Skillshort

Self-Study Preparation Pack

CA INTERMEDIATE

Paper 1: Advanced Accounting

Chapter-wise Detailed Notes

For January 2027 attempt (useful for May 2027) · ICAI BoS study material (new scheme) + RTP January 2027

100 marks · 3 hours | 30 MCQ + 70 descriptive | Q1 compulsory + any 4 of 5 | Pass: 40% paper, 50% group

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This subject pack has 6 parts

1 Chapter-wise notes | 2 Important topics & weightage | 3 Past papers: trends & links

4 Mock tests + solutions | 5 Chapter practice questions | 6 Last-week plan & strategy

Prepared by Skillshort for self-study. Original explanations and questions; not an official ICAI/ICMAI/ICSI publication. Items marked VERIFY should be checked against the latest official material.

How to use these notes

These notes follow the **ICAI new-scheme syllabus order** (15 chapters in 3 modules). For every Accounting Standard (AS) you get: scope → key definitions → recognition and measurement rules → a worked example → exam traps. Company-accounts chapters give formats, entries and fully worked illustrations.

File	Use it for
01 Chapter Notes (this file)	Concept building and first revision
02 Important Topics & Weightage	What to study first; frequency across 4 recent attempts
03 Past Papers – Trend Analysis & Links	How ICAI asks; official download links
04 Mock Tests 1–2 with Solutions	Full 3-hour practice in the exam pattern
05 Chapter-wise Practice Questions	MCQs + descriptive practice after each chapter
06 Last-Week Plan & Exam Strategy	Final revision and exam-day plan

Paper at a glance

Item	Detail
Marks / time	100 marks, 3 hours (+15 minutes advance reading 1:45–2:00 pm)
Part I – MCQs (30 marks)	15 MCQs × 2 marks, mostly **case-scenario based** (3 cases of 4–5 MCQs + a few independent MCQs). No negative marking
Part II – Descriptive (70 marks)	Q1 compulsory (14 marks = 5 + 5 + 4) + **any 4 of Q2–Q6** (14 marks each). Q6 usually has an EITHER/OR theory part
ICAI section-wise weightage (issued 26-10-2023; ±5% deviation allowed)	I Accounting Standards (Ch 1–10) **55%–65%** · II Company accounts – Schedule III, cash flow, buy-back, reconstruction (Ch 11–14) **30%–35%** · III Branches including foreign branches (Ch 15) **5%–10%**
Pass rule	40% in each paper and 50% aggregate in the group (Group I = P1 + P2 + P3)
Applicable for January 2027	Study material (new scheme) + RTP for January 2027 (which carries ICAI's announcement on revised criteria for non-company entities, applicable from 1 April 2024)

NOTE **AS 14 vs Chapter 13**

AS 14 (theory, types, methods, MCQs) sits in Chapter 9; the full **amalgamation problem** (purchase consideration, journal entries, balance sheet) is Chapter 13. ICAI asks a 14-mark amalgamation question in almost every attempt.

Chapter 1: Introduction to Accounting Standards

1.1 Meaning and objectives

Accounting Standards (AS) are written policy documents issued by an expert accounting body (ICAI's Accounting Standards Board) or by Government, covering the **recognition, measurement, presentation and disclosure** of accounting transactions and events in financial statements.

Objectives: to harmonise diverse accounting policies, to reduce alternatives, to improve comparability, reliability and transparency of financial statements, and to reduce the scope for "creative accounting".

Benefits	Limitations
Uniformity and comparability across entities	Difficulty in choosing between alternatives – standards may be rigid
Reduce scope for manipulation	Cannot override the statute (law prevails over AS)
Better disclosure beyond legal requirement	Limited to material items; cannot cover every situation
Credibility with investors, lenders, regulators	Frequent changes increase compliance cost

1.2 Process of formulation of AS (ICAI)

1. The **Accounting Standards Board (ASB)** identifies the area and forms a **study group**.
2. The study group prepares a **preliminary draft**, considering IFRS/IAS, Indian laws and practices.
3. The draft is circulated to Council members, and to specified bodies (MCA, RBI, SEBI, CBDT, C&AG, IRDAI, industry bodies etc.) for comments.
4. The ASB finalises an **Exposure Draft (ED)** and issues it for **public comments**.
5. Comments are considered; the ASB finalises the draft and submits it to the **ICAI Council**.
6. The Council approves (or modifies) and the AS is **issued**. For companies, the Central Government notifies standards under **section 133** of the Companies Act, 2013 after consulting the **National Financial Reporting Authority (NFRA)**.

> **REMEMBER** **For companies, AS are notified by the Central Government**
>
> The Companies (Accounting Standards) Rules, **2021** (notified 23 June 2021) contain AS 1 to AS 29 (excluding withdrawn AS 6 and AS 8) for companies that do not follow Ind AS. For non-company entities, AS issued by ICAI apply.

1.3 Ind AS, IFRS – convergence vs adoption, carve-outs

IFRS are issued by the **International Accounting Standards Board (IASB)** of the IFRS Foundation. India chose to **converge** (not adopt) with IFRS and issued **Indian Accounting Standards (Ind AS)**, notified by MCA through the Companies (Ind AS) Rules, 2015.

Convergence	Adoption
Standards are drafted in line with IFRS but modified to suit local laws and conditions	IFRS are taken as issued by IASB, without changes
Departures (carve-outs/carve-ins) allowed	No departures
India's approach (Ind AS)	e.g., EU listed companies, Australia

Carve-outs are departures from IFRS in Ind AS that remove or modify an IFRS requirement; **carve-ins** add options not in IFRS. **Objectives of carve-outs:** to suit the Indian legal and economic environment, to avoid conflict with laws (e.g., Companies Act), and to address the preparedness of Indian industry.

WORKED EXAMPLE **Typical carve-outs (for theory answers)**

- Ind AS 103: bargain purchase gain recognised in **capital reserve** (IFRS 3: in profit or loss).
- Ind AS 1: breach of a loan covenant – loan need not be classified as current if the lender agrees, before approval of statements, not to demand payment (IFRS: agreement must be before the reporting date).
- Ind AS 28: uniform accounting policies "unless impracticable".

Need for convergence with global standards: globalisation of business, cross-border capital raising, one set of high-quality standards reduces cost of capital, comparability for foreign investors, reduced cost of preparing multiple sets of statements, better quality of financial reporting.

Chapter 2: Framework for Preparation and Presentation of Financial Statements

2.1 Purpose and status

The **Framework** sets out the concepts that underlie the preparation and presentation of financial statements for external users. It is **not an AS** and does not override any AS; where there is a conflict, the AS prevails. It helps the ASB develop standards and helps preparers deal with topics not covered by any AS.

Users and their information needs: investors (risk and return), employees (stability), lenders (repayment ability), suppliers and creditors, customers (continuance), Government and agencies (allocation of resources, taxation, national income), public.

2.2 Underlying assumptions and qualitative characteristics

Fundamental accounting assumptions: going concern, accrual and consistency (AS 1). The Framework names **going concern** and **accrual** as the underlying assumptions.

Qualitative characteristic	Meaning
Understandability	Readily understood by users with reasonable knowledge
Relevance (+ materiality)	Influences economic decisions; materiality is the threshold
Reliability	Faithful representation, substance over form, neutrality, prudence, completeness
Comparability	Over time and across entities; disclosure of policies and changes

Constraints: timeliness, balance between benefit and cost, balance between qualitative characteristics. The overall result is a **true and fair view**.

2.3 Elements of financial statements

Element	Definition (Framework)
Asset	A resource **controlled** by the enterprise as a result of **past events** from which **future economic benefits** are expected to flow
Liability	A **present obligation** arising from past events, settlement of which is expected to result in an **outflow** of resources embodying economic benefits
Equity	Residual interest in assets after deducting all liabilities
Income	Increase in economic benefits during the period (inflows / enhancement of assets or decrease of liabilities) that results in an increase in equity, other than contributions from owners
Expenses	Decrease in economic benefits during the period that results in a decrease in equity, other than distributions to owners

Recognition criteria: (a) it is **probable** that future economic benefit will flow to/from the enterprise, and (b) the item has a cost or value that can be **measured reliably**.

2.4 Measurement bases and capital maintenance

Measurement bases: **historical cost, current cost, realisable (settlement) value, present value**.

Capital maintenance: profit is earned only if closing capital exceeds opening capital after excluding owners' contributions/distributions.

- **Financial capital maintenance (money terms):** profit = closing equity − opening equity.
- **Financial capital maintenance (constant purchasing power):** opening capital is restated by the general price index.
- **Physical capital maintenance:** profit only after maintaining the productive (operating) capacity – opening capital restated at current cost of the same assets.

WORKED EXAMPLE **Capital maintenance**

A trader starts with ₹1,00,000 cash, buys 100 units at ₹1,000 and sells them all for ₹1,40,000. General price index rises 10%; replacement cost per unit rises to ₹1,250.

Money capital: profit = 1,40,000 − 1,00,000 = **₹40,000**.

Constant purchasing power: capital to maintain = 1,10,000 → profit **₹30,000**.

Physical capital: capital to maintain = 100 × 1,250 = 1,25,000 → profit **₹15,000**.

Chapter 3: Applicability of Accounting Standards

3.1 Companies – Companies (AS) Rules, 2021

Companies not following Ind AS are classified as **Small and Medium-sized Companies (SMC)** and **non-SMCs**.

LEGAL PROVISION **SMC means a company that, at the end of the relevant period, satisfies all of the following**

1. Its equity or debt securities are **not listed** or in the process of listing (in India or abroad).
2. It is **not a bank, financial institution or insurance company**.
3. Its **turnover** (excluding other income) does not exceed **₹250 crore** in the immediately preceding accounting year.
4. It does not have **borrowings** (including public deposits) exceeding **₹50 crore** at any time during the immediately preceding accounting year.
5. It is **not a holding or subsidiary** of a company that is not an SMC.

AS / relaxation	Position for SMCs (summary)
AS 3 Cash Flow Statements	Not mandatory for SMCs (also exempt for one-person/small companies under section 2(40))
AS 17 Segment Reporting	Not applicable
AS 15 Employee Benefits	Relaxations – may use simpler measurement (no discounting for certain items, actuarial valuation not compulsory below thresholds) VERIFY
AS 19 Leases, AS 20 EPS	Certain disclosures exempt (diluted EPS not required for SMCs)
AS 28 Impairment	May use reasonable estimate of value in use instead of full discounting
AS 29 Provisions	Not required to disclose certain information (e.g., movement in provisions)

3.2 Non-company entities – revised criteria (applicable from 1 April 2024)

ICAI's Council (433rd meeting, August 2024) revised the scheme; non-company entities are now of only two types: **MSMEs** and **Large entities** (earlier: Level I–IV). The RTP for January 2027 announces it as applicable.

LEGAL PROVISION **Micro, Small and Medium-sized Entity (MSME) – non-company entity that satisfies all**

- securities not listed / not in the process of listing (India or outside);
- not a bank, financial institution or insurance company;
- turnover (excluding other income) **≤ ₹250 crore** in the immediately preceding accounting year;
- borrowings **≤ ₹50 crore** at any time during the immediately preceding accounting year;
- not a holding or subsidiary of an entity that is not an MSME.

Conditions are tested **as at the end of the relevant accounting period**. **Large entity** = any non-company entity that is not an MSME – must comply in full with all AS. "SME"/"Level II, III, IV" in AS are now read as "MSME", and "Level I" as "Large".

EXAM TIP **How ICAI tests applicability**

Short MCQs: "A partnership firm with turnover ₹240 crore and borrowings ₹60 crore last year – is AS 17 applicable?" → borrowings exceed ₹50 crore, so it is a **Large entity**; all AS apply including AS 17.

Chapter 4: Presentation and Disclosure Based Accounting Standards

4.1 AS 1 – Disclosure of Accounting Policies

Accounting policies are the specific accounting principles and methods of applying them adopted in preparing financial statements (e.g., inventory valuation method, depreciation method, revenue recognition).

- **Fundamental accounting assumptions:** going concern, consistency, accrual. If followed, no disclosure is needed; **if not followed, the fact must be disclosed**.
- **Considerations in selecting policies: prudence, substance over form, materiality**.
- All **significant** accounting policies must be disclosed **at one place** as part of the financial statements.
- Disclosure of a wrong or inappropriate treatment **does not cure it**.
- A **change** in policy with material effect must be disclosed with the amount of the effect, where ascertainable; if not ascertainable, that fact.

4.2 AS 3 – Cash Flow Statements

Cash = cash on hand + demand deposits with banks. **Cash equivalents** = short-term (generally **original maturity ≤ 3 months**), highly liquid investments readily convertible into known amounts of cash with insignificant risk of change in value. Bank overdraft repayable on demand may be part of cash and cash equivalents where it is an integral part of cash management VERIFY.

Activity	Examples
Operating (principal revenue-producing)	Receipts from customers, payments to suppliers and employees, income-tax paid (unless identified with investing/financing)
Investing (acquisition/disposal of long-term assets and investments)	Purchase/sale of PPE, investments; loans given; **interest and dividend received** (non-financial enterprise)
Financing (changes in size and composition of owners' capital and borrowings)	Issue of shares/debentures, buy-back, redemption, borrowings and repayment; **interest and dividend paid** (non-financial enterprise)

- **Operating activities** may be reported by the **direct method** (gross receipts and payments) or **indirect method** (net profit adjusted for non-cash items, non-operating items and working-capital changes).
- **Non-cash transactions** (e.g., asset acquired by issue of shares, conversion of debt into equity, bonus issue) are **excluded** and disclosed separately.
- Extraordinary items are shown separately; foreign currency cash flows at the rate on the date of cash flow.

WORKED EXAMPLE Cash from operating activities (indirect method)

Net profit before tax ₹8,40,000 includes: depreciation ₹1,20,000, loss on sale of machine ₹15,000, profit on sale of investment ₹25,000, interest on debentures ₹60,000, dividend received ₹10,000. Working capital: trade receivables up ₹50,000; inventory down ₹30,000; trade payables up ₹20,000; outstanding expenses down ₹5,000. Tax paid ₹2,00,000.

Operating profit before WC changes = 8,40,000 + 1,20,000 + 15,000 − 25,000 + 60,000 − 10,000 = **₹10,00,000**.

Cash generated = 10,00,000 − 50,000 + 30,000 + 20,000 − 5,000 = ₹9,95,000. **Net cash from operating activities = 9,95,000 − 2,00,000 = ₹7,95,000.**

Interest paid ₹60,000 → financing; dividend received ₹10,000 and sale proceeds of investment → investing.

4.3 AS 17 – Segment Reporting

Applies to enterprises whose securities are listed / in the process of listing, and to other **Large** enterprises; **not applicable to SMCs/MSMEs**. If a single report contains both consolidated and separate statements, segment information is needed **only in the consolidated** statements.

- **Business segment** (products/services) and **geographical segment** (economic environment). The dominant source of risks and returns decides the **primary** format; the other is secondary.
- **Reportable segment:** a segment whose **revenue from external sales and inter-segment transfers** is the majority of its revenue **and** which meets **any one** of the **10% tests**:

Revenue test = segment revenue (external + inter-segment) ≥ 10% of total revenue of all segments

Result test = |segment result| ≥ 10% of the greater of (combined profit of profit-making segments, combined loss of loss-making segments)

Assets test = segment assets ≥ 10% of total assets of all segments

- **75% rule:** if total **external** revenue of reportable segments < 75% of the enterprise's total revenue, identify additional segments as reportable (even if below 10%) until 75% is reached.
- A segment reportable last year continues to be reported this year if management judges it of continuing significance.

WORKED EXAMPLE Result test

Segment results (₹ lakh): A 300, B (−90), C 40, D (−20), E 160. Profits total 500; losses total 110 → greater is 500; 10% = 50. Reportable on result test: **A, B and E** (|B| = 90 ≥ 50). C (40) and D (20) fail this test, but may pass the revenue or assets test.

4.4 AS 18 – Related Party Disclosures

Related parties: parties are related if at any time during the period one party has the ability to **control** the other or exercise **significant influence** over it in making financial/operating decisions.

- Covered: holding, subsidiaries, fellow subsidiaries; associates and joint ventures (and the investing party); individuals owning voting power giving control/significant influence and their **relatives**; **key management personnel (KMP)** and their relatives; enterprises over which any of these persons exercises significant influence.
- **Control** = ownership of > 50% voting power, or control of composition of the board, or substantial interest in votes and power to direct policies. **Significant influence** = participation in decisions but not control; presumed at ≥ 20% voting power.
- **Relative:** spouse, son, daughter, brother, sister, father and mother who may be expected to influence or be influenced.
- **Not related parties (by themselves):** two companies merely having a common director; providers of finance, trade unions, utilities, Government departments in the course of normal dealings; a single customer/supplier/agent with whom significant volume is transacted.
- **Disclosures:** name and nature of relationship where **control** exists (even if no transactions); for transactions – name, nature of relationship, description and **volume** of transactions, outstanding amounts, provisions for doubtful debts, write-offs. Items of similar nature may be aggregated by type of related party.
- Exemption: no disclosure where it would conflict with a duty of confidentiality required by statute/regulator; intra-group transactions eliminated in consolidated statements; state-controlled enterprises regarding transactions with other state-controlled enterprises.

4.5 AS 20 – Earnings Per Share

Applies to enterprises whose equity shares/potential equity shares are listed and to all other enterprises that disclose EPS (diluted EPS and certain disclosures relaxed for SMCs/MSMEs).

Basic EPS = (Net profit after tax − preference dividend for the period and tax on it) ÷ weighted average number of equity shares outstanding

- **Preference dividend:** deduct dividend on **non-cumulative** shares only if **provided/declared**; on **cumulative** shares deduct for the **current period whether or not provided** (arrears of earlier years are not deducted again).
- **Weighted shares:** time-weight new issues from the date consideration is receivable. **Partly paid shares** count as a fraction to the extent they are entitled to participate in dividend relative to a fully paid share.

- **Bonus issue, share split, consolidation:** adjust for the event **as if it occurred at the beginning of the earliest period presented** (no fresh resources); restate prior-period EPS.
- **Rights issue (bonus element):** multiply shares before the issue by the adjustment factor.

Theoretical ex-rights fair value (TERP) = (FV of all outstanding shares before exercise + amount received from rights) ÷ shares outstanding after exercise

Rights adjustment factor = fair value per share just before rights (cum-right) ÷ TERP

Diluted EPS = (Earnings for basic EPS + after-tax interest/dividend on dilutive potential shares) ÷ (weighted shares for basic EPS + weighted dilutive potential shares)

- Potential shares are **dilutive** only if their conversion **decreases EPS (or increases loss per share) from continuing ordinary operations**. Rank them from most to least dilutive (incremental EPS) and include one by one.
- **Options/warrants:** only the "free" shares count = shares under option − (shares under option × exercise price ÷ average market price).

WORKED EXAMPLE Basic EPS with a rights issue

Profit after tax 2025-26 ₹30,00,000; 8% cumulative preference capital ₹50,00,000 (dividend ₹4,00,000 not yet declared). Equity shares on 1 April 2025: 8,00,000. On 1 July 2025 a rights issue of 1 for 4 at ₹20 per share; fair value just before the rights issue ₹30.

Earnings = 30,00,000 − 4,00,000 = ₹26,00,000 (cumulative dividend deducted though not declared).

TERP = (8,00,000 × 30 + 2,00,000 × 20) ÷ 10,00,000 = ₹28; factor = 30 ÷ 28 = 1.0714.

Weighted shares = 8,00,000 × 1.0714 × 3/12 + 10,00,000 × 9/12 = 2,14,286 + 7,50,000 = 9,64,286.

Basic EPS = 26,00,000 ÷ 9,64,286 = ₹2.70.

If the company also has ₹10,00,000 of 10% debentures convertible into 1,00,000 shares (outstanding all year; tax 25%): add back 1,00,000 × 75% = ₹75,000. Diluted EPS = 26,75,000 ÷ 10,64,286 = **₹2.51** (dilutive, as 2.51 < 2.70).

4.6 AS 24 – Discontinuing Operations

A **discontinuing operation** is a component of an enterprise that (a) the enterprise, under a single plan, is disposing of substantially in its entirety (demerger, sale) or piecemeal, or terminating through abandonment; (b) represents a **separate major line of business or geographical area of operations**; and (c) can be **distinguished operationally and for financial reporting**.

- **Initial disclosure event:** the earlier of (i) entering into a **binding sale agreement** for substantially all the assets, or (ii) the board approving a **detailed formal plan** and **announcing** it.
- **Initial disclosures** (in the statements of the period of the initial disclosure event): description of the discontinuing operation; business/geographical segment(s); date and nature of the initial disclosure event; expected date or period of completion; carrying amounts of total assets and liabilities to be disposed of; amounts of revenue, expenses, pre-tax profit/loss and related income tax; net cash flows attributable to operating, investing and financing activities.
- Later periods: update disclosures; disclose gain/loss on disposal of assets and settlement of liabilities, net selling price. Disclosures continue up to completion. Disclosures are presented separately for each discontinuing operation; comparatives are restated.
- **Not** a discontinuing operation: gradual phasing out of a product line, shifting production location, closing a facility for cost cutting, changing scope of operations without a separate major line.

4.7 AS 25 – Interim Financial Reporting

Interim period = a financial reporting period shorter than a full year (e.g., a quarter). AS 25 does not mandate interim reports; it prescribes their minimum content and principles when prepared (e.g., by SEBI listing rules).

- **Minimum components:** condensed balance sheet, condensed statement of P&L, condensed cash flow statement and selected explanatory notes.
- **Same accounting policies** as annual statements. Measurement on a **year-to-date basis** (the frequency of reporting should not affect annual results).
- **Seasonal/cyclical revenues and costs** incurred unevenly are **not anticipated or deferred** at interim dates unless that would be appropriate at year-end.
- **Income-tax expense:** apply the **estimated weighted average annual effective tax rate** to the interim period's pre-tax income. Capital gains taxed at a different rate are dealt with separately.

WORKED EXAMPLE **Interim tax with a slab structure**

Expected annual income ₹40 lakh, evenly earned (₹10 lakh per quarter). Tax: 20% on first ₹20 lakh, 30% on the balance. Annual tax = 4 + 6 = ₹10 lakh → average effective rate **25%**. Tax expense each quarter = 10 × 25% = **₹2.5 lakh** (not 20% in Q1–Q2 and 30% in Q3–Q4).

Chapter 5: Assets Based Accounting Standards

5.1 AS 2 – Valuation of Inventories

Inventories are measured at the **lower of cost and net realisable value (NRV)**. Not covered: WIP under construction contracts (AS 7), financial instruments, livestock/agricultural/forest produce and mineral oils measured at NRV per trade practice, and **spare parts/servicing equipment** that qualify as PPE (AS 10).

- **Cost** = cost of purchase (price + duties and non-refundable taxes + freight – trade discounts, rebates, **input credits availed**) + cost of conversion + other costs to bring inventory to present location and condition.
- **Fixed production overheads** are allocated on **normal capacity**; unallocated overheads (low production/idle plant) are expensed. At abnormally high production, the fixed overhead per unit is reduced so that inventory is not above cost.
- **Excluded from cost:** abnormal wastage, storage costs (unless necessary in the production process), administrative overheads not related to production, **selling costs**, **interest** (normally), foreign exchange differences.
- **Cost formulas:** specific identification for items not ordinarily interchangeable; otherwise **FIFO or weighted average**. LIFO not permitted. Standard cost / retail method allowed if results approximate cost.
- **NRV** = estimated selling price in the ordinary course – estimated costs of completion – estimated costs necessary to make the sale. Write-downs usually item by item.
- **Raw materials** held for production are **not written down below cost** if the finished products in which they will be used are expected to be sold **at or above cost**. If finished goods' cost exceeds NRV, raw materials are written down, and **replacement cost** may be the best measure of their NRV.

WORKED EXAMPLE **Raw material and finished goods valuation**

Purchased 40,000 units of raw material at ₹125. 2 units of material make 1 finished unit. 10,000 FG produced (20,000 RM used); conversion cost ₹10,00,000 (₹100 per FG unit). Closing RM 20,000 units (assume none used elsewhere). NRV of FG ₹300; replacement cost of RM ₹100.

Cost of FG = 2 × 125 + 100 = ₹350 > NRV ₹300 → FG at **₹300 × 10,000 = ₹30,00,000**. As FG are sold below cost, RM is written down to replacement cost: **20,000 × ₹100 = ₹20,00,000**.

If the FG NRV had been ₹400 (≥ cost), RM would stay at cost ₹125 even though replacement cost fell to ₹100.

5.2 AS 10 – Property, Plant and Equipment

PPE are tangible items held for use in production/supply of goods or services, rental or administrative purposes, and expected to be used for **more than one period**. Recognised when future benefits are probable and cost is reliably measurable. Spare parts, stand-by and servicing equipment are PPE when they meet the definition; otherwise inventory.

Elements of cost: purchase price (incl. import duties and non-refundable taxes, after trade discounts and rebates; **GST input credit availed is excluded**), directly attributable costs (site preparation, delivery, installation, professional fees, employee benefits of construction, **testing costs net of proceeds from items produced during testing**), and the **initial estimate of dismantling and site restoration** (decommissioning) cost.

- **Not part of cost:** opening a new facility, introducing a new product (advertising), conducting business in a new location or with a new class of customer (training), administration and general overheads, costs after the asset is capable of operating as intended (initial operating losses), relocation costs, **income/expenses of incidental operations** (e.g., using a site as a car park before construction – to P&L).
- **Self-constructed asset:** same principles; abnormal waste and internal profits excluded.
- **Exchange of assets:** cost = fair value of asset given up (unless the exchange lacks commercial substance or fair values are not reliable → carrying amount of asset given up).
- **Subsequent costs:** day-to-day servicing → P&L; replacement of parts and **major inspections** → capitalised if criteria met, with derecognition of the carrying amount of the replaced part/previous inspection.
- **Component approach:** each part with a cost significant to the total is **depreciated separately**.

- **Measurement after recognition: cost model** or **revaluation model** for an entire class. Revaluation increase → credited to **revaluation surplus** (unless reversing a previous decrease charged to P&L); decrease → P&L (unless reversing a previous surplus). Surplus may be transferred directly to retained earnings when realised (or yearly, the difference between depreciation on revalued and original cost).
- **Depreciation:** systematic allocation of depreciable amount (cost – residual value) over useful life; begins when the asset is **available for use**; does not stop when the asset is idle. Residual value, useful life and method are **reviewed at least at each financial year-end**; changes are **changes in estimates** (AS 5) applied prospectively. **Land** is generally not depreciated (except quarries, landfill).
- **Derecognition:** gain/loss = net disposal proceeds – carrying amount, to P&L (gains are not revenue). Assets retired from active use and held for disposal are carried at lower of carrying amount and NRV.

WORKED EXAMPLE **Machine with government grant and GST**

Machine invoice ₹7,35,000 including GST 5% (₹35,000, full ITC available); freight ₹15,000; installation ₹25,000; trial-run materials ₹10,000 with net sale of trial output ₹4,000. Cost = 7,00,000 + 15,000 + 25,000 + 10,000 – 4,000 = **₹7,46,000**. GST ₹35,000 is excluded as ITC is availed.

5.3 AS 13 – Accounting for Investments

Current investment: readily realisable and intended to be held for **not more than one year** from the date of acquisition. **Long-term investment:** any other.

- **Cost** includes brokerage, fees and duties. Investments acquired by **issue of shares/securities** at fair value of securities issued; in exchange for another asset at fair value of the asset given up or of the investment, whichever is more clearly evident.
- **Pre-acquisition interest/dividend:** interest accrued up to the date of purchase (cum-interest purchase) and dividends **out of pre-acquisition profits** reduce the cost; they are not income.
- **Rights:** if subscribed, cost of rights shares added; if **sold** (renounced), the sale proceeds are credited to P&L (for current investments, proceeds may be applied to reduce cost if the investment is ex-rights and the fair value falls VERIFY). **Bonus shares:** no cost; increase the number and reduce the average cost per share.
- **Carrying amount: current** investments at **lower of cost and fair value** – determined **category-wise** (e.g., equity shares, debentures) or individually, but **not on a global (overall) basis**; **long-term** investments at **cost**, less provision for a decline **other than temporary**.
- **Reclassification:** long-term → current: at lower of cost and carrying amount; current → long-term: at lower of cost and fair value on the date of transfer.
- **Disposal:** difference between carrying amount and net proceeds to P&L; when part of a holding is sold, carrying amount allocated on **average carrying amount** of the total holding.
- **Investment property** (land/building not intended for occupation substantially for use by or in operations of the investing enterprise) is accounted for as a **long-term investment** (cost model).

WORKED EXAMPLE **Investment account with pre-acquisition dividend and bonus**

1 June 2025: bought 10,000 shares (FV ₹10) for ₹1,20,000 including brokerage. 1 Aug 2025: received dividend @ 10% for 2024-25 = ₹10,000 (pre-acquisition) → cost = ₹1,10,000. 1 Sept 2025: bonus 1 for 5 → 12,000 shares, cost unchanged ₹1,10,000. 1 Dec 2025: sold 6,000 shares @ ₹15 = ₹90,000. Cost of shares sold = 1,10,000 × 6,000/12,000 = ₹55,000 → **profit ₹35,000**. Closing 6,000 shares at cost ₹55,000; if a **current** investment with fair value ₹8 per share at 31 March 2026, carry at **₹48,000** (write-down ₹7,000 to P&L).

5.4 AS 16 – Borrowing Costs

Borrowing costs = interest and other costs incurred in connection with borrowing: interest on loans and overdrafts, amortisation of discounts/premiums and ancillary costs, finance charges on finance leases, and **exchange differences on foreign currency borrowings to the extent they are regarded as an adjustment to interest cost**.

Qualifying asset = an asset that necessarily takes a **substantial period of time** (ordinarily **12 months** or more, unless a shorter period is justified) to get ready for its intended use or sale.

- **Specific borrowings:** capitalise **actual borrowing costs – income on temporary investment** of those borrowings.
- **General borrowings:** capitalise **expenditure on the asset × capitalisation rate** (weighted average borrowing cost of general borrowings outstanding), limited to actual borrowing costs incurred.
- **Commencement:** when (i) expenditure is being incurred, (ii) borrowing costs are being incurred, and (iii) activities necessary to prepare the asset are in progress.
- **Suspension:** during **extended periods** in which active development is interrupted (not during a temporary delay that is a necessary part of the process, e.g., high water level for a bridge).
- **Cessation:** when **substantially all** activities necessary to prepare the asset are complete; if completed in parts and each part is usable, capitalisation ceases part by part.

Exchange difference treated as borrowing cost =
interest on foreign loan at a comparable local rate – actual interest in ₹ (limited to the actual exchange loss)

WORKED EXAMPLE Specific and general borrowings

Construction of a factory (qualifying asset) throughout 2025-26. Specific 12% loan ₹40,00,000 taken 1 April 2025; ₹10,00,000 of it was temporarily invested for 6 months at 8% (income ₹40,000). On 1 October 2025 a further ₹20,00,000 was spent from general borrowings: 10% loan ₹50,00,000 and 12% loan ₹30,00,000 outstanding all year.

Specific: 4,80,000 – 40,000 = ₹4,40,000. Capitalisation rate = (5,00,000 + 3,60,000) ÷ 80,00,000 = 10.75%. General: 20,00,000 × 10.75% × 6/12 = ₹1,07,500. **Total capitalised ₹5,47,500.**

5.5 AS 19 – Leases

A **finance lease** transfers **substantially all risks and rewards** incidental to ownership; title may or may not transfer. Otherwise an **operating lease**. Indicators: transfer of ownership by the end of the term; bargain purchase option; lease term for the **major part of the economic life**; PV of minimum lease payments (MLP) at inception ≥ **substantially all** of fair value; specialised asset. AS 19 does not apply to leases of land, and to licensing agreements (films, patents, copyrights).

Party	Finance lease	Operating lease
Lessee	Recognise asset and liability at **lower of fair value and PV of MLP** (discount at interest rate implicit in the lease, else incremental borrowing rate). Split rentals into finance charge (constant periodic rate on outstanding liability) and principal. Depreciate as per AS 10 (over useful life if ownership is reasonably certain, else shorter of lease term and life)	Lease payments as expense on a **straight-line basis** over the lease term (unless another systematic basis is more representative)
Lessor	Recognise a **receivable = net investment in the lease** (gross investment – unearned finance income). Finance income on a pattern reflecting a constant periodic rate of return	Asset shown as PPE and depreciated; lease income on straight-line basis; initial direct costs deferred over lease term or expensed

Gross investment = MLP from lessor's view (incl. guaranteed residual value) + unguaranteed residual value

Net investment = gross investment discounted at the interest rate implicit in the lease (= fair value + initial direct costs of lessor)

- **Manufacturer/dealer lessor:** recognise selling profit/loss as for an outright sale; sales revenue = lower of fair value and PV of MLP at a commercial rate; cost of sale = cost – PV of unguaranteed residual value.
- **Sale and leaseback:** if **finance lease** – excess of sale proceeds over carrying amount is **deferred** and amortised over the lease term. If **operating lease** – sale at fair value: profit/loss recognised immediately; sale **below** fair value: loss recognised immediately, unless compensated by future below-market rentals (then deferred); sale **above** fair value: excess over fair value deferred and amortised.

WORKED EXAMPLE **Annual lease rent (lessor)**

Fair value of asset ₹10,00,000; 3-year finance lease; guaranteed residual value ₹1,00,000 at end; implicit rate 10% (PV factors 0.9091, 0.8264, 0.7513; total 2.4868). Annual rent R: 10,00,000 = R × 2.4868 + 1,00,000 × 0.7513 → **R = ₹3,71,912** (rounded).

5.6 AS 26 – Intangible Assets

An **intangible asset** is an identifiable non-monetary asset, without physical substance, held for use in production/supply, rental or administration. Recognised if **identifiable, controlled**, future benefits are probable and cost is reliably measurable.

- **Research phase:** all expenditure **expensed**.
- **Development phase:** capitalise only if the enterprise can demonstrate **all six**: technical feasibility; intention to complete; ability to use or sell; how it will generate probable future benefits (market or internal usefulness); availability of adequate technical, financial and other resources; ability to measure the expenditure reliably.
- **Never recognised as assets:** internally generated **goodwill**, **brands, mastheads, publishing titles, customer lists**; start-up, training, advertising and relocation costs. Expenditure once expensed **cannot be reinstated** later.
- **Amortisation:** over the best estimate of useful life; **rebuttable presumption** that useful life does not exceed **10 years** from the date the asset is available for use. Residual value assumed **zero** unless a third-party commitment or active market exists. Review period and method at least at each year-end. If life > 10 years, test for impairment at least annually (AS 28) and disclose reasons.
- Intangibles acquired in an amalgamation in the nature of purchase are recognised at fair value.

5.7 AS 28 – Impairment of Assets

An asset is impaired when its **carrying amount exceeds its recoverable amount**.

Recoverable amount = higher of (net selling price, value in use)

Value in use = present value of estimated future cash flows from continuing use and from disposal at the end of useful life

Impairment loss = carrying amount − recoverable amount

- **Indications** (assess at each balance-sheet date): external – significant fall in market value, adverse changes in technology/market/legal environment, increase in interest rates, carrying amount of net assets > market capitalisation; internal – obsolescence or physical damage, restructuring or discontinuance plans, worse economic performance than expected.
- **Recognition:** loss to P&L, unless the asset is carried at revalued amount (then first to revaluation surplus). Depreciation thereafter on the revised carrying amount over the remaining life.
- **Cash-generating unit (CGU):** the smallest identifiable group of assets generating largely independent cash inflows. Goodwill is tested by **bottom-up** (allocate goodwill that can be reasonably allocated) and, if not, **top-down** test (larger CGU). A CGU impairment loss is allocated **first to goodwill**, then to other assets **pro rata on carrying amounts**, but no asset is reduced below the highest of its NSP, value in use and zero.
- **Reversal:** allowed if estimates have changed, up to the carrying amount that would have been determined (net of depreciation) had no loss been recognised; **reversal of goodwill impairment** only if caused by a specific external event of an exceptional nature that is not expected to recur.

WORKED EXAMPLE **Impairment of a revalued machine**

Carrying amount ₹50 lakh (includes revaluation surplus ₹6 lakh still in reserve); NSP ₹38 lakh; value in use ₹42 lakh. Recoverable = ₹42 lakh; loss = ₹8 lakh → ₹6 lakh debited to **revaluation surplus**, ₹2 lakh to **P&L**. If remaining life is 4 years, future annual depreciation = 42 ÷ 4 = ₹10.5 lakh.

Chapter 6: Liabilities Based Accounting Standards

6.1 AS 15 – Employee Benefits

AS 15 covers all employee benefits **except** employee share-based payments. Four categories:

Category	Examples	Accounting
Short-term (due within 12 months after the period of service)	Salary, bonus, paid leave, medical care	Undiscounted amount as expense when service rendered. **Accumulating** compensated absences (carry forward) – expense as service is rendered (expected additional amount payable). **Non-accumulating** (e.g., maternity, sick leave not carried forward) – recognise only when the absence occurs
Post-employment	Gratuity, pension, PF, post-retirement medical	**Defined contribution** – contribution payable as expense. **Defined benefit** – actuarial valuation (see below)
Other long-term	Long-service leave, sabbatical, long-term disability	Simplified DB method; actuarial gains/losses and past service cost recognised immediately
Termination	VRS, retrenchment compensation	When the enterprise has a present obligation (demonstrably committed); if due > 12 months, discount

Defined benefit plan (Projected Unit Credit Method): each period of service gives rise to an additional unit of benefit; each unit is measured separately to build the final obligation. Discount rate = market yields on **government bonds** at the balance-sheet date for the term of the obligation.

Interest cost = opening PV of obligation × discount rate (adjust for benefits paid during the year if timing given)

Actuarial (gain)/loss on obligation = closing PV of DBO − (opening PV + current service cost + interest cost − benefits paid ± past service cost)

Actual return on plan assets = closing FV of plan assets − opening FV − contributions + benefits paid

Expense in P&L = current service cost + interest cost − expected return on plan assets ± net actuarial loss/(gain) + past service cost

Liability in balance sheet = PV of DBO − FV of plan assets (± unrecognised past service cost)

WORKED EXAMPLE **Gratuity plan**

PV of DBO 1 April ₹10,00,000; discount rate 8%; current service cost ₹1,50,000; benefits paid (year-end) ₹1,20,000; PV of DBO 31 March ₹11,30,000. Plan assets 1 April ₹9,00,000; expected return 9%; contributions ₹1,40,000; FV of plan assets 31 March ₹10,10,000.

Interest cost = ₹80,000. Expected DBO = 10,00,000 + 1,50,000 + 80,000 − 1,20,000 = 11,10,000 → **actuarial loss ₹20,000**.

Expected return = ₹81,000; actual return = 10,10,000 − 9,00,000 − 1,40,000 + 1,20,000 = **₹90,000** → actuarial gain on assets ₹9,000.

P&L expense = 1,50,000 + 80,000 − 81,000 + (20,000 − 9,000) = **₹1,60,000**. **Net liability** = 11,30,000 − 10,10,000 = **₹1,20,000**. Under AS 15, actuarial gains and losses are recognised **immediately in P&L** (no corridor, no OCI).

6.2 AS 29 – Provisions, Contingent Liabilities and Contingent Assets

Item	Definition	Treatment
Provision	Liability that can be measured only by using a **substantial degree of estimation**	**Recognise** when (a) present obligation (legal or constructive) from a past event, (b) outflow **probable** (more likely than not), (c) reliable estimate possible

Item	Definition	Treatment
Contingent liability	Possible obligation whose existence will be confirmed by uncertain future events; or present obligation where outflow not probable or amount not reliably measurable	**Disclose** (unless outflow is remote)
Contingent asset	Possible asset from past events whose existence will be confirmed by uncertain future events not wholly within control	**Neither recognised nor disclosed** in the financial statements; may be disclosed in the approving authority's (Board's) report when inflow is probable

- **Measurement: best estimate** of expenditure to settle the obligation at the balance-sheet date; large populations → **expected value**; single obligation → most likely outcome. **Not discounted** (except decommissioning/restoration costs as per AS 10 VERIFY). Future events (new technology, legislation) considered when there is sufficient objective evidence. Expected disposal gains are ignored.
- **Reimbursements** (e.g., insurance): recognised as a **separate asset** only when **virtually certain**, not exceeding the provision; in P&L may be netted.
- **Future operating losses:** no provision. **Onerous contract** (unavoidable costs exceed expected benefits): recognise provision for the present obligation. **Restructuring:** provision only when a detailed formal plan exists and valid expectation is raised; includes only direct expenditures (not retraining, relocation, marketing).
- Provisions are reviewed at each balance-sheet date and used only for the purpose originally recognised.

WORKED EXAMPLE Warranty provision (expected value)

10,000 units sold under a 1-year warranty. Experience: 80% no defects, 15% minor defects (cost ₹100 per unit), 5% major defects (₹400 per unit). Provision = 10,000 × (0.15 × 100 + 0.05 × 400) = 10,000 × 35 = **₹3,50,000**.

Chapter 7: Accounting Standards Based on Items Impacting Financial Statements

7.1 AS 4 – Contingencies and Events Occurring after the Balance Sheet Date

Events after the balance-sheet date are those occurring **between the balance-sheet date and the date on which the financial statements are approved** by the Board (or approving authority).

Adjusting events	Non-adjusting events
Provide **additional evidence of conditions existing at the balance-sheet date** – adjust assets and liabilities	Conditions arising **after** the balance-sheet date – no adjustment; **disclose** in the report of the approving authority if material
Insolvency of a debtor that existed at the year end; sale of inventory below cost soon after year end (evidence of NRV); settlement of a court case; **discovery of fraud or errors** relating to the year	Fall in market value of investments after the year end; destruction of plant by fire after year end; major acquisition; issue of shares

- **Proposed dividend** declared after the balance-sheet date is **not a liability** at that date – disclose in notes (AS 4 revised).
- Events indicating that the **going concern** assumption is no longer appropriate require adjustment even if they arise after the year end.
- The "contingencies" part of AS 4 is now covered by AS 29, except for impairment of financial assets VERIFY.

7.2 AS 5 – Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

- **Ordinary activities** vs **extraordinary items** (events clearly distinct from ordinary activities and not expected to recur, e.g., expropriation, earthquake). Extraordinary items are disclosed separately in P&L.
- **Exceptional items** within ordinary activities (write-down of inventories, disposal of PPE, litigation settlements, restructuring) are disclosed separately when of such size, nature or incidence.
- **Prior period items:** income/expenses arising in the current period as a result of **errors or omissions** in the preparation of financial statements of one or more prior periods. Shown in the current P&L **separately**, with nature and amount disclosed. They are **not** changes in estimates.
- **Change in accounting estimate** (useful life, bad debt provision): effect included in P&L of the period of change and future periods if affected (prospective).
- **Change in accounting policy:** only if required by **statute**, by an **accounting standard**, or if it gives a **more appropriate presentation**. Disclose the change and its impact. Adoption of a policy for events that are different in substance, or that did not occur previously, is not a change in policy.

> **EXAM TIP** **ICAI's favourite MCQ**
>
> "A change in the method of depreciation (SLM to WDV) is a ____" → **change in accounting estimate** (AS 10 read with AS 5), applied prospectively; not a change in accounting policy.

7.3 AS 11 – The Effects of Changes in Foreign Exchange Rates

Monetary items: money held and assets/liabilities to be received/paid in fixed or determinable amounts of money (cash, receivables, payables, loans). **Non-monetary:** PPE, inventories, investments in equity, advances for goods.

Stage	Rule
Initial recognition	Exchange rate on the **date of the transaction** (average rate for a week/month acceptable if rates do not fluctuate significantly)
Each balance-sheet date	**Monetary** items at the **closing rate**; non-monetary items at historical cost → rate on the transaction date; at fair value → rate when value was determined
Exchange differences	Recognised as **income or expense in the period** in which they arise (on settlement or restatement)

- **Para 46/46A option** (long-term foreign currency monetary items – LTFCMI, term ≥ 12 months at inception): exchange differences relating to the **acquisition of a depreciable capital asset** may be **added to/deducted from the cost** of the asset and depreciated over its balance life; others may be accumulated in the **Foreign Currency Monetary Item Translation Difference Account (FCMITDA)** and amortised over the balance period of the item. The option, once exercised, is irrevocable.
- **Foreign operations: integral** (activities are an extension of the reporting enterprise) – translate as if the transactions were the enterprise's own (monetary closing rate, non-monetary historical). **Non-integral** – assets and liabilities (monetary and non-monetary) at the **closing rate**; income and expenses at transaction-date (or average) rates; all differences to a **foreign currency translation reserve** until disposal of the net investment.
- **Forward exchange contracts** (not for trading/speculation): premium or discount (difference between forward rate and spot rate at inception) is **amortised as expense/income over the life of the contract**; exchange differences on the contract are recognised in P&L in the period of change. Contracts for **trading/speculation**: no premium amortisation; gain/loss computed as contract rate vs forward rate for the remaining maturity at each balance sheet date, recognised in P&L.

WORKED EXAMPLE Foreign currency loan for a depreciable asset

1 April 2025: borrowed USD 10,000 at 6% (rate ₹85) and bought a machine. 31 March 2026: rate ₹90; interest USD 600 paid at ₹90 = **₹54,000** (expense). Exchange loss on the loan = 10,000 × (90 − 85) = **₹50,000**.

Without para 46A: ₹50,000 to P&L. With para 46A: add ₹50,000 to the cost of the machine (8,50,000 → 9,00,000 before depreciation) and depreciate over its remaining life.

7.4 AS 22 – Accounting for Taxes on Income

Tax expense = current tax + deferred tax. **Taxable income** is computed under tax laws; **accounting income** is net profit before tax.

- **Timing differences** originate in one period and reverse in later periods (e.g., depreciation differences, expenses disallowed u/s 43B and allowed on payment, provisions allowed later) → **deferred tax**. **Permanent differences** (e.g., penalties, exempt income) never reverse → no deferred tax.
- **Deferred tax liability (DTL):** recognised for all timing differences. **Deferred tax asset (DTA):** recognised only if there is **reasonable certainty** of sufficient future taxable income; where there is **unabsorbed depreciation or carry-forward losses**, only if there is **virtual certainty supported by convincing evidence**.
- Measured at tax rates **enacted or substantively enacted** at the balance-sheet date; **not discounted**. Reviewed at each balance-sheet date (write-down / reversal).
- Tax holiday periods (e.g., sections 80-IA/80-IB): deferred tax only on timing differences that reverse **after** the holiday period. DTA and DTL are offset only if there is a legally enforceable right and they relate to the same tax law.

WORKED EXAMPLE Current and deferred tax

PBT ₹10,00,000; book depreciation ₹1,00,000; tax depreciation ₹1,60,000; penalty ₹20,000 (disallowed); rate 25%.

Taxable income = 10,00,000 + 1,00,000 − 1,60,000 + 20,000 = 9,60,000 → **current tax ₹2,40,000**. Timing difference 60,000 → **DTL ₹15,000**. Tax expense = ₹2,55,000 (penalty is a permanent difference – no deferred tax).

Chapter 8: Revenue Based Accounting Standards

8.1 AS 7 – Construction Contracts

Applies to contractors. **Fixed price contract** (fixed price or fixed rate per unit, sometimes with escalation) and **cost plus contract** (reimbursed allowable costs plus a percentage or fixed fee).

- **Contract revenue:** initial agreed amount + variations, claims and incentive payments to the extent probable and reliably measurable. **Contract costs:** costs directly related to the contract + costs attributable to contract activity in general and allocable + other costs chargeable to the customer. Costs that cannot be attributed (general administration, selling, R&D not reimbursable, depreciation of idle plant) are excluded.
- **Percentage of completion method:** when the outcome can be estimated reliably, recognise revenue and costs by reference to the **stage of completion** (costs incurred to date ÷ estimated total costs; surveys; physical proportion).
- **Expected loss** (total contract costs > total revenue) is recognised **as an expense immediately**, irrespective of stage of completion.
- When the outcome cannot be estimated reliably: revenue only to the extent of contract costs incurred that are probable of recovery; costs expensed.

Amount due from (to) customers = costs incurred + recognised profits − recognised losses − progress billings

WORKED EXAMPLE Loss-making contract

Contract price ₹80,00,000; costs to date ₹54,00,000; estimated further costs ₹36,00,000. Total cost ₹90,00,000 → **expected loss ₹10,00,000**, recognised now. Stage = 54/90 = 60%; **revenue = ₹48,00,000**. Expenses recognised = 54,00,000 + provision for future loss 4,00,000 = ₹58,00,000 → loss 10,00,000 ✔.

8.2 AS 9 – Revenue Recognition

Revenue = gross inflow of cash, receivables or other consideration from sale of goods, rendering of services, and use by others of enterprise resources yielding **interest, royalties and dividends**. Excludes amounts collected on behalf of third parties (GST, agency collections).

Source	Recognise when
Sale of goods	Significant **risks and rewards of ownership transferred**, no significant uncertainty as to measurability and collectability (and seller retains no effective control)
Services	**Proportionate completion method** (as service is performed) or **completed service contract method**
Interest	Time-proportion basis on outstanding amount and applicable rate
Royalties	Accrual basis as per the agreement
Dividends	When the owner's **right to receive payment is established**

- Revenue is **postponed** when there is significant uncertainty (e.g., goods on sale-or-return pending approval; consignments until sold by the consignee; claims). If uncertainty arises **after** sale, revenue is not reversed – a **provision** is made.
- **Special cases:** bill-and-hold – when the buyer accepts title and delivery is delayed at its request; instalment sales – sale price excluding interest recognised at the date of sale, interest over time; subscriptions – over the subscription period; admission fees – when the event takes place; tuition – over the period of instruction; advertising commission – when the advertisement appears.

Chapter 9: Other Accounting Standards

9.1 AS 12 – Accounting for Government Grants

Government grants are assistance by Government in cash or kind in return for past or future compliance with conditions. Excluded: assistance that cannot reasonably be valued, and transactions with Government that cannot be distinguished from normal trading. Grants are recognised only when there is **reasonable assurance** that (i) the conditions will be complied with and (ii) the grant will be received.

Type of grant	Treatment
Related to **specific depreciable asset**	Either **deduct from gross value** of the asset (depreciation on net), or treat as **deferred income** recognised in P&L on a systematic basis over the useful life (in proportion to depreciation)
Related to **non-depreciable asset** (e.g., land) without obligations	Credit to **capital reserve**
Non-depreciable asset requiring fulfilment of obligations	Credit to P&L over the period of the cost of meeting the obligations
Promoters' contribution (e.g., grant related to total investment or capital outlay, no repayment)	**Capital reserve** (shareholders' funds)
Revenue grants (related to costs)	P&L – as "other income" or deducted from the related expense, matching the costs
Compensation for losses already incurred / immediate support	P&L of the period when receivable (may be extraordinary)
Non-monetary grants (land, other assets)	At **acquisition cost**; assets given free – at **nominal value**

- **Refund of grants:** revenue grant – first charged against any unamortised deferred credit, excess to P&L. **Asset-related** grant – increase the book value of the asset or reduce the deferred income balance; on increasing book value, **depreciation on the revised book value is provided prospectively** over the residual useful life. Refund of promoters' contribution – reduce capital reserve.

WORKED EXAMPLE Refund of a grant deducted from cost

Machine cost ₹200 lakh; grant ₹50 lakh deducted → net ₹150 lakh; life 5 years, nil residual, SLM (₹30 lakh per year). After 2 years the full grant becomes refundable. Book value before refund = 150 − 60 = ₹90 lakh; after refund = **₹140 lakh**; future depreciation = 140 ÷ 3 = **₹46.67 lakh per year**.

9.2 AS 14 – Accounting for Amalgamations

Amalgamation in the nature of merger – **all five** conditions are satisfied:

1. **All assets and liabilities** of the transferor become those of the transferee.
2. Shareholders holding at least **90% of the face value of equity shares** of the transferor (excluding shares already held by the transferee or its subsidiaries/nominees) become equity shareholders of the transferee.
3. Consideration to those equity shareholders is discharged **wholly by issue of equity shares** of the transferee (cash only for fractional shares).
4. The **business** of the transferor is intended to be **carried on** by the transferee.
5. **No adjustment** is intended to the book values of assets and liabilities of the transferor, except to ensure uniformity of accounting policies.

Otherwise it is an **amalgamation in the nature of purchase**.

Point	Pooling of interests method (merger)	Purchase method (purchase)
Assets and liabilities	At **existing carrying amounts** (after uniformity adjustments)	At carrying amounts or at **fair values** on the date of amalgamation (consideration allocated)
Reserves of transferor	**Preserved** in the same form (general reserve, P&L etc.)	Not preserved, **except statutory reserves**, recorded via "Dr Amalgamation Adjustment Reserve, Cr Statutory Reserve"

Point	Pooling of interests method (merger)	Purchase method (purchase)
Difference	Between consideration and share capital of transferor → adjusted in **reserves**	Excess of consideration over net assets → **goodwill** (amortised over ≤ **5 years** unless a longer period is justified); shortfall → **capital reserve**

Purchase consideration = aggregate of **shares and other securities issued and payment in cash or other assets** by the transferee to the **shareholders** of the transferor. It **excludes** amounts paid to debenture holders and creditors (they are liabilities taken over). Methods: lump sum, **net payment method** (sum of payments to shareholders), **net assets method** (agreed value of assets − liabilities taken over), intrinsic value/exchange ratio.

Chapter 10: Accounting Standards for Consolidated Financial Statements

10.1 AS 21 – Consolidated Financial Statements

Control = ownership (directly or through subsidiaries) of **more than one-half of the voting power**, or control of the **composition of the board** (or governing body) to obtain economic benefits. A parent presents CFS in addition to separate financial statements (mandatory for companies under section 129(3)).

- **Exclusion from consolidation:** (a) control is intended to be **temporary** because the subsidiary is acquired and held exclusively with a view to subsequent disposal in the near future (ordinarily **within 12 months**); (b) it operates under **severe long-term restrictions** impairing its ability to transfer funds to the parent. Such subsidiaries are accounted for as investments under AS 13.
- **Procedure:** add line by line; eliminate cost of investment against parent's portion of equity at the date of investment (difference = **goodwill / capital reserve**); identify **minority interest** in net income and net assets; eliminate **intra-group balances and transactions** and **unrealised profits in full**; unrealised losses eliminated unless cost cannot be recovered.
- **Reporting dates:** if different, adjust for significant transactions; difference **not more than 6 months**. **Uniform accounting policies**; if not practicable, disclose the fact and proportions.
- **Minority interest** shown separately from liabilities and parent shareholders' equity. Losses applicable to minority in excess of its interest are adjusted against the majority, unless the minority has a binding obligation and is able to make good the losses.
- Dividends paid by the subsidiary out of **pre-acquisition profits** reduce the parent's cost of investment.

Steps in a consolidated balance sheet question

1. Analyse subsidiary's reserves and P&L into **pre-acquisition (capital)** and **post-acquisition (revenue)** profits (time-apportion current-year profit when acquired mid-year).
2. **Minority interest** = minority % × (share capital + all reserves and surplus at the balance-sheet date ± revaluation adjustments).
3. **Cost of control** = cost of investment − parent % × (share capital + capital profits ± revaluation at acquisition) → goodwill or capital reserve.
4. **Consolidated reserves** = parent's reserves + parent % of post-acquisition profits − unrealised profit (holding's share; ICAI also allows full elimination against group reserves where the sale is by the parent).
5. Eliminate inter-company debts, bills, loans and unrealised profit in inventory; prepare the balance sheet in Schedule III format.

WORKED EXAMPLE **Consolidated balance sheet working**

H Ltd. acquired 80% of S Ltd. (share capital ₹10,00,000) on 1 April 2025 for ₹13,00,000. On that date S had reserves ₹3,00,000 and P&L ₹1,00,000. On 31 March 2026 S has reserves ₹3,00,000 and P&L ₹3,50,000. S's inventory includes goods sold by H for ₹1,20,000 at cost + 20%.

Capital profits = 3,00,000 + 1,00,000 = 4,00,000; revenue profits = 3,50,000 − 1,00,000 = 2,50,000.

Cost of control = 13,00,000 − 80% × (10,00,000 + 4,00,000) = 13,00,000 − 11,20,000 = **goodwill ₹1,80,000**.

Minority interest = 20% × (10,00,000 + 3,00,000 + 3,50,000) = **₹3,30,000**.

Unrealised profit = 1,20,000 × 20/120 = ₹20,000 (downstream sale – eliminated from H's reserves). H's share of revenue profit = 80% × 2,50,000 = **₹2,00,000** added to consolidated P&L, less ₹20,000.

10.2 AS 23 – Investments in Associates in CFS

An **associate** is an enterprise in which the investor has **significant influence** (power to participate in financial/operating policy decisions, but not control) and which is neither a subsidiary nor a joint venture. Significant influence is **presumed at ≥ 20%** of voting power (directly or through subsidiaries) unless clearly demonstrated otherwise. AS 23 applies only in **consolidated** statements; in separate statements, AS 13 applies.

- **Equity method:** investment initially at **cost**; identify **goodwill/capital reserve** (cost – investor's share of net assets at acquisition) and include it in the carrying amount (disclose separately). Increase/decrease by the investor's share of **post-acquisition profits/losses**; **dividends received reduce** the carrying amount. When the stake is acquired in **stages**, goodwill/capital reserve is computed for each tranche on the basis of the investee's net assets on that date.
- **Unrealised profits and losses** on transactions between investor and associate are eliminated **to the extent of the investor's interest**.
- Share of losses beyond the carrying amount → investment reported at **nil**; further losses provided only if the investor has guaranteed obligations.
- Equity method **not used** when the investment is acquired and held exclusively with a view to subsequent disposal in the near future, or the associate operates under severe long-term restrictions → AS 13.

WORKED EXAMPLE Step acquisition of an associate

Bought 10% of A Ltd. for ₹40 lakh when its net assets were ₹340 lakh, and later another 15% for ₹58 lakh when net assets were ₹400 lakh, obtaining significant influence. Goodwill: tranche 1 = 40 − 34 = ₹6 lakh; tranche 2 = 58 − 60 = (₹2 lakh) → **net goodwill ₹4 lakh**, included in the carrying amount of ₹98 lakh.

10.3 AS 27 – Financial Reporting of Interests in Joint Ventures

A **joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity subject to **joint control** (contractually agreed sharing of control). Three forms:

Form	Venturer's accounts
Jointly controlled operations	Recognise assets it controls, liabilities and expenses it incurs, and its share of income (separate and consolidated)
Jointly controlled assets	Share of jointly controlled assets (by nature), liabilities incurred, share of joint liabilities, income and expenses
Jointly controlled entities	Separate statements: **investment as per AS 13**. Consolidated statements: **proportionate consolidation** (share of each asset, liability, income and expense combined line by line or shown separately)

- Proportionate consolidation is not used where the interest is acquired and held exclusively with a view to its subsequent disposal in the near future, or under severe long-term restrictions.
- Transactions between venturer and JV: recognise gains only to the extent of **other venturers' interests**; recognise full loss when it is evidence of reduction in NRV or impairment.
- An investor in a JV that does not have joint control reports its interest as per AS 13, AS 21 or AS 23 as appropriate.

Chapter 11: Financial Statements of Companies

11.1 Schedule III (Division I) – Balance Sheet format

Section 129 requires financial statements to give a **true and fair view**, comply with notified AS and be in the form in **Schedule III**. Division I applies to companies following **AS** (Division II: Ind AS companies; Division III: Ind AS NBFCs).

Equity and Liabilities	Assets
1. Shareholders' funds: (a) Share capital (b) Reserves and surplus (c) Money received against share warrants	**1. Non-current assets:** (a) PPE and intangible assets – (i) PPE (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. Share application money pending allotment	
3. Non-current liabilities: (a) Long-term borrowings (b) Deferred tax liabilities (net) (c) Other long-term liabilities (d) Long-term provisions	**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
4. Current liabilities: (a) Short-term borrowings (b) Trade payables – MSMEs and others (c) Other current liabilities (d) Short-term provisions	

Current vs non-current: an asset/liability is **current** if it is expected to be realised/settled in the company's **normal operating cycle** or **within 12 months** after the reporting date, is held primarily for trading, or is cash/cash equivalent not restricted. Operating cycle not identifiable → 12 months assumed.

Key classification rules (frequently tested):

- **Current maturities of long-term borrowings** (instalments due within 12 months) → **short-term borrowings** (not "other current liabilities").
- Debit balance of P&L → shown as a **negative figure under "Surplus"** in Reserves and surplus (even if the total becomes negative).
- **Interest accrued but not due** / **interest accrued and due** on borrowings → other current liabilities; **unpaid dividend** → other current liabilities; **calls in advance** → other current liabilities (with interest accrued).
- **Proposed dividend** → not a liability; disclose in notes. **Provision for tax** → short-term provision. **Provision for gratuity** (long-term part) → long-term provision.
- **Loose tools, stores and spares** → inventories; **cheques/drafts on hand** → cash and cash equivalents; **bank deposits with maturity > 12 months** → other non-current assets.
- **Trade receivables** outstanding for more than 6 months shown separately (ageing schedule); trade payables ageing including MSME dues.
- **Rounding off:** turnover < ₹100 crore → nearest hundreds, thousands, lakhs, millions or decimals thereof; ≥ ₹100 crore → nearest lakhs, millions or crores.
- **Additional regulatory information** (since 2021): title deeds not held in company name, revaluation by registered valuer, loans to promoters/directors/KMP, CWIP and intangible-under-development ageing, benami property, wilful defaulter, transactions with struck-off companies, charges pending registration, layers of companies, **ratios** (current, debt-equity, DSCR, ROE, inventory turnover, receivables turnover, payables turnover, net capital turnover, net profit, ROCE, return on investment) with explanation for change > 25%, crypto/virtual currency, undisclosed income.

11.2 Statement of Profit and Loss (Part II)

Revenue from operations → Other income → **Total income** → Expenses: cost of materials consumed; purchases of stock-in-trade; **changes in inventories** of FG, WIP and stock-in-trade; employee benefits expense; finance costs; depreciation and amortisation; other expenses → **Profit before exceptional and extraordinary items and tax** → exceptional items → extraordinary items → **PBT** → tax expense (current, deferred) → profit from continuing

operations → profit/loss from discontinuing operations (after tax) → **Profit for the period** → EPS (basic and diluted).

11.3 Declaration of dividend out of reserves (Rule 3, Companies (Declaration and Payment of Dividend) Rules, 2014)

When profits of the year are inadequate or absent, dividend may be declared out of accumulated profits (free reserves) only if **all** conditions are met:

1. **Rate** of dividend ≤ **average of the rates** declared in the **three immediately preceding years** (not applicable if no dividend was declared in each of those three years).
2. **Amount drawn** from accumulated profits ≤ **one-tenth (10%)** of (paid-up share capital + free reserves) as per the latest audited financial statements.
3. The amount drawn shall **first be utilised to set off the losses** incurred in the financial year in which dividend is declared, before any dividend in respect of equity shares is declared.
4. **Balance of reserves after withdrawal** ≥ **15% of paid-up share capital** as per the latest audited financial statements.

Also: no dividend on equity while the company has failed to repay deposits/interest; dividend only from profits after depreciation (section 123); preference dividend arrears have priority.

WORKED EXAMPLE **Dividend out of reserves**

Paid-up equity ₹50 lakh (₹10 shares); free reserves ₹30 lakh; loss for the current year ₹2 lakh; dividend rates in the last three years 12%, 15%, 18%. Company wants to declare 15%.

Condition 1: average = 15% → **15% allowed**. Dividend = ₹7.5 lakh. Amount needed from reserves = 7.5 + 2 (to set off current loss first) = ₹9.5 lakh.

Condition 2: limit = 10% × (50 + 30) = ₹8 lakh → maximum withdrawal **₹8 lakh**; after setting off the ₹2 lakh loss, only ₹6 lakh is available → maximum dividend **12%** (₹6 lakh).

Condition 4: reserves after withdrawal = 30 − 8 = ₹22 lakh ≥ 15% × 50 = ₹7.5 lakh ✔.

11.4 Cash Flow Statement (Unit 2) – format

```
A. Cash flows from operating activities
   Net profit before tax and extraordinary items            xxx
   Adjustments: + depreciation/amortisation, impairment, loss on sale of assets,
                finance costs, provisions (non-cash); - profit on sale of assets,
                interest/dividend income
   Operating profit before working capital changes          xxx
   ± changes in inventories, receivables, payables, other current items
   Cash generated from operations                           xxx
   - Income taxes paid (net of refunds)                      xxx
   Cash flow before extraordinary items ± extraordinary items
   Net cash from operating activities                       xxx
B. Investing: - purchase of PPE/investments, + sale proceeds, + interest & dividend received
C. Financing: + issue of shares/debentures/loans, - redemption/buy-back/repayment,
              - interest paid, - dividend paid
Net increase/(decrease) in cash and cash equivalents (A+B+C)
+ Opening cash and cash equivalents = Closing cash and cash equivalents
```

EXAM TIP **Reconstructing missing figures**

PPE purchased = closing gross block − opening gross block + cost of assets sold. Tax paid = opening provision + tax charged in P&L − closing provision. Dividend paid = proposed dividend of last year (declared at AGM) + interim dividend this year.

Chapter 12: Buy-back of Securities

12.1 Law – sections 68, 69 and 70

A company may buy back its own shares or other specified securities out of (a) **free reserves**, (b) **securities premium account**, or (c) **proceeds of a fresh issue** of shares or other specified securities – but **not** out of proceeds of an earlier issue of the **same kind**.

Condition (section 68)	Requirement
Authorisation	Articles permit; **special resolution** in general meeting. Board resolution suffices if buy-back ≤ **10%** of paid-up equity capital + free reserves
Resources test	Buy-back ≤ **25%** of aggregate of paid-up capital + free reserves (in case of equity shares, of **paid-up equity capital + free reserves**). Free reserves include securities premium for this purpose
Shares outstanding test	Equity shares bought back in a financial year ≤ **25% of the total paid-up equity capital** (number of shares)
Debt–equity test	After buy-back, **secured and unsecured debt ≤ twice** the paid-up capital + free reserves (higher ratio may be notified for certain classes)
Fully paid	Only fully paid-up shares or securities
Time gap	No buy-back offer within **one year** of a previous offer; completion within one year of the resolution
Extinguishment	Securities bought back to be **extinguished and physically destroyed within 7 days** of completion
Fresh issue	No further issue of the same kind (including allotment of new shares under section 62(1)(a)) within **6 months**, except bonus or discharge of subsisting obligations (conversion of warrants, ESOP, sweat equity, preference/debenture conversion) VERIFY

- **Section 69 – CRR:** where shares are bought back out of free reserves or securities premium, a sum equal to the **nominal value** of the shares bought back is transferred to **Capital Redemption Reserve**. CRR may be used only for issuing **fully paid bonus shares**.
- **Section 70 – prohibitions:** no buy-back through a **subsidiary** or an **investment company** or group of investment companies; not if the company has **defaulted** in repayment of deposits, redemption of debentures/preference shares, repayment of term loans or interest (until 3 years after the default is remedied); not if it has failed to comply with sections 92, 123, 127 and 129.

12.2 Computing the maximum buy-back (ICAI method)

1. **Shares outstanding test:** 25% × number of equity shares.
2. **Resources test:** 25% × (paid-up equity capital + free reserves incl. securities premium) ÷ buy-back price.
3. **Debt–equity test:** minimum equity to be maintained = total debt ÷ 2. For each share bought back, equity falls by the **buy-back price + nominal value transferred to CRR** (because CRR is not a free reserve). Maximum shares = (present equity − minimum equity) ÷ (price + nominal value). Equivalent simultaneous-equation method: (equity − x) − minimum equity = y, and x = y × nominal ÷ price.
4. **Maximum buy-back = least of the three.**

WORKED EXAMPLE **Maximum buy-back**

Equity capital ₹50 lakh (5,00,000 shares of ₹10); securities premium ₹10 lakh; general reserve ₹30 lakh; P&L ₹10 lakh → equity (shareholders' funds) ₹100 lakh. Loans ₹160 lakh. Buy-back price ₹25.

Shares test = 1,25,000. Resources test = 25% × 100 lakh ÷ 25 = 1,00,000. Debt–equity: minimum equity = 160 ÷ 2 = ₹80 lakh; permissible reduction = ₹20 lakh; reduction per share = 25 + 10 = ₹35 → **57,142 shares**.

Maximum buy-back = 57,142 shares (debt–equity test binds).

12.3 Journal entries

Step	Entry
Fresh issue (if any)	Bank Dr; To Share Capital; To Securities Premium
Sale of investments to fund buy-back	Bank Dr; To Investments; To Profit on sale (P&L)
Amount due on buy-back	Equity Share Capital Dr (nominal); Premium payable on buy-back Dr; To Equity Shareholders / Equity Shares Buy-back A/c
Premium written off	Securities Premium Dr / General Reserve Dr; To Premium payable on buy-back
Payment	Equity Shares Buy-back A/c Dr; To Bank
CRR (to the extent buy-back **not** out of fresh issue proceeds)	General Reserve / P&L Dr; To Capital Redemption Reserve (nominal value bought back – nominal value of fresh issue proceeds used VERIFY)

REMEMBER **CRR amount**

CRR = nominal value of shares bought back **minus** the **nominal value of fresh issue** (proceeds of a fresh issue used for buy-back do not need a CRR). Premium on fresh issue does not reduce the CRR requirement.

Chapter 13: Amalgamation of Companies

13.1 Steps in an amalgamation problem

1. Identify the type (merger → pooling; purchase → purchase method) – read the conditions in AS 14.
2. Compute **purchase consideration** (only payments to **shareholders** of the transferor).
3. **Transferor's books** (closing): Realisation A/c (assets at book value Dr, liabilities taken over Cr, PC Cr) → Transferee's A/c → Equity Shareholders' A/c (capital + reserves + realisation profit/loss) → settlement.
4. **Transferee's books:** Business Purchase A/c Dr; To Liquidator of transferor. Then assets Dr (at fair values under purchase method), liabilities Cr, **goodwill/capital reserve** balance; discharge PC.
5. Prepare the balance sheet after amalgamation (Schedule III), with notes.

Transferor's books	Entry
Assets transferred	Realisation A/c Dr; To individual assets (book values) – including fictitious assets (or transfer them to shareholders' A/c)
Liabilities taken over	Liabilities Dr; To Realisation A/c
Purchase consideration due	Transferee Co. Dr; To Realisation A/c
Receipt of PC	Shares in transferee / Bank Dr; To Transferee Co.
Expenses (if borne by transferor)	Realisation Dr; To Bank
Close capital and reserves	Equity Share Capital, Reserves Dr; To Equity Shareholders A/c; Realisation profit/loss transferred
Settle shareholders	Equity Shareholders Dr; To Shares in transferee, To Bank

WORKED EXAMPLE **Absorption – purchase method**

X Ltd. (equity 50,000 shares of ₹10 = ₹5,00,000; general reserve ₹1,00,000; P&L ₹50,000; 10% debentures ₹2,00,000; creditors ₹1,50,000; total ₹10,00,000. Assets: land & building ₹4,00,000; plant ₹2,50,000; inventory ₹1,50,000; receivables ₹1,20,000; bank ₹80,000) is absorbed by Y Ltd.

Y issues **1 equity share of ₹10 at ₹14** and pays **₹1 in cash** for every share of X; X's debentures are discharged by 12% debentures of Y at par. Y values: land & building ₹5,00,000; plant ₹2,20,000; inventory ₹1,40,000; receivables ₹1,15,000; bank ₹80,000; creditors at book value.

PC = 50,000 × 14 + 50,000 × 1 = 7,00,000 + 50,000 = **₹7,50,000** (debentures excluded).

Net assets taken over = (5,00,000 + 2,20,000 + 1,40,000 + 1,15,000 + 80,000) − (2,00,000 + 1,50,000) = 10,55,000 − 3,50,000 = **₹7,05,000** → **goodwill ₹45,000** in Y's books.

X's realisation profit = 7,50,000 − (10,00,000 − 3,50,000) = **₹1,00,000**; shareholders receive 5,00,000 + 1,00,000 + 50,000 + 1,00,000 = ₹7,50,000 ✔.

Y's entries: Business Purchase Dr 7,50,000; To Liquidator of X. Land & building Dr 5,00,000; Plant Dr 2,20,000; Inventory Dr 1,40,000; Receivables Dr 1,15,000; Bank Dr 80,000; Goodwill Dr 45,000; To Debentures of X (liability) 2,00,000; To Creditors 1,50,000; To Business Purchase 7,50,000. Liquidator Dr 7,50,000; To Equity Share Capital 5,00,000; To Securities Premium 2,00,000; To Bank 50,000. Debentures of X Dr 2,00,000; To 12% Debentures 2,00,000.

13.2 Special points

- **Inter-company owings** (transferor owes transferee or vice versa): cancel in the transferee's books – Creditors Dr; To Debtors.
- **Unrealised profit in inventory** (goods sold by one company to the other, still unsold): in the transferee's books, reduce inventory and goodwill/capital reserve (or P&L) by the unrealised profit.
- **Statutory reserves** of transferor under purchase method: Amalgamation Adjustment Reserve Dr; To Statutory Reserve (e.g., Export Profit Reserve, Investment Allowance Reserve) – maintained until the statutory requirement is met; then reversed.

- **Liquidation expenses** of the transferor borne by the transferee: in transferee's books – Goodwill/Capital Reserve Dr; To Bank (they are part of the cost of acquisition under purchase method VERIFY).
- **Formation of a new company** (amalgamation of two companies into a new one): PC computed for each; the new company's capital = total shares issued.

Chapter 14: Accounting for Reconstruction of Companies (Internal Reconstruction)

14.1 Meaning and legal routes

Internal reconstruction reorganises the capital of a company **without liquidating it** – accumulated losses, fictitious assets and over-valued assets are written off by reducing the claims of shareholders (and, if agreed, creditors). Legal routes: **alteration of share capital** (section 61 – consolidation, sub-division; no loss written off by itself), **reduction of share capital** (section 66 – special resolution + **NCLT** confirmation; creditors' interests considered), **variation of shareholders' rights** (section 48 – consent of **three-fourths** of the class), **compromise/arrangement** with creditors and members (section 230).

Event	Entry
Reduce face value (₹10 → ₹4)	Equity Share Capital (₹10) Dr; To Equity Share Capital (₹4); To Capital Reduction A/c (₹6)
Sacrifice by preference shareholders, debenture holders, creditors	Pref. Share Capital / Debentures / Creditors Dr; To Capital Reduction
Arrears of preference dividend waived	No entry (it was a contingent liability); if settled by issue of shares: Capital Reduction Dr; To Equity Share Capital
Write off P&L debit, goodwill, preliminary expenses, discount on issue	Capital Reduction Dr; To respective items
Write down assets / increase assets	Capital Reduction Dr; To Assets — or Assets Dr; To Capital Reduction
Reconstruction expenses	Capital Reduction Dr; To Bank
Surplus left in Capital Reduction A/c	Capital Reduction Dr; To **Capital Reserve**

WORKED EXAMPLE **A balanced scheme**

Balance sheet (₹): Equity 2,00,000 shares of ₹10 = 20,00,000; 9% preference 10,000 shares of ₹100 = 10,00,000 (dividend 2 years in arrears); 12% debentures 6,00,000; creditors 4,00,000; total 40,00,000. Assets: goodwill 3,00,000; PPE 18,00,000; inventory 5,00,000; receivables 4,00,000; bank 1,00,000; P&L (debit) 9,00,000.

Scheme: equity reduced to ₹4 fully paid; preference shares reduced to ₹80 each and arrears waived; creditors accept 25% reduction; P&L and goodwill written off; PPE reduced by ₹1,50,000, inventory by ₹1,00,000, receivables by 10%; expenses ₹10,000 paid.

Credits to Capital Reduction: 12,00,000 + 2,00,000 + 1,00,000 = **₹15,00,000**. Debits: 9,00,000 + 3,00,000 + 1,50,000 + 1,00,000 + 40,000 + 10,000 = **₹15,00,000** → capital reserve nil.

Revised balance sheet: equity 8,00,000 + preference 8,00,000 + debentures 6,00,000 + creditors 3,00,000 = **₹25,00,000** = PPE 16,50,000 + inventory 4,00,000 + receivables 3,60,000 + bank 90,000.

EXAM TIP **Test the scheme first**

Total the sacrifices (credits) and the losses to be written off (debits) before writing entries. A surplus goes to capital reserve; a shortfall means the scheme cannot write off all losses – state this.

Chapter 15: Accounting for Branches including Foreign Branches

15.1 Types and systems

Branch	Accounting
Dependent branch (HO keeps all records)	**Debtors system** (Branch A/c in HO books, nominal account – profit or loss), **Stock and Debtors system** (Branch Stock, Branch Debtors, Branch Expenses, Branch Adjustment, Branch P&L accounts), **Final accounts system** (Trading and P&L for the branch), **Wholesale basis**
Independent branch (keeps full double entry)	Branch maintains HO A/c; HO maintains Branch A/c; at year end, **incorporation** of branch trial balance in HO books; **reconciliation** of HO A/c and Branch A/c
Foreign branch	Translation as per **AS 11** – generally an **integral foreign operation** (monetary items at closing rate, non-monetary at historical rate, income/expenses at average or actual rates, differences to P&L); if non-integral, closing rate for all assets/liabilities and differences to translation reserve

Goods invoiced at invoice price (IP) – reasons: to keep the branch manager unaware of actual profit, to control stock at selling price, to simplify pricing. Remove the **loading** (unrealised profit) by "Branch Adjustment A/c" or a Stock Reserve.

Loading on invoice price = invoice price × mark-up% ÷ (100 + mark-up%)

WORKED EXAMPLE **Loading**

Goods sent to branch at cost + 25% at an invoice price of ₹2,50,000 → loading = 2,50,000 × 25/125 = **₹50,000**; cost ₹2,00,000. If closing branch stock at IP is ₹50,000, stock reserve = ₹10,000.

15.2 Independent branch – year-end points

- **Goods in transit** and **cash in transit** (sent by branch, not received by HO, or vice versa) – recorded in HO books at year end: Goods in Transit Dr / Cash in Transit Dr; To Branch A/c.
- **Depreciation on branch assets kept in HO books** – HO: Branch A/c Dr; To Branch Fixed Assets. Branch: Depreciation Dr; To HO A/c.
- **Expenses paid by HO on behalf of branch** – HO: Branch A/c Dr; To Bank; Branch: Expense Dr; To HO A/c.
- **Inter-branch transactions** – routed through HO (each branch passes entries against HO A/c).
- After reconciliation, the branch's revenue items are incorporated in HO's P&L; assets and liabilities in the consolidated balance sheet; HO A/c and Branch A/c cancel out.

Formula & rules sheet (one page)

Topic	Must-remember rule
AS 2	Lower of cost and NRV; RM not written down if FG sold at/above cost; replacement cost for RM if written down
AS 3	Cash equivalents ≤ 3 months original maturity; interest/dividend paid → financing; received → investing
AS 7	Stage = cost to date ÷ total estimated cost; **expected loss recognised immediately**
AS 10	GST input credit excluded from cost; testing cost net of sale proceeds of trial output; change of method = change in estimate
AS 11	Monetary – closing rate; non-monetary – historical; para 46A – add to cost of depreciable asset
AS 12	Refund of asset grant – increase book value; depreciate prospectively
AS 13	Current – lower of cost and FV, category-wise; long-term – cost less permanent decline; pre-acquisition dividend reduces cost
AS 14	PC = payments to shareholders only; merger – all 5 conditions; goodwill amortised ≤ 5 years
AS 15	Expense = CSC + interest − expected return ± actuarial; actuarial gains/losses immediately to P&L
AS 16	Qualifying asset ≈ 12 months; specific – actual minus investment income; general – weighted rate × expenditure
AS 17	10% tests (revenue, result, assets) + 75% external revenue rule
AS 19	Finance lease – lower of FV and PV of MLP; operating lease – straight line
AS 20	Bonus – retrospective; rights – factor = cum-right price ÷ TERP; diluted – add after-tax interest
AS 22	DTA on losses only with virtual certainty; rates enacted/substantively enacted; no discounting
AS 23	Equity method; goodwill inside carrying amount; dividends reduce carrying amount
AS 25	Tax at estimated annual effective rate
AS 28	Recoverable = higher of NSP and VIU; CGU loss – goodwill first, then pro rata
AS 29	Provision – probable + reliable estimate; contingent asset not disclosed in FS
Buy-back	Least of: 25% shares; 25% (capital + free reserves) ÷ price; (equity − debt/2) ÷ (price + nominal)
Dividend from reserves	Rate ≤ 3-year average; draw ≤ 10% of (capital + free reserves); set off current loss first; balance ≥ 15% of capital

Common mistakes to avoid

COMMON MISTAKE **Where students lose marks in Paper 1**

- Using **profit before tax** for EPS; forgetting cumulative preference dividend; not applying the rights adjustment factor.
- Treating payments to **debenture holders** as part of purchase consideration.
- In buy-back, ignoring the **CRR transfer** in the debt–equity test.
- In AS 15, using simple interest instead of the stated **half-yearly compounding**; confusing actuarial gain/loss with actual return on plan assets.
- In AS 16, capitalising interest on the part of the loan used for a **non-qualifying asset**; ignoring investment income on idle funds.
- Showing **current maturities of long-term debt** under other current liabilities; omitting notes to accounts in Schedule III answers.
- In consolidation, not splitting the subsidiary's profit into **pre- and post-acquisition**; wrong treatment of dividend out of pre-acquisition profits.
- Branch questions: forgetting **goods/cash in transit**; not removing loading on opening and closing stock.
- AS 24: writing circumstances of discontinuance instead of the **initial disclosure requirements** asked.