MOCK TEST PAPER – 1

INTERMEDIATE (IPC) : GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5)	3.36 (approx.)
Present Value of minimum lease payments (Rs.3 lakhs each year)	Rs.10.08 lakhs (approx.)

Thus present value of minimum lease payments is Rs.10.08 lakhs and the fair value of the machine is Rs. 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

(b) As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of Rs. 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

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

Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= Rs. 11,00,000 – Rs. 2,00,000

= Rs. 9,00,000

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

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

(d) As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed programme design or working model. In this case, Rs. 45,000 would be recorded as an expense (Rs. 25,000 for completion of detailed program design and Rs. 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (Rs. 42,000 + Rs. 12,000 + Rs. 13,000) Rs. 67,000.

2. **Realisation Account**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Goodwill		10,000	By Provision to doubtful Debts		2,000
To Land		20,000	By Trade creditors		96,000
To Buildings		1,10,000	By Bills Payable		14,000
To Machinery		50,000	By Bank overdraft		60,000
To Motor Car		28,000	By Mrs. A's loan		15,000
To Furniture		12,000	By ABC Ltd. (Purchase price)		1,95,500
To Investments		18,000	By A's Capital A/c (Investments)		13,000
To Loose tools		7,000	By Cash A/c:		
To Stock		18,000	Debtors	20,000	
To Bill receivable		20,000	Motor Car	24,000	
To Debtors		40,000	Furniture	4,000	
To A's Capital A/c (Mrs. A's Loan)		15,000	Loose tools	1,000	49,000
To Cash A/c:					
Creditors	94,000				
Realisation expenses	500	94,500			
To Profit on Realisation t/f to:					
A's Capital A/c	1,000				
B's Capital A/c	667				
C's Capital A/c	333	2,000			
		4,44,500			4,44,500

ABC Ltd. Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To Realisation A/c	1,95,500	By Cash A/c	75,500
		By Shares in ABC Ltd.	1,20,000
	1,95,500		1,95,500

Partners' Capital Accounts

Particulars	*A Rs.*	*B Rs.*	*C Rs.*	*Particulars*	*A Rs.*	*B Rs.*	*C Rs.*
To Profit and Loss A/c	6,000	4,000	2,000	By Balance b/d	70,000	80,000	10,000
To Realisation A/c	13,000	-	-	By C's Loan A/c	-	-	33,000
To C's Current A/c	-	-	56,000	By General reserve	9,000	6,000	3,000
To shares in ABC Ltd.	60,000	40,000	20,000	By Investment Fluctuation Fund	2,000	1,333	667
To Cash A/c	18,000	44,000	-	By Realization A/c	1,000	667	333
				By Realisation A/c (Mrs. A's loan A/c)	15,000	-	-
				By Cash A/c	-		31,000
	97,000	88,000	78,000		97,000	88,000	78,000

C's Current Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance b/d	56,000	By C's Capital A/c-transfer	56,000
	56,000		56,000

Shares in ABC Ltd. Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To ABC Ltd. Account	1,20,000	By A's Capital A/c	60,000
		By B's Capital A/c	40,000
		By C's Capital A/c	20,000
	1,20,000		1,20,000

Cash Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance b/d	1,000	By Realisation A/c (Liabilities and expenses)	94,500
To ABC Ltd.	75,500	By A's Capital A/c	18,000
To Realisation A/c (sale of assets)	49,000	By B's Capital A/c	44,000
To C's Capital A/c	31,000		-
	1,56,500		1,56,500

Note : Investment Fluctuation Fund Account may be transferred to Realisation Account.

3. (a) **In the books of Mr. Chena Swami**

Salem Branch Account

	Rs.		Rs.
To Balance b/d		By Bank (Remittance to H.O.)	19,50,000

	Opening stock:			
	Ghee	40,000	By Balance c/d	
	Refined Oil	22,500	Closing stock:	
	Debtors	1,80,000	Refined oil	19,500
	Cash on hand	25,690	Ghee	90,000
	Furniture & fittings	23,800	Debtors (W.N. 1)	2,10,000
To	Goods sent to Branch A/c		Cash on hand (W.N. 2)	44,800
	Refined Oil (30x1500x12)	5,40,000	Furniture & fittings	21,420
	Ghee (20x5000x12)	12,00,000		
To	Bank (Expenses paid by H.O.)	76,800		
To	Branch manager's commission (2,26,930 x 10/110)	20,630		
To	Net Profit transferred			
	to General P & L A/c	2,06,300		
		23,35,720		23,35,720

Mr. Chena Swami

Trading and Profit and Loss account for the year ended 31st March, 2018

(Excluding branch transactions)

		Rs.			Rs.
To	Opening Stock:		By	Sales:	
	Refined Oil	44,000		Refined Oil	24,10,000
	Ghee	10,65,000		Ghee	38,40,500
To	Purchases:		By	Closing Stock:	
	Refined Oil 27,50,000			Refined Oil	8,90,000
	Less: Goods sent to Branch (5,40,000)	22,10,000		Ghee	15,70,000
	Ghee 48,28,000				
	Less: Goods sent to Branch (12,00,000)	36,28,000			
To	Direct Expenses	6,35,800			
To	Gross Profit	11,27,700			
		87,10,500			87,10,500
To	Manager's Salary	2,40,000	By	Gross Profit	11,27,700
To	General Expenses	1,86,000	By	Branch Profit transferred	2,26,930
To	Depreciation				
	Furniture (88,600-79,740)	8,860			
	Building (5,10,800+2,41,600- 7,14,780)	37,620			
To	Net profit	8,82,150			
		13,54,630			13,54,630

Working Notes:

(1) **Debtors Account**

		Rs.		*Rs.*
To	Balance b/d	1,80,000	By Cash Collections	20,15,000
To	Sales made during the year:		By Balance c/d (Bal. Figure)	2,10,000
	Refined oil	5,95,000		
	Ghee	14,50,000		
		22,25,000		22,25,000

(2) **Branch Cash Account**

	Rs.		Rs.
To Balance b/d	25,690	By Remittance	19,50,000
To Collections	20,15,000	By Exp.	45,890
		By Balance c/d (Bal. Figure)	44,800
	20,40,690		20,40,690

(b) As per the provisions of the Companies Act, 2013:

No company shall purchase its own shares or other specified securities unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back; however, if the buy back is upto 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed 25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(d) the ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid up capital and its free reserves: (Debt-Equity Ratio Test)

Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.

(e) all the shares or other specified securities for buy-back are fully paid-up;

(f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

No offer of buy back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy back if any. Section 69 (1) of the Companies Act also states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

The shares or other specified securities which are proposed to be bought-back must be fully paid-up.

4. **Books of P Ltd.**

Journal Entries

		Dr. (Rs. in Lacs)	Cr. (Rs. in Lacs)
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd.			9,000
(Being business of V Ltd. taken over for consideration settled as per agreement)			
Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1,700	
Inventory	Dr.	4,041	
Debtors	Dr.	1,020	
Cash at Bank	Dr.	609	
Bills Receivable	Dr.	80	
To Foreign Project Reserve			310
To General Reserve (3,200 - 3,000)			200
To Profit and Loss A/c (825 – 50*)			775
To Liability for 12% Debentures			1,000
To Creditors			463
To Provisions			702
To Business Purchase			9,000
(Being assets & liabilities taken over from V Ltd.)			
Liquidator of V Ltd. A/c	Dr.	9,000	
To Equity Share Capital A/c			9,000
(Purchase consideration discharged in the form of equity shares)			
Profit & loss A/c	Dr.	1	
To Bank A/c			1
(Liquidation expenses paid by P Ltd.)			
Liability for 12% Debentures A/c	Dr.	1,000	
To 13% Debentures A/c			1,000
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	80	
To Bills Receivable A/c			80
(Cancellation of mutual owing on account of bills)			

Balance Sheet of P Ltd. as at 1st April, 20X1 (after merger)

		Particulars	Notes	Rs. (in lakhs)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	24,000
	B	Reserves and Surplus	2	16,654
2		**Non-current liabilities**		
	A	Long-term borrowings	3	1,000
3		**Current liabilities**		
	A	Trade Payables (1,543 + 40)		1,583
	B	Short-term provisions		2,532
		Total		**45,769**
		Assets		
1		**Non-current assets**		
	A	Fixed assets		
		Tangible assets	4	29,004
2		**Current assets**		
	A	Inventories		11,903
	B	Trade receivables		3,140
	C	Cash and cash equivalents		1,722
		Total		**45,769**

Notes to accounts

		Rs.
1.	**Share Capital**	
	Equity share capital	
	Authorised, issued, subscribed and paid up	
	24 crores equity shares of Rs. 10 each (Of the above shares, 9 crores shares have been issued for consideration other than cash)	24,000
	Total	**24,000**
2.	**Reserves and Surplus**	
	General Reserve	9,700
	Securities Premium	3,000
	Foreign Project Reserve	310
	Profit and Loss Account	3,644
	Total	**16,654**
3.	**Long-term borrowings**	
	Secured	
	13% Debentures	1,000
4.	**Tangible assets**	
	Land & Buildings	6,000

Plant & Machinery	19,000
Furniture & Fittings	4,004
Total	**29,004**

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = Rs. 6,000 lacs × $\frac{3}{2}$ = Rs. 9,000 lacs.

* Cost of issue of debenture adjusted against P & L Account of V Ltd.

5. (a). Form B – RA (Prescribed by IRDA)

Name of the Insurer: X Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA: …………………..

Revenue Account for the year ended 31st March, 20X2

	Particulars	*Schedule*	*Current year ended on 31st March, 20X2*
			Rs.
1.	Premium earned (Net)	1	7,00,000
	Total (A)		7,00,000
1.	Claims incurred (Net)	2	8,00,000
2.	Commission	3	50,000
3.	Operating Expenses related to insurance business	4	3,00,000
	Total (B)		11,50,000
	Operating Profit/(Loss) from Fire Insurance Business [C = (A – B)]		(4,50,000)

Schedule 1

Premium earned (Net)

	Rs.
Premium received from direct business written	15,00,000
Less: Premium on re-insurance ceded	(1,00,000)
	14,00,000
Adjustment for change in reserve for unexpired risk	7,00,000
Net Premium Earned	7,00,000

Schedule 2

Claims incurred (Net)

	Rs.
Claims paid – Direct	7,00,000
Add: Claims outstanding on 31.3.20X2	1,00,000
Total claims incurred	8,00,000

Schedule 3

Commission

Commission paid	50,000
Net commission	50,000

Schedule 4

Operating expenses related to insurance business

	Rs.
Expenses of Management	3,00,000

(b) Calculation of Total Remuneration payable to Liquidator

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

Working Note:

Liquidator's remuneration on payment to unsecured creditors =

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

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

= Rs. 27,31,250

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

(c)

Particulars	*Financial Capital Maintenance at Historical Cost (Rs.)*
Closing equity (Rs. 30 x 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units x Rs. 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 – 12,00,000)

Thus, in order to maintain the capital intact, Mohan can withdraw Rs. 6,00,000 as the maximum amount.

6. TOP Bank Limited

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

		Schedule	*Year ended 31.03.2017*
			(Rs. in '000s)
I.	**Income:**		
	Interest earned	13	5923.18
	Other income	14	728.00
	Total		6,651.18
II.	**Expenditure**		
	Interest expended	15	3259.92

	Operating expenses	16	768.46
	Provisions and contingencies (960+210+900)		2,070.00
	Total		6,098.38
IIII.	**Profits/Losses**		
	Net profit for the year		552.80
	Profit brought forward		nil
			552.80
IV.	**Appropriations**		
	Transfer to statutory reserve (25%)		138.20
	Balance carried over to balance sheet		414.60
			552.80

		Year ended 31.3. 2017 (Rs. in '000s)
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	5923.18
		5923.18
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	304
II.	Profit on sale of investments	320
III.	Rent received	104
		728
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	3259.92
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees	320
II.	Rent and taxes	144
III.	Depreciation on bank's properties	48
IV.	Director's fee, allowances and expenses	48
V.	Auditors' fee	28
VI.	Law (statutory) charges	44
VII.	Postage and telegrams	96.46
VIII.	Preliminary expenses	40
		768.46

Working Note:

	(Rs. in '000s)
Interest/discount	5,929.18
Add: Rebate on bills discounted on 31.3. 2016	19.00
Less: Rebate on bills discounted on 31.3. 2017	(25.00)
	5,923.18

7. **(a)** A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29.

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

(b) 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. Trade payables is a monetary item, hence should be valued at the closing rate i.e., Rs. 48 at 31st March, 2017 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs. 5 (Rs. 48 less Rs. 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2017 and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of Rs.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.

(c) **In the books of Company**

Journal Entries

Date	Particulars	Dr. Rs.	Cr. Rs.
1-3-X2 to 31-3-X2	Bank A/c Dr.	2,40,000	
	Employees compensation expenses A/c Dr.	4,32,000	
	To Equity Share Capital A/c		48,000
	To Securities Premium A/c		6,24,000
	(Being allotment to employees 4,800 shares of Rs. 10 each at a premium of Rs. 130 at an exercise price of Rs. 50 each)		
31-3-X2	Profit and Loss account Dr.	4,32,000	
	To Employees compensation expenses A/c		4,32,000
	(Being transfer of employees compensation expenses)		

Working Note:

1. Employee Compensation Expenses = Discount between Market Price and option price = Rs. 140 – Rs. 50 = Rs. 90 per share = Rs. 90 x 4,800 = Rs. 4,32,000 in total.
2. The Employees Compensation Expense is transferred to Securities Premium Account.
3. Securities Premium Account = Rs. 50 – Rs. 10 = Rs. 40 per share + Rs. 90 per share on account of discount of option price over market price = Rs. 130 per share = Rs. 130 x 4,800 = Rs. 6, 24,000 in total.

(d) **Calculation of unrealized profit of each department and total unrealized profit**

	Dept. X	*Dept. Y*	*Dept. Z*	*Total*

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

(e) Under section 27 (3) of the LLP Act, 2008 an obligation of an LLP arising out of a contract or otherwise, shall be solely the obligation of the LLP;

- The Liabilities of an LLP shall be met out of the properties of the LLP;
- Under section 28 (1) a partner is not personally liable, directly or indirectly, for an obligation referred to in Section 27 (3) above, solely by reason of being a partner in the LLP;
- Section 27 (1) states that an LLP is not bound by anything done by a partner in dealing with a person, if:
  - The partner does not have the authority to act on behalf of the LLP in doing a particular act; and
  - The other person knows that the partner has no authority or does not know or believe him to be a partner in the LLP
- Under section 30 (1) the liability of the LLP and the partners perpetrating fraudulent dealings shall be unlimited for all or any of the debts or other liabilities of the LLP.