OPINION BASED ANSWERS, FOR EACH QUESTIONS!

KAVERI'S IAS TEST SERIES

UPSC ANSWER BOOKLET: GENERAL STUDIES

UPSC MAINS
COMMERCE TEST SERIES

RESEARCH BASED Q & A: FA

1. Maximizing the value of the company to its shareholders is consistent with the company exercising considerable social responsibilities". Discuss. 10 marks.

Maximising the wealth of shareholders is the primary aim of any organisation. The wealth can be maximised by company exercising considerable social responsibilities.

Though companies act, 2013 made it mandatory for companies to spend certain (2%) of its profits for social responsibilities, this practice is very old age.

Companies by exercising social responsibilities can enhance their brand value and Leads to creation of goodwill over a period of time. This will lead to increased advertisement / publicity, thereby increasing sales of the company.

Corporate social responsibility has become an essential element of corporate finance and accounting in the following manner.

a. Mandatory expense on social responsibilities to the extent of 2% of profits by every company as per companies act.
b. Feasibility study for projects including environmental Impact assessment (EIA)
c. Social auditing by the community becoming a norm for new projects.

Thus the profit motive of the company as taken a social edge due to.

a. Value attached to such efforts by the shareholders.
b. Government policies emphasizing or social efforts.
c. Employees of organisation taking pitch and motivated by social efforts.

Therefore the social responsibilities exercised by the company will indirectly lead to maximising the value of company.

Morally also, the companies get their inputs from the society and hence give back to society and shareholders being part of society receives the various services of the company.

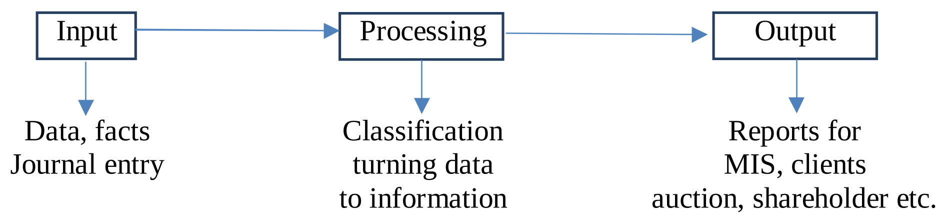
Thus value maximization has become consistent with considerable social responsibilities.

2. Describe the basic information processing model of an accounting system. 10 marks.

Basic information processing model of an accounting system has the following key elements.

1. Input of data and facts as journal entries with financial and non-financial information pertaining to every transaction occurring in a year.
2. Processing of data stored by classification and segmentation to make relevant meaning out of data by arranging them in ledger account and grouping them under larger heads.
3. Output in the form of reports is the result of such processing useful for management, employees, auction and clients.

Accounting Information system



3. Accounting in computerized Environment. Comment. 10 marks.

In olden days books of accounts all maintained manually. Now in the age of computerization books of accounts all maintained in computers using various software's like Oracle, SAP etc.

However the process of maintaining accounts remains some Journal entries, Ledger accounts, trial balance, finally P&L a/c and Balance sheet remains to exist.

The computerized environment made it easy and enhanced the efficiency of accounting. The role of auditor in auditing the books of accounts has changed significantly. He has to verify the accuracy of software used.

Accounting is computerised environment is a substantial shift from the certain manual accounting. The Merits and demerits are:-

Merits:

1. Paperless accounting when large amount of time and space is saved due electronic input data.
2. Faster and accurate processing avoiding manual errors.
3. Quick and meaningful report extraction on realtime basis for decision making and other services
4. Connection on realtime basis with different branches are the world leading to realtime updation extremely essential in an age of globalization.

Demerits

1. Small error in programming may escalates to vast deviations and errors.
2. Vulnerable to hacking and manipulation.

Thus, it has been tremendous positive shift in accounting if we can minimize the demerits through tight security.

4. What do you mean by reconstruction of company? State the essential features of internal reconstruction of a company. Does it necessarily involve reduction of capital? 15 marks.

Reconstruction refers to correction of inherent error in accounting principles which may mislead the viewers by not presenting a term and fair views of the state of affairs of the company.

Reconstruction of a company means reorganisation of capital structure of the company in order to clean up the balance sheet. **Reconstruction is of two types. They are:**

i. External reconstruction: It involves liquidation of the existing company and forming a new company with desired capital structure.

ii. Internal reconstruction: It involves compromise, arrangement with shareholders and other lenders of finance to clean up the balance sheet.

Features:

- It does not involve liquidation of a company
- It can be described as internal adjustment or arrangement
- In order to write off accumulated losses and unrepresented value of assets the shareholders and other lenders all requested to forego their capitals.
- It may include reduction of capital, split or consolidation of shares, surrender of shares etc.
- It may involve converting a debt capital into equity capital.
- Post-reconstruction balance sheet represents true value / fair value of assets.

Others Features:

1. It leads to revaluation of assets and liabilities and reduce own valuation or under valuation as the case may be.
2. It involve the proportion of a capital reduction account of reconstruction account.
3. It may lead to consolidation of assets and liabilities
4. Liabilities and creditors may be requisited for an absolute amount or rates.
5. It may also lead to change in management and layoffs of employers to cut down costs.

It may not necessarily involve reduction is capital if the revaluation of assets increases the net value of assets on short term liabilities are reduced to the extent required for the company to run smoothly.

e.g. value of property owned by the company can be restated at the market value or fair value which is much higher than cost.

Internal reconstruction does not necessarily involve reduction of capital. It may sometime involve reduction. Reduction of capital may be replaced by compromise with creditors, share surrender by shareholders, converting debt into equity etc.

5. Explain accounting standard related to depreciation accounting. 15 marks.

AS-6 prescribes the accounting for depreciation. It says that depreciation should be charged as per rates given in schedule II of the companies Act, 2013.

Other provisions of AS-6 all:

- Two types of methods of depreciation straight line method, written down value method or based on proportion of income.
- The use life of asset should not exceed the life of economic use of asset.
- The method of depreciation chosen should be consistently followed. However it can be changed only in following situations:
  - ✓ Due to change in law
  - ✓ For better presentation of books of accounts
- When the method of depreciation is changed, the new method should be applied retrospectively. And any difference between existing provision of depreciation and depreciation as per new method should charge to P&L a/c.
- The intangible assets are also changeable to depreciation. It is known as amortization.
- When the use life of intangible asset is not known, it should be taken as 10 years.
- The asset should be shown at carrying value in the balance sheet after deducting depreciation.
- Whenever there is a change in estimated useful life of assets, the remaining carrying value of the asset should be charged over revised period.

Depreciation accounting is mentioned in details in accounting standard 6.

Depreciation bring an important element in disclosure of fixed assets in Balance sheet and for providing required funds for its wear and tear. Have dealt in detail by AS-6.

AS-6 explains the method for proceeding for depreciation and in disclosure requirements of depreciation in the financial statements and notes.

There are 2 methods of depreciation specified in AS-6.

1. Straight line method which amortisation equally owns the useful life of the asset.

$$\text{Formula} = \frac{\text{Cost of asset} - \text{salvage value}}{\text{Useful life}}$$

Eg: if an asset costing 1,10,000 has a salvage value of 10,000 asset useful life of 10 year. SLM depreciation would be

$$= \frac{1{,}10{,}000 - 10{,}000}{10} = 10{,}000$$

2. Written down value method (WOV) refers to application of a specific rate to the depreciated value of fixed asset.

Eg. in the above example if the rate of depreciation is 10% was depreciation for different years would be

Year 1	Year 2	Year 3
10% of 1,10,000	10% of 89000	10% of 81100

= 11,000 = 8900 = 8010

Rates of depreciation specified under schedule II should be utilized.

Disclosure requirements as per AS-6 are:-

1. Accumulated depreciation should be shown under Fixed asset schedule in the following manner.

Gross fixed asses	XX
(–) Accumulated dep.	(XX)
Net Fixed Assets	XX

2. Provision for depreciation for that year should be shown in the statement of Profit and loss account.
3. The asset wise rate of depreciation tenure and calculation should be shown as part of notes.

Depreciation accounting

- It refers to approximation of cost of asset over its useful life on systematic basis
- Also property, plant and equipment deals with depreciation
- Depreciation can be calculated in SLM or WDV basis
- Depreciation is calculated based on estimated useful life of asset. If there is change in estimated life, such change shall be dealt in accordance with AS 5.
- Depreciation expense is charged to P&L A/c
- In case of companies, Depreciation shall be charged based on rates given in companies Act, 2013. If above, rates are not followed, then reasons of lame along with technical report should be disclosure.

6. What is share as understood from company account? When and why does the question of valuation of share arise? What are the different methods of valuation of share? 15 marks.

Share as mentioned in the financial statement refers to a unit of ownership held by a subscriber of that unit. In a nutshell it an ownership unit of the company.

Share can be defined as a physical certificate or an equivalent electronic form held as a proof of investment in the company. The holder of the share is identified as owner of the company and he is entitled to dividends.

Valuation of share

Over a period of time the value of the share which was first represented by paid-up value / nominal value keeps changing as the performance of the company. The value of share may increase or decrease over a period. Therefore it is necessary to value shares as and when required to know the exact value represented by it.

Valuation of share arises in the following situation:-

1. Investor deciding to invest in a company would want to know the true value of share.
2. Issues of share to public through an IPO or private placement

3. Amalgamation or absorption of a company
4. Buy Back of shares
5. Trading in shares
6. Reporting requirements to requestors.

The valuation of shares is necessary in following circumstances:-

- While issuing, new shares to determine premium or discount on issue of shares.
- While liquidating the company to settle the shareholders.
- For calculating purchase consideration in case of amalgamation.
- For issue of shares to acquire new assets or payment in other parties.
- While right issue and ESOP for fixing the amount to be collected.

Why and when valuation need arise

Share valuation need to be done

- ✓ To find out actual value of shares
- ✓ Based on market expectation

Share valuation is done:

- ✓ Amalgamation
- ✓ Sale of business
- ✓ Deciding share price in future …

Different methods of valuation of shares:

1. Book building method where bids are raised from potential investors to arrive at a value.
2. Book value of shares where net assets is distributed among equally shareholders.
3. Market value of shares by taking the price trading in a public stock exchange.
4. EPS method where the price multiple is arrived at after comparison of EPS and MPS
5. Dividend method where present value of future dividends are considered to value a share.

Other Methods:

- Net asset method: All liabilities at …. Value less all liabilities at payable value, divided by no. of shares. It represents net worth of each share.
- Intrinsic value: Value of share is fixed taking into consideration various external factors.
- Market price: The price of the share as traded in the market.
- Discounted Cashflow technique: All the future cashflows discounted at appropriate present value and divided by no. of shares. It represent likely value of share.

Share is the term used for investment made by shareholders in a company. Investments are measured in terms of shares

Methods of valuation of shares

1. Net asset value method
2. Discounted cashflow method
3. EPS and DPS method
4. Other reasonable methods

7. Accounting is the language of business". Discuss. 10 marks.

Language in "General refers to medium of communication between two entities / People". In the same way the business entity interacts with its interested parties through accounting treatment (i.e. Books of accounts).

Accounting captures all the business transactions and other results, changes of business. It gives or portrays a true picture of what is happening in the business.

Accounting over the year has become the language of business due to the following reasons:

1. Initial data required for any decision comes through the accounting process. Various reports are generated out of the data.
2. Consistent and conservations principle of accounting which makes the figures comparable
3. Standard regarding estimates is followed to make and Its estimates and provision reasonable.
4. Accounts are compulsorily audited and bank decide credibility of the company based on the audited accounts.
5. Human resource accounting it has been one of the important changes in accounting over the years considering human resource as on integral asset.

   Thus accounting as modified itself to the needs of globalization and changing business environment to the official language of business.

Therefore all those interested in the business should look upto books of accounts for the information of business and its performance. For example a shareholder waiting for dividend looks the profit of the current year Government who wants to know the tax liability of the business looks into books of accounts to know taxable profits.

8. What is Amalgamation companies? How does it differ from reconstruction of companies? 10 marks.

Amalgamation refers to two or more companies coming together to form a new company on one company getting absorbed into another company.

Amalgamation of company and reconstruction of a company is interchangeably used. However there is a difference appreciable between them.

Amalgamation: The liquidation of one or more company and formation of a new company.

Eg: A Ltd and B Ltd (existing company) being liquidated and forming C Ltd (a new company) to take over A ltd and B ltd.

Reconstruction: it is of two types

1. Internal reconstruction: Reorganisation of share capital of a company without liquidating the existing company.

2. External reconstruction: Reorganisation of share capital of accompany by liquidating a company and forming a new company with desired capital structure.

It happens due to the following reasons:-

1. Synergistic advantages
2. Avoiding competition
3. Making a company global
4. Entering a new market
5. Densification

Difference between amalgamation and reconstruction.

1. Profit: Amalgamation can happen between two profitable companies, where reconstruction is crucially associated with loss making companies.
2. No. of companies involved in amalgamation is the more than one while reconstruction can happen involving a single company.

Other differences:

Amalgamation	Reconstruction
• Involvement of two or more companies	• Only one company is involved
• Aim is to sell the investment in a company	• Aim is to reorganise the capital structure
• It involve both liquidation and formation of companies	• It also involve both liquidation formation of companies.

It is to be noted that both the methods are governed by AS-14 for accounting treatment.

9. "Making the Accounting standards mandatory is likely to Improve the accounting reporting practice to the benefit of the Investors". Do you Agree? Explain. 15 marks.

Accounting standards are set of rules or guidance's based on which the accounts of the company should be prepared and disclosed.

There are various merits and demerits to making accounting standard mandatory for all.

Merits

1. Easy comparison between financials of different companies.
2. Reduces ambiguity in reporting and understanding of financial statements.
3. Helps to improve credibility and raise finance
4. Helps to make a company global and expand its operation.

Demerits

1. Increases cost of preparation of accounts.

2. Additional auditing cost has to be borne which may be difficult for start-ups.

Thus considering the above merits and demerits we can conclude that accounting standards may be made mandatory beyond certain threshold of turnover when company can expend on additional costs associated with implementing standard. Below this there should be voluntary compliance with standards.

10. Discuss the need for evolving accounting standards. What is their Primary Aim. 10 marks.

Need for evolving accounting standard are given below.

1. Ensures comparability
2. Ensures transparency in reporting
3. Helps to smoothen decision making
4. Considers customization of standards with respect to a particular country
5. Helps in investing decision
6. Aids raising finance
7. Helps to improve on reporting framework the world over
8. Helps companies to expand and becomes global entities.

Thus the primary aim of accounting standard is to smoother financial transactions and enhance credibility of the financial sector.

11. What are the accounting conventions? Give the rationale of charging depreciation. 15marks.

Accounting conventions refers to norms or custom followed in accounting for a larger period of time.

Accounting conventions are the accounting practices which are developed over a period of time. Conventions are developed in those areas where accounting standards do not prescribe a specific treatment. For example, while issuing new shares securities premium is generally collected at the allotment stage if nothing is specified. This is an accounting convention developed over a period of time.

The convention may be with regard to:-

- Changing depreciations
- Valuation of inventory
- Valuation of fixed assets
- Valuation of investments
- Estimation in construction contracts etc.

The rationales of charging depreciation is as given below:

- An asset is not perpetual and goes through wear and tear
- This leads to a conclusion that the asset after a certain point would not be useful. This is termed as useful life.
- A conversation approach would be to provide for reinvestment into the asset after the useful life.
- This provision can be done at regular intervals day of a year

- Such required provisions for wear and tear of the machine would helps to accumulate fund for reinvestment when time comes.
- Thus it is a prudent approach to asset management from a company's point of view.
- This provision is called depreciation of an asset and charged every year.

Other Rationale for charging depreciation:

- Keeping aside the funds required for replacing the assets after their life is over.
- Like every factors of production has a cost. In the same way machinery being a factor of production has to be charged depreciation.
- Matching concept of charging expenditure in relation to the income generated during a period.

12. What you understand by responsible Accounting? How does its seek to establish a relationship between Planning and controlling. 15 marks.

Responsible accounting refers to each and every individual department or function of a company prepare its own financial statements to arrive at its position and profits.

Responsible accounting

- Under this persons are made responsible for their actions
- Responsibilities will be divided among group of persons and they are made responsible for their actions with regard to such
- A person cannot be held accountable for duties / responsibilities not allocated to him
- It helps in fixing accountability
- It helps in evaluating performance of manager based on his decisions

This method helps to evaluate the performance of every functions visa-viz other in the organisation. Thus promoting competition.

Responsible accounting helps to develop a link between planning and controlling:

1. It help in bottom up approach of preparation of budgets and plans.
2. It helps to allocate targets to different departments based on their previous performance.
3. It helps to regulates and monitor each and every function or department based on the target and the achievement.
4. It helps in performance appraisal of not only the department but also the department heads.
5. Targets can be trickled down right up to the individual employer and as world help in evaluating their performance.

However there are certain actions which are not within control of manager like change in government policy, strike, Expert prohibition.

All this proposing taken into consideration to get full benefits of responsibility accounting because manger cannot be held responsible for actions not which in his control.

13. A company has indulged in massive advertising campaign a huge sum of Rs. 1 crore during the current year against its usual yearly expenditures of Rs. 20,00,000. How would you deal with this type of expenditure in the annual accounts of the company. 15 marks.

Company has indulges in making advertisement campaign of a huge sum of Rs. 1 crore as against a usual expense of Rs. 20,00,000.

- This expense would be incurred with increase of sales in future. Thus this expense can be construct as a capital expenditure with future economic benefits and can be disclosed under "other non-current assets"
- However As-26 specifically mention that all expenses of advertisement although having future economic benefit should be expensed in the same year. Thus the above disclosure under other non-current assets cannot be followed and should be expressed in 'Statement of Profit and loss".
- However this expense of extensive nature relating to the operations of the company. Thus as per new schedule III of companies Act 2013 such expense should be disclosed separately below profits from business activities as an 'exceptional item'.

Statement of Profit and Loss:

Profit before exceptional item	XX
Exceptional item	
Advertisement expense	1 crore
Profit before extraordinary items:	XX

14. Accounting Issues in foreign Exchange transactions'. 10 marks.

Accounting issues in Foreign exchange transactions

1. Transaction of reporting currencies of foreign currency.
    a. At the time of recording transaction
    b. At the time of reporting at year end
2. Valuation of Investments and assets in foreign currency
3. Treatment of Net gain or loss in foreign exchange fluctuation
4. Consolidation of subsidiary entities located abroad
5. Branch accounting in foreign currency

15. Explain Accounting standards. State main features of International Accounting standards. 10 marks.

Accounting standards refer to guidance on treatment of accountancy transactions in a standardised manner to improve comparability and transparency.

Main features of International Accounting standard:

- Companion global of financial statement is facilitates
- MNC's are advantages at the cost of preparing different financial statement are avoided.

- Smoother financial transaction a globally.
- Acceptance by all the countries
- Inbuilt flexibility to customize.

16. What objectives prompt a company to opt for buy – back shares? Through what sources can such a company execute the scheme of buy back?. Examine. 10 marks.

Objectives of a company to opt for buy back are:

1. To reduce dilution of equity share by buying it back from shareholders.
2. To keep close control own company by management
3. To reduce dividend obligation
4. To improve image of company and increase market prices
5. To increase value per share of company

Sources that a company can use to execute buy back are.

a. Proceeds from issues of different class of equity shares on other instruments such as investments etc.
b. Securities Premium
c. Free reserves and general reserves of the company

Thus the companies Act 2013, and the SEB1 regulation have allowed restricted source, same class of share cannot be sold to raise fund for buyback.

17. What is the purpose of statement of cash flows? Why is the statement of cash flows divided in to three main parts? Where are dividends received reported on the statement of cash flows? Is interest received an Investing activity? Comment. 20 marks.

As per section 2(43) of companies Act, 2013. The financial statement of company include cash flow statement.

Cashflow statement is a statement which shows cash flows of companies from various activities

Purpose:

- To clearly know the sources of cash and the payments made in cash
- Generally when the profits of a company increases it is expected that the cash balance of the company also increases. This need not be true in every case. Because the profit earned in cash may be used for purchasing a capital asset etc.
- It is to be clearly understood that profit earned during a year is totally different from cash balance of the company. While profit earned is reflected in statement of P&L the cash inflows and outflows are reflected in cashflow statement.
- Also cash is the lifeline of any business and it is also most vulnerable to window dressing: Therefore to maintain transparency the cash flow statement is prepared.

Purpose of cash flow

- Segregation of cashflows from different activities

- ✓ Operating activities
- ✓ Investing activities
- ✓ Financial activities

- Shows net cash rotation of firm and reasons for cash surplus & cash deficit comparisons
- Helps in future planning for finances in case of deficit and investment planning in case of surplus cash
- It helps in judging efficiency of management in managing cash flows

It is divided into 3 main parts: 1. Operating, 2. Financing and 3. Investing to explain clearly. From which source cash has been received (or) paid, so that it helps in management decisions.

1. **Operating activities:** day to day business operations. Eg. Purchasing & selling etc.
2. **Investing**: cash flows from investments in fixed assets, securities.
3. **Financing:** cash flows from sources of capital and borrowings. Eg. Equity debt, Debentures.

The statement of cash flow is divided into three main parts because the business activities of a company compromise the following:-

i. Raising funds
ii. Utilising those funds to earn profit
iii. Using the cash generated to pay off investors or invest further

These three activities explain the general business cycle. Therefore the cashflow statement is also divided into same three parts i.e.

i. Cashflow from operating activities
ii. Cashflow from financing activities
iii. Cashflow from investing activities

Dividends received are reported in investing activities cashflows, because we receive dividends on the investments made in other companies. So it clearly stands out to be a investing activity.

Interest received is also an investing activity. Hence interest received is shown in "Cashflow from investing activities". We generally receive interest on the investments made in debt instruments. For example investments made in debentures of other companies.

Dividends received is an income from investment in shares of other company, so it should be shown under cash flow from investing activities.

Interest received is an income earned on loan given to others (or) investment in debentures of other company, so it is investing activity and shown under cash flow from investing activities.

18. What is Employee stock Option (ESO)? How stock options are taxed in India? How ESO differ with vested stock? 15 marks.

Employee stock option (ESO)

- It is stock of company issued to employees of company to make them shareholders of company
- It is issued to create sense of belongingness along employees and can motivate them to work better

- It is given to employees who satisfied certain conditions
- AOA should override issue of ESO
- It should not be issued to group of promoters.
- Shareholders must authorize the issue by putting special resolution in general meeting
- Shares issued under ESO shall be subject to certain restrictions like minimum holding period.
- These shares are issued to employees at price lower than fair value of share at the time of issue

Taxation of ESO in India

In hands of company

- Employee stock option expense shall be charged to profit and loss (P&L) a/c over lasting period.
- Employee stock option expense will be debited and corresponding credit shall be given to ESO payable a/c
- At time of receipt of money from Employees

Bank A/c	Dr (amount received from shareholders)
ESO payable a/c	Dr (Fair value of ESOP)
To equity share capital a/c	(Nominal value of shares)
To securities premium a/c	(premium on shares, if any)

In case of any ESOP ………

ESOP payable should be debited and corresponding credit should be given to general reserve.

In hands of Employees

- No taxation at time of receipt of ESO
- Capital gains shall be chargeable to tax if any gain made on sale of share acquired under ESO. Loss also allowed to set off (or) carry forward to adjust against capital gains from others.

Vested stock

- It is the right given to employee to purchase shares of company from market at a price lower than market value.
- Difference amount shall be charged to P&L a/c: A books of company.

ESO	Vested Stock
Company issued shares at price lower than fair value	Purchase of shares from market @ lower value
Employees need to satisfy various conditions to avail this	No such conditions
Shares are subject to certain restrictions	No such restrictions

19. What you understand by stock right? What is difference between bonus issue and right issue? 10 marks.

Stock right

- It is right of existing shareholders of a company to subscribe to further shares of company in case of future issue
- It is given to existing shareholders under companies Act, 2013
- Shareholder can use his stock right:
  - ✓ To purchase shares in further issue or
  - ✓ Renounce shares in name of other or
  - ✓ Allow it be lapsed
- If stock right is lapsed, board of directors can issue such shares in manner as determined by them.

Bonus Issue	Right issue
Issued to existing shareholders at free of cost	Issued to existing shareholders at prise generally lower than issue price.
It results in capitalization of profits	No such impact
Certain sources are eligible for bonus issue (CRR, Securities premium, profit, realised in cash)	No such restriction
In case of listed companies, if there are partly / fully convertible debentures. Bonus issue shall be made to such holders after conversion of debentures into shares	Right issue shall be made to holder of partly/ fully convertible debentures after its conversion into shares
These are issued when company has huge reserves and no alternative investment opportunities	These are issued when company wants to raise further capital for its business
Board of directions shall decide Bonus issue and it is approved by shareholders in general meeting	Shareholder's approval not required, only Boss decides
No inflow of cash	There will be inflow of cash from shareholder's
No right to renounce	Has fight to renounce.

As per provisions of companies act, 2013 if a company wants to further raise capital, it should offer the shares firstly to the existing shareholders [i.e. only equity share holders]. Such a right is known as stock right of the existing equity shareholders.

The difference between rights issue and bonus issues is as follows:

Rights issue	**Bonus issue**
• It will result in cash in flows	• No cash inflows arise to the company
• Capitalisation of reserves is not required	• It involves capitalization of scenario
• Rights issue can be partly paid or fully paid	• Bonus issue can be only fully paid shares

• Shares should be applied	• No such application required
• Right to renounce exists	• No such right exists

20. What is the impact of behavioral sciences on financial accounting? Discuss. 10 marks.

Financial accounting is art of recording, classifying and analysing financial transactions of business. It cannot be mechanical accounting of only debit and credit. It is impacted by behavioural sciences as follows:

- Change in method of accounting
- Prevalence concept i.e. recognition of future losses but not accounting for future revenue.
- Materialistic concept i.e. accounting based on cost benefit analysis and miscellaneous expenditure whole cost exceeds benefit shall not shown separately
- Depreciation accounting: Depreciation is charged based on estimation of useful life of asset.
- Human resource accounting: Since in IT companies, Human resource becomes very significant, accounting for human resource is also done.
- Social accounting: Under this benefit of business to society like employment, local development, Taxes to government shall be recorded and cost of business to society such as pollution, Land acquisition shall be recorded.

  Recently companies are contributing towards CSR activities as per companies act 2013.
- Judgements is needed in deciding accounting policies to be followed.

21. What is meant by Inventory management? Discuss the important methods that are associated with management of Inventories in organization. 15 marks.

Inventory refers to stock of raw material, finished goods, work in progress, spares, etc. lining with the company at the given point of time.

Inventory management refers to the mechanism of ensuring that the company maintains "adequate inventory" balancing both carrying cost and ordering cost. It is of such immense importance because it has direct impact on profitability and credibility of the company.

Inventory management

- It means proper acquisition, recording, storage and use of inventories. All these activities comes under Inventory management.
- Basic aim is to manage inventories "efficiently with lowest cost"
- It includes periodic verification of inventories and revision of their prices according to market prices
- Inventory ageing analysis is proposed based on period for which inventory lying and it can be used for managerial decisions

Methods of Inventory management

- ABC analysis
- Periodic verification of inventories
- Making store managers accountable for abnormal loss in inventories
- Placing future purchase orders only after checking that inventory is not lying in stock
- Ensuring condition between purchase manager, production manager, store manager and also with finance department for effective management.
- Frequent inventory ageing analysis to be done to track movement of inventories.

ABC Analysis

Under this inventories are classified into A, B & C categories based on their value

A = High value items – Full control

B = Medium value items – Moderate control

C = Low value items – Low/ No control

It is based on logic that 100% of inventories cannot be effectively managed due to scarce resources, so inventories of high values should be effectively management as it cause huge cost to organisation.

As per this method the inventory is divided into three categories 'A', 'B', 'C' as per their importance. The 'A' category is given much importance and 'C' category management is delegated. This method believes in 'Everything controlled will result in nothing controlled'.

Merit: Save management time and associated costs

Demerit: Need skilled knowledge for classification of goods and regular review.

Just in Time method:

As per this method the raw materials required are ordered in such a way that, they are received just before the issue for production and finished goods are produced just before

Merit: savings in carrying cost and reduction in wastage of goods

Demerit: Should have trusted suppliers and may sometimes leads to disruption in production

EOQ Method:

This method is known as economic order quantity. This is calculated using a formula i.e.

OEQ = $\sqrt{\frac{2 \times A \times O}{C}}$

Where A = annual demand

O = ordering cost

C = carrying cost

As per this method, inventory is ordered in required quantities in such way that it balances both ordering cost and carrying cost, thereby reducing the overall cost.

22. What is the significance of financial information system as compared to other subsystems coexisting in a manufacturing organization? Explain. 15 marks.

Financial information system is use of information system for processing financial transactions and non-financial transactions that will be significant financial impact

Significance

- It process all financial effects of business transaction
- It also provides information to other departments for discharging their duties.

  Eg. Report on account receivables, account payables, stock of inventories.
- Provides useful information to users: Internal (managements) or External – share holders, debenture, creditors, government
- 3 sub-systems under financial information system
  - ✓ Transaction processing system: Recording of day to day business transactions
  - ✓ General ledger/Financial reporting system: Provides traditional reports like P&L Balance sheet.
  - ✓ Management reporting system: provides specific purpose reports to management
- Helps in processing of all financial transactions with low human intervention
- Real time updating of all financial transactions
- Facilitates auditors in their audit by providing evidence of transactions took place.

In a manufacturing organisation there exists many subsystems. They are:

i. Financial information
ii. Production
iii. Marketing
iv. Personnel etc.

Every subsystem has its own importance and the efficient management of all such subsystems is required for success of organisation.

However relatively speaking, financial information system is more significant for following reasons:

- Finance is the life blood of any organisation. Any decision taken w.r.t. any subsystem is always evaluated in financial terms.
- Majority of the business decisions are taken based on finance information only.
- Decisions w.r.t. to other subsystems like production, technology, marketing are internal to the company. But decision w.r.t. financial information like raising capital, declaring dividend effects the value and goodwill of the company.
- All other subsystems are dependent on financial information. For example whether to upgrade to newer technology or not, is evaluated by taking into consideration its impact on cost, sales etc. Therefore financial information plays an important role.

  Therefore, we can conclude saying that financial information system is relatively significant when compared to other sub-systems in a manufacturing organisation.

23. Accounting is a broad Information system catering to the needs of a wide variety of people". Elucidate this statements bringing out the main functions of Accounting. 15 marks.

Yes, it is true to say that accounting is a broad information system catering to the needs of a wide variety of people.

Accounting contains information related to every aspect of business like raising finance, operations, investments, taxes paid, dividends paid, assets and liabilities etc. thereby standing out to be truly broad.

Accounting is used by wide variety of people. They are :-

i. Management: The management of the organisation is the first user of accounting. It gives them the full picture of business operations. They look into various costs incurred and scope for their reduction.

ii. Investors: The shareholders being the owners of the organisation are more concerned about accounting. It gives them information regarding profits earned and divisible profits available. Also the various investments made and proposed by the company.

iii. Lenders: They are creditors, debenture holders, banker and other financial institution. They are considered about the safety cushion available to them in case of liquidation. Also accounting gives information regarding company's capability to pay interests.

iv. Government: The government looks upto accounting to know the taxable profits and the amount of tax paid and payable.

v. Society: Society as a whole are also users of accounting. They are effected by pricing decisions and future investment options of the company.

24. Explain Accounting standards. State main features of International Accounting standards. 10 marks.

Section 133 of the companies Act, 2013 mandates the Central Government to prescribe accounting standards which are suggested by ICAI and approved by National Financial Reporting Agency (NFRA).

Accounting standards are the predetermined methods of accounting on various subjects, which are generally vulnerable to various treatments. They ensure uniformity of accounting across the companies, making it easy for comparison. They are a way to imbibe financial discipline.

At present there are 31 accounting standards prescribed by Government. In the age of globalisation, investments do not respect national boundaries. Therefore there arise a need for universal accounting standards, hence all the corporates across the globe will present their accounts in a similar manner. They are known as international financial reporting standards (IFRS).

Features of IFRS:

- They are prescribed by International accounting bodies
- It is still not mandatory for corporates to follow international standards. A phased approach is in place to adhere to those standards. At present in India we have modified our accounting standards into IND-AS based on IFRS.
- If followed, it ensure uniformity in reporting across the globe.
- They will enhance global trade and FDI.

25. Distinguish between Amalgamation and Absorption in regard to joint stock companies. 10 marks.

The words amalgamation and absorption are used inter-changeably. But there is a thin line of difference between them.

Amalgamation: The liquidation of one or more companies in order to form a new company.

Eg: Liquidation of A ltd and B Ltd. (existing companies) and formation of a new company C ltd to take over the business A ltd and B Ltd.

Absorption: The taking over of an existing company by another existing company.

Eg: A ltd (existing company) being taken over by another existing company B ltd.

The following are the further differences:

Amalgamation	**Absorption**
• A new company is formed	• No new company is formed
• One or more companies are liquidated	• Only one company is liquidated
• The legal provinces and procedure is too complicated	• The legal procedure is relatively easy

Other Differences

Amalgamation	**Absorption**
Under this two more companies come together to form new company Eg: A or B become AB Ltd.	Under this one company acquires another company Eg: A Ltd or B Ltd. Become A Ltd.
Formation of new company	New company is not formed
Purchase consideration (PC) is dis-charged by issuing shares in new company to existing shareholders, payment in cash (or) other forms	Purchase consideration is disclosed by purchasing company by issue of shares in it to shareholder of company (or) paying in cash
Change in management	Existing management shall be continued and management of company shall be included in existing structure

It is to be noted that the accounting treatment for both amalgamation and absorption is same. It is as per AS-14.

26. Accounting Issues in foreign Exchange transactions'. 10 marks.

Accounting Issues

- In foreign exchange transactions there will be two different currencies which should be properly accounted.
- Calculation of Realised gain/loss or Unrealised gain/loss
- Accounting of each gain/loss

AS-11 deals with accounting issues in foreign exchange transactions. AS-11 mainly deals with the exchange that should be used and treatment of exchange rate differences arising.

As-11 prescribes accounting treatment for following transactions:

- Transactions in foreign currency
- Foreign operations
- Forward exchange contracts
- Accounting for foreign exchange transactions are covered under AS 11.
- AS II covers:
  - ✓ Recording of foreign exchange transactions
  - ✓ Translation of financial statements in foreign currency
  - ✓ Forward exchange contracts

Disclosure requirements resolving above.

I. Foreign currency transactions.

They are recorded at the exchange rate existing on that date. On the date of settlement any difference in exchange rate is either debited or credited to P&L a/c.

I.

Foreign operations

Integral operations

- Any change in exchange rate will have immediate effect on books.

On the date of B/s:

- ✓ Monitory items @ closing value
- ✓ Non-monitory items @ initial value
- ✓ Any difference in exchange rate charged to P&L a/c

Non-integral operations

- Any change in exchange rate will not have immediate effect on books

On the date of B/s:

- ✓ Balance sheet items @ closing value
- ✓ P&L a/c items @ initial value
- ✓ Any difference is c/f to "foreign exchange fluctuation reserve a/c

Forward contracts

Purpose of hedging

- Premium / discount is spread across the life of the control
- Exchange difference calculated on the closing date o contract

Purpose of Speculation

- Premium / discount is not considered
- On every B/s date they all marked to market and differences charged to P&L a/c

27. What objectives prompt a company to opt for buy – back shares? Through what sources can such a company execute the scheme of buy back?. Examine. 10 marks.

The following are the objectives of the company to opt for buy-back:

- To utilize the idle reserves
- To increase the future EPS by reducing number of shares
- To strengthen the share holding pattern by reducing number of share holders
- To increase the market value of shares in future i.e. wealth maximisation of shareholders.

Source of buy-back of shares are:

i. Issue of new kind of shares or other specified securities.

ii. General reserve and other free reserves

iii. Balance i.e. surplus in the P&L a/c

28. Accounting is a broad Information system catering to the needs of a wide variety of people". Elucidate this statements bringing out the main functions of Accounting. 15 marks.

Accounting is the language of business and it provides various information about to its users, Internal or external who use each information in their decision making.

Main functions of accounting

- Recording of business transactions since all business transactions can be remembered, accounting helps in systematic recording of all business transactions in timely manner.
- Calculation of net result of operations for the period eg. Profit / loss
- Shows true financial position of entity as on date. It records all assets and liabilities to depict true financial position.
- Source of information to users for their decisions.
  - ✓ Management: Decisions like price fixation, Budgeting, cash flow projection

  External users:
  - ✓ Investors: Earning on their risk
  - ✓ Employees: Profit earned by entity and its distribution
- Help in business valuation in case of amalgamation / sale of business
- Acts as evidence in court of law
- Helps in compliance with law, various returns like sales tax return, excise return, IT return can be fixed based on accounting information.
- Resolving disputes between various parties like company and its shareholders (or) employees (or) between shareholders and lenders etc.
- Helps government in making economic decisions
- Helps in effective management by making persons accountable

29. Explain Accounting standards. State main features of International Accounting standards. 10 marks.

- Accounting standards are generally "Certified principles of accounting"
- It is set of norms and practices regarding measurement of items in financial statements and its disclosure
- It helps in, better presentation of financial statements, better comparison (between inter firm and Inter firs [for different periods]) and Maintains consistency in accounting principles followed because they can be changed under status of low (or) to ensure better presentation.

Main features of International Accounting standards

- Helps in presentation of financial statements at global standards
- Better comparison of financials of companies between different countries
- Help in significant foreign investments
- Harmonization of various laws and low cost of compliance.

30. From the following summary cash account of X Ltd, prepare cash flow statement for the year ended 31st march 2016 in accordance with AS 3 (revised) using the direct method. The company does not have any cash equivalents. 15 marks.

	Rs. '000		**Rs. '000**
Balance on 1.4. 2015	50	Payment to suppliers	2000
Issue of equity shares	300	Purchase of fixed assts	200
Receipt from customers	2,800	Overhead expenses	200
Sale of fixed Assets	100	Wages & salaries	100
		Taxation	250
		Dividend	50
		Payment of Bank loan	300
		Balance on 31.3.2016	150
	3250		3250

Statement of cash flow for the ear Ended 31st March 2016.

	Particulars	**Amount (Rs)**
I	Cash flow from operating activities	
	Receipts from customers	2800
	Less	
	Payment to suppliers	2000
	Overhead expenses	200
	Wages and salaries	100
	Tax paid	250
	Net cash flow from operations	**250**

II	Cash flow from investing activity	
	Sale of Fixed assets	100
	Less	
	Purchase of fixed assets	200
	Net cash flow from investments	**100**
III	Cash flow from financing activity	
	Issues of Equity shares	300
	Less	
	Payment of dividend	50
	Payment of bank loan	300
	Net cash flow from finance	**50**
	Net cash flow (I+II+III)	**100**
	Add	
	Opening cash balance	**50**
	Closing cash balance as on 31st March 2016	**150**

31. A Limited company issue prospects inviting applications for 2000 equity shares of Rs. 10 Each at a premium of Rs. 2 per share payable as follows: 15 marks.

On Application Rs. 2/-

On allotment Rs. 5/- (Incl premium)

On first Call Rs. 3/-

On Second and final call Rs. 2/-

Applications were received for 3000 shares and pro data allotment was made on the applications for 2400 shares. Money over paid on applications was employed on account of sum due on allotment. Shree, to whom 40 shares were allotted, failed to pay the payment money and on her subsequent failure to pay the first call, her shares were forfeited. Pooja, the holder of 60 shares, failed to pay the two calls, and her shares were forfeited after second call.

Of the shares forfeited, 80 shares were reissues to Narman credited as fully paid @ Rs. 9 per share, the whole of shrees shares being included.

Pass the necessary journal entries and prepare the cash book of the company.

Cash book summary

Particulars (Dr)	Amount	Particular (Cr)	Amount
To share application A/c	6000	By Share application A/c	1200
To share allotment A/c	9020		
To share First call A/c	5700		
To hare final call a/c	3800		

To share Capital A/c (reissue)	720	By Balance closed	
	25240		**24040**

Journal entries for the issue of shares

1	Bank A/c Dr.	6000
	To share Application A/c (being application money received for 3000 shares)	6000
2.	Share application A/c Dr.	6000
	To share capital a/c	4000
	To share allotment a/c	800
	To bank a/c (being application for 600 shares rejected and excess money of application of 400 shares utilised for allotment)	1200
3.	Share allotment a/c Dr	10,000
	To share capital a/c	6000
	To securities Premium a/c (being, accrual entry for allotment paused)	4000
4.	Bank A/c Dr.	9020
	Call in arrears a/c dr	180
	To share allotment a/c (being, money on allotment received and default of shares with 40 shares accounted for) (WN.1)	9200
5.	Share First call a/c Dr.	6000
	To share capital (Being, accrual entry for 1st cell paused)	6000
6.	Bank A/c Dr.	5700
	Calls in arrears a/c Dr	300
	To share first call a/c (being. Money received on first call and default of 2 applicants accounted)	6000
7.	Share Capital a/c Dr.	320
	Securities Premium a/c Dr.	80
	To share forfeitures a/c	100
	To calls in arrear a/c (Being the shares of share forfeitures)	300
8.	Share second and Final call a/c Dr.	3920
	To share capital a/c (Being, second and final call made for 1960 shares)	3920
9.	Bank A/c Dr.	3800

	Call in Arrears a/c Dr.	120
	To share second and Final call a/c (Being money received for second call and Pooj as non payment of 60 shares accounted)	3920
10	Share Capital a/c Dr.	600
	To share forfeiture A/c	300
	To call in arrears (being 60 shares of Pooja forfeited)	300
11.	Bank a/c Dr.	720
	Share forfeiture a/c Dr.	80
	To share capital a/c (Being, 80 shares reissued at R. 9/- each)	800
12.	Share forfeiture a/c Dr.	60
	To capital Rescue a/c (being, excess profit share forfeiture a/c related to all shown of share transferred to capital rescue) – WN2	60

WN-1

Shares allotted to Shree	40	
Share applied by Shree	$40 \times \frac{3000}{2400}$	= 50
Application money paid by Shree	= 50 × 2	= 100
Apportioned to share	= 40 × 2	= 80
Advance taken to allotment		= **20**
Amount called on allotment	= 40×5	= 200
Advance received on application		= 20
Due and Net paid taken to call in arrears		= **180**

WN- - Reissue

Share forfeited of share reissued = 40 Shares

Amount remaining of Shree in share forfeited a/c = 100

Share reissued at discount of Rs. 1/-

Discount effecting forfeiture a/c with respect of Share of Shree = 40× 1= 40

Amount remaining taken to capital rescue (100 -40) = **60**

32. A. From the following details of a company, you are required to calculate Earnings per share? 20 marks.

Net Profit (After Tax) – Rs, 20,000

Preference share capital (Rs. 100 each) – 50,000

Equity share capital (Rs. 10 each) – Rs. 1,50,000

Preference shares carry 10 % dividend and cumulative and participating to the extent of 50 % of profits after paying dividend on Equity shares of 25 % and Transfer 0f 10 % of net profits (after Tax) to general reserves.

You are further that last year due to overall recessionary conditions prevailing in the industry, the company suffered heavy losses, resulting in to skipping the dividend on equity shares.

Accounting standard 20: - talks about the calculation methodology and various conditions for profits or earnings available to equity share holders.

Net profit (After Tax) = R. 20,000 (Given)

Profit available for equity shareholder

= Net profit — Preference dividend — due or arrears on preference shares.

1. = 20000 – 10% (50,000) — Participatory portion of Preference shares — arrears for last year
2. Participatory Portion of preference share

   = Net profit – 25% dividend on equity shares — 10 % Transfer to General Rescue

   = 20,000 – (2.5×15000) – 10% (50,000)

   = 20,000 – 37500 – 5000

   = –22,500

As it can be seen there is no profit remaining for participating Preference shareholders.

3. Arrears of Previous year

   Since the company suffered heavy losses in the previous year, it can be safely assumed that no. preference dividend is paid and is in arrears.

   There is no compulsion to pay equity dividend so no arrears on equity dividend

   = 50,000 × 10% = **5000**

   Substituting value of B and C in A we get.

   = 20,000 – 5000 – 0 – 5000

   = **10,000**

   EPS = $\frac{Profit\ Available\ to\ equity\ shareholders}{No.of\ shares\ outstanding}$

   = $\frac{10,000}{15,000}$ = 0.67

How would you Deal with the following items in relation to cash flow statement? State in respect of each item (transaction) whether it leads to inflow or outflow of cash: 20 marks.

a) Depreciation

b) Payment of interim dividend

c) Revaluation of assets

d) Issue of bonus shares.

e) Transfer of certain sum of money out of profits to general reserves.

Part B

The effect of following items on cash flow statement as per AS-3

a. Depreciation: does not affect the cash flow statement as it is a non-cash expenses or rather a provision for future expenditure or wear and tear of the asset.

   Cash flow statement deals with cash items only. If direct method of cash flow is depreciation does not appear at all. Whereas if in direct method of cash flow is used, depreciation appears as an addition to cash flow from operating activities since it is considered in Net profit after tax and has to added back.

b. Payment of Interim dividend as per As-3 is a cash payment and reduces the cash flow from financing activities. It is a return paid for the source equity finance. Thus payment of Interim dividend reduces he net cash.

c. Revaluation of asset is a non cash adjustment made in the books to correct a gross. As per As-3 in the indirect method any such expense or income appearing in the statement of profit and loss should be added back or subtracted to net profit while calculating cash flow from operating activities.

d. Issue of bonus share is again a non cash transaction capitalization of reserves takes place and not a cash transaction. Thus the cash flow statement as per AS-3 will not be affected.

e. Transfer of certain sum of money out of profits to general rescue is a book entry and does not involve cash movement. Thus as per AS-3 cash flow statement will not be affected.

33. A Limited company issue prospects inviting applications for 2000 equity shares of Rs. 10 Each at a premium of Rs. 2 per share payable as follows: 15 marks.

On Application Rs. 2/-

On allotment Rs. 5/- (Incl premium)

On first Call Rs. 3/-

On Second and final call Rs. 2/-

Applications were received for 3000 shares and pro data allotment was made on the applications for 2400 shares. Money over paid on applications was employed on account of sum due on allotment. Shree, to whom 40 shares were allotted, failed to pay the payment money and on her subsequent failure to pay the first call, her shares were forfeited. Pooja, the holder of 60 shares, failed to pay the two calls, and her shares were forfeited after second call.

Of the shares forfeited, 80 shares were reissues to Narman credited as fully paid @ Rs. 9 per share, the whole of shrees shares being included.

Pass the necessary journal entries and prepare the cash book of the company.

Journal Entries

	Particulars	Debt	Credit
1.	Bank a/c (3000×2 rs) Dr	6000	
	To Share application a/c		6000
	(being application money received on 3000 shares)		
2.	Share Application a/c Dr	6000	
	To Equity share capital a/c (2400×2)		4800
	To share allotment a/c		1200
	(being equity shares allotted on prorate Rs. 2400 shares and balance adjusted in Allotment)		
3.	Share allotment a/c Dr	12,000	
	To equity share capital a/c (2400×3)		7200
	To securities on premium a/c (2400×2)		4800
	(being accounted for allotment)		
4.	Bank A/c (12,000 – 1200 –180) Dr	10620	
	To share allotment a/c		10620
	(being allotment money received)		
5.	Share first call a/c (2400×3) Dr	7200	
	To equity share capital a/c		7200
	(being accounted for first call)		
6.	Bank a/c [(2400-40)×3] Dr	6900	
	To share first call a/c		6900
	(being 1st call money received)		
7.	Equity share capital a/c Dr	320	
	Securities premium a/c Dr	60	
	To share forfeiture a/c		80
	To calls in arrears a/c		120
	To allotment money due a/c		180
	(Being share forfeited from share on failure to pay call money)		
7.	Allotment money due a/c Dr	80	

	Calls in arrears a/c Dr	120	
	To share allotment a/c		80
	To share 1st call a/c		120
8.	Share 2nd and Final call a/c (2360×3)	4720	
	To Equity share capital a/c		4720
	(being 2nd call accounted)		
9.	Bank a/c [(2360-60)×2] Dr	4600	
	To share 2nd and Final call a/c		4600
10.	Share 1st call a/c Dr	180	
	Share 2nd call a/c Dr	120	
	To call in arrears a/c		300
11.	Equity share capital a/c Dr	600	
	To share forfeiture a/c		300
	To call in arrear a/c		300
12.	Bank a/c Dr	720	
	Share forfeiture a/c	80	
	To Equity share capital		800

Cash A/c

Particulars	Debit	Particulars	Credit
To Share application	6000	By Balance c/d	28,840
To share allotment	10,620		
To share 1st call	6900		
To share 2nd and final call	4600		
To Equity share capital	720		
	28,840		**28,840**

WN1:

Shree Share allotted = 40

Share applied = 50

$\left(40 \times \frac{3000}{2400}\right)$

Application money received (50×2) = 100

(–) Application money adjusted (40×2) = 80

= **20**

Allotment money due	= 200
(–) Surplus adjusted	= 20
Allotment money not received	= **180**

34. What do you mean by reconstruction of company? State the essential features of internal reconstruction of a company. Does it necessarily involve reduction of capital? 15 marks.

When a company suffering losses and has huge negative balances go for internal reconstruction.

Features

- It involves: Reduction of share capital (or) variation of shareholder rights.
- Arrangements and negotiations with creditors and debenture holders for restructuring of dues, reduction in claims (or) converting them into equity
- Writing off fictitious assets: It is not compulsory that reconstruction involves reduction of capital. There can be alteration of shareholders rights without reduction in share capital.

JAI HIND

KAVERIS IAS
