CA-IPCC November 2014

ADVANCED ACCOUNTS

QUESTION & SOLUTION

By

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Total No. of Questions – 7 Time Allowed - 3 Hours Maximum Marks -100

Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his answers in Hindi will not be valued.

Question No. 1 is compulsory.

Candidates are also required to answer any five questions from the remaining six questions.

Wherever appropriate, suitable assumptions should be made and indicated in answer by the candidate. Working notes should form part of the answer.

Marks

1. (a) 5

A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are Rs. 7,00,000. The amount will be paid in 4 equal installments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of 4th year is Rs.70,000. The IRR of the investment is 10%. The present value of annuity factor of Rs.1 due at the end of 4th year at 10% IRR is 3.169. The present value of Rs.1 due at the end of 4th year at 10% rate of interest is 0.683. State with reason whether the lease constitutes finance lease and also compute the unearned finance income.

(b) 5

A company is showing an intangible asset at ` 88 lakhs as on 1-4-2013. This asset was acquired for ` 120 lakhs on 1-4-2009 and the same was available for use from that date. The company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting standard.

(c) 5

Stem Ltd. purchased a plant for US $ 30,000 on 30th November, 2013 payable after 6 months. The company entered into a forward contract for 6 months @ ` 62.15 per dollar. On 30th November, 2013, the exchange rate was ` 60.75 per dollar.

How will you recognize the profit or loss on forward contract in the books of Stem Limited for the year ended 31st March, 2014.

(d) 5

WZW Ltd.is in dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ` 1000 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?

2. 16

P and Q were carrying on business sharing profits and losses equally. The firm's Balance Sheet as at 31.12.2013 was:

Liabilities	`	Assets	`
Sundry Creditors	80,000	Building	48,000
Bank overdraft	45,000	Plant	1,60,000
Capital Accounts:		Debtors	75,000
P 1,50,000		Joint Life Policy	6,000
Q 1,30,000	2,80,000	Stock	70,000
		Profit & Loss A/c	30,000
		Drawings Accounts:	
		P 9000	
		Q 7000	16,000
Total	4,05,000	Total	4,05,000

The operations of the business were carried on till 30.6.2014. P & Q both withdrew in equal amounts half the amount of profits made during the current period of six months after charging depreciation at 10% p.a. on plant and after writing off 5% on building.

During the current period of six months, creditors were reduced by ` 20,000 and bank overdraft by ` 5,000.

The joint life policy was surrendered for Rs.6000 before 30th june 2014. Stock was valued at ` 84,000 and debtors at ` 68,000 on 30th june 2014. The other items remained the same as at 31.12.2013.

On 30.6.2014, the firm sold the business to PQ Ltd. The value of goodwill was estimated at ` 1,30,000 and the remaining assets were valued on the basis of the balance Sheet as on 30.6.2014.

PQ Ltd. paid the purchase consideration in Equity Shares of ` 10 each.
You are required to prepare:
(a) Balance Sheet of the firm as at 30.6.2014,
(b) Realisation account,
(c) Partners' Capital Accounts showing the final settlement between them.

3 (a) 8

X Ltd. granted 500 stock options to its employees on 1.4.2011 at ` 50 per share. The vesting period is two and a half years and the maximum exercise period is one year. Market price on that date is ` 140 per share. All the options were exercised on 31.6.2014. Pass journal entries giving suitable narrations, if the face value of equity share is ` 10 per share.

(b) 8

Venus Limited recently made a public issue in respect of which the following information is available:
(i) No. of partly convertible debentures issued 4,00,000; face value and issue price ` 100 per debenture.
(ii) Convertible portion per debenture -80%, date of conversion on expiry of 7 months from the date of closing of issue.
(iii) Date of closure of subscription lists -1.6.2013, date of allotment 1.7.2013, Rate of interest on debenture -10%p.a. payable from the date of allotment. Value of equity share for the purpose of conversion -` 40 (Face Value ` 10).
(iv) Underwriting Commission -3%.
(v) No. of debentures applied for -3,00,000.
(vi) Interest payable on debentures –half yearly on 30th September and 31st March.
Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2014 (including cash and bank entries).

4. 16

The Balance Sheet of X Ltd. as at 31st March, 2014 was as follows:

	Particulars	Amount(Rs.)
I	**Equity and liabilities**	
1	Share holder's fund	

	Share capital		
	(a) 40,000 Equity shares of ` 100 each fully paid		40,00,000
	(b)20,000,10% preference shares of ` 100 each fully paid		20,00,000
	Reserves & Surplus		
	(a)Securities Premium Account		1,50,000
	(b) Profit & Loss Account		(23,00,000)
2	Non-current Liabilities		
	Long term Borrowings		
	7% Debentures of Rs.100 each		4,00,000
3	Current Liabilities		
	Other Current Liabilities		
	(a)Creditors		10,00,000
	(b)Loan from director		2,00,000
	Total Liabilities		54,50,000
II	**Assets**		
1	Non Current Assets		
	Fixed Assets		
	(a)Land &Building	20,00,000	
	(b)Plant&Machinery	12,00,000	32,00,000
	Intangible Assets		
	Goodwill		4,00,000
2	Current Assets		
	(a)Debtors	12,00,000	
	(b)Stock	5,00,000	
	(c)Cash at bank	1,50,000	18,50,000
	Total Assets		54,50,000

No dividend on Preference shares has been paid for the last 5 years.
The following scheme of reorganization was duly approved by the court:
(i) Each Equity share to be reduced to ` 25.
(ii) Each existing Preference share to be reduced to ` 75 and then exchanged for 1 new 13% Preference share of ` 50 each and 1 Equity share of ` 25 each.
(iii) Preference shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity Shares of ` 25.
(iv) The Debenture holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of ` 50 each issued at par. One- fourth (in value) of the debenture holders accepted Preference shares for their claims. The rest were paid cash.
(v) Contingent liability of ` 2,00,000 is payable, which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the company.
(vi) Goodwill does not have any value in the present. Decrease the value of Plant and Machinery, Stock and Debtors by ` 3,00,000;` 1,00,000 and ` 2,00,000 respectively. Increase the value of Land and Buildings to ` 25,00,000.
(vii) 50,000 new Equity shares of ` 25 each are to be issued at par, payable in full on application. The issue was underwritten for a commission of 4%. Shares were fully taken up.
(viii) Total expenses incurred by the company in connection with the Scheme excluding Underwriting commission amounted to ` 20,000.
Pass necessary Journal Entries to record the above transactions.

5(a) 8

Metro General Insurance Company submits the following information for the year ended 31st Mar 2014:

Particulars	Direct Business `	Reinsurance `
Premium received	75,25,000	8,25,000
Premium paid	---	4,90,000
Claims paid during the year	49,70,000	5,10,000
Claims payable 1st April, 2013	6,85,000	95,000
31st March, 2014	7,38,000	70,000
Claims received	---	3,95,000

Claims receivable 1st April, 2013	-	75,000
31st March, 2014	-	1,25,000
Expenses of management	2,90,000	-
Commission:		
On insurance accepted	1,60,000	15,000
On insurance ceded	-	18,000

The following additional information is also available:
(1) Expenses of management include ` 45,000 surveyor's fee and ` 55,000 legal expenses for settlement of claims.
(2) Reserve for unexpired risk is to be maintained @ 40%. The balance of reserve for unexpired risk as on 1.4.13 was ` 28,40,000.
You are required to prepare the Revenue Account for the year ended 31st March, 2014.

(b) 8

A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk adjusted asset and risk weighted assets ratio. State your observation on the risk weighted asset ratio.

Particulars	Amount(` in crores)
Equity share capital	400.00
Statutory reserve	250.00
Capital reserve (of which ` 18 crores were due to revaluation of assets and the balance due to sale of capital asset)	86.00
Assets:	
Cash balance with RBI	12.00
Balance with other banks	20.00
Other investments	40.00
Loans and advances:	
(i) Guaranteed by the Government	14.50
(ii) Others	5,465.00
Premises, furniture and fixtures	74.00
Off-Balance Sheet items:	
(i) Guarantee and other obligations	700.00
(ii) Acceptances, endorsements and letter of credit	4,900.00

6 (a) 8

LMN is having its Branch at Mumbai. Goods are invoiced to the branch at 25% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch. From the following particulars prepare branch account in the books of Head Office.

Particulars	(`)	Amount	(`)
Stock on 1st April 2013(Invoice Price)	40,000	Discount allowed to debtors	300
Sundry Debtors as on 1st April, 2013	25,000	Expenses paid by head office:	
Cash in hand as on 1st April, 2013	1,000	Salary	4000
Office furniture as on 1st April, 2013	4,000	Staff Welfare	750
Goods invoiced from the head office (invoice price)	1,80,000	Telephone Expenses	1200
Goods return to Head Office	6,000	Other misc. expenses paid by branch	700
Goods return by debtors	1,250	Stock as on 31st March,2014(at invoice price)	35,000
Cash received from debtors	65,000	Depreciation to be provided on branch furniture	10% p.a.
Cash Sales	1,20,000		
Credit sales	70,000		

(b) 8

Mega Ltd. has two departments A and B. From the following particulars, prepare departmental trading accounts and General profits& loss account for the year ending 31st March, 2014:

Particulars	Department A(Rs.)	Department B(Rs.)
Opening stock (at cost)	70,000	54,000
Purchases	3,92,000	2,98,000
Carriage inward	6,000	9,000

Wages	54,000	36,000
Sales	5,72,000	4,60,000
Purchased goods transferred		
By department B to A	50,000	
By department A to B		36,000
Finished goods transferred		
By department B to A	1,50,000	-
By department A to B	-	1,75,000
Return of finished goods		
By department B to A	45,000	-
By department A to B	-	32,000
Closing stock		
Purchased goods	24,000	30,000
Finished goods	1,02,000	62,000

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 30% of the closing finished stock with each department represents finished goods received from the other department.

7. Answer any four of the following:

(a) 4

Give two examples of each of the following items:

(i) Change in accounting Policy

(ii) Change in Accounting Estimate

(iii) Extra Ordinary Item

(iv) Prior Period Item

(b) 4

What are the indicators of Non-Integral Foreign Operation(NFO)?

(c) 4

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii)Equity Shares issued as a result of conversion of a debt instrument,

(iii)Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv)Equity shares issued for rendering of services to the enterprises,

(v) Equity Shares issued in lieu of interest and/or principal of an other financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash,

Also define Potential Equity Share.

(d) 4

Find out the income to be recognized by ABC Bank Ltd. for the year ended 31st March,2014 in respect of interests on advances(Rs. In Lakhs) as detailed below:

	Performing Asset		N.P.A.	
	Interest earned	Interest received	Interest earned	Interest received
Term loan	280	180	170	20
Cash credits and overdrafts	1700	1630	310	48
Bills purchased & Discounted	400	400	180	70

(e) 4

State any four alternative accounting treatment of the fund received by an Electricity Company from consumer towards capital expenditure/service line contributions.

SOLUTIONS

Ans. 1 (a)

(i) Finance or Operating Lease

Lease period as % of useful life = 4 x 100 / 6 = 66.66%

At the end of lease term, the machinery will revert back to lessor.

Cost of the machinery	7,00,000
(-) Present Value of Unguaranteed Residual Value (70000x.683)	(47810)

Present Value of Minimum Lease Payment	6,52,190
Fair Value of the Machinery	7,00,000

PV of MLP as % of FV = 652190 x100 /700000 = 93.17%

The PV of MLP (more than 90%) covers substantially Fair Value, therefore lease constitute Finance Lease.

(ii) Unearned Finance Income

Annual Lease Payment = 652190 / 3.169 = 205803

Total Lease Payment in lease period (205803 x 4)	823212
+ Unguaranteed Residual Value	70000
Gross Investment in Lease	893212
(-) Present Value of investment (652190 +47810)	(700000)
Unearned Finance Income	193212

Ans. 1 (b)

As per AS-26 "Intangible Assets", the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates of its useful life. AS-26 specifies presumption that the useful life of an intangible asset will not exceed ten years and cost of intangible assets should be amortized accordingly.

The company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis which is more than the maximum period of 10 years specified as per AS-26. Therefore the present policy of the company is not appropriate as per AS-26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 1.4.2013.

Existing carrying amount as on 01.04.2013	88
(-) Revised carrying amount as on 01.04.2013 based on AS-26 [120x(10-4)/10]	72
Excess carrying amount to be adjusted from Opening balance of P & L A/c or Revenue Reserve	16

The revised carrying amount of 72 lakhs will be amortized over remaining 6 year life @ 12 lakhs per year.

Ans. 1(c)

As per AS-11, when forward exchange contract entered to establish the amount of the reporting currency required or available at the settlement date of a transaction (not for trading or speculation purposes), the premium or discount arising at the inception of such a forward exchange contract should be amortized as expense or income over the life of the contract.

In the present case, Stem Ltd. requires foreign currency (dollar) for payment after 6 months for purchase of Plant on 30.11.13, which is not a trading or speculative transaction. Therefore premium at inception of lease will be amortized as expense over the life of contract (6 months)

Forward Rate payable after 6 months	Rs.62.15	
(-) Spot Rate on 30.11.2013		Rs.60.75
Premium Payable per US$		Rs.01.40
Total Premium Payable (US$30000x1.40)		Rs.42000
Contract Period	6 months	
Period in the year (30.11.13 – 31.03.14)		4 months

Loss on forward contract recognized for the year = 42000x4/6 = Rs.28000

Balance loss of ` 14,000 (i.e. ` 42,000 – ` 28,000) for the month of April & May 2014 will be recognised in the financial year 2014-2015.

Ans. 1(d)

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources will be required; and

(c) a reliable estimate can be made of the amount of the obligation.

Further As per AS 29, A Contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore neither it is present obligation nor there will be outflow of the resources. It is a possible obligation, existence of which will be confirmed by future event not in control of the enterprise.

The company should disclose the same as contingent liability in Annual Accounts by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ` 1000 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Ans. 2

(a) Balance Sheet of Firm as on 30.6.2014

Liabilities	`	Assets	`
Sundry Creditors	60,000	Plant	1,52,000
Bank overdraft	40,000	Building	46,800
Capital A/cs:		Stock	84,000
P 1,34,400		Debtors	68,000
Q 1,16,400	2,50,800		
	3,50,800		3,50,800

(b) Realisation Account

Particulars	`	Particulars	`
To Plant A/c	1,52,000	By Sundry Creditors A/c	60,000
To Building A/c	46,800	By Bank Overdraft A/c	40,000
To Stock A/c	84,000	By PQ Ltd. A/c (W.N.2)	3,80,800
To Sundry Debtors A/c	68,000		
To P's Capital A/c 65,000			
To Q's Capital A/c 65,000	130000		
	480800		480800

(c) Partners' Capital Accounts

Date	Particulars	P	Q	Date	Particulars	P	Q
1.1.14	To Profit & Loss A/c	15,000	15,000	1.1.14	By Balance b/d	1,50,000	1,30,000
1.1.14	To Drawings A/c	9,000	7,000	30.06.14	By Profit & Loss Appropriation A/c	16,800	16,800
30.6.14	To Drawings A/c	8,400	8,400				
30.6.14	To Balance c/d	134400	116400				
		166800	146800			166800	146800
30.6.14	To ES in PQ Ltd.(b.f.)	199400	181400	30.6.14	By Balance b/d	134400	116400
				30.6.14	By realization A/c	65000	65000
		199400	181400			199400	181400

Working Notes:

(1) Ascertainment of profit for the 6 months ended 30th June, 2014

Closing Assets:	
Stock	84,000
Sundry Debtors	68,000
Plant less depreciation (1,60,000 - 1,60,000x10%x6/12)	1,52,000
Building less written off (48,000 - 48,000x5%x6/12)	46,800
Less: Closing liabilities:	
Sundry Creditors (80000-20000)	(60,000)
Bank overdraft (45,000 -5000)	(40,000)
Closing Net Assets	2,50,800
Less: Opening combined capital: (280000-30000-16000)	(2,34,000)
Profit retained in the firm	16,800
Add: Combined drawings during the 6 months (16,800 x 50%/50%)	16,800
Profit earned during the 6 months	33,600

(2) Purchase Consideration

Closing Net Asset as per Balance Sheet	250800
+ Goodwill purchased	130000
Total PC	380800

Note: The JLP were surrendered at amount equal to book value, therefore no effect will arise on partner's capital a/c.

Ans. 3(a)

Books of X Ltd.

Date	*Particulars*	*Debit `*	*Credit `*
31.3.12	Employees Compensation Expense Account Dr. To Employees Stock Option Outstanding Account (Being compensation expense recognized in respect of 500 options granted to employees at discount of ` 90 each, amortized on straight line basis over 2½ years)	18,000	 18,000
	Profit and Loss Account Dr. To Employees Compensation Expense Account (Being employees compensation expense of the year transferred to P&L A/c)	18,000	 18,000
31.3.13	Employees Compensation Expense Account Dr. To Employees Stock Option Outstanding Account (Being compensation expense recognized in respect of 500 options granted to employees at discount of ` 90 each, amortized on straight line basis over 2½ years)	18,000	 18,000
	Profit and Loss Account Dr. To Employees Compensation Expense Account (Being employees compensation expense of the year transferred to P&L A/c)	18,000	 18,000
31.3.14	Employees Compensation Expense Account Dr. To Employees Stock Option Outstanding Account (Being balance of compensation expense amortized ` 45000 less ` 36000)	9,000	 9,000
	Profit and Loss Account Dr. To Employees Compensation Expense Account (Being employees compensation expense of the year transferred to P&L A/c)	9,000	 9,000
30.6.14	Bank Account (` 50 × 500) Dr. Employees Stock Option Outstanding Account (` 90×500) Dr. To Equity Share Capital Account (10 x 500) To Securities Premium Account (140-10)x500 (Being exercise of 500 options at an exercise price of ` 50)	25,000 45,000	 5,000 65,000

Working Notes:

1. Total employees compensation expense = 500 x (` 140 – ` 50) = ` 45,000
2. Employees compensation expense has been written off during 2½ years on straight line basis as under:

11-12 year = ` 45,000/2.5 = 18,000
12-13 year = ` 18,000
13-14 year = ` 18000/2 = 9000 (for half year)

Ans. 3(b)

In the books of Venus Ltd.

Date	*Particulars*	*Amount Dr.*	*Amount Cr.*
1.6.2013	Bank A/c Dr. To Debenture Application A/c (Application money received on 3,00,000 debentures @ ` 100 each)	3,00,00,000	 3,00,00,000
1.7.2013	Debenture Application A/c Dr. Underwriters A/c Dr. To 10% Debentures A/c (Allotment of 3,00,000 debentures to applicants and 1,00,000 debentures to underwriters)	3,00,00,000 1,00,00,000	 4,00,00,000
	Underwriting Commission Dr. To Underwriters A/c (Commission payable to underwriters @ 3% on ` 4,00,00,000)	12,00,000	 12,00,000
	Bank A/c Dr. To Underwriters A/c (Amount received from underwriters in settlement of account)	88,00,000	 88,00,000
30.9.2013	Debenture Interest A/c Dr. To Bank A/c (Interest paid on debentures for 3 months @10% on ` 4,00,00,000)	10,00,000	 10,00,000

1.1.2014	10% Debentures A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Conversion of 80% of debentures into shares at ` 40 each with a face value of ` 10)	3,20,00,000	 80,00,000 2,40,00,0000
31.3.2014	Debenture Interest A/c Dr. To Bank A/c (Interest paid on debentures for the half year)	12,00,000	 12,00,000

Working Note:

Calculation of Debenture Interest for the half year ended 31st March, 2014

On ` 80,00,000 for 6 months @ 10% = `4,00,000

On ` 3,20,00,000 for 3 months @ 10% = `8,00,000

Ans. 4

In the books of X Ltd.

	Particulars	*Dr.*	*Cr.*
1	Equity Share Capital (` 100) A/c Dr. To Equity Share Capital (` 25) A/c To Capital Reduction A/c (Being Equity shares of ` 100 each reduced to ` 25 each and balance transferred to Capital Reduction A/c)	40,00,000	 10,00,000 30,00,000
2	10% Preference Share Capital (` 100) A/c Dr. To 10% Preference Share Capital (` 75) A/c To Capital Reduction A/c (Being Preference shares of ` 100 each reduced to ` 75 each and balance transferred to Capital Reduction A/c)	20,00,000	 15,00,000 5,00,000

3	10% Preference Share Capital (` 75) A/c Dr. To 13% Preference Share Capital A/c To Equity Share Capital A/c (Being one new 13% Preference share of ` 50 each and one equity share of ` 25 each issued against 10% Preference Share of ` 75 each)	15,00,000	 10,00,000 5,00,000
4	Capital Reduction A/c Dr. To Preference share dividend payable A/c (Being arrear of Preference share dividend payable for one year)	2,00,000	 2,00,000
5	Preference share dividend payable A/c Dr. To Equity Share Capital A/c (Being Equity Shares of ` 25 each issued for arrears of Preference Share dividend)	2,00,000	 2,00,000
6	7% Debentures A/c Dr. To Debenture holders A/c (Being balance of 7% Debentures transferred to Debenture holders A/c)	4,00,000	 4,00,000
7	Debenture holders A/c Dr. To 13% Preference Share Capital A/c To Bank A/c To Capital Reduction A/c (Being 1/4 of Debenture holders opted to take 13% Preference shares at par and remaining took 90% cash payment for their claims)	4,00,000	 1,00,000 2,70,000 30,000
8	Loan from Director A/c Dr. To Provision for Contingent Liability A/c (Being contingent liability of ` 2,00,000 is payable and adjusted against Loan from director A/c)	2,00,000	 2,00,000
9	Bank A/c Dr. To Equity Share Application & Allotment A/c (Being application money received on 50,000 Equity shares @ ` 25 each)	12,50,000	 12,50,000
10	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c (Being application money transferred to capital A/c, on allotment)	12,50,000	 12,50,000
11	Underwriting Commission A/c Dr. To Bank A/c (Being underwriting commission paid)	50,000	 50,000
12	Land & Buildings A/c Dr. To Capital Reduction A/c (Being value of Land & Buildings appreciated)	5,00,000	 5,00,000
13	Expenses on Reconstruction A/c Dr. To Bank A/c (Being payment of expenses on reconstruction)	20,000	 20,000
14	Capital Reduction A/c Dr. To Goodwill A/c To Plant & Machinery A/c To Stock A/c To Debtors A/c To Profit & Loss A/c To Expenses on Reconstruction A/c To Underwriting Commission A/c To Capital Reserve A/c (Being various losses written off and balance of Capital Reduction A/c transferred to Capital Reserve A/c)	38,30,000	 4,00,000 3,00,000 1,00,000 2,00,000 23,00,000 20,000 50,000 460000

Ans. 5(a)

Form B-RA
Metro General Insurance Company
Revenue Account for the year ended 31st March, 2014

Particulars	*Schedule*	*Amount (`)*
Premium earned (net) Interest, dividend and rent Other income	1	75,56,000 – –
Total (A)		75,56,000
Claims incurred (Net) Commission Operating expenses related to insurance business Bad debts	2 3 4	50,63,000 1,57,000 1,90,000 -
Total (B)		54,10,000
Operating profit from insurance business (A-B)		21,46,000

Schedules forming part of revenue account

Schedule 1 : Premium Earned (Net)	
Premium from direct business	75,25,000
Add: Premium on reinsurance accepted	8,25,000
Less: Premium on reinsurance ceded	(4,90,000)
Net premium	78,60,000
Adjustment for change in reserve for unexpired risks (W.N.1)	(3,04,000)
Total premium earned (net)	75,56,000
Schedule 2 : Claims Incurred (Net)	
Claims paid on direct business	49,70,000
Add: Re-insurance accepted	5,10,000
Less: Re-insurance ceded	(3,95,000)
Net claims paid	50,85,000
Add: Claims outstanding at the end of the year (738000+70000-125000)	683000
Less: Claims outstanding at the beginning of the year (685000+95000-75000)	(705000)
Total claims incurred	50,63,000
Schedule 3 : Commission	
Commission paid on direct business	1,60,000
Add: Commission on reinsurance accepted	15,000
Less: Commission on reinsurance ceded	(18,000)
	1,57,000
Schedule 4 : Operating Expenses related to Insurance Business	
Expenses of management (2,90,000 – 45,000 – 55,000)	1,90,000

W.N. 1. Change in reserve for unexpired risk

Opening reserve as on 31st March, 2013	28,40,000
Less: Closing reserve as on 31st March, 2010 (` 78,60,000 x 40%)	(31,44,000)
	(3,04,000)

Ans. 5(b)

	` in crores	*` in crores*
Capital funds – Tier I		
Equity share capital		400
Statutory reserve		250
Capital reserve (arising out of sale of assets) (86-18)		68

		718
Capital funds – Tier II		
Capital reserve (arising out of revaluation of assets)	18	
Less: Discount to the extent of 55%	(9.9)	8.1
Capital Fund		726.1

	` in crores	% of weight	` in crores
Risk Adjusted Assets			
Funded Risk Assets			
Cash balance with RBI	12	0	0
Balance with other banks	20	20	4
Other investments	40	100	40
Loans and advances:			
(i) Guaranteed by the government	14.50	0	0
(ii) Others	5465	100	5465
Premises, furniture and fixtures	74	100	74
			5583
Off-Balance Sheet items:			
Guarantees and other obligations	700	100	700
Acceptances, endorsements and letters of credit	4,900	100	4,900
Total			11183

Risk Weighted Assets Ratio: Capital fund x 100/Risk adjusted assets
= (726.1/11,183) x 100 = 6.49%
At present, capital adequacy ratio as per RBI norms is 9%. However this bank has very low capital adequacy ratio. Therefore, Bank has to improve the ratio by introducing further Tier I capital.

Ans. 6(a)

In the books of Head Office – LMN
Mumbai Branch Account

Particulars	Amount	Particulars	Amount
To Balance b/d		By Stock reserve (opening)	10,000
Stock	40,000	(40000x25%)	
Debtors	25,000	By Remittances:	
Cash in hand	1000	Cash Sales	1,20,000
Furniture	4,000	Cash from Debtors	65,000
To Goods sent to branch	1,80,000	By Goods sent to branch	45,000
To Goods returned by	1500	(loading) (180000x25%)	
branch (loading) (6000x25%)		By Goods returned by	
To Bank (exp. paid by H.O.)		branch (Return to H.O.)	6,000
Salary	4000	By Balance c/d	
Staff Welfare	750	Stock	35000
Telephone Exp.	1200	Debtors	28450
To Stock reserve (closing)	8750	Cash (1000-700)	300
(35000x25%)		Furniture (4,000x.9))	3600
To Profit transferred to			
General Profit & Loss A/c	47150		
	313350		313350

Working Note:

Debtors Account

To Balance b/d	25,000	By Cash account	65,000
To Sales account (credit)	70,000	By Sales return account	1250
		By Discount allowed account	300
		By Balance c/d	28450
	95000		95000

Note: It is assumed that goods returned by branch are also at invoice price.

Ans. 6(b)

Mega Ltd.
Departmental Trading A/c for the year ending 31st December, 2014

Particulars	*Deptt. A.*	*Deptt. B*	*Particulars*	*Deptt. A.*	*Deptt. B*
To Stock	70,000	54,000	By Sales	572000	460000
To Purchases	3,92,000	2,98,000	By Purchased	36000	50000
To Wages	54,000	36,000	Goods transferred		
To Carriage	6,000	9,000	By Finished goods transferred	175000	150000
To Purchased Goods transferred	50000	36000	By Return of finished Goods	32000	45000
To F.G. transferred	150000	175000	By Closing Stock:		
To Ret. of finished Goods	45000	32000	Purchased Goods	24000	30000
To Gross profit c/d	174000	157000	Finished Goods	102000	62000
	941000	797000		941000	797000

General Profit and Loss A/c
for the year ended 31st March, 2011

Particulars	`	*Particulars*	`
To Provision for unrealized profit			
included in closing stock		By Gross profit b/d	
Department A (W.N. 2)	8312	Department A	1,74,000
Department B (W.N. 2)	4610	Department B	1,57,000
To Net profit	318078		
	3,31,000		3,31,000

Working Notes:

1. Calculation of rates of gross profit margin on sales

	Department A	Department B
Sales	572000	460000
Add: Transfer of finished goods	175000	150000
Less: Return of finished goods	(45000)	(32000)
Sales including internal transfer	702000	578000
Gross Profit	174000	157000
Gross profit margin =	24.786%	27.162%
	[174000x100/702000]	[157000x100/578000]

2. Unrealsed profit included in the closing stock

	Department A	Department B
Stock of finished goods	102000	62000
Stock related to other department (30% of finished goods)	30,600	18,600
GP ratio of other dept	27.162%	24.786%
Unrealized profit in stock	8312	4610
	[30600x27.162%]	[18600x24.786%]

Ans. 7(a)

(i) Examples of Changes in Accounting Policy:
a. Change of depreciation method from WDV to SLM and vice-versa.
b. Change in cost formula in measuring the cost of inventories from FIFO to Weighted Average
(ii) Examples of Changes in Accounting Estimates:
a. Change in estimate of provision for doubtful debts on sundry debtors.
b. Change in estimate of useful life or residual value of fixed assets.
(iii) Examples of Extraordinary items:
a. Loss due to earthquakes / fire / strike
b. Attachment of property of the enterprise by government
(iv) Examples of Prior period items:
a. Applying incorrect rate of depreciation in one or more prior periods.
b. Omission to account for income or expenditure in one or more prior periods.

Ans. 7(b)

The following are indications that a foreign operation is a non-integral foreign operation:

(a) Transactions with the reporting enterprise are not a high proportion of the foreign operation's activities.
(b) The activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise.
(c) Costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency.
(d) The foreign operation's sales are mainly in currencies other than the reporting currency.
(e) There is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports.

Ans. 7(c)

In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable. The specific date for these cases are as follows:

(i) Date of cash receivable
(ii) Date of conversion
(iii) Date on which the settlement becomes effective
(iv) When the services are rendered
(v) Date when interest ceases to accrue
(vi) Date on which the acquisition is recognized

A *potential equity share* is a financial instrument or other contract that entitles its holder to equity shares. Examples of potential equity shares are:
a. Debt instruments or preference shares, that are convertible into equity shares;
b. Share warrants & Options

Ans. 7(d)

Interest on performing assets to be recognized on accrual basis, but interest on Nonperforming asset should be recognized on Cash Basis.

Particular	Int. earned on PA	Int. received on NPA	Total Interest Income
Interest on Term Loan	280	20	300
Cash Credits and Over Drafts	1700	48	1748
Bills Purchases and Discounted	400	70	470
Total Interest to be recognized	2380	138	2518

Ans. 7(e)

Accounting treatment for this source of funds of Electricity Company can be performed as per any of the following alternatives:

1. Amount received from consumer towards capital/service line contributions is accounted as liability and subsequently recognized as income over the life of the asset;
2. Amount received from consumer towards capital / service line contributions is accounted as reserves as the amount is not refundable and reported under the head reserves and surplus, without transferring any proportionate amount to the income statement over the life of asset;
3. Amount received from consumer towards capital / service line contributions is accounted as capital reserve as the amount is not refundable and subsequently proportionate amount is transferred to income statement during the expected life of the asset to match against depreciation on total cost of such asset;
4. Amount received from consumer towards capital/service line contributions is accounted as reduction in the cost of non-current asset and depreciation may be provided on such reduced cost.