PAPER – 1 : ACCOUNTING

*Answer **all** questions.*

Working notes should form part of the answer.

Question 1

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	500	400	Debtors	651	440
			Stock	393	680
General reserve	180	170	Cash at bank	26	130
Profit and loss account	–	15	Own debentures (Nominal value Rs. 2,00,000)	192	–
12% Debentures of Rs. 100 each	600	200			
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)*

Answer

Journal Entries in the books of Max Ltd.

2005	*Particulars*		*Dr. Amount Rs.*	*Cr. Amount Rs.*
April 1	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)			
April 2	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 A/c			10,00,000
To 9% Preference share capital A/c			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 2nd April, 2005

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity share capital	17,50,000	Fixed assets	19,60,000
9% Preference share capital	8,20,000	Stock	10,40,000
Profit and loss account	15,000	Debtors	10,30,000
General reserve	4,30,000	Cash at bank	2,05,900
Capital reserve	2,45,900		
12% Debentures	4,00,000		
Sundry creditors	5,75,000		
	42,35,900		42,35,900

* Rs. 80,000 is the balancing figure adjusted to general reserve account as per AS 14 "Accounting for Amalgamation".

Working Notes:

1. *Purchase Consideration:*

		Rs.
Equity share capital	$10{,}000 \times \frac{50}{5} \times Rs. 10$	= 10,00,000
9% Preference share capital	$4{,}000 \times \frac{4}{5} \times Rs. 100$	= 3,20,000
		13,20,000

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 2

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 at 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)*

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	–	–
To	Balance c/d	1,90,000	2,00,333	–	1,95,167	By	Loan A/c – transfer	–	–	–	2,00,000
						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 of the reconstituted firm
(after 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.*	*Rs.*
To	Plant and machinery	30,000	By	Land and building		70,000
To	Stock	10,000	By	Partners' capital accounts		
To	Debtors	50,000		Ram	10,000	
				Rahim	6,000	
				Robert	4,000	20,000
		90,000				90,000

2. **Calculation of Goodwill:**

	Rs.
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 $\times$ 2 years = Rs. 1,10,000.

3. **Bank Account**

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

Question 3

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)*

Answer

In the books of Shah & Co.

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

	Particulars	*H.O.* *Rs.*	*Branch* *Rs.*	*Total* *Rs.*			*H.O.* *Rs.*	*Branch* *Rs.*	*Total* *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 from H.O.	–	8,80,000	–	By	Stock shortage	–	16,000	16,000
					By	Goods in transit	–	–	44,000
To	Gross profit c/d	3,40,000	1,64,000	5,04,000	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	25,24,000			23,60,000	10,44,000	25,24,000
To	Admn. expenses	1,39,000	15,000	1,54,000	By	Gross profit b/d	3,40,000	1,64,000	5,04,000
To	Selling expenses	50,000	6,200	56,200					
To	Stock shortage	–	16,000	16,000					
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	5,04,000			3,40,000	1,64,000	5,04,000

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	4,23,200
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	2,29,500
			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 stocks:**

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

Stock at Branch:		*Rs.*
Goods received from H.O. (at invoice price)		8,80,000
Less: Invoice value of goods sold Rs. $8,20,000 \times \frac{100}{125}$	6,56,000	
Invoice value of stock shortage Rs. $20,000 \times \frac{100}{125}$	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 $\left(\text{Rs.}2,08,000 \times \frac{10}{110}\right)$	18,909
Unrealised profit on goods in transit $\left(\text{Rs.}44,000 \times \frac{10}{110}\right)$	4,000
	22,909

Question 4

From the following particulars 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)*

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. 3)	11,60,000				14,36,200	
		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	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
Outstanding expenses		6,600	Cash in hand		24,000
			Cash at 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 (Balancing figure)	11,60,000
To	Returns	8,000			
To	Balance c/d	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 for the year 2004 - 2005	55,000

(5) Expenses to be shown in profit and loss account

Expenses (in cash)	1,91,400
Add: Outstanding of 2005	6,600
	1,98,000
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 5

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)

Answer

(a) Computation of underwriters' liability of (number 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 (number of shares)	2,57,500	1,42,500	1,00,000

(b) Computation of amounts payable by underwriters:

	Rs.	*Rs.*	*Rs.*
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) Journal Entries in the books of Scorpio Ltd.

		Dr.	Cr.
		Rs.	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 6

*Answer any **four** of the following:*

(a) Under what circumstances can an enterprise change its accounting policy?

(b) 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?

(c) 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.

(d) 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?

(e) Ram Co. (P) Ltd. furnishes you the following information for the year ended 31.3.2005:

Depreciation for the year ended 31.3.2005	*Rs. 100 lakhs*
(under straight line method)	
Depreciation for the year ended 31.3.2005	*Rs. 200 lakhs*
(under written down value method)	
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.

(f) How refund of revenue grant received from the Government is disclosed in the Financial Statements? *(4 $\times$ 4 = 16 Marks)*

Answer

(a) 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.

(b) 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.

(c) 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 liability on account of wages amounting 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.

(d) AS 26 on 'Intangible Assets' came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature.

As per para 63 of the standard, the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of the intangible asset will not exceed ten years from the date when the asset is available for use. Since, in this situation, the amortisation period of ten years determined by applying para 63 has already expired on 31.03.2004, therefore, the carrying amount of Rs. 16 lakhs has to be eliminated with a corresponding adjustment to the balance of revenue reserves of 31.03.2004.

However, if there is persuasive evidence that the useful life of an intangible asset is more than ten years (as per para 67 of the standard), then an intangible asset has to be amortised over the best estimate of its useful life and therefore, assuming that the best estimate of its useful life is 20 years as given in the question, depreciation amounting Rs.2 lakhs $\left(\frac{\text{Rs.40 lakhs - Nil}}{\text{20 years}}\right)$ as per straight line basis should be charged by A Co. Ltd. and no other adjustment is required as on 31.3.2004.

(e) As per para 15 of AS 6 'Depreciation Accounting', 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 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. 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.

(f) 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.