AIR1CA CAREER INSTITUTE

CA INTER

ADVANCED ACCOUNTING

SEP 2025, JAN 2026 & MAY 2026 ONWARDS

Concept Book

This Concept Book is prepared in Multicolor:

- Headings in ORANGE
- Sub-headings in BLUE
- Main Content in BLUE
- Keywords in RED
- Examples in GREEN

Best Wishes... Radhe Radhe!!

Advanced Accounting

Edition: August 2025

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About the Book

नमस्कार दोस्तों, राधे राधे !!

This Concept Book is prepared by **HP Agarwal** and **Ajay Agarwal (AIR 1)**. **HP Sir** has taught more than **35,000 students** till date and his **7** students has secured **AIR 1** in CA Exams. **CA Ajay Agarwal** got **Ever Highest Marks (653 out of 800)** in the history of ICAI in CA Final. He is also a **Gold Medalist** in Accounts and FM.

This Concept Book contains all provisions of CA Inter Advanced Accounting in **169 pages**. It also contains approx **40 examples** for better understanding of concepts.

This book is fully prepared as per **ICAI Syllabus**. All special adjustments relating to ICAI Questions are also covered in this book.

This book has been prepared for those **learning the subject for the first time as well as for last day revision before the exam.** On first time reading, refer this book along with lectures or revision videos. On last day before exam, you can refer only keywords marked in RED in this book.

Best wishes

HP Agarwal & Ajay Agarwal (AIR 1)

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ADVANCED ACCOUNTING

Scan this QR code to watch Free Revision Lectures on YouTube for Advanced Accounting

INTRODUCTION AND APPLICABILITY OF ACCOUNTING STANDARDS (AS)

Topics Covered

- Meaning of AS
- Objectives of AS
- Benefits/ Advantages of AS
- Applicability of AS on non corporate entities
- Applicability of AS on corporate entities
- Effect on exemptions and relations on change in category of entity

Meaning of AS

- Written documents which deals with following accounting issues:
  - Recognition
  - Measurement
  - Presentation
  - Disclosure
- Drafted by expert accounting body [ICAI]
- Issued by Government

Objectives of AS

- Harmonize diverse accounting policies
- Facilitates preparation of financial statements
- Give sense of faith and reliability to users

Advantages/Benefits of AS

- Comparability of financial statements
- Standardization of alternative accounting treatment to prevent any misleading accounting treatment
- Additional disclosure requirements to prevent any manipulation

Applicability of AS on Non Corporate Entities [Sole Proprietor, Firm, LLP]

MSME [Micro, Small and Medium Sized Entity]

- Not listed entity, &
- Not banking/insurance/financial institution, &
- Turnover (excluding other income) in previous year ≤ ₹ 250 crores, &
- Borrowing (including public deposits) anytime in previous year ≤ ₹ 50 crores, &
- Holding or subsidiary of above

AS are applicable with exemptions and relaxations

- Exemptions [AS fully not applicable]
  AS 3, 17, 20, 24
  AS 18, 28 [Only if Turnover ≤ ₹ 50 crores & Borrowings ≤ ₹ 10 crores]
- Relaxations [Some part of AS not applicable]
  AS 10, 11, 15, 19, 22, 26, 29
  AS 28 [If not covered by exemption]

Large Entity

Which is not MSME

AS are fully applicable

Applicability of AS on Corporate Entities

SMC [Small and Medium Company]

Same conditions as for MSME (Non Corporate Entities)

AS are applicable with exemptions and relaxations

- Exemptions [AS fully not applicable]
  AS 17
- Relaxations [Some part of AS not applicable]
  AS 15, 19, 20, 28, 29

Non SMC

Which is not SMC

AS are fully applicable

Effect on Exemptions and Relations on Change in Category of Entity

MSME → Large Entity SMC → Non SMC	Exemptions and relaxations earlier available are immediately withdrawn
Large Entity → MSME Non SMC → SMC	Exemptions and relaxations will be available only if it remains MSME or SMC for 2 consecutive years

FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Topics Covered

- Application of framework
- Theoretical concepts
- Accounting equation
- Preparation of financial statements if entity is not a going concern
- Capital maintenance

Application of Framework

It provides assistance to preparer of financial statements (FS) to develop accounting policy when no AS is available for a particular transaction [Example: Agriculture accounting].

Theoretical Concepts

Components of FS	Elements of FS	Users of FS	Qualitative Characteristics of FS	Measurement Basis
Balance sheet	Equity	Investor	Relevant	Historical cost
Statement of P&L	Asset	Employee	Reliable	Current cost
Notes to accounts	Liability	Creditor	Complete	Realizable value
Cash flow statement	Income	Lenders	Comparable	Present value
	Expenses	Public	Understandable	
		Customers		
		Government		

Accounting Equation

Assets – Liabilities = Equity

Example

Assets, liabilities and equity of a trader on 1.4.20X1 are ₹ 5 lakh, ₹ 2 lakh and ₹ 3 lakh respectively.

Prepare accounting equation with following transactions during the accounting period:

(a) Introduced capital ₹ 20,000.

(b) Earned income from investment ₹ 8,000.

(c) Liability of ₹ 31,000 was finally settled on payment of ₹ 30,000.

(d) Wages paid ₹ 2,000.

(e) Rent outstanding ₹ 1,000.

(f) Drawings ₹ 4,000.

Solution

Transactions	Assets (₹ lakh)	-	Liabilities (₹ lakh)	=	Equity (₹ lakh)
Opening	5.00	-	2.00	=	3.00
(a) Capital introduced	5.20	-	2.00	=	3.20
(b) Income from investments	5.28	-	2.00	=	3.28
(c) Settlement of liability	4.98	-	1.69	=	3.29
(d) Wages paid	4.96	-	1.69	=	3.27
(e) Rent Outstanding	4.96	-	1.70	=	3.26
(f) Drawings	4.92	-	1.70	=	3.22

Preparation of Financial Statements if Entity is not a Going Concern

Assets	Assets are disclosed at expected realizable value
Liabilities	Liabilities are disclosed at expected settlement value

Capital Maintenance

- It is used to calculate whether entity has maintained the capital in business to repeat the whole process endlessly.
- **Approaches to Capital Maintenance**
  - **Financial Capital Maintenance at Historical Cost [No Inflation]**

Closing capital [Opening capital ± Profit/(Loss) during year – Drawings during year]	XX
(-) Capital to be maintained [Same as opening capital]	(XX)
Maximum amount which can be withdrawn/(Capital to be introduced)	XX/(XX)

  - **Financial Capital Maintenance at Current Purchasing Power [With Inflation using General Price Index]**

Closing capital [Opening capital ± Profit/(Loss) during year – Drawings during year]	XX
(-) Capital to be maintained [Op. capital x (Closing price index/Opening price index)]	(XX)
Maximum amount which can be withdrawn/(Capital to be introduced)	XX/(XX)

  - **Physical Capital Maintenance [With Inflation using Price Index of Particular Product]**

Closing capital [Opening capital ± Profit/(Loss) during year – Drawings during year]	XX
(-) Capital to be maintained [Op. capital x (Cl. price of product/Op. price of product)]	(XX)
Maximum amount which can be withdrawn/(Capital to be introduced)	XX/(XX)

AS 1: DISCLOSURE OF ACCOUNTING POLICIES

Topics Covered

- Accounting policies
- Fundamental Accounting Assumptions

Accounting Policies

(1) Meaning of Accounting Policies

- Specific accounting principles [Example: Inventory is valued at lower of cost or NRV] and
- Methods of applying those specific accounting principles [Example: Cost formula of inventory (FIFO and Weighted average method)].

(2) Areas where Different Accounting Policies can be Adopted

- Valuation of Inventory or Investment.
- Accounting of Government Grant.
- Method for Preparation of Cash Flow Statement.
- Model for subsequent recognition of PPE at balance sheet date, etc.

Note:

(i) There is no single list of accounting policies which are applicable to all circumstances.

(ii) Entity is free to choose its accounting policy such that it reflects a true and fair view but application of different accounting policies by different entities affects comparability which is mitigated by giving disclosure of accounting policies followed by an entity.

(3) Factors to be Considered for Selection and Application of Accounting Policies

Materiality	Prudence	Substance Over Form
▪ All material items should be disclosed separately. ▪ Material items are those which will influence decisions of users. ▪ It varies from business to business depending upon its nature and size.	▪ Profits are not anticipated but recognised only when it is certain. ▪ Provision is made for all estimated losses even if it is not certain. Example: Inventory is valued at lower of cost or NRV	Prefer reality of transaction over legality Example ▪ Asset recorded by lessee in finance lease. ▪ Recording of sale of building even if registry is done on later date.

(4) Disclosure of Accounting Policies

- All significant accounting policies adopted in preparation of financial statements should be disclosed in financial statements at one place.
- Disclosure is not a remedy for wrong or inappropriate treatment in accounting.

(5) Change in Accounting Policies

Change Only When	▪ It is required by AS. ▪ It is required by statute. ▪ If it results in more appropriate presentation in financial statements.
Disclosure for Change	▪ Disclose details of old and new policy with reason of change. ▪ Disclose material effect in current period and future period, if it is ascertainable [Otherwise, disclose the fact that it is not ascertainable].

Fundamental Accounting Assumptions

Consistency
Same accounting policy should be followed consistently

Accrual
- Revenue and expenses are recognised as they are earned or incurred rather than the cash is received or paid.
- Goal of accrual basis of accounting is to follow the matching concept.

Going Concern
No intention to liquidate business in near future

If followed: Specific disclosure is not required

If not followed: This fact should be disclosed

AS 2: VALUATION OF INVENTORY

Topics Covered

- Meaning of Inventory
- Cost of Inventory
- Valuation of Inventory
- Valuation of Inventory in case of joint products

Meaning of Inventory

Assets

- Held for sale in ordinary course of business [Finished goods & Stock in trade]
- In production process for such sale [WIP]
- Materials used in production process [Raw material]

Note: If Spare parts [Nut-bolt & screws], Stand-by equipments [Items in backup] & Servicing equipments [Loose tools] does not meets the definition of PPE, then these are considered as inventory.

Cost of Inventory

- It includes any cost necessary to bring inventory to present location & condition.
- **Calculation of Cost of Inventory**

Step 1: Calculate Total Cost

Total Purchase Cost [In case of Raw Material & Stock in Trade]	
Purchase price	XX
(-) Trade discount/Rebate	(XX)
(+) Duties & taxes on purchase [Only if non-refundable]	XX
(+) Initial delivery & handling cost [Example: Loading, Unloading, Transport/Freight, etc]	XX
(+) Any other cost necessary to bring inventory to present location & condition	XX
Total purchase cost	XX

Total Production Cost [In case of Finished Goods & WIP]	
Material consumed	XX
(+) Direct labour cost	XX

(+) Variable overheads	XX
(+) Fixed overheads	XX
(+) Any other cost necessary to bring inventory to present location & condition	XX
Total production cost	XX

Step 2: Calculate Cost per unit

$$= \frac{\text{Total purchase or production cost}}{\text{Total purchase or production units} - \text{Normal loss (if any)}}$$

Step 3: Allocate Cost to Various Components

Closing Stock	Closing stock units x Cost per unit
Material Consumed or COGS	Material consumed or COGS units x Cost per unit
Abnormal Loss [Expense in P&L]	Abnormal loss units x Cost per unit

Note:

(i) In silent situation, assume all duties & taxes are non-refundable.

(ii) Fixed overhead per unit = $\frac{\text{Total fixed overheads}}{\text{Higher of Normal production units or Actual production units}}$

*In silent situation, assume normal & actual production units as same.

(iii) Abnormal loss units = Actual transit loss – Normal transit loss

(iv) **Following Costs are not Included in Cost of Inventory**

Particulars	Example
Abnormal Costs	Abnormal material, labour or other cost
Storage Costs [Unless necessary for production]	Godown rent for storing finished goods
Administrative Overheads	Salary of accounting department
Selling & Distribution Costs	Sales commission, warranty costs
Interest Expense [Unless allowed by AS 16]	Interest on loan to purchase inventory.

(v) **Cost Measurement Formula**

If units are purchased or produced several times in a year, then we have to apply any of the following cost measurement formula:	
FIFO	It considers units purchased or produced first are sold first.
Weighted Average Cost	Weighted cost per unit = $\frac{\text{Total cost}}{\text{Total units}}$
Retail Method	Cost of closing inventory = Sales value of closing inventory – Gross margin %

Valuation of Inventory

(1) **Finished Goods or Stock in Trade**

Lower of	
Cost	As discussed already
Net Realisable Value [NRV]	Estimated selling price – Estimated selling cost [Eg: Commission]

(2) **WIP**

Lower of	
Cost	As discussed already
NRV	Estimated selling price – Estimated completion cost – Estimated selling cost

(3) **Raw Material**

If Replacement Cost of Raw Material is ≥ Cost of Raw Material	Raw material is valued at Cost.
If Replacement Cost of Raw Material is < Cost of Raw Material	▪ If Finished Goods are expected to sold at ≥ Cost Raw material is valued at Cost. ▪ If Finished Goods are expected to sold at < Cost Raw material is valued at Replacement Cost.

*Replacement cost is generally NRV of raw material.

Note: Above valuations are generally done on 'Item by Item basis'.

Valuation of Inventory in Case of Joint Products

Step 1: Calculate Joint Production Cost

Total common production cost	XX
(-) NRV of By-product [Market price – Processing & packing charges]	(XX)
(-) Amount realised from sale of scrap	(XX)
	XX

Step 2: Allocate Joint Production Cost to Each Joint Product

$$= \text{Joint production cost} \times \frac{\text{Sales value of total units produced of each joint product}}{\text{Sales value of total units produced of all joint products}}$$

Step 3: Apply Valuation of Inventory Rules

As discussed already

AS 3: CASH FLOW STATEMENT

Topics Covered

- Meaning of cash flow statement
- Methods for preparation of cash flow statement
- Preparation of cash flow statement by direct method
- Preparation of cash flow statement by indirect method

Meaning of Cash Flow Statement

- It is a statement which provides details about how cash is generated & applied by the entity during the period.
- **Cash Flows are Classified into 3 Categories as Follows:**

Cash flows from operating activities	Cash flows from investing activities	Cash flows from financing activities
These are cash flows from principal revenue generating activities [i.e. activities which are not investing or financing activities]	These are cash flows from purchase & sale of assets like PPE, intangible assets, investments, etc.	These are cash flows from issue & redemption of share capital & borrowings

Methods for Preparation of Cash Flow Statement

Cash Flow Statement can be Prepared by Following 2 Methods:

Direct method

This method is used in following cases:

- Specifically mentioned in question.
- If summary of cash A/c is given in question.
- If information of cash sales, cash purchases, collection from debtors, payment to creditors, payment for expenses, etc. is given in question.

Indirect method

This method is used in all other cases

Preparation of Cash Flow Statement by Direct Method

Cash Flow Statement of ……. for the year ended …….

Particulars	Amount	Amount
(A) **Cash Flows from Operating Activities**		
Cash sales	XX	
Cash purchases	(XX)	
Cash received from debtors	XX	
Cash paid to creditors/suppliers	(XX)	
Trade commission received	XX	
Cash paid for operating expenses [Example: Wages/salary, office, administration, selling & distribution expenses, overheads, rent, insurance, etc.]	(XX)	
Loans/Advances given to suppliers or employees	(XX)	
Cash received on maturity of loans/advances given to suppliers or employees	XX	
Interest received on loans/advances given to suppliers or employees	XX	
	XX	
Income tax paid relating to operating activities [Example: Tax on business profit]	(XX)	
Refund of income tax received	XX	
	XX	
Extraordinary items [Example: Insurance claim received for loss of stock by fire]	XX/(XX)	
Net cash flows from operating activities [A]		**XX**
(B) **Cash Flows from Investing Activities**		
Cash received from sale of PPE, Intangible assets, Investments, etc.	XX	
Cash paid for purchase of PPE, Intangible assets, Investments, etc.	(XX)	
Cash paid for construction of capital work-in-progress	(XX)	
Cash received from redemption of deposits	XX	
Cash paid for making deposits	(XX)	
Loans/Advances given	(XX)	
Interest received	XX	
Dividend received	XX	
Rent received on property held as investment	XX	

Expenses paid on purchase of investment [Example: Brokerage]	(XX)	
Grant received	XX	
	XX	
Income tax paid relating to investing activities [Example: Capital gain tax]	(XX)	
	XX	
Extraordinary items [Example: Insurance claim received for loss of fixed assets by fire]	XX/(XX)	
Net cash flows from investing activities [B]		**XX**
(C) Cash Flows from Financing Activities		
Cash received from issue of share capital and borrowings [Example: Debentures, bonds, loan, bank overdraft, cash credit limit, etc.]	XX	
Cash received from calls in arrears	XX	
Cash paid for redemption of share capital and borrowings [Example: Debentures, bonds, loan, bank overdraft, cash credit limit, etc.]	(XX)	
Interest paid	(XX)	
Dividend paid	(XX)	
Underwriting commission paid	(XX)	
Drawings [In case of sole proprietorship]	(XX)	
	XX	
Income tax paid relating to financing activities [Example: DDT]	(XX)	
Net cash flows from financing activities [C]		**XX**
Net cash flows from all the activities [A + B + C]		XX
(+) Opening balance of cash & cash equivalents		XX
Closing balance of cash & cash equivalents		XX

Other Important Points

(1) Cash & Cash Equivalents

Particulars	Amount
Cash balance	XX
(+) Bank balance	XX
(+) Investment in highly liquid marketable securities (without risk) having maturity upto 3 months from acquisition date	XX
	XX

(2) **Calculation of Amount of Special Items**

- **Cash Received from Debtors**

Debtors A/c

Particulars	Amount	Particulars	Amount
To Balance b/d [Opening balance]	XX	By Bank [Balancing figure]	XX
To Sales [Credit]	XX	By Balance c/d [Closing balance]	XX
	XX		XX

- **Cash Paid to Creditors**

Creditors A/c

Particulars	Amount	Particulars	Amount
To Bank [Balancing figure]	XX	By Balance b/d [Opening balance]	XX
To Balance c/d [Closing balance]	XX	By Purchases [Credit]*	XX
	XX		XX

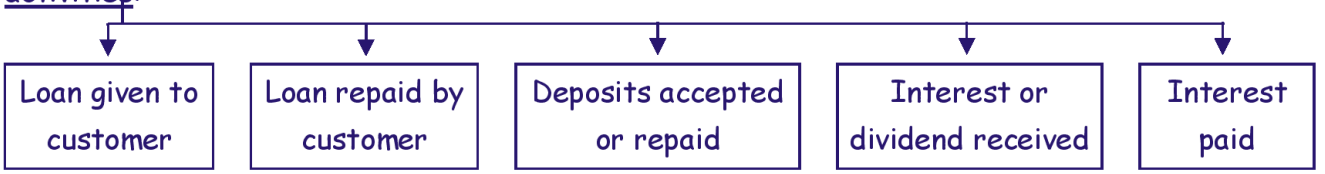
Note: Calculation of purchases [In silent situation, all purchases are assumed on credit basis]

Trading A/c			
Particulars	**Amount**	**Particulars**	**Amount**
To Opening stock	XX	By Sales	XX
To Purchases (Balancing figure)	XX	By Closing stock	XX
To Direct expenses	XX		
To Gross profit	XX		
	XX		**XX**

(3) Cash flows should not be presented on net basis. These should be presented on gross basis only [i.e. Cash receipts & payments will be shown separately].

(4) Non cash transactions are excluded from cash flow statement [Example: Machine purchased in exchange of other PPE, Shares/Bonds issued in exchange of PPE, etc.].

(5) If entity is financial institution (Bank), then following cash flows will be part of operating activities:



*Dividend paid will be part of financing activities for financial institution also.

Preparation of Cash Flow Statement by Indirect Method

Cash Flow Statement of ……. for the year ended …….

Particulars	Amount	Amount
(A) Cash Flows from Operating Activities		
Difference of P&L A/c [Retained earnings] from balance sheet	XX	
(+) Dividend declared in current year (CY)	XX	
(+) Transferred to general reserve in CY	XX	
Profit after tax for CY [Net profit]	XX	
(+) Provision for tax made during CY	XX	
(–) Refund of income tax received during CY	XX	
Profit before tax for CY	XX	
(±) Reversal adjustment of non cash & non operating items [If already adjusted in above profit]:		
Depreciation on PPE & Amortisation of intangible assets	XX	
Bad debts	XX	
Discount on issue of debentures	XX	
Premium on redemption of shares & debentures	XX	
Amortisation of government grant income	(XX)	
Loss on sale of PPE, Intangible assets, Investments, etc.	XX	
Profit on sale of PPE, Intangible assets, Investments, etc.	(XX)	
Interest expense	XX	
Interest income	(XX)	
Dividend income	(XX)	
Exchange loss on bank balance held in foreign currency	XX	
Exchange gain on bank balance held in foreign currency	(XX)	
Extraordinary expense	XX	
Extraordinary income	(XX)	
Operating profit before working capital changes	XX	
(–) Increase in operating current assets	(XX)	
(+) Decrease in operating current assets	XX	
(+) Increase in operating current liabilities	XX	
(–) Decrease in operating current liabilities	(XX)	
	XX	

	Income tax paid relating to operating activities [Example: Tax on business profit]	(XX)	
	Refund of income tax received	XX	
		XX	
	Extraordinary items [Example: Insurance claim received for loss of stock by fire]	XX/(XX)	
	Net cash flows from operating activities [A]		**XX**
(B)	**Cash Flows from Investing Activities**		
	Cash received from sale of PPE, Intangible assets, Investments, etc.	XX	
	Cash paid for purchase of PPE, Intangible assets, Investments, etc.	(XX)	
	Cash paid for construction of capital work-in-progress	(XX)	
	Cash received from redemption of deposits	XX	
	Cash paid for making deposits	(XX)	
	Loans/Advances given	(XX)	
	Interest received	XX	
	Dividend received	XX	
	Rent received on property held as investment	XX	
	Expenses paid on purchase of investment [Example: Brokerage]	(XX)	
	Government grant received	XX	
		XX	
	Income tax paid relating to investing activities [Example: Capital gain tax]	(XX)	
		XX	
	Extraordinary items [Example: Insurance claim received for loss of fixed assets by fire]	XX/(XX)	
	Net cash flows from investing activities [B]		**XX**
(C)	**Cash Flows from Financing Activities**		
	Cash received from issue of share capital and borrowings [Example: Debentures, bonds, loan, bank overdraft, cash credit limit, etc.]	XX	
	Cash received from calls in arrears	XX	
	Cash paid for redemption of share capital and borrowings [Example: Debentures, bonds, loan, bank overdraft, cash credit limit, etc.]	(XX)	
	Interest paid	(XX)	
	Dividend paid	(XX)	
	Underwriting commission paid	(XX)	

Drawings [In case of sole proprietor]	(XX)	
	XX	
Income tax paid relating to financing activities [Example: DDT]	(XX)	
Net cash flows from financing activities [C]		**XX**
Net cash flows from all the activities [A + B + C]		XX
(+) Opening balance of cash & cash equivalents		XX
Closing balance of cash & cash equivalents		XX

Other Important Points

(1) If 'profit before tax for CY' or 'profit after tax for CY [Net profit]' is available in question, then we will directly take such profit as starting point in operating activity.

(2) **Operating Current Assets and Operating Current Liabilities**

Inclusion	▪ Trade receivables. ▪ Trade payables. ▪ Inventory. ▪ Outstanding expenses, prepaid expenses, accrued income and unearned income related to operating nature items only [Example: Outstanding wages, prepaid insurance, etc.]. **Note:** In silent situation; outstanding expenses, prepaid expenses, accrued income and unearned income are assumed to be related to operating nature items only.
Exclusion	▪ Cash & cash equivalents [Cash balance, bank balance, etc.]. ▪ Current investment ▪ Short term borrowings ▪ Provision for tax ▪ Dividend payable ▪ Outstanding expenses, prepaid expenses, accrued income and unearned income not related to operating nature items [Example: Outstanding interest, prepaid interest, accrued interest, etc.].

Note: If change in working capital is given in question, then treat it as operating current asset.

(3) Calculation of Amount of Special Adjustments

- **Provision for Tax made in CY and Tax Paid in CY**

Cases	Opening balance of Provision for tax A/c	Closing balance of Provision for tax A/c	Tax paid in CY	Provision for tax made in CY
I	✓	✓	X [Opening balance of Provision for tax A/c]	X [Closing balance of Provision for tax A/c]
II	✓	✓	✓	X [Balancing figure using ledger]
III	✓	✓	X [Balancing figure using ledger]	✓
IV	X	X	✓	X [Tax paid in CY]
V	X	X	X [Provision for tax made in CY]	✓

Provision for Tax [Tax Payable] A/c

Particulars	Amount	Particulars	Amount
To Bank [Tax paid in CY]	XX	By Balance b/d [Opening balance]	XX
To Balance c/d [Closing balance]	XX	By P&L [Provision for tax made in CY]	XX
	XX		XX

Note:

(i) Tax amount given in P&L or income statement is 'Provision for tax made in CY'.

(ii) If 'Advance Tax A/c' balance is given in question, then 'Provision for tax made in CY and Tax paid in CY' is calculated as follows:

Advance Tax A/c

Particulars	Amount	Particulars	Amount
To Balance b/d [Opening balance]	XX	By Provision for tax A/c [Opening balance of advance tax]	XX
To Bank [Tax paid in CY]	XX	By Balance c/d [Closing balance]	XX
	XX		XX

Provision for Tax [Tax Payable] A/c

Particulars	Amount	Particulars	Amount
To Advance tax [Opening balance of advance tax]	XX	By Balance b/d [Opening balance]	XX
To Bal. c/d [Closing balance]	XX	By P&L [Provision for tax made in CY]	XX
	XX		XX

- **Dividend Declared in CY and Dividend Paid in CY**

Cases	Opening balance of Dividend payable A/c	Closing balance of Dividend payable A/c	Dividend paid in CY	Dividend declared in CY
I	✓	✓	X [Opening balance of Dividend payable A/c]	X [Closing balance of Dividend payable A/c]
II	✓	✓	✓	X [Balancing figure using ledger]
III	✓	✓	X [Balancing figure using ledger]	✓
IV	X	X	✓	X [Dividend paid in CY]
V	X	X	X [Dividend declared in CY]	✓

Note: Dividend amount given in P&L appropriation is 'Dividend declared in CY'.

- **Amount of Interest Expense or Dividend Declared in CY**

Cases	Issue or redemption date of share capital & borrowings	Amount of interest expense or dividend declared in cy
I	Share capital & borrowings are issued or redeemed at the beginning of CY [✓]	Calculate on closing balance
II	Share capital & borrowings are issued or redeemed at the end of CY	Calculate on opening balance

- **Depreciation on PPE, Purchase of PPE and Sale of PPE**

Case I: If 'Provision for depreciation [Accumulated depreciation] A/c' opening & closing balance is given in question:

PPE A/c [At Cost]

Particulars	Amount	Particulars	Amount
To Bal. b/d [Gross opening]	XX	By Bank [Sale amount]	XX
To Bank [Purchase amount]	XX	By P&L [Loss on sale]	XX
To Share capital/Debentures/ Bonds A/c [Purchase of PPE by issue of share capital/ debentures/bonds]	XX	By Provision for depreciation A/c [Accumulated depreciation on PPE sold]	XX
		By Bal. c/d [Gross closing]	XX
To P&L [Profit on sale]	XX		
	XX		**XX**

Provision for Depreciation [Accumulated Depreciation] A/c

Particulars	Amount	Particulars	Amount
To PPE A/c [Accumulated depreciation on PPE sold]	XX	By Balance b/d [Opening balance]	XX
To Balance c/d [Closing balance]	XX	By Depreciation A/c [Charged to P&L in CY]	XX
	XX		**XX**

Case II: If 'Provision for depreciation [Accumulated depreciation] A/c' opening & closing balance is not given in question:

PPE A/c [At WDV]

Particulars	Amount	Particulars	Amount
To Bal. b/d [Net opening]	XX	By Bank [Sale amount]	XX
To Bank [Purchase amount]	XX	By P&L [Loss on sale]	XX
To Share capital/Debentures/ Bonds A/c [Purchase of PPE by issue of share capital/ debentures/bonds]	XX	By Depreciation A/c [Charged to P&L in CY]	XX
		By Bal. c/d [Net closing]	XX
To P&L [Profit on sale]	XX		
	XX		**XX**

- **Drawings [In Case of Sole Proprietor]**

Capital A/c

Particulars	Amount	Particulars	Amount
To Drawings [Balancing figure]	XX	By Balance b/d [Opening balance]	XX
To Balance c/d [Closing balance]	XX	By P&L [Net profit]	XX
	XX		XX

(4) Exchange gain/(loss) arising on bank balance held in foreign currency should be added/(deducted) from 'Opening balance of cash & cash equivalents' to reconcile closing balance of cash & cash equivalents.

AS 4: CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

Topics Covered

- Events occurring after balance sheet date
- Types of events occurring after balance sheet date
- Special cases
  - Dividend
  - Going concern
  - Back dated cheque

Events Occurring After Balance Sheet Date

- 01.4.20X1 Beginning
- 31.3.20X2 B/s date
- 30.06.20X2 Approval of FS by BOD

Events Occurring After Balance Sheet Date

These are favourable & unfavourable significant events occurring after Balance sheet date but before approval of financial statements by approving authority

Note: Events occurring after approval of financial statements are not covered by AS 4.

Types of Events Occurring After Balance Sheet Date

Adjusting events

Events which provide evidence of conditions existing on balance sheet date

Examples

- Debtor suffering heavy losses before B/S date has become bankrupt after B/S date.
- Theft/fraud occurred before B/S date but detected after B/S date.
- Negotiations finalised/decided before B/S date but investment done after B/S date.
- Property sold before B/S date but registry done after B/S date.
- Court case started before B/S date but settlement done after B/S date.
- NRV of inventory determined by its selling price after B/S date.
- Violation of grant condition before B/S date but refund notice received after B/S date.

→ Adjust respective amount in financial statement

Non adjusting events

Events which are indicative of conditions arising after balance sheet date

Examples

- Loss by fire/earthquake after B/S date.
- Negotiations just started before B/S date but investment done after B/S date.
- Proposal for sale of property before B/S date but registry done after B/S date.
- Property sale agreement entered before B/S date but risks & rewards are transferred after B/S date.
- Suit against company is filed after B/S date.

→ Do not adjust amount in financial statements but disclose it in report of approving authority

Special Cases

Dividend	Dividend declared after B/S date is non adjusting event ▪ Not recognised as liability at B/S date because no obligation exists at that time. ▪ Disclosed in notes in financial statements.
Going Concern	Event indicating going concern assumption is no longer appropriate occurring after B/S date is adjusting event ▪ Entity should prepare its financial statements on liquidation basis. Example: Loss by fire in factory of such magnitude that it is not possible for entity to start its operations again.
Back Dated Cheque	Back dated cheque received from customer after B/S date is non adjusting event ▪ No need to disclose since it doesn't change entity's financial condition materially.

AS 5: NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES

Topics Covered

- Net profit or loss for the period
- Ordinary items
- Extra ordinary items
- Prior period items
- Changes in accounting estimates
- Changes in accounting policies
- Special items [Neither change in accounting policy nor change in accounting estimate]

Net Profit or Loss for The Period

- All items of income and expense recognized in a period should be included in determination of net profit or loss for the period.
- **Items of Income and Expense are Further Classified as Follows:**

- Ordinary items
- Extra ordinary items
- Prior period items
- Changes in accounting estimates
- Changes in accounting policies

Ordinary Items

Meaning	Income & expense arising from ordinary course of business of entity
Example	▪ Sale of goods/services. ▪ Cost of goods sold. ▪ Business expenses like salary, etc. ▪ Payment of GST demand.
Presentation in P&L	If ordinary items are of such size, nature or incidence that their disclosure is relevant, then such items are considered as exceptional items and their nature & amount is disclosed separately. Example of exceptional items ▪ Write down of inventory to NRV & its reversal. ▪ Litigation settlement. ▪ Revision of wages of employees with retrospective effect. ▪ Legislative changes having retrospective application.

Extra Ordinary Items

Meaning	Income & expense that are clearly distinct from ordinary activities of entity and are not expected to recur frequently.
Example	▪ Government grant receivable or refundable. ▪ Sale of PPE & long term investment. ▪ Attachment of property. ▪ Loss by theft, natural calamities (like earthquake), etc.
Presentation in P&L	Always disclose separately

Prior Period Items

Meaning	Income & expense which arise in current period due to errors or omissions in prior periods.
Example	▪ Wrong accounting/wrong amount/omission in past. ▪ Treating operating lease as finance lease. ▪ Capitalisation of borrowing cost on working capital. ▪ Non-provision for salary already due in earlier year.
Presentation in P&L	Always disclose separately as follows: Option 1 → Adjust in related head (current & prior period separately) Option 2 → Adjust after calculation of current period profit

Changes in Accounting Estimates

Meaning	▪ Many items cannot be measured but only can be estimated using judgement on the basis of latest available information. ▪ Entity shall revise an accounting estimate if circumstances change as a result of new information or more experience.
Example	▪ Change in provision rate/amount. ▪ Actual expense is more than provision. ▪ Change in depreciation rate/method, salvage value, useful life, etc.
Presentation in P&L	Effect of change should be present under same classification

Changes in Accounting Policies

Same as AS 1

Special Items [Neither Change in Accounting Policy Nor Change in Accounting Estimate]

Following items are considered as ordinary item [Neither considered as change in accounting policy nor change in accounting estimate]:

- Adoption of accounting policy for events or transactions that differ in substance from previously occurring events or transactions.

  Example: Introduction of formal retirement gratuity scheme by employer in place of ad hoc ex-gratia payments to employees on retirement.

- Adoption of new accounting policy for events or transactions which did not occur previously or that were immaterial.

  Example: Entity decided to pay pension to employees on retirement. Earlier there was no such scheme of pension in the organisation.

AS 7: CONSTRUCTION CONTRACTS

Topics Covered

- Applicability of this AS
- Accounting of construction contracts
- Combining and segmenting of construction contracts

Applicability of this AS

It provides accounting for construction contracts in the books of entity (Contractor) who is engaged in the business of construction, destruction or restoration of assets.

Accounting of Construction Contracts

Step 1: Calculate Total Estimated Contract Revenue at Each Year End

- Fixed price contract

Particulars	Amount
Initially agreed contract price	XX
(+) Increase in contract price due to escalation/increase in estimated cost	XX
(+) Increase in contract price due to variation in contract	XX
(+) Any other amount entitled to be claimed from contractee	XX
(+) Incentive for performance [only if probable]	XX
(-) Penalty for non-performance [only if probable]	(XX)
	XX

- Cost plus contract

Particulars	Amount
Reimbursable cost incurred in contract	XX
(+) Agreed % of profit	XX
	XX

Step 2: Calculate Total Estimated Contract Cost at Each Year End

Particulars	Amount
Cost incurred till date [Contract work in progress (WIP)]	XX
(+) Further estimated contract cost	XX
	XX

Calculation of cost incurred till date [Contract WIP]

It includes all cost incurred on contract till date, whether such cost is

- Paid or outstanding, &
- For work certified or work not certified.

Particulars	Amount
Material consumed [Material purchased – Unused material at end of year]	XX
(+) Labour cost	XX
(+) Sub contract cost	XX
(+) Other contract costs [Example: Hire charges of plant]	XX
(–) Sale of scrap (if any)	(XX)
	XX

Step 3: Calculate % of Contract Completion at Each Year End

$$= \frac{\text{Cost incurred till date [Contract WIP]}}{\text{Total estimated contract cost}} \times 100$$

Step 4: Calculate Profit/(Loss) to be Recognised in Each Year

Particulars		Year 1	Year 2	Year 3
Cumulative revenue till date [Step 1 x Step 3]		✓	✓	✓
(–) Revenue recognised upto previous years			(✓)	(✓)
Revenue recognised in CY	(A)	XX	XX	XX
Cost incurred till date [Contract WIP]		✓	✓	✓
(–) Cost recognised upto previous years			(✓)	(✓)
Cost recognised in CY	(B)	XX	XX	XX
Profit/(Loss) recognised in CY	(A – B)	XX/(XX)	XX/(XX)	XX/(XX)

Note:

(i) If loss is arising in above step, then following provision for expected loss is also made during the year [so that total loss is recognised immediately]:

Particulars	Amount
Total estimated contract cost [Step 2]	XX
(–) Total estimated contract revenue [Step 1]	(XX)
Total expected loss in contract	XX
(–) Loss recognised in current year [Step 4]	(XX)
Provision for expected loss in contract	**XX**

(ii) If there is uncertainty in outcome of contract, then revenue is recognised only upto the amount of recoverable cost incurred on contract.

Step 5: Prepare Contract P&L A/c at Each Year End [Only If Required]

Particulars	Amount	Particulars	Amount
To cost recognised in CY	XX	By revenue recognised in CY	XX
To profit recognised in CY	XX	By total expected loss in contract	XX
To provision for expected loss	XX		
	XX		XX

Step 5: Calculate Amount Due From/To Customer at Each Year End [Only If Required]

Particulars		Amount
Cost incurred till date [Contract WIP]		XX
(+) Profit recognised in current year (if any)		XX
(–) Total expected loss in contract (if any)		(XX)
Total payment to be received from customer	**(A)**	**XX**
Progress payments received from customer		XX
(+) Progress payments to be received from customer [Retention money]		XX
Progress billing	**(B)**	**XX**
Amount due from customer/(Amount due to customer)	**(A – B)**	**XX/(XX)**

Combining and Segmenting of Construction Contracts

When a contract involves construction of multiple assets, then such contract is treated as

Single Construction Contract for All Assets	Separate Construction Contract for Each Asset
▪ Negotiated as a single package. ▪ Closely interrelated. ▪ Performed concurrently or in continuous sequence.	▪ Separate proposals for each asset. ▪ Separate negotiation for each asset. ▪ Separate costs and revenues of each asset can be identified.

AS 9: REVENUE RECOGNITION

Topics Covered

- Applicability of this AS
- Accounting of revenue [Journal entries]
- Amount of revenue to be recognised
- Timing when revenue to be recognised
- Sale with repurchase agreement

Applicability of this AS

It Deals with Accounting/Recognition of Revenue Arising in Ordinary Course of Business from

- Sale of goods.
- Rendering of services.
- Dividend, interest, royalty income due to use of enterprise resources by others [Example: Entity's business is of financing/investment, Entity charges interest on delayed payment by customer, etc.]

Note: Entity engaged in construction contracts shall apply AS 7 for accounting of revenue.

Example 1

Determine whether AS 9 should apply for revenue recognition in following cases:

(i) Entity sells a machine being used at its factory at a price of ₹ 2 lakh. Carrying value of machine is ₹ 1.80 lakh.

(ii) Entity is engaged in business of buying & selling properties. It sells a land at a price of ₹ 1 crore.

(iii) Entity is a pharma company which has been conducting research on new medicine since last 2 years. During the current year, it decides to sell the outcome of research to another competitor for ₹ 50 crore. Entity has already incurred ₹ 30 crore on ongoing research.

Solution

(i) AS 9 shall not apply. Gain on sale of machine of ₹ 20,000 (₹ 2 lakhs – ₹ 1.80 lakhs) is recognised as other income in P&L.

(ii) AS 9 shall apply. Sales amount of ₹ 1 crore is recognised as revenue.

(iii) AS 9 shall not apply. Amount of ₹ 50 crore is recognised as other income in P&L.

Accounting of Revenue [Journal Entries]

	Particulars		Debit	Credit
(i)	**Credit Sales**			
	Debtors A/c [Asset]	Dr.	XX	
	To Sales A/c			XX
(ii)	**Cash Sales**			
	Bank A/c	Dr.	XX	
	To Sales A/c			XX
(iii)	**Advance Received Against Sales**			
	Bank A/c	Dr.	XX	
	To Advance from Customer A/c [Liability]			XX

Amount of Revenue to be Recognised

Revenue means Gross Inflow of Consideration from Customer Excluding

- Trade discounts & volume rebates [i.e., It should be deducted from revenue].
- Tax payable to government [Example: GST].

Note:

(i) If entity is performing as an agent [i.e. person who does not bear any risks & rewards relating to goods], then only commission amount is considered as revenue.

(ii) Cash discount is not deducted from revenue. It is separately booked as an expense in P&L.

Example 2

'MMT' is a website that allows people to book airlines tickets. As a part of its business, it agrees to buy 100 tickets from an airline on a particular date and resell those tickets to customers. However, 'MMT' bears the loss for any unsold tickets. How much revenue 'MMT' shall recognise as per AS 9?

Solution

Since, risk & reward relating to tickets are borne by 'MMT'. So, 'MMT' is acting as principal [not agent]. Hence, full ticket sale amount will be recognized as revenue.

Timing When Revenue to be Recognised

(1) **Sale of Goods**

Revenue is recognized only when following conditions are satisfied:

- Property in goods has been transferred, or risks & rewards of ownership (effective control) has been transferred.

- No significant uncertainty exists regarding the amount of consideration [Collectability & Measurability].

Special Cases	Timing of Revenue Recognition
Delay of Delivery on Buyer's Request	Revenue is recognised immediately [i.e. when goods are ready for delivery to the buyer].
Sale to Distributors, Dealers or Others for Resale	▪ Generally [Normal sale] Revenue is recognised only when significant risks of ownership are passed. ▪ If buyer is in substance an agent [Consignment sale] Revenue is recognised only when goods are sold to 3rd party.
Sale on Approval Basis	Revenue is recognised only when [Earlier of] ▪ Goods are accepted by buyer. ▪ Buyer has done any act for adopting transaction. ▪ Allowed time period of rejection is expired [Where no time period is given, reasonable time is expired].
Retail Sales Offering Guarantee with Money Back	▪ It means selling goods with unlimited right of return from customers. ▪ Total sales are recognised as revenue on date of sale. ▪ Provision for sales return is also created as follows: = Expected sales return amount x Profit % on sales
Goods Subject to Installation	▪ If installation is simple Revenue is recognised normally. ▪ If installation is complicated Revenue is recognised when installation is completed or goods are accepted by the customer (whichever is earlier).
Purchaser Makes Payment in Installments & Seller Deliver Goods on Final Payment	Revenue is recognised when ▪ Goods are delivered, or ▪ Significant deposit is received [If most of the such sales are already consummated].
Installment Sales	▪ Sales price exclusive of interest is recognised as revenue on date of sale. ▪ Interest element in each installment is recognized as revenue proportionately.
Inter Divisional Transfers	Revenue is not recognised.

(2) Rendering of Services

Revenue is recognized only when following conditions are satisfied:

- Service is completed as per completed service contract method [If only 1 service in contract] or proportionate completion method [If more than 1 service in contract].
- No significant uncertainty exists regarding the amount of consideration [Collectability & Measurability].

Special Cases	Timing of Revenue Recognition
Membership Fee/ Subscriptions for Publications	Revenue is recognised on the basis of ▪ SLM over the time, or ▪ Sales value of delivered item in relation to total sales value of all items in subscription.
Advertising/Media Commissions	Revenue is recognised only when related advertisement/commercial appears before the public.
Insurance Agency Commissions	Revenue is recognised on effective commencement or renewal dates of related policies.
Installation Fees	Revenue is recognised only when equipment is installed and accepted by the customer.

(3) Dividend, Interest, Royalty Income Due to Use of Enterprise Resources by Others

Cases	Timing of Revenue Recognition
Dividend	Revenue is recognized only when following conditions are satisfied: ▪ Right to receive dividend is established, i.e., when dividend is declared. ▪ No significant uncertainty exists regarding the amount of consideration [Collectability & Measurability].
Interest	Revenue is recognized only when following conditions are satisfied: ▪ On time proportion basis. ▪ No significant uncertainty exists regarding the amount of consideration [Collectability & Measurability].
Royalty/License Fee	Revenue is recognized only when following conditions are satisfied: ▪ On accrual basis as per agreement. ▪ No significant uncertainty exists regarding the amount of consideration [Collectability & Measurability].

(4) Additional Revenue Due to Increase in Sales Price Retrospectively

It is recognised only if ultimate collection of additional revenue is reasonably certain. Otherwise, postpone recognition of such revenue & disclose it in notes to FS.

Sale with Repurchase Agreement

- It is an arrangement in which seller concurrently agrees to repurchase the same goods at a later date on a pre determined price.
- Hence, such sale is accounted as financing (loan) transaction and cannot be recognised as revenue.
- Finance charges on such loan = Repurchase price – Initial sale price
- Such finance charges are recognised as interest expense in P&L over the period of agreement.
- **Journal Entries**

	Particulars		Debit	Credit
(i)	**Initially on Such Sale [Receiving Loan Amount]**			
	Bank A/c	Dr.	XX	
	To Loan A/c			XX
(ii)	**Recognition of Finance Charges**			
	Finance Charges (Interest Expense) A/c	Dr.	XX	
	To Loan A/c			XX
(iii)	**Transfer of Finance Charges to P&L**			
	P&L A/c	Dr.	XX	
	To Finance Charges (Interest Expense) A/c			XX
(iv)	**At the Time of Repurchase [Repayment of Loan]**			
	Loan A/c	Dr.	XX	
	To Bank A/c			XX

AS 10: PROPERTY, PLANT AND EQUIPMENT (PPE)

Topics Covered

- Meaning of PPE
- Recognition criteria of PPE
- Initial recognition of PPE [Using cost model]
- Depreciation of PPE
- Recognition of PPE at each balance sheet date
- Subsequent costs on PPE

Meaning of Property, Plant and Equipment [PPE]

Tangible items

Held for use in	&	Useful life more than 12 months
▪ Production or supply of goods/services, or ▪ Administrative purposes, or ▪ Rental to others		

Note: If Spare parts [Nut-bolt & screws], Stand-by equipments [Items in backup] & Servicing equipments [Loose tools] meets the definition of PPE, then these are considered as PPE; otherwise considered as inventory.

Recognition Criteria of PPE

PPE is Recognised in Books Only If

- Future economic benefits are probable from such PPE, &
- Its cost can be measured reliably.

Initial Recognition of PPE [Using Cost Model]

(1) **If PPE is Purchased or Self Constructed**

- PPE is initially recognised at cost necessary to bring PPE in ready to use condition.
- **Calculation of Cost of PPE**

Particulars	Amount
Purchase price	XX
(-) Trade discount/Rebate	(XX)
(+) Duties & taxes on purchase [Only if non-refundable] [Example: Stamp duty, Registration charge, Purchase tax, Import duty, etc.]	XX

(+) Any other direct attributable costs	
Title guarantee insurance	XX
Transit insurance	XX
Initial delivery & handling cost [Example: Loading, Unloading, Transport, etc.]	XX
Professional/Consultant/Legal/Architect fee	XX
Installation & assembly cost	XX
Site preparation cost [Cost – Sale value excluding tax of material salvaged] [Example: Preparation & levelling of land, Demolition of existing structure]	XX
Direct material [Cost – Sale of scrap]	XX
Labour/Employment cost on construction	XX
Overhead cost on construction	XX
Salary of supervisor engaged in construction/installation	XX
Spare parts & tools consumed in construction/installation	XX
Depreciation on assets used for construction/installation	XX
Test/Trial run cost [Cost – Incidental recovery]	XX
Significant renovation & remodelling cost	XX
(+) PV of dismantling & site restoration cost [Estimated cost x PV factor]	XX
	XX

Note:

(i) In silent situation, assume all duties & taxes are non-refundable.

(ii) Ignore profit on material/services internally used by company in construction of PPE.

- **Following Costs are Not Added in Calculation of Cost of PPE:**

Particulars	Example
Relocating & Reorganising Cost	Setup, rent, removal cost, etc. for moving production facility to another site.
Advertisement/Promotional Cost	Inauguration cost of opening new facility.
General Expenses	▪ Staff training cost. ▪ Salary of staff engaged in preparation of store before its opening. ▪ Administrative, general & selling overheads. ▪ Abnormal material, labour or other cost.
Operating Losses	▪ Expenses incurred before commercial production [i.e. between ready to use & put to use period]. ▪ Loss due to asset operating at low capacity.

Interest Expense	▪ Interest paid to supplier against deferred credit. ▪ Interest on loan taken to buy or construct the PPE [Unless allowed by AS 16].

- **Following Benefits are Not Deducted in Calculation of Cost of PPE:**

Particulars	Example
Cash Discount	Discount given for early settlement.
Income from Incidental Activities	Income from car parking on land during construction.

- **Journal Entry**

Particulars		Debit	Credit
PPE A/c	Dr.	Calculated above	
To Bank A/c			XX
To Provision for Dismantling Cost A/c			XX

(2) If PPE is Acquired in Exchange of Asset

Case	Cost of Acquired PPE
If Transaction has Commercial Substance [✓]	1st priority: Fair value of asset given up – Cash received (if any) 2nd priority: Fair value of PPE received 3rd priority: Carrying value of asset given up – Cash received (if any)
If Transaction Lacks Commercial Substance	Carrying value of asset given up – Cash received (if any)

- Commercial substance means transaction will affect cash flows of entity.

Example 1

Commercial substance: Acquire PPE producing 10,000 units by giving PPE producing 8,000 unit.

Lack of commercial substance: Exchange warehouse with other warehouse in same area.

- **Journal Entry**

Particulars		Debit	Credit
PPE A/c [Acquired]	Dr.	Calculated above	
Cash A/c [Received]	Dr.	If any	
Loss on Exchange of Asset A/c (P&L)	Dr.	Balancing figure	
To Asset A/c [Given]			Carrying value
To Profit on Exchange of Asset A/c (P&L)			Balancing figure

Depreciation of PPE

(1) Depreciation Methods

Straight Line Method [SLM] [✓]	Deprecation p.a. = $\frac{\text{Cost – Residual value}}{\text{Total useful life}}$
Written Down/Diminishing/ Reducing Value Method [WDV]	Deprecation p.a. = Opening carrying value x Depreciation rate
Units of Production Method	Deprecation p.a. = Cost x $\frac{\text{Units produced in respective year}}{\text{Total units to be produced}}$

(2) Depreciation Period

Depreciation Start	When PPE is available for use, i.e. in ready to use condition [Put to use date is not relevant].
Depreciation Stop	When PPE is derecognised.

(3) Change in Depreciation Method, Depreciation Rate, Useful Life & Residual Value

- It is change in accounting estimate.
- Prospective effect will be given, i.e., give effect in remaining future period.

(4) Depreciation as per Componentization

- Entity should allocate initially recognised amount of PPE into significant parts & charge depreciation on each such part separately.
- Depreciation is not charged on 'Land' component of a PPE.

Example 2

Aircraft: Body, Interior, Engine.

Building: Land, Lift, Furniture & Fixtures, Building structure.

Recognition of PPE At Each Balance Sheet Date

At each balance sheet date, PPE can be shown at cost model or revaluation model.

(1) Cost Model

Carrying amount at balance sheet date = Cost – Depreciation till date

(2) Revaluation Model

Carrying amount at balance sheet date = Fair value

Effect of Revaluation

- Depreciation will be charged on revalued amount in future.
- Revaluation gain/(loss) = Fair value – Carrying amount

- Journal entries

1st Time Revaluation				
Revaluation	**Particulars**		**Debit**	**Credit**
(+)	PPE A/c	Dr.	XX	
	To Revaluation Reserve A/c			XX
(–)	P&L A/c	Dr.	XX	
	To PPE A/c			XX
Subsequent Revaluation				
Revaluation	**Particulars**		**Debit**	**Credit**
Previous (+) Current (+)	PPE A/c	Dr.	XX	
	To Revaluation Reserve A/c			XX
Previous (–) Current (–)	P&L A/c	Dr.	XX	
	To PPE A/c			XX
Previous (–) Current (+)	PPE A/c	Dr.	XX	
	To P&L A/c [Upto previous decrease]			XX
	To Revaluation Reserve A/c			XX
Previous (+) Current (–)	Revaluation Reserve A/c [Upto available balance]	Dr.	XX	
	P&L A/c	Dr.	XX	
	To PPE A/c			XX

Note: Balance in 'Revaluation reserve A/c' is transferred to 'Revenue reserve' when the respective PPE is derecognised [It is not transferred to P&L A/c].

Subsequent Costs on PPE

Subsequent Costs	Treatment
Repair & Maintenance	▪ Charged to P&L A/c. ▪ Example: Day to day repairs, Annual maintenance contract, etc.
Replacement of Part	▪ Capitalised to PPE. ▪ Example: Replacement of compressor in AC, etc. ▪ Calculation of revised carrying amount of PPE after replacement of part

Carrying amount of PPE on part replacement date	XX
(+) Cost of new part	XX
(–) Value of old part in carrying amount of replacement date	(XX)
	XX

	Value of old part in carrying amount of replacement date Step 1: Cost of old part at beginning = Cost of new part x PV factor of part replacement year Step 2: Value of old part in carrying amount of replacement date = Cost of old part at beginning − Depreciation till date assuming same useful life as of PPE
Any Other	▪ If it increases life of PPE or benefits/efficiency of PPE → Capitalised. ▪ Otherwise → Charged to P&L A/c.

Example 3

On 1.4.20X1, A ltd. purchased a car for ₹ 10,00,000. Useful life of car is 10 years.

On 1.4.20X4, engine of the car is replaced. Cost of new engine is ₹ 2,00,000.

Discounting rate is 10%. Calculate new carrying amount of car after 3 years (post engine replacement).

Solution

Carrying amount of car on 1.4.20X4 = 10,00,000 – [(10,00,000/10) x 3] = ₹ 7,00,000

Value of old engine on on 1.4.20X4

Cost of old engine on 1.4.20X1 = ₹ 2,00,000 x 0.751 (PV factor @ 10% for 3rd year) = ₹ 1,50,200

Value of old engine on 1.4.20X4 = 1,50,200 – [(1,50,200/10) x 3] = ₹ 1,05,140

Revised carrying amount of car on 1.4.20X4 = 7,00,000 + 2,00,000 – 1,05,140 = ₹ 7,94,860

AS 11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Topics Covered

- Applicability of AS 11
- Accounting of foreign currency transactions
- Accounting of forward contracts
- Early payment or late payment decision

Applicability of AS 11

It Deals with

- Accounting of foreign currency transactions.
- Accounting of forward contracts.
- Translation of financial statements of foreign operations [Discussed in branch accounting chapter].

Accounting of Foreign Currency Transactions

(1) Meaning of Foreign Currency Transaction

- It means any transaction that will be settled in foreign currency.
- Example: Purchase/Sale of goods/PPE in foreign currency, Borrowing in foreign currency, etc.

(2) Accounting of Foreign Currency Transactions

Initially	At Balance Sheet Date	At Settlement Date
Record transaction by converting at exchange rate existing on transaction date	Asset or liability initially recognised in foreign currency transaction [whose settlement will be actually done in foreign currency in future] is remeasured at exchange rate existing on balance sheet date [closing rate at year end]	Asset or liability initially recognised in foreign currency transaction [whose settlement is being done in foreign currency] is settled at exchange rate existing on settlement date
	Difference is recorded in P&L as exchange loss/gain	Difference is recorded in P&L as exchange loss/gain

Note: If para 46A is adopted for long term borrowing payable in foreign currency, then exchange loss/gain on such borrowing at balance sheet & settlement date is recognised as follows:

If Such Borrowing is Taken to Finance PPE	▪ Add/(less) exchange loss/(gain) to value of PPE ▪ Depreciation on PPE is charged on revised value [For current year & remaining years].
If Such Borrowing is Taken for Any Other Purpose	▪ Transfer exchange loss/gain to 'Foreign Currency Monetary Item Translation Difference (FCMITDA) A/c'. ▪ Amortise balance of FCMITDA A/c to P&L in remaining borrowing period [including current year]. ▪ Unamortised balance in FCMITDA A/c is shown under 'Reserve and surplus' head in balance sheet.

Example 1

A Ltd. [Indian company] purchased goods from USA for $ 1,000 on 1.1.20X1 for which settlement will be done on 1.6.20X1.

Exchange rate on 1.1.20X1 is 1 $ = ₹ 80.

Exchange rate on 31.3.20X1 is 1 $ = ₹ 82.

Exchange rate on 1.6.20X1 is 1 $ = ₹ 81.

Pass journal entry on 1.1.20X1, 31.3.20X1 and 1.6.20X1 as per AS 11.

Solution

Journal entry on 1.1.20X1

Particulars		Debit	Credit
Purchase A/c	Dr.	₹ 80,000	
To Creditor A/c [$ 1,000 x ₹ 80]			₹ 80,000

Remeasurement on 31.3.20X1

Items initially recognised in foreign currency transaction are

(i) Purchase: No settlement in foreign currency in future → Not remeasured

(ii) Creditor: Actual settlement in foreign currency in future → Remeasured at 1 $ = ₹ 82

→ $ 1,000 x ₹ 82 = ₹ 82,000

So, Increase in Creditor = ₹ 82,000 – ₹ 80,000 = ₹ 2,000

Journal entry on 31.3.20X1

Particulars		Debit	Credit
Exchange Loss A/c (P&L)	Dr.	₹ 2,000	
To Creditor A/c [$ 1,000 x (₹ 82 – ₹ 80)]			₹ 2,000

Settlement on 1.6.20X1

Items initially recognised in foreign currency transaction are

(i) Purchase: No settlement in foreign currency → Not remeasured

(ii) Creditor: Actual settlement in foreign currency → Settlement at 1 $ = ₹ 81

→ $ 1,000 x ₹ 81 = ₹ 81,000

Journal entry on 1.6.20X1

Particulars		Debit	Credit
Creditor A/c	Dr.	₹ 82,000	
To Bank A/c [$ 1,000 x ₹ 81]			₹ 81,000
To Exchange Gain A/c (P&L)			₹ 1,000

Example 2

A Ltd. [Indian company] has borrowed $ 1,000 1.4.20X1 which will be repaid after 5 years and also acquired a PPE of same amount whose useful life is 10 years.

Exchange rate on 1.4.20X1 is 1 $ = ₹ 80.

Exchange rate on 31.3.20X2 is 1 $ = ₹ 82.

Pass journal entry on 1.4.20X1 and 31.3.20X2 if

(i) Para 46A is not adopted.

(ii) Para 46A is adopted and borrowing is taken to finance PPE.

(iii) Para 46A is adopted and borrowing is not taken to finance PPE.

Solution

Borrowing on 1.4.20X1 = $ 1,000 x ₹ 80 = ₹ 80,000

Borrowing on 31.3.20X2 = $ 1,000 x ₹ 82 = ₹ 82,000

Exchange loss on borrowing on 31.3.20X2 = ₹ 82,000 – ₹ 80,000 = ₹ 2,000

(i) Para 46A is not adopted

Date	Particulars		Debit	Credit
1.4.20X1	Bank A/c	Dr.	₹ 80,000	
	To Loan A/c			₹ 80,000
1.4.20X1	PPE A/c	Dr.	₹ 80,000	
	To Bank A/c			₹ 80,000
31.3.20X2	Exchange Loss A/c (P&L)	Dr.	₹ 2,000	
	To Loan A/c			₹ 2,000
31.3.20X2	Depreciation A/c (P&L)	Dr.	₹ 8,000	
	To PPE A/c [₹ 80,000/10 years]			₹ 8,000

(ii) Para 46A is adopted and borrowing is taken to finance PPE

Date	Particulars		Debit	Credit
1.4.20X1	Bank A/c	Dr.	₹ 80,000	
	To Loan A/c			₹ 80,000
1.4.20X1	PPE A/c	Dr.	₹ 80,000	
	To Bank A/c			₹ 80,000
31.3.20X2	Exchange Loss A/c	Dr.	₹ 2,000	
	To Loan A/c			₹ 2,000
31.3.20X2	PPE A/c	Dr.	₹ 2,000	
	To Exchange Loss A/c			₹ 2,000
31.3.20X2	Depreciation A/c (P&L)	Dr.	₹ 8,200	
	To PPE A/c [₹ 82,000/10 years]			₹ 8,200

(iii) Para 46A is adopted and borrowing is not taken to finance PPE

Date	Particulars		Debit	Credit
1.4.20X1	Bank A/c	Dr.	₹ 80,000	
	To Loan A/c			₹ 80,000
1.4.20X1	PPE A/c	Dr.	₹ 80,000	
	To Bank A/c			₹ 80,000
31.3.20X2	Exchange Loss A/c	Dr.	₹ 2,000	
	To Loan A/c			₹ 2,000
31.3.20X2	FCMITDA A/c	Dr.	₹ 2,000	
	To Exchange Loss A/c			₹ 2,000
31.3.20X2	Depreciation A/c (P&L)	Dr.	₹ 8,000	
	To PPE A/c [₹ 80,000/10 years]			₹ 8,000
31.3.20X2	P&L	Dr.	₹ 400	
	To FCMITDA A/c [₹ 2,000/5 years]			₹ 400

Unamortised balance in FCMITDA A/c of ₹ 1,600 [₹ 2,000 – ₹ 400] is shown under R&S head in balance sheet.

Accounting of Forward Contracts

(1) Meaning of Forward Contract

It means a contract for purchase or sale of foreign currency on a specified future date at agreed forward exchange rate.

(2) Accounting of Forward Contracts

Non-Speculative Forward Contract

If first transaction is done for purchase/sale of goods, PPE, etc. in foreign currency & thereafter forward contract is entered to manage foreign currency settlement risk

- Calculate exchange loss/gain on forward contract agreement date
  = Forward contract rate – Spot rate
- Allocate exchange loss/gain to P&L over the forward contract period

Speculative Forward Contract

If directly entered into forward contract

- Calculate exchange loss/gain on forward contract settlement date
  = Forward contract sale rate – Forward contract purchase rate
- Transfer exchange loss/gain to P&L immediately on settlement date

Early Payment or Late Payment Decision

Steps to Decide Whether to Make Early Payment or Late Payment to Foreign Currency Creditor

Step 1: Calculate Total Outflow in Early Payment

Particulars	Amount
Amount payable in foreign currency	XX
(–) Cash discount (if any)	(XX)
Net amount payable in foreign currency	XX
Convert it in home currency at exchange rate existing on early payment date	XX
(+) Interest loss @ home currency borrowing rate till late payment date	XX
	XX

Step 2: Calculate Total Outflow in Late Payment

Particulars	Amount
Amount payable in foreign currency	XX
(+) Interest charged by supplier till late payment date	XX
Net amount payable in foreign currency	XX
Convert it in home currency at exchange rate existing on late payment date	**XX**

Step 3: Decide Whether Early Payment or Late Payment is Beneficial

Where outflow in home currency is lower, i.e., Lower of Step 1 or Step 2

AS 12: ACCOUNTING FOR GOVERNMENT GRANTS

Topics Covered

- Meaning of government grant
- Recognition of government grant
- Accounting of government grant related to specific PPE
- Accounting of government grant related to revenue
- Accounting of government grant related to promoter's contribution

Meaning of Government Grant

- Assistance by government to entity in cash or kind with certain conditions [Example: Subsidy].
- Government can provide grant related to
  - Specific PPE
  - Revenue
  - Promoter's contribution
- Grant received for specific purpose should be utilised for the same purpose only.

Recognition of Government Grant

Entity shall recognise government grant in books only when there is reasonable assurance that

- It will comply with conditions of grant, &
- Grant will be received.

Accounting of Government Grant Related to Specific PPE

It means government grant is received for purchase/construction of PPE.

(1) **If Government Grant is in Cash**

Method 1: Deduct Grant from Cost of PPE

- Initially

	Particulars		Debit	Credit
(i)	**Purchase of PPE**			
	PPE A/c	Dr.	XX	
	To Bank A/c			XX
(ii)	**Receiving of Grant**			
	Bank A/c	Dr.	XX	
	To PPE A/c			XX

- **At Each Balance Sheet Date**

	Particulars		Debit	Credit
(i)	**Depreciation on Net Value of PPE**			
	Depreciation A/c	Dr.	XX	
	To PPE A/c			XX
(ii)	**Transfer Depreciation to P&L A/c**			
	P&L A/c	Dr.	XX	
	To Depreciation A/c			XX

- **At the Time of Refund of Grant (If any)**

Particulars		Debit	Credit
PPE A/c	Dr.	XX	
To Bank A/c			XX
Now, Depreciation in future will be charged on revised amount of PPE			

Method 2: Treat Grant as Deferred Income & Amortise to P&L using Depreciation Method

- **Initially**

	Particulars		Debit	Credit
(i)	**Purchase of PPE**			
	PPE A/c	Dr.	XX	
	To Bank A/c			XX
(ii)	**Receiving of Grant**			
	Bank A/c	Dr.	XX	
	To Deferred Grant Income A/c			XX

- **At Each Balance Sheet Date**

	Particulars		Debit	Credit
(i)	**Depreciation on Full Value PPE**			
	Depreciation A/c	Dr.	XX	
	To PPE A/c			XX
(ii)	**Transfer Depreciation to P&L A/c**			
	P&L A/c	Dr.	XX	
	To Depreciation A/c			XX

(iii)	**Amortisation of Grant using Depreciation Method**		
	Deferred Grant Income A/c Dr.	XX	
	To P&L A/c (Other Income)		XX
Unamortised balance of 'Deferred Grant Income A/c' is shown under 'Reserve & Surplus' head in balance sheet			

- **At the Time of Refund of Grant (If any)**

Particulars		Debit	Credit
Deferred Grant Income A/c	Dr.	Upto balance in this A/c	
P&L A/c	Dr.	Balancing figure	
To Bank A/c			XX
Refund debited in P&L A/c is shown as extra ordinary item			

(2) **If Government Grant is in Kind**

PPE Received Free of Cost	▪ Recognise PPE at nominal value (₹ 1) & no depreciation is charged. ▪ If grant is refunded, then incorporate PPE at refund amount and charge depreciation in future accordingly.
PPE Received at Concessional Price	▪ Recognise PPE at concessional price paid & depreciate accordingly. ▪ If grant is refunded, then increase value of PPE with refund amount and charge depreciation in future accordingly.

Accounting of Government Grant Related to Revenue

- It means government grant is received for incurring expenses [Example: Grant received for welfare activity or providing salary/medical facilities to employees].
- Treat grant as deferred income & amortise to P&L in respective expense ratio.
- **Journal Entries**
  - **Initially**

	Particulars	Debit	Credit
(i)	**Receiving of Grant**		
	Bank A/c Dr.	XX	
	To Deferred Grant Income A/c		XX
(ii)	**Expense Incurred in Current Year**		
	Expense A/c Dr.	XX	
	To Bank A/c		XX

➢ **At Each Balance Sheet Date**

	Particulars		Debit	Credit
(i)	**Amortisation of Grant in Respective Expense Ratio**			
	Deferred Grant Income A/c	Dr.	XX	
	To P&L A/c (Other Income)			XX
	OR			
	To Expense A/c			XX
(ii)	**Transfer Balance in Expense A/c to P&L A/c**			
	P&L A/c	Dr.	XX	
	To Expense A/c			XX

➢ **At the Time of Refund of Grant (If any)**

Particulars		Debit	Credit
Deferred Grant Income A/c	Dr.	Upto balance in this A/c	
P&L A/c	Dr.	Balancing figure	
To Bank A/c			XX

Accounting of Government Grant Related to Promoter's Contribution

- It means government grant is received as capital subsidy for setting up of business, unit, undertaking, project, factory, etc.
- Treat grant as capital reserve.
- **Journal Entries**

	Particulars		Debit	Credit
(i)	**Receiving of Grant**			
	Bank A/c	Dr.	XX	
	To Capital Reserve A/c			XX
(ii)	**At the Time of Refund of Grant (If any)**			
	Capital Reserve A/c	Dr.	XX	
	To Bank A/c			XX

AS 13: ACCOUNTING FOR INVESTMENTS

Topics Covered

- Meaning of investment
- Classification of investment
- Accounting for investment in equity shares
- Accounting for investment in interest bearing securities
- Reclassification of investment

Meaning of Investment

- Asset of the business
- Held with intention to generate following income:
  - Regular/periodic income [Example: Interest, dividend etc.]
  - Capital appreciation [Example: Increase in market price of investment]

Classification of Investment

- Current/short term/temporary investment
  - Intention to hold for maximum 12 months, &
  - Readily convertible in cash.
- Non-current/long term/permanent investment
  - Which is not current investment

Accounting for Investment in Equity Shares

(1) **Format of Investment A/c**

Date	Particulars	Nos	Dividend	Amount	Date	Particulars	Nos	Dividend	Amount

- No need to draw dividend column, if adjustment of dividend is not given.
- Number of shares involved in a transaction are disclosed in "Number of shares (Nos)" column.
- Net holding = Total debit Nos – Total credit Nos

(2) Adjustments to be Done in Investment A/c

Opening Balance of Investment

- **Presentation in Investment A/c**
  - Disclose opening balance (if any) in debit side [Nos & Amount column].

Purchase of Shares from Open Market

- **Calculation of total purchase cost**

Purchase price/cost	XX
(+) Brokerage/commission	XX
(+) Taxes/duties [Example: Stamp duty]	XX
Total purchase cost	XX

- **Journal entry**

Particulars		Debit	Credit
Investment A/c	Dr.	At total purchase cost	
To Bank A/c			

- **Presentation in Investment A/c**
  - Disclose in debit side [Nos & Amount column].

Receiving Bonus Shares

- **Meaning**
  - Issue of equity shares to existing shareholders free of cost (by capitalisation of profits) in a certain proportion.
- **Calculation of bonus shares to be received**
  - Net holding as on date of bonus issue x Bonus issue ratio
- **Journal entry**
  - No journal entry as it is received free of cost.
- **Presentation in Investment A/c**
  - Disclose in debit side [Nos column only] as it increases holding of shares.

Receiving Right Shares Option

- **Meaning**
  - Option given by company to existing shareholders to purchase equity shares at price less than fair value.
- **Calculation of right share options to be received**
  - Net holding as on date of rights issue x Rights issue ratio

- **Accounting if right share options are exercised/purchased/subscribed**
  - Journal entry

Particulars		Debit	Credit
Investment A/c	Dr.	At right issue price	
To Bank A/c			

  - Presentation in Investment A/c: Disclose in debit side [Nos & Amount column].
- **Accounting if right share options are renounced/transferred/sold to another person**
  - Calculation of total renouncement income

    = Number of right share options renounced x Transfer price per share
  - Determine nature of renouncement income

If it is given in question that market price of shares after rights issue is decreased

↓

Capital nature income = Decrease in value of existing investment of shareholder

↓

Revenue nature income = Total renouncement income – Capital nature income

Otherwise

↓

Total renouncement income is considered as revenue nature income

  - Journal entry & Presentation in Investment A/c

Capital Nature Income	Revenue Nature Income
Bank A/c Dr. To Investment A/c	Bank A/c Dr. To P&L A/c
Disclose in credit side [Amount column only] of Investment A/c	Not to be disclosed in Investment A/c

- **Accounting if right share options are rejected/lapsed**
  - Ignore completely [No adjustment].

Receiving Dividend Income

- **Basics of dividend**
  - Dividend is received by current shareholders irrespective of their period of holding.
  - Dividend is not calculated on time proportionate basis.
  - Types of dividend
    (i) Final dividend: Dividend for previous year is declared in current year.
    (ii) Interim dividend: Dividend for current year is declared during current year.
- **Accounting for receiving final dividend**
  - Final dividend is received on
    (i) Opening balance of investment, &
    (ii) Shares purchased from open market till dividend declaration date.
    Note: Final dividend is not received on bonus shares and right shares.
  - Calculation of final dividend amount received

Final dividend received on opening balance of investment	Final dividend received on shares purchased from open market till dividend declaration date
Net holding of opening balance × Face value per share × Dividend rate	Net holding of open market purchase × Face value per share × Dividend rate

  - Journal entry & Presentation

Final dividend received on opening balance of investment	Final dividend received on shares purchased from open market till dividend declaration date
Bank A/c Dr. To Dividend Income A/c (P&L)	Bank A/c Dr. To Investment A/c
Disclose in credit side in 'Dividend' column only	Disclose in credit side [Amount column only] of Investment A/c

- **Accounting for receiving interim dividend**
  - Interim dividend is received on entire net holding as on date of dividend declaration [i.e. opening balance, open market purchase, right shares & bonus shares].

➢ Calculation of interim dividend amount received

= Entire net holding as on date of dividend declaration × Face value per share × Dividend rate

➢ Journal entry

Particulars		Debit	Credit
Bank A/c	Dr.	XX	
To Dividend Income A/c (P&L)			XX

➢ Presentation: Disclose in credit side in 'Dividend' column only

Note: 'Dividend column' represents 'Dividend income A/c'. At end of the year, it is balanced by transferring to P&L A/c.

Sale of Shares

▪ **Calculation of net sale value**

Total sale value	XX
(-) Brokerage/commission	(XX)
Net sale value	XX

▪ **Journal entry**

Particulars		Debit	Credit
Bank A/c	Dr.	At net sale value	
To Investment A/c			

▪ **Presentation in Investment A/c**

➢ Disclose in credit side [Nos & Amount column].

Profit/ (Loss) on Sale of Shares

▪ Implied treatment on each transaction of sale of shares.

▪ **Calculation of profit/(loss) on sale of shares**

Step 1: Calculate cost of sales [By average cost method]

$$= \frac{\text{Total debit amount} - \text{Total credit amount}}{\text{Total debit Nos} - \text{Total credit Nos}} \times \text{No. of shares sold}$$

*While calculating cost of sales, details from Investment A/c is to be taken excluding current sale transaction.

Step 2: Profit/(loss) on sale of shares

Net sale value	XX
(-) Cost of sales	(XX)
Profit/(loss) on sale of shares	XX

<table>
<tr><td></td><td>

- **Journal entry & Presentation in Investment A/c**

<table>
<tr><th>Loss on sale of shares</th><th>Profit on sale of shares</th></tr>
<tr><td>P&L A/c Dr.
To Investment A/c</td><td>Investment A/c Dr.
To P&L A/c</td></tr>
<tr><td>Disclose in credit side [Amount column only]</td><td>Disclose in debit side [Amount column only]</td></tr>
</table>

</td></tr>
<tr><td>Closing Balance/ Carrying Value of Investment</td><td>

- **Calculation of closing balance/carrying value of investment**
  - Current investment: Disclose at cost or fair value, whichever is lower.
  - Non-current investment: Disclose at cost after adjustment of decline other than of temporary nature.

Note: Assumption regarding nature of investment for practical questions

(i) Specifically given.

(ii) If fair value of shares at the end of year is given in question, then treat it as current investment. Otherwise, non-current investment.

- **Presentation in Investment A/c**

Disclose closing balance (if any) in credit side [Nos & Amount column].

Note:

(i) If closing balance is disclosed at cost, then Investment A/c is automatically gets balanced.

(ii) If closing balance is disclosed at fair value, then loss is recognized:
  - At balancing figure in credit side of amount column of Investment A/c.
  - Journal entry

<table>
<tr><th>Particulars</th><th>Debit</th><th>Credit</th></tr>
<tr><td>P&L A/c Dr.
To Investment A/c</td><td>XX</td><td>
XX</td></tr>
</table>

</td></tr>
</table>

Example

Mr. Rahul has current investment in equity shares (Nominal value ₹ 10 each) of Dhruv Ltd. He entered into following transactions during the year:

1.4.20X1 Opening balance of 50,000 equity shares at cost of ₹ 7,00,000

1.5.20X1 Purchase of 1,00,000 equity shares at ₹ 20 each

1.6.20X1 Dhruv Ltd. declared bonus shares in ratio of 1:3

1.7.20X1 Sale of 1,30,000 equity shares at ₹ 19 each

31.3.20X2 Market value per equity share of Dhruv Ltd. is ₹ 15

Prepare Investment A/c in the books of Mr. Rahul.

Solution

Investment in equity shares of Dhruv Ltd. A/c

Date	Particulars	Nos	Amount	Date	Particulars	Nos	Amount
1.4.X1	To Bal. b/d	50,000	7,00,000	1.7.X1	By Bank	1,30,000	24,70,000
1.5.X1	To Bank	1,00,000	20,00,000	31.3.X2	By bal. c/d	70,000	9,45,000
1.6.X1	To Bonus share	50,000	-				
1.7.X1	To P&L (Profit)	-	7,15,000				
		2,00,000	**34,15,000**			**2,00,000**	**34,15,000**

Working notes:

(i) Number of bonus shares = (50,000 + 1,00,000) x 1/3 = 50,000 shares

(ii) Profit on sale of shares on 1.7.20X1

Net sale value (1,30,000 x 19)	24,70,000
(-) Cost of sales $\frac{27,00,000 - Nil}{2,00,000 - Nil} \times 1,30,000$	(17,55,000)
Profit on sale	7,15,000

(iii) Closing balance of investment

Fair value (70,000 x 15)	10,50,000
Cost $\frac{34,15,000 - 24,70,000}{2,00,000 - 1,30,000} \times 70,000$	9,45,000
Closing balance (Lower)	**9,45,000**

Accounting for Investment in Interest Bearing Securities [Debentures, Bonds, etc.]

(1) Format of Investment A/c

Date	Particulars	F.V.	Interest	Amount	Date	Particulars	F.V.	Interest	Amount

- Total face value of investment involved in a transaction are disclosed in "Face value (F.V.)" column.
- Net holding in terms of face value = Total debit F.V. – Total credit F.V.
- 'Interest column' represents 'Interest on investment A/c'. At end of the year, it is balanced by transferring to P&L A/c.

(2) Basics of Interest and Market Price

Interest	▪ **Due date of interest** ➢ Fixed dates on which interest is received by investor from company. ➢ It can be half yearly, annually, etc. ▪ **Interest adjustments in Investment A/c** ➢ On opening balance: Accrued interest from last due date to opening date. ➢ On closing balance: Accrued interest from last due date to closing date. ➢ On each purchase: Pay interest from last due date to purchase date. ➢ On each sale: Receive interest from last due date to sale date. ➢ On each due date: Receive interest from last due date to current due date on net holding. **Note:** (i) If due date is coming exactly at end of the year, then no adjustment is done for accrued interest on opening and closing balance. (ii) If purchase/sale transaction happens on next day of due date, then no adjustment is done to pay/receive interest on such purchase/sale. ▪ **Calculation of interest** $= \text{Face value} \times \text{Interest rate} \times \frac{\text{Period of interest}}{12}$
Types of Market Price	▪ **Cum-interest market price:** Market price includes interest component. ▪ **Ex-interest market price:** Market price excludes interest component.

(3) Adjustments to be Done in Investment A/c

Opening Balance of Investment	▪ **Presentation in Investment A/c** ➢ Disclose opening balance (if any) in debit side [F.V. & Amount column] and its interest adjustment in 'Interest' column.
Purchase of Investment	▪ **Calculation of total purchase cost**

If purchase transaction is at cum-interest market price		If purchase transaction is at ex-interest market price	
Cum-interest market price	XX	Ex-interest market price	XX
(-) Interest adjustment	(XX)	(+) Brokerage/commission	XX
Ex-interest market price	XX		
(+) Brokerage/commission	XX		
Total purchase cost	XX	Total purchase cost	XX

<table>
<tr>
<td></td>
<td>

<u>Journal entry</u>

<table>
<tr><th>Particulars</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Investment A/c Dr.</td><td>At total purchase cost</td><td></td></tr>
<tr><td>Interest on investment A/c Dr.</td><td>At interest adjustment</td><td></td></tr>
<tr><td>To Bank A/c</td><td></td><td>Total</td></tr>
</table>

<u>Presentation in Investment A/c</u>

Disclose in debit side [F.V. & Amount column] and its interest adjustment in 'Interest' column.

</td>
</tr>
<tr>
<td>Receiving Interest on Each Due Date</td>
<td>

Implied treatment on each due date of interest.
<u>Journal entry</u>

<table>
<tr><th>Particulars</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Bank A/c Dr.</td><td rowspan="2">Interest amount</td><td></td></tr>
<tr><td>To Interest on investment A/c</td><td></td></tr>
</table>

<u>Presentation in Investment A/c</u>

Disclose in credit side [Interest column only].

</td>
</tr>
<tr>
<td>Sale of Investment</td>
<td>

<u>Calculation of net sale value</u>

<table>
<tr><th colspan="2">If sale transaction is at cum-interest market price</th><th colspan="2">If sale transaction is at ex-interest market price</th></tr>
<tr><td>Cum-interest market price</td><td>XX</td><td>Ex-interest market price</td><td>XX</td></tr>
<tr><td>(-) Interest adjustment</td><td>(XX)</td><td>(-) Brokerage/commission</td><td>XX</td></tr>
<tr><td>Ex-interest market price</td><td>XX</td><td rowspan="2"></td><td rowspan="2"></td></tr>
<tr><td>(-) Brokerage/commission</td><td>XX</td></tr>
<tr><td>Net sale value</td><td>XX</td><td>Net sale value</td><td>XX</td></tr>
</table>

<u>Journal entry</u>

<table>
<tr><th>Particulars</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Bank A/c Dr.</td><td>Total</td><td></td></tr>
<tr><td>To Investment A/c</td><td></td><td>At net sale value</td></tr>
<tr><td>To Interest on investment A/c</td><td></td><td>At interest adjustment</td></tr>
</table>

<u>Presentation in Investment A/c</u>

Disclose in credit side [F.V. & Amount column] and its interest adjustment in 'Interest' column.

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</table>

Profit/ (Loss) on Sale of Investment

- Implied treatment on each transaction of sale.
- **Calculation of profit/(loss) on sale**

  Step 1: Calculate cost of sales [By FIFO or Average cost method as mentioned in question]

  Step 2: Profit/(loss) on sale

Net sale value	XX
(-) Cost of sales	(XX)
Profit/(loss) on sale	XX

- **Journal entry & Presentation in Investment A/c**

Loss on sale	Profit on sale
P&L A/c Dr. To Investment A/c	Investment A/c Dr. To P&L A/c
Disclose in credit side [Amount column only]	Disclose in debit side [Amount column only]

Closing Balance/ Carrying Value of Investment

Same as investment in equity shares.

Example

Mr. Rahul has current investment in 9% bonds (Nominal value ₹ 100 each). He entered into following transactions during the year:

1.1.20X1 Opening balance (nominal value ₹ 60,000) at cost of ₹ 59,000

1.3.20X1 Purchase of 100 bonds at ex-interest price of ₹ 98 each

1.7.20X1 Sale of 250 bonds (out of original holding) at cum-interest price of ₹ 102.25 each

Interest due dates are 30th September and 31st March. Mr. Rahul closes his books every 31st December. Mr. Rahul follows FIFO method. Prepare Investment A/c in the books of Mr. Rahul.

Solution

Investment in 9% Bonds A/c

Date	Particulars	F.V.	Int.	Amount	Date	Particulars	F.V.	Int.	Amount
20X1					20X1				
1.1	To Bal. b/d	60,000	1,350	59,000	31.3	By Bank	-	3,150	-
1.3	To Bank	10,000	375	9,800	1.7	By Bank	25,000	563	25,000

1.7	To P&L	-	-	417	30.9	By Bank	-	2,025	-
31.12	To P&L (B/f)		5,026		31.12	By Bal. c/d	45,000	1,013	44,217
		70,000	6,751	69,217			70,000	6,751	69,217

Working notes:

(i) Interest element in opening balance = ₹ 60,000 x 9% x 3/12 = ₹ 1,350

(ii) Purchase of bonds on 1.3.20X1

Interest element in purchase of bonds = 100 bonds x ₹ 100 x 9% x 5/12 = ₹ 375

Investment element in purchase of bonds = 100 bonds x ₹ 98 = ₹ 9,800

(iii) Interest for half-year ended 31.3.20X1 = 700 bonds x ₹ 100 x 9% x 6/12 = ₹ 3,150

(iv) Sale of bonds on 1.7.20X1

Cum-interest market price (250 bonds x ₹ 102.25)	25,563
(-) Interest adjustment (250 bonds x ₹ 100 x 9% x 3/12 = ₹ 1,125)	(563)
Net sale value	25,000

(v) Profit on sale of bonds on 1.7.20X1

Sale proceeds	₹ 25,000
(-) Cost of sales using FIFO method [(₹ 59,000/600) x 250]	₹ (24,583)
Profit	₹ 417

(vi) Interest for half-year ended 30.9.20X1 = 450 x 100 x 9% x 6/12 = ₹ 2,025

(vii) Closing balance of investment [Assuming non-current investment]

Bonds remained in hand at 31.12.20X1	Nominal value (₹)		Cost (₹)
Out of original holding (60,000 – 25,000)	35,000	(59,000/60,000) x 35,000	34,417
Out of bonds purchased on 1.3.20X1	10,000		9,800
	45,000		44,217

(viii) Interest element in closing balance = ₹ 45,000 x 9% x 3/12 = ₹ 1,013

Reclassification of Investments

- **Current to non-current investment**
  - Transfer at lower of
    - Cost, or
    - Fair value
- **Non-current to current investment**
  - Transfer at lower of
    - Cost, or
    - Carrying value

AS 14: ACCOUNTING FOR AMALGAMATIONS

Topics Covered

- Meaning of amalgamation
- Classification of amalgamation for the purpose of accounting
- Methods for accounting of amalgamation
- Process to solve practical questions of amalgamation
  - Amalgamation in nature of purchase
  - Amalgamation in nature of merger
    - Calculation of purchase consideration (PC).
    - Accounting in books of selling company.
    - Accounting in books of purchasing company.

Meaning of Amalgamation

- Amalgamation [Also known as Absorption/Merger/Take over] is the process of merger of 2 or more companies into 1 single company.
- Selling company gets wind up in amalgamation.
- It involves 2 parties
  - Purchasing company [Also known as Amalgamated/Resulting/Transferee/Vendee company].
  - Selling company [Also known as Amalgamating/Merged/Transferor/Vendor company].

Example 1

(i)

A Ltd.	+	B Ltd.	=	C Ltd.
Selling company [Existing]		Selling company [Existing]		Purchasing company [New]
↓ Wind up		↓ Wind up		

(ii)

A Ltd.	+	B Ltd.	=	A Ltd.
Purchasing company [Existing]		Selling company [Existing]		Purchasing company [Existing]
		↓ Wind up		

Classification of Amalgamation for the Purpose of Accounting

Amalgamation in Nature of Merger [Pooling of Interest Method]
Only if all of the following conditions are satisfied: ▪ All assets and liabilities (including reserves) of transferor are transferred to transferee. ▪ All assets and liabilities (including reserves) of are transferred at book value. ▪ Atleast 90% equity shareholders of transferor become equity shareholders of transferee. ▪ Equity shareholders agreed as above are discharged wholly by issue of equity shares in transferee, except that cash may be paid for any fractional shares. ▪ Business of transferor is carried on by transferee after amalgamation.
Amalgamation in Nature of Purchase [Purchase Method]
If any of the above condition is not satisfied.

Methods for Accounting of Amalgamation

Amalgamation in Nature of Purchase	Purchase method
Amalgamation in Nature of Merger	Pooling of interest method

Process to Solve Practical Questions of Amalgamation

Step 1	Decide nature of amalgamation ▪ Specifically given in question. ▪ Otherwise, assume as amalgamation in nature of purchase [Purchase method].
Step 2	Calculate purchase consideration (PC).
Step 3	Accounting in books of selling company [Only if required].
Step 4	Accounting in books of purchasing company [Only if required].

Calculation of Purchase Consideration (PC) [Amalgamation in Nature of Purchase]

(1) Meaning of PC

- PC means total amount paid by purchasing company (P Co.) to owners [Equity and preference shareholders] of selling company (S Co.).
- Amount paid to outsiders [Debenture holders, creditors, employees, etc.] is not part of PC.
- Payment of liquidation/amalgamation/absorption expense is also not considered as part of PC.

(2) Calculation of PC by Net Payment Method

Payment to Equity & Preference Shareholders of S Co.		
Mode of Payment: What is given by P Co.	**Calculation**	**Amount**

▪ By cash payment		XX
Case A: Total cash payment is given	Given	XX
Case B: Cash payment per share is given	No. of shares of S Co. × Cash payment per share	XX
▪ By issue of equity or preference shares		
Case A: No. of shares to be issued by P Co. is given	No. of shares to be issued by P Co. × Issue price per share of P Co.	XX
Case B: Exchange ratio is given	No. of shares of S Co. × Exchange ratio × Issue price per share of P Co.	XX
Case C: Intrinsic/fair/market value [Value given by registered valuer] per share of both P Co. & S Co. is given	No. of shares of S Co. × Intrinsic value per share of S Co. / Intrinsic value per share of P Co. × Issue price per share of P Co.	XX
Case D: Total amount is calculatable for which shares are to be issued	According to information given in question	XX
▪ By any other mode [Issue of debenture, etc.]	Same as above Cases A, B, C, D	XX
Total PC		**XX**

Example 2

P ltd. is acquiring S ltd. Following details of S ltd. are available on this date:

Particulars	Amount (₹)
13,000 7% Preference shares of ₹ 100 each	13,00,000
5,000 Equity shares of ₹ 100 each	5,00,000

P ltd. is discharging PC as follows:

(i) Issue 15,000 9% preference shares of ₹ 100 each to preference shareholders of S. ltd.

(ii) Pay ₹ 20 per share in cash to equity shareholders of S ltd. and also issue 6 equity shares of ₹ 100 each at market value of ₹ 120 in lieu of every 5 equity shares held in S. ltd.

Calculate total PC.

Solution

Mode of payment	Calculation	Amount (₹)
To equity shareholders of S ltd.		
Cash payment [Case B]	5,000 x ₹ 20	1,00,000
Issue of equity shares [Case B]	5,000 x 6/5 x ₹ 120	7,20,000
To preference shareholders of S ltd.		
Issue of 9% preference shares [Case A]	15,000 x ₹ 100	15,00,000
Total PC		**23,20,000**

Example 3

P ltd. is acquiring S ltd. S ltd. has 5,000 equity shares outstanding of ₹ 100 each.

Intrinsic value per share of P ltd. is ₹ 200 and of S ltd. is ₹ 150. P ltd. will issue equity shares to satisfy equity shareholders of S ltd. on the basis of intrinsic value. Calculate total PC.

Solution

Mode of payment	Calculation	Amount (₹)
To equity shareholders of S ltd.		
Issue of equity shares [Case C]	5,000 x (₹ 150/₹ 200) x ₹ 200	7,50,000
Total PC		**7,50,000**

Example 4

P ltd. is acquiring S ltd. Following details of S ltd. are available on this date:

Particulars	Amount (₹)
Assets	27,00,000
3,000 7% Preference shares of ₹ 100 each	3,00,000
6,000 8% Preference shares of ₹ 100 each	6,00,000
4,000 9% Preference shares of ₹ 100 each	4,00,000
5,000 Equity shares of ₹ 100 each	5,00,000
Reserves	6,00,000
6% Debentures	2,00,000
Trade payables	1,00,000

P ltd. is discharging PC as follows:

(i) Discharging 7% preference shareholders of S ltd.: Issue 10% preference shares of ₹ 100 each to discharge the preference shareholders at a premium of 10%.

(ii) Discharging 8% preference shareholders of S ltd.: Issue such number of its 12%

debentures of ₹ 100 each so as to provide income equivalent to 8% return on net assets (capital employed) of S ltd.

(iii) Discharging 9% preference shareholders of S ltd.: Issue such number of its 15% preference shares of ₹ 100 each so as to maintain same amount of dividend.

(iv) Discharging equity shareholders of S ltd.: As per registered valuer, value of equity shares of S ltd. is ₹ 120 per share which is agreed by its shareholders. P ltd. will issue sufficient number of equity shares of ₹ 100 each at premium of ₹ 100 per share.

Calculate total PC.

Solution

Mode of payment	Calculation	Amount (₹)
To equity shareholders of S ltd.		
Issue of equity shares [Case C]	5,000 x (₹ 120/₹ 200) x ₹ 200	6,00,000
To 7% preference shareholders of S ltd.		
Issue of 10% preference shares [Case D]	₹ 3,00,000 + (₹ 3,00,000 x 10%)	3,30,000
To 8% preference shareholders of S ltd.		
Issue of 12% debentures [Case D]	₹ 24,00,000* x 8%/12%	16,00,000
To 9% preference shareholders of S ltd.		
Issue of 15% preference shares [Case D]	₹ 4,00,000 x 9%/15%	2,40,000
Total PC		**27,70,000**

*Calculation of net assets (capital employed) of S ltd.

Particulars	Amount (₹)
Assets	27,00,000
(-) 6% Debentures	(2,00,000)
(-) Trade payables	(1,00,000)
	24,00,000

(3) Calculation of PC by Net Asset Method

- Total PC = Net assets taken over of S Co.
- **Calculation of Net Assets Taken Over of S Co.**

Particulars	Amount
Assets taken over of S Co. [Agreed value → Fair/Market value → Book value]	XX
(-) Liabilities taken over of S Co. [Agreed value → Fair/Market value → Book value]	(XX)
Net assets taken over of S Co. [Total PC]	**XX**

Determination of Assets & Liabilities of S Co. Taken Over by P Co.

Share Capital	Never taken
Reserves & Surplus	Never taken
Fictitious Assets	Never taken
All Other Assets & Liabilities [Including Goodwill, Cash & Bank Balance]	Taken at Agreed value → Fair/Market value → Book value [If any indication of not taken is given in question regarding any asset or liability, then such asset or liability is not taken]
Unrecorded Assets & Liabilities	Taken at Agreed value → Fair/Market value → Book value

- **PC is Calculated by Net Asset Method Only in Following Scenarios:**
  - Specifically mentioned in question.
  - Question is completely silent about PC, i.e. Information related to PC is not given.
  - Wordings like "Pay balance PC or necessary PC" are given in question.
  - PC is to be paid on basis of intrinsic value but intrinsic value is not available in question.
- **Mode of Payment of PC is Determined as Follows in Net Asset Method:**
  - According to information given in question.
  - Otherwise, assume P Co. is issuing equity shares at par to shareholders of S Co.

Example 5

P ltd. is acquiring S ltd. Following details of S ltd. are available on this date:

Particulars	Amount (₹)
PPE	2,00,000
Other assets	25,00,000
13,000 7% Preference shares of ₹ 100 each	13,00,000
5,000 Equity shares of ₹ 100 each	5,00,000
Reserves	6,00,000
6% Debentures	2,00,000
Trade payables	1,00,000

(i) Issue 15,000 9% preference shares of ₹ 100 each to preference shareholders of S. ltd.

(ii) Issue 6 equity shares of ₹ 100 each at market value of ₹ 120 in lieu of every 5 equity shares held in S. ltd and pay the balance in cash.

(iii) Discharge 6% debentures at premium of 10% by issuing 15% debentures of P ltd.

(iv) PPE is taken over at 10% above the book value and other assets at par value.

Calculate total PC.

Solution

Calculation of net assets taken over of S ltd.

Particulars	Amount (₹)
PPE (2,00,000 x 110%)	2,20,000
Other assets	25,00,000
(-) 15% Debentures (2,00,000 x 110%)	(2,20,000)
(-) Trade payables	(1,00,000)
Net assets taken over of S ltd. [Total PC]	**24,00,000**

Calculation of mode of payment of PC

Mode of payment	Calculation	Amount (₹)
Total PC		24,00,000
(-) To preference shareholders of S ltd.		
Issue of 9% preference shares	15,000 x ₹ 100	(15,00,000)
(-) To equity shareholders of S ltd.		
Issue of equity shares	5,000 x 6/5 x ₹ 120	(7,20,000)
Cash payment	Balancing figure	1,80,000

(4) Other Points

- **Issue Price Per Share of P Co.**
  - Directly given in question [At par, premium, discount, intrinsic/fair/market value].
  - Otherwise, assume shares are issued at par.

  Note:

  (i) If shares are to be issued at intrinsic value but intrinsic value per share of P Co. is not given in question, then it is calculated as follows:

  $$= \frac{\text{Net assets of P Co. [Fair/Market value → Book value]}}{\text{No. of equity shares in P Co.}}$$

  (ii) Issue price needs to be bifurcated into face value and premium/discount component for accounting in books of P Co. [Not relevant for accounting in books of S Co.].

- If premium/discount wording is given in any transaction, then always read it carefully.

Example	Interpretation
Issued fully paid up 15% preference shares of ₹ 100 each to discharge the preference shareholders (₹ 3,00,000) of S ltd. at a premium of 10%.	Premium is on payment amount, i.e. PC = ₹ 3,30,000

Discharge the preference shareholders (₹ 3,00,000) of S ltd., by issue of fully paid up 15% preference shares of ₹ 100 each, at a premium of 10%.	Premium is on payment amount, i.e. PC = ₹ 3,30,000
Issue 15% preference shares of ₹ 100 each at 10% premium to discharge preference shareholders of S ltd.	Premium is on issue price, i.e. Issue price = ₹ 110
Issue of such amount of 15% debentures (₹ 100 each) as is sufficient to discharge preference shareholders (₹ 3,00,000) of S ltd. at a discount of 5% after takeover.	Discount is on issue price, i.e. Issue price = ₹ 95
Issue fully paid up 15% preference shares of ₹ 100 each at 5% discount to discharge the preference shareholders (₹ 3,00,000) of S ltd. at a premium of 10%.	Discount is on issue price, i.e. Issue price = ₹ 95 Premium is on payment amount, i.e. PC = ₹ 3,30,000

Accounting in Books of Selling Company [Amalgamation in Nature of Purchase]

Steps to be Followed to Close the Books of Selling Company:

(1) Transfer Balance Sheet Items into Appropriate Ledger Accounts at Book Value

	Particulars		Debit	Credit
(i)	**Equity Share Capital A/c and Reserves & Surplus to Equity Shareholders A/c**			
	Equity Shares Capital A/c	Dr.	XX	
	Reserves & Surplus A/c	Dr.	XX	
	To Equity Shareholders A/c			XX
(ii)	**Fictitious Assets to Equity Shareholders A/c**			
	Equity Shareholders A/c	Dr.	XX	
	To Fictitious Assets A/c			XX
(iii)	**Preference Share Capital A/c to Preference Shareholders A/c**			
	Preference Share Capital A/c	Dr.	XX	
	To Preference Shareholders A/c			XX
(iv)	**Assets Taken Over by P Co. to Realisation A/c**			
	Realisation A/c	Dr.	XX	
	To Assets A/c			XX
(v)	**Liabilities Taken Over by P Co. to Realisation A/c**			
	Liabilities A/c	Dr.	XX	
	To Realisation A/c			XX

(2) Adjustment of PC

	Particulars		Debit	Credit
(i)	**Due Entry of PC**			
	Purchasing Company A/c	Dr.	XX	
	To Realisation A/c			XX
(ii)	**Receiving PC with Each Mode of PC**			
	Equity Shares of Purchasing Company A/c	Dr.	XX	
	Preference Shares of Purchasing Company A/c	Dr.	XX	
	Debentures of Purchasing Company A/c	Dr.	XX	
	Bank A/c	Dr.	XX	
	To Purchasing Company A/c			XX

(3) Realisation of Assets Not Taken Over by P Co.

Particulars		Debit	Credit
Bank A/c	Dr.	XX	
To Asset A/c			XX
Any balance remaining in 'Asset A/c' after above realisation is transferred to 'Realisation A/c'			

Note: If realised amount of assets not taken over by P Co. is not given in question, then assume such assets are realised at book value [Intangible assets at 'zero' value].

(4) Payment of Liabilities Not Taken Over by P Co.

Particulars		Debit	Credit
Liability A/c	Dr.	XX	
To Bank A/c			XX
Any balance remaining in 'Liability A/c' after above payment is transferred to 'Realisation A/c'			

Note: If payment amount of liabilities not taken over by P Co. is not given in question, then assume such liabilities are paid at book value.

(5) Liquidation/Amalgamation/Absorption Expense Borne by S Co.

Particulars		Debit	Credit
Realisation A/c	Dr.	XX	
To Bank A/c			XX

Note: In silent situation, assume liquidation expense is borne by S Co.

(6) Payment to Preference Shareholders [Only with Mode & Amount of PC which is Given to Preference Shareholders]

Particulars		Debit	Credit
Preference Shareholders A/c	Dr.	XX	
To Equity Shares of Purchasing Company A/c			XX
To Preference Shares of Purchasing Company A/c			XX
To Debentures of Purchasing Company A/c			XX
To Bank A/c			XX
Any balance remaining in 'Preference Shareholders A/c' after above payment is transferred to 'Realisation A/c'			

(7) Transfer Balance of Realisation A/c to Equity Shareholders A/c

	Particulars		Debit	Credit
(i)	**If Credit Balance in Realisation A/c [Profit]**			
	Realisation A/c	Dr.	XX	
	To Equity Shareholders A/c			XX
(ii)	**If Credit Balance in Realisation A/c [Loss]**			
	Equity Shareholders A/c	Dr.	XX	
	To Realisation A/c			XX

(8) Close Equity Shareholders A/c by Making Final Payment to Equity Shareholders

Particulars		Debit	Credit
Transfer All Remaining Ledger A/c Balance to Equity Shareholders A/c			
Equity Shareholders A/c	Dr.	XX	
To Equity Shares of Purchasing Company A/c			XX
To Preference Shares of Purchasing Company A/c			XX
To Debentures of Purchasing Company A/c			XX
To Bank A/c			XX

Note: If ledger accounts to close the books of selling company are required in question, then directly prepare following ledger accounts using above steps:

(i) Equity Shareholders A/c

(ii) Preference Shareholders A/c

(iii) Realisation A/c

(iv) Purchasing Company A/c

(v) Modes of PC A/c [Individually for each mode of PC]

(vi) Assets not taken over by P Co. A/c [Individually for each such asset]

(vii) Liabilities not taken over by P Co. A/c [Individually for each such liability]

Accounting in Books of Purchasing Company [Amalgamation in Nature of Purchase]

Steps to be Followed for Accounting in the Books of Purchasing Company:

(1) Calculate Net Assets Taken Over of S Co.

Same as discussed in 'Calculation of PC by Net Asset Method'.

(2) Calculate Goodwill/Capital Reserve Arising Due to Amalgamation

Particulars	Amount
Purchase consideration (PC)	XX
(-) Net assets taken over of S Co.	(XX)
Goodwill/(Capital Reserve)	**XX/(XX)**

(3) Journal Entries

	Particulars		Debit	Credit
(i)	**Due Entry of PC**			
	Business Purchase A/c	Dr.	PC amount	
	To Liquidator of Selling Company A/c			
(ii)	**Incorporate Asset & Liabilities Taken Over of S Co. [Big Entry]**			
	Asset A/c [Taken over of S Co.]	Dr.	Taken over value	
	Goodwill A/c [Arising due to amalgamation]	Dr.	B/f	
	To Capital Reserve [Arising due to amalgamation]			B/f
	To Liabilities A/c [Taken over of S Co.]			Taken over value
	To Business Purchase A/c			PC Amount
(iii)	**Payment of PC with Each Mode of PC**			
	Liquidator of Selling Company A/c	Dr.	PC amount	
	To Equity Share Capital A/c			Paid-up value
	To Preference Share Capital A/c			Paid-up value
	To Debentures A/c			Paid-up value
	To Securities Premium A/c			XX
	To Bank A/c			XX

(iv)	**Payment of Liability for Debentures Taken Over of S Co.**		
	Liability for Debentures of S Co. A/c Dr.	Taken over value	
	Discount on Issue of Debentures A/c Dr.	XX	
	To Debentures A/c		Paid-up value
	To Securities Premium A/c		XX
(v)	**Cancellation of Inter Company Debt [Debtors, Creditors, Loan, B/R, B/P, etc.]**		
	Liability A/c Dr.	Mutual indebtedness amount	
	To Asset A/c		
(vi)	**Stock Reserve [Unrealised Gain on Stock]**		
	Capital Reserve A/c → Goodwill A/c Dr.	XX	
	To Stock A/c		XX
(vii)	**Liquidation/Amalgamation Expense Borne by P Co.**		
	Capital Reserve A/c → Goodwill A/c Dr.	XX	
	To Bank A/c		XX
(viii)	**Incorporate Statutory Reserves of S Co.**		
	Amalgamation Adjustment Reserve A/c Dr.	Book value of statutory reserve	
	To Statutory Reserve A/c		
(ix)	**Elimination of 1 A/c [Goodwill or Capital Reserve] When Both A/c are Existing in Books**		
	Capital Reserve A/c Dr.	Balance in Goodwill A/c or Capital Reserve A/c (whichever is lower)	
	To Goodwill A/c		

Note:

(i) Stock reserve [Unrealised gain on stock]

If any stock has been sold/purchased between P Co. & S Co. and such stock is lying in inventory [i.e., remained unsold] on amalgamation date, then profit earned on such stock [Unrealised gain on stock] is eliminated.

$$\text{Stock reserve} = \frac{\text{Unsold stock value}}{} \times \frac{\text{Profit \% on sales}}{} \quad \boxed{\text{OR}} \quad \frac{\text{Unsold stock value} \times \text{Profit \% on cost}}{100 + \text{Profit \% on cost}}$$

(ii) If there are more than 1 selling company, then 'Big entry' and 'Payment of PC entry' is passed separately for all selling companies.

(iii) Amalgamation adjustment reserve is disclosed as negative item under 'Reserves and surplus' head in balance sheet.

(4) **Balance Sheet of P Co. After Amalgamation**

Balance Sheet Items of P Co.	Take 'All items' as it is.
Balance Sheet Items of S Co.	▪ Ignore 'Never taken' items. ▪ Ignore 'Not taken. items. ▪ Consider only 'Taken' items.
Other Adjustments	▪ Consider mode of payment of PC. ▪ Consider effect of payment of liability for debentures taken over of S Co. ▪ Cancel inter company debt from respective asset & liability. ▪ Consider effect of stock reserve. ▪ Consider effect of liquidation/amalgamation expense borne by P Co. ▪ Consider effect of incorporating statutory reserves of S Co. ▪ Consider balance of 'Goodwill/Capital reserve' after giving above effects.

Calculation of Purchase Consideration (PC) [Amalgamation in Nature of Merger]

Same as Amalgamation in Nature of Purchase Except in case of 'Calculation of PC by Net Asset Method', Net Assets Taken Over of S Co. is Calculated as Follows:

Particulars	Amount
All assets including fictitious assets of S Co. [Book value]	XX
(–) All liabilities of S Co. [Book value]	(XX)
(–) All reserves & surplus of S Co. [Book value]	(XX)
Net assets taken over of S Co. [Total PC]	**XX**

OR

Particulars	Amount
Total share capital (equity & preference) of S Co.	XX
Net assets taken over of S Co. [Total PC]	**XX**

Determination of Assets & Liabilities of S Co. Taken Over by P Co.

Share Capital	Never taken
All Other Assets & Liabilities [Including Reserves & Surplus, Fictitious Assets]	Always taken at book value
Unrecorded Assets & Liabilities	First, recorded by S co. in its books through P&L & then, taken by P Co. at book value

Accounting in Books of Selling Company [Amalgamation in Nature of Merger]

Same as Amalgamation in Nature of Purchase Except Following:

- Step 3 [Realisation of assets not taken over by P Co.] & Step 4 [Payment of liabilities not taken over by P Co.] do not exist since all assets & liabilities of S Co. are taken over by P Co.
- 'Reserves & surplus' & 'Fictitious asset' are still transferred to 'Equity shareholders A/c' in Step 1.

Accounting in Books of Purchasing Company [Amalgamation in Nature of Merger]

Steps to be Followed for Accounting in the Books of Purchasing Company:

(1) Calculate Net Assets Taken Over of S Co.

Same as discussed in 'Calculation of PC by net asset method' in amalgamation in nature of merger.

(2) Calculate Loss/Gain Arising Due to Amalgamation

Particulars	Amount
Purchase consideration (PC)	XX
(-) Net assets taken over of S Co.	(XX)
Loss/(Gain) arising due to amalgamation [General Reserve → P&L]	**XX/(XX)**

(3) Journal Entries

	Particulars		Debit	Credit
(i)	**Due Entry of PC**			
	Business Purchase A/c	Dr.	PC amount	
	To Liquidator of Selling Company A/c			PC amount
(ii)	**Incorporate Asset & Liabilities of S Co. [Big Entry]**			
	Asset A/c [All assets incl. fictitious assets of S Co.]	Dr.	Book value	
	To Liabilities A/c [All liabilities of S Co.]			Book value
	To Reserves & Surplus A/c [All R&S of S Co. after adjustment of loss/gain arising due to amalgamation]			XX
	To Business Purchase A/c			PC Amount
(iii)	**Payment of PC with Each Mode of PC**			
	Liquidator of Selling Company A/c	Dr.	PC amount	
	To Equity Share Capital A/c			Paid-up value
	To Preference Share Capital A/c			Paid-up value
	To Debentures A/c			Paid-up value
	To Securities Premium A/c			XX
	To Bank A/c			XX

(iv)	**Payment of Liability for Debentures Taken Over of S Co.**		
	Liability for Debentures of S Co. A/c Dr.	Book value	
	Discount on Issue of Debentures A/c Dr.	XX	
	To Debentures A/c		Paid-up value
	To Securities Premium A/c		XX
(v)	**Cancellation of Inter Company Debt [Debtors, Creditors, Loan, B/R, B/P, etc.]**		
	Liability A/c Dr.	Mutual indebtedness amount	
	To Asset A/c		
(vi)	**Stock Reserve [Unrealised Gain on Stock]**		
	General Reserve A/c → P&L A/c Dr.	XX	
	To Stock A/c		XX
(vii)	**Liquidation/Amalgamation Expense Borne by P Co.**		
	General Reserve A/c → P&L A/c Dr.	XX	
	To Bank A/c		XX

Note: No separate entry is passed for incorporating statutory reserves of S Co. since all 'Reserves & surplus of S Co.' are already taken over in 'Big entry'.

(4) Balance Sheet of P Co. After Amalgamation

Balance Sheet Items of P Co.	Take 'All items' as it is.
Balance Sheet Items of S Co.	▪ Ignore 'Share capital'. ▪ Take 'All other items' at book value.
Other Adjustments	▪ Consider mode of payment of PC. ▪ Consider effect of payment of liability for debentures taken over of S Co. ▪ Cancel inter company debt from respective asset & liability. ▪ Consider effect of stock reserve. ▪ Consider effect of liquidation/amalgamation expense borne by P Co.

AS 15: EMPLOYEE BENEFITS

Topics Covered

Meaning and types of employee benefits	Accounting of short term employee benefits	Accounting of post employment benefits	Accounting of long term employee benefits	Accounting of termination benefits

Meaning and Types of Employee Benefits

- Employee benefits means any type of consideration given by entity to its employees for services rendered by them [Example: Salary].
- Accounting of employee benefits is completely based on accrual concept [i.e. Record the employee benefit expense in the period in which employee renders the service].
- **Types of Employee Benefits**

Short Term Employee Benefits	▪ That will be paid within 12 months from balance sheet date. ▪ Example: Salary, Wages, etc.
Post Employment Benefits	▪ That will be paid on retirement. ▪ Example: Provident fund, Gratuity, Pension etc.
Long Term Employee Benefits	▪ That will be paid after 12 months from balance sheet date. ▪ Example: Jubilee benefits, etc.
Termination Benefits	▪ That will be paid on termination of employment. ▪ Example: Retrenchment compensation, etc.

Accounting of Short Term Employee Benefits

(1) **Salary/Wages**

	Particulars		Debit	Credit
(i)	**If Salary is Accrued & Paid**			
	Salary A/c (P&L - Employee Benefits Expense)	Dr.	XX	
	To Bank A/c			XX
(ii)	**If Salary is Accrued But Not Paid**			
	Salary A/c	Dr.	XX	
	To Salary Outstanding A/c (Liability)			XX

(iii)	**If Salary is Paid in Advance**			
	Prepaid Salary A/c (Asset)	Dr.	XX	
	To Bank A/c			XX

(2) **Paid Leaves**

- It means leaves given to employees for which salary will not be deducted. These leaves are provided in addition to Sundays & Public Holidays [Example: Casual leaves, Sick leaves, etc.].
- **Accounting of Paid Leaves**

Type	Meaning	Accounting
Non Accumulating	Unused leaves cannot be carried forward to next year	No accounting
Accumulating	Unused leaves can be carried forward to next year ▪ Encashed in in next year [Vesting]. ▪ Utilised for excess leaves in next year [Non vesting].	Create provision in current year & settle in next year

Accounting of Post Employment Benefits

(1) **Defined Contribution Plan**

- In this, entity pays fixed contribution into a fund on behalf of employee & have no obligation to pay any further amount to employee on his retirement [Example: Provident fund].
- **Journal Entries**

	Particulars		Debit	Credit
(i)	**On Accrual**			
	Defined Contribution A/c (P&L - Employee Benefits Expense)	Dr.	XX	
	To Defined Contribution Payable A/c (Liability)			XX
(ii)	**On Payment**			
	Defined Contribution Payable A/c (Liability)	Dr.	XX	
	To Bank A/c			XX

(2) **Defined Benefit Plan**

- In this, entity has obligation to pay agreed benefits directly to employee on his retirement [Example: Gratuity, Pension, etc.].
- **Calculation of Defined Benefit Obligation [DBO]**

  Step 1: Calculate Total Benefits to be Paid

  = Expected last drawn salary p.a. x No. of years of service x Benefit %

Step 2: Calculate Benefits Attributed to Each Year of Service

$$= \frac{\text{Step 1}}{\text{No. of years of service}}$$

Step 3: Calculate Current Service Cost for Each Year of Service

Year of Service (1)	Benefits Attributed to Each Year of Service (2)	PVF @ Discounting Rate (3)	Current Service Cost [CSC] (2) x (3)
1	XX	PVF of 4th year	XX
2	XX	PVF of 3rd year	XX
3	XX	PVF of 2nd year	XX
4	XX	PVF of 1st year	XX
5	XX	PVF of 0 time	XX

Step 4: Calculate Interest Expense for Each Year of Service

Year of Service (1)	Opening Balance of CSC (2)	Interest Expense (3) = (2) x Rate	Current Service Cost (4)	Closing Balance of CSC (2) + (3) + (4)
1	-	XX	XX	XX
2	XX	XX	XX	XX
3	XX	XX	XX	XX
4	XX	XX	XX	XX
5	XX	XX	XX	XX

Step 5: Calculate Closing Balance of DBO for Each Year of Service

Particulars	Amount
Opening balance of DBO	XX
(+) Current service cost	XX
(+) Interest expense	XX
(±) Actuarial loss/(gain)	XX/(XX)
(-) Past service cost	(XX)
(-) Curtailment	(XX)
(-) Payment of benefits to employee on retirement	(XX)
Closing balance of DBO	XX

Note:

(i) Actuarial loss/gain arise due to change in actuarial assumptions.

(ii) Past service cost means reduction in DBO due to decrease in benefit % of defined benefit plan previously announced by entity.

(iii) Curtailment means reduction in DBO due to any other reason like financial difficulty of entity.

- **Calculation of Actual Return on Plan Asset**

Particulars	Amount
Opening fair value of plan asset [Opening balance]	XX
(+) Contributions	XX
(-) Benefits paid	(XX)
	XX
(-) Closing fair value of plan asset [Closing balance]	(XX)
	XX

- **Calculation of Expected Return on Plan Asset**

Particulars	Amount
Opening fair value of plan asset [Opening balance] x Expected return %	XX
(+) Inward contributions received x Expected return % x Time/12	XX
(-) Benefits paid x Expected return % x Time/12	(XX)
	XX

- **Calculation of Net Defined Liability/(Asset)**

Particulars	Amount
Closing balance of DBO	XX
(-) Closing fair value of plan asset [Closing balance]	(XX)
Net defined liability/(asset)	XX/(XX)

Note: If it is net defined asset, then it is shown at lower of

(i) Above net defined asset amount

(ii) PV of future refund from plan

Accounting of Long Term Employee Benefits

Same as 'Accounting of Defined Benefit Plan' [as already discussed]

Accounting of Termination Benefits

Recognise termination expense on the date of announcement of termination plan by entity.

AS 16: BORROWING COSTS

Topics Covered

- Meaning of borrowing costs
- Treatment of borrowing costs
- Period of capitalisation of borrowing cost on qualifying asset
- Types of borrowings
- If multiple assets are purchased/ constructed using specific borrowing
- If single qualifying asset is purchased/ constructed using specific & general borrowing
- Exchange difference on foreign currency borrowing to be treated as borrowing cost

Meaning of Borrowing Costs

It means costs incurred for borrowing of funds including

- Interest costs.
- Amortisation of discount on issue or premium on redemption of borrowing.
- Exchange difference on foreign currency borrowing upto some extent.

Treatment of Borrowing Costs

If borrowing cost is incurred for

Qualifying asset

- Qualifying asset means any asset that takes substantial time to get ready for its intended use or sale.
- Example: Construction of factory building, Installation of purchased machinery, etc.

→ Borrowing cost is capitalised to cost of such asset

Non qualifying asset

- Non qualifying asset means any asset which is already in ready to use or sale condition.
- Example: Purchase of furniture/vehicle, Investment in shares, Working capital, etc.

→ Borrowing cost is recognised as expense in P&L

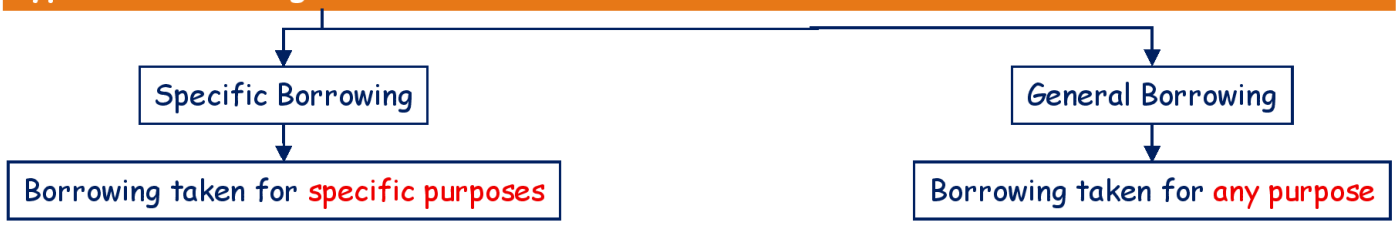
Note: Substantial time is generally 12 months. However, in silent situation, even a period of less than 12 months is considered as substantial period.

Period of Capitalisation of Borrowing Cost on Qualifying Asset

Commencement Date [COD]	Cessation Date [CED]
Later of ▪ Borrowing is taken. ▪ Expense is incurred on qualifying asset. ▪ Development activity [Technical work] on qualifying asset has started.	▪ When substantially all necessary activities are completed to prepare qualifying asset for its intended use or sale. ▪ If construction of qualifying asset is done in parts & each part can be used individually, then CED for each part should be determined separately [Example: Building construction project in phases].

Note: If construction work is paused due to abnormal reason, then capitalisation of borrowing cost on such asset is suspended for such period. However, if work is paused due to normal reason, then capitalisation of borrowing cost is continued.

Types of Borrowings



We have to understand calculation & treatment of borrowing cost in following 2 scenarios:

(i) If multiple assets [Both qualifying & non qualifying] are purchased/constructed using specific borrowing

(ii) If single qualifying asset is constructed using specific & general borrowing.

If Multiple Assets are Purchased/Constructed using Specific Borrowing

Step 1: Calculate Total Borrowing Cost

Specific borrowing amount x Interest rate x $\frac{\text{Borrowing Months}}{12}$	XX
(-) Investment income on temporary investment of specific borrowing [If any]	(XX)
	XX

Step 2: Allocation of Total Borrowing Cost to Multiple Assets

$$= \text{Total borrowing cost} \times \frac{\text{Expense on respective asset}}{\text{Expense on total assets}}$$

Step 3: Treatment of Borrowing Cost Allocated to Multiple Assets

Nature of Asset	Capitalise	Expense to P&L
Qualifying Asset	Allocated borrowing cost x $\frac{\text{COD to CED Months}}{12}$	Remaining
Non Qualifying Asset		Fully

If Single Qualifying Asset is Purchased/Constructed using Specific & General Borrowing

Step 1: Calculate Specific Borrowing Cost to be Capitalised

Specific borrowing amount x Interest rate x $\frac{\text{COD to CED Months}}{12}$	XX
(-) Investment income on temporary investment of specific borrowing [If any]	(XX)
	XX

Step 2: Calculate General Borrowing Cost to be Capitalised

(i) Capitalisation Rate [Weighted Average Borrowing Rate]

$$= \frac{\text{Actual interest on all general borrowings}}{\text{Weighted average amount of all general borrowings on time basis}} \times 100$$

(ii) Eligible General Borrowing Cost

$$= \text{Expense incurred on asset on each date [after utilising specific borrowing]} \times \text{Capitalisation rate} \times \frac{\text{Expense date to CED Months}}{12}$$

(iii) General Borrowing Cost to be Capitalised → Lower of

- Eligible general borrowing cost as calculated in (ii) above
- Actual interest on all general borrowings

Step 3: Calculate Total Borrowing Cost to be Capitalised

= Step 1 + Step 2

Example 1

A Ltd. started construction of a building on 1st April for which it has obtained a specific loan of ₹ 2 Lakh at 9% p.a.

A Ltd. has also taken other loans as follows:

₹ 8,00,000 @ 10% p.a.

₹ 12,00,000 @ 13% p.a.

Expense incurred on construction of building

Date	Amount (₹)
1st April	1,50,000
1st August	1,40,000
1st October	3,00,000

Construction completed on 31st December. Calculate borrowing cost to be capitalised.

Solution

Specific borrowing cost to be capitalised = ₹ 2,00,000 x 9% x $\frac{9}{12}$ = ₹ 13,500

General borrowing cost to be capitalised

(i) Capitalisation rate = $\frac{(8,00,000 \times 10\%) + (12,00,000 \times 13\%)}{8,00,000 + 12,00,000} = \frac{2,36,000}{20,00,000} \times 100 = 11.80\%$

(ii) Eligible general borrowing cost

Expense Date	Calculation	Amount (₹)
1st April	₹ 1,50,000 – ₹ 1,50,000 (Specific) = 0	
1st August	₹ 1,40,000 – ₹ 50,000 (Specific) = ₹ 90,000 x 11.80% x 5/12	4,425
1st October	₹ 3,00,000 x 11.80% x 3/12	8,850
		13,275

(iii) General borrowing cost to be capitalised

Lower of eligible (₹ 13,275) & actual (₹ 2,36,000) general borrowing cost = ₹ 13,275

Total borrowing cost to be capitalised = ₹ 13,500 + ₹ 13,275 = ₹ 26,775

Exchange Difference on Foreign Currency Borrowing to be Treated as Borrowing Cost

- Exchange loss on foreign currency borrowing upto saving in interest is treated as borrowing cost as per AS 16 & remaining exchange loss is recognised in P&L as per AS 11.
- **Step to be Followed to Solve the Question:**

Step 1: Calculate Actual Interest on Foreign Currency Borrowing

= Foreign currency borrowing × Foreign currency borrowing interest rate × Exchange rate at year end

Step 2: Calculate Notional Interest on Local Currency Borrowing

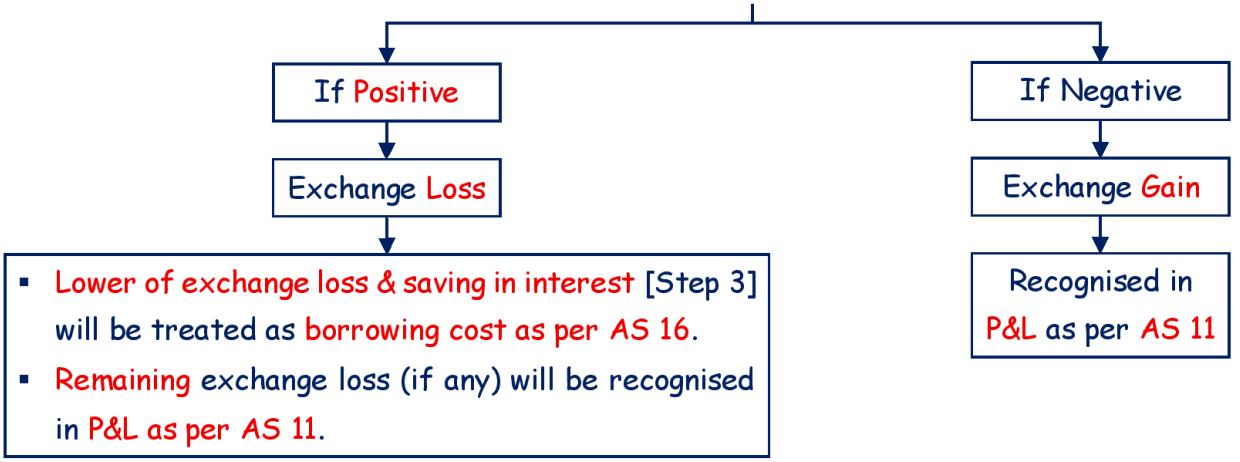
= Foreign currency borrowing × Exchange rate on borrowing date × Local currency borrowing interest rate

Step 3: Calculate Saving in Interest

= Step 2 – Step 1

Step 4: Calculate Exchange Difference on Foreign Currency Borrowing

= Foreign currency borrowing x [Exchange rate at year end – Exchange rate at beginning]



Step 5: Calculate Total Borrowing Cost on Foreign Currency Borrowing

= Actual interest on foreign currency borrowing [Step 1] + Exchange loss on foreign currency borrowing upto saving in interest [Step 3]

Example 2

A Ltd. [Indian company] has taken a loan of $ 1,000 on 1st April for constructing a qualifying asset at 4% p.a. Equivalent amount of loan could have been taken in local currency at 12% p.a. Exchange rate on 1st April was 1$ = ₹ 40 and on year end (31st March) was 1 $ = ₹ 41.

Calculate total borrowing cost.

Solution

Step 1: Actual interest on foreign currency ($) borrowing

= 1,000 $ x 4% x ₹ 41 = ₹ 1,640

Step 2: Notional interest on local currency (₹) borrowing

= 1,000 $ x ₹ 40 x 12% = ₹ 4,800

Step 3: Saving in interest

= ₹ 4,800 – ₹ 1,640 = ₹ 3,160

Step 4: Exchange loss = 1,000 $ x (₹ 41 – ₹ 40) = ₹ 1,000

Exchange loss as borrowing cost = Lower of ₹ 1,000 & ₹ 3,160 = ₹ 1,000

So, Exchange loss as per AS 11 = Nil

Step 5: Total borrowing cost = ₹ 1,640 + ₹ 1,000 = ₹ 2,640

AS 17: SEGMENT REPORTING

Topics Covered

- Meaning & types of segments
- Reportable segments
- Preparation of segment report

Meaning & Types of Segments

Segment means distinguishable component of entity which has its own separate risks & returns.	
Business Segments	▪ Segments based on products/services. ▪ Example: Samsung → Deals in Mobile, Laptop, Home appliances, etc.
Geographical Segments	▪ Segments based on economic environment. ▪ Example: Samsung → Business in India, South Korea, USA, etc.

Reportable Segments

- These are those segments for which information is separately disclosed in financial statements.
- A segment is considered as reportable segment if it meets any one of the following criteria:

Revenue, Result & Asset [RRA] Test	
Revenue Test	Revenue of segment is ≥ 10% of total revenue of all segments. Here, revenue includes ➢ External revenue (Sales to outsiders), & ➢ Internal revenue (Inter segment sales).
Result Test	Profit/loss of segment is ≥ 10% of total result of all segments. Here, total result of all segments means higher of ➢ Total profit of all segments which are in profit. ➢ Total loss of all segments which are in loss.
Asset Test	Asset of segment is ≥ 10% of total assets of all segments. Here, asset does not include ➢ Deferred tax asset (DTA) ➢ Corporate assets

Note:

(i) If any segment was identified as reportable segment in previous year (By fulfilling RRA test), then it is considered as reportable segment in current year also.

(ii) If external revenue of above identified all reportable segments is < 75% of total external revenue of the entity, then additional segments should be identified as reportable.

(iii) If entity wants to consider any other segment as reportable (which does not meet above conditions), then it can do so.

Preparation of Segment Report

Particulars	Segment A	Segment B	Inter Segment Eliminations	Total
1. Segment Revenue				
External revenue				
Sales incurred directly by segment	XX	XX		XX
Entity sales allocated to segments	XX	XX		XX
Internal revenue	XX	XX	XX	-
Total revenue	XX	XX		XX
2. Segment Expense				
External expense				
Expense incurred directly by segment	XX	XX		XX
Entity expense allocated to segments	XX	XX		XX
Internal segment expense	XX	XX	XX	-
Total expense	XX	XX		XX
3. Segment Result [Profit/(Loss)] (1 - 2)	XX	XX		XX
(±) Head office income/(expense)				XX/(XX)
Operating profit				XX
(-) Interest expense				(XX)
Profit before tax				XX
(-) Tax				(XX)
4. Profit After Tax of Entity				XX
5. Assets				
Segment fixed assets	XX	XX		XX
Segment current assets	XX	XX		XX
Total segment assets	XX	XX		XX
(+) Head office assets				XX
Total assets				XX

6. Liabilities				
Segment liabilities	XX	XX		XX
(+) Head office liabilities				XX
Total liabilities				XX

Revenue by Geographical Market

Particulars	Domestic Sales	Export Sales to Country 1	Export Sales to Country 2	Total
External revenue	XX	XX	XX	XX

Note: Even if 'Head office income/expense' & 'Interest expense' are allocated to segments; these are presented in Total column only.

AS 18: RELATED PARTY DISCLOSURES

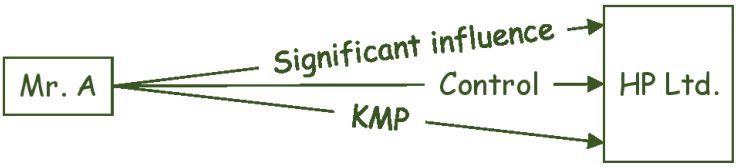
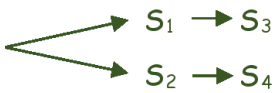
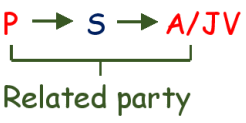
Topics Covered

- Objective of AS 18
- Identification of related party
- Related party disclosures

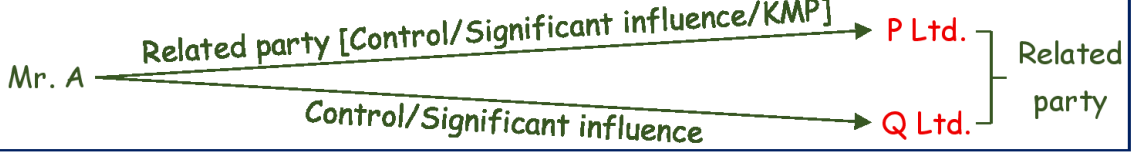
Objective of AS 18

Objective of this AS is to identify & disclose transactions with related parties in financial statements.

Identification of Related Party

Related Party of an Entity can be	
A Person	**A Person will be Considered as Related Party of an Entity if that Person** ▪ Has control over entity [Voting power > 50%], or ▪ Has significant influence over entity [Voting power ≥ 20%], or ▪ Is KMP [Director] of entity. **Note:** Personal relatives [Parents, Siblings, Spouse & Children] of above person are also considered as related party. 
Another Entity	**Another Entity will be Considered as Related Party of an Entity** (i) Parent & its all subsidiaries (including fellow subsidiaries) are related to each other.  (ii) Parent & its associate/joint venture. P → A/JV (iii) Parent & associate/joint venture of its subsidiary. 

(iv) If a person is 'Related party' in 1 entity & having 'Control/Significant influence' over another entity, then such entities are related parties to each other.

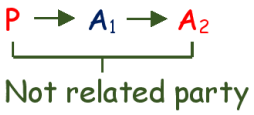


Note:

(i) A person or another entity is considered as related party if above relationship exists anytime during the reporting period.

(ii) **Following are Not Considered as Related Party:**

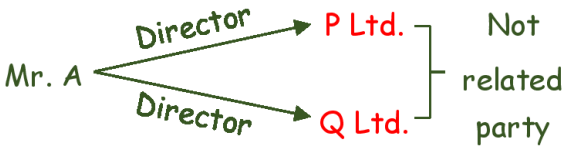
- Associate of associate company is not related to parent.



- Associate of parent is not related to any other associate of parent.

- Associate of parent is not related to any subsidiary of parent.

- Two companies having a common director are not considered as related parties.



- Major customers, suppliers, agents, distributors, financers, trade unions, government, public utilities, etc. only because of their dealings with the entity.

Related Party Disclosures

If There are No Transaction with Related Party	▪ Name of related party ▪ Description of relationship
If There are Transactions with Related Party	▪ Name of related party ▪ Description of relationship ▪ Description of nature of transactions ▪ Volume of transactions ▪ Outstanding amount ▪ Amount written off

Note:

(i) Disclosure of transaction is required only for the related party relationship period.

(ii) Related party transaction means transfer of resources or obligations between related parties, regardless of whether price is charged or not.

Example: Remuneration paid to KMP is related party transaction requiring disclosures.

(iii) **Entity is Exempt from Disclosure Requirements**

- If related party transaction is in conflict with the entity's duties of confidentiality as required by statute, regulator or any similar competent authority.
- If related party transaction is entered with state-controlled enterprises.
- Intra-group transactions in Consolidated financial statements.

AS 19: LEASES

Topics Covered

- Meaning & types of leases
- Accounting of operating lease
- Accounting of finance lease
- Accounting of sale and lease back

Meaning & Types of Leases

- Lease means an arrangement in which Lessor (Owner of asset) transfers right of use of asset to Lessee for agreed period & lessee will pay lease rent.
- **Types of Leases**

Finance Lease	▪ In this, risks and rewards relating to ownership of asset are transferred to lessee without transferring ownership. ▪ **If any of the following condition is satisfied, lease is classified as finance lease:** (i) Lease term covers major part [> 50%] of life of asset. (ii) PV of minimum lease payments substantially [> 90%] covers the fair value of asset. (iii) Ownership of asset will be transferred to lessee at end of lease. (iv) Lessee has option to purchase asset at price less than fair value of asset on exercise date. (v) Asset is of specialised nature that can be used by lessee only.
Operating Lease	▪ In this, risks and rewards relating to ownership of asset are not transferred to lessee.

Accounting of Operating Lease

In operating lease, asset is continued in lessor's book & hence, depreciation is also charged by lessor.

Step 1: Calculate Annual Lease Rent for Lease Period

As per information given in question

Step 2: Calculate Lease Rent to be Recognised in P&L in Each Year [Allocate Total Lease Rent for Lease Period to Each Year in Ratio of Output]

$$= \text{Total lease rent for lease period} \times \frac{\text{Output of respective period}}{\text{Total output during lease period}}$$

Step 3: Journal Entries in Lessee's Books [At Each Year End]

	Particulars		Debit	Credit
(i)	**Payment of Annual Lease Rent**			
	Lease Rent A/c	Dr.	Allocated rent [Step 2]	
	Lease Equalisation A/c	Dr.	B/f	
	To Bank A/c			Annual rent [Step 1]
	To Lease Equalisation A/c			B/f
(ii)	**Transfer Lease Rent to P&L**			
	P&L A/c	Dr.	XX	
	To Lease Rent A/c			XX

Step 3: Journal Entries in Lessor's Books

- **At Beginning of Lease – If Lessor is Also Dealer of Asset**

Particulars		Debit	Credit
Convert Inventory to PPE			
PPE on Operating Lease A/c	Dr.	XX	
To Purchase A/c			XX

- **At Each Year End**

	Particulars		Debit	Credit
(i)	**Receiving of Annual Lease Rent**			
	Bank A/c	Dr.	Annual rent [Step 1]	
	Lease Equalisation A/c	Dr.	B/f	
	To Lease Rent A/c			Allocated rent [Step 2]
	To Lease Equalisation A/c			B/f
(ii)	**Transfer Lease Rent to P&L**			
	Lease Rent A/c	Dr.	XX	
	To P&L A/c			XX
(iii)	**Depreciation on PPE**			
	Depreciation A/c	Dr.	XX	
	To PPE on Operating Lease A/c			XX
(iv)	**Transfer Depreciation to P&L**			
	P&L A/c	Dr.	XX	
	To Depreciation A/c			XX

Example 1

A machine was given on 3 years operating lease by a dealer of machine for annual lease rentals of ₹ 25,000, ₹ 45,000 and ₹ 50,000 respectively. Outputs from machine are estimated as 10,000, 20,000 and 50,000 units in year 1,2 and 3 respectively. Cost of machine is ₹ 5,00,000. Life of machine is 10 years. Depreciation is charged on SLM basis. Pass 1st year journal entries in books of lessee and lessor.

Solution

Total lease rent for lease period = ₹ 25,000 + ₹ 45,000 + ₹ 50,000 = ₹ 1,20,000

Total output during lease period = 10,000 + 20,000 + 50,000 = 80,000 units

Calculation of lease rent to be recognised in P&L in each year

$$\text{Year 1} = ₹\ 1,20,000 \times \frac{10,000}{80,000} = ₹\ 15,000$$

$$\text{Year 2} = ₹\ 1,20,000 \times \frac{20,000}{80,000} = ₹\ 30,000$$

$$\text{Year 3} = ₹\ 1,20,000 \times \frac{50,000}{80,000} = ₹\ 75,000$$

Journal entries in lessee's books [At 1st year end]

	Particulars		Debit	Credit
(i)	Lease Rent A/c	Dr.	15,000	
	Lease Equalisation A/c	Dr.	10,000	
	To Bank A/c			25,000
(ii)	P&L A/c	Dr.	15,000	
	To Lease Rent A/c			15,000

Journal entries in lessor's books [At 1st year end]

	Particulars		Debit	Credit
(i)	PPE on Operating Lease A/c	Dr.	5,00,000	
	To Purchase A/c			5,00,000
(ii)	Bank A/c	Dr.	25,000	
	To Lease Rent A/c			15,000
	To Lease Equalisation A/c			10,000
(iii)	Lease Rent A/c	Dr.	15,000	
	To P&L A/c			15,000
(iv)	Depreciation A/c (P&L) [₹ 5,00,000/10 years]	Dr.	50,000	
	To PPE on Operating Lease A/c			50,000

Accounting of Finance Lease

In finance lease, asset is derecognised from lessor's book and recognised by lessee & hence, depreciation is charged by lessee.

(1) Accounting in Lessee's Books

Step 1: Calculate Cost of Asset or Lease Liability

Year	Minimum Lease Payments (MLP)	PV Factor	PV of MLP
1	XX	XX	XX
2	XX	XX	XX
3	XX	XX	XX
Total PV of MLP			XX
Fair value of asset			XX
Cost of Asset or Lease Liability [Lower of above]			**XX**

Note: MLP = Annual lease rent + Guaranteed residual value (GRV)

Step 2: Calculate Interest Expense (Finance Charge)

MLP is like an instalment [i.e., settlement of principal component & interest component]. So, interest component is bifurcated & recognised as expense in lessee's books.

Year (1)	Opening Balance of Lease Liability (2)	Interest Expense (Finance Charge) (3) = (2) x Rate	MLP (4)	Principal Component (5) = (4) – (3)	Closing Balance of Lease Liability (6) = (2) – (5)
1	XX	XX	XX	XX	XX
2	XX	XX	XX	XX	XX
3	XX	XX	XX	XX	XX

Step 3: Pass Journal Entries [If Required]

- **At Beginning of Lease**

Particulars		Debit	Credit
PPE A/c	Dr.	Step 1	
To Lessor A/c (Lease Liability)			

- **At Each Year End**

	Particulars		Debit	Credit
(i)	**Recognise Finance Charge**			
	Finance Charge A/c (P&L)	Dr.	XX	
	To Lessor A/c (Lease Liability)			XX
(ii)	**Payment of MLP**			
	Lessor A/c (Lease Liability)	Dr.	XX	
	To Bank			XX
(iii)	**Depreciation on PPE**			
	Depreciation A/c (P&L)	Dr.	XX	
	To PPE A/c			XX
	Depreciation is charged over lease period but if lessee also gets the ownership of asset at end of lease period, then depreciation is charged over total useful life of asset.			

(2) Accounting in Lessor's Books

Step 1: Gross Investment in Lease

Total MLP	XX
(+) Unguaranteed residual value (UGRV)	XX
Gross investment in lease	**XX**

Step 2: Calculate PV of Gross Investment in Lease (Fair Value of Asset)

PV of MLP	XX
(+) PV of Unguaranteed residual value (UGRV)	XX
PV of gross investment in lease (Fair value of asset)	**XX**

Step 3: Calculate Unearned Finance Income

Gross investment in lease [Step 1]	XX
(-) PV of gross investment in lease [Step 2]	XX
Unearned finance income	**XX**

Step 4: Pass Journal Entries [If Required]

- **At Beginning of Lease**

Particulars		Debit	Credit
Lease Receivable A/c	Dr.	Step 2	
To PPE A/c			

- **At Each Year End**

	Particulars		Debit	Credit
(i)	**Recognise Finance Income**			
	Lease Receivable A/c	Dr.	XX	
	To Finance Income A/c (P&L)			XX
(ii)	**Receiving of MLP**			
	Bank A/c	Dr.	XX	
	To Lease Receivable A/c			XX

Accounting of Sale and Lease Back

Treatment of Profit/Loss on Sale Transaction in Seller (Lessee) Books

(1) If Lease Back Transaction is Finance Lease

- Profit/(loss) = Sale price of asset – Carrying value (WDV) of asset
- Amortise to P&L over the total lease period.

(2) If Lease Back Transaction is Operating Lease

Case	Situation	Calculation of Profit/(Loss)	Treatment of Profit/(Loss)
1	Sale price of asset = Fair value of asset	Sale price of asset − Carrying value (WDV) of asset	Recognise immediately in P&L
2	Sale price of asset < Fair value of asset	Sale price of asset − Carrying value (WDV) of asset	Recognise immediately in P&L [But if loss is compensated by future lease payments, then amortise to P&L over the total lease period]
3	Sale price of asset > Fair value of asset	Fair value of asset − Carrying value (WDV) of asset	Recognise immediately in P&L
		Sale price of asset − Fair value of asset	Amortise to P&L over the total lease period

AS 20: EARNINGS PER SHARE (EPS)

Topics Covered

- Meaning & types of EPS
- Calculation of Basic EPS
- Calculation of Basic EPS in case of bonus issue
- Calculation of Basic EPS in case of rights issue
- Calculation of diluted EPS
- Calculation of diluted EPS in case of multiple potential equity shares
- Calculation of EPS in case of continuing & discontinuing operations

Meaning & Types of Earnings Per Share (EPS)

- EPS is a measure of performance of company.
- Entity is required to calculate & present EPS on the face of statement of profit & loss for current year (CY) & previous year (PY).
- EPS is of 2 types as follows:
  - (i) Basic EPS [BEPS]
  - (ii) Diluted EPS [DEPS]

Calculation of BEPS

$$\text{BEPS} = \frac{\text{Earnings available to equity shareholders [EATESH]}}{\text{Weighted average number of equity shares [WANES]}}$$

Note:

(i) EPS can be negative also.

(ii) Calculation of EATESH

Particulars	Amount
Earnings before interest & tax [EBIT]	XX
(-) Interest expenses on loan/debentures/bonds etc.	(XX)
Profit before tax [PBT]	XX
(-) Tax	(XX)
Profit after tax/Profit for the year/Net profit [PAT]	XX
(-) Preference dividend	(XX)
EATESH	XX/(XX)

(iii) Calculation of WANES

- It means equity shares are adjusted by time factor & paid-up value.
- It is calculated as follows:

No. of equity shares outstanding at beginning of the year $\times \frac{\text{Paid-up value}}{\text{Face value}}$	✓
(+) No. of equity shares issued during the year $\times \frac{\text{No. of months}}{12} \times \frac{\text{Paid-up value}}{\text{Face value}}$	✓
(–) No. of equity shares bought back during the year $\times \frac{\text{No. of months}}{12}$	(✓)
WANES	✓

Calculation of BEPS in Case of Bonus Issue

- Bonus issue means shares issued to existing shareholders at free of cost. So, issue of bonus shares is considered from beginning of PY [Bonus issue date is irrelevant].
- **Following BEPS are Calculated in case of Bonus Issue:**
  - (i) Original BEPS of PY: Originally reported BEPS of PY without bonus issue
  - (ii) Restated BEPS of PY: Adjusted BEPS of PY after considering bonus issue
  - (iii) BEPS of CY: BEPS of CY after considering bonus issue

  Note: Bonus issue is considered by adding bonus shares to WANES

Calculation of BEPS in Case of Rights Issue

- Rights issue means shares issued to existing shareholders at a price below current market price of share. So, rights issue has some bonus element which needs to be adjusted.
- **Calculation of BEPS in case of Rights Issue**

Step 1: Calculate Theoretical Ex-right Value Per Share

$$= \frac{\text{[Fair value of share before rights issue} \times \text{No. of shares before rights issue]} + \text{[Rights issue price} \times \text{No. of right shares]}}{\text{No. of existing shares} + \text{No. of right shares}}$$

Step 2: Calculate Bonus Adjustment Factor

$$= \frac{\text{Fair value of share before rights issue}}{\text{Theoretical ex-right value per share [Step 1]}}$$

Step 3: Calculate Original BEPS of PY [Originally reported BEPS of PY without rights issue]

$$= \frac{\text{EATESH of PY}}{\text{WANES of PY}}$$

Step 4: Calculate Restated BEPS of PY [Adjusted BEPS of PY after considering bonus element of rights issue]

$$= \frac{\text{EATESH of PY}}{\text{WANES of PY} \times \text{Bonus adjustment factor [Step 2]}}$$

Step 5: Calculate BEPS of CY [BEPS of CY after considering rights issue]

$$= \frac{\text{EATESH of CY}}{\left[\begin{array}{c}\text{No. of shares before rights issue} \\ \times \\ \text{Bonus adjustment factor [Step 2]} \\ \times \\ \text{No. of months till rights issue}/12\end{array}\right] + \left[\begin{array}{c}\text{Total no. of shares after rights issue} \\ \times \\ \text{No. of months after rights issue}/12\end{array}\right]}$$

Example

Financial Year: 1st Jan 20X1 to 31st Dec 20X1

A Ltd. has 1,000 equity shares outstanding on 1st Jan 20X1.

On 31st Mar 20X1, Rights issue is made for 1 new share against each 5 outstanding shares. Fair value of share before rights issue is ₹ 10. Rights issue exercise price is ₹ 7.

Profit available to equity shareholders for 20X1 & previous year 20X0 is ₹ 1,10,000 & ₹ 1,00,000 respectively.

Calculate Basic EPS for 20X0 and 20X1.

Solution

No. of right shares = 1,000 x 1/5 = 200 shares

$$\text{Theoretical ex-right value per share} = \frac{[₹\ 10 \times 1{,}000] + [₹\ 7 \times 200]}{1{,}000 + 200} = ₹\ 9.50$$

$$\text{Bonus adjustment factor} = \frac{₹\ 10}{₹\ 9.50} = 1.05$$

$$\text{Original BEPS of PY 20X0} = \frac{₹\ 1{,}00{,}000}{1{,}000} = ₹\ 100$$

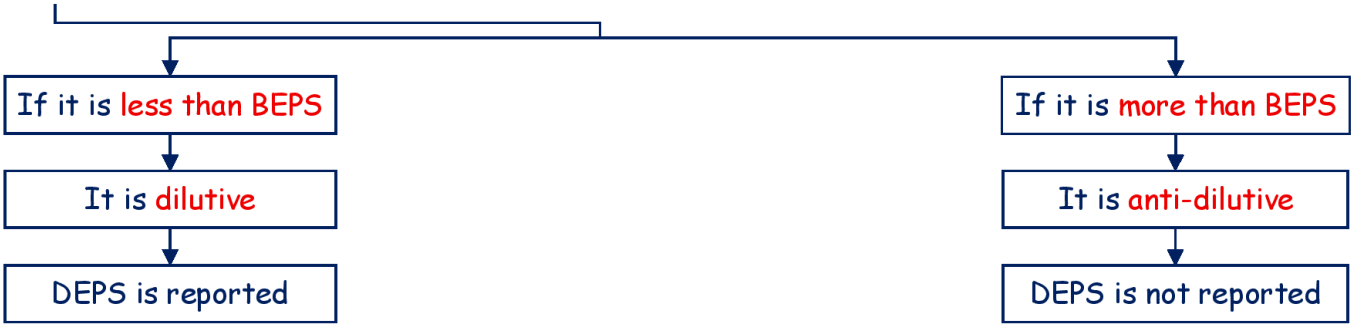
$$\text{Restated BEPS of PY 20X0} = \frac{₹\ 1{,}00{,}000}{1{,}000 \times 1.05} = ₹\ 95.24$$

$$\text{BEPS of CY 20X1} = \frac{₹\ 1{,}10{,}000}{[1{,}000 \times 1.05 \times 3/12] + [1{,}200 \times 9/12]} = ₹\ 94.62$$

Calculation of DEPS

- DEPS means reduction in BEPS assuming potential equity shares [PES] are issued [PES include convertible preference shares, convertible debentures, options/warrants].
- It is calculated as follows:

$$DEPS = \frac{\text{EATESH used in BEPS + Increase due to PES}}{\text{WANES used in BEPS + Increase due to PES}}$$



Note: Increase due to PES

	Increase in EATESH [Numerator]	Increase in WANES [Denominator]
Convertible Preference Shares	Preference dividend	No. of equity shares on conversion
Convertible Debentures	Interest (1 – Tax)	No. of equity shares on conversion
Options/Warrants	-	$\frac{\text{No. of equity shares} \times [\text{Fair value} - \text{Exercise price}]}{\text{Fair value}}$

*If convertible preference shares or convertible debentures are issued during CY, then adjust no. of equity shares on conversion by time factor [From convertible instrument issue date to year end].

Calculation of DEPS in Case of Multiple Potential Equity Shares

Step 1: Calculate Incremental EPS for Each PES

$$= \frac{\text{Increase in EATESH due to PES}}{\text{Increase in WANES due to PES}}$$

Step 2: Rank Each PES in Ascending Order of Incremental EPS

Rank 1 PES = 1st lowest incremental EPS

Rank 2 PES = 2nd lowest incremental EPS

And so on.

Step 3: Calculate Multiple DEPS

DEPS 1 = By considering only Rank 1 PES

DEPS 2 = By considering Rank 1 & Rank 2 PES

And so on.

Step 4: Determine DEPS

DEPS = Lowest of all multiple DEPS calculated in Step 3

Calculation of EPS in Case of Continuing & Discontinuing Operations

Step 1: Calculate BEPS & DEPS of Continuing Operations

Step 2: Calculate BEPS of Total Operations

Step 3: Calculate DEPS of Total Operations

It is calculated only if DEPS of continuing operations is less than BEPS of continuing operations [In this case, DEPS of total operations is always reported whether it is dilutive or anti dilutive].

AS 21, 23, 27: CONSOLIDATED FINANCIAL STATEMENTS

Topics Covered

AS 21
- Meaning of consolidated financial statements
- Preparation of consolidated balance sheet
- Special adjustments
- Preparation of consolidated statement of P&L

AS 23
- Meaning of associate company
- Accounting for investment in associate company [SFS & CFS]

AS 27
- Meaning of joint venture
- Classification of joint venture
- Accounting of joint venture

AS 21: Consolidated Financial Statements [CFS]

Meaning of Consolidated Financial Statements

H Ltd. ---- Investment in > 50% equity shares ----> S Ltd.

H Ltd. → Holding Company [Parent] → Prepares its own Separate Financial Statements (SFS)

S Ltd. → Subsidiary Company [Child] → Prepares its own Separate Financial Statements (SFS)

Holding company combines both SFS in its books which is known as Consolidated Financial Statements [CFS]

CFS includes
- Consolidated Balance Sheet
- Consolidated Profit & Loss Statement
- Consolidated Notes to Accounts

Preparation of Consolidated Balance Sheet

Step 1: Shareholding Pattern in Equity Shares of Subsidiary Company

- **Share of Holding Company (%)**

  (i) Given in question

  (ii) Otherwise, it is calculated as follows:

$$= \frac{\text{Number of equity shares of subsidiary company held by holding company}}{\text{Total number of equity shares of subsidiary company}} \times 100$$

- **Share of Minority (%)**

  100% – Share of holding company (%)

Step 2: Date of Acquisition [DOA]

Step 3: Date of Consolidation [DOC]

Step 4: Analysis of Reserves of Subsidiary Company

- Pre Acquisition Reserves [Capital nature]: Reserves existing on DOA.
- Post Acquisition Reserves [Revenue nature]: Reserves arising between DOA to DOC.

Particulars	Pre Reserves	Post Reserves		
		P&L	G/R	Other
P&L balance	XX	XX		
General reserve	XX		XX	
Other reserves	XX			XX
Effect of special adjustments (if any)				
Total	**XX**	**XX**	**XX**	**XX**
Share of Holding Company %	✓	✓	✓	✓
Share of Minority %	✓	✓	✓	✓

Note:

(i) If DOA is incorporation date of subsidiary, then all reserves of subsidiary are treated as post reserves.

(ii) If DOA is in between of current year, then current year profit of subsidiary is allocated to pre & post reserves on time basis.

(iii) If DOA is same as DOC, then all reserves of subsidiary are treated as pre reserves.

(iv) In silent situation, general reserve & other reserves of subsidiary are treated as pre reserves.

Example 1

Current year 1.4.20X1 to 31.3.20X2

DOA = 30.6.20X1, DOC = 31.3.20X2

P&L balance of subsidiary company on 30.6.20X1 = ₹ 10,00,000

P&L balance of subsidiary company on 31.3.20X2 = ₹ 14,00,000

Share of holding company = 80%, Share of minority = 20%

Show analysis of reserves of subsidiary company.

Solution

Particulars	Pre Reserves	Post P&L
P&L balance on 30.6.20X1	10,00,000	-
Profit arising between 30.6.20X1 to 31.3.20X2 of ₹ 4,00,000 [14,00,000 – 10,00,000]	-	4,00,000
Total	**10,00,000**	**4,00,000**
Share of Holding Company (80%)	8,00,000	3,20,000
Share of Minority (20%)	2,00,000	80,000

Example 2

Current year 1.4.20X1 to 31.3.20X2

DOA = 30.6.20X1, DOC = 31.3.20X2

P&L balance of subsidiary company on 31.3.20X1 = ₹ 10,00,000

P&L balance of subsidiary company on 31.3.20X2 = ₹ 14,00,000

General reserve balance of subsidiary company on 31.3.20X2 = ₹ 50,000

Share of holding company = 80%, Share of minority = 20%

Show analysis of reserves of subsidiary company.

Solution

Particulars	Pre Reserves	Post Reserves	
		P&L	G/R
P&L balance on 31.3.20X1	10,00,000	-	-
Current year profit of ₹ 4,00,000 [14,00,000 – 10,00,000] is allocated to pre and post on time basis [3:9]	1,00,000	3,00,000	-
General reserve balance	50,000	-	-
Total	**11,50,000**	**3,00,000**	-
Share of Holding Company (80%)	9,20,000	2,40,000	-
Share of Minority (20%)	2,30,000	60,000	-

Step 5: Calculate Net Assets of Subsidiary Company on DOA

Particulars	Amount
Equity share capital of subsidiary company	XX
(+) Pre acquisition reserves of subsidiary company [Step 4]	XX
Net assets of subsidiary company on DOA	**XX**
Share of Holding Company (%)	✓
Share of Minority (%) [It is Minority Interest on DOA]	✓

Note: If equity share capital or pre acquisition reserves of subsidiary is not available in question, then net assets of subsidiary on DOA is calculated as follows:

Particulars	Amount
Assets of subsidiary company on DOA [Revalued amount → Book value]	XX
(-) Liabilities of subsidiary company on DOA [Revalued amount → Book value]	(XX)
Net assets of subsidiary company on DOA	**XX**
Share of Holding Company (%)	✓
Share of Minority (%) [It is Minority Interest on DOA]	✓

Step 6: Calculate Goodwill/Capital Reserve [Cost of Control (COC)]

Particulars	Amount
Cost of investment [Investment by holding company in subsidiary company]	XX
(-) Share of holding company in net assets of subsidiary company [Step 5]	(XX)
Goodwill/(Capital reserve)	**XX/(XX)**

Step 7: Calculate Minority Interest (MI)

Particulars	Amount
MI on DOA [Share of minority in net assets of subsidiary company (Step 5)]	XX
(+) Share of minority in post acquisition reserves of subsidiary company	XX
MI on DOC	**XX**

Note:

(i) It represents share of minority in net assets of subsidiary company.

(ii) It is disclosed as separate line item in balance sheet just after 'Shareholders fund' but before 'Non-current liabilities'.

(iii) If MI is negative, then

- It is deducted from P&L balance of holding company instead of showing it as separate line item, &

- Whenever such MI becomes positive, firstly add back to P&L balance of holding company upto previously deducted & excess positive MI is disclosed as separate line item in balance sheet.

Step 8: Calculation of Consolidated Reserves/Group Reserves

It represents final balance of reserves & surplus in consolidated balance sheet.

Particulars	P&L	General Reserve	Other Reserve	Capital Reserve
Holding company's own reserves balance on DOC	XX	XX	XX	XX
(+) Share of holding company in post reserves of subsidiary company [Step 4]	XX	XX	XX	-
(+) Capital reserve arising in Step 6 (if any)	-	-	-	XX
(±) Effect of special adjustments (if any)	XX	-	-	-
Total	**XX**	**XX**	**XX**	**XX**

Step 9: Preparation of Consolidated Balance Sheet

Equity & Liabilities	Amount
Share capital	Holding
Reserves	Step 8
Minority interest	Step 7 + Preference share capital of subsidiary (if any)
All other liabilities	Holding + Subsidiary [Give effect of special adjustments, if any]
Assets	**Amount**
Investment in equity shares of subsidiary by holding	Ignore
Goodwill	Step 6
All other assets	Holding + Subsidiary [Give effect of special adjustments, if any]

Special Adjustments

(1) Inter Company Debt [Mutual Debt]

- It means amount due to holding by subsidiary, or vice versa on DOC [Example: B/R & B/P, T/R & T/P, Loan, etc.].
- **Effect of this Adjustment**
  - Step 9: Deduct inter company debt amount from 'Respective asset'.
  - Step 9: Deduct inter company debt amount from 'Respective liability'.

(2) Stock Reserve [Unrealised Gain on Stock]

- If any stock has been sold/purchased between holding & subsidiary 'only after DOA' and such stock is lying in inventory [i.e., remained unsold] on DOC, then profit earned on such stock [Unrealised gain on stock] is eliminated.
- **Effect of this Adjustment**

Case	Effect of Adjustment
Downstream Transfer [Goods Sold by Holding to Subsidiary]	▪ Step 8: Deduct stock reserve amount from 'Group P&L'. ▪ Step 9: Deduct stock reserve amount from 'Inventory'.
Upstream Transfer [Goods Sold by Subsidiary to Holding]	▪ Step 4: Deduct stock reserve amount from 'Post P&L'. ▪ Step 9: Deduct stock reserve amount from 'Inventory'.

(3) Cash in Transit/Cheque in Transit

- It means cash/cheque given by subsidiary to holding but not received by holding, or vice versa on DOC.
- **Effect of this Adjustment**
  - ➢ Step 9: Add cash/cheque in transit amount to 'Cash & cash equivalents'.
  - ➢ Step 9: Deduct cash/cheque in transit amount from 'Respective asset of receiver'.

(4) Revaluation of Assets of Subsidiary on DOA

- It means assets of subsidiary are revalued on DOA.
- **Revaluation Profit/(Loss)**

Particulars	Amount
Revalued amount of asset on DOA	XX
(-) Book value of asset on DOA	(XX)
Profit/(Loss) on revaluation	**XX/(XX)**

Effect of this adjustment

Case	Effect of Adjustment
Profit on Revaluation	▪ Step 4: Add profit amount to 'Pre reserves'. ▪ Step 9: Add profit amount to 'Respective asset'.
Loss on Revaluation	▪ Step 4: Deduct loss amount from 'Pre reserves'. ▪ Step 9: Deduct loss amount from 'Respective asset'.

- **Change in Depreciation Due to Revaluation of Asset**

Particulars	Amount
Depreciation on revalued amount of asset [From DOA to DOC]	XX
(–) Depreciation on original amount of asset [From DOA to DOC]	(XX)
Additional depreciation/(Reversal of depreciation)	**XX/(XX)**

Effect of this adjustment

Case	Effect of Adjustment
Additional Depreciation Due to Profit on Revaluation	▪ Step 4: Deduct additional depreciation from 'Post P&L'. ▪ Step 9: Deduct additional depreciation from 'Respective asset'.
Reversal of Depreciation Due to Loss on Revaluation	▪ Step 4: Add reversal of depreciation to 'Post P&L'. ▪ Step 9: Add reversal of depreciation to 'Respective asset'.

Example 3

Samay Ltd. acquired 40,000 equity shares of ₹ 10 each in Lord Puneet Ltd. on 1.10.20X1 for ₹ 4,90,000. The plant and machinery of Lord Puneet Ltd. which stood in the books at ₹ 4,50,000 on 1.4.20X1 was considered worth ₹ 5,40,000 on the date of acquisition.

The furniture of Lord Puneet Ltd. which stood in the books at ₹ 3,00,000 on 1.4.20X1 was considered worth ₹ 2,60,000 on the date of acquisition.

Balance sheet of Lord Puneet Ltd. as on 31.3.20X2 provides following details:

Furniture = ₹ 2,85,000

Plant and Machinery = ₹ 4,05,000

Date of consolidation is 31.3.20X2

Calculate impact of revaluation of assets of Lord Puneet Ltd. on consolidation.

Solution

(i) Calculation of depreciation rate

	Furniture	Plant and Machinery
Book value on 1.04.20X1	3,00,000	4,50,000
(–) Book value on 31.03.20X2	(2,85,000)	(4,05,000)
Depreciation in current year	15,000	45,000
Depreciation rate	5% [(15,000/3,00,000) x 100]	10% [(45,000/4,50,000) x 100]

(ii) Calculation of book value of assets on DOA

	Furniture	Plant and Machinery
Book value on 1.04.20X1	3,00,000	4,50,000
(–) Dep. upto 30.9.20X1	(7,500)	(22,500)
	[3,00,000 x 5% x 6/12]	[4,50,000 x 10% x 6/12]
Book value on 1.10.20X1	2,92,500	4,27,500

(iii) Calculation of profit/(loss) on revaluation of assets on DOA

	Furniture	Plant and Machinery
Revalued amount on 1.10.20X1	2,60,000	5,40,000
(–) Book value on 1.10.20X1	2,92,500	4,27,500
Profit/(Loss) on revaluation	(32,500)	1,12,500

(iv) Calculation of change in depreciation amount from DOA to DOC [1.10.X1 to 31.3.X2]

	Furniture	Plant and Machinery
Depreciation on revalued amount from 1.10.20X1 to 31.3.20X2	6,500 [2,60,000 x 5% x 6/12]	27,000 [5,40,000 x 10% x 6/12]
(–) Depreciation on book value from 1.10.20X1 to 31.3.20X2	(7,500) [3,00,000 x 5% x 6/12]	(22,500) [4,50,000 x 10% x 6/12]
Additional dep./(Reversal of dep.)	(1,000)	4,500

(v) Calculation of final balance of assets for consolidation on DOC

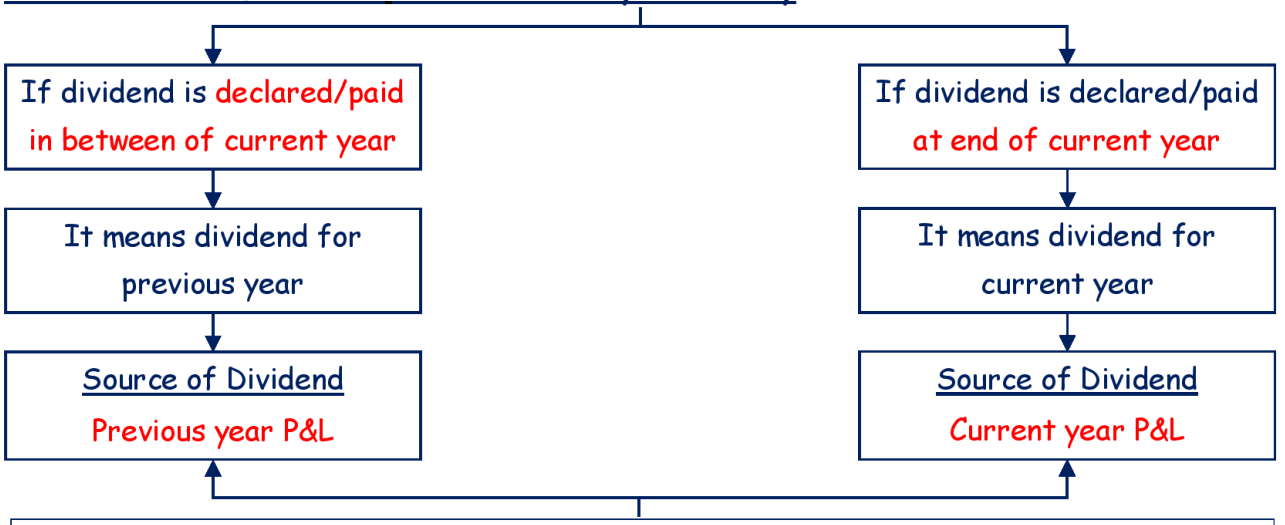
	Furniture	Plant and Machinery
Book value of asset on 31.3.20X2	2,85,000	4,05,000
(±) Profit/(loss) on revaluation	(32,500)	1,12,500
(±) Reversal of depreciation/(Additional depreciation)	1,000	(4,500)
Final balance of asset on consolidation	2,53,500	5,13,000

(5) Dividend Declared/Paid by Subsidiary [DOA to DOC]

- **Total Dividend Declared/Paid by Subsidiary**

  = Paid-up equity share capital of subsidiary x Dividend rate

- **Decide Nature of Dividend Declared/Paid by Subsidiary**



Decide Nature of Dividend

Compare 'Source of dividend' with DOA to decide whether dividend declared/paid is 'Pre acquisition dividend' or 'Post acquisition dividend'

Case	Source of dividend v/s DOA	Nature of dividend
1	Period of source of dividend is completely before DOA	Pre acquisition dividend
2	Period of source of dividend is completely after DOA	Post acquisition dividend
3	Period of source of dividend is spread between before and after DOA	Pre & Post acquisition dividend [Allocated on time basis]

- **Effect of this Adjustment**
  - Step 4: Deduct pre acquisition dividend from 'Pre P&L' [Before doing analysis].
  - Step 4: Deduct post acquisition dividend from 'Post P&L' [Only if already not adjusted].

- **Accounting of Dividend Received by Holding from Subsidiary**

<table>
<tr><th>Case</th><th>Accounting by Holding Company</th></tr>
<tr><td>Pre Acquisition Dividend</td><td>Holding's share in dividend declared/paid by subsidiary is credited to investment A/c adjusting cost of investment.
<table>
<tr><th>Particulars</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Bank A/c Dr.
To Investment A/c</td><td>XX</td><td>
XX</td></tr>
</table></td></tr>
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Post Acquisition Dividend

Holding's share in dividend declared/paid by subsidiary is credited to P&L A/c.

Particulars		Debit	Credit
Bank A/c	Dr.	XX	
To P&L A/c			XX

If pre acquisition dividend received by holding company is wrongly credited to its P&L A/c, then following adjustment is also required in CFS:

Step 6: Deduct holding's share in dividend received from 'Cost of investment'.

Step 8: Deduct holding's share in dividend received to 'Group P&L'.

Particulars [Rectification Entry in CFS]		Debit	Credit
P&L A/c	Dr.	XX	
To Investment A/c			XX

Example 4

Current year 1.4.20X2 to 31.3.20X3

H Ltd. invests in 60% equity shares of S Ltd.

S Ltd. declares 20% dividend on 1.7.20X2.

Find out nature of dividend if DOA is

(i) 1.4.20X2 (ii) 1.7.20X2 (iii) 31.3.20X2

(iv) 1.4.20X1 (v) 31.3.20X1 (vi) 30.6.20X1

Solution

Dividend is declared between current year. So, it is for previous year (1.4.20X1 to 31.3.20X2).

So, source of dividend is previous year profit (1.4.20X1 to 31.3.20X2).

Nature of dividend under different DOA

(i) Pre acquisition dividend (ii) Pre acquisition dividend (iii) Pre acquisition dividend

(iv) Post acquisition dividend (v) Post acquisition dividend

(vi) Pre & Post acquisition dividend [Allocated on time basis in ratio of 3 months and 9 months]

Example 5

Current year 1.4.20X2 to 31.3.20X3

H Ltd. invests in 60% equity shares of S Ltd.

S Ltd. declares 20% dividend on 31.3.20X3.

Find out nature of dividend if DOA is

(i) 30.6.20X1 (ii) 31.3.20X2 (iii) 1.4.20X2

(iv) 31.3.20X3 (v) 1.7.20X2

Solution

Dividend is declared at end of current year. So, it is for current year (1.4.20X2 to 31.3.20X3).

So, source of dividend is current year profit (1.4.20X2 to 31.3.20X3).

Nature of dividend under different DOA

(i) Post acquisition dividend (ii) Post acquisition dividend (iii) Post acquisition dividend

(iv) Pre acquisition dividend

(v) Pre & Post acquisition dividend [Allocated on time basis in ratio of 3 months and 9 months]

Example 6

H Ltd. acquired 3,000 shares in S Ltd. at a cost of ₹ 4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed an opening balance of ₹ 1,25,000 and profit for the year was ₹ 3,00,000. At the end of the year, it declared a dividend of 40%.

Record the entry in the books of H Ltd. in respect of the dividend. Assume the profit is accruing evenly and calendar year as financial year.

Solution

H Ltd.'s share of holding = (3,000 shares/5,000 shares) x 100 = 60%

Current year = 1.1.20X1 to 31.12.20X1

DOA = 31.7.20X1

Total dividend declared by S Ltd. = ₹ 5,00,000 x 40 % = ₹ 2,00,000

H Ltd.'s share in the dividend = ₹ 2,00,000 x 60% = ₹ 1,20,000

Dividend is declared at end of current year. So, it is for current year (1.1.20X1 to 31.12.20X1).

So, source of dividend is current year profit (1.1.20X1 to 31.12.20X1).

Nature of dividend = Pre & Post acquisition dividend [Allocated on time basis in ratio of 7 months and 5 months]

Pre acquisition dividend received by parent = ₹ 1,20,000 x 7/12 = ₹ 70,000

Post acquisition dividend received by parent = ₹ 1,20,000 x 5/12 = ₹ 50,000

Journal entry in books of H Ltd. in respect of the dividend

Particulars		Debit	Credit
Bank A/c	Dr.	1,20,000	
To Investment A/c			70,000
To P&L A/c			50,000

(6) Bonus Shares Issued by Subsidiary [DOA to DOC]

- **If Accounting of Bonus Shares Issued by Subsidiary is Already Done [i.e. Balance Sheet of Subsidiary is Given After Adjustment of Bonus Issue] [✓]**

Total Face Value of Bonus Shares	Total face value of bonus shares = Equity share capital of subsidiary on DOC $\times$ Numerator of bonus ratio / (Numerator + Denominator) of bonus ratio
Share of Holding (%) in Subsidiary [Step 1]	Share of holding (%) in subsidiary = Existing number of equity shares of subsidiary held by holding / Total number of equity shares of subsidiary on DOC – Total bonus shares issued by subsidiary $\times$ 100

- **If Accounting of Bonus Shares Issued by Subsidiary is Not Done [i.e. Balance Sheet of Subsidiary is Given Before Adjustment of Bonus Issue]**

Total Face Value of Bonus Shares	Total face value of bonus shares = Equity share capital of subsidiary on DOC x Bonus ratio
Share of Holding (%) in Subsidiary [Step 1]	Share of holding (%) in subsidiary = Existing number of equity shares of subsidiary held by holding / Total number of equity shares of subsidiary on DOC $\times$ 100
Effect on Net Assets of Subsidiary Company [Step 5]	Add total face value of bonus shares to equity share capital of subsidiary.

- **Effect of this Adjustment**
  - Step 4: Deduct total face value of bonus shares made out of pre reserves from 'Pre G/R' [Before doing analysis].
  - Step 4: Deduct total face value of bonus shares made out of post reserves from 'Post G/R' [Only if already not adjusted].

Example 7

Current year 1.4.20X1 to 31.3.20X2

H Ltd. purchased 90,000 equity shares of S Ltd. on 1.4.X1 at cost of ₹ 9,50,000.

On 1.7.20X1, S Ltd. issued 2 bonus shares for every 3 shares held by equity shareholders out of its general reserve balance on 1.4.20X1.

General reserve of S Ltd. on 1.4.20X1 = ₹ 11,50,000

Balance sheet of S Ltd. as on 31.3.20X2 provides following details:

2,00,000 equity shares of ₹ 10 each = ₹ 20,00,000

General reserve = ₹ 15,20,000

Consolidation date is 31.3.20X2. Calculate shareholding pattern & analysis of reserves of S Ltd.

Solution

Total face value of bonus shares = $20,00,000 \times \frac{2}{2+3}$ = ₹ 8,00,000

So, total number of bonus shares issued = 80,000 shares [₹ 8,00,000/₹ 10]

Share of holding (%) in S Ltd. = $\frac{90,000}{2,00,000 - 80,000} \times 100 = 75\%$

Analysis of reserves of S Ltd.

Particulars	Pre Reserves	Post G/R
G/R balance on 1.4.20X1 [11,50,000 – 8,00,000]	3,50,000	-
Increase in G/R balance during the year [15,20,000 – 3,50,000]	-	11,70,000
Total	**3,50,000**	**11,70,000**
Share of Holding Company (75%)	2,62,500	8,77,500
Share of Minority (25%)	87,500	2,92,500

(7) Uniformity of Accounting Policy in Holding & Subsidiary Books

If subsidiary company is doing accounting of any item using different accounting policy as compared to holding company, then such accounting policies of subsidiary company should be matched according to holding company before preparing CFS.

Example 8

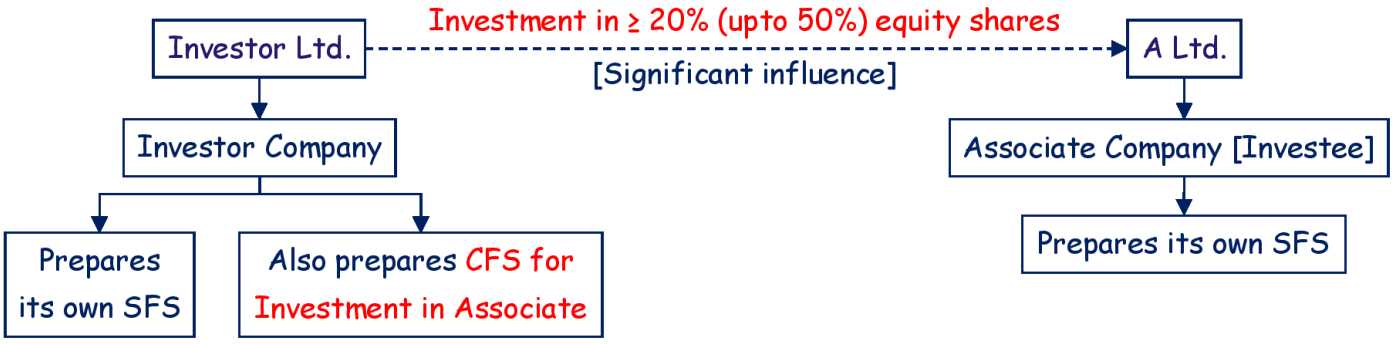
Accounting Policies Followed	Holding	Subsidiary
Inventory valuation	Weighted average	FIFO → Weighted average
Provision for doubtful debt	No	Yes → No
Deferring advertisement expense	No	Yes → No

Preparation of Consolidated Statement of Profit and Loss

- Add line by line all items of income & expense of holding company & subsidiary company at full amount as appearing in their separate P&L of consolidation date.
- Eliminate intra group transactions of income and expense from respective income and expense [Example: Sale/purchase of goods between holding & subsidiary].
- Eliminate stock reserve from value of stock.

AS 23: Accounting for Investments in Associates in Consolidated Financial Statements

Meaning of Associate Company



Note: If investor company is also having investment in potential equity shares of investee company [convertible debentures, convertible preference shares, ESOP, etc.], then significant influence of investor company is checked without considering investment in potential equity shares.

Accounting for Investment in Associate Company by Investor Company

Investor Company will do Accounting for Investment in Associate Company as Follows:

Accounting for Investment in Associate Company in SFS by Investor Company [AS 13]

Carrying amount of 'Investment in Associate A/c' = Cost – Pre acquisition dividend

Accounting for Investment in Associate Company in CFS by Investor Company [AS 23]

- Assets and liabilities of associate are not taken in CFS.
- **'Investment in Associate A/c' is Continue to be Disclosed using Equity Method in Asset Side in CFS as Follows:**
  - Calculation of goodwill/(capital reserve) on DOA

Particulars	Amount
Cost of investment after adjustment of pre acquisition dividend	XX
(-) Share of investor company in net assets of associate on DOA	(XX)
Goodwill/(Capital reserve)	**XX/(XX)**

➢ Carrying value of 'Investment in Associate A/c' in CFS

Particulars	Amount
Share of investor company in net assets of associate on DOA	XX
(±) Goodwill/(capital reserve)	XX/(XX)
Cost of investment [Initial recognition]	XX
(+) Share of investor company in post acquisition profit of associate	XX
(-) Share of investor company in post acquisition loss of associate	(XX)
(-) Share of investor company in post acquisition dividend of associate	(XX)
Carrying value of Investment in Associate in CFS	**XX**

Note:

(i) If above carrying value of Investment in CFS comes negative, then disclose it at 'Nil' value.

(ii) Dividend declared/paid by associate company after DOC is completely ignored.

- **In Case of Step up Acquisition of Associate or Further Acquisition of Stake in Associate, Goodwill/Capital Reserve is Calculated as Follows:**

Particulars	1st Stake	2nd Stake
Cost of investment after adjustment of pre acquisition dividend	XX	XX
(-) Share of investor company in net assets of associate	(XX)	(XX)
Goodwill/(Capital reserve)	**XX/(XX)**	**XX/(XX)**
Final Goodwill/(Capital reserve)	**XX/(XX)**	

Example 9

X Ltd. acquired 10% stake in A Ltd. on 1.4.20X1 at ₹ 1,00,000 and further 15% on 1.10.20X1 at ₹ 1,45,000. Net assets of A Ltd. on 1.4.20X1 was ₹ 8,50,000 and on 1.10.20X1 was ₹ 10,00,000

Calculate goodwill/capital reserve arising on step up acquisition of associate A Ltd.

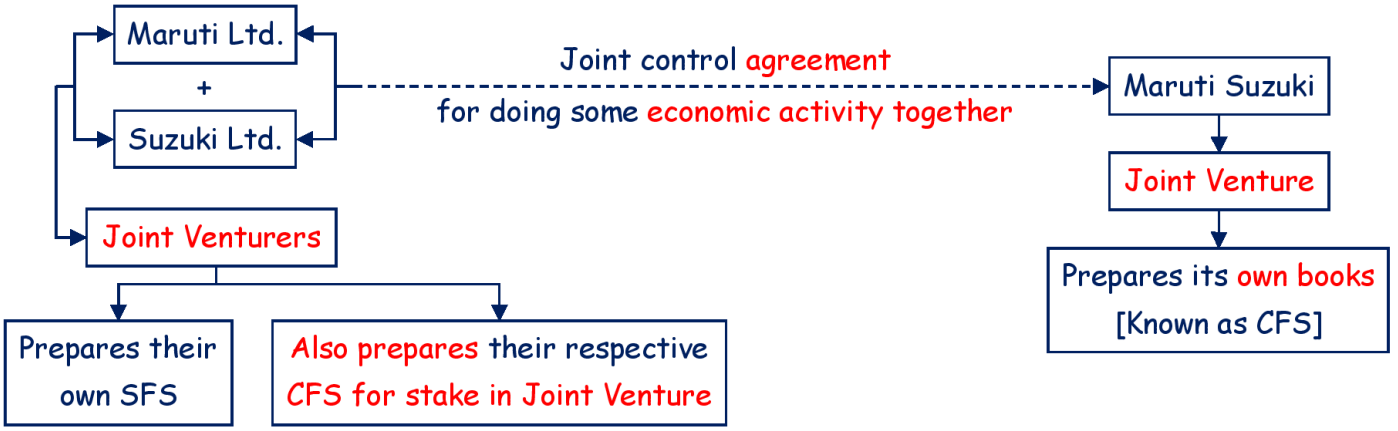
Solution

Particulars	1.4.20X1	1.10.20X1
Cost of investment	1,00,000	1,45,000
(-) Share of X Ltd. in net assets of A Ltd.	(85,000) [8,50,000 x 10%]	(1,50,000) [10,00,000 x 15%]
Goodwill/(Capital reserve)	15,000	(5,000)
Final Goodwill	10,000	

- If investor has sold some stake in associate company ceasing it to be an associate, then 'Investment in such company' is accounted in SFS only at carrying value as per AS 13 [Fair value is of no use].

AS 27: Financial Reporting of Interests in Joint Ventures

Meaning of Joint Venture (JV)



Classification of Joint Venture

Jointly Controlled Operation [JCO]	Joint venturers have common control over a joint business [not registered as separate entity].
Jointly Controlled Asset [JCA]	Joint venturers have common control over assets [not registered as separate entity].
Jointly Controlled Entity [JCE]	Joint venture is registered as a separate entity.

Accounting of Joint Venture

(1) **Accounting in Books of Joint Venture [CFS of Joint Venture]**

- **Consolidated Statement of P&L**

  Prepare normal P&L (like SFS) but

  - Present bifurcation of all income & expense between each joint venturer as specified.
  - Allocate net profit/loss to each joint venturer in agreed ratio.

- **Consolidated Balance Sheet**

  Prepare normal balance sheet (like SFS) but present bifurcation of all assets & liabilities between each joint venturer as specified.

(2) Accounting of JV in SFS of Each Joint Venturer

Investment in Joint Venture A/c

Particulars	Amount	Particulars	Amount
To Anything done for JV	XX	By Anything received from JV	XX
To P&L [Share in profit of JV]	XX	By P&L [Share in loss of JV]	XX
To Bank [Pay shortfall amount to other joint venturer]	B/f	By Bank [Recover extra payment made from other joint venturer]	B/f
	XX		XX

(3) Accounting of JV in CFS of Each Joint Venturer [Proportionate Consolidation Method]

- **Consolidated Statement of P&L**
  - Consider all income & expense of itself (Joint venturer).
  - Take proportionate share in each income & expense of JV.
- **Consolidated Balance Sheet**
  - Consider all assets, liabilities, capital & reserves of itself (Joint venturer).
  - Take proportionate share in each asset & liability [except share capital] of JV.
  - Ignore 'Investment in joint venture A/c' as appearing in joint venturer books.
  - Ignore 'Share capital A/c' as appearing in joint venture books.

AS 22: ACCOUNTING FOR TAXES ON INCOME

Topics Covered

- Basics
- Calculation of deferred tax
- Journal entries for accounting of taxes
- Presentation of tax expense in statement of P&L
- Special cases

Basics

Accounting Income	It is profit before tax as per accounting books.
Taxable Income	It is profit before tax as per income tax act.
Tax Expense	▪ It means tax expense recognised in books. ▪ Tax expense [Current tax ± Deferred tax] = Accounting income x Tax rate
Current Tax	▪ It is actual tax payable as per income tax act. ▪ Current tax = Taxable income x Tax rate
Deferred Tax	▪ It is temporary saving in tax or temporary payment of additional tax due to timing differences. ▪ **Timing Difference [Deferred Tax is Created]** It means difference in accounting & taxable income which will be revered in future [Example: Depreciation, Preliminary expense, etc.]. ▪ **Permanent Difference [Deferred Tax is Not Created]** It means difference in accounting & taxable income which will not be revered in future [Example: Fines, Penalties, Donation, etc.].

Example 1

A ltd. incurs preliminary expense of ₹ 5,000 in year 1. It is recognised as expense in books in year 1. However, in income tax, it is recognised as expense over 5 years.

Profit before preliminary expense & tax in each year (Year 1 to 5) = ₹ 10,000 [As per books & income tax]

Tax rate is 30%.

Solution

Calculation of tax expense as per books

	Year 1	Year 2	Year 3	Year 4	Year 5
Profit	10,000	10,000	10,000	10,000	10,000

(-) Preliminary expense	(5,000)	-	-	-	-
Profit before tax	5,000	10,000	10,000	10,000	10,000
Tax @ 30%	1,500	3,000	3,000	3,000	3,000

Total tax over 5 years = ₹ 13,500

Calculation of tax payable as per income tax act

	Year 1	Year 2	Year 3	Year 4	Year 5
Profit	10,000	10,000	10,000	10,000	10,000
(-) Preliminary expense	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Profit before tax	9,000	9,000	9,000	9,000	9,000
Tax @ 30%	2,700	2,700	2,700	2,700	2,700

Total tax over 5 years = ₹ 13,500

Tax expense in books in Year 1

Current tax as per income tax act	₹ 2,700
(-) Future tax saving [2,700 – 1,500] → It is deferred tax which will be reversed in next 4 years as ₹ 300 p.a. [3,000 – 2,700]	(₹ 1,200)
Tax expense in books	₹ 1,500

Calculation of Deferred Tax

Deferred tax [DTA/DTL] = Timing difference x Tax rate

Deferred Tax Liability (DTL) is created on following timing differences:

- Expense recognised in Income Tax > Expense recognised in Books
- Income recognised in Income Tax < Income recognised in Books

Deferred Tax Asset (DTA) is created on following timing differences:

- Expense recognised in Income Tax < Expense recognised in Books
- Income recognised in Income Tax > Income recognised in Books

Note:

(i) DTA/DTL created in a year are reversed in future.

(ii) Tax rate to be used for calculation of DTA/DTL

- 1st priority: Enacted tax rate [Future tax rate]
- 2nd priority: Current applicable tax rate

(iii) DTA is created only if there is possibility of sufficient taxable profits in future.

Example 2

Tax rate is 30%. Calculate DTA/DTL in following cases in Year 1:

(i) Depreciation as per accounting records = ₹ 2,000

Depreciation as per income tax records = ₹ 5,000

Depreciation [Expense: Income Tax > Books]	
Timing Difference [5,000 – 2,000]	₹ 3,000
DTL [₹ 3,000 x 30%]	₹ 900

Logical verification

	Expense	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	₹ 2,000				
Income Tax	₹ 5,000	(–)	(–)	Additional tax	DTL

(ii) Repair expenses made during year 1 for ₹ 10,000 and was spread over year 1 and year 2 equally in the books. As per Income Tax Act, entire expense is allowed year 1.

Repair Expenses [Expense: Income Tax > Books]	
Timing Difference [10,000 – 5,000]	₹ 5,000
DTL [₹ 5,000 x 30%]	₹ 1,500

Logical verification

	Expense	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	₹ 5,000				
Income Tax	₹ 10,000	(–)	(–)	Additional tax	DTL

(iii) Unamortised preliminary expenses as per tax record = ₹ 5,000

Preliminary Expenses [Expense: Income Tax < Books]	
Timing Difference [5,000 – 0]	₹ 5,000
DTA [₹ 5,000 x 30%]	₹ 1,500

Logical verification

	Expense	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	₹ 5,000				
Income Tax	0	(+)	(+)	Tax saving	DTA

(iv) ₹ 2,000 towards GST liability is debited in P&L in books. As per Income Tax Act, it will be allowed in subsequent years on payment basis only.

GST Expense [Expense: Income Tax < Books]	
Timing Difference [2,000 – 0]	₹ 2,000
DTA [₹ 2,000 x 30%]	₹ 600

Logical verification

	Expense	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	₹ 2,000				
Income Tax	0	(+)	(+)	Tax saving	DTA

(v) Share issue expenses incurred of ₹ 10,000. As per Income Tax Act, $1/10^{th}$ expense will be allowed in each year till 10 years.

Share Issue Expenses [Expense: Income Tax < Books]	
Timing Difference [10,000 – 1,000]	₹ 9,000
DTA [₹ 9,000 x 30%]	₹ 2,700

Logical verification

	Expense	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	₹ 10,000				
Income Tax	₹ 1,000	(+)	(+)	Tax saving	DTA

(vi) Interest of ₹ 5,000 is paid to NBFC which is accounted in books on accrual basis but actual payment was made before due date of filing return and allowed for tax purpose also.

Interest to NBFC [Expense: Income Tax = Books]	
Timing Difference [5,000 – 5,000]	0
Deferred tax	0

(vii) Donation of ₹ 3,000 is made to private trust. It is not allowed under income tax laws. It is permanent difference. So, no deferred tax is created.

(viii) Company has sold its investment for ₹ 10,000 (Investment was made at cost of ₹ 4,000). Profit on sale of investment of ₹ 6,000 [₹ 10,000 – ₹ 4,000] will be recorded in books in next year but considered as capital gain in current year in income tax.

Profit on Sale of Investment [Income: Income Tax > Books]	
Timing Difference [6,000 – 0]	₹ 6,000
DTA [₹ 6,000 x 30%]	₹ 1,800

Logical verification

	Income	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	0				
Income Tax	₹ 6,000	(+)	(+)	Tax saving	DTA

Example 3

A Limited is working on a construction project. Revenue of ₹ 1,100, ₹ 1,600, ₹ 2,100 is recognised in books during year 1, 2 and 3 respectively as per percentage of completion method.

As per Income Tax Act, revenue of ₹ 700, ₹ 1,800, ₹ 2,300 is recognised during year 1, 2 and 3 respectively as per completed contract method.

Tax rate is 30%. Calculate DTA/DTL for year 1, 2 and 3.

Solution

Year 1

Construction Contract Revenue [Income: Income Tax < Books]	
Timing Difference [1,100 – 700]	₹ 400
DTL [₹ 400 x 30%]	₹ 120

Logical verification

	Income	Impact on Taxable Income	Impact on Current Tax	Impact on Future Tax	Creation of Deferred Tax
Books	₹ 1,100				
Income Tax	₹ 700	(–)	(–)	Additional tax	DTL

Year 2

Construction Contract Revenue [Income: Income Tax > Books]	
Timing Difference [1,800 – 1,600]	₹ 200
Reversal of DTL [₹ 200 x 30%]	₹ 60

Year 3

Construction Contract Revenue [Income: Income Tax > Books]	
Timing Difference [2,300 – 2,100]	₹ 200
Reversal of DTL [₹ 200 x 30%]	₹ 60

Journal Entries for Accounting of Taxes

	Particulars		Debit	Credit
(i)	**Payment of Current Tax**			
	Current Tax A/c	Dr.	XX	
	To Bank A/c			XX
(ii)	**Transfer of Current Tax to P&L**			
	P&L A/c	Dr.	XX	
	To Current Tax A/c			XX
(iii)	**Creation of DTL**			
	P&L A/c	Dr.	XX	
	To DTL A/c			XX
(iv)	**Reversal of DTL**			
	DTL A/c	Dr.	XX	
	To P&L A/c			XX
(v)	**Creation DTA**			
	DTA A/c	Dr.	XX	
	To P&L A/c			XX
(vi)	**Reversal of DTA**			
	P&L A/c	Dr.	XX	
	To DTA A/c			XX

Presentation of Tax Expense in Statement of P&L

Profit before tax	XX
Tax Expense	
(-) Current Tax	(XX)
(-) Creation of DTL	(XX)
(+) Reversal of DTL	XX
(+) Creation of DTA	XX
(-) Reversal of DTA	(XX)
Profit after tax	XX

Special Cases

(1) **Carry Forwarded Loss or Unabsorbed Depreciation [As per Income Tax]**

It is considered as timing difference over which DTA can be created.

(2) **If Minimum Alternate Tax [MAT] Rate is Also Given in Question**

- Calculate Tax as per MAT = Book profit as per MAT x MAT Rate
- Calculate Excess Tax due to MAT = Tax as per MAT – Current Tax
- Debit Excess Tax due to MAT in P&L

(3) **Creation of Deferred Tax during Tax Holiday Period**

DTA/DTL is created only on such timing difference which will get reversed after end of tax holiday period, i.e., Ignore timing difference which is getting reversed (according to FIFO method) within tax holiday period.

AS 24: DISCONTINUING OPERATIONS

Topics Covered

- Meaning of discontinuing operation
- Initial disclosure event of discontinuing operation
- Disclosure requirements for discontinuing operation

Meaning of Discontinuing Operation

It is component of entity which

- Represents separate major line of business or geographical area of operations
- &
- Can be distinguished operationally and financially
- &
- Pursuant to a single plan
  - Disposing of in its entirety, or
  - Disposing of in piecemeal, or
  - Terminating through abandonment.

Note: Activities which are not considered as discontinuing operation in general

(i) Gradual or evolutionary phasing out of a product line or class of service.

(ii) Discontinuing out several products within an ongoing line of business.

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another.

(iv) Closing of a facility to achieve productivity improvements or other cost savings.

Initial Disclosure Event of Discontinuing Operation

- It is the date on which a continuing operation is classified as discontinuing operation.
- It is earlier of

(i) Entity has entered into binding sale agreement for all assets.

(ii) Entity has approved and announced detailed formal plan for discontinuance.

Disclosure Requirements for Discontinuing Operation

Initial Disclosures	▪ Description of discontinuing operation. ▪ Business or geographical segment. ▪ Date and nature of initial disclosure event. ▪ Date on which discontinuance is expected to be completed.

	▪ Carrying amount of total and liabilities to be disposed of. ▪ Revenue, expenses and pre-tax profit/loss from ordinary activities of discontinuing operation during the current period. ▪ Net cash flows from operating, investing and financing activities of discontinuing operation during the current period.
Other Disclosures	Entity shall also disclose following on disposal of assets or liabilities of discontinuing operation: ▪ Pre-tax gain or loss. ▪ Income tax expense relating to gain or loss. ▪ Net selling price.
Disclosure in Interim Financial Reports	▪ Any significant activities/events relating to discontinuing operation since end of recent annual reporting period. ▪ Any significant changes in amount or timing of cash flows relating to assets or liabilities to be disposed of.
Presentation of Disclosures	▪ All above disclosures should be presented in notes to accounts. ▪ Pre-tax profit/loss of discontinuing operation and income tax thereon should be shown on face of statement of P&L.

AS 25: INTERIM FINANCIAL REPORTING

Topics Covered

- Types of financial reporting
- Preparation of interim financial statements
- Recognition of items in interim financial statements

Types of Financial Reporting

- **Annual Financial Reporting**
  - Preparation of financial statements (FS) for 1 financial year (FY)
  - Example: 1.4.20X1 to 31.3.20X2 [12 months]
- **Interim Financial Reporting**
  - Preparation of financial statements (FS) for less than 1 financial year (FY)
  - Example: 1.4.20X1 to 30.6.20X2 [3 months]

Preparation of Interim Financial Statements

- **Interim FS can be Prepared using Any of the Following Way:**
  - As a complete set of FS
    - Detailed FS Schedule III
  - As a condensed set of FS
    - Summarised FS having headings, sub-headings & selected notes
- **Interim FS are Presented for Following Periods:**

Example: If interim reporting period is 1.7.20X1 to 30.9.20X1 [3 months]	
Balance Sheet	▪ At end of current interim period [B/s as on 30.9.20X1] ▪ Comparative at end of previous FY [B/s as on 31.3.20X1]
Statement of Profit & Loss	▪ For current interim period [1.7.20X1 to 30.9.20X1] ▪ For current year to date [1.4.20X1 to 30.9.20X1] ▪ Comparative for same interim period of previous FY [1.7.20X0 to 30.9.20X0] ▪ Comparative for same year to date of previous FY [1.4.20X0 to 30.9.20X0]
Cash Flow Statement	▪ For current year to date [1.4.20X1 to 30.9.20X1] ▪ Comparative for same year to date of previous FY [1.4.20X0 to 30.9.20X0]

Recognition of Items in Interim Financial Statements

All Assets, Liabilities, Income & Expenses are Recognised in Interim FS using Same Principles of Accounting as for Annual FS as Follows:

Any Income Earned or Expense Incurred in Interim Reporting Period	▪ Recognise completely in interim period in which they are earned or incurred. ▪ Expenses should not be deferred to the upcoming interim periods on the basis that sales will be more in upcoming interim periods. Example: Bad debts, advertisement or sales promotion expense, depreciation, employee benefits expense, finance cost, administrative & selling expense, extra ordinary loss/gain, loss/gain on sale of investment, dividend income, etc. incurring in an interim period should be recognised in that interim period only. These will not be deferred to the upcoming interim period in any case.
Income Tax Expense for Interim Reporting Period	▪ **If Tax Rate is Given in Slabs** Recognise income tax expense in each interim reporting period using weighted average tax rate (WATR) as follows: Step 1: Calculate estimated annual tax on estimated annual income Step 2: Calculate WATR $= \frac{\text{Estimated annual tax [Step 2]}}{\text{Estimated annual income}} \times 100$ Step 3: Calculate income tax expense in each interim period = Profit/(Loss) of each interim period x WATR ▪ **If Tax Rate is Not Given in Slabs** Recognise income tax expense in each interim reporting period using actual applicable tax rate in respective interim reporting period.

AS 26: INTANGIBLE ASSETS

Topics Covered

- Meaning of Intangible Asset
- Recognition criteria of Intangible Asset
- Initial recognition of Intangible Asset
- Amortisation of Intangible Asset

Meaning of Intangible Asset

Intangible items [No physical substance]

- Identifiable & non-monetary
- &
- Held for use in
  - Production or supply of goods/services, or
  - Administrative purposes, or
  - Rental to others

Recognition Criteria of Intangible Asset

Intangible Asset is Recognised in Books Only If

- Future economic benefits are probable from such Intangible Asset, &
- Its cost can be measured reliably.

Note:

(i) If Intangible Asset (Software) is integral part of a Tangible Asset (Hardware), then such Intangible Asset is not recognised separately [Entire amount is recognised as PPE].

(ii) Self generated Goodwill/Brand is not recognised in books.

Initial Recognition of Intangible Asset

(1) **Cost of Purchased/Acquired Intangible Asset**

Particulars	Amount
Purchase price	XX
(-) Trade discount/Rebate	(XX)
(+) Duties & taxes on purchase [Only if non-refundable]	XX
(+) Any other direct attributable costs	XX
	XX

Note: In silent situation, assume all duties & taxes are non-refundable.

(2) Cost of Internally Generated Intangible Asset

- **Phases Involved in Internally Generating an Intangible Asset**

Research Phase
Planned investigation to gain new knowledge

↓

Expenses incurred in research phase are charged to P&L A/c

Development Phase
- Application of research findings to develop Intangible Asset.
- It starts after establishment of technical feasibility.

↓

Expenses incurred in development phase are considered in cost of Intangible Asset

- **Calculation of Cost of Internally Generated Intangible Asset**

Particulars	Amount
Development phase expense	XX
PV of expected future economic benefits from such Intangible Asset	XX
Cost of Intangible Asset (Lower)	XX

(3) Following Costs are Not Added in Cost of Intangible Asset [i.e. Charged to P&L A/c]:

Particulars	Example
Marketing & Advertisement Campaign	Publicity expenses.
Preliminary Expenses	Incorporation expenses of an entity.
Subsequent Costs	▪ Legal advisor fee to defend the patent or to stop infringement of trademark. ▪ Annual fee on franchisee as % of sales.
Other Expenses	▪ Development phase expenses earlier charged to P&L. ▪ Expenses incurred after completion of development phase, i.e. Duplication of computer software, Packing of product, etc.

Amortisation of Intangible Asset

(1) Amortisation Methods

Expected Cash Flows Method	Step 1: Calculate amortisation ratio for each year of useful life $= \frac{\text{Expected cashflow from such Intangible Asset of respective year}}{\text{Total expected cashflows from such Intangible Asset}}$ Step 2: Calculate amortisation for each year of useful life = Cost × Amortisation ratio

Straight Line Method [SLM]	▪ It is applied only if ➢ Expected cash flows are not given in question. ➢ Expected cash flows for each year are same. ▪ Amortisation p.a. = $\frac{\text{Cost – Residual value}}{\text{Total useful life}}$

(2) Amortisation Period

Amortisation Start	When Intangible Asset is available for use, i.e. in ready to use condition [Put to use date is not relevant].
Amortisation Stop	When Intangible Asset is derecognised.
Maximum period of amortisation is 10 years unless any virtual evidence is available	

(3) Change in Amortisation Method, Expected Cash flows, Useful Life & Residual Value

- It is change in accounting estimate.
- Prospective effect will be given, i.e., give effect in remaining future period.

(4) Amortisation Charged on Wrong Basis/Not Charged in Earlier Years

Difference amount of amortisation should be adjusted to Intangible Asset as prior period item.

AS 28: IMPAIRMENT OF ASSETS

Topics Covered

- Meaning of impairment of assets
- Recognition & measurement of impairment loss on individual asset
- Recognition & measurement of impairment loss on CGU
- Impairment of goodwill
- Impairment of corporate assets

Meaning of Impairment of Assets

- This AS is applicable on impairment of PPE & Intangible Assets.
- Impairment of asset means decline in value of asset due to change in technological, market or economic environment.
- An asset is impaired when its Carrying value > Recoverable value.

Recognition & Measurement of Impairment Loss [IL] on Individual Asset

Step 1: Calculate Existing Carrying Value of Asset on Impairment Date [ECV]

Cost of asset	XX
(-) Depreciation till impairment date	(XX)
ECV	**XX**

Step 2: Calculate Net Selling Price of Asset on Impairment Date [NSP]

Estimated sales value/market value of asset	XX
(-) Estimated disposal cost	(XX)
NSP	**XX**

Step 3: Calculate Value in Use of Asset on Impairment Date [VIU]

PV of future cash flows from use of asset	XX
(+) PV of residual value of asset	XX
VIU	**XX**

Step 4: Calculate Recoverable Value of Asset on Impairment Date [RV]

NSP	XX
VIU	XX
RV [Whichever is Higher]	**XX**

Step 5: Calculate Impairment Loss on Asset [IL]

ECV	XX
(-) RV	(XX)
IL [Only when ECV > RV]	**XX**

Step 6: Calculate Revised Carrying Value of Asset After Impairment [RCV]

ECV	XX
(-) IL	(XX)
RCV [Depreciation will be charged on this RCV in future]	**XX**

Step 7: Journal Entries [If Required]

	Particulars		Debit	Credit
(i)	**Recognising IL**			
	Impairment Loss A/c	Dr.	XX	
	To Asset A/c			XX
(ii)	**Transfer of IL**			
	Revaluation Reserve A/c	Dr.	Upto balance in this A/c	
	P&L A/c	Dr.	Balancing figure	
	To Impairment Loss A/c			XX

Note: If RV becomes > CV in future of previously impaired asset, then IL is reversed upto that extent.

Recognition & Measurement of Impairment Loss [IL] on Cash Generating Unit [CGU]

(1) Meaning of CGU

- Sometimes RV of individual asset cannot be determined because that asset cannot generate independent cash flows. So, impairment of such asset will be done in CGU.
- CGU is the smallest group of assets which are capable of generating independent cash flows.

Example 1

A juice company prepares juice by machine 1 & pack it in bottles for sale by machine 2.

Machine 1 & 2 cannot generate independent cash flows for the business. Hence, they should be clubbed together as a CGU for impairment testing.

(2) Calculation of Impairment Loss on CGU

ECV of CGU	XX
(-) RV of CGU	(XX)
IL [Allocate this IL to individual assets of CGU in ratio of their ECV]	**XX**

Impairment of Goodwill

(1) Impairment Testing of Goodwill

- Goodwill cannot be tested for impairment individually because they cannot generate independent cash flows.
- So, impairment of goodwill will be done in CGU only.

(2) Calculation of IL if Goodwill is Allocable to CGU [Bottom Up Test]

Step 1: Allocate goodwill to multiple CGUs in ratio of fair value of CGU at the time of acquisition.

Step 2: Calculate IL

Particulars	CGU 1	CGU 2	CGU 3
ECV of other assets in CGU	XX	XX	XX
(+) Goodwill allocated to CGU	XX	XX	XX
ECV of each CGU including goodwill	XX	XX	XX
(-) RV of each CGU	XX	XX	XX
IL of each CGU [Allocate this IL firstly to goodwill & then remaining IL to other assets in respective CGU]	**XX**	**XX**	**XX**

Example 2

P ltd. acquires S Ltd. on 31.3.20X0 for ₹ 3,000. On this date, S Ltd. has 3 CGUs A, B and C with net fair values of ₹ 1,200, ₹ 800 and ₹ 400 respectively. P Ltd. recognises goodwill of ₹ 600 (₹ 3,000 – ₹ 2,400) that relates to S Ltd.

Following information is available on 31.3.20X4

31.3.20X4	CGU A	CGU B	CGU C	Goodwill	Total
Carrying amount	1,300	1,200	800	120	3,420
Recoverable amount	1,350	1,250	850		3,400

Calculate impairment loss if goodwill can be allocated to each CGU.

Solution

Allocation of goodwill to each CGU on 31.3.20X4

	CGU A	CGU B	CGU C
Fair value on 31.3.20X0	1,200	800	400
Fair value ratio	0.50	0.33	0.17
Allocation of goodwill of ₹ 120 (Using above ratio)	60	40	20

Calculation of IL of each CGU

	CGU A	CGU B	CGU C
ECV of other assets in CGU on 31.3.20X4	1,300	1,200	800
(+) Allocated goodwill	60	40	20
ECV of CGU including goodwill	1,360	1,240	820
(-) RV of CGU	(1,350)	(1,250)	(850)
IL of CGU	10	-	-

IL of CGU A is firstly allocated to goodwill. So, IL of ₹ 10 is fully allocated to goodwill in CGU A.

(3) Calculation of IL if Goodwill is Not Allocable to CGU [Bottom Up & Top Down Test]

Step 1: Calculate IL of each CGU ignoring goodwill [Bottom up test]

Particulars	CGU 1	CGU 2	CGU 3
ECV of other assets in CGU	XX	XX	XX
(-) RV of each CGU	XX	XX	XX
IL of each CGU	XX	XX	XX

Step 2: Calculate IL of overall entity including goodwill [Top down test]

Particulars	CGU 1	CGU 2	CGU 3	Total
ECV of other assets in CGU	XX	XX	XX	XX
(-) IL of each CGU [Step 1]	(XX)	(XX)	(XX)	(XX)
	XX	XX	XX	XX
(+) Goodwill				XX
CV of overall entity including goodwill				XX
(-) RV of overall entity				(XX)
IL of Goodwill [Only when ECV > RV]				**XX**

Example 3

In above example 2; calculate impairment loss if goodwill cannot be allocated to each CGU.

Solution

Calculation of IL of each CGU ignoring goodwill [Bottom up test]

	CGU A	CGU B	CGU C
ECV of other assets in CGU on 31.3.20X4	1,300	1,200	800
(-) RV of CGU	(1,350)	(1,250)	(850)
IL of CGU	-	-	-

Calculation of IL of overall entity including goodwill [Top down test]

	CGU A	CGU B	CGU C	Total
ECV of other assets in CGU on 31.3.20X4	1,300	1,200	800	3,300
(-) IL of CGU	-	-	-	-
	1,300	1,200	800	3,300
(+) Goodwill				120
CV of overall entity including goodwill				3,420
(-) RV of overall entity				3,400
IL of goodwill				20

Impairment of Corporate Assets [Example: Office Building]

Same as 'Impairment of Goodwill'.

AS 29: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Topics Covered

- Provision and Contingent liability
- Contingent assets
- Special cases
  - Onerous contracts
  - Restructuring
  - Reimbursements

Provision and Contingent Liability

Obligation of uncertain amount or timing can be

Provision

- Present obligation arising from past events where outflow of resources is probable [> 50%].

+

- Amount can be estimated reliably.

→ Recognise provision by debiting to P&L & disclose its as liability in B/S

Contingent Liability

- Possible obligation arising from past events where outflow of resources is not probable [≤ 50%].

OR

- Present obligation of which amount cannot be estimated reliably.

→
- Contingent liability is not recognised but disclosed in notes to financial statements.
- However, if possibility of outflow is remote, then disclosure is also not required.

Note: If entity can avoid any expenditure by its future actions, then it is neither recognised as provision nor disclosed as contingent liability [Example: Future operating costs like overhauling or inspection of ships, future operating losses, etc.].

Contingent Assets

- It means possible asset arising from past events that will be confirmed only on occurrence or non-occurrence of uncertain future events.
- It is recognised only when it becomes virtually certain.

Special Cases

(1) Onerous Contract

Meaning	It is a contract in which unavoidable costs of meeting the obligation exceeds economic benefits to be received under it.
Recognition of Provision	Provision is recognised on onerous contract at lower of ▪ Loss on fulfilling the onerous contract, or ▪ Penalty for cancellation of contract

(2) Restructuring

Meaning	It means a plan to change the scope or manner of conducting business [Example: Discontinuing a line of business].
Recognition of Provision	▪ Provision is recognised for direct restructuring costs. ▪ Provision is not recognised for ➢ Marketing cost. ➢ Relocating/Retraining cost of staff. ➢ Investment in new systems.

(3) Reimbursements

If expenditure required to settle an obligation is expected to be reimbursed by other party

- Reimbursement is recognised as separate asset in balance sheet [only if virtually certain]
- Respective provision expense is presented net off of reimbursement amount in P&L
- Reimbursement shall not exceed respective provision amount

PREPARATION OF FINANCIAL STATEMENTS OF COMPANIES

Topics Covered

- Components of financial statements of companies
- Balance sheet
- Statement of profit and loss
- Declaration of dividend to equity shareholders

Components of Financial Statements of Companies

- Balance Sheet [As per Part I of Schedule III of Companies Act, 2013]
- Statement of P&L [As per Part II of Schedule III of Companies Act, 2013]
- Cash Flow Statement [As per AS 3]
- Notes to accounts

Balance Sheet

(1) **Format of Balance Sheet**

Balance Sheet of _____ as at _____

Particulars			Note No.	As at end of current period (₹)	As at end of previous period (₹)
Equity and Liabilities					
1		**Shareholders' funds**			
	(a)	Share capital			
	(b)	Reserves and surplus			
	(c)	Money received against share warrants			
2		**Share application money pending allotment**			
3		**Non-current liabilities**			
	(a)	Long term borrowings			
	(b)	Deferred tax liabilities (Net)			
	(c)	Other non-current liabilities			
	(d)	Long term provisions			
4		**Current liabilities**			
	(a)	Short term borrowings			
	(b)	Trade payables			
	(c)	Other current liabilities			

	(d)	Short term provisions			
		Total			
Assets					
1		**Non-current assets**			
	(a)	Property, plant & equipment and Intangible assets			
		(i) Property, plant and equipments			
		(ii) Intangible assets			
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
	(b)	Non-current investments			
	(c)	Deferred tax assets (Net)			
	(d)	Long-term loans and advances			
	(e)	Other non-current assets			
2		**Current assets**			
	(a)	Current investments			
	(b)	Inventories			
	(c)	Trade receivables			
	(d)	Cash and cash equivalents			
	(e)	Short-term loans and advances			
	(f)	Other current assets			
		Total			

(2) **Description of Balance Sheet Items**

Share Capital	▪ **Disclosure in notes to accounts** ➢ Disclose amount of 'Authorised capital' & 'Issued capital' separately for both equity shares and preference shares. ➢ If shares are issued for consideration other than cash or as bonus shares, then separately disclose number of such shares issued. ▪ Deduct calls in arrears [calls unpaid] from amount of issued share capital. **Note**: 'Calls in advance' is not adjusted here. It will be disclosed in 'Other current liability'.
Reserves & Surplus	▪ **Types of reserves & surplus** ➢ Free reserve It can be used freely for any purpose including distribution of dividend [Example: P&L balance, General/Revenue reserve, etc.]. ➢ Specific reserve

<table>
<tr><td></td><td>
It can be used for specific purpose only [Example: Securities premium, Capital reserve, Capital redemption reserve, Revaluation reserve, Share option outstanding account, etc.].
➢ <u>Statutory reserve</u>
It is created due to requirements of law [Example: Investment allowance reserve, Export profit reserve, Infrastructure development reserve etc].
▪ <u>Calculation of amount of each reserve</u>
➢ <u>P&L balance</u>
<table>
<tr><td>Opening balance
(+) Profit/(loss) after tax for the period
(-) Dividend to shareholders [Refer crux]
(-) Transfer to any reserve from P&L [Amount as given directly or % of profit after tax for the period]</td><td>XX
XX/(XX)
(XX)
(XX)</td></tr>
<tr><td>Closing balance</td><td>XX/(XX)</td></tr>
</table>
<u>Note</u>: Negative balance is also shown in 'Reserves & surplus' head.
➢ <u>Other reserves</u>
<table>
<tr><td>Opening balance
(+) Addition to reserve
(-) Deduction from reserve</td><td>XX
XX
(XX)</td></tr>
<tr><td>Closing balance</td><td>XX</td></tr>
</table>
</td></tr>
<tr><td>Long Term Borrowings</td><td>
▪ It includes debentures, bonds, loan, etc.
▪ <u>Deduct following items [if already included] from amount of such borrowings</u>:
➢ Current maturities of long-term borrowing [i.e. payable within 1 year].
➢ Outstanding interest [i.e. interest accrued but not due or interest due but not paid].
</td></tr>
<tr><td>Long Term Provisions</td><td>It includes retirement gratuity fund, provident fund, etc.</td></tr>
<tr><td>Short Term Borrowings</td><td>
<u>It includes</u>
▪ Short term loan.
▪ Bank overdraft.
▪ Cash credit limit.
▪ Current maturities of long-term borrowings [i.e. payable within 1 year].
</td></tr>
<tr><td>Trade Payables</td><td>It includes creditors & bills payable.</td></tr>
</table>

Other Current Liabilities	**It includes** ▪ Calls in advance. ▪ Outstanding interest [i.e. interest accrued but not due or interest due but not paid]. ▪ Outstanding expenses. ▪ Unearned income [Income received in advance]. ▪ Dividend payable, unpaid dividend or unclaimed dividend. ▪ Share application money received in excess of issued share capital.
Short Term Provisions	It includes provision for tax, etc.
Property, Plant and Equipments	▪ It includes assets covered by AS 10 [Example: Land, building, plant & machinery, equipment, furniture, vehicle, etc.]. ▪ Deduct 'Provision for depreciation' from amount of PPE.
Intangible Assets	▪ It includes assets covered by AS 26 [Example: Goodwill, trademark, copyright, patent, license, software, etc.]. ▪ Deduct 'Provision for amortization' from amount of intangible assets.
Inventories	It includes raw materials, work-in-progress, finished goods, stock-in-trade, stores, loose tools, etc.
Trade Receivables	▪ It includes debtors & bills receivable. ▪ Deduct 'Provision for doubtful debts' from amount of debtors.
Cash and Cash Equivalents	**It includes** ▪ Bank balance [Separately disclose balance with scheduled bank, non-scheduled bank & deposits]. ▪ Cash in hand.
Short-Term Loans and Advances	It includes short term loans and advances given [Example: Advance tax paid].
Other Current Assets	It includes accrued income, prepaid expense, PPE held for sale, etc.

Note: Following items are disclosed in foot note to balance sheet:

(i) Contingent liabilities [Example: Bills receivable discounted with bank].

(ii) Commitments [Example: Contract for the erection of machinery].

(iii) Proposed dividend [Example: Dividend declared in next year].

Statement of Profit and Loss

(1) Format of Statement of Profit and Loss

Statement of Profit and Loss of _____ for the year ended _____

Particulars		Note No.	As at end of current period (₹)	As at end of previous period (₹)
I	Revenue from operations			
II	Other income			
III	**Total Income (I + II)**			
	Expenses: Cost of materials consumed Purchases of stock in trade Changes in inventory of finished goods, WIP, and stock in trade Employee benefits expenses Finance costs Depreciation and amortization expense Other expenses			
IV	**Total expenses**			
V	**Profit/(loss) before tax**			
VI	**Tax expense** (1) Current tax (2) Deferred tax			
VII	**Profit/(loss) after tax (V – VI)**			
VIII	**Earnings per equity share:** (1) Basic (2) Diluted			

(2) Description of Statement of Profit and Loss Items

Income

Classification of Income

- Revenue from operations
  - Revenue arising in ordinary course of business
    - Example: Revenue from sale of goods & services
- Other income
  - All other income
    - Example:
      - Profit on sale of long-term assets.
      - Transfer fees.
      - Interest, dividend & rent income.
      - Commission income.
      - Other miscellaneous income.

Inventory

- **Classification of Inventory**
  - Trading business [✓]
    - Inventory includes stock in trade (SIT)
  - Manufacturing business
    - Inventory includes raw material, WIP & finished goods
- **Calculation of amounts related to inventory**
  - Cost of materials consumed

Opening raw material	XX
(+) Purchase of raw material	XX
(-) Closing raw material	(XX)
	XX

  - Purchases of stock in trade (SIT)

Cases	Purchases of SIT
Case 1: Closing SIT is given outside of trial balance	Purchase amount as given in trial balance
Case 2: Closing SIT is given in trial balance & opening SIT is not given	Adjusted purchase amount as given in trial balance
Case 3: Closing SIT is given in trial balance & opening SIT is given outside of trial balance	Adjusted purchase (+) Closing SIT (-) Opening SIT

<table>
<tr><td></td><td>➢ <u>Changes in inventory of finished goods, WIP, and stock in trade</u>
<table>
<tr><td>Opening inventory</td><td>XX</td></tr>
<tr><td>(–) Closing inventory</td><td>(XX)</td></tr>
<tr><td></td><td>XX</td></tr>
</table>
<u>Note</u>: If closing SIT is given in trial balance & opening SIT is not given, then it is not possible to calculate changes in inventory of SIT. Hence, it is not disclosed.</td></tr>
<tr><td>Employee Benefits Expenses</td><td>It includes salaries, wages, etc.
<u>Note</u>: 'Director fees/remuneration' is not disclosed here. It will be disclosed in 'Other expenses'.</td></tr>
<tr><td>Finance Costs</td><td>It includes interest on loan, overdraft, debentures etc.</td></tr>
<tr><td>Other Expenses</td><td><u>It includes</u>
▪ Selling & distribution expenses [Example: Bad debts, Advertisement, Travelling expenses, Discount & rebates, Commission & brokerage, etc.].
▪ Office/Administrative expenses [Example: Rent, rates and taxes, Director fees/remuneration, Auditor fees, Repairs, etc.].
▪ All other expenses [Example: Manufacturing/Factory expenses, Carriage & cooliage, Distribution freight, Transit insurance, Trade expenses, Coal & firewood laundry, Consumables, Dealers aids, Loss on sale of long-term assets, Preliminary & formation expense, General charges, Sundry expenses, Miscellaneous expenses, etc.].</td></tr>
</table>

Crux for Some Special Items

(1) Dividend Declared/Paid to Shareholders

Cases	Deduct from 'P&L balance' in Reserves & Surplus	Disclose in 'Other current liability' head in Balance Sheet
Case 1: Dividend paid is given in debit side of trial balance	Yes	No
Case 2: Dividend payable, unpaid dividend or unclaimed dividend is given in credit side of trial balance	No	Yes
Case 3: If adjustment of dividend is given outside of trial balance: ▪ Dividend declared in current period ▪ Dividend declared in next period (Proposed dividend)	 Yes No	 Yes No

(2) Depreciation & Amortization

Cases	Disclose in 'Depreciation & amortization expenses' head in P&L	Deduct from respective asset in Balance Sheet
Case 1: Depreciation/Amortization is given in debit side of trial balance	Yes	No
Case 2: Provision for depreciation/ amortization is given in credit side of trial balance	No	Yes
Case 3: If adjustment of depreciation/ amortization is given outside of trial balance	Yes	Yes

(3) Outstanding Expense, Prepaid Expense, Accrued Income and Unearned Income

Cases	Adjustment in respective item in P&L	Disclose in respective head in Balance Sheet
Case 1: Given in trial balance	No	Yes
Case 2: If adjustment is given outside of trial balance	Yes	Yes

Declaration of Dividend to Equity Shareholders

(1) Source of Dividend

- Dividend should be declared out of current year profits.
- If current year profits are inadequate, then dividend can be declared out of free reserves.

(2) Maximum Dividend that can be Declared out of Free Reserves

Step 1

Calculate total dividend desired to be declared by company

= Paid up equity share capital x Dividend rate

Step 2

Calculate amount to be utilised out of free reserves to declare desired dividend

Total dividend desired to be declared by company [Step 1]	XX
(-) Dividend that can be declared out of current year profit [Net profit for the current year – Preference share dividend]	(XX)
	XX

Step 3

Maximum dividend that can be declared out of free reserves shall be lower of following:

(i) Dividend rate shall not exceed average dividend rate of last 3 years.

(ii) $10\% \times \left[\text{Paid up share capital (Equity \& preference)} + \text{Free reserves other that current year profit} - \text{Current year loss (if any)}\right]$

(iii) $\left[\text{Free reserves other that current year profit} - \text{Current year loss (if any)} - \text{Step 2 amount}\right] \geq 15\% \times \text{Paid up share capital (Equity \& preference)}$

BUY BACK OF SECURITIES

Topics Covered

- Meaning of buy back of shares
- Accounting for buy back of shares
- Accounting for other adjustments given in buy back questions
- Capital redemption reserve [CRR]
- Maximum permissible number of equity shares that can be bought back

Meaning of Buy Back of Shares

- Buy back of shares means purchase of its own shares by a company.
- Shares bought back by company should be cancelled, i.e. these shares cannot be held as investment.
- It results in decrease in share capital of company.

Accounting for Buy Back of Shares [Journal Entries]

	Particulars		Debit	Credit
(i)	**Arrangement of Premium Payable on Buy Back**			
	Securities Premium A/c	Dr.	XX	
	↓			
	Free Reserves A/c [Revenue Reserve → General Reserve → P&L]	Dr.	XX	
	To Premium Payable on Buy Back A/c			XX
(ii)	**Amount Due on Buy Back**			
	Equity Share Capital A/c [Face value]	Dr.	XX	
	Premium Payable on Buy Back A/c	Dr.	XX	
	To Equity Shares Buy Back A/c			XX
(iii)	**Payment for Buy Back**			
	Equity Shares Buy Back A/c	Dr.	XX	
	To Bank A/c			XX
(iv)	**Creation of Capital Redemption Reserve (CRR) due to Buy Back**			
	Free Reserves A/c [Revenue Reserve → General Reserve → P&L]	Dr.	XX	
	↓			
	Securities Premium A/c	Dr.	XX	
	To Capital Redemption Reserve A/c			XX

(v)	**Expense on Buy Back**			
	Buy Back Expense A/c	Dr.	XX	
	To Bank A/c			XX
(vi)	**Transfer of Buy Back Expense to P&L**			
	P&L A/c	Dr.	XX	
	To Buy Back Expense A/c			XX

Accounting for Other Adjustments Given in Buy Back Questions [Journal Entries]

(1) Redemption of Preference Shares

	Particulars		Debit	Credit
(i)	**Arrangement of Premium Payable on Redemption**			
	Free Reserves A/c [Revenue Reserve → General Reserve → P&L]	Dr.	XX	
	To Premium Payable on Redemption of Preference Shares A/c			XX
(ii)	**Amount Due on Redemption**			
	Preference Share Capital A/c [Face value]	Dr.	XX	
	Premium Payable on Redemption of Preference Shares A/c	Dr.	XX	
	To Preference Shareholders A/c			XX
(iii)	**Payment for Redemption**			
	Preference Shareholders A/c	Dr.	XX	
	To Bank A/c			XX
(iv)	**Creation of CRR due to Redemption**			
	Free Reserves A/c [Revenue Reserve → General Reserve → P&L]	Dr.	XX	
	To Capital Redemption Reserve A/c			XX

(2) Issue of Bonus Shares [At Total Face Value of Bonus Shares]

	Particulars		Debit	Credit
(i)	**Arrangement for Bonus Shares**			
	Specific Reserve A/c [CRR → Capital Reserve → Securities Premium]	Dr.	XX	
	↓			
	Free Reserves A/c [Revenue Reserve → General Reserve → P&L]	Dr.	XX	
	To Bonus to Shareholders A/c			XX
(ii)	**Allotment of Bonus Shares**			
	Bonus to Shareholders A/c	Dr.	XX	
	To Equity Share Capital A/c			XX

(3) Sale of Investment

Particulars		Debit	Credit
Bank A/c	Dr.	Sale value	
P&L A/c [Loss]	Dr.	Balancing figure	
To Investment A/c			Cost
To P&L A/c [Profit]			Balancing figure

(4) Issue of Shares or Debentures

Particulars		Debit	Credit
Bank A/c	Dr.	XX	
To Share Capital A/c or Debentures A/c			XX
To Securities Premium A/c			XX

(5) Cancellation of Own Debentures

Particulars		Debit	Credit
Debentures A/c	Dr.	Face value	
To Own Debentures Investment A/c			Cost
To Profit on Cancellation A/c [Capital Reserve]			Balancing figure

(6) Issue of Shares to Employees Against Employee Stock Options Plan [ESOP]

Particulars		Debit	Credit
Bank A/c	Dr.	Exercise price	
ESOP Outstanding A/c	Dr.	Market price – Exercise price	
To Equity Share Capital A/c			Face value
To Securities Premium A/c			Market price – Face value

Capital Redemption Reserve [CRR]

Meaning of CRR	▪ If buy back of equity shares or redemption of preference shares is made out of reserves, then CRR needs to be created. ▪ CRR is created to keep share capital intact to protect interest of outsiders. ▪ CRR is used for issue of fully paid bonus shares only.
Calculation of CRR	▪ **CRR Amount on Buy Back of Equity Shares** Total face value of equity shares bought back: XX (-) Total face value of fresh share capital issued for buy back: (XX) Buy back made out of reserves [CRR Amount]: XX

	▪ **CRR Amount on Redemption of Preference Shares**

Total face value of preference shares redeemed	XX
(–) Total face value of fresh share capital issued for redemption	(XX)
Redemption made out of reserves [CRR Amount]	XX

Maximum Permissible Number of Equity Shares that can be Bought Back

Maximum no. of equity shares that can be bought back will be lower of following 3 criteria:

Shares Outstanding Test	▪ Number of shares that can be bought back = 25% of existing number of equity shares
Resources Test	▪ Step 1: Available resources for buy back = 25% of equity shareholders fund ▪ Step 2: Number of shares that can be bought back = $\frac{\text{Available resources for buy back}}{\text{Buy back price}}$
Debt Equity Ratio Test	Debt equity ratio shall not exceed 2:1 after buy back of equity shares. ▪ Step 1: Excess equity shareholders fund

Existing equity shareholders fund	XX
(–) Minimum equity fund to be maintained [50% of debt]	(XX)
Excess equity shareholders fund [For buy back + CRR]	XX

▪ Step 2: Number of shares that can be bought back = $\frac{\text{Excess equity shareholders fund}}{\text{Buy back price + Face value}}$

Additional calculations required only for presentation in questions

(i) Amount of shares to be bought back as per debt equity ratio test = Number of shares that can be bought back as per debt equity ratio test × Buy back price

(ii) Future equity shareholders fund = Existing equity shareholders fund – Total face value of equity shares that can be bought back as per debt equity ratio test

Note:

(i) Calculation of maximum permissible number of equity shares that can be bought back is done only if specifically required by question.

(ii) Debt includes both long term & short term borrowings [whether secured or unsecured].

(iii) Equity shareholders fund

Paid up equity share capital	XX
(+) Paid up preference share capital	XX
(+) Free reserves	XX
(+) Securities premium	XX
(–) Debit balance of P&L and other fictitious losses	(XX)
Equity shareholders fund	XX

Example

ABC ltd. has following capital structure on 31st Match, 20X1:

Particulars	₹
Equity share capital (120 shares of ₹ 10 each)	1,200
General reserve	1,080
Securities premium	400
Profit & loss	200
Statutory reserve	320
Loan	3,200

Company has offered buy back price of ₹ 30 per equity share.

Calculate maximum permissible number of equity shares that can be bought back.

Solution

Existing equity shareholders fund = ₹ 1,200 + ₹ 1,080 + ₹ 400 + ₹ 200 = ₹ 2,880

Excess equity shareholders fund = ₹ 2,880 – [₹ 3,200 x 50%] = ₹ 2,880 – ₹ 1,600 = ₹ 1,280

No. of shares that can be bought back as per

(i) Shares outstanding test = 120 x 25% = 30 shares

(ii) Resources test = $\frac{₹\ 2,880 \times 25\%}{₹\ 30} = \frac{₹\ 720}{₹\ 30}$ = 24 shares

(iii) Debt equity ratio test = $\frac{₹\ 1,280}{₹\ 30 + ₹\ 10} = \frac{₹\ 1,280}{₹\ 40}$ = 32 shares

Maximum number of equity shares that can be bought back = Lower of above 3 tests, i.e. 24 shares

INTERNAL RECONSTRUCTION

Topics Covered

- Meaning of reconstruction of company
- Methods for internal reconstruction of company
- Capital reduction A/c
- Accounting for
  - Alteration of share capital
  - Variation of shareholders or debenture holders rights
  - Reduction of share capital
  - Surrender of shares
  - Settlement of outside liabilities
  - Other adjustments
- Journal entry to close capital reduction A/c

Meaning of Reconstruction of Company

- It is process of reorganizing affairs of a company (by incorporating major changes) so that it can overcome from poor financial condition.
- **Reconstruction of a Company can be Done in Following 2 Ways:**

External Reconstruction	Internal Reconstruction
Existing company is liquidated & a new company is incorporated with same business and management [Amalgamation]. Example: Bad Luck Ltd. is liquidated & Lucky Ltd. is incorporated with same business and management.	Existing company will restructure its balance sheet without liquidating.

Methods for Internal Reconstruction of Company

Internal Reconstruction of a Company involves Following Methods:

- Alteration of share capital.
- Variation of shareholders or debenture holders rights.
- Reduction of share capital.
- Surrender of shares.
- Settlement of outside liabilities.
- Other adjustments.

Capital Reduction A/c [Reconstruction A/c]

- Losses arise during internal reconstruction of a company are debited in this account.
- Profits arise during internal reconstruction of a company are credited in this account.
- After doing all adjustments, Net balance in this account will be credit balance which will be used to write off existing losses of company.
- Remaining credit balance (if any) in this account will be transferred to 'Capital reserve A/c'.

Accounting for Alteration of Share Capital

- **Meaning**
  - It means change in composition of share capital [Total paid-up share capital remains same].
  - No effect on 'Capital reduction A/c' since there is no gain/loss to company.
- **Journal Entries**

(i) **Sub-Division/Splitting of Share Capital**

Face value of share is decreased but number of shares are increased in same proportion.

Particulars		Debit	Credit
Share Capital (Old face value) A/c	Dr.	XX	
To Share Capital (New face value) A/c			XX

(ii) **Consolidation of Share Capital**

Face value of share is increased but number of shares are decreased in same proportion.

Particulars		Debit	Credit
Share Capital (Old face value) A/c	Dr.	XX	
To Share Capital (New face value) A/c			XX

(iii) **Conversion of Share Capital into Equity Stock**

Share capital is bundled together by removing face value and number of shares.

Particulars		Debit	Credit
Share Capital A/c	Dr.	XX	
To Equity Stock A/c			XX

(iv) **Conversion of Equity Stock into Share Capital**

Equity stock is divided into small units by introducing face value and number of shares.

Particulars		Debit	Credit
Equity Stock A/c	Dr.	XX	
To Share Capital A/c			XX

Accounting for Variation of Shareholders or Debenture Holders Rights

- **Meaning**
  - It means change in right attached to shares or debentures, i.e. dividend/interest rate [Total share capital or debentures amount remains same].
  - No effect on 'Capital reduction A/c' since there is no gain/loss to company.
- **Journal Entry**

Particulars		Debit	Credit
Share Capital or Debenture (Old %) A/c	Dr.	XX	
To Share Capital or Debenture (New %) A/c			XX

Accounting for Reduction of Share Capital

- **Meaning**
  - It means shareholders are sacrificing some part of their per share paid-up share capital [Total paid-up share capital is reduced].
  - Credit 'Capital reduction A/c' for sacrificed part of total paid-up share capital since there is gain to company.
  - If question is silent regarding sub-division or reduction of share capital, then assume it as reduction of share capital.
- **Journal Entries**

(i) **Reduction of Share Capital with Change in Face Value of Shares [✓]**

Face value of share is decreased but number of shares remains same.

Particulars		Debit	Credit
Share Capital (Old face value) A/c	Dr.	XX	
To Share Capital (New face value) A/c			XX
To Capital Reduction A/c			XX

(ii) **Reduction of Share Capital without Change in Face Value of Shares**

Both face value of share and number of shares remain unchanged.

Particulars		Debit	Credit
Share Capital A/c	Dr.	XX	
To Capital Reduction A/c			XX

Accounting for Surrender of Shares

- **Meaning**
  - It means shareholders are sacrificing some part of their paid-up share capital by surrendering shares to company [Total paid-up share capital is reduced].
  - Company can reissue such surrendered shares for settlement of other liabilities.
- **Journal Entries**

	Particulars		Debit	Credit
(i)	**Surrender of Shares by Shareholders**			
	Share Capital A/c	Dr.	XX	
	To Share Surrender A/c			XX
(ii)	**Settlement of Liability by Reissuing Surrendered Shares**			
	(a) Issue of surrendered shares			
	Share Surrender A/c	Dr.	XX	
	To Share Capital A/c			XX
	(b) Cancellation of Liability			
	Liability A/c	Dr.	Total amount of liability settled	
	To Capital Reduction A/c			
(iii)	**Cancellation of Unissued Part of Share Surrender A/c**			
	Share Surrender A/c	Dr.	XX	
	To Capital Reduction A/c			XX

Accounting for Settlement of Outside Liabilities

(1) **If Liability Exists in Balance Sheet of Company [Example: Creditors, Debentures, etc.]**

Cases	Effect	Journal Entry
If Liability is paid	▪ No effect on 'Capital reduction A/c' since there is no gain/loss to company.	Liability A/c Dr. To Bank A/c
If Liability is Forgone	▪ Credit 'Capital reduction A/c' for forgone amount since there is gain to company.	Liability A/c Dr. To Capital Reduction A/c
If Liability is to be Settled in Future	▪ No effect on 'Capital reduction A/c' since there is no gain/loss to company. ▪ Liability will continue in balance sheet.	No journal entry

(2) If Liability Not Exists in Balance Sheet of Company [Example: Arrear of preference share dividend, Other contingent liability, etc.]

Cases	Effect	Journal Entry
If Liability is paid	▪ Dedit 'Capital reduction A/c' for amount paid since there is loss to company.	Capital Reduction A/c Dr. To Bank A/c
If Liability is Forgone	▪ No effect on 'Capital reduction A/c' since there is no gain/loss to company.	No journal entry
If Liability is to be Settled in Future	▪ Dedit 'Capital reduction A/c' for amount of liability since there is loss to company. ▪ Incorporate liability in balance sheet.	Capital Reduction A/c Dr. To Liability A/c

Accounting for Other Adjustments

(1) Increase in Value of Any Asset [Upward Revaluation]

Particulars		Debit	Credit
Asset A/c	Dr.	XX	
To Capital Reduction A/c			XX

(2) Sale of Any Asset

Particulars		Debit	Credit
Bank A/c	Dr.	Sale value	
Capital Reduction A/c [Loss]	Dr.	Balancing figure	
To Asset A/c			Carrying amount
To Capital Reduction A/c [Profit]			Balancing figure

(3) Payment of Expenses during Internal Reconstruction [Example: Reconstruction expense, Penalty payment for cancellation of capital commitments, Underwriting commission, etc.]

Particulars		Debit	Credit
Capital Reduction A/c	Dr.	XX	
To Bank A/c			XX

(4) Fees Refunded by Director of Company

Particulars		Debit	Credit
Bank A/c	Dr.	XX	
To Capital Reduction A/c			XX

Journal Entry to Close Capital Reduction A/c [Big Entry]

- **This Entry is Passed to Write Off**
  - Losses existing in balance sheet [Example: Debit balance of P&L].
  - Fictitious assets existing in balance sheet [Example: Discount on issue of shares/debentures, share issue expense, underwriting commission, preliminary expense, etc.].
  - Goodwill existing in balance sheet.
  - Any other asset existing in balance sheet, only if required by question [including downward revaluation of any asset].
- Remaining credit balance (if any) of 'Capital reduction A/c' account will be transferred to 'Capital reserve A/c'.
- **Journal Entry**

Particulars		Debit	Credit
Capital Reduction A/c	Dr.	XX	
To P&L A/c [Debit balance]			XX
To Fictitious Asset A/c			XX
To Goodwill A/c			XX
To Other Asset [Write off or Downward revaluation, as required]			XX
To Capital Reserve A/c			Balancing figure

Note: If there is shortfall [Debit balance] in 'Capital reduction A/c' after writing off above items, then such shortfall is taken from reserve already given in balance sheet as follows:

Particulars		Debit	Credit
Reserve A/c	Dr.	XX	
To Capital Reduction A/c			XX

ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES

Topics Covered

- **Dependent Branch**
  - Basics
  - Profit/Loss of branch if HO sent goods to branch at cost
  - Profit/Loss of branch if HO sent goods to branch at invoice price
  - Profit/Loss of branch if HO sent goods to branch at wholesale price
- **Independent Branch**
  - Basics
  - Day to day accounting
  - Reconciliation of balance
  - Preparation of final accounts
- **Foreign Branch**
  - Basics
  - Conversion of trial balance

Introduction to Branch Accounting

- Branch accounting means evaluating performance of branches by determining profit/loss of each branch separately and transferring it to Overall P&L A/c in the books of head office [HO].
- **Branches are Classified as Follows:**

Inland Branch
Reporting currency of HO & Branch is same
- Dependent Branch
- Independent Branch

Foreign Branch
Reporting currency of HO & Branch is different

Part I: Dependent Branch

Basics of Dependent Branch

- In this case, books are not maintained by branch but it keeps only record of transactions and those details are sent to HO for accounting purpose. So, profit/loss of branch is calculated by HO.
- **Methods for Calculation of Profit/Loss of Dependent Branch**
  - Stock & Debtors Method
  - Debtors Method
  - Trading and P&L Method

Calculation of Profit/Loss of Branch if HO Sent Goods to Branch at Cost

Method 1: Stock & Debtors Method

HO prepares Branch related Ledger Accounts as follows:

(1) Branch Stock A/c

- It is similar to 'Trading A/c' in which gross profit is calculated as balancing figure.
- Opening stock & transactions reflecting increase in branch stock are disclosed in debit side.
- Closing stock & transactions reflecting decrease in branch stock are disclosed in credit side.

Particulars	Amount	Particulars	Amount
To Balance b/d [Opening stock]	XX	By Branch Cash [Cash sales]	XX
To Goods sent to branch	XX	By Branch Debtors [Credit sales]	XX
To Branch Debtors [Return]	XX	By Goods returned by branch	XX
To Gross profit → T/f to Branch P&L A/c	B/f	By Balance c/d [Closing stock]	XX
	XX		XX

(2) Branch Expenses A/c

It is debited for each branch expense & final balance is transferred to 'Branch P&L A/c'.

Particulars	Amount	Particulars	Amount
To Each expense of branch	XX	By Branch P&L A/c	B/f
	XX		XX

(3) Branch P&L A/c

Particulars	Amount	Particulars	Amount
To Branch Expenses A/c [Carried]	XX	By Gross profit	XX
To Net profit → T/f to Overall P&L A/c	B/f		
	XX		XX

Note: Also prepare 'Branch Debtors A/c, Branch Cash A/c and Branch Fixed Assets A/c' if their information is given in question.

Method 2: Debtors Method

HO prepares Branch A/c as follows:

Particulars	Amount	Particulars	Amount
To balance b/d [Opening assets]		By Balance b/d [Opening liabilities]	
Stock	XX	Creditors	XX
Debtors	XX	Outstanding expenses	XX
PPE	XX	By transactions where branch is giver	
Cash	XX	Cash remitted by branch	XX
To transactions where branch is receiver		Goods returned by branch	XX
Cash remitted by HO	XX	Branch debtor collected by HO	XX
Goods sent to branch	XX	By balance c/d [Closing assets]	
Branch expenses/purchase paid by HO	XX	Stock	XX
To balance c/d [Closing liabilities]		Debtors	XX
Creditors	XX	PPE	XX
Outstanding expenses	XX	Cash	XX
To Net profit → T/f to Overall P&L A/c	B/f		
	XX		XX

Note: Also prepare 'Branch Debtors A/c, Branch Cash A/c and Branch Fixed Assets A/c' if their information is given in question.

Method 3: Trading and P&L Method

HO prepares Branch Trading and P&L A/c as follows:

Particulars	Amount	Particulars	Amount
To Opening stock	XX	By Sales	XX
To Purchases	XX	By Closing stock	XX
To Goods sent to branch [Net of return]	XX		
To Direct expenses	XX		
To Gross profit c/d	XX		
	XX		XX
To Indirect expenses	XX	By Gross profit b/d	XX
To Net profit → T/f to Overall P&L A/c	B/f		
	XX		XX

Note: Also prepare 'Branch Debtors A/c, Branch Cash A/c and Branch Fixed Assets A/c' if their information is given in question.

Calculation of Profit/Loss of Branch if HO Sent Goods to Branch at Invoice Price

Step 1: Prepare Analysis of 4 Items

If HO sent goods to branch at invoice price & branch further sale such goods at same price, then following 4 items are affected:

Items	Cost	Profit	Invoice Price
Opening Stock [Received from HO]	XX	XX (Opening stock reserve)	XX
Closing Stock [Received from HO]	XX	XX (Closing stock reserve)	XX
Goods Sent to Branch	XX	XX (Loading in goods sent to branch)	XX
Goods Returned by Branch	XX	XX (Loading in goods returned by branch)	XX

Step 2: Give Effect of Above 4 Items as per Respective Method of Branch Accounting

Method 1: Stock & Debtors Method

- Prepare 'Branch Stock A/c' using invoice price [Gross profit is not calculated here]

Particulars	Amount	Particulars	Amount
To Balance b/d [Opening stock]	Invoice	By Branch Cash [Cash sales]	XX
To Goods sent to branch	Invoice	By Branch Debtors [Credit sales]	XX
To Branch Debtors [Return]	XX	By Goods returned by branch	Invoice
To Branch Adjustment A/c	B/f	By Balance c/d [Closing stock]	Invoice
[Increase in selling price of goods]		By Branch Adjustment A/c [Reduction in selling price of goods]	B/f
	XX		XX

- Prepare 'Branch Adjustment A/c' to eliminate profit portion of 4 items & calculate gross profit

Particulars	Amount	Particulars	Amount
To Branch Stock A/c [Carried]	XX	By Branch Stock A/c [Carried]	XX
To Closing stock reserve	XX	By Opening stock reserve	XX
To Loading in goods returned by branch	XX	By Loading in goods sent to branch	XX
To Gross profit → T/f to Branch P&L A/c	B/f		
	XX		XX

- Prepare all other ledger A/c normally as already discussed.

Method 2: Debtors Method

Prepare 'Branch A/c' using invoice price & reverse profit portion of 4 items

Particulars	Amount	Particulars	Amount
To balance b/d [Opening assets]		By Balance b/d [Opening liabilities]	
Stock	Invoice	Creditors	XX
Debtors	XX	Outstanding expenses	XX
PPE	XX	By transactions where branch is giver	
Cash	XX	Cash remitted by branch	XX
To transactions where branch is receiver		Goods returned by branch	Invoice
Cash remitted by HO	XX	Branch debtor collected by HO	XX
Goods sent to branch	Invoice	By balance c/d [Closing assets]	
Branch expenses/purchase paid by HO	XX	Stock	Invoice
To balance c/d [Closing liabilities]		Debtors	XX
Creditors	XX	PPE	XX
Outstanding expenses	XX	Cash	XX
To Closing stock reserve	XX	By Opening stock reserve	XX
To Loading in goods returned by branch	XX	By Loading in goods sent to branch	XX
To Net profit → T/f to Overall P&L A/c	B/f		
	XX		XX

Method 3: Trading and P&L Method

Prepare 'Branch Trading and P&L A/c' using cost

Particulars	Amount	Particulars	Amount
To Opening stock	Cost	By Sales	XX
To Purchases	XX	By Closing stock	Cost
To Goods sent to branch [Net of return]	Cost		
To Direct expenses	XX		
To Gross profit c/d	XX		
	XX		XX
To Indirect expenses	XX	By Gross profit b/d	XX
To Net profit → T/f to Overall P&L A/c	B/f		
	XX		XX

Calculation of Profit/Loss of Branch if HO Sent Goods to Branch at Wholesale Price

If HO sent goods to branch at wholesale price & branch further sale such goods at retail price, then

- **Adjustment in 'HO P&L A/c'**

Particulars	Amount	Particulars	Amount
To Closing stock reserve	XX	By Opening stock reserve	XX

- **Adjustment in 'Overall Balance Sheet'**

Liabilities	Amount	Assets		Amount
		Stock	XX	
		(-) Closing stock reserve	(XX)	XX

- **Branch Accounting**

Same as Discussed in Topic [Calculation of Profit/Loss of Branch if HO Sent Goods to Branch at Cost] Except Disclosure of Following 4 Items	
Items	**Amount**
Opening Stock [Received from HO]	Disclosed at wholesale price in all 3 methods [i.e., Invoice price of HO & Cost of Branch]
Closing Stock [Received from HO]	
Goods Sent to Branch	
Goods Returned by Branch	

Part II: Independent Branch

Basics of Independent Branch

- In this case, separate set of books are maintained by branch itself.
- **Process of Accounting of Independent Branch**
  - Day to day accounting of independent branch
  - Reconciliation of 'HO A/c' balance in branch books and 'Branch A/c' balance in HO books
  - Preparation of final accounts of independent branch

Day to Day Accounting of Independent Branch [Journal Entries]

(1) Transactions of Branch

Recorded in Branch Books in Normal Manner				
	Particulars		**Debit**	**Credit**
(i)	**Sales by Branch**			
	Cash/Debtors A/c	Dr.	XX	
	To Sales A/c			XX
(ii)	**Expense Incurred by Branch**			
	Expense A/c	Dr.	XX	
	To Cash A/c			XX

(2) Transactions of HO

Recorded in HO Books in Normal Manner				
	Particulars		**Debit**	**Credit**
(i)	**Sales by HO**			
	Cash/Debtors A/c	Dr.	XX	
	To Sales A/c			XX
(ii)	**Expense Incurred by HO**			
	Expense A/c	Dr.	XX	
	To Cash A/c			XX

(3) Mutual Transactions Between HO & Branch

Recorded in Both HO & Branch Books in Normal Manner		
	HO Books	**Branch Books**
(i)	**Cash Remitted by HO to Branch**	
	Branch A/c Dr. To Cash A/c	Cash A/c Dr. To HO A/c
(ii)	**Cash Remitted by Branch to HO**	
	Cash A/c Dr. To Branch A/c	HO A/c Dr. To Cash A/c
(iii)	**Goods Sent by HO to Branch**	
	Branch A/c Dr. To Goods Sent to Branch A/c	Goods Received from HO A/c Dr. To HO A/c
(iv)	**Goods Returned by Branch to HO**	
	Goods Sent to Branch A/c Dr. To Branch A/c	HO A/c Dr. To Goods Received from HO A/c
(v)	**Branch Expense/Purchase/Creditor Paid by HO**	
	Branch A/c Dr. To Cash A/c	Expense/Purchase/Creditor A/c Dr. To HO A/c
(vi)	**Branch Income/Debtor Collected by HO**	
	Cash A/c Dr. To Branch A/c	HO A/c Dr. To Debtor/Income A/c
(vii)	**HO Expense Paid by Branch**	
	Expense A/c Dr. To Branch A/c	HO A/c Dr. To Cash A/c
(viii)	**Purchase of Asset by Branch but Record Kept by HO**	
	Branch Asset A/c Dr. To Branch A/c	HO A/c Dr. To Cash A/c
(ix)	**Depreciation on Above Asset**	
	Branch A/c Dr. To Branch Asset A/c	Depreciation A/c Dr. To HO A/c

(4) Inter Branch Transactions [Transaction Between Two Branches]

Recorded by Intermediation of HO (Debit Receiver Branch & Credit Giver Branch) [One branch will not open account of another branch in its books]			
	HO Books	Branch 1 Books	Branch 2 Books
(i)	Cash Remitted by Branch 1 to Branch 2		
	Branch 2 A/c Dr. To Branch 1 A/c	HO A/c Dr. To Cash A/c	Cash A/c Dr. To HO A/c
(ii)	Branch 1 Incurred Expense on Behalf of Branch 2		
	Branch 2 A/c Dr. To Branch 1 A/c	HO A/c Dr. To Cash A/c	Expense A/c Dr. To HO A/c

Reconciliation of HO A/c Balance in Branch Books and Branch A/c Balance in HO Books

(1) Difference in Balance Due to Transit Items

Reconciled by Adjustment Entry in Receiver Books			
	Particulars	Debit	Credit
(i)	Cash/Goods Sent by HO not Received by Branch [Branch Books]		
	Cash in Transit/Goods in Transit A/c Dr.	XX	
	To HO A/c		XX
(ii)	Cash/Goods Sent by Branch not Received by HO [HO Books]		
	Cash in Transit/Goods in Transit A/c Dr.	XX	
	To Branch A/c		XX

Note: In balance sheet, 'Cash in transit' is considered as part of 'Cash & cash equivalents' and 'Goods in transit' is considered as part of 'Closing stock'.

(2) Difference in Balance Due to Error in Accounting

Reconciled by rectification entry in the books in which error has been incurred.

Preparation of Final Accounts of Independent Branch

(1) Trading and P&L A/c

Method 1: If Branch Prepares its Trading and P&L A/c

Transfer Final Net Profit/Loss to HO		
	Branch Books	HO Books
(i)	Transfer of Net Profit	

	P&L A/c Dr. To HO A/c	Branch A/c Dr. To P&L A/c
(ii)	**Transfer of Net Loss**	
	HO A/c Dr. To P&L A/c	P&L A/c Dr. To Branch A/c

Method 2: If Branch does not Prepares its Trading and P&L A/c

Transfer All Revenue & Expenses to HO → HO will prepare Trading and P&L of Branch		
	Branch Books	**HO Books**
(i)	**Transfer of Revenue Accounts**	
	Revenue A/c Dr. To HO A/c	Branch A/c Dr. To Branch Revenue A/c
(ii)	**Transfer of Expense Accounts**	
	HO A/c Dr. To Expense A/c	Branch Expense A/c Dr. To Branch A/c

(2) **Balance Sheet**

Transfer All Assets & Liabilities to HO → HO will prepare Overall Balance Sheet		
	Branch Books	**HO Books**
(i)	**Transfer of Asset Accounts**	
	HO A/c Dr. To Asset A/c	Branch Asset A/c Dr. To Branch A/c
(ii)	**Transfer of Liability Accounts**	
	Liability A/c Dr. To HO A/c	Branch A/c Dr. To Branch Liability A/c

Note:

(i) In overall balance sheet, HO A/c balance in branch books and Branch A/c balance in HO books is not disclosed since these gets automatically closed after transfer of entire trail balance of branch.

(ii) In separate balance sheet of branch, HO A/c balance is disclosed in liability side.

(iii) In separate balance sheet of HO, Branch A/c balance is disclosed in asset side.

Part III: Foreign Branch

Basics of Foreign Branch

- In this case, reporting currency of branch books is different from reporting currency of HO books.
- **Foreign Branch is Further Classified as Follows:**

Integral Foreign Operation [IFO]	Non Integral Foreign Operation [NIFO]
▪ Activities of foreign branch are integral part of HO. ▪ Business of branch is not carried independently.	▪ Activities of foreign branch are not integral part of HO. ▪ Business of branch is carried independently [i.e., Branch accumulates cash, incur expenses, arrange borrowings, etc.]

Note: In silent situation, assume foreign branch as IFO.

Conversion of Trail Balance of Foreign Branch

(1) Exchange Rate for Conversion of Trial Balance

Items	Exchange Rate
Opening Stock	Opening rate
Closing Stock	Closing rate
Income and Expense	Average rate
Monetary Items	Closing rate
Goods Received from HO	Goods sent to branch amount in HO books
HO A/c Balance	Branch A/c balance amount in HO books
PPE and Deprecation on PPE	IFO → Rate on purchase of such PPE NIFO → Closing rate

(2) Treatment of Exchange Difference Arising on Conversion of Trial Balance

- IFO → Treated as 'Gain/loss' which is transferred to P&L A/c
- NIFO → Treated as 'Reserve' which is disclosed in balance sheet

Note:

(i) Monetary item means money held and other assets & liabilities to be received or paid in fixed amount of money [Example: Cash & Bank balance, Trade receivables, Trade payables, Outstanding expenses, Unearned income, Borrowings, etc.].

(ii) Non monetary item means assets & liabilities other than monetary items [Example: PPE, Intangible assets, Inventory, Investment in equity shares, Share capital, etc.].