PAPER – 1 : ACCOUNTING

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

*Answer any **four** questions from the remaining **five** questions.*

Wherever necessary, suitable assumptions may be made and indicated in answer by the candidates.

Working Notes should form part of the answer.

Question 1

(a) *Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.*

Management has prepared the following budget for this period –

Salaries of the staff engaged in preparation of restaurant before its opening	*₹ 7,50,000*
Construction and remodelling cost of restaurant	*₹ 30,00,000*

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

(b) *(i)* *ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹ 30,00,000. It was recorded at US \$1 = ₹ 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US \$1 = ₹ 62.00.*

(ii) *Trade receivable includes amount receivable from Preksha Ltd.,₹ 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$1 = ₹ 59.00. The exchange rate on balance sheet date (31.03.2018) was US \$1 = ₹ 62.00.*

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

(c) *HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2017. The company now wants to make provision based on technical evaluation during the year ending 31.03.2018.*

Total value of stock ₹ 120 lakhs

Provision required based on technical evaluation ₹ 3.00 lakhs.

Provision required based on 12 months no issues ₹ 4.00 lakhs.

You are requested to discuss the following points in the light of Accounting Standard (AS)-1:

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting?

(d) The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again.

State with reasons, whether the loss due to fire is an adjusting or non- adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised). ***(4 Parts x 5 Marks = 20 Marks)***

Answer

(a) As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

(b) Amount of Exchange difference and its Accounting Treatment

Long term Loan		Foreign Currency Rate	₹
(i)	Initial recognition US $ 50,000 ₹ (30,00,000/60)	1 US $ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Loss US $ 50,000 x ₹ (62 – 60)		1,00,000
	Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial recognition US $ 16,949.152* (₹10,00,000/59)	1 US $ = ₹ 59	10,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Gain US $ 16,949.152* x ₹ (62-59)		50,847.456*
	Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* And Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting ₹ 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting ₹ 50,847.456 is required to be transferred to Profit and Loss A/c.

(c) The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 4 lakhs to ₹ 3 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2017-18 in the following manner:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the value of net assets at the end of the year would have been lower by ₹ 1 lakh."

(d) As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner:

"Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

Question 2

(a) Following transactions of Nisha took place during the financial year 2017-18:

1st April, 2017	*Purchased ₹ 9,000 8% bonds of ₹ 100 each at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.*
1st May, 2017	*Received half year's interest on 8% bonds.*
10 July, 2017	*Purchased 12,000 equity shares of ₹ 10 each in Moon Limited for ₹ 44 each through a broker, who charged brokerage @ 2%.*
1st October 2017	*Sold 2,250 8% bonds at ₹ 81 Ex-interest.*
1st November, 2017	*Received half year's interest on 8% bonds.*
15th January, 2018	*Moon Limited made a rights issue of one equity share for every four Equity shares held at ₹ 5 per share. Nisha exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹ 2.25 per share.*
15th March, 2018	*Received 18% interim dividend on equity shares of Moon Limited.*

Prepare separate investment account for 8% bonds and equity shares of Moon Limited in the books of Nisha for the year ended on 31st March, 2018. Assume that the average cost method is followed.

(b) *A fire engulfed the premises of a business of M/S Kite Ltd. in the morning, of 1st October, 2017. The entire stock was destroyed except, stock salvaged of ₹ 50,000. Insurance Policy was for ₹ 5,00,000 with average clause.*

The following information was obtained from the records saved for the period from 1st April to 30th September, 2017:

	₹
Sales	*27,75,000*
Purchases	*18,75,000*
Carriage inward	*35,000*
Carriage outward	*20,000*
Wages	*40,000*
Salaries	*50,000*
Stock in hand on 31st March, 2017	*3,50,000*

Additional Information:

(1) *Sales upto 30th September, 2017, includes ₹ 75,000 for which goods had not been dispatched.*

(2) *On 1st June, 2017, goods worth ₹ 1,98,000 sold to Hari on approval basis which was included in sales but no approval has been received in respect of 2/3rd of the goods sold to him till 30th September, 2017.*

(3) *Purchases upto 30th September, 2017 did not include ₹ 1,00,000 for which purchase invoices had not been received from suppliers, though goods have been received in godown.*

(4) *Past records show the gross profit rate of 25% on sales.*

You are required to prepare the statement of claim for loss of stock for submission to the Insurance Company. ***(10 + 10 = 20 Marks)***

Answer

(a) In the books of Nisha

8% Bonds for the year ended 31st March, 2018

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2017 1 April,	To Bank A/c	9,000	30,000	6,94,500	1 May 2017	By Bank-Interest	-	36,000	

Oct. 1									
2018 March 31	To P & L A/c (W.N.1)	-	-	8,625	1 Oct. 2017	By Bank A/c	2,250	7,500	1,82,250
	To P & L A/c		40,500		1 Nov. 2018	By Bank-Interest		27,000	
					2018 Mar. 31	By Balance c/d (W.N.2)	6,750	-	5,20,875
		9,000	70,500	7,03,125			9,000	70,500	7,03,125

Investment in Equity shares of Moon Ltd. for the year ended 31st March, 2018

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
2017 July 10	To Bank A/c	12,000	--	5,38,560	2018 March 15	By Bank – dividend *	-	23,760	
2018 Jan. 15	To Bank A/c (W.N. 3)	1,200	-	6,000	March 31	By Balance c/d (bal. fig.)	13,200	-	5,44,560
March 31	To P & L A/c	-	23,760						
		13,200	23,760	5,44,560			13,200	23,760	5,44,560

* Considering that dividend was received on right shares also.

Working Notes:

1. **Profit on sale of 8% Bonds**

Sales price	₹ 1,82,250
Less: Cost of bond sold = 6,94,500/9,000x 2,250	(₹ 1,73,625)
Profit on sale	₹ 8,625

2. **Closing balance as on 31.3.2018 of 8 % Bonds**

   6,94,500/ 9,000 x 6,750= ₹ 5,20,875

3. **Calculation of right shares subscribed by Moon Ltd.**

   Right Shares = 12,000/4 x 1= 3,000 shares

   Shares subscribed by Nisha = 3,000 x 40%= 1,200 shares

   Value of right shares subscribed = 1,200 shares @ ₹ 5 per share = ₹ 6,000

4. **Calculation of sale of right entitlement by Moon Ltd.**

No. of right shares sold = 3,000 – 1,200 = 1,800 rights for ₹ 4,050

Note: As per para 13 of AS 13, sale proceeds of rights are to be credited to P & L A/c.

(b) Computation of claim for loss of stock

	₹
Stock on the date of fire (i.e. on 1.10.2017)	3,75,000
Less: Stock salvaged	(50,000)
Stock destroyed by fire (Loss of stock)	3,25,000

Insurance claim = ₹ 3,25,000

(Average clause is not applicable as insurance policy amount (₹ 5,00,000) is more than the value of closing stock ie. ₹ 3,75,000)

Memorandum Trading A/c
(1.4.17 to 30.9.17)

Particulars	*(₹)*	*Particulars*	*(₹)*
To Opening stock	3,50,000	By Sales	25,68,000
To Purchases (₹ 18,75,000+₹ 1,00,000)	19,75,000	By Goods with customers* (for approval) (W.N.1)	99,000
To Carriage inward	35,000	By Closing stock (bal. fig.)	3,75,000
To Wages	40,000		
To Gross profit (₹ 25,68,000 x 25%)	6,42,000		
	30,42,000		30,42,000

* For financial statement purposes, this would form part of closing stock (since there is no sale). However, this has been shown separately for computation of claim for loss of stock since the goods were physically not with the entity and, hence, there was no loss of such stock.

Working Notes:

1. **Calculation of goods with customers**

Since no approval for sale has been received for the goods of ₹ 1,32,000 (i.e. 2/3 of ₹ 1,98,000) hence, these should be valued at cost i.e. ₹ 1,32,000 – 25% of ₹ 1,32,000 =₹ 99,000.

2. **Calculation of actual sales**

   Total sales – Goods not dispatched - Sale of goods on approval (2/3rd) =

   Sales (₹ 27,75,000 – 75,000 – ₹1,32,000) = ₹ 25,68,000

Question 3

(a) Aman, a readymade garment trader, keeps his books of account under single entry system. On the closing date, i.e. on 31st March, 2017 his statement of affairs stood as follows:

Liabilities	*Amount ₹*	*Assets*	*Amount ₹*
Aman's capital	*4,80,000*	*Building*	*3,25,000*
Loan	*1,50,000*	*Furniture*	*50,000*
Creditors	*3,10,000*	*Motor car*	*90,000*
		Stock	*2,00,000*
		Debtors	*1,70,000*
		Cash in hand	*20,000*
		Cash at bank	*85,000*
	9,40,000		*9,40,000*

Riots occurred and a fire broke out on the evening of 31st March, 2018, destroying the books of accounts. On that day, the cashier had absconded with the available cash. You are furnished with the following information:

1. *Sales for the year ended 31st March, 2018 were 20% higher than the previous year's sales, out of which, 20% sales were for cash. He always sells his goods at cost plus 25%. There were no cash purchases.*
2. *Collection from debtors amounted to ₹ 14,00,000, out of which ₹ 3,50,000 was received in cash.*
3. *Business expenses amounted to ₹ 2,00,000, of which ₹ 50,000 were outstanding on 31st March, 2018 and ₹ 60,000 paid by cheques.*
4. *Gross profit as per last year's audited accounts was ₹ 3,00,000.*
5. *Provide depreciation on building and furniture at 5% each and motor car at 20%.*
6. *His private records and the Bank Pass Book disclosed the following transactions for the year 2017-18:*

	₹
Payment to creditors (paid by cheques)	*13,75,000*
Personal drawings (paid by cheques)	*75,000*

Repairs (paid by cash)	*10,000*
Travelling expenses (paid by cash)	*15,000*
Cash deposited in bank	*7,15,000*
Cash withdrawn from bank	*1,20,000*

7. *Stock level was maintained at ₹ 3,00,000 all throughout the year.*
8. *The amount defalcated by the cashier is to be written off to the Profit and Loss Account.*

You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2018 and Balance Sheet as on that date of Aman. All the workings should form part of the answer.

(b) *Axe Limited has four departments, A, B, C and D. Department A sells goods to other departments at a profit of 25% on cost. Department B sells goods to other department at a profit of 30% on sales. Department C sells goods to other departments at a profit of 10% on cost, Department D sells goods to other departments at a profit of 15% on sales.*

Stock lying at different departments at the year-end was as follows:

	Department A	*Department B*	*Department C*	*Department D*
Transfer from Department A	-	*45,000*	*50,000*	*60,000*
Transfer from Department B	*50,000*	-	-	*75,000*
Transfer from Department C	*33,000*	*22,000*	-	-
Transfer from Department D	*40,000*	*10,000*	*65,000*	-

Departmental managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated.

Departmental profits after charging manager's commission, but before adjustment of unrealized profit are as under:

	₹
Department A	*2,25,000*
Department B	*3,37,500*
Department C	*1,80,000*
Department D	*4,50,000*

Calculate the correct departmental profits after charging Manager's commission.

(15 + 5= 20 Marks)

Answer

(a) Trading and Profit and Loss Account of Aman for the year ended 31st March, 2018

		₹			₹
To	Opening Stock	2,00,000	By	Sales	18,00,000
To	Purchases (Bal. fig.)	15,40,000	By	Closing Stock	3,00,000
To	Gross Profit c/d	3,60,000			
		21,00,000			21,00,000
To	Business Expenses	2,00,000	By	Gross Profit b/d	3,60,000
To	Repairs	10,000			
To	Depreciation: Building 16,250 Machinery 2,500 Motor Car 18,000	36,750			
To	Travelling Expenses	15,000			
To	Loss by theft (cash defalcated)	20,000			
To	Net Profit	78,250			
		3,60,000			3,60,000

Balance Sheet of Aman as at 31st March, 2018

Liabilities	₹	₹	Assets	₹	₹
Capital	4,80,000		Building	3,25,000	
Add:			*Less*: Depreciation	(16,250)	3,08,750
Net Profit	78,250		Furniture	50,000	
Drawings	(75,000)	4,83,250	*Less*: Depreciation	(2,500)	47,500
Loan		1,50,000	Motor car	90,000	
			Less: Depreciation	(18,000)	72,000
Sundry Creditors		4,75,000	Stock in Trade		3,00,000
Outstanding business Expenses		50,000	Sundry Debtors		2,10,000
			Bank Balance		2,20,000
		11,58,250			11,58,250

Working Notes:

1. Cash and Bank Account

	Particulars	Cash	Bank		Particulars	Cash	Bank
To	Balance b/d	20,000	85,000	By	Payment to Creditors	-	13,75,000
To	Collection from Debtors	3,50,000	10,50,000	By	Business Expenses	90,000	60,000
To	Sales (18,00,000 x 20%)	3,60,000	–	By	Repairs	10,000	–
To	Cash (C)	–	7,15,000	By	Cash (C) (withdrawal)		1,20,000
				By	Bank (C)	7,15,000	
To	Bank (C)	1,20,000	-	By	Travelling Expenses	15,000	–
				By	Private Drawings	-	75,000
				By	Balance c/d		2,20,000
				By	Cash defalcated (balancing fig.)	20,000	
		8,50,000	18,50,000			8,50,000	18,50,000

2. Calculation of sales during 2017-18 ₹

Gross profit (last year i.e. for year ended 31.3.2017	3,00,000
Goods sold at cost plus 25% i.e. 20% of sales Sales for 2016-17 3,00,000/0.2	15,00,000
Sales for 2017-18 (15,00,000 x 1.2)	18,00,000
Credit sales for 2017-18	14,40,000 (80% of 18,00,000)

3. Debtors Account

To	Bal. b/d.	1,70,000	By	Cash	3,50,000
To	Sales (18,00,000 x 80%)	14,40,000	By	Bank	10,50,000
			By	Bal. c/d	2,10,000
		16,10,000			16,10,000

4. Creditors Account

		₹			₹
To	Bank	13,75,000	By	Bal. b/d	3,10,000
To	Bal. c/d (bal. fig.)	4,75,000	By	Purchases	15,40,000
		18,50,000			18,50,000

(b) Calculation of correct departmental Profits

	Department A	*Department B*	*Department C*	*Department D*
	₹	₹	₹	₹
Profit after charging managers' commission	2,25,000	3,37,500	1,80,000	4,50,000
Add back: Managers' commission (1/9)	25,000	37,500	20,000	50,000
	2,50,000	3,75,000	2,00,000	5,00,000
Less: Unrealized profit on stock (Working Note)	31,000	37,500	5,000	17,250
Profit before Manager's commission	2,19,000	3,37,500	1,95,000	4,82,750
Less: Commission for Department Manager @ 10%	21,900	33,750	19,500	48,275
Correct Departmental Profits after manager's commission	1,97,100	3,03,750	1,75,500	4,34,475

Working Note :

Stock lying with

	Dept. A	Dept. B	Dept. C	Dept. D	Total
	₹	₹	₹		₹
Unrealized Profit of:					
Department A		45,000 x 25/125 = 9,000	50,000 x 25/125 =10,000	60,000 x 25/125 = 12,000	31,000
Department B	50,000 x 0.3 = 15,000			75,000 x 0.3 = 22,500	37,500

Department C	33,000 x10/110 = 3,000	22,000x 10/110 = 2,000			5,000
Department D	40,000 x 0.15 = 6,000	10,000 x 0.15 = 1,500	65,000 x 0.15 = 9,750		17,250

Question 4

E, F and G were partners in a firm, sharing profits and losses in the ratio of 3:2:1, respectively. Due to extreme competition, it was decided to dissolve the partnership on 31st December, 2017. The balance sheet on that date was as follows:

Liabilities		*₹*	*Assets*	*₹*
Capital accounts:			*Machinery*	*1,54,000*
E	*1,13,100*		*Furniture & fittings*	*25,800*
F	*35,400*		*Investments*	*5,400*
G	*31,500*	*1,80,000*	*Stock*	*97,700*
Current accounts:			*Debtors*	*56,400*
E	*26,400*		*Bank*	*29,700*
G	*6,000*	*32,400*	*Current account: F*	*18,000*
Reserves		*1,08,000*		
Loan account: G		*15,000*		
Creditors		*51,600*		
		3,87,000		*3,87,000*

The realization of assets is spread over the next few months as follows:

February, Debtors, ₹ 51,900; March, Machinery, ₹ 1,39,500; April, Furniture, etc. ₹18,000; May, G agreed to take over investment at ₹6,300; June, Stock, ₹96,000.

Dissolution expenses, originally provided, were ₹ 13,500, but actually amounted to ₹ 9,600 and were paid on 30th April. The partners decided that after creditors were settled for ₹ 50,400, all cash received should be distributed at the end of each month in the most equitable manner.

You are required to prepare a statement of actual cash distribution as received using "Maximum loss basis" method. ***(20 Marks)***

Answer

Statement of Distribution of Cash by 'Maximum Loss Method'

	Creditors ₹	*G 's Loan* ₹	*E* ₹	*F* ₹	*G* ₹	*Total*
Feb: Balance due	51,600	15,000	1,93,500	53,400	55,500	3,02,400*

Cash available 29,700						
Collection from debtors 51,900						
81,600						
Less: prov for expenses 13,500						
68,100						
Creditors & Loan paid (50,400 +15,000) 65,400	(50,400)	(15,000)				
	1,200	-				
Discount written off	(1,200)					
Available for E, F & G 2,700	-					
Maximum possible loss						
(3,02,400-2,700) =2,99,700						
In ratio of 3:2:1			(1,49,850)	(99,900)	(49,950)	(2,99,700)
			43,650	(46,500)	5,550	
Adjustment for F's deficiency in ratio of 1,13,100: 31,500			(36,370)	46,500	(10,130)	
			7,280	-	(4,580)	
Adjustment for G's deficiency			(4,580)	-	4,580	
			2,700			
Cash paid to E			2,700			
Balance due			1,90,800	53,400	55,500	(2,99,700)
March						
Cash available ₹ 1,39,500						
Maximum possible loss ₹ 2,99,700 – ₹ 1,39,500						
= ₹ 1,60,200 in ratio of 3:2:1			(80,100)	(53,400)	(26,700)	(1,60,200)
Cash paid			1,10,700	-	28,800	1,39,500
Balance			80,100	53,400	26,700	1,60,200
April						
18,000 +3,900 (saving in expenses) = 21,900						
Maximum possible loss ₹ 1,60,200-21,900= 1,38,300 in ratio of 3:2:1			(69,150)	(46,100)	(23,050)	(1,38,300)
Cash paid			10,950	7,300	3,650	21,900
Balance May			69,150	46,100	23,050	1,38,300

Investment taken by G Balance			 69150	 46100	<u>6300</u> 16750	<u>6300</u> 132000
Maximum loss (1,38,300 less 6,300)			(66,000)	(44,000)	(22,000)	(1,32,000)
Balance			3,150	2,100	1,050	6,300
Cash brought by G (6,300 less 1,050)					5,250	5,250
Cash paid to E and F			(3,150)	(2,100)		(5,250)
Balance			<u>66,000</u>	<u>44,000</u>	<u>22,000</u>	1,32,000
June Stock 96,000 Maximum loss (1,32,000-96,000) <u>Cash paid</u> <u>Unpaid balance</u>			 <u>(18,000)</u> <u>48,000</u> <u>(18,000)</u>	 <u>(12,000)</u> <u>32,000</u> <u>(12,000)</u>	 <u>(6,000)</u> <u>16,000</u> <u>(6,000)</u>	 <u>36,000</u> <u>96,000</u> <u>36,000</u>

*Partners' capital balances after adjusting reserves and current A/c balance.

Working Note:

Statement showing the cash available for distribution:

Feb. ₹ 29,700 + 51,900 - 13,500 = ₹ 68,100

March ₹ 1,39,500

April ₹ 18,000 + 3,900 = 21,900

May - Nil

June ₹ 96,000

Question 5

(a) Sun Limited took over the running business of a partnership firm M/s A & N Brothers with effect from 1st April, 2017. The company was incorporated on 1st September, 2017. The following profit and loss account has been prepared for the year ended 31st March, 2018.

Particulars	*₹*	*Particulars*	*₹*
To salaries	*1,33,000*	*By Gross Profit b/d*	*7,50,000*
To rent	*96,000*		
To carriage outward	*75,000*		
To audit fees	*12,000*		
To travelling expenses	*66,000*		

To commission on sales	*48,000*		
To printing and stationery	*24,000*		
To electricity charges	*30,000*		
To depreciation	*80,000*		
To advertising expenses	*24,000*		
To preliminary expenses	*9,000*		
To Managing Director's remuneration	*8,000*		
To Net Profit c/d	*1,45,000*		
	7,50,000		*7,50,000*

Additional Information :

1. *Trend of sales during April, 2017 to March, 2018 was as under:*

April, May	*₹ 85,000 per month*
June, July	*₹ 1,05,000 per month*
August, September	*₹ 1,20,000 per month*
October, November	*₹ 1,40,000 per month*
December onwards	*₹ 1,50,000 per month*

2. *Sun Limited took over a machine worth ₹ 7,20,000 from A&N Brothers and purchased a new machine on 1st February, 2018 for ₹ 4,80,000. The company decides to provide depreciation @ 10% p.a.*
3. *The company occupied additional space from 1st October, 2017 @ rent of ₹ 6,000 per month.*
4. *Out of travelling expenses, ₹ 30,000 were incurred by office staff while remaining expenses were incurred by salesmen.*
5. *Audit fees pertains to the company.*
6. *Salaries were doubled from the date of incorporation.*

You are required to prepare a statement apportioning the expenses between pre and post incorporation periods and calculate the profit/(loss) for such periods.

(b) A Company had issued 1,000 12% debentures of ₹ 100 each redeemable at the company's option at the end of 10 years at par or prior to that by purchase in open market or at ₹ 102 after giving 6 months notice. On 31st December, 2016, the accounts of the company showed the following balances:

Debenture redemption fund ₹ 53,500 represented by 10% Govt. Loan of a nominal value of ₹ 42,800 purchased at an average price of ₹ 101 and ₹ 10,272 uninvested cash in hand.

On 1st January 2017, the company purchased ₹ 11,000 of its own debentures at a cost of ₹ 10,272.

On 30th June, 2017, the company gave a six months notice to the holders of ₹ 40,000 debentures and on 31st December, 2017 carried out the redemption by sale of ₹ 40,800 worth of Govt. Loan at par and also cancelled the own debentures held by it.

Prepare ledger account of Debenture Redemption Fund Account and Debenture Redemption Fund Investment Account for the year ended 31.12.2017, assuming that, interest on company debentures & Govt. loan was payable on 31st December every year.

(12+ 8 = 20 Marks)

Answer

(a) Statement showing calculation of profits for pre and post incorporation periods for the year ended 31.3.2018

Particulars	*Pre-incorporation period* ₹	*Post- incorporation period* ₹
Gross profit (1:2)	2,50,000	5,00,000
Less: Salaries (5:14)	35,000	98,000
Carriage outward (1:2)	25,000	50,000
Audit fee	-	12,000
Travelling expenses (W.N.3)	24,500	41,500
Commission on sales (1:2)	16,000	32,000
Printing & stationary (5:7)	10,000	14,000
Rent (office building) (W.N.4)	25,000	71,000
Electricity charges (5:7)	12,500	17,500
Depreciation	30,000	50,000
Advertisement (1:2)	8,000	16,000
Preliminary expenses	-	9,000
MD remuneration	-	8,000
Pre-incorporation profit – ts/f to Capital reserve (Bal. Fig.)	64,000	-
Net profit (Bal. Fig.)	-	81,000

Working Notes:

1. **Time Ratio**

   Pre incorporation period = 1st April, 2017 to 31st August, 2017

   i.e. 5 months

   Post incorporation period is 7 months

   Time ratio is 5: 7.

2. **Sales ratio**

April	85,000
May	85,000
June	1,05,000
July	1,05,000
August	1,20,000
	5,00,000
September	1,20,000
Oct & Nov.	2,80,000
Dec. to March (1,50,000 x 4)	6,00,000
	10,00,000

5,00,000:10,00,000 = 1:2

3. **Travelling expenses**

	₹	₹
	Pre-incorporation	*Post- incorporation*
30,000 office staff (5:7)	12,500	17,500
36,000 sales (1:2)	12,000	24,000
	24,500	41,500

4. **Rent**

	₹
Rent for additional space ₹ (6,000 x 6)	36,000
Remaining rent ₹ (96,000-36,000)	60,000
Pre-incorporation period (5/12 of 60,000)	25,000
Post- incorporation period ₹35,000 + ₹36,000	71,000

5. Salaries

Suppose x for a month in pre- incorporation period then salaries for pre-incorporation period = 5x salaries for post- incorporation period = 2x X 7= 14x

Ratio = 5:14

6. Depreciation

	₹	₹ Pre-incorporation	₹ Post-incorporation
Total depreciation	80,000		
Less: Depreciation exclusively for post incorporation period (₹ 4,80,000 x 10 x 2/12)	8,000		8,000
	72,000		
Depreciation for pre-incorporation period (₹ 72,000 x 5/12)		30,000	
Depreciation for post incorporation period (₹ 72,000 x 7/12)			42,000
		30,000	50,000

(b) Debenture Redemption Fund Account

Date	Particulars	₹	Date	Particulars	₹
31.12.17	To Debenture Redemption Fund Investment A/c	408	1.1.17	By Balance b/d	53,500
	To Premium on redemption of debentures	800	31.12.17	By interest on DRFI (10% of ₹ 42,800)	4,280
	To Balance c/d	57,892		By interest on own debentures (ie. 12% on ₹ 11,000)	1,320
		59,100			59,100
			1.1.18	To Balance b/d	57,892

Debenture Redemption Fund Investment Account

		₹			₹
1.1.17	To Balance b/d (428 x ₹ 101)	43,228	31.12.17	By Bank A/c	40,800
				By Debenture redemption Fund (1% of ₹ 40,800)	408
				By 12% Debentures	11,000
1.1.17	To Bank	10,272		By Balance c/d	2,020
31.12.17	To capital Reserve (Profit on cancellation of Debentures)	728			
		54,228			54,228
1.1.18	To Balance b/d	2, 020			

Question 6

Answer any ***four*** *of the following:*

(a) *"Accounting Standards standardize diverse accounting policies with a view to eliminate the non-comparability of financial statements and improve the reliability of financial statements. "Discuss and explain the benefits of Accounting Standards.*

(b) *"One of the characteristic of the financial statement is neutrality."Do you agree with this statement? Explain in brief.*

(c) *AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows :*

On 1st January, 2018 ₹ 60.75 per dollar

On 31st March, 2018 ₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(d) *Explain the conditions when a company should issue new equity shares for redemption of the preference shares. Also discuss the advantages and disadvantages of redemption of preference shares by issue of equity shares.*

(e) *Amit paid ₹ 50,000 as premium to other partners of the firm at the time of his admission to the firm, with a condition that it will not be dissolved before expiry of five years. The firm is dissolved after three years. Amit claims refund of premium. Explain -*

(1) Whether he is entitled to get a refund of the premium? If yes, list the criteria for the calculation of the amount of the refund.

(2) Also explain any two conditions when no claim in this respect will arise.

(4 x 5 Marks = 20 Marks)

Answer

(a) Accounting Standards standardize diverse accounting policies with a view to eliminate the non-comparability of financial statements and improve the reliability of financial statements. Accounting Standards provide a set of standard accounting policies, valuation norms and disclosure requirements. Accounting standards aim at improving the quality of financial reporting by promoting comparability, consistency and transparency, in the interests of users of financial statements.

The following are the benefits of Accounting Standards:

(i) ***Standardization of alternative accounting treatments:*** Accounting Standards reduce to a reasonable extent confusing variations in the accounting treatment followed for the purpose of preparation of financial statements.

(ii) ***Requirements for additional disclosures:*** There are certain areas where important is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) ***Comparability of financial statements:*** The application of accounting standards would facilitate comparison of financial statements of different companies situated in India and facilitate comparison, to a limited extent, of financial statements of companies situated in different parts of the world. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in Accounting Standards adopted in different countries.

(b) Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias.

Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion based on the business results. Information contained in the financial statements must be free from bias. It should reflect a balanced view of the financial position of the company without attempting to present them in biased manner. Financial statements cannot be prepared with the purpose to influence certain division, i.e. they must be neutral.

(c) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate ₹ 62.50

Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 1.75
Contract Amount	US$ 5,00,000
Total Loss (5,00,000 x 1.75)	₹ 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹ 5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

(d) A company may prefer issue of new equity shares in the following situations:

(a) When the company realizes that the capital is needed permanently and it makes more sense to issue Equity Shares in place of Redeemable Preference Shares which carry a fixed rate of dividend.

(b) When the balance of profit, which would otherwise be available for dividend, is insufficient.

(c) When the liquidity position of the company is not good enough.

Advantages of redemption of preference shares by issue of fresh equity shares

(1) No cash outflow of money is required – now or later.

(2) New equity shares may be valued at a premium.

(3) Shareholders retain their equity interest.

Disadvantages of redemption of preference shares by issue of fresh equity shares

(1) There will be dilution of future earnings;

(2) Share-holding in the company is changed.

(e) If the firm is dissolved before the term expires, as is the case, Amit, being a partner who has paid premium on admission, will have to be repaid / refunded.

The criteria for calculation of refund amount are:

(i) Terms upon which admission was made,

(ii) The time period for which it was agreed that the firm will not be dissolved,

(iii) The time period for which the firm has already been in existence

No claim for refund will arise if:

(i) The firm is dissolved due to death of a partner or If the dissolution of the firm is basically because of misconduct of,

(ii) If the dissolution is through an agreement and such agreement does not have a stipulation for refund *of premium.*