FINANCIAL ACCOUNTING

(New syllabus)

CONTENT

Bank Reconciliation Statement (BRS)

At any point of time, the balances as per cash book (bank column) and pass book should be equal in amount. But, in reality it rarely happens due to certain specific reasons. To reconcile the balances as reflected by these two related books a statement is prepared, which is referred to as the Bank Reconciliation Statement.

This statement is not a part of the books of accounts of an organisation. These are prepared at periodical intervals for verification of the accuracy of cash book and pass book. It is to be noted that this statement does not rectify any error that may exist in the books. Its primary objective is to identify the causes of discrepancy between the two books as on a particular date.

The main reason for disagreement between balances of cash book and pass book is caused by time gap and or communication gap between the entries made at end of the client and bank. Some of the common transactions which cause disagreement between the cash book (bank cloumn) and pass book are:

- Cheque issued but not presented at the bank;
- Cheque deposited in bank, but not yet collected;
- Amount deposited directly in bank by other parties;
- Incidental charges, interest on overdraft etc. debited by bank;
- Interest on deposits credited by bank;
- Dishonor of cheque deposited;
- Clerical errors made in recording of transactions etc.

It is worth mentioning at this point that in this technologically advanced era many of the abovementioned causes of disagreement has been done away with the emergence of digital transactions.

Preparation of Bank Reconciliation Statement

- ❖ **Without Amended Cash Book Method:** The preparation of Bank Reconciliation Statement can start with any of the available balances viz. balance of cash book (bank column) or balance of pass book. To this logical adjustments must be made of the transactions that has caused the disagreement – either by making addition or subtraction of the relevant items. Once all the items of disagreement gets adjusted, the balances as per the two books should get tallied.
- ❖ **Amended Cash Book Method:** Alternatively, cash book (amended) can be prepared for ascertaining the correct balance of the cash book (bank column) and thereafter the Bank Reconciliation Statement is to be drafted to reconcile this correct balance of cash book with the balance as per pass book. The amended cash book is drafted with the items that have been correctly recorded in the pass book but is yet to be recorded in the cash book. Moreover, any error committed and appearing in the cash book should also be considered while drafting the amended cash book.

1. On comparing the Cash Book of Saksham with the Bank Pass Book for the year ended 31st March, 2022, following discrepancies were noticed:
   - **(a)** Out of ₹82,000 paid in by cheques into the bank on 25th March, cheques amounting to ₹30,000 were collected on 5th April.
   - **(b)** Out of cheques drawn amounting to ₹31,200 on 28th March a cheque for ₹10,000 was presented on 3rd April.
   - **(c)** A cheque for ₹4,000 entered in Cash Book but omitted to be banked on 31st March.
   - **(d)** A cheque for ₹2,400 deposited into bank but omitted to be recorded in Cash Book and was collected by the bank on 29th March.
   - **(e)** A bill receivable for ₹2,080 previously discounted (discount ₹80) with the bank had been dishonoured but advice was received on 3rd April.
   - **(f)** A bill for ₹40,000 was retired/paid by the bank under a rebate of ₹600 but the full amount of the bill was credited in the bank column of the Cash Book.
   - **(g)** A cheque of ₹10,000 wrongly credited in the Pass Book on 29th March was reversed on 2nd April.
   - **(h)** Bank had wrongly debited ₹20,000 in the account on 31st March and reversed it on 10th April, 2022.
   - **(i)** A cheque of ₹800 drawn on the Savings Account has been shown as drawn on Current Account in Cash Book.

   Prepare a Bank Reconciliation Statement as on 31st March, 2022, if the Balance as per Cash Book on 31st March was ₹1,58,280.

2. On 31st January, 2022, Sethi's cash book showed a bank overdraft of ₹2,50,000. On comparing with the pass book, the following differences were noted.
   - **(a)** Cash and cheques amounting to ₹26,800 were sent to the bank on 27th January, but cheques worth 4600 were credited on 2nd February and one cheque for 900 was returned by them as dishonoured on 4th February.
   - **(b)** During the month of January, Sethi issued cheques worth ₹33,400 to his creditors. Out of these, cheques worth 27,400 were presented for payment on 5th February.
   - **(c)** According to Sethi's standing orders, the bankers have made the following payments during the month of January:
     - **i.** Life insurance premium ₹3,840
     - **ii.** Television license fee ₹2,400
   - **(d)** Sethi's bankers have collected ₹3,000 as dividend on his shares.
   - **(e)** Interest charged by the bank ₹2,500
   - **(f)** A bill receivable of ₹2,000 discounted with the bank in December, 2021, was dishonoured on 31st January, 2022.

   You are required to:
   - **i.** Ascertain the amended cash book balance as on 31st January, 2022
   - **ii.** Prepare a Bank Reconciliation Statement from the amended cash book as on 31st January 2022.

Consignment

1. Veemal of Delhi sends a consignment of wall clocks to Anand of Kolkata and charges proforma invoice price so as to show a profit of 25% on cost. The agent received commission @ 5% on all sales plus 3% del credere commission on credit sales made by him. Stock of goods with the agent at the beginning of the year: 40 clocks at proforma invoice price ₹25,000. During the year ended 31st December 2011, Veemal had the following transactions with Anand:

(a) Proforma invoice price of 200 Clocks consigned to Anand: ₹1,25,000

(b) Railway charges and insurance on the consignment paid by Veemal: ₹3,500

(c) Advance received from Anand : ₹37,500

(d) Sales made by Anand;

  (i) 80 clocks for cash : ₹53,750

  (ii) 100 clocks on credit: ₹70,000

(e) Selling expenses made by agent: ₹6,250 and discount allowed by him ₹2,500.

(f) 30 clocks were damaged by the railway for which Anand recovered ₹6,750. The damaged clocks were sold on cash by Anand at ₹5,750.

(g) Out of the clock sold on credit, ₹5,000 was irrecoverable and considered bad by the agent.

(h) The agent remitted the balance due by him by a bank draft.

Show necessary Ledger Accounts in the books of Veemal.

2. Mr. P consigned goods to Mr. D, his agent at Dhanbad, at cost price of ₹40,000. Mr. P's accountant at the end of the year drew up the agent account as below:

Mr. D Account

Particulars	Dr. (₹)	Particulars	Cr. (₹)
To, Goods	40,000	By, Cash	25,000
To, Cash-Freight	3,000	By, Balance	19,300
To, P/L A/c	1,300		
	44,300		**44,300**

Mr. D sold part of the goods for ₹45,000, which exceeded by ₹9,000 their invoice value. He collected ₹38,000 after allowing discount of ₹2,000 to customers. Bad Debts came to ₹1,000 and his expenses to ₹800 (including ₹200 for loading and cartage). Mr. D was entitled to a 5% commission on cash collected.

From the above information draw up Consignment A/c, Consignment Debtors A/c and Mr. D A/c in the books of Mr. P.

3. Hyder is a producer of sandalwood miniature handicraft items having his business at the city of Mysore, Karnataka. He has gathered that even though Mysore is a popular tourist destination in South India, Agra happens to be the most popular destination, especially for foreign tourists in India. He was interested in selling his handcrafted items in Agra, but lacked the resources to open a full-fledged store in Agra. So, the only viable option available to him was to appoint an agent who would sell the handicraft items on his behalf for a commission. With this objective in mind, he searched for a reliable agent in Agra and got the reference of a popular business agent in Agra named Jalal from Yasin, one of his long-term business partner. After a few formal meeting and negotiations, Jalal was officially appointed as Hyder's agent who would receive goods from Hyder on consignment basis and sell them to customers in Agra.

On April 1, 2021, Hyder sent goods to Jalal of Agra. However, Hyder lost all the documents that recorded the details of the goods sent on consignment. The only information available from his office is that the forwarding expenses incurred by of him for sending the goods to Agra was ₹12,000. Hyder gathered the following information from Jalal in relation to this consignment:

- He incurred expenses to the tune of ₹25,000 out of which a sum of ₹9,000 is recurring in nature.
- The Jalal had remitted the balance due from him through Bank Draft after deducting the expenses, 5% commission on gross sales, bad debts ₹4,250 and a Bills payable accepted by him for ₹50,000.
- The value of unsold stock at original cost lying with Jalal as on March 31, 2022 amounted to ₹2,50,000.
- Jalal sent an Account Sales reflecting the total sales effected by him during 2021-22 of ₹22,50,000. This included ₹15,62,500 for sales made at invoice price which is cost plus 25% and the balance at 10% above the invoice price.
  - **i.** What is the amount of goods sent on consignment by Hyder to Jalal?
  - **ii.** Ascertain the amount of profit or loss made by Hyder out of this consignment to Agra. Show by drafting the relevant ledger account.
  - **iii.** Determine the amount of final remittance made by Jalal to Hyder by drafting Jalal Account in the books of Hyder.

Joint Venture

1. Mr. Sudheer Kapoor is an executive in a multi-national financial consultancy firm and is presently working at Pune, Maharashtra. He belongs to a well-to-do family who were erstwhile landlords at Hisar district of Haryana. He inherited large plots of land as a result of his family lineage. During the end of 2020, Mr. Kapoor decided to develop a part of the inherited land and for this purpose entered into a joint venture with Mr. Harmeet Singh of Ludhiana to develop some building sites and sell them. They agreed amongst themselves that the operating results will be shared between them in 4:5 ratio. It was further agreed between them that any cash investment made by the co-venturers in the venture would entitle them to interest at 10% p.a.

Mr. Kapoor decided to use five-bigha (1 bigha = 20 katthas) plot for this purpose and it was purchased by the venture for ₹60 lakhs. Mr. Kapoor and Mr. Singh approached Bank of Baroda, a nationalized book for financing the venture. The bank, after due consideration of the case, agreed to finance them to the extent of 80% of the cost at 16% rate of interest p.a. The buying agreements were finalized by the advocate of Mr. Kapoor and Mr. Singh on January 1, 2021 and the payment was made on the same day. Mr. Singh agreed to pay the balance of the purchase consideration and registration expenses amounting to ₹48 lakhs was also met by him.

Mr. Kapoor approached Mrs. Kulwinder Kaur, his school friend, who is a practicing architect. Mrs. Kaur provided the following detailed plan relating to the plot:

- 10% of the total area is to be left for roads, parks etc.;
- Three types of buildings were to be developed – Regular (1.5 katthas), Deluxe (2.5 katthas) and Executive (3 katthas).
- 12 buildings of each type i.e. Regular, Deluxe and Executive will be developed;
- The sale price of each type were determined as follows:
- Regular – Cost plus 50% premium, Deluxe – Cost plus 40% premium, and Executive – Cost plus 25% premium,
- The balance area will be taken equally by the co-venturers at cost.

Advertisements of the project were given in local newspapers and other media on February 1, 2021 and the following expenses took place in relation to this project:

- Levelling and ground preparation expenses ₹12,000 per kattha;
- Engineering expenses ₹28,000 per kattha
- Construction expenses ₹22,000 per kattha;
- Municipal taxes ₹3,000 per kattha;
- Advertisement expenses incurred ₹15 lakhs;
- Office and administrative expenses ₹6,50,000;
- Site expenses ₹2,70,000;
- Sundry expenses ₹80,000.

Mr. Kapoor met all these afore-mentioned expenses. Moreover, it was Mr. Kapoor who took the sole responsibility of the sale of the plots for which he was entitled to receive 8% of the sale proceeds. The entire business was over by December 31, 2021 and all the remaining transactions were settled on that date. You, being a professional accountant and colleague-cum-friend of Mr. Kapoor have been approached by him to do the accounts of this joint venture.

1. What is the cost per kattha of land?
2. Calculate the sale price of each type of building.
3. Calculate the amount of interest due to each of the co-venturers.
4. Determine how much profit, if any, has been earned by Mr. Kapoor and Mr. Singh.
5. Ascertain the amount that had to be transacted for the final settlement of the accounts.

Preparation of Final Accounts

1. Mrs. Joshi has presented you the following Trial Balance as on 31st December 2021:

Trial Balance as on 31.12.2021

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Purchases	1,75,000	Sales	3,25,000
Interest	8,000	10 % Loan from UBI	1,00,000
Debtors	1,04,000	Bills Payable	86,000
Suspense A/c	8,000	Capital	4,87,000
Rent	6,600	Sundry Creditors	1,02,500
Plant & Machinery	5,30,000	Apprenticeship Premium Received	2,000
Furniture & Fixture	85,000	Purchase Return	1,500
Salaries	7,000		
Wages	2,500		
GST	6,000		
Motor Car	70,000		
Octroi	500		
Insurance	10,000		
Unexpired insurance	2,300		
Factory Shed	30,000		
Bills Receivable	25,000		
Patent	32,100		
Sales Return	2,000		
	11,04,000		**11,04,000**

You are required to prepare a Trading and Profit & Loss account and a Balance Sheet as on 31st Dec 2021 after considering the following adjustment:

1. A sale of ₹25,000 made for cash had been credited to Purchase A/c.
2. Private purchase amounting to ₹600 had been included in Purchase Day Book.
3. The loan account in the books of proprietor appeared as follows:

10% Loan from UBI Account

Date	Particulars	Dr. (₹)	Date	Particulars	Cr. (₹)
31.12.21	To Balanced c/f	1,00,000	1.1.21	By Balance b/f	50,000
			31.12.21	By Bank A/c	50,000
		1,00,000			**1,00,000**

4. Interest paid includes ₹3,000 interest paid to UBI Bank.
5. During the year goods worth ₹1,00,000 were invoiced on ‘sale on approval basis’ at cost plus 25%. Out of these, goods worth ₹20,000 accepted by the customers, ₹40,000 worth of goods were rejected and properly accounted for but no intimation has been obtained for the balance of the goods and its period is yet to expire.

6. Debtors were shown after deduction of Provision for Doubtful Debt of ₹2,000. It was decided that this debt was considered to be bad and should be written off and a provision of ₹1,000 should be made which was considered doubtful.
7. Suspense account represents money advanced to sales manager who was sent to Mumbai in August, 2021 for sales promotion. On returning to Kolkata submitted a statement disclosing that ₹2,000 was incurred for travelling, ₹1,200 for legal expenses and ₹1,800 for miscellaneous expenses. The balance lying with him is yet to be refunded.
8. Business is carried on in a two-storied rented house. The ground floor, being 50 per cent of the accommodation, is used for business. Mrs. Joshi lives with her family on the first floor.
9. The Furniture account represents old furniture which was replaced on 1.1.2021 by a new one, costing ₹1,20,000 with an additional cash payment of ₹80,000 lying debited to purchases account. However, the assets were put to use on 1.4.2021.
10. Depreciation is to be charged on Furniture @ 10% p.a., Plant & Machinery @ 5% p.a., Motor Car @ 5% p.a.
11. The General manager is entitled to commission based on a percentage of net profit (such commission being charged to profit and loss account before ascertaining the net profits), calculated in the following manner: On the first ₹30,000 of net profit Nil On the next ₹30,000 of net profit 10% On the next ₹30,000 of net profit 20% And on the balance of net profit 30%
12. Closing Stock was 31.12.2021 was ₹22,000.

Non–Trading Organisation

1. The Income and Expenditure account of an association for year ended 31st March 2022 is as under:

Particulars	Dr. (₹)	Particulars	Cr. (₹)
To, Salaries	1,20,000	By, Subscription	1,70,000
To, Printing and Stationery	6,000	By, Entrance fee	4,000
To, Telephone	1,500	By, Contribution for Dinner	36,000
To, Postage	500		
To, General expenses	12,000		
To, Interest and bank charges	5,500		
To, Audit fees	2,500		
To, Annual Dinner Expenses	25,000		
To, Depreciation	7,000		
To, Surplus	30,000		
	2,10,000		**2,10,000**

The aforesaid Income and Expenditure account has been prepared after following adjustments:

Particulars	(₹)
Subscription outstanding as on 31st March 2021	16,000
Subscription outstanding as on 31st March 2022	18,000
Subscription received in advance as on 31st March 2021	13,000
Subscription received in advance as on 31st March 2022	8,400
Salaries outstanding as on 31st March 2021	6,000
Salaries outstanding as on 31st March 2022	8,000
Audit fees for 2020-21 paid during 2021-22	2,000
Audit fee for 2021-22 not paid	2,500
The building owned by the association since 2004 costs	1,90,000
Equipment as on 31st March, 2021 valued at	52,000
At the end of the year after depreciation of ₹7,000, equipment amounted to	63,000
In 2020-21, the association raised a bank loan of which is still not paid	30,000
Cash in hand as on 31st March 2022	28,500
Cash in hand as on 31st March 2021	13,600
Capital Fund as on 31st March 2021	2,20,600

You are required to prepare Receipts and Payment Account of the association for the year ended 31st March 2022 and the Balance Sheet as at that date.

2. The following are the items of Receipts and Payments of the BJ Club as summarized from the books of account maintained by the Secretary:

Receipts	(₹)	Payments	(₹)
Opening Balance 1.1.2022	4,200	Manager's Salary	1,000
Entrance Fees: For 2021	1,000	Printing and Stationery	2,600
For 2022	10,000	Advertising	1,800
Subscriptions: For 2021	600	Fire Insurance	1,200
For 2022	15,000	Investments Purchased	20,000
Interest Received on Investments	3,000	Closing Balance 31.12.2022	7,600
Subscriptions 2023	400		
	34,200		**34,200**

It was ascertained from enquiry that the following represented a fair picture of the Income and Expenditure of the Club for the year 2022 for audit purpose:

Receipts	(₹)	(₹)	Payments	(₹)
Manager's Salary		1,500	Entrance Fees	10,500
Printing & Stationery	2,000		Subscription	15,600
Add: Accrued	400	2,400	Interest on Investments	4,000
Advertising (accrued Nil)		1,600		
Audit Fees		500		
Fire Insurance		1,000		
Depreciation		4,940		
Excess of Income over Expenditure		18,160		
		30,100		**30,100**

You are required to prepare the Balance Sheet of the Club as on 31.12.2021 and 31.12.2022, it being given that the values of the Fixed Assets as on 31.12.2021 were: Building ₹44,000, Cricket Equipment ₹25,000 and Furniture ₹4,000. The rates of depreciation are Building 5%, Cricket Equipments 10%, Furniture 6%.

Your are entitled to make assumptions as may be justified.

3. Citizen Sports Club is a prominent sports club of Nagpur, Maharashtra. During the immediately concluded financial year, the club organised a number of activities during a year involving its members. The following extracts of the various receipts and payments made by the club during the year ended December 31, 2022 has been made available to you from the club's office records:

Receipts	(₹)	Payments	(₹)
To Balance (1.1.2021)	2,40,000	By Upkeep of ground	2,10,000
To Subscriptions	8,70,000	By Secretary's Salary	3,60,000
To Entrance Fees	50,000	By Wages of groundsmen	2,40,000
To Proceeds of Concerts	1,50,000	By Ground rent	15,000
To Interest on Investments	50,000	By Printing & Stationery	20,000
		By Sundry Expenses	17,500
		By Balance (31.12.2022)	4,97,500
	13,60,000		**13,60,000**

Mr. Girish Agarkar, the secretary of the club has approached you to finalise the accounts of the club. As per his advice, the chief accountant of the club, Mr. Parash Ojha proived you the following additional information:

(a) Subscriptions include arrear subscription brought over from previous year ₹50,000.

(b) Interest on Investments includes ₹10,000 in respect of interest accrued in the preceding period.

(c) Upkeep of ground and Wages of groundsmen include ₹30,000 and ₹15,000 respectively applicable to the preceding year.

(d) Other ledger balances at the commencement of the financial period were: Capital Fund ₹40,10,000; Surplus brought forward ₹8,90,000; Club Premises and Grounds (as per valuation) ₹30,00,000; Investments ₹10,00,000; Sports materials ₹2,45,000; Furniture ₹400,000.

(e) Entrance fees are to be capitalised.

(f) Outstanding liabilities on 31.03.2022: Wages of groundsmen ₹20,000; Printing ₹10,000.

(g) Interest accrued and outstanding on investments was ₹12,000.

(h) Depreciation to be provided on different assets at the following rates:
Club Premises by 2%, Furniture by 5% and Sports Equipments by 33.33%

1. Determine how much surplus, if any, has been earned by Citizen Sports Club during the financial year 2021-22.
2. Prepare the Balance Sheet of the Club as on March 31, 2022.

Single Entry

1. The following information is available from Mrs. Sashi who maintains books of accounts on single entry system.

Particulars	01.04.2021 (₹)	31.03.2022 (₹)
Cash and Bank	20,000	21,000
Sundry Debtors	17,000	25,000
Stock	40,000	60,000
Furniture	29,000	29,000
Creditors	32,000	22,000
10 % Loan from Mrs. Sashi	30,000	30,000

Mrs. Sashi withdrew ₹5,000 from the business every month for meeting her household expenses. During the year She sold investments held by her privately for ₹35,000 and invested the amount in her business. At the end of the year 2021-2022, it was found that full years interest t on loan from Mrs. Sashi had not been paid. Depreciation @ 10% p.a was to be provided on furniture for the full year. Shop assistant was to be given a share of 5% on the profits ascertained before charging such share. Calculate profit earned during the year ended 31.03.2022 by Mrs. Sashi.

2. Mr. M. Raja, is a graduate in Sociology who hails from a middle-class family in Madurai, Tamil Nadu. Since his childhood, Raja intended to be a businessman like Mr. P. Nageswar, father of his best friend N. Premnath. Accordingly, he started his personal sole proprietary business trading in coconut oil in the year 2019-20. Mr. Raja, not being very conversant with accounts of the business, approaches you for helping him with the finalisation of the accounts of the financial year 2021-22. He furnishes you with the following bank summary for the year ended March 31, 2022:

Particulars	(₹)	(₹)
Balance on April 1, 2021		11,000
Add: Deposits		
Cash (out of cash sales)	1,25,000	
Collection from Credit Customers	3,50,000	
Income from personal investments	36,000	5,11,000
		5,22,000
Less: Deductions		
Cash withdrawn for personal drawings	20,000	
Shop expenses	40,000	
Cheques issued to suppliers of:		
Goods	3,50,000	
Supplies	40,000	
Cheques issued for personal purposes	55,000	
Bank charges	500	5,05,500
Balance on March 31, 2022		16,500

Mr. Raja informs you that he had the following Assets and Liabilities (in addition to the Bank Balances) on March 31, the extracts of which are as under:

Particulars	2021-22(₹)	2020-21(₹)
Assets:		
Cash Balance	7,000	4,000
Amounts due from Customers	37,000	27,500
Unsold Inventory at Cost	13,000	10,000
Prepaid Expenses	3,000	2,000
	60,000	**43,500**
Liabilities:		
Creditors for Goods 23,000 28,000	23,000	28,000
Creditors for Services	2,500	1,500
	25,500	**29,500**

He also informs you the following:

(a) He uses 75% of cash sale proceeds for making cash purchases; the remaining balance being deposited in Bank.

(b) He had allowed cash discount of ₹5,000 to his credit customers for prompt payment; he was allowed cash discount ₹7,000 by his suppliers of goods for prompt payment.

(c) Collections from credit customers and payments to suppliers of goods are invariable by crossed cheques.

1. What is the balance of Mr. M. Raja’s capital account as on April 1, 2021?

2. Ascertain the amounts of credit sales and credit purchases made by the business during the year 2021-22.

3. Determine the operating result of the business by preparing the Trading and Profit & Loss account for the year ended March 31, 2022.

4. Draft the Balance Sheet of the business as at March 31, 2022.

Branch Accouting

1. Blue Ltd has a retail branch at Mumbai. Goods are sold at 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Pune H.O. to Mumbai Branch at wholesale price. From the following particulars ascertain the profit made at H.O. and Branch for the year ended on 31.3.2019. [Fig. in ₹]:

Particulars	H.O	Branch	Particulars	H.O	Branch
Stock on 1.4.2018	7,00,000	-	Sales	42,84,000	14,40,000
Purchases	42,00,000	-	Stock on 31.3.2019	16,80,000	2,52,000
Goods sent to Branch (at IP)	15,12,000	-			

Sales at H.O are made only on wholesale basis and that at Branch only to consumers.

2. Journalise the following transactions in the books of Kolkata Head Office, Delhi Branch and Agra Branch :

(a) Goods worth ₹50,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office.

(b) Delhi Branch draws a bill receivable for ₹40,000 on Agra Branch which sends its acceptance.

(c) Delhi Branch received ₹10,000 from Agra Branch.

(d) Goods worth ₹20,000 were returned by a customer of Agra Branch to Delhi Branch.

(e) Agra Branch collected ₹20,000 from a customer of Delhi Branch.

3. Pal & Co., is a manufacturer of umbrella with their head office at Kolkata. In order to expand their business, Mr. Sourav Pal, grandson of the founder Mr, Suresh Pal, opened a branch of their business at Bangalore in the southern Indian state of Karnataka in the year 2018-19.

It was decided by Sourav that the goods will be invoiced from Kolkata head office to their Bangalore branch at 20% less than list price, which is cost plus 100%, with instruction that cash sales are made at invoice price and credit sales at list price.

There were not much transactions between the head office and Bangalore branch during the next to financial years due to the lockdown induced by the COVID-19 outbreak. However, the business started with slowly but steadily in 2021-22.

The following particulars have been made available to you for the year ended 31.03.2022:

Particulars	(₹)
Stock at Bangalore branch on 01.04.2021 (at invoice price)	24,000
Amount due from debtors on 01.04.2021	20,000
Goods received from head office (at invoice price)	2,64,000
Goods returned to head office (at invoice price)	2,000
Sales:	
Cash	92,000
Credit	2,00,000

Cash received from debtors	1,71,268
Expenses incurred at Bangalore branch	34,732
Remittance from Bangalore branch to Kolkata head office	2,40,000
Amount due from debtors on 31.03.2022	48,732
Stock at Bangalore branch on 31.03.2022 (at invoice price)	30,800

It is further communicated by the branch manager that there has been some stock shortage at their Bangalore branch which were identified in the month of March 2022.

(a) Calculate amount of stock shortage (at invoice price) that occurred at Bangalore branch.

(b) Determine gross profit or loss made by Bangalore branch for the year ended 31.03.2022.

(c) Determine net profit or loss made by Bangalore branch for the year ended 31.03.2022.

4. M/s Jai Traders, a manufacturer of ceramic utensils has been in business for last 36 years. In the year 2015-16, it decided to open a branch for cater to their customers in the eastern part of India. It was decided by the senior management members to open the branch at Patna. The Patna branch ultimately started its operations from January 1, 2017. Over the years, its business gradually grew in the eastern states of the country. The following particulars relate to Patna branch for the year ending March 31, 2022:

Particulars	(₹)
Balances on April 1, 2021:	
Stock	40,000
Debtors	14,000
Petty cash	1,500
Furniture	12,000
Prepaid fire insurance premium	1,150
Outstanding salaries	2,100
Goods sent to branch	2,80,000
Cash sales	3,30,000
Credit sales	1,83,000
Cash received from debtors	1,35,000
Cash paid by debtors direct to head office	22,000
Discount allowed	1,100
Cash sent to branch for expenses:	
Rent: ₹12,000; Salaries; ₹5,400; Petty cash: ₹4,000; Insurance premium (from 1.4.2012 to 31.3.2013)	
Goods returned by the branch	4,000
Goods returned by the debtors	7,000
Stock at branch on 31.03.2022	38,000
Petty expenses paid by the branch	2,850
Loss of stock by fire	4,800

It is the policy of the organisation to provide depreciation on furniture @ 10% p.a.

a. Determine the amount due from Branch debtors as at the end of the financial year 2021-22.

b. Ascertain the amount of profit or loss at Kanpur Branch for the year ending 31.03.2022 by preparing Branch Account in the books of Jaipur head office.

5. SS Textiles Ltd. have a branch in Auckland, New Zealand. The trail balance of the branch as on 31.03.2022 was as given below:

Particulars	Dr. (NZ $)	Cr. (NZ $)
Head Office Account		18,000
Sales		1,20,000
Goods from the Head Office Account	90,000	
Opening Stock	15,000	
Office furniture	20,000	
Cash	100	
Bank	1,900	
Expenses outstanding		2,000
Salaries	6,000	
Taxes & Insurance	500	
Rent	2,000	
Debtors	4,500	
	1,40,000	**1,40,000**

The Branch Account in the head office showed a debit balance of ₹13,20,000 and 'Goods sent to Branch Accounts' a credit balance of ₹80,00,000.

Office furniture were acquired in 2005 when NZ $1 = ₹80.

The exchange rates were (NZ $1):

January 1, 2020 - ₹88;

December 31, 2020 - ₹92;

Average – ₹90.

The stock at branch on December 31, 2022 was valued at NZ $9,000.

Convert the Branch Trial Balance into rupees and prepare the Branch Trading and Profit and Loss Account for 2022, and the Branch Account in Head Office books. Depreciation is to be written off the office furniture @ 10%.

Departmental Accounts

1. A Ltd. manufacturing electronic components operates with two departments. Transfer made between the departments of both purchased goods and manufactured finished goods. Goods purchased are transferred at cost and manufactured goods are transferred only at selling price as is the case with open market.

Transactions for the year ended Mar. 31, 2022 are given below:

Particulars	Dept. X (₹)	Dept. Y (₹)
Opening Stock	20,000	15,000
Sales	1,90,000	1,35,000
Wages	12,500	7,500
Purchases	1,00,000	80,000
Closing stock:		
Purchased goods	2,000	5,000
Manufactured goods	7,000	8,000

The following were transfers from Dept. X to Dept. Y: Purchased goods ₹6,000 and finished goods ₹20,000; and from Dept. Y to Dept. X: Purchased goods ₹5,000 and finished goods ₹35,000. Stocks were valued at cost to the department concerned. It is estimated that closing stock of manufactured goods of Dept. Y consists of 20% for goods received from Dept. X.

You are required to prepare Departmental Trading Account and A Ltd.'s Trading Account for the year ended Mar. 31, 2022. Also show the reconciliation of the profits ascertained from these accounts.

2. Samudra & Co. a partnership firm has three departments viz. K, L, M which are under the charge of the Partners B, C and D respectively. The following Consolidated P&L Account is given below :

Profit and Loss Account

Particulars	Dr. (₹)	Particulars	Cr. (₹)
To, Opening Stocks (Note i)	81,890	By, Sales (Note vii)	4,00,000
To, Purchases (Note ii)	2,65,700	By, Closing Stocks (Note viii)	89,000
To, Salaries and Wages (Note iii)	48,000	By, Discounts Received (Note x)	800
To, Rent Expenses (Note iv)	10,800		
To, Selling Expenses (Note v)	14,400		
To, Discount Allowed (Note v)	1,200		
To, Depreciation (Note vi)	750		
To, Net Profit for the year	67,060		
	4,89,800		**4,89,800**

From the above account and the following additional information, prepare the Departmental P&L Account for the year ended 31st March, 2013.

- **(i)** Break up of Opening Stock Department wise is: K - ₹37,890; L - ₹24,000 and M - ₹20,000.
- **(ii)** Total Purchases were as under: K - ₹1,40,700; L - ₹80,600; M - ₹44,400.
- **(iii)** Salaries and Wages include ₹12,000 wages of Department M. The balance Salaries should be apportioned to the three departments as 4:4:1.
- **(iv)** Rent is to be apportioned in the ratio of floor space which is as 2:2:5.
- **(v)** Selling Expenses and Discount Allowed are to be apportioned in the ratio of Turnover.
- **(vi)** Depreciation on assets should be equally charged to the three departments.
- **(vii)** Sales made by the three departments were: K - ₹1,80,000; L - ₹1,30,000 and M - ₹90,000.
- **(viii)** Break up of Closing Stock Department wise is: K - ₹45,100; L - ₹22,300 and M - ₹21,600. The Closing Stock of Department M includes ₹5,700 goods transferred from Department K. However, Opening Stock does not include any goods transferred from other departments.
- **(ix)** Departments K and L sold goods worth ₹10,700 and ₹600 respectively to Department M.
- **(x)** Discounts received are traceable to Departments K, L and M as ₹400; ₹250 and ₹150 respectively.
- **(xi)** Partners are to share the profits as under: (a) 75% of the Profits of Departments K, L and M to the respective Partner in Charge, (b) Balance Profits to be credited as 2:1:1.

3. M/s Auto Garage consists of three departments: Spares, Services and Repairs. Each department being managed by a departmental manager whose commission was respectively 5%, 10% and 10% of the respective departmental profit. In the absence or inadequacy of profit, a minimum commission of ₹3,000 is to be paid to managers. Interdepartmental transfers of goods and services are made on the basis of loaded price given as under:

From Spares to Services 5% above cost

From Spares to Repairs 10% above cost

From Repairs to Services 10% above cost

In respect of the year ended 31st March, 2022 the books has already been closed and positions drawn. Subsequently it was discovered that closing stock of departments had included inter-departmental transferred goods at loaded price instead of the correct cost price. From the following information prepare a revised statement recomputing the departmental profit or loss.

Particulars	Spares (₹)	Service (₹)	Repairs (₹)
Net Profit/Loss as per accounts	19,000 (loss)	25,200 (profit)	36,000 (profit)
Inter-departmental transfers included at loaded price in the departmental stocks	---	32,500 (₹10,500 from Spares and ₹22,000 from Repairs)	2,100 (from spares)

Insurance Claim

1. Mr. X's godown was destroyed by fire on 1.6.2022 when the goods in stock were insured for ₹60,000. The following particulars are given:

Balance Sheet (Extract) as at 31st December 2021

Liabilities	Amount (₹)	Asset	Amount (₹)
Creditor for goods	20,000	Stock (including goods held by agent ₹2,000)	36,000
		Debtors	70,000

Transactions upto 31st May, 2022 include:

Particulars	Amount (₹)	Particulars	Amount (₹)
Cash Received from Debtors	3,40,000	Cash paid to Creditors	2,20,000
Bad Debt written off	3,500	Discount Received	1,000
Balance on 31.5.2022:			
Debtors	70,000		
Creditors	30,000		

Additional information:

(i) Debtors on 31.5.2022, included an amount owing from the agent from sales to date ₹4,000 less 10% commission and his expenses amounting to ₹100 on 31.5.2022 – the agent still held the said goods valued at ₹3,600 (at selling price).

(ii) Sales (total) for the periods include ₹1,600 for goods which have the selling price reduced by 50% and also ₹6,000 reduced by 25%.

(iii) The normal mark up is 50% on cost and except the above, all sales can be assumed to be at the full selling price.

(iv) All the goods were destroyed and there was no salvage value of the goods.

Calculate the amount of claim.

2. A fire occurred in the premises of Sri. G. Vekatesh on 1.4.2022 and a considerable part of the stock was destroyed. The stock salvaged was ₹28,000. Sri Venkatesh had taken a fire insurance policy for ₹17,10,000 to cover the loss of stock by fire.

You are required to ascertain the insurance claim which the company should claim from the insurance company for the loss of stock by fire. The following particulars are available:

Particulars	(₹)	Particulars	(₹)
Purchases for the year 2021	9,38,000	Stock on 1.1.21	1,44,000
Sales for the year 2021	11,60,000	Stock on 31.12.2021	2,42,000
Purchases from 1.1.22 to 1.4.22	1,82,000	Wages paid during 2021	1,00,000
Sales from 1.1.22 to 1.4.22	24,00,000	Wages paid 1.1.22 to 1.4.22	1,80,000

Sri Venkatesh had in June 2021 consigned goods worth ₹50,000, which unfortunately were lost in an accident. Since there was no insurance cover taken, the loss had to be borne by him full.

Stocks at the end of each year for and till the end of calendar year 2020 had been valued at cost less 10%. From 2021, however there was a change in the valuation of closing stock which was ascertained by adding 10% to its costs.

3. A fire occurred in the premises of M/s Bad Luck Traders twice during the accounting year 2021-22 that is on 31st August 2021 and again on 30th November, 2021. From the following particulars, calculate the claim to be lodged in respect of the goods lost by fire on the aforementioned date:

a. The stock as at 31st March, 2021 was valued at ₹59,000.

b. The purchases from 1st April, 2021 to 31st August, 2021 amounted to ₹3,45,000.

c. The purchases from 1st September, 2021 to 30th November, 2021 amounted to ₹1,90,000 of which goods costing ₹45,000 were received on 10th December, 2021.

d. Sales for the period from 1st April, 2021 to 31st August, 2021 amounted to ₹4,71,000.

e. The sales for the period from 1st September, 2021 to 30th November, 2021 amounted to ₹2,25,000. It includes sale of old furniture of ₹27,000.

The company earns a steady rate of Gross profit at 20% at the beginning of the year 2021. However, the selling price was raised by 20% from the month of April.

The value of the goods salvaged was ₹30,000 and ₹2,000 on 31st August, 2021 and on 30th November, 2021 respectively.

The firm had taken out a fire insurance policy of ₹45,000 on 1st April, 2021. At the time of receiving the insurance claim on 31st August, 2021, no additional premium was paid for restoration of the insurance policy to its original amount. The policy was subject to average clause.

4. A fire occurred on Mar. 15, 2021 in the premises of Omega Ltd. A Loss of Profit policy was taken by Omega Ltd. for ₹80,000. The indemnity period was for 3 months. Net Profit for the year ending Dec. 31, 2020 was ₹56,000 and standing charges (all insured) amounted to ₹49,600. Determine insurance claim from the following details available from quarterly sales tax returns:

Sales	2018 (₹)	2019 (₹)	2020 (₹)	2021 (₹)
From Jan.1 to Mar.31	1,20,000	1,30,000	1,42,000	1,30,000
From Apr.1 to June 30	80,000	90,000	1,00,000	40,000
From July 1 to Sept.30	1,00,000	1,10,000	1,20,000	1,00,000
From Oct.1 to Dec.31	1,36,000	1,50,000	1,66,000	1,60,000

Particulars	(₹)
Sales from 16.3.2020 to 31.3.2020	28,000
Sales from 16.3.2021 to 31.3.2021	Nil
Sales from 16.6.2020 to 30.6.2020	24,000
Sales from 16.6.2021 to 30.6.2021	6,000

5. X & Co. suffered a loss of stock due to fire on 31.3.2022. From the following information prepare a statement showing the claim for the loss to be submitted:

Particulars	Amount (₹)
Purchase for the year 2021	3,20,000
Sales for the year 2021	4,05,200
Purchase from 1.1.2022 to 30.6.2022	1,08,000
Sales from 1.1.2012 to 30.6.2022	1,22,800
Stock on 1.1.2021	76,800
Stock on 1.1.2022	63,600

An item of goods purchased in 2020 at a cost of ₹20000 was valued at ₹12,000 on 31.12.2020. Half of these goods were sold during 2021 for ₹5,200 and the remaining stock was valued at₹4,800 on 31.12.2021. ¼th of the original stock was sold for ₹2,800 in February 2022 and the remaining stock was valued at 60% of the original cost. With the exception of this item, the rate of gross profit remained fixed. The stock salvaged was estimated at ₹24,000. The insurance policy value was for ₹3,00,000.

LEASE ACCOUNTING

A lease is an agreement which is entered into by the owner of an asset (lessor) with the intended user of the asset (lessee) in return for a payment or series of payments for an agreed period of time. It is a transaction which gives the lease the right to use an asset for a specified period of time.

It is to be noted here that the definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements.

In India, accounting for leases is covered under Accounting Standard (AS) 19 Leases.

Objective

The objective of AS 19 is to prescribe the appropriate accounting policies and disclosures in relation to finance leases and operating leases for both lessees and lessors.

Applicability

AS 19 should be applied in accounting for all leases other than:

- **(a)** lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights;
- **(b)** licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and
- **(c)** lease agreements to use lands.

Leases are classified into two types:

1. **Finance lease:** A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred.
2. **Operating lease:** A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

It is important to note that lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease the revised agreement is considered as a new agreement over its revised term. However, Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

1. Finance Lease

Finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form.

Situations which lead to a lease being classified as a finance lease

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

Indicators of situations leading to finance lease

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.

Treatment of finance lease in financial statement of lessee

Treatment of finance lease transactions is very significant because if such transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments.

At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.

Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

Lease payments should be apportioned between finance charge and reduction of outstanding liability. The finance charge should be allocated to periods during lease term so as to produce a constant periodic rate of interest on the remaining balance of liability for each period.

Finance lease and Depreciation: A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

Treatment of finance lease in financial statement of lessor

The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

2. Operating Lease

Operating lease is a lease other than a finance lease.

Treatment in financial statement of lessee

Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Treatment in financial statement of lessor

The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

Operating lease and Depreciation: The depreciation of leased assets should be on a basis consistent with the normal depreciation policy of the lessor for similar assets, and the depreciation charge should be calculated on the basis set out in AS 6, Depreciation Accounting.

Sale and Leaseback Transactions

A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package.

Accounting of sale and leaseback transaction

The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

When a sale and leaseback transaction results in a finance lease: Any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

When a sale and leaseback transaction results in an operating lease: In such a case, if it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the Accounting Standard dealing with impairment of assets.

1. Arun Ltd. has taken an equipment on operating lease for the coming 5 years. As per the agreement with the lessor, it will not make any payment for lease rentals for the first 2 years, and will have to pay ₹21,00,000 in each of the following 3 years. Advise Arun Ltd. on accounting for the lease rentals in this case.

2. Vishnu Ltd. leased a printing machine from Garur Ltd. for a period of 3 years. The useful life of the printing machine is known to be of 5 years. It was agreed between the lessor and lessee that the amount will be paid in 3 instalments and at the termination of the lessee, Garur Ltd. will take back the said machine. The following details are available in respect of the machine lessee:
   - Cost of the printing machine is ₹15,00,000;
   - Unguaranteed residual value at the end of the lease period is ₹2,00,000;
   - Fair value of the machine is ₹15,00,000;
   - The internal rate of return of the investment is 10%.

   You are required to:

   (a) State whether the lease is a finance lease or an operating lease?

   (b) Ascertain the amount of unearned finance income.

   Given: PVF10%, 3 = 0.7513; PVAF10%, 3 = 2.4868.

3. Unique Ltd. availed a lease from Papan Ltd. on following terms:
   - A lease for a tenor of 3 years, in the beginning of year 2020 for equipment costing ₹7,00,000 and which has an expected useful life of 5 years. The fair market value is also ₹7,00,000.
   - 3 equal annual payments are made at end of each year.
   - The property reverts back to the lessor on termination of the lease.
   - The unguaranteed residual value is estimated at ₹75,000 at the end of year 2022.
   - IRR=10% ~ The present value of ₹1 due at the end of 3rd year at 10% rate of interest is 0.7513.
   - The present value of annuity of ₹1 due at the end of 3rd year at 10% IRR is ₹2.4868

   You are required to:

   (I) State with reason whether the lease constitute finance lease.

   (II) Calculate unearned finance income.

Fill in the Blanks

1. As per AS-19 in__________ lease risk and reward is not transferred to the lessee.
2. In financial lease as per As-19 leased assets is shown in the Balanced sheet of _________.
3. __________ account is credited when lessor receive an amount.

Multiple Choice Questions

1. The person who undertake an agreement, conveys to another person the right to use in return for rent, an assest for an agreed period of time.
   a. Lessor
   b. Lessee
   c. Both
   d. None of the above
2. Operating lease is a:
   a. Revocable contract
   b. Non revocable contract
   c. Operating contract
   d. None of the above
3. Which lease transfer substantially all the risk and rewards incident to ownership of an asset?
   a. Operating lease
   b. Finance lease
   c. Both
   d. None of the above
4. In which types of lease expenses like maintenance, repair, and taxes are born by the lessor?
   a. Operating lease
   b. Financial lease
   c. Both
   d. None of the above
5. Short-term lease which is often cancellable is known as
   a. Finance Lease
   b. Net Lease
   c. Operating Lease
   d. Leverage Lease
6. A lease which is generally not cancellable and covers full economic life of the asset is known as:
   a. Sale and leaseback
   b. Operating Lease
   c. Finance Lease
   d. Economic Lease

7. One difference between Operating and Financial lease is:

a. There is often an option to buy in operating lease

b. There is often a call option in financial lease.

c. An operating lease is generally cancelable by lease

d. A financial lease in generally cancelable by lease.

Accounting Standards – AS

Disclosure of Accounting Policies (AS-1)

This standard deals with **disclosure of significant accounting policies followed in the preparation and presentation of the financial statements and is mandatory in nature.**

The accounting policies refer to the specific accounting principles adopted by the enterprise.

Proper disclosure would ensure meaningful comparison both inter/intra enterprise and also enable the users to properly appreciate the financial statements.

Financial statements are intended to present a **fair reflection of the financial position financial performance and cash flows of an enterprise**.

Areas involving different accounting policies by different enterprises are:

- Methods of depreciation, depletion and amortization
- Treatment of expenditure during construction
- Treatment of foreign currency conversion/translation.
- Valuation of inventories
- Treatment of intangible assets
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long-term contracts
- Valuation of fixed assets
- Treatment of contingent liabilities

Factors governing the selection and application of accounting policies are:

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

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

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

(a) As to the disclosure of all material items, individually or in aggregate in the context of fair presentation of financial statements as a whole if its omission or misstatement could influence the economic or financial decision of the user relying upon the financial statements.

(b) **Depends on the size of the items or errors** judged in the particular circumstances of its omissions or misstatements.

(c) Is a **cutoff point rather than being a primary qualitative characteristic** which information must have.

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

AS 1 requires that all "significant" (i.e. only accounting policy that is useful for an understanding by the user of the financial statements) accounting policies adopted in the preparation and presentation of financial statements, should be disclosed by way of 'Note in one place'.

Changes in Accounting Policies :

Any change in the accounting policies which has a **material effect in the current period or which is reasonably expected to have a material effect in the later period should be disclosed**. In the case of a **change in accounting policies, having material effect in the current period**, the amount by which any item in the financial statements, is affected by such change should also be disclosed to the **extent as ascertainable**, otherwise **the fact that the effect is not (wholly or partially) ascertainable, should be disclosed.**

The following are **<u>not considered</u>** as changes in accounting policies :

(a) Accounting policies adopted for events or transactions that differ in substance at present (introducing Group Gratuity Scheme for employees in place of adhoc ex-gratia payment earlier followed.)

(b) Accounting policies pertains to events or transactions which did not occur previously or that were immaterial.

Fundamental Accounting Assumptions

Certain basic assumptions, in the preparation of financial statements are accepted and their use are assumed, no separate disclosure is required except for noncompliance in respect of —

(a) **Going Concern:** continuing operation in the foreseeable future and no interim necessity of liquidation or winding up or reducing scale of operation.

(b) **Consistency:** accounting policies are consistent from one period to another

(c) **Accrual:**

- **(i)** Revenues and costs are accrued i.e. they are earned or incurred (not actually received or paid) and recorded in the financial statements
- **(ii)** Extends to matching revenue against relevant costs.

1. Jivandeep Ltd. had made a right issue in 2020. In the offer document to its members, it had projected a surplus of ₹40 crores during the accounting year to be ended on 31st March 2022. The draft results for the year prepared on the hitherto followed accounting policies and presented for perusal of the Board of Directors showed a deficit of ₹10 crores. The Board, in consultation with the Managing Director, decided on the following:

(i) Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at Prime Cost (₹30 crores).

(ii) Provide depreciation for the year on straight line basis or account of substantial additions in gross block during the year, instead of on the Reducing Balance Method, which had been hitherto adopted. As a consequence, the charge for depreciation at ₹27 crores is lower than the amount of ₹45 crores -which would have been provided had the old method been followed-by ₹18 crores.

(iii) Not to provide for "after-sales expenses" during the warranty period. Till the last year, provision at 2% on sales used to be made under the concept of "matching of cost against revenue" and actual expenses used to be charged against the provision. The Board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹600 crores.

(iv) Provide for permanent fall in the value of investment-which fall had taken place over the past 5 years-the provision being ₹10 crores. As chief accountant of the company, you are asked by the Managing Director to draft the Notes on Accounts for inclusion in the annual report for 2021-2022.

2. Which one is the correct one?

Fundamental accounting assumptions as per AS 1 are:

(a) Going Concern, Matching and Consistency;

(b) Money Measurement, Going Concern and Prudence;

(c) Accounting Period, Going Concern and Entity Concept; and

(d) Going Concern, Consistency and Accruals.

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

4. Explain the methods/criteria for the selection and application of Accounting Policies.

Property Plant and Equipment (AS-10)

Objective

The **objective** of AS 10 is to prescribe the **accounting treatment for property, plant and equipment** so that **users of the financial statements can discern information about investment** made by an enterprise in its property, plant and equipment and the changes in such investment.

Scope

This Standard shall be applied in accounting for property, plant, and equipment **except** when another Standard **requires or permits a different accounting treatment.**

This Standard **does not apply** to:

(a) **biological assets related to agricultural activity other than bearer plants**. This Standard applies to bearer plants but it **does not apply** to **the produce on bearer plants**; and

(b) **wasting assets** including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (a) and (b) above.

Property, plant and equipment are **tangible items** that:

(a) are **held for use in the production or supply of goods or services**, for **rental to others, or for administrative purposes**; and

(b) are **expected to be used during more than a period of twelve months**. Recoverable amount is the higher of an asset's net selling price and its value in use.

Recognition

The cost of an item of property, plant and equipment should be **recognised as an asset if, and only if:**

(a) it is probable that **future economic benefits associated with the item will flow to the enterprise**; and

(b) the **cost of the item can be measured reliably**.

An enterprise **evaluates under this recognition** principle all **its costs on property, plant and equipment at the time they are incurred**. These costs include costs incurred: (i) **initially to acquire or construct** an item of property, plant and equipment; and (ii) **subsequently to add to, replace part of**, or service it.

Measurement at Recognition

An item of property, plant and equipment that qualifies for **recognition as an asset should be measured at its cost**.

The **cost of an item** of property, plant and equipment comprises:

(a) its **purchase price**, including import duties and non–refundable purchase taxes, **after deducting trade discounts and rebates.**

(b) any **costs directly attributable to bringing the asset to the location and condition** necessary for it to be capable of operating in the manner intended by management.

(c) the **initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located**, referred to as decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in AS 15, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

Examples of costs that are not costs of an item of property, plant and equipment are:

(a) costs of opening a new facility or business, such as, inauguration costs;

(b) costs of introducing a new product or service(including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

The cost of a **self-constructed asset** is determined using **same principles as for an acquired asset**.

Bearer plants are accounted for in the same way as **self-constructed items of property, plant and equipment** before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Measurement after Recognition

An enterprise should choose **either the cost model or the revaluation model as its accounting policy** and should apply that policy to an entire class of property, plant and equipment.

Cost Model : After recognition as an asset, an item of property, plant and equipment should be carried at **its cost less any accumulated depreciation and any accumulated impairment losses**.

Revaluation Model : After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, **being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient**

regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. If an item of property, plant and equipment is revalued, the **entire class** of property, plant and equipment to which that **asset belongs should be revalued**.

An **increase in the carrying amount** of an asset arising on revaluation should be **credited directly to owners' interests under the heading of Revaluation Surplus**. However, the increase should be recognised in the **Statement of Profit and Loss to the extent that it reverses** a **revaluation decrease of the same asset previously recognised** in the Statement of Profit and Loss.

A **decrease in the carrying amount** of an asset arising on revaluation should be **charged to the Statement of Profit and Loss.** However, the decrease should be **debited directly to owners' interests under the heading of revaluation surplus** to the **extent of any credit balance existing in the Revaluation Surplus in respect of that asset**.

Depreciation

Each part of an item of property, plant and equipment with a **cost that is significant in relation to the total cost of the item should be depreciated separately**.

The **depreciation charge** for each period should be recognised in the **Statement of Profit and Loss unless** it is **included in the carrying amount of another asset**.

Depreciable Amount and Depreciation Period

Depreciable amount of an asset should be allocated on a systematic basis over its useful life. The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

Depreciation Method

The depreciation method used should **reflect the pattern** in which **future economic benefits of asset are expected to be consumed by the enterprise**. The **depreciation method applied** to an asset should be **reviewed at least at each financial year-end and**, if there has been a **significant change** in the **expected pattern of consumption of the future economic benefits embodied** in the asset, the method should be **changed to reflect the changed pattern**. Such a **change** should be **accounted for as a change in an accounting estimate in accordance with AS 5**, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

Changes in Existing Decommissioning, Restoration and Other Liabilities

The cost of property, plant and equipment may undergo **changes subsequent to its acquisition or construction** on account of changes in liabilities, price adjustments, changes in duties, changes in initial estimates of amounts provided for dismantling, removing, restoration and similar factors and **included in the cost of the asset**.

Retirements

Items of property, plant and equipment **retired from active use and held for disposal** should be stated at the **lower of their carrying amount and net realisable value**. Any **write-down** in this regard should be recognised **immediately in the Statement of Profit and Loss**.

Derecognition

The carrying amount of an item of property, plant and equipment should be **derecognized**:

(a) **on disposal**; or

(b) when **no future economic benefits are expected from its use or disposal**.

<u>Gain or loss</u> **arising from the derecognition:** The gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as **the difference between the net disposal proceeds**, if any, and the carrying amount of the item. Such gain or loss should be **included in the Statement of Profit and Loss when the item is derecognised** (unless AS 19, Leases, requires otherwise on a sale and leaseback). It is to be noted that such gains **should not be classified** as **revenue as per AS 9, Revenue Recognition**. However, an enterprise that in the course of its ordinary activities, routinely sells items of property, plant and equipment that it had held for **rental to others** should **transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale**. The proceeds from the sale of such assets should **be recognised** in **revenue in accordance with AS 9, Revenue Recognition.**

1. Machineries which appeared in the books of Dee Ltd. at ₹86,00,000 has been revalued at ₹90,00,000. The accumulated depreciation associated was ₹28,00,000. The accountant suggested that revaluation should be accounted for by adjusting accumulated depreciation account. You are required to discuss the treatment as per AS 10.

2. Jay Ltd., a chemical producing company changed a semi-automatic component in an existing machine with a fully-automatic component incurring ₹85,000. This new component would result in increasing the output by 150%. The component changing exercise required the company to dismantle a part of the machine and also re-erect the same for which the company incurred ₹38,000. How should the costs be treated as per AS 10?

3. Alpha Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹45,000 per month. The machine was purchased at ₹1,58,00,000 and ₹50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized as per AS 10.

The Effects of Changes in Foreign Exchange Rate (AS-11)

This accounting standard deals with the **reporting of foreign exchange transactions** in the financial statements of an organisation.

Objective

An enterprise may carry on activities involving foreign exchange in **two** ways. Firstly, it may have **transactions in foreign currencies**, and secondly, it may have **foreign operations**. For these purposes, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide **which exchange rate to use and how to recognise in the financial statements** the financial effect of changes in exchange rates.

Scope

AS 11 deals with:

- Accounting for transactions in **foreign currencies**;
- **Translating financial statements** of foreign operations to reporting currency; and
- Accounting for foreign currency transactions in the **nature of forward exchange contracts**.

The standard however **<u>does not cover</u>** the following issues:

- It **does not specify the currency** in which an enterprise should presents its financial statements;
- **Restatement** of an enterprise's financial statements from its reporting currency into another currency;
- **Presentation in cash flow statements**, of cash flows arising from transactions in foreign currency and translation of cash flows of a foreign operation (AS 3 Cash Flow Statements); and
- **Exchange differences arising from foreign currency** borrowings to the extent they are regarded as adjustment to interest costs (AS 16 Borrowing costs).

Foreign Currency Transactions

Meaning:

A foreign currency transaction is a transaction which **is denominated in or requires settlement in a foreign currency**, including transactions arising when an enterprise either:

(a) **buys or sells goods or services** whose **price is denominated** in a foreign currency;
(b) **borrows or lends funds** when the **amounts payable or receivable are denominated** in a foreign currency;
(c) becomes a **party to an unperformed forward exchange contract**; or
(d) otherwise **acquires or disposes of assets, or incurs or settles liabilities**, denominated in a foreign currency.

Initial Recognition:

A foreign currency transaction **should be recorded, on initial recognition** in the reporting currency, by **applying to the foreign currency amount** the exchange rate between the reporting currency and the foreign currency at the date of the transaction. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used. Eg: An average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period.

Reporting at Subsequent Balance Sheet Dates:

At each balance sheet date:

(a) **Foreign currency monetary items:** Such items should be **reported using the closing rate**. However, in certain circumstances, the closing rate may not reflect with **reasonable accuracy** amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the **reporting currency at the amount which is likely to be realised from, or required to disburse, such item at the balance sheet date**;

(b) **Foreign currency non-monetary items at historical cost:** Such items which are carried in terms of historical cost denominated in a foreign currency should be reported using **the exchange rate at the date of the transaction**; and

(c) **Foreign currency non-monetary items at fair value etc.:** Such items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the **exchange rates that existed when the values were determined**.

Recognition of Exchange Differences

An exchange difference results when there is a **change in the exchange rate** between the **transaction date and the date of settlement of any monetary items** arising from a foreign currency transaction.

Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be **recognised as income or as expenses in the period in which they arise**. However, exchange differences **arising on a monetary item** that, in substance, forms part of an enterprise's net investment in a non-integral foreign operation should be accumulated in a **Foreign Currency Translation Reserve in the enterprise's financial statements** until the disposal of the net investment, at which time they should be **recognised as income or as expenses**. Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

When the transaction is settled within the **same accounting period** as that in which it occurred, all the **exchange difference is recognised in that period**. However, when the transaction is settled in a **subsequent accounting period**, the exchange difference **recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period**.

Translation of Financial Statements of Foreign Operations

Classification of Foreign Operations: Foreign operations are **classified** as either "integral foreign operations" or "non-integral foreign operations". The method used to translate the financial statements of a foreign operation **depends on the way in which it is financed and operates in relation to the reporting enterprise**.

Integral foreign operations: A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it **were an extension of the reporting enterprise's operations**. For example, such a foreign operation might only sell goods imported from the reporting enterprise and remit the proceeds to the reporting enterprise. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an **almost immediate effect on the reporting enterprise's cash flow from operations**. Therefore, the change in the exchange rate affects the **individual monetary items held by the foreign operation rather than the reporting enterprise's net investment in that operation.**

Non-integral foreign operations: A non-integral foreign operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, **all substantially in its local currency**. It may also enter into transactions in foreign currencies, including transactions in the reporting currency. When there is a change in the exchange rate between the reporting currency and the local currency, there **is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise**. The change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non-monetary items held by the non-integral foreign operation.

Factors indicating that a foreign operation is a non-integral foreign operation: The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation:

- **(a)** while the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise;
- **(b)** transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;
- **(c)** the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;

(d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;

(e) the foreign operation's sales are mainly in currencies other than the reporting currency;

(f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation;

(g) sales prices for the foreign operation's products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation; and

(h) there is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports. However, it is to be noted that the appropriate classification for each operation can, in principle, be established from factual information related to the above-mentioned indicators.

Translation of financial statements of an integral foreign operation:

As Integral foreign operation is an extension to the reporting entity's business, there is a **need to convert all the items of financial statements as if they are of the reporting entity**. For converting financial statements of integral foreign operations, the rate should be taken as follows:

- For **Monetary items and Contingent liabilities**: **Closing rate**.
- For **Profit and Loss items**: **Rate on date of transaction or Average rate**.
- For **Non monetary items, if carrying value is measured at Historical Cost** then **no need to revalue**. If **carrying value is measured at Fair value/NRV** – **Rate on date of Valuation is used**.

Translation of Financial Statements of Non-integral Foreign Operations

In translating the financial statements of a non-integral foreign operation for incorporation in its financial statements, the reporting enterprise should use the following procedures:

(a) the **assets and liabilities, both monetary and non-monetary**, of the non-integral foreign operation should be translated at the **closing rate**;

(b) **income and expense items** of the non-integral foreign operation should be translated **at exchange rates at the dates of the transactions**; and

(c) **all resulting exchange differences** should be **accumulated in a foreign currency translation reserve until the disposal of the net investment**.

Change in the Classification of a Foreign Operation

When there is a **change in the classification of a foreign operation**, the translation procedures applicable to the revised classification should be **applied from the date of the change in the classification**.

Forward Exchange Contracts

An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is **not intended for trading or speculation purposes**, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The **premium or discount arising at the inception of such a forward exchange contract** should be **amortised as expense or income over the life of the contract**. **Exchange differences** on such a contract should be **recognised in the statement of profit and loss in the reporting period in which the exchange rates change**. Any **profit or loss arising on cancellation or renewal of such a forward exchange contract** should be recognised as **income or as expense for the period**.

A gain or loss on a forward exchange contract to which paragraph 36 **does not apply** should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the **forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate** (or the forward rate last used to measure a gain or loss on that contract for an earlier period). The gain or loss so computed should be **recognised in the statement of profit and loss for the period**. The **premium or discount on the forward exchange contract** is **not recognised separately**.

1. During the financial year 2021-22, Zeds Ltd., an e-commerce firm entered into a foreign currency transaction relating to fees for technical services paid to a Lucas Ltd., an Atlanta based organisation in the USA. The transaction was for $24,000, which was entered into on 07.12.2021. The payment for the same was made on 20.05.2022. Given that the exchange rates are:

   on 07.12.2021: $1 = ₹68.80;
   on 01.01.2021: $1 = ₹68.95;
   on 31.03.2022: $1 = ₹70.45;
   on 20.05.2022: $1 = ₹71.50.
   You are required to:

   a) ascertain the amount at which the transaction would get recognised in the books; and
   b) calculate amount of foreign exchange gain/ loss to be recorded in the financial statement for the years 2021- 22 and 2022-23.

2. Subhash Ltd. purchased a machine costing ₹216 lakhs on 1.4.2021 and the same was fully financed by foreign currency loan (US $) payable in three annual equal instalments. Exchange rates were $1 = ₹67.50 and ₹70.45 as on 1.4.2021 and 31.03.2022 respectively. First instalment was paid on 31.03.2022. The entire difference in foreign exchange has been capitalized. Advice how the exchange gain/ loss should be accounted for by the company.

3. Mrs. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹47.10 when exchange rate was US$ 1 = ₹47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹47.15. On 31st January, he decided to sell the contract at ₹47.18 per dollar. Show how the profits from contract will be recognised in the books as per AS 11.

4.

Particulars	Exchange Rate per $
Goods purchased on 1.1.20 × 1 for US $ 15,000	₹75
Exchange rate on 31.3.20 × 1	₹74
Date of actual payment 7.7.20 × 1	₹73

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 2021 and 31st March, 2022 as per AS 11.

Accounting for Government Grants (AS-12)

Governments across the world provide different forms of incentives and grants to various organisations which undertake activities that are of importance to the country. The grants received from the government are in various forms such as subsidy, incentives, duty drawbacks among others. Accounting Standard 12 deals with accounting for government grants.

However, this Standard **does not deal** with:

1. the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;
2. government assistance other than in the form of government grants;
3. government participation in the ownership of the enterprise.

Definitions

The following terms are used in this Standard with the meanings specified:

Government refers to **government, government agencies and similar bodies whether local, national or international.**

Government grants are **assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions**. They **exclude** those forms of government assistance which **cannot reasonably have a value placed upon them** and **transactions with government which cannot be distinguished from the normal trading transactions of the enterprise**.

Recognition

Government grants **should not be recognised** until there is reasonable assurance that:

(i) the enterprise will comply with the conditions attached to them; and
(ii) the grants will be received.

Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

Methods of accounting for Government Grants

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

1. **Capital approach**; and
2. **Income approach**.

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

Capital approach: Under this approach, a grant is treated as part of **shareholders' funds**. This approach is followed because many government grants are in the **nature of promoters'**

contribution, i.e., they are given with reference to the **total investment** in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants. These are **credited directly to shareholders' funds.**

Income approach: Under this approach, a grant is considered to be an item of **income over one or more periods**. This approach is followed when the government grants are **not gratuitous in nature**. The enterprise earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.

Non-monetary Government Grants

Government grants may take the form of **non-monetary assets**, such as land or other resources, given at **concessional rates**. In these circumstances, it is usual to account for such assets at their acquisition cost. **Non-monetary assets given free of cost are to be recorded at a nominal value**.

Presentation of Government Grants in financial statements

Presentation of Grants Related to Specific Fixed Assets: The **primary condition** of government grants related to **specific fixed assets** is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.
Two methods of presentation of grants (or the appropriate portions of grants) related to specific fixed assets are regarded as acceptable alternatives:

First method: The grant is shown as a **deduction from the gross value of the asset concerned in arriving at its book value**. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation. Where the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

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

Grants related to non-depreciable assets are credited to **capital reserve as there is usually no charge to income in respect of such assets**. However, if a grant related to a **non-depreciable asset** requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account. For example, in the case of a company, it is shown after 'Reserves and Surplus'.

Presentation of Grants Related to Revenue: Grants related to revenue are sometimes presented as a **credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'**. Alternatively, they are **deducted in reporting the related expense.**

Presentation of Grants of the nature of Promoters' contribution: Where the government grants are of the nature of promoters' contribution, and no repayment is ordinarily expected in respect thereof, the grants are treated as **capital reserve which can be neither distributed as dividend nor considered as deferred income.**

Refund of Government Grants

Government grants sometimes become **refundable because certain conditions do not get fulfilled**. A government grant that becomes **refundable is treated as an extraordinary item** (**and treated accordingly as per AS 5**).

Treatment of refund of government grant depends on the nature of grant recvd. These are discussed hereunder:

Refund of government grant is in the nature of promoters' contribution: The amount refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government **is reduced from the capital reserve.**

Refund of government grant is related to revenue: The amount refundable is applied first against any **unamortised deferred credit remaining in respect of the grant**. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount **is charged immediately to profit and loss statement.**

Refund of government grant is related to specific fixed asset: The amount refundable is recorded by **increasing the book value of the asset or by reducing the capital reserve or the deferred income balance**, as appropriate, by the amount refundable. In case the **book value of the asset is increased, depreciation is provided on the revised book value.**

Disclosure

The following should be disclosed:

(i) the **accounting policy adopted for government grants**, including the **methods of presentation in the financial statements;**

(ii) the **nature and extent of government grants recognised in the financial statements**, including **grants of non-monetary assets given at a concessional rate or free of cost**.

1. Dee Ltd. received ₹80,00,000 from the Central Government as subsidy for setting up a factory in a backward area. How would you treat the transaction in the financial statement of the company?

2. Big Box Ltd., a start-up purchased on April 1, 2020, a machine worth ₹44,85,000 in relation to which it received ₹7,35,000 as grant from Government of India. The company decided to treat this grant as a capital receipt. It is estimated that the realizable value of the machine at the end of its useful life of 4 years will be ₹15,36,000. During the financial year 2022-23, the grant became refundable as the start-up company failed to comply with the necessary terms and conditions of the grant. You are required to calculate the amount of depreciation that is to be charged to the statement of profit and loss for the years 2022-23 and 2023-24 given that the company follows straight line method of charging depreciation.

3. On 1.4.2021, AS Ltd. received government grant of ₹300 lakhs for acquisition of machinery costing ₹1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20 × 4 due to non-fulfilment of certain conditions. How you would deal with the refund of grant in the books of AS Ltd. as per AS 12 assuming that the company did not charge any depreciation for year 20X4?

Borrowing Costs (AS-16)

An entity shall apply this Standard in **accounting for borrowing costs**. The Standard **does not deal with the actual or imputed cost of equity**, including preferred capital not classified as a liability. Further, an entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:

(a) a **qualifying asset measured at fair value**, for example, a biological asset; or

(b) **inventories that are manufactured**, or otherwise produced, in large quantities on a repetitive basis.

Definitions

Borrowing costs are **interest and other costs** that an entity incurs in connection with the borrowing of funds. **Borrowing costs may include:**

(a) **interest and commitment charges on bank borrowings** and other short-term and long-term borrowings;

(b) **amortisation of discounts or premiums** relating to borrowings;

(c) **amortisation of ancillary costs** incurred in connection with the arrangement of borrowings;

(d) **finance charges** in respect of assets acquired under **finance leases** or under other similar arrangements; and

(e) **exchange differences arising from foreign currency** borrowings to the extent that they are regarded as an adjustment to interest costs.

Borrowing Cost and Exchange differences arising from foreign currency borrowings

Exchange differences arising from foreign currency borrowings and considered as borrowing costs are those exchange differences which arise on the **amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings**. Thus, the **amount of exchange difference not exceeding the difference between interest on local currency borrowings and interest on foreign currency borrowings** is considered as borrowings costs to be **accounted for under this Standard** and the **remaining exchange difference**, if any, **is accounted for under AS 11, The Effects of Changes in Foreign Exchange Rates**. For this purpose, the interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

A **qualifying asset** is an asset that necessarily takes a **substantial period of time to get ready for its intended use or sale**.

'Substantial Period of time' w.r.t Qualifying Asset

What constitutes a substantial period of time primarily depends on the facts and circumstances of each case. Ordinarily, **a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the**

case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

Examples of Qualifying Assets

Qualifying assets include **manufacturing plants, power generation facilities, inventories** that require a **substantial period of time to bring them to a saleable condition, and investment properties**.

Other investments, and those inventories that are **routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time**, are **not qualifying assets**. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Recognition of Borrowing Costs

The borrowing costs that are **directly attributable to the acquisition, construction or production of a qualifying asset** are those **borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made**. Such borrowing costs should be **capitalised as part of the cost of that asset**. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard.

Other borrowing costs should be **recognised** as **an expense in the period in which they are incurred**.

Capitalisation of Borrowing Costs

Borrowing costs are capitalised as part of the **cost of a qualifying asset** when it is probable that they will result **in future economic benefits to the enterprise and the costs can be measured reliably**. For the purpose of capitalisation, borrowings can be considered to be of two broad types:

1. **Specific Borrowing:** To extent that **funds are borrowed specifically for the purpose of obtaining a qualifying asset**, amount of borrowing costs eligible for capitalisation on that asset should be determined **as actual borrowing costs incurred on that borrowing during period less any income on the temporary investment of those borrowings**. At times it may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided, and in that case the exercise of judgement is required.

2. **General borrowing:** To the extent that **funds are borrowed generally and used for the purpose of obtaining a qualifying asset**, the amount of borrowing costs eligible for capitalisation should be determined by **applying a capitalisation rate to the expenditure on that asset**. The **capitalisation rate** should be the **weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period**, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The

amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

Commencement, Suspension and Cessation of capitalisation of Borrowing Costs

As per AS – 16, there are three situations arise in relation to capitalization of borrowing costs – **Commencement of Capitalisation of Borrowing Costs, Suspension of Capitalisation of Borrowing Costs, and Cessation of Capitalisation of Borrowing Costs**. These are discussed hereunder:

Commencement of capitalisation of Borrowing Costs

The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:

- **(a)** **expenditure** for the **acquisition, construction or production of a qualifying asset is being incurred**;
- **(b)** **borrowing costs** are being **incurred**; and
- **(c)** activities that are **necessary to prepare the asset for its intended use or sale are in progress**.

Suspension of capitalisation of Borrowing Costs

Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted. However, capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. Borrowing cost which are related to the suspension period should be treated as an expense and transferred to P/L A/c.

Cessation of capitalisation of Borrowing Costs

Capitalisation of borrowing costs should **cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete**. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, **capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete**.

Disclosure

The financial statements should disclose:

- **(a)** the **accounting policy adopted for borrowing costs**; and
- **(b)** the **amount of borrowing costs capitalised during the period**; and

1. T&L Ltd. is a large construction company which is presently involved in the construction of a railway bridge over the Ganga river at Patna. The project cost is ₹125 crores, 40% of which is financed by borrowing from Asian Development Bank at an interest of 3%. There has been a delay in the completion of the project, and the project manager of the railway bridge construction site has identified that delay construction of the railway bridge has happened due to high water levels during the monsoon months of July to September. Ms. Sonali Mathur, the accountant of T&L Co. has not suspended the capitalisation of the borrowing cost and reflected the same in the cost of the qualifying asset. You are required to comment on the treatment

2. On 14.08.2021, Pushkar Ltd. obtained a loan from RBC Bank of ₹65 lakhs to be utilised as under: Purchase of equipment: ₹19,50,000; Construction of factory shed: ₹26,00,000; Advance for purchase of delivery vehicle: ₹6,50,000; Working capital: ₹13,00,000. In March, 2022 installation of the machinery was completed and also construction of factory shed was completed and the machinery installed. However, the truck was not delivered within 31.03.2022. Total interest charged by the bank for the year ending 31.3.2004 was ₹11.70 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

3. Ashima Ltd. has obtained Institutional Term Loan of ₹580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20 × 2 amounted to ₹406 lakhs, ₹58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹580 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

Accounting for Taxes on Income (AS-22)

The operating results ascertained by drafting financial statements seldom match with the taxable profits. It would not be prudent to ignore this difference between the two profits. AS 22 Accounting for Taxes on Income **governs the accounting for such differences**. The objective of this Standard is to prescribe **accounting treatment** for **matching the differences between accounting income and taxable income**.

Scope

This Standard should be applied in accounting for taxes on income. This includes the **determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements**. For the purposes of this Standard, income taxes include **all domestic and foreign taxes which are based on taxable profits**. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity. However, **AS 22 does not specify when**, or how, an enterprise should account for taxes that are **payable on distribution of dividends and other distributions made by the enterprise.**

Important Definitions

The following terms are used in this Standard with the meanings specified:

Accounting income (loss) is the **net profit or loss for a period**, as **reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving**.

Taxable income (tax loss) is the amount of the income (loss) for a period, **determined in accordance with the tax laws**, based upon which **income tax payable (recoverable) is determined**.

Tax expense (tax saving) is the **aggregate of current tax and deferred tax** charged or credited to the statement of profit and loss for the period.

Current tax is the amount of **income tax determined to be payable (recoverable)** in respect of the taxable income (tax loss) for a period.

Deferred tax is the tax effect of **timing differences**.

Timing differences are the differences between **taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods**.

Permanent differences are the differences between taxable income and accounting income **for a period that originate in one period and do not reverse subsequently**.

Timing differences arise because the period in which some items of revenue and expenses are included in taxable income **do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income.**

Example 1: A machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ.

Example 2: For the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used.

Example 3: Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences.

Recognition

Tax expense for the period, comprising current tax and deferred tax, should be **included** in the **determination of the net profit or loss for the period.** Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the revenue and expenses to which they relate. Such **matching may result into timing differences.**

The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence) or as deferred tax liabilities, in the balance sheet. Permanent differences do not result in deferred tax assets or deferred tax liabilities. Deferred tax should be recognised for **all the timing differences, subject to the consideration of prudence in respect of deferred tax assets.**

The **deferred tax in respect of timing differences** which reverse during the tax holiday period **is not recognised to the extent the enterprise's gross total income** is subject to the deduction during the tax holiday period. Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which the timing differences originate. For the above purposes, the timing differences which originate first are considered to reverse first.

Recognition of Deferred Tax Assets

This Standard requires recognition of deferred tax for all the timing differences. This is based on principle that the financial statements for a period should recognise the tax effect, whether current or deferred, of all the transactions occurring in that period. **Deferred tax assets should be recognised and carried forward** only to the extent that there **is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised**. Where an enterprise has **unabsorbed depreciation or carry forward of losses under tax laws**, deferred tax assets should be recognised only to the **extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.** Determination of virtual certainty that sufficient future taxable income will be available is a matter of judgement based on convincing evidence and will have to be evaluated on a case to case basis. **Virtual certainty** refers to the **extent of certainty, which, for all practical purposes, can be considered certain**. **Virtual certainty cannot** be based **merely on forecasts of performance such as business plans**. Virtual certainty is not a matter of perception and is to be supported by convincing evidence. **Evidence is a matter of fact.** To be **convincing,** the **evidence should be available at the reporting date in a concrete form**, for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party.

Re-assessment of Unrecognised Deferred Tax Assets

At each balance sheet date, an enterprise should **re-assess the unrecognised deferred tax assets**. The enterprise should recognise previously unrecognised deferred tax assets to the extent that it has become **reasonably certain or virtually certain that sufficient future taxable income will be available against which such deferred tax assets can be realised**.

Measurement

Current tax should be measured at the amount expected **to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws**. **Deferred tax assets and liabilities** should be measured using the **tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date**. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using **average rates**. Deferred tax assets and liabilities **should not be discounted** to their present value.

Review of Deferred Tax Assets

The carrying amount of deferred tax assets should be **reviewed at each balance sheet date.** An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is **no longer reasonably certain or virtually certain that sufficient future taxable income** will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain that sufficient future taxable income will be available.

Presentation and Disclosure

Offsetting Current Tax: An enterprise should **offset assets and liabilities representing current tax** if the enterprise:

- **(a)** has a **legally enforceable right to set off the recognised amounts**; and
- **(b)** **intends to settle the asset and the liability on a net basis**.

Offsetting Deferred Tax: An enterprise should **offset deferred tax assets and deferred tax liabilities** if:

- **(a)** the enterprise has a **legally enforceable right to set off assets against liabilities representing current tax**; and

(b) the deferred tax assets and the deferred tax liabilities relate to **taxes on income levied by the same governing taxation laws**.

Deferred tax assets and liabilities should be **distinguished** from assets and liabilities **representing current tax for the period.**

Deferred tax assets and liabilities should be **disclosed** under a **separate heading in the balance sheet of the enterprise**, **separately from current assets and current liabilities**. Deferred tax assets (net of the deferred tax liabilities, if any) is **disclosed** on the **face of the balance sheet separately after the head 'Investments'**, while deferred tax liabilities (net of the deferred tax assets, if any) is disclosed on the face of the balance sheet **separately after the head 'Long term Borrowings'**. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the **notes to accounts.** Further, **the nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.**

1. Classify the following as Timing Difference and Permanent Difference and also state whether they would result in Deferred Tax Asset or Deferred Tax Liability:

(a) Unabsorbed depreciation

(b) Income tax penalty

(c) Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.

2. Parshuram Ltd., which commenced its operations in 2018-19, provides the following details:

Financial year	Profit before tax (Rs.)	Timing Difference (Rs.)	Permanent Difference (Rs.)	Corporate tax rate	Remarks
2018-19	28,00,000	+ 3,15,000	+ 3,50,000	40%	Reversible in 2021-22
2019-20	31,50,000	+ 2,10,000	+2,80,000	38%	Reversible in 2020-21
2020-21	35,00,000	- 70,000	+ 3,15,000	35%	Reversible in 2021-22
2021-22	24,50,000	Nil	+ 4,20,000	30%	--

3. The following information is available from the records of Vishnu Ltd.: Depreciation charged to income statement ₹8,00,000; Depreciation u/s 32 of Income Tax Act ₹20,00,000; Unamortised preliminary expenditure as per income tax records ₹1,50,000.

It is communicated that there is adequate evidence of future profit sufficiency. Given that the corporate tax rate is 40%, you are required to ascertain the amount of deferred tax asset/ deferred tax liability to be created in this situation.