PAPER – 1 : ACCOUNTING

QUESTIONS

Branch Accounting

1. Pappu Limited with its head office in Kolkata invoiced goods to its branch at Mumbai at 20% less than the catalogue price which is cost plus 50% with instructions that cash sales were to be made at invoice price and credit sales at catalogue price. Head office also gave the instruction to provide discount @ 15% of catalogue price on prompt payments by debtors. From the particulars available from the branch, prepare the Branch Stock Account, Branch Adjustment Account and Branch Profit and Loss Account for the year ended 31st March, 2008 (showing workings) in the head office books:

	Rs.
Stock on 1st April, 2007 (Invoice Price)	12,000
Debtors on 1st April, 2007	10,000
Goods received from H.O. (Invoice Price)	1,32,000
Sales (Cash)	46,000
Sales (Credit)	1,00,000
Cash received from Debtors	85,635
Discount allowed to Debtors	13,365
Expenses at the Branch	6,000
Remittances to H.O.	1,20,000
Debtors on 31st March, 2008	11,000
Cash in hand on 31st March, 2008	5,635
Stock on 31st March, 2008 (Invoice Price)	15,000

It was further reported that a part of the stock was lost by fire (not covered by insurance) during the year whose value is to be ascertained and a provision should be made for discount to be allowed to debtors as on 31st March, 2008 on the basis of year's trend of prompt payments.

Hire Purchase System

2. Welwash (Pvt.) Ltd. sells washing machines for outright cash as well as on hire-purchase basis. The cost of a washing machine to the company is Rs. 10,500. The company has fixed cash price of the machine at Rs. 12,300 and hire-purchase price at Rs. 13,500 payable as to Rs. 1,500 down and the balance in 24 equal monthly instalments of Rs. 500 each.

On 1st April, 2007 the company had 26 washing machines lying in its showroom. On that date 3 instalments had fallen due, but not yet received and 675 instalments were yet to fall due in respect of machines lying with the hire purchase customers.

During the year ended 31st March, 2008 the company sold 130 machines on cash basis and 80 machines on hire-purchase basis. After paying five monthly installments, one customer failed to pay subsequent installments and the company had to repossess the washing machine. After spending Rs. 1,000 on it, the company resold it for Rs. 11,500.

On 31st March, 2008 there were 21 washing machines in stock, 810 installments were yet to fall due and 5 installments had fallen due, but not yet received in respect of washing machines lying with the hire-purchase customers. Total selling expenses and office expenses including depreciation on fixed assets totalled Rs. 1,60,000 for the year.

You are required to prepare for the accounting year ended 31st March, 2008:

1. Hire purchase Trading Account, and

2. Trading and Profit and Loss Account showing net profit earned by the company after making provision for income-tax @ 35%.

Partnership Accounts (Piecemeal Distribution System)

3. A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were Rs. 9,600, Rs. 6,000 and Rs. 8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	Rs.		Rs.
Liability for interest on loans from :		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.

Partnership Accounts: (Profit and Loss Adjustment A/c)

4. M/s Neptune & Co.'s Balance Sheet as at 31st March, 2008:

Liabilities	Rs.	Assets	Rs.
Bank overdraft (State Bank)	54,000	Cash at Bank of India	800
Sundry Creditors	1,56,000	Sundry Debtors	2,80,000
		Stock	1,00,000

Capital Accounts : Mr. A			Motor Cars cost as per last B/S	1,60,000	
Balance as per last B/S	4,02,000		Less : Depreciation till date	54,000	1,06,000
Add : Profits for the year	95,400		Machinery cost as per last B/S	3,00,000	
	4,97,400				
Less : Drawings	40,000	4,57,400	Less : Depreciation till date	1,40,000	1,60,000
Mr. B			Land and Building		2,40,000
Balance as per last B/s	2,00,000				
Add : Profit for the year	95,400				
	2,95,400				
Less : Drawings	76,000	2,19,400			
		8,86,800			8,86,800

You have examined the foregoing Draft of the Balance Sheet and have ascertained that the following adjustments are required to be carried out:

(i) Land and Buildings are shown at cost less Rs. 60,000 being the proceeds of the sale during the year of premises costing Rs. 70,000.

(ii) Machinery having a net book value of Rs. 4,300 had been scrapped during the year. The original cost was Rs. 12,300.

(iii) Rs. 2,000 paid for the Licence fees for the year ending 30th September, 2008 had been written off.

(iv) Debts amounting to Rs. 10,420 were considered to be bad and further debts amounting to Rs. 5,400 were considered doubtful and required 100% provision. Provision for doubtful debts had previously been made for Rs. 10,000.

(v) An item in the inventory was valued at Rs. 37,400, but had a realisable value of Rs. 26,000 only. Scrap material having a value of Rs. 6,600 had been omitted from the stock valuation.

(vi) The cashier had misappropriated Rs. 700.

(vii) The cash-book for the year ending 31st March, 2008 included payments amounting to Rs. 6,924, the cheques having been made out, but not despatched to suppliers until April 2008.

(viii) Interest is to be allowed on the partners' opening capital account balances less drawings during the year at 9%.

You are required to prepare:

(a) Profit & Loss Adjustment Account for the year.

(b) Capital Accounts of the Partners.

Insolvency Accounts for Non-Corporate Entities

5. Ram commenced business on 1.7.2002 with a capital of Rs. 2,00,000. On 31st March, 2008 an adjudication order for insolvency was made against him. Following are the other details available relating to his business as on 31.3.2008:

	Rs.
Sundry Creditors	1,50,000
Mortgage Loan (of building)	1,00,000
Godown Rent (2 months)	5,000
Wages due	8,000
Mrs. Ram loan (given out of her own source)	25,000
Cost of Building (estimated to realise Rs. 1,00,000)	1,60,000
Debtors (includes bad of Rs. 10,000)	90,000
Stock in trade (Realisation value 10,000)	15,000
Cash in Hand/Bank	10,000

He maintained books upto 31.3.2005 and profit upto 31.3.2005 was Rs. 1,40,000. He did not maintain books from 1.4.2005 onwards. He has been drawing Rs. 4,000 per month and goods worth Rs. 1,500 per month uniformly from April, 2005 onwards.

Prepare statement of affairs and deficiency account.

Company Accounts (Redemption of Preference Shares & Bonus Issue)

6. The following is the Balance Sheet of Trinity Ltd. as at 31.3.2006:

Trinity Ltd.

Balance Sheet as at 31st March, 2006

Liabilities	Rs.	Assets		Rs.
Share Capital		Fixed Assets:		
Authorised		Gross Block	3,00,000	
10,000 10% Redeemable Preference Shares of Rs. 10 each	1,00,000	Less : Depreciation	1,00,000	2,00,000
90,000 Equity Shares of Rs. 10 each	9,00,000	Investments		1,00,000
	10,00,000	Current Assets and Loans		

		and Advances:	
Issued, Subscribed and Paid-up Capital:		Inventory	25,000
10,000, 10% Redeemable Preference		Debtors	25,000
Shares of Rs. 10 each	1,00,000	Cash and Bank Balances	50,000
10,000 Equity Shares of Rs. 10 each	1,00,000	Misc. Expenditure to the extent not written of	20,000
Reserves and Surplus:			
General Reserve	1,20,000		
Securities Premium	70,000		
Profit and Loss A/c	18,500		
Current Liabilities and Provisions	11,500		
	4,20,000		4,20,000

For the year ended 31.3.2007, the company made a net profit of Rs. 15,000 after providing Rs. 20,000 depreciation and writing off the miscellaneous expenditure of Rs. 20,000.

The following additional information is available with regard to company's operation :

1. The preference dividend for the year ended 31.3.2007 was paid before 31.3.2007.
2. Except cash and bank balances other current assets and current liabilities as on 31.3.2007 was the same as on 31.3.2006.
3. The company redeemed the preference shares at a premium of 10%.
4. The company issued bonus shares in the ratio of one share for every equity share held as on 31.3.2007.
5. To meet the cash requirements of redemption, the company sold a portion of the investments, so as to leave a minimum balance of Rs. 30,000 after such redemption.
6. Investments were sold at 90% of cost on 31.3.2007.

   You are required to

   (a) Prepare necessary journal entries to record redemption and issue of bonus shares.

   (b) Prepare the cash and bank account.

   (c) Prepare the Balance Sheet as at 31st March, 2007 incorporating the above transactions.

Final Accounts of Companies:

7. Provisional Balance Sheet of P Ltd. as at 31st March, 2008 was as under:

Balance Sheet as at 31st March, 2008

Liabilities	Rs.	Rs.	Assets	Rs.
Share Capital:			Fixed Assets (at cost less	
50,000 equity shares of Rs. 10 each, Rs. 7 per share called up	3,50,000		depreciation)	7,00,000
			Cash & Bank balances	2,00,000
Less : Calls in arrear on 10,000 shares @ Rs. 2 per share	20,000		Other Current assets	6,00,000
	3,30,000			
Add : Calls in advance on				
40,000 shares @ Rs. 3 per share	1,20,000	4,50,000		
20,000, 10% Redeemable preference shares of Rs. 10 each, fully paid up		2,00,000		
Reserves & Surplus:				
General Reserve		3,00,000		
Profit & Loss Account		2,70,000		
Current Liabilities		2,80,000		
		15,00,000		15,00,000

Calls in arrear are outstanding for 6 months. Calls in advance were also received 6 months back.

Interest @ 10% p.a. on calls in advance and 12% p.a. on calls in arrear are allowed/charged.

The Board of Directors have recommended that:

(i) Dividend for the year 2007-08 be allowed @ 20% on equity shares.

(ii) Money on calls in advance be refunded and partly paid equity shares be converted as fully paid up by declaring bonus dividend to shareholders.

(iii) The preference shares, which are redeemable at a premium of 10% any time after 31st March, 2008 may be redeemed by issue of 10% Debentures of Rs. 100 in cash.

Show Journal Entries to give effect to the above proposals including payment and receipt of cash and redraft the Profit and Loss Account and Balance Sheet of P Ltd.

Profit or Loss Prior to Incorporation

8. The partners of Pal agencies decided to convert the partnership into a private limited company called PA (P) Ltd with effect from 1st January 2007. The consideration was agreed at Rs. 11,70,000 based on the firm balance sheet as at 31st December 2006. However due to some procedural difficulties, the company could be incorporated only on 1st April 2007. Meanwhile, the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% p.a. the same books of accounts were continued by the company which closed its account for the first time on 31st March 2008. Prepare the following summarized Profit and Loss Account

	Rs.
Sales	23,40,000
Cost of goods sold	16,38,000
Salaries	1,17,000
Depreciation	18,000
Advertisements	70,200
Discounts	1,17,000
Managing director's remuneration	9,000
Miscellaneous office expenses	12,000
Office cum showroom rent	72,000
Interest	95,100
	21,48,300
Profit	1,91,700

The company only borrowing was a loan of Rs. 5,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.

The company was able to double the average monthly sales of the firm, from 1st April 2007 but salaries tripled from the date. It had to occupy additional space from July 2007 rent for which was Rs. 3,000 per month.

Prepare Profit and Loss Account in columnar from apportioning costs and revenue between pre-incorporation and post incorporation periods. Also suggest how the pre-incorporation profits are to be dealt with.

Amalgamation

9. Star and Moon had been carrying on business independently. They agreed to amalgamate and form a new company Neptune Ltd. with an authorised share capital of Rs. 2,00,000 divided into 40,000 equity shares of Rs. 5 each.

On 31st December, 2007, the respective Balance Sheets of Star and Moon were as follows:

	Star	Moon
	Rs.	Rs.
Fixed Assets	3,17,500	1,82,500
Current Assets	1,63,500	83,875
	4,81,000	2,66,375
Less: Current Liabilities	2,98,500	90,125
Representing Capital	1,82,500	1,76,250

Additional Information :

(a) Revalued figures of Fixed and Current Assets were as follows :

	Star	Moon
	Rs.	Rs.
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875

(b) The debtors and creditors—include Rs. 21,675 owed by Star to Moon.

The purchase consideration is satisfied by issue of the following shares and debentures :

(i) 30,000 equity shares of Neptune Ltd., to Star and Moon in the porportion to the profitability of their respective business based on the average net profit during the last three years which were as follows :

		Star	Moon
2005	Profit	2,24,788	1,36,950
2006	(Loss)/Profit	(1,250)	1,71,050
2007	Profit	1,88,962	1,79,500

(ii) 15% debentures in Neptune Ltd., at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 2007 after revaluation of assets.

You are requested to :

(1) Compute the amount of debentures and shares to be issued to Star and Moon.

(2) A Balance Sheet of Neptune Ltd., showing the position immediately after amalgamation.

Accounting of Banking Companies

10. The following is an extract from the Trial Balance of a Dena Bank as at 31st March 2008:

	Rs.	Rs.
Bills Discounted	51,50,000	
Rebate on bills discounted not yet due, April 1, 2007		30,501
Discount received		1,45,500

An analysis of the bills discounted as shown above shows the following:

Date of Bills	Amount Rs.	Term Months	Rate of Discount p.a.(%)
January 13	7,50,000	4	12
February 17	6,00,000	3	10
March 6	4,00,000	4	11
March 16	2,00,000	2	10

Find out the amount of discount received to be credited to Profit and Loss Account and pass appropriate Journal Entries for the same. How the relevant items will appear in the Dena Bank's Balance Sheet? For calculation take 1 year = 365 days.

Accounting for Insurance Companies

11. The following are the Balances of Hercules Insurance Co. Ltd. as on 31st March, 2007:

		(Rs. in '000)
Capital	320,00	
Balances of Funds as on 1.4.2006		
Fire Insurance		800,00
Marine Insurance		950,00
Miscellaneous Insurance		218,65
Unclaimed Dividends		8,50
Amount Due to Other Insurance Companies		34,50
Sundry Creditors		72,50
Deposit and Suspense Account (Cr.)		22,80
Profit and Loss Account (Cr.)		80,40
Agents Balances (Dr.)		135,00
Interest accrued but not due (Dr.)		22,50
Due from other Insurance Companies		64,50
Cash in Hand		3,50

Balance in Current Account with Bank		74,80
Furniture and Fixtures WDV (cost 100,00)		58,00
Stationery Stock		1,40
Expenses of Management		
Fire Insurance	280,00	
Marine Insurance	160,00	
Miscellaneous Insurance	40,00	
Others	30,00	510,00
Foreign Taxes—Marine		8,00
Outstanding premium		82,00
Donation Paid (No 80G Benefit)		10,00
Transfer Fees		1,00
Reserve for Bad Debts		11,70
Income Tax Paid		120,00
Mortgage Loan (Dr.)		975,00
Sundry Debtors		25,00
Government Securities Deposited with RBI		37,00
Government Securities (1,02,000)		1020,00
Debentures		465,50
Equity Shares of Joint Stock Companies		225,00
Claims Less Re-insurance		
Fire	450,00	
Marine	358,90	
Miscellaneous	68,00	876,90
Premium Less Re-insurance		
Fire	1762,50	
Marine	1022,50	
Miscellaneous	262,25	3047,25
Interest and Dividends Received on Investments		58,50
Tax Deducted at Source		11,70
Commission		
Fire	500,00	
Marine	350,00	

Miscellaneous	80,00	930,00
You are required to make the following provisions :		
Depreciation on Furniture—10% of Original Cost		
Depreciation on investments of Joint Stock Companies Shares		10,00
Transfer to General Reserve		10,00

Outstanding claims as on 31.3.2007

Fire	200,00
Marine	50,00
Miscellaneous	32,50

Provision for tax @ 50%. Proposed dividends @ 20%. Provision for the unexpired risks is to be made as follows:

(a) On Marine Policies - 100% Premium less reinsurance.

(b) On Other Policies - 50% Premium less reinsurance.

You are required to prepare the revenue and profit and loss account for the year ended 31.3.2007

Accounting of Electricity Companies

12. The Gurgaon Electricity Company Limited decided to replace one of its old plants with a modern one with a larger capacity. The plant when installed in the year 2000 cost the company Rs. 24 lakhs, the components of materials, labour and overheads being in the ratio of 5:3:2. It is ascertained that the costs of materials and labour have gone up by 40% and 80% respectively. The proportion of overheads to total costs is expected to remain the same as before.

    The cost of the new plant as per improved design is Rs. 60 lakhs and in addition, material recovered from the old plant of a value of Rs. 2,40,000 has been used in the construction of the new plant. The old plant was scrapped and sold for Rs. 7,50,000.

    The accounts of the company are maintained under Double Account system. Indicate how much would be capitalised and the amount that would be charged to revenue. Show the Ledger Accounts.

Cash Flow Statement

13. The following are the changes in the account balance taken from the Balance Sheets of Raj Ltd. at the beginning and end of the year:

	Changes in Rupees in Debit or (Credit)
Equity share capital 30,000 shares of Rs. 10 each issued and fully paid	0
Capital reserve	(49,200)
8% Debentures	(50,000)
Debenture discount	1,000
Freehold property at cost/revaluation	43,000
Plant and machinery at cost	60,000
Depreciation on plant and machinery	(14,400)
Debtors	50,000
Stock and work-in-progress	38,500
Creditors	(11,800)
Net profit for the year	(76,500)
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	(3,300)
Trade investments at cost	47,000
Bank	(64,300)
	0

You are informed that :

(a) Capital reserve as at the end of the year represented realised profits on sale of one freehold property together with surplus arising on the revaluation of balance of freehold properties.

(b) During the year plant costing Rs. 18,000 against, which depreciation provision of Rs.13,500 was lying, was sold for Rs. 7,000.

(c) During the middle of the year Rs. 50,000 debentures were issued for cash at a discount of Rs. 1,000.

(d) The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.

You are required to prepare a statement which will explain, why bank borrowing has increased by Rs. 64,300 during the year end. Ignore taxation.

Accounting from Incomplete Records

14. K. Azad, who is in business as a wholesaler in sunflower oil, is a client of your accounting firm. You are required to draw up his final accounts for the year ended 31.3.2008.

From the files, you pick up his Balance Sheet as at 31.3.2007 reading as below:

Balance Sheet as at 31.3.2007

	Rs.	Rs.
Liabilities:		
K. Azad's Capital		1,50,000
Creditors for Oil Purchases		2,00,000
12% Security Deposit from Customers		50,000
Creditors for Expenses :		
Rent	6,000	
Salaries	4,000	
Commission	20,000	30,000
Total		4,30,000
Assets:		
Cash and Bank Balances		75,000
Debtors		1,60,000
Stock of Oil (125 tins)		1,25,000
Furniture	30,000	
Less : Depreciation	3,000	27,000
Rent Advance		12,000
Electiricity Deposit		1,000
3–Wheeler Tempo Van	40,000	
Less : Depreciation	10,000	30,000
Total		4,30,000

A Summary of the rough Cash Book of K. Azad for the year ended 31.3.2008 is as below :

Cash and Bank Summary

Receipts:	
Cash Sales	5,26,500
Collections from Debtors	26,73,500
Payments to:	
Landlord	79,000
Salaries	48,000
Miscellaneous Office Expenses	12,000
Commission	20,000
Personal Income–tax	50,000
Transfer on 1.10.2007 for 12% Fixed Deposit	6,00,000
Creditors for Oil Supplies	24,00,000

A scrutiny of the other records gives you the following information :

(i) During the year oil was purchased at 250 tins per month basis at a unit cost of Rs. 1,000. 5 tins were damaged in transit in respect of which insurance claim has been preferred. The surveyors have since approved the claim at 80%. The damaged ones were sold for Rs. 1,500 which is included in the cash sales. One tin has been used up for personal consumption. Total number of tins sold during the year was 3,000 at a unit price of Rs. 1,750.

(ii) Rent until 30.9.2007 was Rs. 6,000 per month and was increased thereafter by Rs. 1,000 per month. Additional advance rent of Rs. 2,000 was paid and this is included in the figure of payments to landlord.

(iii) Provide depreciation at 10% and 25% of WDV on furniture and tempo van respectively.

(iv) It is further noticed that a customer has paid Rs. 10,000 on 31.3.2008 as security deposit by cash. One of the staff has defalcated. The claim against the Insurance Company is pending.

You are requested to prepare final accounts for the year ended 31.3.2008

Introduction to Government Accounts

15. Define the term consolidated fund in context of Government accounting.

Accounting for Agricultural Forms

16. Describe what records are required for the compilation of accounting information for agricultural farm.

Theory Questions

17. (a) Explain the purpose of the conceptual framework for preparation and presentation of financial statements in brief.

    (b) Write short note on liquidity norms of Banking Companies under section 24 of Banking Regulations Act.

    (c) Describe the term Co-insurance.

18. (a) What do you mean by over-riding preferential payments under section 529A of the Companies Act?

    (b) What are the advantages of maintaining subsidiary books by Trading/Manufacturing organizations?

19. Theory questions based on Accounting Standards

    (a) Explain the provisions of AS 20 for restatement of shares.

    (b) If a sale and lease back transaction results in an operating lease, what provisions will be applicable? Describe in line with AS 19.

    (c) What criteria is applied for rating an enterprise as Level II enterprise for the purpose of compliance of Accounting Standards in India?

20. (a) Which borrowing costs are eligible for capitalisation as per AS 16? Describe in brief.

    (b) A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. Is it a liability?

    (c) Explain the provisions of AS 26 relating to retirement and disposal of intangible assets.

21. (a) Describe with reference to Accounting Standards, the methods which may be used for recognising revenue on construction contracts.

    (b) Discuss the accounting principles relevant to the auditors relating to:

        (i) Prior period items.

        (ii) Change in accounting estimates.

    (c) Summarise briefly the requirements of AS 1 relating to the disclosure of significant accounting policies.

22. Practical problems based on application of Accounting Standards

(a) A raw material costing Rs. 150 has net realisable value (which can be the replacement cost) Rs. 130. The finished goods for which this raw material is used has other cost to incur Rs. 60. At what price raw material should be valued if finished goods has a net realisable value (i) Rs. 210 or above (ii) less than Rs. 190 and (iii) Rs. 200.

(b) Astha Ltd. paid an interim dividend of Rs. 1,00,000 during the financial year 2007-2008. Alongwith, it also paid Rs. 10,200 as corporate dividend tax, ABC Ltd., while preparing cash flow statement for 2007-2008, classified dividend paid as financing activities and Corporate Dividend Tax paid as cash flow from operating activities. Do you agree with such treatment? Answer your question in framework of AS-3.

(c) Heera Ltd. has two divisions. It provides depreciation for both divisions on straight line basis as per rates prescribed by Schedule XIV to the Companies Act. While finalizing the accounts for the year ended 31-3-2007, it however wants to change the method to Written Down Value method for one of its divisions since in the opinion of the management the assets of the said division suffer faster wear and tear. Please advise the company on the above and also whether the change should be prospective or retrospective.

(d) A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 2007.

	(Rs. in lakhs)
Total Contract Price	1,000
Work Certified	500
Work not Certified	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 (Revised) issued by ICAI.

23. (a) A newly set up Private Ltd. manufacturing company has incurred following expenditures for the acquisition of plant & Machinery:

(a) Foreign tour expenses of directors for purchasing Plant & Machinery.

(b) Technical staff's salary for erection of Plant & Machinery.

(c) Non-techincal staff's salary during the period of installation of Plant & Machinery

(d) Other sundry expenses such as stationery, printing, postage, telegram and telephone and local conveyance charge etc.

The company intends to capitalize the above expenses. Is the company justified? State with reasons.

(b) Daya Ltd. acquired a machine on 1-1-2004 for Rs. 10,00,000. The useful life is 5 years. The company had applied on 1-4-2004, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy, was received in November 2007. The company's Fixed Assets Account as at 31-3-2008 shows a credit balance as under:

Machine (original cost)	10,00,000
Accumulated depreciation (from 2004-2005 to 2006-2007 at straight line method)	(6,00,000)
	4,00,000
Less: Grant received	(8,00,000)
	(4,00,000)

How should the company deal with this asset in its account for 2007-08? Does it need to charge depreciation or negative depreciation for 2007-08? Can it credit Rs. 4,00,000 to capital reserve?

(c) X Co. Ltd., has obtained an Institutional Loan of Rs. 680 lakhs for modernisation and renovation of its plant & machinery. Plant & machinery acquired under the modernisation scheme and installation completed on 31.3.2008 amounted to Rs. 520 lakhs, 30 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 130 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to Rs. 62 lakhs during 2007-2008.

You are required to state how the interest on the institutional loan is to be accounted for in the year 2007-2008.

24. (a) A Ltd. leased a machinery to B Ltd. on the following terms:

	(Rs. in Lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

(b) A Ltd. has income from continuing ordinary operations of Rs. 2,40,000, a loss from discontinuing operations of Rs. 3,60,000 and accordingly a net loss of Rs. 1,20,000. The company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2008. Compute basic and diluted EPS.

(c) An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.

25. (a) During 2004-05, Enterprise X gives a guarantee of certain borrowings of Enterprise Y, whose financial condition at that time is sound. During 2005-06, the financial condition of Enterprise Y deteriorates and at 30 September, 2005 Enterprise Y goes into liquidation. How it will be dealt with by 'X'?

(b) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.

(c) A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2007, when the exchange rate was Rs.43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2007 when the exchange rate was Rs.47 per US Dollar. However, on 31st March, 2007, the rate of exchange was Rs.48 per US Dollar. The company passed an entry on 31st March, 2007 adjusting the cost of raw materials consumed for the difference between Rs.47 and Rs.43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

(d) A company signed an agreement with the Employees Union on 1.9.2007 for revision of wages with retrospective effect from 30.9.2006. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2007-08?

SUGGESTED ANSWERS/HINTS

1.	Cost Price	100
	Catalogue Price (100x150%)	150
	Invoice Price (150-20%)	120

In the books of Kolkata - Head Office

Mumbai Branch Stock Account

		Rs.			Rs.
To	Balance b/d	12,000	By	Branch Cash Account (Cash Sales)	46,000
To	Goods sent to Branch Account	1,32,000	By	Branch Debtors Account (Credit sales)	1,00,000
To	Branch Adjustment Account (W.N.1)	20,000	By	Branch Adjustment Account (loading on stock destroyed)	500
			By	Branch profit and Loss Account (at cost)	2,500
				(Stock destroyed by fire Balancing Figure Rs. 3,000)	
			By	Balance c/d	15,000
		1,64,000			1,64,000

Mumbai Branch Adjustment Account

		Rs.			Rs.
To	Mumbai Branch Stock Account (loading on stock destroyed by fire)	500	By	Stock Reserve Account (opening)	2,000
To	Stock Reserve Account (closing)	2,500	By	Goods sent to Branch Account (loading)	22,000
To	Branch Profit and Loss Account (Gross Profit)	41,000	By	Mumbai Branch Stock Account (W.N.1)	20,000
		44,000			44,000

Branch Profit and Loss Account

		Rs.			Rs.
To	Branch Expenses Account (6,000 + 13,365)	19,365	By	Branch Adjustment Account	41,000
To	Mumbai Branch Stock Account	2,500			
	(Cost of stock destroyed by fire)				
To	Provision for Discount Account (W.N.2)	1,485			
To	General Profit and Loss Account	17,650			
		41,000			41,000

Working Notes :

1. Since the Branch Stock Account is prepared at invoice price, it is necessary to calculate the invoice price of the goods sold on credit, i.e.,

$$\frac{1,00,000 \times 120}{150} = 80,000$$

Hence, surplus of Rs.20,000 (1,00,000 – Rs.80,000) has been transferred to Branch Adjustment Account.

2. Calculation of Provision for Discount on Debtors on 31st March, 2008:

Rate of Discount (Given)	15%
Total discount allowed during the year (Given)	Rs.13,365

Thus, the total amount of debtors who availed discount by making prompt payments is:

$$\frac{13,365 \times 100}{15} = 89,100$$

But the total amount of debtors who made payments during the year:

85,635 + 13,365	Rs.99,000

Thus, the amount of debtors likely to pay promptly out of the closing debtors could be worked out as under:

$$\frac{89,100 \times 11,000}{99,000} = \text{Rs.}9,900$$

Provision for discount: 15% on Rs.9,900 = Rs.1,485.

2. In the books of Welwash (Pvt.) Ltd.

Hire Purchase Trading Account

for the year ended on 31st March, 2008

Dr.		Rs.			Cr. Rs.
To	Hire Purchase Stock (Rs. 500 × 675)	3,37,500	By	Cash (W.N. 1)	10,02,000
To	Instalments due (Rs. 500 × 3)	1,500	By	Stock Reserve $\left(Rs.3,37,500 \times \frac{3,000}{13,500}\right)$	75,000
To	Goods sold on Hire Purchase (Rs. 13,500×80)	10,80,000	By	Goods Repossessed (Rs. 13,500–Rs. 1,500–Rs. 2,500)	9,500
To	Stock Reserve $\left(Rs.4,05,000 \times \frac{3,000}{13,500}\right)$	90,000	By	Goods sold on Hire Purchase $\left(Rs.10,80,000 \times \frac{3,000}{13,500}\right)$	2,40,000
To	Profit and Loss A/c (Transfer of profit)	2,25,000	By	Hire Purchase Stock (Rs. 500 × 810)	4,05,000
			By	Instalments due (Rs. 500 × 5)	2,500
		17,34,000			17,34,000

Trading and Profit and Loss Account
for the year ended on 31st March, 2008

		Rs.			Rs.
To	Opening Stock (Rs.10,500×26)	2,73,000	By	Sales (Rs. 12,300×130)	15,99,000
To	Purchases(W.N.2)	21,52,500	By	Goods sold on Hire Purchase (Rs. 10,80,000–Rs. 2,40,000)	8,40,000
To	Gross Profit	2,34,000	By	Closing Stock (Rs. 10,500×21)	2,20,500
		26,59,500			26,59,500

To	Sundry Expenses	1,60,000	By	Gross Profit	2,34,000
To	Provision for Income Tax		By	Hire Purchase Trading A/c	2,25,000
	(35% of Rs.3,00,000)	1,05,000	By	Goods Repossessed	1,000
To	Net Profit for the year	1,95,000		(Rs. 11,500–Rs.1,000–Rs. 9,500)	
		4,60,000			4,60,000

Working Notes :

1. Cash collected during the year

			Rs.
Hire purchase stock on 1.4.2007			3,37,500
Instalments due on 1.4.2007			1,500
Hire purchase price of goods sold during the year			10,80,000
			14,19,000
Less :	Repossessed goods	9,500	
	Hire purchase stock on 31.3.2008	4,05,000	
	Instalments due on 31.3.2008	2,500	4,17,000
Cash collected during the year			10,02,000

2. Washing machines purchased during the year

	No.	No.
Closing balance	21	
Add : Cash Sales	130	
Sales on hire purchase basis	80	231
Less : Opening stock		26
Purchase during the year		205
Purchases in Rs.	205 × Rs. 10,500 = Rs. 21,52,500	

3. Statement of Distribution of Cash

	Realisation	Interest on loans from partners' spouses	Interest on loans from partners	Partners' Capitals A	B	C	Total
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs
Balances due		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	(1,000)	-	-	-	-	-
		1,000	1,000	9,600	6,000	8,400	24,000
(ii) Sale of furniture	2,000	(1,000)	(1,000)	-	-	-	-
(a)		-	-	9,600	6,000	8,400	24,000
(iii) Sale of machinery	1,200						
Maximum possible loss Rs. 22,800 (total of capital A/cs Rs. 24,000 less cash available Rs. 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2				(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit				(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C				1,800	840	(2,640)	–
Amount paid (b)				–	–	1,200	1,200
Balances in capital accounts (a-b)=(c)				9,600	6,000	7,200	22,800
(iv) Sale of stock	4,000						
Maximum possible loss Rs. 18,800 (Rs. 22,800 – Rs.							

4,000) Allocated to partners in the ratio 5 : 3 : 2	(9,400)	(5,640)	(3,760)	(18,800)
Amounts paid (d)	200	360	3,440	(4,000)
Balances in capital accounts left unpaid — Loss (c)-(d)=(e)	9,400	5,640	3,760	18,800

4. M/s Neptune & Co.

Profit and Loss Adjustment Account

for the year ended 31st March, 2008

			Rs.				Rs.
To	Land & Building (Loss on sale)		10,000	By	Partners' Capital Accounts :		
To	Machinery (Loss on scrapping)		4,300		Mr. A	95,400	
To	Provision for Doubtful Debts (W.N.1)		5,820		Mr. B	95,400	1,90,800
				By	Prepaid		
To	Stock Adjustment (Fall in the Market value)		11,400		expenses (Licence fee)		1,000
To	Cash (Misappropriated)		700	By	Stock Adjustment (items omitted)		6,600
To	Interest on Capital (W.N.2)						
	Mr. A	32,580					
	Mr. B	11,160	43,740				
To	Profit transferred to Partners' Capital Accounts:						
	Mr. A	61,220					
	Mr. B	61,220	1,22,440				
			1,98,400				1,98,400

(a) Partners' Capital Accounts

as on 31st March, 2008

	Mr. A	Mr. B		Mr. A	Mr. B
	Rs.	Rs.		Rs.	Rs.
To Drawings	40,000	76,000	By Balance b/d	4,02,000	2,00,000
To Profit & Loss Adjustment Account	95,400	95,400	By Profit & Loss A/c	95,400	95,400
			By Profit & Loss Adjustment A/c:		
To Balance c/d	4,55,800	1,96,380	Interest on capital	32,580	11,160
			Profit for the year	61,220	61,220
	5,91,200	3,67,780		5,91,200	3,67,780

Working Notes :

(1) Provision for doubtful debts charged to profit and loss adjustment account

Provision for Doubtful Debts Accounts

	Rs.		Rs.
To Bad Debts	10,420	By Balance b/d	10,000
To Balance c/d (required)	5,400	By Profit & Loss Adjustment A/c (balancing figure)	5,820
	15,820		15,820

(2) Interest on Capitals

Mr. A Rs. 3,62,000 × 9% p.a. = Rs. 32,580

Mr. B Rs. 1,24,000 × 9% p.a. = Rs. 11,160

5. Statement of Affairs as on 31.3.2008

Rs.		Rs.	Rs.		Rs.	Rs.
1,80,000	Unsecured creditors as per list A (W.N.1)		1,80,000	Property as per list E: Cash in hand	10,000	10,000
1,00,000	Creditors fully secured as per list B	1,00,000		Stock in hand	15,000	10,000
				Book debts as per list F:		

	Estimated value of Security	1,00,000	-	Good	80,000	80,000
Nil	Creditors partly secured as per list C		Nil	Bad	10,000	Nil
						1, 00,000
8,000	Creditors for taxes, wages etc. being payable in full as per list D	8,000		Deduct creditors for wages etc. as per list D		8,000
						92,000
	Deducted as per contra	8,000	Nil	Deficiency as explained in list H		88,000
2,88,000			1,80,000			1,80,000

Deficiency Account (List H)

	Rs.		Rs.
Excess of assets over liabilities on 1.7.2002	2,00,000	Net loss arising from carrying on of business from 1.4.2002 to the date of adjudication (W.N. 2)	1,55,000
Net profit upto 31.3.2005	1,40,000		
Deficiency	88,000	Loss on realisation of:	
		Building	60,000
		Stock in trade	5,000
		Debtors	10,000
		Drawings for household expenses since 1.4.2005	1,98,000
	4,28,000		4,28,000

Working Notes:

(1) The unsecured creditors in this case will be as follows:

	Rs.
Sundry Creditors	1,50,000
Godown Rent	5,000
Mrs. Ram loan (Since loan was given out of her own sources)	25,000
	1,80,000

(2) Since accounts were not prepared for the period of 1.4.2002 to 31.3.2005 it is necessary to ascertain the profit or loss incurred in these three years. Hence, the following trial balance has been prepared with the given book figures.

Trial Balance

Dr.			Cr.		
		Rs.			Rs.
Building		1,60,000	Capital introduced	2,00,000	
Book debts			Add: Profit upto 31.3.2005	1,40,000	
Good	80,000				
Bad	10,000	90,000		3,40,000	
Stock in trade		15,000	Less: Drawings for		
Cash in hand/bank		10,000	(Rs. 5,500 × 36 months)	1,98,000	1,42,000
Loss (balancing figure)		1,55,000	Creditors		1,50,000
			Mortgage on building		1,00,000
			Godown rent		5,000
			Wages due		8,000
			Mrs. Ram's loan		25,000
		4,30,000			4,30,000

6. (a) Journal Entries in the Books of Trinity Ltd.

		Dr. Rs.	Cr. Rs.
Securities Premium A/c	Dr.	10,000	
To Premium on Redemption of Preference shares A/c			10,000
(Being amount of premium payable on redemption of preference shares)			
10% Redeemable Preference Capital A/c	Dr.	10,00,000	
Premium on redemption of Preference Shares A/c	Dr.	10,000	
To Preference Shareholders			1,10,000
(Being the amount payable to preference shareholders on redemption)			
General Reserve A/c	Dr.	1,00,000	
To Capital Redemption Reserve A/c			1,00,000
(Being transfer to the latter account on redemption of shares)			

Bank A/c	Dr.	45,000	
Profit and Loss A/c	Dr.	5,000	
To Investments A/c			50,000
(Being amount realised on sale of Investments and loss thereon adjusted)			
Preference shareholders A/c	Dr.	1,10,000	
To Bank A/c			1,10,000
(Being payment made to preference shareholders)			
Capital Redemption Reserve A/c	Dr.	1,00,000	
To Bonus to Shareholders A/c			1,00,000
(Amount adjusted for issuing bonus shares in the ratio of 1 : 1)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital A/c			1,00,000
(Balance on former account transferred to latter)			

(b) Cash and Bank A/c

Dr.					Cr.
			Rs.		Rs.
To	Balance b/d		50,000	By Preference Dividend	10,000
To	Cash from operations:			By Preference shareholders	1,10,000
	Profit	15,000		By Balance c/d	30,000
	Add : Depreciation	20,000			
	Add: Miscellaneous expenditure written off	20,000	55,000		
To	Investments		45,000		
			1,50,000		1,50,000

(c) Balance Sheet of Trinity Limited
as at 31st March, 2007 (after redemption)

Liabilities		Rs.	Assets			Rs.
Share Capital:			Fixed Assets:			
Authorised Capital		10,00,000	Gross Block		3,00,000	
Issued, Subscribed and Paid-up Capital			Less:Depreciation upto 31.3.2006	1,00,000		
20,000 Equity Share of Rs. 10 each fully paid		2,00,000	For the year	20,000	1,20,000	1,80,000
allotted as Bonus Shares by capitalising capital Redemption Reserve)			Investments (Market Value Rs. 45,000- W.N.5)			50,000
Reserves and Surplus:			Current Assets, Loans and Advances			
General Reserve (WN.2)	20,000		Inventory		25,000	
Securities Premium (WN.3)	60,000		Debtors		25,000	
Profit and Loss A/c (WN.1)	18,500	98,500	Cash and Bank Balance		30,000	80,000
Current Liabilities and Provisions:						
Sundry Creditors		11,500				
		3,10,000				3,10,000

Working Notes:

(i) Profit and Loss Account for the year ending 31st March, 2007

	Rs.
Balance as on 1.4.2006	18,500
Add : Profit for the year	15,000
	33,500

	Less : Preference Dividend	10,000	
	Loss on sale of investments	5,000	15,000
	Balance as on 31.3.2007		18,500
(ii)	General Reserve		1,20,000
	Less : Transfer to Capital Redemption Reserve		1,00,000
	Balance as on 31.3.2007		20,000
(iii)	Securities Premium		70,000
	Less : Premium on Redemption of Preference shares		10,000
	Balance as on 31.3.2007		60,000
(iv)	Capital Redemption Reserve		1,00,000
	Less : Transfer for Bonus Shares		1,00,000
	Balance as on 31.3.2007		NIL
(v)	Sale of Investments:		
	Cost of Investments		50,000
	Less :Cash Received		45,000
	Loss on Sale of Investments		5,000
	Total Investments:		1,00,000
	Less : Cost of Investments sold		50,000
	Cost of Investments on hand		50,000
	Market value (90% of Rs. 50,000)		45,000

7. Journal Entries

P Ltd.

		Dr. Rs.	Cr. Rs.
Interest on Calls in Arrear A/c	Dr.	1,200	
To Profit & Loss A/c			1,200
(Being interest @ 12 % p.a. on Rs. 20,000 for 6 months credited to Profit and Loss Account)			

Bank A/c	Dr.	21,200	
To Calls in Arrear A/c			20,000
To Interest on Calls in Arrear A/c			1,200
(Being interest on calls in arrear received)			
Profit & Loss A/c	Dr.	6,000	
To Interest on Calls in Advance A/c			6,000
(Being interest @ 10% on Rs. 1,20,000 for 6 months allowed on calls in advance)			
Profit & Loss A/c	Dr.	90,000	
To Preference Dividend			20,000
To Equity Dividend			70,000
(Being dividend @ 10% on Preference share capital & 20% on Equity share capital proposed)			
Profit & Loss A/c	Dr.	1,50,000	
To Bonus to Equity Shareholders A/c			1,50,000
(Being bonus dividend declared)			
Share Final Call A/c	Dr.	1,50,000	
To Equity Share Capital A/c			1,50,000
(Being final call made @ Rs. 3 on 50,000 shares)			
Bonus to Equity shareholders A/c	Dr.	1,50,000	
To Share Final Call A/c			1,50,000
(Being adjustment of bonus dividend against final call)			
Calls in Advance A/c	Dr.	1,20,000	
Interest on Calls in Advance A/c	Dr.	6,000	
To Bank A/c			1,26,000
(Being amount of calls in advance along with interest refuned)			
Bank A/c	Dr.	2,20,000	
To 10% Debentures A/c			2,20,000
(Being 2,200 Debentures of Rs.100 each issued in cash)			

Profit & Loss A/c	Dr.	20,000	
To Premium on Redemption of Preference shares A/c			20,000
(Being premium payable on redemption)			
Profit & Loss A/c	Dr.	5,200	
General Reserve A/c	Dr.	1,94,800	
To Capital Redemption Reserve A/c			2,00,000
(Transfer to capital redemption reserve)			
Preference Share Capital A/c	Dr.	2,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	20,000	
To Preference Shareholders A/c			2,20,000
(Amount due on redemption of preference shares)			
Preference Shareholders A/c	Dr.	2,20,000	
To Bank A/c			2,20,000
(Amount paid to preference shareholders)			

Profit & Loss Account of P Ltd.

for the year ended 31st March, 2008

	Rs.		Rs.
To Interest on calls in advance	6,000	By Balance b/d	2,70,000
To Balance c/d	2,65,200	By Interest on calls in arrear	1,200
	2,71,200		2,71,200
To Premium on redemption	20,000	By Balance b/d	2,65,200
To Preference Dividend	20,000		
To Equity Dividend	70,000		
To Bonus Dividend	1,50,000		
To Capital Redemption Reserve	5,200		
	2,65,200		2,65,200

Balance Sheet of P Ltd.

as on 31st March 2008

Liabilities		Rs.	Assets	Rs.
Share Capital:			Fixed Assets	7,00,000
50,000 equity shares of Rs. 10 each			(Cost less depreciation)	
fully paid up		5,00,000		
(Of the above equity shares Rs. 3 per			Cash & Bank balance (W.N.)	95,200
share has not been received in cash				
but has been capitalised by issuing			Other Current Assets	6,00,000
bonus dividend)				
Reserves & Surplus:				
Capital Redemption Reserve		2,00,000		
General Reserve	3,00,000			
Less: Utilised for redemption				
of preference share	1,94,800	1,05,200		
Profit & Loss Account		—		
10% Debentures		2,20,000		
Current liabilities		2,80,000		
Proposed dividend		90,000		
		13,95,200		13,95,200

Working Note :

Cash and Bank balance as on 31st March, 2008

		Rs.
Cash and bank balance (given)		2,00,000
Add: Recovery of calls in arrear and interest thereon		21,200
Proceeds from issue of 10% Debentures		2,20,000
		4,41,200
Less: Payment of calls in advance and interest thereon	1,26,000	
Redemption of preference shares	2,20,000	3,46,000
		95,200

Assumptions made:

1. It has been assumed that the amount of calls in arrear has been received.
2. It has also been assumed that 20% dividend on equity shares has been proposed before the equity shares are made fully paid by way of bonus dividend.

8. PA (P) Ltd.

Dr. Profit and Loss Account for 15 months ended 31st March, 2008 Cr.

	Particulars	Notes	Total Rs.	Pre-Incopor-ation 1.1.2007 to 31.3. 2007	Post-incor-poration 1.4.2007 to 31.3. 2008		Particulars	Notes	Total Rs.	Pre-incorpora tion 1.1.2007 to 31.3. 2007	Post-incor-poration 1.4.2007 to 31.3.2008
To	Salaries	2	1,17,000	9,000	1,08,000	By	Gross Profit	1	7,02,000	78,000	6,24,000
To	Depreciation	3	18,000	3,600	14,400	By	Goodwill		-	1,900	-
To	Advertisement	4	70,200	7,800	62,400						
To	Discounts	4	1,17,000	13,000	1,04,000						
To	M.D.'s remuneration	5	9,000	-	9,000						
To	Misc. office exp.	3	12,000	2,400	9,600						
To	Rent	6	72,000	9,000	63,000						
To	Interest	7	95,100	35,100	60,000						
To	Net Profit		1,91,700	-	1,93,600						
			7,02,000	79,900	6,24,000				7,02,000	79,900	6,24,000

Working Notes:

(1) Gross Profit = Sales – Cost of goods sold
= Rs.23,40,000 – 16,38,000 = Rs.7,02,000

Gross Profit is apportioned in the ratio of sales which is calculated as follows:

Let, the average monthly sales of 3 months ending on 31st March, 2007 = Rs.100. the average monthly sales of remaining 12 months starting from 1st April, 2007 = Rs.100 ×200. The total sales of pre-incorporation period will be = 100 × 3 = Rs.300 and that of post-incorporation period will be Rs.200 × 12 = 2400. Therefore, the ratio of sales will be: 3:24 or 1:8.

$$\text{Gross profit of Pre} - \frac{\text{Rs.7,02,000}}{9} \times 1 = \text{Rs.78,000}$$

$$\text{Post} - \frac{\text{Rs.7,02,000}}{9} \times 8 = \text{Rs.6,24,000}$$

(2) Let, the pre-incorporation monthly salary = Rs.100. Therefore, the monthly salary of post-incorporation period = Rs.100 × 3 = 300. Total salary of pre-incorporation period = Rs.100 × 3 = Rs.300 and that of post-incorporation period will be Rs.300 × 12 = 3,600. Hence, the ratio = 2300: 3,600 or 1:12.

(3) These expenses have been apportioned on the basis of time: 3:12 or 1:4.

(4) Advertisement and discounts are apportioned in the ratio of sales i.e., 1:8.

(5) Managing Directors' remuneration is related to post-incorporation period.

(6) Rent to be apportioned as follows:

Total rent as per Profit and Loss Account	=Rs.72,000
Less:Additional rent for 9 months @ Rs.30,000	=<u>Rs.27,000</u>
	=<u>Rs.45,000</u>

Therefore, rent of pre-incorporation period is calculated as $\frac{45{,}000}{15} \times 3 = \text{Rs.9,000}$

And that of post-incorporation period = $\frac{45{,}000}{15} \times 12 + \text{Rs.27,000} = \text{Rs.63,000}$.

(7) Interest for the pre-incorporation period is calculated as $\frac{12}{100} \times \text{Rs.11,70,000} \times \frac{3}{12} = \text{Rs.35,100}$

The balance interest (Rs.95,100 – Rs.35,100) = Rs.60,000 is related to post-acquisition period.

9. (1) Computation of Amount of Debentures and Shares to be issued:

		Star Rs.	Moon Rs.
(i) Average Net Profit			
$\frac{2{,}24{,}788 - 1{,}250 + 1{,}88{,}962}{3}$	=	1,37,500	
$\frac{1{,}36{,}950 + 1{,}71{,}050 + 1{,}79{,}500}{3}$	=		1,62,500
(ii) Equity Shares Issued			
(a) Ratio of distribution			
Star : Moon			
1,375 : 1,625			
(b) Number			
Star : 13,750			
Moon: 16,250			
30,000			
(c) Amount			
13,750 shares of Rs. 5 each	=	68,750	
16,250 shares of Rs. 5 each	=		81,250
(iii) Capital Employed (after revaluation of assets)			
Fixed Assets		3,55,000	1,95,000
Current Assets		1,49,750	78,875
		5,04,750	2,73,875
Less: Current Liabilities		2,98,500	90,125
		2,06,250	1,83,750
(iv) Debentures Issued			
8% Return on capital employed		16,500	14,700
15% Debentures to be issued to provide equivalent income :			
Star : $16{,}500 \times \frac{100}{15}$	=	1,10,000	
Moon : $14{,}700 \times \frac{100}{15}$	=		98,000

(2) Balance Sheet of Neptune Ltd.

As at 31st December, 2007

Liabilities	Amount Rs.	Assets	Amount Rs.
Share Capital:		Fixed Assets	5,50,000
Authorised		Current Assets	2,06,950
40,000 Equity Shares of Rs. 5 each	2,00,000		
Issued and Subscribed			
30,000 Equity Shares of Rs. 5 each (all the above shares are allotted as fully paid-up pursuant to a contract without payments being received in cash)	1,50,000		
Reserves and Surplus			
Capital Reserve	32,000		
Secured Loans			
15% Debentures	2,08,000		
Unsecured Loans	–		
Current Liabilities and Provisisons			
Current Liabilties	3,66,950		
Provisions	–		
	7,56,950		7,56,950

Working Notes :

	Star Rs.	Moon Rs.	Total Rs.
(1) Purchase Consideration			
Equity Shares Issued	68,750	81,250	1,50,000
15% Debentures Issued	1,10,000	98,000	2,08,000
	1,78,750	1,79,250	3,58,000

(2) Capital Reserve

(a)	Net Assets Taken Over			
	Fixed Assets	3,55,000	1,95,000	5,50,000
	Current Assets	1,49,750	57,200*	2,06,950
		5,04,750	2,52,200	7,56,950
	Less : Current Liabilities	2,76,825**	90,125	3,66,950
		2,27,925	1,62,075	3,90,000
(b)	Purchase Consideration	1,78,750	1,79,250	3,58,000
(c)	Capital Reserve [(a) - (b)]	49,175		
(d)	Goodwill [(b) - (a)]		17,175	
(e)	Capital Reserve [Final Figure(c) - (d)]			32,000

10. Calculation of Unexpired Discounts or Rebate on Bills Discounted

Date of Bill	Date of Maturity including three days of grace	No. of days after March 31	Amount Rs.	Rate of discount % p.a.	Total Annual Discount	Proportionate Discount for days after 31st March
2008	2008					
Jan. 13	May 16	46	7,50,000	12	90,000	11,342 $\left(90{,}000 \times \frac{46}{365}\right)$
Feb.17	May 20	50	6,00,000	10	60,000	8,219 $\left(60{,}000 \times \frac{50}{365}\right)$
March 6	July 9	100	4,00,000	11	44,000	12,055 $\left(44{,}000 \times \frac{100}{365}\right)$
March 16	May 19	49	2,00,000	10	20,000	2,685 $\left(20{,}000 \times \frac{49}{365}\right)$
						34,301

So, unexpired discounts on 31st March, 2008, Rs.34,301.

* 78, 875 - 21,675

** 2,98,500 - 21,675

The amount to be credited to Profit and Loss Account is ascertained from the Discount Account as follows:

Discount Account

2008			Rs.	2008			Rs.
March 31	To	Profit and Loss A/c (Bal. fig.) (transferred)	1,41,700	Mar. 31	By	Sundries	1,45,500
March 31	To	Rebate on Bills Discounted (on 31.3.08)	34,301	March 31	By	Rebate on Bills Discounted (on 1-4-2007)	30,501
			1,76,001				1,76,001

Journal Entries

2008			Rs.	Rs.
March 31	Rebate on Bills Discounted A/c	Dr.	30,501	
	To Discount Account			30,501
	(Being unexpired discount brought forward from the previous year, credited to Discount Account)			
March 31	Discount Account	Dr.	34,301	
	To Rebate on Bills Discounted Account			34,301
	(Being provision for unexpired discount required at the end of the year)			
March 31	Discount Account	Dr.	1,41,700	
	To Profit and Loss Account			1,41,700
	(Being discount earned for the year 2007-08 transferred)			

Extracts of Balance Sheet
as at 31-3-2008

Liabilities	Rs.	Assets	Rs.
Other Liabilities		Advances	
Rebate on Bills Discounted	34,301	Bills Discounted	51,50,000

11. Form B – RA (Prescribed by IRDA)

Hercules Insurance Co. Ltd.

Revenue Account for the year ended 31st March, 2007

Fire, Marine and Misc. Insurance Businesses

	Schedule	Fire Current Year	Marine Current Year	Misc. Current Year
		Rs. '000	Rs. '000	Rs. '000
Premiums earned (net)	1	1762,50	1022,50	262,25
Change in provision for unexpired risk		(-)81,25	(-) 72,50	87,52
Interest, Dividends and Rent – Gross		—	—	—
Double Income Tax refund		—	—	—
Profit on sale of motor car		—	—	—
Total (A)		1681,25	950,00	349,77
Claims incurred (net)	2	650,00	408,90	100,50
Commission	3	500,00	350,00	80,00
Operating expenses related to Insurance business	4	280,00	160,00	40,00
Bad debts		—	—	—
Indian and Foreign taxes		—	8,00	—
Total (B)		1430,00	926,90	220,50
Profit from Marine Insurance business (A-B)		251,25	23,10	129,27

Schedules forming part of Revenue Account

Schedule –1

	Fire Current Year	Marine Current Year	Misc. Current Year
Premiums earned (net)	Rs. '000	Rs'000.	Rs. '000
Premiums less reinsurance (net)	1762,50	1022,50	262,25

Schedule – 2

Claims incurred (net)	650,00	408,90	100,50

Schedule – 3			
Commission paid	500,00	350,00	80,00
Schedule – 4			
Operating expenses related to insurance business			
Expenses of Management	280,00	160,00	40,00

Form B-PL
Hercules Insurance Co. Ltd.
Profit and Loss Account for the year ended 31st March, 2007

Particulars	Schedule	Current Year	Previous Year
		Rs. ' (000)	Rs. ' (000)
Operating Profit/(Loss)			
(a) Fire Insurance		251,25	
(b) Marine Insurance		23,10	
(c) Miscellaneous		129,27	
Income From Investments			
(a) Interest, Dividend & Rent–Gross		58,50	
Other Income			
Transfer Fees		1,00	
Total (A)		463,12	
Provisions (Other than taxation)			
Depreciation of Furniture		10,00	
Depreciation of Investments		10,00	
Other Expenses			
Expenses of Management		30,00	
Donation		10,00	
Total (B)		60,00	
Profit before Tax		403,12	

Provision for Taxation		206,56
Profit after Tax		196,56
Profit Appropriated		
(a)	Interim dividends paid during the year	—
(b)	Proposed final dividend	(64,00)
(c)	Dividend distribution tax	—
(d)	Transfer to General Reserves or Other Accounts (to be specified)	(10,00)
		122,56
Balance of profit/loss brought forward from last year		80,40
Balance carried forward to Balance Sheet		202,96

Working Notes :

1. Reserve for unexpired risk 50% of net premium for fire and miscellaneous and 100% of net premium for marine.
2. Provision for Taxation Rs.

Net Profit before tax	403,12
Add : Donation	10,00
Taxable Profit	413,12
Tax @ 50%	206,56

12. Gurgaon Electricity Company Limited

Plant Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	24,00,000	By Balance c/d	49,20,000
To Bank Account	22,80,000		
(Cost of new plant-capitalised)			
To Replacement Account			
(Old parts)	2,40,000		
	49,20,000		49,20,000
To Balance b/d	49,20,000		

Replacement Account

Dr.	Rs.		Cr. Rs.
To Bank Account (Current cost of replacement)	37,20,000	By Bank Account (Sale of scrap)	7,50,000
		By Plant Account (Old material used)	2,40,000
		By Revenue Account (Transfer)	27,30,000
	37,20,000		37,20,000

Working Notes :

(1) Cost to be incurred for replacement of present plant :

	Cost of Existing Plant Rs.	Increase %	Current Cost Rs.
Materials	12,00,000	40%	16,80,000
Labour	7,20,000	80%	12,96,000
			29,76,000
Overheads (1/4 of above or 1/5 of total)			7,44,000
Current Replacement Cost			37,20,000
Total Cash Cost			60,00,000
Amount capitalised, excluding old materials used			22,80,000

13. Cash Flow Statement of Raj Ltd.
for the year ended ....

	Rs.	Rs.
Cash flows from operating activities		
Net profit	76,500	
Adjustments for		

Depreciation (W.N.4)	27,900	
Profit on sale of plant (W.N.2)	(2,500)	
Accrued Interest on debentures for half year	2,000	
Operating profit before working capital changes	1,03,900	
Adjustments for:		
Increase in debtors less provision for doubtful debts	(46,700)	
Increase in stock and work-in-progress	(38,500)	
Increase in creditors	11,800	
Net cash from operating activities		30,500
Cash flows from investing activities		
Purchase of plant and machinery (W.N.1)	(78,000)	
Proceeds from sale of plant	7,000	
Proceeds from sale of freehold property (W.N.3)	6200	
Increase in trade investments	(47,000)	
Net cash used in investing activities		(1,11,800)
Cash flows from financing activities		
Proceeds from issuance of debentures at discount	49,000	
Debenture interest paid	(2,000)	
Dividend paid in respect of earlier year	(30,000)	
Net cash from financing activities		17,000
Excess of outflows over inflows		(64,300)
Add: Cash and cash equivalents at the beginning of the year		Nil
Cash & cash equivalents at the end of the year		(64,300)

Thus, the shortfall of Rs. 64,300 was made up through borrowings from bank.

Working Notes:

1. Acquisition of plant and machinery:

	Rs.
Amount of increase, at cost	60,000
Add: Cost of plant disposed of	18,000
Cost of plant and machinery purchased	78,000

2. Profit on sale of plant = Rs. 7,000 - (Rs. 18,000 - Rs. 13,500)

   = Rs. 7,000 - Rs. 4,500 = Rs. 2,500

3. Proceeds from sale of freehold property:

Capital reserve	49,200
Less: Increase in freehold property (given)	43,000
Proceeds from sale	6,200

4. Depreciation on Plant and Machinery provided for the year:

Increase in Provision for Depreciation (given)	14,400
Add: Accumulated depreciation on plant sold	13,500
Depreciation for the year ..	27,900

14. In the books of K. Azad

Trading and Profit and Loss Account

for the year ended 31st March, 2008

		Rs.		Rs.
To Opening Stock		1,25,000	By Sales	52,50,000
To Purchases	30,00,000		By Damaged Stock A/c	5,000
Less : Transferred to			By Closing Stock	1,19,000
Drawings A/c	1,000	29,99,000		
To Gross Profit c/d		22,50,000		
		53,74,000		53,74,000
To Salaries		44,000	By Gross Profit b/d	22,50,000
To Rent		78,000	By Interest accrued	
To Miscellaneous Office Expenses		12,000	on fixed deposit	36,000
To Loss of Deposit		10,000	By Profit on Damaged Stock	500
To Interest on Security Deposits		6,000		

To Depreciation :				
Furniture	2,700			
Tempo Van	7,500	10,200		
To Net profit		21,26,300		
		22,86,500		22,86,500

Balance Sheet as on 31st March, 2008

Liabilities Amount	Rs.	Rs.	Assets Amount	Rs.	Rs.
K.Azad's Capital			Furniture	27,000	
Balance	1,50,000		Less : Depreciation	2,700	24,300
Add : Net Profit	21,26,300				
	22,76,300		3–Wheeler Tempo Van	30,000	
Less : Drawings	51,000	22,25,300	Less : Depreciation	7,500	22,500
12% Security Deposit from Customers		60,000	Closing Stock		1,19,000
Interest Payable on Security Deposit		6,000	Debtors		22,11,500
Creditors for Oil Purchases		8,00,000	Cash and Bank Balances		66,000
Outstanding Rent		7,000	Fixed Deposit		6,00,000
			Interest Accrued on Fixed Deposit		36,000
			Rent Advance		14,000
			Electricity Deposit		1,000
			Insurance Claim Receivable		4,000
		30,98,300			30,98,300

Working Notes :

(1) Memorandum Stock Account

	No.	Cost (Rs.)		No.	Cost (Rs.)
To Opening Stock	125	1,25,000	By Damages	5	5,000
To Purchases	3,000	30,00,000	By Drawings	1	1,000
			By Sales	3,000	30,00,000
			By Closing Stock	119	1,19,000
	3,125	31,25,000		3,125	31,25,000

(2) Damaged Stock Account

	Rs.		Rs.
To Trading Account	5,000	By Insurance Claim Receivable A/c	4,000
To Profit and Loss Account		By Cash and Bank A/c (Sale)	1,500
(Balance Transferred)	500		
	5,500		5,500

(3) Debtors Account

	Rs.		Rs.
To Balance b/d	1,60,000	By Cash and Bank A/c	26,73,500
To Sales A/c (Credit Sales*)	47,25,000	By Balance c/d	22,11,500
	48,85,000		48,85,000

*Credit Sales in respect of (normal) sales of 3,000 tins

Total Sales (3,000 × Rs. 1,750)	= 52,50,000
Less : Cash Sales (5,26,500 – 1,500)	= 5,25,000
	47,25,000

(4) Creditors Account

	Rs.		Rs.
To Cash and Bank A/c	24,00,000	By Balance b/d	2,00,000
To Balance c/d	8,00,000	By Purchases A/c	30,00,000
	32,00,000		32,00,000

(5) Cash and Bank Account

	Rs.		Rs.
To Balance b/d	75,000	By Rent A/c	79,000
To Sales A/c	5,25,000	By Salaries A/c	48,000
To Damaged Stock A/c	1,500	By Miscellaneous Office Expenses	12,000
To Debtors A/c	26,73,500	By Commission	20,000
To Security Deposit A/c	10,000	By Drawings A/c	50,000
		(Personal Income–tax)	
		By Fixed Deposit A/c	6,00,000
		By Creditors A/c	24,00,000

		By Loss of deposit A/c	10,000
		(Defalcation of security deposit)	
		By Balance c/d	66,000
	32,85,000		32,85,000

Notes :

(1) 12% interest on Fixed Deposit is assumed to be per annum. Similar assumption applies to 12% Security Deposit from customers.

(2) The treatment of claim pending against the Insurance Company in respect of defalcation of security deposit by one of the staff has been considered on the basis of Conservatism Concept. Conservatism suggests non–consideration of claim as an asset in anticipation. Where the ability to assess the ultimate collection with reasonable certainly is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved (AS 9). In this case, it may reasonably assume that collectability of claim is not certain.

15. In India, Government accounts are kept in three main parts i.e., consolidated fund, contingency fund and public account.

    Revenue of the Government arising out of taxation, other receipts classified as revenue, certain capital receipts by way of deposits, advances and expenditure there from are classified and accounted under "Consolidated fund".

    Accounting for the Central Government and State Government is done separately i.e., in consolidated fund of India for the Central Government and a separate consolidated fund for each state and Union Territory. The two main sub-divisions under the consolidated fund are Revenue A/c and Capital A/c.

16. Agricultural activities are carried on mostly in an unorganized manner. The farmer has no office and also does not find time for day by day record keeping. The transactions and events are also not supported by vouchers or other documents in most of the cases. So it is desirable to maintain a Diary to record happenings of the day. This Diary becomes the source document for record keeping.

    Seven registers are required for running the accounting system.

    1. Cash Book: to record cash transactions.

    2. Fixed Assets Register: to record details of fixed assets like description of assets, cost of purchases/construction/generation, disposal, depreciation and balance.

    3. Loan Register: to record borrowings from bank, cooperatives and other agencies trade creditors along with interest paid or payable.

    4. Stock Register: to record details of input, output and by product – receipts, utilization, wastage and balance.

5. Debtors and Creditors Register: to record credit transactions classified by parties involved.

6. Register for National Transactions: to record transactions between farm and farm household.

7. Cost Analysis Register: to record cropwise input and output inclusive of apportionment of common costs and finding out crop profit.

17. (a) Purpose of the Conceptual Framework:

The framework sets out the concepts underlying the preparation and presentation of general-purpose financial statements prepared by enterprises for external users. The main purpose of the framework is:

(a) To assist enterprises in preparation of their financial statements in compliance with the accounting standards and in dealing with the topics not yet covered by any accounting standard.

(b) To assist Accounting Standard Board (ASB) of ICAI in its task of development and review of accounting standards.

(c) To assist ASB in promoting harmonisation of regulations, accounting standards and procedures relating to the preparation and presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by accounting standards.

(d) To assist auditors in forming an opinion as to whether financial statements conform to the accounting standards.

(e) To assist the users in interpretation of financial statements.

(b) Liquidity Norms: Banking companies have to maintain sufficient liquid assets in the normal course of business. In order to safeguard the interest of depositors and to prevent banks from over-extending their resources, liquidity norms have been settled and given statutory recognition. Every banking company has to maintain in cash, gold or unencumbered approved securities, an amount not less than 25% of its demand and time liabilities in India. However, this percentage is changed by the Reserve Bank of India from time to time considering the general economic conditions. This is in addition to the average daily balance which a scheduled bank is required to maintain under Section 42 of the Reserve Bank of India Act and in case of other banking companies, the cash reserve required to be maintained under Section 18 of the Banking Regulations Act.

(c) Co-Insurance: In cases of large risks the business is shared between more than one insurer under co-insurance arrangements at agreed percentages. The leading insurer issues the documents, collects premium and settles claims. Statements of Account are rendered by the leading insurer to the other co-insurers. Accounting for premium, claims etc. under co-insurance is done in the same manner as that of the direct business except in respect of the following peculiar features:

(i) Premium: The co-insurer books the premium based on the statement received from the leading insurer usually by issuing dummy documents. Entries are made in the Premium Register from which the Premium Account is credited and the Leading Insurer Company's Account debited. In case the statement is not received, the premium is accounted for on the basis of advices to ensure that all premium in respect of risk assumed in any year is booked in the same year; share of premium relatable to further extension/endorsements on policies by the leading insurer are also accounted for on the basis of subsequent advices. Reference to the relevant communications should be made from the concerned companies to ensure that premium collected by them and attributable to the company is recorded.

(ii) Claims Paid: Normally, on the basis of claims paid, advices received from the leading insurer, the Claims Paid Account is debited with a credit to the co-insurer. All such advices are entered into the Claims Paid Register. It is a practice to treat all claims paid advices relating to the accounting year received upto 31st January of the subsequent year from leading insurer as claims paid.

Outgoing co-insurance: The share of the insurer only for both premium and claims has to be accounted under respective accounts. The share of other co-insurers is credited or debited, as the case may be, to their personal accounts and not routed through revenue accounts.

18. (a) Over-riding preferential payments under Section 529A of the Companies Act, 1956:

The Companies (Amendment) Act, 1985 introduced Section 529A which states that certain dues are to be settled in the case of winding up of a company even before the payments to preferential creditors under Section 530. Section 529A states that in the event of winding up of a company, workmen's dues and debts due to secured creditors, to the extent such debts rank under Section 529(1)(c), shall be paid in priority to all other debts. The workmen's dues and debts to secured creditors shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Workmen's dues, in relation to a company, means the aggregate of the following sums:

1. all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;
2. all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order or resolution;
3. all amounts due in respect of any compensation or liability for compensation under Workmen's Compensation Act, 1923 in respect of death or disablement

of any workman of the company.

4. all sums due to any workman from a provident fund, pension fund, a gratuity fund or any other fund for the welfare of the workmen, maintained by the company.

(b) Advantages of maintaining subsidiary books by a trading/manufacturing organization are:

(i) Division of work: In place of one journal, there are many subsidiary books. The accounting work can be divided amongst a number of people.

(ii) Specialisation and efficiency: As a person is handling only one type of work, he acquires full knowledge and becomes efficient in handling the work. Accounting work is done efficiently.

(iii) Saving of time: Various accounting processes can be undertaken simultaneously because of the use of a number of books. This results in quicker completion of work.

(iv) Availability of information: Since a separate register is kept for each class of transactions, the information relating to each class of transaction is available at one place.

Additional information for sales tax, excise, octroi etc., can also be compiled from the appropriate columns in the pruchases and sales registers.

(v) Facility in checking: When the trial balance does not agree, the location of errors is facilitated by the existence of separate books. Similarly audit of the various books of prime entry can be conducted simultaneously by a team of audit staff.

19. (a) According to para 44 of AS 20, 'If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

(b) As per para 50 and 52 of AS 19, 'if a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.'

(c) Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

(i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include 'other income'.

(ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.

(iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

20. (a) To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period.

(b) It is a present obligation as a result of past obligating event. The obligating event is the sale of the product which gives rise to an obligation because obligations also arise from normal business practices. An outflow of resources, embodying economic benefits in settlement is probable because a proportion of goods are returned for refund. For the best estimate of the cost of refunds, a provision should be recognized as per AS 29.

(c) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

21. (a) As per AS 7, when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35 of the same standard.

(b) (i) 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.

(ii) The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

(a) the period of the change, if the change affects the period only; or

(b) the period of the change and future periods, if the change affects both.

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

(c) For disclosure of significant accounting policies, AS 1 in its para nos. 24, 25, 26 and 27 requires, 'all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

If the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.'

22. (a) (i) The raw material price has declined to Rs. 130 but the cost of finished goods Rs. 210 including raw material cost Rs. 150 is fully realizable hence no need to write down inventory to Rs. 130 i.e. raw material will be valued at Rs. 150.

(ii) If the net realizable value of finished goods say Rs. 190 or less, is less than its cost of Rs. 210 then raw material should be valued at Rs. 130.

(iii) Although wordings of AS 2 does not say so clearly but if finished goods can be sold at Rs. 10 less than its expected total cost, then raw material can be valued at Rs.140 i.e. Rs. 10 less than its cost. That is, it need not be written down to Rs.130. This is in view of the purpose of writing down to net realizable in AS 2. According to AS 2, the practice of writing down inventories below cost to net realizable value is consistent with the view that assets should not be carried in excess of the amount that can be realized from its use since it is held for the purpose of that use. Hence the entire cost of Rs. 150 is not recovered by use in finished production. Only Rs. 140 is recoverable by use in production i.e. (Rs. 140+60= 200). Hence, the stock of raw materials should be valued at Rs. 140.

(b) Both dividend paid and Corporate Dividend Tax paid should be shown as financing activities as per AS 3.

(c) According to the Guidance Note on Accounting for Depreciation in Companies issued by ICAI, it is permissible for a company to adopt more than one method of depreciation simultaneously that is to say that-

1. Company may follow different methods for different types of assets; and
2. Company geographical locations can follow different methods.

Only condition is that same methods should be consistently adopted from year to year.

Change in the method of depreciation is a change in accounting policy. According to AS 6, such a change is permissible only when at least one of the following 3 conditions is satisfied:-

(i) Such change is required by law.

(ii) Such change is required by the Accounting Standards

(iii) Such change will result in more appropriate presentation.

Here, from the facts given it appears that condition (iii) is satisfied i.e. change will lead to more appropriate presentation (since WDV method will better represent the pattern of faster wear & tear instead of SLM).

According to AS 6, change should be retrospective. Any difference arising thereon should be changed/ credited to P&L account in the year of change.

(d) (i) Amount of foreseeable loss

	(Rs in lakhs)
Total cost of construction (500 + 105 + 495)	1,100
Less: Total contract price	1,000
Total foreseeable loss to be recognized as expense	100

According to para 35 of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii) Contract work-in-progress i.e. cost incurred to date are Rs. 605 lakhs

	(Rs in lakhs)
Work certified	500
Work not certified	105
	605

This is 55% (605/1,100 $\times$ 100) of total costs of construction.

(iii) Proportion of total contract value recognised as revenue as per para 21 of AS 7 (Revised).

55% of Rs. 1,000 lakhs = Rs. 550 lakhs

(iv) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= [605 + Nil – 100 – (400 + 140)] Rs. in lakhs

= [605 – 100 – 540] Rs. in lakhs

Amount due to customers = Rs. 35 lakhs

The amount of Rs. 35 lakhs will be shown in the balance sheet as liability.

(v) The relevant disclosures under AS 7 (Revised) are given below:

	Rs. in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognized losses	(100)

Progress billings (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

23. (a) 1. Yes, as foreign tour expenses of directors for purchase of Plant and Machinery is for the acquisition of the asset, therefore it should be capitalised.

2. Yes, salary of technical staff for erection of Plant and Machinery is the cost directly attributable for bringing the asset to its working conditions for its intended use. Therefore, it should be capitalised.

3. No, as per para 9 of AS 10 only salary of technical staff can be said to as directly attributable to bring the asset to its working conditions for its intended use. Therefore, salary of non-technical staff cannot be capitalised.

4. No, as per para 9.3 of AS 10, 'administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset.' Hence the same should not be capitalized.

(b) In respect of depreciable assets, AS 12 does not permit the crediting of the grant or any part thereof to capital reserve. The company has only two options – reduce the grant from the cost of fixed assets or treat it as deferred income. It appears that company follows the first option. Out of the Rs. 8,00,000 that has been received, Rs. 4,00,000 is the balance in Machinery account and so Rs. 4,00,000 should be credited to the Machinery account. The balance Rs. 4,00,000 may be credited to profit & loss account as already the cost of the assets to the tune of Rs. 6,00,000 has been debited to profit and loss account in the earlier years and Rs. 4,00,000 transferred to profit & loss account would be partial recovery of that cost. There is no need to provide depreciation for 2007-08 or 2008-09 as the depreciable amount is now Nil.

(c) Statement showing the treatment for total interest amount of Rs. 62 lakhs

Purpose	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
		Rs. in lakhs	Rs. in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset*	$\frac{62\times 520}{680} = 47.41$	
Advance to suppliers for additional assets	Qualifying asset*	$\frac{62\times 30}{680} = 2.74$	

Working Capital	Not a qualifying asset		$\frac{62 \times 130}{680}$
			= 11.85
		50.15	11.85

24. (a) Computation of Unearned Finance Income

(i) Gross investment = Minimum lease payments + Unguaranteed residual value

= (Total lease rent + Guaranteed residual value) + Unguaranteed residual value

= [(Rs. 5,00,000 × 5 years) + Rs. 1,00,000] + Rs. 1,00,000

= Rs. 27,00,000

(ii) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV	Internal rate of return (Discount factor 15%)	Present Value	
	Rs.		Rs.	
1	5,00,000	.8696	4,34,800	
2	5,00,000	.7561	3,78,050	
3	5,00,000	.6575	3,28,750	
4	5,00,000	.5718	2,85,900	
5	5,00,000	.4972	2,48,600	
	1,00,000	.4972	49,720	
	(guaranteed residual value)			
			17,25,820	(1)
	1,00,000	.4972	49,720	(2)
		(unguaranteed residual value)		
		(1) + (2)	17,75,540	

Unearned Finance Income = Gross investment – PV of MLP

= Rs. 27,00,000 – Rs. 17,75,540

= Rs. 9,24,460

Journal Entries in the books of B Ltd.

		Rs.	Rs.
At the inception of lease			
Machinery account	Dr.	17,25,820*	
To A Ltd.'s account			17,25,820*
(Being lease of machinery recorded at present value of MLP)			
At the end of the first year of lease			
Finance charges account (Refer W. N.)	Dr.	2,58,873	
To A Ltd.'s account			2,58,873
(Being the finance charges for first year due)			
A Ltd.'s account	Dr.	5 ,00,000	
To Bank account			5,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of Rs. 2,41,127 and finance charge of Rs. 2,58,873)			
Depreciation account	Dr.	1,72,582	
To Machinery account			1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr.	4,31,455	
To Depreciation account			1,72,582
To Finance charges account			2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)			

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

Year	Outstanding liability (opening balance)	Lease rent	Finance charge	Reduction in outstanding liability	Outstanding liability (closing balance)
	Rs.	Rs.	Rs.	Rs.	Rs.
1	17,25,820	5,00,000	2,58,873	2,41,127	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,296	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,276	3,66,724	5,21,783
5	5,21,783	5,00,000	78,267	5,21,783	1,00,050*
			8,74,230	17,25,820	

*The difference between this figure and guaranteed residual value (Rs. 1,00,000) is due to approximation in computing the interest rate implicit in the lease.

(b) As per para 39 of AS 20, 'Potential Equity Shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.'

As income from continuing operations is the control figure as per para 40, Rs. 2,40,000 should be considered and not Rs. (1,20,000) for deciding whether the potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion decrease the net profit per share from continuing operations from Rs. 240 (i.e. Rs.2,40,000/ 1,000 shares) to Rs. 200 (i.e. Rs.2,40,000/1,200 shares). In view of the above, the basic loss per share would be Rs. 120 and diluted loss per share would be Rs. 100.

(c) According to AS 26, the enterprise should amortise the right to generate power over sixty years, unless there is evidence that its useful life is shorter. But the enterprise should subject this right to impairment testing at each year end during its useful life since useful life is considered to be more than 10 years.

25. (a) (i) At 31 March, 2005

The giving of the guarantee, gives rise to a possible obligation.

No outflow of benefits is probable at 31 March, 2005 since financial position of Y is sound. Hence, no provision is recognised. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(ii) At 31 March, 2006

The obligating event is the giving of the guarantee, which gives rise to a legal obligation to make good enterprise Y's defaults.

At 31 March 2006, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, since enterprise Y has gone into liquidation.

A provision should be recognised for the best estimate of the obligation.

Note: This example deals with a single guarantee. If an enterprise has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable. Where an enterprise gives guarantees in exchange for a fee, revenue is recognised under AS 9, Revenue Recognition.

(b) According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

(c) As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item, hence should be valued at the closing rate i.e, Rs.48 at 31st March, 2007 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs.5 (48-43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2007 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs.48 and Rs.47 per Us dollar. Hence, the accounting treatment adopted by the company is incorrect.

(d) It is given that revision of wages took place on 1st September, 2007 with retrospective effect from 30.9.2006. Therefore wages payable for the half year from 1.10.2006 to 31.3.2007 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs. 7,50,000 (for 1½ years @ Rs. 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Note: AS 1 to AS 29 are applicable for November, 2008 Examination

APPENDIX

Announcement

Withdrawal of the Announcement issued by the Council on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956'

1. The Council of the Institute of Chartered Accountants of India had issued an Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', which was published in the November 2003 issue of 'The Chartered Accountant' (pp. 497)[1]

2. Subsequent to the issuance of the above Announcement, the Ministry of Company Affairs (now known as the Ministry of Corporate Affairs) issued the Companies (Accounting Standards) Rules, 2006, by way of Notification in the Official Gazette dated 7th December, 2006. As per Rule 3(2) of the said Rules, the Accounting Standards shall come into effect in respect of accounting periods commencing on or after the publication of these accounting standards under the said Notification.

3. AS 11, as published in the above Government Notification, carries a footnote that "it may be noted that the accounting treatment of exchange differences contained in this Standard is required to be followed irrespective of the relevant provisions of Schedule VI to the Companies Act, 1956".

4. In view of the above footnote to AS 11, the Council of the Institute of Chartered Accountants of India has decided at its 269th meeting held on July 18, 2007, to withdraw the Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', published in 'The Chartered Accountant' of November 2003. Accordingly, the accounting treatment of exchange differences contained in AS 11 notified as above is applicable and not the requirements of Schedule VI to the Act, in respect of accounting periods commencing on or after 7th December, 2006.

Students are advised to refer the following rates of Non-Performing Assets in case of Banking Companies

PROVISIONS

Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the banks, it has been decided that banks should make provision against sub-standard assets, doubtful assets and loss assets on the following basis:

(a) Loss assets : The entire amount should be written off or full provision should be made for the amount outstanding.

(b) Doubtful assets : (i) Full provision to the extent of the unsecured portion should be made. In doing so, the realisable value of the security available to the bank should be determined on a realistic basis. DICGC/ECGC cover is also taken into account (this aspect is discussed later in this chapter). In case the advance covered by CGTSI guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

(ii) Additionally, 20% - 100% of the secured portion should be provided for, depending upon the period for which the advance has been considered as a doubtful asset, as follows:

Period for which the advance has been considered as doubtful	% of provision on secured portion
Upto 1 year	20%
More than 1 year and upto 3 years	30%
More than three years	
i. Outstanding stock of NPA's as on 31.03.2004	60% w.e.f. 31.03.2005
	75% w.e.f. 31.03.2006
	100% w.e.f. 31.03.2007
ii. Advances classified as doubtful for more than three years on or after 01.04.2004	100% w.e.f. 31.03.2005

(iii) Banks are permitted to phase the additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 to 12 months over a four year period commencing from the year ending March 31, 2005, with a minimum of 20% each year.

(c) Sub-standard assets : A general provision of 10% on total outstanding should be made without making any allowance for DICGC/ECGC cover and securities available. An additional provision of 10% (i.e., total 20% of total outstanding) is required to be made on 'unsecured exposure' ab initio sanction of loan. Generally such a situation may arise in case of personal and education loans etc. Unsecured exposure is defined as 'an exposure where the realizable value of security is not more than 10% of the outstanding exposure (fund based and non-fund based). Security should not include guarantees, comfort letters etc

(d) Standard assets : A general provision of a minimum of 0.40% of total standard assets should be made. It has been clarified that the provision should be made on global loan portfolio basis and not on domestic advances alone.

For the practice of students following illustrations are given below:

Illustration 1 (Existing stock of advances classified as 'doubtful more than 3 years' as on 31 March, 2004.)

The outstanding amount as on 31st March, 2004: Rs.25,000.

Realisable value of security: Rs.20,000.

Period for which the advance has remained in 'doubtful' category as on 31st March, 2004: 4 years (i.e., Doubtful more than 3 years)

Solution:

Provisioning requirement:

As on….	Provisions on secured portion		Provisions on unsecured portion		Total (Rs.)
	Rate (in %)	Amount	Rate (in %)	Amount	
31 March 2004	50	10,000	100	5,000	15,000
31 March 2005	60	12,000	100	5,000	17,000
31 March 2006	75	15,000	100	5,000	20,000
31 March 2007	100	20,000	100	5,000	25,000

Illustration 2 (Advances classified as 'doubtful more than three years' on or after 1 April, 2004.)

The outstanding amount (funded as well as unfunded) as on 31st March, 2004: Rs.10,000

Realisable value of security: Rs.8,000

Period for which the advance has remained in 'doubtful' category as on 31st March, 2004: 2.5 years.

Solution:

Provisioning requirement:

As on…	Asset Classification	Provisions on secured portion		Provisions on unsecured portion		Total (Rs.)
		%	Amount	%	Amount	
31 March, 2004	Doubtful 1 to 3 years	30	2,400	100	2,000	4,400
31 March, 2005	Doubtful more than 3 years	100	8,000	100	2,000	10,000