DISCLAIMER

The Suggested Answers hosted in the website do not constitute the basis for evaluation of the students' answers in the examination. The answers are prepared by the Faculty of the Board of Studies with a view to assist the students in their education. While due care is taken in preparation of the answers, if any errors or omissions are noticed, the same may be brought to the attention of the Director of Studies. The Council of the Institute is not in anyway responsible for the correctness or otherwise of the answers published herein.

PAPER – 5 : ADVANCED ACCOUNTING

Question No. 1 is compulsory

*Answer any **five** questions from the remaining **six** questions.*

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

Working Notes should form part of the answer.

Question 1

Answer the following questions:

(a) Net profit for the year 2012 : ₹ 24,00,000

Weighted average number of equity shares outstanding during the year 2012: 10,00,000

Average Fair value of one equity share during the year 2012 : ₹ 25.00

Weighted average number of shares under option during the year 2012: 2,00,000

Exercise price for shares under option during the year 2012 : ₹ 20.00

Compute Basic and diluted earnings per share.

(b) Closing Stock for the year ending on 31st March, 2013 is ₹ 1,50,000 which includes stock damaged in a fire in 2011-12. On 31st March, 2012, the estimated net realizable value of the damaged stock was ₹ 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 2012-13 is ₹ 4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 2012-13, using provisions of Accounting Standard 5.

(c) An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year : 2% provision

More than 1 year : 3% provision

The company has raised invoices as under:

Invoice Date	*Amount ₹*
19th January, 2011	*40,000*
29th January, 2012	*25,000*
15th October, 2012	*90,000*

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013.

(d) An enterprise acquired patent right for ₹ 400 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year	*Estimated Future Cash Flows (₹ in lakhs)*
1	*200*
2	*200*
3	*200*
4	*100*
5	*100*

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹ 50 lakhs. Determine the amortization under Accounting Standard 26. *(4 x 5 = 20 Marks)*

Answer

(a) Computation of earnings per share

	Earnings (₹)	*Shares*	*Earnings per share*
Net profit for the year 2012	24,00,000		
Weighted average number of shares outstanding during the year 2012		10,00,000	
Basic earnings per share			₹ 2.40
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value: (2,00,000 x 20.00)/25.00	-*	(1,60,000)	
Diluted earnings per share	24,00,000	10,40,000	₹ 2.31

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of computation to have been issued for no consideration.

(b) The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per para 25 of AS 5 'Net Profit or Loss the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. It is presumed that the loss by fire in the year ended 31.3.2012, i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item. Therefore, in the year 2012-13, revision in accounting estimate should also be classified as extra-ordinary item in the profit and loss account and closing stock should be shown excluding the value of damaged stock.

Value of closing stock for the year 2012-13 will be as follows:

	₹
Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

(c) Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2012 = ₹ 40,000 x .02 + ₹ 25,000 x .03

= ₹ 800 + ₹ 750

= ₹ 1,550

As at 31st March, 2013 = ₹ 25,000 x .02 + ₹ 90,000 x .03

= ₹ 500 + ₹ 2,700 = ₹ 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2013

	₹
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on 1.4.2012	(1,550)
Amount debited to profit and loss account	1,650

Note: No provision will be made on 31st March, 2013 in respect of sales amounting ₹ 40,000 made on 19th January, 2011 as the warranty period of 2 years has already expired.

(d) Amortization of cost of patent as per AS 26

Year	*Estimated future cash flow (₹ in lakhs)*	*Amortization Ratio*	*Amortized Amount (₹ in lakhs)*
1	200	.25	100
2	200	.25	100
3	200	.25	100
4	100	.40 (Revised)	40
5	100	.40 (Revised)	40
6	50	.20 (Revised)	20
			400

In the first three years, the patent cost will be amortised in the ratio of estimated future cash flows i.e. (200: 200: 200: 100: 100).

The unamortized amount of the patent after third year will be ₹ 100 (400-300) which will be amortised in the ratio of revised estimated future cash flows (100:100:50) in the fourth, fifth and sixth year.

Question 2

The following is the Balance Sheet of M/s. P and Q as on 31st March, 2012:

Liabilities	*₹*	*Assets*	*₹*
Capital Accounts:		*Machinery*	*54,000*
P	*50,000*	*Furniture*	*5,000*
Q	*30,000*	*Investment*	*50,000*
Reserves	*20,000*	*Stock*	*20,000*
Loan Account of Q	*15,000*	*Debtors*	*21,000*
Creditors	*40,000*	*Cash*	*5,000*
	1,55,000		*1,55,000*

It was agreed that Mr. R is to be admitted for a fourth share in the future profits from 1st April, 2012. He is required to contribute cash towards goodwill and ₹ 15,000 towards capital.

The following further information is furnished:

(a) P & Q share the profits in the ratio 3 : 2.

(b) P was receiving salary of ₹ 750 p.m. from the very inception of the firm in 2005 in addition to share of profit.

(c) The future profit ratio between P, Q & R will be 2:1:1. P will not get any salary after the admission of R.

(d) It was agreed that the value of goodwill of the firm shall appear in the books of the firm. The goodwill of the firm shall be determined on the basis of 3 years' purchase of the average profits from business of the last 5 years. The particulars of the profits are as under:

Year ended	*Profit/(Loss) ₹*
31st March, 2008	*25,000*
31st March, 2009	*12,500*
31st March, 2010	*(2,500)*
31st March, 2011	*35,000*
31st March, 2012	*30,000*

The above Profits and Losses are after charging the Salary of P. The Profit of the year ended 31st March, 2008 included an extraneous profit of ₹ 40,000 and the loss for the year ended 31st March, 2010 was on account of loss by strike to the extent of ₹ 20,000.

(e) *The cash trading profit for the year ended 31st March, 2013 was ₹ 50,000 before depreciation.*

(f) *The partners had drawn each ₹ 1,000 p.m. as drawings.*

(g) *The value of other assets and liabilities as on 31st March, 2013 were as under:*

	₹
Machinery (before depreciation)	*60,000*
Furniture (before depreciation)	*10,000*
Investment	*50,000*
Stock	*15,000*
Debtors	*30,000*
Creditors	*20,000*

(h) *Provide depreciation @ 10% on Machinery and @ 5% on Furniture on the Closing Balance and interest is accumulated @ 6% on Q's loan. The loan alongwith interest would be repaid within next 12 months.*

(i) *Investments are held from inception of the firm and interest is received @ 10% p.a.*

(j) *The partners applied for conversion of the firm into a Private Limited Company. Certificate was received on 1st April, 2013. They decided to convert Capital A/cs of the partners into share capital in the ratio of 2:1:1 on the basis of a total Capital as on 31st March, 2013. If necessary, partners have to subscribe to fresh capital or withdraw.*

Prepare the Profit and Loss Account of the firm for the year ended 31st March, 2013 and the Balance Sheet of the Company on 1st April, 2013. *(16 Marks)*

Answer

M/s P, Q and R

Profit and Loss Account for the year ending on 31st March, 2013

		₹		₹
To Depreciation on Machinery		6,000	By Trading Profit	50,000
To Depreciation on furniture		500	By Interest on Investment	5,000
To Interest on Q's loan		900		
To Net Profit to :				
P's Capital A/c	23,800			

Q's Capital A/c	11,900			
R's Capital A/c	11,900	47,600		
		55,000		55,000

Balance Sheet of the PQR Pvt. Ltd. as on 1st April, 2013

	Notes No.	₹
I Equity and Liabilities		
Shareholders' funds		
Share capital		1,41,600
Current liabilities		
Short term borrowings	1	15,900
Trade payables		20,000
Total		1,77,500
II Assets		
Non-current assets		
Fixed assets		
Tangible assets	2	63,500
Non-current investments		50,000
Current assets		
Inventories		15,000
Trade receivables		30,000
Cash and cash equivalents		19,000
Total		1,77,500

Notes to Accounts

		₹
1. Short term borrowings		
Loan from Q		15,900
2. Tangible assets		
Machinery	54,000	
Furniture	9,500	63,500

Working Notes:

1. Calculation of goodwill

	2007-08 ₹	*2008-09* ₹	*2009-10* ₹	*2010-11* ₹	*2011-12* ₹
Profits/(Loss)	25,000	12,500	(2,500)	35,000	30,000

Adjustment for extraneous profit of 2007-08 and abnormal loss of 2009-10	(40,000)	-	20,000	—	—
	(15,000)	12,500	17,500	35,000	30,000
Add: Salary of P (750 x12)	9,000	9,000	9,000	9,000	9,000
	(6,000)	21,500	26,500	44,000	39,000
Less: Interest on non-trading investment*	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
	(11,000)	16,500	21,500	39,000	34,000
Total Profit from 2008-09 to 2011-12					1,11,000
Less : Loss for 2007-08					(11,000)
					1,00,000
Average Profit					20,000
Goodwill equal to 3 years' purchase					60,000
Contribution from R for ¼ share					15,000

* Investments are assumed to be non-trading investments.

2. Calculation of sacrificing ratio of Partners P and Q on admission of R

	Old share	*New share*	*Sacrificing share*	*Gaining share*
P	3/5	1/2	$\frac{3}{5}-\frac{1}{2}=\frac{6-5}{10}=\frac{1}{10}$	
Q	2/5	1/4	$\frac{2}{5}-\frac{1}{4}=\frac{8-5}{20}=\frac{3}{20}$	
R		1/4		1/4

3. Goodwill adjustment entry* through Partners' capital accounts (in their sacrificing ratio of 2:3)

		₹	₹
R' s capital A/c	Dr.	15,000	
To P's capital A/c			6,000

**As per AS 26 "Intangible Assets", only purchased goodwill should appear in the books. Therefore, goodwill though required to be shown in the books as per the requirement of the question, has been adjusted through capital accounts of the partners in line with the provisions of AS 26.*

To Q' s capital A/c (R's share in goodwill adjusted through P and Q)		9,000

4. Partners' Capital Accounts

	P ₹	*Q* ₹	*R* ₹		*P* ₹	*Q* ₹	*R* ₹
To Drawings (1,000 x 12)	12,000	12,000	12,000	By Balance b/d	50,000	30,000	—
To P			6,000	By General Reserve	12,000	8,000	—
To Q			9,000	By R	6,000	9,000	—
To Balance c/d	79,800	46,900	14,900	By Bank (15,000 + 15,000)	—	—	30,000
				By Profit & Loss A/c	23,800	11,900	11,900
	91,800	58,900	41,900		91,800	58,900	41,900

5. Balance Sheet of the firm as on 31st March, 2013

Liabilities	₹	₹	*Assets*	₹	₹
P's Capital	79,800		Machinery	60,000	
Q's Capital	46,900		*Less* : Depreciation	(6,000)	54,000
R's Capital	14,900	1,41,600	Furniture	10,000	
			Less : Depreciation	(500)	9,500
Q's Loan	15,000		Investments		50,000
Add : Interest due	900	15,900	Stock-in-trade		15,000
Creditors		20,000	Debtors		30,000
			Cash (W.N.6)		19,000
		1,77,500			1,77,500

6. Cash balance as on 31.3.2013

	₹	₹
Cash trading profit		50,000
Add: Investment Interest		5,000
Add: Decrease in Stock Balance		5,000
		60,000

Less: Increase in Debtors	9,000	
Less: Decrease in Creditors	20,000	(29,000)
		31,000
Add: Opening cash balance	5,000	
Add: Cash brought in by R	30,000	35,000
		66,000
Less: Drawings (12,000 +12,000 +12,000)	36,000	
Less: Additions to Machine (60,000 - 54,000)	6,000	
Furniture (10,000 - 5,000)	5,000	(47,000)
Closing cash balance		19,000

7. Distribution of shares – Conversion into Company

		₹
Capital :	P	79,800
	Q	46,900
	R	14,900
Share Capital		1,41,600
Distribution of shares :	P (1/2)	70,800
	Q (1/4)	35,400
	R (1/4)	35,400

P and Q should withdraw capital of ₹ 9,000 (₹ 79,800 – ₹ 70,800) and ₹11,500 (₹ 46,900 – ₹ 35,400) respectively and R should subscribe shares of ₹ 20,500 (₹35,400 – ₹ 14,900).

Question 3

(a) *A company issued 1,50,000 shares of ₹ 10 each at a premium of ₹ 10. The entire issue was underwritten as follows:*

X – 90000 shares (Firm underwriting 12000 shares)

Y – 37500 shares (Firm underwriting 4500 shares)

Z – 22500 shares (Firm underwriting 15000 shares)

Total subscriptions received by the company (excluding firm underwriting and marked applications) were 22500 shares.

The marked applications (excluding firm underwriting) were as follows:

X – 15000 shares

Y – 30000 shares

Z – 7500 shares

Commission payable to underwriters is at 5% of the issue price. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

(i) Determine the liability of each underwriter (number of shares);

(ii) Compute the amounts payable or due from underwriters; and

(iii) Pass Journal Entries in the books of the company relating to underwriting. (12 Marks)

(b) Arihant Limited has its share capital divided into equity shares of ₹ 10 each. On 1-10-2012, 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, 2012 and 31st March, 2013. 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, 2013. (4 Marks)

Answer

(a) (i) Computation of total liability of underwriters in shares

	(In shares)			
	X	Y	Z	*Total*
Gross liability	90,000	37,500	22,500	1,50,000
Less: Marked applications (excluding firm underwriting)	(15,000)	(30,000)	(7,500)	(52,500)
	75,000	7,500	15,000	97,500
Less: Unmarked applications in the ratio of gross liabilities of 12:5:3 (excluding firm underwriting)	(13,500)	(5,625)	(3,375)	(22,500)
	61,500	1,875	11,625	75,000
Less : Firm underwriting	(12,000)	(4,500)	(15,000)	(31,500)
	49,500	(2,625)	(3,375)	43,500
Less: Surplus of Y and Z adjusted in X's balance (2,625+3,375)	(6,000)	2,625	3,375	
Net liability	43,500	-	-	43,500
Add: Firm underwriting	12,000	4,500	15,000	31,500
Total liability	55,500	4,500	15,000	75,000

(ii) Calculation of amount payable to or due from underwriters

	X	*Y*	*Z*	*Total*
Total Liability in shares	55,500	4,500	15,000	75,000
Amount receivable @ ₹ 20 from underwriter (in ₹)	11,10,000	90,000	3,00,000	15,00,000
Less: Underwriting Commission payable @ 5% of ₹ 20 (in ₹)	(90,000)	(37,500)	(22,500)	(1,50,000)
Net amount receivable (in ₹)	10,20,000	52,500	2,77,500	13,50,000

(iii) Journal Entries in the books of the company (relating to underwriting)

			₹	₹
1.	X	Dr.	11,10,000	
	Y	Dr.	90,000	
	Z	Dr.	3,00,000	
	To Share Capital A/c			7,50,000
	To Securities Premium A/c			7,50,000
	(Being allotment of shares to underwriters)			
2.	Underwriting commission A/c	Dr.	1,50,000	
	To X			90,000
	To Y			37,500
	To Z			22,500
	(Being amount of underwriting commission payable)			
3.	Bank A/c	Dr.	13,50,000	
	To X			10,20,000
	To Y			52,500
	To Z			2,77,500
	(Being net amount received by underwriters for shares allotted less underwriting commission)			

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

			₹	₹
10.12.12	Bank A/c (16,000 x 50)	Dr.	8,00,000	
to 31.3.13	Employee compensation expense A/c (16,000 x 70)	Dr.	11,20,000	
	To Equity share capital A/c (16,000 x 10)			1,60,000

	To Securities premium A/c (16,000 x 110)			17,60,000
	(Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)			
31.3.13	Profit and Loss A/c	Dr.	11,20,000	
	To Employee compensation expense A/c			11,20,000
	(Being transfer of employee compensation expenses to Profit and Loss Account)			

Question 4

The summarized Balance Sheet of Bad Luck Ltd. as on 31st March, 2013 was as follows:

	Note	Amount ₹	Amount ₹
A. Equity and Liabilities			
1. Shareholders' Fund			
(a) Share Capital	*1*	*7,50,000*	
(b) Reserves and Surplus	*2*	*(10,00,000)*	*(2,50,000)*
2. Non-current Liabilities			
(a) Long Term borrowings	*3*		*5,00,000*
3. Current Liabilities			
(a) Short Term Borrowings	*4*	*5,00,000*	
(b) Trade Payables		*2,50,000*	*7,50,000*
Total			*10,00,000*
B. Assets			
1. Non-current assets			
(a) Fixed Assets			
(i) Tangible assets	*5*	*5,50,000*	
(ii) Intangible assets	*6*	*1,50,000*	*7,00,000*
2. Current Assets			
(a) Inventories		*1,50,000*	
(b) Trade Receivables		*1,25,000*	
(c) Deferred revenue expenditure		*25,000*	*3,00,000*
Total			*10,00,000*

Notes to Accounts

		Amount ₹	Amount ₹
1.	Share Capital		
	Authorised, issued & fully paid		
	5,000 equity shares of ₹100 each	5,00,000	
	2,500 8% preference shares of ₹100 each	2,50,000	7,50,000
2.	Reserves and Surplus		
	Profit and Loss Account		(10,00,000)
3.	Long Term borrowings		
	8% Debentures		5,00,000
4.	Short Term Borrowings		
	Loan from Directors	3,00,000	
	Bank overdraft	2,00,000	5,00,000
5.	Tangible Assets		
	Freehold property	4,00,000	
	Plant	1,50,000	5,50,000
6.	Intangible Assets		
	Goodwill	1,00,000	
	Trademark	50,000	1,50,000

The following scheme of internal reconstruction was framed, approved by the Court, all the concerned parties and implemented:

(i) The preference shares to be written down to ₹ 25 each and the equity shares to ₹ 20 each. Each class of shares then to be converted into shares of ₹100 each.

(ii) The debenture holders to take over freehold property (book value ₹ 2,00,000) at a valuation of ₹2,50,000 in part repayment of their holdings. Remaining freehold property to be revalued at ₹6,00,000.

(iii) Loan from directors to be waived off in full.

(iv) Stock of ₹50,000 to be written off, ₹12,500 to be provided for bad debts.

(v) Profit and Loss account balance, Trademark, goodwill and deferred revenue expenditure to be written off.

Pass Journal Entries for all the above mentioned transactions. Also Prepare Capital Reduction account and company's Balance Sheet immediately after reconstruction. *(16 Marks)*

Answer

Journal entries in the books of Bad Luck Ltd.

	Particulars		*Debit(₹)*	*Credit(₹)*
i	8% Preference Share Capital A/c (₹ 100 each)	Dr.	2,50,000	
	To 8% Preference Share Capital A/c (₹ 25 each)			62,500
	To Capital Reduction A/c			1,87,500
	(Being the preference shares of ₹ 100 each reduced to ₹ 25 each as per the approved scheme)			
ii	Equity Share Capital A/c (₹ 100 each)	Dr.	5,00,000	
	To Equity Share Capital A/c (₹ 20 each)			1,00,000
	To Capital Reduction A/c			4,00,000
	(Being the equity shares of ₹ 100 each reduced to ₹ 20 each)			
iii	Preference Share Capital A/c (₹ 25)	Dr.	62,500	
	To Preference Share Capital A/c (₹ 100)			62,500
	(Being conversion of 2500 shares of ₹ 25 each to 625 shares of ₹ 100 each)			
iv	Equity Share Capital A/c (₹ 20)	Dr.	1,00,000	
	To Equity Share Capital A/c (₹100)			1,00,000
	(Being conversion of 5,000 shares of ₹ 20 each to 1000 shares of ₹ 100 each)			
v	Freehold Property	Dr.	50,000	
	To Capital Reduction A/c			50,000
	(Being value of freehold property appreciated)			
vi	8% Debentures A/c	Dr.	2,50,000	
	To Freehold Property			2,50,000
	(Being claim of Debenture holders settled in part by transfer of freehold property)			
vii	Freehold Property	Dr.	4,00,000	
	To Capital Reduction A/c			4,00,000
	(Being appreciation in the value of freehold property)			
viii	Director's Loan A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being director's loan waived in full)			
ix	Capital Reduction A/c	Dr.	13,37,500	
	To Deferred Revenue Expenditure			25,000
	To Profit and Loss A/c			10,00,000
	To Provision of Doubtful Debts A/c			12,500

	To Inventories		50,000
	To Goodwill A/c		1,00,000
	To Trademark		50,000
	To Capital Reserve A/c		1,00,000
	(Being certain value of various assets (tangible & intangible), profit and loss account debit balance written off and balance transferred to capital reserve account as per the scheme)		

(b) Capital Reduction Account

	(₹)		(₹)
To Provision for Doubtful Debts	12,500	By Preference Share Capital	1,87,500
To Inventories	50,000	By Equity Share Capital	4,00,000
To Profit & Loss A/c To Trademark	10,00,000 50,000	By Freehold Property (50,000 + 4,00,000)	4,50,000
To Goodwill	1,00,000	By Director's Loan	3,00,000
To Deferred Revenue Expenditure	25,000		
To Capital Reserve	1,00,000		
	13,37,500		13,37,500

Balance Sheet of Bad Luck Ltd. (And Reduced)

As on 31st March 2013

Particulars	*Note No.*	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,62,500
(b) Reserves and Surplus	2	1,00,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	2,50,000
(3) Current Liabilities		
(a) Short Term borrowings	4	2,00,000
(b) Trade payable		2,50,000
		9,62,500
II. Assets		
(1) Non-current assets		
(a) Fixed assets		

Tangible assets	5	7,50,000
(2) Current assets		
(a) Inventories		1,00,000
(b) Trade receivables	6	1,12,500
Total		9,62,500

Notes to Accounts

		₹
1.	Share Capital	
	Authorised, issued and fully paid up	
	1,000 Equity shares of ₹100 each fully paid-up	1,00,000
	625, 8% Preference Share of ₹ 100 each	62,500
		1,62,500
2.	Reserve and Surplus	
	Capital Reserve	1,00,000
3.	Long Term Borrowings	
	8% Debentures ₹ (5,00,000-2,50,000)	2,50,000
4.	Short-Terms Borrowings	
	Bank Overdraft	2,00,000
5.	Tangible assets	
	Freehold Property	6,00,000
	Plant	1,50,000
		7,50,000
6.	Trade Receivables	
	Trade Receivables	1,25,000
	Less: Provision for doubtful debts	(12,500)
		1,12,500

Question 5

(a) *From the following information as on 31st March, 2013 of Bachao Insurance Co. Ltd. engaged in fire insurance business, prepare the Revenue Account, reserving 40% of the net premiums for unexpired risks and an additional reserve of ₹ 3,50,000:*

Particulars	*Amount ₹*
Reserve for unexpired risk on 31st March, 2012	*7,50,000*
Additional reserve on 31st March, 2012	*1,50,000*
Claims paid	*9,60,000*

Estimated liability in respect of outstanding claims on 31st March, 2012	*97,500*
Estimated liability in respect of outstanding claims on 31st March, 2013	*1,35,000*
Expenses of management (including ₹ 45,000 in connection with claims)	*4,20,000*
Re-insurance premium paid	*1,12,500*
Re-insurance recoveries	*30,000*
Premiums	*16,80,000*
Interest and dividend	*75,000*
Profit on sale of investments	*15,000*
Commission	*1,75,000*

(8 Marks)

(b) The following information is available in the books of X Bank Limited as on 31st March, 2013:

	₹
Bills discounted	*1,37,05,000*
Rebate on bills discounted (as on 1-4-2012)	*2,21,600*
Discount received	*10,56,650*

Details of bills discounted are as follows:

Value of Bills (₹)	*Due Date*	*Rate of Discount*
18,25,000	*05-06-2013*	*12%*
50,00,000	*12-06-2013*	*12%*
28,20,000	*25-06-2013*	*14%*
40,60,000	*06-07-2013*	*16%*

Calculate the rebate on bills discounted as on 31-3-2013 and give necessary Journal Entries in the books of X Bank Ltd. as on 31st March, 2013. *(8 Marks)*

Answer

(a) FORM B– RA

Name of the Insurer: Bachao Insurance Company Limited

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

Revenue Account for the year ended 31st March, 2013

Particulars	*Schedule*	*Amount (₹)*
Premium earned (net)	1	14,90,500
Profit on sale of investment		15,000
Others		–
Interest and dividend (gross)		75,000
Total (A)		15,80,500

Claims incurred (Net)	2	10,12,500
Commission	3	1,75,000
Operating expenses related to insurance	4	3,75,000
Total (B)		15,62,500
Operating profit from insurance business (A) – (B)		18,000

Schedule –1 Premium earned (net)

	₹
Premium received	16,80,000
Less: Premium on reinsurance ceded	(1,12,500)
Net Premium	15,67,500
Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.)	(77,000)
Total premium earned	14,90,500

Schedule -2 Claims incurred (net)

	₹
Claims paid	9,60,000
Add: Expenses regarding claims	45,000
	10,05,000
Less: Re-insurance recoveries	(30,000)
	9,75,000
Add: Claims outstanding as on 31st March, 2013	1,35,000
	11,10,000
Less: Claims outstanding as on 31st March, 2012	(97,500)
	10,12,500

Schedule -3 Commission

	₹
Commission paid	1,75,000

Schedule-4 Operating expenses related to Insurance Business

	₹
Expenses of management (₹4,20,000 – ₹45,000)	3,75,000

Working Note:

Calculation for change in Reserve for Unexpired risk:

		₹
Reserve for Unexpired Risk as on 31st March, 2013	6,27,000	
Additional Reserve as on 31st March, 2013	3,50,000	9,77,000

Less: Reserve for Unexpired Risk as on 31st March, 2012	7,50,000	
Additional Reserve as on 31st March, 2012	1,50,000	(9,00,000)
		77,000

Note: Interest and dividends are shown at gross value in Revenue account. It is assumed that amount of interest and dividend given in the question is before TDS.

(b) Calculation of Rebate on bills discounted

S.No.	*Amount (₹)*	*Due date (year 2013)*	*Unexpired portion from 31st March, 2013*	*Rate of discount*	*Rebate on bills discounted (₹)*
(i)	18,25,000	June 5	66 days	12%	39,600
(ii)	50,00,000	June 12	73 days	12%	1,20,000
(iii)	28,20,000	June 25	86 days	14%	93,021
(iv)	40,60,000	July 6	97 days	16%	1,72,633
	1,37,05,000				4,25,254

Journal Entries in the books of X Bank Ltd.

	Particulars		*Dr. (₹)*	*Cr. (₹)*
(1)	Rebate on bills discounted A/c	Dr.	2,21,600	
	To Discount on bills A/c			2,21,600
	(Being the transfer of opening balance of rebate on bills discounted account to discount on bills account)			
(2)	Discount on bills A/c	Dr.	4,25,254	
	To Rebate on bills discounted A/c			4,25,254
	(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward to next year)			
(3)	Discount on bills A/c	Dr.	8,52,996	
	To Profit and Loss A/c			8,52,996
	(Being the amount of income for the year transferred from Discount on bills A/c to Profit and Loss A/c)			

Working Note:

Amount of discount to be credited to the Profit and Loss Account

	₹
Transfer from Rebate on bills discounted A/c as on 31st March, 2012	2,21,600
Add: Discount received during the year ended 31st March, 2013	10,56,650
	12,78,250
Less: Rebate on bills discounted as on 31st March, 2013	(4,25,254)
Discount credited to Profit and Loss Account	8,52,996

Question 6

(a) *ABCD Ltd., Delhi has a branch in New York, USA, which is an integral foreign operation of the company. At the end of 31st March, 2013, the following ledger balances have been extracted from the books of the Delhi office and the New York Branch:*

Particulars	Delhi (₹ thousands)		New York ($ thousands)	
	Debit	Credit	Debit	Credit
Share Capital		1,250		
Reserves and Surplus		940		
Land	475			
Building (cost)	1,000			
Buildings Depreciation Reserve		200		
Plant & Machinery (cost)	2,000		100	
Plant & Machinery Depreciation Reserve		500		20
Trade receivables/payables	500	270	60	20
Stock (01-04-2012)	250		25	
Branch Stock Reserve		65		
Cash & Bank Balances	125		4	
Purchases/Sales	275	600	25	125
Goods sent to Branch		1,500	30	
Managing Director's salary	50			
Wages & Salaries	100		18	
Rent			6	
Office Expenses	25		12	
Commission receipts		275		100
Branch/H.O. Current A/c	800			15
Total	5,600	5,600	280	280

The following information is also available:

(1) *Stock as at 31-03-2013*

Delhi - ₹ 2,00,000

New York - $ 10 (all stock received from Delhi)

(2) *Head Office always sent goods to the Branch at cost plus 25%.*

(3) *Provision is to be made for doubtful debts at 5%.*

(4) *Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down values.*

You are required:

(a) To convert the branch Trial Balance into rupees, using the following rates of exchange:

Exchange:

Opening rate 1 $ = ₹50

Closing rate 1 $ = ₹55

Average rate 1 $ = ₹52

For fixed assets 1 $ = ₹45

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 2013, showing to the extent possible, Head Office results and Branch results separately. (16 Marks)

Answer

(a) ABCD Ltd.

New York Branch Trial Balance

As on 31st March 2013

	($ '000)				*(₹'000)*
	Dr.	*Cr.*	*Conversion rate per $*	*Dr.*	*Cr.*
Plant & Machinery (cost)	100		₹45	4,500	
Plant & Machinery Dep. Reserve		20	₹45		900
Trade receivable/payable	60	20	₹55	3,300	1,100
Stock (1.4.2012)	25		₹50	1,250	
Cash & Bank Balances	4		₹55	220	
Purchase / Sales	25	125	₹52	1,300	6,500
Goods received from H.O.	30		Actual	1,500	
Wages & Salaries	18		₹52	936	
Rent	6		₹52	312	
Office expenses	12		₹52	624	
Commission Receipts		100	₹ 52		5,200
H.O. Current A/c		15	Actual		800
				13,942	14,500
Exchange loss (bal. fig.)				558	
	280	280		14,500	14,500
Closing stock	.010		₹55	0.55	

(b) Trading and Profit & Loss Account
for the year ended 31st March, 2013

									(₹000)
		H.O.	*Branch*	*Total*			*H.O.*	*Branch*	*Total*
To	Opening Stock	250	1,250.00	1,500.00	By	Sales	600	6,500.00	7,100.00
To	Purchases	275	1,300.00	1,575.00	By	Goods sent to Branch	1,500	–	1,500.00
To	Goods received from Head Office	–	1,500.00	1,500.00	By	Closing Stock	200	0.55	200.55
To	Wages & Salaries	100	936.00	1,036.00					
To	Gross profit c/d	1,675	1,514.55	3,189.55					
		2,300	6,500.55	8,800.55			2,300	6,500.55	8,800.55
To	Rent	–	312.00	312.00	By	Gross profit b/d	1,675	1,514.55	3,189.55
To	Office expenses	25	624.00	649.00	By	Commission receipts	275	5,200.00	5,475.00
To	Provision for doubtful debts @ 5%	25	165.00	190.00					
To	Depreciation (W. N. 1)	380	720.00	1,100.00					
To	Balance c/d	1,520	4,893.55	6,413.55					
		1,950	6,714.55	8,664.55			1,950	6,714.55	8,664.55
To	Exchange loss			558.00	By	Balance b/d			6,413.55
To	Managing Director's Salary			50.00	By	Branch Stock Reserve (W. N. 2)			64.89
To	Balance c/d			5,870.44					
				6,478.44					6,478.44

Working Notes:

(1) Calculation of Depreciation

	H.O *₹'000*	*Branch* *₹'000*
Building – Cost	1,000	
Less : Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,000	4,500
Less : Dep. Reserve	(500)	(900)
	1,500	3,600
Depreciation @ 20% (B)	300	720
Total Depreciation (A+B)	380	720

(2) Calculation of Additional Branch Stock Reserve

	(₹'000)
Closing stock of Branch	0.55
Reserve on closing stock (0.55 × 1/5)	0.11
Less : Branch Stock Reserve (as on 1.4.2012)	(65)
Reversal of Stock Reserve	(64.89)

Question 7

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

(a) Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2013.

(b) *Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non-monetary item:*

(i) *Share Capital*

(ii) *Trade Receivables*

(iii) *Investments*

(iv) *Fixed Assets.*

(c) *Department A sells goods to Department B at a profit of 50% on cost and to Department C at 20% on cost. Department B sells goods to A and C at a profit of 25% and 15% respectively on sales. Department C charges 30% and 40% profit on cost to Department A and B respectively.*

Stock lying at different departments at the end of the year are as under:

	Department A	*Department B*	*Department C*
	₹	₹	₹
Transfer from Department A	-	*45,000*	*42,000*
Transfer from Department B	*40,000*	-	*72,000*
Transfer from Department C	*39,000*	*42,000*	-

Calculate the unrealized profit of each department and also total unrealized profit.

(d) *Explain Garner V/S Murrary rule applicable in the case of partnership firms. State, when is this rule not applicable.*

(e) *What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?* *(4 ×4 = 16 Marks)*

Answer

(a) (i) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31st March, 2013 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2013) are presented in the bank in the month of April, 2013 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(ii) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2013, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2013 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

(b) As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

(c) Calculation of unrealized profit of each department and total unrealized profit

	Dept. A	*Dept. B*	*Dept. C*	*Total*
	₹	₹	₹	₹
Unrealized Profit of:				
Department A		45,000 x 50/150 = 15,000	42,000 x 20/120 = 7,000	22,000
Department B	40,000 x .25 = 10,000		72,000 x .15= 10,800	20,800
Department C	39,000 x 30/130 = 9,000	42,000 x 40/140 = 12,000		21,000
				63,800

(d) Garner vs. Murray rule

When a partner is unable to pay his debt due to the firm, he is said to be insolvent and the share of loss is to be borne by other solvent partners in accordance with the decision held in the English case of Garner vs. Murray. According to this decision, normal loss on realisation of assets is to be brought in cash by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in their capital ratio. In order to calculate the capital ratio, no adjustment will be made in case of fixed capitals. However, in case of fluctuating capitals, ratio should be calculated on the basis of adjusted capital before considering profit or loss on realization at the time of dissolution.

Non-Applicability of Garner vs Murray rule:

1. When the solvent partner has a debit balance in the capital account.

   Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.

2. When the firm has only two partners.

3. When there is an agreement between the partners to share the deficiency in capital account of insolvent partner.

4. When all the partners of the firm are insolvent.

(e) The qualitative characteristics of financial statements which improve the usefulness of information provided in financial statements are as follows:

1. Understandability: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities.

2. Relevance: The financial statements should contain relevant information only which influences the economic decisions of the users.

3. Reliability: To be useful, the information must be reliable; that is to say, they must be free from material error and bias.

4. Comparability: The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

5. True and Fair view: Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise.