Guideline Answers to Nov 2014 Exam Questions CA IPCC ADVANCED ACCOUNTING Group II

Question 1 is compulsory **(4 × 5 = 20 Marks)**
Answer **any five** questions from the **remaining six** questions **(16 × 5 = 80 Marks).** [Answer any 4 out of 5 in Q.7]

Note: Page Number References are given from
Padhuka's Students' Handbook on Advanced Accounting for CA Inter (IPC) – Group II

Question 1 (a): AS–19 Leases **5 Marks**

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 ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, Lessor will get back the Machinery. The Unguaranteed Residual Value at the end of the 4th year is ₹ 70,000. The IRR of the investment is 10%. The Present Value of Annuity Factor of ₹ 1 due at the end of 4th year at 10% IRR is 3.169. The Present Value of ₹ 1 due at the end of 4th year at 10% Rate Interest is 0.683.

State with reasons whether the Lease constitutes Finance Lease and also compute the Unearned Finance Income.

Solution: **See Page B.6.6, 6.7, Q.No.17, 18, Inter A/cs M–10, Final A/cs M 05, N 13 Qn**

1. Finance vs Operating Lease

Particulars		₹
(a) Present Value of Unguaranteed Residual Value (URV)	₹ 70,000 × 0.683	47,810
(b) Present Value of Lease Payments (PV of MLP)	₹ 7,00,000 – ₹ 47,810	6,52,190
(c) % of PV of MLP to Fair Value	$\frac{₹\ 6,52,190}{₹\ 7,00,000}$	**93.17%**

Conclusion: The Lease Term is 67%, 4/6th of the Asset's Useful Life. Also, the Present Value of Lease Payments is around 93% of the Fair Value, constituting substantial portion of the Fair Value. Therefore, the Lease is a **Finance Lease.**

2. Computation of Unearned Finance Income

	Particulars	₹
	Annual Lease Payments= $\frac{\text{PV of Lease Payments}}{\text{Annuity Factor for 3 years at 10\%}} = \frac{₹ 6,52,190}{3.169}$	2,05,803 p.a
	Total Lease Rentals for the Lease Period = ₹ 2,05,803 p.a × 4 years = MLP	8,23,212
Add:	Residual Value	70,000
	Gross Investment in the Lease	**8,93,212**
Less:	Present Value of MLP & URV = (6,52,190 + 47,810) **(See Note)**	(7,00,000)
	Unearned Finance Income	**1,93,212**

Note: PV of MLP & URV equals the Fair Value / Cost of Equipment at the inception of the lease = ₹ **7,00,000.**

Question 1 (b): As – 26 Intangible Assets **5 Marks**

A Company is showing an Intangible Asset at ₹ 88 Lakhs as on 01.04.2013. This asset was acquired for ₹ 120 Lakhs on 01.04.2009 and the same was available for use from that date. The Company has been following the policy of amortization of the Intangible Assets 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.

Solution: **See Page B.8.15, Q.No.43, Final A/cs N 08, Inter A/cs N 05, M 11 Qn**

1. **Rebuttable Presumption:** AS – 26 assumes that the useful life of an Intangible Asset will not exceed a period of 10 years, but this presumption is rebuttable.

2. **Amortisation Amount as per Company Policy:**
   (a) Amortisation Amount ₹ 120 Lakhs ÷ 15 years = ₹ 8 Lakhs p.a.
   (b) Accumulated Amortisation upto 31st March 2014 (for four years) = ₹ 8 Lakhs × 4 = ₹ 32 Lakhs.
   (c) Carrying Amount = ₹ 120 Lakhs – ₹ 32 Lakhs = ₹ 88 Lakhs = as per Books

3. **Future Amortisation:** The balance Carrying Amount of ₹ 88 Lakhs should be amortised over the balance Useful Life (11 years) at ₹ 8 Lakhs per annum.

Question 1 (c): AS – 11 Forward Contract — 5 Marks

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 Ltd, for the year ended 31st March 2014?

Solution: **See Page B.3.15, Q.No.32, Inter A/cs N 09 Qn**

The treatment under AS – 11 is as under –

Particulars		₹
1. Value at the rate prevailing at the inception of Forward Contract	30,000$ ×60.75	18,22,500
2. Value at the forward rate	30,000$×62.15	18,64,500
3. Total Loss on entering into forward contract=arising at inception for 6 months contract period (1–2)		42,000
4. Loss to be recognized for the year ended 31st March 2014, i.e. for 4 months	$= 42{,}000 \times \frac{4}{6}$	28,000

Interest Payments should be charged to Profit and Loss Account of each year at the Transaction Value on payment dates.

Question 1 (d): AS – 29 Contingent Liability — 5 Marks

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?

Solution: **See Page B.9.10, Q.No.21, Same as Inter A/cs N 12 Qn**

Hint Answer: Conditions as to recognition of Provision are **not satisfied**.
Only a Disclosure Note of Contingent Liability is required.

Question 2: Partnership – Sale to Company 6 months after Balance Sheet date — 16 Marks

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	₹
Capital Accounts:		**Plant**	**1,60,000**
P – 1,50,000		**Building**	**48,000**
Q – 1,30,000	**2,80,000**	**Debtors**	**75,000**
Sundry Creditors	**80,000**	**Stock**	**70,000**
Bank Overdraft	**45,000**	**Joint Life Policy**	**6,000**
		Profit & Loss A/c	**30,000**
		Drawings Account: P – 9,000	
		Q – 7,000	**16,000**
Total	**4,05,000**	**Total**	**4,05,000**

The operations of the business were carried on till 30.06.2014. P & Q both withdrew in equal amount half the amount of profit made during the current period of six months after charging depreciation at 10% per annum 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 ₹ 6,000 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 30.06.2014, the Firm sold its 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 30.06.2014.

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 30.06.2014.

(b) Realisation Account.

(c) Partners' Capital Accounts showing the final settlement between them.

Solution: **See Page A.2.46, Q.No.27, Similar to Inter A/cs N 88, M 90, M 08, N 08 Qn.**

1. Realisation Account

Particulars		₹	Particulars	₹
To Sundry Assets A/c (transfer)			By Creditors A/c (transfer)	60,000
– Stock		84,000	By Bank Overdraft A/c (transfer)	40,000
– Debtors		68,000	By PQ Ltd (Purchase Consideration)	3,79,600
– Plant		1,52,000		
– Building		45,600		
To Profit: trfd to Capital (equal)				
– P	65,000			
– Q	65,000	1,30,000		
Total		**4,79,600**	**Total**	**4,79,600**

2.Partners' Capital Accounts

Date	Particulars	P	Q	Date	Particulars	P	Q
30.06.2014	To Drawings (B/s)	9,000	7,000	01.01.2013	By balance b/d	1,50,000	1,30,000
30.06.2014	To P&L (as per B/s)	15,000	15,000	30.06.2014	By Profit **(WN 2)**	15,600	15,600
30.06.2014	To Drawings**(WN 2)**	7,800	7,800				
30.06.2014	To balance c/d	1,33,800	1,15,800				
	Total	**1,65,600**	**1,45,600**		**Total**	**1,65,600**	**1,45,600**
30.06.2014	To Shares in PQ Ltd	1,98,800	1,80,800	30.06.2014	By balance b/d	1,33,800	1,15,800
				30.06.2014	By Realisation A/c	65,000	65,000
	Total	**1,98,800**	**1,80,800**		**Total**	**1,98,800**	**1,80,800**

WN 1: Summary Balance Sheet as on 30th September 2014 (To find out Total Capital of the Firm)

Capital and Liabilities	₹	Properties and Assets		₹
		Non–Current Assets:		
Sundry Creditors (80,000 – 20,000)	60,000		Building (48,000 – 5%) **(Note)**	45,600
Bank Overdraft (45,000 – 5,000)	40,000		Plant (16,000 – 10% × 6 months)	1,52,000
Total Capital (Bal.fig)	**2,49,600**	**Current Assets:**	Stock	84,000
			Debtors	68,000
Total	**3,49,600**	**Total**		**3,49,600**

Note: The Question specifies Depreciation at 10% p.a. on Plant but 5% write off on Building. Hence, 6 months period not applied for Building [Alternatively, 6 months period can be applied for Building also.]

WN 2: Profit earned during six months to 30th June 2014

	Particulars	₹
	Total Capital on 30th June 2014 **(WN 1)**	2,49,600
	Net Capital on 31.12.2013 (Capital 2,80,000 – P & L Dr. 30,000 – Drawings 16,000)	2,34,000
	Net Increase (after Drawings)	15,600
Add:	Drawings (1/2 of Total Profit), hence equal to the Net Increase after Drawings	15,600
	Total Profit for the period	**31,200**

WN 3: Purchase Consideration

	Particulars	₹
	Total Net Assets as per Balance Sheet on takeover date **(WN 1)**	2,49,600
Add:	Goodwill	1,30,000
	Total	3,79,600

Question 3 (a): ESOP – Vesting Period > 1 Year **8 Marks**

X Ltd granted 500 Stock Options to its employees on 01.04.2011 at ₹ 50 per Share. The vesting period is 2 ½ years and the maximum exercise period is one year. Market Price on that date is ₹140 per Share. All the options were exercised on 30.06.2014. Pass Journal Entries giving suitable narrations, if the Face Value of Equity Share is ₹ 10 per Share.

Solution: **See Page A.3.30, Q.No.16, Similar to M 09 Qn**

1. Computation of Expense to be recognised (Vesting Period = 2½ years)

Particulars	Result
(a) **Fair Value of Option per Share =** MPS on Grant Date ₹ 140 **less** Exercise Price ₹ 50	₹ **90**
(b) No. of Shares vesting under the Scheme = given	500 Shares
(c) Total Fair Value of Options (a×b) to be recognised as Expense in 2½ years on straight–line basis	₹ 45,000
(d) Amount (in months rate 12:12:6) are ₹ 18,000, ₹ 18,000 and ₹ 9,000 for Financial Years 2011–2012, 2012–2013 and 2013–2014 respectively.	

2. Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
Year 1			
31.3.2012 (yr–end)	Employees Compensation Expense A/c Dr. To Employees Stock Option Outstanding A/c (Being Employee Compensation Expense recognised for 500 Options granted to Employees at discount of ₹ 90 each, amortised on SLM basis.)	18,000	 18,000
31.3.2012 (yr–end)	Profit and Loss A/c Dr. To Employees Compensation Expense A/c (Being Employees Compensation Expense of the year transferred to P&L A/c)	18,000	 18,000
Year 2			
31.3.2013 (yr–end)	Employees Compensation Expense A/c Dr. To Employees Stock Option Outstanding A/c (Being Employee Compensation Expense recognised for 500 Options granted to Employees at discount of ₹ 90 each, amortised on SLM basis.)	18,000	 18,000
31.3.2013 (yr–end)	Profit and Loss A/c Dr. To Employees Compensation Expense A/c (Being Employees Compensation Expense of the year transferred to P&L A/c)	18,000	 18,000
Year 3			
30.6.2013 (Date of Exercise)	Employees Compensation Expense A/c Dr. To Employees Stock Option Outstanding A/c (Being balance of Employee Compensation Expense amortised ₹ 45,000 – ₹ 36,000)	9,000	 9,000
30.6.2013 (Date of Exercise)	Bank A/c (500 Shares × ₹ 50) Dr. Employees Stock Option Outstanding A/c (500 Shares × ₹ 90) Dr. To Equity Share Capital A/c (500 Shares × ₹ 10) To Securities Premium A/c (500 Shares × ₹ 130) (Being 500 Shares allotted to Employees under ESOP at a Premium of ₹ 130 per Share, ₹ 50 per Share received in Cash, balance being ESOP Entitlement)	25,000 45,000	 5,000 65,000
31.3.2014 (yr–end)	Profit and Loss A/c Dr. To Employees Compensation Expense A/c (Being Employees Compensation Expense of the year transferred to P&L A/c)	9,000	 9,000

Question 3 (b): Issue of Convertible Debentures **8 Marks**

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 of ₹ 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 List – 01.06.2013, Date of Allotment – 01.07.2013, Rate of Interest on Debentures – 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 on 31st March 2014 (including Cash and Bank entries).

Solution: **See Page A.3.62, Q.No.1, Similar to N 13 Qn**

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
1st June 2013	Bank A/c [3,00,000 Debentures × ₹100]	Dr.	3,00,00,000	
	To Debenture Application & Allotment A/c			3,00,00,000
	(Being application money received for 3,00,000 Debentures at ₹100 each)			
1st July 2013	Debenture Application & Allotment A/c	Dr.	3,00,00,000	
	Underwriters A/c	Dr.	1,00,00,000	
	To Debentures A/c			4,00,00,000
	(Being allotment of 3,00,000 Debentures to Applicants, balance to Underwriters.)			
1st July 2013	Underwriting Commission A/c [4,00,00,000 × 3%]	Dr.	12,00,000	
	To Underwriters A/c			12,00,000
	(Being Commission Payable to Underwriters at 3%)			
1st July 2013	Bank A/c	Dr.	88,00,000	
	To Underwriters A/c			88,00,000
	(Being balance amount receivable from Underwriters, received)			
30th Sept 2013	Debenture Interest A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Being Debenture Interest paid at 10% p.a. for 3 months)			
1st Jan 2014	10% Debentures A/c	Dr.	3,20,00,000	
	To Equity Share Capital A/c (at ₹ 10)			80,00,000
	To Securities Premium A/c (at ₹ 30)			2,40,00,000
	(Being 8,00,000 Shares issued on Conversion of 4,00,000 × 80% = 3,20,000 Debentures)			
31st March 2014	Debenture Interest A/c	Dr.	12,00,000	
	To Cash / Bank			12,00,000
	(Being Interest paid on Debentures for 2nd half–year, computed as under –			
	$(4{,}00{,}00{,}000 \times 10\% \times \frac{3}{12} + 80{,}00{,}000 \times 10\% \times \frac{3}{12})$			
31st March 2014	Profit & Loss A/c		22,00,000	
	To Debenture Interest			22,00,000
	(Being Total Interest for the year transferred to P&L)			

Question 4: Internal Reconstruction **16 Marks**

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

Particulars		₹
EQUITY AND LIABILITIES		
1. Share Holders' Funds		
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)**

Particulars				₹
2. Non–Current Liabilities: Long Term Borrowings – 7% Debentures of ₹ 100 each				**4,00,000**
3. Current Liabilities:	**Other Current Liabilities**	**– Creditors**		**10,00,000**
		– Loan from Director		**2,00,000**
Total Liabilities				**54,50,000**
ASSETS				
1. Non–Current Assets				
Fixed Assets	**(a) Land & Building**		**20,00,000**	
	(b) Plant and 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 last 5 years.

The following scheme of reorganization was duly approved by the Court:

(a) Each Equity Share be reduced to ₹ 25.

(b) Each existing Preference Share to be reduced to ₹ 75, and then exchanged for one new 13% Preference Share of ₹ 50 each and one Equity Share of ₹ 25 each.

(c) 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.

(d) 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 in cash.

(e) 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.

(f) Goodwill does not have any value in the present. Decrease the value of Plant & Machinery, Stock and Debtors by ₹ 3,00,000, ₹ 1,00,000 and ₹ 2,00,000 respectively. Increase the value of Land & Building to ₹ 25,00,000.

(g) 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.

(h) 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.

Solution: **See Page A.4.7, Q.No.6, Similar to M 09 Qn**

Journal Entries

S.No.	Particulars		Dr. (₹)	Cr. (₹)
1.	Equity Share Capital (₹ 100) A/c	Dr.	40,00,000	
	To Equity Share Capital (₹ 25) A/c			10,00,000
	To Reconstruction A/c			30,00,000
	(Being Equity Shares of ₹ 100 each reduced to 25 each, and balance transferred to Reconstruction A/c, as per approved Scheme of Reconstruction dated……)			
2.	10% Preference Share Capital (₹ 100) A/c	Dr.	20,00,000	
	To 13% Preference Share Capital (₹ 50) A/c			10,00,000
	To Equity Share Capital (₹ 25) A/c			5,00,000
	To Reconstruction A/c			5,00,000
	(Being 20,000 Preference Shares of ₹ 100 each are converted into 20,000 13% Preference Shares of ₹ 50 each & 20,000 Equity Shares of ₹ 25 each)			

S.No.	Particulars		Dr. (₹)	Cr. (₹)
3.	Reconstruction A/c To Preference Dividend Payable A/c (Being arrears of Dividend on Pref.Shares payable for 1 year, ₹ 20,00,000 × 10%)	Dr.	2,00,000	 2,00,000
4.	Preference Dividend Payable A/c To Equity Share Capital (₹ 25) A/c (Being Equity Shares issued for arrears of Pref. Share Dividend)	Dr.	2,00,000	 2,00,000
5.	7% Debentures A/c To Debentureholders A/c (Being balance of 7% Debentures transferred to Debentureholders A/c)	Dr.	4,00,000	 4,00,000
6.	Debentureholders A/c To 13% Preference Share Capital (₹ 50) A/c To Bank A/c To Reconstruction A/c (Being ¾ of Debentureholders opting to take 13% Preference Shares at par, and remaining Debentureholders taking 90% cash payment for their Claims.)	Dr.	4,00,000	 1,00,000 2,70,000 30,000
7.	Directors' Loan A/c To Provision for Expenses / Contingent Liability (Being Contingent Liability provided & adjusted Interest of Loan payable to Director)	Dr.	2,00,000	 2,00,000
8.	Bank A/c To Equity Share Application & Allotment A/c (Being application money received on the 50,000 Equity Shares at ₹ 25 each)	Dr.	12,50,000	 12,50,000
9.	Equity Share Application & Allotment A/c To Equity Share Capital (₹ 25) A/c (Being Application Money transferred to Equity Capital A/c, on allotment)	Dr.	12,50,000	 12,50,000
10.	Underwriting Commission A/c To Bank A/c (Being Underwriting Commission paid, 4% on ₹ 12,50,000)	Dr.	50,000	 50,000
11.	Reconstruction A/c To Underwriting Commission (Being Underwriting Commission Expense transferred to Reconstruction A/c)	Dr.	50,000	 50,000
12.	Land and Buildings A/c To Reconstruction A/c (Being value of Land and Buildings appreciated as per Reconstruction Scheme)	Dr.	5,00,000	 5,00,000
13.	Reconstruction A/c To Bank A/c (Being payment of expenses on reconstruction)	Dr.	20,000	 20,000
14.	Reconstruction A/c To Profit and Loss A/c Being Profit and Loss A/c Debit balance written off using Reconstruction A/c)	Dr	23,00,000	 23,00,000
15.	Reconstruction A/c To Goodwill A/c To Plant and Machinery A/c To Stock A/c To Debtors A/c (Being various losses / intangible items written off using Reconstruction A/c, as per approved Scheme of Reconstruction dated……..)	Dr.	10,00,000	 4,00,000 3,00,000 1,00,000 2,00,000
16.	Reconstruction A/c To Capital Reserve A/c **(See Reconstruction A/c below)** (Being balance in Reconstruction A/c transferred to Capital Reserve)	Dr.	4,60,000	 4,60,000

WN: Reconstruction A/c

Particulars	₹	**Particulars**	₹
To Preference Dividend Payable (10%) A/c	2,00,000	By Equity Share Capital (₹ 100) A/c	30,00,000
To Bank (Expenses on Reconstruction)	20,000	By 10% Preference Share Capital (₹ 100) A/c	5,00,000
To Goodwill A/c	4,00,000	By Debentureholders A/c	30,000
To Plant and Machinery A/c	3,00,000	By Land and Buildings A/c	5,00,000
To Stock A/c	1,00,000		
To Debtors A/c	2,00,000		
To Profit & Loss A/c	23,00,000		
To Underwriting Commission A/c	50,000		
To Capital Reserve A/c **(balancing figure)**	**4,60,000**		
Total	**40,30,000**	**Total**	**40,30,000**

Note: Reconstruction A/c is prepared for clarification of Journal Entries, and computing the amt trfd to Capital Reserve.

Question 5 (a): Revenue A/c – General Insurance **8 Marks**

Metro General Insurance Company submits the following information for the year ended 31st March 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 are also available:

(i) Expenses of Management include ₹ 45,000 Surveyor's Fees and ₹ 55,000 Legal Expenses for settlement of claims.

(ii) Reserve for Unexpired Risk is to be maintained @ 40%. The balance of Reserve for Unexpired Risk as on 01.04.2013 was ₹ 28,40,000.

You are required to make the Revenue Account for the year ended 31st March 2014.

Solution: **See Page A.8.57, Q.No.18 & 19, M 88, N 02, N 11 Qn**

Form–B–RA – Revenue Account of Metro General Insurance Co. Ltd for the year ending 31st March 2014

	Particulars	**Sch.**	**This Yr**	**Last Yr**
	Premium Earned (Net)	1	75,56,000	
	Total (A)		**75,56,000**	
1.	Claims Incurred (Net)	2	51,63,000	
2.	Commission	3	1,57,000	
3.	Operating Expenses related to Insurance Business (Given 2,90,000 – Legal Exps 55,000 – Surveyor Fees 45,000)	4	1,90,000	
	Total (B)		**55,10,000**	
	Operating Profit / (Loss) from Marine Insurance Business (A – B)		**20,46,000**	
	Appropriations		**NIL**	
	Total (C)		**20,46,000**	

Schedule 1 – Premium Earned (Net)

	Particulars	This Yr
	Premiums from Direct Business Written	75,25,000
Add:	Premium on Re–Insurance accepted	8,25,000
Less:	Premium on Re–Insurance Ceded	(4,90,000)
	Total Premium Earned (Net)	78,60,000
Less:	Adjustment for change in Unexpired Risk Reserve **(Note)**	(3,04,000)
	Total Premium Earned (Net)	**75,56,000**

Note: Adjustment for Changes in Reserve for Unexpired Risks is computed as under –

	Particulars	Reserve
	Closing Balance required	40% of 78,60,000 = 31,44,000
Less:	Opening Balance available	28,40,000
	Amt to be transferred to Reserve for the year	**3,04,000**

Schedule 2 – Claims Paid (Net)

	Particulars	This Yr
	Claims Paid – Direct (Paid 49,70,000+ Due at end 7,38,000 (–) Due at beginning 6,85,000)	50,23,000
Add:	Claims on Re–Insurance accepted (Paid 5,10,000 + Due at end 70,000 (–) Due at beginning 95,000)	4,85,000
Less:	Claims on Re–Insurance Ceded (Paid 3,95,000 + Due at end 1,25,000 (–) Due at beginning 75,000)	(4,45,000)
Add:	Surveyor's Fees	45,000
Add:	Legal Expenses	55,000
	Total Claims Incurred	**51,63,000**

Schedule 3 – Commission

	Particulars	This Yr
	Commission paid :Direct	1,60,000
Add:	Commission on Re–Insurance accepted	15,000
Less:	Commission on Re–Insurance ceded	(18,000)
	Net Commission	**1,57,000**

Question 5 (b): CRAR of Banks **8 Marks**

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 Asset Ratio. State your observation on the Risk Weighted Asset Ratio.

Particulars	₹ Crores
Equity Share Capital	**400.00**
Statutory Reserve	**250.00**
Capital Reserve (of which ₹18 Crores were due to Revaluation of Assets & Balance due to Sale of Capital Assets)	**86.00**
Assets:	
Cash Balance with RBI	**12.00**
Balances with other Banks	**20.00**
Other Investments	**40.00**
Loans & Advances	
(a) Guaranteed by Government	**14.50**
(b) Others	**5,465.00**
Premises, Furniture & Fixtures	**74.00**
Off Balance Sheet Items	
(a) Guarantees and Other Obligations	**700.00**
(b) Acceptances, Endorsements and Letter of Credit	**4,900.00**

Solution: **See Page A.7.45, Q.No.18, N 10 Qn**

1. Computation of Tier I and Tier II Capital

Particulars		₹ Crores
Tier I – Capital:	Equity Share Capital	400.00
	Statutory Reserve	250.00
	Capital Reserve arising out of Surplus on Sale of Assets = Total 86 – Revaluation of Assets 18	68.00
Total (A)		**718.00**
Tier II – Capital:	Revaluation Reserve	18.00
	Less: Discount at 55%	(9.90)
Total (B)		**8.10**
Tier III – Capital Not yet operative		**NA**
Grand Total (A + B)		**726.10**

2. Computation of Risk Weighted Assets

Particulars	(%) Weight	₹ Crores	₹ Crores
Cash Balance with RBI	0	12.00	0
Balance with Other Banks	20	20.00	4.00
Other Investments (assumed not Equity Shares) **(See Note)**	100	40.00	40.00
Loans and Advances:			
(i) Guaranteed by the Government	0	14.50	0
(ii) Others	100	5,465.00	5,465.00
Premises, Furniture and Fixtures	100	74.00	74.00
Off–Balance Sheet Items:			
(i) Guarantees and other Obligations	100	700.00	700.00
(ii) Acceptance, Endorsements and Letter of Credit	100	4,900.00	4,900.00
Total			**11,183.00**

Note: If Other Investments are assumed as Equity Shares, Risk Weight shall be **125%.**

3. Capital to Risk–Weighted Assets Ratio (CRAR) = $\frac{\text{Capital Funds}}{\text{Risk Adjusted Assets}} \times 100 = \frac{726.10}{11183.00} \times 100 = \mathbf{6.49\%}$.

Inference: Benchmark CRAR is 9% whereas the Bank's CRAR is only **6.49%.**

Higher the CRAR – better stability – less risky, and lower the CRAR – lower stability – more risky.

Question 6 (a): Branch Account in Head Office Books **8 Marks**

LMN is having 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	₹	Particulars	₹
Stock as on 1st April 2013 (Invoice Price)	**40,000**	**Credit Sales**	**70,000**
Sundry Debtors as on 1st April 2013	**25,000**	**Discount Allowed to Debtors**	**300**
Cash in Hand as on 1st April 2013	**1,000**	**Expenses Paid by Head Office:**	
Office Furniture as on 1st April 2013	**4,000**	**Salary**	**4,000**
Goods Invoiced from Head Office (Invoice Price)	**1,80,000**	**Staff Welfare**	**750**
Goods Return to Head Office	**6,000**	**Telephone Expense**	**1,200**
Goods Return by Debtors	**1,250**	**Other Misc. Expenses paid by Branch**	**700**
Cash Received from Debtors	**65,000**	**Stock as on 31st March 2014 (at Invoice Price)**	**35,000**
Cash Sales	**1,20,000**	**Depreciation to be provided on Branch Furniture**	**10%**

Solution: **See Page A.1.60, Q.No.18, N 99, M 11 Qn**

Notes:

1. Depreciation on Furniture is not debited as a separate item in the Branch Account since the Furniture (Closing Balance) at the end is shown at the Depreciated Value.
2. Sales Returns and Discount are accounted for automatically since Opening and Closing balances of Debtors are stated in the Branch Account.

Branch Account in the books of Head Office

Particulars		₹	Particulars		₹
To balance b/d			By Stock Reserve on Opg Stk (₹ 40,000 × 25%)		10,000
– Stock	40,000		By Stock Reserve (₹ 1,80,000 × 25%)		45,000
– Debtors	25,000		By Goods Sent to Branch A/c (Returns)		6,000
– Furniture	4,000		By H.O Cash (65,000 + 1,20,000)		1,85,000
– Cash	1,000	70,000			
To Goods sent to Branch A/c		1,80,000			
To Stock Reserve (₹ 6,000 × 25%)		1,500	By balance c/d		
To Bank A/c:			– Stock	35,000	
– Staff Welfare	750		– Debtors **(WN)**	28,450	
– Salary	4,000		– Cash (1,000 – 700)	300	
– Telephone	1,200	5,950	– Furniture (4,000 – 10%)	3,600	67,350
To Stock Reserve on Clg Stk (35,000 × 25%)		8,750			
To P & L A/c – profit tfr **(balancing figure)**		**47,150**			
Total		**3,13,350**	**Total**		**3,13,350**

Working Notes: **Branch Debtors Account** (To ascertain Closing Debtors)

Particulars	₹	Particulars	₹
To balance b/d	25,000	By Cash (Collections)	65,000
To Credit Sales	70,000	By Sales Returns	1,250
		By Discount Allowed	300
		By balance c/d **(balancing figure)**	**28,450**
Total	**95,000**	**Total**	**95,000**

Question 6 (b): Departmental Accounts **8 Marks**

Mega Ltd, has two departments, A and B. From the following particulars, prepare Departmental Trading A/c and General Profit & Loss Account for the year ended 31st March 2014.

Particulars	Department A	Department B
Opening Stock as on 01.04.2013 (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.

Solution: **See Page A.1.13, Q.No.7, M 86, M 10 Qn**

Departmental Trading and Profit and Loss A/c for the year ending 31st March (₹)

Particulars	Dept A	Dept B	Total	Particulars	Dept A	Dept B	Total
To Opening Stock	70,000	54,000	1,24,000	By Sales	5,72,000	4,60,000	10,32,000
To Purchases	3,92,000	2,98,000	6,90,000	By Tfr – Pur. Goods	36,000	50,000	86,000
To Carriage Inward	6,000	9,000	15,000	By Tfr – FG	1,75,000	1,50,000	3,25,000
To Wages	54,000	36,000	90,000	By Tfr – FG Return	32,000	45,000	77,000
To Tfr – Purc. Goods	50,000	36,000	86,000	By Closing Stock			
To Tfr – FG	1,50,000	1,75,000	3,25,000	– Purc. Goods	24,000	30,000	54,000
To Tfr – Return of FG	45,000	32,000	77,000	– FG	1,02,000	62,000	1,64,000
To Gross Profit	**1,74,000**	**1,57,000**	**3,31,000**				
Total	**9,41,000**	**7,97,000**	**17,38,000**	**Total**	**9,41,000**	**7,97,000**	**17,38,000**
To Stock Reserve	8,311	4,609	12,920	By Gross Profit b/d	1,74,000	1,57,000	3,31,000
To Net Profit	**1,65,689**	**1,52,391**	**3,18,080**				
Total	**1,74,000**	**1,57,000**	**3,31,000**	**Total**	**1,74,000**	**1,57,000**	**3,31,000**

Working Note 1: GP Ratio

	Particulars	A	B
	Sales	5,72,000	4,60,000
Add:	Transfer of Finished Goods	1,75,000	1,50,000
Less:	Return of Finished Goods	(45,000)	(32,000)
	Net Sales	**7,02,000**	**5,78,000**
	Gross Profit as computed above	1,74,000	1,57,000
	Gross Profit Ratio	**24.78%**	**27.16%**

Working Note 2: Stock Reserve to be provided

Particulars	A	B
Closing Stock of Finished Goods	₹ 1,02,000	₹ 62,000
Element of Finished Goods from other Department 30%	30,600	18,600
Gross Profit Ratio of Other Department (**WN 1**)	27.16%	24.78%
Stock Reserve required to be maintained	**8,311**	**4,609**

Question 7 (a): AS – 5 Examples **4 Marks**

Give two examples of each of the following items:

Question	Example	Reference
(i) Change in Accounting Policy	• Change of Method of Depreciation from WDV to SLM or vice–versa. • Change in Cost Formula in measuring the Cost of Inventories.	**Page B.2.6, Q.No.22, (N 12 Qn)**
(ii) Change in Accounting Estimate	• Change in the estimate of Provision for Doubtful Debts on Sundry Debtors. • Change in the estimate of Useful Life of Fixed Assets.	**Page B.2.6, Q.No.22, (N 12 Qn)**
(iii) Extra Ordinary Items	• Attachment of property of the Enterprise, • An Earthquake, etc.	**Page B.2.1, Q.No.2, (N 12 Qn)**
(iv) Prior Period Items	• Omission of Income or Expenditure of prior periods rectified now, • Incorrect Rate of Depreciation in prior period, rectified now.	**Page B.2.1, Q.No.2, (N 12 Qn)**

Question 7 (b): AS – 11 Indicators of NFO **4 Marks**

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

Solution: **See Page B.3.16, Q.No.35**

The indicators of a Non–Integral Foreign Operation are –

1. **Autonomy:** While the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise,

2. **Transaction Pattern:** Transactions with the reporting enterprise are not a high proportion of the foreign operation's activities,
3. **Financing:** The activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise,
4. **Expenditure in Local Currency:** 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,
5. **Sales Pattern:** The foreign operation's sales are mainly in currencies other than the reporting currency,
6. **Effect of Cash Flows:** Cash Flows of the reporting enterprise are insulated from the day–to–day activities of the foreign operation rather than being directly affected by the activities of the foreign operation,
7. **Prices of products:** Sales Prices for the foreign operation's products are not primarily responsive on a short–term basis to changes in exchange rates but are determined more by local competition or local government regulation, and
8. **Local Market:** There is an active local sales market for the foreign operation's products, although there might be significant amounts of exports.

The appropriate classification for each operation can be established from **factual information** and **proper judgment**, based on the indicators listed above.

Question 7 (c): AS – 20 EPS **4 Marks**

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 Debt Instrument,

(iii) Equity Shares issued in Exchange for the settlement of Liability of the Enterprise,

(iv) Equity Shares issued for rendering of Services to the Enterprise,

(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 Asset other than in Cash.

Also define Potential Equity Share.

Solution: **See Page B.7.7, Q.No.17, and Page B.7.2, Q.No.5, Point 3**

When Equity Shares are issued.........	Included with effect from the ......
(a) In exchange for Cash.	Date when Cash is receivable.
(b) As a result of conversion of a Debt Instrument to Equity.	Date of conversion.
(c) In lieu of Interest or Principal on other Financial Instruments.	Date when interest ceases to accrue.
(d) In exchange for the settlement of a liability of the Enterprise.	Date when settlement becomes effective.
(e) As consideration for acquisition of an asset other than cash.	Date on which the acquisition is recognised.
(f) For the rendering of services to the enterprise.	Date on which the services are rendered.

Potential Equity Share: A Potential Equity Share is a Financial Instrument or other contract that entitles, or may entitle, its holder to Equity Shares. Some examples are –

(a) Debt Instruments or Preference Shares that are convertible into Equity Shares,

(b) Share Warrants,

(c) Options including Employee Stock Option Plans (ESOP) under which Employees of an Enterprise are entitled to receive Equity Shares as part of their remuneration, and other similar plans, and

(d) Shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements **(Contingently Issuable Shares)**, such as the acquisition of a business or other assets, or Shares issuable under a Loan Contract, upon default of payment of principal or interest, if the contract so provides.

Question 7 (d):Income Recognition Norms of Banks **4 Marks**

Find out the Income to be recognized by ABC Bank Ltd, for the year ended 31st March 2014, in respect of Interest on Advance [₹ in Lakhs] as detailed below:

	Performing Asset		Non–Performing Asset	
	Interest Earned	Interest Received	Interest Earned	Interest Received
Term Loan	280	180	170	20
Cash Credits and Overdrafts	1700	1630	310	48
Bills Purchased and Discounted	400	400	180	70

Solution: **See Page A.7.41, Q.No.9, N 98, N 09, M 10 Qn**

Particulars	Performing Asset (Accrual Basis)	Non–Performing Asset (Receipt Basis)	Total Interest (in ₹ Crores)
Interest on Term Loan	280	20	300
Interest on Cash Credit and Overdrafts	1,700	48	1,748
Interest on Bills Purchased and Discounted	400	70	470
Total Income to be recognised	**2380**	**138**	**2,518**

Question 7 (e): Electricity Companies – Treatment of SLC **4 Marks**

State any four alternative Accounting Treatment of the Fund received by an Electricity Company from Consumer towards Capital Expenditure/Service Line Contribution.

Solution: **See Page A.9.7, Q.No.14**

Capital Service Line Contributions: Different SERCs prescribe Service Line cum Development (SLD) Charges Norms as per Sec.47 of the Electricity Act. Accounting for and Reporting of this source of funds of Electricity Companies may be in any of the following ways –

1. Initial Recording as **Liability,** and subsequently recognized as **Income** over the life of the asset,
2. Recording 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. Recording as **Reserves** (as the amount is not refundable) and **subsequent** transfer of proportionate amount to Income Statement during the expected life of the asset to match against Depreciation on total cost of such asset, or
4. Recording as reduction in the Cost of Non–Current Asset, and providing Depreciation on such reduced cost.

Note: Generally, the **third alternative** suggested above, i.e. treatment as Reserve and consequent recognition of **Income** every year may be widely adopted.

STUDENTS' NOTES

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