SUGGESTED SOLUTION

CS EXECUTIVE JUNE 2019 EXAM

SUBJECT- CORPORATE ACCOUNTING

Test Code - CSE 2023

BRANCH - () (Date :)

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Answer 1:

(A)

Calculation of profit as per section 198:

Particulars	Rs. '000
Net Profit	9500
+ Director's Remuneration	5000
+ Depreciation as per books	1000
+ Loss on sale of investment	200
+ Purchase of computers	3000
+ Transfer to General Reserve	500
+ Provision for doubtful debts	300
+ Provision for Tax	5000
+ Proposed Dividend	1000
- Interest on Investment	500
- Depreciation as per Act	(800)
	25200

(4 marks)

Remuneration payable under Companies Act, 2013: Rs.25200 X 6% = Rs. 1512

(Rs. In '000)

(1 marks)

(B)

'Collateral security' means **additional security given for a loan**. Where a company takes a loan from a bank, it may issue its own debentures to the lender as collateral security against the loan in addition to any other security that may be offered. In such a case, **the lender has the absolute right over the debentures until and unless the loan is repaid**. On repayment of the loan, the lender has to release the debentures. But in case the loan is not repaid by the company, the lender has the right to retain these debentures and to realize them. The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures. Such an issue of debentures is known as "Debentures issued as Collateral Security". **(2 marks)**

Example : Z Ltd. secured loan of Rs. 50,000 from the bank by issuing 600,12% Debentures of Rs. 100 each as collateral security. Pass journal entries and also show balance sheet extracts.

Accounting entries : The following are the two alternative ways by which debentures issued as collateral security can be dealt with.

Method 1 :

(1) Pass entry for loan taken.

(2) No accounting entry is required to issue debentures as collateral security.

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
	For taking loan:			
	Bank A/c	Dr.	50,000	
	To Loan A/c			50,000
	(Being, bank loan taken)			

	For issuing debenture as collateral security: No entry

Balance Sheet of Z Ltd. as at

EQUITIES & LIABILITIES	Rs.
Non-Current Liabilities:	
Bank Loan	
(Secured by the issue of 600,12% Debentures of Rs. 100 each as collateral security)	50,000
ASSETS	**Rs.**
Current Assets:	
Cash at bank	50,000

(1.5 marks)

Method 2:

(1) Pass entry for loan taken.

(2) Pass following entry for issue debentures as collateral security.
Debentures Suspense A/c........... Dr.
To Debentures A/c

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
	For taking loan:			
	Bank A/c	Dr.	50,000	
	To Loan A/c			50,000
	(Being, bank loan taken)			
	For issuing debenture as collateral security:			
	Debentures Suspense A/c	Dr.	60,000	
	To 12% Debentures A/c			60,000
	(Being, 600,12% Debentures of Rs. 100 each issued as collateral security as per contra)			

Balance Sheet of Z Ltd. as at

EQUITIES & LIABILITIES	Rs.
Non-Current Liabilities:	
Bank Loan	50,000
(Secured by the issue of 600,12% Debentures of Rs. 100 each as collateral security)	
600, 12% Debentures of Rs. 100 each	
(issued as collateral security as per contra)	60,000
ASSETS	**Rs.**
Non-Current Assets:	
Debentures Suspense Account	60,000
(issued as collateral security as per contra)	
Current Assets:	
Cash at Bank	50,000

(1.5 marks)

Answer 2:

(A)

$$\text{Control Ratio} = \frac{\text{No. of shares held by holding}}{\text{Total shares of subsidiary}} \times 100 = \frac{8{,}000}{10{,}000} \times 100 = 80\%$$

(1 mark)

Dr. **General Reserve A/c (S Ltd.)** **Cr.**

To Balance c/d	4,00,000	By Balance b/d (Bal. Fig.)	4,00,000
	4,00,000		**4,00,000**

(1 mark)

Dr. **Profit & Loss A/c (S Ltd.)** **Cr.**

To Dividend	1,00,000	By Balance b/d	1,60,000
To Balance c/d	3,00,000	By Profit during year (Bal. Fig.)	2,40,000
	4,00,000		**4,00,000**

(1 mark)

Analysis of profits of Honey Ltd.

Particulars	H Ltd. 80%	Minority 20%	Total 100%
Pre-acquisition/Capital Profit:			
Opening general reserve	3,20,000	80,000	4,00,000
Opening Profit & Loss balance	1,28,000	32,000	1,60,000
Profit during the year (2,40,000 X 4/12)	64,000	16,000	80,000
Dividend	(80,000)	(20,000)	(1,00,000)
	4,32,000	1,08,000	5,40,000
Post-acquisition/Revenue Profit:			
Profit during the year (2,40,000 X 8 /12)	1,28,000	32,000	1,60,00
	,28,000	32,000	1,60,000

(1.5 marks)

Minority Interest	Rs.	Cost of Control	Rs.
Share Capital	2,00,000	Cost of Investment (8,000 X 175)	14,00,000
Share of profits		(-) Face value of shares	(8,00,000)
- Pre-acquisition	1,08,000	(-) Pre-acquisition profits	(4,32,000
- Post-acquisition	32,000	(-) Pre-acquisition dividend(1,00,000X80%)	(80,000)
		Goodwill	
	3,40,000		**88,000**

(1.5 marks)

(B)

The objectives of financial reporting given by Financial Accounting Standard Board (FASB) are summarized as follows:

(1) Financial reporting should provide information that is useful to present/potential investors and creditors and other users in making rational decisions.

(2) It should provide information about the economic resources of an enterprise the claims to those resources and the effects of transactions event, and circumstances that change resources and claims to those resources.

(3) It should provide information about the enterprise's financial performance during a period.

(4) It should provide information about how management of an enterprise obtains and spends cash, its borrowing and repayment of borrowing, capital transactions including cash dividends and other distributions of enterprise resources to owners, and other factors that may affect an enterprise's liquidity or solvency.

(5) It should provide information about how management of an enterprise has discharged its steward-ship responsibilities to shareholders for the use of enterprise resource entrusted to it.

(6) It should provide information that is useful to management and directors in making decisions in the interest of owners.

Answer 3:

(A)

Particulars	Rs. in lakhs	Rs. in lakhs
Value Added:		
Gross sales		1,250
Less:		
- Discount allowed	50	
- Raw material consumed	780	
- Office expenses	30	(860)
Gross value added		**390**
Value Applied:		
Towards employee		
- Salary & wages		160
Towards Government		
- Income tax		30
Towards providers of finance		
- Dividend to equity shareholders	40	
- Interest on term loan	60	100
Towards replacement & expansion		
- Depreciation on plant & machinery	70	
- Retained profit for the year	30	100
Gross value applied		**390**

(3 marks)

Working Note:

Gross sales	1,250
Discount allowed	(50)
Depreciation on plant & machinery	(70)
Raw material consumed	(780)
Salary & wages	(160)
Interest on term loan	(60)
Office expenses	(30)
Profit before tax	100

(2 marks)

Income tax = 100 X 30% = 30

Reconciliation of 'gross value added' and 'profit before tax':

Profit before tax	100
- Salary & wages	160
- Interest on term loan	60
- Depreciation on plant & machinery	70
	390

(2 marks)

(B)

1. **Ascertaining true profit or loss:**

   (i) True profit of an enterprise can be ascertained when all costs incurred for the purpose of earning revenues have been debited to the profit and loss account.

   (ii) Fall in the value of assets used in business operations is a part of the cost and should be shown in the profit and loss account of concerned accounting period.

   (iii) Keeping this in view, depreciation must be debited to profit & loss account, since loss in value of fixed assets is also an expense like other expenses.

2. **Presentation of True and Fair value of assets :** if depreciation is not provided, the value of assets shown in the Balance Sheet will not present the true and fair value of assets because assets are shown at the cost price though actual value is less than the cost price of the assets.

3. **To ascertain the accurate cost of the Production :** Depreciation is an item of expense, the correct cost of production cannot be calculated unless it is also taken into consideration. Hence, depreciation must be provided to ascertain the correct cost of production.

4. **computation of correct income tax:**

   (i) Income tax of an enterprise is determined after charging all costs of production.

   (ii) If depreciation is not charged, the profits will be higher and the income tax will also be higher.

   (iii) If depreciation is charged, tax liability gets reduced.

5. **Provision of funds and replacement of assets:** Depreciation is a non-cash expense. So that amount of depreciation charged to profit and loss account is retained in business every year. These funds are available for replacement of the assets when its useful life is over. **(5 marks)**

Answer 4:

(A)

Journal Entries **(3 marks)**

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
1.4.2011	Bank A/c (70,000 X 105%)	Dr.	73,500	
	Loss on Issue on Debenture A/c (70,000 X 10%)	Dr.	7,000	
	To 12% Debenture A/c (70,000 X 100%)			70,000
	To Securities Premium A/c (70,000 X 5%)			3,500
	To Premium on Redemption of Debenture A/c (70,000 X 10%)			7,000

(Being, issued 12% debentures of the face value of Rs. 100 each at 5% premium redeemable at 10% premium)

EQUITIES & LIABILITIES	**Rs.**	**Rs.**
Shareholder's Funds:		
Securities Premium	3,500	
Less: Loss on Issue on Debenture	(7,000)	(3,500)
Non-Current Liabilities:		
12% Debenture		70,000
Premium on Redemption of Debenture		7,000
		73,500
ASSETS	**Rs.**	**Rs.**
Current Assets:		
Bank Balance		73,500
		73,500

(2 marks)

(B)

Corrective action to improve EVA

1. Operating performance with respect to Operating Profit Margins or Asset Turnover Ratios could be improved to generate more revenue without using more capital.

2. The capital invested in the business might be reduced by selling under-utilized assets; this strategy will simultaneously improve operating performance through a higher asset turnover ratio, as well as a reduced capital charge against those earnings because of a reduced debt or equity capital investment.

3. Redeploy the capital invested to projects and activities that have higher operating performance than the current projects or investments are exhibiting.

4. If the business is not highly leveraged, change the capital structure by substituting lower cost debt for higher cost equity. Although this last strategy will decrease net income because of the higher interest cost, it will improve the EVA of the business because the total cost of debt and equity is reduced, and EVA measures the value created after all costs of capital (debt and equity) have been taken into account.

(5 marks)

Answer 5:

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash Flows From Operating Activities	**Rs.**	**Rs.**
NetProfit	22,40,000	
Add: Adjustment For Depreciation (Rs.7,90,000 – Rs.6,10,000)	1,80,000	
Operating Profit Before Working Capital Changes	24,20,000	
Add: Decrease In Inventories (Rs. 20,10,000 – Rs. 19,20,000)	90,000	
Increase In Provision For Doubtful Debts (Rs. 4,20,000 – Rs.1,50,000)	2,70,000	
	27,80,000	
Less: Increase In Current Assets:		

Trade Receivables (Rs. 30,60,000 – Rs.23,90,000)	6,70,000		
Prepaid Expenses (Rs. 1,20,000 – Rs.90,000)	30,000		
Decrease In Current Liabilities:			
Trade Payables (Rs. 8,80,000 – Rs. 8,20,000)	60,000		
Expenses Outstanding (Rs. 3,30,000 – Rs.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(Rs. 40,70,000 – Rs. 27,30,000)		13,40,000	
Net Cash Used In Investing Activities			(13,40,000)
Cash Flows From Financing Activities			
Bank Loan Raised (Rs. 3,00,000 – Rs. 1,50,000)		1,50,000	
Issue Of Debentures		9,00,000	
Payment Of Dividend (Rs. 12,00,000 – Rs. 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 1.4.20X0 (Rs. 15,20,000 + Rs. 11,80,000)			27,00,000
Cash And Cash Equivalents As On 31.3.20X1 (Rs. 18,20,000 + Rs. 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 31.3.20X1. 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 31.3.20X1. **(10 marks)**