MOCK TEST PAPER - 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 1: ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) The question deals with the issue of Applicability of Accounting Standards to a non-corporate entity. For availment of the exemptions, first of all, it has to be seen that M/s X& Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under 3 levels viz Level I, Level II (SMEs) and Level III (SMEs).

An entity whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year, will fall under the category of Level I entities. Non-corporate entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees one crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(ii) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

As the turnover of M/s X& Co. is more than Rs. 1 crore, it falls under 1st criteria of Level II non-corporate entities as defined above. Even if its borrowings of Rs. 0.95 crores is less than Rs. 1 crores, it will be classified as Level II Entity. In this case, AS 3, AS 17, AS 21, AS 23, AS 27 will not be applicable to M/s X & Co. Relaxations from certain requirements in respect of AS 15, AS 19, AS 20, AS 25, AS 28 and AS 29 are also available to M/s X& Co.

(b) Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

(c) As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

Material used	12,000 MT @ Rs. 150 = Rs. 18,00,000
Normal Loss (4% of 12,000 MT)	480 MT

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Net quantity of material	11,520 MT
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)
Abnormal Loss	Rs. 23,437.50 [150 units @ Rs. 156.25 (Rs.18,00,000/11,520)]

Amount of Rs. 23,437.50 will be charged to the Profit and Loss statement.

(d) Statement showing amount to be charged to Profit and Loss Statement as per AS 7

		Rs. in crores
	Cost of construction incurred upto 31.03.2017	120
Add:	Estimated future cost	45
	Total estimated cost of construction	165
	Degree of completion (120/165 x 100)	72.73%
	Revenue recognized (72.73% of 150)	109 (approx)
	Total foreseeable loss (165 – 150)	15
Less:	Loss for the current year (120 – 109)	11
	Loss to be provided for in the P&L statement	4

2. (a) In the books of Meera Investment Account (Shares in Kumar Limited)

Date	*Particulars*	*No. of Shares*	*Income*	*Amount*	*Date*	*Particulars*	*No. of Shares*	*Income*	*Amount*
2017			*Rs.*	*Rs.*	*2017*			*Rs.*	*Rs.*
April 1	To Bank (Purchases)	40,000	-	60,000	May	By Bank (Sale)	8,000	-	15,200
May	To Profit & Loss A/c (W.N.1)	-	-	3,200					
June	To Bonus Issue	8,000	-	Nil	2018				
July	To Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By Bank (Dividend @ 15% on Rs. 32,000)		4,800	-
Sept.	To Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By Bank (Sale)	20,000	-	28,000
2018 Mar. 31	To Profit & Loss A/c (W.N.2)			3,455	Mar. 31	By Balance c/d $\left(\frac{24,000}{44,000}\times 54,000\right)$	24,000	-	29,455
	To Profit & Loss A/c	-	4,800						
		52,000	4,800	72,655			52,000	4,800	72,655

Working Notes:

(1)	**Profit on Sale on 15-5-2017:**		
	Cost of 8,000 shares @ Rs.1.50	Rs. 12,000	
	Less: Sales price	Rs. 15,200	
	Profit		Rs. 3,200

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(2)	**Cost of 20,000 shares sold:**		
	Cost of 44,000 shares Rs. (48,000 + 6,000)		Rs. 54,000
	$\therefore$ Cost of 20,000 shares $\left(\frac{\text{Rs. } 54,000}{44,000 \text{ shares}} \times 20,000 \text{ shares}\right)$		Rs. 24,545
	Profit on sale of 20,000 shares (Rs. 28,000 – Rs. 24,545)		Rs. 3,455

(b) Calculation of Interest and Cash Price

No. of installments	*Outstanding balance at the end after the payment of installment*	*Amount due at the time of installment*	*Outstanding balance at the end before the payment of installment*	*Interest*	*Outstanding balance at the beginning*
[1]	*[2]*	*[3]*	*[4] = 2 +3*	*[5] = 4 x 10/110*	*[6] = 4-5*
3rd	-	5,50,000	5,50,000	50,000	5,00,000
2nd	5,00,000	4,90,000	9,90,000	90,000	9,00,000
1st	9,00,000	4,20,000	13,20,000	1,20,000	12,00,000

Total cash price = Rs. 12,00,000+ 6,00,000 (down payment) = Rs. 18,00,000.

Cars Account in the books of Krishan

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
1.4.2015	To Fair Value Motors A/c	18,00,000	31.3.2016	By Depreciation A/c	4,50,000
				By Balance c/d	13,50,000
		18,00,000			18,00,000
1.4.2016	To Balance b/d	13,50,000	31.3.2017	By Depreciation A/c	3,37,500
				By Balance c/d	10,12,500
		13,50,000			13,50,000
1.4.2017	To Balance b/d	10,12,500	31.3.2018	By Depreciation A/c	2,53,125
				By Fair Value Motors A/c (Value of 1 Car taken over after depreciation for 3 years @ 40% p.a.) [9,00,000 - (3,60,000 + 2,16,000 + 1,29,600)]	1,94,400
				By Loss transferred to Profit and Loss A/c on surrender (Bal. fig.)	1,85,288
				By Balance c/d ½ (10,12,500-2,53,125)	3,79,687
		10,12,500			10,12,500

3. Trading and Profit and Loss Account

for the year ended 31st March, 2017

		Rs.	*Rs.*
Sales			1,20,000
Less:	Cost of goods sold:		
	Opening Stock	15,500	
	Purchases	84,000	
		99,500	

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Less: Closing stock	(18,550)	(80,950)
Gross Profit		39,050

	Half year to 30th September 2016		*Half year to 31st March 2017*	
	Rs.	*Rs.*	*Rs.*	*Rs.*
Gross profit allocated on time basis		19,525		19,525
Less: Expenses				
Salaries (W.N. 1)	6,750		5,250	
Travelling expenses	400		400	
Office maintenance	600		600	
Conveyance	250		250	
Trade expenses (W.N.2)	625		625	
Rent and rates (W.N. 3)	1,200		1,200	
Bad debts	500		400	
Provision for doubtful debts	-		270	
Depreciation:				
Plant and machinery	1,100		1,100	
Motor vehicles	1,500		1,500	
Interest on loan (W.N. 4)	-	(12,925)	1,638	(13,233)
		6,600		6,292
Appropriation of profits:				
Remaining profits				
L and M (2:1)	4,400			
	2,200	6,600	3,775	
M and N (3:2)			2,517	6,292

Partners' Capital Accounts

	L	*M*	*N*		*L*	*M*	*N*
	Rs.	*Rs.*	*Rs.*		*Rs.*	*Rs.*	*Rs.*
To L (goodwill)		4,000	6,000	By Balance b/d	24,000	12,000	-
To Drawings	2,000	3,000	1,000	By Cash	-	-	9,000
To Transfer to loan a/c	36,400	-	-	By M (Goodwill)	4,000	-	-
				By N (Goodwill)	6,000	-	-
To Balance c/d	-	10,975	4,517	By Profit	4,400	5,975	2,517
	38,400	17,975	11,517		38,400	17,975	11,517

Balance Sheet as on 31st March, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital A/c			Plant & Machinery	
M	10,975		*Less:* Depreciation	
N	4,517	15,492	(22,000 – 6,600)	15,400

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L's Loan 36,400 Interest 1,638	38,038	Motor Car *Less:* Depreciation (30,000 – 9,000)	21,000
Current Liabilities		Current Assets:	
Creditors	10,100	Stock	18,550
Out-standing Trade expenses	250	Debtors (*Less:* Provision (5,400-270)	5,130
		Prepaid Rent	600
		Balance at bank	3,200
Total	63,880		63,880

Working Notes:

			Rs.	*Rs.*
1.	**Salaries**			
	Total as per trial balance			18,000
	Less: Partners' Drawings -	L	2,000	
		M	3,000	
		N	1,000	(6,000)
				12,000
	Less: N's Salary up to 30.09.2016			1,500
				10,500
			Upto 30.09.2016	Upto 31.03.2017
	Allocation on time basis		5,250	5,250
	Add: N's salary upto 30.09.2016		1,500	0
			6,750	5,250
2.	**Trade Expenses**			
	Total as per trial balance			1,000
	Add: Accrual			250
				1,250
	Allocation: on time basis (50 : 50)		625	625
3.	**Rent and rates**			
	Total as per trial balance			3,000
	Less: Rent paid in advance			(600)
				2,400
	Allocation: on time basis (50 : 50)		1,200	1,200
4.	**Interest on loan account of 'L'**			
	Balance in Capital a/c as per trial balance			24,000
	Less: Drawings			(2,000)
	Add: Share of Goodwill		10,000	
	Share in Profit		4,400	14,400
				36,400
	Interest payable @9% p.a. from 01.10.2016 to 31.03.2017 (6 months)			
	36,400 x 6/12 x 9/100 =			1,638

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Adjustment of L's share of Goodwill

Value of goodwill Rs. 15,000

Net entry for Goodwill

M's Capital account Dr. Rs. 4,000

N's Capital account Dr. Rs. 6,000

To L's Capital account Rs. 10,000

(L's share in goodwill adjusted to existing partners in their gaining ratio)

4. (a) Cash Flow Statement as per AS 3

		Rs. in lacs
Cash flows from operating activities:		36,000
Net profit before tax provision		
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048
		72,048
Less: Non cash income		
Amortisation of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Sale of assets (222 – 48)	174	
Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of fixed assets	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,168)
Cash flows from financing activities:		
Grants for capital projects	18	
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,640
Net increase in cash		2,000
Add: Cash and bank balance as on 1.4.2016		6,000
Cash and bank balance as on 31.3.2017		8,000

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(b) Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceeds the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

5. **In the books of M Ltd.**

Journal Entries

	Particulars		*Dr. Amount (Rs.)*	*Cr. Amount (Rs.)*
1.	Equity Share Capital (Rs. 100) A/c	Dr.	35,00,000	
	To Equity Share Capital (Rs. 25) A/c			8,75,000
	To Capital Reduction A/c			26,25,000
	(Being Equity shares of Rs. 100 each reduced to Rs. 25 each and balance transferred to Capital Reduction A/c)			
2.	10% Preference Share Capital (Rs. 100) A/c	Dr.	15,00,000	
	To 10% Preference Share Capital (Rs. 75) A/c			11,25,000
	To Capital Reduction A/c			3,75,000
	(Being Preference shares of Rs. 100 each reduced to Rs. 75 each and balance transferred to Capital Reduction A/c. Total Pref Shares = 15,000)			
3.	10% Preference Share Capital (Rs. 75) A/c	Dr.	11,25,000	
	To 13% Preference Share Capital (Rs. 50) A/c			7,50,000
	To Equity Share Capital A/c (Rs. 25)			3,75,000
	(Being one new 13% Preference share of Rs. 50 each and one equity share of Rs. 25 each issued against 10% Preference Share of Rs. 75 each. Total Pref Shares = 15,000)			
4.	Capital Reduction A/c	Dr.	1,50,000	
	To Preference share dividend payable A/c			1,50,000
	(Being arrear of Preference share dividend payable for one year)			
5.	Preference share dividend payable A/c	Dr.	1,50,000	
	To Equity Share Capital A/c			1,50,000
	(Being Equity Shares of Rs. 25 each issued for arrears of Preference Share dividend)			
6.	7% Debentures A/c	Dr.	5,00,000	
	To Debenture holders A/c			5,00,000
	(Being balance of 7% Debentures transferred to Debenture holders A/c)			

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7.	Debenture holders A/c	Dr.	5,00,000	
	To 13% Preference Share Capital A/c			2,50,000
	To Bank A/c			2,25,000
	To Capital Reduction A/c			25,000
	(Being 50% of Debenture holders opted to take 13% Preference shares at par and remaining took 90% cash payment for their claims)			
8.	Loan from Director A/c	Dr.	1,50,000	
	To Provision for Contingent Liability A/c			1,50,000
	(Being provision for contingent liability of Rs. 1,50,000 as it is payable and the same is adjusted against Loan from director A/c)			
9.	Bank A/c	Dr.	10,00,000	
	To Equity Share Application & Allotment A/c			10,00,000
	(Being application money received on 40,000 Equity shares @ Rs. 25 each)			
10.	Equity Share Application & Allotment A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(Being application money transferred to capital A/c, on allotment)			
11.	Land & Buildings A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being value of Land & Buildings appreciated)			
12.	Expenses on Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of expenses on reconstruction)			
13.	Capital Reduction A/c	Dr.	31,75,000	
	To Plant & Machinery A/c			4,00,000
	To Inventory A/c			1,00,000
	To Trade receivables A/c			1,50,000
	To Profit & Loss A/c			23,00,000
	To Expenses on Reconstruction A/c			15,000
	To Capital Reserve A/c (bal fig)			2,10,000
	(Being various losses written off and balance of Capital Reduction A/c transferred to Capital Reserve A/c)			

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6. (a) **Mahaveer hospital**

Income & Expenditure Account
for the year ended 31 December, 2016

Expenditure	*Rs.*	*Income*	*Rs.*
To Salaries	24,000	By Subscriptions	24,500
To Diet expenses	15,600	By Govt. Grants (Maintenance)	20,000
To Rent & Rates	1,700	By Fees, Sundry Patients	4,800
To Printing & Stationery	2,400	By Donations	8,000
To Electricity & Water-charges	2,400	By Benefit shows (net collections)	6,000
To Office expenses	2,000	By Interest on Investments	800
To Excess of Income over expenditure transferred to Capital Fund	16,000		
	64,100		64,100

Balance Sheet as at 31st Dec., 2016

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital Fund :			Building :		
Opening balance	49,300		Opening balance	90,000	
Excess of Income			Addition	50,000	1,40,000
Over Expenditure	16,000	65,300	Hospital Equipment :		
Building Fund :			Opening balance	34,000	
Opening balance	80,000		Addition	17,000	51,000
Add : Govt. Grant	80,000	1,60,000	Furniture		6,000
Subscriptions			Investments-		
received in advance		2,400	8% Govt. Securities		20,000
			Subscriptions receivable		1,400
			Accrued interest		800
			Prepaid expenses (Rent)		300
			Cash at Bank		6,800
			Cash in hand		1,400
		2,27,700			2,27,700

Working Notes:

(1) Balance sheet as at 31st Dec., 2015

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Fund		Building	90,000
(Balancing Figure)	49,300	Equipment	34,000
Building Fund	80,000	Subscription Receivable	6,500
Creditors for Expenses:		Cash at Bank	5,200
Salaries payable	7,200	Cash in hand	800
	1,36,500		1,36,500

(2) Building

	Rs.
Balance on 31st Dec. 2016	1,40,000
Paid during the year	(50,000)
Balance on 31st Dec. 2015	90,000

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(3) Equipment

Balance on 31st Dec. 2016	51,000
Paid during the year	(17,000)
Balance on 31st Dec. 2015	34,000

(4) Subscription due for 2015

Receivable on 31st Dec. 2015	6,500
Received in 2016	(5,100)
Still Receivable for 2015	1,400

(b)

Capital Redemption Reserve A/c	Dr.	30,000	
Securities Premium A/c	Dr.	40,000	
General Reserve A/c	Dr.	30,000	
To Bonus to Shareholders			1,00,000
(Being issue of bonus shares by utilization of various Reserves, as per resolution dated .....)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital			1,00,000
(Being capitalization of Profit)			

7. (a) The proposals will be evaluated and vendor will be selected considering the following criteria:

1. Quantum of services provided and whether the same matches with the requirements of the hospital.
2. Reputation and background of the vendor.
3. Comparative costs of the various propositions.
4. Organizational set up of the vendor particularly technical staffing to obtain services without inordinate delay.
5. Assurance of quality, confidentiality and secrecy.
6. Data storage and processing facilities.

(b) Calculation of number of days from base date

Transaction date	Due date	Amount Rs.	No. of days from Base date (Base date 19.6.2017)	Product
8.3.2017	11.7.2017	4,000	22	88,000
16.3.2017	19.6.2017	5,000	0	0
7.4.2017	10.9.2017	6,000	83	4,98,000
17.5.2017	20.8.2017	5,000	62	3,10,000
		20,000		8,96,000

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of Product}}{\text{Total of Amount}}$$

= 19.6.2017 + Rs. 8,96,000 / Rs. 20,000

= 19.6.2017 + 45 days approximately = 3.8.2017

(c) As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to

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the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2017-18, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs. 16,000.

(d) Determination of Capital balances of Mr. Aman on 31.3.2016 and 31.3.2017

	31.3.2016	*31.3.2017*
	Rs.	*Rs.*
Assets	16,65,000	28,40,000
Less: Liabilities	(4,13,000)	(5,80,000)
Capital	12,52,000	22,60,000

Determination of Profit by applying the method of the capital comparison

	Rs.
Capital Balance as on 31-3-2017	22,60,000
Less: Fresh capital introduced (matured life insurance policy amount)	(50,000)
	22,10,000
Add: Drawings (Rs. 32,000 × 12)	3,84,000
	25,94,000
Less: Capital Balance as on 1.4.2016	(12,52,000)
Profit	13,42,000
Income declared	9,12,000
Suppressed Income	4,30,000

The Income-tax officer's contention that Mr. Aman has not declared his true income is correct. Mr. Aman's true income is in excess of the disclosed income by Rs. 4,30,000.

Note:

- Closing capital is increased due to fresh capital introduction, so it is deducted.
- Closing capital was reduced due to withdrawal by proprietor; so it is added back.

(e) As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of Rs. 5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 5 lakhs as interest amount.

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