PAPER – 5 : ADVANCED ACCOUNTING

*Question No.**1** is compulsory.*

*Candidates are also required to answer any **five** questions from the remaining **six** questions.*

Working notes should form part of the respective answers.

Wherever necessary, candidates are permitted to make suitable assumptions which should be disclosed by way of a note.

Question 1

Answer the following questions:

(a) From the following information compute Basic and Diluted Earnings Per Share (EPS) of M/s. XYZ Limited for the year ended 31st March, 2017 :

Net Profit for the year after tax: ₹ 75,00,000

Number of Equity Shares of ₹ 10 each outstanding: ₹ 10,00,000

Convertible Debentures Issued by the Company

Particulars	*Nos.*
8% Convertible Debentures of ₹ 100 each	*1,00,000*
Equity Shares to be issued on conversion	*1,10,000*

Rate of Income Tax: 30%.

(b) Legal department of XYZ Limited provides that as on 31st March 2017, there were 25 law suits pending which have not been settled till the approval of accounts by the Board of Directors. The possible outcome of suits are follows:

Particulars	*Probability*	*Loss (₹)*
In respect of Seven cases (Win)	*100%*	
Next Twelve cases (Win)	*60%*	
Loss (Low damages)	*30%*	*1,50,000*
Loss (High damages)	*10%*	*2,50,000*
Remaining Six cases (Win)	*50%*	
Loss (Low damages)	*35%*	*1,25,000*
Loss (High damages)	*15%*	*3,00,000*

Outcome of each case is to be taken as a separate one. Ascertain the amount of contingent loss to be reported in the Financial Statement.

(c) Small Limited began construction of a building on 1st April, 2016 which is expected to cost ₹ 25,00,000. The construction of the building was financed through a special loan of

₹ 10,00,000 obtained at an interest rate of 10% per annum on 1st April, 2016. Further, expenditure on the building was financed through other non-specific finance arrangements of the company. Details of non-specific finance arrangements are as under:

Amount	*Rate of Interest P.a.*
₹ 30,00,000	*12%*
₹ 20,00,000	*15%*

Cumulative expenses incurred on the building were as follows:

Date	*Amount*
1st April, 2016	*₹ 5,00,000*
1st July 2016	*₹ 13,00,000*
1st November, 2016	*₹ 20,00,000*
31st January, 2017	*₹ 25,00,000*

Construction of the building was completed on 31st March, 2017. Following the principles specified in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized.

(d) The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories. ***(4 x 5 Marks = 20 Marks)***

Answer

(a) Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year

₹ 75,00,000 / 10,00,000 = ₹ 7.50 per share

Computation of diluted earnings per share $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of ₹ 8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

= 80,60,000/ 11,10,000

= ₹ 7.26 per share

Note:

1. Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.
2. The date of issue of convertible debentures is not given in the question. It has been assumed that debentures were issued at the beginning of the year.

(b) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning for first 7 cases is 100% and hence requirement of providing contingent loss does not arise. The probability of winning of next 12 cases is 60% and for remaining 6 cases is 50%. In other words, probability of losing the cases is 40% and 50% respectively. According to AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the probability or possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss. Hence, disclosure will be made for contingent liability.

For disclosure by way of note of contingent liability, amount may be calculated as under:

Expected loss in 12 cases = [₹ 1,50,000 x 0.3 + ₹ 2,50,000 x 0.1] x 12

= [₹ 45,000 + ₹ 25,000] x 12

= ₹ 70,000 x 12 = ₹ 8,40,000

Expected loss in remaining 6 cases = [₹ 1,25,000 x 0.35 + ₹ 3,00,000 x 0.15] x 6

= [₹ 43,750 + ₹ 45,000] x 6

= ₹ 5,32,500

Therefore, the overall expected loss of 13,72,500 (₹ 8,40,000 + ₹ 5,32,500) will be disclosed by way of contingent liability

(c) Interest amount to be capitalized

	Amount	*Rate of Interest*	*Interest to be capitalised*
Specific borrowings			
₹ 13,00,000 x 3 / 12	1,25,000		
₹ 10,00,000 x 9 / 12	7,50,000		
Total of Specific borrowings	8,75,000	10%	87,500
Non-specific borrowings			
(₹ 13,00,000 -10,00,000) x 4 / 12	1,00,000		
(₹ 20,00,000 -10,00,000) x 3 / 12	2,50,000		
(₹ 25,00,000 -10,00,000) x 2 / 12	2,50,000		

Amount of interest to be capitalized	6,00,000	13.20%	79,200
Total of Non-specific borrowings			1,66,700

Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	*Rate of interest*	*Amount of interest (₹)*
30,00,000	12%	3,60,000
20,00,000	15%	3,00,000
50,00,000		6,60,000
Weighted average rate of interest $\left(\frac{6,60,000}{50,00,000}\times 100\right)$		13.2%

(d) (i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 2

R and S are partners of RS & Co. sharing the profit and losses in the ratio of 3:2 and S and M were partners in SM & Co. sharing the profits and losses in the ratio of 4:1. On 31st March, 2017, they decided to amalgamate their firms and form a new firm namely M/s RSM & Co. wherein R, S, and M will share the profits and losses in the ratio of 5 : 3 : 2. The Balance Sheets of the two firms as on 31st March, 2017 were as under:

Liabilities	*RS& Co.*	*SM & Co.*	*Assets*	*RS& Co.*	*SM & Co.*
Capitals			*Fixed Assets*		
R	*2,50,000*		*Building*	*75,000*	*80,000*
S	*1,50,000*	*1,75,000*	*Plant and Machinery*	*2,00,000*	*1,50,000*
M		*1,25,000*	*Office Equipment*	*30,000*	*15,000*
Reserves	*40,000*	*1,25,000*			
Sundry Creditors	*60,000*	*2,25,000*	*Current Assets:*		
Due to SM & Co.	*50,000*		*Stock-in-trade*	*1,30,000*	*1,25,000*
Bank Overdraft	*1,00,000*		*Sundry Debtors*	*1,50,000*	*1,75,000*
			Bank Balances	*40,000*	*35,000*
			Cash in Hand	*25,000*	*20,000*
			Due from RS & Co.		*50,000*
Total	***6,50,000***	***6,50,000***	***Total***	***6,50,000***	***6,50,000***

The amalgamation of the firms was done on the following terms:

(a) Building of both the firms were valued at ₹ 1.00 lac each.

(b) Plant and Machinery of RS & Co. was valued at ₹ 1,75,000 and of SM & Co. was at ₹ 1,60,000.

(c) Stock in trade of RS & Co. was to be appreciated by 10% and of SM & Co. by 15%.

(d) Goodwill of RS & Co. was valued at ₹ 1,50,000 and of SM & Co. at ₹ 1,00,000, but the same will not appear in the books of accounts of the amalgamated firm.

(e) Provisions for doubtful debts @ 5% for debtors of both the firms have to be made.

(f) Other assets and liabilities will be taken over at their respective book value.

(g) The partners will bring necessary cash as may be required to pay the other partners to adjust their capitals according to their profit sharing ratio.

Prepare the Balance Sheet of the Amalgamated Firm and Capital Accounts of the partners in the books of the old Firms. ***(16 Marks)***

Answer

Balance Sheet of M/s RSM & Co. as at 31st March, 2017

Liabilities		₹	Assets		₹
Capitals:			Building (₹ 1,00,000 + ₹ 1,00,000)		2,00,000
R	4,55,250		Plant & machinery (₹ 1,75,000 + ₹ 1,60,000)		3,35,000

S	2,73,150		Office equipment (₹ 30,000+₹ 15,000)		45,000
M	1,82,100	9,10,500	Stock-in-trade (₹ 1,43,000+₹ 1,43,750)		2,86,750
Sundry creditors (60,000+2,25,000)		2,85,000	Sundry debtors (₹ 1,50,000+₹ 1,75,000)	3,25,000	
Bank overdraft		1,00,000	*Less:* Provision for doubtful debts (₹ 7,500+₹ 8,750)	(16,250)	3,08,750
			Bank balance (₹ 40,000+ ₹ 35,000)		75,000
			Cash in hand		45,000*
		12,95,500			12,95,500

In the books of RS & Co.

Partners' Capital Accounts

	Particulars	*R* ₹	*S* ₹		*Particulars*	*R* ₹	*S* ₹
To	Capital A/cs – M/s RSM & Co.	3,67,300	2,28,200	By	Balance b/d	2,50,000	1,50,000
				By	Reserve (3:2)	24,000	16,000
				By	Profit on Realisation A/c (W.N.4)	93,300	62,200
		3,67,300	2,28,200			3,67,300	2,28,200

In the books of SM Co.

Partners' Capital Accounts

	Particulars	*S* ₹	*M* ₹		*Particulars*	*S* ₹	*M* ₹
To	Capital A/cs – M/s RSM & Co.	3,87,000	1,78,000	By	Balance b/d	1,75,000	1,25,000
				By	Reserve (4:1)	1,00,000	25,000

** ₹ 25,000+ ₹ 20,000+ ₹ 2,12,950 + ₹ 54,100 – ₹ 2,67,050 = ₹ 45,000*

			By Profit on Realisation (W.N.5)	1,12,000	28,000
	3,87,000	1,78,000		3,87,000	1,78,000

Working Notes:

1. Computation of purchase consideration

		RS& Co. ₹	*SM & Co.* ₹
Assets:			
Goodwill		1,50,000	1,00,000
Building		1,00,000	1,00,000
Plant & machinery		1,75,000	1,60,000
Office equipment		30,000	15,000
Stock-in-trade		1,43,000	1,43,750
Sundry debtors		1,50,000	1,75,000
Bank balance		40,000	35,000
Cash in hand		25,000	20,000
Due from RS & Co.		-	50,000
	(A)	8,13,000	7,98,750
Liabilities:			
Creditors		60,000	2,25,000
Provision for doubtful debts		7,500	8,750
Due to SM & Co.		50,000	-
Bank overdraft		1,00,000	-
	(B)	2,17,500	2,33,750
Purchase consideration (A-B)		5,95,500	5,65,000

2. Computation of proportionate capital

	₹
M/s RSM & Co. (Purchase Consideration) (₹ 5,95,500+ ₹ 5,65,000)	11,60,500
Less: Goodwill adjustment	(2,50,000)

Total capital of new firm (Distributed in ratio 5:3:2)	9,10,500
R's proportionate capital	4,55,250
S's proportionate capital	2,73,150
M's proportionate capital	1,82,100

3. Computation of Capital Adjustments

	R	*S*	*M*	*Total*
	₹	₹	₹	₹
Balance transferred from RS & Co.	3,67,300	2,28,200		5,95,500
Balance transferred from SM & Co.		3,87,000	1,78,000	5,65,000
	3,67,300	6,15,200	1,78,000	11,60,500
Less: Goodwill written off in the ratio of 5:3:2	(1,25,000)	(75,000)	(50,000)	(2,50,000)
Existing capital	2,42,300	5,40,200	1,28,000	9,10,500
Proportionate capital	4,55,250	2,73,150	1,82,100	9,10,500
Amount to be brought in (paid off)	2,12,950	(2,67,050)	54,100	

4. In the books of RS & Co.

Realisation Account

	₹		₹
To Building	75,000	By Creditors	60,000
To Plant & machinery	2,00,000	By Bank overdraft	1,00,000
To Office equipment	30,000	By Due to SM & Co.	50,000
To Stock-in-trade	1,30,000	By M/s RSM & Co. (purchase consideration) (W.N.1)	5,95,500
To Sundry debtors	1,50,000		
To Bank balance	40,000		
To Cash in hand	25,000		
To Partners' capital A/cs:			
R 93,300			
S 62,200	1,55,500		
	8,05,500		8,05,500

5. **In the books of SM & Co.**

Realisation Account

		₹			₹
To	Building	80,000	By	Creditors	2,25,000
To	Plant & machinery	1,50,000	By	M/s RSM & Co.	5,65,000
To	Office equipment	15,000		(purchase consideration)	
To	Stock-in-trade	1,25,000		(W.N.1)	
To	Sundry debtors	1,75,000			
To	Bank balance	35,000			
To	Cash in hand	20,000			
To	Due from RS & Co.	50,000			
To	Partners' capital A/cs:				
	S 1,12,000				
	M 28,000	1,40,000			
		7,90,000			7,90,000

Note:

1. The adjustments in the Capital Accounts of R, S and M (both for Goodwill and the amounts paid to S by R and M) can also be shown in their Capital Accounts in the Books of RS & Co. and SM & Co respectively. In such a case, the Capital Accounts of the partners carried to RSM & Co will be the same amounts as shown in the Balance Sheet of RSM & Co.
2. In the above solution, Realization accounts have been prepared in the books of RS & Co. and SM Co. Alternatively, Revaluation Accounts can also be prepared for giving effect of profit or loss on revaluation of assets and liabilities without closing accounts of all assets and liabilities in the books of amalgamating firms.

Question 3

(a) You are provided with the following details in respect of ABC Limited:

(i) 10,000 equity shares of nominal value of ₹ 10 each were issued on 31st March, 2014;

(ii) Exercise price of equity shares granted under ESOP was ₹ 160 per share;

(iii) Market price of share was ₹ 400 each on the date of the grant;

(iv) Vesting of shares was in the ratio of 30%, 60% and 100% after 1 year, 2 year and 3 year respectively from the date of grant;

(v) Vested options can be exercised up to 1 year from the date of vesting;

(vi) The number of shares expired and exercised are as under:

	Years ending		
Particulars	**31.03.2015**	**31.03.2016**	**31.03.2017**
Vested Options Lapsed during the year	-	200	600
Unvested Options Lapsed during the year	400	600	1,000
Options Exercised during the year		2,500	2,000

From the above details you are required to calculate:

(i) Employee Compensation Expense for the year ending 31st March, 2015, 31st March, 2016 and 31st March, 2017

(ii) Balance of Employee Stock Option Outstanding Account as on 31st March, 2015, 31st March, 2016 and 31st March, 2017

Entries relating to ESOP lapsed and options exercised were passed at the end of the respective financial year. ***(8 Marks)***

(b) The following balances appeared in the books of Heaven Ltd. on 1st April, 2016:

(i) 12% Debentures ₹ 9,50,000;

(ii) Balance of Sinking Fund ₹ 8,00,000

(iii) Sinking Fund Investment ₹ 8,00,000 represented by 10% ₹ 8,50,000 Secured Bonds of Government of India.

Annual contribution to the Sinking Fund was ₹ 1,50,000 made on 31st March every year. On 31st March, 2017, balance at bank was ₹ 4,00,000 before receipt of interest. The company sold the 90% face value of its investments, for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended on 31st March, 2017:

(a) Debentures Account;

(b) Sinking Fund Account;

(c) Sinking Fund Investment Account;

(d) Bank Account; and

(e) Debenture Holders Account. ***(8 Marks)***

Answer

(a) (i) Calculation of Employee Compensation Expense for the Year ended 31st March 2015, 31st March 2016 and 31st March, 2017 (Refer Working Note)

Vesting Date	Cost to be recognized in the year ending on 31st March		
as on 31st March	2015	2016	2017
2015	6,24,000		
2016	2,88,000	2,88,000	
2017	2,40,000	2,40,000	2,40,000
Cost for the year	11,52,000	5,28,000	2,40,000
Cumulative cost	11,52,000	16,80,000	19,20,000

(ii) Balance of ESOP Outstanding Account as on 31st March 2015, 31st March 2016 and 31st March, 2017

	Total	2015	2016	2017
ESOS outstanding A/c at the end of 1st year	11,52,000	11,52,000		
Less: Vested Options lapsed during year (200 x 240)	(48,000)			
Less: Vested Options exercised during year (2,500 x 240)	(6,00,000)			
Add: ESOP credited in the 2nd year	5,28,000			
ESOP outstanding A/c at the end of 2nd year	10,32,000		10,32,000	
Less: Vested options lapsed (600 x 240)	(1,44,000)			
Less: Vested options exercised (2,000 x 240)	(4,80,000)			
Add: ESOP credited in the 3rd year	2,40,000			
ESOP outstanding at the end of 3rd year	6,48,000			6,48,000

Working Note:

Determination of number of options expected to vest under each group

Vesting Date (Year-end) 31st March		Shares expected to vest	Value per Shares (₹) (400 – 160)	Compensation Expense (₹)
2015	(10,000 shares x 30%) - 400 shares	2,600 shares	240	6,24,000
2016	(10,000 shares x 30%) - 600 shares	2,400 shares	240	5,76,000
2017	(10,000 shares x 40%) - 1,000 shares	3,000 shares	240	7,20,000
				19,20,000

Total compensation expense of ₹ 19,20,000, determined at the grant date, is attributed to 3 years.

Note: The solution can be given in the following Alternative manner:

(i) Calculation of Employee Compensation Expense for the Year ended 31st March 2015, 31st March 2016 and 31st March, 2017

Particulars	Year ended 31.3.15	Year ended 31.3.16	Year ended 31.3.17
Number of options in vesting ratio (30%/30%/40%)	3,000	3,000	4,000
Less: Unvested options lapsed during the year	(400)	(600)	(1,000)
Net options vested during the year (A)	2,600	2,400	3,000
Per Option Expenses (₹ 400- ₹160) (B)	240	240	240
Employee compensation expenses for the year (A x B)	6,24,000	5,76,000	7,20,000

(ii) Balance of ESOP Outstanding Account

	As on 2015	As on 2016	As on 2017
Opening balance		6,24,000	5,52,000
Amount transferred from employee compensation exp.	6,24,000	5,76,000	7,20,000
Less: Expenses of options vested and lapsed @240 per option (transferred to general reserve)	-	(48,000) (200 x 240)	(1,44,000) (600 x 240)

Less: Utilized for issue of shares @ 240 per option	-	(6,00,000) (2,500 x 240)	(4,80,000) (2,000 x 240)
Closing balance	6,24,000	5,52,000	6,48,000

Note: In the absence of estimated figures regarding lapse of unvested options, it is assumed that actual lapses were in accordance with the estimation.

(b) 1. Debentures Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31.3.17	To Debenture holders A/c	9,50,000	1.4.16	By Balance b/d	9,50,000
		9,50,000			9,50,000

2. Sinking Fund Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
31.3.17	To General reserve A/c	9,50,000	1.4.16	By Balance b/d	8,00,000
	To Capital Reserve	1,30,000	31.3.17	By Profit and Loss A/c	1,50,000
			31.3.17	By Interest on sinking fund A/c (Interest on 10% stock (₹ 8,50,000 x 10%)	85,000
			31.3.17	By Sinking Fund Investment A/c	45,000
		10,80,000			10,80,000

3. Sinking Fund Investment A/c (10% Secured Bonds of Govt.)

		₹			₹
1.4.16	To Balance b/d (face value ₹ 8,50,000)	8,00,000	31.3.17	By Bank A/c (8,50,000 x 90% = 7,65,000)	7,65,000
	To Sinking Fund	45,000	31.3.17	By Bal. c/d	80,000
		8,45,000			8,45,000

4. **Bank A/c**

		₹			₹
31.3.17	To Balance b/d	4,00,000	31.3.17	By 12% Debenture holders A/c	10,45,000
31.3.17	To Interest on Sinking fund Investment A/c	85,000			
31.3.17	To Sinking fund Investment A/c	7,65,000	31.3.17	By Balance c/d	2,05,000
		12,50,000			12,50,000

5. **Debenture holders' A/c**

		₹			₹
31.3.17	To Bank A/c	10,45,000	31.3.17	By 12% Debentures	9,50,000
			31.3.17	By Premium on redemption of debentures	95,000
		10,45,000			10,45,000

Note:

1. It has been considered that the sale of investments and redemption of debentures take place on 31st March, 2017.
2. The question states that the company sold 90% face value of investments, for redemption of debentures at a premium of 10%. It has been considered in the above solution that the sale of investments is at par and redemption of debentures is at premium. The alternative answer considering the fact that the sale of investments is at premium and redemption of debentures is at par is also possible.

Question 4

The summarized balance sheet of Z Limited as on 31st March, 2017 is as under:

Liabilities	***Amount in ₹***
Share Capital	
5,00,000 Equity shares of ₹ 10 each fully paid up	*50,00,000*
9%, 20,000 Preference shares of ₹ 100 each fully paid up	*20,00,000*
Reserves and Surplus	
Profit and Loss Account	*(14,60,000)*

Non-Current Liabilities:	
10% Secured Debentures	*16,00,000*
Current Liabilities:	
Interest due on Debentures	*1,60,000*
Trade Payables	*5,00,000*
Loan from Directors	*1,00,000*
Bank Overdraft	*1,00,000*
Provision for Tax	*1,00,000*
Total	***81,00,000***
Assets:	
Non-Current Assets:	
Fixed Assets:	
(a) Tangible Assets:	
Land & Buildings	*30,00,000*
Plant & Machinery	*12,50,000*
Furniture & Fixtures	*2,50,000*
(b) Intangible Assets:	
Goodwill	*10,00,000*
Patents	*5,00,000*
Current Assets:	
Trade Investments	*5,00,000*
Trade Receivables	*5,00,000*
Inventory	*10,00,000*
Discount on issue of debentures	*1,00,000*
Total	***81,00,000***

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹ 1,00,000 and ₹ 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.

(ii) The Preference shares be reduced to ₹ 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.

(vii) Directors refunded ₹ 1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid ₹ 15,000.

(ix) The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	*32,00,000*
Plant and Machinery	*6,00,000*
Inventory	*7,50,000*
Trade Receivables	*4,00,000*
Furniture and Fixtures	*1,50,000*
Trade Investments	*4,50,000*

You are required to pass journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents. Loss in Profit and Loss account arid Discount on issue of debentures. And also prepare Bank Account and Reconstruction A/c. ***(16 Marks)***

Answer

Journal Entries in the Books of Z Ltd.

			Dr.	Cr.
			₹	₹
(i)	Equity Share Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of			

	reconstruction.)			
(ii)	9% Preference Share Capital (₹ 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures outstanding A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000

	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	*Dr.*	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
(xii)	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Discount on issue of Debentures A/c			1,00,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000

	To Capital Reserve (bal. fig.) (Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)		7,75,000

Bank Account

	₹		₹
To Reconstruction (Y)	1,00,000	By Balance b/d	1,00,000
To Reconstruction(Z)	60,000	By Reconstruction A/c (capital commitment penalty paid)	15,000
To Reconstruction A/c (refund of earlier fees by directors)	1,00,000		
		By Reconstruction A/c (reconstruction expenses paid)	15,000
		By Provision for tax A/c (tax paid)	75,000
		By Balance c/d	55,000
	2,60,000		2,60,000

Reconstruction Account

	₹		₹
To Bank (penalty)	15,000	By Equity Share	
To Bank (reconstruction expenses)	15,000	Capital A/c	25,00,000
To Goodwill	10,00,000	By 9% Pref. Share	
To Patent	5,00,000	Capital A/c	10,00,000
To P & L A/c	14,60,000	By Mr. Y (Settlement)	5,78,000
To Discount on issue of debentures	1,00,000	By Mr. Z (Settlement)	3,82,000
To P & M	6,50,000	By Trade Payables A/c	1,70,000
To Furniture and Fixtures	1,00,000	By Director's loan	60,000
To Trade investment	50,000	By Bank	1,00,000
To Inventory	2,50,000	By Provision for tax	25,000
To Trade Receivables	1,00,000	By Land and Building	2,00,000
To Capital Reserve (bal. fig.)	7,75,000		
	50,15,000		50,15,000

Note: The solution based on the alternative set of entries and corresponding postings in reconstruction account is also possible.

Question 5

(a) From the following information as on 31st March, 2017 from the books of Ocean Insurance Company Limited, which is engaged in Marine Insurance business prepare the Revenue Account.

	Particulars		*Direct Business (₹)*	*Re-Insurance (₹)*
I	*Premium*			
	Received		*22,00,000*	*3,40,000*
	Receivable –	*1st April, 2016*	*1,20,000*	*21,000*
		31St March, 2017	*1,80,000*	*28,000*
	Premium paid		*2,50,000*	*-*
	Payable -	*1st April, 2016*		*22,000*
		31st March, 2017		*40,000*
II	*Claims:*			
	Paid		*16,50,000*	*1,25,000*
	Payable -	*1st April, 2016*	*98,000*	*12,000*
		31st March, 2017	*1,90,000*	*24,000*
	Received			*1,05,000*
	Receivable –	*1st April, 2016*	*-*	*12,000*
		31St March, 2017	*-*	*10,000*
III	*Commissions*			
	On Insurance accepted		*1,40,000*	*12,000*
	On Insurance ceded		*-*	*16,000*

Other expenses and income:

Salaries - ₹ 2,50,000; Rent, Rates and Taxes - ₹ 15,000; Printing and Stationery - ₹ 22,000; Interest, Dividend and Rent Received (Net) - ₹ 1,10,000; Income tax deduction at source - ₹ 24,000; Legal expenses (Inclusive of ₹ 15,000 in connection with the settlement of claims)- ₹ 50,000;

Balance of fund as on 1st April, 2016 was ₹ 25,50,000 including additional reserve of ₹ 3,25,000. Additional Reserve has to be maintained at 5% of the net premium of the year. ***(10 Marks)***

*(b) The following is a**n** extract from the trial balance of Novel Bank Limited as on 31st March 2017:*

Rebate on bills discounted as on 1st April 2016 ₹ 78,566 (Cr. bal)

Discount Received ₹ 1,60,572 (Cr. bal)

An analysis of bills discounted is as follows:

Amount ₹	*Due Date*
2,90,000	*01 June 2017*
8,75,000	*08 June 2017*
5,65,000	*21 June 2017*
8,12,000	*01 July 2017*
6,50,000	*05 July 2017*

Find out the amount of discount to be credited to Profit and Loss Account for the year ending on 31st March, 2017 and pass the necessary journal entries. The rate of discount shall be taken at 10% per annum. ***(6 Marks)***

Answer

(a) Form B – RA (Prescribed by IRDA)

Revenue Account for the year ended 31st March, 2017

(Marine Insurance Business)

	Schedule	*Current Year*	*Previous Year*
		₹	₹
Premiums earned (net)	1	24,33,050	
Profit/(Loss) on sale/redemption of investments		-	
Others (to be specified)		-	
Interest, Dividends and Rent – Gross (Net + TDS) (1,10,000 +24,000)		1,34,000	
Total (A)		25,67,050	
Claims incurred (net)	2	17,91,000	
Commission	3	1,36,000	
Operating expenses related to Insurance business	4	3,22,000	
Total (B)		22,49,000	
Operating Profit from Marine Insurance business (A-B)		**3,18,050**	

Schedules forming part of Revenue Account

	Current Year	*Previous Year*
	₹	₹
Schedule –1		
Premium earned (net) (22,60,000 +3,47,000)		
Total Premiums earned	26,07,000	
Less: Premium on reinsurance ceded	(2,68,000)	
Total Premium earned (net)	23,39,000	
Change in provision for unexpired risk (Required provision – existing reserve)		
[(₹ 23,39,000 +5% of 23,39,000 i.e. 24,55,950) – ₹ 25,50,000)]	94,050	
Net Premium earned	24,33,050	
Schedule – 2		
Claims incurred (net)	17,91,000	
Schedule – 3		
Commission paid		
Direct	1,40,000	
Add: Re-insurance accepted	12,000	
Less: reinsurance ceded	(16,000)	
	1,36,000	
Schedule – 4		
Operating expenses related to insurance business		
Employees' remuneration and welfare benefits	2,50,000	
Rent, Rates and Taxes	15,000	
Printing and Stationery	22,000	
Legal and Professional charges	35,000	
	3,22,000	

Working Notes:

1.	Total Premium Income	*Direct*	*Re-insurance*
		₹	₹
	Received	22,00,000	3,40,000

	Add: Receivable on 31st March, 2017	1,80,000	28,000
		23,80,000	3,68,000
	Less: Receivable on 1st April, 2016	(1,20,000)	(21,000)
		22,60,000	3,47,000

Total premium income 22,60,000 + 3,47,000 = 26,07,000

2.	Premium Expense on reinsurance	₹
	Premium Paid during the year	2,50,000
	Add: Payable on 31st March, 2017	40,000
		2,90,000
	Less: Payable on 1st April, 2016	(22,000)
		2,68,000
3.	Claims Paid	
	Direct Business	16,50,000
	Re-insurance	1,25,000
	Legal Expenses	15,000
		17,90,000
	Less: Re-insurance claims received	(1,05,000)
		16,85,000
4.	Claims outstanding as on 31st March, 2017	
	Direct	1,90,000
	Re-insurance	24,000
		2,14,000
	Less: Recoverable from Re-insurers on 31stMarch, 2017	(10,000)
		2,04,000
5.	Claims outstanding as on 1st April, 2016	
	Direct	98,000
	Re-insurance	12,000
		1,10,000
	Less: Recoverable from Re-insurers on 1st April, 2016	(12,000)
		98,000

(b) The amount of rebate on bills discounted as on 31st March, 2017 the period which has not been expired upto that day will be calculated as follows:

Discount on ₹ 2,90,000 for 62 days @ 10%	4,926
Discount on ₹ 8,75,000 for 69 days @ 10%	16,541

Discount on ₹ 5,65,000 for 82 days @ 10%	12,693
Discount on ₹ 8,12,000 for 92 days @ 10%	20,467
Discount on ₹ 6,50,000 for 96 days @ 10%	17,096
Total	71,723

Note: The due date of the bills discounted is included in the number of days above.

The amount of discount to be credited to the profit and loss account will be:

	₹
Transfer from rebate on bills discounted as on 1.4. 2016	78,566
Add: Discount received during the year	1,60,572
	2,39,138
Less: Rebate on bills discounted as on 31.03. 2017 (as above)	(71,723)
	1,67,415

Journal Entries

		₹	₹
Rebate on bills discounted A/c	Dr.	78,566	
To Discount on bills A/c			78,566
(Transfer of opening unexpired discount on 31.03. 2016)			
Discount on bills A/c	Dr.	71,723	
To Rebate on bills discounted			71,723
(Unexpired discount on 31.03. 2017 taken into account)			
Discount on Bills A/c	Dr.	1,67,415	
To P & L A/c			1,67,415
(Discount earned in the year, transferred to P&L A/c)			

Question 6

(a) M & S Co. of Lucknow has a branch in Canberra, Australia. At the end of 31st March 2017, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

	(₹ In thousand)		*(Aust. Dollars in thousand)*	
	Dr.	*Cr.*	*Dr.*	*Cr.*
Capital		*2,000*		
Reserves & Surplus		*1,000*		
Land	*500*			
Buildings (Cost)	*1,000*			
Buildings Dep. Reserves		*200*		

Plant and Machinery (Cost)	*2,500*		*200*	
Plant and Machinery Dep.				
Reserves		*600*		*130*
Debtors/Creditors	*280*	*200*	*60*	*30*
Stock as on 1- 4-2016	*100*		*20*	
Branch Stock Reserve		*4*		
Cash & Bank Balances	*10*		*10*	
Purchases/Sales	*240*	*520*	*20*	*123*
Goods sent to Branch		*100*	*5*	
Managing Partner's Salary	*30*			
Wages and Salary	*75*		*45*	
Rent			*12*	
Office Expenses	*25*		*18*	
Commission Receipts		*256*		*100*
Branch/HO Current Account	*120*			*7*
	4,880	*4,880*	*390*	*390*

The following information is also available:

(i) Stock as at 31st March, 2017

Lucknow ₹ 1,50,000

Canberra A$ 3125 (all stock are out of purchases made at Abroad)

(ii) Head Office always sent goods to the Branch at cost plus 25%

(iii) Provision is to be made for doubtful debts at 5%

(iv) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down value.

You are required to:

(1) Convert the Branch Trial Balance into rupees by using the following exchange rates:

Opening rate	*1 A $ = ₹ 50*
Closing rate	*1 A $ = ₹ 53*
Average rate	*1 A $ = ₹ 51.00*
For Fixed Asets	*1 A $ = ₹ 46.00*

(2) Prepare Trading and Profit and Loss Account for the year ended 31st March 2017 showing to the extent possible H.O. results and Branch results separately.

(12 Marks)

(b) Department X sells goods to Department Y at a profit of 50% on cost and to Department Z at 20% on cost. Department Y sells goods to Department X and Z at a profit of 25% and 15% respectively on sales. Department Z charges 30% profit on cost to Department X and 40 profit on sale to Y.

Stocks lying at different departments at the end of the year are as under:

	Dept. X	Dept. Y	Dept. Z
	₹	₹	₹
Transfer from Department X		*75,000*	*48,000*
Transfer from Department Y	*50,000*		*82,000*
Transfer from Department Z	*52,000*	*56,000*	

Calculate the unrealized profit of each department and also total unrealized profit.

(4 Marks)

Answer

(a) **M & S Co. Ltd.**

Canberra, Australia Branch Trial Balance

As on 31st March 2017

	($ 'thousands)				(₹ 'thousands)
	Dr.	Cr.	Conversion rate per $	Dr.	Cr.
Plant & Machinery (cost)	200		₹ 46	9,200	
Plant & Machinery Dep. Reserve		130	₹ 46		5,980
Trade receivable/payable	60	30	₹ 53	3,180	1,590
Stock (1.4.2016)	20		₹ 50	1,000	
Cash & Bank Balances	10		₹ 53	530	
Purchase / Sales	20	123	₹ 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		₹ 51	2,295	
Rent	12		₹ 51	612	
Office expenses	18		₹ 51	918	

Commission Receipts		100	₹ 51		5,100
H.O. Current A/c		7	Actual		120
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				208	
	390	390		19,063	19,063
Closing stock	3.125		53	165.625*	

Trading and Profit & Loss Account for the year ended 31st March, 2017

		H.O.	*Branch*	*Total*			*H.O.*	*Branch*	*Total*
To	Opening Stock	100	1,000.000	1,100.000	By	Sales	520	6,273.000	6,793.000
To	Purchases	240	1,020.000	1,260.000	By	Goods sent to Branch	100	–	100.000
To	Goods received from Head Office	–	100.000	100.000	By	Closing Stock	150	165.625	315.625
To	Wages & Salaries	75	2,295.000	2,370.000					
To	Gross profit c/d	355	2,023.625	2,378.625					
		770	6,438.625	7,208.625			770	6,438.625	7,208.625
To	Rent	–	612.000	612.000	By	Gross profit b/d	355	2,023.625	2,378.625
To	Office expenses	25	918.000	943.000	By	Commission receipts	256	5,100.000	5,356.000
To	Provision for doubtful debts @ 5%	14	159.000	173.000					
To	Depreciation (W. N.)	460	644.000	1,104.000					
To	Balance c/d	112	4,790.625	4,902.625					
		611	7,123.625	7,734.625			611	7,123.625	7,734.625
To	Managing Partner's Salary			30.000	By	Balance b/d			4,902.625
To	Exchange Loss			208.000	By	Branch stock reserve			4.000
To	Balance c/d			4,668.625					
				4,906.625					4,906.625

Working Note:

Calculation of Depreciation

	H.O *₹ '000*	*Branch* *₹ '000*
Building – Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,500	9,200
Less: Dep. Reserve	(600)	(5,980)
	1,900	3,220
Depreciation @ 20% (B)	380	644
Total Depreciation (A+B)	460	644

Note:

1. In the above solution, it has been assumed that the Australia branch is an integral foreign operation of M & S Co. Alternative solution considering branch as non-integral foreign operation is also possible.
2. As the closing stock of Branch does not consist any stock transferred from M& S Co., there is no need to create closing stock reserve. But the opening branch stock reserve has to be reversed in the P&L A/c.

(b) Calculation of unrealized profit of each department and total unrealized profit

	Dept. X	*Dept. Y*	*Dept. Z*	*Total*
	₹	₹	₹	₹
Unrealized Profit of:				
Department X		75,000 x 50/150 = 25,000	48,000 x 20/120 = 8,000	33,000
Department Y	50,000 x .25 = 12,500		82,000 x .15 = 12,300	24,800
Department Z	52,000 x 30/130 = 12,000	56,000 x 40/100 = 22,400		34,400
				92,200

Question 7

Answer any ***FOUR*** *of the followings:*

(a) *Rahul Ltd. purchased a plant for US$ 2,00,000 on 1st January 2017, payable after 5 months. Company entered into a forward contract for five months @ ₹ 64.75 per dollar. Exchange rate per dollar on 1st Jan. 2017 was ₹ 64.25. How will you recognize the profit or loss on forward contract in the books of Rahul Ltd.?*

(b) *Briefly define the Fundamental Accounting Assumptions?*

(c) *Explain the nature of Limited Liability Partnership. Who can be a designated partner in a Limited Liability Partnership?*

(d) *Discuss the following types of FIRE INSURANCE Policies:*

(i) *Average Policy;*

(ii) *Comprehensive Policy;*

(iii) *Excess Policy; and*

(iv) *Floating Policy.*

(e) *List out the criteria laid down for classification of non-corporate entities to bring them under Level I category as per ICAI.* ***(4 x 4 = 16 Marks)***

Answer

(a) Calculation of profit or loss to be recognized in the books of Rahul Limited

	₹
Forward contract rate	64.75
Less: Spot rate	(64.25)
Loss	0.50
Forward Contract Amount	\$2,00,000
Total loss due to entering into forward contract (\$2,00,000 × ₹ 0.5)	₹ 1,00,000
Contract period is	5 months
Loss for the period 1st January, 2017 to 31st March, 2017 i.e. 3 months falling in the year 2016-2017 will be ₹ 1,00,000 $\times \frac{3}{5}$ =	₹ 60,000

Balance loss of ₹ 40,000 (i.e. ₹ 1,00,000 – ₹ 60,000) for the month of May, 2017 will be recognized in the financial year 2017-2018.

(b) As per the Framework on Preparation and Presentation of Financial Statements, there are three fundamental accounting assumptions: Going Concern, Accrual Basis and Consistency.

(a) **Going Concern:** Financial statements are normally prepared on the assumption that an enterprise will continue in operation in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.

(b) **Accrual Basis:** Under this basis of accounting, transactions are recognized as soon as they occur, whether cash or cash equivalent is actually received or paid. Accrual basis ensures better matching between revenue and cost and profit/loss obtained on this basis reflects activities of the enterprise during an accounting period, rather than cash flows generated by it.

(c) **Consistency:** It refers to the practice of using same accounting policies for similar transactions in all accounting periods. The consistency improves comparability of financial statements through time.

(c) **Nature of Limited Liability Partnership:** A limited liability partnership is a body corporate formed and incorporated under the LLP Act, 2008 and is a legal entity separate from that of its partners. A limited liability partnership shall have perpetual succession and any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Designated partners: Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

In case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners

(d) **(i)** ***Average policy* -** An average policy contains the 'average clause' which lays down that if the property is under-insured, *i.e.* insured for a sum smaller than the value of the property, the insurer will bear only that proportion of the actual loss which the sum assured bears to the actual value of the property at the time of loss.

(ii) ***Comprehensive policy* -** A policy which covers risks such as fire, flood, riots, strikes, burglary etc. up to a certain specified amount is known as the comprehensive policy.

(iii) ***Excess policy* -** Where the stocks of the insured fluctuate he may take out a policy for the amount below which his stocks normally do not fall and another policy to cover the maximum amount of stocks which may be reached at times. The former type of policy is known as the *First Loss Policy* and the latter as the *Excess Policy.*

(iv) ***Floating policy* -** It is the policy which covers several types of goods lying at different locations under one amount and for one premium. The premium normally charged under this policy is the average of the premia that would have been paid if each lot of the goods had been insured under specific policies for specific sums.

(e) Criteria for classification of non-corporate entities as decided by the Institute of Chartered Accountants of India

Non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year.

(iv) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year.

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