

CMA Inter

Financial Accounting

**Theory Questions
from Past Papers**



CA BISHNU KEDIA

Chapter 1: Accounting Fundamentals

Question 1

(PYQ, June 19)

Write short notes on any three of the following:

- a) The Accrual concept.
- b) Provision for Discount on Debtors

Answer

a) **The Accrual Concept:**

The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

When goods are sold on credit as per normally accepted trade practices, the business gets the legal right to claim the money from the customer. Acquiring such right to claim the consideration for sale of goods or services is called accrual of revenue. The actual collection of money from customer could be at a later date. Similarly, when the business procures goods or services with the agreement that the payment will be made at a future date, it does not mean that the effect of expense should not be recognized. Because an obligation to pay for goods or services is created upon the procurement thereof, the expense effect also must be recognized. Today's accounting systems based on accrual concept are called as Accrual System or Mercantile System of Accounting.

b) **Provision for Discount on Debtors:**

We know that Cash discount is allowed by the suppliers to customer for prompt settlement of cash. Naturally a provision is created for this purpose. Thus, the provision which is created on Sundry Debtors for allowing discount on receipt of Cash in that accounting period is called Provision for Discount on Debtors. It is needless to say that if the customer pays their debts before the due dates, they may claim discounts and that is why discount is allowed to debtors for prompt settlement is an usual practice. Where goods are sold on credit, debtors accounts are debited but the amount may not be realized in this same accounting periods. Naturally, a possible aim is to allow discount whether cash is received. The same will happen in the next accounting period. Due to this reason a provision for discount on debtors is made on the basis of past experience at an estimate rate on Sundry Debtors. Care should be taken while calculating discount. Discount should be calculated at a specified rate on of debtors (i.e. after discounting bad debts and provision for bad debts).

Question 2

(PYQ, Dec 19)

Write short notes on any three of the following:

- a) Objective and necessity for providing Depreciation

Answer

Eric Kohler defined depreciation as "the lost usefulness, expired utility, the diminution in service yield." Its measurement and charging are necessary for cost recovery. It is treated as a part of the expired cost for an asset. For determination of revenue, that part or cost should be matched against revenue. The objects or necessities of charging depreciation are:

1. Correct calculation of cost of production: Depreciation is an allocated cost of a fixed asset. It is to be calculated and charged correctly against the revenue of an accounting period. It must be correctly included within the cost of production.
2. Correct calculation of profits: Costs incurred for earning revenues must be charged properly for correct calculation of profits. The consumed cost of assets (depreciation) has to be provided for correct matching of revenues with expenses.
3. Correct disclosure of fixed assets at reasonable value: Unless depreciation is charged, the depreciable asset cannot be correctly valued and presented in the Balance Sheet. Depreciation is charged so that the Balance Sheet exhibits a true and fair view of the affairs of the business.
4. Provision of replacement cost: Depreciation is a non-cash expense. But net profit, is calculated after charging it. Through annual' depreciation cash resources are saved and accumulated to provide replacement cost at the end of the useful life of an asset.
5. Maintenance of capital: A significant portion of capital has to be invested for purchasing fixed assets. The values of such assets are gradually reduced due to their regular use and passage of time. Depreciation on the assets is treated as an expired cost and it is matched against revenue. It is charged against profits. If it is not charged the profits will remain inflated. This will cause capital erosion.
6. Compliance with technical and legal requirements: Depreciation has to be charged to comply with the relevant provisions of the Companies Act and Income Tax Act.

Question 3

(PYQ Dec 21)

Write short notes on

1. Source documents
2. Error of principle.
3. Overriding Commission.

Answer

1. Source documents: Vouchers are the documentary evidence of the transactions so happened. Source documents at the basis on which transactions are recorded in subsidiary books, i.e. source documents are the evidence and proof of transactions.
2. Error of principle: Entering revenue expenses as capital expense or vice versa or entering revenue receipt as capital receipt or vice versa.
3. Overriding Commission: it is an extra commission allowed over and above, the normal Commission is generally offered for the following reasons:
 - i) When, the agent is required to put in hard work in introducing a new product in the market.
 - ii) Where he is entrusted with the work of supervising the performance of other agents in a particular area. For effecting sales at prices higher than the price fixed by the consignor.

Question 4**(PYQ Dec 22)**

Write a short Notes on

1. Advantages of Double Entry System
2. The main Objective of Depreciation Policy

Answer**1. Advantages of Double Entry System**

- It helps the trade know about his debtors and creditors from to time
- It helps the trader to prepare the final accounts to reflect the true trading results at the end of period
- It provides a Balance Sheet on a particular date to know the true value of assets, liabilities and capital
- It helps the trader who can have a comparative study of working results and financial position over a number of years
- It helps to find out and prevent errors and frauds
- It provides ready-made information to be sent to Sales tax and Income Tax Authorities
- It provides good guidance on which management take new decisions to increase the profit and correct losses into profit

2. The main Objective of Depreciation Policy

The main objectives of depreciation policy are given below.

- Description is the allocation of the cost of the asset over its effective life and being „tax shield“ is deductible expense while calculating taxable income of the concern. Diminishing balance method of calculating depreciation results in greater tax saving in a balanced firm is compared to straight line method.

- To keep intact the capital invested in depreciable assets and to make provision for their replacement, modernization and expansion on most favourable terms. It is a process of allocation and helps the management to retain this amount of profit in business for replacing asset. Otherwise this profit would have gone to the Government in the form of tax.
- To match the cost with revenue, depreciation is necessary to measure the cost incurred during a given period. Thus, know correct net income and financial condition for external reporting.
- Depreciation helps to measure managerial performance. But, charging it on historical cost or replacement cost basis is again a controversial issue and will affect the managerial decisions to be taken by the top management. Differences in costs because of charge of depreciation under different methods, tend to mislead management in selecting their operational alternative for more profitable for the firm as a whole.
- Withdrawal of asset before the end of its useful life is not up to standard to cope with the increasing competition in the market but due to the external factor of technological improvements in the existing asset is referred to as obsolescence. In such an atmosphere the asset is depreciated quickly otherwise profit and loss account will be overburdened with the amount of loss on account of obsolescence in the year in which the asset becomes obsolete.
- Serving consistently to follow a particular method of depreciation otherwise would make the financial statements unreliable to the stakeholders. It means a convention of consistency.
- Depreciation makes it to retain funds for replacement asset at the end of its working life.
- Apportioning total cost of the asset over its useful life is achieved by charging depreciation; and investing such amount of depreciation the public may not be misled and a correct investment decision may be made.

Question 5

(PYQ June 23)

- i. Briefly explain expenditure.
- ii. When an account is said to have a debit balance?
- iii. Explain the accounting treatment of normal loss in Branch Account.
- iv. What is depreciable cost?
- v. If adjusted purchase and Closing Stock are given in Trial Balance, will you transfer Closing Stock in Trading Account? Comment.

Answer:

- i. Expenditure is the amount spent or liability incurred for acquiring assets, goods or services.
- ii. An account is said to have a debit balance if the total of the debit side is more than the credit side.
- iii. Normal loss does not appear in the Branch Account since the closing stock appears at the adjusted figure.
- iv. Depreciable cost = cost of the asset – scrap value.
- v. No. Closing Stock will not be transferred to Trading Account because it already stands credited to Trading Account as adjusted purchase means opening stock + Purchase (net) -Closing Stock.

Question 6

(PYQ June 23)

Differences between bad debts and provision of bad debts.

Answer

| Bad debts | Doubtful Debts |
|---|--|
| The debts which cannot be realized are known as Bad Debts. | The debts which may or may not become bad are known as Doubtful Debts. |
| Bad Debts are immediately written off. | Doubtful debts are not written off but provided for. |
| A bad debt is a known loss. | A doubtful debt is an anticipated loss. |
| In case of bad debt, the Debtor's Amount is brought down by the amount of bad debt. | In case of doubtful debt, the Debtor's Account remains as it is since, debtor's Account and provision for Doubtful Debts Account are two separate accounts. But provision is made against expected loss. |

Question 7

(PYQ June 23)

The accounting cycle consists of certain sequential steps. List out those steps.

Answer

Stages of Accounting Cycle.

The accounting cycle consists of the following sequential steps:

1. Identifying transactions: The first step in the accounting cycle is to analyze events to determine if they are " transactions ". Transactions are the starting point from which the rest of the accounting cycle follows.
2. Recording transactions in books of original entry: The second step in the accounting cycle is to record the identified transactions in the relevant books of original entry as journal entries.

3. Posting to the Ledger: The next step is to record a summary of the activities in the relevant account in the Ledger (referred to as posting).
4. Drafting of unadjusted Trial Balance: At the end of an accounting period, data from the Ledger Accounts may be taken to draft a Trial Balance. It is prepared for identifying any errors that may have occurred during the initial stages of the accounting cycle. However, this step is not mandatory.
5. Passing of adjustment entry: Identification of necessary adjustment and passing of adjusting entries make up the fifth step in the cycle.
6. Drafting of Adjusted Trial Balance: Once all adjusting entries are completed, then an adjusted trial balance can be prepared. This happens to be the last step before the preparations of Financial Statements.
7. Closing of books: In this stage of the accounting cycle, the Ledger Accounts are closed and balanced. (also refers to as zeroed out) at the end of every accounting period.
8. Drafting the financial statements: In the last stage of the accounting cycle, the income statement is prepared with the closing balances of the Nominal Accounts, While the balances of real and personal accounts gets reflected in the Balance Sheet. Financial Statements are prepared in the following order: Income statement, Statements of retained earnings, Balance Sheet and statements of cash flows.

Question 8

(PYQ June 23)

Write short notes on the following.

1. Give any four points of difference between Fundamental Accounting Assumptions and Accounting Policies.
2. Give any four points of difference between Provision and Contingent Liability.
3. Meaning and implications of Going Concern Assumption

Answer

1. Distinction between fundamental accounting assumptions and accounting Policy

| Fundamental Accounting Assumptions | Accounting policy |
|--|--|
| There are only three fundamental accounting assumptions viz. going concern, consultancy, and accrual | They are in no simple list of accounting policies which are applied in all circumstances. As a result, there may be different accounting policies adopt by different enterprises |
| No disclosure is required if all the fundamental assumptions have been followed | Disclosure is required if the particular accounting policy have been followed |

| | |
|---|--|
| In case of the fundamental assumption are not followed, the fact has to be disclosed in the financial statements together with the reason | In case the policy is changed in the subsequent year, the reason for such change and the resulting financial consequences have to be disclosed |
| There is no choice | The firm has a choice to select a particular policy |

2. Distinguish between provision and contingent liability

| Provision | Contingent Liability |
|--|--|
| Provision is a present liability of uncertain amount which can be measured reliably by using a subsequent degree of estimation | It is an obligation which may or may not arise depending on the happening or not happening of an uncertain future event |
| A provision meet the recognition criteria | A contingent liability failed to meet the same |
| Provision is recognised when (a) an enterprise has a present obligation arise from past events and outflow of resources embodying economic benefit is probable and (b) a reliable estimate can be made of the amount of obligation | Contingent liability includes present obligations that do not meet the recognition criteria, because either it is not probable that settlement of those obligations will be required. Outflow of economic benefits or the amount cannot be reliably estimate |
| Provision is disclosed in income statement and balance sheet | Contingent liability is disclosed in note to accounts |

3. Meaning of going concern assumption

1. The enterprise is normally viewed as a going concern that is, as containing operations of the foreseeable future.
2. It is assumed that the enterprise has neither the intention nor the necessary of liquidation or curtailing materially its scale of operations.
3. If an enterprise is not a going concern valuation of its assets and liability on historical cost become irrelevant and as a consequence, its profit or loss may not give reliable information.

Implication of going concern assumption

It is because of the going concern assumption:-

1. That the assets are classified as current assets and fixed assets
2. That the liabilities are classified as short term liability and long term liability
3. That the unused resources are shown as unutilized cost or unexpected cost as against the break up value as in the case of liquidation enterprise. According the earning

power and not the breakup value of evolution, the continuing enterprise.

1. Disclosure of going concern assumption

According to accounting standard 1 issued by The Institute of Chartered Accountants of India If this fundamental assumption is followed, the fact need not to be disclosed in the financial statements, since its acceptance and use are assumed in case this concept is not followed, the fact should be disclosed in the financial statement together with reasons.

Question 9

(Mock Dec'19)

Write short note on features of a Trial Balance;

Answer

Following are the features of Trial Balance:

- i. It is a list of debit and credit balances which are extracted from various ledger accounts.
- ii. It is a statement of debit and credit balances.
- iii. The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
- iv. It does not prove arithmetical accuracy which can be determined by audit.
- v. It is not an account. It is only a statement of account.
- vi. It is not a part of the final statements.
- vii. It is usually prepared at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly.
- viii. It is a link between books of accounts and the Profit and Loss Account and Balance Sheet.

Question 10

(Mock Dec 19)

Classify the following between Capital and Revenue giving reasons.

1. Heavy expenditure incurred on advertisement at the time of introducing a new product.
2. Accrued Dividend or Interest included in the cost price of investment.
3. Cost of imported goods confiscated by Customs Authority for non-disclosure of
4. material facts.
5. Construction of College common room for students.

Answer:

1. Usually the benefit of this type of advertisement is enjoyed over more than one accounting period. As such it is deferred revenue expenditure. As per AS-26, it is a

part of other expenses which is shown in the Profit and Loss A/c and to be treated as revenue expenditure.

2. The accrued interest or dividend must be related to a period before the date of purchase of the investment. For this it has been included in the cost price of investment. The cost of Investment minus accrued Interest or Dividend is a capital Expenditure. It is the cost of acquisition of asset. The payment for the accrued interest or dividend is a revenue expenditure.
3. It is a revenue loss. It has arisen in course of the normal business activities. Though it is an abnormal loss which is non-regular and non-recurring in nature.
4. It will cause an addition to the College building, a fixed asset. Hence, it is Capital Expenditure in nature.

Question 11

(Mock Dec'19)

Write short note on debts.

Answer

The amount which is receivable from a person or a concern for supplying goods or services is called Debt. Debts may be classified into:

- a) Bad debts;
- b) Doubtful debts and
- c) Good debts

Bad Debts: Bad debts are uncollectable or irrecoverable debt or debts which are impossible to collect. If it is definitely known that amount recoverable from a customer cannot be realized at all, it should be treated as a business loss and should be adjusted against profit. In short, the amount of bad debt should be transferred to Profit and Loss Account for the current year to confirm the principles of matching.

Doubtful Debts: The debts which will be receivable or cannot be ascertainable at the date of preparing the final accounts (i.e., the debts which are doubtful to realise) is known as doubtful debts. Practically it cannot be treated as a loss on that particular date, as such, it cannot be written off. But, it should be charged against Profit and Loss Account on the basis of past experience of the firm.

Good Debts: The debts which are not bad i.e., there is neither any possibility of bad debts nor any doubts about its realization, is called good debts. As such, no provision is necessary for it.

Question 12

(Mock Dec'19)

Write the differences between revenue receipts and capital receipts.

Answer

| S.N | Revenue Receipt | Capital Receipt |
|-----|---|---|
| 1 | It has short-term effect. The benefit is enjoyed within one accounting period. | It has long-term effect. The benefit is enjoyed for many years in future. |
| 2 | It occurs repeatedly. It is recurring and regular. | It does not occur again and again. It is nonrecurring and irregular |
| 3 | It is shown in Profit and Loss Account on the credit side, as an income for the year | It is shown in the Balance Sheet on the liability side. |
| 4 | It does not produce capital receipt. | Capital receipt, when invested, produces revenue receipt e.g. when capital is invested by the owner, business gets revenue receipt (i.e. sale proceeds of goods etc.) |
| 5 | This does not increase or decrease the value of asset or liability. | The capital receipt decreases the value of asset or increases the value of liability e.g. sale of a fixed asset, loan from bank etc. |
| 6 | Sometimes, expenses of capital nature are to be incurred for revenue receipt, e.g. purchase of shares of a company is capital expenditure but dividend received on shares is a revenue receipt. | Sometimes expenses of revenue nature are to be incurred for such receipt e.g. on obtaining loan (a capital receipt) interest is paid until its repayment. |

Question 13

(Mock Dec 23)

Write short notes on features of single-entry system.

Answer

Single Entry System has the following features.

1. Maintenance of books by a sole trader or partnership firm: The books which are maintained according to this system can be kept only by a sole trader or by a partnership firm.

2. Maintenance of cash book: In this system it is very often to keep one cash book which mixes up business as well as private transactions.
3. Only personal accounts are kept: In this system, it is very common to keep only personal accounts and to avoid real and nominal accounts. Therefore, sometimes, this is precisely defined as a system where only personal accounts are kept.
4. Collection of information from original documents: For information one has to depend on original vouchers, example, in the case of credit sales, the proprietor may keep the invoice without recording it anywhere and at the end of the year the total of the invoices gives an idea of total credit sales of the business.
5. Lack of uniformity: It lacks uniformity as it is a mere adjustment of double entry system according to the convenience of the person.
6. Difficulty in preparation of final accounts: It is much difficult to prepare trading, profit and loss account and balance sheet due to the absence of nominal and real accounts in the ledger.

Question 14**(Mock June 23)**

Classify the following items as capital or revenue expenditure with reason:

- a) An extension of railway tracks in the factory area;
- b) Wages paid to machine operators;
- c) Installation costs of new production machine;
- d) Materials for extension to foremen's offices in the factory;
- e) Rent paid for a running factory;
- f) Payment for computer time to operate a new stores control system,
- g) Wages paid to own employees for building the foremen's offices.

Answer

- a) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period.
- b) Wages paid to machine operators should be treated as a Revenue Expenditure as it will yield benefit for the current period only.
- c) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- d) Materials for extension to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- e) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit the Company only during the current period.
- f) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.

- g) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

Question 15

(PYQ Dec 23)

Explain the following accounting conventions:

1. Full Disclosure
2. Consistency
3. Materiality
4. Conservatism

Answer

1. According to the Convention of Full Disclosure, all significant information relating to the economic affairs of the entity should be reported in the financial statements in an understandable manner.
2. According to the Convention of Consistency, accounting practices once selected and adopted should be consistently applied year after year.
3. According to the Convention of Materiality, a transaction should be reported in the financial statements on the basis of its materiality. An item is material if it can influence the decision of the user.
4. According to the Convention of Conservatism, anticipated losses should be accounted for while anticipated incomes should not be accounted.

Chapter 2: Accounting for Special Transactions (Bills of Exchange, Consignment and Joint Venture)

Question 16

(PYQ Dec'22)

Write short notes on bill of exchange.

Answer

As per Section 5 of the Negotiable Instruments Act, a bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person, to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument. The essential of bill of exchange are as:

- There are three parties the “Maker” is termed as the „Drawer“ in Bill of Exchange. He is the creditor. The person liable to pay the money is called the „Drawee“. The person entitled to get the money is termed as the „Payee“. It should be noted that drawer himself can also be the payee. It must be drawn on a specific person
- The bill drawer being the creditor, orders the drawee to pay a certain sum of money.
- A Time Bill of Exchange can be made payable to the bearer.
- It is an instrument in writing and unconditional
- It must be in writing, dated, stamped and signed by Drawer

It must be payable in demand or after a definite period of time, and for a certain amount of money

Question 17

(Mock Dec 19)

Write short notes on Bill- renewal and retirement.

Answer

Renewal of Bills

Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a first bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be face value of the original bill minus cash payment, if any, plus interest for the renewed period.

Retirement of Bill

Sometimes the drawee pays the bill before the date of maturity. Under the circumstances, the drawer allows certain amount of rebate or discount which is

calculated on certain percentage p.a. basis. The rebate is calculated from the date of payment to the date of maturity.

Question 18

(PYQ Dec 2019)

Write the Difference between Sale and Consignment

Answer:

Difference between Sale and Consignment

1. In sale the property in goods is transferred to the buyer immediately whereas in consignment the property is transferred to the buyer only when goods are sold by the consignee. The ownership of goods remains with the consignor when goods are transferred to the consignee by the consignor.
2. In sale, the risk attaching to the goods passes with ownership to the buyer. In case of a consignment, the risk attaching to the goods does not pass to the consignee who acts as a mere agent. If there is any damage or loss to the goods it is borne by the consignor provided the consignee has taken reasonable care of the goods and the damage or loss is not due to his negligence.
3. The relationship of consignor and consignee is that of a principal, and an agent as in a contract of agency whereas the relationship of buyer and seller is governed by the Sale of Goods Act.
4. Unsold goods on consignment are the property of the consignor and may be returned if not saleable in the market whereas goods sold on sale basis are normally not returnable unless there is some defect in them.

Chapter 3: Preparation of Financial Statements

Question 19

(PYQ, June 19)

Write the Features of Income and Expenditure Account

Answer

Features of Income and Expenditure Account:

1. It follows Nominal Account.
2. All expenses of revenue nature for the particular period are debited to this Account on accrual basis.
3. Similarly all revenue incomes related to the particular period are credited to this account on accrual basis.
4. All Capital Incomes and Expenditures are excluded.
5. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
6. Profit on Sale of Asset is credited. Loss on Sale of Asset is debited. Annual Depreciation on Assets is also debited.
7. If income is more than expenditure, it is called a Surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
8. If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

Question 20

(PYQ Dec 2021)

Why is goodwill considered an „Intangible asset“ but not “fictitious asset”?

Answer:

Goodwill cannot be seen or touched. It can only be felt. Hence it is treated an intangible asset. But it is not a fictitious asset because fictitious do not have a value. Whereas Goodwill has value and it can be purchased or sold with any other asset.

Question 21

(Mock Dec 19)

Write differences between Receipts and Payments Account and Income and Expenditure Account;

Answer:

Differences between Receipts and Payments Account and Income and Expenditure Account

| S No | Receipts & Payments Account | Income & Expenditure Account |
|------|---|--|
| 1 | It is a summarised Cash Book | It closely resembles the Profit & Loss Account of a Trading concern |
| 2 | Receipts are debited and Payments are credited. | Incomes are credited and Expenditures are debited. |
| 3 | Transactions are recorded on Cash basis. | Transactions are recorded on Accrual Basis |
| 4 | Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded. | Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added. |
| 5 | It records both Capital and Revenue transactions | It records Revenue transactions only. |
| 6 | It serves the purpose of a Real Account. | It serves the purpose of a Nominal Account |
| 7 | It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances | It does not record such balances, rather its final balance shows a surplus or a deficit for the period |
| 8 | It does not record notional loss or noncash expenses like bad debts, depreciations etc. | It considers all such expenses for matching against revenues |
| 9 | Its closing balance is carried forward to the same account of the next accounting Period. | Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet. |
| 10 | It helps to prepare an Income & Expenditure A/c. | It helps to prepare a Balance Sheet |

Chapter 4: Partnership Accounting

Question 22

(Mock June 23)

Discuss the treatment of goodwill on admission of new partner if:

- i. the new partner brings in premium for goodwill in cash.
- ii. the new partner is temporarily not able to bring in premium and the amount due in this respect will be treated as a loan.
- iii. the new partner does not bring the premium and the goodwill a/c may appear in the new balance sheet.
- iv. the new partner does not bring the premium and the goodwill a/c shall not appear in the new balance sheet.

Answer

The amount of premium will be shared by the old partners in sacrificing ratio.

i. The entry will be:

| |
|--|
| Cash A/cDr. To Premium for Goodwill A/c |
| Premium for Goodwill A/c.....Dr. To Old Partners' Capital A/c |

ii. The amount of premium will be shared by the old partners in sacrificing ratio. The amount for premium due from New Partner will be debited to Loan A/c. The entry will be:

| |
|---|
| Loan to New Partner A/c..... Dr. To Premium for Goodwill A/c |
| Premium for Goodwill A/c..... Dr. To Old Partners' Capital A/c |

iii. The Goodwill A/c will be raised in the books by crediting Old Partners' Capital A/c in old ratio.

| |
|---|
| Goodwill A/cDr. To Old Partners' Capital A/c |
|---|

iv. The Goodwill A/c will be raised in the books by crediting Old Partners' Capital A/c in old ratio and then written off by debiting All Partners' Capital A/c in new ratio. Alternatively, a capital adjustment entry may be made by debiting the New Partners' Capital A/c and crediting the Old Partners' Capital A/c in sacrificing ratio.

| |
|---|
| New Partner's Capital A/c.....Dr. To Old Partners' Capital A/c |
|---|

Question 23

(PYQ, June 19)

Write short notes on Maximum Possible Loss Method

Answers

Maximum loss method

Steps:

1. Prepare a statement showing distribution of cash
2. Pay off the external Liabilities
3. After all the payment is made for the external liabilities, the partners will be paid off.

| | |
|----------------------------------|----------------------|
| Total Due of Partners | xxx |
| Less: Net/Balance of Realisation | (x) Maximum Loss xxx |
4. The maximum loss shall be shared amongst the partners in their profit sharing ratio, as if, there will be no further realisation.
5. If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.
6. The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner vs. Murray Rule.
7. Repeat the steps (3) to (6) till final realisation.

Chapter 5: Lease, Branch, Departmental Accounts and Hire Purchase

Question 24

(PYQ Dec 22)

Distinguish Between Hire-Purchase and Installment Purchase.

Answers

| Factor | Hire-Purchase System | Installment Purchase System |
|--|--|--|
| Transfer of Ownership | Ownership in the goods sold passes to the buyer only on payment of the last installment | Ownership in the goods passes to the buyer immediately at the time of sale |
| Recovery of Goods | If the buyer fails to pay any installment, the seller can recover the goods back from buyer | The seller cannot recover the goods but he can sue for recovery of price and damages |
| Forfeiture of installments paid | If the buyer default in payment, the seller can forfeit money paid by the buyer so far | Money paid by the buyer will be taken as a payment towards part of selling price and the seller can sue only for the balance |
| Accounting Entries | In the books of purchaser, vendor is debited with full purchase price once contract signed. Amount due, if any, is shown separately as a liability of the purchaser and not a deduction from the asset | In the books of vendor, the purchaser is credited with full price. Purchased goods become property of the buyer and shown in his Balance Sheet at cost less depreciation |

Question 25

(Mock Dec 19)

Write short notes on calculation of the amount of claim under “loss of Profit” Policy;

Answer

Calculation of the amount of claim under “loss of Profit” Policy:

1. Find out the rate of Gross Profit [after considering trend of business etc.]
2. Find out the short sales [Standard turnover – Actual turnover of the period of dislocation]
3. Find out Gross Profit on short sales.
4. Find out the Amount Admissible for Additional Expenses

It should be the minimum of: (a) Actual expenses (b) Gross profit on additional sales generated by additional expenditure and

Additional expenses \times $\frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Net Profit} + \text{All Standing Charges}}$

a. Net Profit + All Standing Charges

ii. or

Additional Expenses \times Gross Profit on Annual Turnover

1. Gross Profit on Annual Turnover + Uninsured Standing Charges
5. Add (3) and (4). From the total deduct saving in any insured standing charge during the period of indemnity. The result is gross claim.
6. Under average clause: Net Claim = $\frac{\text{Gross Claim} \times \text{Policy Value}}{\text{Gross Profit on Annual Turnover}}$

Question 26

(Mock Dec'23)

Write the differences between Branch Account and Departmental Account.

Answer

| Points | Branch Account | Departmental Account |
|--------------------------------|--|--|
| Allocation of expenses | In case of branch accounting allocation of common expenses does not arise. | Allocation of common wealth is the fundamental consideration here. |
| Result of the operation | It shows that trading result of each individual branch. | It shows the trading result of each individual department. |
| Maintenance of accounts | Method of Branch Accounting depends on the nature and type of branch whether dependent or independent. | It is centrally maintained. |
| Types of accounting | It is practically a condensation of accounts. | It is a segment of accounts. |
| Control | It is not possible to control all branch by the Head Office | Effective control is possible by the departmental supervisors who is closely related and who is to keep a constant watch over the departments. |

Chapter 6: Accounting Standards

Question 27

(PYQ June 23)

What is meant by 'substance over form' as per AS 1?

Answer

Substance over form means the transactions should be accounted for in accordance with actual happening over the economic reality of the transactions, not by its legal form.

Question 28

(PYQ June 23)

Explain in short, the relevant Disclosures of Accounting policies as per AS 1.

Answer

As per AS1, the disclosure of Accounting policies are:

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place. Any change in the accounting policies which has a material effect in the current periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the Financial Statements is affected by such change should also be disclosed to the extent ascertainable where such amount is not ascertainable, wholly or in part, the fact should be indicated. If the fundamental accounting assumptions, viz, Going concern, Consistency and Accrual, are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact to be disclosed.

Question 29

(PYQ Dec 2021)

State your views in line with provision of AS-1 and give reasons for your answer in respect of the following:

1. Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
2. If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
3. All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
4. Any change in accounting policy which has a material effect should be disclosed.

Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

5. There is no single list of accounting policies which are applicable to all circumstances.

Answer:

1. False, As per AS1 “disclosure of accounting policies”, Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed Disclosure is necessary if they are not followed.
2. False, As per AS1 if the fundamental accounting assumptions, VIZ going concern, consistency and accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.
3. True, to ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of a financial statement and they should be disclosed at one place.
4. False, Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
5. True, As per AS1, There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable

Question 30

(PYQ Dec 23)

Explain the methods/ criteria for selection and application of accounting policies

Answer

Factors governing the selection and application of accounting policies are:

Prudence: Generally maker of financial statement has to face uncertainties at the time of preparation of financial statement. These uncertainties may be regarding collectability of receivables, number of warranty claims that may occur. Prudence means making of estimates, which is required under conditions of uncertainty.

Substance over form: it means that transaction should be accounted for in accordance with actual happening and economic reality of the transactions not by its legal form. Like in hire purchaser if the assets are purchased on hire purchase by the hire purchaser the assets are shown in the books of hire purchaser in spite of the fact that the hire purchaser is not the legal owner of the assets purchased. Under the purchase the purchaser, becomes the owner only on the payment of last instalment. Therefore the legal form the transaction is ignored and the transaction is accounted as per as substance.

Materiality: Financial Statement should disclose all the items and facts which are sufficient enough to influence the decisions of reader or/user of financial statement.

- a) As to the disclosure of all material items, individually or in aggregate in the context of fair presentation of financial statements as a whole if its omission or misstatement could influence the economic or financial decision of the user relying upon the financial statements.
- b) Depends on the size of the items or errors judged in the particular circumstances of its omissions or misstatements.
- c) Is a cut-off point rather than being a primary qualitative characteristic which information must have.

This is a matter of judgment, varies from one entity to another and over one period to another.

Question 31

(PYQ June 23)

Explain the relevant accounting assumptions or principle which is an exception to Full Disclosure Principle.

Answer

1. Meaning of materiality principle

- a. According to the maturity principle, all relatively relevant item, the knowledge of which might influence the decision of the user of the financial statements, should be disclosed in the financial statement.
- b. Which information is more relevant than? Others are largely a matter of judgement For instance, accounting and recording of a small calculator of an asset in the balance sheet may Justified due to the excess cost of recording over the benefit in terms of usefulness of recording and the accounting of calculators as assets.

2. What is materiality

The materiality depend not only upon the amount of item, but also upon the size of business level and nature of information. Level of the person department who makes the judgement about materiality for instance, a worker reporting to his foreman

about the production in grams. That is (part of kilogramme), A foreman to his superior in kilograms. A superior to his production manager in Quintals And the production manager to the top management in turns may be justified with regardin circumstances It hardly makes any difference if the production manager reports to the top management that the production is 1,99,000.90 kilogramme of simply 200 tonnes (nearly).

1. It is desirable to establish the follow uniform policy governing material or non material items so that, while measuring income for an accounting. And the non material item can be ignored on uniform basis.

3. Exception to the Full Disclosure Principle

1. This principle is basically an exception to the full disclosure principle
2. The full discovery principle required that all facts necessary to ensure that the financial statement are not misleading. Must be disclosed, whereas the materiality principle requires that the item or event having an insignificant economic effect are not relevant to the users need not to be disclosed

Question 32

1. Entity A carried plant and machinery in its books at 2,00,000 which were destroyed in a fire. These machines were insured 'New For Old' and were replaced by the insurance company with new machines of fair value ₹ 20,00,000. The old destroyed machines were acquired by the insurance company and the company did not receive any cash compensation. State, how Entity A should account for the same.
2. Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after store reopens, which include the cost of remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers

Decide whether Omega Ltd can capitalize the remodeling cost or not as per provision of AS-10 'Property Plant & Equipment

Answers

1. Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10 on Property, Plant and Equipment. Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets provided by the insurer.

2. The expenditure in remodeling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodeling can be measured reliably, therefore, it should be capitalized in line with AS 10.

Question 33

ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. Is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and publics at large. Whether ABC Ltd can capitalize expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd?

Answer

Paragraph 7 of AS 10 states that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- i. it is probable that future economic benefits associated with the item will flow to the entity; and
- ii. the cost of the item can be measured reliably. measure for recognition, i.e., what constitutes an item of property, plant and Further, paragraph 9 provides that the standard does not prescribe the unit of equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances.

Paragraph 17, inter alia, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many

cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

Depreciation

As per paragraph 45 and 47 of AS 10, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment.

The useful lives of these assets should not exceed that of the asset to which it relates.

Presentation

These assets should be presented within the class of asset to which they relate.

Question 34

(Mock Dec 19)

The Company's plant and machinery was ₹ 6,000 lakhs as on 1.4.2017. It provided depreciation at 15% per annum under WDV method. However, it noticed that about ₹ 1,000 lakhs worth of imported asset, which is component of above plant and machinery acquired on 1.4.2017, would be obsolete in 2 years. Company wants to write-off this asset over 2 years. Can Company do so? Give comments.

Answer:

As per AS-10, each part of an item of Property Plant and Equipment that has a cost that is significant when compared to the total cost of the item should be depreciated separately. As it appears that imported asset of ` 1,000 lakhs, which is component of plant and machinery, has significant cost as compared to the total cost. Therefore, it should be depreciated separately. The company's policy to write off over two years is correct.

Question 35**(PYQ Dec 23)**

ABC Ltd has received the following grants from the Government of Delhi for its newly started pharmaceutical business:

- i. ₹ 20 lakh for immediate start-up of business without any condition.
- ii. ₹ 50 lakh received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:
 - a) That drugs should be available to the public at 20% cheaper from current market price; and
 - b) The drugs should be in accordance with quality prescribed by the World Health Organization (WHO)
- iii. Two acres of land received for set up of plant.
- iv. ₹ 2 lakh received for purchase of machinery of ₹ 10 lakh. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line-basis.

How should ABC Ltd recognize the government grants in its books of accounts.

Answer

ABC Ltd. should recognise the grants in the following manner:

- As per para 6.4 of AS 12, in certain circumstances, a government grant is awarded for the purpose of giving immediate financial support to an enterprise rather than as an incentive to undertake specific expenditure. Such grants may be confined to an individual enterprise and may not be available to a whole class of enterprises. These circumstances may warrant taking the grant.
To income in the period in which the enterprise qualifies to receive it, as an Prior Period Items and Changes in Accounting Policies). Therefore, 20 lakhs has been received for immediate start-up of business. This should be recognised in the statement of Profit and Loss immediately as there are no conditions attached to the grant.
- As per para 9.1, grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense. 50 lakhs should be recognised in profit or loss on a systematic basis over the periods which the entity recognises as expense the related costs for which the grants are intended to compensate provided that there is reasonable assurance that ABC Ltd. will comply with the conditions attached to the grant.
- As per para 7.1, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.

- The standard provides the option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per para 8.3 and 8.4 of the standard. Under the first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹10 lakhs - ₹2 lakhs = 8 lakhs and depreciation will be charged on it as follows:
 $\text{₹ } 8 \text{ lakhs} / 5 \text{ years} = 1.60 \text{ lakhs per year.}$

Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation depreciation on related assets is charged. Income is usually made over the periods and in the proportions in which depreciation on related assets is charged.

₹2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, 40,000 [2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 36

(Mock June 23)

Suggest two approaches of accounting for government grant.

Answer

There are two broad approaches which can be adopted for the accounting treatment of Government grants. They are:

1. Capital approach; and
2. Income approach.

It is generally considered appropriate that accounting for Government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated under Capital approach, whereas Income approach is considered more appropriate in the case of other grants.

Capital approach: Under this approach, a grant is treated as part of shareholders' funds. This is credited directly to shareholders' funds.

Income approach: Under this approach, a grant is considered to be an item of income over one or more periods. It should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.