MOCK TEST PAPER - 2

INTERMEDIATE (NEW): GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of Rs. 5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 5 lakhs as interest amount.

(b) (i) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2017. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs. 2.10 crore.

(ii) The arrears for the period from June, 2016 to March, 2017 are required to be provided for in the accounts of the company for the year ended on 31st March, 2017.

(c) As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	*Net operating Cash in flow (Rs.)*	*Ratio*	*Amortize amount (Rs. in lakhs)*
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200	0.11 (bal.)	22
	27,400	1.00	200

(d) As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is Rs. 10, 00,000 and the net present value of minimum lease payments is Rs. 10, 07,020 (Refer working Note). As the present value of the machine is more than the fair value of the machine, the machine and the corresponding liability will be recorded at value of Rs.10,00,000.

Calculation of finance charges for each year

Year	*Finance charge* (Rs.)	*Payment* (Rs.)	*Reduction in outstanding liability* (Rs.)	*Outstanding liability* (Rs.)
1st year beginning	-	-	-	10,00,000
End of 1st year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2nd year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3rd year	94,336	3,50,000	2,55,664	3,33,936
End of 4th year	53,430	3,50,000	2,96,570	37,366*

Working Note:

Present value of minimum lease payments

Annual lease rental x PV factor Rs. 3,50,000 x (0.8621 + 0.7432 + 0.6407+ 0.5523)	Rs. 9,79 ,405
Present value of guaranteed residual value Rs. 50,000 x (0.5523)	Rs. 27,615
	Rs. 10,07,020

2. (a) **Z Ltd.**

Journal Entries

		Dr. Rs.	Cr. Rs.
Bank A/c	Dr.	10,50,000	
To Share Application A/c			10,50,000
(Application money received on firm applications for 140,000 shares each @ Rs. 2.50 per share from D, E & F)			
D	Dr.	2,80,000	
E	Dr.	2,80,000	
F	Dr.	11,30,500	
Share Application A/c	Dr.	10,50,000	

* *The difference between this figure and guaranteed residual value (Rs. 50,000) is due to rounding off.*

To Share Capital A/c (Allotment of shares to underwriters - 1,40,000 to D; 1,40,000 to E and 3,29,000 to F; application and allotment money credited to share capital)		27,40,500
Underwriting Commission A/c Dr. To D To E To F (Amount of underwriting commission payable to D, E and F @ 5% on the amount of shares underwritten.)	22,50,000	 7,50,000 7,50,000 7,50,000
Bank A/c Dr. To F (Amount received from F on shares allotted less underwriting commission)	3,80,500	 3,80,500
D Dr. E Dr. To Bank A/c (Amount paid to D & E in final settlement of underwriting commission due less amount payable on shares allotted payable by them.)	4,70,000 4,70,000	 9,40,000

Working Notes:

(1) Calculation of Liability of Underwriters

	D	E	F
Gross Liability (No. of shares)	15,00,000	15,00,000	15,00,000
Less: Marked Applications (excluding firm underwriting)	(12,75,000)	(13,50,000)	(10,50,000)
	2,25,000	1,50,000	4,50,000
Less: Unmarked Applications (equally)	(72,000)	(72,000)	(72,000)
	1,53,000	78,000	3,78,000
Less: Firm Underwriting	(1,40,000)	(1,40,000)	(1,40,000)
	13,000	(62,000)	2,38,000
Surplus of E distributed between D & F equally	(31,000)	62,000	(31,000)
	(18,000)	-	2,07,000
Surplus of D allocated to F totally	18,000	—	(18,000)
Net Liability, excluding Firm Underwriting	-	-	1,89,000
Add: Firm underwriting	1,40,000	1,40,000	1,40,000
Total liability of underwriters	1,40,000	1,40,000	3,29,000

(2) Calculation of Amounts Payable by Underwriters

Liability (No. of shares)	1,40,000	1,40,000	3,29,000
Amount payable @ Rs. 4.50 per share	6,30,000	6,30,000	14,80,500

Less: Amount paid on Firm Applications of 1,40,000 each @ Rs. 2.50*	(3,50,000)	(3,50,000)	(3,50,000)
Balance payable	2,80,000	2,80,000	11,30,500
Underwriting Commission Receivable	7,50,000	7,50,000	7,50,000
Amount Paid	4,70,000	4,70,000	—
Amount received by the Co.	—	—	3,80,500

* *Underwriters had already paid the application money on these shares.*

(b) Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	When loan fund is	
	Rs. 3,200 crores	Rs. 6,000 crores
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil
Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy Back

(applicable only when loan fund is Rs.3,200 crores)

			Rs. in crores	
			Debit	Credit
(a)	Equity share buyback account	Dr.	720	
	To Bank account			720
	(Being payment for buy back of 24 crores equity shares of Rs. 10 each @ Rs. 30 per share)			
(b)	Equity share capital account	Dr.	240	
	Premium Payable on buyback account	Dr.	480	
	To Equity share buyback account			720
	(Being cancellation of shares bought back)			
	Securities Premium account	Dr.	400	
	General Reserve / Profit & Loss A/c	Dr.	80	
	To Premium Payable on buyback account			480
	(Being Premium Payable on buyback account charged to securities premium and general reserve/Profit & Loss A/c)			
(c)	General Reserve / Profit & Loss A/c	Dr.	240	
	To Capital redemption reserve account			240
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. Shares Outstanding Test

Particulars	*(Shares in crores)*
Number of shares outstanding	120
25% of the shares outstanding	30

2. Resources Test

Particulars	
Paid up capital (Rs. in crores)	1,200
Free reserves (Rs. in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (Rs. in crores)	2,880
25% of Shareholders fund (Rs. in crores)	Rs. 720 crores
Buy back price per share	Rs. 30
Number of shares that can be bought back	24 crores shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy Back

	Particulars	When loan fund is	
		Rs. 3,200 crores	Rs. 6,000 crores
(a)	Loan funds (Rs.)	3,200	6,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (Rs.) (a/2)	1,600	3,000
(c)	Present equity shareholders fund (Rs.)	2,880	2,880
(d)	Future equity shareholders fund (Rs.) (see W.N.4)	2,560 (2,880-320)	N.A.
(e)	Maximum permitted buy back of Equity (Rs.) [(d) – (b)]	960	Nil
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share	32 crore shares	Nil
	As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

3. (a) **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.

(b) Section 326 of the Companies Act, 2013 talks about the overriding preferential payments to be made from the amount realized from the assets to be distributed to various kind of creditors. According to the proviso given in the section 326 the security of every secured creditor should be deemed to be subject to a paripassu change in favor of the workman to the extent of their portion.

$$\text{Workman's Share to Secured Asset} = \frac{\text{Amount Realied X Workman's Dues}}{\text{Workman's Dues } + \text{Secured Loan}}$$

$$\text{Workman's Share to Secured Asset} = \frac{4{,}00{,}00{,}000 \text{ X } 1{,}25{,}00{,}000}{1{,}25{,}00{,}000 + 5{,}00{,}00{,}000}$$

$$4{,}00{,}00{,}000 \text{ X} \frac{1}{5}$$

$$\text{Workman's Share to Secured Assets} = 80{,}00{,}000$$

Amount available to secured creditor is Rs. 400 Lakhs – 80 Lakhs = 320 Lakhs

Hence, no amount is available for payment of government dues and unsecured creditors.

4. (a) 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

(b) (i) Net Premium earned

		Rs. In lakhs
Premium from direct business received	4,400	
Add: Receivable as 31.03.16	189	
Less: Receivable as on 01.04.2015	(220)	4,369
Add: Premium on re-insurance accepted	376	
Add: Receivable as on 31.03.16	16	
Less: Receivable as on 01.04.2015	(18)	374
		4,743
Less: Premium on re-insurance ceded	305	
Add: Payable as on 31.03.16	9	
Less: Payable as on 01.04.15	(14)	(300)
Net Premium earned		4,443

(ii) Net Claims incurred

		Rs. In lakhs
Claims paid on direct business		3,450
Add: Reinsurance	277	
Add: Reinsurance outstanding as 31.03.16	6	
Less: Reinsurance outstanding as on 01.04.2015	(8)	275
Less: Claims Received from re-insurance	101	
Add: Receivable as on 31.03.16	19	
Less: Receivable as on 01.04.2015	(20)	100
		3,625
Add: Outstanding direct claims at the end of the year		48
		3,673
Less: Outstanding Claims at the beginning of the year		(45)
Net Claims Incurred		3,628

5. (a) Adjusted revenue reserves of Neel Ltd.

	Rs.	*Rs.*
Revenue reserves as given		3,57,000
Add: Provision for doubtful debts [4,45,500 / 99 X 1]		4,500
		3,61,500
Less: Reduction in value of Inventory	17,000	
Advertising expenditure to be written off	15,000	(32,000)
Adjusted revenue reserve		3,29,500

Note: Since Neel Ltd. follows FIFO basis, it is assumed that opening inventory has been sold out during the year 2015. Therefore, reduction in inventory would have been taken care of by sale value. Hence no adjustment has been made for the same.

Restated Balance Sheet of Neel Ltd.
as at 31st December, 2016

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		2,50,000
(b) Reserves and Surplus	1	3,29,500
(2) Current Liabilities		
(a) Short term borrowings	2	85,000
(b) Trade Payables		2,47,000
(c) Short-term provision	3	2,15,000
Total		11,26,500
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	4	1,12,000
(b) Non-current Investment		2,00,000
(2) Current assets		
(a) Inventories		3,54,000
(b) Trade Receivables		4,50,000
(c) Cash & Cash Equivalents		1,500
(d) Other current assets	5	9,000
Total		11,26,500

Notes to Accounts

			Rs.
1.	**Reserves and Surplus**		
	Revenue Reserve (refer computation of adjusted revenue reserves of Neel Ltd)		3,29,500
2.	**Short term borrowings**		
	Bank overdraft		85,000
3.	**Short-term provision**		
	Provision for taxation		2,15,000
4.	**Tangible Assets**		
	Cost	1,60,000	
	Less: Depreciation to date	(48,000)	1,12,000

5.	**Other current assets** Prepaid expenses (After adjusting advertising expenditure to be written off each year)		9,000

(b)

Total value of business	*Rs.*
Total net Asset as on 31.3.2017	42,40,000
Less: Goodwill as per Balance Sheet	(6,00,000)
Add: Goodwill as calculated in Working Note 2	20,56,250
Value of Business	56,96,250

Working Notes:

1. Capital Employed at the end of each year

	31.3.2015 Rs.	*31.3.2016 Rs.*	*31.3.2017 Rs.*
Goodwill	10,00,000	8,00,000	6,00,000
Building and Machinery (Revaluation)	18,00,000	20,00,000	22,00,000
Inventory (Revalued)	12,00,000	14,00,000	16,00,000
Trade Receivables	20,000	1,60,000	4,40,000
Bank Balance	1,20,000	2,00,000	4,00,000
Total Assets	41,40,000	45,60,000	52,40,000
Less: Trade Payables	(6,00,000)	(8,00,000)	(10,00,000)
Closing Capital	35,40,000	37,60,000	42,40,000
Add: Opening Capital	36,60,000	35,40,000	37,60,000
Total	72,00,000	73,00,000	80,00,000
Average Capital	36,00,000	36,50,000	40,00,000

Since the goodwill has been purchased, it is taken as a part of Capital employed.

2. Valuation of Goodwill

		31.3.2015	31.3.2016	31.3.2017
(i)	**Future Maintainable Profit**			
	Net Profit as given	4,20,000	6,20,000	8,20,000
	Less: Opening Balance	(1,20,000)	(1,40,000)	(1,60,000)
	Adjustment for Valuation of Opening Inventory	-	(2,00,000)	(2,00,000)
	Add: Adjustment for Valuation of closing inventory	2,00,000	2,00,000	2,00,000
	Goodwill written off	-	2,00,000	2,00,000
	Transferred to General Reserve	2,00,000	2,00,000	2,00,000
	Future Maintainable Profit	7,00,000	8,80,000	10,60,000
	Less: 12.50% Normal Return	(4,50,000)	(4,56,250)	(5,00,000)
(ii)	**Super Profit**	2,50,000	4,23,750	5,60,000

(iii) Average Super Profit = Rs. (2,50,000+4,23,750+5,60,000) ÷3 = Rs. 4,11,250

(iv) Value of Goodwill at five years' purchase= Rs. 4,11250 × 5 = Rs. 20,56,250.

6. **(a)** As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

(i) that the enterprise, pursuant to a **single plan**, is:

(1) disposing of substantially in its entirety,

(2) disposing of piecemeal, or

(3) terminating through abandonment; and

(ii) that represents a separate major line of business or geographical area of operations; and

(iii) that can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

(b) Eight Schedule of the SEBI (Mutual Fund) Regulations, 1996 states the Investment Valuation Norms. NAV of a scheme is determined by dividing the net assets of the scheme by the number of outstanding units on the valuation date.

Traded Securities:-

(i) The securities shall be valued at the last quoted closing price on the recognized stock exchange.

(ii) When the securities are traded on more than one recognised stock exchange, the securities shall be valued at the last quoted closing price on the stock exchange where the security is principally traded. It would be left to the asset management company to select the appropriate stock exchange, but the reasons for the selection should be recorded in writing. There should however be no objection for all scrips being valued at the prices quoted on the stock exchange where a majority in value of the investments is principally traded.

(iii) Once a stock exchange has been selected for valuation of a particular security, reasons for change of the exchange shall be recorded in writing by the asset management company.

(iv) When on a particular valuation day, a security has not been traded on the selected stock exchange, the value at which it is traded on another stock exchange may be used.

(v) When a security is not traded on any stock exchange on a particular valuation day, the value at which it was traded on the selected stock exchange or any other stock exchange, as the case may be, on the earliest previous day may be used provided such date is not more than sixty days prior to the valuation date.

(c) Computation of capital employed

				(Rs. in lakhs)
		31.3.14		31.3.15
Total Assets as per Balance Sheet		38,00		40,40
Less: Non-trade Investments		(75)		(1,50)
		37,25		38,90
Less: Outside Liabilities:				
12% Debentures	2,00		2,00	
18% Term Loan	3,00		3,20	
Cash Credit	1,20		80	
Trade payables	70		60	
Tax Provision	30	7,20	40	7,00
Capital employed		30,05		31,90

Average capital employed = $\frac{30{,}05 \text{ lakhs} + 31{,}90 \text{ lakhs}}{2}$ = Rs. 3,097.5 lakhs.

(d) Total dividend paid = Rs. 60,000

Out of post-acquisition profit = Rs. 40,000

Out of pre-acquisition profit = Rs. 20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = Rs. 60,000 X 80% = Rs. 48,000

In the books of XYZ Ltd.

		Rs.	Rs.
Bank A/c	Dr.	48,000	
To Profit & Loss A/c			32,000
To Investments in ABC Ltd.			16,000
(Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits – as explained above)			
Goodwill on Consolidation:			Rs.
Cost of shares less dividend out of capital profits			2,64,000
Less: Face value of capital i.e. 80% of capital		1,60,000	
Add: Share of capital profits [1,20,000-20,000 (dividend portion out of pre-acquisition profits)] X 80 %		80,000	2,40,000
Goodwill			24,000
Minority interest on:			64,000
1st January, 2016: 20% of Rs. 3,20,000 [2,00,000 + 1,20,000]			
31st December, 2016: 20% of Rs. 3,00,000 [2,00,000 + 1,20,000 + 40,000 – 60,000]			60,000