TEST - 1
PAPER – 1
ACCOUNTING
VSMART ACADEMY EXAMPREP
SUGGESTED ANSWERS

1(a)	Although legal title has not been transferred, the economic reality and substance is that the rights and beneficial interest in the immovable property have been transferred. Therefore, recording of acquisition/disposal (by the transferee and transferor respectively) would, in substance, represent the purchase/sale. In view of this A Ltd., should record the sales and recognize the profit of ₹ 15 lakhs in its profit and loss account. It should eliminate building from its balance sheet. In notes to accounts, it should disclose that building has been sold, full consideration has been received, possession has been handed over to the buyer and documentation and legal formalities are pending. The buyer should recognize the building as an asset in his balance sheet and charge depreciation on it. The buyer should disclose in his notes to account that possession has been received however documentation and legal formalities are pending.
1(b)	As per Accounting Standard 2 "Valuation of Inventories", cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. However, it makes clear that interest and other borrowing costs are usually not included in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition. Therefore, the proposal of CC Ltd. to include interest on bank overdraft as an element of cost is not acceptable because it does not form part of cost of production.
1(c)	1. As per AS 13 "Accounting for Investments", current investments should be carried at cost or fair value, whichever is lower. Here, the current Investment should be carried at fair value of ₹ 48 Lakhs; being the lower of ₹ 60 Lakhs (cost) or ₹ 48 Lakhs (fair value). The difference of ₹ 12 Lakhs should be charged to profit and loss account. 2. Current investment should be carried at cost or fair value, whichever is lower. In the given case, the current investments should be carried at cost of ₹ 86 Lakhs, being the lower of ₹ 86 Lakhs (cost) or ₹ 90 Lakhs (fair value).
1(d)	As per AS 14 on Accounting for Amalgamations, the term „consideration‟ has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration.

Computation of Purchase Consideration

	₹
Cash payment [₹ 15 x 1,50,000]	22,50,000
11% Preference Shares of Rs. 10 each @ 10% discount [(1,50,000 x 3/5) x ₹ 9]	8,10,000
Equity shares of ₹ 10 each @ 20% premium [(1,50,000 x 4/5) x ₹ 12]	14,40,000
Total Purchase consideration	45,00,000

For every 5 shares Anjana Ltd. will receive (i) 4 equity shares @ ₹ 12 per share and (ii) 3 11% Preference Shares @ ₹ 9 per share.

2

Journal Entries related to internal reconstruction

in the books of Planet Ltd.

(₹ in lakhs)

	Particulars		Debit ₹	Credit ₹
i	8% Preference share capital A/c (₹ 100 each)	Dr.	600	
	To 8% Preference share capital A/c (₹ 75 each)			450
	To Capital reduction A/c			150
	(Being the preference shares of ₹ 100 each reduced to ₹ 75 each as per the approved scheme)			
ii	Equity share capital A/c (₹ 10 each)	Dr.	1,500	
	To Equity share capital A/c (₹ 2 each)			300
	To Capital reduction A/c			1,200
	(Being the equity shares of ₹ 10 each reduced to ₹ 2 each)			
iii	Capital reduction A/c	Dr.	48	
	To Equity share capital A/c (₹ 2 each)			48
	(Being 1/3rd of arrears of preference share dividend of three years to be satisfied by issue of 24 lakh equity shares of ₹ 2 each)			
iv	6% Debentures A/c	Dr.	450	
	To Freehold property A/c			450
	(Being claim settled in part by transfer of freehold property)			
v	Accrued debenture interest A/c	Dr.	36	
	To Bank A/c			36
	(Being accrued debenture interest paid)			

vi	Freehold property A/c	Dr.	175	
	To Capital reduction A/c			175
	(Being appreciation (550-375) in the value of freehold property)			
vii	Bank A/c	Dr.	425	
	To Investment A/c			300
	To Capital reduction A/c			125
	(Being investment sold on profit)			
viii	Director's loan A/c	Dr.	450	
	To Equity share capital A/c (₹ 2 each)			135
	To Capital reduction A/c			315
	(Being director's loan waived by 70% and balance being discharged by issue of 67.5 lakh equity shares of ₹ 2 each)			
ix	Capital Reduction A/c	Dr.	1,485	
	To Profit and loss A/c			783
	To Trade receivables A/c (675 x 40%)			270
	To Inventories-in-trade A/c (450 x 80%)			360
	To Bank A/c			72
	(Being various assets, penalty on cancellation of contract, profit and loss account debit balance written off through capital reduction account)			
x	Capital Reduction A/c	Dr.	432	
	To Capital reserve A/c			432
	(Being balance transferred to capital reserve account as per the scheme)			

(b) **Capital Reduction Account**

(₹ in lakhs)

To	Equity Share Capital	48	By	8% Pref. Share Capital	150
To	P & L A/c	783	By	Equity Share Capital	1,200
To	Trade Receivables	270	By	Freehold property	175
To	Inventories	360	By	Bank (profit on sale of investment)	125
To	Bank	72	By	Director's loan	315
To	Capital Reserve	432			
		1,965			1,965

Bank Account

(₹ in lakhs)

To	Balance b/d	6	By	Accrued debenture interest	36
To	Investments	300	By	Capital Reduction Account (Penalty on cancellation of contract)	72
To	Capital reduction	125	By	Balance c/d	323
		431			431

(c) **Note to Accounts on Share Capital and Tangible Assets after implementation of internal reconstruction**

Share Capital	(₹ in lakhs)
Authorised:	
300 lakh shares of ₹ 2 each	600
12 lakh, 8% Preference shares of ₹ 75 each	900
	1,500
Issued, subscribed and paid up:	
241.5 lakh Equity shares of ₹ 2 each	483
(out of which 91.5 lakh shares have been issued for consideration other than cash)	
6 lakh, 8% Preference shares of ₹75 each fully paid up	450
Total	933
Tangible assets	
Freehold property 825	
Less: Utilized to pay Debenture holders (450)	
Add: Appreciation 175	550
Plant and machinery	300
Total	850

Working Note:

Calculation of number of equity shares issued:

To equity shareholders	150 Lakh
To Preference shareholders (in lieu of arrear of preference dividend)	24 Lakh
To Directors	67.5 Lakh
	241.5 Lakh

Note: In place of Capital Reduction Account, Re-organization or Reconstruction Account may also be used.

3a)

Schedule of Profit or Loss on Sales
(Average cost method)

2009		Nominal ₹	Cum-Dividend cost ₹	Dividend ₹	Cost ₹	Realized ₹	Profit ₹	Loss ₹
Sept 1	Purchase	10,000	10,150	50	10,100			
Oct 1	Purchase	25,000	25,250	250	25,000			
		35,000			35,100			
Nov. 1	Sale	15,000			15,043[1]	15,262.50	219.50	
		20,000			20,057			
Nov. 1	Purchase	5,000	5,150	75	5,075			
		25,000			25,132			
2010								
Jan. 15	Sale	10,000			10,053[2]	10,500	447.00	
		15,000			15,079			
Mar.1	Sales	4,000			4,021[3]	4,080	59.00	
		11,000			11,058		750.50	
July 15	Purchase	5,000	5,062.5	-	5,062			
		16,000			16,120			
Nov.1	Purchase	5,000	5,100	75	5,025			
		21,000			21,145			
2011								
Jan.15	Sale	15,000			15,104[4]	15,037		67
		6,000			6,041			

Working Notes:

1. $\frac{15}{35}$ x 35,100 = ₹ 15,043 (approx)

2. $\frac{10}{25}$ x 25,132 = ₹ 10,053 (approx)

3. $\frac{4}{15}$ x 15,079 = ₹ 4,021 (approx)

4. $\frac{15}{21}$ x 21,146 = ₹ 15,104 (approx)

6% State Government Stock
(*Interest payable half-yearly on 1st February & 1st August*)

Date 2009	*Particulars*	*Nominal* ₹	*Interest* ₹	*Capital* ₹	*Date* 2009	*Particulars*	*Nominal* ₹	*Interest* ₹	*Capital* ₹
Sept. 1	To Cash A/c: Purchase at ₹ 101.50	10,000	50	10,100	Nov. 1	By Cash A/c: Sale at ₹ 103.25	15,000	225	15,263
Oct.1	To Cash A/c: Purchase at ₹ 101	25,000	250	25,000	2010 Jan. 15	By Cash A/c: Sale at ₹ 105 ex-interest	10,000	275	10,500
Nov. 1	To Cash A/c: Purchase at ₹103	5,000	75	5075	Feb. 1	By Interest on 15,000 at 6% p.a. for half year		450	
Nov. 1	To P/L A/c (Profit on transaction)			220	Mar. 1	By Cash A/c: Sale at ₹ 102.50	4,000	20	4,080
2010									
Jan. 15	To P/L A/c			447	June 30	By Balance c/d (Stock at average cost) Accruing interest there on for 5 months)	11,000	275	11,058
Mar.1	To P/L A/c			59					
June 30	To P/L A/c		870						
		40,000	1,245	40,901			40,000	1,245	40,901
2010					2010				
July 1	To Balance b/d	11,000	275	11,058	Aug. 1	By Interest on ₹16,000 at 6% p.a. for half year		480.00	
July 15	To Cash A/c: Purchase at ₹101.25 ex-interest	5,000	138	5,062	2011 Jan. 15	By Cash A/c: Sale at ₹103	15,000	413	15,037
					Jan. 15	By P/L A/c (Loss and transaction)			67.00
Nov. 1	To Cash A/c: Purchase at ₹102	5,000	75	5,025	Feb. 1	By Bank A/c (Int on ₹6,000 for 1/2 year)		180.00	
2011 June 30	To P/L A/c		710		June 30	By Balance c/d (Stock at average cost accruing interest for 5 months)	6,000	125.00	6,041
		21,000	1,198	21,145			21,000	1,198	21,145

2011									
July 1	To Balance b/d	6,000	125	6,041					
July 1	To Cash A/c: Purchase at ₹102	2,000	50	1,990					

3b)

Calculation of total Interest and Interest included in each installment

Hire Purchase Price (HPP) = Down Payment + instalments

= 30,000 + 50,000 + 50,000 + 30,000 + 20,000 = 1,80,000

Total Interest = 1,80,000 – 1,50,000 = 30,000

Computation of IRR (considering two guessed rates of 6% and 12%)

Year	*Cash Flow*	*DF @6%*	*PV*	*DF @12%*	*PV*
0	30,000	1.00	30,000	1.00	30,000
1	50,000	0.94	47,000	0.89	44,500
2	50,000	0.89	44,500	0.80	40,000
3	30,000	0.84	25,200	0.71	21,300
4	20,000	0.79	15,800	0.64	12,800
		NPV	1,62,500	NPV	1,48,600

Interest rate implicit on lease is computed below by interpolation:

Interest rate implicit on lease = $6\% + \frac{1{,}62{,}500 - 1{,}50{,}000}{1{,}62{,}500 - 1{,}48{,}600} \times (12 - 6) = 11.39\%$

$$= \quad 6\% + \frac{12{,}500}{13{,}900} \times 6 = 11.39\%$$

Thus repayment schedule and interest would be as under:

Installment no.	***Principal at beginning***	***Interest included in each installment***	***Gross amount***	***Installment***	***Principle at end***
Cash down	1,50,000		1,50,000	30,000	1,20,000
1	1,20,000	13,668	1,33,668	50,000	83,668
2	83,668	9,530	93,198	50,000	43,198
3	43,198	4,920	48,118	30,000	18,118
4	18,118	2,064	20,182	20,000	182*
		30,182*			

4

Balance Sheet of AB Ltd.

Particulars	*Notes*	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	30,80,000
b Reserves and Surplus	2	6,17,100
2 Current liabilities		
a Other liabilities		38,900
Total		37,36,000
Assets		
1 Non-current assets		
a Fixed assets		
Tangible assets	3	23,09,000
Intangible assets	4	1,12,000
b Non-current investments		1,55,000
2 Current assets		
a Inventories (3,58,000 + 2,40,000)		5,98,000
b Trade receivables (72,000 +70,000)		1,42,000
c Cash and cash equivalents		4,20,000
Total		37,36,000

Notes to accounts

		₹
1 **Share Capital**		
Authorized share capital		
3,00,000 equity shares of ₹ 10 each	30,00,000	
60,000, 8% cumulative Preference Shares of ₹10 each	6,00,000	36,00,000
Equity share capital		
2,48,000 equity shares of ₹ 10 each (Of the above shares, 2,18,000 shares have been issued for consideration other than cash)		24,80,000
Preference share capital		
60,000, 8% cumulative Preference Shares of ₹10 each		6,00,000
Total		30,80,000
2 **Reserves and Surplus**		
Debit balance of Profit and Loss Account		
Underwriting commission	38,900	
Preliminary expenses	24,000	(62,900)
Securities Premium A/c		
(2,48,000 equity shares x 2.50)	6,20,000	
(60,000 Preference shares x ₹ 1)	60,000	6,80,000
		6,17,100

3	**Tangible assets**		
	Building	5,40,000	
	Motor car	1,26,000	
	Plant & machinery	15,10,000	
	Furniture	1,33,000	23,09,000
4	**Intangible assets**		
	Goodwill (W.N. 4) (15,000 +62,000-65,000)	12,000	
	Patents	1,00,000	1,12,000

Working Notes:

1. **Mode of discharge of Purchase Consideration of A Ltd.**

	₹
Cash payment	5,75,000
Equity shares (1,80,000 Shares x ₹ 12.5)	22,50,000
Total Purchase consideration	28,25,000

2. **Mode of discharge of Purchase Consideration of B Ltd.**

	₹
Cash payment	16,000
Equity shares (38,000 shares x ₹ 12.5)	4,75,000
Total Purchase consideration	4,91,000

3. **Cash at bank balance in the initial balance sheet of AB Ltd.**

Cash and Bank Account

		₹			₹
To	Issue of preference shares		By	Payment to A ltd.	5,75,000
	(60,000 x 11)	6,60,000	By	Payment to B ltd.	16,000
To	Equity shares		By	Preliminary expenses	24,000
	(30,000 x 12.50)	3,75,000	By	Balance c/d	4,20,000
		10,35,000			10,35,000

4. **Calculation of goodwill/ capital reserve of A Ltd. & B Ltd.**

Particulars	A Ltd.		B Ltd.	
Business Purchase A/c		28,25,000		4,91,000
Less: Goodwill			62,000	
Patent A/c	1,00,000		-	
Building A/c	5,40,000		-	
Plant & Mach. A/c	15,10,000		-	
Motor car A/c	-		1,26,000	
Furniture A/c	75,000		58,000	
Investment A/c	1,55,000		-	
Stocks A/c	3,58,000		2,40,000	
Debtors A/c	72,000	(28,10,000)	70,000	(5,56,000)
Goodwill / Capital reserve (Bal. fig.)		15,000		(65,000)
Net goodwill (15,000 +62,000 -65,000) = 12,000				

Note:

1. As per the information given in the question, only the assets of A Ltd. and B Ltd. are taken over by AB Ltd. Thus the creditors are considered to be paid by the liquidators of the respective companies and hence being not taken over by AB Ltd.
2. As per the information given in the second last para of the question, it is stated that the preliminary expenses of AB Ltd. will amount to ₹ 24,000 exclusive of the underwriting commission of ₹ 38,900 payable on the public issue. It has been assumed that ₹ 24,000 has been paid and underwriting commission is still payable in the balance sheet of the amalgamated company. Alternatively, any other reasonable assumption about this may be considered.
3. Preliminary expenses and underwriting commission have been written off as per the provisions of Accounting standards.

5 (a)

In the books of Prime Ltd.

Total Debtors Account

		₹			₹
To	Balance b/d	1,56,000	By	Cash	8,50,000
To	Bank (Cheque dishonoured)	15,000	By	Discount Allowed	6,000
To	B/R (Dishonoured)	5,000	By	B/R	40,000
To	Interest	2,400	By	Returns Inward	17,000
To	Sales	9,80,000	By	Bad Debts	2,000
To	Sundry Creditors (endorsed bill dishonoured with noting charges)	11,150	By	Balance c/d	2,54,550
		11,69,550			11,69,550

Total Creditors Account

		₹			₹
To	Cash	3,24,000	By	Balance b/d	1,70,000
To	B/R (endorsed)	15,800	By	Purchases	5,60,000
To	Discount received	5,000	By	Sundry Debtors A/c (endorsed B/R dishonoured with noting charges)	11,150
To	Bills Payable	32,000			
To	Return outward	7,400	By	Cash (over payments refunded)	1,200
To	Balance c/d	3,58,150			
		7,42,350			7,42,350

Note: Transactions relating to cash sales or purchases; honour of bills receivable or payable; recovery of bad debts and discount or endorsement of bill will not be entered in Total Debtors and Total Creditors Accounts.

(b) While choosing the accounting software, the following points should be considered:

1. **Fulfillment of business requirements:**

   Some packages have little functionality more than the others. The purchaser may try to match his requirement with the available solutions.

2. **Completeness of reports:**

   Some packages might provide extra reports or the reports match the requirements more than the others.

3. **Ease of Use:**

   Some packages could be very detailed and cumbersome compare to the others.

4. **Cost:**

   The budgetary constraints could be an important deciding factor. A package having more features cannot be opted because of the prohibitive costs.

5. **Reputation of vendor:**

   Vendor support is essential for any software. A stable vendor with good reputation and track records will always be preferred.

6. **Regular updates:**

   Law is changing frequently. A vendor who is prepared to give updates will be preferred to a vendor unwilling to give updates.

(c)

1. Hire Purchaser gets possession of the goods at the outset and can use it, while paying for it in instalments as per the agreement.
2. The ownership of the goods remains with the Hire Vendor until the all the instalments.
3. Each instalment paid by the hire purchaser is treated as hire charges for using the asset.
4. In case he fails to pay any of the instalments (even the last one) the hire vendor will take back his goods without compensating the buyer, i.e., the hire vendor is not going to pay back a part or whole of the amount received through instalments till the date of default from the buyer.

6 Cash Flow Statement of ABC Ltd. for the year ended 31.3.2017

Cash flows from Operating Activities	₹	₹
Net Profit	22,40,000	
Add: Adjustment for Depreciation (₹ 7,90,000 - ₹ 6,10,000)	1,80,000	
Operating profit before working capital changes	24,20,000	
Add: Decrease in Inventories (₹ 20,10,000 - ₹ 19,20,000)	90,000	
Increase in provision for doubtful debts (₹ 4,20,000 - ₹ 1,50,000)	2,70,000	
	27,80,000	
Less: Increase in Current Assets:	27,80,000	
Trade receivables (₹ 30,60,000 - ₹ 23,90,000) 6,70,000		
Prepaid expenses (₹ 1,20,000 - ₹ 90,000) 30,000		
Decrease in current liabilities:		
Trade payables (₹ 8,80,000 - ₹ 8,20,000) 60,000		
Expenses outstanding (₹ 3,30,000 - ₹ 2,70,000) 60,000	(8,20,000)	
Net cash from operating activities		19,60,000
Cash flows from Investing Activities		
Purchase of Plant & Equipment (₹ 40,70,000 - ₹ 27,30,000)	13,40,000	
Net cash used in investing activities		(13,40,000)
Cash flows from Financing Activities		
Bank loan raised (₹ 3,00,000 - ₹ 1,50,000)	1,50,000	
Issue of debentures	9,00,000	
Payment of Dividend (₹ 12,00,000 - ₹ 1,50,000)	(10,50,000)	
Net cash used in financing activities		NIL
Net increase in cash during the year		6,20,000
Add: Cash and cash equivalents as on 1.4.2016 (₹ 15,20,000 + ₹ 11,80,000)		27,00,000
Cash and cash equivalents as on 31.3.2017 (₹ 18,20,000 + ₹ 15,00,000)		33,20,000

Note: Bad debts amounting Rs. 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.2017. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.2017.

7 (a)

In the books of Mr. Mishra
Investment Account for the year ended 31st Dec. 2012
(Scrip: Equity Shares of Fillco Ltd.)

Date		*Particulars*	*Nominal Value (₹)*	*Cost (₹)*	*Date*		*Particulars*	*Nominal Value (₹)*	*Cost (₹)*
1.5.2012	To	Bank A/c	8,000	42,080	30.11.12	By	Bank A/c	2,000	11,400
31.10.2012	To	Bonus shares	2,000	–	31.12.12	By	Balance c/d	8,000	33,664
31.12.2012	To	Profit & loss A/c	–	2,984					
			10,000	45,064				10,000	45,064

Working Notes:

(i) Cost of equity shares purchased on 1.5.2012 = 800 × ₹ 50 + 5% of ₹ 40,000 + .002 of ₹ 40,000 = ₹ 42,080.

(ii) Sale proceeds of equity shares sold on 30.11.2012 = 200 × ₹ 60 – 5% of ₹ 12,000 = ₹ 11,400

(iii) Profit on sale of bonus shares on 30.11.12

= Sales proceeds – Average cost

Sales proceeds = ₹ 11,400

Average cost $= ₹ \frac{42,080}{10,000} \times 2,000$

= ₹ 8,416

Profit = ₹ 11,400 – ₹ 8,416 = ₹ 2,984

(iv) Valuation of equity shares on 31st Dec., 2012

Cost = (₹ 42,080/10,000 x 8,000) = ₹ 33,664

Market Value = 800 × ₹ 60 = 48,000

Closing balance has been valued at ₹ 33,664 being lower than the market value

(b)

(a) False- Under the self balancing system, general ledger adjustment account is opened in each of the sales ledger and purchases ledger. In general ledger, two adjustment accounts namely sales ledger adjustment account and purchases ledger adjustment accounts are maintained.

(b) True- Purchase ledger adjustment account is in reality, total creditors account, hence also known as creditors ledger control account under sectional balancing system.

(c) False- Whenever a balance is transferred from one account in one ledger to that in another, the entry is recorded through the journal. Also an additional entry is made in the control accounts for recording the corresponding effect.

(c)	**The following are the points of distinction between The pooling of interests method and The purchase method of recording transactions relating to amalgamation:** **1.** The pooling of interests method is applied in case of an amalgamation in the nature of merger whereas purchase method is applied in the case of an amalgamation in the nature of purchase. **2.** In the pooling of interests method all the reserves of the transferor company are also recorded by the transferee company in its books of account while in the purchase method the transferee company records in its books of account only the assets and liabilities taken over, the reserves, except the statutory reserves, of the transferor company are not aggregated with those of the transferee company. **3.** Under the pooling of interests method, the difference between the consideration paid and the share capital of the transferor company is adjusted in the general reserve or other reserves of the transferee company. Under the purchase method, the difference between the consideration and net assets taken over is treated by the transferee company as goodwill or capital reserve. **4.** Under the pooling of interests method, the statutory reserves are recorded by the transferee company like all other reserves without opening amalgamation adjustment account. In the purchase method, while incorporating statutory reserves the transferee company has to open amalgamation adjustment account debiting it with the amount of the statutory reserves being incorporated.
(d)	**Disadvantages of a spreadsheet as an accounting tool are as follows:** 1. Spreadsheet has data limitations. Depending upon the package, it can accept data only up to a specified limit. 2. Simultaneous access on a network may not be possible. Many of the modern softwares allow locking of the table when updation is taking place. This is not possible in a spread sheet. 3. Double entry is not automatically completed in Spread Sheet. Formulas or other means have to be adopted to complete the double entry. 4. Reports are not automatically formatted and generated but have to be user controlled. Each time a report has to be printed, settings have to be checked and data range has to be set. In many accounting softwares this is automatically taken care of by the program.