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# SUGGESTED SOLUTION

## INTERMEDIATE MAY 2019 EXAM

### SUBJECT- ADVANCE ACCOUNTS

## Test Code - CIM 8181

**BRANCH - () (Date :)**

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**Answer 1:**

Paragraph 19 of the Guidance Note on Share Based Payments requires, for a performance condition that is not a market condition, the enterprise to recognize the services received during the vesting period based on the best available estimate of the number of shares or stock options expected to vest and to revise that estimate, if necessary, if subsequent information indicates that the number of shares or stock options expected to vest differs from previous estimates. On vesting date, the enterprise revises the estimate to equal the number of instruments that ultimately vested. However, paragraph 24 of the Guidance Note requires, irrespective of any modifications to the terms and conditions on which the instruments were granted, or a cancellation or settlement of that grant of instruments, the enterprise to recognize, as a minimum, the services received, measured at the grant date fair value of the instruments granted, unless those instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date.

Furthermore, paragraph 26(c) of the Guidance Note specifies that, if the enterprise modifies the vesting conditions in a manner that is not beneficial to the employee, the enterprise does not take the modified vesting conditions into account when applying the requirements for treatment of vesting conditions as specified in Guidance Note.

Therefore, because the modification to the performance condition made it less likely that the stock options will vest, which was not beneficial to the employee, the enterprise takes no account of the modified performance condition when recognizing the services received. Instead, it continues to recognize the services received over the three-year period based on the original vesting conditions. Hence, the enterprise ultimately recognizes cumulative remuneration expense of Rs. 1,80,000 over the three- year period (12 employees × 1,000 options × Rs. 15).

The same result would have occurred if, instead of modifying the performance target, the enterprise had increased the number of years of service required for the stock options to vest from three years to ten years. Because such a modification would make it less likely that the options will vest, which would not be beneficial to the employees, the enterprise would take no account of the modified service condition when recognizing the services received. Instead, it would recognize the services received from the twelve employees who remained in service over the original three-year vesting period. **(8 marks)**

**Answer 2:**

**Note:** Since Question requires the use of Capital Reduction A/c, the entries have been made accordingly. Alternatively, Reconstruction A/c can be used.

**Journal Entries**

| S.No | Particulars | | Dr.( Rs.) | Cr. ( Rs.) |
|---|---|---|---|---|
| 1. | Preference Share Capital (2,500 x Rs. 100) | Dr. | 2,50,000 | |
| | To Preference Share Capital (2,500 x Rs. 25) | | | 62,500 |
| | To Capital Reduction A/c | | | 1,87,500 |
| | (Being Preference Shares of Rs. 100 each reduced to Rs. 25 each, balance transferred to Reconstruction A/c, as per approved Scheme of Reconstruction dated.....) | | | |
| 2. | Preference Share Capital (2,500 x Rs. 25) [Face Value Rs. 25 each] | Dr. | 62,500 | |
| | To Preference Share Capital (625 x 100) [Face Value Rs. 100 each] | | | 62,500 |

| | | | | |
|---|---|---|---|---|
| | (Being re-organisation of 2,500 Preference Shares of Rs. 25 each into 625 Preference Shares of Rs. 625 each, as per approved Scheme of Reconstruction dated....) | | | |
| 3. | Equity Share Capital (5,000 x Rs. 100) | Dr. | 5,00,000 | |
| | To Equity Share Capital (5,000 x Rs. 20) | | | 1,00,000 |
| | To Capital Reduction A/c | | | 4,00,000 |
| | (Being Equity Shares of Rs. 100 each reduced to Rs. 20 each, and balance transferred to Reconstruction A/c, as per approved Scheme of Reconstruction dated...) | | | |
| 4. | Equity Share Capital (5,000 x Rs. 20) [Face Value 20 each] | Dr. | 1,00,000 | |
| | To Equity Share Capital (1,000 x Rs. 100) [Face Value Rs. 100 each] | | | 1,00,000 |
| | (Being re-organisation of 5,000 Equity Shares of Rs. 20 each into 1,000 Equity Shares of Rs.100 each, as per approved Scheme of Reconstruction dated.,....) | | | |
| 5. | 8% Debentures A/c | Dr. | 2,50,000 | |
| | To Freehold Property A/c | | | 2,00,000 |
| | To Capital Reduction A/c | | | 50,000 |
| | (Being transfer of title deed on Freehold Property to Debenture holders of the Company, in part settlement, as per approved Scheme of Reconstruction dated....) | | | |
| 6. | Freehold Property A/c (6,00,000 - 2,00,000) | Dr. | 4,00,000 | |
| | To Capital Reduction A/c | | | 4,00,000 |
| | (Being Revaluation of Freehold Property, as per approved Scheme of Reconstruction dated....) | | | |
| 7. | Loan from Director's A/c | Dr. | 3,00,000 | |
| | To Capital Reduction A/c | | | 3,00,000 |
| | (Being Directors' Loan claim waived off in full, as per approved Scheme of Reconstruction dated...) | | | |
| 8. | Capital Reduction A/c | Dr. | 12,37,500 | |
| | To Stock A/c | | | 50,000 |
| | To Provision for Bad Debts A/c | | | 12,500 |
| | To Profit 8i Loss A/c | | | 10,00,000 |
| | To Trademark A/c | | | 50,000 |
| | To Goodwill A/c | | | 1,00,000 |
| | To Deferred Revenue Expenditure A/c | | | 25,000 |
| | (Being writing off of losses, providing for bad debts, and reduction in the value of assets, as per approved Scheme of Reconstruction dated....) | | | |

| | | | | |
|---|---|---|---|---|
| 9. | Capital Reduction A/c | Dr. | 1,00,000 | |
| | To Capital Reserve A/c | | | 1,00,000 |
| | (Being balance in Capital Reduction A/c transferred to Capital Reserve) | | | |

**(9 marks)**

**Dr.** **2. Capital Reduction i.e. Reconstruction) A/c** **Cr.**

| **Particulars** | **Rs.** | **Particulars** | **Rs.** |
|---|---|---|---|
| To Stock A/c | | By Preference Share Capital A/c | |
| To Provision for Bad Debts A/c | | By Equity Share Capital A/c | |
| To Profit & Loss A/c | | By 8% Debentures A/c | |
| To Trademark A/c | | By Freehold Property A/c | |
| To Goodwill A/c | | By Loan from Directors A/c | |
| To Deferred Revenue Expenditure A/c | | | |
| To Capital Reserve A/c (balancing fig.) | | | |
| **Total** | **13,37,500** | **Total** | **13,37,500** |

**(2 marks)**

**3. Balance Sheet of Bad Luck Ltd as on 31st March 2018 (after Reconstruction)**

| | **Particulars as at 31st March** | **Note** | **This Year** | **Prev. Yr** |
|---|---|---|---|---|
| **I** | **EQUITY AND LIABILITIES:** | | | |
| **(1)** | **Shareholders' Funds:** | | | |
| | (a) Share Capital | 1 | 1,62,500 | |
| | (b) Reserves and Surplus - Capital Reserve | | 1,00,000 | |
| **(2)** | **Non-Current Liabilities:** | | | |
| | Long Term Borrowings 8% Debentures | | | |
| | (5,00,000 - 2,50,000) | | 2,50,000 | |
| **(3)** | **Current Liabilities:** | | | |
| | (a) Short Term Borrowings - Bank Overdraft | | 2,00,000 | |
| | (b) Trade Payables (Sundry Creditors) | | 2,50,000 | |
| | **Total** | | **9,62,500** | |
| **II** | **ASSETS** | | | |
| **(1)** | **Non-Current Assets Fixed Assets:** | | | |
| | Tangible Assets | 2 | 7,50,000 | |
| **(2)** | **Current Assets:** | | | |
| | (a) Current Investments | | | |
| | (b) Inventories -Stock-in-Trade (1,50,000-50,000) | | | |
| | (write off on reconstruction) | | 1,00,000 | |
| | (c) Trade Receivables -Debtors(l,25,000-12,500) | | | |

| | |
|---|---|
| (write off on reconstruction) | 1,12,500 |
| **Total** | **9,62,500** |

**(3 marks)**

**Note 1: Share Capital**

| **Particulars** | **This Year** | **Prev. Yr** |
|---|---|---|
| Authorised: ...Equity Shares of Rs. 100 each | | |
| Preference Shares of Rs. 100 each | 1,00,000 | |
| Issued, Subscribed & Paid up: 1,000 Equity Shares of | | |
| Rs. 100 each625 8% Preference Shares of Rs. 100 each | 62,500 | |
| **Total** | **1,62,500** | |

**(1 mark)**

**Note 2: Tangible Assets**

| **Particulars** | **This Year** | **Prev. Yr** |
|---|---|---|
| (a) Freehold Property (Net Book Value 2,00,000 + Incr under Reconstruction 4,00,000) --Takeover under Reconstruction Rs. 2,00,000 | 6,00,000 | |
| (b) Plant | 1,50,000 | |
| **Total** | **7,50,000** | |

**(1 mark)**

**Answer 3:**

**(Note:** Buyback is approved by Shareholders by Special Resolution in their General Meeting.)

**Rule 1: Percentage of Shares Bought Back:** Maximum Permissible Percentage of Buyback Shares = 25% of Total Shares Outstanding, i.e. 25% of 30 Crore Shares = 7.5 Crore Shares. (Shareholders' approval by Special Resolution) **(2 mark)**

**Rule 2: Amount < 25% of (ESC + Free Reserves):** (For Sec.68, Free Reserves include Securities Premium A/c.)

- 25% of Paid Up Capital and Free Reserves = 25% x (300 + 270 + 100 + 50) = 25% of 720 = Rs.180 Crores.

  [It is assumed that the Company has adequate resources to an extent of 25% of its Net Worth.]

Note: Export Reserve is not considered in above computation.

- Offer Price for Buyback = Market Price + 20% = Rs. 25 + 20% thereon = Rs. 30 per Share.
- Maximum Permissible Buyback = Rs. 180 Crores ÷ Rs. 30 per Share = 6 Crore Shares. **(3 marks)**

**Rule 3: Debt Equity Ratio to be 2:1**

| **Particulars** | **Situation I** | **Situation II** | **Situation III** |
|---|---|---|---|

| | | | |
|---|---|---|---|
| (a) Desired Debt Equity Ratio after Buyback | 2:1 | 2:1 | 2:1 |
| (b) Debt (given in the question) | 800 | 1200 | 1500 |
| (c) Equity to be maintained after Buyback =(b) ÷ 2 | 400 | 600 | 750 |
| (d) Existing Equity (Share Capital 8i All Free Reserves) | 720 | 720 | 720 |
| (e) Permissible Dilution in Equity = (c) - (d) | 320 | 120 | Nil |
| (f) Buyback Price as calculated above | 30 | 30 | 30 |
| (g) Maximum Permissible Buyback in Crores of Shares = (e) + [(f) + FV] | 8 | 3 | Not Applicable |

**(4 marks)**

**Summary of above for determining the maximum number of shares that can be bought back**

| Particulars (in Crore Shares) | Situation I | Situation II | Situation III |
|---|---|---|---|
| Rule 1: Percentage of Shares Bought Back | 7.50 | 7.50 | 7.50 |
| Rule 2: Amount ≤ 25% of (ESC + Free Reserves) | 6.00 | 6.00 | 6.00 |
| Rule 3: Debt Equity Ratio to be 2:1 | 8.00 | 3.00 | Not Applicable |
| Maximum Permissible Buyback = Least of the above | 6.00 | 3.00 | No buy back is possible |

**(1 mark)**

**Journal Entries in the books of Rudra Ltd in respect of Situation I (in Rs. Crores)**

| | **Particulars** | | **Dr.** | **Cr.** |
|---|---|---|---|---|
| 1. | Equity Share Capital A/c | Dr. | 60 | |
| | Premium on Buyback A/c | Dr. | 120 | |
| | To Equity Shareholders A/c | | | 180 |
| | (Being Equity Shares Bought Back vide Resolution No dated..., Share Capital cancelled and Premium on Buyback payable to Shareholders) | | | |
| 2. | Securities Premium A/c | Dr. | 100 | |
| | General Reserve A/c | Dr. | 20 | |
| | To Premium on Buyback A/c | | | 120 |
| | (Being Premium on Equity Shares Buyback provided out of Securities Premium first and balance from General Reserve) | | | |
| 3. | General Reserve A/c | Dr. | 60 | |
| | To Capital Redemption Reserve A/c | | | 60 |
| | (Being transfer to Capital Redemption Reserve on account of Equity Shares being bought back) | | | |

| | | | |
|---|---|---|---|
| 4. | Equity Shareholders A/c | Dr. 180 | |
| | To Bank A/c | | 180 |
| | (Being payment to Equity Shareholders on Buyback) | | |

**(4 marks)**

**Answer 4:**

The winding up commenced on 25th June 2017. Hence, only those persons who had transferred their Shares within a period of 12 months preceding the date of winding up is liable as a B List Contributory. **In this case, P is not a B List Contributory since his Shares have been transferred much earlier than the 12 month period.**

The other Transferors are liable, only upto the unpaid value on the Shares.

**Statement of Liability of B List Contributories (in Rs.)**

| Name of Shareholder | | | Q | R | S | T | Amt P'ble to Crs |
|---|---|---|---|---|---|---|---|
| Number of Shares held | | | 3,000 | 2,400 | 1,600 | 1,000 | |
| Creditors payable on the date of ceasing to be Member | | | | | | | |
| Date | Amount Payable to Crs. | Ratio | | | | | |
| 22.07.2016 | (Given) 12,000 | 30:24:16:10 | 4,500 | 3,600 | 2,400 | 1,500 | 12,000 |
| 15.09.2016 | 13,500 - 12,000 = 1,500 | 24:16:10 | - | 720 | 480 | 300 | 1,500 |
| 14.12.2016 | 14,000 - 13,500 = 500 | 16:10 | - | - | 308 | 192 | 500 |
| 09.03.2017 | 14,200 - 14,000 = 200 | Only T (Note) | - | - | - | * 200 | 200 |
| **(a) Total of above** | | | **4,500** | **4,320** | **3,188** | **2,192** | **14,200** |
| (b) Maximum Liability on Shares held (Rs. 2 per Share) | | | 6,000 | 4,800 | 3,200 | 2,000 | |
| **(c) Amount paid (a) or (b) whichever is lower** | | | **4,500** | **4,320** | **3,188** | **2,000** | **14,008** |

**Note:** T can be called upon to pay maximum only Rs. 2,000. T will pay only Rs. 8 out of Rs. 200 marked * above. Hence, Incremental Creditors on 09.03.2017 totalling to Rs. 192 (Rs. 2,192 - Rs. 2,000) will not be receiving any payment. **(8 marks)**

**Answer 5:**

**1. Computation of Expense to be recognised (Vesting Period = 1 month)**

| **Particulars** | **Result** |
|---|---|
| (a) Fair Value of Option per Share = Fair Value per Share under the Plan Rs. 28 less Issue Price Rs. 25 | Rs.3 |
| (b) No. of Shares expected to vest under the Scheme = 400 Employees x 100 Shares x 50% | 20,000 Shares |
| (c) Total Fair Value of Options = 20,000 x Rs. 3, to be recognised as Expense | Rs. 60,000 |

**Note:** Market Price of Shares on Grant Date is not considered for accounting here since Fair Value is specifically given. **(2 marks)**

**2. Journal Entry for ESOP**

| Particulars | | Dr.( Rs.) | Cr. ( Rs.) |
|---|---|---|---|
| Bank A/c (20,000 Shares x Rs. 25) | Dr. | 5,00,000 | |
| Employees' Compensation Expense A/c | | | |
| (20,000 Shares x Rs. 3) | Dr. | 60,000 | |
| To Equity Share Capital A/c | | | |
| (20,000 Shares x Rs. 10) | | | 2,00,000 |
| To Securities Premium A/c | | | |
| (20,000 Shares x Rs. 18) | | | 3,60,000 |
| (Being 20,000 Shares allotted to Employees under | | | |
| ESOP at a Premium of Rs. 18 per Share) | | | |

**(2 marks)**