Test Series: Oct. 2019

MOCK TEST PAPER - 1

INTERMEDIATE (NEW): GROUP – I

PAPER – 1: ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) (i) Statement showing amount of depreciation as per Componentization Method

Component	**Depreciation (Per annum) (Rs.)**
Land	Nil
Roof	60,000
Lifts	37,500
Fixtures	25,000
Remainder of Building	80,000
	2,02,500

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognised as a new component.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10 PPE.

(b) (i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2018. Subsequently in 2018-19, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

(c) As per AS 2 "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product X is Rs. 300 and total cost per unit for production is Rs. 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at Rs. 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost Rs. 320 (Rs. 260 + additional cost Rs. 60) or Net estimated selling price or NRV i.e.Rs. 240 (Estimated selling price Rs. 300 per unit less additional cost of Rs. 60).

(iii) 1,500 units of finished product X will be valued at NRV of Rs. 300 per unit since it is lower than cost Rs. 320 of product X.

Valuation of Total Inventory as on 31.03.2019:

	Units	*Cost (Rs.)*	*NRV/Replacement cost*	*Value = units x cost or NRV whichever is less (Rs.)*
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000
Finished goods X	1,500	320	300	4,50,000
Value of Inventory				6,24,000

(d) **(i)** **False;** As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

(ii) **False;** As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

(iii) **True;** To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed at one place.

(iv) **False;** Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

(v) **True**; As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

2. (a) **M & S Co. Ltd.**

Canberra, Australia Branch Trial Balance
As on 31st March 2019

	($ ' thousands)				(Rs.' thousands)
	Dr.	Cr.	Conversion rate per $	Dr.	Cr.
Plant & Machinery (cost)	200		Rs. 46	9,200	
Plant & Machinery Dep. Reserve		130	Rs. 46		5,980
Trade receivable/payable	60	30	Rs. 53	3,180	1,590
Stock (1.4.2018)	20		Rs. 50	1,000	
Cash & Bank Balances	10		Rs. 53	530	
Purchase / Sales	20	123	Rs. 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		Rs. 51	2,295	
Rent	12		Rs. 51	612	
Office expenses	18		Rs. 51	918	
Commission Receipts		100	Rs. 51		5,100
H.O. Current A/c		7	Actual		120
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				208	
	390	390		19,063	19,063
Closing stock	3.125		53	165.625	

Trading and Profit & Loss Account for the year ended 31st March, 2019

							(Rs.'000)
	H.O.	*Branch*	*Total*		*H.O.*	*Branch*	*Total*
To Opening Stock	100	1,000.000	1,100.000	By Sales	520	6,273.000	6,793.000
To Purchases	240	1,020.000	1,260.000	By Goods sent to Branch	100	–	100.000
To Goods received from Head Office	–	100.000	100.000	By Closing Stock	150	165.625	315.625
To Wages & Salaries	75	2,295.000	2,370.000				
To Gross profit c/d	355	2,023.625	2,378.625				
	770	6,438.625	7,208.625		770	6,438.625	7,208.625
To Rent	–	612.000	612.000	By Gross profit b/d	355	2,023.625	2,378.625
To Office expenses	25	918.000	943.000	By Commission receipts	256	5,100.000	5,356.000
To Provision for doubtful debts @ 5%	14	159.000	173.000				

To Depreciation (W. N.)	460	644.000	1,104.000				
To Balance c/d	112	4,790.625	4,902.625				
	611	7,123.625	7,734.625		611	7,123.625	7,734.625
To Managing Partner's Salary			30.000	By Balance b/d			4,902.625
To Exchange Loss			208.000	By Branch stock reserve			4.000
To Balance c/d			4,668.625				
			4,906.625				4,906.625

Working Note:

Calculation of Depreciation

	H.O Rs. '000	*Branch Rs. '000*
Building - Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,500	9,200
Less: Dep. Reserve	(600)	(5,980)
	1,900	3,220
Depreciation @ 20% (B)	380	644
Total Depreciation (A+B)	460	644

Note: As the closing stock of Branch does not consist any stock transferred from M& S Co., there is no need to create closing stock reserve. But the opening branch stock reserve has to be reversed in the P&L A/c.

(b) Departmental Trading Account for the year ended on 31st December, 2018

Particulars	*A*	*B*	*Particulars*	*A*	*B*
	Rs.	Rs.		Rs.	Rs.
To Opening Stock	3,00,000	2,40,000	By Sales	60,00,000	90,00,000
To Purchases	39,00,000	54,60,000	By Closing Stock	6,00,000	12,00,000
To Gross Profit	24,00,000	45,00,000			
	66,00,000	1,02,00,000		66,00,000	1,02,00,000

General profit and loss account of Beta for the year ended on 31st December, 2018

Particulars	*Amount*	*Particulars*	*Amount*
	Rs.		Rs.
To General expenses*	7,50,000	By Stock reserve (opening stock)	

* *General expenses have not been allocated to individual department and are charged to General Profit and Loss Account.*

To Stock reserve (Closing Stock)		Dept. A	30,000
Dept. A	60,000	Dept. B	36,000
Dept. B	72,000	By Gross Profit	
To Net Profit	60,84,000	Dept. A	24,00,000
		Dept. B	45,00,000
	69,66,000		69,66,000

Working Notes:

		Dept. A	Dept. B
1.	Percentage of Profit	24,00,000/60,00,000 x 100 40%	45,00,000/90,00,000 x 100 50%
2.	Opening Stock reserve	60,000 x 50% = 30,000	90,000 X 40% = 36,000
3.	Closing Stock reserve	1,20,000 x 50%=60,000	1,80,000 x 40% = 72,000

3. (a) Balance Sheet of the Firm as at 30.6.2019

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital Accounts:			Machinery	3,60,000	
Ali balance as on 1.1.2019	2,80,800		*Less*: Depreciation @ 10% p.a. for 6 months	(18,000)	3,42,000
Add: Profit for 6 months	28,320		Leasehold premises	81,600	
	3,09,120		*Less*: Written-off @ 5%		
Less: Drawings for 6 months	(14,160)	2,94,960	for 6 months	(4,080)	77,520
Beta balance as on 1.1.2019	2,66,400		Stock		1,80,000
Add: Profit for 6 months	28,320		Sundry Debtors		1,44,000
	2,94,720				
Less: Drawings for 6 months	(14,160)	2,80,560			
Sundry Creditors (1,44,000 – 24,000)		1,20,000			
Bank overdraft (84,000 – 36,000)		48,000			
		7,43,520			7,43,520

(b) Realization Account

	Particulars	Rs.		Particulars	Rs.
To	Machinery A/c	3,42,000	By	Sundry Creditors A/c	1,20,000
To	Leasehold Premises A/c	77,520	By	Bank Overdraft A/c	48,000
To	Stock A/c	1,80,000	By	Purchasing Company A/c (W.N.1)	8,15,520
To	Sundry Debtors A/c	1,44,000			
To	Ali Capital A/c	1,20,000			

To Beta Capital A/c	1,20,000		
	9,83,520		9,83,520

(c) **Partners' Capital Accounts**

Date	Particulars	Ali	Beta	Date	Particulars	Ali	Beta
		Rs.	Rs.			Rs.	Rs.
1.1.19	To Profit & Loss A/c	31,200	31,200	1.1.19	By Balance b/d	3,36,000	3,12,000
	To Drawings A/c	24,000	14,400				
29.6.19	Balance c/d	2,80,800	2,66,400				
		3,36,000	3,12,000			3,36,000	3,12,000
30.6.19	To Drawings A/c	14,160	14,160	30.6.19	By Balance b/d	2,80,800	2,66,400
	To Shares in Purchasing Company A/c	4,14,960	4,00,560	30.6.19	By Profit & Loss Appropriation A/c	28,320	28,320
					By Realization A/c	1,20,000	1,20,000
		4,29,120	4,14,720			4,29,120	4,14,720

Working Notes:

(1) Ascertainment of purchase consideration

	Rs.	Rs.
Assets:		
Stock		1,80,000
Sundry Debtors		1,44,000
Machinery less depreciation		3,42,000
Leasehold premises less written off		77,520
		7,43,520
Less: Liabilities:		
Sundry Creditors	1,20,000	
Bank overdraft	48,000	
		(1,68,000)
Closing Net Assets		5,75,520
Add: Goodwill		2,40,000
Purchase Consideration		8,15,520

(2) Ascertainment of profit for the 6 month ended 30th June, 2019

	Rs.	Rs.
Closing Net Assets		5,75,520

Less: Opening Combined Capital		
Ali – (3,36,000- 31,200-24,000)	2,80,800	
Beta – (3,12,000-31,200-14,400)	2,66,400	5,47,200
Profit after adjustment of Drawings		28,320
Add: Combined drawings during the 6 month (equal to profit)		28,320
Profit for 6 months		56,640

(b) Nature of Limited Liability Partnership: A limited liability partnership is a body corporate formed and incorporated under the LLP Act, 2008 and is a legal entity separate from that of its partners. A limited liability partnership shall have perpetual succession and any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Designated partners: Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

In case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

4. (a) Ascertainment of rate of gross profit for the year 2015-16

Trading A/c for the year ended 31-3-2016

	₹		₹
To Opening stock	4,81,100	By Sales	26,00,000
To Purchases	22,62,500	By Closing stock	6,63,600
To Gross profit	5,20,000		
	32,63,600		32,63,600

Rate of gross profit = $\frac{\text{GP}}{\text{Sales}} \times 100 \quad = \frac{5,20,000}{26,00,000} \times 100 \ = 20\%$

Memorandum Trading A/c for the period from 1-4-2016 to 22-01-2017

	₹	₹		₹	₹
To Opening stock		6,63,600	By Sales	24,58,500	
To Purchases	17,41,350		*Add*: Unrecorded cash sales (W.N.)	20,000	24,78,500
Less: Goods used for advertisement	(50,000)	16,91,350	By Closing stock		3,72,150
To Gross profit (20% of ₹ 24,78,500)		4,95,700			
		28,50,650			28,50,650

Estimated stock in hand on the date of fire was ₹ 3,72,150.

Working Note:

Cash sales defalcated by the Accountant:

Defalcation period = 1.4.2016 to 18.8.2016= 140 days

Since, 140 days / 7 weeks = 20 weeks

Therefore, amount of defalcation = 20 weeks × ₹ 1,000 = ₹ 20,000.

(b) **Investment Account-Equity Shares in X Ltd.**

Date		*No. of shares*	*Dividend*	*Amount*	*Date*		*No. of shares*	*Dividend*	*Amount*
			Rs.	*Rs.*				*Rs.*	*Rs.*
2018					2019				
April 1	To Balance b/d	4,000	-	60,000	Jan. 20	By Bank (dividend)		8,000	2,000
Sept 1	To Bank	1,000	-	14,000	Feb. 1	By Bank	4,000		56,000
Sept.30	To Bonus Issue	2,000		—	Mar. 31	By Balance c/d	4,000		42,250
Dec.1	To Bank (Right)	1,000	-	12,500					
2019									
Feb. 1	To Profit & Loss A/c			13,750					
Feb. 1	To Profit & Loss A/c (Dividend income)		8,000						
		8,000	8,000	1,00,250			8,000	8,000	1,00,250
April. 1	To Balance b/d	4,000		42,250					

Working Notes:

1. **Cost of shares sold — Amount paid for 8,000 shares**

	Rs.
(Rs. 60,000 + Rs. 14,000 + Rs. 12,500)	86,500
Less: Dividend on shares purchased on 1st Sept, 2018	(2,000)
Cost of 8,000 shares	84,500
Cost of 4,000 shares (Average cost basis*)	42,250
Sale proceeds (4,000 shares @ 14/-)	56,000
Profit on sale	13,750

* For ascertainment of cost for equity shares sold, average cost basis has been applied.

2. **Value of investment at the end of the year**

   Closing balance will be valued based on lower of cost (Rs. 42,250) or net realizable value (Rs.13 x 4,000). Thus investment will be valued at Rs. 42,250.

3. **Calculation of sale of right entitlement**

   1,000 shares x Rs. 8 per share = Rs. 8,000

   Amount received from sale of rights will be credited to P & L A/c as per AS 13 'Accounting for Investments'.

4. **Dividend received on investment held as on 1st April, 2018**

= 4,000 shares x Rs. 10 x 20%

= Rs. 8,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1stSep. 2018

= 1,000 shares x Rs. 10 x 20% = Rs. 2,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30th Sept., 2018 and dividend pertains to the year ended 31.3.2018.

(c) Determination of Capital balances of Mr. Aman on 31.3.2018 and 31.3.2019

	31.3.2018	*31.3.2019*
	Rs.	*Rs.*
Assets	16,65,000	28,40,000
Less: Liabilities	(4,13,000)	(5,80,000)
Capital	12,52,000	22,60,000

Determination of Profit by applying the method of the capital comparison

	Rs.
Capital Balance as on 31-3-2019	22,60,000
Less: Fresh capital introduced (matured life insurance policy amount)	(50,000)
	22,10,000
Add: Drawings (Rs. 32,000 × 12)	3,84,000
	25,94,000
Less: Capital Balance as on 1.4.2018	(12,52,000)
Profit	13,42,000
Income declared	9,12,000
Suppressed Income	4,30,000

The Income-tax officer's contention that Mr. Aman has not declared his true income is correct. Mr. Aman's true income is in excess of the disclosed income by Rs. 4,30,000.

Note:

- Closing capital is increased due to fresh capital introduction, so it is deducted.
- Closing capital was reduced due to withdrawal by proprietor; so it is added back.

5. (a) Cash Flow Statement as per AS 3

		Rs. in lacs
Cash flows from operating activities: Net profit before tax provision		36,000
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048

		72,048
Less: Non cash income		
Amortisation of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Sale of assets (222 – 48)	174	
Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of fixed assets	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,168)
Cash flows from financing activities:		
Grants for capital projects	18	
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,640
Net increase in cash		2,000
Add: Cash and bank balance as on 1.4.2018		6,000
Cash and bank balance as on 31.3.2019		8,000

(b) Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceeds the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

(c) **Calculation of effective capital and maximum amount of monthly remuneration**

	(Rs. in lakhs)
Paid up equity share capital	180

Paid up Preference share capital	30
Reserve excluding Revaluation reserve (225- 15)	210
Securities premium	60
Long term loans	60
Deposits repayable after one year	30
	570
Less: Accumulated losses not written off	(30)
Investments	(270)
Effective capital for the purpose of managerial remuneration	270

Since PQ Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of effective capital of the company, therefore maximum remuneration payable to the Managing Director should be @ Rs. 60,00,000 per annum.

Note: Revaluation reserve and application money pending allotment are not included while computing effective capital of PQ Ltd.

6. (a)

Capital Redemption Reserve A/c	Dr.	30,000	
Securities Premium A/c	Dr.	40,000	
General Reserve A/c	Dr.	30,000	
To Bonus to Shareholders			1,00,000
(Being issue of bonus shares by utilization of various Reserves, as per resolution dated …….)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital			1,00,000
(Being capitalization of Profit)			

(b) A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of Rs. 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of Rs. 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

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

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

Thus, eligible borrowing cost

= Rs. 11,00,000 – Rs. 2,00,000

= Rs. 9,00,000

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

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

OR

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of Rs. 1,000 lakhs depreciation, timing difference amounting Rs. 400 lakhs (Rs. 50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for Rs. 600 lakhs (Rs. 1,000 lakhs – Rs. 400 lakhs), deferred tax liability will be recognized for Rs. 240 lakhs (40% of Rs. 600 lakhs) in first year. In the second year, the entire amount of timing difference of Rs. 2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting Rs. 800 lakhs (40% of Rs. 2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be Rs. 1,040 lakhs (240 lakhs + 800 lakhs).

(d) Nominal value of preference shares Rs.5,00,000

Maximum possible redemption out of profits Rs.3,00,000

Minimum proceeds of fresh issue Rs.5,00,000 - 3,00,000 = Rs.2,00,000

Proceeds of one share = Rs.9

Minimum number of shares $= \frac{2,00,000}{9} = 22,222.22$ shares

As fractional shares are not permitted, the minimum number of shares to be issued is 22,223 shares.

If shares are to be issued in multiples of 50, then the next higher figure which is a multiple of 50 is 22,250. Hence, minimum number of shares to be issued in such a case is 22,250 shares.