PAPER – 5 : ADVANCED ACCOUNTING

QUESTIONS

Partnership - Dissolution of a firm

1. A partnership firm was dissolved on 30th June, 2011. Its Balance Sheet on the date of dissolution was as follows:

Liabilities	₹	₹	Assets	₹
Capitals:			Cash	5,400
Hary	38,000		Sundry Assets	94,600
Charlie	24,000			
Prince	18,000	80,000		
Loan A/c – Charlie		5,000		
Sundry Creditors		15,000		
		1,00,000		1,00,000

The Assets were realized in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 14,500 in full settlement of their account. Expenses of realization were estimated to be ₹ 2,700 but actual amount spent was ₹ 2,000. This amount was paid on 15th September. Draw up a statement showing distribution of cash, which was realized as follows:

	₹
On 5th July, 2011	12,600
On 30th August, 2011	30,000
On 15th September, 2011	40,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Give working notes.

Partnership - Conversion of a firm to a Company

2. Ramesh, Roshan and Rohan were partners of the firm '3R Enterprises' sharing profits and losses in the ratio of 3:2:1 respectively. On 31st March, 2011 their Balance Sheet stood as follows:

Liabilities	₹	*Assets*	₹
Ramesh's Capital A/c	16,80,000	Land and Buildings	14,00,000
Roshan's Capital A/c	11,60,000	Machinery	11,00,000
Rohan's Capital A/c	6,70,000	Furniture	6,10,000
General Reserve	6,30,000	Stock	8,40,000

Creditors	6,00,000	Debtors	6,00,000
		Cash at Bank	1,90,000
	47,40,000		47,40,000

On the above-mentioned date, the partners decided to convert their firm into a private limited company and named it '3R Enterprises (Private) Ltd.'. The company took over all the assets including cash at bank and all the creditors for ₹ 42,00,000 payable in the form of fully paid equity shares of ₹ 10 each. It recorded in its books, land and buildings at ₹ 16,40,000, machinery at ₹ 9,90,000 and created a provision for bad debts @ 5% on debtors. The expenses of the take-over came to ₹ 23,000 which were paid and borne by the company.

The expenses of getting the company incorporated were ₹ 57,000.

The partners distributed the company's shares amongst themselves in their profit sharing ratio. They settled their accounts by paying or receiving cash.

Prepare Realization Account and all the partners' capital accounts in the firm's ledger and pass journal entries in the books of the company for all of its transactions mentioned above.

Partnership-Sale to a Company

3. A and B were carrying on business sharing profits and losses equally. The firm's Balance Sheet as at 31.12.2009 was:

Liabilities		₹	Assets		₹
Sundry Creditors		60,000	Stock		60,000
Bank overdraft		35,000	Machinery		1,50,000
Capital A/cs:			Debtors		70,000
A	1,40,000		Joint Life Policy		9,000
B	1,30,000	2,70,000	Leasehold Premises		34,000
			Profit & Loss A/c		26,000
			Drawings Accounts:		
			A	10,000	
			B	6,000	16,000
		3,65,000			3,65,000

The business was carried on till 30.6.2010. The partners withdrew in equal amounts half the amount of profits made during the period of six months after charging depreciation at 10% p.a. on machinery and after writing off 5% on leasehold premises. In the half year, sundry creditors were reduced by ₹ 10,000 and bank overdraft by ₹ 15,000.

On 30.6.2010, stock was valued at ₹ 75,000 and Debtors at ₹ 60,000; the Joint Life Policy had been surrendered for ₹ 9,000 before 30.6.2010 and other items remained the same as at 31.12.2009.

On 30.6.2010, the firm sold the business to a Limited Company. The value of goodwill was fixed at ₹ 1,00,000 and the rest of the assets were valued on the basis of the Balance Sheet as at 30.6.2010. The company paid the purchase consideration in Equity Shares of ₹ 10 each.

You are required to prepare: (a) Balance Sheet of the firm as at 30.6.2010; (b) The Realisation Account; (c) Partners' Capital Accounts showing the final settlement between them.

Employees Stock Option Plan

4. Brite Ltd. has its share capital divided into shares of ₹ 10 each. On 1st April, 2010, it granted 25,000 employees stock options at ₹ 50 when the market price was ₹ 140 per share. The options were to be exercised between 1st January, 2011 and 28th February, 2011. The employees exercised options for 24,000 shares only; the remaining options lapsed. The company closes its books of account on 31st March every year.

   You are required to show journal entries for all the above-mentioned transactions.

Buy-back of Shares

5. X Ltd. resolves to buy back 4 lakhs of its fully paid equity shares of ₹ 10 each at ₹ 22 per share. For the purpose, it issues 1 lakh 11 % preference shares of ₹ 10 each at par, the entire amount being payable with applications. The company uses ₹ 16 lakhs of its balance in Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back. Give necessary journal entries to record the above transactions.

Underwriting of Shares

6. W Ltd. issued 1,00,000 equity shares and got the entire issue underwritten as follows:

   P 60% shares, Q 25% shares and R 15% shares.

   In addition to the above-mentioned arrangement, there was the following firm underwriting:

   P 5,000 shares, Q 4,000 shares and R 3,000 shares.

   Total subscriptions including firm underwriting were 85,000 shares.

   The marked applications were as follows:

   P 19,000 shares, Q 20,000 shares and R 6,000 shares.

   The shares underwritten firm were treated as unmarked applications.

   Calculate the liability of each one of the underwriters in shares.

Redemption of Debentures

7. On 1st January, 2011, Blue Lotus Limited had ₹ 8,00,000 5% Debentures, outstanding in its books, redeemable on 31st December, 2011.

   On 1st January, 2011, the balance in Sinking Fund was ₹ 7,49,000 represented by:

   (i) ₹ 1,00,000 Own Debentures purchased at an average price of ₹ 99; and

   (ii) ₹ 6,60,000 nominal value of 3% War Loan.

   The amount annually credited to the Sinking Fund was ₹ 28,400.

   The interest on debentures was paid by the company every year on 31st December and interest on War Loan was received also on 31st December annually.

   On 31st December, 2011 the outside investments were realized at 98 per cent and all the outstanding Debentures were redeemed on that date.

   You are required to write up the necessary ledger accounts for the year 2011 in the books of the company.

Amalgamation of Companies

8. All India Motels Ltd. absorbed the business of West India Motels Ltd. as on 31st March, 2011. Their respective positions of assets and liabilities as on that date to absorption were as under:

	All India	West India
	₹	₹
Share Capital	6,00,00,000	6,00,00,000
Reserves and Surplus	5,40,00,000	3,60,00,000
Debentures	8,00,00,000	9,60,00,000
Sundry Creditors	2,20,00,000	4,80,00,000
Goodwill	4,48,00,000	3,20,00,000
Buildings	11,60,00,000	11,20,00,000
Machinery	1,80,00,000	1,60,00,000
Sundry Debtors	60,00,000	5,60,00,000
Stock/Inventory	80,00,000	2,00,00,000
Cash	32,00,000	40,00,000
Investments	2,00,00,000	-

The intrinsic value of West India shares has to be determined. Equivalent intrinsic value worth of ₹ 10 fully paid up shares of All India are to be issued to the shareholders of West India. 50% of debtors of All India comprises of moneys due from West India. Inventory of West India includes goods worth ₹ 30 lakhs sold by All India at cost plus

20% value. Called and paid up on All India shares is ₹ 8 per share whilst it is ₹ 5 per share in case of West India. Face value of shares of both the companies is ₹ 10. Investments were valued at ₹ 2,60,00,000.

Indicate the necessary journal entries to record the above transactions assuming amalgamation in the nature of purchase.

Internal Reconstruction of a Company

9. The Balance Sheet of Assurance Co. Ltd. as on 31-3-2011 is as follows:

Liabilities		₹	Assets	₹
Share capital:			Freehold Property	3,50,000
2,000, 6% Cumulative preference			Plant	50,000
shares of ₹ 100 each fully paid up		2,00,000	Trade Investments (at cost)	60,000
75,000, Equity shares of ₹ 10			Debtors	4,00,000
each fully paid up		7,50,000	Stock	2,00,000
6% Debentures			Deferred Advertising Exp.	1,50,000
(Secured by freehold property)	3,75,000		Profit & Loss A/c	3,50,000
Accrued interest	22,500	3,97,500		
Creditors		12,500		
Directors' loan		2,00,000		
		15,60,000		15,60,000

The Court approved a scheme of reorganization to take effect on 1-4-2011 whereby:

(i) Preference shares to be written down to ₹ 75 each and Equity shares to ₹ 2 each.

(ii) Preference dividends is in arrears for 4 years, 75% to be waived off and Equity shares of ₹ 2 each to be allotted for the remaining quarter.

(iii) Accrued debenture interest to be paid in cash.

(iv) Debentureholders agreed to take over Freehold Property (Book Value – ₹ 1,50,000) at a valuation of ₹ 1,50,000 in part repayment of their holdings and to provide additional cash of ₹ 1,30,000 secured by a floating charge on the Company's assets at an interest rate of 10% p.a.

(v) Deferred Advertising to be written off.

(vi) Stock to be written off fully.

(vii) ₹ 2,33,000 to be provided as doubtful debts.

(viii) Remaining Freehold Property to be revalued at ₹ 4,00,000.

(ix) Investment sold out for ₹ 1,50,000.

(x) In settlement of their loans, Directors are to accept Equity Share of ₹ 2 each for 90% of their loans, waving 10% of the balance of their loan amount.

(xi) Capital commitments contracts totaling ₹ 3,00,000 are to be cancelled by payment of penalty @ 5% of Contract Value.

(xi) Taxation and cost of scheme are to be ignored.

Show Journal entries, reflecting the effect of the above transactions (including cash transactions) and draw up the Balance Sheet after effecting the Scheme.

Liquidation of a Company

10. The liquidation of a joint stock company commenced on 1st April, 2011. Certain creditors could not receive payment out of realization of assets and the contributions from A list contributories. The following are the details of certain transfers which took place:

Shareholder's name	No. of shares transferred	Date of ceasing to be a member	Creditors remaining unpaid and outstanding on the date of each transfer ₹
A	2,000	2nd March, 2010	5,000
B	1,500	3rd May, 2010	3,300
C	1,000	1st Sept., 2010	4,300
D	500	23rd Nov., 2010	4,600
E	300	1st Feb.,2011	6,000

All the shares were of the face value of ₹ 10 each, ₹ 8 per share paid up.

Show the amount to be realized from the various persons listed above, ignoring expenses and remuneration to liquidator.

Financial Statements of Banking Companies

11. The following figures have been taken from the books of National Bank Limited as on 31st March, 2011:

	₹
Paid up share capital	20,00,000
Interest and discount received	74,11,000
Interest paid on deposits	40,74,000
Salaries and allowances	4,00,000
Rent and taxes paid	1,80,000
Directors' fees and allowances	60,000

Statutory reserve fund	16,00,000
Postages and telegrams	1,20,000
Rent received	1,30,000
Commission, exchange and brokerage	3,80,000
Profit on sale of investments	4,00,000
Depreciation on bank's property	60,000
Law charges	80,000
Auditors' fees	10,000

The following additional information is given to you :

(i) One customer to whom a sum of ₹ 20 lakhs was advanced has become insolvent and it is expected that only 50% of the amount will be recovered from his estate.

(ii) Auditors find that a provision of ₹ 3 lakhs is necessary against other debts.

(iii) Rebate on bills discounted on 31st March, 2010 was ₹ 24,000 and on 31st March, 2011 was ₹ 32,000.

(iv) Provide ₹ 13,00,000 for income tax.

(v) The Board of Directors decides to declare dividend @ 10% after transfer of 25% of the year's profit to Statutory Reserve.

You are required to prepare Profit and Loss Account of the bank with all the necessary schedules for the year ended 31st March, 2011. Ignore figures for the previous year and corporate dividend tax.

Financial Statements of Insurance Companies

12. The following particulars are presented to you by Goodluck General Insurance Company regarding its fire insurance business for the year ended 31st March, 2011:

	₹	₹
Reserve for unexpired risk on 31st March, 2010		
(i) 50% of net premium income for 2009-2010	5,00,000	
(ii) Additional reserve on 31st March, 2010	1,00,000	6,00,000
Claims paid		2,80,000
Commission paid		80,000
Bad debts		10,000
Expenses of management		2,90,000
Premiums received less reinsurances		12,10,000

Claims outstanding on 31st March, 2010		1,00,000
Commission earned on reinsurance ceded		59,000
Estimated liability on 31st March, 2011 in respect of claims due or intimated		2,00,000

Prepare the Fire Revenue Account for the year ended 31st March, 2011 in the proper form and with necessary schedules. On 31st March, 2011 the company decides to keep total additional reserve for unexpired risk equal to 15% of the net premium income for the year.

Financial Statements of Electricity Companies

13. Damini Electricity Company earned a profit of ₹ 1,20,00,000 (after tax) for the year ended 31st March, 2011 on which date it had a capital base of ₹ 8,74,00,000 and the bank rate was 8%. The following additional information about the company is also provided to you:

	₹
Reserve Fund Investment, invested in 8% Government securities at par	1,20,00,000
Contingencies Reserve Fund Investments @ 7% per annum	50,00,000
Loan from State Electricity Board	1,00,00,000
11% Debentures	8,00,000
Development Reserve	32,00,000

Show how the surplus of the company will be disposed off under the provisions of the Electricity Act.

Departmental Accounting

14. The following balances were extracted from the books of M/s Division. You are required to prepare Departmental Trading Account and Profit and Loss account for the year ended 31st December, 2011 after adjusting the unrealized department profits if any.

	Deptt. A ₹	Deptt. B ₹
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were ₹ 1,25,000 and you are also supplied with the following information: (a) Closing stock of Department A ₹ 1,00,000 including goods from Department B for ₹ 20,000 at cost of Department A. (b) Closing stock of Department B ₹ 2,00,000 including goods from Department A for ₹ 30,000 at cost to Department B. (c) Opening stock of Department A and Department B include goods of the value of ₹ 10,000 and ₹ 15,000 taken form Department B and Department A respectively at cost to transferee departments. (d) The gross profit is uniform from year to year.

Branch Accounts

15. Universal Ltd. has a branch which closes its books of account every year on 31st March.

    You are required to show journal entries in the books of branch on 31st March, 2011 to rectify or adjust the following:

    (i) Head office allocates ₹ 35,000 to the branch as head office expenses, which have not yet been recorded by branch.

    (ii) Depreciation of branch fixed assets, whose accounts are kept by head office in its books, not yet recorded in the branch books, ₹ 15,000.

    (iii) Branch paid ₹ 40,000 as salary to a head office official on visit to branch and debited the amount to its Salaries Account.

    (iv) Head Office collected ₹ 30,000 directly from a branch customer on behalf of the branch but no intimation was received earlier by the branch. Now the branch learns about it.

    (v) It is learnt that a remittance of ₹ 50,000 sent by the branch has not been received by head office till date.

16. A Chennai merchant opens a new branch in Kolkata which trades independently of the Head Office. The transactions of the Branch for the year ended 31-3-2011 are as under:

	₹	₹		₹
Goods supplied by			Cash received from	30,400
Head Office		20,000	Customers	
Purchases from outsiders-			Cash paid to Creditors	14,200
Credit	15,500		Expenses paid by Branch	8,950
Cash	3,000	18,500	Furniture purchased by	
Sales : Credit	25,000		Branch on Credit	3,500
Cash	4,600	29,600	Cash received from Head	
			Office initially	4,000
			Remitted to Head Office	11,000

Prepare the Branch Trading and Profit & Loss Account and the Branch Account in the Head Office Books after incorporation of the Branch trial balance taking the following into consideration:

(a) The accounts of the Branch Fixed Assets are maintained in H.O. books.

(b) Write off depreciation on Furniture at 5 per cent per annum.

(c) A remittance of ₹ 2,000 from the Branch to the Head Office is in transit.

(d) The Branch Closing Stock is valued at ₹ 12,000.

Accounting Standards

AS 4

17. (a) A Limited Company closed its accounting year on 30.6.2010 and the accounts for that period were considered and approved by the board of directors on 20th August, 2010. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2010 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.2010.

AS 5

(b) A Limited Company finds that the stock sheets as on 31.3.2010 had included twice an item the cost of which was ₹ 20,000.

You are asked to suggest, how the error would be dealt with in the accounts of the year ended 31.3.2010.

AS 11

18. (a) S Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.2010 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.2010 and 31.12.2010 respectively. First instalment was paid on 31.12.2010. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

AS 12

(b) A company purchased on April 1, 2010 a special purpose machinery for ₹ 1 crore, and received Central Government subsidy for 25% of the price. Effective life of the machinery is 8 years. Explain the accounting treatment and quote the relevant AS.

AS 16

19. (a) In May, 2010, S Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2011 and the building was put to use immediately thereafter. Interest on actual amount used for construction of the building till its completion was ₹ 18 lakhs whereas the total interest paid to the bank on the loan for the period till 31st March, 2011 amounted to

₹ 25 lakhs.

What amount of interest should be capitalized as per Accounting Standard - 16 ?

AS 19

(b) S&P Ltd. availed a lease from N&S Ltd. The conditions of the lease terms are as under:

(i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 years.

(ii) The Fair market value is also ₹ 10,00,000.

(iii) The property reverts back to the lessor on termination of the lease.

(iv) The unguaranteed residual value is estimated at ₹ 1,00,000 at the end of the year 2011.

(v) 3 equal annual payments are made at the end of each year.

Consider IRR = 10%.

The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513.

The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

State whether the lease constitute finance lease and also calculate unearned finance income.

AS 26

20. (a) AIIMS spent ₹ 4 crores during the last three years to develop a drug to be used in the treatment of brain tumour; the expenditure was charged to Profit and Loss Account since the expenditure did not meet Accounting Standard 26 criteria for capitalization. However, in the current year, approval of the Central Government Authority has been received to market the product. The Hospital wishes to capitalize 4 crores, the amount spent in the earlier years also and disclose it as a prior period item. Can it do so? Give reasons in support of your answer.

AS 20

(b) Compute Basic Earnings per share from the following information:

Date	*Particulars*	*No. of shares*
1st April, 2009	Balance at the beginning of the year	1,500
1st August, 2009	Issue of shares for cash	600
31st March, 2010	Buy back of shares	500

Net profit for the year ended 31st March, 2010 was ₹ 2,75,000.

AS 29

(c) An airline is required by law to overhaul its aircraft once in every five years. A company which operates aircrafts does not provide any provision as required by law in its final account. Discuss with reference to relevant Accounting Standard.

SUGGESTED ANSWERS/HINTS

1. Statement showing distribution of cash

	Creditors	Charlie's Loan	Hari	Charlie	Prince
2011	₹	₹	₹	₹	₹
June 30					
Balance b/d	15,000	5,000	38,000	24,000	18,000
Cash balance less Provision for expenses (₹ 5,400 – ₹ 2,700)	2,700	-	-	-	-
Balances unpaid	12,300	5,000	38,000	24,000	18,000
July 5					
1st Instalment of ₹ 12,600	11,800	800	-	-	-
Discount received on full settlement	500	4,200	38,000	24,000	18,000
Less: Transferred to Realisation A/c	500				
	Nil				
August 8					
2nd instalment of ₹ 30,000 (W.N. 2)		4,200	16,320	2,320	7,160
Balance unpaid		Nil	21,680	21,680	10,840
September 15					
Amount realised ₹ 40,000					
Add: Balance out of the Provision for Expenses A/c 700					
40,700					
Amount unpaid being loss on Realisation in the ratio of 2 : 2 : 1			16,280	16,280	8,140
			5,400	5,400	2,700

Working Notes:

1. Cash distribution to make capital proportionate

		Hari	Charlie	Prince
		₹	₹	₹
1.	Present Capitals	38,000	24,000	18,000
2.	Profit-sharing ratio	2	2	1
3	Capital per unit of Profit share (1 ÷ 2)	19,000	12,000	18,000
4.	Proportionate capitals taking Charlie, whose capital is the least, as the basis	24,000	24,000	12,000
5.	Excess capital (1-4)	14,000	Nil	6,000
6.	Proportionate capitals as between Hari and Prince taking Prince capital as the basis	36,000	-	18,000
7.	Excess of Hari's Capital (1-6)	2,000	-	-
8.	Distribution sequence:			
	First ₹ 2,000 (2 : 0 : 0)	2,000	-	-
	Next ₹ 18,000 (2 : 0 : 1)	12,000	-	6,000
	Over ₹ 20,000 (2 : 2 : 1)			

2. Second instalment is distributed as follows

			Creditors	Hari	Charlie	Prince
First	₹ 4,200		4,200	-	-	-
Next	₹ 2,000	(2 : 0 : 0)		2,000	-	-
Next	₹ 18,000	(2 : 0 : 1)		12,000	-	6,000
Balance	₹ 5,800	(2 : 2 : 1)		2,320	2,320	1,160
	30 000		4,200	16,320	2,320	7,160

2. In the books of 3R Enterprises

Realisation Account

	₹		₹
To Land and Buildings	14,00,000	By Creditors	6,00,000
To Machinery	11,00,000	By 3R Enterprises (Pvt.) Ltd. A/c	42,00,000
To Furniture	6,10,000		
To Stock	8,40,000		

To Debtors	6,00,000		
To Cash at Bank	1,90,000		
To Ramesh's capital	30,000		
To Roshan's capital	20,000		
To Rohan's capital	10,000		
	48,00,000		48,00,000

Partners' Capital Accounts

	Ramesh	Roshan	Rohan		Ramesh	Roshan	Rohan
	₹	₹	₹		₹	₹	₹
To Shares in 3R Enterprises (Pvt.) Ltd. A/c	21,00,000	14,00,000	7,00,000	By Balance b/d	16,80,000	11,60,000	6,70,000
				By General Reserve	3,15,000	2,10,000	1,05,000
To Bank A/c (Settlement)	-	-	85,000	By Realization A/c (Profit)	30,000	20,000	10,000
				By Bank A/c (Settlement)	75,000	10,000	-
	21,00,000	14,00,000	7,85,000		21,00,000	14,00,000	7,85,000

Journal Entries

			₹	₹
1.	Business Purchase A/c	Dr.	42,00,000	
	To M/s 3R Enterprises			42,00,000
	(Consideration payable for business purchased)			
2.	Land and Buildings A/c	Dr.	16,40,000	
	Machinery A/c	Dr.	9,90,000	
	Furniture A/c	Dr.	6,10,000	
	Stock A/c	Dr.	8,40,000	
	Debtors A/c	Dr.	6,00,000	
	Bank A/c	Dr.	1,90,000	
	To Creditors A/c			6,00,000
	To Provision for doubtful debts A/c			30,000
	To Business Purchase A/c			42,00,000
	To Capital Reserve A/c			40,000
	(Assets and liabilities taken over for ₹ 42,00,000; balance credited to capital reserve)			

3.	Capital reserve A/c To Bank A/c (Expenses for take over debited to capital reserve)	Dr.	23,000	 23,000
4.	M/s 3R Enterprises A/c To Equity share capital A/c (Allotment of fully paid equity shares to discharge consideration for business)	Dr.	42,00,000	 42,00,000
5.	Preliminary expenses A/c To Bank A/c (Expenses incurred to get the company incorporated)	Dr.	57,000	 57,000

3. (a) Balance Sheet as on 30.6.2010

Liabilities	₹	₹	Assets	₹	₹
Capital Accounts:			Machinery	1,50,000	
A's balance as on 1.1.2010	1,17,000		*Less*: Depreciation @ 10% p.a.	(7,500)	1,42,500
Add: Profit for 6 months	11,800		Leasehold premises	34,000	
	1,28,800		*Less*: Written-off @ 5%	(1,700)	32,300
Less: Drawings for 6 months	(5,900)	1,22,900	Stock		75,000
B's balance as on 1.1.2010	1,11,000		Sundry Debtors		60,000
Add: Profit for 6 months	11,800				
	1,22,800				
Less: Drawings for 6 months	(5,900)	1,16,900			
Sundry Creditors		50,000			
Bank overdraft		20,000			
		3,09,800			3,09,800

(b) Realisation Account

	Particulars	₹		Particulars	₹
To	Machinery A/c	1,42,500	By	Sundry Creditors A/c	50,000
To	Leasehold Premises A/c	32,300	By	Bank Overdraft A/c	20,000
To	Stock A/c	75,000	By	Limited Company A/c (W.N.2)	3,39,800

To Sundry Debtors A/c	60,000		
To A's Capital A/c	50,000		
To B's Capital A/c	50,000		
	4,09,800		4,09,800

(c) Partners' Capital Accounts

Date	Particulars	A	B	Date	Particulars	A	B
		₹	₹			₹	₹
1.1.10	To Profit & Loss A/c	13,000	13,000	1.1.10	By Balance b/d	1,40,000	1,30,000
	To Drawings A/c	10,000	6,000				
29.6.10	To Balance c/d	1,17,000	1,11,000				
		1,40,000	1,30,000			1,40,000	1,30,000
30.6.10	To Drawings A/c	5,900	5,900	30.6.10	By Balance b/d	1,17,000	1,11,000
	To Shares in Limited Company A/c	1,72,900	1,66,900	30.6.10	By Profit & Loss Appropriation A/c	11,800	11,800
					By Realisation A/c	50,000	50,000
		1,78,800	1,72,800			1,78,800	1,72,800

Working Notes:

(1) Ascertainment of profit for the 6 months ended 30th June, 2010

Closing Assets:	₹	₹
Stock		75,000
Sundry Debtors		60,000
Machinery less depreciation		1,42,500
Leasehold premises less written off		32,300
		3,09,800
Less: Closing liabilities:		
Sundry Creditors	50,000	
Bank overdraft	20,000	(70,000)
Closing Net Assets		2,39,800
Less: Opening combined capital:		
A – ₹ (1,40,000 – 13,000 – 10,000)	1,17,000	
B – ₹ (1,30,000 – 13,000 – 6,000)	1,11,000	(2,28,000)

Profit before adjustment of drawings		11,800
Add: Combined drawings during the 6 months (equal to profit)		11,800
Profit for 6 months		23,600

(2) Ascertainment of purchase consideration:

Closing net assets (as above) ₹ 2,39,800 + Goodwill ₹ 1,00,000 = ₹ 3,39,800.

4. Journal Entries

			₹	₹
April, 2010	Employees Compensation Expense A/c	Dr.	22,50,000	
	To Employees Stock Options Outstanding A/c			22,50,000
	(Grant of 25,000 stock options at ₹ 50 when the market price is ₹140)			
1st Jan. 2011 to 28th Feb. 2011	Bank A/c	Dr.	12,00,000	
	Employees Stock Options Outstanding 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 ₹10 each at a premium of ₹130 per share to the employees)			
Mar. 1	Employees Stock Options Outstanding A/c	Dr.	90,000	
	To Employee Compensation Expense A/c			90,000
	(Lapse of stock options for 1,000 shares)			
Mar 31	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. Journal Entries

			₹	₹
1.	Bank A/c	Dr.	10,00,000	
	To 11% Preference share application & allotment A/c			10,00,000
	(Being receipt of application money on preference shares)			
2.	11% Preference share application & allotment A/c	Dr.	10,00,000	
	To 11% Preference Share Capital A/c			10,00,000
	(Being allotment of 1 lakh preference shares)			
3.	Securities Premium A/c	Dr.	16,00,000	
	General Reserve A/c	Dr.	14,00,000	
	To Capital Redemption Reserve A/c			30,00,000
	(Being creation of capital redemption reserve for buy back of shares)			
4.	Equity share capital A/c	Dr.	40,00,000	
	General reserve A/c	Dr.	48,00,000	
	To Equity shareholders / Equity Shares buy back A/c			88,00,000
	(Amount payable to equity shareholder on buy back)			
5.	Equity shareholders/ Equity Shares buy back A/c	Dr.	88,00,000	
	To Bank A/c			88,00,000
	(Being payment made for buy back of shares)			

Working Notes:

1. Calculation of amount used from General Reserve Account

	₹
Amount paid for buy back of shares (4,00,000 shares x ₹22)	88,00,000
Less: Proceeds from issue of Preference Shares (1,00,000 shares x ₹10)	(10,00,000)

Less: Utilisation of Securities Premium Account	(16,00,000)
Balance used from General Reserve Account	62,00,000

2. Amount to be transferred to Capital Redemption Reserve account

	₹
Nominal value of shares bought back (4,00,000 shares x ₹10)	40,00,000
Less: Nominal value of Preference Shares issued for such buy back (1,00,000 shares x ₹10)	(10,00,000)
Amount transferred to Capital Redemption Reserve Account	30,00,000

Note: It is assumed that the buy-back of 4,00,000 equity shares is within the prescribed 25% limit of total equity shares.

6. Statement showing liability of underwriters

				(In shares)
	P	Q	R	Total
Gross liability	60,000	25,000	15,000	1,00,000
Less : Unmarked applications (85,000-45,000)	(24,000)	(10,000)	(6,000)	(40,000)
	36,000	15,000	9,000	60,000
Less : Marked applications	(19,000)	(20,000)	(6,000)	(45,000)
	17,000	(5,000)	3,000	15,000
Excess of Q distributed to P and R in the ratio of 60:15	(4,000)	5,000	(1,000)	-
	13,000	-	2,000	15,000
Add: Firm underwriting	5,000	4,000	3,000	12,000
Final/Total liability of the underwriters	18,000	4,000	5,000	27,000

7. 5% Debentures Account

Date	Particulars	₹	Date	Particulars	₹
2011			2011		
Dec. 31	To Sinking Fund Investment (Own Deb.)	1,00,000	Jan. 1	By Balance b/d	8,00,000
Dec. 31	To Bank	7,00,000			
		8,00,000			8,00,000

Sinking Fund Account

Date	Particulars	₹	Date	Particulars	₹
2011			2011		
Dec. 31	To Sinking Fund Investment (3% war loan)	3,200	Jan. 1	By Balance b/d	7,49,000
Dec. 31	To General Reserve	8,00,000	Dec. 31	By Bank (Interest on War loan)	19,800
				By Interest on own Debentures	5,000
				By P & L Appropriation A/c	28,400
				By Sinking Fund Investment (Own Debentures) A/c	1,000
		8,03,200			8,03,200

Sinking Fund Investments Accounts

(Own Debentures)

Date	Particulars	₹	Date	Particulars	₹
2011 Jan. 1	To Balance b/d (F.V. ₹ 1,00,000)	99,000	2011 Dec. 31	By 5% Debentures A/c	1,00,000
	To Sinking Fund A/c	1,000			
		1,00,000			1,00,000

Sinking Fund Investments Account

(3% War Loan Account)

Date	Particulars	₹	Date	Particulars	₹
2011 Jan. 1	To Balance b/d (7,49,000 – 99,000)	6,50,000	2011 Dec. 31	By Bank	6,46,800*
				By Sinking Fund A/c	3,200
		6,50,000			6,50,000

* Amount realized from sale of investments @ 98% (₹ 6,60,000 x 0.98 = ₹ 6,46,800).

8. Calculation of Intrinsic Value of Shares of West India Motels Ltd.

		₹
Goodwll		3,20,00,000
Buildings		11,20,00,000
Machinery		1,60,00,000
Sundry Debtors		5,60,00,000
Stock/Inventory		2,00,00,000
Cash		40,00,000
		24,00,00,000
Less: Creditors	4,80,00,000	
Debentures	9,60,00,000	(14,40,00,000)
Net assets available for shareholders		9,60,00,000
Share Capital		6,00,00,000
Paid-up value per share		₹ 5
Number of shares $\left(\frac{\text{₹ } 6,00,00,000}{\text{₹ } 5}\right)$		1,20,00,000
Initial value per share $\left(\frac{\text{₹ } 9,60,00,000}{1,20,00,000}\right)$		₹ 8

Calculation of Intrinsic Value of Shares of All India Motels Ltd.

		₹
Goodwill		4,48,00,000
Buildings		11,60,00,000
Machinery		1,80,00,000
Sundry Debtors		60,00,000
Stock/Inventory		80,00,000
Cash		32,00,000
Investments		2,60,00,000
		22,20,00,000
Less: Debentures	8,00,00,000	
Sundry Creditors	2,20,00,000	(10,20,00,000)
Value of Net assets available for shareholders		12,00,00,000

Paid-up value per share		₹ 8
Share Capital		6,00,00,000
Number of shares (₹ 6,00,00,000 ÷ 8)		75,00,000
Intrinsic value per share $\left(\frac{₹\ 12,00,00,000}{75,00,000}\right)$		₹ 16

Intrinsic value of Rs. 8 paid up value per share is ₹16. Therefore, intrinsic value of ₹ 10 paid up share will be ₹ 20 $\left(\text{i.e., } \frac{16}{8} \times ₹\ 10\right)$.

Calculation of purchase consideration

Total number of shares of West India Motels Ltd.	1,20,00,000 shares
Intrinsic value of 1,20,00,000 shares @ ₹ 8	₹ 9,60,00,000
Shares to be issued by All India Motels Ltd. @ ₹ 20	48,00,000 shares

In the Books of All India Motels Ltd.

Journal Entries

Date	Particulars		Dr.	Cr.
			Amount	Amount
2011			₹	₹
	Business Purchase A/c	Dr.	9,60,00,000	
	To Liquidators of West India Ltd.			9,60,00,000
	(Being business purchased)			
March	Goodwill (Bal. fig.)	Dr.	3,20,00,000	
31	Buildings A/c	Dr.	11,20,00,000	
	Machinery A/c	Dr.	1,60,00,000	
	Sundry Debtors A/c	Dr.	5,60,00,000	
	Stock A/c	Dr.	2,00,00,000	
	Cash A/c	Dr.	40,00,000	
	To Debentures A/c			9,60,00,000
	To Creditors A/c			4,80,00,000
	To Business Purchase A/c			9,60,00,000
	(Being assets and liabilities of West India Motels Ltd. taken over)			

	Liquidators of West India Motels Ltd.	Dr.	9,60,00,000	
	To Share Capital A/c			4,80,00,000
	To Securities Premium A/c			4,80,00,000
	(Being payment of purchase price by issue of 48,00,000 shares of ₹ 10 each at a premium of ₹ 10 per share)			
	Sundry Creditors A/c	Dr.	30,00,000	
	To Sundry Debtors A/c			30,00,000
	(Being the adjustment of mutual indebtedness)			
	Goodwill A/c	Dr.	5,00,000	
	To Stock A/c			5,00,000
	(Being the adjustment of unrealized profit on stock = ₹ 30,00,000 $\times \frac{20}{120}$)			

9. Journal Entries

	₹	₹
6% Preference Share Capital A/c Dr.	50,000	
To Capital Reduction A/c		50,000
(Being Preference Shares of ₹ 100 each reduced to ₹ 75 as per reconstruction scheme)		
Equity Share Capital A/c Dr.	6,00,000	
To Capital Reduction A/c		6,00,000
(Being equity shares of ₹ 10 reduced to ₹ 2 as per reconstruction scheme)		
Capital Reduction A/c Dr.	12,000	
To Equity Share Capital A/c		12,000
(Arrears of Preference Share dividend ₹ 48,000 for 4 years are to be satisfied by issue of ₹ 12,000 equity shares to the extent of 25% of ₹ 48,000)		
Accrued Debentures Interest A/c Dr.	22,500	
To Bank		22,500
(Accrued debenture interest paid)		

6% Debentures A/c Dr.	1,50,000	
To Freehold Property A/c		1,50,000
(Claim of debentureholders settled in part in respect of principal amount by transfer of freehold property as per reconstruction scheme)		
Bank A/c Dr.	1,30,000	
To 10% Debentures A/c		1,30,000
(10% Debentures issued for cash)		
Freehold Property A/c Dr.	2,00,000	
To Capital Reduction A/c		2,00,000
(Remaining freehold properties revalued)		
Bank A/c Dr.	1,50,000	
To Trade Investments		60,000
To Capital Reduction A/c		90,000
(Trade investment sold and profit credited to Capital Reduction A/c)		
Directors' Loan A/c Dr.	2,00,000	
To Equity Share Capital A/c		1,80,000
To Capital Reduction A/c		20,000
(Directors' Loan discharged by issue of share capital and the balance transferred to Capital Reduction A/c)		
Capital Reduction A/c Dr.	15,000	
To Bank		15,000
(Payment of cancellation of capital commitments)		
Capital Reduction A/c Dr.	9,33,000	
To Profit & Loss A/c		3,50,000
To Deferred Advertising Expenses A/c		1,50,000
To Stock A/c		2,00,000
To Provision for doubtful debts A/c		2,33,000
(Being the various assets written off as per reconstruction scheme)		

Balance Sheet of Assurance & Co. (As reduced) as on 1st April, 2011

Liabilities	₹	Assets	₹
Share Capital:		Fixed Assets	
1,71,000 Equity Shares of ₹ 2 each	3,42,000	Freehold Property Plant	4,00,000 50,000
[of the above 90,000 shares have been issued for consideration other than cash]		Current Assets, Loans & Advances Debtors (4,00,000- 2,33,000)	1,67,000
2,000 6% Cum. Pref. Shares of ₹ 75 each fully paid	1,50,000	Cash at Bank (1,30,000 + 1,50,000 – 22,500 – 15,000)	2,42,500
Reserves & Surplus	-		
Secured Loans:			
6% Debentures	2,25,000		
10% Debentures	1,30,000		
Current Liabilities:			
Creditors	12,500		
	8,59,500		8,59,500

10. Statement showing liability of B List Contributories

Name of shareholders	Shares	Maximum liability @ ₹ 2	3.5.2010	1.9.2010	23.11.10	1.2.11	Total
		₹	₹	₹	₹	₹	₹
B	1,500	3,000	1,500	-	-	-	1,500
C	1,000	2,000	1,000	555	-	-	1,555
D	500	1,000	500	278	188	-	966
E	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Notes:

1. Ratio of distribution

Date	Cumulative liability	Increase in liability	Ratio for distribution as per the maximum liability
3-5-2010	3,300	-	30:20:10:6
1-9-2010	4,300	1,000	20:10:6
23-11-2010	4,600	300	10:6
1-2-2011	6,000	1,400	Only E

2. Liability of shareholder 'E' is restricted to ₹ 600. Therefore, the amount payable by 'E' on 1.2.2011 is restricted to ₹ 21 only.

3. Shareholder 'A' is not liable as he had transferred his shares prior to one year preceding the date of winding up.

11. National Bank Limited

Profit and Loss account for the year ended 31st March, 2011

		Schedule No.	Year ended 31.3.2011
			₹
I.	Income		
	Interest earned	13	74,03,000
	Other income	14	9,10,000
			83,13,000
II.	Expenditure		
	Interest expended	15	40,74,000
	Operating expenses	16	9,10,000
	Provisions and contingencies (W.N.2)		26,00,000
			75,84,000
III.	Profit		
	Net profit for the year		7,29,000
	Profit brought forward		-
			7,29,000

IV.	Appropriations		
	Transfer to Statutory Reserve		1,82,250
	Proposed dividend		2,00,000
	Balance carried over to balance sheet		3,46,750
			7,29,000

Schedule 13 – Interest earned

	₹
Interest and discount earned (W.N.1)	74,03,000
	74,03,000

Schedule 14 - Other Income

	₹
Commission, exchange and brokerage	3,80,000
Profit on sale of investment	4,00,000
Rent	1,30,000
	9,10,000

Schedule 15-Interest Expended

	₹
Interest paid on deposits	40,74,000
	40,74,000

Schedule 16-Operating Expenses

	₹
Payment and provisions for employees	4,00,000
Rent and taxes paid	1,80,000
Depreciation on bank's property	60,000
Directors' fees and allowances	60,000
Auditors' fees	10,000
Law charges	80,000
Postage and Telegrams	1,20,000
	9,10,000

Working Notes:

			₹
1.	**Calculation of interest earned**		
	Interest and discount received		74,11,000
	Add: Rebate on bills discounted as on 31st March, 2010		24,000
			74,35,000
	Less: Rebate on bills discounted as on 31st March, 2011		(32,000)
			74,03,000
2.	**Provisions and Contingencies**		
	Provision for doubtful debts:		
	Doubtful debts due to insolvency of a customer (50% of ₹ 20 lakhs)	10,00,000	
	Provision for other debts	3,00,000	13,00,000
	Provision for income tax		13,00,000
			26,00,000

12. Goodluck General Insurance Company

Fire Revenue Account for the year ended 31st March, 2011

	Schedule	Current year ₹
Premium earned (Net)	1	10,23,500
Total (A)		10,23,500
Claims incurred (net)	2	3,80,000
Commission	3	21,000
Operating expenses relating to insurance business	4	2,90,000
Total (B)		6,91,000
Operating Profit from General Insurance Business C=(A)-(B)		3,32,500
Appropriations:		
Transfer to shareholders' accounts		3,32,500

Schedule 1: Premium Earned (Net)

			₹
Premium received less reinsurance			12,10,000

Adjustment for change in reserve for unexpired risk:			
Total opening provisions		6,00,000	
Closing provision:			
50% of net premium	6,05,000		
Additional provision @ 15%	1,81,500	(7,86,500)	(1,86,500)
Premium Earned (Net)			10,23,500

Schedule 2: Claims Incurred (Net)

	₹
Claims paid	2,80,000
Add: Claims outstanding at the end of the year	2,00,000
	4,80,000
Less: Claims outstanding at the beginning of the year	(1,00,000)
	3,80,000

Schedule 3: Commission

	₹
Commission paid	80,000
Less: Commission earned in reinsurance ceded	(59,000)
	21,000

Schedule 4: - Operating expenses relating to insurance business

Expenses of management	₹ 2,90,000

13. Calculation of Reasonable Return

	₹
10% (Bank rate 8% +2%) of capital base	87,40,000
8% on Reserve fund investments	9,60,000
½% on Loan from State Electricity Board	50,000
½% on 11% Debentures	4,000
½ on Development reserve	16,000
	97,70,000
Surplus:	
Clear Profit – Reasonable return (₹ 1,20,00,000-97,70,000)	₹ 22,30,000

20% of Reasonable Return	₹ 19,54,000
whichever is less is for disposal as surplus i.e.	₹ 19,54,000

Statement showing disposal of surplus

		₹
(i)	1/3rd of surplus limited to 5% of reasonable return is at the disposal of the company (1/3rd of surplus = ₹ 6,51,333 Or, 5% of reasonable return = ₹ 4,88,500)	4,88,500
(ii)	Credit to Tariffs and Dividend Control Reserve (1/2 of remaining balance of 20% of reasonable return) ₹ 19,54,000 – 4,88,500 = ₹ 14,65,500 x 1/2	7,32,750
(iii)	Remaining balance credited to customers account	7,32,750
		19,54,000

14. Departmental Trading and Profit & Loss Account of M/s Division

For the year ended 31st December, 2011

	Deptt. A	Deptt. B		Deptt. A	Deptt. B
	₹	₹		₹	₹
To Opening stock	50,000	40,000	By Sales	10,00,000	15,00,000
To Purchases	6,50,000	9,10,000	By Closing stock	1,00,000	2,00,000
To Gross profit	4,00,000	7,50,000			
	11,00,000	17,00,000		11,00,000	17,00,000
To General Expenses (in ratio of sales)	50,000	75,000	By Gross profit	4,00,000	7,50,000
To Profit transferred to general profit and loss account	3,50,000	6,75,000			
	4,00,000	7,50,000		4,00,000	7,50,000

General Profit and Loss Account

	₹		₹
To Stock reserve required (additional)		By Profit from:	
Stock in Deptt. A		Deptt. A	3,50,000
50% of (₹ 20,000 - ₹ 10,000) (W.N.1)	5,000	Deptt. B	6,75,000
Stock in Deptt. B			
40% of (₹ 30,000 - ₹ 15,000) (W.N.2)	6,000		
To Net Profit	10,14,000		
	10,25,000		10,25,000

Working Notes:

1. Stock of department A will be adjusted according to the rate applicable to department B = [(7,50,000 ÷ 15,00,000) x 100] = 50%
2. Stock of department B will be adjusted according to the rate applicable to department A = [(4,00,000 ÷ 10,00,000) x 100] = 40%

15. In the books of the Branch

Journal Entries

			₹	₹
(i)	Head Office Expenses A/c	Dr.	35,000	
	To Head Office A/c			35,000
	(Expenses allocated by the Head Office)			
(ii)	Depreciation of Fixed Assets A/c	Dr.	15,000	
	To Head Office A/c			15,000
	(Depreciation on fixed assets whose accounts are maintained by the Head Office)			
(iii)	Head Office A/c	Dr.	40,000	
	To Salaries A/c			40,000
	(Rectification of errors regarding salary paid to head office official)			
(iv)	Head Office A/c	Dr.	30,000	
	To Debtor A/c			30,000
	(Amount directly collected by head office from a branch debtor)			
(v)	No entry will be passed in the books of the Branch			

Note: It is presumed that Universal Ltd. has an independent branch which maintains comprehensive books of account for recording their transactions.

16. In the books of Head Office

Kolkata Branch Trading and Profit & Loss Account

For the year ending 31-3-2011

	₹	₹		₹	₹
To Goods supplied by			By Sales:		
Head Office		20,000	Cash	4,600	
Purchases:			Credit	25,000	29,600
Cash	15,500		By Closing Stock		12,000
Credit	3,000	18,500			
To Gross Profit c/d		3,100			
		41,600			41,600
To Expenses		8,950	By Gross Profit b/d		3,100
To Depreciation on Furniture		175	By Net Loss transferred to General Profit and and Loss A/c		6,025
		9,125			9,125

Kolkata Branch Account

	₹		₹	₹
To Cash	4,000	By Furniture		3,500
To Goods Sent to Branch	20,000	By Remittance	11,000	
To Branch Furniture	175	*Less*: In transit	2,000	9,000
		By General Profit and Loss A/c		6,025
		By Balance c/d		
		(15,850 – 10,200)		5,650
	24,175			24,175

Note:

1. Sundry Assets = Closing Stock ₹ 12,000 + Cash in transit ₹ 2,000+Cash in hand ₹ 1,850 [i.e. 4,000 +4,600 + 30,400 – 14,200 – 8,950 – 3,000 – 11,000] = ₹ 15,850.
2. Liabilities = Sundry Creditors ₹ 1,300 (i.e. 15,500 – 14,200) + Creditors for furniture ₹ 3,500 + Advance from Debtors ₹ 5,400 (i.e. ₹ 30,400 – ₹ 25,000) = ₹ 10,200.

17. (a) Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as

'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

In this case the incidence, which was expected to push up cost by ₹ 80 lakhs became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Directors' Report.

(b) The error in the recording of closing stock of the year ended 31st March, 2010 must have also resulted in overstatement of profits of previous year, brought forward to the current year ended 31st March, 2011. Vide para 4 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the rectifications is required in the current year as 'Prior Period Item'. Accordingly, ₹ 20,000 should be deducted from opening stock in the trading account and should be charged as prior period adjustment in the profit and loss account for the year ended 31st March 2011 in accordance with para 15 of AS 5 (Revised) which requires that the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

18. (a) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expense in the period in which they arise. Thus, exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{₹\ 3{,}000 \text{ lakhs}}{₹\ 40} = 75 \text{ lakhs US Dollars}$$

Exchange difference = 75 lakhs US Dollars ´ (42.50 – 40.00)

= ₹ 187.50 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

(b) As per para 8 of AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

According to the first alternative, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Therefore, on the basis of this alternative, the cost of special purpose machinery will be recorded in the books after reducing it by the amount of government subsidy of ₹ 25 lakhs. Thus, the depreciable value of the machinery recorded in the books will be ₹ 75 lakhs (i.e. ₹ 1 crore – ₹ 25 lakhs). Depreciation of ₹ 9.375 lakhs (i.e. ₹ 75 lakhs / 8 years) will be charged on it every year on straight line method.

Under the second alternative, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged.

Accordingly, machinery will be recorded in the books by ₹ 1 crore and depreciation will be charged on it for ₹ 12.5 lakhs (i.e. ₹ 1 crore / 8 years) per year on straight line method. Government subsidy of ₹ 25 lakhs will be treated as deferred income which will be recognized as income in the statement of profit and loss every year by ₹ 3.125 lakhs (i.e. ₹ 25 lakhs / 8 years).

19. (a) According to para 19 of AS 16 'Borrowing Costs', capitalisation of borrowing costs should cease when substantially all the activities to prepare the qualifying asset for its intended use or sale are completed.

In the given case, since the qualifying asset was ready to use in January, 2011, therefore, interest till that date can only be capitalized. Hence, interest of ₹ 18 lakhs will only be capitalized. The balance of ₹ 7 lakhs (i.e. 25-18) will be debited to Profit and Loss Account.

(b) (i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10% (₹ 1,00,000 × 0.7513)	75,130
Fair value to be recovered from lease payments (₹ 10,00,000 – ₹ 75,130)	9,24,870
Present value of annuity for three years is 2.4868	
Annual lease payment = ₹ 9,24,870/ 2.4868	3,71,911.70

The present value of lease payment i.e., ₹ 9,24,870 equals 92.48% of the fair market value i.e., ₹ 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	12,15,735
Less: Present value of investment (lease payments and residual value) (₹ 75,130 + ₹ 9,24,870)	(10,00,000)
Unearned finance income	2,15,735

20. (a) As per para 58 of AS 26 'Intangible assets', expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date.

Hence, AIIMS cannot capitalize ₹ 4 crores, which was spent and charged as an expense in the earlier years.

(b) Computation of weighted average number of shares outstanding during the period

Date	No. of equity shares	Period outstanding	Weights (months)	Weighted average number of shares
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1st April, 2009	1,500 (Opening)	12 months	12/12	1,500
1st August, 2009	600 (Additional issue)	8 months	8/12	400
31st March, 2010	500 (Buy back)	0 months	0/12	-
Total				1,900

$$\text{Basic Earnings Per Share} = \frac{\text{Net Profit or Loss for the period attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding during the period}}$$

$$= \frac{₹\ 2{,}75{,}000}{1{,}900 \text{ shares}} = ₹\ 144.74$$

(c) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprises can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

Appendix

Announcements and Notifications applicable for November, 2011 examination

1. **Limited Revisions due to Issuance of AS 30 and 31**

As per the announcement issued by the Accounting Standard Board of the ICAI regarding applicability of AS 30 (dated 11th February, 2011) in respect of the financial statements, it has been clarified that to the extent of accounting treatments covered by any of the existing notified accounting standards (for eg. AS 11, AS 13 etc,) the existing notified accounting standards would continue to prevail over AS 30.

2. **Amendment to Accounting Standard 11 of Companies (Accounting Standards) Rules, 2006**

Ministry of Corporate Affairs vides its notification number G.S.R. (E) has partially amended the notification number GSR No. 225(E) dated 31.03.2009. Through this notification, the MCA has extended the option (for the enterprises) to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March 2012 instead of 31st March 2011.

3. **Sale of Investments held under Held to Maturity (HTM) category**

Securities acquired by banks with the intention to hold them up to maturity may be classified under Held to Maturity (HTM) category. Banks are, however, allowed to shift investments to/from HTM with the approval of the Board of Directors once a year. Such shifting is normally allowed at the beginning of the accounting year and no further shifting to/from HTM is allowed during the remaining part of that accounting year. However, securities under HTM category are intended to be held till maturity and accordingly are not required to be marked to market.

RBI has decided vide a notification that if the value of sales and transfers of securities to/from HTM category exceeds 5 per cent of the book value of investments held in HTM category at the beginning of the year, bank should disclose the market value of the investments held in the HTM category and indicate the excess of book value over market value for which provision is not made. This disclosure is required to be made in 'Notes to Accounts' in banks' audited Annual Financial Statements.

Note: Accounting Standards 4, 5, 11, 12, 16, 19, 20 26, 29 are covered in the syllabus.

Non- applicability of Announcements and Notifications for November, 2011 examination

1. The MCA has issued 35 converged Indian Accounting Standards (Ind AS) without announcing the applicability date. These are the standards which are being converged by eliminating the differences of the Indian Accounting Standards vis-à-vis IFRS. These standards shall be applied for all companies falling under Phase I to Phase III as prescribed under the roadmap issued by the core group. **These Ind ASs are not applicable for the students appearing in November, 2011 Examination.**

2. **Enhancement of Rates of Provisioning for Non-Performing Assets and Restructured Advances**

   RBI vide its notification RBI 2010-11/529 DBOD.No.BP.BC. 94/21.04.048/2011-12 dated May 18, 2011 has revised provisioning requirements for the following categories of non-performing advances and restructured advances for all Scheduled Commercial Banks (Excluding RRBs) as under:

   1. **Sub-Standard Advances** : Advances classified as **"sub-standard"** will attract a provision of 15 per cent as against the existing 10 per cent. The "unsecured exposures" classified as sub-standard assets will attract an additional provision of 10 per cent, *i.e.,* a total of 25 per cent as against the existing 20 per cent. However, "unsecured exposures" in respect of Infrastructure loan accounts classified as sub-standard, in case of which certain safeguards such as escrow accounts are available will attract an additional provision of 5 per cent only i.e. a total of 20 per cent as against the existing 15 per cent.

   2. **Doubtful Advances** : Doubtful Advances will continue to attract 100% provision to the extent the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis. However, in respect of the secured portion, following provisioning requirements will be applicable:

      (i) The secured portion of advances which have remained in "doubtful" category up to one year will attract a provision of 25 per cent (as against the existing 20 per cent);

      (ii) The secured portion of advances which have remained in "doubtful" category for more than one year but upto 3 years will attract a provision of 40 per cent (as against the existing 30 per cent); and

      (iii) The secured portion of advances which have remained in "doubtful" category for more than 3 years will continue to attract a provision of 100%.

3. Restructured Advances:

   (i) Restructured accounts classified as standard advances will attract a provision of 2 per cent in the first two years from the date of restructuring. In cases of moratorium on payment of interest/principal after restructuring, such advances will attract a provision of 2 per cent for the period covering moratorium and two years thereafter (as against existing provision of 0.25-1.00 per cent, depending upon the category of advances); and

   (ii) Restructured accounts classified as non-performing advances, when upgraded to standard category will attract a provision of 2 per cent in the first year from the date of upgradation (as against existing provision of 0.25-1.00 per cent, depending upon the category of advances).

4. All other instructions on provisioning will remain unchanged.

   Rates of Provisioning for Non-Performing Assets and Restructured Advances are summarized as follows:

Category of Advances	Existing Rate (%)	Revised Rate (%)
Sub- standard Advances		
· Secured Exposures	10	15
· Unsecured Exposures	20	25
· Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as escrow accounts are available.	15	20
Doubtful Advances – Unsecured Portion	100	100
Doubtful Advances – Secured Portion		
· For Doubtful upto 1 year	20	25
· For Doubtful > 1 year and upto 3 years	30	40
· For Doubtful > 3 years	100	100
Loss Advances	100	100
Restructured accounts classified as standard advances in the first two years from the date of restructuring; and in cases of moratorium on payment of interest/principal after restructuring – period covering moratorium and two years thereafter.	0.25 to 1.00 (depending upon the category of advance)	2
Restructured accounts earlier classified as NPA and later upgraded to standard category in the first year from the date of upgradation	0.25 to 1.00 (depending upon the category of advance)	2

3. Non-applicability of Revised Schedule VI for November 2011 Examination

   This is to bring to the attention of students that a decision has been taken to defer the applicability of the Revised Schedule VI for CA examination, consequent to which the same will not be applicable for IPCC examinations to be held in November, 2011.