in lacs)

Reconstruction Account

		Rs.			Rs.
To	Goodwill	15	By	Equity Share Capital A/c	375
To	Plant and Machinery	66	By	Director's Remuneration Outstanding A/c	10
To	Stock	22	By	Debenture Interest Outstanding A/c	48
To	Debtors	4	By	Trade Creditors	20
To	Discount on issue of		By	Capital Reserve	6
	Debentures	8	By	Land and Building	46
To	Profit and Loss A/c	390			
		505			505

2. Equity share capital as on 31st March, 2002 (after reconstruction)

	Rs.
Equity Share Capital (Rs. 2.50 each)	125
Add: Fresh issue	125
Add: Equity shares issued to creditors	65
	315

3. Cash at bank as on 31st March, 2002 (after reconstruction)

Cash at bank (before reconstruction)	27
Add: Proceeds from issue of equity shares	125
	152
Less: Payment made to creditors	80
	72

Question 9

The financial position of two companies Hari Ltd. and Vayu Ltd. as on 31st March, 2002 was as under:

Assets	*Hari Ltd. (Rs.)*	*Vayu Ltd. (Rs.)*
Goodwill	*50,000*	*25,000*
Building	*3,00,000*	*1,00,000*
Machinery	*5,00,000*	*1,50,000*
Stock	*2,50,000*	*1,75,000*
Debtors	*2,00,000*	*1,00,000*
Cash at Bank	*50,000*	*20,000*
Preliminary Expenses	*30,000*	*10,000*
	13,80,000	*5,80,000*

Liabilities

Share Capital:	*Hari Ltd. (Rs.)*	*Vayu Ltd. (Rs.)*
Equity Shares of Rs. 10 each	*10,00,000*	*3,00,000*
9% Preference Shares of Rs. 100 each	*1,00,000*	–
10% Preference Shares of Rs. 100 each	–	*1,00,000*
General Reserve	*1,00,000*	*80,000*
Retirement Gratuity fund	*50,000*	*20,000*
Sundry Creditors	*1,30,000*	*80,000*
	13,80,000	*5,80,000*

Hari Ltd. absorbs Vayu Ltd. on the following terms:

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.

(b) Goodwill of Vayu Ltd. is valued at Rs. 50,000, Buildings are valued at Rs. 1,50,000 and the Machinery at Rs. 1,60,000.

(c) Stock to be taken over at 10% less value and Reserve for Bad and Doubtful Debts to be created @ 7.5%.

(d) Equity Shareholders of Vayu Ltd. will be issued Equity Shares @ 5% premium.

Prepare necessary Ledger Accounts to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 2002. (16 marks) (PE-II–Nov. 2002)

Answer

In the Books of Vayu Ltd.
Realisation Account

		Rs.			Rs.
To	Sundry Assets (5,80,000 – 10,000)	5,70,000	By	Gratuity Fund	20,000
To	Preference Shareholders		By	Sundry Creditors	80,000
	(Premium on Redemption)	10,000	By	Hari Ltd.	
To	Equity Shareholders			(Purchase Consideration)	5,30,000
	(Profit on Realisation)	50,000			
		6,30,000			6,30,000

Equity Shareholders Account

		Rs.			Rs.
To	Preliminary Expenses	10,000	By	Share Capital	3,00,000
To	Equity Shares of Hari Ltd.	4,20,000	By	General Reserve	80,000
			By	Realisation Account	
				(Profit on Realisation)	50,000
		4,30,000			4,30,000

Preference Shareholders Account

		Rs.			Rs.
To	9% Preference Shares of Hari Ltd.	1,10,000	By	Preference Share Capital	1,00,000
			By	Realisation Account	
				(Premium on Redemption of Preference Shares)	10,000
		1,10,000			1,10,000

Hari Ltd. Account

		Rs.			Rs.
To	Realisation Account	5,30,000	By	9% Preference Shares	1,10,000
			By	Equity Shares	4,20,000
		5,30,000			5,30,000

In the Books of Hari Ltd.
Journal Entries

		Dr. Rs.	Cr. Rs.
Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Stock Account	Dr.	1,57,500	
Debtors Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Gratuity Fund Account			20,000
To Sundry Creditors Account			80,000
To Provision for Doubtful Debts Account			7,500
To Liquidators of Vayu Ltd. Account			5,30,000
(Being Assets and Liabilities takenover as per agreed valuation).			
Liquidators of Vayu Ltd. A/c	Dr.	5,30,000	
To 9% Preference Share Capital A/c			1,10,000
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			20,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Hari Ltd. (after absorption)
as at 31st March, 2002

Liabilities	Rs.	Assets		Rs.
Share Capital :		*Fixed Assets*:		
2,100 9% Preference Shares of Rs.100 each	2,10,000	Goodwill		1,00,000
1,40,000 Equity Shares of Rs. 10 each fully paid	14,00,000	Building		4,50,000
		Machinery		6,60,000
(1,100 Preference Shares and 40,000 Equity Shares were issued in consideration other than for cash)		*Current Assets*:		
		Stock		4,07,500
Reserve and Surplus:		Debtors	3,00,000	
Securities Premium	20,000	Less: Provision for bad debts	7,500	2,92,500
General Reserve	1,00,000	Cash and Bank		70,000
Current Liabilities:		*Miscellaneous Expenses to the extent not written off*		
Gratuity Fund	70,000			
Sundry Creditors	2,10,000	Preliminary expenses		30,000
	20,10,000			20,10,000

Working Notes:

Purchase Consideration:

Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Stock	1,57,500
Debtors	92,500
Cash at Bank	20,000
	6,30,000
Less: Liabilities	
Gratuity	20,000
Sundry Creditors	80,000
Net Assets	5,30,000

To be satisfied as under:

10% Preference Shareholders of Vayu Ltd.		1,00,000
Add: 10% Premium		10,000
1,100 9% Preference Shares of Hari Ltd.		1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium		4,20,000
	Total	5,30,000

Question 10

The Balance Sheet of Y Limited as on 31st March, 2003 was as follows:

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
5,00,000 Equity Shares of Rs. 10 each fully paid	*50,00,000*	*Goodwill*	*10,00,000*
		Patent	*5,00,000*
9% 20,000 Preference shares of Rs. 100 each fully paid	*20,00,000*	*Land and Building*	*30,00,000*
		Plant and Machinery	*10,00,000*
10% First debentures	*6,00,000*	*Furniture and Fixtures*	*2,00,000*
10% Second debentures	*10,00,000*	*Computers*	*3,00,000*
Debentures interest outstanding	*1,60,000*	*Trade Investment*	*5,00,000*
Trade creditors	*5,00,000*	*Debtors*	*5,00,000*
Directors' loan	*1,00,000*	*Stock*	*10,00,000*
Bank O/D	*1,00,000*	*Discount on issue of debentures*	*1,00,000*
Outstanding liabilities	*40,000*		
Provision for Tax	*1,00,000*	*Profit and Loss Account (Loss)*	*15,00,000*
	96,00,000		*96,00,000*

Note: *Preference dividend is in arrears for last three years.*

A holds 10% first debentures for Rs. 4,00,000 and 10% second debentures for Rs. 6,00,000. He is also creditors for Rs. 1,00,000. B holds 10% first debentures for Rs. 2,00,000 and 10% second debentures for Rs. 4,00,000 and is also creditors for Rs. 50,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

(i) All the equity shares be converted into fully paid equity shares of Rs. 5 each.

(ii) The preference shares be reduced to Rs. 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. 'A' is to cancel Rs. 6,00,000 of his total debt including interest on debentures and to pay Rs. 1 lakh to the company and to receive new 12% debentures for the Balance amount.

(iv) Mr. 'B' is to cancel Rs. 3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

(v) Trade creditors (other than A and B) agreed to forego 50% of their claim.

(vi) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

(vii) There were capital commitments totalling Rs. 3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(viii) The Directors refund Rs. 1,10,000 of the fees previously received by them.

(ix) Reconstruction expenses paid Rs. 10,000.

(x) The taxation liability of the company is settled at Rs. 80,000 and the same is paid immediately.

(xi) The assets are revalued as under:

	Rs.
Land and Building	28,00,000
Plant and Machinery	4,00,000
Stock	7,00,000
Debtors	3,00,000
Computers	1,80,000
Furniture and Fixtures	1,00,000
Trade Investment	4,00,000

Pass Journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit & Loss Account and Discount on issue of debentures. Prepare Bank Account and working of allocation of Interest on Debentures between A and B.

(16 marks) (PE-II–Nov. 2003)

Answer

Journal Entries in the Books of Y Ltd.

			Dr. *Rs.*	*Cr.* *Rs.*
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs.100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs.50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% First Debentures A/c	Dr.	4,00,000	
	10% Second Debentures A/c	Dr.	6,00,000	
	Trade Creditors A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	1,00,000	
	Bank A/c	Dr.	1,00,000	
	To 12% New Debentures A/c			7,00,000
	To Reconstruction A/c			6,00,000
	(Being Rs. 6,00,000 due to A (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			
(iv)	10% First Debentures A/c	Dr.	2,00,000	
	10% Second Debentures A/c	Dr.	4,00,000	
	Trade Creditors A/c	Dr.	50,000	
	Interest on Debentures Outstanding A/c	Dr.	60,000	
	To 12% New Debentures A/c			4,10,000
	To Reconstruction A/c			3,00,000
	(Being Rs. 3,00,000 due to B (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			

(v)	Trade Creditors A/c	Dr. 1,75,000	
	To Reconstruction A/c		1,75,000
	(Being remaining creditors sacrificed 50% of their claim.)		
(vi)	Directors' Loan A/c	Dr. 1,00,000	
	To Equity Share Capital (Rs. 5) A/c		60,000
	To Reconstruction A/c		40,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 5 each as per scheme of reconstruction.)		
(vii)	Reconstruction A/c	Dr. 15,000	
	To Bank A/c		15,000
	(Being payment made for cancellation of capital commitments.)		
(viii)	Bank A/c	Dr. 1,10,000	
	To Reconstruction A/c		1,10,000
	(Being refund of fees by directors credited to reconstruction A/c.)		
(ix)	Reconstruction A/c	Dr. 10,000	
	To Bank A/c		10,000
	(Being payment of reconstruction expenses.)		
(x)	Provision for Tax A/c	Dr. 1,00,000	
	To Bank A/c		80,000
	To Reconstruction A/c		20,000
	(Being payment of tax for 80% of liability in full settlement.)		
(xi)	Reconstruction A/c	Dr. 47,20,000	
	To Goodwill A/c		10,00,000
	To Patent A/c		5,00,000
	To Profit and Loss A/c		15,00,000
	To Discount on issue of Debentures A/c		1,00,000
	To Land and Building A/c		2,00,000
	To Plant and Machinery A/c		6,00,000
	To Furniture & Fixture A/c		1,00,000
	To Computers A/c		1,20,000
	To Trade Investment A/c		1,00,000
	To Stock A/c		3,00,000
	To Debtors A/c		2,00,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.)		

Working Notes:

(1) Outstanding interest on debentures have been allocated between A and B as follows:

			Rs.
A's Share			
10% First Debentures	4,00,000		
10% Second Debentures	6,00,000	10,00,000	
10% on Rs. 10,00,000 i.e.			1,00,000
B's Share			
10% First Debentures	2,00,000		
10% Second Debentures	4,00,000	6,00,000	
10% on Rs. 6,00,000 i.e.			60,000
		Total	1,60,000

(2) **Bank Account**

		Rs.			Rs.
To	A (reconstruction)	1,00,000	By	Balance b/d	1,00,000
To	Reconstruction A/c (paid by directors)	1,10,000	By	Reconstruction A/c (capital commitment penalty paid)	15,000
			By	Reconstruction A/c (reconstruction expenses paid)	10,000
			By	Provision for tax A/c(tax paid)	80,000
			By	Balance c/d	5,000
		2,10,000			2,10,000

Question 11

Following are the Balance Sheet of companies as at 31.12.2003:

Liabilities	*D Ltd.*	*V Ltd.*	*Assets*	*D Ltd.*	*V Ltd.*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Equity share capital (Rs. 100)	*8,00,000*	*6,00,000*	*Goodwill*	*6,00,000*	*—*
			Fixed Assets	*5,00,000*	*8,00,000*
General Reserve	*4,00,000*	*3,00,000*	*Investments*	*2,00,000*	*4,00,000*
Investment Allowance Reserve	*—*	*4,00,000*	*Current Assets*	*4,00,000*	*3,00,000*
Sundry Creditors	*5,00,000*	*2,00,000*			
	17,00,000	*15,00,000*		*17,00,000*	*15,00,000*

D Ltd. took over V Ltd. on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information:

(i) Investment Allowance Reserve was in respect of addition made to fixed assets by V Ltd. in the year 1997-2002 on which income tax relief has been obtained. In terms of the Income Tax Act, 1961, the company has to carry forward till 2006 reserve of Rs. 2,00,000 for utilization.

(ii) Investments of V Ltd. included 1,000 shares in D Ltd. acquired at cost of Rs. 150 per share. The other investments of V Ltd. have a market value of Rs. 1,92,500.

(iii) The market value of investments of D Ltd. are to be taken at Rs. 1,00,000.

(iv) Goodwill of D Ltd. and V Ltd. are to be taken at Rs. 5,00,000 and Rs. 1,00,000 respectively.

(v) Fixed assets of D Ltd. and V Ltd. are valued at Rs. 6,00,000 and Rs. 8,50,000 respectively.

(vi) Current assets of D Ltd. included Rs. 80,000 of stock in trade received from V Ltd. at cost plus 25%.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee. (16 marks) (PE-II May 2004)

Answer

Journal Entries in the Books of D Ltd.

		Dr. Amount Rs.	*Cr. Amount Rs.*
Business Purchase Account	Dr.	12,42,500	
To Liquidator of V Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	
Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			

Liquidator of V Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (Rs. 100)			9,03,600
To Securities Premium Account (Rs. 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of D Ltd.
as on 31st December, 2003

Liabilities	*Amount* *Rs.*	*Assets*	*Amount* *Rs.*
Equity Share Capital: 17,036 shares of Rs. 100 each (out of which 9036 shares are issued in favour of vendor for consideration other than cash)	17,03,600	Fixed Assets (5,00,000 + 8,50,000)	13,50,000
		Goodwill (6,00,000 + 1,00,000 + 16,000)	7,16,000
General Reserve	4,00,000	Investments (2,00,000 + 1,92,500)	3,92,500
Securities Premium	3,38,850	Current Assets	
Investment Allowance Reserve	2,00,000	(7,00,000 – 50 – 16,000)	6,83,950
Sundry Creditors	7,00,000	Amalgamation Adjustment Account	2,00,000
	33,42,450		33,42,450

Working Notes:

1. Calculation of net asset value of shares

	D Ltd. *Rs.*	*V Ltd.* *Rs.*
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*

Current Assets	4,00,000	3,00,000
	16,00,000	15,80,000
Less: Sundry Creditors	5,00,000	2,00,000
Net assets	11,00,000	13,80,000
Number of shares	8,000	6,000
Value per equity share	137.50	230

*Investments of V Ltd. are calculated as follows:	*Rs.*
Shares in D Ltd. (1,000 × 137.50)	1,37,500
Market value of remaining investments (given)	1,92,500
	3,30,000

2. Calculation of Purchase Consideration

	Rs.
Net assets of V Ltd.	13,80,000
Value of Shares of D Ltd.	137.50
Number of shares to be issued in D Ltd. to V Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by V Ltd.	1,000
Additional shares to be issued	9,036.36
Total value of shares to be issued (9036 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	50
	12,42,500

Question 12

Exe Limited was wound up on 31.3.2004 and its Balance Sheet as on that date was given below:

Balance Sheet of Exe Limited as on 31.3.2004

Liabilities	*Rs.*	*Assets*			*Rs.*
Share capital:		*Fixed assets*			*9,64,000*
1,20,000 Equity shares of Rs. 10 each	*12,00,000*	*Current assets:* *Stock*		*7,75,000*	
Reserves and surplus:		*Sundry debtors*	*1,60,000*		
Profit prior to incorporation	*42,000*	*Less: Provision for bad and doubtful debts*	*8,000*	*1,52,000*	

Contingency reserve	*2,70,000*	*Bills receivable*	*30,000*	
Profit and loss A/c	*2,52,000*	*Cash at bank*	*3,29,000*	*12,86,000*
Current liabilities:				
Bills payable	*40,000*			
Sundry creditors	*2,26,000*			
Provisions:				
Provision for income tax	*2,20,000*			
	22,50,000			*22,50,000*

Wye *Limited took over the following assets at values shown as under:*

Fixed assets Rs. 12,80,000, Stock Rs. 7,70,000 and Bills Receivable Rs. 30,000.

Purchase consideration was settled by Wye Limited as under:

Rs. 5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of Rs. 100 each. The balance was settled by issuing equity shares of Rs. 10 each at Rs. 8 per share paid up.

Sundry debtors realised Rs. 1,50,000. Bills payable was settled for Rs. 38,000. Income tax authorities fixed the taxation liability at Rs. 2,22,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to Rs. 8,000.

You are required to:

(i) *Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.*

(ii) *Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limited account in the books of Exe Limited.*

(iii) *Pass journal entries in the books of Wye Limited.* *(16 marks) (PE-II May 2005)*

Answer

(i) Purchase consideration

	Rs.
Fixed assets	12,80,000
Stock	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares	= Rs. 5,10,000
No. of preference shares to be allotted	= $\frac{\text{Rs. }5,10,000}{100} = 5,100$ shares
Amount discharged by allotment of equity shares	= Rs. 20,80,000 – Rs. 5,10,000
	= Rs. 15,70,000
Paid up value of equity share	= Rs. 8
Hence, number of equity shares to be issued	= $\frac{\text{Rs. }15,70,000}{8}$
	= 1,96,250 shares

(ii)

Realisation Account
In the books of Exe Ltd.

Dr.		*Rs.*			*Cr.* *Rs.*
To	Fixed assets	9,64,000	By	Provision for bad and doubtful debts	8,000
To	Stock	7,75,000	By	Bills payable	40,000
To	Sundry debtors	1,60,000	By	Sundry creditors	2,26,000
To	Bills receivable	30,000	By	Provision for taxation	2,20,000
To	Bank account:		By	Wye Ltd. account	
	Liquidation expenses	8,000		(Purchase consideration)	20,80,000
	Bills payable	38,000	By	Bank account: Sundry debtors	1,50,000
	Tax liability	2,22,000			
	Sundry creditors	2,11,000			
To	Equity shareholders (profit transferred)	3,16,000			
		27,24,000			27,24,000

Cash/Bank Account

Dr.		*Rs.*			*Cr.* *Rs.*
To	Balance b/d	3,29,000	By	Realisation account:	
To	Realisation account:			Liquidation expenses	8,000
	Sundry debtors	1,50,000		Bills payable	38,000
				Tax liability	2,22,000
				Sundry creditors (Balancing figure)	2,11,000
		4,79,000			4,79,000

Equity Shareholders Account

Dr.		Rs.			Cr. Rs.
To	10% Preference shares in Wye Ltd.	5,10,000	By	Equity share capital account	12,00,000
To	Equity shares in Wye Ltd.	15,70,000	By	Profit prior to incorporation	42,000
			By	Contingency reserve	2,70,000
			By	Profit and loss account	2,52,000
			By	Realisation account (Profit)	3,16,000
		20,80,000			20,80,000

Wye Limited Account

Dr.		Rs.			Cr. Rs.
To	Realisation account	20,80,000	By	10% Preference shares in Wye Ltd.	5,10,000
			By	Equity shares in Wye Ltd.	15,70,000
		20,80,000			20,80,000

(iii)

Journal Entries
in the books of Wye Ltd.

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			
Fixed assets account	Dr.	12,80,000	
Stock account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account	Dr.	20,80,000	
To 10% Preference share capital account			5,10,000
To Equity share capital account			15,70,000
(Being the allotment of 10% fully paid up preference shares and equity shares of Rs 10 each, Rs. 8 each paid up as per agreement for discharge of purchase consideration)			

Question 13

Following is the Balance Sheet as at March 31, 2005:

(Rs. '000)

Liabilities	Max Ltd.	Mini Ltd.	Assets	Max Ltd.	Mini Ltd.
Share capital:			Goodwill	20	–
Equity shares of Rs. 100 each	1,500	1,000	Other fixed assets	1,500	760
9% Preference shares of Rs. 100 each			Debtors	651	440
	500	400	Stock	393	680
General reserve	180	170	Cash at bank	26	130
Profit and loss account	–	15	Own debenture		
12% Debentures of Rs. 100 each	600	200	(Nominal value Rs. 2,00,000)	192	
Sundry creditors	415	225	Discount on issue of debentures	2	
			Profit and loss account	411	
	3,195	2,010		3,195	2,010

On 1.4.2005, Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of Rs. 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 90% of the dividend claim and accept payment for the balance.

(iii) Own debentures of Rs. 80,000 were sold at Rs. 98 cum-interest and remaining own debentures were cancelled.

(iv) Debentureholders of Rs. 2,80,000 agreed to accept one machinery of book value of Rs. 3,00,000 in full settlement.

(v) Creditors, debtors and stocks were valued at Rs. 3,50,000, Rs. 5,90,000 and Rs. 3,60,000 respectively. The goodwill, discount on issue of debentures and Profit and Loss (Dr.) are to be written off.

(vi) The Company paid Rs. 15,000 as penalty to avoid capital commitments of Rs. 3,00,000.

On 2.4.2005 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of Rs. 10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of Rs. 100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of Rs. 100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2005. (20 Marks) (PE-II – Nov. 2005)

Answer

In the Books of Max Ltd.

	Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
01.04.2005				
	Equity share capital A/c	Dr.	15,00,000	
	To Equity share capital A/c			15,00,000
	(Being sub-division of one share of Rs. 100 each into 10 shares of Rs. 10 each)			
	Equity share capital A/c	Dr.	7,50,000	
	To Capital reduction A/c			7,50,000
	(Being reduction of capital by 50%)			
	Capital reduction A/c	Dr.	13,500	
	To Bank A/c			13,500
	(Being payment in cash of 10% of arrear of preference dividend)			
	Bank A/c	Dr.	78,400	
	To Own debentures A/c			76,800
	To Capital reduction A/c			1,600
	(Being profit on sale of own debentures transferred to capital reduction A/c)			
	12% Debentures A/c	Dr.	1,20,000	
	To Own debentures A/c			1,15,200
	To Capital reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			

	12% Debentures A/c	Dr.	2,80,000	
	Capital reduction A/c	Dr.	20,000	
	To Machinery A/c			3,00,000
	(Being machinery taken up by debentureholders for Rs. 2,80,000)			
	Creditors A/c	Dr.	65,000	
	Capital reduction A/c	Dr.	29,000	
	To Debtors A/c			61,000
	To Stock A/c			33,000
	(Being assets and liabilities revalued)			
	Capital reduction A/c	Dr.	4,33,000	
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	(Being the balance of capital reduction transferred to capital reserve account)			
	Capital reduction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being penalty paid for avoidance of capital commitments)			
	Capital reduction A/c	Dr.	2,45,900	
	To Capital reserve A/c			2,45,900
	(Being penalty paid for avoidance of capital commitments)			
02.04.2005	Business Purchase A/c	Dr.	13,20,000	
	To Liquidators of Mini Ltd.			13,20,000
	(Being the purchase consideration payable to Mini Ltd.)			
	Fixed Assets A/c	Dr.	7,60,000	
	Stock A/c	Dr.	6,80,000	
	Debtors A/c	Dr.	4,40,000	
	Cash at Bank A/c	Dr.	1,30,000	
	To Sundry Creditors A/c			2,25,000
	To 12% Debentures A/c of Mini Ltd.			2,00,000

To Profit and Loss A/c			15,000
To General reserve A/c Rs. (1,70,000 + 80,000*)			2,50,000
To Business purchase A/c			13,20,000
(Being the take over of all assets and liabilities of Mini Ltd. by Max Ltd.)			
Liquidators of Mini Ltd. A/c	Dr.	13,20,000	
To Equity Share Capital			10,00,000
To 9% Preference share capital			3,20,000
(Being the purchase consideration discharged)			
12% Debentures of Mini Ltd. A/c	Dr.	2,00,000	
To 12% Debentures A/c			2,00,000
(Being Max Ltd. issued their 12% Debentures in against of every Debentures of Mini Ltd.)			

Balance Sheet of Max Ltd. as at 2.4.2005

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital:		Fixed Assets	19,60,000
Equity Share Capital	17,50,000	Stock	10,40,000
9% Preference share capital	8,20,000	Debtors	10,30,000
Profit and Loss A/c	15,000	Cash in hand/Bank	2,05,900
General Reserve	4,30,000		
Capital Reserve	2,45,900		
12% Debentures	4,00,000		
Sundry Creditors	5,75,000		
	42,35,900		42,35,900

Working Notes:

1. Purchase Consideration

Equity share capital $10{,}000 \times \frac{50}{5} \times \text{Rs.}10$ = 10,00,000

9% Preference share capital $4{,}000 \times \frac{4}{5} \times \text{Rs.}100$ = 3,20,000

Rs. 13,20,000

* Rs. 80,000 is the balancing figure adjusted to general reserve A/c as per AS 14 "Accounting for Amalgamation".

2. General Reserve

	Rs.
Share Capital of Mini Ltd. (Equity + Preference)	14,00,000
Less: Share Capital issued by Max Ltd.	13,20,000
General reserve (resulted due to absorption)	80,000
Add: General reserve of Mini Ltd.	1,70,000
General reserve of Max Ltd.	1,80,000
	4,30,000

Question 14

The following is the Balance Sheet of A Ltd. as at 31st March, 2006:

Liabilities	*Rs.*	*Assets*	*Rs.*
8,000 equity shares of Rs.100 each	*8,00,000*	*Building*	*3,40,000*
10% debentures	*4,00,000*	*Machinery*	*6,40,000*
Loan from A	*1,60,000*	*Stock*	*2,20,000*
Creditors	*3,20,000*	*Debtors*	*2,60,000*
General Reserve	*80,000*	*Bank*	*1,36,000*
		Goodwill	*1,30,000*
		Misc. Expenses	*34,000*
	17,60,000		*17,60,000*

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all Assets, except bank balance at their book values less 10%. Goodwill is to be valued at 4 year's purchase of superprofits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over creditors at book value.

(3) The purchase consideration is to be paid in cash to the extent of Rs.6,00,000 and the balance in fully paid equity shares of Rs.100 each at Rs.125 per share.

The average profit is Rs.1,24,400. The liquidation expenses amounted to Rs.16,000. B Ltd. sold prior to 31st March, 2006 goods costing Rs.1,20,000 to A Ltd. for Rs.1,60,000. Rs.1,00,000 worth of goods are still in stock of A Ltd. on 31st March, 2006. Creditors of A Ltd. include Rs.40,000 still due to B Ltd.

Show the necessary Ledger Accounts to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2006 after the takeover.

(20 Marks) (PE-II – Nov. 2006)

Answer

Books of A Limited

Realisation Account

		Rs.			Rs.
To	Building	3,40,000	By	Creditors	3,20,000
To	Machinery	6,40,000	By	B Ltd.	12,10,000
To	Stock	2,20,000	By	Equity Shareholders (Loss)	76,000
To	Debtors	2,60,000			
To	Goodwill	1,30,000			
To	Bank (Exp.)	16,000			
		16,06,000			16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realisation (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% debentures	4,00,000
			By	Loan from A	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

10% Debentures Account

To	Bank	4,00,000	By	Balance b/d	4,00,000
		4,00,000			4,00,000

Loan from A Account

To	Bank	1,60,000	By	Balance b/d	1,60,000
		1,60,000			1,60,000

Misc. Expenses Account

To	Balance b/d	34,000	By	Equity shareholders	34,000
		34,000			34,000

General Reserve Account

To	Equity shareholders	80,000	By	Balance b/d	80,000
		80,000			80,000

B Ltd. Account

To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd.(4,880 shares at Rs.125 each)	6,10,000
		12,10,000			12,10,000

Equity Shares in B Ltd. Account

To	B Ltd.	6,10,000	By	Equity shareholders	6,10,000
		6,10,000			6,10,000

Equity Share Holders Account

To	Realisation	76,000	By	Equity share capital	8,00,000
To	Misc. Expenses	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd

Balance Sheet as on 1st April, 2006 (An extract)*

Liabilities	*Rs.*	*Assets*		*Rs.*
4880 Equity shares of Rs.100 each	4,88,000	Goodwill		2,16,000
(Shares have been issued for consideration other than cash)		Building		3,06,000
Securities Premium	1,22,000	Machine		5,76,000
Profit and Loss A/c				
....	.....			
Less: unrealized profit 15,000				
Creditors (3,20,000 - 40,000)	2,80,000	Stock (1,98,000 -15,000)		1,83,000
Bank Overdraft	6,00,000	Debtors (2,60,000 – 40,000)	2,20,000	
		Less: Provision for bad debts	26,000	1,94,000

* In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the complete Balance Sheet of B Ltd. after takeover cannot be prepared.

Working Notes:

1. Valuation of Goodwill		*Rs.*
Average profit		1,24,400
Less: 8% of Rs.8,80,000		70,400
Super profit		54,000
Value of Goodwill = 54000 x 4		2,16,000
2. Net Assets for purchase consideration		
Goodwill as valued in W.N.1		2,16,000
Building		3,06,000
Machinery		5,76,000
Stock		1,98,000
Debtors		2,60,000
Total Assets		15,56,000
Less: Creditors	3,20,000	
Provision for bad debts	26,000	3,46,000
Net Assets		12,10,000

Out of this Rs.6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) Rs. 6,10,000 in shares of Rs.125/-. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. Unrealised Profit on Stock	Rs.
The stock of A Ltd. includes goods worth Rs.1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this stock will be $\frac{40,000}{1,60,000} \times 1,00,000$	25,000
As B Ltd purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the stock i.e., 10% of Rs.1,00,000.	(-10,000)
Amount of unrealized profit	15,000

Question 15

The following is the Balance sheet of Weak Ltd. as on 31.3.2006:

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity shares of Rs.100 each	*1,00,00,000*	*Fixed assets*	*1,25,00,000*
12% cumulative preference shares of Rs.100 each	*50,00,000*	*Investments (Market value Rs.9,50,000)*	*10,00,000*
10% debentures of Rs.100 each	*40,00,000*	*Current assets*	*1,00,00,000*

Sundry creditors	*50,00,000*	*P & L A/c*	*4,00,000*
Provision for taxation	*1,00,000*	*Preliminary expenses*	*2,00,000*
	2,41,00,000		*2,41,00,000*

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to Rs.40 each.

(ii) All preference shares are reduced to Rs.60 each.

(iii) The rate of interest on debentures is increased to 12%. The debentureholders surrender their existing debentures of Rs.100 each and exchange the same for fresh debentures of Rs.70 each for every debenture held by them.

(iv) One of the creditors of the company to whom the company owes Rs.20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of Rs.40 each in full satisfaction of his claim.

(v) Fixed assets are to be written down by 30%.

(vi) Current assets are to be revalued at Rs.45,00,000.

(vii) The taxation liability of the company is settled at Rs.1,50,000.

(viii) Investments to be brought to their market value.

(ix) It is decided to write off the fictitious assets.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

(16 Marks) (PE-II – May, 2007)

Answer

Journal Entries in the books of Weak Ltd.

		Rs.	*Rs.*
(i)	Equity share capital (Rs.100) A/c Dr.	1,00,00,000	
	To Equity Share Capital (Rs.40) A/c		40,00,000
	To Capital Reduction A/c		60,00,000
	(Being conversion of equity share capital of Rs.100 each into Rs.40 each as per reconstruction scheme)		
(ii)	12% Cumulative Preference Share capital (Rs.100) A/c Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (Rs.60) A/c		30,00,000
	To Capital Reduction A/c		20,00,000
	(Being conversion of 12% cumulative preference share		

	capital of Rs.100 each into Rs.60 each as per reconstruction scheme)			
(iii)	10% Debentures A/c	Dr.	40,00,000	
	To 12% Debentures A/c			28,00,000
	To Capital Reduction A/c			12,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Sundry Creditors A/c	Dr.	20,00,000	
	To Equity Share Capital A/c			12,00,000
	To Capital Reduction A/c			8,00,000
	(Being a creditor of Rs.20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of Rs.40 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	1,00,000	
	Capital Reduction A/c	Dr.	50,000	
	To Liability for Taxation A/c			1,50,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
(vi)	Capital Reduction A/c	Dr.	99,50,000	
	To P & L A/c			4,00,000
	To Preliminary Expenses A/c			2,00,000
	To Fixed Assets A/c			37,50,000
	To Current Assets A/c			55,00,000
	To Investments A/c			50,000
	To Capital Reserve A/c			50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Preliminary Expenses, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)			
(vii)	Liability for Taxation A/c	Dr.	1,50,000	
	To Current Assets (Bank A/c)			1,50,000
	(Being the payment of tax liability)			

Balance Sheet of Weak Ltd. (and reduced) as on 31.3.2006

Liabilities	*Rs.*	*Assets*	*Rs.*
Issued, subscribed and paid up capital: 1,30,000 equity shares of Rs.40 each	52,00,000	Fixed Assets (1,25,00,000 – 37,50,000)	87,50,000
12% Cumulative Preference Shares of Rs. 60 each	30,00,000	Investments (10,00,000 – 50,000)	9,50,000
Reserves & Surplus: Capital Reserve	50,000	Current Assets (45,00,000 – 1,50,000)	43,50,000
Secured Loan: 12% Debentures	28,00,000		
Current Liabilities and Provisions:			
Sundry Creditors: (50,00,000 – 20,00,000)	30,00,000		
	1,40,50,000		1,40,50,000

Working Note:

Capital Reduction Account

	Rs.		Rs.
To Liability for taxation A/c	50,000	By Equity share capital	60,00,000
To P & L A/c	4,00,000	By 12% Cumulative preference share capital	20,00,000
To Preliminary expenses	2,00,000	By 10% Debentures	12,00,000
To Fixed assets	37,50,000	By Sundry creditors	8,00,000
To Current assets	55,00,000		
To Investment	50,000		
To Capital Reserve (balancing figure)	50,000		
	1,00,00,000		1,00,00,000

Question 16

The following is the Balance Sheet of 'A' Ltd. as on 31.3.2007:

Liabilities	*Rs.*	*Assets*	*Rs.*
14,000 Equity shares of Rs.100 each fully paid	*14,00,000*	*Sundry assets*	*18,00,000*
		Discount on issue of	

General reserve	*10,000*	*debentures*	*10,000*
10% Debentures	*2,00,000*	*Preliminary expenses*	*30,000*
Sundry creditors	*2,00,000*	*P & L A/c*	*60,000*
Bank overdraft	*50,000*		
Bills payable	*40,000*		
	19,00,000		*19,00,000*

'R' Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis of the following:

The market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is an unrecorded liability of Rs.25,000.

(6 Marks) (PE II, Nov. 2007)

Answer

Calculation of Purchase Consideration under Net Assets Method

Sundry assets			*Rs.*
	$18,00,000 \times \frac{75}{100} \times \frac{112}{100} =$	15,12,000	
	$18,00,000 \times \frac{25}{100} \times \frac{92}{100} =$	4,14,000	19,26,000
Less:	*Liabilities:*		
	10% Debentures	2,00,000	
	Sundry creditors	2,00,000	
	Bank overdraft	50,000	
	Bills payable	40,000	
	Unrecorded liability	25,000	5,15,000
Purchase consideration			14,11,000

Question 17

The Balance Sheet of A Limited and B Limited as at 31st March, 2008 are as follows:

Liabilities	*A Ltd.*	*B Ltd.*	*Assets*	*A Ltd.*	*B Ltd.*
Equity share of Rs.10 each	*20,00,000*	*12,00,000*	*Sundry assets*	*30,00,000*	*14,00,000*
General reserve	*4,00,000*	*2,20,000*	*40,000 Equity shares in A Ltd.*	*-*	*4,00,000*
Creditors	*6,00,000*	*3,80,000*			
	30,00,000	*18,00,000*		*30,00,000*	*18,00,000*

A Ltd. absorbed B Ltd. on the basis of intrinsic value of the shares. The purchase consideration is to be discharged in fully paid-up equity shares. A sum of Rs.1,00,000 is owed by A Ltd. to B Ltd., also included in the stock of A Ltd. is Rs.1,20,000 goods supplied by B Ltd. at cost plus 20%.

Give Journal entries in the books of both the companies, if entries are made at intrinsic value. Also prepare Balance Sheet of A Ltd. after absorption. (16 Marks) (PE II- May, 2008)

Answer

In the Books of B Ltd.

Journal Entries

			Dr. (Rs.)	*Cr. (Rs.)*
(i)	Realisation A/c	Dr.	14,00,000	
	To Sundry assets A/c			14,00,000
	(Being assets transferred to realization account on sale of business to A Ltd.)			
(ii)	Creditors A/c	Dr.	3,80,000	
	To Realisation A/c			3,80,000
	(Being creditors transferred to realization account on sale of business to A Ltd.)			
(iii)	Equity share capital A/c	Dr.	12,00,000	
	General reserve A/c	Dr.	2,20,000	
	To Equity shareholders A/c			14,20,000
	(Being transfer of share capital and general reserve to shareholders account)			
(iv)	A Ltd.	Dr.	10,20,000	
	To Realisation A/c			10,20,000
	(Being purchase consideration due – W.N. 2)			
(v)	Equity shares in A Ltd.	Dr.	10,20,000	
	To A Ltd.			10,20,000
	(Being purchase consideration received by A Ltd.)			

(vi)	Equity shares in A Ltd. A/c	Dr.	80,000	
	To Realisation A/c			80,000
	(Being appreciation in the value of shares of A Ltd. brought into books as entries are to be made at intrinsic value)			
(vii)	Realisation A/c	Dr.	80,000	
	To Equity shareholders A/c			80,000
	(Being profit on realization transferred to shareholders account)			
(viii)	Equity shareholders A/c	Dr.	15,00,000	
	To Equity shares in A Ltd. A/c			15,00,000
	(Being 85,000+ 40,000 = 1,25,000 shares distributed to equity shareholders of B Ltd.)			

In the Books of A Ltd.
Journal Entries

			Dr. (Rs.)	Cr. (Rs.)
(i)	Business purchase A/c	Dr.	10,20,000	
	To Liquidators of B Ltd. A/c			10,20,000
	(Being amount payable to B Ltd. – W.N. 2)			
(ii)	Sundry assets A/c	Dr.	14,00,000	
	To Creditors A/c			3,80,000
	To Business purchase A/c			10,20,000
	(Being assets & liabilities taken over and purchase consideration due)			
(iii)	Liquidators of B Ltd. A/c	Dr.	10,20,000	
	To Equity share capital A/c			8,50,000
	To Securities premium A/c			1,70,000
	(Being shares allotted in full payment of purchase consideration)			
(iv)	Creditors A/c	Dr.	1,00,000	

	To Debtors (of B Ltd.) A/c			1,00,000
	(Being cancellation of mutual liability of debtors & creditors of Rs.1,00,000)			
(v)	General reserve A/c	Dr.	20,000*	
	To Stock A/c			20,000
	(Being elimination of unrealized profit on unsold stock of Rs.1,20,000, bought from B Ltd.)			

*Unrealized profit = Rs.1,20,000 × 20/120 = Rs.20,000.

Balance Sheet of A Ltd.
as at 31st March, 2008

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital:		Sundry assets	42,80,000
2,85,000 Equity shares of Rs.10 each	28,50,000	(30,00,000 + 14,00,000 – 1,00,000 – 20,000)	
(of the above, 85,000 equity shares of Rs.10 each are issued for consideration other than cash)			
Securities premium	1,70,000		
General reserve	3,80,000		
Creditors	8,80,000		
(6,00,000 + 3,80,000- 1,00,000)			
	42,80,000		42,80,000

Working Notes:

1. Calculation of Intrinsic Value of shares of 'A' Ltd.

	Rs.
Sundry assets of A Ltd.	30,00,000
Less: Creditors	6,00,000
Net assets	24,00,000
Number of equity shares	2,00,000 shares
Intrinsic value per equity share = $\frac{\text{Rs.24,00,000}}{\text{2,00,000 shares}}$	Rs. 12 per share

2. Calculation of Purchase Consideration

	Rs.
Sundry assets of B Ltd.	14,00,000
Add: Investments in shares of A Ltd. (40,000 shares × Rs.12)	4,80,000
	18,80,000
Less: Creditors	3,80,000
Net assets	15,00,000
	Shares
Total number of equity shares to be issued by A Ltd. @Rs.12 per share (Rs.15,00,000 / Rs.12)	1,25,000
Less: Number of equity shares of A Ltd. which are already with B Ltd.	40,000
Number of shares to be issued to outsiders	85,000
	Rs.
Equity share capital (85,000 shares × Rs.10)	8,50,000
Securities premium (85,000 shares × Rs.2)	1,70,000
Purchase consideration	10,20,000

Question 18

Following is the Balance Sheet of X Co. Ltd. as at 31st March, 2008:

Balance Sheet as at 31st March, 2008

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity share capital (Rs. 100 each)	*15,00,000*	*Land and building*	*10,00,000*
11% Pref. share capital	*5,00,000*	*Plant and machinery*	*7,00,000*
General reserve	*3,00,000*	*Furniture and fittings*	*2,00,000*
Sundry creditors	*2,00,000*	*Stock in trade*	*3,00,000*
		Sundry debtors	*2,00,000*
		Cash in hand and at bank	*1,00,000*
	25,00,000		*25,00,000*

Y Co. Ltd. agreed to take over X Co. Ltd. on the following terms:

(i) Each equity share in X Co. Ltd. for the purpose of absorption is to be valued at Rs. 80.

(ii) Equity shares will be issued by Y Co. Ltd. by valuing its each equity share of Rs. 100 each at Rs. 120 per share.

(iii) 11% Preference shareholders of X Co. Ltd. will be given 11% redeemable debentures of Y Co. Ltd. at equivalent value.

(iv) All the Assets and Liabilities of X Co. Ltd. will be recorded at the same value in the books of Y Co. Ltd.

(a) Calculate Purchase consideration.

(b) Pass Journal entries in the books of Y Co. Ltd. for absorbing X Co. Ltd.

(8 Marks)(PE II- Nov. 2008)

Answer

Computation of Purchase Consideration

	Rs.
Value of 15,000 equity shares @ Rs.80 per share = Rs.12,00,000	
Shares to be issued by Y Co. Ltd. (Rs,12,00,000/120 per share = 10,000 shares @ Rs.120 each)	12,00,000
11% Preference shareholders to be issued equivalent 11% Redeemable Debentures by Y Co. Ltd.	5,00,000
Total Purchase consideration	17,00,000

Journal Entries in the books of Y Co. Ltd.

		Rs.	*Rs.*
Business Purchase A/c	Dr.	17,00,000	
To Liquidator of X Co. Ltd.			17,00,000
(Being the amount payable to X Co. Ltd's liquidator)			
Land & Building A/c	Dr.	10,00,000	
Plant & Machinery A/c	Dr.	7,00,000	
Furniture & Fittings A/c	Dr.	2,00,000	
Stock in Trade A/c	Dr.	3,00,000	
Sundry Debtors A/c	Dr.	2,00,000	
Cash & Bank A/c	Dr.	1,00,000	
To Sundry Creditors			2,00,000
To Capital Reserve (Balancing figure)			6,00,000
To Business Purchase			17,00,000
(Being the value of assets and liabilities taken over from X Co. Ltd.)			
Liquidators of X Co. Ltd. Account	Dr.	17,00,000	
To Equity Share Capital			10,00,000
To Securities Premium Account			2,00,000
To 11% Debentures			5,00,000
(Being purchase consideration discharged)			

UNIT 5 : LIQUIDATION OF COMPANIES

(A) Write short notes on :

Question 1

What are the contents of "Liquidators' statement of account"? How frequently does a liquidator has to submit such statement? *(5 marks) (Intermediate Nov. 1999)*

Answer

The statement prepared by the liquidator showing receipts and payments of cash in case of voluntary winding up is called "Liquidators' statement of account" (Form No. 156 Rule 329 of the Companies Act, 1956). There is no double entry involved in the preparation of liquidator's statement of account. It is only a statement though presented in the form of an account.

While preparing the liquidator's statement of account, receipts are shown in the following order :

(a) Amount realised from assets are included in the prescribed order.

(b) In case of assets specifically pledged in favour of creditors, only the surplus from it, if any, is entered as 'surplus from securities'.

(c) In case of partly paid up shares, the equity shareholders should be called up to pay necessary amount (not exceeding the amount of uncalled capital) if creditors' claims/claims of preference shareholders can't be satisfied with the available amount. Preference shareholders would be called upon to contribute (not exceeding the amount as yet uncalled on the shares) for paying of creditors.

(d) Amounts received from calls to contributories made at the time of winding up are shown on the Receipts side.

(e) Receipts per Trading Account are also included on the Receipts side.

Payments made to redeem securities and cost of execution and payments per Trading Account are deducted from total receipts.

Payments are made and shown in the following order :

(a) Legal charges;

(b) Liquidator's expenses;

(d) Debentureholders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);

(e) Creditors :

  (i) Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge);

  (ii) Unsecured creditors;

(f) Preferential shareholders (Arrears of dividends on cumulative preference shares should be paid up to the date of commencement of winding up); and

(g) Equity shareholders.

Liquidator's statement of account of the winding up is prepared for the period starting from the commencement of winding up to the close of winding up. If winding up of company is not concluded within one year after its commencement, Liquidator's statement of account pursuant to section 551 of the Companies Act, 1956 (Form No. 153) is to be filed by a Liquidator within a period of two months of the conclusion of one year and thereafter until the winding up is concluded at intervals of not more than one year or at such shorter intervals, if any, as may be prescribed.

Question 2

Overriding preferential payments under section 529A of the Companies Act, 1956.

(5 marks) (Intermediate May 2000)

Answer

The Companies (Amendment) Act, 1985 introduced Section 529A which states that certain dues are to be settle in the case of winding up of a company even before the payments to preferential creditors under Section 530. Section 529A states that in the event of winding up of a company, workmen's dues and debts due to secured creditors, to the extent such debts rank under Section 529(1)(c), shall be paid in priority to all other debts. The debts provable [Section 529(i)(a)] and the valuation of annuities and future and contingent liabilities [Section 529(1)(b)] shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions. Workmen's dues, in relation to a company, means the aggregate of the following sums:

1. all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;
2. all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order or resolution;
3. all amounts due in respect of any compensation or liability for compensation under Workmen's Compensation Act, 1923 in respect of death or disablement of any workman of the company;
4. all sum due to any workman from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the workmen, maintained by the company.

Question 3

B List of Contributories and the liability of contributories included in the list.

(4 marks) (Intermediate–May 2001), (PE II –May, 2007)

Answer

The shareholders who transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.

Their liability will crystallize only (i) when the existing assets available with the liquidator are not sufficient to cover the liabilties; (ii) when the existing shareholders fail to pay the amount due on the shares to the liquidator.

(B) Practical Questions :

Question 1

The following is the Balance Sheet of Y Limited as at 31st March, 1994:

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital:		*Fixed Assets :*	
2,000 Equity Shares of Rs. 100		*Land & Buildings*	*4,00,000*
each Rs. 75 per share paid up	*1,50,000*	*Plant and Machineries*	*3,80,000*
6,000 equity shares of Rs. 100		*Current Assets :*	
each Rs. 60 per share paid up	*3,60,000*	*Stock at cost*	*1,10,000*
		Sundry Debtors	*2,20,000*
2,000 10% Preference Share of		*Cash at Bank*	*60,000*
Rs. 100 each fully paid up	*2,00,000*	*Profit and Loss A/c*	*2,40,000*
10% Debentures (having a floating			
charge on all assets)	*2,00,000*		
Interest accrued on Debentures			
(also secured as above)	*10,000*		
Sundry Creditors	*4,90,000*		
	14,10,000		*14,10,000*

On that date, the company went into Voluntary Liquidation. The dividends on preference shares were in arrear for the last two years. Sundry Creditors include a loan of Rs. 90,000 on mortgage of Land and Buildings. The assets realised were as under :-

	Rs.
Land and Buildings	*3,40,000*
Plant & Machineries	*3,60,000*
Stock	*1,20,000*
Sundry Debtors	*1,60,000*

Interest accrued on loan on mortgage of buildings upto the date of payment amounted to Rs. 10,000. The expenses of Liquidation amounted to Rs. 4,600. The Liquidator is entitled to a remuneration of 3% on all the assets realised (except cash at bank) and 2% on the amounts distributed among equity shareholders. Preferential creditors included in sundry creditors amount to Rs. 30,000. All payments were made on 30th June, 1994. Prepare the liquidator's final statement of account. *(15 marks)(Intermediate Nov. 1994)*

Answer

Liquidator's Final Statement of Account

Receipts	*Rs.*	*Rs.*	*Payments*	*Rs.*	*Rs.*
Cash at Bank		60,000	Liquidation expenses		4,600
Assets realised :					
Sundry Debtors	1,60,000		Liquidator's remuneration *(W.N. 1)*		30,400
Stock	1,20,000		Debentureholders :		
Plant & Machinery	3,60,000	6,40,000	10% debentures	2,00,000	
Surplus from Land &			Interest accured *(W.N. 2)*	15,000	2,15,000
Buildings:			Preferential creditors		30.000
Amount realised	3,40,000		Unsecured creditors		3,70,000
Less : Secured			Preference shareholders:		
Creditors	1,00,000	2,40,000	10% Preference Share		
			Capital	2,00,000	
			Arrear dividend	40,000	2,40,000
			Equity Shareholders		
			(W.N. 3) :		
			Rs. 17.50 per share		
			on 2,000 shares	35,000	
			Rs. 2.50 per share		
			on 6,000 shares	15,000	50,000
		9,40,000			9,40,000

Working Notes :

(1) **Liquidator's remuneration :**

	Rs.
3% on Assets realised (3% of Rs. 9,80,000)	29,400
2% of the amounts distributed among Equity Shareholders (2/102 × Rs. 51,000)	1,000
	30,400

(2) **Interest accrued on 10% debentures**

Interest accrued as on 31.3.1994	10,000
Interest accrued upto the date of payment (upto 30th June, 1994)	5,000
	15,000

(3) **Amount payable to Equity Shareholders**

Equity Share Capital	5,10,000
Less: Surplus available for Equity Shareholders	50,000
Loss to be borne by them	4,60,000
Loss per Equity share (Rs. 4,60,000/8,000)	57.50
Amount payable to Equity shareholders :	
Each Equity share of Rs. 75 paid up	17.50
Each Equity share of Rs. 60 paid up	2.50

Question 2

In a winding up of a company, certain creditors remained unpaid. The following persons had transferred their holding sometime before winding up :

Name	*Date of Transfer*	*No. of Shares transferred*	*Amount due to creditors on the date of transfer*
	1996		*Rs.*
P	*January 1*	*1,000*	*7,500*
Q	*February 15*	*400*	*12,500*
S	*March 15*	*700*	*18,000*
T	*March 31*	*900*	*21,000*
U	*April 5*	*1,000*	*30,000*

The shares were of Rs. 100 each, Rs. 80 being called up and paid up on the date of transfers.
A member, R, who held 200 shares died on 28th February, 1996 when the amount due to creditors was Rs. 15,000. His shares were transmitted to his son X.
Z was the transferee of shares held by T. Z paid Rs. 20 per share as calls in advance immediately on becoming a member.
The liquidation of the company commenced on 1st February, 1997 when the liquidator made a call on the present and the past contributories to pay the amount.
You are asked to quantify the maximum liability of the transferors of shares mentioned in the above table, when the transferees :

(i) pay the amount due as "present" member contributories;

(ii) do not pay the amount due as "present" member contributories.
Also quantity the liability of X to whom shares were transmitted on the demise of his father R. *(12 marks)(Intermediate Nov. 1997)*

Answer

Statement of liability as contributories of former members

Creditors outstanding on the date of transfer (ceasing to be member)			Q	R/X	S	U	Amount to be paid to creditor
No. of Shares			400	200	700	1,000	
1996		*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*
Feb. 15		12,500	2,174	1,087	3,804	5,435	12,500
Feb. 28	15,000						
	–12,500	2,500	–	263	921	1,316	2,500
March 15	18,000						
	–15,000	3,000	–	316	1,105	1,579	3,000
April 5	30,000						
	18,000	12,000		2,000		10,000	12,000
Total (a)		30,000	2,174	3,666	5,830	18,330	30,000
Maximum Liablity at Rs. 20 per share on shares held (b)			8,000	4,000	14,000	20,000	
Lower of (a) and (b)			2,174	3,666	5,830	18,330	

Working Note :

The transferors are P, Q, S, T and U. When the transferees pay the amount due as "present" member contributories, there will not be any liability on the transferors. It is only when the transferees do not pay as "present" member contributories then the liability would arise in the case of "past" members as contributories.

X to whom shares were transmitted on demise of his father R would be liable as an existing member contributory. He steps into the shoes of his deceased father under section 430. His maximum liability would be at Rs. 20 per share on 200 shares received on transmission i.e. for Rs. 4,000.

P will not be liable to pay any amount as the winding up proceedings commenced after one year from the date of the transfer. T also will not be liable as the transferee Z has paid the balance Rs. 20 per share as call in advance. Q, R/X, S and U will be liable, as former members, to the maximum extent as indicated, provided the transferees do not pay the calls.

Question 3

The following was the Balance Sheet of X Limited as on 31.3.1998 :

Balance Sheet of X Limited as at 313.1998

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital		*Fixed Assets*	
14%, 40,000 preference shares of		*Land*	*40,000*
Rs. 100 each fully paid up	*4,00,000*	*Buildings*	*1,60,000*
8,000 equity shares of Rs. 100 each,		*Plant and Machinery*	*5,40,000*
Rs. 60 per share paid up	*4,80,000*	*Patents*	*40,000*
Reserves and Surplus	*NIL*	*Investments*	*NIL*
Secured Loans		*Current assets, loans and advances*	
1. 14% debentures	*2,30,000*	*A. Current Assets*	
(Having a floating charge		*Stock at cost*	*1,00,000*
on all assets)		*Sundry debtors*	*2,30,000*
Interest accrued on above		*Cash at bank*	*60,000*
debentures	*32,200*	*B. Loans and Advances*	*NIL*
(Also having a floating		*Miscellaneous expenses*	
charge as above)		*Profit and Loss A/c*	*2,40,000*
2. Loan on mortgage of land			
and building	*1,50,000*		
Unsecured Loan	*NIL*		
Current Liabilities and provisions			
A. Current liabilities			
Sundry creditors	*1,17,800*		
	14,10,000		*14,10,000*

On 31.3.1998 the company went into voluntary liquidation. The dividend on 14% preference shares was in arrears for one year. Sundry creditors include preferential creditors amounting to Rs. 30,000.

The assets realised the following sums

Land Rs. 80,000; Buildings Rs. 2,00,000; Plant and machinery Rs. 5,00,000; Patent Rs. 50,000; Stock Rs. 1,60,000; Sundry debtors Rs. 2,00,000.

The expenses of liquidation amounted to Rs. 29,434. The liquidator is entitled to a commission of 2% on all assets realised (except cash at bank) and 2% on amounts among unsecured creditors other than preferential creditors. All paymnts the on 30th June, 1998. Interest on mortgage loan shall be ignored at the time of payment.

Prepare the liquidator's final statement of account. *(10 marks)(Intermediate Nov. 1998)*

Answer

X Ltd.
Liquidator's Final Statement of Account

Receipts	*Value Realised*		*Payments Rs.*	*Payment Rs.*
Assets Realised :				
Cash at Bank	60,000	Liquidator's Remuneration (W.N. 1)		25,556
Sundry Debtors	2,00,000	Liquidation Expenses		29,434
Stock	1,60,000	Debentureholders :		
Plant and Machinery	5,00,000	14% Debentures	2,30,000	
Patents	50,000	Interest Accrued (W.N. 2)	40,250	2,70,250
Surplus from Securities		Creditors :		
(W.N. 3)	1,30,000	Preferential	30,000	
		Unsecured	87,800	1,17,800
		Preference Shareholders :		
		Preference Share Capital	4,00,000	
		Arrears of Dividend	56,000	4,56,000
		Equity Shareholders (W.N.4) :		
		Rs. 25.12 per share on 8,000 shares		2,00,960
	11,00,000			11,00,000

Working Notes :

	Rs.
1. Liquidator's remuneration :	
2% on assets realised (2% of Rs. 11,90,000)	23,800
2% on payments to unsecured creditors (2% on Rs. 87,800)	1,756
	25,556
2. Interest accrued on 14% Debentures :	
Interest accrued as on 31.3.1998	32,200
Interest accrued upto the date of payment i.e. 30.6.1998	8,050
	40,250

3. Surplus from Securities :

Amount realised from Land and Buildings (Rs. 80,000 + Rs. 2,00,000)	2,80,000
Less : Mortgage Loan	1,50,000
	1,30,000

4. Amount payable to Equity Shareholders :

Equity share capital (paid up)	4,80,000
Less : Amount available for equity shareholders	2,00,960
Loss to be born by equity shareholders	2,79,040
Loss per equity share (Rs. 2,79,040/8,000)	34.88
Amount payable to equity shareholders for each equity share (60-34.88)	25.12

Notes : (1) Commission due to the liquidator has been calculated on the total realisation on the supposition that the securities (land and buildings) are realised by the liquidator on behalf of the lender.

(2) Preference shares have been taken as cumulative.

Question 4

Pessimist Ltd. has gone into liquidation on 10th May, 2000. The details of members, who have ceased to be members, within the year ended 31st March, 2000 are given below. The debts that could not be paid out of realisation of assets and contribution from present membrs ('A' contributories) are also given with their date-wise break up. Shares are of Rs. 10 each, Rs. 6 per share paid up.

You are to determine the amount realisable from each person.

Shareholders	*No. of shares transferred*	*Date of transfer*	*Proportionate unpaid debts*
P	*1,000*	*20.04.1999*	*3,000*
Q	*1,200*	*15.05.1999*	*5,000*
R	*1,500*	*18.09.1999*	*9,200*
S	*800*	*24.12.1999*	*10,500*
T	*500*	*12.03.2000*	*11,000*

(7 marks)(Intermediate Nov. 2000)

Answer

Statement of liabilities of B List Contributories

Creditors outstanding on the date of transfer (ceasing to be member)		*Q*	*R*	*S*	*T*	*Amount* to be paid to creditors
No. of shares		1,200	1,500	800	500	
Date	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*
15.5.99	5,000	1,500	1,875	1,000	625	5,000

18.9.99	9,200 –5,000	4,200	–	2,250	1,200	750	4,200
24.12.99	10,500 -9,200	1,300	–	–	800	500	1,300
12.3.2000	11,000 10,500	500	–	–	–	500	125*
Total (a)		11,000	1,500	4,125	3,000	2,375	10,625
Maximum liability on shares held (b)			4,800	6,000	3,200	2,000	
Amount paid (a) and (b) whichever is lower			1,500	4,125	3,000	2,000	

Working Note :

P Will not be liable since he transferred his shares prior to one year preceding the date of winding up. The amount of Rs. 5,000 outstanding on 15th May, 1999 will have to contributed by Q, R, S and T in the ratio of number of shares held by them, i.e. in the ratio of 12:15:8:5; thus Q will have to contribute Rs. 1,500; R Rs. 1,875; S Rs. 1,000; T Rs. 625. Similarly, the further debts incurred between 15th May, 1999 to 18th September, 1999, viz. Rs. 4,200 for which Q is not liable will be contributed by R, S and T in the ratio of 15:8:5. R will have to contribute Rs. 2,250. S and T will contribute Rs. 1,200 and Rs. 750 respectively. The further increase from Rs. 9,200 to Rs. 10,500 viz. Rs. 1,300 occurring between 18th September and 24th December will be shared by S and T who will be liable for Rs. 800 and Rs. 500 respectively. The increase between 24th December and 12th March, is solely the responsibility of T.

Question 5

Liquidation of YZ Ltd. commenced on 2nd April, 2004. Certain creditors could not receive payments out of the realisation of assets and out of the contributions from A list contributories. The following are the details of certain transfers which took place in 2003 and 2004:

Shareholders	*No. of Shares transferred*	*Date of Ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of such transfer*
A	*2,000*	*1st March, 2003*	*Rs. 5,000*
P	*1,500*	*1st May, 2003*	*Rs. 3,300*
Q	*1,000*	*1st October, 2003*	*Rs. 4,300*
R	*500*	*1st November, 2003*	*Rs. 4,600*
S	*300*	*1st February, 2004*	*Rs. 6,000*

All the shares were of Rs. 10 each, Rs. 8 per share paid up. Show the amount to be realised from the various persons listed above ignoring expenses and remuneration to liquidator etc.

(8 marks) (PE-II–Nov. 2004)

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* Against T's liability of Rs. 2,375, he can be called upon to pay Rs. 2,000, the loss of Rs. 375 will have to be suffered by the creditors.

Answer

Statement of liabilities of B list contributories

Share-holders	*No. of shares transferred*	*Maximum liability (upto Rs. 2 per share)*	*Division of Liability as on 1.5.2003*	*1.10.2003*	*1.11.2003*	*1.2.2004*	*Total*
		Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*
P	1,500	3,000	1,500	–	–	–	1,500
Q	1,000	2,000	1,000	555	–	–	1,555
R	500	1,000	500	278	188	–	966
S	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Note:

Date	Cumulative liability	Increase in liability	Ratio of no. of shares held by the members
1.5.2003	3,300	–	30 : 20 : 10 : 6
1.10.2003	4,300	1,000	20 : 10 : 6
1.11.2003	4,600	300	10 : 6
1.2.2004	6,000	1,400	Only S

Liability of S has been restricted to the maximum allowable limit of Rs. 600, therefore amount payable by S is restricted to Rs. 21 only, on 1.2.2004.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2003 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

Question 6

The position of Valueless Ltd. on its liquidation is as under:

Issued and paid up Capital:

3,000	*11% preference shares of Rs. 100 each fully paid.*
3,000	*Equity shares of Rs. 100 each fully paid.*
1,000	*Equity shares of Rs. 50 each Rs. 30 per share paid.*

Calls in Arrears are Rs. 10,000 and Calls received in Advance Rs. 5,000. Preference Dividends are in arrears for one year. Amount left with the liquidator after discharging all liabilities is Rs. 4,13,000. Articles of Association of the company provide for payment of preference dividend arrears in priority to return of equity capital. You are required to prepare the Liquidators final statement of account. (8 marks) (PE-II–Nov. 2004)

Answer

Liquidators' Final Statement of Account

Receipts	*Rs.*	*Payments*	*Rs.*
Cash	4,13,000	Return to contributors:	
Realisation from:		Preference dividend	33,000
Calls in arrears	10,000	Preference shareholders	3,00,000
Final call of Rs. 5 per		Calls in advance	5,000
equity share of Rs. 50 each		Equity shareholders of	
(Rs. 5 × 1,000)	5,000	Rs. 100 each (3,000 × Rs. 30)	90,000
	4,28,000		4,28,000

Working Note:

			Rs.
Cash account balance			4,13,000
Less:	Payment for dividend	33,000	
	Preference shareholders	3,00,000	
	Calls in advance	5,000	3,38,000
			75,000
Add: Calls in arrears			10,000
			85,000
Add: Amount to be received from equity shareholders of Rs. 50 each (1,000 × 20)			20,000
Amount disposable			1,05,000

Number of equivalent equity shares:

3,000 shares of Rs. 100 each	= 6,000 shares of Rs. 50 each
1,000 shares of Rs. 50 each	= 1,000 shares of Rs. 50 each
	= 7,000 shares of Rs. 50 each

Final payment to equity shareholders = $\dfrac{\text{Amount left for distribution}}{\text{Total number of equivalent equity shares}}$

= Rs. 1,05,000 / 7,000 shares = Rs. 15 per share to equity shareholders of Rs. 50 each.

Therefore for equity shareholders of Rs. 100 each $\left(\text{Rs.}15 \times \dfrac{100}{50}\right)$

= Rs. 30 per share to equity shareholders of Rs. 100 each.

Calls in advance must be paid first, so as to pay the shareholders on prorata basis. Equity shareholders of Rs. 50 each have to pay Rs. 20 and receive Rs. 15 each. As a result, they are required to pay net Rs. 5 per share.

Question 7

The following particulars relate to a Limited Company which has gone into voluntary liquidation. You are required to prepare the Liquidator's Statement of Account allowing for his remuneration @ 2½% on all assets realized excluding call money received and 2% on the amount paid to unsecured creditors including preferential creditors.

Share capital issued:

10,000 Preference shares of Rs.100 each fully paid up.

50,000 Equity shares of Rs.10 each fully paid up.

30,000 Equity shares of Rs.10 each, Rs.8 paid up.

Assets realized Rs.20,00,000 excluding the amount realized by sale of securities held by partly secured creditors.

	Rs.
Preferential creditors	*50,000*
Unsecured creditors	*18,00,000*
Partly secured creditors (Assets realized Rs.3,20,000)	*3,50,000*
Debentureholders having floating charge on all assets of the company	*6,00,000*
Expenses of liquidation	*10,000*

A call of Rs.2 per share on the partly paid equity shares was duly received except in case of one shareholder owning 1,000 shares.

Also calculate the percentage of amount paid to the unsecured creditors to the total unsecured creditors. *(10 Marks) (PE II - Nov. 2007)*

Answer

(a) (i) Liquidator's Final Statement of Account

		Rs.			*Rs.*
To	Assets Realised	20,00,000	By	Liquidator's remuneration	

To	Receipt of call money on 29,000 equity shares @ 2 per share	58,000		2.5% on 23,20,000*	58,000	
				2% on 50,000	1,000	
				2% on 13,12,745 (W.N.3)	26,255	85,255
			By	Liquidation Expenses		10,000
			By	Debenture holders having a floating charge on all assets		6,00,000
			By	Preferential creditors		50,000
			By	Unsecured creditors		13,12,745
		20,58,000				20,58,000

(ii) Percentage of amount paid to unsecured creditors to total unsecured creditors

$$= \frac{13,12,745}{18,30,000} \times 100 = 71.73\%$$

Working Notes:

1. Unsecured portion in partly secured creditors=Rs.3,50,000-Rs.3,20,000
   = Rs.30,000
2. Total unsecured creditors = 18,00,000 + 30,000 (W.N.1)
   = Rs.18,30,000
3. Liquidator's remuneration on payment to unsecured creditors

   Cash available for unsecured creditors after all payments including payment to preferential creditors & liquidator's remuneration on it = Rs.13,39,000

   Liquidator's remuneration on unsecured creditors = $\frac{2}{102} \times 13,39,000 = \text{Rs.}26,255$

   or on Rs. 13,12,754 x 2/100 = Rs. 26,255

* Total assets realised = Rs.20,00,000 + Rs.3,20,000 = Rs.23,20,000

10

ACCOUNTS OF BANKING COMPANIES

(A) Write short notes on :

Question 1

Non-Performing Assets. *(5 marks) (Intermediate–May 1995 and May 2001)*

Answer

An asset is classified as non-performing asset (NPA) if dues in the form of principal and interest are not paid by the borrower for a period of 90 days. If any advance or credit facilities granted by a bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

Income from the non-performing assets can only be accounted for as and when it is actually received. In concept, any credit facility (assets) becomes non-performing when it eases to generate income. The RBI has issued guidelines to commercial banks regarding the classification of advances between performing and non-performing assets.

A term loan is treated as a non-performing assets (NPA) if interest and/or instalments of principal remains over due for a period of more than 90 days. A cash credit/overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated an 'out of order' if any of the following conditions is satisfied :

(a) the outstanding balance remains continuously in excess of the sanctional limit/drawing power.

(b) though the outstanding balance is less than the sanctioned limit/drawing power—

    (i) there are credits continuously for more than 90 days as on the date of balance sheet or

    (ii) credits during the aforesaid periods are not enough to cover the interest debited during the same period.

Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. Necessary provision should be made for non-performing assets after classifying them as sub-standard, doubtful or loss asset as the case may be.

Question 2

Classification of advances in the case of a Banking Company.

(5 Marks) (Intermediate–Nov. 1996 and Nov. 2000)

Answer

Banks have to classify their advances into four broad groups:

(i) **Standard Assets—**Standard assets is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not a NPA as discussed earlier.

(ii) **Sub-standard Assets—**Sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months. In the case of term loans, those where instalments of principal are overdue for period exceeding one year should be treated as sub-standard. In other words, such an asset will have well-defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected.

(iii) **Doubtful Assets**—A doubtful asset is one which has remained NPA for a period exceeding 18 months. In the case of term loans, those where instalments of principal have remained overdue for a period exceeding 18 months should be treated as doubtful. A loan classified as doubtful has all the weaknesses inherent in that classified as sub-standard with added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

(iv) **Loss Assets**—A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspectors but the amount has not been written off, wholly or partly.

The classification of advances should be done taking into account (i) Degree of well defined credit worthiness and (ii) Extent of dependence on collateral security.

The above classification is meant for the purpose of computing the amount of provision to be made in respect of advances and not for the purpose of presentation of advances in the balance sheet.

Question 3

Draft a specimen accounting policy concerning advances of a bank.

(5 marks) (Intermediate—May 1997)

Answer

(1) Provisions for doubtful advances have been made to the satisfaction of auditors :

- In respect of identified advances based on a periodical review and after taking into account the portion of advances guaranteed by DICGC & ECGC and similar statutory bodies.

- In respect of general advances as a percentage of total advances taking into account guidelines issued by the Government of India and RBI.

(2) Provisions in respect of doubtful advances have been deducted from advances to the extent necessary and the excess has been included under "other liabilities and provisions".

(3) Provisions have been made on a gross basis. Tax relief which will be available when the advance is written off will be accounted for in the year of write off.

Question 4

Slip system of posting and double voucher system. *(5 marks) (Intermediate–May 2000)*

Answer

Slip system of posting : Under this system used in the case of banking companies, entries in the personal ledgers are made directly from vouchers instead of being posted from the day book. Pay-in-slips (used by the customers at the time of making deposits) and the cheques are used as slips which form the basis of most of the transactions directly recorded in the accounts of customers. As the slips are mostly filled by the customers themselves, this system saves a lot of time and labour of the bank staff. The vouchers entered into different personal ledgers are summarised on summary sheets every day, totals of which are posted to the different control accounts which are maintained in the general ledger.

Double voucher system : In a bank, two vouchers are prepared for every transaction not involving cash—one debit voucher and another credit voucher. This system is called double voucher system. The vouchers are sent to different clerks who make entries in books under their charge.

Question 5

Acceptances and endorsements *(5 marks) (Intermediate–Nov. 2000)*

Answer

A bank has a more acceptable credit as compared to that of its customers. On this account, it is often called upon to accept or endorse bills on behalf of its customers. In such a case, the bank undertakes a liability towards the party which agrees to receive such a bill in payment of a debt or agreed to discount the bill after the same has been accepted by the bank. As against this liability, the bank has a corresponding claim against the customer on whose behalf it has undertaken to be a party to the bill, either as an acceptor or as an endorser. Such liabilities which are outstanding at the close of the year and the corresponding assets are disclosed as contingent liability in the financial statements. As a safeguard against the customer not being able to meet the demand of the bank in this respect, usually the bank requires the customer to deposit a security equivalent to the amount of the bill accepted on his behalf. A record of the particulars of the bills accepted as well as of the securities collected from the customers is kept in the Bills Accepted Register. A bank may not treat this book as part of the system of its account. In such a case no further record of the transactions is kept until the bill matures for payment. If the bill, at the end of its term, has to be retired by the bank and the amount cannot be collected from the customer on demand, the bank reimburses itself by disposing of the security deposited by the customer.

Question 6

Classification of investments by a banking company. *(4 marks) (Intermediate–Nov. 2001)*

Answer

The investment portfolio of a bank would normally consist of both approved securities (predominantly government securities) and other securities (shares, debentures, bonds etc.). Banks are required to classify their entire investment portfolio into three catogories : held-to-maturity, available-for-sale and held-for-maturity. Securities acquired by banks with the intention to hold them upto maturity should be classified as 'held-to-maturity'. Securities acquired by banks with the intention to trade by taking advantage of short–term price interest rate movements should be classifed as held-for trading/maturity. Securities which do not fall within the above two categories should be classified as available-for-sale'.

(B) Practical Questions :

Question 1

From the following information, prepare a Balance Sheet of International Bank Ltd. as on 31st March, 1994 giving the relevant schedules and also specify at least four important Principal Accounting Polcies :

	Rs. in lakhs	
	Dr.	*Cr.*
Share Capital		*198.00*
19,80,000 Shares of Rs. 10 each		
Statutory Reserve		*231.00*
Net Profit Before Appropriation		*150.00*
Profit and Loss Account		*412.00*
Fixed Deposit Account		*517.00*
Savings Deposit Account		*450.00*
Current Accounts	*28.00*	*520.12*
Bills Payable		*0.10*
Cash credits	*812.10*	
Borrowings from other Banks		*110.00*
Cash in Hand	*160.15*	
Cash with RBI	*37.88*	
Cash with other Banks	*155.87*	
Money at Call	*210.12*	
Gold	*55.23*	

Government Securities	*110.17*	
Premises	*155.70*	
Furniture	*70.12*	
Term Loan	*792.88*	
	2,588.22	*2,588.22*

Additional Information :

Bills for collection	*18,10,000*
Acceptances and endorsements	*14,12,000*
Claims against the Bank not acknowledged as debt	*55,000*
Depreciation charges—Premises	*1,10,000*
Furniture	*78,000*

50% of the Term Loans are secured by Government guarantees. 10% of cash credit is unsecured. Also calculate cash reserves required and statutory liquid reserves required.

Note : *Cash reserves required 3% of demand and time liabilities; liquid reserves required 30% of demand and time liabilities.* *(20 marks) (Intermediate–Nov. 1994)*

Answer

Balance Sheet of International Bank Ltd.
As on 31st March, 1994

(Rs. in lacs)

Capital and Liabilities	**Schedule**	**As on 31.3.94**	**As on 31.3.93**
Share Capital	1	1,98.00	
Reserves and Surplus	2	7,93.00	
Deposits	3	14,87.12	
Borrowings	4	1,10.00	
Other liabilities and provisions	5	0.10	
		25,88.12	
Assets			
Cash and balances with RBI	6	2,04.76	
Balances with banks and money at call and short notice	7	3,59.26	
Investments	8	1,65.40	
Advances	9	16,32.98	
Fixed Assets	10	2,25.82	
Other Assets	11	–	
		25,88.22	
Contingent liabilities	12	14.67	
Bills for collection		18.10	

Schedule 1— Capital

Authorised Capital		–
Issued, Subscribed and		
Paid up Capital		
19,80,000 Shares of Rs. 10 each		1,98.00

Schedule 2— Reserves and Surplus

(1) Statutory Reserve-		
Opening balance	2,31.00	
Additions during the year	30.00	
		2,61.00
(2) Balance in Profit & Loss		
Account *(W.N. 1)*		5,32.00
		7,93.00

Schedule 3— Deposits

(i) Demand deposits from others	5,20.12
(ii) Saving bank deposits	4,50.00
(iii) Fixed Deposits	5,17.00
	14,87.12

Schedule 4— Borrowings

Borrowing in India-	
Other banks	1,10.00

Schedule 5— Other Liabilities and Provisions

Other liabilities and provisions	0.10

Schedule 6— Cash and balances with RBI

(i) Cash in hand	1,60.15
(ii) Balances with RBI	
In current account *(W.N. 2)*	44.61
	2,04.76

Schedule 7—Balances with banks and money at call and short notice

1. In India	
(i) Balances with banks	
(a) in current accounts *(W.N. 3)*	1,49.14

	(ii)	Money at call and short notice	2,10.12
			3,59.26

Schedule 8— Investments

(1)		Investment in India in	
	(i)	Government securities	1,10.17
	(ii)	Others—Gold	55.23
			1,65.40

Schedule 9— Advances

A.	(i)	Cash credits, overdrafts	8,40.10
	(ii)	Term Loans	7,92.88
			16,32.98
B	(i)	Secured by tangible assets	11,52.53
	(ii)	Secured by bank/government guarantees	3,96.44
	(iii)	Unsecured	84.01
			16,32.98

Schedule 10— Fixed Assets

1.	Premises	
	At cost on 31st March, 1994	156.80
	Depreciation to date	1.10
		155.70
2.	Other Fixed Assets	
	Furniture at cost on 31st March, 1994	70.90
	Depreciation to date	0.78
		70.12
	Total (1 + 2)	2,25.82

Schedule 11— Other Assets

Nil

Schedule 12— Contingent Liabilities

(i)	Claims against bank not acknowledged as debts	0.55
(ii)	Acceptances, endorsements	14.12
		14.67

Calculation of cash reserves and statutory liquid reserves

Total of demand and time liabilities	
(Rs. 5,17.00 + Rs. 4,50.00 + Rs. 5,20.12)	14,87.12
Cash reserves (3% of above)	44.61
Statutory liquid reserves	
(30% of demand and time liabilities)	4,46.14

Working Note :

(1)	Balance in Profit & Loss Account :	
	Net Profit before appropriation	1,50.00
	Add : Profit for the year	4,12.00
		5,62.00
	Less : Transfer to statutory reserve	
	(20% of 1,50.000)	30.00
		532.00
(2)	Transfer from Cash with other banks to Cash with RBI	
	Cash reserve required	44.61
	Cash with RBI	37.88
	Transfer needed to maintain cash reserve	6.73
(3)	Liquid Assets :	
	Cash on hand	1,60.15
	Cash with other Banks	1,55.87
	Money at call and short notice	2,10.12
	Gold	55.23
	Government securities	1,10.17
		6,91.54
	Excess liquidity (6,91.54 – 4,46.14)	2,45.40

The excess liquidity enables the transfer as per(2) above.

After the transfer, cash with other Banks = Rs. (in lacs) (1,55.87 - 6.73) = Rs (in lacs) 1,49.14

Principal Accounting Policies :

(a) Foreign Exchange Transactions

(i) Monetary assets and liabilities have been translated at the exchange rate prevailing at the close of year. Non-monetary assets have been carried in the books at the historical cost.

(ii) Income and Expenditure items in respect of Indian branches have been translated at the exchange rates on the date of transactions and in respect of foreign branches at the exchange rates prevailing at the close of the year.

(iii) Profit or Loss on foreign currency position including pending forward exchange contracts have been accounted for at the exchange rates prevailing at the close of the year.

(b) Investment

Permanent category investments are valued at cost. Valuation of investment in current category depends on the nature of securities. While valuation of government securities held as current investments have been made on yield to maturity basis, the investments in shares of companies are valued on the basis of book value.

(c) Advances

Advances due from sick nationalised units under nursing programmes and in respect of various sticky, suit filed and decreed accounts have been considered good on the basis of–

(i) Available estimate value of existing and prospective primary and collateral securities including personal worth of the borrowers and guarantors.

(ii)The claim lodged/to be lodged under various credit guarantee schemes.

(iii) The claim lodged/to be lodged under various credit guarantee schemes.

(iii) Pending settlement of claims by Govt.

Provisions to the satisfaction of auditors have been made and deducted from advances. Tax relief available when the advance is written off will be accounted for in the year of write-off.

(d) Fixed Assets

The premises and other fixed assets except for foreign branches are accounted for at their historical cost. Depreciation has been provided on written down value method at the rates specified in the Income Tax Rules, 1962. Depreciation in respect of assets of foreign branches has been provided as per the local laws.

Question 2

On 31st March, 1997, Uncertain Bank Ltd. had a balance of Rs. 9 crores in "rebate on bills discounted" account. During the year ended 31st March, 1998, Uncertain Bank Ltd. discounted bills of exchange of Rs. 4,000 crores charging interest at 18% per annum the average period of discount being for 73 days. Of these, bills of exchange of Rs. 600 crores were due for realisation from the acceptors/customers after 31st March, 1998, the average period outstanding after 31st March, 1998 being 36.5 days.

Uncertain Bank Ltd. asks you to pass journal entries and show the ledger accounts pertaining to :

(i) discounting of bills of exchange and

(ii) rebate on bills discounted. *(10 marks) (Intermediate–May 1998)*

Answer

Uncertain Bank Ltd.

Journal Entries

		(Rupees in crores) Dr. Rs.	Cr. Rs.
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
$\left[\text{Rs. }4{,}000\text{ crores}\times\frac{18}{100}\times\frac{73}{365}\right]$			
To Clients A/c			3,856.00
(Being the discounting of bills of exchange during the year)			
Discount on bills A/c	Dr.	10.80	
To Rebate on bills discounted A/c			10.80
(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)			
Discount on bills A/c	Dr.	142.20	
To Profit and loss A/c			142.20
(Being the amount of income for the year from discounting of bills of exchange transferred to Profit and Loss A/c)			

Ledger Accounts

(i) **Discount on bills A/c**

1998		*Rs.*	*1997*		*Rs.*
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	1997-98	By Bills purchased and discounted A/c	144.00
		153.00			153.00

(ii) **Rebate on bills discounted A/c**

1997		*Rs.*	1997		*Rs.*
April 1	To Discount on bills A/c	9.00	April 1	By Balance b/d	9.00
1998			1998		
March 31	To Balance c/d	10.80	March 31	By Discount on bills A/c	10.80
		19.80			19.80

Question 3

Following are the statements of interest on advances in respect of performing and non-performing assets of Madura Bank Ltd. Find out the income to be recognised for the year ended 31st March. 1998.

		(Rs. in lakhs)
Performing Assets	*Interest earned*	*Interest received*
Cash credit and overdrafts	*1,800*	*1,060*
Term loans	*480*	*320*
Bills purchased and discounted	*700*	*550*
Non-performing Assets		
Cash credit and overdrafts	*450*	*70*
Term loan	*300*	*40*
Bills purchased and discounted	*350*	*36*

(4 Marks) (Intermediate–Nov. 1998)

Answer

Interest on Performing Assets should be recognised on accrual basis, but interest on Non-performing Assets should be recognised on cash/realisation basis.

			Rs. in lakhs
Interest on cash credit and overdrafts	(1,800 + 70)	=	1,870
Interest on term loan	(480 + 40)	=	520
Interest on bills purchased and discounted	(700 + 36)	=	736
Total income to be recognised			3,126

Question 4

From the following details prepare "Acceptances, Endorsements and other Obligation A/c" as would appear in the general ledger.

On 1.4.98 Acceptances not yet satisfied stood at Rs. 22,30,000. Out of which Rs. 20 lacs were subsequently paid off by clients and bank had to honour the rest. A scrutiny of the Acceptance Register revealed the following :

Client	*Acceptances/Guarantees Rs.*	*Remarks*
A	*10,00,000*	*Bank honoured on 10.6.98*
B	*12,00,000*	*Party paid off on 30.9.98*
C	*5,00,000*	*Party failed to pay and bank had to honour on 30.11.98*
D	*8,00,000*	*Not satisfied upto 31.3.99*
E	*5,00,000*	*-do-*
F	*2,70,000*	*-do-*
Total	*42,70,000*	

(4 marks) (Intermediate–Nov. 1999)

Answer

Acceptances, Endorsements and other Obligation Account
(in general ledger)

Dr. *Cr.*

			Rs. '000					*Rs. '000*
1998-99	To	Constituents' liabilities for acceptances/guarantees etc. (Paid off by clients)	20,00	1.4.98	By	Balance b/d		22,30
	To	Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank Rs. 22.30 lakhs less Rs. 20 lakhs)	2,30	1998-99	By	Constituents' liabilities for acceptances/guarantees etc.		
						A	10,00	
						B	12,00	
						C	5,00	
10.6.98	To	Constituents' liabilities for acceptances/guarantees etc. (Honoured by bank)	10,00			D	8,00	
						E	5,00	
						F	2,70	42,70
30.9.98	To	Constituents' liabilities for						

		acceptances/guarantees etc.		
		(Paid off by party)	12,00	
30.11.98	To	Constituent's liabilities for		
		acceptances/guarantees etc.		
		(Honoured by bank on		
		party's failure to pay)	5,00	
31.3.99	To	Balance c/d		
		(Acceptances not yet satisfied)	15,70	
			65,00	65,00

Question 5

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, 2000 :

(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*

(5 marks) (Intermediate–May 2000)

Answer

(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%)*	15.0
	42.0

(ii) Other advances :

(Rs. in lakhs)

Assets	*Amount Rs.*	*% 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 2000 is required.

Question 6

Bidisha Bank Ltd. had extended the following credit lines to a Small Scale Industry which had not paid any interest since March, 1995.

	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, 2001

(6 marks) (Intermediate–May 2002)

Answer

	Term Loan	*Export Credit*
	Rs. in Lacs	*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	25.00	27.00
Provision in respect of secured portion (100%)*	20.00	15.00
Provision for unsecured portion (100%)	25.00	27.00
Provision required	45.00	42.00

* 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 2000 is required.

Question 7

The following particulars are extracted from the (Trial Balance) Books of the M/s Commercial Bank Ltd. for the year ending 31st March, 2003:

		Rs.
(i)	*Interest and Discounts*	*1,96,62,400*
(ii)	*Rebate on Bills Discounted (balance on 1.4.2002)*	*65,040*
(iii)	*Bills Discounted and purchased*	*67,45,400*

It is ascertained that proportionate discount not yet earned on the Bills Discounted which will mature during 2003-2004 amounted to Rs. 92,760.

Pass the necessary Journal entries with narration adjusting the above and show:

(a) Rebate on Bill Discounted Account; and

(b) Interest and Discount Account in the ledger of the Bank. *(6 marks) (PE-II–Nov. 2003)*

Answer

The Commercial Bank Ltd.
Journal

Date			*Dr.*	*Cr.*
2003			*Rs.*	*Rs.*
March 31	Rebate on Bills Discounted A/c	Dr.	65,040	
	To Interest and Discount A/c			65,040

	(Being the amount of provision for unexpired discount brought forward from the previous year credited to Interest and Discount A/c).			
March 31	Interest and Discount A/c	Dr.	92,760	
	To Rebate on Bills Discounted A/c			92,760
	(Being provision for unexpired discount required at the end of the current year.)			
March 31	Interest and Discount A/c	Dr.	1,96,34,680	
	To Profit & Loss A/c			1,96,34,680
	(Being transfer of balance to Profit and Loss A/c).			

(a) **Rebate on Bills Discounted Account**

2003			*Rs.*	2002			*Rs.*
March 31	To	Interest and Discount A/c	65,040	April 1	By	Balance b/d	65,040
2003				2003			
March 31	To	Balance c/d	92,760	March 31	By	Interest and Discount A/c (rebate required)	92,760
			1,57,800				1,57,800

(b) **Interest and Discount Account**

2003			*Rs.*	2002			*Rs.*
March 31	To	Rebate on Bills Discounted A/c	92,760	April 1	By	Rebate on Bills Discounted A/c (opening balance)	65,040
				2003			
March 31	To	Profit & Loss A/c (transfer)	1,96,34,680	March 31	By	Cash and Sundries	1,96,62,400
			1,97,27,440				1,97,27,440

Question 8

Rajatapeeta Bank Ltd. had extended the following credit lines to a Small Scale Industry, which had not paid any Interest since March, 1997:

	Term Loan	*Export Loan*
Balance Outstanding on 31.03.2003	*Rs. 35 lakhs*	*Rs. 30 lakhs*
DICGC/ECGC cover	*40%*	*50%*
Securities held	*Rs. 15 lakhs*	*Rs. 10 lakhs*
Realisable value of Securities	*Rs. 10 lakhs*	*Rs. 08 lakhs*

Compute necessary provisions to be made for the year ended 31st March, 2003.

(6 marks) (PE-II–May 2004)

Answer

	Term loan Rs. in lakhs	Export credit Rs. in lakhs
Balance outstanding on 31.3.2003	35.0	30.0
Less: Realisable value of Securities	10.0	8.0
	25.0	22.0
Less: DICGC cover @ 40%	10.0	
ECGC cover @ 50%	___	11.0
Unsecured balance	15.0	11.0
Required Provision:		
100%* for unsecured portion	15.0	11.0
100% for secured portion	10.0	8.00
Total provision required	25.0	19.0

* 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 2000 is required.

Question 9

From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a Commercial Bank:

Assets	*Rs. (in lakhs)*
Standard	*4,000*
Sub-standard	*2,000*
Doubtful upto one year	*900*
Doubtful upto three years	*400*
Doubtful more than three years	*300*
Loss Assets	*500*

(4 marks) (PE-II–Nov. 2004)

Answer

Computation of provision:

Assets	*Amount (Rs. in lakhs)*	*% of Provision*	*Provision (Rs. in lakhs)*
Standard	4,000	0.40**	16
Sub-standard	2,000	10	200

Doubtful upto one year*	900	20	180
Doubtful upto three years*	400	30	120
Doubtful more than three years*	300	100**	300
Loss	500	100	500
			1316

* Doubtful assets are taken as fully secured.
** 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 2000 is required.

Question 10

From the following information calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of Zed Bank Ltd. for the year ended 31.3.2004:

		(Rs. in '000)
Interest and Discount		*8,860*
(Includes interest accrued on investments)		
Other Income		*220*
Interest expended		*2,720*
Operating expenses		*2,830*
Interest accrued on Investments		*10*
Additional Information:		
(a)	*Rebate on bills discounted to be provided for*	*30*
(b)	*Classification of Advances:*	
	(i) Standard assets	*4,000*
	(ii) Sub-standard assets	*2,240*
	(iii) Doubtful assets–(fully unsecured)	*390*
	(iv) Doubtful assets – covered fully by security	
	Less than 1 year	*100*
	More than 1 year, but less than 3 years	*600*
	More than 3 years	*600*
	(v) Loss assets	*376*
(c)	*Provide 35% of the profit towards provision for taxation.*	
(d)	*Transfer 20% of the profit to Statutory Reserve.*	

(16 marks) (PE-II – May 2005)

Answer

ZED Bank Ltd.
Profit and Loss Account
for the year ended 31st March, 2004

(Rs. in '000)

	Particulars	*Schedule No.*	*Year ended on 31st March, 2004*
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	220
	Total		9,050
II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		2,399
	Total		7,949
III.	Profit/Loss		
	Net profit/(loss) for the year		1,101
	Profit/(loss) brought forward		Nil
	Total		1,101
IV.	Appropriations		
	Transfer to statutory reserve @ 20%		220
	Balance carried to balance sheet		881
	Total		1,101

Working notes:

1. **Schedule 13 – Interest earned** *(Rs.'000s)*

(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted	(30)	
	Interest accrued on investments	(10)	8,820
(ii)	Interest accrued on investments		10
			8,830

2. **Calculation of Provisions and Contingencies**

Assets	*Amount (Rs. in '000)*	*% of Provision*	*Provision (Rs. in '000)*
Standard assets	4,000	0.40*	16
Sub-standard assets	2,240	10	224
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	20	20
More than 1 year but less than 3 years	600	30	180
More than 3 years	600	100*	600
Loss assets	376	100	376
Total provision	8,306		1,806

3. Calculation of provision on tax = 35% (Total income – Total expenditure)

= 35% of Rs. [(9,050 – (2,720 + 2,830 + 1,806)]

= 35% of Rs. 1,694

= Rs. 593

4. Total provisions and contingencies = Rs. 1,806 + Rs. 593 = Rs. 2,399.

* 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 2000 is required.

Question 11

(a) From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial bank:

	Assets	Rs. in lakhs
(i)	Standard (Value of security Rs.6,000 lakhs)	7,000
(ii)	Sub-standard	3,000
(iii)	Doubtful	
	(a) Doubtful for less than one year (Realisable value of security Rs.500 lakhs)	1,000
	(b) Doubtful for more than one year, but less than 3 years (Realisable value of security Rs.300 lakhs)	500
	(c) Doubtful for more than 3 years (No security)	300

(b) From the following details, prepare bills for collection (Asset) Account and Bills for collection (Liability) Account:

	Rs.
On 1.4.2005, Bills for Collection were	*51,00,000*
During the year 2005-06 Bills received for Collection amounted to	*75,00,000*
Bill collected during the year 2005-06	*98,47,000*
Bill dishonoured and returned during the year	*27,10,000*

(8+4= 12 Marks) (PE-II – May 2006)

Answer

(a)

	Asset Amount Rs. in lakhs	*% of provision*	*Provision Rs. in lakhs*
Standard	7,000	0.40*	28
Sub-standard	3,000	10	300
Doubtful (less than one year)			
On secured portion	500	20	100
On unsecured portion	500	100	500
Doubtful (more than one year but less than three years)			
On secured portion	300	30	90
On unsecured portion	200	100	200
Doubtful Unsecured (more than three years)	300	100	300
Total provision			1,518

* 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 2000 is required.

(b) **Bills for collection (Asset) Account**

		Rs.			*Rs.*
1.4.2005	To Balance b/d	51,00,000	2005-06	By Bills for collection (Liability) A/c	98,47,000
2005-06	To Bills for collection	75,00,000		By Bills for collection (Liability) A/c	27,10,000
			31.3.2006	By Balance c/d	43,000
		1,26,00,000			1,26,00,000
1.4.2006	To Balance b/d	43,000			

Bills for collection (Liability) Account

2005- 06	To Bills for collection (Asset) A/c	98,47,000	1.4.2005	By Balance b/d	51,00,000
			2005-06	By Bills for collection (Asset) A/c	75,00,000
	To Bills for collection (Asset) A/c	27,10,000			
31.3.2006	To Balance c/d	43,000			
		1,26,00,000			1,26,00,000
			1.4.2006	By Balance b/d	43,000

Question 12

The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2006:

Rebate on bills discounted as on 1-4-2005	*68,259 (Cr.)*
Discount received	*1,70,156 (Cr.)*

Analysis of the bills discounted reveals as follows:

Amount (Rs.)	*Due date*
2,80,000	*June 1, 2006*
8,72,000	*June 8, 2006*
5,64,000	*June 21, 2006*
8,12,000	*July 1, 2006*
6,00,000	*July 5, 2006*

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2006 and pass Journal Entries. The rate of discount may be taken at 10% per annum. *(8+8= 16 Marks) (PE-II – Nov. 2006)*

Answer

The amount of rebate on bills discounted as on 31st March, 2006 the period which has not been expired upto that day will be calculated as follows:

Discount on Rs.2,80,000 for 62 days @ 10%	4,756
Discount on Rs.8,72,000 for 69 days @ 10%	16,484
Discount on Rs.5,64,000 for 82 days @ 10%	12,671
Discount on Rs.8,12,000 for 92 days @ 10%	20,467
Discount on Rs.6,00,000 for 96 days @ 10%	15,781
Total	70,159

The amount of discount to be credited to the profit and loss account will be:

	Rs.
Transfer from rebate on bills discounted as on 31.03.2005	68,259
Add: Discount received during the year	1,70,156
	2,38,415
Less: Rebate on bills discounted as on 31.03.2006 (as above)	70,159
	1,68,256

Journal Entries

		Rs.	Rs.
Rebate on bills discounted A/c	Dr.	68,259	
To Discount on bills A/c			68,259
(Transfer of unexpired discount on 31.03.2005)			
Discount on bills A/c	Dr.	70,159	
To Rebate on bills discounted			70,159
(Unexpired discount on 31.03.2006 taken into account)			
Discount on Bills A/c	Dr.	1,68,256	
To P & L A/c			1,68,526
(Discount earned in the year, transferred to P&L A/c)			

Question 13

From the following information of details of advances of X Bank Limited calculate the amount of provisions to be made in profit and loss account for the year ended 31.3.2007:

Asset classification	*Rs. in lakhs*
Standard	*6,000*
Sub-standard	*4,400*
Doubtful:	
For one year	*1,800*
For two years	*1,200*
For three years	*800*
For more than three years	*600*
Loss assets	*1,600*

(6 Marks) (PE II- May, 2007)

Answer

Statement showing provisions on various performing and non-performing assets

Asset Classification	*Amount*	*Provision*	*Amount of Provision*
	Rs. in Lakhs	*%*	*Rs. in lakhs*
Standard	6,000	0.40	24
Sub-standard**	4,400	10	440
Doubtful**			
One year	1,800	20	360
2 years	1,200	30	360
3 years	800	30	240
More than 3 years	600	100*	600
Loss assets	1,600	100	1,600
			3,624

Question 14

The following are the figures extracted from the books of New Generation Bank Limited as on 31.3.2008:

	Rs.
Interest and discount received	*37,05,738*
Interest paid on deposits	*20,37,452*
Issued and subscribed capital	*10,00,000*
Salaries and allowances	*2,00,000*
Directors fee and allowances	*30,000*
Rent and taxes paid	*90,000*
Postage and telegrams	*60,286*
Statutory reserve fund	*8,00,000*
Commission, exchange and brokerage	*1,90,000*
Rent received	*65,000*
Profit on sale of investments	*2,00,000*

** Sub standard and doubtful assets have been treated as fully secured.

* w.e.f. 31st March 2007

Depreciation on bank's properties	*30,000*
Statutory expenses	*40,000*
Preliminary expenses	*25,000*
Auditor's fee	*5,000*

The following further information is given:

(i) A customer to whom a sum of Rs.10 lakhs has been advanced has become insolvent and it is expected only 50% can be recovered from his estate.

(ii) There were also other debts for which a provision of Rs.1,50,000 was found necessary by the auditors.

(iii) Rebate on bills discounted on 31.3.2007 was Rs.12,000 and on 31.3.2008 was Rs.16,000.

(iv) Provide Rs.6,50,000 for Income-tax.

(v) The directors desire to declare 10% dividend.

Prepare the Profit and Loss account of New Generation Bank Limited for the year ended 31.3.2008 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 31.3.2007.

(10 Marks) (PE II- May, 2008)

Answer

New Generation Bank Limited

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

		Schedule	*Year ended 31.03.2008 (Rs. in '000s)*
I.	**Income:**		
	Interest earned	13	3,701.74
	Other income	14	455.00
	Total		4,156.74
II.	**Expenditure**		
	Interest expended	15	2,037.45
	Operating expenses	16	480.29
	Provisions and contingencies (500 + 150 + 650)		1,300.00
	Total		3,817.74

IIII.	**Profits/Losses**	
	Net profit for the year	339.00
	Profit brought forward	Nil
		339.00
IV.	**Appropriations**	
	Transfer to statutory reserve (25%)	84.75
	Proposed dividend	100.00
	Balance carried over to balance sheet	154.25
		339.00

The Profit & Loss Account balance of Rs.154.25 thousand will appear in the Balance Sheet under the head 'Reserves and Surplus' in Schedule 2.

		Year ended 31.3.2008 (Rs. in '000s)
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	3,701.74
		3,701.74
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	190.00
II.	Profit on sale of investments	200.00
III.	Rent received	65.00
		455.00
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	2,037.45
		2,037.45
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees	200.00
II.	Rent, taxes and lighting	90.00
III.	Depreciation on bank's properties	30.00

IV.	Director's fee, allowances and expenses	30.00
V.	Auditors' fee	5.00
VI.	Law (statutory) charges	40.00
VII.	Postage and telegrams	60.29
VIII.	Preliminary expenses	25.00*
		480.29

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

Working Note:

Interest/discount (net of rebate on bills discounted)	3,705.74
Add: Rebate on bills discounted on 31.3.2007	12.00
Less: Rebate on bills discounted on 31.3.2008	(16.00)
	3701.74

Question 15

Following information is furnished to you by Sound Bank Ltd. for the year ended 31st March, 2008:

	(Rs. in thousands)
Interest and discount - (Income)	*8,860*
Interest on public deposits – (Expenditure)	*2,720*
Operating expenses	*2,662*
Other incomes	*250*
Provisions and contingencies (it includes provision in respect of Non-performing Assets (NPAs) and tax provisions)	*2,004*
Rebate on bills discounted to be provided for as on 31.3.2008	*30*
Classification of Advances:	
Standard Assets	*5,000*
Sub-standard Assets	*1,120*
Doubtful Assets – fully unsecured	*200*
Doubtful assets – fully secured	

Less than 1 year	*50*
More than 1 year but less than 3 years	*300*
More than 3 years	*300*
Loss assets	*200*

You are required to prepare:

(i) Profit and Loss Account of the Bank for the year ended 31st March, 2008.

(ii) Provision in respect of advances. (8 Marks) (PE II- Nov. 2008)

Answer

Sound Bank Ltd.

Profit and Loss Account

for the year ended 31st March, 2008

			Schedule No.	*(Rs. in thousands)*
Income:	Interest and Discount (8,860 – 30)		13	8,830
	Other income		14	250
				9,080
Expenditure:		Interest expenses	15	2,720
		Operating expenses	16	2,662
		Provision and Contingencies		2,004
				7,386
Net Profit/Loss for the year				1,694

Assets	*Value*	*% of provision*	*Provision*
Standard Assets	5,000	0.40	20.00
Sub-standard Assets*	1,120	10	112.00
Doubtful Assets			
100% unsecured	200	100	200.00
Secured:			
Less than 1 year	50	20	10.00
More than 1 year but less than 3 years	300	30	90.00
More than 3 years	300	100	300.00
Loss Assets	200	100	200.00
Total Provision			932.00

* Sub-standards assets are assumed to be fully secured.

Appendix: Latest Provisioning Norms

Students are advised to refer the following rates of Non-Performing Assets in case of Banking Companies

Provisions

Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the banks, it has been decided that banks should make provision against sub-standard assets, doubtful assets and loss assets on the following basis:

(a) *Loss assets* : The entire amount should be written off or full provision should be made for the amount outstanding.

(b) *Doubtful assets* : (*i*) Full provision to the extent of the unsecured portion should be made. In doing so, the realisable value of the security available to the bank should be determined on a realistic basis. DICGC/ECGC cover is also taken into account (this aspect is discussed later in this chapter). In case the advance covered by CGTSI guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

(ii) Additionally, 20% - 100% of the secured portion should be provided for, depending upon the period for which the advance has been considered as a doubtful asset, as follows:

Period for which the advance has been considered as doubtful	% of provision on secured portion
Upto 1 year	20%
More than 1 year and upto 3 years	30%
More than three years	
i. Outstanding stock of NPA's as on 31.03.2004	60% w.e.f. 31.03.2005
	75% w.e.f. 31.03.2006
	100% w.e.f. 31.03.2007
ii. Advances classified as doubtful for more than three years on or after 01.04.2004	100% w.e.f. 31.03.2005

(iii) Banks are permitted to phase the additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 to 12 months over a four year period commencing from the year ending March 31, 2005, with a minimum of 20% each year.

(c) *Sub-standard assets* : A general provision of 10% on total outstanding should be made without making any allowance for DICGC/ECGC cover and securities available. An additional provision of 10% (i.e., total 20% of total outstanding) is required to be made on 'unsecured exposure' *ab initio* sanction of loan. Generally such a situation may arise in case of personal and education loans etc. Unsecured exposure is defined as 'an exposure where the realizable value of security is not more than 10% of the outstanding exposure (fund based and non-fund based). Security should not include guarantees, comfort letters etc

(d) *Standard assets* : A general provision of a minimum of 0.40% of total standard assets should be made. It has been clarified that the provision should be made on global loan portfolio basis and not on domestic advances alone.

11

ACCOUNTS OF INSURANCE COMPANIES

(A) Write short notes on:

Question 1

Unexpired Risks Reserve *(5 marks) (Intermediate–May 1995 and PE-II–Nov. 2004)*

Answer

In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies extend into the following year during which the risk continues. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance. This reserve is based on the net premium income earned by the insurance company during the year

Question 2

Re-insurance. *(5 marks) (Intermediate–Nov. 1995 and Nov. 2000)*

Answer

If an insurer does not wish to bear the whole risk of policy written by him, he may reinsure a part of the risk with some other insurer. In such a case the insurer is said to have ceded a part of his business to other insurer. The reinsurance transaction may thus be defined as an agreement between a 'ceding company' and 'reinsurer' whereby the former agreed to 'cede' and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement.

A 'ceding company' is the original insurance company which has accepted the risk and has agreed to 'cede' or pass on that risk to another insurance company or a reinsurance company. It may however be emphasised that the original insured does not acquire any right under a reinsurance contract against the reinsurer. In the event of loss, therefore, the insured's claim for full amount is against the original insurer. The original insurer has to claim the proportionate amount from the reinsurer.

There are two types of reinsurance contracts, namely, facultative reinsurance and treaty reinsurance. Under facultative reinsurance each transaction has to be negotiated invididually and each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. Under treaty reinsurance a treaty agreement is entered into between ceding company and the reinsurer whereby the volume of the reinsurance transactions remain within the limits of the treaty.

Question 3

Give accounting entries pertaining to re-insurance business ceded to and by an insurance company and also corresponding commission entries? (5 marks)(Intermediate Nov. 1999)

Answer

A re-insurance business transaction may be defined as an agreement between a ceding company and re-insurer, whereby the former agrees to cede and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement. The accounting entries pertaining to re-insurance business ceded to and by an insurance company may be explained with the help of an example given below:

(X insurance company cedes re-insurance business to Y insurance company and Z insurance company cedes re-insurance business to X insurance company.) Accounting entries pertaining to re-insurance business ceded to and by X insurance company in the above example may be given as follows :

1.	Re-insurance Premium (on re-insurance ceded) Account	Dr.
	To Y Insurance Company	
	(Being premium on re-insurance business ceded to Y insurance company recorded)	
2.	Z Insurance Company	Dr.
	To Re-insurance Premium (on re-insurance accepted) Account	
	(Being premium on business ceded by Z insurance company recorded)	
3.	Y Insurance Company	Dr.
	To Claims (on re-insurance ceded) Account	
	(Being claims receivable from Y Co. for part of insurance business ceded)	
4.	Claims (on re-insurance accepted) Account	Dr.
	To Z Insurance Company	
	(Being claims on re-insurance business accepted from Z Company recorded	

5.	Y Insurance Company To Commission (on re-insurance ceded) Account (Being commission due on re-insurance business ceded to Y insurance company recorded)	Dr.
6.	Commission (on re-insurance accepted) Account To Z Insurance Company (Being commission due on re-insurance business ceded to Z Company debited)	Dr.

Question 4

Give computation of "premium income," "claims expense" and "commission expense" in the case of an insurance company. *(5 marks)(Intermediate–May 2000)*

Answer

Premium income : The payment made by the insured as consideration for the grant of insurance is known as premium. The amount of premium income to be credited to revenue account for a year may be computed as :

		Rs.
Premium received on risks undertaken during the year (direct & re-insurance accepted)		–
Add : Receivable at the end of year (direct & re-insurance accepted)		–
Less : Receivable at the beginning of year (direct & re-insurance accepted)		–
Less : Premium on re-insurance ceded:		–
Paid during the year	–	
Add : Payable at the end of year	–	
Less : Payable at the beginning of year	–	
Premium income		–

Claims expenses : A claim occurs when a policy falls due for payment. In the case of alife insurance business, it will arise either on death or maturity of policy that is, on the expiry of the specified term of years. In the case of general insurance business, a claim arises only when the loss occurs or the liability arises.

The amount of claim to be charged to revenue account may be worked out as under :

	Rs.
Claims settled during the year—direct & re-insurance accepted	–
(including legal fees, survey charges etc.)	
Add : Payments to co-insurers	–
Less : Received from co-insurers and re-insurers	–
Net payment	–
Add : Estimated liability at the end of the year	–
(After deducting recoverable from co-insurers and re-insurers)	
Less : Estimated liability at the beginning of the year	–
(after deducting recoverable from co-insurers and re-insurers)	
Claims expense	–

Commission expenses : Insurance Regulatory and Development Authority Act, 1999 regulates the commission payable on policies to agents. Commission expense to be charged to revenue account is computed as follows :

	Rs.
Commission paid (direct & re-insurance accepted)	–
Add : Commission payable at the end of the year	–
(direct & re-insurance accepted)	
Less : Commission payable at the beginning of the year	–
(direct & re-insurance accepted)	
Commission expense	–

(B) Practical Questions:

Question 1

The following are the Balances of Hercules Insurance Co. Ltd. as on 31st March, 1996 :

	(Rs. in '000)
Capital	*320,00*
Balances of Funds as on 1.4.95	
Fire Insurance	*800,00*
Marine Insurance	*950,00*
Miscellaneous Insurance	*218,65*
Unclaimed Dividends	*8,50*
Amount Due to Other Insurance Companies	*34,50*

Sundry Creditors		*72,50*
Deposit and Suspense Account (Cr.)		*22,80*
Profit and Loss Account (Cr.)		*80,40*
Agents Balances (Dr.)		*135,00*
Interest accrued but not due (Dr.)		*22,50*
Due from other Insurance Companies		*64,50*
Cash in Hand		*3,50*
Balance in Current Account with Bank		*74,80*
Furniture and Fixtures WDV (cost 100,00)		*58,00*
Stationery Stock		*1,40*
Expenses of Management		
Fire Insurance	*280,00*	
Marine Insurance	*160,00*	
Miscellaneous Insurance	*40,00*	
Others	*30,00*	*510,00*
Foreign Taxes—Marine		*8,00*
Outstanding premium		*82,00*
Donation Paid (No 80G Benefit)		*10,00*
Transfer Fees		*1,00*
Reserve for Bad Debts		*11,70*
Income Tax Paid		*120,00*
Mortgage Loan (Dr.)		*975,00*
Sundry Debtors		*25,00*
Government Securities Deposited with RBI		*37,00*
Government Securities (1020,00)		*1020,00*
Debentures		*465,50*
Equity Shares of Joint Stock Companies		*225,00*
Claims Less Re-insurance		
Fire	*450,00*	
Marine	*358,90*	
Miscellaneous	*68,00*	*876,90*
Premium Less Re-insurance		

Fire	*1762,50*	
Marine	*1022,50*	
Miscellaneous	*262,25*	*3047,25*
Interest and Dividends Received on Investments		*58,50*
Tax Deducted at Source		*11,70*
Commission		
Fire	*500,00*	
Marine	*350,00*	
Miscellaneous	*80,00*	*930,00*

You are required to make the following provisions :

Depreciation on Furniture—10% of Original Cost	
Depreciation on investments of Joint Stock Companies Shares	*10,00*
Transfer to General Reserve	*10,00*

Outstanding claims as on 31.3.96

Fire	*200,00*
Marine	*50,00*
Miscellaneous	*32,50*

Provision for tax @50%. Proposed dividends @20%. Provision for the unexpired risks is to be made as follows:

(a) On Marine Policies 100% Premium less reinsurance.

(b) On Other Policies 50% Premium less reinsurance.

You are required to prepare the revenue and profit and loss account for the year ended 31.3.1996 of the company. *(20 marks) (Intermediate–Nov. 1996)*

Answer

Form B – RA (Prescribed by IRDA)

Hercules Insurance Co. Ltd.

Revenue Account for the year ended 31st March, 1996

Fire and Marine and Misc Insurance Businesses

	Schedule	*Fire Current Year*	*Marine Current Year*	*Misc. Current Year*
		Rs. '000	Rs. '000	*Rs.* '000
Premiums earned (net)	1	1762,50	1022,50	262,25
Change in provision for unexpired risk		(-)81,25	(-) 72,50	87,52
Interest, Dividends and Rent – Gross		—	—	—

Double Income Tax refund		—	—	—
Profit on sale of motor car		—	—	—
Total (A)		1681,25	950,00	349,77
Claims incurred (net)	2	650,00	408,90	100,50
Commission	3	500,00	350,00	80,00
Operating expenses related to Insurance business	4	280,00	160,00	40,00
Bad debts		—	—	—
Indian and Foreign taxes		—	8,00	—
Total (B)		1430,00	926,90	220,50
Profit from Marine Insurance business (A-B)		251,25	23,10	129,27

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)	*Fire Current Year*	*Marine Current Year*	*Misc. Current Year*
	Rs. '000	*Rs*'000.	*Rs.* '000
Premiums *Less* reinsurance (net)	1762,50	1022,50	262,25
Schedule – 2			
Claims incurred (net)	650,00	408,90	100,50
Schedule – 3			
Commission paid	500,00	350,00	80,00
Schedule – 4			
Operating expenses related to insurance business			
Expenses of Management	280,00	160,00	40,00

Form B-PL
Hercules Insurance Co. Ltd.
Profit and Loss Account for the year 31st March, 1996

Particulars	*Schedule*	*Current Year*	*Previous Year*
		Rs. ' (000)	Rs. ' (000)
Operating Profit/(Loss)			
(a) Fire Insurance		251,25	

(b) Marine Insurance	23,10
(c) Miscellaneous	129,27
Income From Investments	
(a) Interest, Dividend & Rent–Gross	58,50
Other Income	
Transfer Fees	1,00
Total (A)	463,12
Provisions (Other than taxation)	
Depreciation of Furniture	10,00
Depreciation of Investments	10,00
Other Expenses –	
Expenses of Management	30,00
Donation	10,00
Total (B)	60,00
Profit Before Tax	403,12
Provision for Taxation	206,56
Profit After Tax	196,56
Profit	
(a) Interim dividends paid during the year	—
(b) Proposed final dividend	64,00
(c) Dividend distribution tax	—
(d) Transfer to General Reserves or Other Accounts (to be specified)	10,00
Balance of profit/loss brought forward from last year	80,40
Balance carried forward to Balance Sheet	202,96

Working Notes :

1. Reserve for unexpired risk 50% of net premium for fire and miscellaneous and 100% of net premium for marine.
2. Provision for Taxation

	Rs.
Net Profit before tax	403,12
Add : Donation	10,00
Taxable Profit	413,12
Tax 50%	206,56

Question 2

Indian Insurance Co. Ltd. furnishes you with the following information :

(i) On 31.12.1996 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 1997, the following business was conducted :

	Marine	Fire	Miscellaneous
		(Rs. in crores)	
	Rs.	Rs.	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 1997.

(6 marks)(Intermediate–May 1998)

Answer

(a) Journal of Indian Insurance Co. Ltd.

(Rupees in crores)

1997			Dr.	Cr.
			Rs	Rs.
Dec. 31	Marine Revenue A/c	Dr.	3.30	
	To Unexpired Risks Reserve A/c			3.30
	(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)			

Fire Revenue A/c	Dr.	1.85	
To Unexpired Risks Reserve A/c			1.85
(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)			
Unexpired Risks Reserve A/c	Dr.	0.50	
To Miscellaneous Revenue A/c			0.50
(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).			

(b) **Unexpired Risks Reserve A/c**

(Rs in crores)

		Marine	*Fire*	*Miscellaneous*			*Marine*	*Fire*	*Miscellaneous*
1997		*Rs.*	*Rs.*	*Rs.*	*1997*		*Rs.*	*Rs.*	*Rs.*
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.

Question 3

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, 1999 :

		Direct Business	*Re-Insurance*
		Rs.	*Rs.*
Claim paid during the year		*46,70,000*	*7,00,000*
Claim Payable—	*1st April, 1998*	*7,63,000*	*87,000*
	31st March, 1999	*8,12,000*	*53,000*
Claims received		–	*2,30,000*
Claims Receivable—	*1st April, 1998*	–	*65,000*

31st March, 1999	*–*	*1,13,000*
Expenses of Management	*2,30,000*	*–*
(includes Rs. 35,000 Surveyor's fee and Rs. 45,000		
Legal expenses for settlement of claims)		

(6 marks)(Intermediate–Nov. 1999)

Answer

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
		52,20
2. Claims outstanding on 31st March, 1999		
Direct business	8,12	
Reinsurance	53	8,65
Less : Claims receivable from re-insurers		1,13
		7,52
3. Claims outstanding on 1st April, 1998		
Direct business	763	
Reinsurance	87	8,50
Less : Claims receivable from re-insurers		65
		7,85

Question 4

From the following balances extracted from the books of Perfect General Insurance Company Limited as on 31.3.2000, you are required to prepare Revenue Accounts in respect of Fire and marine Insurance business for the year ended 31.3.2000 to and a Profit and Loss Account for the same period :

	Rs.		Rs.
Directors' Fees	*80,000*	*Interest received*	*19,000*
Dividend received	*1,00,000*	*Fixed Assets (1.4.1999)*	*90,000*
Provision for Taxation		*Income-tax paid during*	
(as on 1.4. 1999)	*85,000*	*the year*	*60,000*

	Fire	Marine
Outstanding Claims on 1.4.1999	*28,000*	*7,000*
Claims paid	*1,00,000*	*80,000*
Reserve for Unexpired Risk on 1.4.1999	*2,00,000*	*1,40,000*
Premiums Received	*4,50,000*	*3,30,000*
Agent's Commission	*40,000*	*20,000*
Expenses of Management	*60,000*	*45,000*
Re-insurance Premium (Dr.)	*25,000*	*15,000*

The following additional points are also to be taken into account :

(a) *Depreciation on Fixed Assets to be provided at 10% p.a.*

(b) *Interest accrued on investments Rs. 10,000.*

(c) *Closing provision for taxation on 31.3.2000 to be maintained at Rs. 1,24,138*

(d) *Claims outstanding on 31.3.2000 were Fire Insurance Rs. 10,000; Marine Insurance Rs. 15,000.*

(e) *Premium outstanding on 31.3.2000 were Fire Insurance Rs. 30,000; Marine Insurance Rs. 20,000.*

(f) *Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.*

(g) *Expenses of management due on 31.3.2000 were Rs. 10,000 for Fire Insurance and Rs. 5,000 in respect of marine Insurance.*

(12 marks)(Intermediate–Nov. 2000)

Answer

Form B – RA (Prescribed by IRDA)
Perfect General Insurance Co. Ltd
Revenue Account for the year ended 31st March, 2000
Fire and Marine Insurance Businesses

	Schedule	*Fire Current Year* Rs.	*Marine Current Year* Rs.
Premiums earned (net)	1	4,55,000	3,35,000
Change in provision for unexpired risk		(-)27,500	(-) 1,95,000
Interest, Dividends and Rent – Gross		—	—
Double Income Tax refund		—	—
Profit on sale of motor car		—	—
Total (A)		4,27,500	1,40,000
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	70,000	50,000
Bad debts		—	—
Indian and Foreign taxes		—	—
Total (B)		1,92,000	1,58,000
Profit from Marine Insurance business (A-B)		2,35,500	(18000)

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)	*Fire Current Year* *Rs.*	*Marine Current Year* *Rs.*
Premiums from direct business written	4,80,000	3,50,000
Less: Premium on reinsurance ceded	25,000	15,000
Total Premium earned (net)	4,55,000	33,5000
Schedule – 2		
Claims incurred (net)	82,000	88,000
Schedule – 4		
Operating expenses related to insurance business		
Expenses of Management	70,000	50,000

Form B-PL
Perfect General Insurance Co. Ltd.
Profit and Loss Account for the year 31st March, 2000

Particulars	*Schedule*	*Current Year Rs.*	*Previous Year Rs.*
Operating Profit/(Loss)			
(a) Fire Insurance		2,35,500	
(b) Marine Insurance		(18,000)	
(c) Miscellaneous Insurance		—	
Income From Investments			
(b) Interest, Dividend & Rent–Gross		1,29,000	
(c) Profit on sale of investments			
Less : Loss on sale of investments			
Other Income (To be specified)			
Total (A)		3,46,500	
Provisions (Other than taxation)		—	
Depreciation		9,000	
Other Expenses –Director's Fee		80,000	
Total (B)		89,000	
Profit Before Tax		2,57,500	
Provision for Taxation		99,138	
Profit After Tax		1,58,362	

Working Notes :

	Fire Rs.	*Marine Rs.*
1. Claims under policies less reinsurance		
Claims paid during the year	1,00,000	80,000
Add: Outstanding on 31st March, 2000	10,000	15,000
	1,10,000	95,000
Less : Outstanding on 1st April, 1999	28,000	7,000
	82,000	88,000
2. Expenses of management		
Expenses paid during the year	60,000	45,000
Add: Outstanding on 31st March, 2000	10,000	5,000
	70,000	50,000

3. Premiums less reinsurance

Premiums received during the year	4,50,000	3,30,000
Add: Outstanding on 31st March, 2000	30,000	20,000
	4,80,000	3,50,000
Less : Reinsurance premiums	25,000	15,000
	4,55,000	3,35,000

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance.

5. Provision for taxation account

		Rs.			*Rs.*
31.3.2000	To Bank A/c (taxes paid)	60,000	1.4.1999	By Balance b/d	85,000
31.3.2000	To Balance c/d	1,24,138	31.3.2000	By P & L A/c	99,138
		1,84,138			1,84,138

Question 5

From the following information as on 31st March, 2002, prepare the Revenue Accounts of Sagar Bhima Co. Ltd. engaged in Marine Insurance Business:

	Particulars	*Direct Business (Rs.)*	*Re-insurance (Rs.)*
I.	*Premium :*		
	Received	*24,00,000*	*3,60,000*
	Receivable – 1st April, 2001	*1,20,000*	*21,000*
	– 31st March, 2002	*1,80,000*	*28,000*
	Premium paid	*2,40,000*	*–*
	Payable – 1st April, 2001	*–*	*20,000*
	– 31st March, 2002	*–*	*42,000*
II.	*Claims :*		
	Paid	*16,50,000*	*1,25,000*
	Payable – 1st April, 2001	*95,000*	*13,000*
	– 31st March, 2002	*1,75,000*	*22,000*
	Received	*–*	*1,00,000*
	Receivable – 1st April, 2001	*–*	*9,000*
	– 31st March, 2002	*–*	*12,000*
III.	*Commission :*		
	On Insurance accepted	*1,50,000*	*11,000*
	On Insurance ceded	*–*	*14,000*

Other expenses and income:

Salaries – Rs. 2,60,000; Rent, Rates and Taxes – Rs. 18,000; Printing and Stationery – Rs. 23,000; Indian Income Tax paid – Rs. 2,40,000; Interest, Dividend and Rent received (net) – Rs. 1,15,500; Income Tax deducted at source – Rs. 24,500; Legal Expenses (Inclusive of Rs. 20,000 in connection with the settlement of claims) – Rs. 60,000; Bad Debts – Rs. 5,000; Double Income Tax refund – Rs. 12,000; Profit on Sale of Motor car Rs. 5,000.

Balance of Fund on 1st April, 2001 was Rs. 26,50,000 including Additional Reserve of Rs. 3,25,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

(16 marks) (PE-II–Nov. 2002)

Answer

In exercise of the powers conferred by Section 114A of the Insurance Act, 1938 (4 of 1938), the Insurance Regulatory and Development Authority in consultation with the Insurance Advisory Committee prescribed the new formats for the financial statements of Insurance Companies i.e. preparation of Financial Statements and Auditor's Report of Insurance Companies Regulations, 2000. Therefore, the above revenue account can be prepared as:

Form B – RA (Prescribed by IRDA)
Revenue Account for the year ended 31st March, 2002
Marine Insurance Business

	Schedule	*Current Year*	*Previous Year*
		Rs.	Rs.
Premiums earned (net)	1	25,65,000	
Change in provision for unexpired risk (Rs. 26,93,250 – Rs. 26,50,000)		(-)43,250	
Interest, Dividends and Rent – Gross		1,15,500	
Double Income Tax refund		12,000	
Profit on sale of motor car		5,000	
Total (A)		26,54,250	
Claims incurred (net)	2	17,81,000	
Commission	3	1,47,000	
Operating expenses related to Insurance business	4	3,41,000	
Bad debts		5,000	
Indian and Foreign taxes		2,40,000	
Total (B)		25,14,000	
Profit from Marine Insurance business (A-B)		1,40,250	

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)	*Current Year*	*Previous Year*
	Rs.	*Rs.*
Premiums from direct business written	28,27,000	
Less: Premium on reinsurance ceded	2,62,000	
Total Premium earned (net)	25,65,000	

Schedule – 2

Claims incurred (net)	17,81,000	

Schedule – 3

Commission paid		
Direct	1,50,000	
Add: Re-insurance accepted	11,000	
Less: reinsurance ceded	14,000	
	1,47,000	

Schedule – 4

Operating expenses related to insurance business		
Employees' remuneration and welfare benefits	2,60,000	
Rent, Rates and Taxes	18,000	
Printing and Stationery	23,000	
Legal and Professional charges	40,000	
	3,41,000	

Working Notes:

1. Total Premium Income	Direct	Re-insurance
	Rs.	Rs.
Received	24,00,000	3,60,000
Add: Receivable on 31st March, 2002	1,80,000	28,000
	25,80,000	3,88,000

	Less: Receivable on 1st April, .2001	1,20,000	21,000
		24,60,000	3,67,000

Total premium income 24,60,000 + 3,67,000 = 28,27,000

2.	**Premium Paid**	
	Paid	2,40,000
	Add: Payable on 31st March, 2002	42,000
		2,82,000
	Less: Payable on 1st April, 2001	20,000
		2,62,000
3.	**Claims Paid**	
	Direct Business	16,50,000
	Re-insurance	1,25,000
	Legal Expenses	20,000
		17,95,000
	Less: Re-insurance claims received	1,00,000
		16,95,000
4.	**Claims outstanding as on 31st March, 2002**	
	Direct	1,75,000
	Re-insurance	22,000
		1,97,000
	Less: Recoverable from Re-insurers on 31st March, 2002	12,000
		1,85,000
5.	**Claims outstanding as on 1st April, 2001**	
	Direct	95,000
	Re-insurance	13,000
		1,08,000
	Less: Recoverable from Re-insurers on 1st April, 2001	9,000
		99,000
6.	**Expenses of Management**	
	Salaries	2,60,000
	Rent, Rates and taxes	18,000
	Printing and Stationery	23,000
	Legal Expenses	40,000
		3,41,000

Question 6

X Fire Insurance Co. Ltd. commenced its business on 1.4.2005. It submits you the following information for the year ended 31.3.2006:

	Rs.
Premiums received	*15,00,000*
Re-insurance premiums paid	*1,00,000*
Claims paid	*7,00,000*
Expenses of Management	*3,00,000*
Commission paid	*50,000*
Claims outstanding on 31.3.2006	*1,00,000*
Create reserve for unexpired risk @40%	
Prepare Revenue account for the year ended 31.3.2006.	

(4 Marks) (PE-II – May 2006)

(c) **Form B – RA (Prescribed by IRDA)**

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

Registration No. and Date of registration with the IRDA: …………………..

Revenue Account for the year ended 31st March, 2006

	Particulars	*Schedule*	*Current year ended on 31st March, 2006*
			Rs.
1.	Premiums earned (Net)	1	14,00,000
2.	Change in provision for unexpired risk (NIL–5,60,000)	2	(5,60,000)
	Total (A)		8,40,000
1.	Claims incurred (Net)	3	8,00,000
2.	Commission		50,000
3.	Operating Expenses	4	3,00,000
	Total (B)		11,50,000
	Operating Profit/(Loss) from Fire Insurance Business [C =(A - B)]		(3,10,000)

Schedule 1

Premiums earned (Net)	*Rs.*
Premium received	15,00,000
Less: Premium on re-insurance paid	1,00,000
	14,00,000

Schedule 2

Reserve for unexpired risk @ 40% on net premium

$$\text{Rs.}14{,}00{,}000 \times \frac{40}{100} = \text{Rs.}\,5{,}60{,}000$$

Schedule 3

Claims	*Rs.*
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2006	1,00,000
	8,00,000

Schedule 4

Operating expenses	*Rs.*
Expenses of Management	3,00,000

Question 7

Prepare the Fire Insurance Revenue A/c as per IRDA regulations for the year ended 31st March, 2008 from the following details:

	Rs.
Claims paid	*4,90,000*
Legal expenses regarding claims	*10,000*
Premiums received	*13,00,000*
Re-insurance premium paid	*1,00,000*
Commission	*3,00,000*
Expenses of management	*2,00,000*
Provision against unexpired risk on 1st April, 2007	*5,50,000*
Claims unpaid on 1st April, 2007	*50,000*
Claims unpaid on 31st March, 2008	*80,000*

(6 Marks) (PE II- May, 2008)

Answer

FORM B - RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

Fire Insurance Revenue Account

for the year ended 31st March, 2008

	Particulars	*Schedule*	*Amount (Rs.)*
(1)	Premium earned	1	11,50,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		11,50,000
(4)	Claims incurred	2	5,30,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,30,000
	Operating Profit (A)- (B)		1,20,000

Schedule 1 : Premium earned (net)	*Rs.*
Premium received	13,00,000
Less: Re-insurance premium	1,00,000
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	50,000
	11,50,000

Schedule 2 : Claims Incurred	*Rs.*
Claims paid including legal expenses (4,90,000 + 10,000)	5,00,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,30,000

Schedule 3 : Commission	*Rs.*
Commission paid	3,00,000

	3,00,000
Schedule 4: Operating expenses	*Rs.*
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	*Rs.*
Unexpired risk reserve on 31st March, 2008 =50% of net premium	
i.e. 50% of Rs.12,00,000 (See Schedule 1)	6,00,000
Less : Unexpired risk reserve as on 1st April 2007	5,50,000
Change in the provision for unexpired risk	50,000

Question 8

Heaven Life Insurance Co. furnishes you the following information:

	Rs.
Life Insurance fund on 31.3.2008	*52,00,000*
Net liability on 31.3.2008 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. *(8 Marks)(PE II- Nov. 2008)*

Answer

(i) **Heaven Life Insurance Co.**

Valuation Balance Sheet as at 31st March, 2008

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

(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	3,00,000
	15,00,000

(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	3,00,000
Amount due to policyholders	11,25,000

12

ACCOUNTS OF ELECTRICITY SUPPLY COMPANIES

(A) Write short notes on:

Question 1

Main features of "Double Accounts" system of presentation of financial information in the case of public utility concern. (5 marks) (Intermediate–May 1995, Nov. 1997 and May 1999)

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.

Question 2

"Receipt and payment on capital account" and "General Balance Sheet" of a public utility.

(5 marks) (Intermediate–May 2000)

Answer

Under the double accounts system, which is followed by a public utility concern, the balance sheet is split into two parts : (a) Receipt and payment on capital account and (b) General Balance Sheet.

The main purpose of the former is to show (i) the total amount of capial raised its sources and (ii) the manner and the extent to which this capital has been applied in the acquisition of fixed assets for the purpose of carrying on the business of the undertaking. It thus discloses the receipt and expenditure on capital account, that is, the receipts from issue of shares, debentures and loans and the expenditure, out of such receipts, on acquisition of and addition to fixed assets. The receipt and expenditure on capital account is shown in a columnar form. There are three money columns : (a) one showing the amount at the commencement of the period; (b) another disclosing the amount received or spent during the period; and (c) the third showing the balance left at the end of the period.

The other part (called general balance sheet) contains other assets and liabilities and the balance of the receipt and expenditure on capital account. It is drawn up in the usual way, showing on the liabilities side–reserves, depreciation fund, current liabilities and other credit balances and total receipts as per capital account, on the assets side–total of expenditure as per capital account, floating assets and other debit balances.

Question 3

Reasonable returns in electricity supply companies. *(5 marks)(Intermediate–Nov. 2000)*

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 :

(a) An yield at the standard rate which is Reserve Bank rate plus two percent on the capital base as defined below;

(b) Income derived from investment except investment made against Contingencies Reserve;

(c) An amount equal to 1/2% on loans advanced by the Electricity Board;

(d) An amount equal to 1/2% on the amounts borrowed from organisations or institutions approved by the State Government;

(e) An amount equal to 1/2% on the amount raised by the issue of debentures;

(f) An amount equal to 1/2% on balance of Development Reserve; and

(g) 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:

(a) 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;

(b) the cost of intangible assets;

(c) the original cost of work in progress;

(d) the amount of investments compulsorily made agaisnt contingencies reserve; and

(e) 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:

(i) 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;

(ii) the amount of any loans advanced by the Board;

(iii) the amount of any loans borrowed from organisations or institutions approved by the State Government;

(iv) 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.

(B) Pratical Questions:

Question 1

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. *(8 marks) (Intermediate–Nov. 1999)*

Answer

Electric Supply Ltd.
Journal Entries

		Dr.	*Cr.*
		Rs.	*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	*Increase in cost Rate*	*Increase in cost Amount*	*Current cost*
	Rs.		*Rs.*	*Rs.*
Materials (3/5 × Rs. 15 lacs)	9,00,000	25%	2,25,000	11,25,000
Labour (2/5 × 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	20,95,000

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

Question 2

Power Electric Company decides to replace one of its old plant by an improved plant with larger capacity. The cost of the new plant is Rs. 16,00,000.

Materials and Labour earlier and now are in the ratio of 4 : 6.

Original cost of the old plant is Rs. 3,00,000. Materials cost has gone up by 2½ times and Labour cost by 3 times since then. Old materials worth Rs. 10,000 were used in the construction of the new plant and Rs. 20,000 were realised from the sale of old materials.

Give the necessary Journal Entries for recording the above transactions.

(6 marks) (PE-II–Nov. 2004)

Journal Entries

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Plant account	Dr.	7,70,000	
To Bank account			7,60,000
To Replacement account			10,000
(Being the additional cost incurred and old materials utilized in new plant)			
Replacement account	Dr.	8,40,000	
To Bank account			8,40,000
(Being the current cost of replacement)			
Bank account	Dr.	20,000	
To Replacement account			20,000
(Being the old materials sold)			
Revenue account	Dr.	8,10,000	
To Replacement account			8,10,000
(Being the balance of replacement account transferred to revenue account)			

Working Note:

Old cost of the plant Rs. 3,00,000:

Material = $3,00,000 \times \frac{4}{10} = 1,20,000$

Labour = $3,00,000 \times \frac{6}{10} = 1,80,000$

		Rs.
Cost of materials increased by 250% = 1,20,000 × 250%		3,00,000
Cost of labour increased by 300% = 1,80,000 × 300%		5,40,000
Current cost of replacing old plant		8,40,000
Less: Sale of old materials	20,000	
Old materials utilized in new plant	10,000	30,000
Amount to be transferred to Revenue account		8,10,000

Cash cost of the new plant	16,00,000*
Add: Old materials utilized	10,000
	16,10,000
Less: Current cost of replacing old plant	8,40,000
Amount to be capitalized	7,70,000

* The cost of new plant has been given as Rs. 16,00,000 in the question. It has been assumed in the above solution that this cost does not include the cost of old materials used in the construction of new plant worth Rs. 10,000.

Question 3

X Electricity Company Limited decides to replace one of its old plants with a modern one in April, 2006. The plant when installed in the year 2000, costed the company Rs.26 lakhs, the components of materials and labour being in the ratio of 7:3. It is ascertained that the cost of labour and materials have risen by 30% and 25% respectively. The cost of new plant is Rs.66 lakhs and in addition old materials worth Rs.92,000 are reused. Old materials worth Rs.1,68,000 are sold. Under double account system compute the following:

(i) The amount to be written off to Revenue A/c.

(ii) The amount to be capitalized.

(iii) Draw up the necessary Journal entries.

(iv) Draw up the Replacement Account. *(10 Marks)(PE II – May, 2007)*

Answer

(i) **Statement showing amount to be written off to Revenue Account**

			Rs.
Cost of old plant			26,00,000
Add:. Increase in cost of material	$26{,}00{,}000 \text{x} \frac{7}{10} \times \frac{25}{100}$		4,55,000
Increase in cost of Labour	$26{,}00{,}000 \text{ x } \frac{3}{10} \times \frac{30}{100}$		2,34,000
Current cost of old plant			32,89,000
Less: Cost of Material used	92,000		
Cost of Material sold	1,68,000		(-) 2,60,000
Amount to be written off to Revenue A/c			30,29,000

(ii) **Statement showing amount to be capitalised**

Cost of new plant excluding the value of old materials used	66,00,000
Less: Current cost of old plant	32,89,000
Current cost to be capitalized	33,11,000
Add: Value of old material used	92,000
Total amount to be capitalized	34,03,000

(iii) **Journal Entries in the Books of X Electricity Company Ltd.**

			Rs.	Rs.
(a)	Replacement Account	Dr.	32,89,000	
	To Bank Account			32,89,000
	(Being the replacement of old plant by a new plant; the current cost of replacement Rs.32,89,000)			
(b)	Plant Account	Dr.	34,03,000	
	To Replacement Account			92,000
	To Bank Account			33,11,000
	(Being additional cost of new plant capitalized and also old materials used in construction of new plant)			

(c)	Bank Account	Dr.	1,68,000	
	To Replacement A/c			1,68,000
	(Being the sale of old materials for Rs.1,68,000)			
(d)	Revenue A/c	Dr.	30,29,000	
	To Replacement Account			30,29,000
	(Being the balance of replacement account transferred to revenue account)			

(iv)

Replacement Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Bank A/c	32,89,000	By	New Plant A/c	92,000
			By	Bank A/c	1,68,000
			By	Revenue A/c (Balancing figure)	30,29,000
		32,89,000			32,89,000

Question 4

'H' Electricity Company earned a profit of Rs.60,00,000 (after tax) after paying Rs.48,000 at 12% interest on debentures for the year ended 31.3.2007. The following further information is supplied to you:

	Rs.
Share Capital	*2,50,00,000*
Reserve Fund Investment (invested in 8% Government Securities at par)	*60,00,000*
Contingencies Reserve Fund Investment (7%)	*25,00,000*
Loan from State Electricity Board	*50,00,000*
Development Reserve	*16,00,000*
Fixed Assets	*6,00,00,000*
Depreciation Reserve on Fixed Assets	*60,00,000*
Security Deposits of customers	*80,00,000*
Amount contributed by consumers towards cost of Fixed Assets	*4,50,000*
Intangible Assets	*17,50,000*

Tariffs and Dividends Control Reserve	*22,00,000*
Monthly average of Current Assets including amount due from customers Rs.5,00,000	*36,00,000*

Show, how the profits of the company will be dealt with under the provisions of the Electricity Act, assuming the bank rate of the year was 8%. All working notes should form part of your answer. *(16 Marks) (PE II, Nov. 2007)*

Answer

'H' Electricity Company

Statement of Distribution of Profit for the year ended 31.3.2007

Capital Base

	Rs.	*Rs.*
Fixed Assets as reduced by customers contribution		
(6,00,00,000 – 4,50,000)	5,95,50,000	
Intangible Assets	17,50,000	
Monthly average of Current Assets (Excluding amount due from customers i.e. 36,00,000 – 5,00,000)	31,00,000	
Contingencies Reserve Fund Investment	25,00,000	6,69,00,000
Deduct:		
Depreciation Reserve	60,00,000	
Loan from Electricity Board	50,00,000	
12% Debentures ($48{,}000 \times \frac{100}{12}$)	4,00,000	
Development Reserve	16,00,000	
Security Deposits of Customers	80,00,000	
Tariffs and Dividends Control Reserve	22,00,000	2,32,00,000
Capital Base		4,37,00,000

Reasonable Return

	Rs.
10% (Bank Rate + 2%) on Capital Base	43,70,000
8% on Reserve Fund Investment	4,80,000

½% on Loan from Electricity Board	25,000
½% on Debentures	2,000
½% on Development Reserve	8,000
Reasonable Return	48,85,000

Surplus and its Disposal

	Rs.
Clear Profit	60,00,000
Surplus (Rs.60,00,000 – Rs.48,85,000)	11,15,000
Less: 20% of Reasonable Return (to be disposed off)	9,77,000
Amount refundable to consumers	1,38,000

Disposal of Surplus of Rs.9,77,000

		Rs.
(i)	$\frac{1}{3}$ of surplus over clear profit limited to 5% of reasonable return will be at the disposal of the company i.e. Rs.3,71,667 >Rs.2,44,250	2,44,250
(ii)	Credit to Tariffs and Dividends Control Reserve (1/2 of remaining balance of 20% of Reasonable Return)	3,66,375
(iii)	Credit to Consumers' Suspense Account	3,66,375
		9,77,000

Total amount at the disposal of the company

		Rs.
(a)	Amount of reasonable return	48,85,000
(b)	Share in surplus	2,44,250
		51,29,250

Total amount refunded to consumers

		Rs.
(a)	Surplus in excess of 20% of reasonable return	1,38,000
(b)	Share in surplus	3,66,375
		5,04,375

13

FINANCIAL ANALYSIS

UNITS 1 & 2 : FUND FLOW STATEMENT AND CASH FLOW STATEMENT

(A) Write short notes on:

Question 1

Cash Flow Statement. *(5 marks) (Intermediate–Nov. 1997)*

Answer

Cash flow statement is a statement of inflows and outflows of cash and cash equivalents. It starts with the opening balance of cash and cash equivalents at the start of the accounting period. It then gives in a summary form, the inflows and outflows relating to the following three classifications of activities :

(i) **Operating activities :** They are the principal revenue producing activities of the enterprise.

(ii) **Investing activities :** They deal with the acquisition and disposal of long-term assets and long term investments.

(iii) **Financing activities :** They reflect changes in the size and composition of capital in the case of a company this would preference capital and borrowings of the enterprise.

The cash flows arising from extraordinary items are disclosed separately under each of the above three classifications.

Likewise where the amount of significant cash and cash equivalent balances held by an enterprise are not available for use by the enterprise, the same should be disclosed separately together with a commentary by the management.

Question 2

In the case of manufacturing company :

(i) List the items of 'inflows' of cash receipts from operating activities;

(ii) List the items of "outlflows" of investing activities. *(4 marks) [Intermediate May 1998]*

Answer

(i) **Inflows of cash receipts from operating activities :**

(a) Cash receipts from the sales of goods;

(b) Royalties, fees, commission and other revenue;

(c) Refunds of income-tax.

(ii) **Outflows of investing activities :**

(a) Cash payments for acquisition of fixed assets;

(b) Cash payments for acquisition of shares, warrants or debts instruments of other enterprises and interests in joint ventures (other than payments for instruments considered to cash equivalents and those for dealing or trading purposes);

(c) Cash advances and loans to third parties.

Question 3

Classification of activities (with two examples) as suggested in AS 3, to be used for preparing a cash flow statements. (5 marks) (Intermediate–May 2001)

Answer

AS 3 (Revised) on Cash Flow Statements requires that the cash flow statement should report cash flows by operating, investing and financing activities.

(i) **Operating activities** are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities. Cash receipts from sale of goods and cash payments to suppliers of goods are two examples of operating activities.

(ii) **Investing activities** are acquisition and disposal of long-term assets and other investments not included in cash equivalents. Payment made to acquire machinery and cash received for sale of furniture are examples of investing activities.

(iii) **Financial activities** are those activities that result in changes in the size and composition of the owner's capital (including preference share capital in the case of a company) and borrowings of the enterprise. Cash proceeds from issue of shares and cash paid to redeem debentures are two examples of financing activities.

Question 4

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3, (AS 3) revised.

(8 marks) (Final Nov. 2001)

Answer

As per para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either :

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss in adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either :

(a) from the accounting records of the enterprise; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statment of profit and loss for :

   (i) changes during the period in inventories and operating receivables and payables;

   (ii) other non-cash items; and

   (iii) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activies is determined by adjusting net profit or loss for the effects of :

(a) changes during the period in inventories and operating receivables and payables;

(b non-cash items such as depreciation, provisions, deferred taxes and unrealised foreign exchange gains and losses; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses, excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Question 5

What all are the differences between Cash Flow statement and Fund Flow statement?

(4 Marks) (PE-II – May 2006)

Answer

Differences between cash flow statement and fund flow statement

(i) Cash flow statement deals with the change in cash position between two points of time. Fund flow statement deals with the changes in working capital position.

(ii) Cash flow statement contains opening as well as closing balances of cash and cash equivalents. The fund flow statement does not contain any such opening and closing balance.

(iii) Cash flow statement records only inflow and outflow of cash. Fund flow statement records sources and application of funds.

(iv) Fund flow statement can be prepared from the cash flow statement under indirect method. However, a cash flow statement cannot be prepared from fund flow statement.

(v) A statement of changes in working capital is usually prepared alongwith fund flow statement. No such statement is prepared along with the cash flow statement.

(B) Practical Questions:

Question 1

Given below are the condensed Balance Sheets of Lambakadi Ltd. for two years and the statement of Profit and Loss for one year :

(Figures Rs. in lakhs)

As at 31st March	*1998*	*1997*
Share Capital		
In equity shares of Rs. 100 each	*150*	*110*
10% redeemable preference shares of Rs. 100 each	*10*	*40*
Capital redemption reserve	*10*	*—*
General reserve	*15*	*10*
Profit and loss account balance	*30*	*20*
8% debentures with convertible option	*20*	*40*
Other term loans	*15*	*30*
	250	*250*
Fixed assets less depreciation	*130*	*100*
Long term investments	*40*	*50*
Working capital	*80*	*100*
	250	*250*

Statement of Profit and Loss for the year ended 31st March, 1998

(Figures Rs. in lakhs)

Sales		*600*
Less : Cost of sales		*400*
		200
Establishment charges	*30*	
Selling and distribution expenses	*60*	
Interest expenses	*5*	
Loss on sale of equipment (Book value Rs. 40 lakhs)	*15*	*110*
		90
Interest income	*4*	
Dividend income	*2*	
Foreign exchange gain	*10*	
Damages received for loss of reputation	*14*	*30*
		120

Depreciation	*50*
	70
Taxes	*30*
	40
Dividends	*15*
Net profit carried to Balance Sheet	*25*

Your are informed by the accountant that ledgers relating to debtors, creditors and stock for both the years were seized by the income-tax authorities and it would take atleast two months to obtain copies of the same. However, he is able to furnish the following data :

(Figures Rs. in lakhs)

	1998	*1997*
Dividend receivable	*2*	*4*
Interest receivable	*3*	*2*
Cash on hand and with bank	*7*	*10*
Investments maturing within two months	*3*	*2*
	15	*18*
Interest payable	*4*	*5*
Taxes payable	*6*	*3*
	10	*8*
Current ratio	*1.5*	*1.4*
Acid test ratio	*1.1*	*0.8*

It is also gathered that debentureholders owning 50% of the debentures outstanding as on 31.3.97 exercised the option for conversion into equity shares during the financial year and the same was put through.

You are required to prepare a direct method cash flow statement for the financial year, 1998 in accordance with para 18(a) of Accounting Standard (AS) 3 revised. (20 marks) (Final May 1998)

Answer

Lambakadi Ltd.

Direct Method Cash Flow Statement

for the year ended 31st March, 1998

(Rs. in lakhs)

Cash flows from operating activities		
Cash receipts from customers	621	
Cash paid to suppliers and employees	(496)	
Cash generated from operations	125	
Taxes paid	(27)	
Cash flows before extraordinary item	98	
Damages received for loss of reputation	14	
Net cash from operating activities		112

Cash flows from investing activities		
Purchase of fixed assets	(120)	
Proceeds from sale of equipment	25	
Proceeds from sale of long term investments	10	
Interest received	3	
Dividend received	4	
Net cash used in investing activities		(78)
Cash flows from financing activities		
Proceeds from issuance of share capital	20	
Redemption of preference share capital	(30)	
Repayments of term loans	(15)	
Interest paid	(6)	
Dividend paid	(15)	
Net cash used in financing activities		(46)
Net increase in cash and cash equivalents		(12)
Cash and cash equivalents at beginning of period		12
(See Note 1 to the Cash Flow Statement)		
Cash and cash equivalents at end of the period		
(See Note 1 to the Cash Flow Statement)		NIL

Notes to the Cash Flow Statement

(Rs. in lakhs)

1. Cash and Cash Equivalents	*31.3.1998*	*31.3.1997*
Cash on hand and with bank	7	10
Short-term investments	3	2
	10	12
Effect of exchange rate changes	(10)	–
Cash and cash equivalents	Nil	12

2. Conversion of debentures into equity shares, a non-cash transaction, amounted to Rs.20 lakhs.

Working Notes :

(Rs. in lakhs)

1. Calculation of debtors, creditors and stock	*31.3.98*	*31.3.97*
(a) Current Ratio	1.5:1	1.4:1

	Working Capital to Current Liabilities Ratio	0.5:1	0.4:1
	Working Capital (Rs.in lakhs)	80	100
	Current Assets (Rs.in lakhs)	$\frac{80 \times 1.5}{0.5} = 240$	$\frac{10 \times 1.4}{0.4} = 350$
	Current Liabilities (Rs.in lakhs)	240 – 80 = 160	350 – 100 = 250
(b)	Current Ratio	1.5	1.4
	Less : Acid Test Ratio	1.1	0.8
		0.4	0.6
	Stock : Current Liabilities	0.4:1	0.6:1
	Stock (Rs.in lakhs)	160 × 0.4 = 64	250 × 0.6 = 150
			(Rs. in lakhs)
(c)	Break-up of Current Assets		
	Stock	64	150
	Debtors (Balancing figures)	161	182
	Other Current Assets	15	18
		240	350
(d)	Break-up of Current Liabilities		
	Creditors (Balancing figures)	150	242
	Others	10	8
		160	250

2. Cash receipts from customers

Sales		600
Add: Debtors at the beginning of the year		182
		782
Less : Debtors at the end of the year		161
		621

3. Cash paid to suppliers and employees

Cost of sales		400
Establishment charges		30
Selling and distribution expenses		60
		490
Add: Creditors at the beginning of the year	242	
Stock at the end of the year	64	306
		796
Less : Creditors at the end of year	150	
Stock at the beginning of the year	150	300
		496

4. Taxes paid

Tax expense for the year	30
Add : Tax liability at the beginning of the year	3
	33
Less : Tax liability at the end of year	6
	27

5. Fixed assets acquisitions

W.D.V. at 31.3.1998	130
Add back : Depreciation for the year	50
Disposals	40
	220
Less : W.D.V. at 31.3.1997	100
Purchase of fixed assets	120

6. Interest received

Interest income for the year	4
Add : Amount receivable at the beginning of the year	2
	6
Less : Amount receivable at the end of the year	3
	3

7. Dividend received

Dividend income for the year	2
Add : Amount receivable at the beginning of the year	4
	6
Less : Amount receivable at the end of the year	2
	4

8. Issue of shares

Equity share capital at the end of the year	150
Less : Equity share capital at the beginning of the year	110
	40
Less : Conversion of debentures into equity shares during the year (non-cash transaction)	20
Cash flow from issue of equity shares	20

9. Interest paid

Interest expense for the year	5
Add : Interest payable at the beginning of the year	5

	10
Less : Interest payable at the end of the year	4
	6

Notes :

1. It has been assumed that dividends for the year, Rs. 15 lakhs have been paid off.
2. It has been assumed that foreign exchange gain represents the effect of changes in exchange rates on cash and cash equivalents held in a foreign currency.

Question 2

The following are the changes in the account balances taken from the Balance Sheets of PQ Ltd. as at the beginning and end of the year. :

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

You are informed that.

(a) Capital reserve as at the end of the year represented realised profits on sale of one freehold property together with surplus arising on the revaluation of balance of freehold properties.

(b) During the year plant costing Rs. 18,000 against which depreciation provision of Rs. 13,500 was lying, was sold for Rs. 7,000.

(c) *During the middle of the year Rs. 50,000 debentures were issued for cash at a discount of Rs. 1,000.*

(d) *The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.*

You are required to prepare a statement which will explain, why bank borrowing has increased by Rs. 64,300 during the year end. Ignore taxation. (15 marks)(Final Nov. 1998)

Answer

PQ Ltd.
Cash Flow Statement for the year ended...

		Rs.
Cash flows from operating activities		
Net profit	76,500	
Adjustments for :		
Depreciation	27,900	
Profit on sale of plant	(2,500)	
Interest expense	2,000	
Operating profit before working capital changes	1,03,900	
Increase in debtors (less provision)	(46,700)	
Increase in stock and work-in-progress	(38,500)	
Increase in creditors	11,800	
Net cash operating activities		30,500
Cash flows from investing activities		
Purchase of plant and machinery	(78,000)	
Proceeds from sale of plant	7,000	
Proceeds from sale of freehold property	6,200	
Increase in trade investments	(47,000)	
Net cash used in investing activities		(1,11,800)
Cash flows from financing activities		
Proceeds from issuance od debentures at discount	49,000	
Debenture interest paid	(2,000)	
Dividend paid in financing activities	(30,000)	
Net cash from financing activities		17,000
Excess of outflows over inflows		64,300

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

Working Notes :

(1) *Plant and Machinery*	*Rs*
Amount of increase (at cost)	60,000
Add : Disposal (at cost)	18,000
Acquisition during the year	78,000

Disposal of plant :	
proceeds from sale	7,000
Net book value (18,000 – 13,500)	4,500
Profit on sale	2,500
(2) *Freehold property*	
Capital Reserve	49,200
Less : Increase in freehold property (closing balance minus opening balance)	43,000
Proceeds from sale of freehold property	6,200

Memorandum Accounts

(a) *Plant and Machinery Account*

		Rs.			*Rs.*
To	Balance b/d		By	Bank (Sale proceeds)	7,000
To	Profit and Loss A/c	2,500	By	Provision for Depreciation	13,500
	(Profit on sale)		By	Balance c/d	60,000
To	Bank (Balancing figure)	78,000			
		80,500			80,500

(b) *Provision for Depreciation (Plant and Machinery) Account*

To	Plant and Machinery A/c	13,500	By	Balance b/d	
To	Balance c/d	14,400	By	Profit and Loss A/c	27,900
				(Balancing figure)	
		27,900			27,900

(c) *Freehold Property Account*

To	Balance b/d	—	By	Bank A/c	6,200
To	Capital reserve	49,200		(Balancing figure)	
			By	Balance c/d	43,000
		49,200			49,200

In the absence of information about the opening balances, the entire amount of change has been considered under the closing balances for the purpose of calculation of missing figures.

Notes :

(1) Investment income and dividend pertaining to the current year have not been considered in the absence of any related information.

(2) Debenture interest has been calculated for 6 months @ 8% on Rs. 50,000.

Question 3

Examine the following schedule prepared by K Ltd.

K Ltd.

Schedule of funds provided by operations for the year ended 31st July, 1999

		(Rs.'000)	(Rs.'000)
Sales		32,760	
Add : Decrease in bills receivable.		1,000	
Less : Increase in accounts receivable		(626)	
Inflow from operating revenues			33,134
Cost of goods sold	18,588		
Less : Decrease in inventories	(212)		
Add : Decrease in trades payable	81	18,457	
Wages and Salaries	5,284		
Less : Increase in wages payable	(12)	5,272	
Administrative Expenses	3,066		
Add : Increase in prepaid expenses	11	3,077	
Property taxes		428	
Interest expenses	532		
Add : Amortisation of premium on bonds payable	20	552	
Outflow from operating expenses			27,786
From operations			5,348
Rent Income	207		
Add : Increase in unearned rent	3		210
			5,558
Income tax	1,330		
Less : Increase in deferred tax	50		1,280
Funds from operations			4,278

Required :

(i) *What is the definition of funds shown in the schedule?*

(ii) *What amount was reported as gross margin in the income statement?*

(iii) *How much cash was collected from the customers?*

(iv) *How much cash was paid for the purchases made?*

(v) As a result of change in inventories, did the working capital increase or decrease and by what amount?

(vi) How much rent was actually earned during the year?

(vii) What was the amount of tax expenses reported on the income statement?

Can you reconcile the profit after tax-with the funds provided by the operations?

(16 marks)(Final May 2000)

Answer

(i) 'Funds' shown in the schedule refer to the cash and cash equivalents [as defined in AS 3 (Revised) on Cash Flow Statements].

(ii) Gross margin in the income statement :

	Rs. ('000)
Sales	32,760
Cost of goods sold	18,588
	14,172

(iii)	Cash collected from the customers	33,134
(iv)	Cash paid for purchases made	18,457
(v)	Change in inventories would reduce the working capital by	212
(vi)	Rental income earned during the year	207
(vii)	Tax expenses reported in the income statement	1330

(Viii) **Reconciliation Statement**

	Rs.('000)
Profit after tax (See W.N.)	3,719
Decrease in bills receivable	1,000
Increase in accounts receivable	(626)
Decrease in inventories	212
Decrease in trades payable	(81)
Increase in wages payable	12
Increase in prepaid expenses	(11)
Increase in unearned rent	3
Increase in deferred tax	50
Funds from operations as shown in the schedule (i.e. cash and cash equivalents)	4,278

Working Note :

Calculation of Profit after Tax		*Rs. ('000)*
Sales		32,760
Less : Cost of goods sold		18,588
Gross margin		14,172
Add : Rental income		207
		14,379
Less : Wages and salaries	5,284	
Administrative expenses	3,066	
Property taxes	428	
Interest expenses	532	
Amortisation of premium on bonds payable	20	
		9,330
Profit before tax		5,049
Less : Income tax		1,330
Profit after tax		3,719

Question 4

Ms. Joyti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2000 :

	(Rs. in Lakhs)
Net Profit	*25,000*
Dividend (including dividend tax) paid	*8,535*
Provision for Income tax	*5,000*
Income tax paid during the year	*4,248*
Loss on sale of assets (net)	*40*
Book value of the assets sold	*185*
Depreciation charged to Profit & Loss Account	*20,000*
Amortisation of Capital grant	*6*
Profit on sale of Investments	*100*
Carrying amount of Investment sold	*27,765*
Interest income on investments	*2,506*
Increase expenses	*10,000*
Interest paid during the year	*10,520*

Increase in Working Capital (excluding Cash & Bank Balance)	*56,075*
Purchase of fixed assets	*14,560*
Investment in joint venture	*3,850*
Expenditure on construction work in progress	*34,740*
Proceeds from calls in arrear	*2*
Receipt of grant for capital projects	*12*
Proceeds from long-term borrowings	*25,980*
Proceeds from short-term borrowings	*20,575*
Opening cash and Bank balance	*5,003*
Closing cash and Bank balance	*6,988*

Required :

Prepare the Cash Flow Statement for the year 2000 in accordance with AS 3, Cash Flow Statements issued by the Institute of Chartered Accountants of India. (make necessary assumptions). *(16 marks)(Final May 2001)*

Answer

Star Oils Limited

Cash Flow Statement

for the year ended 31st December, 2000

(Rs. in lakhs)

Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Amortisation of capital grant	(6)	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,428	
Changes in working capital (Excluding cash and bank balance)	(56,075)	
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flows from investing activities		
Sale of assets	145	
Sale of investments (27,765 + 100)	(27,865)	

Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,634)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Receipts of grant for capital projects	12	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	
		27,514
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note :

Book value of the assets sold	185
Less : Loss on sale of assets	40
Proceeds on sale	145

Assumption :

Interest income on investments Rs. 2,506 has been received during the year.

Question 5

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2001 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2001

	Rs. '000		*Rs. '000*
Balance on 1.4.2000	*50*	*Payment to Suppliers*	*2,000*
Issue of Equity Shares	*300*	*Purchase of Fixed Assets*	*200*
Receipts from Customers	*2,800*	*Overhead expense*	*200*
Sale of Fixed Assets	*100*	*Wages and Salaries*	*100*
		Taxation	*250*

	Dividend	*50*
	Repayment of Bank Loan	*300*
	Balance on 31.3.2001	*150*
3,250		*3,250*

(8 marks)(Final Nov. 2001)

Answer

X Ltd.

Cash Flow Statement for the year ended 31st March, 2001

(Using the direct method)

	Rs. '000	*Rs.'000*
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at beginning of the period		50
Cash at end of the period		150

Question 6

From the following details relating to the Accounts of Grow More Ltd. prepare Cash Flow Statement:

Liabilities	*31.03.2002 (Rs.)*	*31.03.2001 (Rs.)*
Share Capital	*10,00,000*	*8,00,000*
Reserve	*2,00,000*	*1,50,000*
Profit and Loss Account	*1,00,000*	*60,000*
Debentures	*2,00,000*	*–*
Provision for taxation	*1,00,000*	*70,000*
Proposed dividend	*2,00,000*	*1,00,000*
Sundry Creditors	*7,00,000*	*8,20,000*
	25,00,000	*20,00,000*
Assets		
Plant and Machinery	*7,00,000*	*5,00,000*
Land and Building	*6,00,000*	*4,00,000*
Investments	*1,00,000*	*–*
Sundry Debtors	*5,00,000*	*7,00,000*
Stock	*4,00,000*	*2,00,000*
Cash on hand/Bank	*2,00,000*	*2,00,000*
	25,00,000	*20,00,000*

(i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.

(ii) During the year one old machine costing 50,000 (WDV 20,000) was sold for Rs. 35,000.

(iii) Rs. 50,000 was paid towards Income tax during the year.

(iv) Building under construction was not subject to any depreciation.

Prepare Cash flow Statement. *(16 marks) (PE-II–Nov. 2002)*

Answer

Grow More Ltd
Cash Flow Statement
for the year ended 31st March, 2002

Cash Flow from Operating Activities

Net Profit	40,000
Proposed Dividend	2,00,000

Provision for taxation		80,000	
Transfer to General Reserve		50,000	
Depreciation		1,25,000	
Profit on sale of Plant and Machinery		(15,000)	
Operating Profit before Working Capital changes		4,80,000	
Increase in Stock		(2,00,000)	
Decrease in debtors		2,00,000	
Decrease in creditors		(1,20,000)	
Cash generated from operations		3,60,000	
Income tax paid		(50,000)	
Net Cash from operating activities			3,10,000
Cash Flow from Inventing Activities			
Purchase of fixed assets	(3,45,000)		
Expenses on building	(2,00,000)		
Increase in investments	(1,00,000)		
Sale of old machine	35,000		
Net Cash used ininvesting activities			(6,10,000)
Cash Flow from financing activities:			
Proceeds from issue of shares	2,00,000		
Proceeds from issue of debentures	2,00,000		
Dividend paid	(1,00,000)		
Net cash used in financing activities			3,00,000
Net increase in cash or cash equivalents			NIL
Cash and Cash equivalents at the beginning of the year			2,00,000
Cash and Cash equivalents at the end of the year			2,00,000

Working Notes:

Provision for taxation account

		Rs.			Rs.
To	Cash (Paid)	50,000	By	Balance b/d	70,000
To	Balance c/d	1,00,000	By	Profit and Loss A/c (Balancing figure)	80,000
		1,50,000			1,50,000

Plant and Machinery account

		Rs.			Rs.
To	Balance b/d	5,00,000	By	Depreciation	1,25,000
To	Cash (Balancing figure)	3,45,000	By	Cash (sale of machine)	20,000
			By	Balance c/d	7,00,000
		8,45,000			8,45,000

Question 7

From the following Balance Sheet and information, prepare Cash Flow Statement of Ryan Ltd. for the year ended 31st March, 2003:

Balance Sheet

	31st March, 2003	31st March, 2002
	Rs.	Rs.
Liabilities		
Equity Share Capital	6,00,000	5,00,000
10% Redeemable Preference Capital	–	2,00,000
Capital Redemption Reserve	1,00,000	–
Capital Reserve	1,00,000	–
General Reserve	1,00,000	2,50,000
Profit and Loss Account	70,000	50,000
9% Debentures	2,00,000	–
Sundry Creditors	95,000	80,000
Bills Payable	20,000	30,000
Liabilities for Expenses	30,000	20,000
Provision for Taxation	95,000	60,000
Proposed Dividend	90,000	60,000
	15,00,000	12,50,000

	31st March, 2003	31st March, 2002
	Rs.	Rs.
Assets		
Land and Building	1,50,000	2,00,000
Plant and Machinery	7,65,000	5,00,000

Investments	*50,000*	*80,000*
Inventory	*95,000*	*90,000*
Bills Receivable	*65,000*	*70,000*
Sundry Debtors	*1,75,000*	*1,30,000*
Cash and Bank	*65,000*	*90,000*
Preliminary Expenses	*10,000*	*25,000*
Voluntary Separation Payments	*1,25,000*	*65,000*
	15,00,000	*12,50,000*

Additional Information:

(i) A piece of land has been sold out for Rs. 1,50,000 (Cost – Rs. 1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on sale and profit on revaluation.

(ii) On 1st April, 2002 a plant was sold for Rs. 90,000 (Original Cost – Rs. 70,000 and W.D.V. – Rs. 50,000) and Debentures worth Rs. 1 lakh was issued at par as part consideration for plant of Rs. 4.5 lakhs acquired.

(iii) Part of the investments (Cost – Rs. 50,000) was sold for Rs. 70,000.

(iv) Pre-acquisition dividend received Rs. 5,000 was adjusted against cost of investment.

(v) Directors have proposed 15% dividend for the current year.

(vi) Voluntary separation cost of Rs. 50,000 was adjusted against General Reserve.

(vii) Income-tax liability for the current year was estimated at Rs. 1,35,000.

(viii) Depreciation @ 15% has been written off from Plant account but no depreciation has been charged on Land and Building. (20 marks) (PE-II–May 2003)

Answer

Cash Flow Statement of Ryan Limited

For the year ended 31st March, 2003

Cash flow from operating activities	*Rs.*	*Rs.*
Net Profit before taxation	2,45,000	
Adjustment for		
Depreciation	1,35,000	
Preliminary expenses	15,000	
Profit on sale of plant	(40,000)	
Profit on sale of investments	(20,000)	
Interest on debentures	18,000	
Operating profit before working capital changes	3,53,000	
Increase in inventory	(5,000)	

Decrease in bills receivable	5,000	
Increase in debtors	(45,000)	
Increase in creditors	15,000	
Decrease in bills payable	(10,000)	
Increase in accrued liabilities	10,000	
Cash generated from operations	3,23,000	
Income taxes paid	(1,00,000)	
	2,23,000	
Voluntary separation payments	(1,10,000)	
Net cash from operating activities		1,13,000
Cash flow from investing activities		
Proceeds from sale of land	1,50,000	
Proceeds from sale of plant	90,000	
Proceeds from sale of investments	70,000	
Purchase of plant	(3,50,000)	
Purchase of investments	(25,000)	
Pre-acquisition dividend received	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares	1,00,000	
Proceeds from issue of debentures	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(60,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(78,000)
Net decrease in cash and cash equivalents		(25,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		65,000

Working Notes:

1.

	Rs.
Net profit before taxation	
Retained profit	70,000
Less: Balance as on 31.3.2002	(50,000)

	20,000
Provision for taxation	1,35,000
Proposed dividend	90,000
	2,45,000

2. **Land and Building Account**

		Rs.			Rs.
To	Balance b/d	2,00,000	By	Cash (Sale)	1,50,000
To	Capital reserve (Profit on sale)	30,000	By	Balance c/d	1,50,000
To	Capital reserve (Revaluation profit)	70,000			
		3,00,000			3,00,000

3. **Plant and Machinery Account**

		Rs.			Rs.
To	Balance b/d	5,00,000	By	Cash (Sale)	90,000
To	Profit and loss account	40,000	By	Depreciation	1,35,000
To	Debentures	1,00,000	By	Balance c/d	7,65,000
To	Bank	3,50,000			
		9,90,000			9,90,000

4. **Investments Account**

		Rs.			Rs.
To	Balance b/d	80,000	By	Cash (Sale)	70,000
To	Profit and loss account	20,000	By	Dividend (Pre-acquisition)	5,000
To	Bank (Balancing figure)	25,000	By	Balance c/d	50,000
		1,25,000			1,25,000

5. **Capital Reserve Account**

		Rs.			Rs.
To	Balance c/d	1,00,000	By	Profit on sale of land	30,000
			By	Profit on revaluation of land	70,000
		1,00,000			1,00,000

6. **General Reserve Account**

		Rs.			Rs.
To	Voluntary separation cost	50,000	By	Balance b/d	2,50,000
To	Capital redemption reserve	1,00,000			
To	Balance c/d	1,00,000			
		2,50,000			2,50,000

7. **Proposed Dividend Account**

		Rs.			Rs.
To	Bank (Balancing figure)	60,000	By	Balance b/d	60,000
To	Balance c/d	90,000	By	Profit and loss account	90,000
		1,50,000			1,50,000

8. **Provision for Taxation Account**

		Rs.			Rs.
To	Bank (Balancing figure)	1,00,000	By	Balance b/d	60,000
To	Balance c/d	95,000	By	Profit and loss account	1,35,000
		1,95,000			1,95,000

9. **Voluntary Separation Payments Account**

		Rs.			Rs.
To	Balance b/d	65,000	By	General reserve	50,000
To	Bank (Balancing figure)	1,10,000	By	Balance c/d	1,25,000
		1,75,000			1,75,000

Note: Cash Flow statement has been prepared using 'indirect method'.

Question 8

The Balance Sheet of New Light Ltd. for the years ended 31st March, 2001 and 2002 are as follows:

Liabilities	*31st March 2001 (Rs.)*	*31st March 2002 (Rs.)*	*Assets*	*31st March 2001 (Rs.)*	*31st March 2002 (Rs.)*
Equity share capital	*12,00,000*	*16,00,000*	*Fixed Assets*	*32,00,000*	*38,00,000*
10% Preference			*Less: Depreciation*	*9,20,000*	*11,60,000*
share capital	*4,00,000*	*2,80,000*		*22,80,000*	*26,40,000*
Capital Reserve	*–*	*40,000*	*Investment*	*4,00,000*	*3,20,000*

General Reserve	*6,80,000*	*8,00,000*	*Cash*	*10,000*	*10,000*
Profit and Loss A/c	*2,40,000*	*3,00,000*	*Other current assets*	*11,10,000*	*13,10,000*
9% Debentures	*4,00,000*	*2,80,000*	*Preliminary expenses*	*80,000*	*40,000*
Current liabilities	*4,80,000*	*5,20,000*			
Proposed dividend	*1,20,000*	*1,44,000*			
Provision for Tax	*3,60,000*	*3,40,000*			
Unpaid dividend	*–*	*16,000*			
	38,80,000	*43,20,000*		*38,80,000*	*43,20,000*

Additional information:

(i) The company sold one fixed asset for Rs. 1,00,000, the cost of which was Rs. 2,00,000 and the depreciation provided on it was Rs. 80,000.

(ii) The company also decided to write off another fixed asset costing Rs. 56,000 on which depreciation amounting to Rs. 40,000 has been provided.

(iii) Depreciation on fixed assets provided Rs. 3,60,000.

(iv) Company sold some investment at a profit of Rs. 40,000, which was credited to capital reserve.

(v) Debentures and preference share capital redeemed at 5% premium.

(vi) Company decided to value stock at cost, whereas previously the practice was to value stock at cost less 10%. The stock according to books on 31.3.2001 was Rs. 2,16,000. The stock on 31.3.2002 was correctly valued at Rs. 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

(16 marks) (PE-II–Nov. 2003)

Answer

New Light Ltd.
Cash Flow Statement for the year ended 31st March, 2002

A.	**Cash Flow from operating activities**	*Rs.*	*Rs.*
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [Rs.3,00,000 – (Rs.2,40,000 + Rs.24,000)]	36,000	
	Transfer to general reserve	1,20,000	
	Proposed dividend	1,44,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	6,40,000	
	Adjustments for:		

	Preliminary expenses written off	40,000	
	Depreciation	3,60,000	
	Loss on sale of fixed assets	20,000	
	Decrease in value of fixed assets	16,000	
	Premium on redemption of preference share capital	6,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	10,88,000	
	Increase in current liabilities (Rs.5,20,000 –Rs.4,80,000)	40,000	
	Increase in other current assets [Rs.13,10,000 – (Rs.11,10,000 + Rs.24,000)]	(1,76,000)	
	Cash generated from operations	9,52,000	
	Income taxes paid	(3,60,000)	
	Net Cash from operating activities		5,92,000
B.	**Cash Flow from investing activities**		
	Purchase of fixed assets	(8,56,000)	
	Proceeds from sale of fixed assets	1,00,000	
	Proceeds from sale of investments	1,20,000	
	Net Cash from investing activities		(6,36,000)
C.	**Cash Flow from financing activities**		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital (Rs.1,20,000 + Rs.6,000)	(1,26,000)	
	Redemption of debentures (Rs. 1,20,000 + Rs. 6,000)	(1,26,000)	
	Dividend paid	(1,04,000)	
	Net Cash from financing activities		44,000
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

Working Notes:

1. Revaluation of stock will increase opening stock by Rs. 24,000.

$$\frac{2,16,000}{90} \times 10 = \text{Rs. } 24,000$$

Therefore, opening balance of other current assets would be as follows:

Rs. 11,10,000 + Rs. 24,000 = Rs. 11,34,000

Due to under valuation of stock, the opening balance of profit and loss account be increased by Rs. 24,000.

The opening balance of profit and loss account after revaluation of stock will be

Rs. 2,40,000 + Rs. 24,000 = Rs. 2,64,000

2. Investment Account

		Rs.			*Rs.*
To	Balance b/d	4,00,000	By	Bank A/c (balancing figure being investment sold)	1,20,000
To	Capital reserve A/c (Profit on sale of investment)	40,000	By	Balance c/d	3,20,000
		4,40,000			4,40,000

3. Fixed Assets Account

		Rs.			*Rs.*	*Rs.*
To	Balance b/d	32,00,000	By	Bank A/c (sale of assets)	1,00,000	
To	Bank A/c (balancing figure being assets purchased)	8,56,000	By	Accumulated depreciation A/c	80,000	
			By	Profit and loss A/c(loss on sale of assets)	20,000	2,00,000
			By	Accumulated depreciation A/c	40,000	
			By	Profit and loss A/c (assets written off)	16,000	56,000
			By	Balance c/d		38,00,000
		40,56,000				40,56,000

4. Accumulated Depreciation Account

		Rs.			*Rs.*
To	Fixed assets A/c	80,000	By	Balance b/d	9,20,000
To	Fixed assets A/c	40,000	By	Profit and loss A/c	
To	Balance c/d	11,60,000		(depreciation for the period)	3,60,000
		12,80,000			12,80,000

5. Unpaid dividend is taken as non-current item and dividend paid is shown at Rs. 1,04,000 (Rs.1,20,000 – Rs.16,000).

Note: Alternatively, unpaid dividend can be assumed as current liability and hence, dividend paid can be shown at Rs. 1,20,000. Due to this assumption cash flow from operating activities would be affected. The cash flow from operating activities will increase by Rs. 16,000 to Rs. 6,08,000 and cash flow from financing activities will get reduced by Rs. 16,000 to Rs. 28,000.

Question 9

ABC Ltd. gives you the following informations. You are required to prepare Cash Flow Statement by using indirect methods as per AS 3 for the year ended 31.03.2004:

Balance Sheet as on

Liabilities	*31st March 2003*	*31st March 2004*	*Assets*	*31st March 2003*	*31st March 2004*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Capital	*50,00,000*	*50,00,000*	*Plant & Machinery*	*27,30,000*	*40,70,000*
Retained Earnings	*26,50,000*	*36,90,000*	*Less: Depreciation*	*6,10,000*	*7,90,000*
Debentures	*–*	*9,00,000*		*21,20,000*	*32,80,000*
Current Liabilities			*Current Assets*		
Creditors	*8,80,000*	*8,20,000*	*Debtors*	*23,90,000*	*28,30,000*
Bank Loan	*1,50,000*	*3,00,000*	*Less: Provision*	*1,50,000*	*1,90,000*
Liability for expenses	*3,30,000*	*2,70,000*		*22,40,000*	*26,40,000*
Dividend payable	*1,50,000*	*3,00,000*	*Cash*	*15,20,000*	*18,20,000*
			Marketable securities	*11,80,000*	*15,00,000*
			Inventories	*20,10,000*	*19,20,000*
			Prepaid Expenses	*90,000*	*1,20,000*
	91,60,000	*1,12,80,000*		*91,60,000*	*1,12,80,000*

Additional Information:

(i) *Net profit for the year ended 31st March, 2004, after charging depreciation Rs. 1,80,000 is Rs. 22,40,000.*

(ii) *Debtors of Rs. 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.*

(ii) *ABC Ltd. declared dividend of Rs. 12,00,000 for the year 2003-2004.*

(16 marks) (PE-II–May 2004)

Answer

Cash flow Statement of ABC Ltd. for the year ended 31.3.2004

Cash flows from Operating activities	*Rs.*	*Rs.*
Net Profit	22,40,000	
Add: Adjustment for Depreciation (Rs.7,90,000 – Rs.6,10,000)	1,80,000	
Operating profit before working capital changes	24,20,000	

Add: Decrease in Inventories (Rs.20,10,000 – Rs.19,20,000)		90,000	
Increase in provision for doubtful debts (Rs. 4,20,000 – Rs.1,50,000)		2,70,000	
		27,80,000	
Less: Increase in Current Assets:			
Debtors (Rs. 30,60,000 – Rs.23,90,000)	6,70,000		
Prepaid expenses (Rs. 1,20,000 – Rs.90,000)	30,000		
Decrease in current liabilities:			
Creditors (Rs. 8,80,000 – Rs. 8,20,000)	60,000		
Expenses outstanding (Rs. 3,30,000 – Rs.2,70,000)	60,000	8,20,000	
Net cash from operating activities			19,60,000
Cash flows from Investing activities			
Purchase of Plant & Equipment (Rs. 40,70,000 – Rs.27,30,000)		13,40,000	
Net cash used in investing activities			(13,40,000)
Cash flows from Financing Activities			
Bank loan raised (Rs. 3,00,000 – Rs. 1,50,000)		1,50,000	
Issue of debentures		9,00,000	
Payment of Dividend (Rs. 12,00,000 – Rs. 1,50,000)		(10,50,000)	
Net cash used in financing activities			**NIL**
Net increase in cash during the year			6,20,000
***Add:* Cash and cash equivalents as on 1.4.2003 (Rs. 15,20,000 + Rs.11,80,000)**			27,00,000
Cash and cash equivalents as on 31.3.2004 (Rs. 18,20,000 + Rs.15,00,000)			33,20,000

Note: Bad debts amounting Rs. 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and debtors as on 31.3.2004. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of debtors and provision for doubtful debts as appearing in the balance sheet on 31.3.2004.

Question 10

From the following balance sheets of Sneha Ltd. as on 31.3.2003 and 31.3.2004 prepare a statement of sources and applications of fund and a schedule of changes in working capital for the year ending 31.3.2004:

Balance Sheets

Liabilities	31.3.2003	31.3.2004	Assets	31.3.2003	31.3.2004
	Rs.	Rs.		Rs.	Rs.
Equity share capital	13,00,000	16,90,000	Goodwill	65,000	42,500
Profit and loss account	4,90,100	8,77,500	Building	11,70,000	11,37,500
10% Debentures	16,25,000	13,00,000	Machinery	16,18,500	21,38,500
Creditors	9,00,000	10,00,000	Non-trade investments	5,07,000	3,93,250
Bills payable	42,500	1,70,000	Debtors	4,16,000	11,70,000
Provision for tax	2,60,000	9,75,000	Stock	5,07,000	7,99,500
Dividend payable	–	42,250	Cash	2,60,000	2,92,500
			Prepaid expenses	42,250	52,000
			Debenture discount	31,850	29,000
	46,17,600	60,54,750		46,17,600	60,54,750

The following additional information is given:

(i)

	Building	Machinery
	Rs.	Rs.
Accumulated depreciation 31.3.2003	4,87,500	15,92,500
Accumulated depreciation 31.3.2004	5,20,000	15,66,500
Depreciation for 2003-2004	32,500	1,36,500

(ii) Profit and loss account for 2003-2004 is as follows:

	Rs.
Balance as on 31.3.2003	4,90,100
Add: Profit for 2003-2004	4,71,900
	9,62,000
Less: Dividend	84,500
	8,77,500

(iii) During 2003-2004 machinery costing Rs. 2,92,500 was sold for Rs. 97,500.

(iv) Investments which were sold for Rs. 1,17,000 had cost Rs. 97,500.

(v) Provision for Taxation and Dividend are to be taken as Non-current liabilities.

(20 marks) (PE-II–Nov. 2004)

Answer

(a)

Sneha Ltd.
Fund Flow Statement
for the year ended 31st March, 2004

	Amount (Rs.)
Sources of funds	
Share capital (Rs. 16,90,000 – Rs. 13,00,000)	3,90,000
Sale of machinery	97,500
Sale of investments	1,17,000
Funds from operation (W.N. 1)	16,70,500
	22,75,000
Applications of funds	
Debentures redeemed (Rs. 16,25,000 – Rs. 13,00,000)	3,25,000
Machinery purchased (W.N. 4)	7,86,500
Tax paid*	2,60,000
Dividend (Rs. 84,500 – Rs. 42,250)	42,250
Increase in working capital	8,61,250
	22,75,000

Schedule of Changes in Working Capital
for the year ended 31st March, 2004

		Balance as on		Changes in working capital	
		1.4.2003	31.3.2004	Increase	Decrease
		Rs.	Rs.	Rs.	Rs.
Current Assets:					
Debtors		4,16,000	11,70,000	7,54,000	–
Stock		5,07,000	7,99,500	2,92,500	–
Cash		2,60,000	2,92,500	32,500	–
Prepaid expenses		42,250	52,000	9,750	–
	A	12,25,250	23,14,000		
Current Liabilities:					
Creditors		9,00,000	10,00,000		1,00,000

* The provision for taxation has been treated as a non-current liability as per the requirement of the question. Last year's provision for taxation amounting Rs. 2,60,000 has been assumed to be paid in the current year ended 31st March, 2004.

Bills payable	42,500	1,70,000		1,27,500
B	9,42,500	11,70,000	10,88,750	2,27,500
Working capital (A – B)	2,82,750	11,44,000		
Increase in working capital			—	8,61,250
			10,88,750	10,88,750

Working Notes:

1. Statement showing funds generated from operations

			(Rs.)
Increase in profit and loss account during the year (Rs. 8,77,500 – Rs. 4,90,100)			3,87,400
Add: Non-cash expenditures			
(1) Loss on sale of machinery (W.N. 4)		32,500	
(2) Investments written off (W.N. 2)		16,250	
(3) Provision for tax		9,75,000	
(4) Depreciation			
on building (Rs. 11,70,000 – Rs. 11,37,500)	32,500		
on machinery (W.N. 3)	1,36,500	1,69,000	
(5) Goodwill written off (Rs. 65,000 – Rs. 42,500)		22,500	
(6) Debenture discount written off (Rs. 31,850 – Rs. 29,000)		2,850	
(7) Dividend		84,500	13,02,600
			16,90,000
Less: Non-cash incomes			
(1) Profit on sale of investments (Rs. 1,17,000 – Rs. 97,500)			19,500
Funds from operations			16,70,500

2. Non Trade Investment Account

Dr.		*Rs.*			*Cr.* *Rs.*
To	Balance b/d	5,07,000	By	Bank -Sale	1,17,000
To	Profit on sale (Rs. 1,17,000 – Rs. 97,500)	19,500	By	Profit and loss account – written off (balancing figure)	16,250
			By	Balance c/d	3,93,250
		5,26,500			5,26,500

3. Provision for Depreciation on Machinery Account

Dr.		Rs.			Cr. Rs.
To	Machinery -sale (balancing figure)	1,62,500	By	Balance b/d	15,92,500
			By	Depreciation	1,36,500
To	Balance c/d	15,66,500			
		17,29,000			17,29,000

4. Machinery Account

Dr.			Rs.				Cr. Rs.
To	Balance b/d	16,18,500		By	Bank (sale)		97,500
	Add: Provision			By	Depreciation		1,62,500
	for depreciation	15,92,500	32,11,000	By	Loss on sale		32,500
To	Bank -purchase (balancing figure)		7,86,500	By	Balance c/d W.D.V.	21,38,500	
					Add: Provision for depreciation	15,66,500	37,05,000
			39,97,500				39,97,500

Question 11

The following figures have been extracted from the Books of X Limited for the year ended on 31.3.2004. You are required to prepare a cash flow statement.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was Rs. 20 lakhs:

(a) Depreciation on Fixed Assets Rs. 5 lakhs.

(b) Discount on issue of Debentures written off Rs. 30,000.

(c) Interest on Debentures paid Rs. 3,50,000.

(d) Book value of investments Rs. 3 lakhs (Sale of Investments for Rs. 3,20,000).

(e) Interest received on investments Rs. 60,000.

(f) Compensation received Rs. 90,000 by the company in a suit filed.

(ii) Income tax paid during the year Rs. 10,50,000.

(iii) 15,000, 10% preference shares of Rs. 100 each were redeemed on 31.3.2004 at a premium of 5%. Further the company issued 50,000 equity shares of Rs. 10 each at a premium of 20% on 2.4.2003. Dividend on preference shares were paid at the time of redemption.

(iv) Dividends paid for the year 2002-2003 Rs. 5 lakhs and interim dividend paid Rs. 3 lakhs for the year 2003-2004.

(v) Land was purchased on 2.4.2003 for Rs. 2,40,000 for which the company issued 20,000 equity shares of Rs. 10 each at a premium of 20% to the land owner as consideration.

(vi) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 31.3.2003	*As on 31.3.2004*
	Rs.	*Rs.*
Stock	*12,00,000*	*13,18,000*
Sundry Debtors	*2,08,000*	*2,13,100*
Cash in hand	*1,96,300*	*35,300*
Bills receivable	*50,000*	*40,000*
Bills payable	*45,000*	*40,000*
Sundry Creditors	*1,66,000*	*1,71,300*
Outstanding expenses	*75,000*	*81,800*

(20 marks) (PE-II – May 2005)

Answer

X Ltd.

Cash Flow Statement

for the year ended 31st March, 2004

	Rs.	*Rs.*
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		20,00,000
Adjustments for:		
Depreciation on fixed assets	5,00,000	
Discount on issue of debentures	30,000	
Interest on debentures paid	3,50,000	
Interest on investments received	(60,000)	
Profit on sale of investments	(20,000)	8,00,000
Operating profit before working capital changes		28,00,000
Adjustments for:		
Increase in stock	(1,18,000)	
Increase in sundry debtors	(5,100)	
Decrease in bills receivable	10,000	
Decrease in bills payable	(5,000)	
Increase in sundry creditors	5,300	

Increase in outstanding expenses	6,800	
		(1,06,000)
Cash generated from operations		26,94,000
Income tax paid		(10,50,000)
		16,44,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		90,000
Net cash flow from operating activities		17,34,000
Cash flow from Investing Activities		
Sale proceeds of investments	3,20,000	
Interest received on investments	60,000	
Net cash flow from investing activities		3,80,000
Cash flow from Financing Activities		
Proceeds by issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(15,75,000)	
Preference dividend paid	(1,50,000)	
Interest on debentures paid	(3,50,000)	
Dividend paid (5,00,000 + 3,00,000)	(8,00,000)	
Net cash used in financing activities		(22,75,000)
Net decrease in cash and cash equivalents during the year		(1,61,000)
Add: Cash and cash equivalents as on 31.3.2003		1,96,300
Cash and cash equivalents as on 31.3.2004		35,300

Note: Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

Question 12

Raj Ltd. gives you the following information for the year ended 31st March, 2006:

(i) Sales for the year Rs.48,00,000. The Company sold goods for cash only.

(ii) Cost of goods sold was 75% of sales.

(iii) Closing inventory was higher than opening inventory by Rs.50,000.

(iv) Trade creditors on 31.3.2006 exceed the outstanding on 31.3.2005 by Rs.1,00,000.

(v) Tax paid during the year amounts to Rs.1,50,000.

(vi) Amounts paid to Trade creditors during the year Rs.35,50,000.

(vii) Administrative and Selling expenses paid Rs.3,60,000.

(viii) One new machinery was acquired in December, 2005 for Rs.6,00,000.

(ix) Dividend paid during the year Rs.1,20,000.

(x) Cash in hand and at Bank on 31.3.2006 Rs.70,000.

(xi) Cash in hand and at Bank on 1.4.2005 Rs.50,000.

Prepare Cash Flow Statement for the year ended 31.3.2006 as per the prescribed Accounting standard. (12 Marks) (PE-II – May 2006)

Answer

Cash flow statement of Raj Limited
for the year ended 31.3.2006

Direct Method

	Rs.	*Rs.*
Cash flow from operating activities:		
Cash receipt from customers (sales)	48,00,000	
Cash paid to suppliers and expenses (Rs.35,50,000 + Rs.3,60,000)	39,10,000	
Cash flow from operation	8,90,000	
Less: Tax paid	1,50,000	
Net cash from operating activities		7,40,000
Cash flow from investing activities:		
Purchase of fixed assets	(6,00,000)	
Net cash used in investing activities		(6,00,000)
Cash flow from financing activities:		
Dividend Paid	(1,20,000)	
Net cash from financing activities		(1,20,000)
		20,000
Add: Opening balance of Cash in Hand and at Bank		50,000
Cash in Hand and at Bank on 31.3.2006		70,000

Question 13

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2005 and 2006:

Liabilities	*As on 31.3.2005 (Rs.)*	*As on 31.3.2006 (Rs,.)*
Equity share capital	*10,00,000*	*12,50,000*
Capital Reserve	---	*10,000*
General Reserve	*2,50,000*	*3,00,000*
Profit and Loss A/c	*1,50,000*	*1,80,000*
Long-term loan from the Bank	*5,00,000*	*4,00,000*
Sundry Creditors	*5,00,000*	*4,00,000*
Provision for Taxation	*50,000*	*60,000*
Proposed Dividends	*1,00,000*	*1,25,000*
	25,50,000	*27,25,000*

Assets	*Year 2005 (Rs.)*	*Year 2006 (Rs.)*
Land and Building	*5,00,000*	*4,80,000*
Machinery	*7,50,000*	*9,20,000*
Investment	*1,00,000*	*50,000*
Stock	*3,00,000*	*2,80,000*
Sundry Debtors	*4,00,000*	*4,20,000*
Cash in Hand	*2,00,000*	*1,65,000*
Cash at Bank	*3,00,000*	*4,10,000*
	25,50,000	*27,25,000*

Additional Information:

(i) *Dividend of Rs.1,00,000 was paid during the year ended March 31, 2006.*

(ii) *Machinery during the year purchased for Rs.1,25,000.*

(iii) *Machinery of another company was purchased for a consideration of Rs.1,00,000 payable in equity shares.*

(iv) *Income-tax provided during the year Rs.55,000.*

(v) Company sold some investment at a profit of Rs.10,000, which was credited to Capital reserve.

(vi) There was no sale of machinery during the year.

(vii) Depreciation written off on Land and Building Rs.20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2006 as per AS 3 (Indirect method). (16 Marks) (PE-II - Nov. 2006)

Answer

Cash Flow Statement for the year ending on March 31, 2006

		Rs.	Rs.
I.	**Cash flows from Operating Activities**		
	Net profit made during the year (W.N.1)	2,60,000	
	Adjustment for depreciation on Machinery (W.N.2)	55,000	
	Adjustment for depreciation on Land & Building	20,000	
	Operating profit before change in Working Capital	3,35,000	
	Decrease in Stock	20,000	
	Increase in Sundry Debtors	(20,000)	
	Decrease in Sundry Creditors	(1,00,000)	
	Income-tax paid	(45,000)	
	Net cash from operating activities		1,90,000
II.	**Cash flows from Investing Activities**		
	Purchase on Machinery	(1,25,000)	
	Sale of Investments	60,000	(65,000)
III.	**Cash flows from Financing Activities**		
	Issue of equity shares (2,50,000-1,00,000)	1,50,000	
	Repayment of Long term loan	(1,00,000)	
	Dividend paid	(1,00,000)	(50,000)
Net increase in cash and cash equivalent			75,000
Cash and cash equivalents at the beginning of the period			5,00,000
Cash and cash equivalents at the end of the period			5,75,000

Working Notes:

(i) **Net Profit made during the year ended 31.3.2006**

Increase in P & L (Cr.) Balance		30,000
Add:	Transfer to general reserve	50,000
Add:	Provision for taxation made during the year	55,000
Add:	Provided for proposed dividend during the year	1,25,000
		2,60,000

(ii) **Machinery Account**

		Rs.			Rs.
To	Balance b/d	7,50,000	By	Depreciation (Bal. Fig.)	55,000
To	Bank	1,25,000	By	Balance c/d	9,20,000
To	Equity share capital	1,00,000			
		9,75,000			9,75,000

(iii) **Provision for Taxation Account**

		Rs.			*Rs.*
To	Cash (Bal. Fig.)	45,000	By	Balance b/d	50,000
To	Balance c/d	60,000	By	P & L A/c	55,000
		1,05,000			1,05,000

(iv) **Proposed Dividend Account**

		Rs.			Rs.
To	Bank	1,00,000	By	Balance b/d	1,00,000
To	Balance c/d	1,25,000	By	P & L A/c (Bal. Fig.)	1,25,000
		2,25,000			2,25,000

(v) **Investment Account**

		Rs.			*Rs.*
To	Balance b/d	1,00,000	By	Bank A/c (Balancing figure for investment sold)	60,000
To	Capital Reserve A/c (Profit on sale of investment)	10,000			
			By	Balance c/d	50,000
		1,10,000			1,10,000

14

ACCOUNTS FROM INCOMPLETE RECORDS

Question 1

K. Azad, who is in business as a wholesaler in sunflower oil, is a client of your accounting firm. You are required to draw up his final accounts for the year ended 31.3.1996.

From the files, you pick up his Balance Sheet as at 31.3.1995 reading as below:

Balance Sheet as at 31.3.1995

Liabilities	*Rs.*	*Rs.*
K. Azad's Capital		*1,50,000*
Creditors for Oil Purchases		*2,00,000*
12% Security Deposit from Customers		*50,000*
Creditors for Expenses :		
Rent		*6,000*
Salaries		*4,000*
Commission		*20,000*
		4,30,000
Assets		
Cash and Bank Balances		*75,000*
Debtors		*1,60,000*
Stock of Oil (125 tins)		*1,25,000*
Furniture	*30,000*	
Less : Depreciation	*3,000*	*27,000*
Rent Advance		*12,000*
Electiricity Deposit		*1,000*
3–Wheeler Tempo Van	*40,000*	
Less : Depreciation	*10,000*	*30,000*
		4,30,000

A Summary of the rough Cash Book of K. Azad for the year ended 31.3.1996 is as below :

Cash and Bank Summary

Receipts	*Rs.*
Cash Sales	*5,26,500*
Collections from Debtors	*26,73,500*
Payments	
To Landlord	*79,000*
Salaries	*48,000*
Miscellaneous Office Expenses	*12,000*
Commission	*20,000*
Personal Income–tax	*50,000*
Transfer on 1.10.95 to 12% Fixed Deposit	*6,00,000*
To Creditors for Oil Supplies	*24,00,000*

A scrutiny of the other records gives you the following information :

(i) During the year oil was purchased at 250 tins per month basis at a unit cost of Rs. 1,000. 5 tins were damaged in transit in respect of which insurance claim has been preferred. The surveyors have since approved the claim at 80%. The damaged ones were sold for Rs. 1,500 which is included in the cash sales. One tin has been used up for personal consumption. Total number of tins sold during the year was 3,000 at a unit price of Rs. 1,750.

(ii) Rent until 30.9.95 was Rs. 6,000 per month and was increased thereafter by Rs. 1,000 per month. Additional advance rent of Rs. 2,000 was paid and this is included in the figure of payments to landlord.

(iii) Provide depreciation at 10% and 25% of WDV on furniture and tempo van respectively.

(iv) It is further noticed that a customer has paid Rs. 10,000 on 31.3.96 as security deposit by cash. One of the staff has defalcated. The claim against the Insurance Company is pending.

You are requested to prepare final accounts for the year ended 31.3.96

(20 marks) (Intermediate–May 1996)

Answer

In the books of K. Azad
Trading and Profit and Loss Account
for the year ended 31st March, 1996

		Rs.		Rs.
To Opening Stock		1,25,000	By Sales	52,50,000
To Purchases	30,00,000		By Damaged Stock A/c	5,000
Less : Transferred to			By Closing Stock	1,19,000
drawings A/c	1,000	29,99,000		
To Gross Profit c/d		22,50,000		
		53,74,000		53,74,000
To Salaries		44,000	By Gross Profit b/d	22,50,000

To Rent		78,000	By Interest accrued	
To Miscellaneous Office Expenses		12,000	on fixed deposit	36,000
To Loss of Deposit		10,000	By Profit on Damaged Stock	500
To Interest on Security Deposits		6,000		
To Depreciation :				
Furniture	2,700			
Tempo Van	7,500	10,200		
To Capital A/c		21,26,300		
(Net Profit Transferred)				
		22,86,500		22,86,500

Balance Sheet as on 31st March, 1996

Liabilities	*Amount* *Rs.*	*Rs.*	*Assets*	*Amount* *Rs.*	*Rs.*
K.Azad's Capital			Furniture	27,000	
Balance	1,50,000		*Less* : Depreciation	2,700	24,300
Add : Net Profit	21,26,300				
	22,76,300		3–Wheeler Tempo Van	30,000	
Less : Drawings	51,000	22,25,300	*Less* : Depreciation	7,500	22,500
12% Security Deposit from Customers		60,000	Closing Stock		1,19,000
Interest Payable on Security Deposit		6,000	Debtors		22,11,500
Creditors for Oil Purchases		8,00,000	Cash and Bank Balances		66,000
Outstanding Rent		7,000	Fixed Deposit		6,00,000
			Interest Accrued on Fixed Deposit		36,000
			Rent Advance		14,000
			Electricity Deposit		1,000
			Insurance Claim Receivable		4,000
		30,98,300			30,98,300

Working Notes :

(1) **Memorandum Stock Account**

	No.	*Cost (Rs.)*		*No.*	*Cost (Rs.)*
To Opening Stock	125	1,25,000	By Damages	5	5,000
To Purchases	3,000	30,00,000	By Drawings	1	1,000
			By Sales	3,000	30,00,000
			By Closing Stock	119	1,19,000
	3,125	31,25,000		3,125	31,25,000

(2) **Damaged Stock Account**

	Rs.		Rs.
To Trading Account	5,000	By Insurance Claim Receivable A/c	4,000
To Profit and Loss Account (Balance Transferred)	500	By Cash and Bank A/c (Sale)	1,500
	5,500		5,500

(3) **Debtors Account**

	Rs.		Rs.
To Balance b/d	1,60,000	By Cash and Bank A/c	26,73,500
To Sales A/c (Credit Sales*)	47,25,000	By Balance c/d	22,11,500
	48,85,000		48,85,000

*Credit Sales in respect of (normal) sales of 3,000 tins

Total Sales (3000 × Rs. 1,750)	= 52,50,000
Less : Cash Sales (5,26,500 – 1,500)	= 5,25,000
	47,25,000

(4) **Creditors Account**

	Rs.		Rs.
To Cash and Bank A/c	24,00,000	By Balance b/d	2,00,000
To Balance c/d	8,00,000	By Purchases A/c	30,00,000
	32,00,000		32,00,000

(5) **Cash and Bank Account**

	Rs.		Rs.
To Balance b/d	75,000	By Rent A/c	79,000
To Sales A/c	5,25,000	By Salaries A/c	48,000
To Damaged Stock A/c	1,500	By Miscellaneous Office Expenses	12,000
To Debtors A/c	26,73,500	By Commission	20,000
To Security Deposit A/c	10,000	By Drawings A/c (Personal Income–tax)	50,000
		By Fixed Deposit A/c	6,00,000
		By Creditors A/c	24,00,000
		By Loss of deposit A/c (Defalcation of security deposit)	10,000
		By Balance c/d	66,000
	32,85,000		32,85,000

Notes :

(1) 12% interest on Fixed Deposit is assumed to be per annum. Similar assumption applies to 12% Security Deposit from customers.

(2) The treatment of claim pending against the Insurance Company in respect of defalcation of security deposit by one of the staff has been considered on the basis of Conservatism Concept. Conservatism suggests non–consideration of claim as an asset in anticipation. Where the ability to assess the ultimate collection with reasonable certainly is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved (AS 9). In this case, it may reasonably assumed that collectability of claim is not certain.

Question 2

The following is the Balance Sheet of Sanjay, a small trader as on 31.3.96 :

(Figures in Rs. '000)

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital	*200*	*Fixed Assets*	*145*
Creditors	*50*	*Stock*	*40*
		Debtors	*50*
		Cash in Hand	*5*
		Cash at Bank	*10*
	250		*250*

A fire destroyed the accounting records as well as the closing cash of the trader on 31.3.97. However, the following information was available :

(a) Debtors and creditors on 31.3.97 showed an increase of 20% as compared to 31.3.96.

(b) Credit Period :

Debtors – 1 month Creditors – 2 months

(c) Stock was maintained at the same level throughout the year.

(d) Cash sales constituted 20% of total sales.

(e) All purchases were for credit only.

(f) Current ratio as on 31.3.97 was exactly 2.

(g) Total expenses excluding depreciation for the year amounted to Rs. 2,50,000.

(h) Depreciation was provided at 10% on the closing value of fixed assets.

(i) Bank and cash transactions :

(1) Payments to creditors included Rs. 50,000 by cash.

(2) Receipts from debtors included Rs. 5,90,000 by way of cheques.

(3) Cash deposited into the bank Rs. 1,20,000.

(4) Personal drawings from bank Rs. 50,000.

(5) Fixed assets purchased and paid by cheques Rs. 2,25,000.

You are required to prepare :

(a) The Trading and Profit & Loss Account of Sanjay for the year ended 31.3.97 and

(b) A Balance Sheet on that date.

For your exercise, assume cash destroyed by fire is written off in the Profit and Loss Account

(20 marks) (Intermediate–May 1997)

Answer

Books of Sanjay

Trading and Profit & Loss A/c
for the year ended 31.3.97

	(Rs. '000)			(Rs. '000)
To Opening Stock	40	By Sales		
To Purchases	360	Cash	180	
To Gross Profit	540	Credit	720	900
		By Closing Stock		40
	940			940
To Expenses	250	By Gross Profit		540
To Depreciation	37			
To Cash destroyed	10			
To Net Profit	243			
	540			540

Balance Sheet as on 31.3.97

Liabilities		*(Rs '000)*	*Assets*	*(Rs '000)*
Capital	200		Fixed Assets	
Add : Net Profit	243		*Less :* Depreciation (145 + 225 – 37)	333
	443		Stock	40
Less : Drawings	50	393	Debtors	60
Creditors		60	Cash at Bank	20
		453		453

Working Notes : **Cash & Bank A/c**

(Rs. '000)

	Cash	Bank		Cash	Bank

To Balance b/d	5	10	By Creditors	50	300
To Debtors	120	590	By Drawings	–	50
To Cash Sales	180	–	By Bank (c)	120	
To Cash (c)	–	120	By Expenses	125	125*
			By Assets	–	225
			By Cash Destroyed	10*	
			By Balance c/d	–	20
	305	720		305	720

* balancing figures

Other computations

(1)	Debtors Opening balance		= Rs. 50,000
	Closing balance	= Rs. 50,000 + 20%	= Rs. 60,000
	Credit Sales	= Rs. 60,000 × 12	= Rs. 7,20,000
	Total Sales	= 7,20,000/80%	= Rs. 9,00,000
	Cash Sales	= Rs. 9,00,000 × 20%	= Rs. 1,80,000
	Receipt of cash from debtors		
	(50,000 + 7,20,000 – 60,000 – 5,90,000)		= Rs. 1,20,000
(2)	Creditors Opening balance		= Rs. 50,000
	Closing balance	= Rs. 50,000 + 20%	= Rs. 60,000
	Credit Purchase	= Rs. 60,000 × 6	= Rs. 3,60,000
	Payment by cheque		
	(50,000 + 3,60,000 – 60,000 – 50,000)		= Rs. 3,00,000
(3)	Closing Bank Balance :		
	Creditors i.e. current liability		= Rs. 60,000
	Current assets	= Rs. 60,000 × 2	= Rs. 1,20,000
	Bank Balance = Current assets – Stock – Debtors		
	= 1,20,000 – 40,000 – 60,000		= Rs. 20,000
(4)	Expenses by cheque : (Balancing figure in Bank A/c)		
	(Figure Rs. '000) (10 + 590 + 120 – 300 – 50 – 225 – 20)		= 125
	Expenses by cash	= 250–125	= 125
(5)	Cash destroyed = (balancing figure in Cash A/c)		
	(Figure Rs. '000) (5 + 120 + 180 – 50 – 120 – 125)		= 10

Question 3

Shri Rashid furnishes you with the following information relating to his business :

(a) Assets and liabilities as on

	1.1.1997	31.12.1997
	Rs.	Rs.
Furniture (w.d.v)	6,000	6,350
Stock at cost	8,000	7,000
Sundry Debtors	16,000	?
Sundry Creditors	11,000	15,000
Prepaid expenses	600	700
Unpaid expenses	2,000	1,800
Cash in hand and at bank	1,200	625

(b) Receipts and payments during 1997 :

Collections from debtors, after allowing discount of Rs. 1,500 amounted to Rs. 58,500.

Collections on discounting of bills of exchange, after deduction of discount of Rs. 125 by the bank, totalled to Rs. 6,125.

Creditors of Rs. 40,000 were paid Rs. 39,200 in full settlement of their dues.

Payment for freight inwards Rs. 3,000.

Amounts withdrawn for personal use Rs. 7,000.

Payment for office furniture Rs. 1,000.

Investment carrying annual interest of 4% were purchased at Rs. 96 on 1st July, 1997 and payment made therefor.

Expenses including salaries paid Rs. 14,500.

Miscellaneous receipts Rs. 500.

(c) Bills of exchange drawn on and accepted by customers during the year amounted to Rs. 10,000. Of these, bills of exchange of Rs. 2,000 were endorsed in favour of creditors. An endorsed bill of exchange of Rs. 400 was dishonoured.

(d) Goods costing Rs. 900 were used as advertising materials.

(e) Goods are invariably sold to show a gross profit of $33^1/_3$% on sales.

(f) Difference in cash book, if any, is to be treated as further drawing or introduction by Shri Rashid.

(g) Provide at 2.5% for doubtful debts on closing debtors.

Rashid asks you to prepare trading and profit and loss a/c for the year ended 31st December, 1997 and the balance sheet as on that date.

(20 marks) (Intermediate May 1998)

Answer

Trading and Profit and Loss Account of Shri Rashid
for the year ended 31st December, 1997

	Rs.			*Rs.*
To Opening Stock		8,000	By Sales	73,050
To Purchases	45,600		By Closing stock	7,000
Less : For advertising	900	44,700		
To Freight inwards		3,000		
To Gross profit c/d		24,350		
		80,050		80,050
To Sundry expenses		14,200	By Gross profit b/d	24,350
To Advertisement		900	By Interest on investment	2
To Discount allowed –			$\left(\text{Rs.}100\times\frac{4}{100}\times\frac{1}{2}\right)$	
Debtors	1,500		By Discount received	800
Bills Receivable	125	1,625	By Miscellaneous income	500
To Depreciation on furniture		650		
To Provision for doubtful debts		486		
To Net Profit		7,791		
		25,652		25,652

Balance Sheet as on 31st December, 1997

Liabilities		*Amount*	*Assets*		*Amount*
		Rs.			*Rs.*
Capital as on 1st January, 1997	18,800		Furniture (w.d.v.)	6,000	
			Additions during the year	1,000	
Less : Drawings	7,904			7,000	
	10,896		*Less :* Depreciation	650	6,350
Add : Net Profit	7,791	18,687	Investment		96
Sundry creditors		15,000	Interest accrued		2
Outstanding expenses		1,800	Closing Stock		7,000
			Sundry debtors	19,450	
			Less : Provision for doubtful debts	486	18,964

		Bills receivable	1,750
		Cash in hand and at bank	625
		Prepaid expenses	700
	35,487		35,487

Working Notes :

(1) Capital on 1st January, 1997

Balance Sheet as on 1st January, 1997

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital (Balancing figure)	18,800	Furniture (w.d.v.)	6,000
Creditors	11,000	Stock at cost	8,000
Outstanding expenses	2,000	Sundry debtors	16,000
		Cash in hand and at bank	1,200
		Prepaid expenses	600
	31,800		31,800

(2) Purchases made during the year

Sundry Creditors Account

	Rs.		*Rs.*
To Cash and bank A/c	39,200	By Balance b/d	11,000
To Discount received A/c	800	By Sundry debtors A/c	400
To Bills Receivable A/c	2,000	By Purchases A/c	45,600
To Balance c/d	15,000	(Balancing figure)	
	57,000		57,000

(3) Sales made during the year

		Rs.
Opening stock		8,000
Purchases	45,600	
Less : For advertising	900	44,700
Freight inwards		3,000
		55,700
Less : Closing stock		7,000
Cost of goods sold		48,700
Add : Gross profit (@ 50% on cost)		24,350
		73,050

(4) Debtors on 31.12.1997

Sundry Debtors Account

	Rs.		Rs.
To Balance b/d	16,000	By Cash and bank A/c	58,500
To Sales A/c	73,050	By Discount allowed A/c	1,500
To Sundry creditors A/c		By Bills receivable A/c	10,000
(bill dishonoured)	400	By Balance c/d (Balancing figure)	19,450
	89,450		89,450

(5) Additional drawings by Mr. Rashid

Cash and Bank Account

	Rs.		Rs.
To Balance b/d	1,200	By Freight inwards A/c	3,000
To Sundry debtors A/c	58,500	By Furniture A/c	1,000
To Bills Receivable A/c	6,125	By Investment A/c	96
To Miscellaneous income A/c	500	By Expenses A/c	14,500
		By Creditors A/c	39,200
		By Drawings A/c	7,904
		[Rs. 7,000 + Rs. 904	
		(Additional drawings)]	
		By Balance c/d	625
	66,325		66,325

(6) Amount of expenses debited to Profit and Loss A/c

Expenses Account

	Rs.		*Rs.*
To Prepaid expenses A/c	600	By Outstanding expenses A/c	2,000
(on 1.1.1997)		(on 1.1.1997)	
To Bank A/c	14,500	By Profit and Loss A/c	
To Outstanding expenses A/c	1,800	(Balancing figure)	14,200
(on 31.12.1997)		By Prepaid expenses A/c	700
		(on 31.12.1997)	
	16,900		16,900

(7) Bills Receivable on 31.12.1997

Bills Receivable Account

	Rs.		Rs.
To Debtors A/c	10,000	By Creditors A/c	2,000
		By Bank A/c	6,125
		By Discount on bills receivable A/c	125
		By Balance c/d (Balancing figure)	1,750
	10,000		10,000

Note : As regards investment, it has been assumed that investment purchased for Rs. 96 was of the face value Rs. 100.

Question 4

The following is the Balance Sheet of the retail business of Sri Srinivas as at 31st December, 1998:

Liabilities	*Rs.*	*Assets*	*Rs.*
Sri Srinivas's capital	*1,00,000*	*Furniture*	*10,000*
Liabilities for goods	*20,500*	*Stock*	*70,000*
Rent	*1,000*	*Debtors*	*25,000*
		Cash at bank	*14,500*
		Cash in hand	*2,000*
	1,21,500		*1,21,500*

You are furnished with the following information :

(1) Sri Srinivas sells his goods at a profit of 20% on sales.

(2) Goods are sold for cash and credit. Credit customers pay by cheques only.

(3) Payments for purchases are always made by cheques.

(4) It is the practice of Sri Srinivas to send to the bank every weekend the collections of the week after paying every week, salary of Rs. 300 to the clerk, Sundry expenses of Rs. 50 and personal expenses Rs. 100.

Analysis of the Bank Pass–Book for the 13 weeks period ending 31st March, 1999 disclosed the following :

	Rs.
Payments to creditors	*75,000*
Payments of rent upto 31.3.99	*4,000*
Amounts deposited into the bank	*1,25,000*
(include Rs. 30,000 received from debtors by cheques)	

The following are the balances on 31st March, 1999 :

	Rs.
Stock	*40,000*
Debtors	*30,000*
Creditors for goods	*36,500*

On the evening of 31st March, 1999 the Cashier absconded with the available cash in the cash box. There was no cash deposit in the week ended on that date.

You are required to prepare a statement showing the amount of cash defalcated by the Cashier and also a Profit and Loss Account for the period ended 31st March, 1999 and a Balance Sheet as on that date.

(12 marks)(Intermediate–May 1999)

Answer

Statement showing the amount of cash defalcated by the Cashier

	Rs.	Rs.
Cash balance as on 1.1.99		2,000
Add : Cash sales		1,16,250
		1,18,250
Less : Salary to clerk (Rs. 300 × 13)	3,900	
Sundry expenses (Rs. 50 × 13)	650	
Drawings of Sri Srinivas (Rs. 100 × 13)	1,300	
Deposit into bank (Rs. 1,25,000 – Rs. 30,000)	95,000	1,00,850
Cash balance as on 31.3.99 (defalcated by cashier)		17,400

Trading and Profit and Loss Account of Sri Srinivas
for the 13 week period ended 31st March, 1999

	Rs.		Rs.	Rs.
To Opening stock	70,000	By Sales :		
To Purchases	91,000	Cash	1,16,250	
To Gross Profit c/d	30,250	Credit	35,000	1,51,250
		By Closing stock		40,000
	191,250			1,91,250
To Salaries	3,900	By Gross profit b/d		30,250
To Rent (Rs. 4,000 – Rs. 1,000)	3,000			
To Sundry Expenses	650			
To Loss of cash by theft	17,400			
To Net Profit	5,300			
	30,250			30,250

Balance Sheet of Sri Srinivas
as on 31st March, 1999

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital as on 1.1.99	1,00,000		Furniture	10,000
Add : Profit	5,300		Stock	40,000
	1,05,300		Debtors	30,000
Less : Drawings	1,300	1,04,000	Cash at bank	60,500
Liabilities for goods		36,500		
		1,40,500		1,40,500

Working Notes :

(1) *Purchases*

Creditors Account

	Rs.		*Rs.*
To Bank A/c	75,000	By Balance b/d	20,500
To Balance c/d	36,500	By Purchases A/c(Balancing figure)	91,000
	1,11,500		1,11,500

(2) *Total sales*

	Rs.
Opening stock	70,000
Add : Purchases	91,000
	1,61,000
Less : Closing stock	40,000
Cost of goods sold	1,21,000
Add : Gross profit (@25% on cost)	30,250
Total Sales	1,51,250

(3) *Credit Sales*

Debtors Account

	Rs.		*Rs.*
To Balance b/d	25,000	By Bank A/c	30,000
To Sales A/c (Balancing figure)	35,000	By Balance c/d	30,000
	60,000		60,000

(4) *Cash Sales*

	Rs.
Total sales	1,51,250
Less : Credit Sales	35,000
Cash sales	1,16,250

(5) *Bank balance as on 31.3.99*

	Rs.		*Rs.*
To Balance b/d	14,500	By Creditors A/c	75,000
To Debtors A/c	30,000	By Rent A/c	4,000
To Cash A/c	95,000	By Balance c/d	60,500
	1,39,500		1,39,500

Notes :

1. All purchases are taken on credit basis.
2. In the absence of information about the rate of depreciation, no depreciation has been charged on furniture. Alternatively, students may assume any appropriate rate of depreciation and account for the charge.
3. The amount defalcated by the cashier may be treated as recoverable from him. In that case, Rs. 17,400 may be shown as sundry advances on assets side in the Balance Sheet and net profit for the 13 week period ending 31st March, 1999 would amount Rs. 22,700.

Question 5

Shri Kisan, a farmer, maintains a cash book, through which he records all receipts and payments and a diary in which he records other relevant information. On 31st March, 1999 he had cash in hand Rs. 1,000 and balance of Rs. 500 with local Grameen Bank. He also owed Rs. 600 to Beej Bhandar for seeds purchased by that date.

During the year ended 31st March, 2000, he realised :

	Rs.
Sale proceeds of crops	*59,100*
Sale proceeds of cattle and cattle products	*12,500*
Sale proceeds of wood and grass	*3,000*
Sale of cowdung	*5,000*
Receipt on account from Babu (a credit customer)	*12,000*
Grant from Zila Parishad for installing tubewell–cheque	*10,000*
During the year ended 31st March, 2000 he paid :	
Wages	*65,000*
Beej Bhandar	*600*
Seeds, feeds and fertiliser	*3,000*
Power	*5,000*

Land revenue	*2,000*
Tools purchased	*2,500*
Household expenses	*10,000*

During the year ended 31st March, 2000 his other transactions were :

		Rs.
(i)	*Sale of crop to Babu on credit*	*20,000*
(ii)	*Purchased on 25th March, 2000 from Beej Bhandar on credit of one month seeds of*	*2,000*
(iii)	*Efforts put in by self and family members on the farm were conser–vatively valued at*	*60,000*
(iv)	*Value of crop used for comsumption by :*	
	Self and family	*30,000*
	Agricultural labourers	*40,000*

On 31st March, 2000, his cash in hand was only Rs. 2,500

The rest was banked. He did not have any stock of seeds.

The tubewell for which the grant cheque was realised in the last week of March, 2000 is to be installed in April, 2000.

Shri Kisan asks you to prepare his cash and income summaries for the year ended 31st March, 2000 and his statement of financial position as on that date.

(12 marks) (Intermediate–May 2000)

Answer

In the Books of Shri Kisan

Cash summary for the year ended on 31st March, 2000

		Rs.	Rs.
Opening balances (on 1st April, 1999) :			
	Cash in hand	1,000	
	Grameen Bank balance	500	1,500
Receipts :			
Sale proceeds –	Crops	59,100	
	Cattle and cattle products	12,500	
	Wood and grass	3,000	
	Cowdung	5,000	
Collection from babu		12,000	
Grant from Zila Parishad		10,000	1,01,600
			1,03,100
Payments :			
Farm expenses – Wages		65,000	
	Seeds, feeds and fertilizers	3,000	
	Power	5,000	

Land revenue	2,000	
Payment of Beej Bhandar	600	
Tools purchased	2,500	
Household expenses	10,000	88,100
Closing balances (on 31st March, 2000) :		
Cash in hand	2,500	
Grameen Bank balance (Balancing figure)	12,500	15,000
		1,03,100

Income summary for the year ended on 31st March, 2000

		Rs.	Rs.
Revenues:			
Sales –	Crops (Cash sales : 59,100 + Credit sales : 20,000)	79,100	
	Cattle and cattle products	12,500	
	Wood and grass	3,000	
	Cowdung	5,000	
Crop used for consumption –			
	Self and family	30,000	
	Agricultural labourers	40,000	1,69,600
Less :	Expenses :		
	Wages	65,000	
	Consumption of crop by labourers	40,000	
	Seeds, feeds and fertiliser (Cash purchases : 3,000 + Credit purchases : 2,000)	5,000	
	Power	5,000	
	Land revenue	2,000	
	Efforts of self and family members	60,000	1,77,000
Loss			7,400

Statement of financial position as on 31st March, 2000

Liabilities			*Rs.*	*Assets*	*Rs.*
Farm household capital :				Tools	2,500
Balance on 1.4.99		900		Debtors (Babu)	8,000
Add : Notional wages of self and family members		60,000		Cash in hand	2,500
		60,900		Grameen bank balance	12,500
Less : Drawings :					
Cash	10,000				
Crop	30,000				

Loss as per Income summary	7,400	47,400	13,500		
Grant (for tubewell)			10,000		
Creditors (Beej Bhandar)			2,000		
			25,500		25,500

Working note :

Computation of Farm household capital on 1.4.99

Statement of financial position on 31.3.99

	Rs.		Rs.
Liability to Beej Bhandar	600	Cash in hand	1,000
Farm household capital (Balancing figure)	900	Grameen bank balance	500
	1,500		1,500

Question 6

A trader keeps his books of account under single entry system. On 31st March, 2000 his statement of affairs stood as follows :

Liabilities	*Rs.*	*Assets*	*Rs.*
Trade Creditors	*5,80,000*	*Furniture, Fixtures and Fittings*	*1,00,000*
Bills Payable	*1,25,000*	*Stock*	*6,10,000*
Outstanding Expenses	*45,000*	*Trade Debtors*	*1,48,000*
Capital Account	*2,50,000*	*Bills Receivable*	*60,000*
		Unexpired Insurance	*2,000*
		Cash in Hand and at Bank	*80,000*
	10,00,000		*10,00,000*

The following was the summary of Cash–book for the year ended 31st March, 2001 :

Receipts	*Rs.*	*Payments*	*Rs.*
Cash in Hand and at Bank on 1st April, 2001	*80,000*	*Payments to Trade Creditors*	*75,07,000*
Cash Sales	*73,80,000*	*Payments for Bills payable*	*8,15,000*
Receipts from Trade Debtors	*15,10,000*	*Sundry Expenses paid*	*6,20,700*
Receipts for Bills Receivable	*3,40,000*	*Drawings*	*2,40,000*
		Cash in Hand and at Bank on 31st March, 2001	*1,27,300*
	93,10,000		*93,10,000*

Discount allowed to trade debtors and received from trade creditors amounted to Rs. 36,000 and Rs. 28,000 respectively. Bills endorsed amounted to Rs. 15,000. Annual Fire Insurance premium of Rs. 6,000 was paid every year on 1st August for the renewal of the policy. Furniture, fixtures and fittings were subject to depreciation @ 15% per annum on diminishing balances method.

You are also informed about the following balances as on 31st March, 2001 :

	Rs.
Stock	*6,50,000*
Trade Debtors	*1,52,000*
Bills Receivable	*75,000*
Bills Payable	*1,40,000*
Outstanding Expenses	*5,000*

The trader maintains a steady gross profit ratio of 10% on sales.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2001 and Balance Sheet as at that date. *(16 marks) (Intermediate–May 2001)*

Answer

Trading and Profit and Loss Account
for the year ended 31st March, 2001

	Rs.			*Rs.*
To Opening Stock	6,10,000	By Sales		
To Purchases (W.N. 3)	84,10,000	Cash	73,80,000	
To Gross profit c/d	9,30,000	Credit (W.N. 2)	19,20,000	93,00,000
(10% of 93,00,000)		By Closing stock		6,50,000
	99,50,000			99,50,000
To Sundry expenses (W.N. 6)	5,80,700	By Gross profit b/d		9,30,000
To Discount allowed	36,000	By Discount received		28,000
To Depreciation	15,000			
(15% Rs. 1,00,000)				
To Net Profit	3,26,300			
	9,58,000			9,58,000

Balance Sheet as at 31st March, 2001

Liabilities		*Amount* Rs.	*Assets*		*Amount* Rs.
Capital			Furniture & Fittings	1,00,000	
Opening balance	2,50,000		*Less :* Depreciation	15,000	85,000
Less : Drawing	2,40,000		Stock		6,50,000
	10,000		Trade Debtors		1,52,000
Add : Net profit for the years	3,26,300	3,36,300	Bills receivable		75,000
Bills payable		1,40,000	Unexpired insurance		2,000
Trade creditors		6,10,000	Cash in hand & at bank		1,27,300
Outstanding expenses		5,000			
		10,91,300			10,91,300

Working Notes :

1. **Bills Receivable Account**

	Rs.		Rs.
To Balance b/d	60,000	By Cash	3,40,000
To Trade debtors	3,70,000	By Trade creditors (Bills endorsed)	15,000
		By Balance c/d	75,000
	4,30,000		4,30,000

2. **Trade Debtors Account**

	Rs.		Rs.
To Balance b/d	1,48,000	By Cash/Bank	15,10,000
To Credit sales (Balancing figure)	19,20,000	By Discount allowed	36,000
		By Bills receivable	3,70,000
		By Balance c/d	1,52,000
	20,68,000		20,68,000

3. **Memorandum Trading Account**

	Rs.		Rs.
To Opening stock	6,10,000	By Sales	93,00,000
To Purchases (Balancing figure)	84,10,000	By Closing stock	6,50,000
To Gross Profit (10% on sales)	9,30,000		
	99,50,000		99,50,000

4. **Bills Payable Account**

	Rs.		Rs.
To Cash/Bank	8,15,000	By Balance b/d	1,25,000
To Balance c/d	1,40,000	By Creditors (balancing figure)	8,30,000
	9,55,000		9,55,000

5. **Trade Creditors Account**

	Rs.		Rs.
To Cash/Bank	75,07,000	By Balance b/d	5,80,000
To Discount received	28,000	By Purchases (as calculated in W.N. 3)	84,10,000
To Bills receivable	15,000		
To Bills payable	8,30,000		
To Balance c/d (balancing figure)	6,10,000		
	89,90,000		89,90,000

6. **Computation of sundry expenses to be charged to Profit & Loss A/c**

	Rs.
Sundry expenses paid (as per cash book)	6,20,700
Add : Prepaid expenses as on 31–3–2000	2,000
	6,22,700
Less : Outstanding expenses as on 31–3–2000	45,000
	5,77,700
Add : Outstanding expenses as on 31–3–2001	5,000
	5,82,700
Less : Prepaid expenses as on 31–3–2001 (Insurance paid till July, 2001)	2,000
	5,80,700

Question 7

The following is the Balance Sheet of a concern on 31st March, 2000 :

	Rs.		*Rs.*
Capital	*10,00,000*	*Fixed Assets*	*4,00,000*
Creditors (Trade)	*1,40,000*	*Stock*	*3,00,000*
Profit & Loss A/c	*60,000*	*Debtors*	*1,50,000*
		Cash & Bank	*3,50,000*
	12,00,000		*12,00,000*

The management estimates the purchases and sales for the year ended 31st March, 2001 as under :

	upto 28.2.2001	*March 2001*
	Rs.	*Rs.*
Purchases	*14,10,000*	*1,10,000*
Sales	*19,20,000*	*2,00,000*

It was decided to invest Rs. 1,00,000 in purchases of fixed assets, which are depreciated @ 10% on cost.

The time lag for payment to Trade Creditors for purchase and receipt from Sales is one month. The business earns a gross profit of 30% on turnover. The expenses against gross profit amount to 10% of the turnover. The amount of depreciation is not included in these expenses.

Draft a Balance Sheet as at 31st March, 2001 assuming that creditors are all Trade Creditors for purchases and debtors for sales and there is no other item of current assets and liabilities apart from stock and cash and bank balances. *(8 marks)(Intermediate – Nov. 2001)*

Answer

Projected Balance Sheet of ......
as on 31st March, 2001

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital		10,00,000	Fixed Assets	4,00,000	
Profit & Loss Account as on			Additions	1,00,000	
1st April, 2000	60,000			5,00,000	

Add : Profit for the year	3,74,000	4,34,000	*Less :* Depreciation	50,000	4,50,000
Creditors (Trade)		1,10,000	Stock in trade		3,36,000
			Sundry Debtors		2,00,000
			Cash & Bank Balances		5,58,000
		15,44,000			15,44,000

Working Notes:

1. **Projected Trading and Profit and Loss Account for the year ended 31st March, 2001**

	Rs.		Rs.
To Opening Stock	3,00,000	By Sales	21,20,000
To Purchases	15,20,000	By Closing Stock (balancing figure)	3,36,000
To Gross Profit c/d (30% on sales)	6,36,000		
	24,56,000		24,56,000
To Sundry Expenses (10% on sales)	2,12,000	By Gross Profit b/d	6,36,000
To Depreciation	50,000		
To Net Profit	3,74,000		
	6,36,000		6,36,000

2. **Cash and Bank Account for the period 1st April, 2000 to 31st March, 2001**

	Rs.		*Rs.*
To Balance b/d	3,50,000	By Sundry Creditors (Rs. 1,40,000 + Rs. 14,10,000)	15,50,000
To Sundry Debtors (Rs. 1,50,000 + Rs. 19,20,000)	20,70,000	By Expenses	2,12,000
		By Fixed Assets	1,00,000
		By Balance c/d	5,58,000
	24,20,000		24,20,000

Note : The entire sales and purchases are taken on credit basis.

Question 8

The following is the Balance Sheet of Sri Agni Dev as on 31st March, 2001:

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Account	*2,52,500*	*Machinery*	*1,20,000*
Sundry Creditors for purchases	*45,000*	*Furniture*	*20,000*
		Stock	*33,000*

		Debtors	*1,00,000*
		Cash in hand	*8,000*
		Cash at Bank	*16,500*
	2,97,500		*2,97,500*

Riots occurred and fire broke out on the evening of 31st March, 2002, destroying the books of account and Furniture. The cashier was grievously hurt and the cash available in the cash box was stolen.

The trader gives you the following information:

(i) *Sales are effected as 25% for cash and the balance on credit. His total sales for the year ended 31st March, 2002 were 20% higher than the previous year. All the sales and purchases of goods were evenly spread throughout the year (as also in the last year).*

(ii) *Terms of credit*

Debtors	*2 Months*
Creditors	*1 Month*

(iii) *Stock level was maintained at Rs. 33,000 all throughout the year.*

(iv) *A steady Gross Profit rate of 25% on the turnover was maintained throughout. Creditors are paid by cheque only, except for cash purchase of Rs. 50,000.*

(v) *His private records and the Bank Pass-book disclosed the following transactions for the year.*

(i)	*Miscellaneous Business expenses*	*Rs. 1,57,500 (including Rs. 5,000 paid by cheque and Rs. 7,500 was outstanding as on 31st March, 2002)*
(ii)	*Repairs*	*Rs. 3,500 (paid by cash)*
(iii)	*Addition to Machinery*	*Rs. 60,000 (paid by cheque)*
(iv)	*Private drawings*	*Rs. 30,000 (paid by cash)*
(v)	*Travelling expenses*	*Rs. 18,000 (paid by cash)*
(vi)	*Introduction of additional capital by depositing in to the Bank*	*Rs. 5,000*

(vi) *Collection from debtors were all through cheques.*

(vii) *Depreciation on Machinery is to be provided @ 15% on the Closing Book Value.*

(viii) *The Cash stolen is to be charged to the Profit and Loss Account.*

(ix) *Loss of furniture is to be adjusted from the Capital Account.*

Prepare Trading, Profit and Loss Account for the year ended 31st March, 2002 and a Balance Sheet as on that date. Make appropriate assumptions whenever necessary. All workings should form part of your answer. *(20 marks) (PE-II – Nov. 2002)*

Answer

Trading and Profit and Loss Account of Sri. Agni Dev

for the year ended 31st March, 2002

		Rs.			Rs.
To	Opening Stock	33,000	By	Sales	9,60,000
To	Purchases	7,20,000	By	Closing Stock	33,000
To	Gross Profit c/d	2,40,000			
		9,93,000			9,93,000
To	Business Expenses	1,57,500	By	Gross Profit b/d	2,40,000
To	Repairs	3,500			
To	Depreciation	27,000			
To	Travelling Expenses	18,000			
To	Loss by theft	1,500			
To	Net Profit	32,500			
		2,40,000			2,40,000

Balance Sheet of Sri Agni Dev as at 31st March, 2002

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital	2,52,500		Machinery	1,80,000	
Add: Additional Capital	5,000		*Less*: Depreciation	27,000	1,53,000
Net Profit	32,500				
	2,90,000		Stock in Trade		33,000
Less: Loss of Furniture	20,000		Sundry Debtors		1,20,000
Drawings	30,000	2,40,000			
Bank Overdraft		2,667			
Sundry Creditors		55,833			
Outstanding Expenses		7,500			
		3,06,000			3,06,000

Working Notes:

		Rs.
1.	Sales during 2001-2002	
	Debtors as on 31st March, 2001	1,00,000
	(Being equal to 2 months' sales)	
	Total credit sales in 2000- 2001, Rs. 1,00,000 × 6	6,00,000
	Cash Sales, being equal to 1/3rd of credit sales or 1/4th of the total	2,00,000
	Sales in 2000- 2001	8,00,000
	Increase, 20% as stated in the problem	1,60,000
	Total sales during 2001-2002	9,60,000
	Cash sales : 1/4th	2,40,000
	Credit sales : 3/4th	7,20,000
2.	Debtors equal to two months credit sales	1,20,000
3.	Purchases	
	Sales in 2001-2002	9,60,000
	Gross Profit @ 25%	2,40,000
	Cost of goods sold being purchases	7,20,000
	(Since there is no change in stock level)	
4.	Sundry Creditors for goods	
	(Rs. 7,20,000 – Rs. 50,000) /12 = Rs. 6,70,000/12	55,833
5.	Collections from Debtors	
	Opening Balance	1,00,000
	Add: Credit Sales	7,20,000
		8,20,000
	Less: Closing Balance	1,20,000
		7,00,000
6.	Payment to Creditors	
	Opening Balance	45,000
	Add: Credit Purchases (Rs. 7,20,000 – Rs. 50,000)	6,70,000
		7,15,000
	Less: Closing Balance	55,833
	Payment by cheque	6,59,167

7. **Cash and Bank Account**

	Particulars	Cash	Bank		Particulars	Cash	Bank
To	Balance b/d	8,000	16,500	By	Payment to Creditors	50,000	6,59,167
To	Collection from Debtors	–	7,00,000	By	Misc. Expenses	1,45,000	5,000
To	Sales	2,40,000	–	By	Repairs	3,500	–
To	Additional Capital	–	5,000	By	Addition to Machinery	–	60,000
To	Balance c/d	–	2,667	By	Travelling Expenses	18,000	–
	(Bank overdraft)			By	Private Drawings	30,000	–
				By	Balance c/d (lost by theft)	1,500	
		2,48,000	7,24,167			2,48,000	7,24,167

Question 9

Lucky does not maintain proper books of accounts. However, he maintains a record of his bank transactions and also is able to give the following information from which you are requested to prepare his final accounts for the year 2003:

	1.1.2003	*31.12.2003*
	Rs.	*Rs.*
Debtors	*1,02,500*	–
Creditors	–	*46,000*
Stock	*50,000*	*62,500*
Bank Balance	–	*50,000*
Fixed Assets	*7,500*	*9,000*

Details of his bank transactions were as follows:

	Rs.
Received from debtors	*3,40,000*
Additional capital brought in	*5,000*
Sale of fixed assets (book value Rs. 2,500)	*1,750*
Paid to creditors	*2,80,000*
Expenses paid	*49,250*
Personal drawings	*25,000*
Purchase of fixed assets	*5,000*

No cash transactions took place during the year. Goods are sold at cost plus 25%. Cost of goods sold was Rs. 2,60,000. *(16 marks) (PE-II – Nov. 2004)*

Answer

Trading and Profit and Loss Account
for the year ended 31st December, 2003

		Amount Rs.			Amount Rs.
To	Opening stock	50,000	By	Sales (Rs. 2,60,000 × 125/100)	3,25,000
To	Purchases (balancing figure)	2,72,500	By	Closing stock	62,500
To	Gross profit c/d (Rs. 2,60,000 × 25/100)	65,000			
		3,87,500			3,87,500
To	Expenses	49,250	By	Gross profit b/d	65,000
To	Loss on sale of fixed assets	750			
To	Depreciation on fixed assets (W.N.1)	1,000			
To	Net profit	14,000			
		65,000			65,000

Balance Sheet as on 31st December, 2003

Liabilities		Amount Rs.	*Assets*	Amount Rs.
Capital (W.N. 5)	1,69,000		Fixed assets	9,000
Add: Additional capital	5,000		Debtors (W.N. 3)	87,500
Net profit	14,000		Stock	62,500
	1,88,000		Bank balance	50,000
Less: Drawings	25,000	1,63,000		
Creditors		46,000		
		2,09,000		2,09,000

Working Notes:

1. Fixed assets account

Dr.		Rs.			*Cr.* Rs.
To	Balance b/d	7,500	By	Bank (sale)	1,750
To	Bank	5,000	By	Loss on sale of fixed asset	750
			By	Depreciation (balancing figure)	1,000

			By	Balance c/d	9,000
		12,500			12,500

2. **Bank account**

Dr. *Cr.*

		Rs.			*Rs.*
To	Balance b/d (balancing figure)	62,500	By	Creditors	2,80,000
To	Debtors	3,40,000	By	Expenses	49,250
To	Capital	5,000	By	Drawings	25,000
To	Sale of fixed assets	1,750	By	Fixed assets	5,000
			By	Balance c/d	50,000
		4,09,250			4,09,250

3. **Debtors account**

Dr. *Cr.*

		Rs.			*Rs.*
To	Balance b/d	1,02,500	By	Bank	3,40,000
To	Sales (Rs. 2,60,000 $\times \frac{125}{100}$)	3,25,000	By	Balance c/d (balancing figure)	87,500
		4,27,500			4,27,500

4. **Creditors account**

Dr. *Cr.*

		Rs.			*Rs.*
To	Bank	2,80,000	By	Balance b/d (balancing figure)	53,500
To	Balance c/d	46,000	By	Purchases (from trading account)	2,72,500
		3,26,000			3,26,000

5. **Balance Sheet as on 1st January, 2003**

Liabilities	*Rs.*	*Assets*	*Rs.*
Creditors (W.N. 4)	53,500	Fixed assets	7,500
Capital (balancing figure)	1,69,000	Debtors	1,02,500
		Stock	50,000
		Bank balance (W.N. 2)	62,500
	2,22,500		2,22,500

Question 10

The following information relates to the business of Mr. Shiv Kumar, who requests you to prepare a Trading and Profit & Loss Account for the year ended 31st March, 2003 and a Balance Sheet as on that date:

(a)

	Balance as on 31st March, 2002	Balance as on 31st March, 2003
	Rs.	Rs.
Building	3,20,000	3,60,000
Furniture	60,000	68,000
Motorcar	80,000	80,000
Stocks	–	40,000
Bills payable	28,000	16,000
Cash and Bank balances	1,80,000	1,04,000
Sundry Debtors	1,60,000	–
Bills receivable	32,000	28,000
Sundry Creditors	1,20,000	–

(b) Cash transactions during the year included the following besides certain other items:

	Rs.		Rs.
Sale of old papers and miscellaneous income	20,000	Cash purchases	48,000
		Payment to creditors	1,84,000
Miscellaneous Trade expenses (including salaries etc.)	80,000	Cash Sales	80,000
Collection from debtors	2,00,000		

(c) Other information:

(i) Bills receivable drawn during the year amount to Rs. 20,000 and Bills payable accepted Rs. 16,000.

(ii) Some items of old furniture, whose written down value on 31st March, 2002 was Rs. 20,000 was sold on 30th September, 2002 for Rs. 8,000. Depreciation is to be provided on Building and Furniture @ 10% p.a. and on Motorcar @ 20% p.a. Depreciation on sale of furniture to be provided for 6 months and for additions to Building for whole year.

(iii) Of the Debtors, a sum of Rs. 8,000 should be written off as Bad Debt and a reserve for doubtful debts is to be provided @ 2%.

(iv) Mr. Shivkumar has been maintaining a steady gross profit rate of 30% on turnover.

(v) Outstanding salary on 31st March, 2002 was Rs. 8,000 and on 31st March, 2003 was Rs. 10,000 on 31st March, 2002. Profit and Loss Account had a credit balance of Rs. 40,000.

(vi) 20% of total sales and total purchases are to be treated as for cash.

(vii) Additions in Furniture Account took place in the beginning of the year and there was no opening provision for doubtful debts. *(20 marks) (PE-II–Nov. 2003)*

Answer

Trading and Profit and Loss Account of Mr. Shiv Kumar

for the year ended 31st March, 2003

		Rs.			Rs.
To	Opening stock (balancing figure)	80,000	By	Sales	4,00,000
			By	Closing stock	40,000
To	Purchases	2,40,000			
To	Gross profit c/d @ 30% on sales	1,20,000			
		4,40,000			4,40,000
To	Miscellaneous expenses (Rs.80,000 – Rs.8,000 + Rs.10,000)	82,000	By	Gross profit b/d	1,20,000
			By	Miscellaneous receipts	20,000
			By	Net loss transferred to Capital A/c	25,840
To	Depreciation: Building Rs. 36,000; Furniture Rs. 7,800 (Rs.6,800 + Rs.1,000); Motor Car Rs. 16,000	59,800			
To	Loss on sale of furniture	11,000			
To	Bad debts	8,000			
To	Provision for doubtful debts	5,040			
		1,65,840			1,65,840

Balance Sheet of Mr. Shivkumar

as on 31st March, 2003

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital as on 1st April, 2002		7,16,000	Building	3,20,000	
			Add: Addition during the year	40,000	
Profit and Loss A/c				3,60,000	
Opening balance	40,000		*Less*: Provision for depreciation	36,000	3,24,000
Less: Loss for the year	25,840	14,160	Furniture	60,000	
Sundry creditors		1,12,000	*Less:* Sold during the year	20,000	
Bills payable		16,000		40,000	
Outstanding salary		10,000	*Add:* Addition during the year	28,000	
				68,000	
			Less: Depreciation	6,800	61,200
			Motor car (at cost)	80,000	
			Less: Depreciation	16,000	64,000
			Stock in trade		40,000
			Sundry debtors	2,52,000	
			Less: Provision for doubtful debts @ 2%	5,040	2,46,960
			Bills receivable		28,000
			Cash in hand and at bank		1,04,000
		8,68,160			8,68,160

Working Notes:

Sundry Debtors Account

		Rs.			*Rs.*
To	Balance b/d	1,60,000	By	Cash/Bank A/c	2,00,000
To	Sales A/c	3,20,000	By	Bills receivable A/c	20,000
			By	Bad debts A/c	8,000
			By	Balance c/d (balancing fig.)	2,52,000
		4,80,000			4,80,000

Sundry Creditors Account

		Rs.			Rs.
To	Cash/Bank A/c	1,84,000	By	Balance b/d	1,20,000
To	Bills payable A/c	16,000	By	Purchases A/c	1,92,000
To	Balance c/d				
	(balancing figure)	1,12,000			
		3,12,000			3,12,000

Bills Receivable Account

		Rs.			Rs.
To	Balance b/d	32,000	By	Cash/ Bank A/c	24,000
To	Sundry debtors A/c	20,000		(balancing figure)	
			By	Balance c/d	28,000
		52,000			52,000

Bills Payable Account

		Rs.			Rs.
To	Cash/Bank A/c	28,000	By	Balance b/d	28,000
	(balancing figure)		By	Sundry creditors A/c	16,000
To	Balance c/d	16,000			
		44,000			44,000

Furniture Account

		Rs.			Rs.
To	Balance b/d	60,000	By	Bank/Cash A/c	8,000
To	Bank A/c	28,000	By	Depreciation A/c	1,000
			By	Profit and loss A/c (loss on sale)	11,000
			By	Depreciation A/c	6,800
			By	Balance c/d	61,200
		88,000			88,000

Cash/Bank Account

		Rs.			Rs.
To	Balance b/d	1,80,000	By	Misc. trade expenses A/c	80,000
To	Miscellaneous receipts A/c	20,000	By	Purchases A/c	48,000
			By	Furniture A/c (balancing figure)	28,000
To	Sundry debtors A/c	2,00,000			
To	Sales A/c	80,000	By	Sundry creditors A/c	1,84,000
To	Furniture A/c (sale)	8,000	By	Bills payable A/c	28,000
To	Bills receivable A/c	24,000	By	Building A/c	40,000
			By	Balance c/d	1,04,000
		5,12,000			5,12,000

Opening Balance Sheet of Mr. Shivkumar

as on 31st March, 2002

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital (balancing figure)	7,16,000	Building	3,20,000
Profit and loss A/c	40,000	Furniture	60,000
Sundry creditors	1,20,000	Motor car	80,000
Bills payable	28,000	Stock in trade	80,000
Outstanding salary	8,000	Sundry debtors	1,60,000
		Bills receivable	32,000
		Cash in hand and at bank	1,80,000
	9,12,000		9,12,000

Question 11

From the following furnished by Shri Ramji, prepare Trading and Profit and Loss account for the year ended 31.3.2005. Also draft his Balance Sheet as at 31.3.2005:

	1.4.2004	*31.3.2005*
	Rs.	*Rs.*
Creditors	*3,15,400*	*2,48,000*
Expenses outstanding	*12,000*	*6,600*
Fixed assets (includes machinery)	*2,32,200*	*2,40,800*

Stock in hand	*1,60,800*	*2,22,400*
Cash in hand	*59,200*	*24,000*
Cash at bank	*80,000*	*1,37,600*
Sundry debtors	*3,30,600*	*?*

Details of the year's transactions are as follows:

Cash and discount credited to debtors	*12,80,000*
Returns from debtors	*29,000*
Bad debts	*8,400*
Sales (Both cash and credit)	*14,36,200*
Discount allowed by creditors	*14,000*
Returns to creditors	*8,000*
Capital introduced by cheque	*1,70,000*
Collection from debtors (Deposited into bank after receiving cash)	*12,50,000*
Cash purchases	*20,600*
Expenses paid by cash	*1,91,400*
Drawings by cheque	*8,600*
Machinery acquired by cheque	*63,600*
Cash deposited into bank	*1,00,000*
Cash withdrawn from bank	*1,84,800*
Cash sales	*92,000*
Payment to creditors by cheque	*12,05,400*

Note: *Ramji has not sold any Fixed Asset during the year.* *(16 Marks) (PE-II - Nov. 2005)*

Answer

In the books of Shri Ramji
Trading and Profit and Loss Account
for the year ended 31st March, 2005

Dr.							*Cr.*
		Rs.	*Rs.*			*Rs.*	*Rs.*
To	Opening stock		1,60,800	By	Sales:		
To	Purchases:				Cash	92,000	
	Cash	20,600			Credit	13,44,200	
	Credit (W.N.	11,60,000				14,36,200	

	3)						
		11,80,600			*Less:* Returns	29,000	14,07,200
	Less: Returns	8,000	11,72,600				
To	Gross Profit c/d		2,96,200	By	Closing stock		2,22,400
			16,29,600				16,29,600

To	Discount allowed	30,000	By	Gross profit b/d	2,96,200
To	Bad debts	8,400	By	Discount	14,000
To	General expenses (W.N. 5)	1,86,000			
To	Depreciation (W.N. 4)	55,000			
To	Net profit	30,800			
		3,10,200			3,10,200

Balance Sheet as at 31st March, 2005

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital (W.N. 1)	5,35,400		Sundry Assets	2,32,200	
Add: Additional capital	1,70,000		*Add:* New machinery	63,600	
Net profit	30,800			2,95,800	
	7,36,200		*Less:* Depreciation	55,000	2,40,800
Less: Drawings	8,600	7,27,600	Stock in trade		2,22,400
Sundry creditors		2,48,000	Sundry debtors (W.N. 2)		3,57,400
Expenses outstanding		6,600	Cash in hand		24,000
			Cash in Bank		1,37,600
		9,82,200			9,82,200

Working Notes:

(1) Statement of Affairs as at 31st March, 2004

Liabilities	Rs.	Assets	Rs.
Sundry creditors	3,15,400	Sundry Assets	2,32,200
Outstanding expenses	12,000	Stock	1,60,800
Ramji's Capital		Debtors	3,30,600
(Balancing figure)	5,35,400	Cash in hand	59,200
		Cash at Bank	80,000
	8,62,800		8,62,800

(2) Sundry Debtors Account

		Rs.			Rs.
To	Balance b/d	3,30,600	By	Cash	12,50,000
To	Sales (14,36,200 – 92,000)	13,44,200	By	Discount	30,000
			By	Returns (sales)	29,000
			By	Bad debts	8,400
			By	Balance c/d (Balancing figure)	3,57,400
		16,74,800			16,74,800

(3) Sundry Creditors Account

		Rs.			Rs.
To	Bank – Payments	12,05,400	By	Balance b/d	3,15,400
To	Discount	14,000	By	Purchases credit	11,60,000
To	Returns	8,000		(Balancing figure)	
To	Balance c/d (closing balance)	2,48,000			
		14,75,400			14,75,400

(4) *Depreciation on Fixed Assets:*

	Rs.
Opening balance	2,32,200
Add: Additions	63,600

		2,95,800
Less: Closing balance		2,40,800
Depreciation		55,000

(5) *Expenses to be shown in profit and loss account*

Expenses (in cash)	1,91,400	
Add: Outstanding of 2005	6,600	
	1,97,800	
Less: Outstanding of 2004	12,000	
		1,86,000

(6) **Cash and Bank Account**

		Cash	Bank			Cash	Bank
		Rs.	Rs.			Rs.	Rs.
To	Balance b/d	59,200	80,000	By	Purchases	20,600	–
To	Capital		1,70,000	By	Expenses	1,91,400	
To	Debtors		12,50,000	By	Plant and Machinery		63,600
To	Bank	1,84,800		By	Drawings		8,600
To	Cash		1,00,000	By	Creditors		12,05,400
To	Sales	92,000		By	Cash		1,84,800
				By	Bank	1,00,000	
				By	Balance c/d	24,000	1,37,600
		3,36,000	16,00,000			3,36,000	16,00,000

Question 12

Mr. X runs a retail business. Suddenly he finds on 31.3.2006 that his Cash and Bank balances have reduced considerably. He provides you the following information:

(i) Balances	*31.3.2005*	*31.3.2006*
	Rs.	*Rs.*
Sundry Debtors	*35,400*	*58,800*
Sundry Creditors	*84,400*	*22,400*
Cash at Bank	*1,08,400*	*2,500*
Cash in Hand	*10,400*	*500*
Rent (Outstanding for one month)	*2,400*	*3,000*

Stock	*11,400*	*20,000*
Electricity and Telephone bills-outstanding	*--*	*6,400*

(ii) Bank Pass-book reveals the following

	Rs.
Total Deposits	*10,34,000*
Withdrawals:	
Creditors	*8,90,000*
Professional charges	*34,000*
Furnitures and Fixtures (acquired on 1.10.05)	*54,000*
Proprietor's drawings	*1,61,900*

(iii) Rent has been increased from January, 2006.

(iv) Mr. X deposited all cash sales and collections from debtors after meeting wages, shop expenses, rent, electricity and telephone charges.

(v) Mr. X made all purchases on credit.

(vi) His credit sales during the year amounts to Rs.9,00,000.

(vii) He incurred Rs.6,500 per month towards wages.

(viii) He incurred following expenses:

(a) Electricity and telephone charges Rs.24,000 (paid)

(b) Shop expenses Rs.18,000 (paid).

(ix) Charge depreciation on furniture and fixtures @10% p.a.

Finalise the accounts of Mr. X and compute his profit for the year ended 31.3.2006. Prepare his statement of affairs and reconcile the profit and capital balance.

(20 Marks) (PE-Ii – May 2006)

Answer

Trading and profit and Loss Account of Mr. X

For the year ended 31st March, 2006

	Rs.		Rs.	Rs.
To Opening Stock	11,400	By Sales:		
To Purchases	8,28,000	Cash	2,97,500	
To Gross Profit	3,78,100	Credit	9,00,000	11,97,500
		By Closing Stock		20,000
	12,17,500			12,17,500
To Wages	78,000	By Gross Profit		3,78,100
To Rent*	30,600			

To Electricity & Telephone**	30,400	
To Professional charges	34,000	
To Shop Expenses	18,000	
To Depreciation (Rs.54,000$\times \frac{10}{100} \times \frac{1}{2}$)	2,700	
To Net Profit	1,84,400	———
	3,78,100	3,78,100

	Rs.
*Rent Paid	30,000
Less: Outstanding on 1.4.2005	(2,400)
	27,600
Add: Outstanding on 31.3.2006	3,000
	30,600

	Rs.
**Electricity & Telephone charges paid	24,000
Add: Outstanding on 31.3.2006	6,400
	30,400

Statement of Affairs of Mr. X as on 31-03-2005 & 31-03-2006

Liabilities	*31-3-2005*	*31-3-2006*	*Assets*	*31-3-2005*	*31-3-2006*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Capital Account			Furniture	-	51,300
(Balancing Figure)	78,800	1,01,300			
Sundry Creditors	84,400	22,400	Stock	11,400	20,000
Outstanding Expenses:			Sundry Debtors	35,400	58,800
Rent	2,400	3,000	Bank	1,08,400	2,500
Electricity & Telephone	———	6,400	Cash	10,400	500
	1,65,600	1,33,100		1,65,600	1,33,100

Reconciliation of Profit

	Rs.
Capital on 31.03.2006	1,01,300
Add: Drawings	1,61,900
	2,63,200
Less: Opening Capital on 1.4.2005	(78,800)
Profit for the year	1,84,400

Working Notes

1. Total Debtors Account

	Rs.		Rs.
To Balance b/d	35,400	By Cash (Balancing Figure)	8,76,600
To Credit Sales	9,00,000	By Balance c/d	58,800
	9,35,400		9,35,400

2. Total Creditors Account

	Rs.		Rs.
To Bank	8,90,000	By Balance b/d	84,400
To Balance c/d	22,400	By Credit Purchases	8,28,000
	9,12,400		9,12,400

3. Cash Account

	Cash (Rs.)	Bank (Rs.)		Cash (Rs.)	Bank (Rs.)
To Balance b/d	10,400	1,08,400	By Bank	10,34,000	-
To Sundry Debtors	8,76,600	-	By Wages	78,000	-
To Cash Sales (Balancing figure)	2,97,500	-	By Rent	30,000	-
To Cash A/c (Contra)	-	10,34,000	By Electricity & Telephone	24,000	-
			By Shop Expenses	18,000	-
			By Professional charges	-	34,000
			By Sundry Creditors A/c	-	8,90,000
			By Furniture	-	54,000
			By Drawings A/c	-	1,61,900
			By Balance c/d	500	2,500
	11,84,500	11,42,400		11,84,500	11,42,400

Question 13

Mr. Ashok keeps his books in Single Entry system. From the following information, prepare Trading and Profit & Loss Account for the year ended 31st March, 2006 and the Balance Sheet as on that date:

Assets and Liabilities	*31.3.2005 (Rs.)*	*31.3.2006 (Rs.)*
Sundry Creditors	*30,000*	*25,000*
Outstanding expenses	*1,000*	*500*
Fixed Assets	*23,000*	*22,000*
Stock	*16,000*	*22,500*
Cash in Hand and at Bank	*14,000*	*16,000*
Sundry Debtors	*?*	*36,000*

Following further details are available for the Current year:

	Rs.		*Rs.*
*Total receipts from debtors**	*1,30,000*	*Cash purchases*	*2,000*
Returns inward	*3,000*	*Fixed Assets purchased and paid by cheque*	*1,000*
Bad Debts	*1,000*	*Drawings by cheques*	*6,500*
Total Sales	*1,50,000*	*Deposited into the bank*	*10,000*
Discount received	*1,500*	*Withdrawn from bank*	*18,500*
Return outwards	*1,000*	*Cash in hand at the end*	*2,500*
Capital introduced		*Paid to creditors by cheques*	*1,20,000*
(paid into Bank)	*15,000*	*Expenses paid*	*20,000*
Cheques received from Debtors	*1,25,000*		

(16 Marks) (PE-II – Nov. 2006)

Answer

Trading and Profit and Loss Account
for the year ended on 31st March, 2006

	Particulars		*Amount Rs.*		*Particulars*		*Amount Rs.*
To	Opening Stock		16,000	By	Sales:		
To	Purchases:				Cash (W.N.1)	6,500	
	Cash	2,000			Credit	1,43,500	
	Credit (W.N.3)	1,17,500				1,50,000	
		1,19,500			*Less:* Returns	3,000	1,47,000
	Less: Returns	1,000	1,18,500	By	Stock		22,500

*The words given as "Cash receivable from debtors" in the question paper have been replaced by Total receipts from debtors" to draw the final accounts.

To	Gross Profit c/d		35,000			
			1,69,500			1,69,500
To	Expenses	20,000				
	Add: O/s at the end	500		By	Gross profit b/d	35,000
		20,500		By	Discount received	1,500
	Less: O/s at the beginning	1,000	19,500			
To	Bad debts		1,000			
To	Depreciation		2,000			
To	Net Profit		14,000			
			36,500			36,500

Balance Sheet
as on 31st March, 2006

Liabilities		*Amount Rs.*	*Assets*		*Amount Rs.*
Capital (W.N.5)	48,500		Fixed Assets	23,000	
Add: Additional Capital	15,000		*Add:* Purchased during the year	1,000	
Add: Net Profit	14,000		*Less:* Depreciation	2,000	22,000
Less: Drawings	6,500	71,000	Stock		22,500
Creditors		25,000	Cash		2,500
Outstanding Exp.		500	Bank		13,500
			Debtors		36,000
		96,500			96,500

Working Notes:

1. Cash Account

	Particulars	*Amount Rs.*		*Particulars*	*Amount Rs.*
To	Balance b/d	4,500	By	Purchases	2,000
To	Sales (Bal. Fig.)	6,500	By	Bank (contra)	10,000
To	Debtors	5,000	By	Expenses	20,000
To	Bank (contra)	18,500	By	Balance c/d	2,500
		34,500			34,500

2. **Bank Account**

	Particulars	*Amount Rs.*		*Particulars*	*Amount Rs.*
To	Balance b/d (Bal. Fig.)	9,500	By	Fixed Assets	1,000
To	Capital	15,000	By	Drawings	6,500
To	Cash (contra)	10,000	By	Cash (contra)	18,500
To	Debtors	1,25,000	By	Creditors	1,20,000
			By	Balance c/d	13,500
		1,59,500			1,59,500

3. **Creditors Account**

	Particulars	*Amount Rs.*		*Particulars*	*Amount Rs.*
To	Bank	1,20,000	By	Balance b/d	30,000
To	Returns	1,000	By	Purchase (Bal. Fig.)	1,17,500
To	Discount received	1,500			
To	Balance c/d	25,000			
		1,47,500			1,47,500

4. **Debtors Account**

	Particulars	*Amount Rs.*		*Particulars*	*Amount Rs.*
To	Balance b/d (Bal. Fig.)	26,500	By	Cash	5,000
To	Sales	1,43,500	By	Bank	1,25,000
			By	Bad Debts	1,000
			By	Returns	3,000
			By	Balance c/d	36,000
		1,70,000			1,70,000

5. **Opening Balance Sheet as on 31.3.2005**

Liabilities	*Amount Rs.*	*Assets*	*Amount Rs.*
Creditors	30,000	Fixed Assets	23,000
O/s Expenses	1,000	Stock	16,000
Capital (Bal. Fig.)	48,500	Cash	4,500
		Bank (W.N.2)	9,500
		Debtors (W.N.4)	26,500
	79,500		79,500

Question 14

'A' and 'B' are in partnership sharing profits and losses equally. They keep their books by single entry system. The following balances are available from their books as on 31.3.2006 and 31.3.2007

	31.3.2006	31.3.2007
	Rs.	Rs.
Building	1,50,000	1,50,000
Equipments	2,40,000	2,72,000
Furniture	25,000	25,000
Debtors	?	1,00,000
Creditors	65,000	?
Stock	?	70,000
Bank loan	45,000	35,000
Cash	60,000	?

The transactions during the year ended 31.3.2007 were the following:

	Rs.
Collection from debtors	3,80,000
Payment to creditors	2,50,000
Cash purchases	65,000
Expenses paid	40,000
Drawings by 'A'	30,000

On 1.4.2006 an equipment of book value Rs.20,000 was sold for Rs.15,000. On 1.10.2006, some equipments were purchased.

Cash sales amounted to 10% of sales.

Credit sales amounted to Rs.4,50,000.

Credit purchases were 80% of total purchases.

The firm sells goods at cost plus 25%.

Discount allowed Rs.5,500 during the year.

Discount earned Rs.4,800 during the year.

Outstanding expenses Rs.3,000 as on 31.3.2007.

Capital of 'A' as on 31.3.2006 was Rs.15,000 more than the capital of 'B', equipments and furniture to be depreciated at 10% p.a. and building @ 2% p.a.

You are required to prepare:

(I) Trading and Profit and Loss account for the year ended 31.3.2007 and

(ii) The Balance Sheet as on that date. *(PE II- Nov. 2007)(20 Marks)*

Answer

Trading and Profit and Loss A/c for the year ended 31.3.2007

			Rs.				*Rs.*
To	Opening stock (W.N.3)		1,45,000	By	Sales- Cash (W.N.1)	50,000	
To	Purchases-Cash	65,000			Credit	4,50,000	5,00,000
	Credit (W.N.2)	2,60,000	3,25,000	By	Closing stock		70,000
To	Gross profit c/d		1,00,000				
			5,70,000				5,70,000
To	Loss on sale of equipment (20,000-15,000)		5,000	By	Gross profit b/d		1,00,000
To	Depreciation			By	Discount received		4,800
	Building	3,000					
	Furniture	2,500					
	Equipment (W.N.4)	24,600	30,100				
To	Expenses paid	40,000					
	Add : Outstanding expenses	3,000	43,000				
To	Discount allowed		5,500				
To	Net profit transferred to: A's capital A/c	10,600					
	B's capital A/c	10,600	21,200				
			1,04,800				1,04,800

Balance Sheet as on 31-3-2007

Liabilities		*Rs.*	*Assets*		*Rs.*
A's capital (W.N.7)	2,80,250		Building	1,50,000	
Less: Drawings	30,000		*Less:* Depreciation	3,000	1,47,000
	2,50,250		Equipments	2,72,000	

Add: Net profit	10,600	2,60,850	*Less:* Depreciation	24,600	2,47,400
B's capital (W.N.7)	2,65,250		Furniture	25,000	
Add: Net profit	10,600	2,75,850	*Less:* Depreciation	2,500	22,500
Sundry creditors (W.N.5)		70,200	Debtors		1,00,000
Bank loan		35,000	Stock		70,000
Outstanding expenses		3,000	Cash balance (W.N.8)		58,000
		6,44,900			6,44,900

Working Notes:

1. **Calculation of total sales and cost of goods sold**

   Cash sales = 10% of total sales

   Credit sales = 90% of total sales = Rs.4,50,000

   Total sales = $\frac{4,50,000}{90} \times 100 = 5,00,000$

   Cash sales = 10% of 5,00,000 = Rs.50,000

2. **Calculation of total purchases and credit purchases**

   Cash purchases = Rs.65,000

   Credit purchases = 80% of total purchases

   Cash purchases = 20% of total purchases

   Total purchases = $\frac{65,000}{20} \times 100 = \text{Rs.}3,25,000$

   Credit purchases = 3,25,000 – 65,000 = Rs.2,60,000

3. **Calculation of opening stock**

Stock Account

	Rs.		*Rs.*
To Balance b/d (Bal. Fig.)	1,45,000	By Cost of goods sold $\frac{5,00,000}{125} \times 100$	4,00,000
To Total purchases (W.N.2)	3,25,000	By Balance c/d	70,000
	4,70,000		4,70,000

4. Purchase of equipment & depreciation on equipments

Equipment Account

		Rs.			Rs.
To	Balance b/d	2,40,000	By	Cash -equipment sold	15,000
To	Cash-purchase (Bal. Fig.)	52,000	By	Profit and Loss Accounts (Loss on sale)	5,000
			By	Balance c/d	2,72,000
		2,92,000			2,92,000

Depreciation on equipment:

@ 10% p.a. on Rs.2,20,000 (i.e Rs.2,40,000 – Rs.20,000)	=	22,000
@ 10% p.a. on Rs.52,000 for 6 months (i.e. during the year)	=	2,600
		24,600

5. Calculation of closing balance of creditors

Creditors Account

		Rs.			Rs.
To	Cash	2,50,000	By	Balance b/d	65,000
To	Discount received	4,800	By	Credit purchases (W.N.2)	2,60,000
To	Balance c/d (Bal. Fig.)	70,200			
		3,25,000			3,25,000

6. Calculation of opening balance of debtors

Debtors Account

		Rs.			Rs.
To	Balance b/d (Bal. Fig.)	35,500	By	Cash	3,80,000
To	Sales (Credit)	4,50,000	By	Discount allowed	5,500
			By	Balance c/d	1,00,000
		4,85,500			4,85,500

7. Calculation of capital accounts of A & B as on 31.3.2006

Balance Sheet as on 31.3.2006

Liabilities	*Rs.*	*Assets*	*Rs.*
Combined Capital Accounts of A & B (Bal. Fig.)	5,45,500	Building	1,50,000
Creditors	65,000	Equipments	2,40,000

Bank Loan	45,000	Furniture	25,000
		Debtors (W.N.6)	35,500
		Stock (W.N.3)	1,45,000
		Cash balance	60,000
	6,55,500		6,55,500

	Rs.
Combined Capitals of A & B	5,45,500
Less: Difference in capitals of A and B	15,000
	5,30,500

A's Capital as on 31.3.2006 = $\frac{5,30,500}{2} = 2,65,250 + 15,000 = \text{Rs.}2,80,250$

B's Capital as on 31.3.2006 = $\frac{5,30,500}{2} = \text{Rs.}2,65,250$

8. **Cash Account**

		Rs.			Rs.
To	Balance b/d	60,000	By	Creditors	2,50,000
To	Debtors	3,80,000	By	Purchases	65,000
To	Equipment (sales)	15,000	By	Expenses	40,000
To	Cash sales (W.N.1)	50,000	By	A's drawings	30,000
			By	Bank loan paid (45,000-35,000)	10,000
			By	Equipment purchased (W.N.4)	52,000
			By	Balance c/d (Bal. Fig.)	58,000
		5,05,000			5,05,000

Question 15

Following incomplete information of X Ltd. are given below:

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

		Rs.'000			Rs.'000
To	*Opening stock*	*700*	*By*	*Sales*	*?*
To	*Purchases*	*?*	*By*	*Closing stock*	*?*
To	*Direct expenses*	*175*			
To	*Gross profit c/d*	*?*			
		?			*?*

To	Establishment expenses	740	By	Gross profit b/d	?
To	Interest on loan	60	By	Commission	100
To	Provision for taxation	?			
To	Net profit c/d	?			
		?			?
To	Proposed dividends	?	By	Balance b/f	140
To	Transfer to general reserve	?	By	Net profit b/d	?
To	Balance transferred to Balance sheet	?			
		?			?

Balance Sheet as at 31st March, 2008

Liabilities	Amount (Rs.'000)	Assets	Amount (Rs.'000)
Paid-up capital	1,000	Fixed assets:	
General reserve:		Plant & machinery	1,400
Balance at the beginning of the year	?	Other fixed assets	?
Proposed addition	?	Current assets:	
Profit and loss account	?	Stock	?
10% Loan account	?	Sundry debtors	?
Current liabilities	?	Cash at bank	125
	?		?

Other information:

(i) *Current ratio is 2:1.*

(ii) *Closing stock is 25% of sales.*

(iii) *Proposed dividends to paid-up capital ratio is 2:3.*

(iv) *Gross profit ratio is 60% of turnover.*

(v) *Loan is half of current liabilities.*

(vi) *Transfer to general reserves to proposed dividends ratio is 1:1.*

(vii) *Profit carried forward is 10% of proposed dividends.*

(viii) *Provision for taxation is equal to the amount of net profit of the year.*

(ix) *Balance to credit of general reserve at the beginning of the year is twice the amount transferred to that account from the current year's profits.*

All working notes should be part of your answer. You are required to complete:

(i) Trading and Profit and Loss account for the year ended 31st March, 2008 and

(ii) The Balance Sheet as on that date. *(20 Marks)(May, 2008)*

Answer

Trading and Profit & Loss A/c

for the year ended 31st March, 2008

		(Rs. in '000s)			*(Rs. in '000s)*
To	Opening stock	700.00	By	Sales (W.N.10)	5366.66
To	Purchases (Bal. Fig.)	2613.33	By	Closing stock (W.N.11)	1341.67
To	Direct expenses	175.00			
To	Gross profit c/d (W.N.9)	3,220.00			
		6,708.33			6,708.33
To	Establishment expenses	740.00	By	Gross profit b/d (Bal. Fig.)	3,220.00
To	Interest on loan	60.00	By	Commission	100.00
To	Provision for tax (W.N.8)	1,260.00			
To	Net profit c/d	1,260.00			
		3,320.00			3,320.00
To	Proposed dividends (W.N.1)	666.67	By	Balance b/f	140.00
To	Transfer to general reserve (W.N.2)	666.67	By	Net profit b/d (Bal. Fig.)	1,260.00
To	Balance transferred to Balance sheet (W.N.3)	66.66			
		1,400.00			1,400.00

Balance Sheet as at 31st March, 2008

Liabilities	*(Rs. in '000s)*	*Assets*	*(Rs. in '000s)*
Paid-up capital	1,000.00	*Fixed assets:*	
General reserve:		Plant & machinery	1,400.00

Balance at the beginning (W.N.14)	1333.34	Other fixed assets (Bal. Fig.)	1066.67
Proposed addition (W.N.2)	666.67	*Current Assets:*	
Profit and loss A/c	66.66	Stock (W.N.11)	1341.67
10% Loan A/c (W.N.4)	600.00	Sundry debtors (W.N.13)	933.33
Current liabilities (W.N.5)	1,200.00	Cash at bank	125.00
	4,866.67		4,866.67

Working Notes:

1. Proposed dividend to paid up capital is 2:3.

   i.e. Proposed dividend = $\frac{2}{3}$ of paid up capital

   = Rs.1,000.00 thousand × $\frac{2}{3}$ = Rs. 666.67 thousand

2. Transfer to General Reserve is equal to proposed dividend i.e., 1:1.

   Proposed dividend is Rs.666.67 thousand,
   therefore general reserve is also Rs. 666.67 thousand.

3. Profit carried forward to Balance Sheet = 10% of Proposed Dividend

   i.e., Rs. 666.67 thousand × 10% = Rs.66.66 thousand

4. 10% Loan implies interest on loan being 10%

   i.e. Rs.60.00 thousand × $^{100}/_{10}$ = Rs.600.00 thousand

5. Loan is half of current liabilities which means current liabilities are twice of loan
   i.e., Rs.600.00 thousand × 2 = Rs.1,200.00 thousand

6. Current Ratio i.e., $\frac{\text{Current Assets}}{\text{Current Liabilities}}$ = 2:1 or $\frac{2}{1}$

   i.e. Current Assets = 2 x Current Liabilities
   or 2 x Rs.1,200.00 thousand = Rs.2,400.00 thousand

7. Current Net Profit

	(Rs. in '000s)
Proposed dividend	666.67
Transfer to general reserve	666.67
Profit and loss balance transferred to balance sheet	66.66
	1,400.00
Less: Balance b/f	140.00
Net profit for the year	1,260.00

8. Provision for taxation is equal to current net profit i.e., = Rs.1,260.00 thousand
9. Gross profit being balancing figure of Profit and Loss A/c = Rs.3,220.00 thousand
10. Gross profit = 60% of sales i.e.

    Rs.3,220.00 thousand = 60% of sales

    Or, sales = $Rs.3{,}220\,\text{thousand} \times \frac{100}{60}$ = Rs. 5,366.67 thousand
11. Closing stock is 25% of sales i.e., 25% of Rs. 5,366.67 thousand = Rs.1,341.67 thousand
12. Purchases being balancing figure of Trading A/c = Rs.2,613.33 thousand
13. Debtors = Current Assets – Closing Stock – Cash at Bank

    = Rs.2,400.00 thousand – Rs.1,341.67 thousand – Rs.125.00 thousand
    = Rs.933.33 thousand
14. Balance of general reserve at the beginning of the year is twice of the amount transferred to general reserve during the year i.e. 2 x Rs.666.67 thousand = Rs.1,333.34 thousand
15. Other fixed assets = Total of balance sheet (liabilities side)- Current assets – Plant and machinery

    i.e., Rs.4,866.67 thousand - Rs.2,400.00 thousand – Rs.1,400.00 thousand
    = Rs.1,066.67 thousand

Question 16

Ram carried on business as retail merchant. He has not maintained regular account books. However, he always maintained Rs. 10,000 in cash and deposited the balance into the bank account. He informs you that he has sold goods at profit of 25% on sales.

Following information is given to you:

Assets and Liabilities	*As on 1.4.2007*	*As on 31.3.2008*
Cash in Hand	*10,000*	*10,000*
Sundry Creditors	*40,000*	*90,000*
Cash at Bank	*50,000 (Cr.)*	*80,000 (Dr.)*
Sundry Debtors	*1,00,000*	*3,50,000*
Stock in Trade	*2,80,000*	*?*

Analysis of his bank pass book reveals the following information:

(a) Payment to creditors Rs. 7,00,000

(b) Payment for business expenses Rs. 1,20,000

(c) Receipts from debtors Rs. 7,50,000

(d) Loan from Laxman Rs. 1,00,000 taken on 1.10.2007 at 10% per annum

(e) Cash deposited in the bank Rs. 1,00,000

He informs you that he paid creditors for goods Rs. 20,000 in cash and salaries Rs. 40,000 in cash. He has drawn Rs. 80,000 in cash for personal expenses. During the year Ram had not introduced any additional capital. Surplus cash if any, to be taken as cash sales.

Prepare:

(i) Trading and Profit and Loss Account for the year ended 31.3.2008.

(ii) Balance Sheet as at 31st March, 2008 (16 Marks) (PE I- Nov. 2008)

Answer

Trading and Profit and Loss Account

for the year ended 31st March, 2008

		Rs.				Rs.
To	Opening stock	2,80,000	By	Sales		
To	Purchases	7,70,000		Cash	2,40,000	
To	Gross Profit @ 25%	3,10,000		Credit	10,00,000	12,40,000
			By	Closing Stock		1,20,000
		13,60,000				13,60,000
To	Salaries	40,000	By	Gross Profit		3,10,000
To	Business expenses	1,20,000				
To	Interest on loan	5,000				
To	Net Profit	1,45,000				
		3,10,000				3,10,000

Balance Sheet as at 31st March, 2008

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*
Ram's capital:			Cash in hand	10,000
Opening	3,00,000		Cash at Bank	80,000
Add: Net Profit	1,45,000		Sundry Debtors	3,50,000
	4,45,000		Stock in trade	1,20,000
Less: Drawings	80,000	3,65,000		
Loan from Laxman (including interest due)		1,05,000		
Sundry Creditors		90,000		
		5,60,000		5,60,000

Working Notes:

1. Sundry Debtors Account

		Rs.			Rs.
To	Balance b/d	1,00,000	By	Bank A/c	7,50,000
To	Credit sales (Bal. fig)	10,00,000	By	Balance c/d	3,50,000
		11,00,000			11,00,000

2. Sundry Creditors Account

		Rs.			Rs.
To	Bank A/c	7,00,000	By	Balance b/d	40,000
To	Cash A/c	20,000	By	Purchases (Bal. fig.)	7,70,000
To	Balance c/d	90,000			
		8,10,000			8,10,000

3. Cash and Bank Account

		Cash Rs.	Bank Rs.			Cash Rs.	Bank Rs.
To	Balance b/d	10,000		By	Balance b/d		50,000
To	Sales (bal. fig)	2,40,000		By	Bank A/c (C)	1,00,000	
To	Cash (C)		1,00,000	By	Salaries	40,000	
To	Debtors		7,50,000	By	Creditors	20,000	7,00,000
To	Laxman's loan		1,00,000	By	Drawings	80,000	
				By	Business expenses		1,20,000
				By	Balance c/d	10,000	80,000
		2,50,000	9,50,000			2,50,000	9,50,000

4. Calculation of Ram's Capital on 1st April, 2007

Balance Sheet as at 01.04.2007

Liabilities	*Rs.*	*Assets*	*Rs.*
Ram's Capital (bal. fig)	3,00,000	Cash in hand	10,000
Bank Overdraft	50,000	Sundry Debtors	1,00,000
Sundry Creditors	40,000	Stock in trade	2,80,000
	3,90,000		3,90,000