MOCK TEST PAPER – 1

IPCC : GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Case I

As per AS 12, Grant received of ₹ 20 lakhs to be deducted from ₹ 2 crores. The balance of ₹ 1.80 crores to be shown as value of depreciable asset in the Balance Sheet and depreciation should also be charged on ₹ 1.80 crores.

Case II

As the entire grant amount is received it shall be recorded at a normal value of ₹ 100 in the Balance sheet so that the existence of the asset reflected. No depreciation is to be charged in this case.

Note: Alternatively, government grants 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.

(b) Adjusted Net profit for the current year

= 2,00,00,000+5,50,000 – 1,65,000 = ₹ 2,03,85,000

Number of equity shares resulting from conversion of debentures

= 50,000 × 8 = 4,00,000 equity shares

Total number of equity shares resulting from conversion of debentures

= 40,00,000 + 4,00,000 = 44,00,000 shares

Diluted Earnings per share = $\frac{₹\ 2,03,85,000}{44,00,000}$ = ₹ 4.63 (Approximately)

(c) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which 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. Thus, revision of an estimate by its nature, i.e. the difference of ₹ 2 lakhs is not a prior period item.

Therefore, in the given case expenses amounting ₹ 2,00,000 (i.e. ₹ 9,00,000 – ₹ 7,00,000) relating to the previous year recorded in the current year, should not be regarded as prior period item.

(d) As per AS 11, 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2010 and corresponding creditor would be recorded at ₹ 4,50,000 (i.e. $10,000 × ₹ 45).

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2010 will be reported at ₹ 4,40,000 (i.e. $10,000 × ₹ 44) and exchange profit of ₹ 10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2009-10.

On 7.7.2010, creditor of $10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2010-11.

2. (i) Calculation of amount of equity shares issued to L and T

Profits of	*L* ₹	*T* ₹
Ist Year	2,62,800	2,75,125
IInd Year	2,12,200	2,49,875
Total	4,75,000	5,25,000
No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability		
24000 x 475/1000	11,400 equity shares	
24000 x 525/1000		12,600 equity shares

Calculation of amount of 12% Preference shares issued to L and T

	L ₹	*T* ₹
Capital employed (Refer working note 1)	8,40,000	9,24,000

8% return on capital employed	67,200	73,920
12% Preference shares to be issued $\left[67{,}200 \times \frac{100}{12}\right]$	₹ 5,60,000	
$\left[73{,}920 \times \frac{100}{12}\right]$		₹ 6,16,000

Total Purchase Consideration

	L ₹	*T* ₹
Equity shares	2,85,000	3,15,000
12% Preference shares	5,60,000	6,16,000
Total	8,45,000	9,31,000

(ii) Balance Sheet of LT Ltd. (after amalgamation)

Liabilities	₹	*Assets*	₹
Authorised share capital:		*Fixed assets:*	
1,00,000 Equity Shares of ₹ 25 each	25,00,000	Goodwill (W.N.1)	14,000
		Plant and Machinery	12,00,000
Issued and subscribed share capital:		Building	14,23,000
		Current Assets (W.N.2)	2,70,100
24,000 Equity Shares of ₹ 25 each	6,00,000		
1,17,600 12% Preference shares of ₹ 10 each	11,76,000		
(All of the equity and preference shares have been issued for consideration other than cash)			
Current Liabilities (W.N. 3)	11,31,100		
	29,07,100		29,07,100

Working Notes:

1. Goodwill

	L ₹	*T* ₹
Plant and machinery	5,25,000	6,75,000

Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
	14,63,500	14,81,600
Less: Current liabilities	(6,23,500)	(5,57,600)
Net assets taken (capital employed)	8,40,000	9,24,000
Less: Purchase consideration	(8,45,000)	(9,31,000)
Goodwill	5,000	7,000
Total purchased goodwill		12,000
Add: Unrealised profit of ₹ 10,000 @ 20% = ₹ 2,000 adjusted from current assets and from goodwill (since P & L A/c is not given)		2,000
Total Goodwill		14,000

2. Current Assets

	L ₹	*T* ₹
Balances before amalgamation	1,63,500	1,58,600
Less: Liabilities of L due to T	-	(50,000)
Less: Unrealised Profit on stock i.e.₹ 10,000 x 20%	(2,000)	
Total	1,61,500	1,08,600
Grand Total		2,70,100

3. Current Liabilities

	L ₹	*T* ₹
Balances before amalgamation	6,23,500	5,57,600
Less: Liabilities of L due to T	(50,000)	-
Total	5,73,500	5,57,600
Grand Total		11,31,100

3.

ROHAN LTD.
Departmental Trading and Profit and Loss Account
for the year ended 31st March, 2011

		I	J	K	Total			I	J	K	Total
		₹	₹	₹	₹			₹	₹	₹	₹
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	Net profit (J + K)				6,000
To	Stock reserve (J+K) (Refer W.N.)				3,000	By	Stock reserve b/d (J + K)				5,000
To	Balance transferred to Profit and loss account				1,000						
					11,000						11,000

Working Note:

Calculation of unrealized profit on closing stock

	₹
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 = $₹\ 20{,}000 \times \frac{₹\ 30{,}000}{₹\ 60{,}000} = ₹\ 10{,}000$

Stock reserve $= ₹\ 10{,}000 \times \frac{20}{120} = ₹\ 1667$ (approx.)

Stock reserve of K department

	₹
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 $= ₹\ 4{,}000 \times \frac{₹\ 30{,}000}{₹\ 60{,}000} = ₹\ 2{,}000$

Stock reserve $= ₹\ 2{,}000 \times \frac{20}{120} = ₹\ 333$ (approx.)

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

4. Realization Account as on 31.3.2011

2011		₹	₹	2011		₹	₹
March 31	To Sundry assets: Furniture and			March31	By Provision for bad and doubtful debts		500
	fixture	4,000			By Sundry creditors		15,500
	Trade mark	7,000			By Cash:		
	Debtors	16,000			Furniture and fixtures	1,000	
	Stock in trade	10,000	37,000		Trade mark	4,000	
	To Cash (payment to		15,500		Debtors	11,000	

	creditors)				Stock in trade	8,000	
	To Cash (liability for bills discounted)		2,500		Surrender value of joint life policy	3,000	27,000
					By Partners' capital accounts: (loss on realisation)		
					A	3,600	
					B	3,600	
					C	2,400	
					D	2,400	12,000
			55,000				55,000

Cash Account

2011		₹	2011		₹
March 31	To Balance b/d	2,000	March 31	By Realisation A/c	15,500
	To Realisation A/c	27,000		By Realisation A/c	2,500
	To C's capital A/c	3,700		By A's loan A/c	10,000
	To D's capital	8,400		By A's capital A/c	7,619
				By B's capital A/c	5,481
		41,100			41,100

Partners' Capital Accounts

		A	B	C	D			A	B	C	D
2011		₹	₹	₹	₹	2011		₹	₹	₹	₹
March 31	To Balance b/d	-	-	16,000	6,000	March 31	By Balance A/c	20,000	15,000		
	To Realisation A/c (loss)	3,600	3,600	2,400	2,400		By Cash A/c	-	-	3,700	8,400
							By A's Capital A/c	-	-	8,400	-
	To C's Capital A/c (Loss of capital written off)	8,400	6,300	-	-		By B's Capital A/c	-	-	6,300	-
							By A's Capital A/c (commission)	-	381	-	-
	To B's capital A/c										

	(commission)	381	-	-	-						
	To Cash A/c	7,619	5,481								
		20,000	15,381	18,400	8,400			20,000	15,381	18,400	8,400

Working Notes:

(1) There was a debit balance of ₹ 8,400 in D's capital account and D is a solvent partner, therefore he must bring cash for balance capital.

(2) 'C' is insolvent therefore he is not able to bring cash. The deficiency in his account is borne by 'A' and 'B' in the ratio of 4:3 (capital ratio).

Deficiency in 'C's account=₹ 16,000+₹ 2,400-₹ 3,700 = ₹ 14,700

Borne by A=4/7 x ₹ 14,700=₹ 8,400

Borne by B=3/7 x ₹ 14,700 = ₹ 6,300

(3) 'B' is entitled to get 5% commission on the amount finally paid to partner 'A' only. The calculation is as follows: (₹ 20,000-₹ 3,600-₹ 8,400) x 5/105 =₹ 381.

(4) Mr. A's loan is paid off in cash.

5. (a) Uncertain Bank Ltd.

Journal Entries

		(Rupees in crores)	
		Dr. ₹	Cr. ₹
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 $\left[₹\,4{,}000\,\text{crores} \times \frac{18}{100} \times \frac{73}{365}\right]$			144.00
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

2011		₹	*2010*		₹
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	2010-11	By Bills purchased and discounted A/c	144.00
		153.00			153.00

(ii) Rebate on bills discounted A/c

2010		₹	*2010*		₹
April 1	To Discount on bills A/c	9.00	April 1	By Balance b/d	9.00
2011			2011		
March 31	To Balance c/d	10.80	March 31	By Discount on bills A/c	10.80
		19.80			19.80

(b) Form B – RA (Prescribed by IRDA)

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

Registration No. and Date of registration with the IRDA: …………………..

Revenue Account for the year ended 31st March, 2011

	Particulars	Schedule	Current year ended on 31st March, 2011 ₹
1.	Premiums earned (Net)	1	8,40,000
	Total (A)		8,40,000
1.	Claims incurred (Net)	2	8,00,000
2.	Commission		50,000
3.	Operating Expenses	3	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)

	₹
Premium received	15,00,000
Less: Premium on re-insurance paid	1,00,000
	14,00,000
Less: Change in provision for unexpired risk (NIL–5,60,000)	(5,60,000)
Net Premium	8,40,000

Schedule 2

Claims

	₹
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2011	1,00,000
	8,00,000

Schedule 3

Operating expenses	₹
Expenses of Management	3,00,000

6. (a) Electric Supply Ltd.

Journal Entries

		Dr. ₹	*Cr.* ₹
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*		*Current cost*
		Rate	*Amount*	
	₹		₹	₹
Materials (3/5 × ₹ 15 lacs)	9,00,000	25%	2,25,000	11,25,000
Labour (2/5 × ₹ 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

	₹		₹
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 (Bal. fig.)	16,35,000
	19,05,000		19,05,000

(b) Liquidator's Final Statement of Account

	₹		₹
To Cash in hand	7,50,000	By Liquidator's remuneration (2% on 2,65,000[*])	5,300
To Cash / bank (Amount received on call for 7,000 equity shares @ ₹ 6.53 per share)	45,710	By Preferential creditors	35,000
		By Unsecured creditors	2,30,000
		By Preference shareholders	5,00,000
		By Equity shareholders (Amount paid to holders of 3,000 equity shares @ ₹ 8.47 per equity share)	25,410
	7,95,710		7,95,710

Working Note:

Calculation of amount receivable from equity shareholders or payable to equity shareholders

	₹	₹
Cash in hand (Assets realized)		7,50,000
Less: Payments made:		
Liquidator's remuneration	5,300	
Preference creditors	35,000	
Unsecured creditors	2,30,000	
Preference shareholders	5,00,000	7,70,300
		20,300
Add: Amount payable to equity shareholders (paid up):		
3,000 equity shares of ₹ 100 each ₹ 75 paid up	2,25,000	
7,000 equity shares of ₹ 100 each ₹ 60 paid up	4,20,000	6,45,000
Total loss to be borne by equity shareholders		6,65,300
No. of equity shares	10,000 shares	
Loss per equity share = $\frac{6,65,300}{10,000}$ = ₹ 66.53		

[*] 35,000 + 2,30,000 = 2,65,000

Amount receivable from 7,000 equity shareholders
= 7,000 x 6.53 (i.e. 66.53 – 60) = ₹ 45,710

Amount payable to 3,000 equity shareholders
= 3,000 ´ 8.47 (i.e. 75 – 66.53) = ₹ 25,410

7. (a) It is a present obligation as a result of past obligating event. The obligating event is the sale of the product which gives rise to an obligation because obligations also arise from normal business practices. An outflow of resources, embodying economic benefits in settlement is probable because a proportion of goods are returned for refund. For the best estimate of the cost of refunds, a provision should be recognized as per AS 29.

(b) As per para 13 of AS 4 (revised), 'Contingencies 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.

Though the theft, by the cashier ₹ 2,00,000, was detected after the balance sheet date (before approval of financial statements) yet it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to recognize the loss amounting ₹ 2,00,000 and adjust the accounts of the company for the year ended 31st March, 2011.

(c) As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment* amounts to at least substantially all of the fair value of leased asset. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5 Flows ₹ 3 lakhs each year)	₹ 3.36 lakhs (approx.)
Present Value of minimum lease payments	₹ 10.08 lakhs (approx.)

Thus present value of minimum lease payments is ₹ 10.08 lakhs and the fair value of the machine is ₹ 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years.

* In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

Therefore lease agreement is an operating lease. Lease payments under an operating lease should be recognized 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.

(d) In the books of N Co. Ltd.

Journal Entries

			₹	₹
1.10.2010	Employee compensation expense A/c	Dr.	14,00,000	
	To Employee stock option outstanding A/c			14,00,000
	(Being the grant of 20,000 stock options to employees at ₹ 50 when market price is ₹ 120)			
10.12.10	Bank A/c	Dr.	8,00,000	
to 31.3.11	Employee stock option outstanding A/c	Dr.	11,20,000	
	To Equity share capital A/c			1,60,000
	To Securities premium A/c			17,60,000
	(Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)			
31.3.11	Employee stock option outstanding A/c	Dr.	2,80,000	
	To Employee compensation expense A/c			2,80,000
	(Being reverse entry passed for lapse of 4,000 stock options)			
31.3.11	Profit and Loss A/c	Dr.	11,20,000	
	To Employee compensation expense A/c			11,20,000
	(Being transfer of employee compensation transferred to Profit and Loss Account)			

(e) As per AS 26 'Intangible Assets', the condition for recognition of a research and development asset has to be fulfilled when the expenditure was incurred. If the recognition conditions are not fulfilled the amount has to be charged to the profit and loss account. Once the amount is charged to the Profit and Loss account, such amount cannot be restated later as a Research and Development Asset when the condition for recognition get fulfilled. The Company therefore cannot capitalize ₹ 75,00,000 even as a prior period item.