J.K. SHAH® TEST SERIES

Evaluate Learn Succeed

SUGGESTED SOLUTION

CA INTERMEDIATE NOV'19

SUBJECT- ADVANCE ACCOUNTS

Test Code - CIM 8305

BRANCH - () (Date :)

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

Answer 1:

Revenue Account of Kalyan General Insurance Company for the year ended 31.03.2018

Particulars	Sch.	This Yr	Last Yr
Premium (Net)	1	59,75000	
Total (A)		59,75,000	

(1 mark)

	Particulars	Sch.	This Yr	Last Yr
1.	Claims Incurred	2	45,26,000	
2.	Commission	3	1,47,000	
3.	Operating Expenses related to Insurance Business (2,30,000 - 45,000 - 35,000)		1,50,000	
	Total (B)		**48,23,000**	
	Operating Profit / (Loss) from Insurance Business (A - B)		**11,52,000**	
	Appropriations		**NIL**	
	Total (C)		**11,52,000**	

(2 marks)

Schedule 1 - Premium Earned (Net)

Particulars		This Yr	Last Yr
	Premium from Direct Business Written	65,75,000	
Add :	Premium on Re-Insurance accepted	9,50,000	
Less :	Premium on Re-Insurance ceded	(4,75,000)	
	Net Premium	70,50,000	
Less:	Changes in Unexpired Risk Reserve Provn [Reqd 50% of 70,50,000 - Opg 24,50,000)]	(10,75,000)	
	Total Premium Earned (Net)	**59,75,000**	

(2 marks)

Schedule 2 - Claims Paid (Net)

	Particulars	This Yr	Last Yr
Claims Paid - Direct (Paid 42,50,000 + Legal Exps 45,000 + Surveyor's Fees 35,000)		43,30,000	
Add: Claims paid on Re-Insurance Accepted		5,00,000	
Less: Claims from Re-Insurance Ceded			

(Received 3,25,000 + Due at end 1,10,000 - Due at opg 65,000)		(3,70,000)	
Net Claims Paid Add: Claims Outstanding as on 31.03.2018 (Direct Rs. 7,18,000 +Re-Insurance Rs. 60,000) Less: Claims Outstanding as on 01.04.2017 (Direct 6,25,000 + Re-Insurance 87,000)		44,60,000 7,78,000 (7,12,000)	
Total Claims Incurred		**45,26,000**	

(4 marks)

Schedule 3 - Commission

Particulars	This Yr	Last Yr
Commission Paid Add: Re-Insurance Accepted Less: Commission on Re-Insurance ceded	1,50,000 11,000 (14,000)	
Net Commission	**1,47,000**	

(1 mark)

Alternative solution :

Revenue Account of Kalyan General Insurance company for year ended 31.3.18.

Prem Earned (Net)	59,75,000
Profit / loss on sale or Redemption of Invest	NIL
Other Income	NIL
Interest Dividend, Rent etc. (Gross)	NIL
Total A	**59,75,000**
Claims incurred (Net)	45,26,000
Commission	1,47,000
Operating Exps related to insurance business	1,50,000
Total B	**48,23,000**
Operating profit transferred to P/L A/c (A – B)	**11,52,000**

(4 marks)

Schedule – 1 Premiums Earned

Premium on Direct Business	65,75,000
Add : Premium on Re – insurance accepted	9,50,000
Less : Premium on Re – insurance ceded	(4,75,000)
Net Premium	70,50,000
(+) Changes in unexpired Risk Reserve	(10,75,000)
Prem Earned (Net)	59,75,000

(-) Closing unexpired Risk Reserve (50% of NP)	(35,25,000)
(+) Opening unexpired Risk Reserve.	24,50,000
Net change	(10,75,000)

(2 marks)

Schedule – 2
Claims Incurred :

Claims on Direct Business	42,50,000
Add : claims on RI Accepted	5,00,000
Less : claims on RI Ceded	(3,25,000)
Net Claims	44,25,000
Add : O/s at the end	
(7,18,000 + 60,000 – 1,10,000)	6,68,000
Less : O/s at the begging	
(6,25,000 + 87,000 – 65,000)	(6,47,000)
	44,46,000
Add: Legal Exps.	45,000
Sur. Fees	35,000
	45,26,000

(2 marks)

Schedule – 3
Commission

Commission on Direct Business	1,50,000
Add : Commission on RI Accepted	11,000
Less : commission on RI Ceded	(14,000)
Net commission	**1,47,000**

(1 mark)

Schedule – 4
Operating Expenses

Expenses of Management (2,30,000 – 35,000 – 45,000)	1,50,000

(1 mark)

Answer 2:

(1) Capital employed as on 31st March, 2015 (Refer to 'Note')

		Rs. in lakhs
Land and Buildings		1,850
Machinery		3,760
Furniture and Fixtures		1,015
Patents and Trade Marks		32
Inventory		873

Trade receivables		614
Cash in hand and at Bank		546
		8,690
Less: Trade payables	568	
Provision for taxation (net)	22	590
		8,100

(2 marks)

(2) Future maintainable profit

(Amounts in lakhs of Rs.)

	2010-2011 Rs.	**2011-2012 Rs.**	**2012-2013 Rs.**	**2013-2014 Rs.**
Profit before tax	3,190	2,500	3,108	2,900
Less: Extraordinary income due to foreign contract	(100)			
Add: Loss due to earthquake		50		
Less: Income from nontrading investments			(54)	(54)
	3,090	2,550	3,054	2,846

As there is no trend, simple average profits will be considered for calculation of goodwill. Total adjusted trading profits for the last four years = Rs. (3,090 + 2,550 + 3,054 + 2,846)

= Rs. 11,540 lakhs

Average trading profit before tax = $\left(\frac{\text{Rs.11,540 lakhs}}{4}\right)$ = Rs. 2,885 lakhs

Less: Additional remuneration to directors (50) Lakh

2,835 Lakh

Less: Income tax @ 35%(approx.) (992) (Approx.)

1,843 Lakh **(4 marks)**

(3) Valuation of Goodwill on Super Profits Basis

	Rs. in lakh
Future maintainable profits	1,843
Less: Normal profits (20% of Rs. 8,100 lakhs)	(1,620)
Super profits	223

(2 marks)

Goodwill at 3 years' purchase of super profits = 3 x Rs. 223 lakhs = Rs. 669 lakhs

Note: In the above solution, goodwill has been calculated on the basis of closing capital employed (i.e. on 31st March, 2015). Goodwill should be calculated on the basis of 'average capital employed' and not 'actual capital employed' as no trend is being observed in the previous years' profits. The average capital employed cannot be calculated in the absence of details about profits for the year ended 31st March, 2015. Since the current year's profit has not been given in the question, goodwill has been calculated on the basis of capital employed as on 31st March, 2015.

Alternative Solution :

(1) Calculation of operating trading profit of past years

(Rs. In Lakhs)

	2010	2011	2012	2013
	- 11	- 12	- 13	- 14
Profit before tax	3190	2500	3108	2900
Less : Extraordinary income	(100)	-	-	-
Add : Loss due to earthquake	-	50	-	-
Less : Income from non – trading invest	-	-	(54)	(54)
	3,090	2,550	3,054	2,846

Simple average profit (as no trend is seen) = $\frac{3090 + 2550 + 3054 + 2846}{4}$ = Rs. 2,885 Lakhs

(1.5 marks)

(2) Calculation of Future Maintainable profits

Average Profit of past years	2,885
Less : Additional directors remuneration	(50)
	2,835
Less : Income Tax @ 35%	(992.25)
FMP after tax	1842.75

(0.5 marks)

(3) Closing Capital employed

Land & Building	1,850
Machinery	3,760
Furniture & Fixtures	1,015
Patents and Trade Marks	32
Inventory	873
Trade Rec.	614
Cash in hand & at Bank	546
Less : Trade payables	(568)
Provision for tax (net)	(22)
	8,100

(2 marks)

(4) Average Capital Employed :

Closing Capital Employed	8,100
(-) ½ current year NPA Tax	
(2846 – 38%)	(882.26)
	7,21,774

(1 mark)

(5) ERR = NRR + RRR **(1 mark)**

= 20% + NIL

= 20%

(6) **Expected Profit = Average Capital Emp. × ERR** **(1 mark)**

= 7,217.74 × 20%

= 1,443.548

(7) **Super Profit = FMP – Expected Profit** **(1 mark)**

= 1842.75 – 1443.548

= 399.202

(8) **Goodwill = 399.202 × 3**

= 1197.606

Answer 3:

Statement of Affairs of Insol Ltd. (in Liquidation)

as on 30th September, 2016

					Estimated Realisable Value (Rs.)
Assets not specifically pledged (As per list A) :					
Other fixed assets					18,00,000
Current assets					35,00,000
					53,00,000
Assets specifically pledged(As per List B)					
	Estimated realisable value	**Due to secured creditors**	**Deficiency**	**Surplus**	
	Rs.	**Rs.**	**Rs.**	**Rs.**	
Land & Buildings	11,00,000	10,00,000		1,00,000	
	Estimated total assets available to unsecured creditors				54,00,000
	Summary of Gross Assets				
	Gross realisable value of assets specifically pledged			11,00,000	
	Other assets			53,00,000	
	Gross Assets			64,00,000	
Gross liabilities Rs.	**Liabilities**				
	Secured Creditors (as per list B) to the extent to which claims are estimated to be covered by assets				
10,00,000	Specifically pledged				

1,50,000	Preferential creditors (as per list C)	1,50,000
		52,50,000
	Unsecured creditors(as per list E)	
20,00,000	Unsecured Loans	20,00,000
35,00,000	Trade creditors	35,00,000
1,00,000	Contingent Liability on Bills Discounted	1,00,000
67,50,000	Estimated deficiency as regards creditors	3,50,000
	(67,50,000 — 64,00,000)	
	2,50,000 Equity Shares of Rs. 10 each : (as per list G)	25,00,000
	Estimated deficiency as regards members	28,50,000

(10 marks)

Answer 4:

In the books of Bharat Insurance Co. Ltd.

Journal Entries

Date	Particulars		(Rs. In crores)	
			Dr.	Cr.
1.4.2016	Unexpired Risk Reserve (Fire) A/c.	Dr.	28	
	Unexpired Risk Reserve (Marine) A/c.	Dr.	21	
	Unexpired Risk Reserve (Miscellaneous) A/c.	Dr.	6	
	To Fire Revenue Account			28
	To Marine Revenue Account			21
	To Miscellaneous Revenue Account			6
	(Being unexpired risk reserve brought forward from last year)			
31.3.2017	Marine Revenue A/c.	Dr.	23	
	To Unexpired Risk Reserve A/c.			23
	(Being closing reserve for unexpired risk created at 100% of net premium income amounting to Rs. 23 crores i.e. 22 + 8.5 – 7.5)			
	Fire Revenue A/c.	Dr.	23.95	

	To Unexpired Risk Reserve A/c. (Being closing reserve for unexpired risk created at 50% of net premium income of Rs. 47.90 crores i.e. 46 + 7.5 – 5.3)		23.95
	Miscellaneous Revenue A/c. Dr. To Unexpired Risk Reserve A/c. (Being closing reserve for unexpired risk created at 50% net premium income of Rs. 10 crores i.e. 13 + 5 – 8)	5	5

(4 marks)

Unexpired Risk Reserve Account

Date	Particulars	Marine	Fire (Rs.)	Misc. (Rs.)	Date	Particulars	Marine (Rs.)	Fire (Rs.)	Misc (Rs.)
1.4.2016	To Revenue A/c.	21	28	6	1.4.2016	By Balance b/d	21	28	6
31.3.2017	To Balance c/d	23	23.95	5	31.3.2017	By Revenue A/c.	23	23.95	5
		44	51.95	11			44	51.95	11

Working Note :

Premium from other insurance companies in respect of risk undertaken :

Received during the year	11.5	9.2	5.5
Less : Receivable – 01.04.16	(7.0)	(3.0)	(1.5)
Add : Receivable – 31.03.17	4.0	1.0	1.0
	8.5	7.2	5.0

(2 marks)

Alternative Solution :

Dr. **Unexpired Risk Reserve A/c.** **Cr.**

Particulars	Mar	Fire.	Misc.	Particulars	Mar	Fire	Misc.
To Revenue A/c.	21	28	6	By balance b/d	21	28	6
To Balance c/d	23	23.95	5	By Rev. A/c.	23	23.95	5

(2 marks)

Working Note : 1

Reserve for unexpired Risk as on 31.3.17

	Mar.	**Fire**	**Misc.**
Prem on Direct Buss.	22	46	13
(+) Prem on RI Accepted	8.5	7.2	5
(-) Prem on RI Ceded	(7.5)	(5.3)	(8)
Net Premium	23	47.9	10
Unexpired Res as on 31.3.17	100%	50%	50%
	= 23	**23.95**	**5**

(2 marks)

1.4.16	Unexpired Risk Reserve A/c.	55	
	To Marine Revenue A/c.		21
	To Fire Revenue A/c.		28
	To Misc. Revenue A/c.		6
31.3.17	Marine Revenue A/c.	23	
	Fire Revenue a/c.	23.95	
	Misc Revenue A/c.	5	
	To Unexpired Risk Reserve A/c.		51.95

(2*1 = 2 marks)

Answer 5:

			Rs.
A	Profit for equity fund after current cost adjustment		2,20,000
B	Profit (as per long – term fund approach)		
	Profit for equity fund	2,20,000	
	Add : Interest on Long – term loan (5,40,000 × 12%)	64,800	2,84,800
c	Current cost of capital employed (by Equity approach)		12,48,000
d	Capital employed as per Long – term fund approach		
	Current cost of capital employed (by Equity approach)	12,48,000	
	Add : 12% Long term loan	5,40,000	17,88,000
e	Value of Goodwill		
	A. By Equity Approach		
	Capitalised value of Profit as per equity approach = (2,20,000/16.20%)		13,58,025

	Less : Capital employed as per equity approach		(12,48,000)
	Value of Goodwill		**1,10,025**
	B. By Long – Term Fund Approach		
	Capitalized value of Profit as per Long – term fund approach = (2,84,800/14.25%)		19,98,596*
	Less : Capital employed as per Long – term fund approach		(17,88,000)
	Value of Goodwill		**2,10,596**

(7 marks)

Leverage effect on Goodwill :

Adverse Leverage effect on goodwill is Rs. 1,00,571 (i.e. Rs. 2,10,596 – Rs. 1,10,025) **(1 mark)**

Answer 6:

Statement of Liabilities of B list contributors (showing the amount realized)

Creditors Outstanding on the date of ceasing to be member	**P 1,500 Shares Rs.**	**D 2,000 Shares Rs.**	**B 700 Shares Rs.**	**S 300 Shares Rs.**	**Amount to be paid to the creditors Rs.**
a) 9,000	3,000	4,000	1,400	600	9,000
b) 3,000	-	2,000	700	300	3,000
c) 1,500	-	-	1,050	450	1,500
d) 1,000	-	-	-	1,000	150
Total (a)	3,000	6,000	3,150	2,350	
(b) maximum liability on shares held	7,500	10,000	3,500	1,500	
(c) Amount to be realized (a) or (b)					
Whichever is lower	3,000	6,000	3,150	1,500	

(4 marks)

Working Notes:

1. C will not be liable since he transferred his shares prior to one year preceding the date of winding up.

2. P will not be responsible for further debts incurred after 01.01.2017 (from the date when he ceases to be a member). Similarly, D & B will not be liable for the debts incurred after the date of their transfer of shares.

3. The increase between 1st August 2017 and 15th September 2017, is solely the responsibility of S. Liability of S has been restricted to the maximum allowable limit of Rs. 1,500. Therefore, amount payable by S on 15.09.2017 is Rs. 150 only.

4. Ratio of discharge of liability will be in the ratio of no. of shares held by B List Contributories which is as follows :

Calculation of Ratio for discharge of Liabilities

Date	**Cumulative liability Rs.**	**Increase in liabilities Rs.**	**Ratio of no. of shares held by L, M, N, O**
01.01.2017	9,000	-	15 : 20 : 7 : 3
01.04.2017	12,000	3,000	20 : 7 : 3
01.08.2017	13,500	1,500	7: 3
15.09.2017	14,500	1,000	Only S

(4 marks)