

PAPER – 5: ADVANCED ACCOUNTING

Question No. 1 is compulsory

Answer any five questions from the remaining six questions.

Wherever necessary, suitable assumption(s) should be made by the candidates.

Working notes should form part of the answer.

Question 1

Answer the following questions:

- (a) A Company had deferred research and development cost ` 450 Lakhs. Sales expected in the subsequent years are as under:

Years	Sales (` in Lakhs)
1	1200
2	900
3	600
4	300

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of ` 450 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the company ?

- (b) ABC Limited purchased a machinery for ` 25,00,000 which has estimated useful life of 10 years with the salvage value of ` 5,00,000. On purchase of the assets Central Government pays a grant for ` 5,00,000. Pass the journal entries with narrations in the books of the company for the first year, treating grant as deferred income.
- (c) From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial Bank for the year ending on 31-03-2012.

Assets (Category of Advances)	` In Lakhs
Standard Advances	7,000
Sub-standard Advances	3,500
(Include secured exposures ` 1,000 Lakhs and balances unsecured exposures ` 2,500 Lakhs includes ` 1,500 Lakhs in respect of infrastructure loan accounts where escrow accounts are available)	
Doubtful advances-unsecured portion	1,500

Doubtful advances-secured portion	
For doubtful up to 1 year	500
For doubtful more than 1 year and up to 3 years	600
For doubtful more than 3 years	300
Loss Advances	200

- (d) (i) Explain the concept of 'Weighted average number of equity shares outstanding during the period'.

State how would you compute, based on AS-20 the weighted average number of equity shares in the following cases:

		No. of Shares
1 st April, 2011	Balance of Equity Shares	4,80,000
31 st August, 2011	Equity shares issued for cash	3,60,000
1 st February, 2012	Equity shares bought back	1,80,000
31 st March, 2012	Balance of equity shares	6,60,000

- (ii) Compute adjusted earning per share and basic earning per share based on the following information:

Net profit 2010-11	₹ 11,40,000
Net profit 2011-12	₹ 22,50,000
No. of equity shares outstanding	₹ 5,00,000

Until 31st December, 2011

Bonus issue on 1st January, 2012

1 equity share for each equity share

outstanding as at 31st December, 2011

(4 × 5 = 20 Marks)

Answer

- 1 (a) (i) Based on sales, research and development cost (assumed that entire cost of ₹ 450 lakhs is development cost) is allocated as follows:

Year	Research and Development cost allocation
	(₹ in lakhs)
1 st	$\frac{450}{3,000} \times 1200 = 180$

2 nd	$\frac{450}{3,000} \times 900 = 135$
3 rd	$\frac{450}{3,000} \times 600 = 90$
4 th	$\frac{450}{3,000} \times 300 = 45$

- (ii) If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining ₹ 135 lakhs [450 – (180 + 135)] as an expense immediately.

(b) Journal Entries in the books of ABC Ltd.

Year	Particulars	Dr. (₹)	Cr. (₹)
1st	Machinery Account Dr. To Bank Account (Being machinery purchased)	25,00,000	25,00,000
	Bank Account Dr. To Deferred Government Grant Account (Being grant received from the government treated as deferred income)	5,00,000	5,00,000
	Depreciation Account (25,00,000 – 5,00,000)/10 Dr. To Machinery Account (Being depreciation charged on SLM)	2,00,000	2,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	2,00,000	2,00,000
	Deferred Government Grant Account (5,00,000/10) Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	50,000	50,000

(c) Statement showing the amount of Provisions on Assets

(₹ in lakhs)			
Assets	Amount	% of	Provision
		provision	
Standard	7,000	0.40	28

Sub-standard:			
Secured portion	1,000	15	150
Unsecured infrastructure loan account where escrow account is available	1,500	20	300
Other unsecured	1,000	25	250
Doubtful -Secured portion:			
Upto one year	500	25	125
More than 1 year but upto 3 years	600	40	240
For more than three years	300	100	300
Doubtful – unsecured portion	1,500	100	1,500
Loss	200	100	<u>200</u>
Required provision			<u>3,093</u>

- (d) (i) (a) As per para no. 16 of AS 20, the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. For the purpose of calculating basic or diluted earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

- (b) Weighted average number of equity shares

Period		Weighted shares
1 st April, 2011 to 31 st August, 2011	4,80,000 shares x 5/12	2,00,000 shares
1 st September, 2011 to 31 st January, 2012	8,40,000 shares x 5/12	3,50,000 shares
1 st February, 2012 to 31 st March, 2012	6,60,000 shares x 2/12	<u>1,10,000 shares</u>
		<u>6,60,000 shares</u>

- (ii) Earnings per share

Basic EPS 2010-11 = ` 11,40,000/5,00,000 shares = ` 2.28

Basic EPS 2011-12 = ` 22,50,000/10,00,000 shares = ` 2.25

Adjusted EPS 2010-11 = ` 11,40,000/10,00,000 shares = ` 1.14

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2010-11, the earliest period reported.

Question 2

Ajay Enterprises, a Partnership firm in which A,B and C are three partners sharing profits and losses in the ratio of 4 : 3 : 3. the balance sheet of the firm as on 31st December, 2011 is as below:

Liabilities		Assets	
A' s Capital	15,000	Factory Building	24,160,
B' s Capital	7,500	Plant & Machinery	16,275
C' s Capital	15,000	Debtors	5.400
B' s Loan A/c	4,500	Stock	12.390
Sundry crediters	<u>16,500</u>	Cash at Bank	<u>275</u>
	<u>58,500</u>		<u>58.500</u>

On balance sheet date all the three partners have decided to dissolve their partnership. Since the realization of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remunerations 1% of the value of the assets realized other than cash at Bank and 10% of the amount distributed to the partners.

Assets were realized piece-meal as under:

First instalment	18,650
Second instalment	17,320
Third instalment	10,000
Last instalment	7,000
Dissolution expenses were provided for estimated amount of	3,000
The creditors were settled finally for	15,900

Prepare a statement showing distribution of cash amongst the partners by 'Higher* Relative capital method'. (16 Marks)

Answer

Statement showing distribution of cash amongst the partners by Highest Relative Capital method (HRCM)

		Creditors	B's Loan	Capitals		
	(`)	(`)	(`)	A (`)	B (`)	C (`)
Balance due		16,500	4,500	15,000	7,500	15,000

* To be read as highest relative capital method

On receipt of 1 st instalment amount	18,650				
Add: Cash at bank	<u>275</u>				
	18,925				
Less: Dissolution expenses provided for	<u>(3,000)</u>				
	15,925				
Less: C's remuneration of 1% on assets realized (18,650 x 1%)	<u>(187)</u>				
	15,738				
Less: Payment made to creditors	<u>(15,738)</u>	<u>(15,738)</u>			
Balance due	Nil	762			
On realization of 2 nd instalment	17,320				
Less: C's remuneration of 1% on assets realized (17,320 x 1%)	<u>(173)</u>				
	17,147				
Less: Payment made to creditors (settled for the total ` 15,900)	<u>(162)</u>	<u>(162)</u>			
Transferred to P&L A/c		600			
	16,985				
Less: Payment for B's loan A/c	<u>(4,500)</u>		<u>(4,500)</u>		
Amount available for distribution to partners	12,485		nil		
Less: C's remuneration of 10% of the amount distributed to partners (12,485 x 10/110)	<u>(1,135)</u>				
Balance distributed to partners on the basis of HRCM	11,350				
Less: Paid to C (See W.N.)	<u>(3,750)</u>				<u>(3,750)</u>
	7,600				11,250
Less: Paid to A and C in					

4:3 (See W.N.)	<u>(7,600)</u>		<u>(4,343)</u>	<u>-</u>	<u>(3,257)</u>
Balance due	nil		10,657	7,500	7,993
On realization of 3 rd instalment	10,000				
Less: C's remuneration of 1% on assets realized (10,000 x 1%)	<u>(100)</u>				
	9,900				
Less: C's remuneration of 10% of the amount distributed to partners (9,900 x 10/110)	<u>(900)</u>				
	9,000				
Less: Paid to A and C in 4:3 upto ` 8,750 (i.e. ` 7,600 paid on receipt of second instalment and balance of ` 1,150 to be paid now) (See W.N.)	<u>(1,150)</u>		<u>(657)</u>		<u>(493)</u>
	7,850		10,000	7,500	7,500
Less: Now, paid to A, B and C in 4:3:3	<u>(7,850)</u>		<u>(3,140)</u>	<u>(2,355)</u>	<u>(2,355)</u>
Balance due	nil		6,860	5,145	5,145
On realization of 4 th and last instalment	7,000				
Less: C's remuneration of 1% on assets realized (7,000 x 1%)	<u>(70)</u>				
	6,930				
Less: C's remuneration of 10% of the amount distributed to partners (6,930 x 10/110)	<u>(630)</u>				
	6,300				
Less: Paid to A, B and C in 4:3:3	<u>(6,300)</u>		<u>(2,520)</u>	<u>(1,890)</u>	<u>(1,890)</u>
Loss suffered by partners			<u>4,340</u>	<u>3,255</u>	<u>3,255</u>

Working Note:

Calculation of amount paid to partners on the basis of Highest Relative Capital Method

	A `	B `	C `
Balance of Capital Accounts (A)	15,000	7,500	15,000
Profit sharing ratio	4	3	3
Capital - Profit sharing ratio	3,750	2,500	5,000
Capital in profit sharing ratio taking B's Capital as base (B)	<u>10,000</u>	<u>7,500</u>	<u>7,500</u>
Excess of A's Capital and C's Capital (A-B) = (C)	5,000	nil	7,500
Again repeating the process for A and C			
Profit sharing ratio	4		3
Capital - Profit sharing ratio	1,250		2,500
Capital in profit sharing ratio taking A's Capital as base (D)	<u>5,000</u>		<u>3,750</u>
Excess Capital to be paid first (C-D)=(E)	<u>nil</u>		<u>3,750</u>

Therefore, first ` 3,750 will be paid to C. Then A and C will receive in proportion of 4:3 upto ` 8,750 to bring the capital of all partners A, B and C in proportion to their profit sharing ratio. Thereafter, balance available will be paid to all partners viz A, B and C in their profit sharing ratio of 4:3:3.

Question 3

(a) Following is the Balance Sheet of M/s competent Limited as on 31st march, 2012:

Assets	`	Assets	`
Equity Shares of ` 10 Each fully paid	12,50,000	Fixed Assets	46,50,000
Revenue reserve	15,00,000	Current Assets	30,00,000
Securities Premium	2,50,000		
Profit & Loss Account	1,25,000		
Secured Loans:			
12% Debentures	18,75,000		
Unsecured Loans	10,00,000		
Current Liabilities	16,50,000		
Total	76,50,000	Total	<u>76,50,000</u>

The company wants to buy back 25,000 equity shares of ₹ 10 each, on 1st April, 2012 at ₹ 20 per share. Buy back of shares is duly authorized by its articles and necessary resolution passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as part of Current Assets.

Comment with your calculations, whether buy back of shares by company is within the provisions of the companies Act, 1956. If yes, pass necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back of shares. (8 Marks)

(b) The following balances appeared in the books of Paradise Ltd on 1-4-2011:

- (i) 12 % Debentures ₹ 7,50,000
- (ii) Balance of Sinking Fund ₹ 6,00,000
- (iii) Sinking Fund Investment ₹ 6,00,000 represented by 10% ₹ 6,50,000 secured bonds of government of India.

Annual contribution to the Sinking Fund was ₹ 1,20,000 made on 31st March each year. On 31-3-2012, balance at bank was ₹ 3,00,000 before receipt of interest. The company sold the investment at 90%, for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 2012:

- (1) Debentures Account
- (2) Sinking Fund Account
- (3) Sinking Fund Investment Account
- (4) Bank Account
- (5) Debenture Holders Account (8 Marks)

Answer

(a) Determination of Buy back of maximum no. of shares as per the Companies Act, 1956

1. Shares Outstanding Test

Particulars	(Shares)
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2. Resources Test

Particulars	
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Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	<u>18,75,000</u>
Shareholders' funds (₹)	<u>31,25,000</u>
25% of Shareholders fund (₹)	7,81,250
Buy back price per share	₹ 20
Number of shares that can be bought back (shares)	39,063

3. Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds (₹)(18,75,000+10,00,000+16,50,000)	45,25,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹)	22,62,500
(c)	Present equity/shareholders fund (₹)	31,25,000
(d)	Maximum permitted buy back of Equity (₹) [(c) – (b)]	8,62,500
(e)	Maximum number of shares that can be bought back @ ₹ 20 per share (shares)	43,125 shares

Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	31,250
Resources Test	39,063
Debt Equity Ratio Test	43,125
Maximum number of shares that can be bought back [least of the above]	31,250

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 31,250 shares on 1st April, 2012, as per the provisions of Section 77A of the Companies Act, 1956.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 1956.

Journal Entries for buy-back of shares

		Debit	Credit
(a)	Equity shares buy-back account Dr.	5,00,000	

(b)	To Bank account (Being buy back of 25,000 equity shares of ` 10 each @ ` 20 per share)		5,00,000
	Equity share capital account	Dr. 2,50,000	
	Securities premium account	Dr. 2,50,000	
	To Equity shares buy-back account (Being cancellation of shares bought back)		5,00,000
(c)	Revenue reserve account	Dr. 2,50,000	
	To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)		2,50,000

Balance Sheet of M/s. Competent Ltd.

as on 31st March, 2012

Liabilities	`	Assets	`
Share capital:		Fixed Assets	46,50,000
1,00,000 Equity shares of ` 10 each	10,00,000	Current Assets (30,00,000 – 5,00,000)	25,00,000
Reserves and Surplus:			
Capital redemption reserve	2,50,000		
Revenue reserves	12,50,000		
Profit and Loss A/c	1,25,000		
Secured loans:			
12% Debentures	18,75,000		
Unsecured loans	10,00,000		
Current liabilities	16,50,000		
	71,50,000		71,50,000

Note: Revaluation reserve account, Securities premium account and Profit and Loss account are considered as free reserves in total.

(b) 1. 12% Debentures Account

Date	Particulars	`	Date	Particulars	`
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31 st March, 2012	To Debenture holders A/c	7,50,000	1 st April, 2011	By Balance b/d	7,50,000
		<u>7,50,000</u>			<u>7,50,000</u>

2. Sinking Fund Account

Date	Particulars	`	Date	Particulars	`
31 st March, 2012	To 10% Sec. Bond A/c (loss)	15,000	1 st April, 2011	By Balance b/d	6,00,000
31 st March, 2012	To General reserve A/c (Bal.fig.)	7,70,000	31 st March, 2012	By Profit and loss A/c	1,20,000
				By Interest on sinking fund A/c (Interest on 10% Govt. bond (` 6,50,000 x 10%))	<u>65,000</u>
		<u>7,85,000</u>			<u>7,85,000</u>

3. (Sinking Fund Investment) Account 10% Secured Bonds of Govt.

		`			`
1 st April, 2011	To Balance b/d	6,00,000	31 st March, 2012	By Bank A/c (6,50,000 x 90% = 5,85,000)	5,85,000
				By Sinking Fund A/c	<u>15,000</u>
		<u>6,00,000</u>			<u>6,00,000</u>

4. Bank Account

		`			`
31 st March, 2012	To Balance b/d	3,00,000	31 st March, 2012	By 12% Debenture	8,25,000
	To Sinking Fund A/c (Interest)	65,000			
	To Sinking fund Investment A/c	<u>5,85,000</u>	31 March	By Balance c/d	<u>1,25,000</u>

		<u>9,50,000</u>			<u>9,50,000</u>
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5. Debenture holders Account

31 st March, 2012	To Bank A/c	8,25,000	31 st March, 2012	By 12% Debentures	7,50,000
				By Premium on redemption of debentures	<u>75,000</u>
		<u>8,25,000</u>			<u>8,25,000</u>

Question 4

Given below balance sheet of Vasudha Ltd. Vaishali Ltd as at 31st march, 2012.

(Amount in `)

Liabilities	Vasudha Ltd	Vaishali Ltd.	Assets	Vasudha Ltd.	Vaishali Ltd
Issued Share Capital:			Factory Building	2,10,000	1,60,000
Equity Shares of `10 each	5,40,000	4,03,300	Debtors	2,86,900	1,72,900
General Reserves	1,01,000	65,000	Stock	91,500	82,500
Profit & Loss A/c	66,000	43,500	Goodwill	50,000	35,000
Sundry Creditors	44,400	58,200	Cash at Bank	98,000	1,09,590
			Preliminary Expenses	<u>15,000</u>	<u>10,010</u>
Total	<u>7,51,400</u>	<u>5,70,000</u>	Total	<u>7,51,400</u>	<u>5,70,000</u>

Goodwill of the Companies Vasudha Ltd. and Vaishali Ltd. is to be valued at ` 75,000 and ` 50,000 respectively. Factory Building of Vasudha Ltd is worth ` 1,95,000 and of Vaishali Ltd ` 1,75,000. Stock of Vaishali Ltd. has been shown at 10% above of its cost.

It is decided that Vasudha Ltd will absorb Vaishali Ltd without liquidating later, by taking over its entire business by issue of shares at the Intrinsic Value

You are required to draft the balance sheet of the two companies after putting through the scheme. (16 Marks)

Answer

Balance Sheet of Vasudha Ltd. as on 31st March, 2012
(After absorption)

Liabilities		Assets	
Share capital: (54,000 + 40,330) Equity shares of ` 10 each	9,43,300	Fixed Assets: Goodwill (50,000+50,000)	1,00,000
Reserves and Surplus:		Factory building (2,10,000 + 1,75,000)	3,85,000
Securities Premium	1,20,990	Current Assets:	
General reserves	1,01,000	Debtors (2,86,900 + 1,72,900)	4,59,800
Profit and Loss A/c	66,000	Stock (91,500 + 75,000)	1,66,500
Current liabilities:		Cash at Bank (98,000 + 1,09,590)	2,07,590
Sundry creditors (44,400+58,200)	1,02,600	Miscellaneous expenses:	
		Preliminary expenses	<u>15,000</u>
	<u>13,33,890</u>		<u>13,33,890</u>

Working Note:**1. Computation of shares issued on the basis of intrinsic values**

	Vasudha Ltd.	Vaishali Ltd.
Goodwill	75,000	50,000
Factory building	1,95,000	1,75,000
Debtors	2,86,900	1,72,900
Stock	91,500	(82,500/110%)= 75,000
Cash at Bank	<u>98,000</u>	<u>1,09,590</u>
	7,46,400	5,82,490
Less: Sundry Creditors	<u>(44,400)</u>	<u>(58,200)</u>
Net assets	<u>7,02,000</u>	<u>5,24,290</u>
Number of shares	54,000	40,330
Intrinsic value	` 13	` 13

Hence, Vasudha Ltd. will give its 40,330 shares of ` 10 each @ ` 13 each to Vaishali Ltd.

Discharge of Purchase consideration

	Share Capital	Securities Premium
40,330 Shares @ ` 10 each	4,03,300	

40,330 shares @ ` 3 each		1,20,990
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Question 5

- (a) A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier-1 and tier-II Capitals. Find out the risk-adjusted and risk weighted assets and capital adequacy ratio:

Capital Funds:	(` in Crores)
Paid up Equity Share Capital	750
Statutory Reserve	150
Share Premium	150
Capital Reserve (of which Capital Funds ` 40 Crore were due to revaluation of assets and balance due to sale)	90
Assets:	
Cash balance with RBI	60
Claims on Banks	170
Other Investments	2,300
Loss and Advances:	
Guaranteed by Government of India/State Government	400
Granted to Staff of bank. fully covered by Super Annuation	
Benefits and mortgage of Flat/House	50
Other Loans and Advances	6,170
Premises, Furniture and Fixtures, Other Assets	3,925
Intangible Assets	15
Off-Balance Sheet items:	
Acceptance, Endorsements and Letter of Credit, Guarantees and Other obligations.	1,550

(8 Marks)

- (b) M/s Mars Electricity Company laid down a Main at a cost of ` 40,00,000 in 2008. During 2011 company laid down an auxiliary Main for one-fourth of the old Main at a cost of ` 15,00,000. It also replaced the rest of the length of the old Main at a cost of ` 45,00,000. The cost of material and labour gone up by 15%. Sale of old materials realized ` 1,00,000. Old materials valued at ` 1,50,000 were used in auxiliary Main and

those valued at ₹ 1,00,000 were used in replacement of the old Main. Show the Journal entries for recording the above transactions along with required workings. (8 Marks)

Answer**(a)**

		₹ in crores	₹ in crores	
(i)	Capital funds – Tier I			
	Equity share capital		750	
	Statutory reserve		150	
	Securities Premium		150	
	Capital reserve (arising out of sale of assets) (90-40)		<u>50</u>	
			1,100	
	Less: Intangible Assets		<u>(15)</u>	
			1,085	
	Capital funds – Tier II			
	Capital reserve (arising out of revaluation of assets)	40		
	Less: Discount to the extent of 55%	<u>(22)</u>	<u>18</u>	
			<u>1,103</u>	
		₹ in crores	% of risk weight	₹ in crores
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	60	0	0
	Claims on banks	170	20	34
	Other investments	2,300	100	2,300
	Loans and advances:			
	(i) Guaranteed by the government	400	0	0
	(ii) Granted to staff of bank, fully covered by Super Annuation Benefits and mortgage of Flat/House	50	20	10
	(iii) Other loans and advances	6,170	100	6,170
	Other assets			
	Premises, furniture and fixtures and			

	other assets	3,925	100	<u>3,925</u>
				12,439
		` in crores	Credit conversion factor	
	Off-Balance Sheet items: Acceptances, endorsements and Letters of credit, Guarantees and other obligations	1,550	100	<u>1,550</u>
				<u>13,989</u>

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital fund}}{\text{Risk adjusted assets}} \times 100 = \frac{1,103 \text{ crores} \times 100}{13,989 \text{ crores}} = 7.89\%$$

(b) Journal Entries in the books of M/s Mars Electricity Company

		₹	₹
Replacement Account Dr.	34,50,000		
To Bank Account		34,50,000	
(Current cost of replacement of 3/4 Main charged to Replacement account)			
New Main Account Dr.	15,00,000		
To Bank Account		13,50,000	
To Replacement Account		1,50,000	
(Cost incurred on laying auxiliary main including old material)			
New Main Account (See W.N.) Dr.	10,50,000		
To Bank Account		9,50,000	
To Replacement Account		1,00,000	
(Additional Cost of New Main capitalised including cost of old material used)			
Bank A/c Dr.	1,00,000		
To Replacement A/c		1,00,000	
(Sale of old materials)			
Revenue Account Dr.	31,00,000		
To Replacement A/c		31,00,000	
(Net current cost of replacement transferred)			

Working Note:

Amount of additional cost to be capitalised

	₹
Cost of 3/4 of old Main (40,00,000 x 3/4)	30,00,000
Add: Increase in cost by 15%	4,50,000
	34,50,000
Cost of replacement	45,00,000
Additional cost of new Main (to be capitalised)	10,50,000
Less: Cost of old material	1,00,000
Additional cash cost of replacement	9,50,000

Question 6

An Indian company Moon Star Limited has a branch at Verginia (USA) . The Branch is a non-integral foreign operation of the Indian Company. The trial balance of the Branch as at 31st March, 2012 is as follows:

Particulars	US \$	
	Dr.	Cr.
Office equipments	48,000	
Furniture and Furniture's	32,00	
Stock (April 1, 2011)	22,400	
Purchases	96,000	
Sales	---	1,66,400
Goods Sent from HO	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rate & Taxes	800	
Insurance	400	
Trade Expenses	400	
Head office Account	---	45,600
Sundry Debtors	9,600	
Sundry Creditors	---	6,800
Cash at Bank	2,000	
Cash in Hand	<u>400</u>	<u> </u>
	<u>2,18,800</u>	<u>2,18,800</u>

The following further information's are given:

- (1) Salaries outstanding \$400.
- (2) Depreciate office equipment and Furniture & Fixtures @10% p.a. at written down value.
- (3) The Head Office sent goods to Branch for ` 15,80,000
- (4) The Head Office shown an amount of ` 20,50,000 due from Branch.
- (5) Stock on 31st March, 2013 -\$ 21,500.
- (6) There were no transit items either at the start or at the end of the year.

- (7) On April 1, 2010 when the fixed assets were purchased the rate of exchange was ` 43 to one \$ . On April 1, 2011, the rate was ` 47 per \$. On March 31, 2012 the rate was ` 50 per \$. Average Rate during the year was ` 45 to one \$.

Prepare:

- (a) Trial balance incorporating adjustments given converting dollars into rupees.
 (b) Trading, Profit and Loss Account for the year ended 31st March, 2012 and Balance Sheet as on date depicting the profitability and net position of the Branch as would appear in the books of Indian company for the purpose of incorporating in the main Balance Sheet.

(16 Marks)

Answer

In the books of Moon Star Ltd. - an Indian Company

Trial Balance (in Rupees) of Virginia (USA) Branch

as on 31st March, 2012

Particulars	Dr.	Cr.	Conversion	Dr.	Cr.
	US \$	US \$	rate	`	`
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1 st April, 2011)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries(3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	

Cash in hand	400		50	20,000	
Exchange gain (bal. fig.)					4,66,800
	<u>2,19,200</u>	<u>2,19,200</u>		<u>1,03,64,800</u>	<u>1,03,64,800</u>

(b) Trading and Profit and Loss Account of Verginia Branch
for the year ended 31st March, 2012

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US \$ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	<u>15,92,200</u>		
	<u>85,63,000</u>		<u>85,63,000</u>
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	<u>11,02,200</u>		
	<u>15,92,200</u>		<u>15,92,200</u>

Balance Sheet of Verginia Branch
as on 31st March, 2012

Liabilities	₹	₹	Assets	₹	₹
Head Office A/c	20,50,000		Office Equipment	24,00,000	
Add : Net profit	<u>11,02,200</u>	31,52,200	Less : Depreciation	<u>2,40,000</u>	21,60,000
Foreign Currency Translation Reserve		4,66,800	Furniture and fixtures	1,60,000	
Trade creditors		3,40,000	Less : Depreciation	<u>16,000</u>	1,44,000
Outstanding salaries		20,000	Closing stock		10,75,000
			Trade debtors		4,80,000
			Cash in hand		20,000

		Cash at bank	1,00,000
	39,79,000		39,79,000

Question 7

Answer any Four of the following:

- (a) On 1st April, 2012, a company offered 100 shares to each of its 400 employees at ₹ 25 per share. The employees are given a month to accept the shares. The shares issued under the plan shall be subject to lock-in to transfer for three years from the grant date i.e. 30, April 2012. The market price of shares of the company on the grant date is ₹ 30 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 28 per share.

Up to 30th April, 2012, 50% of employees accepted the offer and paid ₹ 25 per share purchased. Normal value of each share is ₹ 10. Record the issue of shares in the books of the company under the aforesaid plan.

- (b) Tiger Motor Car Limited signed an agreement with its employees union for revision of wages on 01.07.2011. The revision of wages is with retrospective effect from 01.04.2008. The arrear wages up to 31.3.2011 amounts to ₹ 40,00,000 and that for the period from 01.04.2011 to 01.07.2011 amount to ₹ 3,50,000. In view of the provisions of AS 5 "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies", decide whether a separate disclosure of arrear wages is required while preparing financial statements for the year ending 31.3.2012.
- (c) An airline is required by law to overhaul its aircraft once in every five years. The Pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.
- (d) X Ltd. sold JCB Machine having WDV of ₹ 50 Lakhs to Y Ltd for ₹ 60 Lakhs and the same JCB was leased back by Y Ltd to X Ltd. The lease is operating lease

Comment according to relevant Accounting Standard if

- Sale price of ₹ 60 Lakhs is equal to fair value
 - Fair Value is ₹ 50 Lakhs and sale price is ₹ 45 Lakhs.
 - Fair value is ₹ 55 Lakhs and sale price is ₹ 62 lakhs
 - Fair value is ₹ 45 Lakhs and sale price is ₹ 48 Lakhs.
- (e) Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 2012. However same comes to the notice of Company management during April, 2012 only. financial statements of the company is not yet approved by the Board of Directors of the

company. With the help of provisions of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012 ?

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Boar Directors of the company ? (4 × 4 = 16 Marks)

Answer

- (a) Fair value of an option = ₹ 28 – ₹ 25 = ₹ 3

Number of employees accepting the offer = 400 employees × 50% = 200 employees

Number of shares issued = 200 employees × 100 shares/employee = 20,000 shares

Fair value of ESPP = 20,000 shares × ₹ 3 = ₹ 60,000

Expenses recognized in 2012-13 = ₹ 60,000

Journal Entry

Date	Particulars	₹	₹
30.04.2012	Bank (20,000 shares × ₹ 25) Dr.	5,00,000	
	Employees compensation expense A/c Dr.	60,000	
	To Share Capital (20,000 shares × ₹ 10)		2,00,000
	To Securities Premium (20,000 shares × ₹ 18)		3,60,000
	(Being option accepted by 200 employees)		

- (b) It is given that revision of wages took place in July, 2011 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2011 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 ₹ 40,00,000 (from 1.4.2008 to 31.3.2011) 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 no. 12 of AS 5, 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 1.4.2011 to 1.7.2011) amounting ₹ 3,50,000 is not a prior period item hence need not be disclosed separately. This may be shown as current year wages.

- (c) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts.

Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime.

A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

- (d) According to AS 19, following will be the treatment in the given situations:
- (i) When sales price of ₹ 60 lakhs is equal to fair value, X Ltd. should immediately recognize the profit of ₹ 10 lakhs (i.e. 60 – 50) in its books.
 - (ii) When fair value of leased JCB machine is ₹ 50 lakhs & sales price is ₹ 45 lakhs, then loss of ₹ 5 lakhs (50 – 45) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payments.
 - (iii) When fair value is ₹ 55 lakhs & sales price is ₹ 62 lakhs, profit of ₹ 5 lakhs (55 - 50) to be immediately recognized by X Ltd. in its books and balance profit of ₹ 7 lakhs (62-55) is to be amortised/deferred over lease period.
 - (iv) When fair value is ₹ 45 lakhs & sales price is ₹ 48 lakhs, then the loss of ₹ 5 lakhs (50-45) to be immediately recognized by X Ltd. in its books and profit of ₹ 3 lakhs (48-45) should be amortised/deferred over lease period.

- (e) As per para no. 13 of AS 4, 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 ₹ 6,00,000, was detected after the balance sheet date (before approval of financial statements) but 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 make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2012 for recognition of the loss amounting ₹ 6,00,000.

If embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5. This being extra ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2013. The nature and the amount of prior period items should be separately disclosed on the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.