Test Series: February, 2016

MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) The loss due to break out of fire is an example of event occurring after the balance sheet date. The event being in the nature of a fire which is unpredictable does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements. However, AS 4 states that disclosure is generally made of events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date. In the given case, the amount of loss of assets in a factory is material and may be considered as an event affecting the substratum of the enterprise. Hence, as recommended in AS 4, disclosure of the event should be made.

(b) As per AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2015, the raw material purchased and its creditors will be recorded at US dollar 9,000 × Rs. 44 = Rs. 3,96,000.

Also, as per the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. Rs. 49 per US dollar (USD 9,000 x Rs. 49 = Rs. 4,41,000) at 31st March, 2015, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of Rs. 5 (49 – 44) per US dollar i.e. Rs. 45,000 (USD 9,000 x Rs. 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2015 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of Rs. 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between Rs. 49 and Rs. 48 per US dollar i.e. Rs. 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

(c) According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also AS 16 "Borrowing Costs" states that 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.

Thus, eligible borrowing cost

= Rs. 11,00,000 – Rs. 2,00,000 = Rs. 9,00,000

Sr. No.	*Particulars*	*Nature of assets*	*Interest to be Capitalized (Rs.)*	*Interest to be charged to Profit & Loss Account (Rs.)*
i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = Rs. 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = Rs. 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = Rs. 2,25,000
	Total		Rs. 3,60,000	Rs. 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

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

As at 31st March, 2015 = Rs. 40,000 x .02 + Rs. 25,000 x .03

= Rs. 800 + Rs. 750 = Rs. 1,550

As at 31st March, 2016 = Rs. 25,000 x .02 + Rs. 90,000 x .03

= Rs. 500 + Rs. 2,700 = Rs. 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2016

	Rs.
Balance of provision required as on 31.03.2016	3,200
Less: Opening Balance as on 1.4.2015	(1,550)
Amount debited to profit and loss account	1,650

Note: No provision will be made on 31st March, 2015 in respect of sales amounting Rs. 40,000 made on 19th January, 2014 as the warranty period of 2 years has already expired.

2. (a) Statement of Distribution of Cash by 'Maximum Loss Method'

	Creditors	*Amar's Loan*	*Amar*	*Akbar*	*Antony*
	Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*
Balance due	80,000	20,000	1,00,000	30,000	90,000
15th April 2015 realised Rs. 60,000					
Paid to creditors	(60,000)	-	-	-	-
Balance due	20,000	20,000	1,00,000	30,000	90,000
1st May, 2015 realised Rs. 1,46,000					
Paid to creditors (Rs. 20,000)	20,000	-	-	-	-
Paid to Amar's loan (Rs. 20,000)	-	20,000	-	-	-
Balance due (1)	Nil	Nil	1,00,000	30,000	90,000
Balance Rs. 1,06,000					
Maximum Loss (1,00,000+30,000+90,000-1,06,000) = Rs. 1,14,000 shared in Profit & Loss ratio 5:3:2			(57,000)	(34,200)	(22,800)
			43,000	(4,200)	67,200
Akbar's deficiency shared by Amar & Antony in capital ratio 100:90			(2,210)	4,200	(1,990)
Cash paid [2]			40,790	-	65,210
Balance due (3) [1-2]			59,210	30,000	24,790
31st May 2015 realised Rs. 94,000					
Maximum Loss [59,210+30,000+24,790-94,000]= Rs. 20,000 shared in 5:3:2			(10,000)	(6,000)	(4,000)
Cash paid (4)			49,210	24,000	20,790
Balance/Loss* on realisation (3-4)			10,000	6,000	4,000

Cash Account

	Rs.		Rs.
To Realization Account	60,000	By Creditors Account	60,000
To Realization Account	1,46,000	By Creditors Account	20,000
To Realization Account	94,000	By Amar's Loan Account	20,000
		By Amar's Capital Account	40,790
		By Antony's Capital Account	65,210
		By Amar's Capital Account	49,210
		By Akbar's Capital Account	24,000
		By Antony's Capital Account	20,790
	3,00,000		3,00,000

Partners' Capital Accounts

	Amar *Rs.*	*Akbar* *Rs.*	*Antony* *Rs.*		*Amar* *Rs.*	*Akbar* *Rs.*	*Antony* *Rs.*
To Cash	40,790	-	65,210	By Balance b/d	1,00,000	30,000	90,000
To Cash	49,210	24,000	20,790				
To Balance c/d Realization loss*	10,000	6,000	4,000				
	1,00,000	30,000	90,000		1,00,000	30,000	90,000

* If no further realization takes place, then Amar, Akbar and Anthony will bear loss on realization Rs. 10,000, Rs. 6,000 and Rs. 4,000 respectively.

3. **Journal Entries**

			Rs. in lacs
		Dr.	*Cr.*
Equity Share Capital (Rs. 10 each) A/c	Dr.	500	
To Equity Share Capital (Rs. 2.50 each) A/c			125
To Reconstruction A/c			375
(Conversion of all the equity shares into the same number of fully paid equity shares of Rs. 2.50 each as per scheme of reconstruction)			
Director's Remuneration Outstanding A/c	Dr.	10	
To Reconstruction A/c			10
(Outstanding remuneration foregone by the directors as per scheme of reconstruction)			

12% Debentures A/c	Dr.	400	
Debenture Interest Outstanding A/c	Dr.	48	
To 13% Debentures A/c			400
To Reconstruction A/c			48
(Conversion of 12% debentures into 13% debentures, Debenture holders forgoing outstanding debenture interest)			
Bank A/c	Dr.	125	
To Equity Share Application A/c			125
(Application money received for fully paid equity shares of Rs. 2.5 each from existing shareholders)			
Equity Share Application A/c	Dr.	125	
To Equity Share Capital (Rs. 2.50 each) A/c			125
(Application money transferred to share capital)			
Trade payables A/c	Dr.	165	
To Equity Share Capital (Rs. 2.50 each) A/c			65
To Bank A/c			80
To Reconstruction A/c			20
(Trade payables for Rs. 65 lakhs accepting shares for full amount and those for Rs. 100 lakhs accepting cash equal to 80% of claim in full settlement)			
Capital Reserve A/c	Dr.	6	
To Reconstruction A/c			6
(Being the loss on reconstruction (balance in the Reconstruction A/c) transferred to Capital Reserve)			
Land and Building A/c	Dr.	46	
To Reconstruction A/c			46
(Appreciation made in the value of land and building as per scheme of reconstruction)			
Reconstruction A/c	Dr.	505	
To Goodwill A/c			15
To Plant and Machinery A/c			66
To Inventory A/c			22
To Trade receivables A/c			4
To Discount on issue of Debentures A/c			8
To Profit and Loss A/c			390
(Writing off losses and reduction in the values of assets as per scheme of reconstruction—W.N. 1)			

Note: In a scheme of Reconstruction, Goodwill, Losses etc should be written off against the Reconstruction Account whether or not it is mentioned in the question.

Balance Sheet of Krishna Ltd. (and Reduced) as on 31st March, 2016

Particulars	*Note No.*	*Amount*
		Rs.
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	315
(2) Non-Current Liabilities		
(a) Long-term borrowings - 13% Debentures		400
(3) Current Liabilities		
(a) Other current liabilities		11
(b) Short-term provisions		33
Total		759
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	2	491
(ii) Intangible assets	3	0
(2) Current assets		
(a) Current investments		
(b) Inventories		120
(c) Trade receivables		76
(d) Cash and cash equivalents(W.N.2)		72
Total		759

Notes to Accounts

			Rs.
1	**Share Capital**		
	Equity Share Capital (Rs. 2.50 each)	125	
	Add: Fresh issue	125	
	Add: Equity shares issued to trade payables	65	
	1,26,000 Fully paid equity shares of Rs. 2.50 each		315

	(26,000 shares have been issued for consideration other than cash)		
2	**Tangible assets**		
	a) Land and Building	184	
	Add: Amount of appreciation under scheme of reconstruction	46	230
	b) Plant and Machinery	286	
	Less: Amount written off under scheme of reconstruction dated.	(66)	220
	c) Furniture and Fixtures		41
			491
3	**Intangible assets**		
	Goodwill	15	
	Less: Amount written off under scheme of reconstruction	15	-

Working Notes :

1. (Rs. in lacs)

Reconstruction Account

		Rs.			Rs.
To	Goodwill	15	By	Equity Share Capital A/c	375
To	Plant and Machinery	66	By	Director's Remuneration Outstanding A/c	10
To	Inventory	22	By	Debenture Interest Outstanding A/c	48
To	Trade receivables	4	By	Trade payables	20
To	Discount on issue of		By	Capital Reserve (Balancing Figure)	6
	Debentures	8	By	Land and Building	46
To	Profit and Loss A/c	390			
		505			505

2. Cash at bank as on 31st March, 2016 (after reconstruction)

	Rs.
Cash at bank (before reconstruction)	27
Add: Proceeds from issue of equity shares	125
	152
Less: Payment made to trade payables (80% of Rs. 100 Lakhs)	(80)
	72

4. (a) Calculation of liability of each underwriter (in shares) assuming that the benefit of firm underwriting is not given to individual underwriters

(Number of shares)

	P	*Q*	*R*	*Total*
Gross Liability (Total Issue – Issued to Promoters, Directors etc)	1,50,000	1,00,000	50,000	3,00,000
Less: Marked applications (excluding firm underwriting)	(60,000)	(50,000)	(60,000)	(1,70,000)
Balance	90,000	50,000	(10,000)	1,30,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(6,000)	(4,000)	10,000	-
Balance	84,000	46,000	-	1,30,000
Less: Unmarked applications including firm underwriting (Refer W.N.)	(57,000)	(38,000)	(19,000)	(1,14,000)
Net Liability	27,000	8,000	(19,000)	16,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(11,400)	(7,600)	19,000	-
	15,600	400	-	16,000
Add: Firm underwriting	20,000	14,000	10,000	44,000
Total Liability	35,600	14,400	10,000	60,000

Working Note:

Applications received from public	2,40,000 shares
Add: Shares underwritten firm (20,000 + 14,000 + 10,000)	44,000 shares
Total applications	2,84,000 shares
Less: Marked applications (60,000 + 50,000 + 60,000)	(1,70,000 shares)
Unmarked applications including firm underwriting	1,14,000 shares

(b) Fair value of an option = Rs. 56 – Rs. 50 = Rs. 6

Number of shares issued = 400 employees x 100 shares/employee = 40,000 shares

Fair value of ESPP = 40,000 shares x Rs. 6 = Rs. 2,40,000

Vesting period = 1 month

Expenses recognized in 2014-15 = Rs. 2,40,000

Date	*Particulars*		*Rs.*	*Rs.*
31.03.2015	Bank (40,000 shares x Rs. 50)	Dr.	20,00,000	
	Employees compensation expense A/c	Dr.	2,40,000	
	To Share Capital (40,000 shares x Rs.10)			4,00,000
	To Securities Premium (40,000 shares x Rs.46)			18,40,000
	(Being option accepted by 400 employees & payment made @ Rs.56 share)			
	Profit & Loss A/c	Dr.	2,40,000	
	To Employees compensation expense A/c			2,40,000
	(Being Employees compensation expense transferred to Profit & Loss A/c)			

5. (a) In the books of Ayushman Insurance Co. Ltd.

Journal Entries

Date	*Particulars*		*(Rs. in crores)*	
			Dr.	*Cr.*
1.1.2015	Unexpired Risk Reserve (Fire) A/c	Dr.	20.00	
	Unexpired Risk Reserve (Marine) A/c	Dr.	15.00	
	Unexpired Risk Reserve (Miscellaneous) A/c	Dr.	5.00	
	To Fire Revenue Account			20.00
	To Marine Revenue Account			15.00
	To Miscellaneous Revenue Account			5.00
	(Being unexpired risk reserve brought forward from last year)			
31.12.2015	Marine Revenue A/c	Dr.	18.30	
	To Unexpired Risk Reserve A/c			18.30
	(Being closing reserve for unexpired risk created at 100% of net premium income amounting to Rs.18.3 crores i.e.18+7-6.70)			
	Fire Revenue A/c	Dr.	21.85	
	To Unexpired Risk Reserve A/c			21.85
	(Being closing reserve for unexpired risk created at 50% of net premium income of Rs. 43.7 crores i.e.43+5-4.30)			

	Miscellaneous Revenue A/c	Dr.	4.50	
	To Unexpired Risk Reserve A/c			4.50
	(Being closing reserve for unexpired risk created at 50% net premium income of Rs. 9 crores i.e. 12+4-7)			

Unexpired Risk Reserve Account

Date	*Particulars*	*Marine (Rs.)*	*Fire (Rs.)*	*Misc. (Rs.)*	*Date*	*Particulars*	*Marine (Rs.)*	*Fire (Rs.)*	*Misc. (Rs.)*
1.1.2015	To Revenue A/c	15.00	20.00	5.00	1.1.2015	By Balance b/d	15.00	20.00	5.00
31.12.2015	To Balance c/d	18.30	21.85	4.50	31.12.2015	By Revenue A/c	18.30	21.85	4.50
		33.30	41.85	9.50			33.30	41.85	9.50

(b) Computation of provision in the books of XY Bank Ltd.

	(Rs. ***in lakhs)***
Doubtful Assets (more than 3 years)	2,000
Less: Value of security (excluding DICGC cover)	(800)
	1,200
Less: DICGC cover	(200)
Unsecured portion	1,000
Provision:	
for unsecured portion @100%	1,000 lakhs
for secured portion @ 100%	800 lakhs
Total provision to be made in the books of XY Bank	1,800 lakhs

6. (a) Trading and Profit and Loss A/c

For the year ended 31st March 2014

	Head office Rs.	*Branch Rs.*		*Head office Rs.*	*Branch Rs.*
To Opening stock	1,25,000	-	By Sales	23,79,600	7,30,000
To Purchases	21,50,000	-	By Goods sent to branch	7,38,000	-
To Goods received from head office	-	7,38,000	By Closing stock (W.N.1 & 2)	5,43,000	81,000

To Gross profit c/d	13,85,600	73,000				
	36,60,600	8,11,000			36,60,600	8,11,000
To Office expenses	50,000	4,500	By Gross profit b/d		13,85,600	73,000
To Selling expenses	32,000	3,300				
To Staff salaries	45,000	8,000				
To Branch Stock Reserve (W.N.3)	36,000	-				
To Net Profit	12,22,600	57,200				
	13,85,600	73,000			13,85,600	73,000

Working Notes:

(1) Calculation of closing stock of head office:	Rs.
Opening Stock of head office	1,25,000
Goods purchased by head office	21,50,000
	22,75,000
Less: Cost of goods sold [31,17,600 (23,79,600+ 7,38,000) x100/180]	(17,32,000)
	5,43,000

(2) Calculation of closing stock of branch:	Rs.
Goods received from head office [At invoice value]	7,38,000
Less: Invoice value of goods sold [7,30,000 x 180/200]	(6,57,000)
	81,000

(3) Calculation of unrealized profit in branch stock:	
Branch stock Rs. 81,000	
Profit included 80% of cost	
Hence, unrealized profit would be = Rs. 81,000 x 80/180 =	Rs. 36,000

(b)

	Departments		
	R Rs.	S Rs.	T Rs.
Profit before adjustment of unrealized profits	54,000	40,500	27,000
Add: Managerial commission (1/9)	6,000	4,500	3,000
	60,000	45,000	30,000
Less: Unrealised profit on stock (Refer W.N.)	(6,000)	(6,750)	(3,000)
	54,000	38,250	27,000

Less: Managers' commission @ 10%	(5,400)	(3,825)	(2,700)
Profit after adjustment of unrealized profits	48,600	34,425	24,300

Working Notes:

Value of unrealised profit

	Rs.
Transfer by department R to	
S department (22,500 $\times$25/125) = 4,500	
T department (16,500 $\times$10/110) = 1,500	6,000
Transfer by department S to	
R department (21,000 $\times$ 15/100) = 3,150	
T department (18,000 $\times$ 20/100) = 3,600	6,750
Transfer by department T to	
R department (9,000 $\times$ 20/120) = 1,500	
S department (7,500 $\times$ 25/125) = 1,500	3,000

7. (a) Under following circumstances, an LLP can be wound up by the Tribunal:

(i) If the LLP decides that it should be wound up by the Tribunal;

(ii) If for a period of more than six months, the number of partners of the LLP is reduced below two;

(iii) If the LLP is unable to pay its debts;

(iv) If the LLP has acted against the interests of the integrity and sovereignty of India, the security of the state or public order;

(v) If the LLP has defaulted in the filing of the Statement of Account and Solvency with the Registrar for five consecutive financial years;

(vi) If the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

(b) Calculation of Total Remuneration payable to Liquidator

		Amount in Rs.
2% on Assets realised	45,00,000 x 2%	90,000
3% on payment made to Preferential creditors	1,25,000 x 3%	3,750
3% on payment made to Unsecured creditors (Refer W.N)		45,000
Total Remuneration payable to Liquidator		1,38,750

Working Note:

Liquidator's remuneration on payment to unsecured creditors =

Cash available for unsecured creditors after all payments including liquidation expenses, payment to secured creditors, preferential creditors & liquidator's remuneration

= Rs. 45,00,000 – Rs. 50,000 – Rs. 15,00,000 – Rs. 1,25,000 – Rs. 90,000 – Rs. 3,750

= Rs. 27,31,250

Sufficient amount is available for unsecured creditors therefore Liquidator's remuneration on payment to unsecured creditors = 3% x Rs. 15,00,000 = Rs. 45,000

(c) As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting Rs. 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2015.

(d)

			Rs. in crores
Profit after depreciation but before VRS Payment			75.00
Less:	Depreciation – No. adjustment required	-	
	VRS payments	32.10	
	Provision for taxation	10.00	
	Fringe benefit tax	5.00	(47.10)
Net Profit			27.90
No. of shares			9.30 crores

$$\text{EPS} = \frac{\text{Net profit}}{\text{No. of shares}} = \frac{27.90}{9.30} = \text{Rs. 3 per share.}$$

(e) Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results. For example if the assets of a company primarily consist of debtors and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key debtors have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.