

PAPER – 5: ADVANCED ACCOUNTING

Question No. 1 is compulsory

Answer any five questions from the remaining six questions.

Working notes should form part of the answer.

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

Question 1

Answer the following questions:

- (a) On 25th April, 2010, Neel Limited obtained a loan from the bank for ₹ 70 lakhs to be utilized as under:

	₹ in lakhs
Construction of factory shed	28
Purchase of machinery	21
Working capital	14
Advance for purchase of truck	7

In March, 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31st March, 2011 was ₹ 12 lakhs. Show the treatment of interest under Accounting Standard 16.

- (b) An equipment having expected useful life of 5 years, is leased for 3 years. Both the cost and the fair value of the equipment are ₹ 6,00,000. The amount will be paid in 3 equal instalments and at the termination of lease, lessor will get back the equipment. The unguaranteed residual value at the end of 3rd year is ₹ 60,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513. State with reason whether the lease constitutes finance lease and also compute the unearned finance income.
- (c) On 1st April, 2010, A Ltd. had outstanding in its books 1,00,000 Debentures of ₹ 100 each, interest @ 12% per annum. The interest on debentures was paid half-yearly on 30th September and 31st March of every year. On 31st May, 2010 the company purchased 30,000 Debentures of its own @ ₹ 98 (ex-interest) per debenture. The company cancelled the debentures so purchased on 31st March, 2011.

Pass the necessary Journal Entries to record the above transactions for the year ended 31st March, 2011.

- (d) Global Limited has a branch which closes its books of account every year on 31st March. This is an independent branch which maintains comprehensive books of account for recording their transactions.

You are required to show journal entries in the books of branch on 31st March, 2011 to rectify or adjust the following:

- (i) Head Office allocates ₹ 1,35,000 to the branch as head office expenses, which have not yet been recorded by branch.
- (ii) Depreciation of branch fixed assets, whose accounts are kept by head office in its books, not yet recorded in the branch books, ₹ 1,15,000.
- (iii) Branch paid ₹ 1,40,000 as salary to an official from head office on visit to branch and debited the amount to its Salaries Account.
- (iv) Head Office collected ₹ 1,30,000 directly from a branch customer on behalf of the branch, but no intimation was received earlier by the branch. Now the branch learns about it.
- (v) It is learnt that a remittance of ₹ 1,50,000 sent by the branch has not been received by head office till date.

(4 x 5 =20 Marks)

Answer

- (a) Treatment of Interest as per AS 16

S. No.	Particulars	Nature	Interest amount to be capitalized	Interest amount to be charged to Profit & Loss account
1	Construction of factory shed	Qualifying asset	₹ 12 lakhs × $\frac{₹ 28 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 4.80 lakhs	
2	Purchase of machinery	Not a qualifying asset		₹ 12 lakhs × $\frac{₹ 21 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 3.60 lakhs
3	Working capital	Not a qualifying asset		₹ 12 lakhs × $\frac{₹ 14 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 2.40 lakhs
4	Advance for purchase of truck	Not a qualifying asset		₹ 12 lakhs × $\frac{₹ 7 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 1.20 lakhs
	Total		₹ 4.80 lakhs	₹ 7.20 lakhs

Note:

1. It is assumed that construction of factory shed was completed at the end of March, 2011. Accordingly, interest for the full year has been capitalized.
2. It is assumed that machinery was ready to use at the time of purchase only and on this basis it has been treated as non-qualifying asset.

(b) (i) Determination of Nature of Lease

It is assumed that the fair value of the leased equipments is equal to the present value of minimum lease payments.

$$\begin{aligned}\text{Present value of residual value at the end of 3rd year} &= ₹ 60,000 \times 0.7513 \\ &= ₹ 45,078\end{aligned}$$

$$\begin{aligned}\text{Present value of lease payments} &= ₹ 6,00,000 - ₹ 45,078 \\ &= ₹ 5,54,922\end{aligned}$$

The percentage of present value of lease payments to fair value of the equipment is
 $(₹ 5,54,922 / ₹ 6,00,000) \times 100 = 92.487\%$.

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

$$\text{Annual lease payment} = ₹ 5,54,922 / 2.4868 = ₹ 2,23,147 \text{ (approx)}$$

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

$$= (₹ 2,23,147 \times 3) + ₹ 60,000 = ₹ 6,69,441 + ₹ 60,000 = ₹ 7,29,441$$

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

$$= ₹ 7,29,441 - ₹ 6,00,000 = ₹ 1,29,441$$

(c) In the books of 'A' Limited**Journal Entries**

Date	Particulars	Dr. (₹)	Cr. (₹)
31 st May, 2010	Investment in own debentures A/c Dr.	29,40,000	
	Debenture interest A/c Dr.	60,000	
	To Bank A/c		30,00,000
	(Being the purchase of own 30,000 debentures @ ₹ 98 ex-interest)		

30 th Sep., 2010	Debenture interest A/c Dr. 5,40,000 To Bank A/c 4,20,000 To Interest on own debentures A/c 1,20,000 (Being interest @ 12% paid on 70,000 debentures & adjustment of interest on 30,000 own debentures for 4 months)	
31 st March, 2011	Debenture interest A/c Dr. 6,00,000 To Bank A/c 4,20,000 To Interest on own debentures A/c 1,80,000 (Being interest @ 12% paid on 70,000 debentures & adjustment of interest on 30,000 own debentures for 6 months)	
31 st March, 2011	12% Debentures A/c Dr. 30,00,000 To Investment in own debentures A/c 29,40,000 To Capital reserve A/c 60,000 (Being cancellation of 30,000, 12% own debentures)	
31 st March, 2011	Profit and Loss A/c Dr. 12,00,000 To Debenture interest A/c 12,00,000 (Being total interest transferred to Profit & Loss account)	
31 st March, 2011	Interest on own debentures A/c Dr. 3,00,000 To Profit & Loss A/c 3,00,000 (Being total interest on own debentures credited to Profit & Loss account)	

(d)

In the books of Branch
Journal Entries

S.No.	Particulars	Dr. (₹)	Cr. (₹)
(i)	Head Office Expenses A/c Dr. 1,35,000 To Global Limited (H.O.) A/c 1,35,000 (Being expenses allocated to branch by head office)		
(ii)	Depreciation A/c Dr. 1,15,000 To Global Limited (H.O.) A/c 1,15,000 (Being depreciation on fixed assets of branch, whose account are maintained by head office)		

(iii)	Global Limited (H.O.) A/c To Salaries A/c (Being the rectification of salary paid, on behalf of the head office)	Dr.	1,40,000	1,40,000
(iv)	Global Limited (H.O.) A/c To Debtors A/c (Being adjustment of direct collection from branch debtors, by head office)	Dr.	1,30,000	1,30,000
(v)	No entry will be passed in the Branch books			

Note: Cash-in-transit of ₹ 1,50,000 will be shown in the books of Head office.

Question 2

P, Q, R and S had been carrying on business in partnership sharing profits & losses in the ratio of 4:3:2:1. They decided to dissolve the partnership on the basis of following Balance Sheet as on 30th April, 2011:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts		Land & building	2,46,000
P 1,68,000		Furniture & fixtures	65,000
Q <u>1,08,000</u>	2,76,000	Stock	1,00,000
General reserve	95,000	Debtors	72,500
Capital reserve	25,000	Cash in hand	15,500
Sundry creditors	36,000	Capital overdrawn:	
Mortgage loan	1,10,000	R 25,000	
		S <u>18,000</u>	43,000
	5,42,000		5,42,000

- (i) The assets were realized as under: ₹
- | | |
|----------------------|----------|
| Land & building | 2,30,000 |
| Furniture & fixtures | 42,000 |
| Stock | 72,000 |
| Debtors | 65,000 |
- (ii) Expenses of dissolution amounted to ₹ 7,800.
- (iii) Further creditors of ₹ 18,000 had to be met.
- (iv) R became insolvent and nothing was realized from his private estate.

Applying the principles laid down in Garner Vs. Murray, prepare the Realisation Account, Partners' Capital Accounts and Cash Account. (16 Marks)

Answer

Realisation Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Land and building	2,46,000	By Sundry creditors	36,000
To Furniture and fixtures	65,000	By Mortgage loan	1,10,000
To Stock	1,00,000	By Cash account -	
To Debtors	72,500	Land and building	2,30,000
To Cash A/c (expenses on dissolution)	7,800	Furniture & fixtures	42,000
To Cash A/c (creditors ₹ 36,000 + ₹ 18,000)	54,000	Stock	72,000
To Cash A/c (Mortgage loan)	1,10,000	Debtors	65,000
		By Partners' capital accounts (Loss 4:3:2:1)	1,00,300
		P = 40,120	
		Q = 30,090	
		R = 20,060	
		S = <u>10,030</u>	
	6,55,300		6,55,300

Partners' Capital Accounts

Particulars	P	Q	R	S	Particulars	P	Q	R	S
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d	-	-	25,000	18,000	By Balance b/d	1,68,000	1,08,000		
To Realization A/c (Loss)	40,120	30,090	20,060	10,030	By General Reserve	38,000	28,500	19,000	9,500
To R's Capital A/c (Deficiency)	12,636	8,424	-	-	By Capital Reserve	10,000	7,500	5,000	2,500
To Cash A/c	2,03,364	1,35,576	-	-	By Cash A/c (realization loss)	40,120	30,090	-	10,030
					By P's Capital A/c			12,636	
					By Q's Capital A/c			8,424	
					By Cash A/c				6,000
	2,56,120	1,74,090	45,060	28,030		2,56,120	1,74,090	45,060	28,030

Note: P, Q and S brought cash to make good, their share of the loss on realization. However, in actual practice they will not be bringing any cash, only a notional entry will be made.

Cash Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	15,500	By Realization A/c:	
To Realization A/c:		Expenses on dissolution	7,800
Land and building	2,30,000	Creditors (36,000+18,000)	54,000
Furniture & fixtures	42,000	Mortgage loan	1,10,000
Stock	72,000	By P's capital A/c	2,03,364
Debtors	65,000	By Q's capital A/c	1,35,576
To P, Q, S's capital A/cs (40,120+30,090+10,030)	80,240		
To S's capital A/c	<u>6,000</u>		
	<u>5,10,740</u>		<u>5,10,740</u>

Working Note:

As per Garner Vs. Murray rule, solvent partners have to bear the loss due to insolvency of a partner in their capital ratio.

Calculation of Capital Ratio of Solvent Partners

	P (₹)	Q (₹)	S (₹)
Opening capital	1,68,000	1,08,000	(18,000)
Add: General reserve	38,000	28,500	9,500
Capital reserve	<u>10,000</u>	<u>7,500</u>	<u>2,500</u>
	<u>2,16,000</u>	<u>1,44,000</u>	<u>(6,000)</u>

Though S is a solvent partner yet he cannot be called upon to bear loss on account of insolvency of R because his capital account has a debit balance.

Therefore, capital ratio of P & Q = 216 : 144 = 3 : 2

Deficiency of R = ₹ {(25,000 + 20,060) – (19,000 + 5,000)} = ₹ 45,060 – ₹ 24,000 = ₹ 21,060.

Deficiency of R will be shared by P & Q in the capital ratio of 3 : 2 i.e.

$$P = ₹ 21,060 \times \frac{3}{5} = ₹ 12,636$$

$$Q = ₹ 21,060 \times \frac{2}{5} = ₹ 8,424$$

Question 3

X Ltd. and Y Ltd. were carrying on same business independently. The companies agreed to amalgamate on and from 1-4-2011 and formed a new company Z Ltd. to take over the assets and liabilities of the existing companies. The Balance Sheets of two companies as on 31-3-2011 are as follows:

<i>Liabilities</i>	<i>X Ltd. (₹)</i>	<i>Y Ltd. (₹)</i>
<i>Share capital: Equity shares of ₹ 10 each (fully paid up)</i>	30,00,000	18,00,000
<i>Securities premium</i>	6,00,000	-
<i>General reserve</i>	9,00,000	7,50,000
<i>Profit & loss account</i>	5,40,000	4,80,000
<i>10% Debentures</i>	15,00,000	-
<i>Secured loan</i>	-	9,00,000
<i>Sundry creditors</i>	7,80,000	5,10,000
	73,20,000	44,40,000
<i>Assets</i>	<i>X Ltd. (₹)</i>	<i>Y Ltd. (₹)</i>
<i>Land & building</i>	27,00,000	13,50,000
<i>Plant & machinery</i>	15,00,000	11,40,000
<i>Investments (15,000 shares of Y Ltd.)</i>	2,40,000	-
<i>Stock</i>	15,60,000	10,50,000
<i>Debtors</i>	12,30,000	7,80,000
<i>Cash at bank</i>	90,000	1,20,000
	73,20,000	44,40,000

Following are the additional information:

- (i) *For the purpose of amalgamation, the shares of the existing companies are to be valued as under:*
X Ltd. = ₹ 18 per share
Y Ltd. = ₹ 20 per share.
- (ii) *A contingent liability of X Ltd. of ₹ 1,80,000 is to be treated as actual existing liability.*
- (iii) *The shareholders of X Ltd. and Y Ltd. are to be paid by issuing sufficient number of shares of Z Ltd. at a premium of ₹ 6 per share.*
- (iv) *The face value of shares of Z Ltd. is to be of ₹ 10 each.*

You are required to:

- (i) Calculate the purchase consideration (i.e. the number of shares to be issued to X Ltd. and Y Ltd.)
- (ii) Prepare Realisation Account and Shareholders Account in the books of X Ltd. & Y Ltd.
- (iii) Prepare the Balance Sheet of Z Ltd. after amalgamation. (16 Marks)

Answer

- (i) Calculation of Purchase Consideration No. of shares

Particulars	X Ltd.	Y Ltd.
Existing Number of shares	3,00,000	1,80,000
Less: Number of shares held by X Ltd. in Y Ltd.	-	(15,000)
Net number of shares	<u>3,00,000</u>	<u>1,65,000</u>
Value per share	₹ 18	₹ 20
Purchase consideration	₹ 54,00,000	₹ 33,00,000
Number of shares of Z Ltd. @ ₹ 16 per share	3,37,500 shares	2,06,250 shares

Discharge of Purchase Consideration

Particulars	X Ltd.	Y Ltd.
In share capital X Ltd. = 3,37,500 shares × ₹ 10 each Y Ltd. = 2,06,250 shares × ₹ 10 each	33,75,000	20,62,500
Securities premium X Ltd. = 3,37,500 shares × ₹ 6 each Y Ltd. = 2,06,250 shares × ₹ 6 each	20,25,000	12,37,500
	<u>54,00,000</u>	<u>33,00,000</u>

- (ii) (a) In the books of X Ltd.
Realization Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Sundry assets:		By 10% Debentures	15,00,000
Land and building	27,00,000	By Sundry creditors	
Plant and machinery	15,00,000	(7,80,000+1,80,000)	9,60,000
Investments	2,40,000	By Z Ltd. (Purchase consideration)	54,00,000
Stock	15,60,000		
Debtors	12,30,000		

Bank	90,000		
To Equity shareholders A/c (Profit)	<u>5,40,000</u>		<u> </u>
	<u>78,60,000</u>		<u>78,60,000</u>

Equity Shareholders Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Shares in Z Ltd. A/c	54,00,000	By Share capital	30,00,000
		By Securities premium	6,00,000
		By General reserve	9,00,000
		By Profit & loss A/c (5,40,000 – 1,80,000)	3,60,000
		By Realization A/c	5,40,000
	<u>54,00,000</u>		<u>54,00,000</u>

(b) In the books of Y Ltd.
Realization Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Sundry assets:		By Secured loan	9,00,000
Land and building	13,50,000	By Sundry creditors	5,10,000
Plant and machinery	11,40,000	By Z Ltd. (Purchase consideration)	33,00,000
Stock	10,50,000		
Debtors	7,80,000		
Bank	1,20,000		
To Equity shareholders A/c (Profit)	2,70,000		
	<u>47,10,000</u>		<u>47,10,000</u>

Equity Shareholders Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Shares in Z Ltd. A/c	33,00,000	By Share capital	18,00,000
		By General reserve	7,50,000
		By Profit & loss A/c	4,80,000
		By Realization A/c	2,70,000
	<u>33,00,000</u>		<u>33,00,000</u>

(iii) Balance Sheet of Z Ltd. (After Amalgamation) as on 01st April, 2011

Liabilities	₹	Assets	₹
Share capital: 5,43,750 Equity shares of ₹ 10 each fully paid up (above shares are issued for consideration other than cash)	54,37,500	Goodwill	10,50,000
Securities premium	32,62,500	Land & building	40,50,000
10% Debentures	15,00,000	Plant & machinery	26,40,000
Secured loan	9,00,000	Stock	26,10,000
Sundry creditors	14,70,000	Debtors	20,10,000
(7,80,000 + 1,80,000 + 5,10,000)		Cash at bank	2,10,000
	1,25,70,000		1,25,70,000

Working Note:

Calculation of Goodwill / (Capital Reserve)

Particulars	X Ltd. ₹	Y Ltd. ₹
Purchase consideration (A)	<u>54,00,000</u>	<u>33,00,000</u>
Assets taken over of		
X Ltd.	70,80,000	
(27,00,000+15,00,000+15,60,000+12,30,000+90,000)		
Y Ltd.		44,40,000
(13,50,000+11,40,000+10,50,000+7,80,000+1,20,000)		
Less: Liabilities taken over of X Ltd.		
(15,00,000 + 7,80,000+ 1,80,000)	(24,60,000)	
Liabilities taken over of Y Ltd.		
(9,00,000 + 5,10,000)		<u>(14,10,000)</u>
Net assets (B)	<u>46,20,000</u>	<u>30,30,000</u>
Goodwill (B-A)	7,80,000	2,70,000

Question 4

M/s. Access Electricity Company earned a profit of ₹ 75,00,000 (after tax for the year 2010-11) after paying ₹ 2,40,000 @ 12% as debenture interest for the year ended March 31, 2011. The following further information has been extracted from the books of company:

	Amount (₹)
Share capital	3,00,00,000
Fixed assets	9,00,00,000
Depreciation reserve on fixed assets	3,00,00,000
Loan from Electricity Board	1,20,00,000
Reserve fund investments, at par, invested in 8% Government securities	50,00,000
Contingencies reserve investments, at par, 10%	24,00,000
Tariff and dividends control reserve	16,00,000
Security deposits of consumers	10,00,000
Consumer's contribution to cost of fixed assets	3,40,000
Intangible assets	7,60,000
Monthly average of current assets, including amount due from consumers, ₹ 7,00,000	34,60,000
Development reserve	12,00,000

Show, how the profits have to be dealt with by the company under the provisions of the Electricity Act. Assume the bank rate to be 10%. (16 Marks)

Answer

Calculation of Capital Base:

Particulars	₹
Fixed assets	9,00,00,000
Intangible assets	7,60,000
Average current assets (₹ 34,60,000 – ₹ 7,00,000)	27,60,000
Contingencies reserve investments	<u>24,00,000</u>
	9,59,20,000
Less: Depreciation reserve on fixed assets	3,00,00,000
Loan from Electricity Board	1,20,00,000
12% Debentures (2,40,000/12%)	20,00,000
Tariff and dividend control reserve	16,00,000
Security deposits of consumers	10,00,000
Consumer's contribution to fixed assets	3,40,000
Development reserve	<u>12,00,000</u>
	<u>(4,81,40,000)</u>
	<u>4,77,80,000</u>

Calculation of Reasonable Return

	₹
12% (Bank Rate 10% + 2 %) of Capital base	57,33,600
8% income from Reserve fund investments	4,00,000
½ % of Loan from Electricity Board	60,000
½ % on 12% Debentures	10,000
½ % on Development reserve	<u>6,000</u>
	<u>62,09,600</u>

Calculation of Surplus

	₹
Clear profit	75,00,000
Less: Reasonable return	<u>(62,09,600)</u>
Surplus	<u>12,90,400</u>

For disposal

20% of Reasonable return i.e. ₹ 12,41,920 (₹ 62,09,600 x 20%) or surplus whichever is less is for disposal as surplus

Since, 20% of Reasonable return is less, therefore, ₹ 12,41,920 is for disposal as surplus.

Disposal of Surplus

	₹
(i) 1/3rd of Surplus limited to 5% of Reasonable return is at the disposal of the company 1/3 of Surplus ₹ 12,41,920 = ₹ 4,13,973 Or, 5% of Reasonable return of ₹ 62,09,600 = ₹ 3,10,480 whichever is less at the disposal of the company i.e.	3,10,480
(ii) ½ of the balance credited to Tariffs & Dividend Control Reserve i.e. ½ (₹ 12,41,920 – ₹ 3,10,480)	4,65,720
(iii) Remaining ½ of the balance credited to Consumers' suspense A/c	<u>4,65,720</u>
Total Surplus	<u>12,41,920</u>

Summary

	₹
Amount to be refunded to consumers [(₹ 4,65,720 + ₹ (12,90,400 – 12,41,920)]	5,14,200
Amount to be credited to Tariffs and Dividend Control Reserve	4,65,720

Amounts at the disposal of the company (₹ 62,09,600 + ₹ 3,10,480)	<u>65,20,080</u>
Net profit	<u>75,00,000</u>

Question 5

- (a) M/s. AM Enterprise had two departments, Cloth and Readymade Clothes. The readymade clothes were made by the firm itself out of the cloth supplied by the Cloth Department at its usual selling price. From the following figures, prepare Departmental Trading and Profit & Loss Account for the year ended 31st March, 2011:

	Cloth Department ₹	Readymade Clothes Department ₹
Opening stock on 1 st April, 2010	31,50,000	5,32,000
Purchases	2,10,00,000	1,68,000
Sales	2,31,00,000	47,25,000
Transfer to Readymade Clothes Department	31,50,000	-
Manufacturing expenses	-	6,30,000
Selling expenses	2,10,000	73,500
Rent & warehousing	8,40,000	5,60,000
Stock on 31 st March, 2011	21,00,000	6,72,000

In addition to the above, the following information is made available for necessary consideration:

The stock in the Readymade Clothes Department may be considered as consisting of 75% cloth and 25% other expenses. The Cloth Department earned a gross profit at the rate of 15% in 2009-10. General expenses of the business as a whole amount to ₹10,85,000.

- (b) The following particulars are extracted from the records of M/s. Engco Bank Limited for the year ended 31st March, 2011:

	Amount (₹)
Rebate on bills discounted (not due on March 31 st , 2010)	60,610
Discount received	6,10,800
Bills discounted	24,42,250

An analysis of the bills discounted is as follows:

Amount (₹)	Due Date
3,75,000	April 15, 2011

4,90,000	May 6, 2011
2,45,000	June 1, 2011
3,68,000	June 20, 2011
4,85,000	July 4, 2011

The rate of discount is 12% per annum. You are required to :

- Calculate rebate on bills discounted as on 31st March, 2011.
- Determine the amount of discount to be credited to the profit and loss account for the year ended 31st March, 2011.
- Show the necessary journal entries in the books of M/s. Engco Bank Ltd. as on 31st March, 2011. (8 + 8 = 16 Marks)

Answer

(a) Departmental Trading and Profit and Loss Account
for the year ended 31st March, 2011

Particulars	Cloth (₹)	Ready- made Clothes (₹)	Total (₹)	Particulars	Cloth (₹)	Ready- made Clothes (₹)	Total (₹)
To Opening stock	31,50,000	5,32,000	36,82,000	By Sales	2,31,00,000	47,25,000	2,78,25,000
To Purchases	2,10,00,000	1,68,000	2,11,68,000	By Transfer to Ready-made Clothes Deptt.	31,50,000	-	31,50,000
To Transfer from Cloth Department	-	31,50,000	31,50,000	By Closing stock	21,00,000	6,72,000	27,72,000
To Manufacturing expenses	-	6,30,000	6,30,000				
To Gross profit c/d	<u>42,00,000</u>	<u>9,17,000</u>	<u>51,17,000</u>				
	<u>2,83,50,000</u>	<u>53,97,000</u>	<u>3,37,47,000</u>		<u>2,83,50,000</u>	<u>53,97,000</u>	<u>3,37,47,000</u>
To Selling expenses	2,10,000	73,500	2,83,500	By Gross profit b/d	42,00,000	9,17,000	51,17,000
To Rent & warehousing	8,40,000	5,60,000	14,00,000				
To Net profit	<u>31,50,000</u>	<u>2,83,500</u>	<u>34,33,500</u>				
	<u>42,00,000</u>	<u>9,17,000</u>	<u>51,17,000</u>		<u>42,00,000</u>	<u>9,17,000</u>	<u>51,17,000</u>

General Profit and Loss Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To General expenses	10,85,000	By Net profit	34,33,500
To Unrealized profit (Refer W.N.)	20,790		
To General net profit (Bal.fig.)	23,27,710		
	<u>34,33,500</u>		<u>34,33,500</u>

Working Note:

Calculation of Stock Reserve

Rate of Gross Profit of Cloth Department, for the year 2010-11 = $\frac{\text{Gross Profit}}{\text{Total Sales}} \times 100$

$$\frac{₹ 42,00,000}{₹ (2,31,00,000 + 31,50,000)} \times 100 = 16\%$$

Closing Stock of cloth in Readymade Clothes Department = 75%

$$\text{i.e. } ₹ 6,72,000 \times 75\% = ₹ 5,04,000$$

Stock Reserve required for unrealized profit @ 16% on closing stock

$$₹ 5,04,000 \times 16\% = ₹ 80,640$$

Stock reserve for unrealized profit included in opening stock of readymade clothes @ 15% i.e.

$$(₹ 5,32,000 \times 75\% \times 15\%) = ₹ 59,850$$

Additional Stock Reserve required during the year = ₹ 80,640 – ₹ 59,850 = ₹ 20,790.

(b) (i) Calculation of Rebate on Bills Discounted as on 31st March, 2011

Amount (₹)	Due date	No. of days from 31 st March, 2011 to due date	Product
3,75,000	April 15, 2011	15	56,25,000
4,90,000	May 06, 2011	36	1,76,40,000
2,45,000	June 01, 2011	62	1,51,90,000
3,68,000	June 20, 2011	81	2,98,08,000
4,85,000	July 04, 2011	95	4,60,75,000
19,63,000			11,43,38,000

Amount of rebate on bills = ₹ 11,43,38,000 × 12% × 1/365 = ₹ 37,591 (approx.)

Note: One can also calculate rebate on each bill individually.

- (ii) Determination of amount of discount to be credited to the Profit and Loss Account for the year ended 31st March, 2011

	₹
Transfer from Rebate on bills discounted account as on 31.03.2010	60,610
Add: Discount received during the year	<u>6,10,800</u>
	6,71,410
Less: Rebate on bills discounted as on 31.03.2011	<u>(37,591)</u>
Amount transferred to Profit and Loss Account	<u>6,33,819</u>

In the books of Engco Bank Ltd.

Journal Entries

Date		Dr. (₹)	Cr. (₹)
(i)	Rebate on bills discounted A/c Dr. To Discount on bills A/c (Being transfer of unexpired discount on bills of 31.3.2010)	60,610	60,610
(ii)	Discount on bills A/c Dr. To Rebate on bills discounted A/c (Being unexpired discount of 31.03.2011 taken into account)	37,591	37,591
(iii)	Discount on bills A/c Dr. To Profit & Loss A/c (Being discount earned during the year transferred to Profit and Loss account)	6,33,819	6,33,819

Question 6

- (a) M/s. ABC Limited has gone into liquidation on 25th June, 2011. Certain creditors could not receive payments out of realization of assets and contributions from A list contributories. The following are the details of certain transfers which took place in the year ended 31st March, 2011:

Shareholders	No. of shares transferred	Date of ceasing to be a member	Creditors remaining unpaid and outstanding on the date of transfer (₹)
P	4,000	10-5-2010	9,000
Q	3,000	22-7-2010	12,000
R	2,400	15-9-2010	13,500

S	1,600	14-12-2010	14,000
T	1,000	09-03-2011	14,200

All the shares are of ₹ 10 each, ₹ 8 per share paid up. Show the amount to be realized from the persons listed above. Ignore remuneration to liquidator and other expenses.

- (b) From the following information of M/s. Bigfish Marine Insurance Co. Ltd., prepare the Revenue Account as per regulations of IRDA for the year ended 31st March, 2011:

Particulars	Amount (₹)
Premium received	18,75,000
Premium outstanding on March 31, 2011	1,25,000
Premium paid on reinsurance ceded	2,28,000
Claims paid	10,54,000
Estimated liability in respect of outstanding claims:	
On April 1, 2010	1,89,000
On March 31, 2011	2,25,000
Expenses of management (includes ₹ 45,000 surveyor's fee and ₹ 65,000 legal expenses paid for settlement of claims)	4,85,000
Interest and dividend (Gross)	1,65,250
Income tax on the above	49,575
Profit on sale of investments	46,000
Commission paid	1,94,000

Balance of fund on 1st April, 2010 was ₹ 18,50,000 including additional reserve of ₹ 1,80,000. Additional reserve has to be maintained at 10% of net premium for the year.

(8 + 8 = 16 Marks)

Answer

- (a) Statement of Liabilities of B List Contributories

Shareholder	No. of shares transferred	Maximum liability upto ₹ 2 per share	Division of liability as on				Total
			22.07.2010	15.09.2010	14.12.2010	09.03.2011	
Q	3,000	6,000	4,500	-	-	-	4,500
R	2,400	4,800	3,600	720	-	-	4,320
S	1,600	3,200	2,400	480	308	-	3,188
T	<u>1,000</u>	<u>2,000</u>	<u>1,500</u>	<u>300</u>	<u>192</u>	<u>8</u>	<u>2,000</u>
	<u>8,000</u>	<u>16,000</u>	<u>12,000</u>	<u>1,500</u>	<u>500</u>	<u>8</u>	<u>14,008</u>

Notes:

1. 'P' transferred shares before one year preceding the date of winding up, therefore, he cannot be held liable for any liability on liquidation.
2. Liability of 'T' has been restricted to the maximum allowable limit of ₹ 2,000. Therefore, amount payable by T on 09.03.2011 is ₹ 8 only.
3. 'Q' will not be responsible for further debts incurred after 10th May, 2010 (from the date when he ceases to be a member). Similarly, 'R' & 'S' will not be liable for the debts incurred after the date of their transfer of shares.

Working Note:**Calculation of Ratio for Discharge of Liabilities**

Date	Cumulative liability (₹)	Increase in liabilities (₹)	Ratio of no. of shares held by Q, R, S & T
22.07.2010	12,000	-	30: 24: 16: 10
15.09.2010	13,500	1,500	24: 16: 10
14.12.2010	14,000	500	16: 10
09.03.2011	14,200	200	Only T

(b)

FORM B-RA

Name of the Insurer: M/s Bigfish Marine Insurance Co. Ltd.

Revenue Account for the year ended 31st March, 2011

Particulars	Schedule	₹
Premium earned (Net)	1	16,72,800
Profit on sale of investment		46,000
Interest, dividend and rent (Gross)		<u>1,65,250</u>
Total (A)		<u>18,84,050</u>
Claims incurred (Net)	2	12,00,000
Commission	3	1,94,000
Operating expenses related to insurance business	4	<u>3,75,000</u>
Total (B)		<u>17,69,000</u>
Profit for Marine Insurance Business (A-B)		1,15,050

Schedule -1

Premium Earned (Net)	₹
Premium received	18,75,000
Add: Outstanding premium as on 31.03.2011	<u>1,25,000</u>

	20,00,000
Less: Premium on reinsurance ceded	<u>(2,28,000)</u>
	17,72,000
Less: Adjustment for change in reserve for unexpired risk (Refer W.N. 1)	<u>(99,200)</u>
Net premium earned	<u>16,72,800</u>

Schedule -2

Claim Incurred (Net)	₹
Claim paid	10,54,000
Add: Surveyor's fee & legal expenses paid for settlement of claim (₹ 45,000 + ₹ 65,000)	1,10,000
Add: Outstanding claims as on 31.03.2011	<u>2,25,000</u>
	13,89,000
Less: Outstanding claims as on 01.04.2010	<u>(1,89,000)</u>
Claim incurred (Net)	<u>12,00,000</u>

Schedule -3

Commission	₹
Commission paid	<u>1,94,000</u>

Schedule -4

Operating expenses related to insurance business	₹
Expenses of Management	4,85,000
Less: Surveyor's fee & legal expenses	<u>(1,10,000)</u>
	<u>3,75,000</u>

Working Notes:

1. Calculation for change in Reserve for Unexpired Risk

		₹
Unexpired risk reserve at the beginning (including additional reserve)		18,50,000
Less: Reserve for unexpired risk as on 31.03.2011 (100% of ₹ 17,72,000)	17,72,000	
Additional reserve as on 31.03.2011		

(10% of ₹ 17,72,000)	1,77,200	(19,49,200)
Change in provision for unexpired risk		<u>99,200</u>

2. Income tax on interest and dividend ₹ 49,575 is part of Profit & Loss Account, therefore, not given effect to in the Revenue Account.

Question 7

Answer any four of the following:

- (a) MEC Limited could not recover an amount of ₹ 8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2011 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2011, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹ 8 lakhs in books of account for the year ended 31-3-2011?
- (b) Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was ₹ 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was ₹ 49 per US Dollar.
The Chief Accountant of the company passed an entry on 31st March, 2011 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).
- (c) A company has its share capital divided into shares of ₹ 10 each. On 1-4-2010, it granted 5,000 employees stock option at ₹ 50, when the market price was ₹ 140. The options were to be exercised between 1-12-2010 to 28-2-2011. The employees exercised their options for 4,800 shares only; remaining options lapsed. Pass the necessary journal entries for the year ended 31-3-2011, with regard to employees' stock option.
- (d) Explain the treatment of refund of Government Grants as per Accounting Standard 12.
- (e) What are the qualitative characteristics that improve the usefulness of information provided in the financial statements? (4 × 4 = 16 Marks)

Answer

- (a) As per para 8 of 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 if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

As per the information given in the question, the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2011 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹ 8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹ 8 lakhs in the books of account for the year ended 31st March, 2011.

- (b) As per para 9 of AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2011, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.

Also, as per para 11 of the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 × ₹ 49 = ₹ 4,41,000) at 31st March, 2011, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of ₹ 5 (49 – 44) per US dollar i.e. ₹ 45,000 (USD 9,000 × ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2011 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

- (c) In the books of Company

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1 st April, 2010	Employees compensation expenses A/c Dr. [₹ 5,000 × (140-50)] To Employees stock option outstanding A/c (Being grant of 5,000 ESOPs to employees @ ₹ 50 when market price was ₹ 140)	4,50,000	4,50,000
1 st Dec. 2010 to 28 th Feb. 2011	Bank A/c Dr. Employees stock option outstanding A/c Dr. To Equity share capital A/c To Securities premium A/c (Being allotment to employees 4,800 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each)	2,40,000 4,32,000	48,000 6,24,000

31 st Mar. 2011	Employees stock option outstanding A/c Dr To Employees compensation expenses A/c (Being reverse entry for lapse of 200 stock options)	18,000	18,000
31 st Mar. 2011	Profit and Loss A/c Dr. To Employees compensation expenses A/c (Being transfer of employees compensation expenses)	4,32,000	4,32,000

Alternatively, one may pass following two entries to give effect to the exercise of options in the same year.

Journal Entries

Date	Particulars	Dr. ₹	Cr. ₹
1 st Dec. 2010 to 28 th Feb. 2011	Bank A/c Dr. Employees compensation expenses A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being allotment to employees 4,800 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each)	2,40,000 4,32,000	48,000 6,24,000
31 st Mar. 2011	Profit and Loss account Dr. To Employees compensation expenses A/c (Being transfer of employees compensation expenses)	4,32,000	4,32,000

(d) Para 11 of AS 12, "Accounting for Government Grants", explains treatment of government grants in following situations:

(i) When government grant is related to revenue

- When deferred credit account has a balance: The amount of government grant refundable will be adjusted against unamortized deferred credit balance remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit the amount is immediately charged to profit and loss account.
- Where no deferred credit account balance exists: The amount of government grant refundable will be charged to profit and Loss account.

(ii) When government grant is related to specific fixed assets

- Where at the time of receipt, the amount of government grant reduced the cost of asset: The amount of government grant refundable will increase the book value of the asset.

- (b) Where at the time of receipt, the amount of government grant was credited to "Deferred Grant Account": The amount of government grant refundable will reduce the capital reserve or unamortized balance of deferred grant account as appropriate.

(iii) When government grant is in the nature of Promoter's contribution

The amount of government grant refundable in part or in full on non-fulfilment of specific conditions, the relevant amount recoverable by the government will be reduced from capital reserve.

A government grant that becomes refundable is treated as an extra-ordinary item.

- (e) The following qualitative characteristics will help in improving the usefulness of the information provided in the financial statements:

1. Understandability : Information in financial statements should be presented in a manner that the users with reasonable knowledge of business and economic activities and accounting, may readily understand it. All relevant information should be given therein.
2. Relevance : The relevance of a piece of information should be judged by its materiality i.e. whether its omission or misstatement can influence economic decisions of users or not. No relevant information should be withheld on the grounds of complexity.
3. Reliability : The information are said to be reliable when transactions and events reported are represented faithfully and also when they are reported in terms of their substance and economic reality. Prudence concept is also used whenever required.
4. Comparability : The financial statements should permit both inter-firm and intra firm comparison. One essential feature or requirement of comparability is disclosure of financial effect of change in accounting policies.