

MOCK TEST PAPER – 1
INTERMEDIATE (IPC): GROUP – II
PAPER – 5: ADVANCED ACCOUNTING
SUGGESTED ANSWERS/HINTS

1. (a) 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 the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

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

- (b) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS 29.

- (c) Adjusted net profit for the current year

	₹
Net profit for the current year (assumed to be after tax)	5,00,00,000
Add: Interest expense for the current year	13,75,000
Less: Tax relating to interest expense (30% of ₹ 13,75,000)	<u>(4,12,500)</u>
Adjusted net profit for the current year	<u>5,09,62,500</u>

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

Weighted Average Number of Equity Shares

Number of equity shares resulting from conversion of debentures:

$$1,25,000 \text{ debentures} \times 8 = 10,00,000 \text{ shares}$$

Number of equity shares for computation of diluted EPS:

$$1,00,00,000 + 10,00,000 = 1,10,00,000 \text{ shares}$$

Computation of diluted earnings per share

$$\begin{aligned} \text{Diluted earnings per share} &= \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}} \\ &= (5,09,62,500 / 1,10,00,000) = ₹ 4.63 \text{ (approx.)} \end{aligned}$$

(d)

In the books of Gunshot Ltd.

Journal Entries for Buy-back of shares

			₹	₹
(i)	Bank A/c To Non-trade Investments To Profit & Loss A/c (Being the entry for sale of Non-trade Investments)	Dr.	3,20,000	3,00,000 20,000
(ii)	Shares Buy back A/c (16,000 x ₹ 20) To Bank A/c (Being purchase of 16,000 shares @ ₹ 20 per share)	Dr.	3,20,000	3,20,000
(iii)	Equity Share Capital A/c (16,000 x ₹ 10) Buy-back Premium (16,000 x ₹ 10) To Shares Buy-back A/c (Being cancellation of shares bought back)	Dr. Dr.	1,60,000 1,60,000	3,20,000
(iv)	Securities Premium A/c General Reserve To Buy-back Premium (Being adjustment of buy-back premium)	Dr. Dr.	1,00,000 60,000	1,60,000
(v)	General Reserve To Capital Redemption Reserve (Being the entry for transfer of General Reserve to Capital Redemption Reserve to the extent of face value of equity shares bought back)	Dr.	1,60,000	1,60,000

2.

Journal Entries in the books of Weak Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr. To Equity Share Capital (₹ 40) A/c To Capital Reduction A/c (Being conversion of equity share capital of ₹ 100 each into ₹ 40 each as per reconstruction scheme)	1,00,00,000	40,00,000 60,00,000
(ii)	12% Cumulative Preference Share capital (₹ 100) A/c Dr. To 12% Cumulative Preference Share Capital (₹ 60) A/c To Capital Reduction A/c (Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)	50,00,000	30,00,000 20,00,000
(iii)	10% Debentures A/c (40,000 @ ₹ 100) Dr. To 12% Debentures A/c (40,000 @ ₹ 70) To Capital Reduction A/c (40,000 x ₹ 30) (Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)	40,00,000	28,00,000 12,00,000
(iv)	Creditors A/c Dr. To Equity Share Capital A/c (30,000 @ ₹ 40) To Capital Reduction A/c (Being a creditor of ₹ 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)	20,00,000	12,00,000 8,00,000
(v)	Provision for Taxation A/c Dr. Capital Reduction A/c Dr. To Liability for Taxation A/c (Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)	1,00,000 50,000	1,50,000
(vi)	Capital Reduction A/c Dr. To P & L A/c	99,50,000	6,00,000

	To Fixed Assets A/c		37,50,000
	To Current Assets A/c		55,00,000
	To Investments A/c		50,000
	To Capital Reserve A/c		50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)		
(vii)	Liability for Taxation A/c Dr.	1,50,000	
	To Current Assets (Bank A/c)		1,50,000
	(Being the payment of tax liability)		

Balance Sheet of Weak Ltd. (and reduced) as on 31.3.2012

Particulars		Notes	₹
Equity and Liabilities			
1	Shareholders' funds		
a	Share capital	1	82,00,000
b	Reserves and Surplus	2	50,000
2	Non-current liabilities		
a	Long-term borrowings	3	28,00,000
3	Current liabilities		
a	Trade Payables		30,00,000
	Total		1,40,50,000
Assets			
1	Non-current assets		
a	Fixed assets		
	Tangible assets	4	87,50,000
b	Investments	5	9,50,000
2	Current assets	6	43,50,000
	Total		1,40,50,000

Notes to accounts

		₹
1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
1,30,000 equity shares of ₹ 40 each		52,00,000
Preference share capital		
Issued, subscribed and paid up		
12% 50,000 Cumulative Preference shares of ₹ 60 each		30,00,000
Total		82,00,000
2. Reserves and Surplus		
Capital Reserve		50,000
3. Long-term borrowings		
Secured		
12% Debentures		28,00,000
4. Tangible assets		
Fixed Assets	1,25,00,000	
Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5. Investments	10,00,000	
Adjustment under scheme of reconstruction	(50,000)	9,50,000
6. Current assets	45,00,000	
Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:

Capital Reduction Account

	₹		₹
To Liability for taxation A/c	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative preference share capital	20,00,000

To Fixed assets	37,50,000	By 10% Debentures	12,00,000
To Current assets	55,00,000	By Sundry creditors	8,00,000
To Investment	50,000		
To Capital Reserve (bal. fig.)	<u>50,000</u>		<u> </u>
	<u>1,00,00,000</u>		<u>1,00,00,000</u>

3. (a) Departmental Trading Account for the year ended on 31st March, 2013

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To Opening Stock	11,520	8,640	12,240	By Sales	2,44,800	5,18,400	7,48,800
To Purchases	96,000	2,16,000	2,88,000	By Closing Stock	9,600	17,280	720
To Gross Profit	<u>1,46,880</u>	<u>3,11,040</u>	<u>4,49,280</u>		<u> </u>	<u> </u>	<u> </u>
	<u>2,54,400</u>	<u>5,35,680</u>	<u>7,49,520</u>		<u>2,54,400</u>	<u>5,35,680</u>	<u>7,49,520</u>

Working Notes:

(1) Profit Margin Ratio	
Selling price of unit purchased:	₹
Department A (6,000 x 40)	2,40,000
Department B (12,000 x 45)	5,40,000
Department C (14,400 x 50)	<u>7,20,000</u>
Total Selling Price	15,00,000
Less: Purchase (Cost) Value	<u>6,00,000</u>
Gross Profit	<u>9,00,000</u>
Profit Margin Ratio = $\frac{9,00,000}{15,00,000} \times 100 = 60\%$	

(2) Statement showing department-wise per unit Cost and Purchase Cost

	A	B	C
Selling Price (Per unit) (₹)	40	45	50
Less: Profit Margin @ 60% (₹)	<u>24</u>	<u>27</u>	<u>30</u>
Purchase price per unit (₹)	<u>16</u>	<u>18</u>	<u>20</u>
Number of units purchased	6,000	12,000	14,400
(Purchase cost per unit x Units purchased)	96,000	2,16,000	2,88,000

- (3) Statement showing calculation of department-wise Opening Stock (in Units)

	A	B	C
Sales (Units)	6,120	11,520	14,976
Add: Closing Stock (Units)	<u>600</u>	<u>960</u>	<u>36</u>
	6,720	12,480	15,012
Less: Purchases (units)	<u>6,000</u>	<u>12,000</u>	<u>14,400</u>
Opening Stock (Units)	<u>720</u>	<u>480</u>	<u>612</u>

- (4) Statement showing department-wise cost of Opening Stock and Closing Stock

	A	B	C
Cost of Opening Stock (₹)	(720 x 16)	(480 x 18)	(612 x 20)
₹	11,520	8,640	12,240
Cost of Closing Stock	(600 x 16)	(960 x 18)	(36 x 20)
₹	9,600	17,280	720

- (b) Liability of Underwriters (No. of Shares)

	Total	X	Y	Z	T
Gross Liability	10,00,000	3,00,000	3,00,000	2,00,000	2,00,000
Less : Marked Application	<u>(5,80,000)</u>	<u>(1,90,000)</u>	<u>(1,00,000)</u>	<u>(2,10,000)</u>	<u>(80,000)</u>
	4,20,000	1,10,000	2,00,000	(10,000)	1,20,000
Less: Surplus of Z allotted to X,Y & T in their gross liability ratio (30:30:20)		<u>(3,750)</u>	<u>(3,750)</u>	<u>10,000</u>	<u>(2,500)</u>
	4,20,000	1,06,250	1,96,250	-	1,17,500
Less: Unmarked Applications (700000 – 580000) in their gross liability ratio	<u>(1,20,000)</u>	<u>(36,000)</u>	<u>(36,000)</u>	<u>(24,000)</u>	<u>(24,000)</u>
	3,00,000	70,250	1,60,250	(24,000)	93,500
Less: Surplus of Z allotted to X,Y & T in their gross liability ratio (30:30:20)	-	<u>(9,000)</u>	<u>(9,000)</u>	<u>24,000</u>	<u>(6,000)</u>
	3,00,000	61,250	1,51,250	-	87,500
Less: Firm Underwriting (A)	<u>(70,000)</u>	<u>(30,000)</u>	<u>(20,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>
	2,30,000	31,250	1,31,250	(10,000)	77,500

Less: Surplus of Z allotted to X,Y & T in their gross liability ratio (30:30:20)		(3,750)	(3,750)	10,000	(2,500)
Net liability excluding firm underwriting	2,30,000	27,500	1,27,500	-	75,000
Add: Firm Underwriting (A)	70,000	30,000	20,000	10,000	10,000
Total Liability including firm underwriting	3,00,000	57,500	1,47,500	10,000	85,000

4. (a)

Sona Bank Ltd.

(i) Profit and Loss Account for the year ended 31st March, 2013

	Schedule No.	(₹ in thousands)
Income: Interest earned (8,860 – 30)	13	8,830
Other income	14	<u>250</u>
		<u>9,080</u>
Expenditure: Interest expended	15	2,720
Operating expenses	16	2,662
Provision and Contingencies		<u>2,004</u>
		<u>7,386</u>
Net Profit/Loss for the year		<u>1,694</u>

(ii) Calculation of provision in respect of advances

Assets	Value	% of provision	Provision
Standard Assets	5,000	0.40	20.00
Sub-standard Assets	1,120	15	168.00
Doubtful Assets			
100% unsecured	200	100	200.00
Secured:			
Less than 1 year	50	25	12.50
More than 1 year but less than 3 years	300	40	120.00
More than 3 years	300	100	300.00
Loss Assets	200	100	<u>200.00</u>
Total Provision			<u>1,020.50</u>

(b)

FORM B– RA

Name of the Insurer: Beta 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	10,85,000
Profit or loss on sale/redemption of investment		11,000
Others		
Interest, dividend & rent (Gross)		<u>64,250</u>
Total (A)		<u>11,60,250</u>
Claim incurred (Net)	2	6,95,000
Commission	3	1,52,000
Operating expenses related to insurance	4	<u>2,50,000</u>
Total (B)		<u>10,97,000</u>
Operating profit/loss from insurance business		<u>63,250</u>

Schedule –1 (Premium earned net)

₹

Premium received	11,20,000
Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.)	<u>35,000</u>
Total premium earned	<u>10,85,000</u>
Schedule -2 (Claims incurred net)	
Claim paid	6,40,000
Add: Legal expenses regarding claims	<u>30,000</u>
	6,70,000
Add: Claims outstanding as on 31 st March, 2013	<u>90,000</u>
	7,60,000
Less: Claims outstanding as on 31 st March, 2012	<u>65,000</u>
	<u>6,95,000</u>
Schedule-3 (Commission)	
Commission paid	1,52,000
Schedule-4 (Operating expenses related to Insurance Business)	
Expenses of management (2,80,000 – 30,000)	2,50,000

Working Note:

Calculation for change in Reserve for Unexpired risk:		₹
As on 31 st March, 2013:		
Reserve for Unexpired Risk	5,60,000	
Additional Reserve	<u>75,000</u>	6,35,000
Less: Reserve for Unexpired risks as on 31 st March, 2012	5,00,000	
Additional reserve as on 31 st March, 2012	<u>1,00,000</u>	<u>6,00,000</u>
		<u>35,000</u>

Note: Interest and dividends are shown at gross value in Revenue A/c. Income tax on the above will not be included in revenue A/c of an insurance company as it is the part of Profit and Loss A/c.

5. Branch Stock Account

Particulars	₹	Particulars	₹
To Balance b/d	12,000	By Cash A/c (Cash sales)	20,000
To Goods sent to Branch A/c	35,000	By Branch Debtors (credit sales)	21,000
To Branch Debtors (Sales Returns)	600	By Goods sent to Branch A/c (Returns)	1,000
		By Shortage of goods	400
		By Balance c/d (Bal. fig.)	5,200
	<u>47,600</u>		<u>47,600</u>

Branch Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	6,200	By Branch stock A/c (Sales Returns)	600
To Branch Stock (Credit sales)	21,000	By Cash A/c	19,800
		By Discount	300
		By Balance c/d (Bal. fig.)	6,500
	<u>27,200</u>		<u>27,200</u>

Branch Expenses Account

Particulars	₹	Particulars	₹
To Cash A/c	6,100	By Branch P/L A/c (Bal. fig.)	6,400
To Discount A/c	300		
	<u>6,400</u>		<u>6,400</u>

Goods Sent to Branch Account			
Particulars	₹	Particulars	₹
To Branch Stock A/c (Returns)	1,000	By Branch Stock A/c	35,000
To Branch Adjustment A/c (Loading) (35,000 × 30%)	10,500	By Branch Adj. A/c (Loading) (1,000 × 30%)	300
To Trading A/c (Bal. fig.)	23,800		
	35,300		35,300
Branch Adjustment Account			
Particulars	₹	Particulars	₹
To Shortage of goods (Loading) (400 × 30%)	120	By Branch Stock Reserve (12,000 × 30%)	3,600
To Branch Stock Reserve A/c (5,200 × 30%)	1,560	By Goods sent to Branch (Net loading) (10,500 – 300)	10,200
To Gross profit transferred to P/L A/c (Bal. fig.)	12,120		
	13,800		13,800
Branch Profit and Loss Account			
Particulars	₹	Particulars	₹
To Branch Expenses A/c	6,400	By Gross Profit transferred from Branch Adjustment A/c	12,120
To Shortage of Goods (cost) (400 × 70%)	280		
To Net Profit	5,440		
	12,120		12,120

6.

Realisation Account

Particulars	Amount	Particulars	Amount
To Debtors	48,000	By Creditors	48,000
To Stock	60,000	By Cash (Assets realized)	
To Fixtures	24,000	Plant and Machinery	1,02,000
To Plant and machinery	1,08,000	Fixtures	18,000
To Cash (Creditors) A/c (48,000 – 5% × 48,000)	45,600	Stock	84,000
To Cash A/c (Bills for sales tax)	4,200	Sundry Debtors	44,400
To Cash A/c (Realisation)	1,500	Mike (Unrecorded assets)	4,800
		By	

expenses)			
To Profit on Realisation			
Tinuu 3,960			
Mike 3,960			
Shine <u>1,980</u>			
		<u>9,900</u>	
		<u>3,01,200</u>	<u>3,01,200</u>

Partners' Capital Accounts

Particulars	Tinu	Mike	Shine	Particulars	Tinu	Mike	Shine
To Realisation (unrecorded assets)		4,800		By Balance	1,20,000	48,000	24,000
				By b/d	24,000	24,000	12,000
				By Reserve fund Realisation			
To Cash (Bal. Fig.)	<u>1,47,960</u>	<u>71,160</u>	<u>37,980</u>	By (Profit)	<u>3,960</u>	<u>3,960</u>	<u>1,980</u>
	<u>1,47,960</u>	<u>75,960</u>	<u>37,980</u>		<u>1,47,960</u>	<u>75,960</u>	<u>37,980</u>

Cash Account

Particulars	Amount	Particulars	Amount
To Balance c/d	60,000	By Realisation A/c (Creditors)	45,600
To Realisation A/c (Assets)	2,48,400	By Realisation A/c (Expenses)	1,500
		By Realisation (Sales Tax)	4,200
		Tinuu's Capital A/c	1,47,960
		Mike's Capital A/c	71,160
		Shine's Capital A/c	<u>37,980</u>
	<u>3,08,400</u>		<u>3,08,400</u>

Note: An unrecorded asset is in the nature of gain hence realization account is credited. Since these assets have been taken over by Mike, his account has been debited.

7. (a) In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to paras 41 to 43 of AS 26 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.
- (b) A liability shall be classified as current when it satisfies any of the following criteria:

- (a) it is expected to be settled in the company's normal operating cycle;
- (b) it is held primarily for the purpose of being traded;
- (c) it is due to be settled within twelve months after the reporting date; or
- (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of twelve months.

- (c) The error in the recording of closing stock of the year ended 31st March, 2013 must have also resulted in overstatement of profits of previous year, brought forward to the current year ended 31st March, 2014. Vide para 4 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the rectifications is required in the current year as 'Prior Period Item'. Accordingly, ₹ 20,000 should be deducted from opening stock in the trading account and should be charged as prior period adjustment in the profit and loss account for the year ended 31st March 2014 in accordance with para 15 of AS 5 (Revised) which requires that the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.
- (d) Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2012-13 should be calculated as follows:

	₹ in crores
Actual interest for 2012-13 (11% of ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 2012-13	13.00

- (e) If a partner goes insolvent then the following are the consequences:

1. The partner adjudicated as insolvent ceases to be a partner.
2. He ceases to be a partner on the date on which the order of adjudication is made.
3. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
4. The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and
5. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.