17

FINANCIAL ACCOUNTING
PAPER - 5

TEST PAPER - I/5/FAC/2008/T-1

Answer to Question No. 1(a)

A The output of financial accounting is
- The preparation of financial statements.

B The basic objective of financial accounting is to
- Provide quantitative information to users of financial statements

C Information about performance is disclosed by
→ Both (i) and (ii)

D The lessee's right to recover the short working is related to - Terms of the agreement

E In the books of lessee, short workings recoverable in future years are - An asset.

Answer to Question 1 (F)

(i) Expenses - Expense is the cost incurred in producing and selling the goods and services
Expenses includes i) Cost of Goods Sold
ii) Amount paid for rent, Commission, Salary etc
iii) Decline in the value of asset by the use of asset for business purpose or depreciation.

(ii) ~~Res~~ Equity - It is residual interest of the owner of an enterprise in the assets of the enterprise which remains after providing for the liabilities of the enterprise.

(iii) Liability - It refers to the amount which the firm owes to outsiders (excepting the amount owed to proprietors)
Liabilities = Assets - Capital
It may be classified as Long term liabilities and Current Liabilities

(iv) Asset - Anything which will enable a business enterprise to get Cash or a benefit in future is an asset. Thus cash & bank balance, stock, furniture, Debtors are all assets.

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

Answer to Question 2(a)

(i) Materiality – As per Accounting Standard-1 "Disclosure of Accounting Policies" one of the major considerations governing the selection and application of accounting policies is "Materiality". Financial statements should disclose all "material" items i.e items the knowledge of which might influence the decisions of the user (investors, lenders, government etc) of the financial statements. According to this convention, the accountant should attach importance of material details and ignore insignificant details in the financial statements. The accountants should not be burdened with insignificant details.

According to this convention of materiality, accountants should report only what is material and ignore insignificant details while preparing the final accounts. The decision is to be made by the accountant or the auditor on the basis of professional experience and judgement where there is no unanimous opinion on the subject.

Moreover, an item may be material for one purpose while immaterial for another. It is generally felt that in respect of items appearing in the profit and loss account and having an effect on the profit for the year, materiality should be judged in relation to the profit shown by profit and loss account and also expenditure under the concerned head.

The financial accounting board U.S.A expreses the openion that no general standards of materiality can be formulated to take into account all the consideration that enter into an experienced human judgement Individual judgements are ~~refused~~ required to asses materiality or to decide what the appropriate minimum quantitative criteria are to be set for given situations.

The Companies Act 1956, also recognize the need for separate disclosure of material items. Part II of schedule VI states that any item of expenses which exceeds 1% of the total revenue of the company or Rs 5,000 whichever is higher should be as shown as separate and distinct item against an appropriated head in the Profit and Loss Account.

Answer to Question 2(a)

(ii) Principles of Government Accounting –
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 foremain 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 what extent its forecast was justified by facts whether it has surplus or deficit balance as a result of year 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 determine (a) whether 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 accounts are kept as per double entry system. A statement of its estimated annual receipt and expenditure is prepared by each government and present to its legislature.

A union territory present 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 to the consolidated fund of state or consolidated fund of union territory and the sums required to meet other expenditure are shown separately. The budget shows receipt and payment of the Government under three heads:

→ Consolidated Fund
→ Contingency Fund
→ Public Account.

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

Answer to Question 2(a)

(iv) Proprietary Ratio - Proprietary ratio is calculated to judge the owner's contribution to total fund application/assets.

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

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

Answer to Question 2(a)

(iii) Consolidated Fund - In India Government account are kept in three main parts i.e Consolidated fund, Contingency fund and public account

Revenue of the Government arising out of taxation, Other receipt 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-division under Consolidated Fund are Revenue Account and Capital Account.

Answer to Question No. 2(b)

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 amortization

(ii) Valuation of Inventories

(iii) Valuation of Fixed Assets.

The above areas are not exhaustive.

Disclosure requirement of Accounting Policies

→ As per prescribed Accounting Standard-1, disclosure requirement of Accounting Policies are as follows:-

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

(ii) Any change in accounting policies which has a material affect 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 reasonable and expected to have a material effect in later period the fact of such change should be appropriately disclosed in the period in which the change is made.

(iii) If the fundamental accounting assumption i.e Going Concern, Consistency and Accrual are followed in the preparation of financial statement, specific disclosure is not required if a fundamental accounting is not followed. The fact should be disclosed

(iv) Amount by which any item in the financial statements is affected in the current period, by a change in the accounting policy, to the extent ascertainable.

(v) Where the quantitative effect of any change in accounting policy is not ascertainable, the fact thereof.

Answer to Question No. 4

Dr. Realisation Account Cr.

Particulars	Amount (Rs)	Particulars	Amount (Rs)
To Stock	40000	By Building	180000
To Plant & Machinery	120000	By Investment	20000
To Provision on Debtor	15000		
To Unrecorded Liability	10000		
To Profit to be distributed to Capital A/c in the ratio 2:1 X 10000 Y 5000	15000		
	200000		200000

Dr Partner's Capital Account Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To bal c/d	1627500	813750	813750	By bal b/d	1000000	500000	
				By Reserve	600000	300000	
				By Premium [W.N-3]	17500	8750	
				By Revaluation Profit	10000	5000	
				By Cash [WN-4]			813750
	1627500	813750	813750		1627500	813750	813750

Balance Sheet as at 31/03/2009

Liabilities	Amount (Rs)	Asset	Amount (Rs)
Capital A/c		Plant & Machinery 1200000	
X 1627500		Less Dep (120000)	1080000
Y 813750		Building 900000	
Z 813750	3255000	Add Appreciation 180000	1080000
Sundry Creditor	400000	Sundry Debtor 300000	
Bills Payable	100000	Less Provision	
Other Liability	10000	for Doubtful Debt (15000)	285000
		Stock 400000	
		Less Depreciation (40000)	360000
		Investment	20000
		Cash - [WN-1]	940000
	3765000		3765000

Working Notes:-

Working Note - 1

	Amount (Rs)
Cash balance as per Balance Sheet	100000
Add Z's Capital	813750
Add Premium on Goodwill	26250
	940000

Working Note - 2

Calculation of New Profit Sharing Ratio

Let the firm's ratio be 1

~~So~~ Z's share = $\frac{1}{4}$

So, remaining ratio = $1 - \frac{1}{4} = \frac{3}{4}$

Now, X's new share $= \frac{3}{4} \times \frac{2}{3} = \frac{6}{12}$

Y's new share $= \frac{3}{4} \times \frac{1}{3} = \frac{3}{12}$

Z's ~~new~~ Share $= \frac{1}{4} \times \frac{3}{3} = \frac{3}{12}$

So, new ratio = 6:3:3 or 2:1:1

Or Sacrificing ratio = Old Ratio - New Ratio

X's Sacrificing ratio $= \frac{2}{3} - \frac{2}{4} = \frac{8-6}{12} = \frac{2}{12}$

Y's sacrificing ratio $= \frac{1}{3} - \frac{1}{4} = \frac{4-3}{12} = \frac{1}{12}$

So, S.R = 2:1

Working Note - 3 → Valuation of Goodwill

Total Value of the firm's goodwill = Rs 105000

∴ Z's share $= \frac{105000}{4} = 26250$

Distribution of Goodwill to Old Partner's In their SR = 2:1

X = Rs 17500

Y = Rs 8750

Working Note - 4 → Calculation of Z's Capital.

Total Capital of X & Y after all adjustments

X → Rs 1627500

Y → Rs 813750

Rs 2441250

Valuation of Capital of the Firm.

$\frac{3}{4}^{th} = 2441250$ [i.e $1 - \frac{1}{4} = \frac{3}{4}$]

So, $\frac{4}{3}^{th} = \frac{2441250 \times 4}{3} =$ Rs 3255000

Z's Capital $= 3255000 \times \frac{1}{4}$

= Rs 813750

Answer to Question No- 5

Calculation of Departmental Profit

Particulars	X	Y	Z
Profit after charging Commision	36000	27000	18000
Add:- Manager Commision @ 10% [Profit $\times \frac{100}{90} \times 10\%$]	4000	3000	2000
Profit before Commission	40000	30000	20000
Less Unrealized Profit [W.N-1]	4000	4500	2000
	36000	25500	18000
Less Commission @ 10%	3600	2550	1800
	32400	22950	16200

Working Note - 1 ⇒ Unrealized Profit on Stock

A) Dept X to Dept Y @ 25% on Cost

Let Cost = 100, Profit 25, Sales = 125

When Sales = 125, Profit is 25

When Sales 15000, Profit $\frac{25}{125} \times 15000$

= Rs 3000

Dept X to Dept Z @ 10% on Cost

Let Cost = 100, Profit = 10, Sales = 110

So, profit = $\frac{10}{110} \times 11000$

= Rs 1000

Total unrealized profit of Dept X = Rs 3000 + Rs 1000

= Rs 4000

B) Department Y to X at 15% on Sales
i.e 15% of 14000 = Rs 2100

Department Y to Dept Z at 20% on Sales

i.e 20% of Rs 12000 = Rs 2400

Total unrealized profit = Rs 2100 + Rs 2400
= Rs 4500

C) Department Z to Dept X at 20% on Cost
Let Cost 100, Profit = 20, Sales = Rs 120
$\therefore$ Profit = $\frac{20}{120} \times 6000$ = Rs 1000

Department Z to Dept Y at 25% on Cost
Let Cost = 100, Profit 25, Sales = Rs 125
$\therefore$ Profit = $\frac{25}{125} \times 5000$ = Rs 1000

Total unrealized Profit = Rs 1000 + Rs 1000
= Rs 2000

Answer to Question 6

Journal Entry in the books of Head office

Date	Particular	LF	Amt (Rs) Debit	Amt (Rs) Credit
2009				
Jan 31.	Madras Branch a/c Dr		6000	
	Patna Branch a/c Dr		16000	
	To Bombay Branch a/c			6000
	To Calcutta Branch a/c			16000
	(Being adjustment entry passed by head office in respect of inter branch transactions during the month) →WN1			

Working Note - 1 → Inter Branch Transactions

	Bombay	Madras	Calcutta	Patna
A) Bombay Branch				
(i) → Received Goods	10000 (Dr)		6000 (Cr)	4000 (Cr)
(ii) → Goods Sent	18000 (Cr)		8000 (Dr)	10000 (Dr)
(iii) → Received B/R	6000 (Dr)			6000 (Cr)
(iv) → Sent Acceptance	6000 (Cr)		4000 (Dr)	2000 (Dr)
B) Madras Branch				
(i) → Goods received	4000 (Cr)	14000 (Dr)	10000 (Cr)	
(ii) → Cash Sent	6000 (Dr)	8000 (Cr)	2000 (Dr)	
C) Calcutta Branch				
(i) → Goods Sent			6000 (Cr)	6000 (Dr)
(ii) → Paid B/P & Cash			8000 (Cr)	8000 (Dr)
	6000 (Cr)	6000 (Dr)	16000 (Cr)	16000 (Dr)