

Test Series: February, 2012

MOCK TEST PAPER – 1

IPCC: GROUP – II

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.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) How would you treat the Government grant received relating to a depreciable asset under the following cases as per AS-12?

Case i: Gross value of asset ₹ 2 crores and Grant received ₹ 20 lakhs only.

Case ii: Gross value of asset ₹ 2 crores and Grant received ₹ 2 crores.

- (b) From the following information relating to Omega Ltd., calculate diluted earnings per share as per AS 20:

Net Profit for the current year	₹ 2,00,00,000
Number of equity shares outstanding	40,00,000
Basic earnings per share	₹ 5.00
Number of 11% convertible debentures of ₹ 100 each	50,000
Each debenture is convertible into 8 equity shares.	
Interest expense for the current year	₹ 5,50,000
Tax saving relating to interest expense (30%)	₹ 1,65,000

- (c) Manisha Ltd. makes provision for expenses worth ₹ 7,00,000 for the year ending March 31, 2010, but the actual expenses during the year ending March 31, 2011 comes to ₹ 9,00,000 against provision made during the last year. State with reasons whether difference of ₹ 2,00,000 is to be treated as prior period item as per AS 5.

- (d)

	Exchange Rate per \$
Goods purchased on 1.1.2010 of US \$ 10,000	₹ 45
Exchange rate on 31.3.2010	₹ 44
Date of actual payment 7.7.2010	₹ 43

Ascertain the loss/gain for financial years 2009-10 and 2010-11, also give their treatment as per AS 11.

(5 Marks each)

2. L and T have been carrying on same business independently. Due to competition in the market, they decided to amalgamate and form a new company called LT Ltd.

Following is the Balance Sheet of L and T as at 31.3.2011:

Liabilities	L ₹	T ₹	Assets	L ₹	T ₹
Capital	7,75,000	8,55,000	Plant & machinery	4,85,000	6,14,000
Current liabilities	6,23,500	5,57,600	Building	7,50,000	6,40,000
	<u>13,98,500</u>	<u>14,12,600</u>	Current assets	<u>1,63,500</u>	<u>1,58,600</u>
				<u>13,98,500</u>	<u>14,12,600</u>

Following are the additional information:

- The authorised capital of the new company will be ₹ 25,00,000 divided into 1,00,000 equity shares of ₹ 25 each.
- Liabilities of L includes ₹ 50,000 due to T for the purchases made. T made a profit of 20% on sale to L.
- L has goods purchased from T, cost to him ₹ 10,000. This is included in the current asset of L as at 31st March, 2011.
- The assets of L and T are to be revalued as under:

	L ₹	T ₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

- The purchase consideration is to be discharged as under:
 - Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years.
 - Profits for the preceding 2 years are given below:

	L ₹	T ₹
1 st year	2,62,800	2,75,125
II nd year	<u>2,12,200</u>	<u>2,49,875</u>
Total	<u>4,75,000</u>	<u>5,25,000</u>

- Issue 12% preference shares of ₹ 10 each fully paid up at par to provide income equivalent to 8% return on capital employed in the business as on 31.3.2011 after revaluation of assets of L and T respectively.

You are required to:

- (i) Compute the amount of equity and preference shares issued to L and T.
- (ii) Prepare the Balance Sheet of L & T Ltd. immediately after amalgamation.

(16 Marks)

3. Rohan Ltd. has three departments I,J,K. The following information is provided for the year ended 31.3.2011:

	I	J	K
	₹	₹	₹
Opening stock	5,000	8,000	19,000
Opening reserve for unrealised profit	—	2,000	3,000
Materials consumed	16,000	20,000	—
Direct labour	9,000	10,000	—
Closing stock	5,000	20,000	5,000
Sales	—	—	80,000
Area occupied (sq. mtr.)	2,500	1,500	1,000
No. of employees	30	20	10

Stock of each department is valued at cost to the department concerned. Stock of I is transferred to J at cost plus 20% and stock of J is transferred to K at a gross profit of 20% on sales. Other common expenses are salaries and staff welfare ₹ 18,000 and rent ₹ 6,000.

Prepare Departmental Trading, Profit and Loss Account for the year ending 31.3.2011.

(16 Marks)

4. A, B, C and D were partners sharing profits and losses in the ratio of 3:3:2:2. Following was the balance sheet as on 31st March, 2011:

Liabilities	₹	₹	Assets	₹	₹
Sundry creditors		15,500	Sundry debtors	16,000	
A's loan		10,000	Less: Provision for bad debts	<u>500</u>	15,500
Capital accounts:			Stock in trade		10,000
A	20,000		Cash at bank		2,000
B	<u>15,000</u>	35,000	Furniture and fixture		4,000
			Trade mark		7,000
			Capital accounts:		

			C	16,000	
			D	<u>6,000</u>	<u>22,000</u>
		<u>60,500</u>			<u>60,500</u>

On 31st March, 2011, the partnership firm was dissolved and B was appointed to realise the assets and pay off the liabilities. He was entitled to receive 5% commission on the amount finally paid to other partners as capital. He was to bear the expenses of realization.

The assets realised were as follows: sundry debtors ₹ 11,000; stock ₹ 8,000; furniture and fixture ₹ 1,000; trade mark ₹ 4,000; creditors were paid off in full; in addition a contingent liability for bills receivable discounted, materialized to the extent of ₹ 2,500. Also there was a joint life insurance policy for ₹ 30,000 This was surrendered for ₹ 3,000. Expenses of realisation amounted to ₹ 500. 'C' was insolvent, but ₹ 3,700 were recovered from his estate.

You are required to show the following accounts in the book of partnership firm:

1. Realisation account
 2. Cash account
 3. Partners' capital accounts. (16 Marks)
5. (a) On 31st March, 2010, Uncertain Bank Ltd. had a balance of ₹ 9 crores in "rebate on bills discounted" account. During the year ended 31st March, 2011, Uncertain Bank Ltd. discounted bills of exchange of ₹ 4,000 crores charging interest at 18% per annum the average period of discount being for 73 days. Of these, bills of exchange of ₹ 600 crores were due for realisation from the acceptors/customers after 31st March, 2011, the average period outstanding after 31st March, 2011 being 365 days.

Uncertain Bank Ltd. asks you to pass journal entries and show the ledger accounts pertaining to :

- (i) discounting of bills of exchange and
 - (ii) rebate on bills discounted. (8 Marks)
- (b) Agni Fire Insurance Co. Ltd. commenced its business on 1.4.2010. It submits you the following information for the year ended 31.3.2011:

	₹
Premium received	15,00,000
Re-insurance premium paid	1,00,000
Claims paid	7,00,000
Expenses of Management	3,00,000

Commission paid	50,000
Claims outstanding on 31.3.2011	1,00,000
Create reserve for unexpired risk @ 40%	
Prepare Revenue account for the year ended 31.3.20116.	

(8 Marks)

6. (a) Electric Supply Ltd. rebuilt and re-equipped one of their Mains at a Cash Cost of ₹ 40,00,000. The old Mains thus superseded cost ₹ 15,00,000. The capacity of the new Main is double that of the old Main. ₹ 70,000 was realised from sale of old materials. Four old motors valued at ₹ 2,00,000 salvaged from the old Main were used in the reconstruction. The cost of Labour and Materials is respectively 30% and 25% higher now than when the old Main was built. The proportion of Labour to Materials in the Main then and now is 2 : 3.

Show the Journal entries for recording the above transactions. (8 Marks)

- (b) From the data relating to a company which went into voluntary liquidation, you are required to prepare the liquidator's Final Statement of Account.
- (i) Cash with liquidators (after all assets are realised and secured creditors and debentureholders are paid) is ₹ 7,50,000.
 - (ii) Preferential creditors to be paid ₹ 35,000.
 - (iii) Other unsecured creditors ₹ 2,30,000.
 - (iv) 5,000, 10% preference shares of ₹ 100 each fully paid.
 - (v) 3,000 equity shares of ₹ 100 each, ₹ 75 per share paid up.
 - (vi) 7,000 equity shares of ₹ 100 each, ₹ 60 per share paid up.
 - (vii) Liquidator's remuneration is 2% on payments to preferential and other unsecured creditors.

(8 Marks)

7. Answer any **four** out of five:

- (a) A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. Is it a liability?
- (b) In Nidhi Co. Ltd., theft of cash of ₹ 2 lakhs by the cashier in January, 2011 was detected in May, 2011. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2011. Decide.

- (c) Rohan Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first

5 years. It enters into an agreement with Ashok Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Rohan Limited is not sure about the treatment of these lease rentals and seeks your advise.

- (d) N Co. Ltd. has its share capital divided into equity shares of ₹ 10 each. On 1.10.2010 it granted 20,000 employees' stock option at ₹ 50 per share, when the market price was ₹ 120 per share. The options were to be exercised between 10th December, 2010 and 31st March, 2011. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year.

Show Journal entries (with narration) as would appear in the books of the company upto 31st March, 2011.

- (e) Himani Ltd. in the past three years spent ₹ 75,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet AS 26 criteria for capitalization. In the current year approval of the concerned Government Authority has been received. The Company wishes to capitalize ₹ 75,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views. *(4 Marks each)*

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

$$= 50,000 \times 8 = 4,00,000 \text{ equity shares}$$

Total number of equity shares resulting from conversion of debentures

$$= 40,00,000 + 4,00,000 = 44,00,000 \text{ shares}$$

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

(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 ₹
I st Year	2,62,800	2,75,125
II nd Year	<u>2,12,200</u>	<u>2,49,875</u>
Total	<u>4,75,000</u>	<u>5,25,000</u>
No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability		
24000 × 475/1000	11,400 equity shares	
24000 × 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	$\frac{67,200 \times 100}{12}$	₹ 5,60,000	
	$\frac{73,920 \times 100}{12}$		₹ 6,16,000

Total Purchase Consideration

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

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

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

Working Notes:

1. Goodwill

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

Building	7,75,000	6,48,000
Current assets	<u>1,63,500</u>	<u>1,58,600</u>
	14,63,500	14,81,600
Less: Current liabilities	<u>(6,23,500)</u>	<u>(5,57,600)</u>
Net assets taken (capital employed)	8,40,000	9,24,000
Less: Purchase consideration	<u>(8,45,000)</u>	<u>(9,31,000)</u>
Goodwill	<u>5,000</u>	<u>7,000</u>
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)		<u>2,000</u>
Total Goodwill		<u>14,000</u>

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%	<u>(2,000)</u>	
Total	<u>1,61,500</u>	<u>1,08,600</u>
Grand Total		<u>2,70,100</u>

3. Current Liabilities

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

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				
To Direct labour	9,000	10,000		19,000	transfer	30,000	60,000		90,000
To Inter-departmental					By Closing stock	5,000	20,000	5,000	30,000
transfer		30,000	60,000	90,000					
To Gross profit	<u>5,000</u>	<u>12,000</u>	<u>6,000</u>	<u>23,000</u>					
	<u>35,000</u>	<u>80,000</u>	<u>85,000</u>	<u>2,00,000</u>		<u>35,000</u>	<u>80,000</u>	<u>85,000</u>	<u>2,00,000</u>
To Salaries and staff					By Gross profit b/d	5,000	12,000	6,000	23,000
welfare	9,000	6,000	3,000	18,000	By Net loss	7,000			7,000
To Rent	3,000	1,800	1,200	6,000					
To Net profit		<u>4,200</u>	<u>1,800</u>	<u>6,000</u>					
	<u>12,000</u>	<u>12,000</u>	<u>6,000</u>	<u>30,000</u>		<u>12,000</u>	<u>12,000</u>	<u>6,000</u>	<u>30,000</u>
To Net loss (l)				7,000	By Net profit (J + K)				6,000
To Stock reserve (J+K)					By Stock reserve b/d (J + K)				5,000
(Refer W.N.)				3,000					
To Balance transferred									
to Profit and loss									
account				<u>1,000</u>					
				<u>11,000</u>					<u>11,000</u>

Working Note:**Calculation of unrealized profit on closing stock**

	₹
<i>Stock reserve of J department</i>	
Cost	30,000
Transfer from I department	<u>30,000</u>
	<u>60,000</u>
Stock of J department	<u>20,000</u>

$$\text{Proportion of stock of I department} = ₹ 20,000 \times \frac{₹ 30,000}{₹ 60,000} = ₹ 10,000$$

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

Stock reserve of K department

	₹
Stock transferred from J department	5,000
Less: Profit (stock reserve) (5,000 × 20%)	<u>(1,000)</u>
Cost to J department	<u>4,000</u>

$$\text{Proportion of stock of I department} = ₹ 4,000 \times \frac{₹ 30,000}{₹ 60,000} = ₹ 2,000$$

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

$$\text{Total stock reserve} = ₹ 1,000 + ₹ 333 = ₹ 1,333.$$

4. Realization Account as on 31.3.2011

2011		₹	₹	2011		₹	₹
March 31	To Sundry assets:			March 31	By Provision for bad and doubtful debts		500
	Furniture and 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	<u>10,000</u>	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	<u>3,000</u>	27,000
				By Partners' capital accounts: (loss on realisation)		
				A	3,600	
				B	3,600	
				C	2,400	
				D	<u>2,400</u>	<u>12,000</u>
			<u>55,000</u>			<u>55,000</u>

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	<u>5,481</u>
		<u>41,100</u>			<u>41,100</u>

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
	To C's Capital A/c (Loss of capital written off)	8,400	6,300	-	-		By A's Capital A/c	-	-	8,400	-
	To B's capital A/c						By B's Capital A/c	-	-	6,300	-
							By A's Capital A/c (commission)	-	381	-	-

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

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 = $4/7 \times ₹ 14,700 = ₹ 8,400$
Borne by B = $3/7 \times ₹ 14,700 = ₹ 6,300$
- (3) 'B' is entitled to get 5% commission on the amount finally paid to partner 'A' only. The calculation is as follows: $(₹ 20,000 - ₹ 3,600 - ₹ 8,400) \times 5/105 = ₹ 381$.
- (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			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	<u>144.00</u>
		<u>153.00</u>			<u>153.00</u>

(ii) Rebate on bills discounted A/c

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

(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 31 st March, 2011 ₹
1.	Premiums earned (Net)	1	<u>8,40,000</u>
	Total (A)		<u>8,40,000</u>
1.	Claims incurred (Net)	2	8,00,000
2.	Commission		50,000
3.	Operating Expenses	3	<u>3,00,000</u>
	Total (B)		<u>11,50,000</u>
	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	<u>1,00,000</u>
	14,00,000
Less: Change in provision for unexpired risk (NIL-5,60,000)	<u>(5,60,000)</u>
Net Premium	<u>8,40,000</u>

Schedule 2**Claims**

	₹
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2011	<u>1,00,000</u>
	<u>8,00,000</u>

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 ($3/5 \times ₹ 15$ lacs)	9,00,000	25%	2,25,000	11,25,000
Labour ($2/5 \times ₹ 15$ lacs)	6,00,000	30%	1,80,000	<u>7,80,000</u>
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	<u>(19,05,000)</u>
Additional cost in new main to be capitalised (excluding old motors used)	<u>20,95,000</u>

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.)	<u>16,35,000</u>
	<u>19,05,000</u>		<u>19,05,000</u>

(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
	<u>7,95,710</u>		<u>7,95,710</u>

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	<u>5,00,000</u>	<u>7,70,300</u>
		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	<u>4,20,000</u>	<u>6,45,000</u>
Total loss to be borne by equity shareholders		<u>6,65,300</u>
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 $= 7,000 \times 6.53$ (i.e. $66.53 - 60$) = ₹ 45,710 Amount payable to 3,000 equity shareholders $= 3,000 \times 8.47$ (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	₹ 3.36 lakhs (approx.)
(Year 1 to Year 5 Flows ₹ 3 lakhs each year)	
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	Employee stock option outstanding A/c Dr.		11,20,000	
31.3.11	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.

Test Series: March, 2012

MOCK TEST PAPER – 2

IPCC: GROUP – II

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.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) At the end of the financial year ending on 31st December, 2011, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	<i>Probability</i>	<i>Loss (₹)</i>
In respect of five cases (Win)	100%	-
Next ten cases (Win)	60%	-
Lose (Low damages)	30%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

- (b) Paras Ltd. had the following borrowings during a year in respect of capital expansion.

Plant	Cost of Asset	Remarks
	₹	
Plant P	100 lakhs	No specific borrowings
Plant Q	125 lakhs	Bank loan of ₹ 65 lakhs at 10%
Plant R	175 lakhs	9% Debentures of ₹ 125 lakhs were issued.

In addition to the specific borrowings stated above, the Company had obtained term loans from two banks (1) ₹ 100 lakhs at 10% from Corporation Bank and (2) ₹ 110 lakhs at 11.50% from State Bank of India, to meet its capital expansion

requirements. Determine the amount of borrowing costs to be capitalized in each of the above Plants, as per AS-16.

- (c) Bharat Ltd. grants 1,000 employees stock options on 1.4.2008 at ₹ 40, when the market price is ₹ 160. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.2010. 600 options are exercised on 30.6.2011. 100 vested options lapse at the end of the exercise period.

Pass Journal Entries giving suitable narrations.

- (d) A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2011-12.

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2012. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item? (5 Marks each)

2. 'S' and 'T' were carrying on business as equal partners. Their Balance Sheet as on 31st March, 2011 stood as follows:

Liabilities		₹	Assets	₹
Capital accounts:			Stock	2,70,000
S	6,40,000		Debtors	3,65,000
T	<u>6,60,000</u>	13,00,000	Furniture	75,000
Creditors		3,27,500	Joint life policy	47,500
Bank overdraft		1,50,000	Plant	1,72,500
Bills payable		<u>62,500</u>	Building	<u>9,10,000</u>
		<u>18,40,000</u>		<u>18,40,000</u>

The operations of the business were carried on till 30th September, 2011. S and T both withdrew in equal amounts, half the amount of profits made during the current period of 6 months after 10% per annum had been written off on building and plant and 5% per annum written off on furniture. During the current period of 6 months, creditors were reduced by ₹ 50,000, Bills payable by ₹ 11,500 and Bank overdraft by ₹ 75,000. The Joint Life policy was surrendered for ₹ 47,500 on 30th September, 2011. Stock was valued at ₹ 3,17,000 and debtors at ₹ 3,25,000 on 30th September, 2011. The other items remained the same as on 31st March, 2011.

On 30th September, 2011 the firm sold its business to ST Ltd. The value of goodwill was estimated at ₹ 5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 2011. The ST Ltd. paid the purchase consideration

in equity shares of ₹ 10 each. You are required to prepare a Realization Account and Capital accounts of the partners. (16 Marks)

3. Success Ltd. issued ₹ 10,00,000, 6% Debenture Stock at par on 21.1.2002. Interest was payable on 30th June and 31st December, in each year.

Under the terms of the Debentures Trust the owned stock is redeemable at par. The trust deed obliges the Company to pay to the trustees on 31st December, 2009 and annually thereafter the sum of ₹ 1,00,000 to be utilized for the redemption and cancellation of an equivalent amount of stock, which is to be selected by drawing lots.

Alternatively, the Company is empowered as from 1st January, 2009 to purchase its own debentures from the open market. These Debentures must be surrendered to the Trustees for cancellation and any adjustments for accrued interest recorded in the books of account. If in any year the nominal amount of the stock surrendered under this alternative does not amount to ₹ 1,00,000 then the shortfall is to be paid by the Company to the Trustees in cash on 31st December.

The following purchases of stock were made by the Company:

	Nominal value of stock purchased ₹	Purchase price per ₹ 100 of stock ₹
(1) 30th September, 2009	1,20,000	98
(2) 31st May, 2010	75,000	95 (Ex-interest)
(3) 31st July, 2011	1,15,000	92

The Company fulfilled all its obligations under the trust deed.

Prepare the Ledger Accounts : (a) Debenture Stock A/c (b) Debenture Redemption A/c
(c) Debenture Interest A/c.

Note: Ignore costs and taxation (16 Marks)

4. Prepare Revenue Account in proper form for the year ended 31st March, 2012, from the following particulars related to Saviour General Insurance Co. for the year ended 2011-12:

	Related to Direct business (₹)	Related to Reinsurance (₹)
Premiums:		
Amount received	30,00,000	2,40,000

Receivable at the beginning	1,80,000	24,000
Receivable at the end	2,40,000	36,000
Amount paid	--	3,60,000
Payable at the beginning	--	30,000
Payable at the end	--	42,000
Claims:		
Amount paid	18,00,000	1,80,000
Payable at the beginning	60,000	12,000
Payable at the end	1,20,000	18,000
Amount recovered	--	1,20,000
Receivable at the beginning	--	18,000
Receivable at the end	--	12,000
Commission:		
Amount paid	72,000	10,800
Amount received	--	14,400

Additional information:

- (i) Interest, dividend and rent received 30,000
Income-tax in respect of above 6,000
 - (ii) Management expenses including ₹ 12,000 related to legal expenses regarding claims 1,32,000.
 - (iii) Provision for income tax existing at the beginning of the year was ₹ 1,95,000, the income-tax actually paid during the year ₹ 1,68,000 and the provision necessary at the year end ₹ 2,07,000.
 - (iv) The net premium income of the company during the year 2010-2011 was ₹ 24,00,000 on which reserve for unexpired risk @ 50% and additional reserve @ 7 ½ % was created. This year, the balance to be carried forward is 50% of net premium on reserve for unexpired risk and 5% on additional reserve. (16 Marks)
5. (a) Here and There and Co. of Mumbai started a branch at Bangalore on 1.4.2011 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2012:

	₹
Cost of goods sent to branch	1,00,000
Goods received by branch till 31.3.2012 at Invoice price	1,08,000
Credit sales for the year	1,16,000
Closing debtors on 31.3.2012	41,600
Bad debts written off during the year	400
Cash remitted to H.O.	86,000
Closing cash on hand at branch on 31.3.2012	4,000
Cash remitted by H.O. to branch during the year	6,000
Closing stock in hand at branch at invoice price	12,000
Expenses incurred at branch	24,000

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment Account for ascertaining gross profit and Branch Profit and Loss Account for ascertaining Branch profit. (8 Marks)

- (b) A joint stock company resolved to issue 10 lakh equity shares of ₹ 10 each at a premium of ₹ 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications. The issue was underwritten by X, Y and Z for a commission @ 2% of the issue price. 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively.

The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows: X - 1,19,500 shares; Y - 57,500 shares and Z – 10,500 shares.

Unmarked applications totalled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to:

- (i) Prepare a statement calculating underwriter's liability for shares.
 - (ii) Pass journal entries for all transactions including cash transactions. (8 Marks)
6. (a) Bright Electricity Company earned a profit of ₹ 1,20,00,000 (after tax) for the year ended 31st March, 2011 on which date it had a capital base of ₹ 8,74,00,000 and the bank rate was 8%. The following additional information about the company is

also provided to you:

	₹
Reserve Fund Investment, invested in 8% Government securities at par	1,20,00,000
Contingencies Reserve Fund Investments @ 7% per annum	50,00,000
Loan from State Electricity Board	1,00,00,000
11% Debentures	8,00,000
Development Reserve	32,00,000

Show how the surplus of the company will be disposed of under the provisions of the Electricity Act. (8 Marks)

- (b) The following balances were extracted from the books of M/s Part & Parcel. You are required to prepare Departmental Trading Account and Profit and Loss account for the year ended 31st December, 2011 after adjusting the unrealized department profits if any.

	Deptt. A ₹	Deptt. B ₹
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were ₹ 1,25,000 and you are also supplied with the following information: (a) Closing stock of Department A ₹ 1,00,000 including goods from Department B for ₹ 20,000 at cost of Department A. (b) Closing stock of Department B ₹ 2,00,000 including goods from Department A for ₹ 30,000 at cost to Department B. (c) Opening stock of Department A and Department B include goods of the value of ₹ 10,000 and ₹ 15,000 taken from Department B and Department A respectively at cost to transferee departments. (d) The gross profit is uniform from year to year. (8 Marks)

7. Answer any **four** out of five:

- (a) From the following information of Honour Bank Limited, compute the provisions to be made in the Profit and Loss account:

	₹ in lakhs
Assets	
Standard	20,000
Substandard	16,000

Doubtful	
For one year (secured)	6,000
For two years and three years (secured)	4,000
For more than three years (secured by mortgage of plant and machinery ₹ 600 lakhs)	2,000
Non-recoverable Assets	1,500

- (b) A Limited Company closed its accounting year on 30.6.11 and the accounts for that period were considered and approved by the board of directors on 20th August, 2011. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2011 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.11.
- (c) S Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.2011 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.2011 and 31.12.2011 respectively. First instalment was paid on 31.12.2011. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

- (d) Should appropriation to mandatory reserves be excluded from net profit attributable to equity shareholders?

Kraft Ltd. is engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered into with its debentureholders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the Reserve constitutes at least half the value of such debentures. As such, appropriations are not available for distribution to the equity shareholders. Kraft Ltd. has excluded this from the numerator in the computation of basis EPS. Is this treatment correct?

- (e) Rishi Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets, received ₹ 10 crore from the Government in January, 2012 (accounting period being 2011-2012). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2012.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.
(5 Marks each)

MOCK TEST PAPER – 2
IPCC : GROUP – II
PAPER – 5: ADVANCED ACCOUNTING
SUGGESTED ANSWERS/HINTS

1. (a) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:
- (i) There is a present obligation arising out of past events but not recognized as provision.
 - (ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
 - (iii) The possibility of an outflow of resources embodying economic benefits is also remote.
 - (iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

$$\begin{aligned}\text{Expected loss in next ten cases} &= 30\% \text{ of ₹ } 1,20,000 + 10\% \text{ of ₹ } 2,00,000 \\ &= ₹ 36,000 + ₹ 20,000 \\ &= ₹ 56,000\end{aligned}$$

$$\begin{aligned}\text{Expected loss in remaining five cases} &= 30\% \text{ of ₹ } 1,00,000 + 20\% \text{ of ₹ } 2,10,000 \\ &= ₹ 30,000 + ₹ 42,000 \\ &= ₹ 72,000\end{aligned}$$

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 9,20,000 (₹ 56,000 × 10 + ₹ 72,000 × 5) as contingent liability.

(b) 1. **Computation of Actual Borrowing Costs incurred during the year**

Source	Loan Amount	Interest Rate	Interest Amount
	₹ in lakhs		₹ in lakhs
Bank Loan	65.00	10%	6.50
9% Debentures	125.00	9%	11.25
Term Loan from Corporation Bank	100.00	10%	10.00
Term Loan from State Bank of India	<u>110.00</u>	11.5%	<u>12.65</u>
Total	<u>400.00</u>		<u>40.40</u>
Specific Borrowings included above	<u>190.00</u>		<u>17.75</u>

2. **Weighted Average Capitalisation Rate for General Borrowings =**

$$\frac{\text{Total Interest} - \text{Interest on Specific Borrowings}}{\text{Total Borrowings} - \text{Specific Borrowings}}$$

$$= \frac{(40.40 - 17.75)}{(400 - 190)} \times 100 = 10.79\%$$

3. **Capitalisation of Borrowing Costs under AS – 16 will be as under:**

Plant	Borrowing	Loan Amount	Interest Rate	Interest Amount	Cost of Asset	
		₹ in lakhs		₹ in lakhs	₹ in lakhs	₹ in lakhs
P	General	100	10.79%	10.79		110.79
Q	Specific	65	10.00%	6.50	71.50	
	General	60	10.79%	6.47	<u>66.47</u>	137.97
R	Specific	125	9.00%	11.25	136.25	
	General	<u>50</u>	10.79%	<u>5.39</u>	<u>55.39</u>	<u>191.64</u>
	Total	<u>400</u>		<u>40.40</u>		<u>440.40</u>

Note: The amount of borrowing costs capitalized should not exceed the actual interest cost.

(c) **Journal Entries in the Books of Bharat Ltd.**

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
31.3.2009	Employees compensation expenses account Dr.	48,000	
	To Employees stock option outstanding account		48,000
	(Being compensation expenses recognized in respect of the employees stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)		
	Profit and loss account Dr.	48,000	
31.3.2010	To Employees compensation expenses account		48,000
	(Being expenses transferred to profit and loss account at the end of the year)		
	Employees compensation expenses account Dr.	48,000	
	To Employees stock option outstanding account		48,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)		
	Profit and loss account Dr.	48,000	
	To Employees compensation expenses account		48,000
	(Being expenses transferred to profit and loss account at the end of the year)		

31.3.2011	Employees stock option outstanding account (W.N.1) Dr.	12,000	
	To General Reserve account (W.N.1)		12,000
	(Being excess of employees compensation expenses transferred to general reserve account)		
30.6.2011	Bank A/c (600 x ₹ 40) Dr.	24,000	
	Employee stock option outstanding account (600 x ₹ 120) Dr.	72,000	
	To Equity share capital account (600 x ₹ 10)		6,000
	To Securities premium account (600 x ₹ 150)		90,000
	(Being 600 employees stock option exercised at an exercise price of ₹ 40 each)		
01.10.2011	Employee stock option outstanding account Dr.	12,000	
	To General reserve account		12,000
	(Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period)		

Working Note:

On 31.3.2011, Bharat Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options, that have actually vested. 700 employees stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

	₹
No. of options actually vested (700 x ₹ 120)	84,000
Less: Expenses recognized ₹ (48,000 + 48,000)	<u>(96,000)</u>
Excess expenses transferred to general reserve	<u>12,000</u>

- (d) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2011-12. Subsequently in 2012 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

2. Realisation Account

Particulars		₹	Particulars	₹
To Sundry assets:			By Creditors	2,77,500
Stock		3,17,000	By Bills payables	51,000
Debtors		3,25,000	By Bank overdraft	75,000
Plant		1,63,875	By Shares in ST Ltd. (W.N. 3)	18,80,000
Building		8,64,500		
Furniture		73,125		
To Profit:				
S	2,70,000			
T	<u>2,70,000</u>	<u>5,40,000</u>		
		<u>22,83,500</u>		<u>22,83,500</u>

Partners' Capital Accounts

Date	Particulars	S	T	Date	Particulars	S	T
2011		₹	₹	2011		₹	₹
April 1	To Cash – Drawings (W.N. 2)	20,000	20,000	April 1	By Balance b/d	6,40,000	6,60,000

Sept. 30	To	Shares in ST Ltd.	9,30,000	9,50,000	Sept. 30	By	Profit (W.N.2)	40,000	40,000
			_____	_____		By	Realisation A/c (Profit)	<u>2,70,000</u>	<u>2,70,000</u>
			<u>9,50,000</u>	<u>9,70,000</u>				<u>9,50,000</u>	<u>9,70,000</u>

Working Notes:

1. Ascertainment of capital as on 30th September, 2011

Balance Sheet as at 30th September, 2011

<i>Liabilities</i>	₹	<i>Assets</i>		₹
Sundry creditors	2,77,500	Building	9,10,000	
Bills payable	51,000	Less: Depreciation	<u>(45,500)</u>	8,64,500
Bank overdraft	75,000	Plant	1,72,500	
Total capital (bal. fig.)	13,40,000	Less: Depreciation	<u>(8,625)</u>	1,63,875
		Furniture	75,000	
		Less: Depreciation	<u>(1,875)</u>	73,125
		Stock		3,17,000
		Debtors		<u>3,25,000</u>
	<u>17,43,500</u>			<u>17,43,500</u>

2. Profit earned during six months ended 30th September, 2011

		₹
Total capital (of S and T) on 30 th September, 2011 (W.N.1)		13,40,000
Capital on 1 st April, 2011		
S	6,40,000	
T	<u>6,60,000</u>	<u>(13,00,000)</u>
Net increase (after drawings)		<u>40,000</u>

Since drawings are half of profits therefore, actual profit earned is ₹ 40,000 x 2 = ₹ 80,000 (shared equally by partners S and T).

Half of the profits, has been withdrawn by both the partners equally i.e. drawings ₹ 40,000 (₹ 80,000 x ½) withdrawn by S and T in 1:1 (i.e. ₹ 20,000 each).

3. Purchase consideration

	₹
Total assets (W.N.1)	17,43,500
Add: Goodwill	<u>5,40,000</u>
	22,83,500
Less: Liabilities (2,77,500 + 51,000 + 75,000)	<u>(4,03,500)</u>
Purchase consideration	<u>18,80,000</u>

Note: The above solution is given on the basis that reduction in bank overdraft is after surrender of Joint life policy.

3. In the Books of Success Ltd. Debenture Stock Account

2009		₹	2009		₹
Sept. 30	To Debenture Redemption A/c	1,20,000	Jan. 1	By Balance b/d	10,00,000
Dec. 31	To Balance c/d	<u>8,80,000</u>			
		<u>10,00,000</u>			<u>10,00,000</u>
2010		₹	2010		₹
May 31	To Debenture Redemption A/c	75,000	Jan. 1	By Balance b/d	8,80,000
Dec.31	To Debenture Redemption A/c	25,000			
	To Balance c/d	<u>7,80,000</u>			
		<u>8,80,000</u>			<u>8,80,000</u>
2011		₹	2011		₹
July 31	To Debenture Redemption A/c	1,15,000	Jan. 1	By Balance b/d	7,80,000
Dec.31	To Balance c/d	<u>6,65,000</u>			
		<u>7,80,000</u>			<u>7,80,000</u>

Debenture Redemption Account

2009		₹	2009		₹
Sept. 30	To Bank A/c (₹ 1,20,000 × 0.98 – ₹ 1,800)	1,15,800	Sept.30	By Debenture Stock A/c	1,20,000

	To Capital Reserve A/c	<u>4,200</u> <u>1,20,000</u>			<u>1,20,000</u>
2010		₹	2010		₹
May 30	To Bank A/c (₹ 75,000 × 0.95)	71,250	May 31	By Debenture Stock A/c	75,000
	To Capital Reserve A/c (Profit on cancellation)	3,750	Dec. 31	By Debenture Stock A/c	25,000
Dec.31	To Bank A/c (Shortfall= ₹1,00,000 – ₹ 75,000)	25,000			
		<u>1,00,000</u>			<u>1,00,000</u>
2011		₹	2011		₹
July 31	To Bank A/c (₹ 1,15,000 ×.92 – ₹ 575)	1,05,225	July 31	By Debenture Stock A/c	1,15,000
	To Capital Reserve A/c (Profit on cancellation)	9,775			
		<u>1,15,000</u>			<u>1,15,000</u>

Debenture Interest Account

2009		₹	2009		₹
June 30	To Bank A/c	30,000	Dec. 31	By Profit and Loss A/c	58,200
Sept. 30	To Bank A/c	1,800			
Dec. 31	To Bank A/c	26,400			
		<u>58,200</u>			<u>58,200</u>
2010		₹	2010		₹
May 31	To Bank A/c	1,875	Dec. 31	By Profit and Loss A/c	50,175
June 31	To Bank A/c	24,150			
Dec. 31	To Bank A/c	24,150			
		<u>50,175</u>			<u>50,175</u>
2011		₹	2011		₹
June 30	To Bank A/c	23,400	Dec. 31	By Profit and Loss A/c	43,925

July 31	To Bank A/c	575			
Dec. 31	To Bank A/c	19,950			
		43,925			43,925

Working Notes :

Interest paid on Debentures @ 6% per annum:

Date	Amount of Debentures ₹	Period	Interest ₹
2009			
June 30	10,00,000	6 months	30,000
Sept. 30	1,20,000	3 months	1,800
Dec. 31	8,80,000	6 months	26,400
2010			
May 31	75,000	5 months	1,875
June 30	8,05,000	6 months	24,150
Dec. 31	8,05,000	6 months	24,150
2011			
June 30	7,80,000	6 months	23,400
July 31	1,15,000	1 month	575
Dec. 31	6,65,000	6 months	19,950

Notes :

- (1) It has been assumed that debentures are purchased for immediate cancellation.
- (2) The purchases of 30th September, 2009 and 31st July, 2011 have been taken on cum-interest basis

4.

FORM B – RA

Name of the Insurer : Saviour General Insurance Company

Registration no. and date of registration with IRDA :

Revenue Account for the year ended 31.3.2012

	Particulars	Schedule	Amount (₹)
1.	Premium earned (Net)	1	27,03,000
2.	Profit/Loss on sales/Redemption of investment	-	-

3.	Other	-	-
4.	Interest, dividend & rent (Gross)	-	<u>30,000</u>
	Total (A)		<u>27,33,000</u>
1.	Claims incurred (Net)	2	19,44,000
2.	Commission	3	68,400
3.	Operating expenses related to insurance business	4	<u>1,20,000</u>
	Total (B)		<u>21,32,400</u>
	Operating profit/Loss from insurance business (C) = (A-B)		<u>6,00,600</u>
	<i>Appropriation:</i>		
	Transfer to Shareholders account		-
	Transfer to Catastrophe Reserve		-
	Transfer to other reserves		-
	Total (D)		-

Schedule – 1 Premium Earned (Net)

Particulars	₹
Premium received from direct business (W.N.1)	30,60,000
Add: Premium on reinsurance accepted (2,40,000 + 36,000 – 24,000)	<u>2,52,000</u>
	33,12,000
Less: Premium on reinsurance ceded (3,60,000 + 42,000 – 30,000)	<u>(3,72,000)</u>
Net Premium	29,40,000
Adjustment for change in reserve for unexpired risk (W.N.2)	<u>(2,37,000)</u>
Total premium earned (Net)	<u>27,03,000</u>

Schedule – 2 Claims Incurred (Net)

Particulars	₹
Claims paid (Direct)	18,00,000
Add: Legal expenses regarding claims	<u>12,000</u>
	18,12,000
Add: Reinsurance Accepted	<u>1,80,000</u>
	19,92,000
Less: Reinsurance ceded (1,20,000 + 12,000 – 18,000)	<u>(1,14,000)</u>

	18,78,000
Add: Claims outstanding at the end (1,20,000 + 18,000)	<u>1,38,000</u>
	20,16,000
Less: Claims outstanding at the beginning (60,000 + 12,000)	<u>(72,000)</u>
Total claim incurred	<u>19,44,000</u>

Schedule –3 Commission

Particulars	₹
Commission paid Direct	72,000
Add: Re-insurance accepted	<u>10,800</u>
	82,800
Less: Re-insurance ceded	<u>(14,400)</u>
Net commission	<u>68,400</u>

Schedule – 4 Operating Expenses related to Insurance Business

Particulars	₹
Expenses of management (1,32,000 – 12,000)	<u>1,20,000</u>
	<u>1,20,000</u>

Working Notes:

1. Calculation of premium received from direct business

	₹
Premium on direct business	30,00,000
Add: Premium outstanding at the end	<u>2,40,000</u>
	32,40,000
Less: Premium outstanding at the beginning	<u>(1,80,000)</u>
	<u>30,60,000</u>

2. Computation of change in reserve for unexpired risk

	₹
Reserve for unexpired risk for the year 2011-12 (29,40,000 x 50%)	14,70,000
Add: Additional reserve for unexpired risk for the year 2011-12 (29,40,000 x 5%)	<u>1,47,000</u>
	16,17,000
Less: Reserve for unexpired risk for the year 2010-11	

(24,00,000 x 50%)	(12,00,000)
Additional reserve for unexpired risk for the year (24,00,000 x 7.5%)	<u>(1,80,000)</u>
	<u>2,37,000</u>

5. (a) **Branch Debtors A/c**

	₹		₹
To Branch Stock A/c	1,16,000	To Branch Cash A/c	74,000
		To Bad Debts written off	400
		To Balance c/d	<u>41,600</u>
	<u>1,16,000</u>		<u>1,16,000</u>
Goods Sent to Branch A/c			
To Branch Adjustment A/c	20,000	By Branch Stock A/c	1,20,000
1,00,000x $\frac{20}{100}$			
To Purchases/ Trading A/c	<u>1,00,000</u>		
	<u>1,20,000</u>		<u>1,20,000</u>
Branch Cash A/c			
To Branch Debtors A/c	74,000	By Branch Expenses A/c	24,000
To Branch remittance from H.O.	6,000	By Cash to H.O.	86,000
To Branch Stock A/c		By Balance c/d	4,000
- Cash Sales (balancing figure)	<u>34,000</u>		
	<u>1,14,000</u>		<u>1,14,000</u>
Branch Stock A/c			
To Goods sent to Branch A/c	1,20,000	By Branch Debtors A/c (balancing figure)	1,16,000
To Branch Adjustment A/c (Excess profit over normal loading)	54,000*	By Cash Sales	34,000
		By Goods in Transit (1,20,000-1,08,000)	12,000

* ₹ [1,16,000 + 34,000 – (1,20,000-12,000-12,000)]

	<u> </u>	By	Balance c/d	<u>12,000</u>	
	<u>1,74,000</u>			<u>1,74,000</u>	
Branch Expenses A/c					
To	Branch Cash A/c	<u>24,000</u>	By	Branch P&L A/c	<u>24,000</u>
Branch Adjustment A/c					
To	Stock Reserve	2,000	By	Goods sent to Branch A/c	20,000
To	Goods in Transit Reserve	2,000	By	Branch Stock A/c	54,000
To	Branch P&L A/c	<u>70,000</u>			<u> </u>
	<u>74,000</u>				<u>74,000</u>
Branch P & L A/c					
To	Branch Expenses A/c	24,000	By	Branch Adjustment A/c	70,000
To	Bad Debts	400			
To	Profit	<u>45,600</u>			<u> </u>
	<u>70,000</u>				<u>70,000</u>

(b)

Total number of shares issued	10,00,000 shares
Less: Shares taken by the directors and others	<u>(1,00,000 shares)</u>
Shares offered to general public	<u>9,00,000 shares</u>

Statement Showing the Liability of Underwriters

	(Number of shares)		
	X	Y	Z
Gross liability (65%: 25%: 10%)	5,85,000	2,25,000	90,000
Less: Marked applications	<u>(1,19,500)</u>	<u>(57,500)</u>	<u>(10,500)</u>
	4,65,500	1,67,500	79,500
Less: Unmarked applications in the ratio of gross liability	<u>(4,55,000)</u>	<u>(1,75,000)</u>	<u>(70,000)</u>
Resultant Liability (or Surplus)	10,500	(7,500)	9,500
Less: Surplus of Y allocated to X and Z in the ratio of 65:10	<u>(6,500)</u>	<u>(7,500)</u>	<u>(1,000)</u>
Net Liability as per agreement	<u>4,000</u>	<u>Nil</u>	<u>8,500</u>

In the books of a Joint Stock Company

Journal Entries

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being the issue of 1,00,000 equity shares of ₹ 10 each at a premium of ₹ 1 per share to the directors, their relatives and friends as per Board's Resolution No.....dated.....)	11,00,000	10,00,000 1,00,000
	Bank A/c Dr. To Share Application A/c (Being application money received on 8,87,500 shares @ ₹ 11 each)	97,62,500	97,62,500
	X (4,000 shares x ₹ 11) Dr.	44,000	
	Z (8,500 shares x ₹ 11) Dr.	93,500	
	Share Application A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being allotment of shares to X – 4,000 and Z- 8,500, application money credited to Equity Share Capital Account and Securities Premium Account as per Board's Resolution No.....dated....)	97,62,500	90,00,000 9,00,000
	Underwriting Commission A/c Dr. To X (Note 1) To Y (Note 1) To Z (Note 2) (Being the amount payable to X, Y and Z as underwriting commission @ 2% of the issue price)	1,98,000	1,28,700 49,500 19,800

X	Dr.	84,700	
Y	Dr.	49,500	
To Bank A/c			1,34,200
(Being the amount paid to X and Y in respect of underwriting commission after adjusting amount payable on shares allotted)			
Bank A/c	Dr.	73,700	
To Z			73,700
(Being the balance money received from Z on shares allotted after adjusting underwriting commission)			

Working Note:

Statement showing the Amount Due from (Due to) Underwriters

Underwriters		X	Y	Z
Number of shares to be subscribed as per agreement		<u>4,000</u>	<u>Nil</u>	<u>8,500</u>
Amount payable @ ₹ 11 per share	(₹)	44,000	-	93,500
Less: Underwriting commission @ 2%				
X – on ₹ 64,35,000		(1,28,700)	-	-
Y – on ₹ 24,75,000		-	(49,500)	-
Z – on ₹ 9,90,000	-	-	-	(19,800)
Amount paid/ (received)		<u>(84,700)</u>	<u>(49,500)</u>	<u>73,700</u>

6. (a) Calculation of Reasonable Return

	₹
10% (Bank rate 8% +2%) of capital base	87,40,000
8% on Reserve fund investments	9,60,000
½% on Loan from State Electricity Board	50,000
½% on 11% Debentures	4,000
½ on Development reserve	<u>16,000</u>
	<u>97,70,000</u>

Surplus:	
Clear Profit – Reasonable return (₹ 1,20,00,000-97,70,000)	₹ 22,30,000
20% of Reasonable Return	₹ 19,54,000
whichever is less is for disposal as surplus i.e.	₹ 19,54,000

Statement showing Disposal of surplus

		₹
(i)	1/3 rd of surplus limited to 5% of reasonable return is at the disposal of the company 1/3 rd of surplus = ₹ 6,51,333 Or, 5% of reasonable return = ₹ 4,88,500	4,88,500
(ii)	Credit to Tariffs and Dividend Control Reserve (1/2 of remaining balance of 20% of reasonable return) ₹ 19,54,000 – 4,88,500 = ₹ 14,65,500 x 1/2	7,32,750
(iii)	Remaining balance credited to customers account	<u>7,32,750</u>
		<u>19,54,000</u>

**(b) Departmental Trading and Loss Account of M/s Part and Parcel
For the year ended 31st December, 2011**

	Deptt. A	Deptt. B		Deptt. A	Deptt. B
	₹	₹		₹	₹
To Opening stock	50,000	40,000	By Sales	10,00,000	15,00,000
To Purchases	6,50,000	9,10,000	By Closing stock	1,00,000	2,00,000
To Gross profit	<u>4,00,000</u>	<u>7,50,000</u>			
	<u>11,00,000</u>	<u>17,00,000</u>		<u>11,00,000</u>	<u>17,00,000</u>
To General Expenses (in ratio of sales)	50,000	75,000	By Gross profit	4,00,000	7,50,000
To Profit to general profit and loss account	3,50,000	6,75,000			
	<u>4,00,000</u>	<u>7,50,000</u>		<u>4,00,000</u>	<u>7,50,000</u>

General Profit and Loss Account

	₹		₹
To Stock reserve required (additional):		By Profit from:	
Stock in Deptt. A		Deptt. A	3,50,000
50% of (₹ 20,000 - ₹ 10,000) (W.N.1)	5,000	Deptt. B	6,75,000
Stock in Deptt. B			
40% of (₹ 30,000 - ₹ 15,000) (W.N.2)	6,000		
To Net Profit	10,14,000		
	10,25,000		10,25,000

Working Notes:

1. Stock of department A will be adjusted according to the rate applicable to department B = $[(7,50,000 \div 15,00,000) \times 100] = 50\%$
2. Stock of department B will be adjusted according to the rate applicable to department A = $[(4,00,000 \div 10,00,000) \times 100] = 40\%$

7. (a) Calculation of amount of provision to be made in the Profit and Loss Account

Classification of Assets	Amount of advances	% age of provision	Amount of provision
	(₹ in lakhs)		(₹ in lakhs)
Standard assets	20,000	0.40	80
Sub-standard assets	16,000	15*	2,400
Doubtful assets:			
For one year (secured)	6,000	25	1,500
For two to three years (secured)	4,000	40	1,600
For more than three years			
(unsecured)	1,400	100	1,400
(secured)	600	100	600
Non-recoverable assets (Loss assets)	1,500	100	<u>1,500</u>
Total provision required			<u>9,080</u>

- (b) Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines events occurring after the balance sheet date as significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company. The given case is discussed in the

* Sub-standards assets have been assumed as fully secured.

light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

In this case the incidence, which was expected to push up cost by ₹ 80 lakhs became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Directors' Report

- (c) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{\text{₹ 3,000 lakhs}}{\text{₹ 40}} = 75 \text{ lakhs US Dollars}$$

$$\begin{aligned}\text{Exchange difference} &= 75 \text{ lakhs US Dollars} \times (42.50 - 40.00) \\ &= \text{₹ 187.50 lakhs}\end{aligned}$$

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

- (d) Para 11 of AS 20 states that "for the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to Equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period".

With an emphasis on the phrase "attributable to equity shareholders", it may be construed that amount appropriated to Mandatory Reserves as described in this case, though not available for distribution as dividend, are still attributable to equity shareholders.

Therefore, the appropriation made to mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. The treatment made by the company is not correct.

- (e) As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as

capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment followed by the company is not proper.