



J.K. SHAH[®]
TEST SERIES
Evaluate Learn Succeed

SUGGESTED SOLUTION

IPCC MAY 2017 EXAM

ACCOUNTS AND ADVANCED ACCOUNTS

Test Code - I M J 7 1 2 5

BRANCH - (MULTIPLE) (Date : 11.12.2016)

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

Tel : (022) 26836666

Answer-1 (a) :

**Statement showing calculation of profits for pre and post incorporation
periods for the year ended 31.3.2016**

Particulars	Pre-incorporation period Rs.	Post-incorporation period
Gross profit (1:3)	80,000	2,40,000
Less: Salaries (1:2)	16,000	32,000
Stationery (1:2)	1,600	3,200
Advertisement (1:3)	4,000	12,000
Travelling expenses (W.N.3)	4,000	8,000
Sales promotion expenses (W.N.3)	1,200	3,600
Misc. trade expenses (1:2)	12,600	25,200
Rent (office building) (W.N.2)	8,000	18,400
Electricity charges (1:2)	1,400	2,800
Director's fee	-	11,200
Bad debts (1:3)	800	2,400
Selling agents commission (1:3)	4,000	12,000
Audit fee (1:3)	1,500	4,500
Debenture interest	-	3,000
Interest paid to vendor (2:1) (W.N.4)	2,800	1,400
Selling expenses (1:3)	6,300	18,900
Depreciation on fixed assets (W.N.5)	<u>3,000</u>	<u>6,600</u>
Capital reserve (Bal.Fig.)	12,800	-
Net profit (Bal.Fig.)	-	<u>74,800</u>

Working Notes:

(5)

1. Time Ratio

Pre incorporation period = 1st April, 2015 to 31st July, 2015

i.e. 4 months

Post incorporation period is 8 months

Time ratio is 1: 2.

2. Sales ratio

Let the monthly sales for first 6 months (i.e. from 1.4.2015 to 30.09.13) be = x

Then, sales for 6 months = 6x

Monthly sales for next 6 months (i.e. from 1.10.13 to 31.3.2016)= $x + \frac{2}{3}x = \frac{5}{3}x$

Then, sales for next 6 months = $\frac{5}{3}x \times 6 = 10x$

Total sales for the year = $6x + 10x = 16x$

Monthly sales in the pre incorporation period = $\text{Rs. } 19,20,000/16 = \text{Rs. } 1,20,000$

Total sales for pre-incorporation period = $\text{Rs. } 1,20,000 \times 4 = \text{Rs. } 4,80,000$

Total sales for post incorporation period = $\text{Rs. } 19,20,000 - \text{Rs. } 4,80,000 = \text{Rs. } 14,40,000$

Sales Ratio = $4,80,000 : 14,40,000 = 1 : 3$

3. Rent

		Rs.
Rent for pre-incorporation period (Rs. 2,000 x 4)		8,000 (pre)
Rent for post incorporation period August, 2015 & September, 2015 (Rs. 2,000 x 2)	4,000	
October, 2015 to March, 2016 (Rs. 2,400 x 6)	<u>14,400</u>	18,400 (post)

4. Travelling expenses and sales promotion expenses

	Pre Rs.	Post Rs.
Traveling expenses Rs. 12,000 (i.e. Rs. 16,800- Rs. 4,800) distributed in 1:2 ratio	4,000	8,000
Sales promotion expenses Rs. 4,800 distributed in 1:3 ratio	1,200	3,600

5. Interest paid to vendor till 30th September, 2015

	Pre Rs.	Post Rs.
Interest for pre-incorporation period ——— (Rs.4200/6*4)	2,800	
Interest for post incorporation period i.e. for August, 2015 & September, 2015 = (Rs.4200/6*2) ———		1,400

6. Depreciation

		Pre Rs.	Post Rs.
Total depreciation	9,600		
Less: Depreciation exclusively for post incorporation period	<u>600</u>		600
	<u>9,000</u>		
Depreciation for pre-incorporation period ($9,000 \times 4/12$)		3,000	
Depreciation for post-incorporation period ($9,000 \times 8/12$)		<u> </u>	<u>6,000</u>
		<u>3,000</u>	<u>6,600</u>

(6 x 0.5 = 3)

Answer-1 (b) :

(6)

Calculation of Average due date (Base Date 15th Jan, 2016)

Date	Amount Rs.	No. of days from base	Product Rs.
January 15	5,000	0	0
February 10	4,000	26	1,04,000
April 5	8,000	81	6,48,000
May 20	10,000	126	12,60,000
June 18	<u>9,000</u>	155	<u>13,95,000</u>
	<u>36,000</u>		<u>34,07,000</u>

$$\text{Average due date} = \text{Base date} + \frac{\text{Total product}}{\text{Total amount}} \times \text{days}$$

$$= 15^{\text{th}} \text{ Jan} + (34,07,000/36,000) = 95 \text{ days}$$

$$= 15^{\text{th}} \text{ Jan} + 95 \text{ days} = 19^{\text{th}} \text{ April, 2016}$$

Number of days after 19th April, 2016 to 30th June, 2016 = 72 days

Interest on drawings after 19th April to 30th June @10%:

$$= \text{Rs. } 36,000 \times \frac{72}{366} \times \frac{10}{100} = \text{Rs. } 708$$

Hence, interest on drawings Rs. 708 will be charged from A on 30th June, 2016.

Answer-2 (a) :

- (i) *Principle of indemnity: Insurance is a contract of indemnity. The insurer is called indemnifier and the insured is the indemnified. In a contract of indemnity, only those who suffer loss are compensated to the extent of actual loss suffered by them. One cannot make profit by insuring his risks.*
- (ii) *Insurable interest: All and sundry cannot enter into contracts of insurance. For example, A cannot insure the life of B who is a total stranger. But if B happens to be his wife or his debtor or business manager, A has insurable interest i.e. vested interest and therefore he can insure the life of B. For every type of policy insurable interest is insisted upon. In the absence of such interest the contract will amount to a wagering contract.*
- (iii) *Principle of UBERRIMAE FIDEI: Under ordinary law of contract there is no positive duty to tell the whole truth in relation to the subject-matter of the contract. There is only the negative obligation to tell nothing but the truth. In a contract of insurance, however there is an implied condition that each party must disclose every material fact known to him. All contracts of insurance are contracts of uberrima fidei, i.e., contracts of utmost good faith. This is because the assessment of the risk and the determination of the premium by the insurer depend on the full and frank disclosure of all material facts in the proposal form.*
- (iv) *Catastrophic Loss: A loss (or related losses) which is unbearable i.e. it causes severe consequences such as bankruptcy to a family, organization, or insurer.*

1.5

1.5

1.5

1.5

Answer-2 (b) :

FORM B - RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

2

Fire Insurance Revenue Account for the year ended 31st March, 2016

	Particulars	Schedule	Amount
(1)	Premium earned	1	11,50,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		<u>11,50,000</u>
(4)	Claims incurred	2	5,30,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	<u>2,00,000</u>
	Total (B)		<u>10,30,000</u>
	Operating Profit (A)- (B)		<u>1,20,000</u>

Schedule 1 : Premium earned (net)	Rs.
Premium received	13,00,000
Less: Re-insurance premium	<u>(1,00,000)</u>
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	<u>(50,000)</u>
	<u>11,50,000</u>
Schedule 2 : Claims Incurred	Rs.
Claims paid including legal expenses (4,90,000 + 10,000)	5,00,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	<u>(50,000)</u>
Total claims incurred	<u>5,30,000</u>

2

Schedule 3 : Commission	Rs.
Commission paid	<u>3,00,000</u>
	<u>3,00,000</u>
Schedule 4: Operating expenses	Rs.
Expenses of management	<u>2,00,000</u>
	<u>2,00,000</u>

2

Working Note:

Change in the provision for unexpired risk	Rs.
Unexpired risk reserve on 31 st March, 2016 = 50% of net premium i.e. 50% of Rs. 12,00,000 (See Schedule 1)	6,00,000
Less : Unexpired risk reserve as on 1 st April, 2015	<u>(5,50,000)</u>
Change in the provision for unexpired risk	<u>50,000</u>

Answer-3 (a) :

Banks have to classify their advances into four broad groups:

- (i) **Standard Assets**—Standard assets are those which do not disclose any problems and which do not carry more than normal risk attached to the business. Such an asset is not a NPA as discussed earlier. 1.5
- (ii) **Sub-standard Assets** — Sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months. In the case of term loans, those where installments of principal are overdue for period exceeding one year should be treated as sub-standard. In other words, such an asset will have well-defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected. 1.5
- (iii) **Doubtful Assets** — A doubtful asset is one which has remained sub-standard for a period of at least 12 months. A loan classified as doubtful has all the weaknesses inherent in that classified as sub-standard with added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. 1.5

- (iv) **Loss Assets** — A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspectors but the amount has not been written off, wholly or partly. In other words such assets are considered uncollectable or if collected of such low value that their being shown as bankable assets is not warranted even though there may be some salvage or recoverable value.

The classification of advances should be done taking into account (i) Degree of well-defined credit weakness and (ii) Extent of dependence on collateral security for the recovery of dues.

The above classification is meant for the purpose of computing the amount of provision to be made in respect of advances.

Answer-3 (b) :

**In the books of ABC Bank Ltd.
Journal Entries**

₹ in crores

Particulars	Debit	Credit
Rebate on bills discounted A/c To Discount on bills A/c (Being the transfer of opening balance in 'Rebate on bills discounted A/c' to 'Discount on bills A/c')	Dr. 40	40
Bills purchased and discounted A/c To Discount on bills A/c To Clients A/c (Being the discounting of bills of exchange during the year)	Dr. 5,000	280 4,720
Discount on bills A/c To Rebate on bills discounted A/c (Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)	Dr. 14	14
Discount on bills A/c To Profit and Loss A/c (Being the amount of income for the year from discounting of bills of exchange transferred to Profit and loss A/c)	Dr. 306	306

Working Notes:

(5)

- Discount received on the bills discounted during the year**

$$₹ 5,000 \text{ crores} \times 14/100 \times 146/365 = ₹ 280 \text{ crores}$$

- Calculation of rebate on bill discounted**

$$₹ 500 \text{ crores} \times 14/100 \times 73/365 = ₹ 14 \text{ crores}$$

- Income from bills discounted transferred to Profit and Loss A/c would be calculated by preparing Discount on bills A/c.

Discount on bills A/c

₹ in crores

Date	Particulars	Amount	Date	Particulars	Amount
31.3.2015	To Rebate on bills discounted	14	1.4.2014	By Rebate on bills discounted b/d	40

	To Profit and Loss A/c (Bal. Fig.)		2014-15	By Bills purchased and discounted	
		<u>306</u>			<u>280</u>
		<u>320</u>			<u>320</u>

(5)

Answer-4 (a) :

Purchase consideration payable:

		Rs.
Total of Assets		3,15,000
Add: Amount of Goodwill		<u>20,000</u>
		3,35,000
Less: Assets not taken over		
Cash balance	5,000	
Book debts	<u>75,000</u>	<u>(80,000)</u>
		<u>2,55,000</u>

(1)

Vendors Trade Receivables' (Debtors) Account

2016		Rs.	2016		Rs.
Jan. 1	To Balance of trade receivables taken over for collection	75,000	Jan. 31	By Cash (Amount collected)	30,000
			Feb. 28	By Cash (Amount collected)	15,000
			Mar. 31	By Cash (Amount collected)	10,000
			Apr. 30	By Cash (Amount collected)	5,000
			May 31	By Cash (Amount collected)	5,000
			June 30	By Balance transferred to Debtors' Account	10,000
		<u>75,000</u>		By Balance transferred to Debtors' Account	<u>10,000</u>
					<u>75,000</u>

(2)

Trade Receivables' Suspense Account

2016		Rs.	2016		Rs.
Jan. 31	To Amount transferred to Vendors' Collection A/c	28,500	Jan. 1	By Balance of vendors' debtors taken over for collection	75,000
	To Commission A/c	1,500			
Feb. 28	To Amount transferred to Vendor's Collection A/c	14,250			
	To Commission A/c	750			
Mar. 31	To Amount transferred to Vendors' Collection A/c	9,500			
	To Commission A/c	500			
Apr. 30	To Amount transferred to Vendors' Collection A/c	4,750			
	To Commission A/c	250			
May. 31	To Amount transferred to Vendors' Collection A/c	4,750			
	To Commission A/c	250			
June 30	To Amount transferred from Vendors' Debtors A/c	10,000			
		<u>75,000</u>			<u>75,000</u>

(2)

Trade Receivables' Suspense Account

2016		Rs.	2016		Rs.
Jan. 1	To Amount recoverable from vendors in respect of liabilities taken over	56,000	Jan. 31	By Vendors' Collection A/c	28,500
			Feb. 28	Vendors' Collection A/c	14,250
			Mar. 31	Vendors' Collection A/c	9,500
			Apr. 30	By Vendors' Collection A/c	3,750
		56,000			56,000

Vendors' Trade Payables (Creditors) Account

(1)

2016		Rs.	2016		Rs.
Jan. 31	To Cash	28,500	Jan. 1	By Amount payable on behalf of vendors	56,000
Feb. 28	To Cash	14,250			
Mar. 31	To Cash	9,500			
Apr. 30	To Cash	3,750			
		56,000			56,000

Vendors' Collection Account

(1)

2016		Rs.	2016		Rs.
Jan. 31	To Amount transferred to Creditors' Suspense A/c	28,500	Jan. 31	By Amount transferred from Debtors' Suspense A/c	28,500
Feb. 28	To Amount transferred to				
Feb. 28	To Creditors' Suspense A/c	14,250	Feb. 28	By Amount transferred from Debtors' Suspense A/c	14,250
Mar. 31	To Amount transferred to Creditors' Suspense A/c	9,500			
Apr. 30	To Amount transferred to Creditors' Suspense A/c	3,750	Mar. 31	By Amount transferred from Debtors' Suspense A/c	9,500
June 30	To Cash (amt. paid to vendors)	5,750	Apr. 30	By Amount transferred from Debtors' Suspense A/c	4,750
			May 31	By Amount transferred from Debtors' Suspense A/c	4,750
		61,750			61,750

(3)