

# Suggested Answer\_Syl08\_Dec13\_Paper 5

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## INTERMEDIATE EXAMINATION

### GROUP I

(SYLLABUS 2008)

## SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2013

### Paper-5: FINANCIAL ACCOUNTING

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

Answer Question No. 1 which is compulsory and any five questions from rest in this section.

1.

(a) From the four alternative answers given against each of the following cases, indicate the correct answer:(just state A, B, C or D) 1×6=6

(i) The concept that business is assumed to exist for an indefinite period and is not established with the objective of closing down is referred to as

- (A) Money Measurement concept
- (B) Going Concern concept
- (C) Full Disclosure concept
- (D) Dual Aspect concept

(ii) The outflow of funds to acquire an asset that will benefit the business for more than one accounting period is referred to as

- (A) Miscellaneous Expenditure
- (B) Revenue Expenditure
- (C) Capital Expenditure
- (D) Deferred Revenue Expenditure

(iii) Which of the following item(s) is (are) shown in the Income and Expenditure Account?

- (A) Only items of Capital nature
- (B) Only items of Revenue nature, which are received during the period of Accounts
- (C) Only items of Revenue nature pertaining to the period of Accounts
- (D) Both the items of Capital and Revenue nature

(iv) As per Insurance Regulatory and Development Authority Regulations, an Insurance Company is required to prepare

- (A) Balance Sheet
- (B) Revenue Account
- (C) Profit and Loss Account
- (D) All of the above

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(v) Ground Rent or Surface rent means

- (A) Minimum Royalty Payable
- (B) Maximum Royalty Payable
- (C) Fixed rent payable in addition to minimum rent
- (D) Rent recovered at the end of lease term

(vi) AS-2 is not applicable to

- (A) Inventories held for sale in ordinary course of business
- (B) Work in progress arising in the ordinary course of business of service provider
- (C) Inventories in the process of production for sale in ordinary course of business
- (D) Inventories in form of material or supplies for the process of production

(b) State whether the following statements are TRUE (T) or FALSE (F): 1×5=5

- (i) The useful life of a depreciable asset is the period over which the asset is expected to be used by the enterprise, which is generally greater than the physical life.
- (ii) As per agreed term in the Royalty agreement, short workings can be recouped in the year when the actual royalty is more than minimum rent.
- (iii) Gain Ratio is generally concerned with the situation of admission of a Partner.
- (iv) Every banking company incorporated in India is required to transfer at least 25% of its profit to Reserve Fund.
- (v) Branch Stock Account is always prepared at cost price.

(c) Fill in the blanks in the following sentences using appropriate word from the alternatives indicated: 1×5=5

- (i) After the transactions are posted to various ledger accounts (either from journal or from subsidiary books), they are \_\_\_\_\_ while preparing Trial Balance for an enterprise. (added, balanced)
- (ii) One of the characteristics of Depreciation is that it is a \_\_\_\_\_ against profit. (charge, appropriation)
- (iii) In a hire purchase system of maintaining accounts, when there is default in making payments in appropriate time, the owner takes back the \_\_\_\_\_ of the goods. (ownership, possession)
- (iv) In Branch Accounting system, the Branch prepares the periodic returns based on which the accounting records are maintained at the \_\_\_\_\_ office. (Head, Branch)
- (v) There is no need to transfer to General reserve if the proposed dividend does not exceed \_\_\_\_\_ (10 or 20) per cent.

(d) Match the following in Column I with the appropriate item in Column II: 1×5=5

Column I	Column II
(i) Undervaluation of Asset	(A) Insurance Account
(ii) AS-24	(B) Segment Reporting
(iii) Average Clause	(C) Intangible Asset

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(iv) AS-17  
(v) AS-26

(D) Discontinuing Operation  
(E) Secret Reserve  
(F) No matching statement found

(e) In the following cases, one out of four answers given is correct. Indicate the correct answer (= 1 mark) and give brief workings in support of your answer (= 1 mark): (1+1)×2=4

(i) Salary debited to Income and Expenditure Account for the year was ₹ 48,000. Outstanding salary paid in the beginning of the year and the outstanding salary at the end of the year were ₹ 6,000 and ₹ 7,500 respectively. The amount of Salary to be shown in Receipts and Payments Account will be:

- (A) ₹ 48,000
- (B) ₹ 40,500
- (C) ₹ 54,000
- (D) ₹ 46,500

(ii) A Company purchased a Machine costing ₹ 15 Lakh for its production process. It paid Freight ₹ 25,000, Cartage ₹ 2,000 and installation charges ₹ 18,000. The Company spent an additional amount of ₹ 40,000 for testing and preparing the Machine for use. As per AS-10, the amount that should be recorded as the cost of Machine would be:

- (A) ₹ 15,00,000
- (B) ₹ 15,25,000
- (C) ₹ 15,85,000
- (D) ₹ 15,65,000

### Answer

(a)

- (i) B — Going Concern concept
- (ii) C — Capital Expenditure
- (iii) C — Only items of Revenue nature pertaining to the period of Accounts
- (iv) D — All of the above
- (v) C — Fixed rent payable in addition to minimum rent
- (vi) B — Work in progress arising in the ordinary course of business of service provider

(b)

- (i) False
- (ii) True
- (iii) False
- (iv) False (The current rate is 20%)
- (v) False

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(c)

(i) Balanced

(ii) Charge

(iii) Possession

(iv) Head

(v) 10

(d)

(i) E — Secret Reserve

(ii) D — Discontinuing Operation

(iii) A — Insurance Account

(iv) B — Segment Reporting

(v) C — Intangible Asset

(e)

(i) D — ₹ 46,500

	₹
Salary debited to Income & Expenditure A/c	48,000
<b>Add:</b> Outstanding Salary at beginning	<u>6,000</u>
	54,000
<b>Less:</b> Outstanding salary at end of the year	<u>7,500</u>
	46,500
Amount of salary paid during the year to Be shown in Receipts & Payments A/c	<u>46,500</u>

(ii) C — ₹ 15,85,000

[₹ 15,00,000 + 25,000 + 2,000 + 18,000 + 40,000]

2.

(a) A company was incorporated on 1st August, 2012 to take over a business from 1st April 2012. The accounts were made up to 31st March, 2013 as usual and the trading and profit and loss account gave the following result:

Particulars	₹	Particulars	₹
To Opening Stock	1,40,000	By Sales	12,00,000
„ Purchase	9,10,000	„ Closing Stock	1,50,000
„ Gross Profit	3,00,000		
	13,50,000		13,50,000
To Rent, rates & insurance	18,000	By Gross Profit b/d	3,00,000
„ Directors fees	20,000		
„ Salaries	51,000		

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,, Office expenses	48,000	
,, Travellers commission	12,000	
,, Discounts	15,000	
,, Bad debts	3,000	
,, Audit fees	8,500	
,, Depreciation	6,000	
,, Debenture interest	4,500	
,, Net Profit	1,14,000	
	3,00,000	3,00,000

It is ascertained that the sales for November and December are one and half times the average of those for the year, whilst those for February and April are only half the average, all the remaining months having average sales. Apportion the year's profit between pre and post incorporation periods.

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(b) Mr. Agarwal could not agree the Trial Balance. He transferred to the Suspense Account of ₹ 296, being excess of the debit side total. The following errors were subsequently discovered,

- Sales Day Book was overcast by ₹ 300
- An amount of ₹ 55, received from Mr. Y was posted to his account as ₹ 550
- Purchases Return Book total on a folio was carried forward as ₹ 221, instead of ₹ 112
- A car sale of ₹ 1,235 duly entered in the Cash Book but posted to Sales A/c as ₹ 235
- Rest of the difference was due to wrong total in Salaries A/c. Show the Journal entries to rectify the above errors.

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### Answer

(a) Apportionment of the year's profit between pre- and post-incorporation periods.

Particulars	Basis of apportionment	Total	Pre incorporation	Post incorporation
Gross Profit (A)	Sales ratio (3.5: 8.5)	3,00,000	87,500	2,12,500
<b>Expenses:</b>				
Rent, Rates & insurance	Time ratio (1:2)	18,000	6,000	12,000
Salaries	"	51,000	17,000	34,000
Office expenses	"	48,000	16,000	32,000
Audit fees	"	8,500	2,833	5,667
Depreciation	"	6,000	2,000	4,000
Director's fee	Allocation	20,000	—	20,000
Debenture interest	"	4,500	—	4,500
Travellers commission	Sales ratio (3.5: 8.5)	12,000	3,500	8,500
Discounts	"	15,000	4,375	10,625

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Bad debts	"	3,000	875	2,125
Total expenses (B)		1,86,000	52,583	1,33,417
Net Profit (A-B)		1,14,000	34,917	79,083

### Working notes:

1.	Time ratio:	
	Pre incorporation period from 1.4.12. to 31.7.12,	= 4 months
	Post incorporation period from 1.8.12. to 31.3.13	= 8 months
	Time ratio	= 4: 8 or 1:2
2.	Sales ratio:	
	Total sales for the year	12,00,000
	Average sales per month ₹ 12,00,000 /12	1,00,000
	Sales in pre-incorporation period:	
	April, ½ of Average sale	50,000
	May, Average sale	1,00,000
	June, average sale	1,00,000
	July, average sale	1,00,000
	Pre incorporation sales	3,50,000
	Sales in post incorporation period:	
	Sales of August to October, at average sale, each month	
	3 x 1,00,000=	3,00,000
	Sales of November and December at $\frac{1}{2}$ times the average,	
	each month = 2 X 1.5 X 1,00,000 =	3,00,000
	Sales of January – average	1,00,000
	Sales of February -1/2 of average	50,000
	Sales of March – average	1,00,000
	Post incorporation sales	8,50,000
	Sales ratio = 3,50,000: 8,50,000 or 3.5: 8.5	
3.	Audit fees is divided on time basis. It can also be treated as fully chargeable to post incorporation period. In that case, the answer will be different. Pre-incorporation profit will be ₹37,750 and Post-incorporation profit will be ₹76,250.	

(b)

### In the books of Mr. Agarwal Journal Entries

Date	Particulars		Amount (₹)	Amount (₹)
1.	Sales A/c	Dr.	300	
	To, Suspense A/c			300
	(Being Sales Book overcast by now rectified)			
2.	YA/c	Dr.	495	

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	To, Suspense A/c (Being amount received from Mr. Agarwal for ₹ 55 wrongly recorded as ₹ 550 now rectified)			495
3.	Returns Outward A/c To, Suspense A/c (Being the total of purchases returns book was carried forward as ₹ 221, instead of ₹ 112 now rectified)	Dr.	109	109
4.	Suspense A/c Sales A/c To, Car A/c./Sale of Asset A/c. (Being cash sales being ₹ 1,235 recorded only ₹ 235 as Sales A/c now rectified)	Dr. Dr.	1,000 235	1,235
5.	Suspense A/c To, Salaries A/c (Being Salary A/c was overcast by ₹ 200 now rectified)	Dr.	200	200

3.

(a) Classify the following Accounts into Personal, Real and Nominal Accounts:

- (i) Patent Rights a/c
- (ii) Drawings a/c
- (iii) Purchase Return a/c
- (iv) South Sports Club a/c
- (v) Prepaid Insurance a/c
- (vi) Charity a/c
- (vii) Bank Overdraft a/c
- (viii) Free samples a/c

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(b) Pass the Journal entries in the books of Head Office to record the following transactions for the year ending 31st March, 2013:

- (i) Head Office collected ₹24,500 from a customer of Delhi Branch.
- (ii) Jaipur Branch paid ₹80,000 for purchase of Office Computer by Head Office for Delhi Branch.
- (iii) Goods sent by Head Office to Jaipur Branch valued ₹45,000 wrongly Debited to Delhi Branch in the Books of Head Office.
- (iv) Goods returned by Delhi Branch valued ₹4,800 on 26th March, 2013, was received by Head Office on 3rd April, 2013.

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(c) From the following particulars of Ritu Limited, you are required to calculate Managerial Remuneration in the following situations:

- (i) There is only one Whole-Time Director,
- (ii) There are two Whole-Time Directors,
- (iii) There are two Whole-Time Directors and one part time Director and Manager

₹

Net Profit before Tax and Managerial remuneration,

but after Depreciation

15,70,410

Depreciation provided in the Books

4,80,000

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Depreciation allowable under Schedule XIV

4,10,000

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- (d) X and Y share profits in the ratio of 3:2. Z joins them with 1/4th share. Find out the sacrificing ratio. 2

Answer

(a)

Real A/c — (i) Patent Rights A/c  
 Personal A/c — (ii) Drawings A/c, (iv) South Sports club A/c, (v) Prepaid Insurance A/c,  
 (vii) Bank Overdraft A/c  
 Nominal A/c- (iii) Purchase Return A/c, (vi) Charity A/c, (vii) Free Samples A/c

(b) Journal Entries in the Books of Head Office

		Dr. (₹)	Cr. (₹)
(i)	Bank A/c To Delhi Branch A/c (Being amount received here from Delhi Branch customer)	24,500	24,500
(ii)	Delhi Branch Fixed Assets ( Computer) A/c To Jaipur Branch A/c (Being amount paid by Jaipur Branch for purchase of Computer for Delhi Branch)	80,000	80,000
(iii)	Jaipur Branch A/c To Delhi Branch A/c (Being reversal of wrong entry)	45,000	45,000
(v)	Goods in Transit A/c To Delhi Branch A/c (Being goods returned by Delhi Branch on 26/3/13 lying in transit)	4,800	4,800

(c) Calculation of Net Profit u/s 349 of Companies Act

Net Profit before Tax and managerial remuneration	₹ 15,70,410
<b>Add back</b> – Depreciation as provided in the Books	4,80,000
<b>Less</b> – Depreciation allowable under Schedule XIV	<u>4,10,000</u>
Profit u/s 349	16,40,410
Managerial Remuneration	

Situation (i) - 5% of ₹ 16,40,410 = ₹ 82,021  
 Situation (ii) - 10% of ₹ 16,40,410 = ₹ 1,64,041  
 Situation (iii) - 11% of ₹ 16,40,410 = ₹ 1,80,445

(d) Computation of Sacrificing Ratio

Z 's share: 1/4	
Balance available for share by X & Y is	$1 - 1/4 = 3/4$
Share of X ( Old ratio x new ratio)	$3/5 \times 3/4 = 9/20$
Share of Y	$2/5 \times 3/4 = 6/20$
Hence New Ratio	9 : 6 : 5
Sacrificing ratio	Old Ratio - New ratio
X = 3/5 minus 9/20	3/20



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Y = 2/5 minus 6/20	2/20
Sacrificing ratio	3 : 2

4.

- (a) Jaggu, Makkhu and Tikku are partners sharing Profit and Loss in the ratio of 3 : 2 : 1. The Balance Sheet of the Firm as on 31st March, 2013 was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	2,10,000	Cash in Hand	19,400
Bills Payable	50,000	Bill Receivable	28,600
General Reserve	75,000	Sundry Debtors	2,60,000
Investment Fluctuation Reserve	18,000	Stock	2,10,000
Bank Loan	2,50,000	Investments	1,10,000
Capital A/Cs		Joint Life Policy	85,000
Jaggu	3,60,000	(surrender value = ₹ 4,00,000)	
Makkhu	2,50,000	Plant & Machinery	2,00,000
Tikku	1,50,000	Land & Building	4,50,000
	13,63,000		13,63,000

Tikku Died on 31st May, 2013. He was entitled to an annual salary of ₹ 30,000 and Interest on Capital @ 15% per annum. According to Partnership deed, Goodwill is to be valued at rate of 2 years purchase on the basis of average of 5 year's profit or loss. Profit for April and May, 2013 is to be calculated proportionately on the average profit of last 2 years.

The Profit and loss for last 5 years were:

Year 2008-09 ₹ 1,02,000; Year 2009-10 ₹ 1,38,000, Year 2010-11 (Loss) ₹ 35,000 and Year 2012-13 ₹ 1,45,000 year 2011-12 ₹95,000(profit)

The full amount of Joint Life Policy of ₹ 4,00,000 was received by the Firm and the stock, Plant & Machinery were revalued at 90% of their Book value. Land & Building was revalued at 125% of Book value.

You are required to prepare an account showing amount payable to Tikku's executors.

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- (b) The Income & Expenditure Account of Jayashree Sangha Club for the year ended 31.12.2012 is given below:

Expenditure		Amount (₹)	Income		Amount (₹)
To	Salaries	20,500	By	Subscription	52,000
,,	Newspaper	1,500	,,	Sale of Newspaper	2,500
,,	Audit Fees	2,500	,,	Admission Fees	12,000
,,	General Expenses	22,000	,,	Donation	15,000
,,	Printing & Stationery	7,500	,,	Misc. Income	500
,,	Travelling Expenses	2,000			
,,	Rent	3,500			
,,	Depreciation on Furniture	2,500			
,,	Surplus	20,000			

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	82,000	82,000
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The following is the Balance Sheet of the Club as on 31.12.11

Liabilities	Amount (₹)	Assets	Amount (₹)
Outstanding salary	2,000	Furniture	15,000
Subscription received in advance	2,500	Sports equipment	20,000
Accumulated Fund	45,500	Accrued Subscription	5,000
		Cash at Bank	10,000
	50,000		50,000

Prepare Receipts & Payments Account for the year ended 31.12.2012 taking into account the following adjustments:

- (i) Subscription received in advance ₹ 1,500
- (ii) Salary due for ₹ 1,500 but not paid for the year
- (iii) 60% of the admission fee to be capitalized
- (iv) Subscription due for 2012 but not received ₹ 3,000

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**Answer**

(a) Account showing amount payable to Tikku's Executors

	₹		₹
To Balance c/d	2,71,667	By Balance b/d	
		(Tikku's capital a/c)	1,50,000
		By General reserve a/c	
		(₹ 75,000 × 1/6)	12,500
		By Investment Fluctuation	
		reserve a/c (₹ 18,000 × 1/6)	3,000
		By Tikku's salary (₹ 30,000 × 2/12)	5,000
		By Interest on capital	
		(₹ 1,50,000 × 15/100 × 2/12)	3,750
		By P&L suspense a/c -profit share	
		(₹ 1,20,000 × 2/12 × 1/6)	3,333
		By Share in goodwill	
		Jaggu's capital a/c- 17,800	
		- Makkhu's Capital a/c-11,867	29,667
		By Revaluation a/c - share of Profit	11,917
		By Joint life policy a/c	
		(₹ 4,00,000 - 85,000) × 1/6	52,500
	2,71,667		2,71,667

**Workings:-**

- (i) Goodwill-  
Average Profit of last 5 years × 2

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$$= \frac{₹102000 + 138000 + 35000 \text{ loss} + 95000 + 145000}{5} \times 2$$

$$₹ 89,000 \times 2 = ₹ 1,78,000$$

Tikku's share in Goodwill =  $1,78,000 \times 1/6 = ₹ 29,667$  (Share 3:2 between Jaggu and Makkhu)

(ii) Share in Profit for April and May -2013

$$= \frac{₹95,000 + 1,45,000}{2} = ₹ 1,20,000 \times 2/12 \times 1/6 = ₹ 3,333$$

(iii) Profit on revaluation =  $₹ 4,50,000 \times 25\% - (21,000 - 20,000) = ₹ 71,500$

Tikku's Share =  $₹ 71,500 \times 1/6 = ₹ 11,917$

(b)

### Jayashree Sangha Club

Receipt and Payment Account for the year ended 31.12.12

Receipts	Amount (₹)	Payments	Amount (₹)
To Balance b/d	10,000	By Salary a/c(w/n-2)	21,000
To Admission Fees ₹ 12,000/40%	30,000	By General Expenses	22,000
To Sale of News Paper	2,500	By Audit Fees	2,500
To Donation	15,000	By Printing & Stationery	7,500
To Misc. Income	500	By Rent	3,500
To Subscription (w/n-1)	53,000	By Travelling Exp	2,000
		By News Paper	1,500
		By Balance c/d at 31.12.12	51,000
	1,11,000		1,11,000

### Balance Sheet as at 31.12.12

Liabilities	Amount (₹)	Assets	Amount (₹)
Accumulated Fund 45,500		Sports Equipment	20,000
Add Surplus <u>20,000</u>	65,500	Furniture 15,000	
Admission Fees	18,000	Less: Depreciation <u>2,500</u>	12,500
Subscription received in advance	1,500	Accrued Subscription	3,000
Outstanding Salaries	1,500	Cash at Bank	51,000
	86,500		86,500

**Working Notes :-**

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w/n-1 - Subscription received during the year

Subscription on accrual basis for 2012

**Add:** Subscription of 2011 received in 2012

52,000

5,000

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Subscription received in advance		1,500	
		58,500	
<b>Less:</b> Subscription for 2012	₹ 3000		
Subscription for 2012 recd. In 2011	2500	5,500	
		53,000	
w/n-2- Salary paid in 2012			
Salary as per Income & Expenditure a/c		20,500	
<b>Add:</b> paid for 2011		2,000	
<b>Less:</b> Outstanding for 2012		1,500	
		21,000	

5.

- (a) For the year ending 31st March, 2013 accounting income of Mithi Limited is ₹ 25 Lakh. However, its taxable income was ₹18 Lakh due to timing differences. Discuss treatment of Income Tax in the Accounts for the year 2012-2013, if applicable tax rate is 30%. 5
- (b) The life insurance fund of Bharat Life Insurance Co. Ltd. was ₹ 34 lakh on 31.03.2013. Its actuarial valuation on 31.03.2013 disclosed a net liability of ₹ 28.80 lakh. An Interim Bonus of ₹ 40,000 was paid to the Policy Holders during the previous two years. It is now proposed to carry forward ₹ 1.10 lakh and to divide the balance between Policy Holders and Share Holders. You are required to show (i) the valuation Balance Sheet, (ii) the net profit for the two year period and(iii) the distribution of profits. 2+2+2=6
- (c) While finalising the Accounts for the year 2012-13 it was realised that XY Ltd. stands to receive ₹ 10 lakh from its customers in respect of sales made in 2012-13 due to price revision granted by the Government.

You are required to advise the Company regarding the treatment of the amount in the Accounts for the year quoting relevant Accounting Standard. 4

**Answer**

- (a) Tax on Accounting Income - 30% of ₹ 25 Lakhs = ₹ 7.5 Lakhs  
 Tax on Taxable Income - 30% of ₹ 18 Lakhs = ₹ 5.4 Lakhs  
 Hence Tax Expense is ₹ 7.5 lakhs and current tax is ₹ 5.4 lakhs  
 Deferred Tax is (₹ 7.5 Lakhs - ₹ 5.4 Lakhs) = ₹ 2.1 lakhs  
 In this case it is a tax liability for future years, and Journal entry will be:-

Particulars	Dr. (₹)	Cr. (₹)
Profit and Loss A/c Dr. To Current Tax a/c To Deferred Tax Liability	7,50,000	5,40,000 2,10,000

- (b) **In the books of Bharat Life Insurance Co. Ltd.**  
 Valuation Balance Sheet as on 31 -3-2013

Particulars	₹	Particulars	₹
To Net Liability	28,80,000	By Life Insurance Fund	34,00,000
To Net Profit	5,20,000		
	34,00,000		34,00,000

Net Profit for two year period.		₹	
Profit as per valuation Balance Sheet		5,20,000	

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<b>Add:</b> Interim Bonus paid during previous two years	40,000
Net profit	<u>5,60,000</u>
Distribution of Profit:	
Net Profit	5,60,000
<b>Less:</b> Amount proposed to be carried forward	<u>1,10,000</u>
	<u>4,50,000</u>
Share of Policy Holders (95% of Rs 4,50,000)	4,27,500
<b>Less:</b> Interim Bonus paid	<u>40,000</u>
Amount paid to policy holders	<u>3,87,500</u>
Share of Share holders (5% of ₹ 4,50,000)	<u>22,500</u>

- (c) As per AS -9, where any uncertainty exists in relation to the collection of revenue, its recognition is postponed to the extent of uncertainty involved. Such item should be recognised as revenue only when it is reasonably certain to be collected. In this case, if the company is able to assess the ultimate collection with reasonable certainty, the additional revenue of ₹ 10 lakhs arising out of the said price revision may be recognised in 2012-13.

6.

- (a) What are the limitations of Ratio Analysis? 4
- (b) The following details are given by the Bhalu Limited for a year:

Inventory ₹ 5,20,000  
Working Capital ₹ 6,76,000  
Cash sales ₹ 2,50,000  
Inventory Turnover 5 times  
Debtors Turnover 6 times  
Current ratio 2 : 3 : 1  
Gross Profit ratio 20% of sales

You are required to calculate the amount of (i) Gross Profit, (ii) Total sales, (iii) Sundry Debtors, (iv) Current Assets, (v) Quick (liquid) Assets. 5

- (c) On 1.1.2010 Dola Ltd. purchased a Taxi from Sayan Ltd., on hire purchase system. A Down payment of ₹ 15,000 and 3 equal instalments together with interest @ 5% per annum on the outstanding balance of capital sum are to be made. The amount of last instalment payment was ₹ 15,750. Depreciation has to be provided @ 10% under reducing balance method. At the end of 3rd year the taxi was sold for ₹ 25,000 in cash. Prepare Taxi Account and Vendor Account in the books of Dola Ltd. 6

Answer

- (a) Limitations of Ratio Analysis

The arithmetical method of ascertaining the interrelations between any two numeric data expressed in accounting statements is known as Accounting Ratio.

The definition implies that in case of an accounting ratio, both the components in the form of numerals or variables used in computing ratio are taken from the financial statements prepared in financial accounting.

The various limitations include the following, namely

- (a) Completely based on comparison as if is not possible to analyse any matter with the help of one ration it requires.
- (b) Difficult to fix up definite standards as the standard already fixed on for a ratio may change over time.
- (c) Dependence on financial statements which have their own limitations, at least two.

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- (d) Problem of inter - firm comparison if there is significant variations in accounting policies adopted.
- (e) Personal influence as the personal sense of judgement and analytical power differs.
- (f) Only quantitative analysis qualitative aspects are totally ignored.
- (g) Ratios indicate trend, do not prove anything.
- (h) Inclusion of window dressing with an fraudulent intention.

There are some other limitations like

- (i) Linkage amongst different contradictor/' figures
- (j) Problem of usage
- (k) Not effective without cause and effect relationship
- (l) Lack of depth
- (m) Ignoring the effect of Inflation

- (b) Inventory Turnover = 5

$$\text{or } 5 = \frac{\text{Cost of Goods Sold (COGS)}}{\text{Inventory}}$$

$$\text{or } 5 = \frac{\text{COGS}}{\text{₹}5,20,000}$$

$$\text{or, COGS} = \text{₹ } 26,00,00$$

- (i) Gross Profit 20% of Sales  
∴ 25% of Cost of Goods Sold  
i.e.  $25\% \times \text{₹ } 26,00,000 = \text{₹ } 6,50,000$

- (ii) Total Sales = Cost of Goods Sold + Gross profit  
= ₹ 26,00,000 + 6,50,000  
= ₹ 32,50,000

- (iii) Sundry Debtors = Credit Sales / Debtors Turnover  
= (Total Sales – Cash Sales) / Debtors Turnover  
= (₹ 32,50,000 – 2,50,000) / 6 times = ₹ 5,00,000

- (iv) Current Assets:  
Current Ratio = 2.3 : 1

i.e. Current Ratio = Current Assets / Current Liabilities

Current Ratio = Current Asset/Current Liabilities

2.3 = Current assets/Current liabilities

Current assets = 2.3 × Current liabilities

Working Capital = Current assets – Current liabilities

$$6,76,000 = 2.3 \times \text{C.L.} - \text{C.L.}$$

$$\text{or, } 1.3 \text{ C.L.} = 6,76,000$$

$$\therefore \text{C.L.} = 5,20,000$$

$$\therefore \text{C.A.} = 5,20,000 \times 2.3 = 11,96,000$$

- (v) Quick (Liquid) Assets

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= Current Assets – Inventory

= ₹ 11,96,000 – ₹ 5,20,000

= ₹ 6,76,000

(c) In the Books of Dola Ltd.

Dr.			Taxi Account			Cr.		
Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)			
1-1-10	To Sayan Ltd A/c	60,000	31-12-10	By Depreciation A/c By Balance c/d	6,000			
		60,000			54,000			
1-1-11	To Balance b/d	54,000	31-12-11	By Depreciation A/c By Balance c/d	5,400			
		54,000			48,600			
1-1-12	To Balance b/d	48,600	31-12-12	By Depreciation A/c By Bank A/c By P & L A/c	4,860			
					25,000			
		48,600			18,740			
					48,600			

Dr.			Sayan Ltd. Account			Cr.		
Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)			
1-1-10 31-12-10	To Bank A/c To Bank A/c To Balance c/d	15,000	1-1-10 31-12-10	By Taxi A/c By Interest c/d (@ 5% on ₹45,000)	60,000			
		17,250			2,250			
		30,000						
		62,250			62,250			
31-12-11	To Bank A/c To Balance b/d	16,500	1-1-11 31-12-11	By Balance c/d By Interest A/c (@5% on ₹30,000)	30,000			
		15,000			1,500			
		31,500			31,500			
31-12-12	To Bank A/c	15,750	1-1-12 31-12-12	By Balance b/d By Interest A/c (@ 5% on ₹15,000)	15,000			
					750			
		15,750			15,750			

**Working Note:**

Let Principal amount be ₹100, Interest is ₹ 5 then amount of Installment including interest is ₹105.

Hence Cash Price of each Installment = (₹ 15,750 x 100) / 105 = ₹ 15,000

Cash Price of taxi = ₹ 15,000 + (15,000 x 3) = ₹ 60,000

7.

(a) M/s Chandu stores has three departments viz. A, B and C. At the end of the year 31st March, 2013 goods were included in departmental stocks out of inter-departmental transfers loading their on cost as follows:

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From A to B ₹ 25,000 and to C ₹ 18,000 respectively at a profit of 25% on cost.  
 From B to A and C ₹ 9,000 and ₹ 6,000 respectively at a profit of 33<sup>1</sup>/<sub>3</sub>% on cost.  
 From C to A and B ₹ 25,000 and ₹ 27,000 respectively at a profit of 20% on transfer price.

Departmental Managers are entitled to 10% commission on net profit subject to unrealised profit on departmental transfers being eliminated. Departmental profits after charging Manager's commission but before adjustment of unrealised profits are:

A— ₹ 1,57,500; B— ₹ 1,62,000; C— ₹ 2,16,000.

You are required to calculate the amount of unrealised profits, correct amount of Manager's commission and departmental profits after charging Manager's commission. 5

- (b) From the following data, Compute the Percentage of Completion & P/L Account (Extract) as would appear in the books of a contractor as per AS-7

Contract Price	₹ 350 Lakh	
Cost incurred to date as follows:		
Material	₹ 250 Lakh	
Labour Charge	₹ 100 Lakh	
Other Expenses	₹ 50 Lakh	₹ 400 Lakh
Estimated Cost to Complete		₹ 100 Lakh

5

- (c) On 31st March, 2013 following was the Balance Sheet of Green India Ltd.

₹ in lakh

Liabilities	Amount	Assets	Amount
Equity Share Capital (fully paid-up shares of ₹ 10 each)	2,400	Machinery	3,000
Securities premium	350	Furniture	312
General Reserve	930	Investments	148
Profit and Loss Account	340	Stock	1,200
Sundry Creditors	1,900	Debtors	520
		Cash at Bank	740
	5,920		5,920

On 1st April, 2013, the company announced the buy-back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all its investments for ₹ 150 lakh and issued 2,00,000 12% preference shares of ₹ 100 each at par with the entire amount being payable on application.

The issue was fully subscribed. The company achieved the target of the buy-back. Show journal entries for all the transactions. 5

Answer

- (a) Calculation of unrealised Profits

	Department A (₹)	Department B (₹)	Department C (₹)	Total (₹)
A to B and C	—	$25,000 \times \frac{25}{125}$ = 5,000	$18,000 \times \frac{25}{125}$ = 3,600	8,600
B to A and C	$\frac{9,000 \times 33.1/3}{133.1/3}$ = 2,250		$\frac{6,000 \times 33.1/3}{133.1/3}$ = 1,500	3,750
C to A and B	$25,000 \times \frac{20}{100}$ = 5,000	$27,000 \times \frac{20}{100}$ = 5,400	—	10,400



## Suggested Answer\_Syl08\_Dec13\_Paper 5

Total	7,250	10,400	5,100	22,750
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### Calculation of correct amount of Manager's commission and Departmental Profits

	Dept A (₹)	Dept B (₹)	Dept C (₹)
Departmental Profits before adjustments	1,57,500	1,62,000	2,16,000
<b>Add:</b> back Manager's Commission (₹ 1,57,500 x 10/90; 1,62,000 x 10/90 ; 2,16,000 x 10/90)	17,500	18,000	24,000
<b>Less:</b> Unrealised Profit	1,75,000 8,600	1,80,000 3,750	2,24,000 10,400
Net Profit Before Commission	1,66,400	1,76,250	2,29,600
Less: Correct amount of Manager's Commission @10%	16,640	17,625	22,960
Correct amount of Departmental Profit	1,49,760	1,58,625	2,06,640

### (b) Calculation of total cost of Contract

	₹ Lakh
Cost incurred to date :	
Material	250
Labour	100
Overhead	<u>50</u>
	400
Add estimated cost to complete	100
Estimated total cost on completion of contract	<u>500</u>

Hence, percentage of completion =  $400/500 \times 100 = 80\%$

Revenue recognised as a percentage to Contract price = 80% Of ₹ 350 L = ₹ 280 lakhs.

As per As -7, when the total construction cost of the contract will exceed total contract revenue, the expected loss should be recognised immediately.

Accordingly, expenses to be recognised in the Profit and Loss A/c will be :

Total Foreseeable Loss (₹ 500 L - ₹ 3 50L)	₹ 150 L
Less Loss for the Current year (₹ 400 - ₹ 280 L)	<u>120 L</u>
Expected loss to be recognised immediately	₹ 30 L

### Profit and Loss Account ( Extract)

	₹ lakh		₹ lakh
To Construction cost	400	By Contract Price	280
To Estimated loss on completion of contract to be provided	30		

### (c)

#### Journal entries

Dr.			Cr.
	<b>Particulars</b>	<b>Lakhs (₹)</b>	<b>Lakhs (₹)</b>

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Bank A/c           Dr. To Investments A/c To Profit & Loss A/c [Being sale of investments and profit transferred]	150	148 2
Bank A/c           Dr. To 12% Preference Share Application A/c [Being application money received for 2,00,000 preference shares of ₹100 each]	200	200
12% Preference Share Application A/c           Dr. To 12% Preference Share Capital [Allotment of preference shares to all applicants]	200	200
Equity Share Capital A/c           Dr. Securities Premium A/c           Dr. To Equity Shareholders A/c [Being amount due to Equity shareholders for buying back 25% of shares at ₹15 each]	600 300	900
Equity Shareholders A/c           Dr. To Bank [Being payment of money to Equity shareholders]	900	900
General Reserve A/c   Dr. To Capital Redemption Reserve A/c [Being transfer of reserves to Capital Redemption Reserve to the extent of Capital is redeemed]	600	600

**8. Write Short notes on (any three):**

**5x3=15**

- (a) Difference between Receipts and Payments Account and Income and Expenditure Account;**
- (b) Distinction between Revaluation Account and Realisation Account;**
- (c) Important provision regarding disposal of Non-Banking Assets as per Section 9 of the Banking Regulation Act, 1949;**
- (d) Recoupment of Short working;**
- (e) Debt Service Coverage ratio.**

**Answer**

- (a)** Difference between Receipts and Payment A/C and Income & Expenditure A/C

Receipt & Payment A/C	Income & Expenditure A/C
It is a summarised Cash Book	It closely resembles the Profit & Loss A/c of a trading concern
Receipts are debited & Payments are credited	Incomes are credited & Expenses are debited

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Transactions are recorded on cash basis	Transactions are recorded on accrual basis
It records both capital & revenue transactions	It records revenue transactions only
It is a Real A/c in nature	It is a nominal A/c in nature
In it outstanding amount for current year is excluded but all receipts/ payments during the current period related to previous/ future period may remain included	In it adjustments are made for outstandings & advances
It has opening and closing Cash & Bank balances	It does not have such balances
It helps to prepare an income and expenditure A/c	It helps to prepare a Balance sheet

**(b) Distinction between revaluation account and realization account**

Revaluation Account	Realization Account
1. It is prepared to record the effect of revaluation of Assets and Liabilities.	1. It records the realisation of various assets and payments of various liabilities.
2. It is prepared to determine the net Profit/Loss on revaluation	2. It is prepared to determine the net profit/loss on realisation
3. This is prepared at the time of admission and retirement of partners. On the other hand it is prepared by any entity for giving effect to the actual value of Assets.	3. This is prepared on dissolution of firm or liquidation of companies.
4. Entries relating to assets and liabilities are made on the basis of difference between the book values and revalued figures.	4. Entries relating to assets and liabilities are made on the basis of their book values and actual payments.
5. As a result of entries passed in this account, the accounts of assets and liabilities revalued, are not closed.	5. As a result of entries passed in this account, the accounts of assets and liabilities are closed.
6. This account may be required to be prepared at a number of occasions during the life time of a firm.	6. This account is prepared only once during the lifetime of a firm.

**(c) Some important provisions of the Banking Regulation Act, 1949 regarding disposal of non-banking assets.**

No banking company shall hold any immovable property howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from the commencement of this Act, whichever is later or any extension of such period as in section provided; and such property shall be disposed of within such period or extended period, as the case may be.

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Provided that the banking company may, within the period of seven years as aforesaid; deal or trade in any such property for the purpose of facilitating the disposal thereof.

Provided further that the Reserve Bank of India may in any particular case extend the aforesaid period of seven years by such period not exceeding five years, where it is satisfied that such extension would be in the interest of the depositors of the banking company.

### (d) Recoupment of short workings

Generally the royalty agreement contains a provision for carrying of short workings with a view to adjust it in future. In the subsequent years, such short workings are adjusted against the surplus royalty. This process of adjustment is called recoupment of short workings. The right of recoupment of short workings enables the lessee to recover the excess payment, made in the earlier years to meet the condition of payment of minimum rent. A time is usually agreed upon the number of years for which such short workings can be recouped. This time limit for recoupment of short workings may be fixed or fluctuating. If the short working cannot be recouped within the specified time, they lapse and are charged to profit and loss account in the year when that specified time limit for recoupment ends.

### (e) Debt Service Coverage ratio ( DSCR)

Debt Service Coverage ratio is used to measure the safety of the lenders' money invested in the firm and the return on the same. It explains the firm's ability to serve the debt timely. DSCR is calculated as under-

$$\frac{\text{Profit after tax + Interest + Depreciation}}{\text{Interest + Installment of Loan due for repayment.}}$$

Debt Service Costs mean payments of installments and interest against money borrowed as per terms of loans. Debts should be paid out of Profits and preferably out of profits resulting from the use of borrowed amounts.

The ratio shows the ability of the business to pay installments and interests out of profits. Although there is no ideal norm, any figure below 1 is totally unacceptable. The higher is the DSCR above 1, it is more and more favourable both for lender and the company, Vice versa, when DSCR is lower it indicates that the firm is not in a satisfactory position to repay the principal and service the payment of interest.