PAPER – 5: ADVANCED ACCOUNTING

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

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

Working notes should form part of the respective answers.

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

Question 1

(a) *A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.*

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under :

Invoice Date	***Amount (₹)***
11th Feb, 2017	*60,000*
25th Dec, 2017	*40,000*
04th Oct, 2018	*1,35,000*

Calculate the provision to be made for warranty under AS-29 as at 31st March, 2018 and 31st March, 2019. Also compute amount to be debited to P & L account for the year ended 31st March, 2019.

(b) *As per provisions of AS-26, how would you deal to the following situations:*

(1) *₹ 23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.*

(2) *During the year 2018-19, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.*

(3) *A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.*

(4) *A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product.*

The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product.

(c) *Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.*

(1) *Trade discount and volume rebate received.*

(2) *Where goods are sold to distributors or others for resale.*

(3) *Where seller concurrently agrees to repurchase the same goods at a later date.*

(4) *Insurance agency commission for rendering services.*

(5) *On 11-03-2019 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request, clothes were delivered on 12-04-2019.*

(d) *Following information is supplied by K Ltd.:*

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹ 98

Last date of exercising rights - 30-06-2018.

Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹ 102.

Net Profit to equity shareholders:

2017-2018 - ₹ 50,00,000

2018-2019 -₹ 75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earnings per Share.

(4 Parts x 5 Marks = 20 Marks)

Answer

(a) Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2018 = ₹ 60,000 x .02 + ₹ 40,000 x .03

= ₹ 1,200 + ₹ 1,200 = ₹ 2,400

As at 31st March, 2019 = ₹ 40,000 x .02 + ₹ 1,35,000 x .03

= ₹ 800 + ₹ 4,050 = ₹ 4,850

Amount debited to Profit and Loss Account for year ended 31st March, 2019

	₹
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 1.4.2018	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31st March, 2019 in respect of sales amounting ₹ 60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

(b) As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹ 23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(ii) The company is required to expense the entire amount of ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 2019 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹ 25,00,000 and it should be recognized as expense

(iv) Expenditure of ₹ 50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

(c) (1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

(d) $$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{102 \text{ x } 2{,}50{,}000 \text{ Shares} + ₹\ 98 \text{ x } 1{,}00{,}000 \text{ shares}}{3{,}50{,}000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 100.86

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = 102/100.86 = 1.01$$

Computation of earnings per share:

EPS for the year 2017-18 as originally reported: ₹ 50,00,000/2,50,000 shares = ₹ 20

EPS for the year 2017-18 restated for rights issue: =₹ 50,00,000/ (2,50,000 shares x 1.01)

= ₹ 19.80

EPS for the year 2018-19 including effects of rights issue:

EPS = 75,00,000/3,25,625* = ₹ 23.03

** [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] =63,125 + 2,62,500 = 3,25,625 shares*

Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

Question 2

(a) *X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2018.*

Liabilities	*(in ₹)*	*(in ₹)*
Share Capital		
Equity Share Capital of ₹ 20 each fully paid up	*50,00,000*	
10,000, 10% Preference Shares of ₹ 100 each fully paid up	*10,00,000*	*60,00,000*

Reserves & Surplus		
Capital Reserve	*1,00,000*	
Security Premium	*12,00,000*	
Revenue Reserve	*5,00,000*	
Profit and Loss	*20,00,000*	
Dividend Equalization Fund	*5,50,000*	*43,50,000*
Non-Current Liabilities		
12% Debenture		*12,50,000*
Current Liabilities and Provisions		*5,50,000*
Total		*1,21,50,000*
Assets		
Fixed Assets		
Tangible Assets		*1,00,75,000*
Current Assets		
Investment	*3,00,000*	
Inventory	*2,00,000*	
Cash and Bank	*15,75,000*	*20,75,000*
Total		*1,21,50,000*

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

(1) Buy back 25% of the paid up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹ 30 per share.

(2) To finance the buy-back of shares, company:

(a) Issues 3000, 14% debentures of ₹ 100 each at a premium of 20%.

(b) Issues 2500, 10% preference shares of ₹ 100 each.

(3) Sell investment worth ₹ 1,00,000 for ₹ 1,50,000.

(4) Maintain a balance of ₹ 2,00,000 in Revenue Reserve.

(5) Later the company issue three fully paid up equity share of ₹ 20 each by way of bonus share for every 15 equity share held by the equity shareholders.

You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back.

(b) *On 1st April, 2018, XYZ Ltd., offered 150 shares to each of its 750 employees at ₹ 60 per share. The employees are given a year to accept the offer. The shares issued under the plan shall be subject to lock-in period on transfer for three years from the grant date. The market price of shares of the company on the grant date is ₹ 72 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 67 per share.*

On 31st March, 2019, 600 employees accepted the offer and paid ₹ 60 per share purchased. Nominal value of each share is ₹ 10.

You are required to record the issue of shares in the books of the XYZ Ltd., under the aforesaid plan. ***(15+5=20 Marks)***

Answer

(a) In the books of X Limited

Journal Entries

	Particulars	Dr. ₹	Cr. ₹
1.	Bank A/c Dr.	3,60,000	
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
	(Being 14 % debentures issued to finance buy back)		
2.	Bank A/c Dr.	2,50,000	
	To 10% preference share capital A/c		2,50,000
	(Being 10% preference share issued to finance buy back)		
3.	Bank A/c Dr.	1,50,000	
	To Investment A/c		1,00,000
	To Profit on sale of investment		50,000
	(Being investment sold on profit)		
4.	Equity share capital A/c (62,500 x ₹20) Dr.	12,50,000	
	Securities premium A/c (62,500 x ₹16) Dr.	10,00,000	
	To Equity shares buy back A/c (62,500 x ₹36)		22,50,000
	(Being the amount due to equity shareholders on buy back)		
5.	Equity shares buy back A/c Dr.	22,50,000	
	To Bank A/c		22,50,000

	(Being the payment made on account of buy back of 62,500 Equity Shares as per the Companies Act)		
6.	Revenue reserve Dr.	3,00,000	
	Securities premium Dr.	2,60,000	
	Profit and Loss A/c Dr.	4,40,000	
	To Capital redemption reserve A/c*		10,00,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law) [12,50,000 less 2,50,000]		
7.	Capital redemption reserve A/c Dr.	7,50,000	
	To Bonus shares A/c (W.N.1)		7,50,000
	(Being the utilization of capital redemption reserve to issue 37,500 bonus shares)		
8.	Bonus shares A/c Dr.	7,50,000	
	To Equity share capital A/c		7,50,000
	(Being issue of 3 bonus equity share for every 15equity shares held)		

**Alternatively, entry for combination of different amounts (from Revenue reserve, Securities premium and profit and Loss account.) may be passed for transferring the required amount to CRR.*

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other **specified securities**. Issue of debentures has been excluded for the purpose of "**specified securities**" and the entire amount of ₹ 10,00,000 (after deducting only pref. share capital) has been credited to CRR while solving the question.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	*Note No*	*Amount ₹*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	57,50,000
(b) Reserves and Surplus	2	27,10,000

(2) Non-Current Liabilities		
(a) Long-term borrowings	3	15,50,000
(3) Current Liabilities		
(a) Trade payables		-
(b) current liabilities & Provisions		5,50,000
Total		1,05,60,000
II. Assets		
(1) Non-current assets		
(a) *Property, Plant and Equipment*		1,00,75,000
(2) Current assets		
(a) Investments		2,00,000
(b) Inventory		2,00,000
(c) Cash and cash equivalents (W.N. 2)		85,000
Total		1,05,60,000

Notes to Accounts

				₹
1.	Share Capital			
	Equity share capital (Fully paid up shares of ₹ 20 each)			
	(2,50,000-62,500+37,500 shares)		45,00,000	
	10% preference shares @ ₹ 100 each			
	(10,00,000 + 2,50,000)		12,50,000	57,50,000
2.	Reserves and Surplus			
	Capital Reserve		1,00,000	
	Revenue reserve		2,00,000	
	Securities premium	12,00,000		
	Add: Premium on debenture	60,000		
	Less: Adjustment for premium paid on buy back	(10,00,000)		
	Less: Transfer to CRR	(2,60,000)	Nil	
	Capital Redemption Reserve			
	Transfer due to buy-back of shares from P&L			

		10,00,000		
	Less: Utilisation for issue of bonus shares			
		(7,50,000)	2,50,000	
	Profit & Loss A/c	20,00,000		
	Add: Profit on sale of investment	50,000		
	Less: Transfer to CRR	(4,40,000)	16,10,000	
	Dividend equalization reserve	(5,50,000)	5,50,000	27,10,000
3	Long-term borrowings - 12% Debentures	12,50,000		
	- 14% Debentures	3,00,000		15,50,000

Working Notes:

1. Amount of bonus shares = [(2,50,000 -25%)3/15] x 20 = 37,500 x 20=7,50,000
2. Cash at bank after issue of bonus shares

	₹
Cash balance as on 30.3.2018	15,75,000
Add: Issue of debenture	3,60,000
Add: issue of preference shares	2,50,000
Add: Sale of investments	1,50,000
	23,35,000
Less: Payment for buy back of shares	(22,50,000)
	85,000

(b) Fair value of an option = ₹ 67(considered on grant date) – ₹ 60 = ₹ 7

Number of shares issued = 600 employees x 150 shares/employee = 90,000 shares

Fair value of ESOP = 90,000 shares x ₹ 7 = ₹ 6,30,000

Vesting period = 1 year

Expenses recognized in 2018-19 = ₹ 6,30,000

Date	*Particulars*		₹	₹
31.03.2019	Bank (90,000 shares x ₹ 60)	Dr.	54,00,000	
	Employees stock compensation expense A/c	Dr.	6,30,000	
	To Share Capital (90,000 shares x ₹ 10)			9,00,000

	To Securities Premium (90,000shares x ₹ 57) (Being option accepted by 600 employees & payment made @ ₹ 60 per share)			51,30,000
	Profit & Loss A/c	Dr.	6,30,000	
	To Employees stock compensation expense A/c			6,30,000
	(Being Employees stock compensation expense transferred to Profit & Loss A/c)			

Question 3

(a) *Following is the summarized Balance Sheet of Fortunate Ltd. as on 31st March, 2019.*

Particulars	*Amount (₹)*
Liabilities	
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	*7,50,000*
(b) 18,750 Equity shares of ₹ 50 each	*9,37,500*
Profit and Loss Account	*(5,63,750)*
Loan	*7,16,250*
Trade Payables	*2,58,750*
Other Liabilities	*43,750*
Total	*21,42,500*
Assets	
Building at cost less depreciation	*5,00,000*
Plant at cost less depreciation	*3,35,000*
Trademarks and goodwill at cost	*3,97,500*
Inventory	*5,00,000*
Trade Receivables	*4,10,000*
Total	*21,42,500*

(Note: Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and not earnings profits. A scheme of reconstruction has been approved by both the classes of shareholders. The summarized scheme of reconstruction is as follows:

(i) The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 5 by cancellation of ₹ 45.00 per share. They have also agreed to subscribe for three new equity shares of ₹ 5.00 each for each equity share held.

(ii) The preference shareholders have agreed to forego the arrears of dividends and to accept for each ₹ 50 preference share, 4 new 6% preference shares of ₹ 10 each, plus 3 new equity shares of ₹ 5.00 each, all credited as fully paid.

(iii) Lenders to the company for ₹ 1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of ₹ 10 each and 7,500 new equity shares of ₹ 5.00 each.

(iv) The directors have agreed to subscribe in cash for 25,000 new equity shares of ₹ 5.00 each in addition to any shares to be subscribed by them under (i) above.

(v) Of the cash received by the issue of new shares, ₹ 2,50,000 is to be used to reduce the loan due by the company.

(vi) The equity share capital cancelled is to be applied:

(a) To write off the debit balance in the Profit and Loss A/c, and

(b) To write off ₹ 43,750 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital, as reduced, is to be increased to ₹ 8,12,500 for preference share capital and ₹ 9,37,500 for equity share capital.

You are required to pass journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction.

(b) A liquidator is entitled to receive remuneration at 5% of the assets realized and 8% of the amount distributed among the unsecured creditors. The assets realized ₹ 13,75,000. Payment was made from realised amount as follows:

Liquidation expenses	*13,000*
Preferential creditors (treated as unsecured creditors)	*88,500*
Secured creditors	*1,00,000*

You are required to calculate remuneration payable to the liquidator. ***(15+5 =20Marks)***

Answer

(a) **In the books of Fortunate Ltd.**

Journal Entries

	Particulars	Debit (₹)	Credit (₹)

1.	Equity share capital A/c (₹ 50)	Dr.	9,37,500	
	To Equity share capital A/c (₹ 5)			93,750
	To Capital reduction A/c*			8,43,750
	(Being equity capital reduced to nominal value of ₹ 5 each)			
2.	Bank A/c	Dr.	2,81,250	
	To Equity share capital			2,81,250
	(Being 3 right shares against each share was issued and subscribed)			
3.	8% Preference share capital A/c (₹ 50)	Dr.	7,50,000	
	Capital reduction A/c	Dr.	75,000	
	To 6% Preference share capital (₹ 10)			6,00,000
	To equity share capital (₹ 50)			2,25,000
	(Being 8% preference shares of ₹ 50 each converted to 6% preference shares of ₹ 10 each and also given to them 3 equity shares for every share held)			
4.	Loan A/c	Dr.	1,87,500	
	To 6% Preference share capital A/c (15,000 x ₹ 10)			1,50,000
	To Equity share capital A/c (7,500 x ₹5)			37,500
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c (25,000 x ₹5)	Dr.	1,25,000	
	To Equity share application A/c			1,25,000
	(Being shares subscribed by the directors)			
6.	Equity share application A/c	Dr.	1,25,000	
	To Equity share capital A/c			1,25,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,50,000	
	To Bank A/c			2,50,000
	(Being loan repaid)			

8.	Capital reduction A/c	Dr.	7,68,750	
	To Profit and loss A/c			5,63,750
	To Plant A/c			43,750
	To Trademarks and Goodwill A/c (Bal. fig.)			1,61,250
	(Being losses and assets written off to the extent required)			

Balance sheet of Fortunate Ltd. (and reduced)

as on 31.3.2019

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	15,12,500
2		Non-current liabilities		
	a	Long-term borrowings (7,16,250 – 1,87,500 – 2,50,000)		2,78,750
3		Current liabilities		
	a	Trade Payables		2,58,750
	b	Other current liabilities		43,750
		Total		20,93,750
		Assets		
1		Non-current assets		
	a	Property, Plant and Equipment	2	7,91,250
	b	Intangible assets	3	2,36,250
2		Current assets		
	a	Inventories		5,00,000
	b	Trade receivables		4,10,000
	c	Cash and cash equivalents	4	1,56,250
		Total		20,93,750

Notes to accounts:

			₹
1	**Share Capital**		

	Authorized capital:		
	81,250 Preference shares of ₹ 10 each	8,12,500	
	1,87,500 Equity shares of ₹ 5 each	9,37,500	17,50,000
	Issued, subscribed and paid up:		
	1,52,500 equity shares of ₹ 5 each	7,62,500	
	75,000, 6% Preference shares of ₹ 10 each	7,50,000	15,12,500
2	**Property, Plant and Equipment**		
	Building at cost less depreciation	5,00,000	
	Plant at cost less depreciation	2,91,250	7,91,250
3.	**Intangible assets**		
	Trademarks and goodwill		2,36,250
4	**Cash and cash equivalents**		
	Bank (2,81,250+1,25,000-2,50,000)		1,56,250

Note: **In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used.*

(b) Calculation of Total Remuneration payable to Liquidator

		Amount in ₹
5% on Assets realised	(13,75,000 x 5%)	68,750
8% on payment made to Unsecured creditors (Refer W.N)		7,080
Total Remuneration payable to Liquidator		75,830

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 and liquidator's remuneration

	₹	
Total amount realized		₹ 13,75,000
Less: Liquidation expenses paid	(13,000)	
Payment to secured creditors	(1,00,000)	
Liquidator's remuneration on assets realized	(68,750)	
		₹ 1,81,750

₹11,93,250

Sufficient amount is available for preference creditors (treated as unsecured creditors) therefore Liquidator's remuneration on payment to unsecured creditors = 8% x ₹ 88,500 = ₹ 7,080

Note: Since the amount of unsecured creditors (other than preferential creditors) is not given in the question, the above solution is based on the assumption that there are no unsecured creditors (other than preferential creditors who are treated as unsecured creditors).

Question 4

(a) *From the following information, you are required to prepare Profit and Loss Account of Simple Bank for the year ended as on 31st March, 2019:*

2017-18 (₹ in '000)	*Item*	*2018-19 (₹ in '000)*
71,35	*Interest and Discount*	*1,02,25*
5,70	*Income from investment*	*5,60*
7,75	*Interest on Balances with RBI*	*8,85*
36,10	*Commission, Exchange and Brokerage*	*35,60*
60	*Profit on sale of investments*	*6,10*
30,60	*Interest on Deposits*	*41,10*
6,35	*Interest to RBI*	*7,35*
36,35	*Payment to and provision for employees*	*42,75*
7,90	*Rent, taxes and lighting*	*8,95*
7,35	*Printing and Stationery*	*10,60*
5,60	*Advertising and publicity*	*4,90*
4,90	*Depreciation*	*4,90*
7,40	*Director's fees*	*10,60*
5,50	*Auditor's fees*	*5,50*
2,50	*Law Charges*	*7,60*
2,40	*Postage, telegrams and telephones*	*3,10*
2,10	*Insurance*	*2,60*
2,85	*Repair and maintenance*	*3,30*

Other Information:

(i) The following items are already adjusted with Interest and Discount (Cr.)

Tax Provision (₹'000)	*7,40*
Provision for Doubtful Debts (₹'000)	*4,60*
Loss on sale of investments (₹'000)	*60*
Rebate on Bills discounted (₹'000)	*2,75*

(ii) Appropriations:

25% of profit is transferred to Statutory Reserves.

5% of profit is transferred to Revenue Reserve.

You are required to give necessary Schedules also.

(b) The investment portfolio of a mutual fund scheme includes 4,000 shares of P Ltd. and 3,200 shares of Q Ltd. acquired on 31-12-2017. The cost of P Ltd.'s share is ₹ 50 and Q Ltd.'s share is ₹ 75. The market value of these shares at the end of 2017-18 were ₹ 47 and ₹ 80 respectively. On 30th June, 2018 shares of both companies were disposed off realizing:

P Ltd.'s share at ₹ 40 and

Q Ltd.' s share at ₹ 82

Show important accounting entries in the books of the fund for the accounting years 2017-18 and 2018-19.

(c) The following information is furnished by ALFA Bank Ltd.

	₹ in Lakhs
Margins held against letter of credit	*200*
Recurring accounts deposits	*100*
Current accounts deposits	*375*
Demand deposits	*125*
Unclaimed deposits	*75*
Gold deposits	*235*
Demand liabilities portion of saving bank deposit	*1325*
Time liabilities portion of saving bank deposit	*722*

Explain CRR and you are required to calculate the amount of Cash Reserve Ratio (CRR) as per the directions of Reserve Bank of India. ***(10+5+5 =20 Marks)***

Answer

(a) **Simple Bank**

Profit and Loss Account for the year ended 31-3-2019

		Schedule No.	(₹ 000's) Year ended 31-3-2019	(₹ 000's) Year ended 31-3-2018
I.	Income			
	Interest Earned	13	1,29,30	84,80
	Other Income	14	41,10	36,70
	Total		1,70,40	1,21,50
II.	Expenditure			
	Interest Expended	15	48,45	36,95
	Operating Expenses	16	1,04,80	84,85
	Provisions and Contingencies		12,00	
	Total		1,65,25	1,21,80
III.	Profit/Loss			
	Net Profit/Loss for the year		5,15	(30)
	Profit/Loss brought forward		(30)	
	Total		4,85	(30)
IV.	Appropriations			
	Transfer to Statutory Reserve		128.75	
	Transfer to Other Reserve, Proposed Dividend		25.75	
	Balance carried over to Balance Sheet		330.5	
	Total		485.0	

Schedule 13 - Interest Earned

(₹ 000's)

	Year ended *31-3-2019*	Year ended *31-3-2018*

I.	Interest/Discount	1,14,85	71,35
II.	Income on Investments	5,60	5,70
III.	Interest on Balances with RBI and other inter-bank fund	8,85	7,75
IV.	Others	------	------
	Total	1,29,30	84,80

Schedule 14 - Other Income

			(₹ 000's)
		Year ended *31-3-2019*	Year ended *31-3-2018*
I.	Commission, Exchange and Brokerage	35,60	36,10
II.	Profit on Sale of Investments	6,10	60
	Less: Loss on sale of Investments	(60)	-
	Total	41,10	36,70

Schedule 15 - Interest Expended

			(₹ 000's)
		Year ended *31-3-2019*	Year ended *31-3-2018*
I.	Interest on Deposits	41,10	30,60
II.	Interest on RBI/inter-bank borrowings	7,35	6,35
	Total	48,45	36,95

Schedule 16 - Operating Expenses

			(₹ 000's)
		Year ended *31-3-2019*	Year ended *31-3-2018*
I.	Payments to and provision for employees	42,75	36,35
II.	Rent, taxes and lighting	8,95	7,90
III.	Printing and stationery	10,60	7,35
IV.	Advertisement and Publicity	4,90	5,60
V.	Depreciation on the Bank's Property	4,90	4,90
VI.	Director's fees, allowances and expenses	10,60	7,40

VII.	Auditor's fees and expenses (including branch auditors)	5,50	5,50
VIII.	Law charges	7,60	2,50
IX.	Postage, telegrams, telephones etc.	3,10	2,40
X.	Repairs and maintenance	3,30	2,85
XI.	Insurance	2,60	2,10
XII.	Other Expenditure	------	------
	Total	1,04,80	84,85

(b) Journal Entries:

			₹ 000	*₹ 000*
31.12.17	Investment in P Ltd's Shares	Dr.	200	
	Investment in Q Ltd's Shares	Dr.	240	
	To Bank			440
	(Being purchase of P Ltd., 4,000 shares @ ₹ 50 and 3,200 shares of Q Ltd., @ ₹ 75 each)			
31.3.18	Revenue A/c	Dr.	12	
	To Provision for Depreciation			12
	(Being market value of P Ltd shares depreciated for ₹ 3 each for 4,000 shares)			
	Investment in Q Ltd's Shares	Dr.	16	
	To Unrealised Appreciation Reserve			16
	(Being 3,200 shares of Q Ltd., appreciated @ ₹ 5 each per share on the closing date)			
1.04.18	Unrealised Appreciation Reserve	Dr.	16	
	To Investment in Q Ltd's Shares			16
	(Being last year's reserve reversed)			
30.6.18	Bank Account	Dr.	160	
	Loss on disposal of Investment	Dr.	40	
	To Investment in P Ltd. Shares			200
	(Being ₹ 2,00,000 of P Ltd. shares sold for ₹ 1,60,000)			
	Provision for Depreciation	Dr.	12	
	Revenue A/c	Dr.	28	
	To Loss on disposal of Investment			40

	(Earlier depreciation provision provided being reversed on disposal of total shares of P Ltd. and the balance amount debited to Revenue Account)		
	Bank Account Dr.	262.4	
	To Investment in Q Ltd. Shares		240
	To Revenue A/c		22.4
	(Being 3,200 shares of Q Ltd. sold @ ₹ 82 accounted on the trade date since this is a regular transaction in the business)		

(c) Cash Reserve Ratio (CRR): For smoothly meeting cash payment requirement, banks are required to maintain certain minimum ready cash balances at all times. This is called as Cash Reserve Ratio (CRR).

Cash reserve can be maintained by way of either a cash reserve with itself or as balance in a current account with the Reserve Bank of India or by way of net balance in current accounts or in one or more of the aforesaid ways. Every Scheduled Commercial Bank has to maintain cash reserve ratio (i.e. CRR) as per direction of the RBI. The current Cash Reserve Ratio (CRR) is 4% of their Net Demand and Time Liabilities (NDTL).

Margins held against letters of credit	Demand Liability	200
Recurring Accounts deposits	Time Liability	100
Current deposits	Demand Liability	375
Demand deposits	Demand Liability	125
Unclaimed deposits,	Demand Liability	75
Gold deposits	Time Liability	235
Demand liabilities portion of savings bank deposits	Demand Liability	1325
Time liabilities portion of savings bank deposits	Time Liability	722
	Total	3,157

Cash Reserve Ratio = Net (demand + Time) liabilities X 4/100

CRR= 3,157 x 4/100 = 126.28 Lakhs

Question 5

(a) Consider the following summarized Balance Sheets of subsidiary MNT Ltd.

Liabilities	*2017-18*	*2018-19*
	Amount in ₹	*Amount in ₹*
Share Capital		

Issued and subscribed 7500 Equity Shares of ₹ 100 each	*7,50,000*	*7,50,000*
Reserve and Surplus		
Revenue Reserve	*2,14,000*	*5,05,000*
Securities Premium	*72,000*	*2,07,000*
Current Liabilities and Provisions		
Trade Payables	*2,90,000*	*2,46,000*
Bank Overdraft	-	*1,70,000*
Provision for Taxation	*2,62,000*	*4,30,000*
	15,88,000	*23,08,000*
Assets		
Fixed Assets (Cost)	*9,20,000*	*9,20,000*
Less: Accumulated Depreciation	*(1,70,000)*	*(2,82,500)*
	7,50,000	*6,37,500*
Investment at Cost	-	*5,30,000*
Current Assets		
Inventory	*4,12,300*	*6,90,000*
Trade Receivable	*2,95,000*	*3,43,000*
Prepaid expenses	*78,000*	*65,000*
Cash at Bank	*52,700*	*42,500*
	15,88,000	*23,08,000*

Other Information:

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2017-2018 and increased by ₹ 12,000 at the end of 2018-2019. (Inventory of 2017-18 has been sold out during the year 2018-19)

(3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

(4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25 ,000 in 2017-18 and ₹ 12,500 in 2018-19 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2017-18, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2017-18.

Restate the balance sheet of MNT Ltd. as on 31st March, 2019 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

(b) *On the basis of the following information, calculate the value of goodwill of Star Ltd. at 5 years' purchase of super profits, if any, earned by the company in the previous three completed accounting years.*

Summarised Balance Sheet of Star Ltd. as at 31st March, 2019 is as follows:

Liabilities	₹ in Lakhs
Share Capital	
Issued and subscribed	
3 Crore Equity Shares of ₹ 10 each, fully paid up	3,000
Capital Reserve	200
General Reserve	5,293
Profit & Loss Account	517
Trade Payables	522
Provision for Taxation (net)	68
	9,600
Assets	
Goodwill	510
Land & Building	1,650
Plant & Machinery	2,715
Furniture & Fixtures	2,062
Patent and Trade Marks	30
Investments	800
Inventory	673
Trade Receivables	546
Cash and Cash equivalents	614
	9,600

The profits before tax of three years are as follows:

Year ended 31st March	Profit before tax in lakhs of (₹)	Weights
2015-16	1,910	1
2016-17	2,050	3
2017-18	2,950	5

Other information:

(1) *Assume that the rate of income tax for all the years is 35%.*

(2) *In the accounting year 2015-16 the company sold its land at a profit of ₹ 75.2 Lakhs, which is included in the profits of the same year.*

(3) *In December, 2016 there was a fire occurred in factory, due to which the company lost property worth ₹ 25 lakhs and the loss was not covered under the insurance policy.*

(4) *In November, 2017 the company earned an extraordinary income of ₹ 48.88 Lakhs due to a special contract.*

(5) *40% of total investments were 8% Non-trading investments (purchased at par on 1st April, 2014).*

(6) *Company values inventory on FIFO basis. On 31st March, 2018 inventory was under valued by ₹ 6 Lakhs. (Inventory of 2017-18 sold during the year 2018-19)*

(7) *Future maintainable profits to be ascertained considering weighted average.*

(8) *The normal rate of return for the industry in which company is engaged is 15%.*

(9) *Capital employed as on 31st March, 2018 was ₹ 5,820 Lakhs.*

(10) *In Shareholder's general meeting, a resolution was passed to sanction the directors additional remuneration of ₹ 15 lakhs every year beginning from the accounting year 2018-19.* ***(10+10=20 Marks)***

Answer

(a) **Restated Balance Sheet of MNT Ltd.**

as at 31st December, 2019

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		

(1) Non-current assets		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\left(\frac{3,43,000}{98} \text{x}100\right)$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		23,14,500

Notes to Accounts

			₹
1.	**Reserves and Surplus**		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	**Short term borrowings**		
	Bank overdraft		1,70,000
3.	**Short-term provision**		
	Provision for taxation		4,30,000
4.	**Property, Plant and Equipment**		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000

Add: Provision for doubtful debts [3,43,000 X 2/98]	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

(b) (1) Capital employed as on 31st March, 2019

		₹ in lakhs
Land and Buildings		1,650
Plant & Machinery		2,715
Furniture and Fixtures		2,062
Patents and Trade Marks		30
Investments (800 x 60%)		480
Inventory (673)		673
Trade receivables		546
Cash in hand and at Bank		614
		8,770
Less: Trade payables	522	
Provision for taxation (net)	68	(590)
Closing Capital employed		8,180

Average capital employed = (opening capital employed + closing capital employed)/2

= (5,820+8,180)/2 = ₹ 7,000 lakhs

(2) Future maintainable profit

(Amounts in lakhs of ₹)

	2015-2016 ₹ in lakhs	*2016-2017 ₹ in lakhs*	*2017-2018 ₹ in lakhs*
Profit before tax	1,910	2,050	2,950
Less: Profit on sale of land	(75.20)		
Add: Loss due to fire		25	
Less: Extraordinary income			(48.88)
Less: Income from non-trading investments (800 x 40% x 8%)	(25.6)	(25.6)	(25.6)
Add: Upward inventory valuation			6.00

	1809.2	2049.4	2881.52
Weight	1	3	5
Weighted Profit	1809.2	6,148.20	14,407.6
Total weight adjusted trading profits			22,365.00
			22,365/(5+3+1)
Average profit			2,485

	₹ In lakhs
Average trading profit before tax	2,485
Less: Additional remuneration to directors	(15)
	2,470
Less: Income tax @ 35%(approx.)	(864.50)
Future Maintainable profit	1,605.50

(3) Valuation of Goodwill on Super Profits Basis

	₹ in lakh
Future maintainable profits	1605.50
Less: Normal profits (7000 x 15%)	(1050.00)
Super profits	555.50

Goodwill at 5 years' purchase of super profits = 555.5 x 5 = ₹ 2777.50 lakhs

Question 6

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

(a) X Ltd. is a company engaged in manufacture and sale of industrial and FMCG products. One of their division also deals in Leasing of properties - Mobile Towers. The accountant showed the rent arising from the leasing of such properties as other income in the Statement of Profit and Loss.

Comment whether the classification of the rent income made by the accountant is correct or not in light of Schedule III to the Companies Act, 2013.

(b) Darshan Ltd. incorporated on 1st January, 2018 issued a prospectus inviting application for 40,000 Equity Shares of ₹ 10 each. The whole issue was fully underwritten by Arun, Babu and Chandran as follows:

Arun	*20,000 shares*
Babu	*12,000 shares*
Chandran	*8,000 shares*

Applications were received for 32,000 shares, of which marked applications were as follows:

Arun 16,000 shares

Babu 5,700 shares

Chandran 8,300 shares

You are required to find out the liabilities of individual underwriters viz. Arun, Babu & Chandran.

(c) *From the following data, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:*

.Case	Subsidiary Company	% of Share Owned	Cost	Date of Acquisition		Consolidation date	
				01-01-2018		31-12-2018	
				Share Capital	Profit and Loss A/c	Share Capital	Profit and Loss A/c
				₹	₹	₹	₹
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000
Case-E	N	100%	1,00,000	40,000	40,000	40,000	65,000

(d) *Explain the criterion of income recognition in the case of Non Banking Financial Companies.*

(e) *Classify the following into either operating lease or finance lease with reason:*

(1) *Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.*

(2) *Lessee has option to purchase the asset at lower than fair value at the end of lease term.*

(3) *Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.*

(4) *Present Value (PV) of Minimum Lease Payment (MLP) = "X".*

Fair value of the asset is "Y". And X = Y.

(5) *Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.*

(4 parts x 5 Marks=20 Marks)

Answer

(a) As per para 4 of the 'General Instructions for preparation of Statement of Profit and Loss' given in the Schedule III to the Companies Act, 2013, 'other income' does not include operating income.

The term "Revenue from operations" has not been defined under Schedule III to the Companies Act 2013. However, as per Guidance Note on Schedule III to the Companies Act 2013 this would include revenue arising from a company's operating activities i.e. either its principal or ancillary revenue-generating activities. Whether a particular income constitutes "Revenue from operations" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities. The classification of income would also depend on the purpose for which the particular asset is acquired or held.

As per the information given in the question, X Ltd is a group engaged in manufacture and sale of industrial and FMCG products and its one of the division deals in leasing of properties- Mobile Towers. Since its one division is continuously engaged in leasing of properties, it shall be considered as its principal or ancillary revenue-generating activities. Therefore, the rent arising from such leasing shall be shown under the head "Revenue from operations" and not as "Other Income".

Hence the presentation of rent arising from the leasing of such properties as "other income" in the statement of Profit and Loss is not correct. It should be shown under the head "Revenue from operations".

(b) **Statement of Net Liability of Underwriters**

	Gross liability	Marked appli-cations	Number of Unmarked applications in the ratio of gross Liability (20:12:8)	Shares Total (2) + (3)	Surplus of Chandran in the ratio of 10:6	Total (4) + (5)	Net liability (1) - (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Arun	20,000	16,000	1,000	17,000	438	17,438	2,562
Babu	12,000	5,700	600	6,300	262	6,562	5,438
Chandran	8,000	8,300	400	8,700	(700)	8,000	Nil
	40,000	30,000	2,000	32,000	-	32,000	8,000

Note: The applications are for 32,000 shares out of which 30,000 are marked. Hence unmarked applications are for 2,000 shares.

(c) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e.

in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2018

B = Profit & loss account balance on 1.1.2018

C = Share capital on 31.12.2018

D = Profit & loss account balance on 31.12.2018

	Minority % Shares Owned *[E]*	*Minority interest as at the date of acquisition* *[E] x [A + B] ₹*	*Minority interest as at the date of consolidation* *[E] X [C + D] ₹*
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750
Case E [100-100]	NIL	NIL	NIL

(d) Income Recognition in case of NBFC

(1) The income recognition shall be based on recognised accounting principles.

(2) Income including interest/ discount or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

(3) In respect of hire purchase assets, where instalments are overdue for more than 12 months, income shall be recognised only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became nonperforming and remaining unrealized, shall be reversed.

(4) In respect of lease assets, where lease rentals are overdue for more than 12 months, the income shall be recognised only when lease rentals are actually received. The net lease rentals* taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.

**'Net lease rentals' mean gross lease rentals as adjusted by the lease adjustment account debited/credited to the profit and loss account and as reduced by depreciation at the rate applicable under Schedule XIV of the Companies Act, 1956 (1 of 1956)/ 2013.*

(e) (i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.