MOCK TEST PAPER - 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables is a monetary item, hence should be valued at the closing rate i.e, Rs. 48 at 31st March, 2012 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs. 5 (Rs. 48-Rs. 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2012 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs. 48 and Rs. 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

(b) Journal Entries

			(Rs.)
		Dr.	*Cr.*
Equity shares buy back A/c	Dr.	6,00,000	
To Bank A/c			6,00,000
(Being Buy back of 10,000 shares @ Rs. 60)			
Equity share capital A/c	Dr.	1,00,000	
Securities premium A/c	Dr.	5,00,000	
To Equity shares buy back A/c			6,00,000
(Being cancellation of equity shares bought back)			
Revenue reserves A/c	Dr.	1,00,000	
To Capital redemption reserve A/c			1,00,000
(Being amount equal to nominal value of shares bought back transferred to capital redemption reserve)			

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(c) Calculation of Preferential Creditors

	Rs.
Tax deducted at source on salaries	1,000
Wages (15 men for 4 months at Rs. 100 each)	6,000
Salaries (5 men for 4 months at Rs. 300 each)	6,000
Workmen's compensation	3,000
Total	16,000

Note:

(i) Wages or Salaries payable to any employee due for the period not exceeding 4 months within the twelve months next before commencement of winding up subject to maximum 20,000 per claimant are preferential creditors.

(ii) Rent for godown is not included in preferential creditors.

(d) According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	*Minimum Lease Payment Rs.*	*Internal rate of return (Discount rate @ 5%)*	*Present value Rs.*
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments Rs. 18,55,850 is less than fair value at the inception of lease i.e. Rs. 20,00,000, therefore, the lease liability should be recognized at Rs. 18,55,850 as per AS 19.

* Minimum Lease Payment of 4th year includes guaranteed residual value amounting Rs. 1,25,000.

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2. (a) Balance Sheet of the PQR Pvt. Ltd. as on 1-4-2014

	Note No.	Rs.
Equity and Liabilities		
Shareholders funds		
Share capital	1	1,90,000
Current liabilities		
Trade Payables		48,000
Total		2,38,000
Assets		
Non-current assets		
Fixed assets		
Tangible assets	2	1,22,000
Intangible assets	3	36,000
Current assets		
Inventories		50,000
Trade Receivables		30,000
Total		2,38,000

Notes to Accounts

	Rs.
1. Share Capital	
Equity share capital 18,000 fully paid shares of Rs. 10 each	1,80,000
Preference share capital (9% Preference Shares)	10,000
(All the shares have been issued for consideration other than cash)	1,90,000
2. Tangible assets	
Plant and Machinery	1,02,000
Fixtures	20,000
	1,22,000
3. Intangible assets	
Goodwill	36,000

(b) In the books of Partnership Firm

Partners' Capital Accounts

	P Rs.	Q Rs.	R Rs.		P Rs.	Q Rs.	R Rs.
To Plant and machinery	3,000	2,000	1,000	By Balance b/d	50,000	30,000	20,000

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account							
To Equity shares in PQR Pvt. Ltd.	90,000	60,000	30,000	By Reserve fund	30,000	20,000	10,000
To 9% Preference shares in PQR Pvt. Ltd.	5,000		5,000	By Realization* A/c (Profit on sale of business	18,000	12,000	6,000
	98,000	62,000	36,000		98,000	62,000	36,000

(c) Statement showing the final settlement between the Partners taking Q's capital as basis

	P	Q	R	Total
	Rs.	Rs.	Rs.	Rs.
Value of Equity Shares to be allotted, taking Q's capital as basis P's Capital = 60,000 × 3/2 R's Capital = 60,000 × 1/2	90,000	60,000	30,000	
Total Value of Equity Shares allotted to P,Q and R				1,80,000
9% Preference Shares to be allotted to P Rs. (95,000-90,000)	5,000			
9%Preference Shares to be allotted to R Rs. (35,000-30,000)			5,000	
Total Value of Preference Shares allotted to P and R				10,000
Total Purchase Consideration				1,90,000

Taking Q's capital as Basis, both P and R have Rs. 5,000 each as excess in their capital account balances. Since interest on capital is meant to compensate those whose capital is in excess of proportionate limits and since in the case of partners it is an appropriation of profit, it will be proper to give 9% preference shares to P and R for Rs. 5,000 each and the remaining amount of Rs. 1,80,000 in the form of Equity Shares to be divided among P, Q and R in the ratio 3:2:1. They will then share the company's profit in the ratio 3:2:1 after allowing preference dividend.

Working Notes:

1. Calculation of goodwill

	2009-10 *Rs.*	*2010-11* *Rs.*	*2011-12* *Rs.*	*2012-13* *Rs.*	*2013-14* *Rs.*
Profits	10,000	(5,000)	18,000	27,000	30,000

Adjustment for abnormal loss in 2010-11	—	10,000	—	—	—
	10,000	5,000	18,000	27,000	30,000
Total Profit from 2009-10 to 2013-14					90,000
Average Profit (90,000 / 5)					18,000
Goodwill equal to 2 years' purchase					36,000

2 Purchase consideration Computation of Value placed on business:

Assets :	Rs.
Goodwill	36,000
Plant & Machinery	1,02,000
Fixtures	20,000
Stock	50,000
Sundry Debtors	30,000
	2,38,000
Less: Liabilities:	
Creditors	48,000
Purchase Consideration	1,90,000

3. Balance Sheet of Star Ltd. as at 1st April, 2014

	Particulars	Note No.	(Rs. in lakhs)
	EQUITY AND LIABILITIES		
1	Shareholders' funds		
	a) Share capital	1	750
	b) Reserves and Surplus	2	875
2	Non-current liabilities		
	Long-term borrowings	3	30
3	Current liabilities		
	Trade Payables	4	305
	Total		1,960
	ASSETS		
1	Non-current assets		
	a) Fixed assets		
	i) Tangible assets	5	775

ii) Intangible assets	6	13
b) Non-current investments	7	100
Other non-current assets	8	50
2 Current assets		
a) Inventories (175+125)		300
b) Trade receivables	9	325
c) Cash and cash equivalents	10	397
Total		1,960

Notes to Accounts

				(Rs. in Lakhs)
1.	Share Capital			
	Authorised share capital:			
		50,00,000 Equity shares of Rs. 10 each		500
	Issued and subscribed:			
		50,00,000 Equity shares of Rs. 10 each		500
		2,50,000 Preference shares of Rs. 100 each		250
	(Of the above shares 35,00,000 equity shares and all preference shares are allotted as fully paid up for consideration other than cash)			
				750
2.	Reserves and Surplus			
	Securities premium			
		Preference shares (2.5 Lakhs x Rs. 50)	125	
		Equity shares (35 Lakhs x Rs. 20)	700	825
	Investment allowance reserve (25+25)			50
				875
3.	Long-term borrowings			
	Secured			
		15% Debentures (W.N. 2)		30
4.	Trade Payables			
	Acceptances (75+35)			110
	Sundry creditors (135+60)			195
				305

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5.	Tangible assets	
	Land and building (275+200)	475
	Plant and machinery (175+125)	300
		775
6.	Intangible assets	
	Goodwill (10+2+1)	13
7.	Non-current investments	
	Other non-current investments(75+25)	100
8.	Other non-current assets	
	Amalgamation adjustment account	50
9.	Trade receivables	
	Sundry debtors (125+150)	275
	Bills receivables (25+25)	50
		325
10.	Cash and cash equivalents	
	Cash and bank (250+150-3)	397

Working Notes:

1.

Computation of Purchase Consideration			*Rs. in lakhs*	
			Sun Ltd.	*Moon Ltd.*
(a)	Preference shareholders:			
	1,50,00,000/100 = 1,50,000 shares			
	Share capital = 1,50,000 shares × Rs. 100 each	150		
	Securities premium = 1,50,000 shares × Rs. 50 each	75	225	
	1,00,00,000/100 = 1,00,000 shares			
	Share capital = 1,00,000 shares × Rs. 100 each	100		
	Securities premium= 1,00,000 shares × Rs. 50 each	50		150
(b)	Equity shareholders:			
	4,00,00,000/100 × 5 = 20,00,000 shares			
	Share capital = 20,00,000 shares × Rs. 10 each	200		
	Securities premium=20,00,000 shares× Rs. 20 each	400	600	
	3,75,00,000/100 × 4 = 15,00,000 shares			

Share capital = 15,00,000 shares ×Rs. 10 each	150		
Securities premium = 15,00,000 shares ×Rs. 20 each	300		450
Amount of purchase consideration		825	600

2. **Calculation of number of debentures issued**

	Rs. in lakhs	
	Sun Ltd.	*Moon Ltd.*
10% Debentures of Rs. 100 each	30	15
15% Debentures to be issued to maintain same amount of interest:		
Interest = Rs. 30,00,000 x 10% = Rs. 3,00,000		
Value of 15% Debentures = $\frac{₹\,3,00,000}{15} \times 100$	20	
Interest = Rs. 15,00,000 x 10%		
Value of 15% Debentures = $\frac{₹\,1,50,000}{15} \times 100$		10

3. **Net assets taken over**

	Rs. in lakhs	
	Sun Ltd.	*Moon Ltd.*
Assets taken over		
Land and building	275	200
Plant and machinery	175	125
Investments	75	25
Stock	175	125
Sundry debtors	125	150
Bills receivable	25	25
Cash and bank	150	100
(A)	1,000	750
Less: Liabilities taken over		
Debentures	20	10
Sundry Creditors	135	60
Bills payable	75	35
(B)	230	105
Net assets taken over (A – B)	770	645

Purchase consideration	825	600
(Goodwill)/ Capital Reserve	(55)	45
Net goodwill		(10)

4. As the Liquidation expenses of Sun Ltd. and Moon Ltd., Rs. 2 lakhs and Rs. 1 lakh respectively are borne by Star Ltd. the same will be debited to Goodwill account in the books of Star Ltd.

4. (a) Calculation of Tier I and Tier II Capital

		Rs. in crores	*Rs. in crores*
(i)	Capital funds – Tier I		
	Equity share capital		750
	Statutory reserve		150
	Securities Premium		150
	Capital reserve (arising out of sale of assets) (90-40)		50
			1,100
	Less: Intangible Assets		(15)
			1,085
	Capital funds – Tier II		
	Capital reserve (arising out of revaluation of assets)	40	
	Less: Discount to the extent of 55%	(22)	18
			1,103

		Rs. in crores	*% of risk weight*	*Rs. in crores*
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	60	0	0
	Claims on banks	170	20	34
	Other investments	2,300	100	2,300
	Loans and advances:			
	(i) Guaranteed by the government	400	0	0
	(ii) Granted to staff of bank, fully covered by Super Annuation Benefits and mortgage of Flat/House	50	20	10

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	(iii) Other loans and advances	6,170	100	6,170
	Other assets			
	Premises, furniture and fixtures and other assets	3,925	100	3,925
				12,439

	Rs. in crores	*Credit conversion factor*	
Off-Balance Sheet items: Acceptances, endorsements and Letters of credit, Guarantees and other obligations	1,550	100	1,550
			13,989

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital fund}}{\text{Risk adjusted assets + off balance sheet items}} \times 100 =$$

$$\frac{₹\ 1{,}103 \text{ crores} \times 100}{₹\ 13{,}989 \text{ crores}} = 7.89\%$$

(b) Journal Entries

			Rs.	Rs.
1.1.12 to 28.2.12	Bank A/c	Dr.	12,00,000	
	Employees compensation expense A/c	Dr.	21,60,000	
	To Equity Share Capital A/c			2,40,000
	To Securities Premium A/c			31,20,000
	(Allotment of 24,000 equity shares of Rs.10 each at a premium of Rs.130 per share to the employees)			
31.3.12	Profit and Loss A/c	Dr.	21,60,000	
	To Employees Compensation Expense A/c			21,60,000
	(For transfer of employees compensation expense to profit and loss account)			

5. (a) Departmental Trading and Profit and Loss Account for six months ending 31.3.2012

Particulars	X	Y	Z	Particulars	X	Y	Z
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Purchases	70,350	45,300	32,200	By Sales	75,000	50,000	12,500
To Gross Profit c/d	34,700	14,850	2,600	By Closing Stock	30,050	10,150	22,300
	1,05,050	60,150	34,800		1,05,050	60,150	34,800
To Salaries & Wages	6,000	12,000	6,000	By Gross Profit b/d	34,700	14,850	2,600
To Rent	4,700	4,700	1,500	By Net Loss			
To Net Profit				(Departmental)	-	1,850	4,900
(Departmental)	24,000						
	34,700	16,700	7,500		34,700	16,700	7,500

General Profit and Loss Account
for six months ending 31.3.2012

Particulars	*Rs.*	*Particulars*	*Rs.*
To Profit & Loss A/c (Dept. Y)	1,850	By Profit & Loss A/c (Dept. X)	24,000
To Profit & Loss A/c (Dept. Z)	4,900		
To Profit (to be transferred to Balance Sheet)	17,250		
	24,000		24,000

Working Notes:

(i) Salaries and wages are to be allocated first between show room and workshop in the ratio of 3:1 i.e. Rs.18,000 and Rs. 6,000. Work shop salaries are to be charged to Dept. Z.

(ii) Since, Dry cleaners and Dumpsters are sold at show room, salaries are to be allocated to Dept. 'X' and Dept. 'Y' respectively in the ratio of 1 : 2.

(iii) Rent to workshop at Rs. 250 p.m. for six months, Rs. 1,500 is to be charged to Dept. 'Z' first and the balance Rs. 9,400 is to be divided equally between Dept. 'X' and 'Y'.

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(b) In the books of Head Office

Journal Entries

	Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
(i)	Loss of goods due to theft during transit	Dr.	12,000	
	To Purchases account			12,000
	(Being goods lost on account of theft during transit)			
(ii)	Salaries account	Dr.	15,000	
	To Branch account			15,000
	(Being salary paid by the branch for H.O. employee)			
(iii)	No entry in the books of head office for goods sent to branch not received by branch till 31st March 2012			
(iv)	Cash in transit account	Dr.	10,000	
	To Branch account			10,000
	(Being remittance by branch not received by 31st March, 2012)			
(v)	Branch account	Dr.	25,000	
	To Purchases account			25,000
	(Being rectification of entry for payment for goods purchased by branch wrongly debited to purchase account)			

Note:

1. In entry (i), it is assumed that refusal of branch manager (to accept liability of stolen goods) is accepted by the Head Office. Alternatively, Branch account will be credited on the basis of assumption that refusal of branch manager is not accepted by the Head Office.
2. In entry (iii) the goods in transit entry will be passed in the Books of the Branch.

6. (a) FORM B-RA

Name of the Insurer: Bigfish Marine Insurance Ltd.

Revenue Account for the year ended 31st March, 2014

Particulars	Schedule	Rs.
Premium earned (Net)	1	16,72,800
Profit on sale of investment		46,000

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Interest, dividend and rent (Gross)		1,65,250
Total (A)		18,84,050
Claims incurred (Net)	2	12,00,000
Commission	3	1,94,000
Operating expenses related to insurance business	4	3,75,000
Total (B)		17,69,000
Profit for Marine Insurance Business (A-B)		1,15,050

Schedule -1

Premium Earned (Net)	Rs.
Premium received	18,75,000
Add: Outstanding premium as on 31.03.2014	1,25,000
	20,00,000
Less: Premium on reinsurance ceded	(2,28,000)
	17,72,000
Less: Adjustment for change in reserve for unexpired risk (Refer W.N. 1)	(99,200)
Net premium earned	16,72,800

Schedule -2

Claim Incurred (Net)	Rs.
Claim paid	10,54,000
Add: Surveyor's fee & legal expenses paid for settlement of claim (Rs. 45,000 + Rs. 65,000)	1,10,000
Add: Outstanding claims as on 31.03.2014	2,25,000
	13,89,000
Less: Outstanding claims as on 01.04.2013	(1,89,000)
Claim incurred (Net)	12,00,000

Schedule -3

Commission	Rs.
Commission paid	1,94,000

Schedule -4

Operating expenses related to insurance business	Rs.
Expenses of Management	4,85,000
Less: Surveyor's fee & legal expenses	(1,10,000)
	3,75,000

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Working Notes:

1. Calculation for change in Reserve for Unexpired Risk

		Rs.
Unexpired risk reserve at the beginning (including additional reserve)		18,50,000
Less: Reserve for unexpired risk as on 31.03.2014 (100% of Rs. 17,72,000)	17,72,000	
Additional reserve as on 31.03.2014 (10% of Rs. 17,72,000)	1,77,200	(19,49,200)
Change in provision for unexpired risk		99,200

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

(b) Statement showing net liability of underwriters *(No. of shares)*

	A	*B*	*C*	*Total*
Gross liability	20,000	12,000	8,000	40,000
Less: Unmarked applications in the Gross Liability ratio of 5:3:2	(1,000)	(600)	(400)	(2,000)
	19,000	11,400	7,600	38,000
Less: Marked applications	(16,000)	(5,700)	(8,300)	(30,000)
	3,000	5,700	(700)	8,000
Credit of C's surplus to A and B in the ratio of 5:3	(438)	(262)	700	-
Net liability	2,562	5,438	-	8,000

7. (a) According to paras 55 and 56 of AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs. 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crores to the Profit and Loss account of the year is correct.

(b) As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

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However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean up cost in the year in which the law is virtually certain to be enacted.

(c) Earnings for the year = No. of Shares x Basic EPS

= 30,00,000 shares x Rs. 5 per share = Rs.1,50,00,000

Adjusted net profit for the current year = Earnings for the year + Interest on debentures (net of tax) = 1,50,00,000 + (6,00,000 – 1,80,000) = Rs. 1,54,20,000

No. of equity shares resulting from conversion of debentures

= 50,000 x 10 shares = 5,00,000 shares

Total number of equity shares for diluted EPS = 30,00,000 + 5,00,000

= 35,00,000 shares.

Diluted earnings per share = Rs. 1,54,20,000/ 35,00,000 shares

= Rs. 4.4 per share.

(d) As per para 13 of AS 4 "Contingencies and Events Ocurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 2012 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 2012.

(e) As per para 21 of AS 12, 'Accounting for Government Grants', amount refundable in respect of a grant related to revenue should be applied first against any unamortized deferred credit remaining in respect of the grant. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to the Statement of Profit and Loss.

(i) In this case, the grant refunded is Rs. 300 lakhs and balance in deferred income is Rs. 210 lakhs. Therefore, Rs. 90 lakhs shall be charged to the Statement of Profit and Loss for the year 2012-13. There will be no effect on the cost of the fixed asset and depreciation charged will be same as charged

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in the earlier years.

(ii) As per para 21 of AS 12, the amount refundable in respect of grant which was related to specific fixed assets should be recorded by increasing the book value of the assets by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case the book value of the plant shall be increased by Rs. 300 lakhs. The increased cost of Rs. 300 lakhs of the plant should be amortised over 7 years (remaining useful life). Depreciation charged during the year 2012-13 shall be 1200/10 + 300/7 = 162.86 lakhs.

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