Chapter – 1

IASB Conceptual Framework

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1	IASB Conceptual Framework for Financial Reporting
2	Objective of General Purpose Financial Statement
3	Financial Statements & Reporting Entity
4	Elements of Financial Statements
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9	Measurement-Historical Cost
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12	Measurement-Current Cost
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Topic Videos 001-017 are mandatory part of this chapter/module

Topic 1 – IASB Conceptual Framework for Financial Reporting

The International Accounting Standard Board (IASB) framework describes the objective of, and the concepts for, general-purpose financial reporting.

The IASB framework is not a standard, and nothing in the framework overrides any standard or any requirement which the standards contain.

The Conceptual Framework describes the objectives of and concepts for the general purpose financial statements.

Its purposes are:

❑ to assist the International Accounting Standards Board (IASB) to develop IFRS Standards that are based on consistent concepts;

❑ to assist the IASB in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IFRSs;

❑ to assist national standard-setting bodies in developing national standards;

❑ to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;

❑ to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs;

The Conceptual Framework is divided into eight chapters, namely:

❑ The objective of general purpose financial reporting;

❑ The qualitative characteristics of useful financial information;

❑ Financial statements and the reporting entity;

❑ The elements of financial statements;

❑ Recognition process and criteria and derecognition;

❑ Measurement of the elements from which financial statements are constructed;

❑ Presentation and disclosure; and

❑ Concepts of capital and capital maintenance.

This Conceptual Framework is not an IFRS and nothing in the Conceptual Framework overrides any specific IFRS.

On very rare occasions there may be a conflict between the Conceptual Framework and an IFRS. In those cases, the requirements of the IFRS prevail over those of the Conceptual Framework.

Topic 2 – Objective of General Purpose Financial Statement

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

General-purpose financial statements provide information about the financial position of an entity, its resources and claims against those resources. Information is provided about the strengths and weaknesses of an entity and its ability to acquire finance.

General-purpose financial statements also provide information about changes in an entity's economic resources and claims that result in entity's financial performance.

Financial performance is assessed both through the process of accrual accounting and changes in cash flows.

Topic 3 – Financial Statement & Reporting Entity

General-purpose financial statements consist of a statement of financial position (recognising assets, liabilities and equity), a statement of financial performance (recognising income and expenses), and other statements and notes.

Financial statements are prepared for a specified period of time**.**

Comparative information for at least one preceding reporting period should also be provided

Going Concern

Financial statements are usually prepared on the assumption that the entity is a **going concern** and will continue to operate for the foreseeable future.

Financial statements are prepared from the perspective of the entity as a whole, instead of from the viewpoint of any particular group of investors, lenders or other creditors.

Reporting entity is not necessarily a legal entity.

Topic 4 – Elements of Financial Statements

The elements are linked to the economic resources and claims, and changes in those economic resources and claims.

The elements of financial statements defined in the conceptual framework are:

❑ assets, liabilities and equity, which relate to a reporting entity's financial position; and

❑ income and expenses, which relate to a reporting entity's financial performance

These elements are linked to the economic resources, claims and changes in economic resources and claims and are explained as below.

An *asset* is defined as a present economic resource controlled by the entity as a result of past events. An economic resource is defined as a right that has the potential to produce economic benefits.

A *liability* is defined as a present obligation of the entity to transfer an economic resource as a result of past events.

Equity is defined as the residual interest in the assets of the entity after deducting all its liabilities.

Income is defined as increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are defined as decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Topic 5 – Elements of Financial Statements – Practice

Identify Assets (Y/N) ?

1. Office stationery
2. Computer & Printer
3. Airconditioning plant
4. Repair and maintenance of machinery
5. Building purchased
6. Building on rent

Identify Liabilities (Y/N) ?

1. Loan from bank
2. Bank overdraft facility
3. Cash received in advance from customer to deliver goods in future
4. Cash received from credit customer after one week of sales of goods
5. Issue of bonds to raise funds from public

Topic 6 – Recognition of the elements of financial statement

Recognition.

Recognition of elements of the financial statements The IASB Framework states that an element (asset, liability, equity, income or expense) should be recognized in the statement of financial position or the statement of financial performance when it:

❑ meets the definition of an element, and also

❑ Satisfies certain criteria for recognition.

Items that fail to meet the criteria for recognition should not be included in the financial statements. However, some of these items may have to be disclosed as additional details in a note to the financial statements.

Recognition is the process of capturing for inclusion in the statement of financial position or the statement of financial performance an item that meets the definition of one of the elements of financial statements (an asset, a liability, equity, income or expenses).

Recognition Criteria

- probable future economic benefit associated with the item will flow **to** or **from** the entity; and
- the item has a cost or value that can be measured with reliability.

❑ Only items that meet the definition of asset, liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement of financial performance. However, not all items that meet the definition of one of those elements are recognised. ❑ Not recognising an item that meets the definition of one of the elements makes the statement of financial position and the statement of financial performance less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information. ❑ An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements:

a) Relevant information about the asset or liability and about any resulting income, expenses or change in equity

b) A faithful representation of the asset or liability and of any resulting income, expenses or changes in equity

Relevance may be affected by

- Low probability of flow of economic benefits
- Uncertainty of Existence

Faithful representation may be affected by

- Uncertainty of measurement
- Recognition inconsistency (accounting mismatch)
- Presentation and disclosure

Topic 7 – Derecognition of the elements of financial statements

Derecognition.

Derecognition is the removal of all or part of an asset or liability from an entity's statement of financial position.

For an Asset

Derecognition normally occurs when the entity loses control of all or part of a recognised asset.

For a Liability

Derecognition normally occurs when the entity no longer has a present obligation for all or part of the recognised liability.

Any assets or liabilities which have expired or been consumed, collected, fulfilled or transferred will be derecognized, with the associated recognition of any resultant income and expenses.

Topic 8 – Measurement of Financial Information

Elements recognised in financial statements are quantified in monetary terms.

The Conceptual Framework allows that several measurement bases are used for the elements in financial statements. These include historic cost and current values.

Historical cost

Current value

a) Fair value

b) Value in use and fulfillment value

c) Current cost

Selection of a measurement basis.

It is noted that for the information provided by a particular measurement basis to be useful to the users of the financial statements, it must be relevant, and it must faithfully represent what it purports to represent.

Topic 9 – Measurement of Historical Cost

Historical cost

❑ Historical cost measure provides monetary information about assets, liabilities and related income and expenses, using information derived, at least in part, from the price of the transaction or other event gave rise to them. Unlike current value, historical cost does not reflect changes in values, except to the extent that those changes relate to impairment of an asset or liability becoming nervous.

❑ The historical cost of an asset, when it is acquired or created is the value of the cost incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction cost. The historical cost of a liability when it is incurred or taken on is the value of consideration received to incur or take on the liability minus transaction costs.

❑ When an asset is acquired or created, or a liability is incurred or taken on, as a result of an event that is not a transaction on market terms, it may not be possible to identify a cost, or the cost may not provide relevant information about the asset or liability. In such cases, a current value of the asset or the liability is used as a deemed cost on initial recognition and that deemed cost is then used as a starting point for subsequent measurement at historical cost.

❑ The historical cost of an asset is updated overtime to depict, if applicable: a) The consumption of part of the economic resource that constitute the asset depreciation or amortization; b) Payments received that extinguish part or all of the asset; c) The effect of events that cause part or all the historical cost of the asset to be no longer recoverable(impairment); d) Accrual of interest to reflect any financing component of the asset.

❑ One way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortized cost. The amortized cost of a financial asset or financial liability reflects estimates of future cash flows, discounted at a rate determined at initial recognition. For variable rate instruments, the discount rate is updated to reflect changes in the variable rate. The amortized cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset and receipt or payments.

Topic 10 – Measurement of Fair Value

❑ Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

❑ Fair value reflects the perspective of market participants—participants in a market to which the entity has access. The asset or liability is measured using the same assumptions that market participants would use when pricing the asset or liability if those market participants act in their economic best interest.

❑ In some cases, fair value can be determined directly by observing prices in an active market. In other cases, it is determined indirectly using measurement techniques, for example, cashflows-based measurement techniques reflecting all the following factors: a) estimates of future cash flows b) possible variations in the estimated amount or timing of future cash flows for the asset or liability being measured, caused by the uncertainty inherent in the cash flows. c) The time value of money d) The price for bearing the uncertainty inherent in the cash (a risk premium or risk discount). The price for bearing that uncertainty depends on the extent of that uncertainty. It also reflects the fact that investors would generally pay less for an asset (and generally require more for taking on a liability) that has uncertain cash flows then for an asset (or liability) whose cash flows are certain. e) Other factors for example; Liquidity, if market participant would take those factors into account in the circumstances.

❑ The factors mentioned earlier include the possibility that a counterparty may fail to fulfill its liability to the entity (credit risk), or that the entity may fail to fulfill its liability (own credit risk). ❑ Because fair value is not derived, even in part, from the price of the transaction or other event that gave rise to the asset or liability fair value is not increased by the transaction cost incurred when acquiring the asset and is not decreased by the transaction cost incurred when the liability is incurred are taken on. In addition, fair value does not reflect the transaction cost that would be incurred on the ultimate disposal of the asset or not transferring or settling the liability.

Topic 11 – Measurement Value in use (of assets) and **Fulfilment value (of liabilities)**

❑ Value in use is the present value of the cash flows or other economic benefit that an entity expects to derive from the use of an asset and from its ultimate disposal. Fulfillment value is the present value of the cash or other economic resources that an entity expects to be obliged to transfer as it fulfills a liability. Those amounts of cash or other economic resources include not only the amounts to be transferred to the liability counter party, but also the amounts that the entity expects to be obliged to transfer to other parties to enable it to fulfill the liability.

❑ Because value in use and fulfillment value are based on future cash flows they don't include transaction cost incurred on acquiring an asset or taking on a liability. However, value in use and fulfillment value include the present value of any transaction cost that entity expects to incur on the ultimate disposal of the asset or on fulfilling the liability.

❑ Value in use and fulfillment value reflect entity specific assumptions rather than assumptions by market participants. In practice there may sometimes be little difference between the assumptions that market participants would use and those that an entity itself would use.

❑ Value in use and fulfillment value cannot be observed directly and or determined using cash flow based measurement techniques. Value in use and fulfillment value reflect the same factors described for fair value earlier, but from an entity specific perspective rather than from a market participant perspective.

Topic 12 – Measurement of **Current Cost**

❑ The current cost of an asset is the cost of an equivalent asset at the measurement date comprising the consideration that would be paid at the measurement date plus the transaction cost that would be incurred at that date. The current cost of a liability is the consideration that would be received for an equivalent liability at the measurement date minus the transaction cost that would be incurred at that date. Current cost, like historical cost is an entry value; it reflects prices in the market in which the entity would acquire the asset or would incur the liability. Hence it is different from fair value in use and fulfillment value, which are exit value. However, unlike historical cost, current cost reflects conditions at the measurement date.

❑ In some cases, current cost cannot be determined directly by observing prices and in an active market and must be determined directly by other means. For example, if prices are available only for new asset the current cost of a used asset might need to be estimated by adjusting the current price of a new asset to reflect the current age and condition of the asset held by the entity.

Topic 13 – Selection of Measurement Basis

Measurement basis to be useful to the users of the financial statements; it must be relevant, and it must faithfully represent what it purports to represent.

Cost is recognised as a constraint on the selection of a measurement basis, as it is with all other areas of financial reporting.

The enhancing qualitative characteristics of comparability, verifiability and understandability are also recognised as having implications for the selection of a measurement basis.

Topic 14 – Measurement Basis - Practice

Question

Sample Co. Purchased a Farm House for Rs. 100 million on 1st Jan, 2011. Its useful life was estimated to be 50 years. The Farm House can be sold at its market price on 31st Dec, 2020 at Rs. 250 million.

Whereas the same size and style of Farm House in the same location can be bought for Rs. 260 million on which Rs. 10 million will be incurred for its registration and legal fee.

Measure the value of Farm House under each of the following measurement basis:

- Historical cost
- Current cost
- Fair value

Historical cost

- Rs. 100 million less depreciation for 10 out of 50 years Rs. 20 million, equals to Rs. 80 million

Fair Value

- Rs. 250 million being the exit price available in the market among market participants.

Current Cost

- Rs. 260 million being purchase consideration plus transaction cost of Rs. 10 million, equals to Rs. 270 million.

Topic 15 – Presentation and Disclosure of Financial Information

Effective communication through presentation and disclosure makes the information more relevant and contributes to a faithful representation of the entity's assets, liabilities, equity, income and expenses.

Classification.

Classification is the sorting of assets, liabilities, equity, income and expenses on the basis of shared characteristics for presentation and disclosure purposes. Like; current asset.

Aggregation.

Aggregation is the adding together of assets, liabilities, equity, income and expenses that have shared characteristics and are included in the same classification. Like; balance in different bank accounts whether current account or short-term deposit account.

Topic 16 – Financial Accounting and Reporting Framework in Pakistan - I

Role of SECP

Companies must prepare financial statements in accordance with accounting standards approved as applicable and notified in the official gazette by the Securities and Exchange Commission of Pakistan (SECP) and in accordance with rules in the Companies' Act 2017.

The Securities and Exchange Commission of Pakistan (SECP) was established under the Securities and Exchange Commission of Pakistan Act, 1997 and became operational in 1999. It is the corporate and capital market regulatory authority in Pakistan. Its stated mission is "To develop a fair, efficient and transparent regulatory framework, based on international legal standards and best practices, for the protection of investors and mitigation of systemic risk aimed at fostering growth of a robust corporate sector and broad based capital market in Pakistan" (SECP website). One of the roles of the SECP is to decide on accounting rules that must be applied by companies in Pakistan. Companies must prepare financial statements in accordance with accounting standards approved as applicable and notified in the official gazette by the Securities and Exchange Commission of Pakistan (SECP) and in accordance with rules in the Companies Act, 2017.

Role of ICAP

ICAP regulates the Chartered Accountancy profession.

ICAP is responsible for recommending reporting standards for notification by the Securities and Exchange Commission of Pakistan.

Companies Act 2017

The Companies Act 2017 contains a series of appendices called *schedules* which set out detailed requirements in certain areas of financial reporting.

Schedules

3rd Schedule classifies companies on the basis of size and nature (profit or nonprofit).

4th Schedule sets out disclosure requirements for listed companies.

5th Schedule applies to non-listed companies.

Topic 17 – Financial Accounting and Reporting Framework in Pakistan - II

Adoption of IFRS

IFRSs cannot be applied in any country without approval of the national regulators in that country.

All jurisdictions have some kind of formal approval process which is followed before IFRS can be applied there.

Adoption Process for IFRSs

Step 1

As a first step the IFRS/IAS is considered by ICAP's Accounting Standards Board, which identifies any issues that may arise on adoption.

Step 2

The Board also determines how the adoption and implementation of the standard can be facilitated. It considers issues like how long any transition period should be.

Step 3

The Board also identifies the need for changes to regulations it refers the matter to the ***SECP*** (and/or the ***SBP*** for matters affecting banks and other financial institutions).

This process is managed by the ***Coordination Committees of ICAP*** and ***SECP (SBP)***.

Step 4

After the satisfactory resolution of issues the **Board** and the ***Council*** reconsider the matter of adoption.

Step 5

ICAP recommends the adoption to the ***SECP*** by decision of the Council.

The decision to adopt the standard rests with the ***SECP.***

Step 6

IFRSs are adopted by the ***SECP*** by notification in the official gazette.

When notified, the standards have the authority of the law.

Chapter – 2

Presentation of Financial Statements

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18	Presentation of financial statement introduction
19	Fair presentation and compliance with IFRSs
20	Going concern
21	Accrual basis of accounting
22	Materiality and aggregation
23	Offsetting
24	Frequency of reporting
25	Comparative information
26	Consistency of presentation
27	Financial statement of limited liability company
28	Reporting requirements for a company
29	Statement of Financial Position-Assets
30	Statement of Financial Position-Equity & Liability
31	Statement of Financial Position-Practice
32	Statement of Profit or Loss and OCI
33	Statement of Profit or Loss - Function of Expense
34	Statement of Profit or Loss - Nature of Expense
35	Statement of Profit or Loss - Practice
36	Statement of Profit or Loss - Separate Disclosure Items
37	Statement of Profit or Loss - Offsetting Items
38	Statement of Profit or Loss -Important Terminology
39	Statement of financial position - Important terminology
40	Financial statements - Important terminology
41	Statement of other comprehensive income - Part 1
42	Statement of other comprehensive income - Part 2
43	Statement of other comprehensive income Practice scenario-1
44	Statement of other comprehensive income Practice scenario-2
45	Accounting for different Sources of finance for a company
46	Accounting for issuing of bonus shares
47	Accounting for issuing of bonus shares practice
48	Accounting for right issuing of shares
49	Accounting for right issuing of shares Practice
50	Movement in retained profits
51	Statement of Changes in Equity
52	SOCE -Practice-1

53	SOCE -Practice-2
54	SOCE -Practice-3
55	SOCE -Practice-4
56	Accounting for Cost on Financial Sources (Dividend and Interest)
57	Accounting for Dividend -Practice
58	Accounting for Interest -Practice
59	Accounting for Tax on Incomes
60	Current Tax Expense - Practice
61	Deferred Tax Expense - Practice

Topic Videos 018-061 are mandatory part of this module

Topic 18 – Presentation of Financial Statements

Introduction

The objective of general-purpose financial reporting is to provide financial information about the reporting entity which is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

IAS 1

Presentation of Financial Statements**,** is the standard that is applicable to all general-purpose financial statements prepared and presented in accordance with IFRS.

IAS 1 focuses on:

- Objective of Financial Statements
- Components of Financial Statements
- General Features of Financial Statements
- Structure and contents of Financial Statements

Objective of Financial Statements

To provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions.

Components of Financial Statements

- a statement of financial position
- a statement of profit or loss and other comprehensive income
- a statement of changes in equity
- a statement of cash flows
- notes

General Features

- Fair presentation
- Compliance & Departure
- Going concern
- Accrual basis of accounting
- Materiality & Aggregation
- Offsetting
- Reporting frequency
- Comparative Information
- Consistency

IAS 1 is developed for profit-orientated entities.

Entities with not-for-profit activities or public sector entities may also apply the standard.

Topic 19 – Fair Presentation and Compliance with IFRSs

Fair Presentation

The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

Fair presentation

- Faithful representation
    - Transactions
    - Other events
    - Conditions
- According to the definition and recognition criteria
    - Assets
    - Liabilities
    - Income
    - Expenses
    - Equity
- Application of IFRS
    - Additional disclosure when necessary

Compliance with IFRS

- An entity, complying with IFRSs, must make an explicit and unreserved statement of such compliance in the notes.
- Compliance means, comply with all the requirements of IFRSs.

Departure from IFRS

- Management may conclude to depart from an IFRS if the requirement of such IFRS are considered misleading and conflicting with the objective of general purpose financial statement.

Topic 20 – Going Concern

Financial statements are normally prepared assuming the entity is a going concern and will continue in operation for the foreseeable future.

If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concern basis, in which case IAS 1 requires a series of disclosures.

Financial Statements should be prepared on Going Concern basis

- Unless Management
    - Intends to liquidate the entity
    - Intends to cease trading
    - Has no realistic alternative but to do so
- **Disclosures** required in case of significant doubt about going concern
    - that fact
    - Basis of preparing financial statements
    - reason why the entity is not regarded as a going concern.

When the financial statements are prepared on the going concern basis it is not necessary to disclose this basis.

Topic 21 – Accrual Basis of Accounting

Financial statements, except for the statement of cash flows, are to be prepared using the accrual basis of accounting.

Under the accrual basis of accounting; an entity recognises the elements of the financial statements (assets, liabilities, income and expenses) when they meet the definition and recognition criteria for those elements.

Transactions and events are recognised when they occur, and they are recorded in the accounting records and presented in the financial statements in the periods when they occur (and not when cash is received or paid).

Revenues are recognised when earned and expenses are recognised when incurred, without regard to the time of receipt or payment of cash.

Topic 22 – Materiality and Aggregation

If a line item is not individually material, it is aggregated with other items either in the financial statements or in the notes.

Financial information is material if its omission or misstatement would influence or change the economic decisions of users made on the basis of the financial statements.

Materiality depends on the relative size and nature of the item or error, judged in the particular circumstances.

Preparers of Financial Statements and auditors sometimes adopt the rule of thumb that anything under 5% of total assets or net income is considered immaterial.

Quantitative as well as qualitative factors must also be considered. For example, the fact that an environmental law (or indeed any law) has been broken could be significant in principle, even if the amount involved is small.

Topic 23 – Offsetting

Assets and liabilities, or income and expenses, may not be offset against each other, unless required or permitted by an IFRS.

Offsetting in the statement of profit or loss or statement of financial position is allowed in rare circumstances when it more accurately reflects the substance of the transaction

Reduction of accounts receivable by an allowance, or of fixed assets by the accumulated depreciation, are acts which reduce these assets to the appropriate valuation amounts and are not in fact offsetting assets and liabilities.

Topic 24 – Frequency of Reporting

An entity should present a complete set of financial statements (including comparative information) at least annually.

If the reporting period changes such that the financial statements are for a period longer or shorter than one year, the entity should disclose the reason for the longer or shorter period and the fact that the amounts presented are not entirely comparable.

Topic 25 – Comparative Information

Comparative information of the previous period should be disclosed for all amounts presented in the current period's financial statements.

Statement of Financial Position	Year 2020	Year 2019
Non-Current Assets	2,000	1,800
Current Assets	700	1,000
Owners' Equity	1,500	950
Non-Current Liability	700	1,050
Current Liability	500	800

Comparability is the quality of information, which enables users to compare the financial statements of an entity through time (among periods), to identify trends in its financial position and performance, as well as across entities.

Comparative narrative and descriptive information should be included when it is relevant to an understanding of the current period's financial statements.

Topic 26 – Consistency of Presentation

The presentation and classification of items in the financial statements should be consistent from one period to the next.

Consistency refers to the use of the same accounting policies and procedures, either from period-to-period with in an entity or in a single period across entities. Comparability is the goal and consistency is a means of achieving that goal.

Reasons of inconsistency:

- significant change in the operations of the entity,
- another presentation or classification is more appropriate, or
- when an IFRS requires a change in presentation.

When making such changes in presentation, an entity should:

- reclassify its comparative information and
- present adequate disclosures

Topic 27 – Financial Statements of a Limited Liability Company – Overview

The financial statements of a limited liability company are to be identified clearly and distinguished from other information in the published annual report.

Components of financial statements:

1. Statement of Financial Position
2. Statement of Profit or Loss and Other Comprehensive Income
3. Statement of Changes in Equity
4. Statement of Cash Flows
5. Notes

Display prominently in each component of financial statement:

a) Name of the reporting entity;

b) Reporting entity is individual or a group;

c) Reporting date or the reporting period;

d) Presentation currency; and

e) Level of rounding

Topic 28 – Reporting requirements for a company

Broad categories of companies in Pakistan:

1. Public Interest Company
2. Large Sized Company
3. Medium Sized Company
4. Small Sized Company

Public Interest Company (PIC)	
a) Listed Co.	IFRS & 4th Sch.
b) Non Listed Co. • Public sector Co. • Public utility Co. • Prescribed number of member and value of assets	IFRS & 5th Sch.
Large Sized Company (LSC)	
a) Non Listed Co. • Paid-up Capital => Rs. 200 million, or • Turnover => Rs. 1 billion, or Employees > 750	IFRS & 5th Sch.
b) Foreign Co. • Turnover => Rs. 1 billion	IFRS & 5th Sch.
c) Non Listed Co. • Formed u/s 42 or 45 of the Act, and • Annual gross revenue => Rs. 200 million	IFRS & Accounting Standards for NPOs
Medium Sized Company (MSC)	
a) Non Listed Co. • Paid-up Capital < Rs. 200 million, or • Turnover < Rs. 1 billion, or • Employees > 250 but < 750	IFRS for SMEs & 5th Sch.
b) Private Limited Co. • Paid-up Cap > Rs.10 million but =< Rs.20 million • Turnover > Rs.100 million=< Rs. 1 billion • Employees > 250 but < 750	
c) Foreign Co. • Turnover < Rs. 1 billion	
d) Non Listed Co. • Formed u/s 42 or 54 of the Act • Annual gross revenue < Rs. 200 million	Accounting Standards for NPOs
Small Sized Company (SSC)	
Private Limited Co. • Paid-up Capital up to Rs. 10 million, or • Turnover =< Rs. 100 million, or • Employees =< 250	Revised AFRS for SSCs & 5th Sch.

Topic 29 – Statement of Financial Position "Assets"

Presentation of Assets in the Statement of Financial Position or Balance Sheet.

Assets are broadly categorized into two:

- Non-Current Assets
- Current Assets

Sample Company Ltd.
Statement of Financial Position
As at 31st December 20X2

	Notes	20X2 Rs. (000)	20X1 Rs. (000)
Non Current Assets			
Property Plant and Equipment Intangible Assets Investment Property Long Term Investments Long Term Loans and Advances Long Term Deposits and Prepayments			
Current Assets			
Inventories Trade Receivables Short Term Investments Short Term Loans and Advances Short Term Deposits and Prepayments Accrued Income Advance Tax (Recoverable) Cash and Bank Balances			

A company is allowed to use a presentation based on liquidity instead of current or non-current assets. Financial institutions often use this approach.

Topic 30 – Statement of Financial Position "Equity and Liability"

Presentation of Owners' Equity in the Statement of Financial Position or Balance Sheet.

Share Capital and Reserves:

1. Share Capital
2. Capital Reserves
3. Revenue Reserves

Presentation of Liabilities in the Statement of Financial Position or Balance Sheet.

Liabilities:

1. Non-Current Liabilities
2. Current Liabilities

Sample Company Ltd. Statement of Financial Position As at 31st December 20X2			
	Notes	20X2 Rs. (000)	20X1 Rs. (000)
Share Capital and Reserves			
Authorized Share Capital Issued and Paid up Share Capital Share Premium Revaluation Surplus Revenue Reserves General Reserves Retained Earnings (Unappropriated Profits)			
Non Current Liabilities			
Long Term Borrowings Deferred Tax Long Term Provisions			
Current Liabilities			
Trade and other payables Short term borrowings Current portion of long term borrowings Current Tax payable Short term borrowings			

Claims on Resources

Assets are the resources of an entity.

Owners' equity and Lenders / Creditors, being source of finance, have claim on those resources.

Topic 31 – Statement of Financial Position – Practice

Question

Sample Co. Limited
Trial Balance – For the year ending on 31st December 20X2

Heads of Accounts	Rs. (000)	Heads of Accounts	Rs. (000)
Fixed Assets	30,300	Paid up share capital	20,000
Intangible Assets	19,300	Share premium	3,000
Inventories	4,600	Retained earnings 1.1.20X2	15,000
Trade receivables	7,600	Revaluation Surplus	3,290
Cash and Bank balances	700	Loan certificates	5,200
Loss for the year 20X2	3,200	Bank borrowings (long term)	11,410
		Trade payables	5,300
		Tax payable	2,500
Total	**65,700**	**Total**	**65,700**

Answer

Sample Co .Limited **Statement of Financial Position – As on 31st December 20X2**	**Year 20X2**		**Year 20X1 (Comparative)**
Assets	Rs. (000)	Rs. (000)	Rs. (000)
Non Current Assets			
Fixed assets	30,300		
Intangible assets	19,300	**49,600**	***
Current Assets			
Inventories	4,600		
Trade receivables	7,600		
Cash and bank balances	700	**12,900**	***
Total Assets		**62,500**	***
Share Capital and Reserves			
Share capital (Paid up)	20,000		
Share premium	3,000		
Revaluation surplus	3,290		
Retained Earnings	11,800	**38,090**	***
Liabilities			
Non Current Liabilities			
Loan certificates	5,200		
Bank borrowings (long term)	11,410	**16,610**	***
Current Liabilities			
Trade payables	5,300		
Tax payable	2,500	**7,800**	
Total Claims		**62,500**	***

Complex scenarios and questions shall be shared through assignments

Topic 32 – Statement of Profit or Loss and other comprehensive income

Total comprehensive income during a period is the combination of:

- Profit or loss; and
- Other comprehensive income.

This may be presented as a single statement with two parts or two separate statements.

Single statements are individually named as "Statement of Profit or Loss" and Statement of Other Comprehensive Income".

Combined statement is named as "Statement of Profit or Loss and Other Comprehensive Income".

Line Items

Following information is required by IAS 1 for presentation as minimum line items on the face of the Statement of Profit or Loss; Revenue, Interest income, Gains or losses arising from the de-recognition of assets, Interest expense, Tax expense.

Analysis of Expenses

Expenses in the Statement of Profit or Loss are analysed by either of the two methods:

- Function of the expenses; or
- Nature of expenses

Other comprehensive income includes:

- Revaluation surplus of PPE and Intangible assets
- Gain or loss on remeasurement of financial assets at fair value through OCI

(Further items of OCI are not discussed here, being not part of the syllabus for MGT 401)

Topic 33 – Statement of Profit or Loss – Function of Expenses

Analysis of Expenses

Expenses should be analysed by either of the two methods:

- Function of the expenses; or
- Nature of expenses

Sample Company Ltd. Statement of Profit or Loss For the year ended 31st December 20X2			
Revenue Cost of sales **Gross profit** Other income Distribution costs Administrative expenses Other expenses Finance expenses **Profit before tax** Tax expense **Profit for the period**	**Notes**	**20X2** **Rs. (000)**	**20X1** **Rs. (000)**

While preparing a statement of profit or loss in the 'cost of sales' or 'expenses by function' method, separately classify the costs for employee benefits and depreciation charges into cost of sales, distribution costs and administrative charges.

Topic 34 – Statement of Profit or Loss – Nature of Expenses

Analysis of Expenses

Expenses should be analysed by either of the two methods:

- Function of the expenses; or
- Nature of expenses

Sample Company Ltd. Statement of Profit or Loss For the year ended 31st December 20X2			
Revenue Other income Changes in inventories of finished goods and work in progress Raw materials and consumables Employee benefits expense Depreciation and amortization expense Other expenses Finance expenses Total expenses **Profit before tax** Tax expense **Profit for the period**	**Notes**	**20X2** **Rs. (000)**	**20X1** **Rs. (000)**

IAS 1 furthermore stipulates that if a reporting entity discloses expenses by function, it must also provide information on the nature of the expenses.

Topic 35 – Statement of Profit or Loss – Practice

Question

Sample Co. Limited
Trial Balance – For the year ending on 31st December 20X2

Heads of Accounts	Rs. (000)	Heads of Accounts	Rs. (000)
Non Current Assets	49,600	Share Capital	23,000
Current Assets (except inventory)	8,300	Retained earnings 1.1.20X2	15,000
Inventories 31.12.20X2	4,600	Revaluation Surplus	3,290
Cost of sales (op inventory 1,250 + Purchases 30,000 – cl inventory 4,600)	26,650	Non current liabilities	16,610
Selling commission	1,000	Current liabilities	7,800
Marketing activities	2,370	Sales	40,000
Staff salaries	5,800		
Depreciation	2,500		
Repair and maintenance	1,630		
Interest expense	490		
Tax expense	2760		
Total	**65,700**	**Total**	**65,700**

Answer

Sample Company Ltd.
Statement of Profit or Loss
For the year ended 31st December 20X2

	Notes	20X2 Rs. (000)	20X1 Rs. (000)
Revenue		40,000	
Cost of sales		26,650	
Gross profit		**13,350**	
Other income		0	
Distribution costs		3,370	
Administrative expenses		9,930	
Other expenses		490	
Finance expenses		**-440**	
Profit before tax		2,760	
Tax expense		**-3,200**	
Profit/(loss) for the period			

Cost of sales

Working will be different if:

- Opening inventory is appearing in the trial balance and closing inventory is provided outside the trial balance, or
- Closing inventory is appearing in the trial balance and purchases are not appearing in the trial balance, instead cost of goods sold is appearing in the trial balance.

Topic 36 – Statement of Profit or Loss – Separate Disclosure Items

Items should be disclosed separately, which are of such size, nature or incidence that their disclosure becomes important in order to explain the performance of the entity for the period to the users of financial information.

Material items only

Following items should be disclosed or presented separately on the face of SOPL or Notes:

- Write-down of inventories to NRV;
- Write-down of the items of Property Plant and Equipment to their recoverable amount;
- Disposals of Property Plant and Equipment;
- Disposal of investments;
- Discontinued operations;
- Litigation settlements;
- Reversal of a provision.

Topic 37 – Statement of Profit or Loss – Offsetting Items

Offsetting means to present the items of income and expenses by netting off i.e., by subtracting income from expense or by subtracting expense from income. Ordinarily offsetting is disallowed.

Materiality plays a role in the matter of allowing or disallowing the offsetting of items of income and expense.

Usually, when more than one event occurs in the same reporting period, losses and gains on disposal of non-current assets are reported on a net basis, because they are not material individually comparing with other items in SOPL.

IAS 1 further clarifies that when items of income or expense are offset, the entity should nevertheless consider, based on materiality, the need to disclose the gross amounts in the notes to the financial statements

Only such items of incomes and expenses are offset whose results reflect the substance of the transaction.

Examples of transactions that are incidental to the main revenue generating activities whose results reflect the substance of the transaction:

- Deducting related cost of disposal of non current asset from the its sales proceeds.
- Expenditure related to a provision that is reimbursed under a contractual arrangement with 3rd party.

Topic 38 – Statement of Profit or Loss – Important terminology

Important Terminologies

1. Component of an entity
2. Discontinued operations

Component of an entity

Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity are known as component of an entity. For example, a cash-generating unit, or group of cash-generating units. Cash generating unit is a smallest identifiable group of assets that can generate cash flows independent of the other resources of the entity. Easy to understand examples include; branch outlet of a garment business, branch of a bank, etc.

Discontinued operations

A component of an entity that has been disposed of, or is classified as held-for-sale, and:

- Represents a separate major line of business or geographical area of operations;
- Is part of a single coordinated disposal plan;
- Is a subsidiary acquired exclusively with a view to resale?

Topic 39 – Statement of Financial Position – Important terminology

Important Terminologies

1. Net Assets
2. Net Current Assets
3. Capital Employed

Net Assets

Net assets are total assets minus total liabilities, which is thus equivalent to owners' equity.

Net Current Assets

Net current assets are working capital of the entity that is total current assets less total current liabilities.

Capital Employed

This is the amount of total resources employed in the entity financed through owners and lenders. It can be calculated in three ways:

1. Total assets less current liabilities
2. Non current assets plus working capital
3. Owners' equity plus non current liabilities

Topic 40 – Financial Statements – Important terminology

Important Terminologies

1. Realisation
2. Recognition

Realisation

The process of converting non-cash resources and rights into money, or more precisely the sale of an asset for cash or claims to cash is known as realisation.

Recognition

The process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of one of the five elements of financial statements is known as recognition.

Topic 41 – Statement of Other Comprehensive Income – Part 1

Other comprehensive income (OCI) includes items of gains and losses that are not recognised in SOPL.

The other comprehensive income must be classified between those that:

1. Will not be reclassified subsequently to profit or loss; and
2. Will be reclassified subsequently to profit or loss.

Sample Company Ltd. Statement of Other Comprehensive Income For the year ended 31st December 20X2			
	Notes	**20X2** **Rs. (000)**	**20X1** **Rs. (000)**
Items that will not be reclassified, subsequently, to SOPL			
Changes in revaluation surplus		***	***
Changes in actuarial gains or losses on defined benefit plan		***	***

Important to note over here is, that all unrealized gains or losses are presented in the statement of other comprehensive income except the only one i.e., loss on revaluation of the items of PPE and intangible assets.

As it is observable from the nature of items appearing in the SOCI that these are just a holding gain or loss, which occur only because of holding the asset over the period and nothing else.

Topic 42 – Statement of Other Comprehensive Income – Part 2

Other comprehensive income (OCI) includes items of gains and losses that are not recognised in SOPL.

The other comprehensive income must be classified between those that:

1. Will not be reclassified subsequently to profit or loss; and
2. Will be reclassified subsequently to profit or loss.

Sample Company Ltd. Statement of Other Comprehensive Income For the year ended 31st December 20X2			
	Notes	**20X2** **Rs. (000)**	**20X1** **Rs. (000)**
Items that will be reclassified, subsequently, to SOPL			
Gain/loss on translation of foreign operation		***	***
Gain/loss on remeasurement of financial assets at fair value		***	***

Those unrealized gains/losses must be deducted from OCI in the year in which the realized gains/losses are included in profit or loss to avoid double counting them.

Topic 43 – Statement of Other Comprehensive Income – Practice Scenario 1

When a sale of financial asset occurs, a reclassification adjustment is required to ensure that the gains or losses are not double counted.

Sample Co. Ltd. has the following two financial assets classified at fair value through other comprehensive income, in its portfolio at the end of 20X1, its first year of operations:

Sample Co. Ltd. reports net income of Rs. 650,000 in 20X1 and presents a statement of profit or loss and other comprehensive income as follows:

	Cost Rs.	Fair Value Rs.	Unrealised Gain/Loss Rs.
	50,000	**85,000**	**35,000**
Investment in Reel Co. Ltd	500,000	**600,000**	**100,000**
Investment in Roll Co. Ltd	**550,000**	**685,000**	**135,000**
Total Investments			

Statement of Profit or Loss		Year 20X1 Rs.
Profit for the year		650,000
Other comprehensive income		
that will be reclassified subsequently to SOPL		
Remeasurement gain of financial assets (at fair value)		135,000
Total Comprehensive Income		**785,000**

During the year 20X2, Sample Co. sold 50% of Investment in Roll Co. for Rs. 340,000 and realized a gain on its sale of Rs. 90,000 (340 – 250), out of which Rs. 50,000 was reported as unrealized gain in the previous year OCI.

At the end of 20X2, Sample Co. reports its Investments (Assets) as follows:

	Op Balance Rs.	Fair Value Rs.	Unrealized Gain/Loss) Rs.
Investment in Reel Co. Ltd	85,000	100,000	**15,000**
Investment in Roll Co. Ltd	300,000	340,000	**40,000**
Total Investments	**385,000**	**440,000**	**55,000**

Sample Co. Ltd. reports net income of Rs. 800,000 in 20X2 and presents a statement of profit or loss and other comprehensive income as follows:

	Notes	20X2 Rs.	20X1Rs.
Statement of Profit or Loss			
Profit for the year (that includes Rs. 90,000 the realized gain on sale of investment in Roll Co.)		800,000	**650,000**
Other comprehensive income			
that will be reclassified subsequently to SOPL			
Remeasurement gain of financial assets (at fair value)		55,000	**135,000**
Total Comprehensive Income		**855,000**	**785,000**

Accumulated Other Comprehensive Income

Ledger Account 20X2	Dr. Rs.	Cr. Rs.	Balance Rs.
Balance b/f			**Cr. 135,000**
Fair Value adjustment for the year 20X2		55,000	**Cr. 190,000**
Reclassification adjustment transferred to SOPL for realizing the unrealized gain on sale of Investment DTY	50,000		**Cr. 140,000**

Topic 44 – Statement of Other Comprehensive Income – Practice Scenario 2

When a sale of a revalued item of property, plant and equipment occurs, unrealized portion of revaluation surplus is transferred to Retained Earning.

Sample Co. Ltd. has the following assets measured at revaluation model, at the end of 20X1, its first year of operations:

	Cost Rs.	Fair Value Rs.	Unrealised Gain/Loss Rs.
Showroom building	50,000	**85,000**	**35,000**
Factory building	500,000	**600,000**	**100,000**
Total PPE	**550,000**	**685,000**	**135,000**

Sample Co. Ltd. reports net income of Rs. 650,000 in 20X1 and presents a statement of profit or loss and other comprehensive income as follows:

Statement of Profit or Loss		Year 20X1 Rs.
Profit for the year		650,000
Other comprehensive income		
that will be reclassified subsequently to SOPL		
Revaluation surplus (gain during the year)		135,000
Total Comprehensive Income		**785,000**

At the start of year 20X2, Sample Co. sold showroom building for Rs. 110,000 and realized a gain on its sale of Rs. 25,000 (110 – 85), which is reported as realized gain on sale of PPE. Revaluation surplus of the same asset shall be transferred to Retained earning. Depreciation on factory building is charged at 5%
At the end of 20X2, Sample Co. reports its Investments (Assets) as follows:

	Op Balance Rs.	Acc Dep Rs.	(Written Down Value) Rs.
Factory building	600,000	30,000	**570,000**
Total PPE	**600,000**	**30,000**	**570,000**

Sample Co. Ltd. reports net income of Rs. 800,000 in 20X2 and presents a statement of profit or loss and other comprehensive income as follows:

	Notes	20X2 Rs.	20X1Rs.
Statement of Profit or Loss			
Profit for the year (that includes Rs. 90,000 the realized gain on sale of investment in Roll Co.)		800,000	**650,000**
Other comprehensive income			
that will be reclassified subsequently to SOPL			
Revaluation surplus during the year		0	**135,000**
Total Comprehensive Income		**800,000**	**785,000**

Accumulated Other Comprehensive Income

Ledger Account 20X2	Dr. Rs.	Cr. Rs.	Balance Rs.
Balance b/f			**Cr. 135,000**
Revaluation surplus during the year		0	**Cr. 135,000**
Revaluation surplus of the showroom sold transferred to Retained Earnings	35,000		**Cr. 100,000**
Excess depreciation of factory building transferred to Retained Earnings	5,000		**Cr. 95,000**

Revaluation surplus is transferred to retained earning upon disposal of the same asset and to the extent of excess depreciation of the same asset.

Topic 45 – Accounting for different Sources of Finance for a Company

Equity Finance	**Debt Finance**
1. Share Capital 2. Share Premium	1. Loan Certificates 2. Long term Loans

Share Capital	
Issue of shares at par Dr. Bank Cr. Share Capital	Issue of shares at premium Dr. Bank Cr. Share Capital (at face value) Cr. Share Premium

Sample Co. Ltd. Issued 1,000 number of equity shares of Rs. 100 each at a premium of Rs. 30 per share		
Particulars	**Debit Rs**	**Credit Rs**
Bank A/C Share Capital A/C Share Premium A/C	130,000	 100,000 30,000

Loan Certificate	
Issue of loan certificate at par Dr. Bank Cr. Loan Certificate (Debenture)	Issue of certificate at discount Dr. Bank Dr. Discount Cr. Loan Certificate (at face value)

Sample Co. Ltd. Issued 1,000 number of debentures of Rs. 100 each at a discount of Rs. 10 each		
Particulars	**Debit Rs**	**Credit Rs**
Bank A/C Loss on issue of Debenture A/C Debenture A/C	90,000 10,000	 100,000

Sample Co. Ltd. Issued 1,000 number of debentures of Rs. 100 each at a discount of Rs. 10 each and a premium of Rs. 5 each at the time of redemption of debentures		
Particulars	**Debit Rs**	**Credit Rs**
Bank A/C Loss on issue of Debenture A/C Debenture A/C Premium on redemption of Debenture A/C	90,000 15,000	 100,000 5,000

Loss on Redemption of Debenture It is amortised over the time period for which debentures are issued, using effective interest rate under the amortised cost method.

Topic 46 – Accounting for issue of bonus shares

Bonus Shares

are given to shareholders when companies are short of cash and shareholders expect a dividend income.

Shareholders may sell the bonus shares and meet their liquidity needs.

Bonus Shares may also be issued to restructure company reserves.

Issuing bonus shares does not involve cash flow.

Sample Co. Ltd. Issued 1,000 number of bonus shares of Rs. 100 each for which retained profits were fully utilized.		
Particulars	**Debit Rs**	**Credit Rs**
Retained profits A/C Share Capital A/C	100,000	 100,000

Sample Co. Ltd. Issued 1,000 number of bonus shares of Rs. 100 each for which Rs. 40,000 were taken from retained profits and balance was taken from general reserves.		
Particulars	**Debit Rs**	**Credit Rs**
Retained profits A/C General reserve A/C Share Capital A/C	40,000 60,000	 100,000

Reserves of Sample Co. consisted of: Share Premium Rs. 700,000, General Reserves Rs. 300,000, Retained Profits Rs, 400,000. The Board approved issue of bonus shares in order to restructure the reserves as follows: Share Premium 10%, General Reserves 50% and Retained Profits 20% to be utilized for issuing bonus shares.		
Particulars	**Debit Rs**	**Credit Rs**
Share premium A/C General reserve A/C Retained profits A/C Share Capital A/C	70,000 150,000 80,000	 300,000

Share premium may be utilized for issuance of bonus shares.

Topic 47 – Accounting for issue of bonus shares – Practice

Sample Co. has a share capital of 500,000 equity shares of Rs. 10 per share, issued at Rs. 15 each. It has a retained profits of Rs. 3,000,000. Share are quoted in the market at Rs. 20 per share.
The Board of Directors pass a resolution to capitalise a part of general reserves and retained profits by issuing Bonus Shares.
One bonus share is being issued for every five equity shares held at present. For this purpose, Rs. 700,000 are to be provided out of Share Premium and the balance out of Retained Profits.
Set out the journal entries to give effect to the resolution and show how they would affect the Balance Sheet of Sample Co.

Working:
500,000 x 1/5 = 100,000 x 10 = Rs. 1,000,000 Bonus to Shareholders.

Particulars	**Debit Rs**	**Credit Rs**
Share premium A/C	700,000	
Retained profits A/C	300,000	
Bonus to Shareholders A/C		1,000,000
(Being declaration of bonus by the board of directors)		
Bonus to Shareholders A/C	1,000,000	
Share Capital A/C		1,000,000
(Issuance of bonus shares to the shareholders)		

Balance Sheet – Prior to Issuance of bonus shares	
Share Capital and Reserves	**Rs**
Share Capital (500,000 equity shares of Rs. 10 per share)	5,000,000
Share Premium	2,500,000
Retained Profits	3,000,000
Total Owners' Equity	**10,500,000**

Balance Sheet – Post issuance of bonus share.	
Particulars	**Rs**
Share Capital (600,000 equity shares of Rs. 10 per share)	6,000,000
Share Premium	1,800,000
Retained Profits	2,700,000
Total Owners' Equity	**10,500,000**

Note: Market price of shares is not consideration while issuing bonus shares. Bonus share is never issued at a premium or discount.

Topic 48 – Accounting for Right issue of Shares

Right Issue means the shares are offered by a company to its members strictly in proportion to the shares already held by the shareholders in respective kinds and classes.

Board of Directors shall approve the decision to increase share capital and the said decision shall be communicated on the same day to SECP and to the Pakistan Stock Exchange for public dissemination.

The price at which these shares are offered to the existing shareholders is normally below the market price of the shares. This specific advantage has a money value called as value of the right.

Value of the Right

1. Ascertain total market value of the shares already in issue.
2. Add the amount of right issue to be received.
3. Find average price by dividing the total prices calculated under step 2 by the total number of shares.
4. Deduct average price from market value to get value of the right.

Scenario

A company makes a rights issue of one share of Rs. 100 at a premium of 10 per cent for every three shares held by the members of the company. Shares of the company are being sold in the market @ Rs. 150 per cent. Find the value of the right.

Market price for every 3 shares already in issue = 3 x 150	450
Issue price of 1 right share	+150
Total price of 4 shares	**560**
Average price = 560/4	140
Value of the right = (Market price – Average price) 150 – 140	10

Accounting treatment of rights share is the same as that of issue of ordinary shares.

Bank A/C **Dr.**

Share Capital A/C **Cr.**

Share Premium A/C **Cr.**

Topic 49 – Accounting for Right issue of Shares – Practice

Sample Co. had the following information:
Authorized Capital 50,000 Rs. 100 ordinary shares.
Issued Capital 30,000 Rs. 100 ordinary shares.
The company decided to make a rights issue of two ordinary shares for every fifteen ordinary shares held at a premium of Rs.30 each.

30,000 equity shares are held by shareholders, the rights issue is 30,000 x 2/15 = 4,000 shares. The amount received from the issue of rights shares = 4,000 x Rs. 100 + 30) = Rs. 520,000.

Particulars	**Debit Rs**	**Credit Rs**
Bank A/C	420,000	
Share Capital A/C		300,000
Share Premium A/C		120,000
(Being issue of right shares to the existing shareholders)		

Topic 50 – Movement in Retained Profits

Retained profits is the balance of accumulated profit on the reporting date that is calculated by adding the profit for the year in the previous year's balance of Retained Profits and incorporating other movement in it.

Movement in Retained Profits

1. Profit/loss for the reporting period
2. Unrealized portion of revaluation surplus upon disposal of revalued asset
3. Excess depreciation charge of revalued asset
4. Distribution to equity shareholder of dividend and bonus shares
5. Setting aside profits for a specific or general reserve

Ledger Account 20X2	**Dr. Rs.**	**Cr. Rs.**	**Balance Rs.**
Balance b/f			**Cr. 500,000**
Profit for the year 20X2		180,000	**Cr. 680,000**
Excess depreciation of revalued assets		2,000	**Cr. 682,000**
Creation of general reserve	300,000		**Cr. 382,000**
Dividend to equity shareholders	150,000		**Cr. 232,000**
Bonus to equity shareholders	30,000		**Cr. 202,000**
Realization of the unrealized portion of revaluation surplus		18,000	**Cr. 220,000**

Movement in Retained Profits

Increase in retained profits

Other accounting head Dr.
Retained profits A/C Cr.

Decrease in retained profits

Retained profits A/C Dr.
Other accounting head Cr.

Topic 51 – Statement of Changes in Equity

Equity (owners', partners' or shareholders')

Equity represents the interest of the owners in the net assets of an entity and shows the cumulative net results of past transactions and other events affecting the entity since its inception.

Statement of changes in equity reflects increases and decreases in the net assets of an entity during the period.

In accordance with IAS 1, all changes in equity from transactions with owners are to be presented separately from non-owner changes in equity.

The following to be disclosed:

1. For share capital:
    - Authorised shares
    - Issued and paid up shares
    - Par value per share
    - Shares outstanding at the beginning and at the end of the periods
2. A description of the nature and purpose of each reserve within equity.

Components of the SOCE:

1. Total comprehensive income for the period;
2. Effects of retrospective treatment in accordance with IAS 8;*(separately for each component of equity)*
3. Contributions from and distributions to owners; and
4. Movement, separately disclosing each change, in each component of equity.

Topic 52 – Statement of Changes in Equity – Practice – 1

Sample Co. had following opening balances on 1st. Jan 2020:	**Rupees**
Share Capital	200,000
Share Premium	40,000
Retained Profits	150,000
Revaluation Surplus	85,000

Incorporate profit after tax for the year Rs. 500,000 and gain on revaluation of fixed assets Rs. 55,000 in the statement of changes in equity.

	Share Capital Rs.	**Share Premium Rs.**	**Retained profits Rs.**	**Revaluation Surplus Rs.**	**Total Rs.**
Balances on 1st. January 2020	**200,000**	**40,000**	**150,000**	**85,000**	**475,000**
Profit after tax (for the year 2020)			500,000	55,000	500,000
Revaluation surplus (during the year)					55,000
Balances on 31st. December 2020	**200,000**	**40,000**	**650,000**	**140,000**	**1,030,000**

Changes in equity from transactions with owners are to be presented separately from non-owner changes in equity.

Topic 53 – Statement of Changes in Equity – Practice - 2

Sample Co. had following opening balances on 1st. Jan 2020:	**Rupees**
Share Capital	200,000
Share Premium	40,000
Retained Profits	150,000
Revaluation Surplus	85,000

Incorporate profit after tax for the year Rs. 500,000 and gain on revaluation of fixed assets Rs. 55,000 in the statement of changes in equity. Sample Co. also paid dividend to equity share holder Rs. 200,000 and created general reserve out of retained profits equal to Rs. 400,000 during the year 2020.

	Share Capital Rs.	**Share Premium** Rs.	**Retained profits** Rs.	**General Reserves** Rs.	**Revaluation Surplus** Rs.	**Total** Rs.
Balances on 1st. January 2020	**200,000**	**40,000**	**150,000**	**0**	**85,000**	**475,000**
Profit after tax (for the year 2020)			500,000			**500,000**
Revaluation surplus (during the year)					55,000	**55,000**
Dividend paid to equity holders			- 200,000			**- 200,000**
Creation of general reserve			- 400,000	400,000		**0**
Balances on 31st. December 2020	**200,000**	**40,000**	**50,000**	**400,000**	**140,000**	**830,000**

Equity dividend is distribution of profits to owners. Profit is set aside as reserve for future need.

Topic 54 – Statement of Changes in Equity – Practice - 3

Sample Co. had following opening balances on 1st. Jan 2020:	**Rupees**
Share Capital	200,000
Share Premium	40,000
Retained Profits	150,000
Revaluation Surplus	85,000

Incorporate profit after tax for the year Rs. 500,000 and gain on revaluation of fixed assets Rs. 55,000 in the statement of changes in equity. Sample Co. issued bonus shares of Rs. 80,000 for which share premium was fully utilized and balance was taken from retained profits, it also paid dividend to equity share holder Rs. 200,000 and created general reserve out of retained profits equal to Rs. 400,000 during the year 2020.

	Share Capital Rs.	**Share Premium** Rs.	**Retained profits** Rs.	**General Reserves** Rs.	**Revaluation Surplus** Rs.	**Total** Rs.
Balances on 1st. January 2020	**200,000**	**40,000**	**150,000**	**0**	**85,000**	**475,000**
Profit after tax (for the year 2020)			500,000			**500,000**
Revaluation surplus (during the year)					55,000	**55,000**
Dividend paid to equity holders			- 200,000			**- 200,000**
Creation of general reserve			- 400,000	400,000		**0**
Bonus Shares	**80,000**	**- 40,000**	**- 40,000**			**0**
Balances on 31st. December 2020	**200,000**	**40,000**	**50,000**	**400,000**	**140,000**	**830,000**

Share premium may be used for issuance bonus shares.

Topic 55 – Statement of Changes in Equity – Practice - 4

Sample Co. had following opening balances on 1st. Jan 2020:	**Rs. (000)**
Share Capital	3,750
Share Premium	750
Retained Profits	6,000
General Reserve	1,500
Revaluation Surplus	2,250

Sample Co. was registered with 200,000 ordinary shares of Rs. 100 each and had already in issue of 37,500 fully paid up share capital.

Following transactions occurred during and at the end of the reporting period ending on 31 December 2020.

1. On 31st May, Land was revalued upward with Rs. 3,000,000.
2. On 1st June, 2 Rights shares were issued against every share held by the equity holders at 20% Premium.
3. Management declared ordinary dividend of Rs. 4 per share that were already in issue till 30th June.
4. On 1st July, 50% of the opening balance in retained profits was transferred to general reserves.
5. Sample Co. issued bonus shares of Rs. 2,250,000 on 1st August. (One-third amount of the bonus shares was taken from Retained Profits, one-half of the bonus shares' amount was taken from Share Premium and balance was taken from General Reserves.

On 31st December, Company earned Profit after Tax of Rs. 3,750,000.

	Share Capital Rs.000	Share Premium Rs.000	Retained profits Rs.000	General Reserves Rs.000	Revaluation Surplus Rs.000	Total Rs.000
Balances on 1st. January 2020	**3,750**	**750**	**6,000**	**1,500**	**2,250**	**14,250**
Revaluation surplus (during the year)					3,000	3,000
Right issue of equity share	7,500	1,500				9,000
Ordinary Dividend @ Rs. 4 per share				- 450		- 450
Creation of general reserve			- 3,000	3,000		0
Bonus Shares	2,250	- 1,125	- 750	- 375		0
Profit after tax (for the year 2020)			3,750			3,750
Balances on 31st. December 2020	**13,500**	**1,125**	**6,000**	**3,675**	**5,250**	**29,550**

Disclosure Note:

Authorised Share Capital 200,000 ordinary shares of Rs. 100 each

Issued and Paid up Share Capital of 135,000 fully paid up.

Topic 56 – Accounting for cost on financial sources

Owners' Equity and Debt Equity are the two sources of finance.

Cost of finance:

1. Dividend (Cost of Equity)
2. Interest (Cost of Debt)

Dividend

Board of directors may declare equity dividend during and after the reporting period as distribution of profits to share holder.

1. Interim dividend
2. Final dividend

Accounting Entries – Interim Dividend

Dividend	Dr.
Dividend payable	Cr.
Dividend payable	Dr.
Cash/Bank	Cr.
Retained profits	Dr.
Dividend	CR.

Final Dividend

No accounting entry is passed for the final dividend as on the reporting date the dividend was not declared by the board of directors.

Directors' meeting is held after the reporting date in which final dividend in declared

Interest on loan/bonds/notes/debentures

Interest on debt certificates is charged at a fixed rate that may be payable during and after the end of reporting period.

Interest is charged to SOPL on accrual basis.

Accounting Entries – Interest Charges

Interest expense	Dr.
Interest payable	Cr.
Interest payable	Dr.
Cash/Bank	Cr.
SOPL	Dr.
Interest expense	Cr.

Unpaid interest on the reporting date is presented as current liability.

Topic 57 – Accounting for Dividend – Practice

Sample Co. was registered with 100,000 ordinary shares of Rs. 100 each and had already in issue of 60,000 fully paid up share capital.

Following transactions occurred during and at the end of the reporting period ending on 31 December 2020.

1. Management declared and paid ordinary dividend (interim) of Rs.10 per share on 30th September 2020.
2. Management declared and paid ordinary dividend (final) of Rs. 20 per share on 5th March 2021.

Pass accounting entries and present relevant extract from financial statements of the year 2020.

Accounting entries on 30th September 2020	**Debit Rs**	**Credit Rs**
Dividend	600,000	
Dividend payable		600,000
Dividend Payable	600,000	
Cash/Bank		600,000
Retained profits	600,000	
Dividend		600,000

Final Dividend declared on 5th March of 2021 is not to be accounted for in the financial statements of the year 2020.

Only disclosure is required in the notes that Directors have announced and approved a dividend to equity share holders of Rs. 20 per share.

Topic 58 – Accounting for Interest – Practice

Sample Co. issued 10% Loan Notes of Rs. 400,000, on 1st April 2020, redeemable in full after five years. Interest on Loan Notes is payable after each six months period. Pass accounting entries to record interest expense for the reporting period ending on 31 December 2020.

Accounting entries		Debit Rs	Credit Rs
30th September 2020			
Interest expense	Rs. 400,000 x 10% x 6/12	20,000	
Interest payable			20,000
Interest payable		20,000	
Cash/Bank			20,000
31st December 2020			
Interest expense	Rs. 400,000 x 10% x 3/12	10,000	
Interest payable			10,000
Statement of profit or loss	Rs. 400,000 x 10% x 9/12	30,000	
Interest expense			30,000

Interest expense is accrued for the number of months the loan remains due in the reporting period.

Topic 59 – Accounting for Tax on Incomes

Tax expense comprises of two components:

1. Current tax expense
2. Deferred tax expense

Tax on Taxable Profits

Current tax expense is tax effect of the entity's taxable profit or loss (taxable income) for the period, as determined by relevant rules of the various taxing authorities to which it is subject.

Tax on Temporary Differences

Deferred tax expense arises as the tax effect of temporary differences occurring during the reporting period.

Temporary Difference

It is the difference between carrying amount and tax base of asset/liability

Carrying amount is calculated as per IFRS

Tax base is calculated as per Tax Rules

Temporary Difference – Types

1. Taxable temporary differences
2. Deductible temporary differences

Taxable Temporary Difference

1. Asset's carrying amount is greater than its tax base.
2. Liability's carrying amount is lesser than its tax base.

Deductible Temporary Difference

1. Asset's carrying amount is lesser than its tax base.
2. Liability's carrying amount is greater than its tax base

Topic 60 – Current Tax Expense – Practice

Sample Co. earned profit before tax Rs. 300,000 for the year ending 31st December 2020. Depreciation expense Rs. 10,000 was charged to SOPL for the year as per IAS 16 *Property Plant and Equipment*, tax rules allow full amount of asset Rs. 50,000 as deductible expense in arriving at the taxable profit. Income tax rate is 30%.

Calculate current tax expense for the year ending 31st December 2020, and pass accounting entry to record provision for current tax for the year 2020.

Step 1 – Calculation of Taxable Profits

Accounting profits	Rs. 300,000
Add back Accounting depreciation	10,000
Subtract Tax depreciation (Capital allowance)	- 50,000
Taxable Profits	**Rs. 260,000**

Step 2 – Calculation of Current tax expense

Taxable profits	Rs. 260,000
Income Tax rate	x 30%
Current Tax Expense	**Rs. 78,000**

Accounting entries on 31st December 2020	**Debit Rs**	**Credit Rs**
Income Tax expense (SOPL) Provision for current tax (Current Liability)	78,000	 78,000

Current tax is calculated on the amount of taxable profits

Topic 61 – Deferred Tax Expense – Practice

Sample Co. earned profit before tax Rs. 300,000 for the year ending 31st December 2020. Depreciation expense Rs. 10,000 was charged to SOPL for the year as per IAS 16 *Property Plant and Equipment*, tax rules allow full amount of asset Rs. 50,000 as deductible expense in arriving at the taxable profit. Income tax rate is 30%.

Calculate deferred tax expense for the year ending 31st December 2020, and pass accounting entry to record provision for deferred tax for the year 2020.

Step 1 – Calculation of Carrying Amount of the Asset	
Cost of Asset	Rs. 50,000
Accumulated Depreciation as per IAS 16	- 10,000
Net Book Value / Carrying Amount	**Rs. 40,000**
Step 2 – Calculation of Tax Base of the Asset	
Cost of Asset	Rs. 50,000
Capital Allowance as per Tax Rules	- 50,000
Net Book Value / Tax Base	**Rs. 0**
Step 3 – Calculation of Temporary Difference	
Carrying amount of asset	Rs. 40,000
Tax base of asset	Rs. 0
Taxable Temporary Difference	**Rs. 40,000**
Step 4 – Calculation of Deferred tax expense	
Taxable temporary difference	Rs. 40,000
Income Tax rate	x 30%
Current Tax Expense	**Rs. 12,000**

Accounting entries on 31st December 2020	Debit Rs	Credit Rs
Income Tax expense (SOPL)	12,000	
Provision for deferred tax (Non Current Liability)		12,000

Extract – Statement of Profit or Loss		
For the year ended 31st December 2020	Rs.	Rs.
Profit before tax		300,000
Income Tax expense		
Current tax	78,000	
Deferred tax	12,000	(90,000)
Profit after tax		**210,000**

Extract – Statement of Financial Position		
As on 31st December 2020	Rs.	Rs.
Non Current Liabilities		
Provision for Deferred tax	12,000	
Current Liabilities		
Provision for Current tax	78,000	

- **Deferred tax on taxable temporary differences is Liability**
- **Deferred tax on deductible temporary differences is Asset**

Chapter – 3

Statement of Cash Flows

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Topic Videos 062-079 are mandatory part of this module/chapter

Topic 62 – Statement of Cash Flows

Statement of cash flows is presented as an integral part of the financial statements in the form of a separate statement.

It provides analysis about the cash receipts and cash payments of an entity during a period as to operating, investing and financing activities.

It helps investors, lenders and creditors to assess:

1. The ability to generate future positive cash flows from operations;
2. The ability to meet obligations;
3. Reasons for differences between profit or loss and cash receipts and payments;

Components of SOCF:

1. Operating Activities
2. Investing Activities

3. Financial Activities
4. Cash & Cash Equivalents

Topic 63 – Statement of Cash Flows – Operating Activities

Main revenue producing activities of the entity. It includes all other activities that are not investing or financing activities (including taxes paid/received, unless clearly attributable to investing or financing activities).

Operating Cash Inflows

- Receipts from sale of goods or rendering of services
- Sale of loans, debt or equity instruments carried in trading portfolio
- Returns on loans (interest)
- Returns on equity securities (dividends)

Operating Cash Outflows

- Payments to suppliers for goods and services
- Payments to or on behalf of employees
- Payments of taxes
- Payments of interest
- Purchase of loans, debt or equity instruments carried in trading portfolio

Topic 64 – Operating Activities – Direct and Indirect Methods

Operating activities belong to the Statement of Profit or Loss

Cash flows from operations can be reported using the:

1. Direct method; and
2. Indirect method.

Direct Method

- Cash received from customers
- Cash paid to suppliers
- Cash paid to and on behalf of employees
- Cash paid for other operating expenses

Net cash from operating activities

Illustration:

Statement of cash flows: direct method	**Rs.**
Cash flows from operating activities	
Cash receipts from customers	348,800
Cash payments to suppliers	(70,000)
Cash payments to employees	(150,000)
Cash paid for other operating expenses	(30,000)
Cash generated from operations	98,800
Taxation paid (tax on profits)	(21,000)
Interest charges paid	(2,500)
Net cash flow from operating activities	75,300

Indirect Method

By adjusting profit/loss for the effects of:

- Changes during the period in inventories, trade receivables, trade payables, operating accrued and prepaid expenses.
- Non-cash items such as depreciation, impairment, provisions, deferred taxes, etc.

Net cash from operating activities

Example:

Cash flows from operating activities		
Profit before taxation	80,000	
Adjustments for:		
Depreciation and amortization charges	20,000	
Interest charge in the statement of comprehensive income	2,300	
Gains on disposal of non-current assets	(6,000)	
Losses on disposal of non-current assets	4,500	
	100,800	
Increase/decrease in:		
Increase in trade and other receivables	(7,000)	
Decrease in inventories	2,000	
Increase in trade payables	3,000	
Cash generated from operations	98,800	
Taxation paid (tax on profits)	(21,000)	
Interest charges paid	(2,500)	
Net cash flow from operating activities		**75,300**

Topic 65 – Statement of Cash Flows – **Investing Activities**

Activities that relate to the acquisition and disposal of long-term assets and other investments that are not included in cash equivalents.

Investing Cash Inflows

- Principal collections from loans and sales of other entities' debt instruments
- Sale of equity instruments* of other entities and returns of investment in those instruments
- Sale of plant and equipment

  **Unless held for trading purposes or considered to be cash equivalents.*

Investing Cash Outflows

- Loans made and acquisition of other entities' debt instruments
- Purchase of equity instruments of other entities
- Purchase of plant and equipment

Topic 66 – Statement of Cash Flows – Financing Activities

Activities that cause changes to contributed equity and borrowings of an entity.

Financing Cash Inflows

- Proceeds from issuing share capital
- Proceeds from issuing debt (short term or long term)
- Not-for-profits' donor restricted cash, which is limited to long term purposes

Financing Cash Outflows

- Payment of dividends
- Repurchase of entity's own shares
- Repayment of debt principal, including capital lease obligations

Topic 67 – Non Cash Investing and Financing Activities

Activities that do not have impact on cash flows of the entity. The statement of cash flows, as its name implies, includes only actual inflows and out-flows of cash and cash equivalents. Accordingly, it excludes all transactions that do not directly affect cash receipts and payments.

Examples of significant non-cash investing and financing activities:

- Acquiring an asset on lease;
- Conversion of debt to equity;
- Exchange of non-cash assets or liabilities for other non-cash assets or liabilities;
- Issue of shares as bonus or to acquire assets.

Acquiring an asset on lease

Asset / Right of use asset	Dr.
Lease liability	Cr.

Conversion of Debt to Equity

Debt Instrument	Dr.
Equity Instrument	Cr.

Exchange of non cash assets

Incoming asset	Dr.
Outgoing asset	Cr.

Issue of shares as bonus

Reserves / Retained profits	Dr.
Share Capital	Cr.

Issue of shares for purchase of asset

Asset	Dr.
Share Capital	Cr.

Topic 68 – Cash and Cash Equivalent

Cash and cash equivalents include unrestricted cash

Cash

Cash on hand and demand deposits with banks or other financial institutions.

Cash equivalents

Short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Equity investments do not qualify as cash equivalents unless they fit the definition above of short-term maturities of three months or less, which would rarely, if ever, be true.

Preference shares carrying mandatory redemption features, if acquired within three months of their predetermined redemption date, would meet the criteria above since they are, in substance, cash equivalents.

Bank overdrafts are included as a component of cash equivalents if the following conditions are met:

1. Repayable on demand; and
2. The bank balance often fluctuates from positive to negative (overdraft).

Cash and Cash Equivalents

1. Cash in hand
2. Cash at bank
3. Bank overdraft (less)
4. Short term investments that meet the criteria

Topic 69 – SOCF – Operating Activities – Direct Method Practice

Operating Activities

This part of the SOCF includes all activities that relate to cash flows from operations, like; customers, suppliers, employees, other operating expenses and other incomes including Income tax.

Cash Receipt and Payment Account

For the year ended December 31, 2020

Receipt	Rs.	Payments	Rs
Opening Balance	5,650	Purchase of Machinery	146,750
Interest on Investment	800	Drawing	8,000
Loan from Babar	100,000	Interest on loan	500
Fresh Capital	74,000	Income tax paid	3,000
Cash from Debtors	60,000	Salaries	5,000
Sales	5,000	Wages	3,000
Bad Debts Recovered	1,350	Electricity Bill	1,000
Sale of Machine	9,200	Rent	500
		Creditors paid	25,000
		Purchases	8,000
		Loan repaid	50,000
		Closing Balance	5,250
Total	**256,000**	**Total**	**256,000**

Statement of Cash Flows

Operating Activities (Direct Method)

For the year ended December 31, 2020

	Rs.
Cash received from customers	
Debtors 60,000 + Sales 5,000 + Bad debts recovered 1,350	66,350
Cash paid to suppliers	
Creditors 25,000 + Purchases 8,000	(33,000)
Cash paid to and on behalf of employees	
Salaries 5,000 + Wages 3,000	(8,000)
Cash payment for other operating expenses	
Electricity 1,000 + Rent 500	(1,500)
Cash generated from operations	**23,850**
Interest and dividend received	800
Interest on loan paid	(500)
Income tax paid	(3,000)
	21,250

Note:

Above is the straight forward example of Operating Activities for concept building.

Topic 70 – SOCF – Operating Activities – Direct Method – Collection from Customers Practice

Cash collected from customers

Customers include both cash and credit customers. It includes; cash sales, cash received from debtors (A/R), advance receipts from customers, bad debts recovered and payment to customers.

Illustration

From the following information, find cash flow from customers:	**Rs.**
Opening balance of debtors	12,000
Sales on credit	52,500
Sales to cash customers	75,000
Returns Inward (against credit sales)	5,000
Discount allowed	3,000
Bad debts (written off)	1,500
Bad debts recovered during the year	3,000
Closing balance of debtors	10,000

Debtors Account (A/R)

Debit	**Rs.**	**Credit**	**Rs.**
Opening Balance b/f	12,000	Cash received from debtors (*)	45,000
Credit Sales	52,500	Discount Allowed	3,000
		Bad Debts	1,500
		Sales returns	5,000
		Closing Balance c/f	10,000
	64,500		**64,500**

* Balancing figure

Cash Collected from Customer

Bad debts recovered	3,000
Cash from debtors	45,000
Cash Sales	75,000
	123,000

Topic 71 – SOCF Operating Activities – Direct Method – Payment to Suppliers – Practice

Cash paid to suppliers

Suppliers include both cash and credit suppliers. It includes; cash purchases, cash paid to creditors (A/P), advance paid to suppliers, payment of services and refund from suppliers.

Illustration

From the following information, find out credit purchases:

	Rs.
Opening balance of creditors	7,600
Cash paid to creditors	20,000
Credit purchases	24,800
Cash purchases	30,000
Discount received	500
Returns outward	2,400
Closing balance of creditors	9,500

Creditors Account (A/P)

Debit	**Rs.**	**Credit**	**Rs.**
Cash paid to creditors*	20,000	Opening balance b/f	7,600
Discount received	500	Credit purchases	24,800
Purchase returns	2,400		
Closing balance c/f	9,500		
	32,400		**32,400**

* Balancing figure

Cash Paid to Supplier

Cash paid to supplier	20,000
Cash purchases	30,000
	50,000

Topic 72 – SOCF Operating Activities – Indirect Method Practice
(Non-cash items relating to non-current assets)

Indirect Method

Reverse calculation is worked out for eliminating non-cash elements form the profit for the year. Statement of profit or loss is prepared on accrual basis whereas, SOCF is prepared on cash basis.

Non-cash Element

Non-cash items appearing in SOPL are categorised as:

1. Relating to non-current net assets
2. Relating to net current assets (working capital)

Indirect Method

Eliminate non-cash items from the amount of profit for the year relating to non-current assets.
(Depreciation, Amortisation, Impairment, Loss on disposal of asset, Gain on disposal of asset)

Scenario

Statement of Financial Position as on 31st December 2020		2020 Rs.	2019 Rs.
Fixed Assets		25,000	15,000
Provision for depreciation		(5,000)	(2,000)
		20,000	13,000
5% Investments		10,000	0
Current Assets			
Stocks		3,000	3,500
Debtors		1,700	1,000
Prepaid expenses		200	300
Bank and Cash balances		3,500	2,000
		38,400	19,800
Owners' Equity	30,000	18,000	
Liabilities:			
8% Bank loan	7,000	0	
Creditors	1,000	1,500	
Accrued Expenses	400	300	
	38,400	19,800	

During the year cash drawings were Rs. 8,000 and fresh capital was introduced Rs. 15,000. Machine Costing Rs. 6,000 and NBV Rs. 4,800 was sold for a loss of Rs. 1,200.

Reverse Working for calculating Net profit

Closing capital	
Drawings	
Fresh capital	
Opening capital	(18,000)
Net profit	5,000

Accumulated Depreciation A/C

	Rs.		Rs.
Disposal a/c	1,200	Op Bal b/f	2,000
Cl Bal c/f	5,000	Depreciation	4,200
	6,200		6,200

Machine Costing Rs. 6,000 and NBV Rs. 4,800 was sold for a loss of Rs. 1,200.

Statement of Cash Flows For the year ending 31st Dec. 2020

	Rs.	Rs.
Operating activity		
Net profit (W)		5,000
Financial charges (Interest on loan)		560
Other income (Interest on investment)		(500)
		———
Profit from operations		5,060
Add back		
Non-cash operating expense (non-current asset)		
Depreciation (W)	4,200	
Loss on disposal	1,200	5,400
		10,460

Topic 73 – SOCF Operating Activities – Indirect Method Practice
(Non-cash items relating to working capital items – net current assets)

Indirect Method

Eliminate non cash items from the amount of profit for the year relating to net current assets.

- Inventory
- Trade receivables / Debtors
- Prepaid operating expenses
- Trade payables / Creditors
- Accrued operating expenses

Statement of Cash Flows – For the year ending 31st December 2020

	Rs.	**Rs.**
Operating activity		
Net profit (W)		5,000
Financial charges (Interest on loan)		560
Other income (Interest on investment)		(500)
		_____
Profit from operations		5,060
Add back		
Non-cash operating expense (non current asset)		
Depreciation (W)	4,200	
Loss on disposal	1,200	5,400
		10,460

Statement of Cash Flows – For the year ending 31st December 2020

	+/-	**Rs.**
Net profit after eliminating depreciation etc. *(Elimination of non-cash items relating to non-current net assets or working capital items)*		**10,460**
Adjustment of non-cash items relating to net current assets		
Inventory decreased by	+	500
Debtors increased by	-	(700)
Prepaid expenses decreased by	+	100
Creditors decreased by	-	(500)
Accrued expenses increased by	+	100
Cash generated from operations		**9,960**

Non-cash Element

Non-cash items appearing in SOPL are categorised as:

1. Relating to non-current net assets
2. Relating to net current assets (working capital)

Both have been illustrated in the above scenario covered under module 72 and module 73.

Topic 74 – SOCF Operating Activities – Indirect Method – Practice (Interest, tax and dividend)

Indirect Method – step 1

Calculate profit after tax from the owners' equity account

Indirect Method – step 2

Calculate profit from operations by adding back tax expense and financial charges in the profit after tax and less back interest income also less back the gain on disposal of fixed assets or investments.

Indirect Method – step 3

Eliminate non-cash items from the operating profit for the year relating to non-current assets, i.e.; Depreciation, Amortisation, Impairment, Loss on disposal of asset, Gain on disposal of asset.

Indirect Method – step 4

Eliminate non-cash items from the operating profit for the year relating to net current assets, i.e.; Inventory, Trade receivables / Debtors, Prepaid operating expenses, Trade payables / Creditors, Accrued operating expenses

Indirect Method – step 5

Add/less the interest paid, interest received, dividend paid, dividend received and tax paid.

Cash flow from Operating Activities

1. Cash generated from operations (Direct/Indirect)
2. Cash received as interest
3. Cash received as dividend
4. Cash paid for interest
5. Cash paid for dividend
6. Cash paid for income tax

Statement of Cash Flows – For the year ending 31st December 2020

		Rs.
Operating activities		
Cash generated from operations *(as per the module 73)*		9,960
Cash received as interest on investment	10,000 x 5%	500
Cash paid for interest on loan	7,000 x 8%	(560)
Net cash inflow from operating activities		**9,900**

Following items may be presented either in Operating Activities or Investing Activities

1 Cash received as interest
2 Cash received as dividend

Following items may be presented either in Operating Activities or Financing Activities

1. Cash paid for interest
2. Cash paid for dividend

Topic 75 – SOCF Operating Activities – Indirect Method Practice
(Opening and closing balances of retained profits)

Scenario

Sample Co. had opening and closing balances of retained profits Rs. 4,000 and Rs. 6,500 respectively. It paid Rs. 10,000 as dividend and created a reserve out of profits for Rs. 3,500. Depreciation for the year were Rs. 15,000 and there was a gain of Rs. 5,000 on disposals of fixed assets. There was no interest income and interest expense for the year. Tax for the year, 100% paid, was Rs. 4,800. There was no amount due for tax on opening and closing dates. Working capital items affecting operations were:

	Current Assets	Current Liabilities
Opening Balance	Rs. 12,000	Rs. 4,000
Closing Balance	Rs. 11,000	Rs. 6,500

Step 1 Ascertain profit FTY from retained profits account

Retained Profits Account			
Dividends Reserves Balance c/f	Rs. 10,000 3,500 6,500	Balance b/f **Profit FTY**	Rs. 4,000 **16,000**
	20,000		**20,000**

Step 2 Reverse working to ascertain profit from operations

	+/-	Rs.
Profit for the year		16,000
Income Tax Expense	+	4,800
Financial charges (Interest on loan)	+	0
Other income (Interest on investment)	-	0
Profit from operations		**20,800**

Step 3 Eliminate non-cash items relating to non-current assets

	+/-	Rs.
Profit from operation		20,800
Depreciation expense for the year	+	15,000
Loss on disposal of assets	+	0
Gain on disposal of assets	-	(5,000)
Profit after eliminating non cash elements		**30,800**

Step 4 Eliminate non cash items relating to w-cap items

	+/-	Rs.
Profit after non cash adjustment		30,800
Current assets increased by	-	0
Current assets decreased by	+	1,000
Current liabilities increased by	+	2,500
Current liabilities decreased by	-	0
Profit after working capital adjustment		**34,300**

Step 5 Effects of cash flows relating to Interest, Dividend & Tax

	+/-	Rs.
Profit after working capital adjustment		34,300
Interest received (cash inflow)	+	0
Dividend received (cash inflow)	+	0
Interest paid (cash outflow)	-	0
Dividend paid (cash outflow)	-	10,000
Income tax paid (cash outflow)	-	4,800
Net cash inflow from operating activities		**19,500**

Topic 76 – SOCF Investing Activities – Practice

Investing Activities

It covers cash flows relating to non-current assets and short-term investments that are not cash equivalents

Scenario

The motor vehicles of Sample Co. at the beginning and the end of its reporting period were as follows:

	At Cost	Accumulated Depreciation	Carrying Amount
	Rs.	Rs.	Rs.
Opening Balance	150,000	105,000	45,000
Closing Balance	180,000	88,000	92,000

During the year a vehicle was disposed of for a gain of Rs. 3,000. The original cost of this asset was Rs. 60,000. Accumulated depreciation on the asset was Rs. 45,000.

Calculate cash flows from investing activities in the above scenario.

Motor Vehicles Account (at Cost)			
	Rs.		Rs.
Opening Balance b/f	150,000	Asset Disposal a/c	60,000
Additions for Cash	90,000	Closing Balance c/f	180,000
	240,000		**240,000**

Accumulated Depreciation Account (Motor Vehicles)			
	Rs.		Rs.
Asset Disposal a/c	45,000	Opening Balance b/f	105,000
Closing Balance c/f	88,000	SOPL – Depreciation	28,000
	133,000		**133,000**

Asset Disposal Account (Motor Vehicles)			
	Rs.		Rs.
Motor Vehicle a/c	60,000	Acc Depreciation a/c	45,000
SOPL – Disposal gain	3,000	Sale proceeds in cash	18,000
	63,000		**63,000**

Statement of Cash Flows - Investing Activities	**+/-**	**Rs.**
Cash received from disposal of fixed asset	+	18,000
Cash received from disposal of investments	+	0
Cash paid for purchase of fixed asset	-	90,000
Cash paid for purchase of investments	-	0
Net cash outflow from investing activities		**(72,000)**

Non-Cash Investing Activities that are not included in or excluded from the statement of cash flows

Increase or decrease in assets because of revaluation or exchange transactions are not accounted for in SOCF.

Topic 77 – SOCF Financing Activities Practice

Financing Activities

It covers cash flows relating to owners' equity and long term debts and short term borrowings other than bank overdraft.

Scenario

From the following information of Sample Co., calculate cash flows from financing activities in year 2020.

	Share Capital	Share Premium	Retained Profits	Loans Long term	Loans Short term
	Rs.		Rs.	Rs.	Rs.
Opening Balance	400,000	275,000	390,000	600,000	80,000
Closing Balance	500,000	615,000	570,000	520,000	55,000

Sample Co. earned profit after tax for the year Rs. 420,000. There was no amount set aside out of profits for reserves neither the bonus shares were issued during the year.

Retained Profits Account			
	Rs.		Rs.
Dividends	240,000	Opening Balance b/f	390,000
Reserves creation	0	Profit after tax FTY	420,000
Closing Balance c/f	570,000		
	810,000		**810,000**

Share Capital Account			
	Rs.		Rs.
Closing Balance c/f	500,000	Opening Balance b/f	400,000
		Fresh issue of shares	100,000
	500,000		**500,000**

Share Premium Account			
	Rs.		Rs.
Closing Balance c/f	615,000	Opening Balance b/f	275,000
		Fresh issue of shares	340,000
	615,000		**615,000**

Decrease in long term loans (outflow) 600,000 – 520,000 = 80,000

Decrease in short term loans (outflow) 80,000 – 55,000 = 25,000

Statement of Cash Flows - Financing Activities	+/-	Rs.
Cash received from issue of share capital	+	100,000
Cash received from issue of capital at premium	+	340,000
Repayment of long term loans	-	80,000
Repayment of short term loans	-	25,000
Cash paid for dividends (if not presented in operating activities)	-	240,000
Net cash inflow from financing activities		**95,000**

Non-Cash Financing Activities

Issue of shares capital against purchase of fixed assets and conversion of debts/loans into shares are not cash flow items.

Topic 78 – SOCF Comprehensive Scenario Practice (Indirect Method)

Statement of Cash Flows – For the year ending 31st December 2020

	Rs.	Rs.
OPERATING ACTIVITY		
Net profit (W)		5,000
Financial charges (Interest on loan)		560
Other income (Interest on investment)		(500)
Profit from operations		5,060
Add back		
Non-cash operating expense (non current asset)		
Depreciation (W)	4,200	
Loss on disposal	1,200	5,400
Net profit after eliminating depreciation etc. *(Elimination of non-cash items relating to non-current net assets)*		10,460
Adjustment of non-cash items relating to net current assets (working capital items)		
Inventory decreased by	+	500
Debtors increased by	-	(700)
Prepaid expenses decreased by	+	100
Creditors decreased by	-	(500)
Accrued expenses increased by	+	100
Cash generated from operations		9,960
Cash received as interest on investment		500
Cash paid for interest on loan		(560)
Net cash inflow from operating activities		9,900
INVESTING ACTIVITY		
Sales proceed of machine	3,600	
Purchase of fixed asset	- 16,000	
Purchase of investments	- 10,000	- 22,400
FINANCING ACTIVITY		
Fresh capital	15,000	
Drawings	- 8,000	
Loan received	7,000	14,000
Net Cash inflow During the Year		**1,500**
Opening Cash and Cash Equivalent		**2,000**
Closing Cash and Cash Equivalent		**3,500**

Topic 79 – SOCF – Comprehensive Scenario – Practice (Direct Method)

Sample Co. – SOFP as on 31st December 2020	2020 Rs. 000	2019 Rs. 000
Property Plant and Equipment (PPE)	158,500	120,000
Investment in Shares of Other Co.	8,500	0
Stock in Trade	58,000	45,000
Trade Receivable	68,000	56,000
Cash Balances	39,434	48,000
	332,434	**269,000**
Share Capital (Rs. 10 per share)	175,000	150,000
Retained Profits	54,434	21,500
Revaluation Surplus of PPE	10,000	0
Debenture (Rs. 100 each)	18,000	24,000
Loan from Lender Bank	0	6,000
Interest Payable	1,000	2,500
Trade Payable	42,000	39,000
Accrued Operating Expenses	20,000	18,000
Provision for Current Tax	12,000	8,000
	332,434	**269,000**

Sample Co. – SOPL For the year 31st December 2020	Rs. 000
Sales	273,000
Cost of Sales	- 187,500
Gross Profit	85,500
Operating Expenses	- 46,766
Other Income	11,200
Operating Profit	49,934
Interest Expense	- 2,000
Profit Before Tax	47,934
Income Tax Expense	15,000
Profit After Tax	**32,934**

Additional information:

a) 60% of sales were made on credit.
b) Company maintains a provision for doubtful receivables at 6%. During the year, trade receivables of Rs. 7 million were written off.
c) Depreciation expense for the year was Rs. 22.5 million.
d) Other income comprises of:
- Gain of Rs. 3 million on disposal of vehicles for Rs. 12 million; and
- Maintenance income of Rs. 8.2 million.

Prepare statement of cash flows for the year ended 31 December 2020 using direct method.

Statement of Cash Flows for the year 31st December 2020

	+/-	Rs.
Operating activity		
Cash Collected from Customers	+	261,434
Cash Paid to Suppliers	-	197,500
Cash Paid Employees & other OpEx	-	14,500
Cash Generated from Operations		49,434
Cash Paid for Interest on Loan	-	3,500
Cash paid for Income Tax	-	11,000
Net cash outflow from oper activities		34,934

Investing Activities		
Purchase of PPE	-	60,000
Disposal proceeds of Vehicle	+	12,000
Purchase of Investments	-	8,500
Net cash outflow from inv activities	-	56,500
Financing Activities		
Issue of Share Capital	+	25,000
Redemption of Debenture	-	6,000
Loan repayment to Lender Bank	-	6,000
Net cash outflow from financing activities		13,000

	+/-	Rs.
Operating Activities	+	34,934
Investing Activities	-	56,500
Financing Activities	+	13,000
Net Cash Outflow During the Year	-	8,566
Opening Cash and Cash Equivalent		48,000
Closing Cash and Cash Equivalent		39,434

Note:
Please refer to the ppt slides of Lecture module 79 for detailed working.

Chapter – 4

Accounting for Current Liabilities

Sr. No	Chapter outline - Topics
80	Accounting for current liabilities classification
81	Accounting for current liabilities Nature
82	Accounting for current liabilities offsetting
83	Accounting for current liabilities types
84	Accounting for current liabilities Payee known and amount known
85	Accounting for current liabilities Payee known and amount not known
86	Accounting for current liabilities Payee not known and amount not known
87	Accounting for current liabilities due to loss contingency
88	Accounting For Non-Current Liabilities
89	Financial Vs. Non-financial Liabilities
90	Measurement of Non-Current Liabilities
91	Amortized Cost Method
92	Amortized Cost Method Practice
93	Effective Interest Rate
94	Effective Interest Rate Practice
95	Accounting for non-current liabilities – Derecognition

Topic Videos 080-095 are mandatory part of this module

Topic 80 – Accounting for Current Liabilities – Classification

Classification of liabilities

IAS 1 requires that the reporting entity must present current and non-current liabilities, as separate classifications on the face of its statement of financial position.

Current liability

A liability of the entity which:

1. The entity expects to settle in its normal operating cycle; or
2. The entity holds primarily for the purpose of trading; or
3. Is due to be settled within 12 months after the reporting period; or
4. The entity does not have an unconditional right to defer settlement for at least 12 months after the reporting period.

Obligating Event

An event that creates a legal or constructive obligation that results in an entity having no realistic alternative but to settle that obligation

Legal obligation

An obligation that derives from the:

1. Terms of a contract, or
2. Legislation, or
3. Operation of law.

Constructive obligation

An obligation resulting from entity's established:

1. Published policy, or
2. Past practice, or
3. Current Statement – to accept certain responsibilities

As a result, the entity has created a valid expectation on the part of other parties to accept such responsibilities.

Presentation

Except in the case of liquidation all assets and liabilities are to be presented broadly in order of liquidity. Because in this case a liquidity presentation provides more relevant and reliable information.

Topic 81 – Accounting for Current Liabilities – Nature

Nature of current liabilities

Generally speaking, current liability is payable within 12 months of the reporting date, means one year after the reporting period as the threshold, subject to the operating cycle issue for liabilities linked to operations

Examples

- Current portions of long-term debt,
- Bank overdrafts,
- Dividends declared and payable,
- Various non-trade payables

Also include

- Trade credit
- Accrued expenses
- Deferred revenues
- Advances from customers for which services/products are to be provided within one year.

Liability type depends upon

- When to pay
- Whom to pay
- What (how much) to pay

Topic 82 – Accounting for Current Liabilities – Offsetting

Offsetting

Means to net-off an asset against a liability while presenting in the Statement of Financial Position.

Reporting Requirement

Reporting framework doesn't support this idea unless required or permitted by IFRS.

Simultaneous Settlement

Sample Co. purchases raw material from Zee Distributors.

Sample Co. also sells its final product to Zee Distributors.

Purchase	= Rs. 9 million
Sales	= Rs. 7 million
Net Exposure	= Rs. 2 million

Unconditional Right of set-off

During the year current tax paid in advance is Rs. 200,000.

Current tax payable on profits for the year is Rs. 300,000.

Net tax payable will be Rs. 100,000 based on legally enforceable right to set-off

Topic 83 – Accounting for Current Liabilities – Types

Liability

Liability means a present obligation that arose from a past event for which there is a probability of out flow of economic resources in future.

Liability type depends upon

- When to pay
- Whom to pay
- What (how much) to pay

Topic 84 – Accounting for Current Liabilities – Payee & Amount Known

Liability

Office rent of a certain amount payable each month to the property owner.

Liability type depends upon

- When to pay
- Whom to pay
- What (how much) to pay

Examples include

- Notes payable
- Dividend payable
- Advance from customer
- Agency liabilities (WHT, VAT)
- Current portion of long-term debts

Topic 85 – Accounting for Current Liabilities – Payee Known and Amount Not Known

Best Estimate

Estimated liabilities come under the definition of provisions. Amount to measure such liabilities should be the *best estimate*, at the end of the reporting period, to settle the obligation.

This is often referred to as the "expected value" of the obligation.

Best Estimate - Scenario

Sample Co. provides warranty for the machine sold to EFF Co., where the EFF Co. is entitled to replacement of parts if the defective machine is returned with valid proof of defect.

Sample Co. estimates that if the machine sold is still in warranty had major defects, total replacement cost would equal Rs. 1,000,000; if the machine suffered from minor defects, the total replacement cost would be Rs. 500,000.

Sample Co.'s past experience, however, suggests that only 10% of the machines sold will have major defects, and that another 30% will have minor defects.

Expected value of the cost of refunds					
Resulting from major defects	Rs. 1,000,000	× 0.10	=	**Rs.** 100,000	
Resulting from minor defects	Rs. 500,000	× 0.30	=	150,000	
No defects	Rs. 0	× 0.60	=	0	
Total amount of Liability			=	**250,000**	

Accounting Entry

Dr. Loss against warranty claim	250,000	
Cr. Provision for warranty claim		250,000

Examples include

- Provision for dismantling asset
- Provision for onerous contract
- Provision for unlawful environmental damage

Topic 86 – Accounting for Current Liabilities – Payee Not Known and Amount Not Known

These are also estimated liabilities that come under the definition of provisions.

Best estimate is required to measure its amount.

Examples include

- Provision for premium offers
- Provision for product warranty

Provision for Product Warranty - Scenario

- Sample Co. manufactures washing machines. It sold washing machines to the value of Rs. 900,000 during the reporting period.
- Based on its historical warranty claims experience, it provides for an estimated warranty expense of 2% of revenues.

Accounting Entries

For creating provision in the current year

Warranty expense	Dr.	18,000	
Provision for warranty		Cr.	18,000

For meeting warranty expense in the following year

Provision for warranty	Dr.	14,000	
Cash / payroll cost / material cost		Cr.	15,000

For reversal of excess provision in the following year

Provision for warranty	Dr.	14,000	
Warranty expense		Cr.	15,000

Provision

Provision is a liability of uncertain timing or amount

Topic 87 – Accounting for Current Liabilities – Due to loss contingency

Contingent Liability

IAS 37 defines a contingent liability as an obligation that is either:

A *possible* obligation arising from past events, the outcome of which will be confirmed only on the occurrence or non-occurrence of one or more uncertain future events which are not wholly within the control of the reporting entity; *or*

A *present* obligation arising from past events, which is not recognised either because it is not probable that an outflow of resources will be required to settle an obligation, or the amount of the obligation cannot be measured with sufficient reliability.

Reporting entity does not recognise a contingent liability in its Statement of Financial Position.

Disclosure requirement

Following disclosures are required in the notes to the financial statements:

1. An estimate of its financial effect;
2. An indication of the uncertainties relating to the amount or timing of any outflow; and
3. The possibility of any reimbursement.

Disclosure not required

Disclosure is not required if the possibility of any outflow in settlement is remote, or if it is impracticable to do so.

Topic 88 – Accounting for Non-Current Liabilities

Non-Current Liability

Generally, it is the obligation that is payable subsequent to the upcoming 12 months from the reporting date. Which is not a current liability.

Examples

- Debentures / Debt Certificates
- Bonds / Loan Notes
- Long term borrowings
- Provision for dismantling
- Provision for gratuity
- Deferred tax liability

Categories

- Financial liability
- Non-financial liability

Topic 89 – Accounting for Non-Current Liabilities – Financial Vs. Non-Financial Liabilities

Categories of Liabilities

Liabilities are broadly be categorized into:

1. Financial liabilities; and
2. Non-Financial liabilities

Financial Liabilities

- These are incurred as a result of normal process of the business.
- These give rise to financial asset of other entity.
- These are mainly payable in cash or are settled by transfer of economic resources.

Examples

Financial Liabilities

- Issue of loan notes
- Borrowings
- Security deposits received

Non-Financial Liabilities

- These do not give rise to financial asset of other entity
- These are not payable in cash.
- These are mainly settled by delivering goods or services.
- These are regarded as contingent liabilities which may or may not occur.

Examples

None Financial Liabilities

- Provision for dismantling
- Provision for product warranty
- Deferred tax liability

Topic 90 – Accounting for Non-Current Liabilities – Measurement

Measurement at recognition

Financial liabilities are initially measured at:

- Fair value of consideration received
- Less transaction cost (if the liability is not classified at FVTPL)

Subsequent Measurement

Subsequent measurement of financial liability depends on its classification. Financial liabilities may be measured at:

1. Amortised cost; or
2. Fair value through profit or loss

Amortised Cost Method

It is used to measure most of the financial liabilities at an amount that is adjusted with the difference of coupon and effective interest rates, minus repayment of the principal amount.

FVTPL Method

It is used to measure very few financial liabilities, under which the difference between carrying amount and fair value is reported in the SOPL either gain or loss.

Topic 91 – Accounting for Non-Current Liabilities – Amortised Cost Method

Amortised Cost Method

It is used to measure most of the financial liabilities at an amount that is adjusted with the difference of coupon and effective interest rates, minus repayment of the principal amount.

Coupon interest rate

Also known as stated rate or nominal rate, is used to calculate the amount of interest payable to the lender or bond holder.

Example:

- 10% Bonds
- 10% Loan notes
- 10% Debentures

It is calculated on the face value outstanding during the reporting period.

Effective interest rate

- It reflects the true amount of interest on the amount of loan due.
- It caters the compounding periods during a payment plan.
- It depicts the true picture of financial payments.
- It is the rate at which future value equates the present value (discounted cashflow)

Topic 92 – Accounting for Non-Current Liabilities – Amortised Cost Method - Practice

Sample Co. took a loan from Bank Rs. 1,000 for 3 years @ 10% per annum. The loan is repayable at maturity equal to Rs. 1,200.

Measure the amount to be presented at the end of each reporting period i.e., year 1, year 2 and year 3 using effective interest rate.

Effective Interest Rate		0.1572	
		1.1572	
	Cash flows	Disc Factor	PV
Yr 1	100	0.86	86.42
Yr 2	100	0.75	74.68
Yr 3	1,300	0.65	838.92
PV			1,000.01

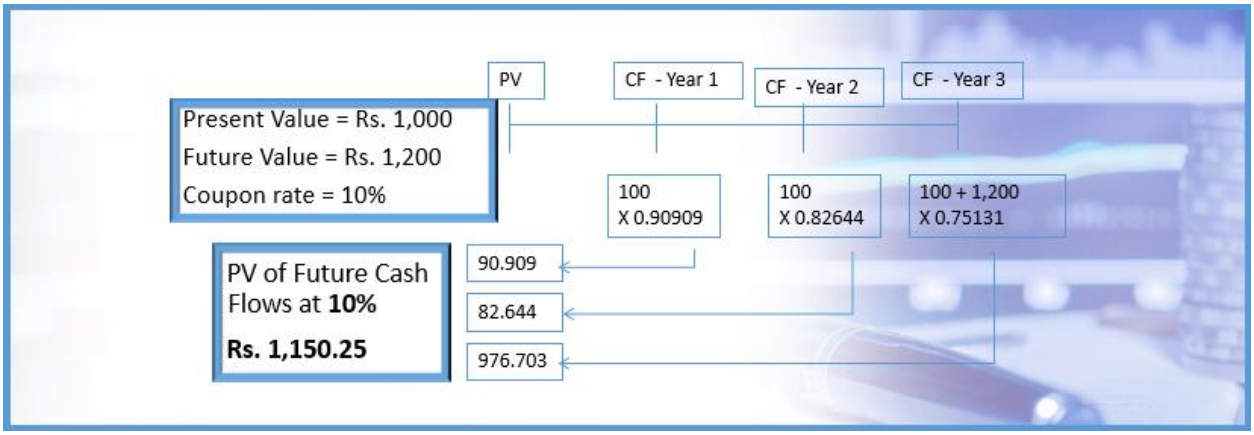
Year	Opening Balance	Interest Income	Interest Received	Closing Balance
1.00	1,000.01	157.20	100	1,057.21
2.00	1,057.21	166.19	100	1,123.40
3.00	1,123.40	176.60	100	1,200.00

Most of the financial liabilities are measured at amortised cost method.

Topic 93 – Accounting for Non-Current Liabilities – Effective Interest Rate

Effective interest rate

- It reflects the true amount of interest on the amount of loan due.
- It caters the compounding periods during a payment plan.
- It depicts the true picture of financial payments.
- It is the rate at which future value equates the present value (discounted cashflow)



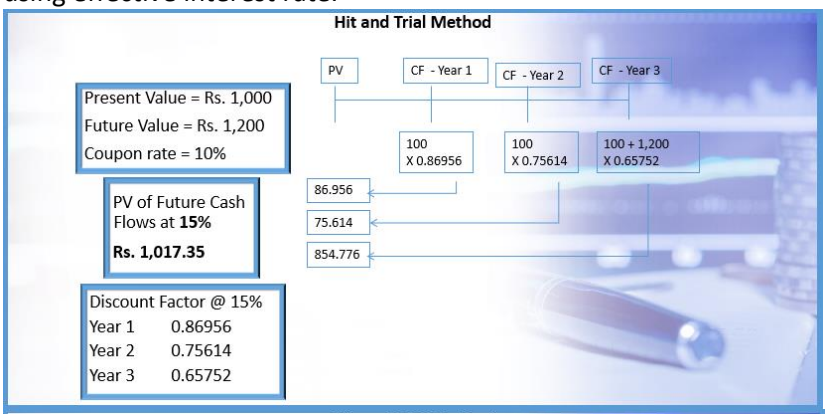
Discounting at coupon / nominal interest rate does not equate the future value to the present value.

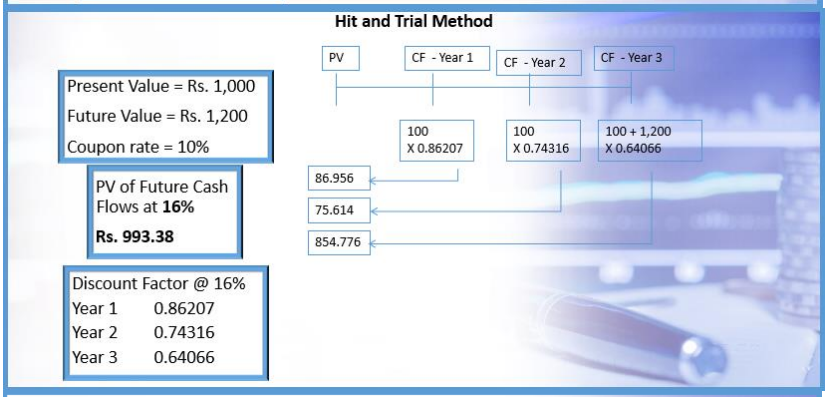
Therefore, the effective interest rate is different from the nominal rate.

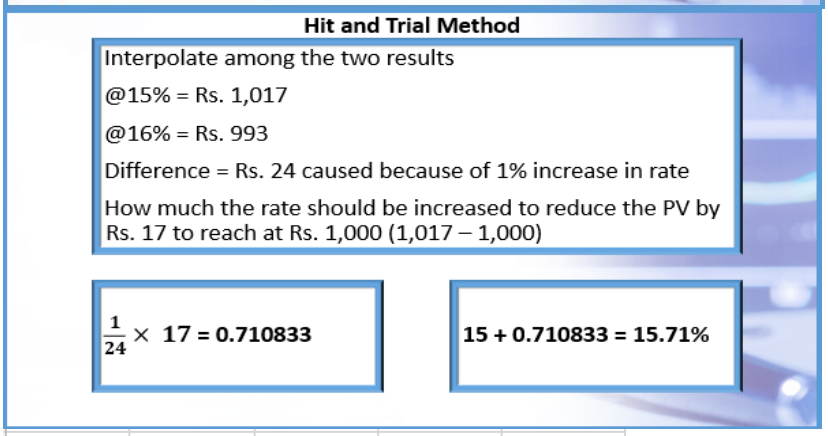
Topic 94 – Accounting for Non-Current Liabilities – Effective Interest Rate – Practice

Sample Co. took a loan from Bank Rs. 1,000 for 3 years @ 10% per annum. The loan is repayable at maturity equal to Rs. 1,200.

Measure the amount to be presented at the end of each reporting period i.e., year 1, year 2 and year 3 using effective interest rate.







Year	Opening Balance	Interest Income	Interest Received	Closing Balance
1.00	1,000.01	157.20	100	1,057.21
2.00	1,057.21	166.19	100	1,123.40
3.00	1,123.40	176.60	100	1,200.00

Effective interest rate

15.71% is the effective interest rate in this scenario that equates the future value to the present value.

Topic 95 – Accounting for Non-Current Liabilities – Derecognition

Financial liabilities (or part thereof) are derecognised from an entity's statement of financial position only when the liability is extinguished i.e., when the obligation specified in the contract is discharged or cancelled or expires.

The difference between the carrying value of a financial liability (or part thereof) extinguished and the consideration paid (including value of non-cash consideration) or liabilities assumed is recognised in profit or loss.

Accounting Entry

Liability	Dr.	1,000	
Cash	Cr.		950
Discount	Cr.		50

Chapter – 5

Accounting for Current Assets

Sr. No	Chapter outline - Topics
96	Accounting for Inventories
97	Accounting for Goods in Transit
98	Accounting for Goods in Transit- Practice
99	Accounting for Consignment Sales
100	Accounting for Consignment Sales Practice
101	Right to Return Sales
102	Right to Return Sales Practice
103	Accounting for Inventories - Periodic and Perpetual
104	Inventories Valuation
105	Inventories Disclosure Requirements IAS 2

Topic Videos 096-105 are mandatory part of this chapter/module

Topic 96 – Accounting for Current Assets – Inventories

Current Asset

Generally, it is the resource that is recoverable/realizable within the upcoming 12-month period from the reporting date or within the normal operating cycle of the entity.

Inventory

Inventory is the *(current)* asset that is held:

1. For sale in ordinary course of business;
2. In the process of production of such sales;
3. As material or supplies

Measurement of Inventories

Inventory is measured at lower of its cost and net realizable value.

Cost components

Cost of inventory includes:

1. Cost of purchase; and
2. Cost of conversion
    a. Labour wages

b. Production overhead

Cost determining formulae

1. First in First out (FIFO)
2. Weighted Average (WA)

Accounting systems

1. Periodic
2. Perpetual

Topic 97 – Accounting for Current Assets – Inventories – Goods in Transit

Recording of Inventory
Purchases and sales of inventory is recorded when legal title passes in or out.
It is necessary to determine when title passes.

Title Vs. Possession
It is misunderstood that title is synonymous with possession of goods in hand.

1. The goods in hand may not be owned; and
2. Goods that are not in hand may be owned.

Ownership of inventory
Confusion about proper ownership is:

1. Goods in transit
2. Consignment sales
3. Buyer having right of return

Goods in Transit

1. Seller has shipped but the buyer did not receive till the reporting date.
2. Goods in transit are included in the inventory of the party (buyer or seller) who is financially responsible for transportation costs. This responsibility may be indicated by shipping terms.

Goods in Transit
Goods in Transit is considered as equivalent to inventory and is classified under the current assets.

For Seller
Goods in Transit for which goods have been dispatched but control has not been transferred:

Dr. Goods in Transit
Cr. Inventory/Purchase

For Seller
Upon sales, means transfer of control:

Dr. Cost of sales
Cr. Goods in transit
Dr. Accounts receivable
Cr. Sales

For Purchaser
Goods in Transit for which invoice has been received:

Dr. Goods in Transit
Cr. Accounts Payable

For Purchaser
Upon receiving possession of goods purchased:

Dr. Inventory/Purchase
Cr. Goods in Transit

Topic 98 – Accounting for Current Assets – Inventories – Goods in Transit – Practice

Sample Co. shipped a truckload of corns costing Rs. 1 million in December 20X1 to its customer Simple Co. at a selling price of Rs. 1.2 million, which remained in transit till 10th January 20X2.

Record entries if:

a) Seller bears shipping cost

Buyer bears shipping cost

a) Seller bears shipping cost and control has not been transferred to buyer

Books of Seller (Sample Co.)

Date	Particulars	Debit Rs. (000)	Credit Rs. (000)
20X1 31st Dec	Goods in Transit	1,000	
	Inventory/Purchases		1,000
20X2 10th Jan	Accounts Receivable	1,200	
	Sales		1,200
	Cost of Sales	1,000	
	Goods in Transit		1,000

Books of Buyer (Simple Co.)

Date	Particulars	Debit Rs. (000)	Credit Rs. (000)
20X1 31st Dec	No Accounting Entry		
20X2 10th Jan	Inventory/Purchases	1,200	
	Accounts Payable		1,200

a) Buyer bears shipping cost and control has been transferred to buyer

Books of Seller (Sample Co.)

Date	Particulars	Debit Rs. (000)	Credit Rs. (000)
20X2 31th Dec	Accounts Receivable	1,200	
	Sales		1,200
	Cost of Sales	1,000	
	Inventory		1,000

Books of Buyer (Simple Co.)

Date	Particulars	Debit Rs. (000)	Credit Rs. (000)
20X1 31st Dec	Goods in Transit	1,200	
	Accounts Payable		1,200
20X2 10th Jan	Inventory/Purchases	1,200	
	Goods in Transit		1,200

Goods in Transit

Goods in Transit is considered as equivalent to inventory and is classified under the current assets.

Topic 99 – Accounting for Current Assets – Inventories – Consignment – Sales

Consignment Sales

Consignment sales is a situation where a party holds the goods to sell as an agent for the true owner.

Consigner & Consignee

Consigner (seller) ships goods to the consignee (buyer) for which title/control is not transferred immediately because the buyer doesn't want to invest cash in inventory and agrees to transfer title when the goods are consumed.

Consignee's Commission

Consignee may also act as an agent to sell the goods sent on behalf of consignee against a commission.

Topic 100 – Accounting for Current Assets – Inventories – Consignment Sales – Practice

Scenario

Sample Co shipped 100 tons of its product to Simple Co. on consignment sales basis. Simple Co. does not take title to such goods until these are consumed in its manufacturing process. The selling price for one ton is set at Rs. 1,000. Sample Co.'s cost of one ton is Rs. 600.

Books of Consigner (Sample Co.)

Date	Particulars	Debit Rs. (000)	Credit Rs. (000)
	On Sending the goods		
	Goods on Consignment	60	
	Inventory/Purchases		60
	On confirmation of consumption		
	Accounts Receivable	100	
	Sales		100
	Cost of Sales	60	
	Goods on Consignment		60

Books of Consignee (Simple Co.)

Date	Particulars	Debit Rs. (000)	Credit Rs. (000)
	On receiving the goods		
	No entry except a memorandum record		
	On confirmation of consumption		
	Inventory/Purchases	100	
	Accounts Payable		100

Consignment Sales

Consignment sales is a situation where a party holds the goods to sell as an agent for the true owner.

Topic 101 – Accounting for Current Assets – Inventories – Right to Return

Right to Return

Buyer is granted an exceptional right to return the merchandise acquired, whether found to be defective or not, within a short time after delivery.

Possible Combination

Sale based on a right of return could be any combination of the following:

1. A full or partial refund of any consideration received.
2. A credit that can be applied against amounts owed.
3. Another product in exchange.

Accounting Effects

1. No revenue is recorded for the sales on right to return.
2. Recognise a refund liability if consideration has been received for such sales.
3. Recognise a contract asset and a corresponding adjustment to cost of sales upon confirmation.

Topic 102 – Accounting for Current Assets – Inventories – Right to Return – Practice

Scenario

Sample Co shipped 1,000 cups to Simple Co. on right to return basis. Simple Co. paid 50% in advance. The selling price for one tablet is set at Rs. 9,000. Sample Co.'s cost of one ton is Rs. 6,000.

Books of Seller (Sample Co.)

Date	Particulars	Dr. Rs. (000)	Cr. Rs. (000)
	On Sending the goods		
	Contract Asset	6,000	
	Inventory/Purchases		6,000
	On receipt of advance		
	Cash/Bank	4,500	
	Refund Liability		4,500
	On confirmation of sales		
	Accounts Receivable	4,500	
	Refund Liability	4,500	
	Sales		9,000
	Cost of Sales	6,000	
	Contract Asset		6,000

Books of Buyer (Simple Co.)

Date	Particulars	Dr. Rs. (000)	Cr. Rs. (000)
	On receiving the goods		
	No entry except a memorandum record		
	On payment of advance		
	Advance to Supplier	4,500	
	Cash/Bank		4,500
	On confirming purchases		
	Inventory/Purchase	9,000	
	Advance to Supplier		4,500
	Accounts Payable		4,500

Right to Return

Buyer is granted an exceptional right to return the merchandise acquired, whether found to be defective or not, within a short time after delivery.

Topic 103 – Accounting for Current Assets – Inventories

Objective

Accounting for inventories is required to match appropriate costs against revenues to arrive at the correct gross profit and the accurate representation of inventories on hand as assets of at the end of the reporting period.

Accounting System

Accounting for inventories is done under either:

1. Periodic system; or
2. Perpetual system.

Periodic Accounting System
Inventory accounting system that requires each purchase of inventory to be recognised as expense and to make a period-end adjustment for inventory on hand for matching cost of goods sold with related revenue.

Periodic Accounting System

Date	Particulars	Dr. Rs.	Cr. Rs.
	For Purchase of goods Purchase expense Accounts payable		
	For Sales of goods Accounts Receivable Sales		
	For Closing stock on hand Inventory asset Purchase expense		
	For Cost of goods sold Cost of goods sold Purchase expense		

Perpetual Accounting System
Inventory accounting system that requires each purchase of inventory to be recognised as asset and to recognise cost of goods sold upon each related revenue.

Perpetual Accounting System

Date	Particulars	Dr. Rs.	Cr. Rs.
	For Purchase of goods Inventory asset Accounts payable		
	For Sales of goods (a) Cost of goods sold Inventory asset		
	For Sales of goods (b) Accounts Receivable Sales		

Inventory account will show a closing balance on hand on reporting date

Topic 104 – Accounting for Current Assets – Inventory Valuation

Measurement of Inventories
Inventory is measured at lower of its cost and net realisable value.

Cost Components
- Cost of purchase,
- Cost of conversion, and
- Other costs incurred in bringing the inventories to their present location and condition

Cost of Purchase
- Purchase price (less trade discounts, rebates, duty drawbacks and similar items),
- Irrecoverable taxes,
- Freight inwards,
- Handling and other costs directly attributable to their acquisition.

Cost of Conversion
Costs directly related to the units of production, such as direct labour and systematically allocated fixed and variable production overheads incurred in producing finished goods.

Net Realisable Value
It is the estimated selling price less the estimated costs of completion and the estimated costs necessary to make the sale.

Sample Co. has stock of finished goods on December 31, 2020 costing Rs 15,000 and work in process inventory costing Rs. 10,000. The estimated cost to complete this work-in-process is Rs 5,000.
The company pays 20% commission on sales to its distributors. Estimated selling price of finished goods and work in process (when this will be converted to finished goods) is Rs. 35,000.

Its NRV shall be calculated as under:

Sales price		35,000
Estimated cost of completion	5,000	
Estimated cost to make sales (35,000 x 20%)	7,000	12,000
Net Realisable Value (NRV)		**23,000**

NRV of Raw Material
NRV of raw material is its replacement cost.

Topic 105 – Accounting for Current Assets – Inventory – Disclosures

Disclosure Requirements

- Accounting policies adopted in measuring inventories, including the cost formula used;
- Total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;
- Carrying amount of inventories at fair value less costs to sell;
- Amount of inventories recognised as expense; and
- Amount of any write-down of inventories
- Information about the carrying amounts held in different classifications of inventories
- The inventories of a service provider may be described as work in progress.

Extract from Notes

(a) Inventories are measured at lower of cost and NRV. Cost is measured by using FIFO, formula.
(b) Inventories comprise the following:

	Rs.'000'
Raw Material	5,400
Work in Process	6,200
Finished Goods	7,600
	19,200

Extract from Notes

1. Carrying amount of finished goods carried at NRV is Rs. 2,000,000.
2. Inventories recognized as expense during the period are Rs. 403,000,000.
3. The amount of write-down of inventory (Finished goods) recognized as expense during the period is Rs. 500,000.
4. There is reversal of write-down of Rs. 100,000.
5. Due to market fluctuations, finished goods are reversed from NRV to cost.
6. Stock is pledged as security against short term loan.

IAS 2

Accounting for Inventories is done under IAS 2.

Chapter – 6

Accounting For Current - Financial Assets

Sr. No	Chapter outline - Topics
106	Accounting For Current - Financial Assets
107	Accounting For Trade Receivables
108	Accounting For Trade Receivables - Practice
109	Trade Receivables - Practice Bad Debts
110	Accounting For Contract Asset
111	Accounting For Contract Asset - Practice
112	Impairment Of Trade Receivables
113	Impairment Of Trade Receivables - Practice

Topic Videos 106-113 are mandatory part of this module

Topic 106 – Accounting for Current Assets – (Financial Assets)

Financial Asset
It arises based on a contract and gives rise to a financial liability or equity instrument of another entity.

Current Financial Asset
Being current, such financial asset should be realisable or recovered within the ordinary operating cycle of the entity or within 12 months from the reporting.

Examples
- Trade Receivables
- Other Receivables (Loans)
- Short Term Investments
- Short Term Deposits
- Cash at Bank
- Cash in Hand

Recognition
A financial asset is recognised in the statement of financial position when, and only when, an entity becomes party to the contractual rights and obligations of such instrument.

Measurement
Financial assets are classified into two categories for measurement purposes:
a) Trade Receivables; and
b) All other financial assets

Topic 107 – Accounting for Trade Receivables – Recognition & Derecognition

Measurement
Trade receivables are measured at transaction price.

Recognition
Trade receivables are recognised when performance obligation is satisfied, either:

1. over the time; or
2. at a point in time.

Performance Obligation
A performance obligation is a promise in a contract with a customer to transfer good or service to the customer

Derecognition
Trade receivables are derecognised when:

1. realised in cash; or
2. settled in other financial assets; or
3. written off as bad debts.

Topic 108 – Accounting for Trade Receivables – Practice – Recognition & Derecognition

Sample Telecom Co. enters into a contract with its customer on 1 July 20X1 for 12 months mobile package plan against a monthly fee of Rs. 800. Customer has following options to pay:

1. Monthly in arrear
2. Annual in arrear

Accounting Entries Option 1 – Customer pays monthly in arrear

At the end of month, upon issuing invoice (Recognition)			
Trade Receivable	Dr.	800	
Sales Revenue	Cr.		800
At the time of realising cash from customer (Derecognition)			
Cash/Bank	Dr.	800	
Trade Receivable	Cr.		800

Accounting Entries Option 2 – Customer pays annually in arrear

At the end of each month, upon issuing invoice (Recognition)			
Trade Receivable x 12 months	Dr.	800	
Sales Revenue x 12 months	Cr.		800
Upon realising cash from customer at the year end (Derecognition)			
Cash/Bank	Dr.	9,600	
Trade Receivable	Cr.		9,600

Derecognition

Trade receivables are derecognised when:

1. realised in cash; or
2. settled in other financial assets; or
3. written off as bad debts

Topic 109 – Accounting for Trade Receivables – Practice – (Bad Debts Derecognition)

Sample Telecom Co. enters into a contract with its two customers, Mr. A and Miss B, on 1 July 20X1 for 12 months mobile package plan against a fee of Rs. 800 per month.
Customer shall pay annually in arrears.
All the cash was realised at the year-end except for
3 installments for which Miss B was unable to pay, Sample Co. decides to write it off.

Accounting Entries

At the end of each month, upon issuing invoice (Recognition)

Trade Receivable x 12 months	Dr.	1,600	
Sales Revenue x 12 months	Cr.		1,600

For writing off trade receivable as bad debts (Derecognition)

Bad Debts (800 X 3 months)	Dr.	2,400	
Trade Receivable	Cr.		2,400

Accounting Entries

Upon realising cash from customer A at the year end (Derecognition)

Cash/Bank (800 x 12 months)	Dr.	9,600	
Trade Receivable	Cr.		9,600

Upon realising cash from customer B at the year end (Derecognition)

Cash/Bank (800 x 9 months)	Dr.	7,200	
Trade Receivable	Cr.		7,200

Provision for Doubtful Debts
Contra to receivable is created against doubtful trade debts named as **"Provision for Doubtful Debts"**

Topic 110 – Accounting for Contract Assets – (Recognition & Derecognition)

Contract Asset
Contract asset arises when an entity satisfies its performance obligation but its invoice is issued at a later stage.
Right to receive consideration is established based on a contract.

Example
Sample Telecom Co. enters into a contract with its customer on 1 July 20X1 for 12 months mobile package plan **and** a mobile phone against a monthly fee of Rs. 1,000. Customer gets mobile phone immediately after signing of contract. Sample Co. issues invoice at the end of each month for Rs. 1,000

Example – cont.….
Stand-alone price for mobile phone is Rs. 2,400 and the price for mobile package plan is Rs. 800 per month.

Right to Receive consideration Recoverable Asset of Rs. 2,400 against the sale of mobile phone is established soon after its delivery to the customer. This creates Contract Asset.

Amount of Contract Asset
In this example, when the stand-alone price of mobile phone is not given, the amount will be calculated as total amount of invoice less the amount of

Topic 111 – Accounting for Contract Assets – Practice – Recognition & Derecognition

Example

Sample Telecom Co. enters into a contract with its customer on 1 July 20X1 for 12 months mobile package plan **and** a mobile phone against a monthly fee of Rs. 1,000. Customer gets mobile phone immediately after signing of contract. Sample Co. issues invoice at the end of each month for Rs. 1,000 Stand-alone price for mobile phone is Rs. 2,400 and the price for mobile package plan is Rs. 800 per month.

Accounting Entries

At the time of handing over mobile phone (Recognition)			
Contract Asset	Dr.	2,400	
Sales Revenue	Cr.		2,400
At the end of each month upon issuing invoice (Derecognition)			
Trade Receivable	Dr.	1,000	
Contract Asset	Cr.		200
Sales Revenue	Cr.		800

Derecognition

A contract asset is a temporary nature of account that is derecognised when invoice is issued.
In this case the contract asset will be converted into trade receivable.

Topic 112 – Impairment of Trade Receivables and Contract Assets

Impairment
Means the asset is no more recoverable to the extent of its carrying amount.

Allowances for Irrecoverable
IFRS 9 guides to create an allowance for irrecoverable against trade receivables and contract assets based on “Expected Credit Losses”.
Such allowance will be created from inception.

Provision Matrix
As a practical expedient, IFRS 9 permits the use of a provision matrix for purposes of measuring lifetime expected credit losses for trade receivables.

Topic 113 – Impairment of Trade Receivables – Practice

Example of a Provision Matrix

Means the allowance for impairment of trade receivable is worked out based on the age of invoice issued.

Scenario

Sample Co. has a portfolio of trade receivables of Rs. 30 million in the year 2020. Its customer base consists of many small clients and the trade receivables are categorised by common risk characteristics, which are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms.

Sample Co. uses a provision matrix for determining the allowance for expected losses.

The provision matrix is based on its historical observed default rates over the expected life of the trade receivables (age debt analysis) and is adjusted for forward-looking estimates.

Sample Co. estimates the following provision matrix:

	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Default rate	0.3%	1.6%	3.6%	6.6%	10.6%

The trade receivables from the large number of small customers amount to Rs. 30 million and are measured using the provision matrix.

Expected Credit Loss		
	Gross Carrying Amount Rs.	Allowance (Gross carrying amount × expected credit loss rate)
Current	15,000,000	45,000
1–30 days past due	7,500,000	120,000
31–60 days past due	4,000,000	144,000
61–90 days past due	2,500,000	165,000
More than 90 days past due	1,000,000	106,000
Total Amount	**30,000,000**	**580,000**

Accounting Entry

Loss of Impairment (Bad Debts)	Dr.	580,000	
Allowance for Doubtful Debts	Cr.		580,000

Annual Review

At every reporting date, the historical observed default rates are updated and changes in the forward looking estimates are analysed.

Chapter – 7

Short Term Investment

Sr. No	Chapter outline - Topics
114	114-Short Term Investment - Equity and Debt Instrument
115	115-Measurement Of Investment - Equity Instrument
116	116-Measurement Of Investment - Equity Instrument Practice

Topic Videos 114-116 are mandatory part of this chapter

Topic 114 – Short Term Investment in Equity or Debt Instruments

Investment in Instruments

a) Equity Instruments
b) Debt Instruments

Investment in Equity Instruments (short-term)

Each financial asset is initially measure at its fair value.

In normal circumstances, transaction price is the fair value.

Transaction cost, if any, is recognised as expense in SOPL.

Topic 115 – Measurement of Investment in Equity Instruments

Investment in Equity Instruments

a) Initial measurement at fair value
b) Subsequent measurement at fair value through profit or loss

Accounting Entries

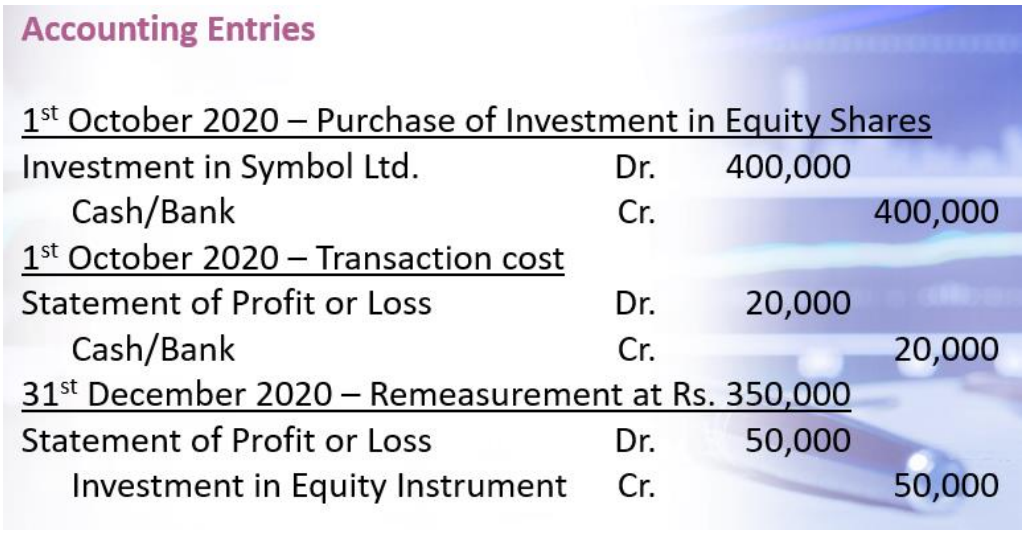
At the time of recognition / initial measurement			
Investment in Equity Instrument	Dr.	5,000	
Cash/Bank	Cr.		5,000
Remeasurement at reporting date (increase in fair value Rs. 6,000)			
Investment in Equity Instrument	Dr.	1,000	
Statement of Profit or Loss	Cr.		1,000
Remeasurement at reporting date (decrease in fair value Rs. 5,400)			
Statement of Profit or Loss	Dr.	600	
Investment in Equity Instrument	Cr.		600

Dividend Income

Dividend received during the reporting period is recognised as income for the year that appears in SOPL

Topic – 116 Measurement of Investment in Equity Instruments – Practice

Sample Co. made an investment of Rs. 400,000 in equity shares of Symbol Ltd. on 1st October 2020. Transaction cost incurred as broker's fee Rs. 20,000.
On the reporting date, 31st December 2020, the fair value of these shares was Rs. 350,000.



It's a simple concept

- Increase in fair value causes a gain (SOPL – Cr.)
- Decrease in fair value causes a loss (SOPL – Dr.)

Chapter – 8

Accounting for fixed Assets

Sr. No	Chapter outline - Topics
117	Accounting for fixed Assets
118	Accounting for fixed Assets revaluation model
119	Revaluation of Land - Practice
120	Revaluation of depreciable assets - Practice
121	Excess depreciation against revalued assets Practice
122	Disposal of revalued assets - Practice
123	Depreciation important points
124	Fixed Assets - Other important concerns
125	Accounting For Fixed Assets - Disclosure Requirements IAS 16
126	Accounting For Fixed Assets - Fixed Assets Schedule

Topic Videos 117-126 are mandatory part of this chapter

Topic 117 – Accounting for Non-Current Assets – Tangible Fixed Assets – (Recap)

Asset

- Non-Current Assets
  - Property Plant & Equipment
  - Investment Property
  - Intangible Assets
  - Long Term Investments
  - Current Assets
  - Inventory
  - Trade Receivable
  - Cash Balances

Fixed Asset

- Property Plant & Equipment are the Fixed Tangible Asset.
- These are subject to Depreciation charge.

Accumulated Depreciation

- Also is known as Provision for Depreciation.
- Always presented as a deduction from relevant fixed asset.
- It is a contra to fixed asset in nature.

Measurement

- Initial measurement at Cost
- Subsequent measurement
  - Cost Model
  - Revaluation Model

Cost Model

Carrying Amount of Fixed Asset is measure at each reporting period as below:

- Historical cost of asset
- Less accumulated depreciation
- Less accumulated impairment loss

Revaluation Model

Fixed Assets are measured at:

- Fair Value
- Less accumulated depreciation (subsequent to revaluation)
- Less accumulated impairment loss (subsequent to revaluation)

Topic 118 – Accounting for Fixed Assets – Revaluation Model

Measurement

- Initial measurement at Cost
- Subsequent measurement
    - Cost Model
    - Revaluation Model

Revaluation

Entire class of asset is revalued at fair value

Class of Assets

A company might have a policy to value all its motor vehicles at cost, but to apply the revaluation model to all its land and buildings.

Fair Value

The price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.

Accounting Issues

1. Accounting treatment for the gain or loss resulting from revaluation
2. Adjustment of accumulated depreciation and cost of asset at the date of revaluation
3. Frequency of revaluation
4. Treatment of Revaluation Surplus

Accounting for Revaluation of Fixed Assets

Step 1 – Calculate depreciation of the asset till the date of revaluation and transfer accumulated depreciation account to the asset account

Accumulated Depreciation		Dr.	x,xxx
	Fixed Asset	Cr.	x,xxx

Step 2 – Adjust the net carrying amount of the asset to its fair value that will result into a gain or loss on revaluation

Step 3 – Recognise; revaluation gain as a Reserve in Equity and; revaluation loss as an Expense in SOPL (if it is first time / initial revaluation)

Accounting treatment for subsequent revaluation gain

Recognise upward revaluation as income in SOPL to the extent of the amount of any previous revaluation loss, any excess should be credited to equity as revaluation surplus.

Accounting treatment for subsequent revaluation loss

Recognise downward revaluation as Debit in revaluation surplus to the extent of the amount of any previous revaluation gain, any excess should be debited to SOPL as expense.

Topic 119 – Revaluation of Land – Practice

Sample Co. purchased land for Rs. 100 million on the 1st January 2020.
Sample Co. applies revaluation model for measurement of land after initial recognition.
The land was revalued to its fair value Rs.130 million on 31st December 2020.

Accounting Entries

			(Rs. in million)
1st Jan 2020 on purchase of land (Initial measurement)			
Land	Dr.	100	
Cash/Bank	Cr.		100
31st Dec 2020 (Subsequent measurement) on reporting date			
Land	Dr.	30	
Revaluation surplus	Cr.		30

Continue with the previous scenario.
On 31st December 2021, the fair value of land was determined at Rs. 95 million.

Accounting Entries

			(Rs. in million)
31st Dec 2021 Subsequent measurement on reporting date			
Revaluation surplus	Dr.	30	
Statement of Profit or Loss	Dr.	5	
Land	Cr.		35

Land is the asset that is not depreciated because of its indefinite useful life.

Topic 120 – Revaluation of Depreciable Asset – Practice

Sample Co. purchased machine for Rs. 100 million on the 1st January 2020, that is to be depreciated at 10% using straight line method. Assume nil residual value.
The machine was revalued at Rs. 120 million on 31st December 2021.

Accounting for Revaluation of Fixed Assets

Step 1 – Calculate depreciation of the asset till the date of revaluation and transfer accumulated depreciation account to the asset account

Accumulated Depreciation	Dr.	x,xxx
Fixed Asset	Cr.	x,xxx

Step 2 – Adjust the net carrying amount of the asset to its fair value that will result into a gain or loss on revaluation

Step 3 – Recognise; revaluation gain as a Reserve in Equity and; revaluation loss as an Expense in SOPL (if it is first time / initial revaluation)

Accounting Treatment

(Rs. in million)

Step 1 – Calculate depreciation till the date of revaluation & transfer to asset account: **Cost Rs. 100 (m) x 10% x 2 years = 20 (m)**

Accumulated Depreciation	Dr.	20	
Machine Asset	Cr.		20

Step 2 – Adjustment of carrying amount of machine to its fair value:

NBV = Rs. 80 (m), Fair value = Rs. 120 (m) ------ Gain Rs. 40 (m)

Step 3 – Recognise revaluation surplus for the gain

Machine Asset	Dr.	40	
Revaluation Surplus	Cr.		40

Topic 121 – Excess Depreciation against Revalued Asset – Practice

Sample Co. purchased machine for Rs. 100 million on the 1st January 2020, that is to be depreciated at 10% using straight line method. Assume nil residual value.
The machine was revalued at Rs. 120 million on 31st December 2021.

Sample Co. estimated that there is no change in the remaining useful life of the revalued machine.
On 31st December 2022, it was found that the carrying amount of the asset was not materially different from its fair value.

Accounting Treatment

(Rs. in million)

On 31st December, Calculate depreciation for the year 2022.

Revalued amount Rs. 120 (m) / 8 years = 15 (m)

Depreciation expense	Dr.	15	
Accumulated Depreciation	Cr.		15

On 31st December 2022, excess depreciation because of revaluation

Rs. 15 (m) – Rs. 10 (m) = Rs. 5 (m)

Revaluation Surplus	Dr.	5	
Retained Profits	Cr.		5

Revaluation surplus 40 – Excess deprecation 5 = Balance 35 (m)

Excess Depreciation
The depreciation charge had the asset not been revalued is subtracted from the depreciation of revalued asset to calculate excess deprecation that is transferred to retained profits, considering realised.

Topic 122 – Disposal of Revalued Asset – Practice

Sample Co. purchased machine for Rs. 100 million on the 1st January 2020, that is to be depreciated at 10% using straight line method. Assume nil residual value.
The machine was revalued at Rs. 120 million on 31st December 2021.

Sample Co. estimated that there is no change in the remaining useful life of the revalued machine.
On 31st December 2022, it was found that the carrying amount of the asset was not materially different from its fair value.

Sample Co. disposed of the revalued machine on 31st December 2023 for Rs. 50m.

Accounting Treatment

(Rs. in million)

On 31st December, Calculate depreciation for the year 2023.			
Revalued amount Rs. 105 (m) / 7 years = 15 (m)			
Depreciation expense	Dr.	15	
Accumulated Depreciation	Cr.		15
On 31st December 2023, excess depreciation because of revaluation			
Rs. 15 (m) – Rs. 10 (m) = Rs. 5 (m)			
Revaluation Surplus	Dr.	5	
Retained Profits	Cr.		5

Accounting Treatment

(Rs. in million)

On 31st December 2023, Disposal of Machine.			
Balances: Machine Rs.120(m), Accumulated Depreciation Rs. 30(m)			
Accumulated Depreciation	Dr.	30	
Cash/Bank	Dr.	50	
Loss on disposal of machine	Dr.	40	
Machine Asset	Cr.		120
On 31st December 2023, transfer balance of revaluation to the RP			
Rs. 40 (m) – Rs. 5 (m) = Rs. 35 (m)			
Revaluation Surplus	Dr.	35	
Retained Profits	Cr.		35

Treatment of Revaluation Surplus
Revaluation surplus of the same asset that has been disposed of is transferred to retained profits.

Topic 123 – Accounting for Fixed Assets Depreciation – Important Points

- The depreciable amount is allocated on a systematic basis over the asset's useful life
- The residual value, the useful life and the depreciation method of an asset are reviewed annually at reporting date
- Changes in residual value, depreciation method and useful life are changes in estimates are accounted for prospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- Depreciation is charged to profit or loss, unless it is included in the carrying amount of another asset
- Depreciation commences when the asset is available for use.
- Revenue based depreciation is prohibited.
- Depreciation method reflects the pattern in which future economic benefits are expected to be consumed.

Topic 124 – Accounting for Fixed Assets – Other Important Concerns

Component accounting

- Significant parts or components are required to be depreciated separately over their estimated useful life.
- Costs of replacing components are required to be capitalized.

Spare Parts, Stand-by or Servicing Equipment

These are classified as items of PPE (fixed assets) when they meet the definition of being PPE, and are classified as inventory when definition of being PPE is not met.

Disposals

- Remove the asset from the statement of financial position on disposal
- The gain or loss on disposal is recognized in profit or loss
- When a revalued asset is disposed of, any revaluation surplus may be transferred directly to retained earnings.

Topic 125 – Accounting for Fixed Assets – Disclosure Requirements

Disclosures include but are not limited to:

- Measurement bases for determining the gross carrying amount
- Depreciation methods
- Useful lives or the depreciation rates used
- Gross carrying amount and the accumulated depreciation at the beginning and end of reporting period

A reconciliation of the carrying amount at the beginning and end of the period showing:

- Additions
- Assets classified as held for sale
- Other disposals
- Acquisitions through business combinations
- Changes resulting from revaluations
- Impairment losses recognized and reversed in profit or loss
- Depreciation
- Exchange differences
- Other changes.

Disclosures

- Significant accounting policies
- Working notes

Topic 126 – Accounting for Fixed Assets – Accounting Policies and Fixed Assets Schedule

Sample Co.
Financial Statements
For the year ended December 31, 20XX

Summary of significant accounting policies

2.5 Property, plant and equipment

All property, plant and equipment assets are stated at cost less accumulated depreciation.	IAS 16 p30
Depreciation of property, plant and equipment is provided to write off the cost, less residual value, on a straight-line basis over the estimated useful life:	IAS 16 p73
• Buildings—50 years • Computer equipment—3 years • Motor vehicles—5 years.	
Residual values, remaining useful lives and depreciation methods are reviewed annually and adjusted if appropriate.	IAS 16 p51
Gains or losses on disposal are included in profit or loss.	IAS 16 p68

Fixed Assets Schedule

It is a comprehensive note that covers all the needful disclosure and reconciliations required by IAS 16

Date	*Gross cost*	*Accumulated depreciation*	*Net carrying amount*
Opening Bal	Rs.4,500,000	2,000,000	2,500,000
Acquisitions	3,000,000	–	3,000,000
Disposals	(€400,000)	(340,000)	(60,000)
Impairment		600,000	(600,000)
Depreciation	–	200,000	(200,000)
Closing Bal	7,100,000	2,460,000	4,640,000

Fixed Assets Accounting

IAS 16 – Property Plant and Equipment provides detailed guideline for Recognition, Measurement, Presentation and Disclosure of Tangible Fixed Assets.

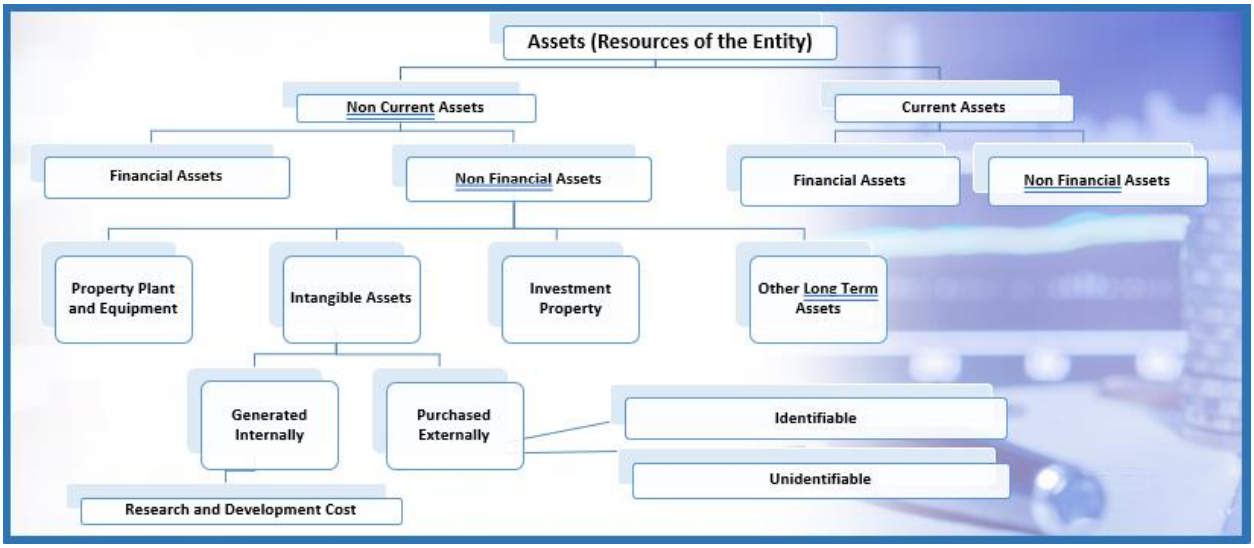
Chapter – 9

Accounting For Non-Current Assets

Sr. No	Chapter outline - Topics
127	Accounting For Non-Current Assets - Intangible Assets
128	Intangible Assets - Recognition
129	Intangible Assets - Measurement
130	Cost Of intangible Assets - Practice
131	Internally Generated Intangible Assets
132	Internally Generated Intangible Assets - Research Phase
133	Internally Generated Intangible Assets - Development Phase
134	Research And Development Cost - Practice
135	Development Cost Practice
136	Amortization Of Intangible Assets
137	Amortization Of Intangible Assets - Practice
138	Intangible Assets - Indefinite Useful Life
139	Intangible Assets - Review Of Useful Life

Topic Videos 127-139 are mandatory part of this chapter

Topic 127 – Accounting for Non-Current Assets – Intangible Fixed Assets (Recap)



Non-Financial Asset

Non-current non-financial assets are classified into two basic types:

1. Tangible and
2. Intangible

Intangible Asset
Identifiable non-monetary assets without physical substance

Identifiable
It is separable; means it can be sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability

Monetary Assets
These are money held and include all the assets that will be received in fixed or determinable amounts of money.

No Physical Substance
Tangible assets have physical substance, while intangible assets either have no physical substance, or have a value that is not conveyed by what physical substance they do have.
For example, the value of gaming software is not reasonably measured by the cost of the DVDs on which these are contained.

Topic 128 – Intangible Assets Recognition Criteria

Recognition
Identifiable intangible assets have much in common with tangible long-lived assets (fixed assets). Recognition depends on whether the *Framework* definition of an asset is satisfied.

Recognition Criteria
1. Separately identifiable;
2. Controlled by the entity as a result of its past actions and events;
3. Flow of future economic benefits to the entity; and
4. Reliable measurement of cost.

Control
Control implies the power to both obtain future economic benefits from the asset as well as restrict others' access to those benefits.

Future Economic Benefits
The future economic benefits may take the form of revenue from the sale of products or services, cost savings resulting from the use of the intangible asset by the entity.

Topic 129 – Intangible Assets Measurement at Initial Recognition

Measurement at Cost

Cost of an intangible asset is categorised in three levels:

1. Acquired separately
2. Acquired as a part of business combination
3. Developed based on research

Acquired Separately

Cost of an intangible asset acquired separately is determined in a manner largely similar to that for tangible fixed assets.

Cost Components

1. Purchase price, including legal and brokerage fees, import duties and non- refundable purchase taxes, after deducting trade discounts and rebates; and
2. Any directly attributable costs incurred to prepare the asset for its intended use.

Acquired as part of Business Combination

Its cost is fair value as at the date of acquisition.

Developed based on Research

When an internally generated intangible asset meets the recognition criteria, the cost is determined using the same principles as for an acquired tangible asset.

Topic 130 – Cost of Intangible Asset – Practice

Scenario I
Sample Co. is a newly established telecom company. It purchased List of customers from a supplier, who developed it over the years, for Rs. 100 million on the 1st January 2020.
Should Sample Co. capitalise it as intangible asset.

Conclusion
No!
Sample Co. should not recognize intangible asset for the purchase of such list of customer, as the cost of list cannot be distinguished from the cost of developing the business as a whole.

Scenario II
Sample Co. acquired a competitor, which also has a large customer list with complete information such as name, address, contacts and average purchase amount. The customer list has a value and could be sold it to third parties.
Should Sample Co. capitalise it as intangible asset.

Conclusion
Yes!
Sample Co. should recognize the customer list acquired in acquisition of competitor as an intangible asset. The possibility to sell the list or to exchange it, provides evidence that it is separately identifiable asset.

Topic 131 – Internally Generated Intangible Asset

These are the intangible assets that are created by the entity over the period of time; like brand name or trade mark etc.

Measurement of the cost of internally generated intangible asset is affected by the fact that many of the costs have already been expensed by the time the entity is able to determine that an asset has indeed been created.

For example; at the point the brand is determined to be an asset, all the costs of creating it have already been expensed, and no past expense is allowed to be recognised as asset.

Expenditures relating to the creation of intangible assets are to be classified into two:

1. Research phase
2. Development phase

Research phase
Costs incurred in the *research* phase are expensed immediately;

Development phase
Costs incurred in the *development* phase are capitalised, provided they meet the recognition criteria for an intangible asset.

Topic 132 – Internally Generated Intangible Asset Research Phase

The terms ‘research phase’ and ‘development phase’ have a broader meaning for the purpose recognising intangible assets.

If an entity cannot distinguish the research phase from the development phase of an internally generated intangible asset, then the entity treats the expenditure as if it were incurred in the research phase only.

In the research phase of a project an entity cannot demonstrate that an intangible asset exists, which will generate probable future economic benefits. Therefore, this expenditure is always recognized as an expense when it is incurred.

Examples of research activities:

a) Activities aimed at obtaining new knowledge;
b) The search for alternatives for materials, devices, products, processes, systems or services; etc.

Topic 133 – Internally Generated Intangible Asset Development Phase

***Development is* the application** of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

Criteria to Capitalise Development Cost

Where an entity can demonstrate all of the following:

a) Technical feasibility of completing the intangible asset;
b) Intention to complete the intangible asset and use or sell it;
c) Ability to use or sell the intangible asset;
d) How the intangible asset will generate probable future economic benefits (existence of a market for intangible asset or its product or, its internal usefulness;
e) Availability of adequate technical, financial and other resources; and
f) Ability to reliably measure the attributable expenditure during its development.

Examples:

a) The design, construction and testing of prototypes;
b) The design of tools, jigs, molds and dies;
c) The design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

Topic 134 – Research and Development Cost – Practice

Distinguish as to which of the following costs would be capitalized.

a) Expenditure on research of new improved material costing Rs. 10,000.
b) Expenditure on applied research amounting Rs. 1,000,000.
c) Donation to a research foundation amounting Rs. 500,000.
d) Expenses of Rs.200,000 on a project which has the technical feasibility to be completed; the management intends to complete the project; future economic benefits will be derived; company has adequate technical and financial resources to complete the project.
e) Expenditure on a project amounting Rs. 500,000. Later on it was discovered that this project is not technically possible to continue.
f) Expenditures on construction of prototypes amounting Rs. 700,000.

1. Research cost to be expensed
2. Development cost to be capitalised based if criteria is met

Topic 135 – Development Cost – Practice

Question

Sample Co. incurred following expenses on design, construction and testing of pre-production prototypes.

Cost of materials	Rs.100,000
Depreciation of machinery (exclusively used for prototypes)	Rs. 7,000
Wages paid to employees engaged in that process	Rs. 54,000
Direct expenses	Rs. 39,000
Administrative expenses	Rs. 28,000

Calculate the cost of the intangible asset generated by the company.

Answer

Cost to be capitalised as intangible asset	
Cost of materials	Rs.100,000
Depreciation of machinery (exclusively used for prototypes)	Rs. 7,000
Wages paid to employees engaged in that process	Rs. 54,000
Direct expenses	Rs. 39,000
Total cost of prototype – Intangible asset	**Rs. 200,000**

Scenario

Sample Co. is conducting an overhaul of the financial reporting systems. Sample Co. has purchased several software to customize and integrate them for its own use.

The customization will take 18 months to complete at a cost of Rs. 500,000 by using internal and external resources.

Conclusion

Sample Co. may capitalize the customized software as an internally generated intangible asset, provided:

1. it has the resources to complete the project;
2. the software will be used in operating the business; and
3. it is probable the system will generate future economic benefits.

Conclusion

The costs that may be capitalised are those directly attributable to the project and incremental to the entity as a result of undertaking the project.

Conclusion

These would usually include:

- Materials and services used in customizing the software;
- The staff salaries engaged on the project;
- Other expenditure such as license fees directly attributable to acquiring the software; and
- Overheads

Topic 136 – Intangible Assets Amortization

Amortization of Development Cost begins when the amortization pattern starts reflecting economic benefit derived from the project/product developed.

Amortization of Intangible Assets with Finite Useful Life These must be amortised over that useful life, which should not exceed the period of legal rights, unless the legal rights are renewable, and the renewal is a virtual certainty.

Amortization of Intangible Assets with Indefinite Life
These are not amortised rather impairment test is conducted on each reporting period.

Amortization Method

- Method should reflect the pattern of economic benefits.
- Method should reflect the expected pattern of the consumption of expected future economic benefits.
- IAS 38 permits straight-line, diminishing balance, and units of production methods.

Start of Amortization

- Amortisation should commence when the asset is available for use
- Amortisation charge for each period should be recognised as an expense unless it is included in the carrying amount of another asset (e.g., inventory).

Topic 137 – Intangible Assets Amortization – Practice

Question

Sample Co. acquired copy rights at Rs. 100,000 to be used for 10 years.

Calculate the amortization expense to be charged in each year. The pattern of consuming economic benefits cannot be estimated.

Solution

Cost	Rs. 100,000
Useful Life	10 years.
Amortization	Rs. 10,000 Per annum

Question

Sample Co. acquired a production formula for Rs. 3 million. Benefits associated to the formula will expire in 5 years' time.

Expected total production is 150,000 units as below:

Year	**Benefit**
1	50,000 units
2	40,000 units
3	30,000 units
4	20,000 units
5	10,000 units

Solution

Amortization expense

Year		**Rs.000**
1	= 3million x 50/150	1,000
2	= 3million x 40/150	800
3	= 3million x 30/150	600
4	= 3million x 20/150	400
5	= 3million x 10/150	200

Topic 138 – Intangible Assets Indefinite Useful Life

An intangible asset with an indefinite useful life shall not be amortised.

Scenario
Sample Co. acquired a trademark that has remaining legal life of five years but is renewable every 10 years at little cost.
Sample Co. intends to renew the trademark continuously and evidence supports its ability to do so.

Scenario ….
An analysis of:

a) product life cycle studies,
b) market, competitive and environmental trends, and
c) brand extension opportunities

provides evidence that trademarked product will generate net cash inflows for the acquiring entity for an indefinite period.

Conclusion
The trademark would be treated as having an indefinite useful life because it is expected to contribute to net cash inflows indefinitely.

Therefore, the trademark would not be amortized until its useful life is determined to be finite.
It would be tested for impairment in accordance with IAS 36 annually and whenever there is an indication that it may be impaired.

Topic 139 – Intangible Assets – Review of Useful Life

The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset.

If the change occurs in useful life assessment from indefinite to finite that shall be accounted for as a change in an accounting estimate in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Scenario
The licensing authority subsequently decides that it will no longer renew broadcasting licenses, but rather will auction the licenses.
At the time the licensing authority's decision is made, the Sample's broadcasting licnese has three years until it expires.

Conclusion
Sample Co. expects that the license will continue to produce net cash inflows until the license expires.
Because the broadcasting license can no longer be renewed, its useful life is not longer indefinite.

The acquired license would be amortized over its remaining three-year useful life and immediately tested for impairment in accordance with IAS 36.

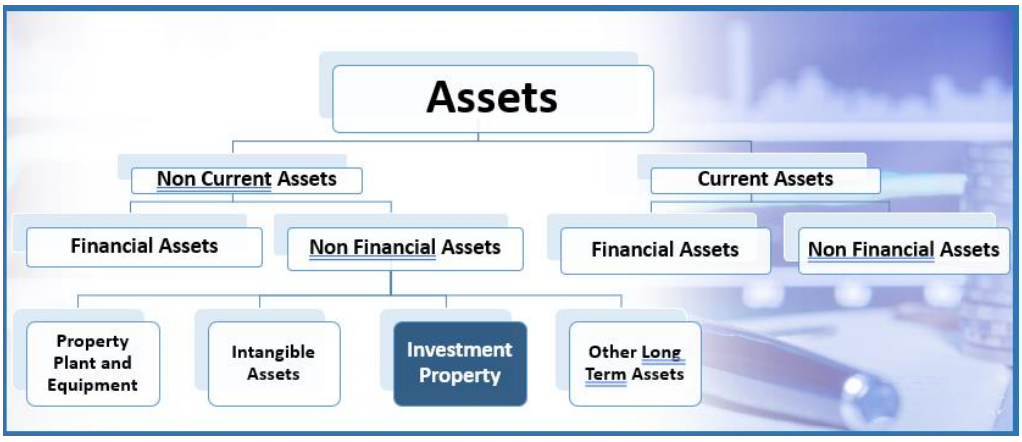
Chapter – 10

Investment property

Sr. No	Chapter outline - Topics
140	Investment property
141	Investment property - Identification
142	Property Not an Investment property
143	Investment property - identification scenario
144	Apportionment of Investment property
145	Investment property - additional services
146	Investment property - recognition and measurement
147	Transfer to or from Investment property
148	Transfer to or from Investment property - Practice

Topic Videos 140-148 are mandatory part of this chapter

Topic 140 – Accounting for Non-Current Assets Investment Property



Investment Property

An investment in land and/or building that is held with the intention of earning rental income or for capital appreciation (or both) is described as an investment property.

Owner Occupied Property

Held by the entity that is used for:

- production of goods or services
- supply of goods or services
- administrative purposes

Topic 141 – Investment Property Identification

Investment Property
Property (land or a building, or part of a building, or both) held (by the owner or by the lessee as a right-of-use asset):

1. to earn rental income; or
2. for capital appreciation purposes; or
3. both

rather than for use in the production or supply of goods or services or for administrative purposes or for sale in the ordinary course of business.

Examples

- Land held for long-term capital appreciation as opposed to short-term purposes like land held for sale in the ordinary course of business;
- Land held for a currently undetermined future use;

Examples

- A building owned by the reporting entity (or a right-of-use asset relating to a building held by the reporting entity) and leased out under one or more operating leases;
- Property under construction or being developed for future use as investment property.

Topic 142 – Property not Identify as Investment Property

Examples

- Property employed in the business (i.e., held for use in production or supply of goods or services or for administrative purposes);
- Property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property;
- Property occupied by employees (whether the employees pay rent at market rates);
- Owner-occupied property awaiting disposal;
- Property being constructed or developed on behalf of third parties; Property held for sale in the ordinary course of business or in the process of construction or development for such sale, the accounting for which is specified by IAS 2;

- Property that is leased to another entity under a finance lease.

Topic 143 – Investment Property Identification Scenario

Sample Co. built a residential property with the intention of selling it.
In the past, Sample Co. has regularly developed property and then sold it immediately after completion.
In order to increase the chances of a sale, this time Sample Co. chooses to let some of the flats on rent as soon as they are ready for occupation.
The tenants move into the property before completion. How should Sample Co. present this property?

Conclusion
Sample Co. should classify this property as inventory. Because of Sample's core business and its strategy regarding selling property.
Letting out strategy is being carried out with the intention of increasing the chances of selling this property.
This property is not let out for the long-term generation of rental income.
Neither this property is held for the purpose of capital appreciation.
Cont…..
X's intention to sell the property under construction immediately after completion in the ordinary course of business has not changed. Consequently, the property under con-struction does not fulfil the definition of an investment property (IAS 40.9(a)).
Sample's intention to sell the property under construction immediately after completion in the ordinary course of business has not changed. Consequently, the property under construction does not fulfil the definition of an investment property.

Topic 144 – Apportionment of Investment Property Between Investment Property and Owner-Occupied Property

Dual Use Property
Certain properties are not held entirely for rental purposes or for capital appreciation purposes.
Portions of these properties might be used by the entity for manufacturing or for administrative purposes.

Purposes
These portions may be earmarked for different purposes that could be:

- sold, or
- leased under a finance lease, separately

The entity is required to account for them separately.

Deemed Investment Property
If the portions cannot be sold, or leased (as a finance lease), separately, then the property would be deemed as an investment property only if an insignificant portion is held by the entity for business use.

Example
A shopping mall, which is rented to tenants, in which the owner maintains an office for the purposes of managing and administering the commercial building.

Topic 145 – Investment Property – Additional Services

Insignificant Services
When ancillary services are provided by the entity and these are a relatively insignificant component of the arrangement, as when the owner of a residential building provides maintenance and security services to the tenants, the entity treats such an investment as investment property.

Example
An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.

Significant Services
When the service provided is a comparatively significant component of the arrangement, then the investment would be considered as an owner-occupied property.

Example
An entity that owns and operates a hotel and provides services to the guests of the hotel would be unable to argue that it is an investment property. Rather, such an investment would be classified as an owner-occupied property.

Topic 146 – Investment Property – Recognition and Measurement

Recognition
Investment property is recognised as an asset when, and only when, it becomes probable that the entity will enjoy the future economic benefits which are attributable to it, and when the costs of the investment property can be reliably measured.

Measurement
- Initial measurement at cost
- Subsequent measurement

1. cost model
2. fair value model

Cost Model
It is exactly the same as IAS 16 i.e., cost less accumulated depreciation less accumulated impairment losses.

Fair Value Model
When investment property is carried at fair value, at each subsequent financial reporting date the carrying amount must be adjusted to the then-current fair value, with the adjustment being reported in the profit or loss for the period in which it arises.

Fair Value Model
When choosing the fair value model all of the investment property must be measured at fair value, except when there is an inability to measure fair value reliably

Topic 147 – Transfer to or from Investment Property

Transfer

- From investment property to owner-occupied property;
- From an owner-occupied property to investment property;
- From investment property to inventories; or
- From inventories to investment property.

Measured at Cost Model

In the case of an entity that employs the cost model, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and thus are measured and disclosed at the same NBV.

Measured at Fair Value Model

In the case of an entity that employs the fair value model, vastly different results follow as far as recognition and measurement is concerned.

Investment property is measured at fair value

Circumstance	Transfer to or from	Deemed transfer value
Commencement of owner occupation	Transfer from investment property to owner-occupied property.	Fair value at the date of change of use becomes the deemed cost for future accounting purposes.
End of owner occupation	Transfer from owner-occupied property (PPE or ROU) to investment property.	Revalue in accordance with IAS-16 prior to the transfer.
Commencement of development with a view to sale	Transfer from investment property to inventories.	Fair value at the date of change of use becomes the deemed cost for future accounting purposes.
Commencement of operating lease to third party	Transfer from inventory to investment property.	Any difference between the fair value and the carrying amount of the inventory at the date of transfer would be reported in profit or loss.
End of construction	Transfer from assets in the course of construction to investment property.	Revalue the property at the date of change of use. Recognize any revaluation difference in the statement of comprehensive income immediately.
Determined that investment property is to be held for sale	Investment property classified as non current asset held for sale.	These continue to be measured at fair value up to the point of sale.

A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use.

Topic 148 – Transfer to or from Investment Property – Practice

Question - 1
Can a property that has previously been classified as an investment property be reclassified as inventory if it is renovated to create disposal through sale?

Answer - 1
Yes. This may be the case when a significantly higher rental standard is achieved through renovation or when the lettable area is notably increased.
However, if the renovation only serves to maintain the property at its current level, then there is no development with the aim of sale.

Question - 2
Can a property under construction classified as inventory be reclassified as an investment property if the disposal plans no longer exist?

Answer - 2
No. A property under construction that has been classified as inventory to date is not to be reclassified solely on the basis of its intended use being changed.
This requires, an operating lease agreement to be commenced.

Chapter – 11

Accounting for impairment of Assets

Sr. No	Chapter outline - Topics
149	149-Accounting for impairment of Assets Basic concept
150	150-Accounting for impairment of assets - indicators of impairment
151	151-Measuring recoverable amount
152	152-Accounting Treatment of impairment loss
153	153-Accounting Treatment of Impairment Loss Practice Scenario-1
154	154-Accounting Treatment of Impairment Loss Practice Scenario-2

Topic Videos 149-154 are mandatory part of this chapter

Topic 149 – Accounting for Impairment of Assets – Basic Concept

Basic Concept
An entity is required to ensure that its assets are not carried at amounts higher than their recoverable amount.

Carrying Amount
The amount at which an asset is presented in the statement of financial position / Balance Sheet.

Recoverable Amount
The amount, which can be recovered by selling the asset or by using the asset in the entity.

Impairment
An asset is termed as impaired if its recoverable amount is lesser than its carrying amount.

Cost of asset		500
Accumulated Dep.	-	100
Carrying amount		**400**
Recoverable amount		**280**
Impairment loss		120

Impairment Assessment
IAS 36 requires an entity to assess at the end of each reporting period whether there is any indication that an asset may be impaired.

Topic 150 – Accounting for Impairment of Assets Indication of Impairment

Impairment Stages
Stage 1 - Indication of impairment
Stage 2 – Assessment of recoverable amount
Stage 3 – Accounting treatment of impairment

Stage 1 - Indicators
Internal indicators

- Asset is damaged
- Plans to discontinue or restructure
- Reduction in remaining useful life
- Expected performance is worse than expected

Stage 1 - Indicators
External indicators

- Decline in market value of asset
- Change in technology, law, or other economic factors that have adverse effect on entity.
- Increase in interest rate
- Decrease in market capitalization

Stage 1 - Indicators
Impairment test is compulsory for intangible assets with an indefinite useful life.

Stage 2 - Assessment
Measurement of recoverable amount that is higher of the:

- Fair value less costs to sell, and
- Value in use

Stage 3 - Accounting
Write down the impaired asset with the amount of impairment loss to its recoverable amount

Topic – 151 Measuring Recoverable Amount

Impairment Stages
Stage 1 - Indication of impairment
Stage 2 – Assessment of recoverable amount
Stage 3 – Accounting treatment of impairment

Stage 2
Recoverable amount is the higher of:

- Fair value less cost to sell, and
- Value in use

Fair value less costs to sell
Fair value of an asset at a particular date is normally its current market value or the price that is determined in a binding sales agreement

Fair value less costs to sell
Costs to sell normally include Incremental costs that are attributable to the disposal of an asset e.g., legal costs and taxes etc.

Value in Use
Present value of the future cash flows by application of an appropriate discount rate.
Cash flows are estimated from the continuing use and ultimate disposal of the asset.

Illustration

Scenarios	Fair value less costs to sell Rs.	Value in use Rs.	Recoverable amount Rs.	Carrying amount Rs.	Impairment loss, impact on carrying amount
Asset # 1	950	1,040	**1,040**	**1,000**	No impairment
Asset # 2	950	960	**960**	**1,000**	Rs. 40, asset to be written down to Rs. 960
Asset # 3	940	920	**940**	**1,000**	Rs. 60, asset to be written down to Rs.940

Prudence Concept
Assets are not presented in the Statement of Financial Position at an amount that is greater than its recoverable amount.

Topic 152 – Accounting Treatment of Impairment Loss

Impairment Stages
Stage 1 - Indication of impairment
Stage 2 – Assessment of recoverable amount
Stage 3 – Accounting treatment of impairment

Stage 3 - Accounting
Write down the impaired asset with the amount of impairment loss to its recoverable amount

Impairment Loss
The impairment loss is normally recognized immediately in profit or loss as an expense.

Accounting Entry
Impairment loss Dr.
Accumulated Impairment Loss Cr.

Example
A company has a machine in its statement of financial position at a carrying amount of Rs.300,000.
The machine has been tested for impairment and found to have recoverable amount of Rs.275,000 meaning that the company must recognize an impairment loss of Rs.25,000.

Accounting Entry

Impairment Loss	Dr. 25,000	
Accumulated Impairment Loss		Cr. 25,000

Statement of Profit or Loss
Impairment Expense 25,000

Statement of Financial Position

Assets	
Machine	300,000
Accumulated Impairment -	25,000
Net Book Value	**275,000**

Topic 153 – Accounting Treatment of Impairment Loss Practice Scenario - 1

Scenario - 1
On 1st January 20X1, Sample Co purchased a machine for Rs.240,000 with an estimated useful life of 20 years and estimated nil residual value. Depreciation is charged on a straight-line basis.
On 1st January 20X4, an impairment review showed the machine's recoverable amount to be Rs.100,000 and its remaining useful life to be 10 years.

Solution
Step 1
Calculate carrying amount of the machine on 31st December 20X3
(immediately before the impairment)

	Rupees
Cost of Machine	240,000
Accumulated depreciation (3 × (240,000 ÷ 20 years))	- 36,000
Carrying amount	**204,000**

Solution
Step 2
Calculate impairment loss
(to be recognized in the year 4 on 1st January 20X4)

Impairment loss on 1st January 20X4 is	Rs.104,000
Net Book Value	204,000
Recoverable Amount	100,000

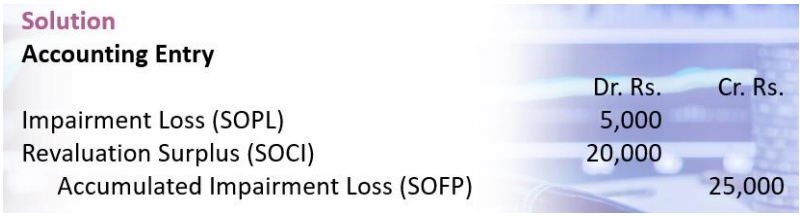
Rs. 104,000 is charged to profit or loss as expense.

Solution
Step 3
Calculate depreciation expense
(to be recognized in the year 4 ending on 31st December 20X4)
Depreciation charge in 20X4 Rs.100,000 ÷ 10 10,000
The recoverable amount is allocated on the expected remaining useful life.

Topic 154 – Accounting Treatment of Impairment Loss Practice Scenario - 2

Scenario - 2
Sample company has a machine in its statement of financial position at a carrying amount of Rs.300,000 including a previously recognized revaluation surplus of Rs.20,000.

Scenario - 2
The machine has been tested for impairment and found to have recoverable amount of Rs.275,000 meaning that the company must recognize an impairment loss of Rs.25,000.



Solution
Impairment not covered by a previously recognized revaluation surplus on the same asset is recognized in statement of profit or loss.

Chapter – 12

Investment in Non-Current Financial Assets

Sr. No	Chapter outline - Topics
155	Investment in Non-Current Financial Assets
156	Investment in Non-Current Financial Assets - Initial Measurement
157	Investment in Equity Instrument-Practice
158	Investment in Debt Instrument-Practice
159	Financial Asset-Subsequent Measurement
160	Financial Asset-Measurement At FVTPL
161	Financial Asset-Measurement At FVTOCI
162	Financial Asset-Measurement At Amortized Cost

Topic Videos 155-162 are mandatory part of this chapter

Topic 155 – Accounting for Investment in Equity or Debt Instruments Non-Current Financial Assets

Financial Assets

These give rise to equity instrument or financial liability of other entity based on a contractual arrangement.

Being non-current, these are long-term investments.

Recognition

Investment in financial asset is recognised as an asset when entity becomes party to the contractual provisions of the instrument.

Investment in Equity Instruments

Buying or subscribing equity shares of another entity

Shares in X Co. Dr.

Cash/Bank Cr.

Investment in Debt Instruments

Advancing loan to another entity

Loan to X Co.	Dr.	
Cash/Bank		Cr.

Investment in Debt Instruments

Buying loan notes or bonds of another entity

Loan notes in X Co.	Dr.	
Cash/Bank		Cr.

Topic 156 – Investment in Equity or Debt Instruments Initial Measurement

Initial Measurement
Investment in Equity or Debt, being non-current financial asset, is initially measured at fair value plus transaction cost

Transaction Price
Fair value of a financial instrument at initial investment is normally the transaction price

Transaction Cost
It is the incremental costs directly attributable to the acquisition of a financial asset. For example; broker's fee, commissions, levies, transfer taxes and stamp duties.

Fair Value
The fair value of a financial asset at initial recognition is normally the transaction price particularly for financial instruments that are traded on the basis of fair values (i.e., the fair value of the consideration given or received).

Fair Value ≠ Transaction Price

1. Recognise day 1 gain/loss in SOPL if the fair value is evidenced from active market or the data is taken only from the observable markets; otherwise
2. Defer the difference over the term (period) of the financial asset.

Accounting Entries Day 1 Gain/Loss

Dr. Financial Asset at FV
    Cr. Cash/Bank at TP
    Cr. Day 1 Gain (SOPL)

Dr. Financial Asset at FV
Dr. Day 1 Loss (SOPL)
    Cr. Cash/Bank at TP

Topic 157 – Investment in Equity Instruments Initial Measurement – Practice

Scenario

On 1 January 20X1, Sample Co. purchased 500 equity shares in Symbol Limited for Rs.100,000 at its fair value on that date.

Transaction costs is amounted to Rs.1,000 on 1 January 20X1.

Solution

		Rs.	Rs.
Investment in Symbol Ltd.	Dr.	100,000	
Bank	Cr.		100,000
Investment in Symbol Ltd.	Dr.	1,000	
Bank	Cr.		1,000

Accounting Treatment

Transaction cost is included in the cost of investment for those investments that are to be measured subsequently at FVTOCI

Topic 158 – Investment in Debt Instruments Initial Measurement – Practice

Scenario

Sample Bank granted a Rs. 1 million loan to Symbol Co. on 1 January 20X1 at par. The loan is repayable in 2 years' time and bears annual interest of 7%.

A similar loan in the market normally bears interest at 9% per annum (as at 1 January 20X1), however Sample Bank is willing to receive a lower yield on the loan as Symbol Co. has agreed to transfer all other banking requirements solely to Sample Bank.

Solution

1 January 20X1		**Rs.**	**Rs.**
Loan to Symbol Co.	Dr.	964,818	
Day-1 Loss (SOPL)	Dr.	35,182	
Bank	Cr.		1,000,000

Loan is recognised at fair value (present value of future cash flows).
Future Value (FV) 1 million;
annual cash flow of interest (pmt) 70,000;
cost of capital (i) = 9%;
No of period (n) = 2;
Present value (PV) 964,818

Solution

31 December 20X1		**Rs.**	**Rs.**
Loan to Symbol Co.	Dr.	86,834	
Interest Income	Cr.		86,834
(Interest earned = 964,818 x 9%)			
Bank	Dr.	70,000	
Loan to Symbol Co.	Cr.		70,000
(Interest received = 1,000,000 x 7%)			

Interest income Vs. received

- Interest income is calculated on the amount due using effective interest rate
- Interest received is calculated on principal amount using the coupon interest rate

Topic 159 – Financial Assets – Subsequent Measurement

Classification
Financial asset shall be classified according to their subsequent measurement methods, that can be either:

- FVTPL,
- FVTOCI or
- Amortised Cost

FVTPL
Fair Value through Profit or Loss
It applies to all financial assets that do not meet the criteria to be measures at amortised cost and FVTOCI options.
As well as it applies to those financial assets that the entity elects to be measured under at FVTPL.

FVTOCI
Fair Value through Other Comprehensive Income
It applies to financial assets whose business model is a combination of holding to collect contractual cash flows as well as sell to manage profitability.

Amortised Cost
This category applies to financial assets whose business model is to hold to collect contractual cash flows and whose contractual cash flows are made solely of
principal and interest

Topic 160 – Financial Assets Measurement at FVTPL

FVTPL

Fair Value through Profit or Loss

It applies to all financial assets that do not meet the criteria to be measures at amortised cost and FVTOCI options.

As well as it applies to those financial assets that the entity elects to be measured under at FVTPL.

Scenario

On 1 January 20X1, Sample Co. purchased 500 equity shares in Symbol Limited for Rs. 100,000 at its fair value on that date. Transaction costs is amounted to Rs. 1,000 on 1 January 20X1.

The fair value of Symbol's shares at 31 December 2014 was Rs. 120 000.

Solution

		Rs.	Rs.
Investment in Symbol Ltd.	Dr.	100,000	
Bank	Cr.		100,000
Statement of Profit or Loss	Dr.	1,000	
Bank	Cr.		1,000
Investment in Symbol Ltd.	Dr.	20,000	
Statement of Profit or Loss	Cr.		20,000

Accounting Treatment

- Transaction cost is charged to SOPL for the Financial Assets that are measured at FVTPL
- Remeasurement gain or loss against fair value adjustment is recognised in SOPL

Topic 161 – Financial Assets Measurement at FVTOCI

FVTOCI

Fair Value through Other Comprehensive Income

It applies to financial assets whose business model is a combination of holding to collect contractual cash flows as well as cash flow from sale to manage profitability.

Scenario

On 1 January 20X1, Sample Co. purchased 500 equity shares in Symbol Limited for Rs. 100,000 at its fair value on that date. Transaction costs is amounted to Rs. 1,000 on 1 January 20X1.

The fair value of Symbol's shares at 31 December 2014 was Rs. 120 000.

Solution

		Rs.	Rs.
Investment in Symbol Ltd.	Dr.	100,000	
Bank	Cr.		100,000
Investment in Symbol Ltd.	Dr.	1,000	
Bank	Cr.		1,000
Investment in Symbol Ltd.	Dr.	20,000	
Other Comprehensive Income	Cr.		20,000

Accounting Treatment

- Transaction cost is included in the Financial Assets that are measured at FVTOCI
- Remeasurement gain or loss against fair value adjustment is recognised in SOCI

Topic 162 – Financial Assets Measurement at Amortised Cost

Amortised Cost

This category applies to financial assets whose business model is to hold to collect contractual cash flows and whose contractual cash flows are made solely of
principal and interest

Scenario

Sample Bank granted a Rs. 1 million loan to Symbol Co. on 1 January 20X1 at par. The loan is repayable in 2 years' time and bears annual interest of 7%.

A similar loan in the market normally bears interest at 9% per annum (as at 1 January 20X1), however Sample Bank is willing to receive a lower yield on the loan as Symbol Co. has agreed to transfer all other banking requirements solely to Sample Bank.

Solution

1 January 20X1		**Rs.**	**Rs.**
Loan to Symbol Co.	Dr.	964,818	
Day-1 Loss (SOPL)	Dr.	35,182	
Bank	Cr.		1,000,000

Loan is recognised at fair value (present value of future cash flows).
Future Value (FV) 1 million;
annual cash flow of interest (pmt) 70,000;
cost of capital (i) = 9%;
No of period (n) = 2;
Present value (PV) 964,818

Solution

31 December 20X1		**Rs.**	**Rs.**
Loan to Symbol Co.	Dr.	86,834	
Interest Income	Cr.		86,834
(Interest earned = 964,818 x 9%)			
Bank	Dr.	70,000	
Loan to Symbol Co.	Cr.		70,000
(Collection of Interest on Principal = 1,000,000 x 7%)			

Solution

31 December 20X2		**Rs.**	**Rs.**
Loan to Symbol Co.	Dr.	88,348	
Interest Income	Cr.		88,348
(Interest earned = 981,652 x 9%)			
Bank	Dr.	70,000	
Loan to Symbol Co.	Cr.		70,000
(Collection of Interest on Principal = 1,000,000 x 7%)			

Solution

31 December 20X2		**Rs.**	**Rs.**
Bank	Dr.	1,000,000	
Loan to Symbol Co.	Cr.		1,000,000
(Collection of principal amount on maturity)			

Business Model

To collect:

- Principal amount on maturity, and
- Interest on principal amount

Chapter – 1

Revenue from Contracts with Customers

Sr. No	Chapter outline - Topics
163	Revenue From Contracts With Customers
164	Revenue Model - Core Principles and Steps
165	Revenue Recognition
166	Identifying a Contract
167	Identifying a Contract-Practice
168	Identifying separate performance obligation
169	Determining transaction price
170	Allocating transaction price to performance obligation
171	Recognizing revenue when or as the entity satisfies PO

Topic Videos 163-171 are mandatory part of this chapter

Topic 163 – Revenue from Contracts with Customers

Revenue
Revenue is income from 'ordinary activities'.

Contract
A **contract** has rights and obligations between two or more parties. That is agreed and enforceable in the law.

Customer
Customer is a person (real or artificial) who receives a good or service that are product or output of the entity's ordinary activities in exchange for consideration.

Accounting Treatment
Customer Dr.
Revenue Cr.

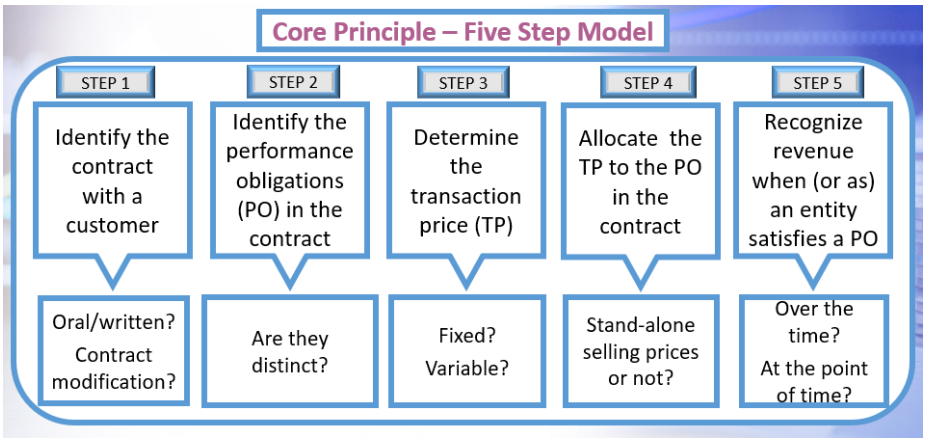
Topic 164 – Revenue from Contracts with Customers Revenue Model

Revenue model is based on core principles that require an entity to recognise revenue:

- For the promised product that is transferred to the customer
- At an amount of that is expected to be entitled in exchange of promised product

Core Principles

1. Identify contract with the customer
2. Identify the separate performance obligations in the contract
3. Determine transaction price
4. Allocate the transaction price to separate performance obligations
5. Recognise revenue when or as an entity satisfies performance obligations



- PO is the Promised product
- TP is the amount in exchange of PO

Topic 165 – Revenue Recognition – Scenario

Scenario

Sample Co. a telecom operator entered into a contract with JQ on 1 July 20X1. In line with the contract, JQ subscribes for **Sample Co**'s monthly telecom services for 12 months and in return, JQ receives free handset from **Sample Co.** JQ will pay a monthly fee of Rs. 100.

JQ gets the handset immediately after contract signature.

Sample Co. sells the same handsets for Rs. 240 and the same monthly telecom plans for Rs. 80 per month without handset.

How should **Sample Co.** recognize revenues from the contract with JQ for the year ending on 31 December 20X1 (six months period)?

Steps

1. Identify contract
2. Identify the separate POs
3. Determine TP
4. Allocate the TP to POs
5. Recognise revenue

Step 1: Identify contract
Written contract between JQ and **Sample Co.**
Step 2: Identify POs
PO1: Monthly telecom services PO2: Handset
Step 3: Determine TP
Monthly fee: Rs. 100
Months of subscription: 12
Transaction price: Rs. 1,200

Step 4: Allocate TP to POs

Performance obligations	Stand alone selling price	Allocated TP to POs	Revenue	Billing Invoice
Telecom services	960	960	80	100 / month
Handset	240	240	240	0
Total	**1,200**	**1,200**		

Step 5: Recognize revenue when (or as) an entity satisfies a PO

PO 1: Monthly telecom services	Over time, as monthly network services are provided
PO 2: Handset	At the point of time, when handset is Delivered

Accounting Entries

1 Jan 20X1			
Contract Asset	Dr.	240	
Sales of handset	Cr.		240
31 Jan 20X1			
Trade Receivable	Dr.	100	
Sales of Services	Cr.		80
Contract Asset	Cr.		20
(for six months Jan to Dec)			

Statement of Profit or Loss Extract – 1 Jan to 31 Dec 20X1

Sales of handset	240
Sales of telecom services	480
Total Revenue	**720**

Statement of Financial Position Extract – as on 31 Dec 20X1

Contract Asset	240
Amortised (Rs.20x6months)	- 120
	120
Trade Receivable (Dec.20X1)	100

Topic 166 – Revenue from Contracts with Customers Identifying a Contract

Contract
A contract is an agreement between two or more parties that creates enforceable rights and obligations.

Revenue model applies:

1. when collection of consideration is probable

and when or if the contract:

2. has commercial substance
3. identifies each party's rights
4. identifies payment terms
5. has been approved by the parties and establishes commitment to perform obligations

If a contract with customer does not meet these criteria, revenue is recognised only when either:

- The entity's performance is complete and substantially all of the consideration in the arrangement has been collected and is non-refundable; or
- The contract has been terminated and the consideration received is non-refundable.

Topic 167 – Identifying a Contract with Customer – Practice

Scenario 1
Sample Co. (car dealer) agreed on 1 March 20X1 to sell 10 cars to Alpha Co. Due to some deficiency in drafting the agreement each party's rights cannot be identified.
On 31 March 20X1 Sample Co. delivered the cars that were accepted by Alpha Co. Full payment was made by Alpha Co. on 10 April 20X1, which is non-refundable.

Conclusion
Sample Co. cannot identify each party's rights so revenue recognition should be delayed until the entity's performance is complete and substantially all of the consideration has been collected and is non-refundable.
Therefore, revenue should be recognised on April 10, 20X1.

Scenario 2
Sample Electronic Co. agreed to deliver 10 lap tops to IQ within 3 months. As per the agreement Sample Co. can cancel the contract any time before delivering the lap tops.
Sample Co. is not required to pay any penalty to IQ if it is unable to satisfy the performance obligation.

Conclusion
A contract does not exist if each party (either buyer or seller) has an enforceable right to terminate a wholly unperformed contract without compensating the other party.
As Sample Co. can cancel the contract without paying any compensation to IQ therefore contract does not exist.

Topic 168 – Identifying a Separate Performance Obligation

Performance Obligation
PO is a promise in a contract with a customer to transfer a good or service to the customer.

Distinct Good or Service
A good or service (or a bundle of goods or services) that is distinct. Like;

- Sale of a car
- Sale of course books
- Servicing a truck
- Providing tax advice

Series of Distinct Good or Service
A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

- Weekly service contract of fleet of cars for 3 months
- Telecom service contract for 12 months

Scenario
Sample Co. sells 10 washing machines for Rs. 50,000 each to SRB Laundry, and agrees to provide following for free:

1. 2 years' after sale service
2. 10 kg detergent every month for the next 12 months
3. 50% discount voucher if next purchase is made in the upcoming 6 months.

Conclusion
There are 4 separate performance obligations:

1. Delivery of 10 washing machines ***(point in time)***
2. Service and maintenance over 2 years ***(over time)***
3. 10 kg detergent over the next 12 months ***(over time)***
4. Discount voucher ***(point in time)***

Topic 169 – Determining Transaction Price

Transaction Price
Transaction price is the amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract, excluding any amounts collected on behalf of third parties (for example, sales taxes).

While determining the TP an entity must consider:
- Variable consideration;
- Time value of money;
- Non-cash consideration;
- Consideration payable to the customer.

Scenario
Sample Co. enters into a contract to supply 100 tons of coal to a customer in two weeks for Rs. 200,000. If the coal is not supplied on time, there will be a penalty of Rs. 20,000.
Sample Co. has a history of supplying coal and there is 90% chance that the coal will be supplied on time.

Conclusion
There are two possible outcomes:
- Rs. 200,000 if supply is made on time
- Rs. 180,000 if supply is not made on time

The **"most likely amount"** method better predicts the amount of consideration
Therefore, transaction price is Rs. 200,000 as there is 90% chance of on time supply.

Scenario
On 1 December 20X1, Sample Co. sold 300 mobile phones for Rs. 5,000 each.
Customer has the right to return the phones within 3 months, with full refund. Thereafter the customer can no longer return and must pay in full.
Sample Co. has previously worked with this customer and can reliably estimate that 5% of the mobile phones will probably be returned within a 3-month period.

Conclusion
Transaction price contains a variable element, when customer has the right to return.
Since the variable element can be reliably estimated, it is taken into account in the revenue estimate, and the total amount of revenue will be Rs. 1,425,000 (300 x 95% x Rs.5,000).

Topic 170 – Allocating Transaction Price to Performance Obligation

Allocation

The entity allocates a contract's transaction price to each separate performance obligation within that contract on a relative stand-alone selling price basis at inception of the contract.

Scenario

Sample Co. a telecom operator entered into a contract with JQ on 1 July 20X1. In line with the contract, JQ subscribes for **Sample Co**'s monthly telecom services for 12 months and in return, JQ receives free handset from **Sample Co.** JQ will pay a monthly fee of Rs. 100.

JQ gets the handset immediately after contract signature.

Sample Co. sells the same handsets for Rs. 300 and the same monthly telecom plans for Rs. 80 per month without handset.

How should **Sample Co.** recognize revenues from the contract with JQ for the year ending on 31 December 20X1 (six months period)?

Step 4: Allocate TP to POs

Performance obligations	Stand alone selling price	Allocate TP to POs		Revenue	Billing Invoice
Telecom services	960	(1200x960/1260)	914	76	100 / month
Handset	300	(1200x300/1260)	286	286	0
Total	1,260		1,200		
	Alternatively				
Performance obligations	**Stand alone selling price**	**Allocate discount to POs**		**Revenue**	**Billing Invoice**
Telecom services	960	(60x960/1260)	46	914/12 = 76	100 / month
Handset	300	(60x300/1260)	14	286	0
Total	1,260		1,200		

Accounting Entries

1 Jan 20X1

Contract Asset	Dr.	286	
Sales of handset	Cr.		286

31 Jan 20X1

Trade Receivable	Dr.	100	
Sales of Services	Cr.		76
Contract Asset	Cr.		24

(for six months Jan to Dec)

Topic 171 – Recognizing Revenue "when" or "as" the entity satisfies PO

Transfer of Control
Revenue Recognition Model is based on transfer of control.

("When" or "as")
Control is transferred in two ways:

1. "When" the entity satisfies PO at a point in time, and
2. "As" the entity keeps on satisfying PO over the time.

Entity must determine "when" or "as" at inception of the contract.
Scenario
Sample Co. a telecom operator entered into a contract with JQ on 1 July 20X1. In line with the contract, JQ subscribes for **Sample Co'**s monthly telecom services for 12 months and in return, JQ receives free handset from **Sample Co.** JQ will pay a monthly fee of Rs. 100.
JQ gets the handset immediately after contract signature.
Sample Co. sells the same handsets for Rs. 300 and the same monthly telecom plans for Rs. 80 per month without handset.
How should **Sample Co.** recognize revenues from the contract with JQ for the year ending on 31 December 20X1 (six months period)?

Step 5: Recognize revenue ("when" or "as") an entity satisfies a PO

PO 1: Handset / Mobile Phone	At the point in time, when handset is Delivered
PO 2: Monthly telecom services	Over time, as monthly telecom services are provided

Accounting Entries

1 July 20X1			
Contract Asset	Dr.	286	
Sales of handset	Cr.		286
(At the point in time, "when" handset is Delivered)			
31 July 20X1 – 31 Dec 20X1			
Trade Receivable	Dr.	100	
Sales of Services	Cr.		76
Contract Asset	Cr.		24
(Over the time, "as" monthly service is provided)			
(for six months July to December 20X1)			

Statement of Profit or Loss
Extract – 1 Jul to 31 Dec 20X1

Sales of handset	286
Sales of telecom services	456
Total Revenue	**742**

Statement of Financial Position
Extract – as on 31 Dec 20X1

Contract Asset	286	
Amortised (Rs.24x6months)	- 144	142
Trade Receivable (Dec.20X1)		100

Chapter – 14

Financial statement analysis

Sr. No	Chapter outline - Topics
172	Financial statement analysis
173	Vertical Analysis
174	Horizontal Analysis
175	Ratio Analysis
176	Profitability Ratio
177	177-Liquidity Ratio
178	178-Debt Ratios or Leverage Ratios
179	179-Efficiency Ratios
180	180-Market Ratios or Owner Ratios
181	181-Cash Flow Ratios
182	182-Limitations in Financial Statement Analysis

Topic Videos 172-182 are mandatory part of this chapter

Topic 172 – Financial Statement Analysis

Forms of information:

1. Absolute form
2. Relative form

Mostly users look for analytical information that is provided in relative form to asses entity's performance and position.

Absolute Vs. Relative

Sample Co.	**Absolute**	**Relative**
	in Rupees	**% of sales**
Sales	800	100%
Cost of Sales	640	80%
Gross Profit	160	20%
Simple Co	Absolute	Relative
	in Rupees	% of sales
Sales	1,800	100%

Cost of Sales	1,620	90%
Gross Profit	180	10%

Financial Statement Analysis

- Vertical Analysis
- Horizontal Analysis
- Ratio Analysis
- Cash Flow Analysis

Use of Analysis

- Interpretation
- Decision Making

Topic 173 – Vertical Analysis

Up-down or Down-up

Vertical analysis restates balance sheet or income statement amounts as a percentage of total assets (balance sheet) or net sales (income statement).

Sample Co. Balance Sheet

	Rupees in Thousand		
	20X1	20X2	20X3
Fixed Asset	500	700	300
Current Asset	300	150	200
Total Assets	**800**	**850**	**500**
Owners Equity	600	500	250
Liabilities	200	350	250
Total Assets	**800**	**850**	**500**

Sample Co. Balance Sheet

	Rupees in Thousand		
	20X1	20X2	20X3
Fixed Asset	63%	82%	60%
Current Asset	37%	18%	40%
Total Assets	**100%**	**100%**	**100%**
Owners Equity	75%	59%	50%
Liabilities	25%	41%	50%
Total Assets	**100%**	**100%**	**100%**

Sample Co. Income Statement

	Rupees in Thousand		
	20X1	20X2	20X3
Sale	400	425	500
Cost of Sale	120	150	200
Gross Profit	**280**	**275**	**300**
Expenses	152	157	240
Net Income	**128**	**118**	**60**

Sample Co. Vertical Analysis

	20X1	20X2	20X3
Sale	100%	100%	100%
Cost of Sale	30%	35%	40%
Gross Profit	**70%**	**65%**	**60%**
Expenses	38%	37%	48%
Net Income	**32%**	**28%**	**12%**

Common Size Analysis

Wherein, each item in the financial statement is shown as percentage of base figure.
Comparing results for two or more successive periods help in analyzing financial statements.

Topic 174 – Horizontal Analysis

Line by Line Item Analysis

It analyses information of one accounting period (comparison period) with the same information of other accounting period (base period).

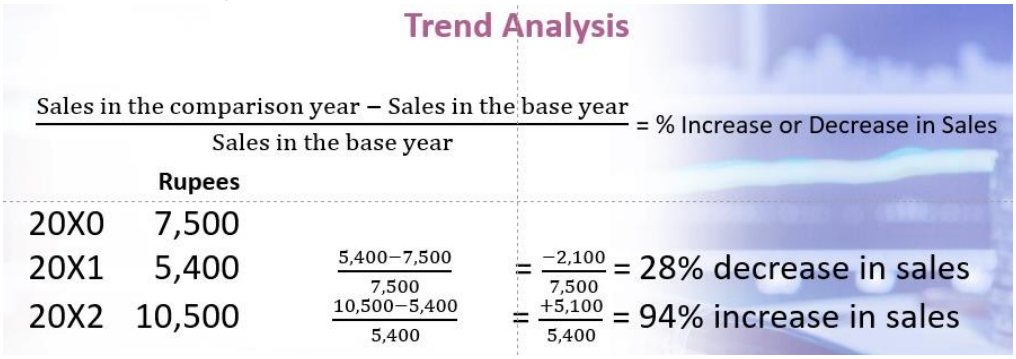
- Chain analysis
- Index analysis

Chain Analysis

	Sales in the year Rs.	
20X0	7,500	
20X1	5,400	72% of 20X0
20X2	10,500	194% of 20X1
20X3	11,250	107% of 20X2

Index Analysis

	Sales in the year Rs.	
20X0	7,500	Base Year
20X1	5,400	72%
20X2	10,500	140%
20X3	11,250	150%



Spotting Trend

Normally two accounting periods are required for a valid comparison.

In order to spot actual trends, it's better to include three or more accounting periods when calculating horizontal analysis.

Topic 175 – Ratio Analysis

Financial Performance

A process of ascertaining the financial ratios for indicating the ongoing financial performance of an entity.

Types of Ratio Analysis

- Profitability Ratios
- Liquidity Ratios
- Debt or Leverage Ratios
- Efficiency Ratios
- Market or Owners Ratios

Management Tool

Ratio analysis is a useful management tool that improves understanding of financial results and trends over time, and provides key indicators of organizational performance.

Use of Ratio Analysis

Managers use ratio analysis to pinpoint strengths and weaknesses from which strategies and initiatives can be formed.

Topic 176 – Profitability Ratios

Profitability Ratios

These ratios measure an entity's ability to generate profits relative to revenue, costs, assets and equity.

Ratios Include

- Profit on sales
- Cost of goods sold on sales
- Specific expense on sales
- Return on capital employed
- Return on owners' equity
- Return on Assets

Sample Co.
Income Statement

	Rs (000)
Sale	500
Cost of sale	200
Gross profit	**300**
Operating expenses	120
Profit before tax	**180**
Income tax	**60**
Profit after tax	**120**

Profit on Sales

$$\frac{\text{Gross Profit}}{\text{Net Sales}} \times 100 = \% \quad \frac{300}{500} \times 100 = 60\%$$

Profit on Cost

$$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100 = \% \quad \frac{300}{200} \times 100 = 150\%$$

Expense on Sales

$$\frac{\text{Operating expense}}{\text{Net Sales}} \times 100 = \% \quad \frac{120}{500} \times 100 = 24\%$$

Sample Co.
Income Statement

	Rs (000)
Sale	500
Cost of sale	200
Gross profit	**300**
Operating expenses	120
Profit before tax	**180**
Income tax	**60**
Profit after tax	**120**

Sample Co.
Balance Sheet

	Rs (000)
Non Current Asset	300
Current Assets	100
Total Assets	**400**
Owners Equity	250
Non Current Liab.	70
Current Liabilities	80
Total Assets	**400**

Return on Owners Equity

$$\frac{\text{Profit after Tax}}{\text{Owners Equity}} \times 100 = \%$$

$$\frac{120}{250} \times 100 = 40\%$$

Return on Capital Employed

$$\frac{\text{PBIT}}{\text{Capital Employed}} \times 100 = \%$$

$$\frac{180}{320} \times 100 = 56\%$$

Return on Assets

$$\frac{\text{Operating Profit}}{\text{Total Assets}} \times 100 = \%$$

$$\frac{180}{400} \times 100 = 45\%$$

Other Profitability Ratios

- Markup rate
- Analysis of different profits on sales
- Percentage annual growth in sales
- Percentage annual change in operating expenses

Topic 177 – Liquidity Ratios

Liquidity Ratios

These are the financial ratios that measure an entity's ability to repay both short term and long-term obligations.

Ratios Include

- Current Ratio
- Acid Test Ratio
- Cash Ratio
- Operating Cash Flow Ratio

Sample Co.
Balance Sheet

	Rs (000)
Non Current Asset	300
Current Assets	100
(Inventory 15; A/R 45; Cash 40)	
Total Assets	**400**
Owners Equity	250
Non Current Liabilities	70
Current Liabilities	80
Total Assets	**400**

Current Ratio

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{times}$$

$$\frac{100}{80} = 1.25 \text{ times}$$

Quick or Acid-test Ratio

$$\frac{\text{Quick Asset}}{\text{Current Liabilities}} = \text{times}$$

$$\frac{85}{80} = 1.06 \text{ times}$$

Cash Ratio

$$\frac{\text{Cash \& Cash equivalent}}{\text{Current Liabilities}} = \text{times}$$

$$\frac{40}{80} = 0.5 \text{ time}$$

Liquidity Position

Holding excessive liquid assets is always a bad sign. Liquidity should be managed in a way that current and noncurrent obligation could be managed conveniently.

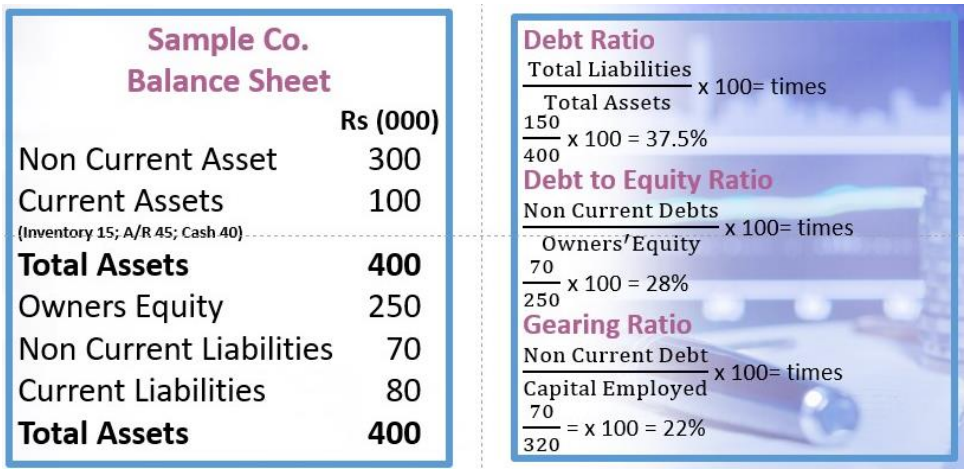
Topic 178 – Debt/Leverage Ratios

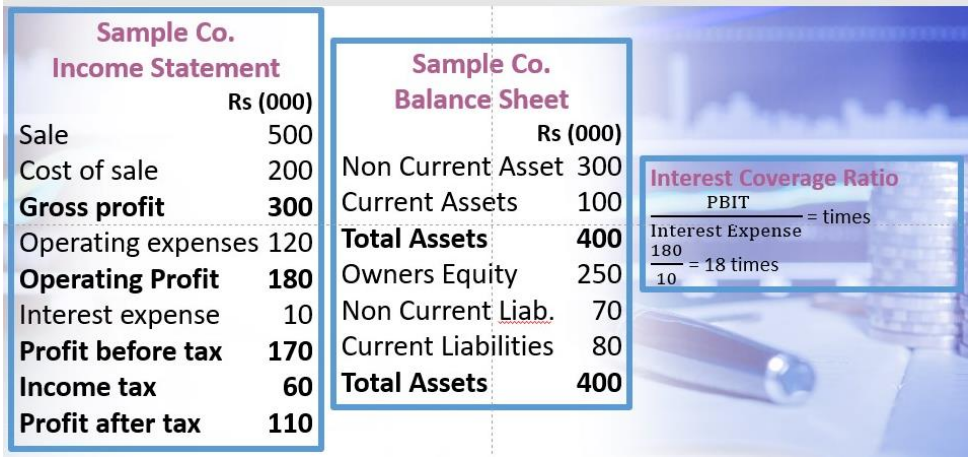
Leverage Ratios

These are the financial ratios that measure the amount of capital that comes from debt. In other words, leverage financial ratios are used to evaluate an entity's debt levels.

Ratios Include

- Debt Ratio
- Debt to Equity
- Gearing Ratio
- Interest Coverage Ratio





High Geared Vs. Low Geared

- An entity is high-geared when its gearing ratio is above 50%
- An entity is low-geared when its gearing ratio is below 50%

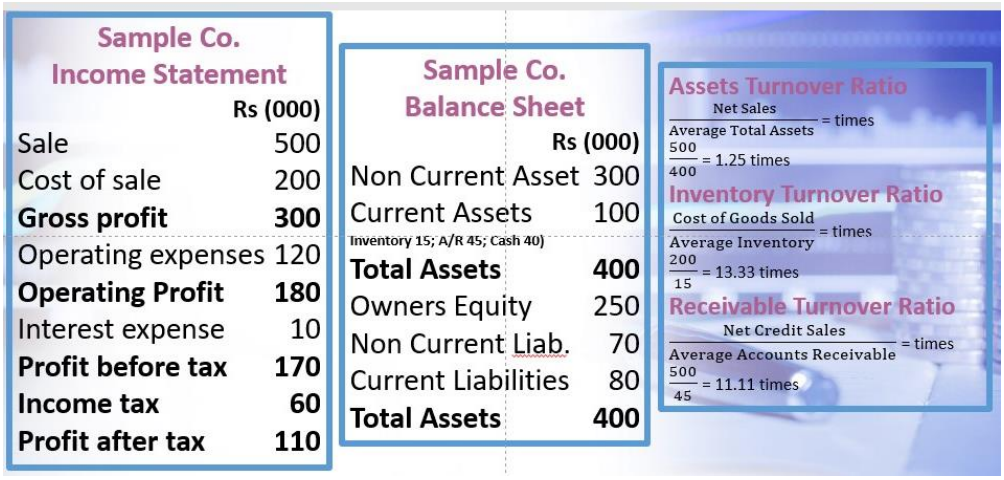
Topic 179 – Efficiency Ratios

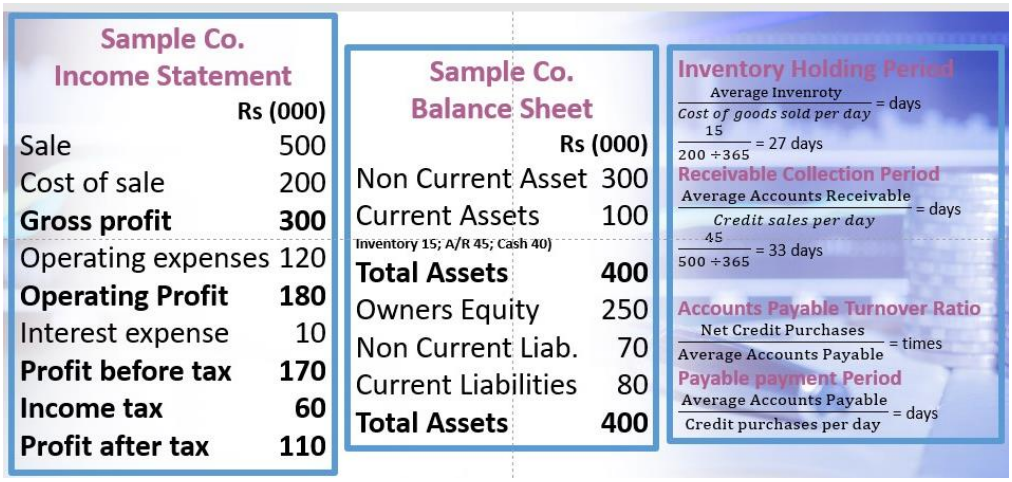
Efficiency Ratios

These are also known as activity financial ratios. Efficiency Ratios are used to measure how well an entity is utilizing its assets and other resources.

Ratios Include

- Asset Turnover Ratio
- Inventory Turnover Ratio
- Receivable Turnover Ratio
- Inventory Holding Period
- Receivable Collection Period





Alternative Replacements

- Total sales instead of credit sales
- Total purchases instead of credit purchases
- Ending Accounts Receivable instead of average amount
- Ending Accounts Payable instead of average amount
- Ending Inventory instead of average amount

Topic 180 – Market/Owners' Ratios

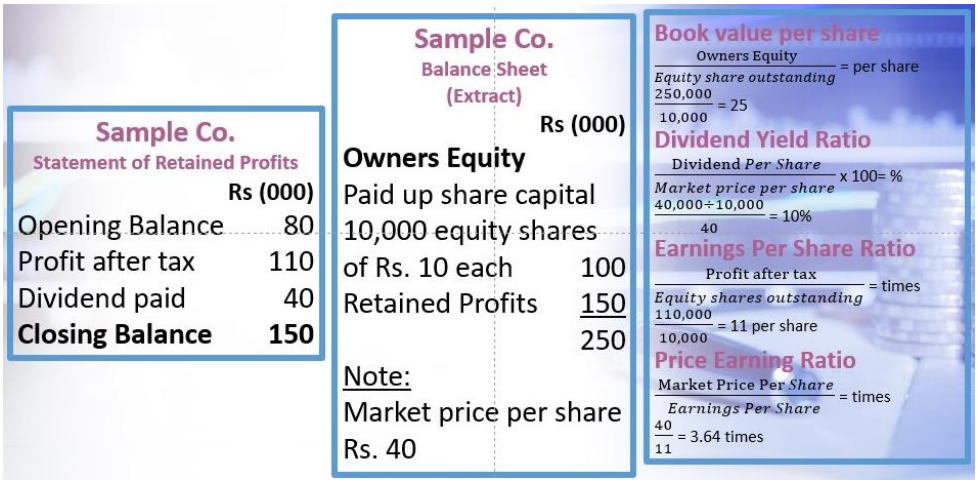
Market Ratios

These are also known as Owners or Shareholders Ratios.

Market ratios are used to evaluate the share price of an entity's stock.

Ratios Include

- Book Value Per Share
- Dividend Yield Ratio
- Earnings Per Share
- Price Earnings Ratio



Potential and Current Investors

Current and potential investors are interested to know the results of market ratios that are also known as investors' ratios or shareholders' ratios.

Topic 181 – Cash Flow Ratios

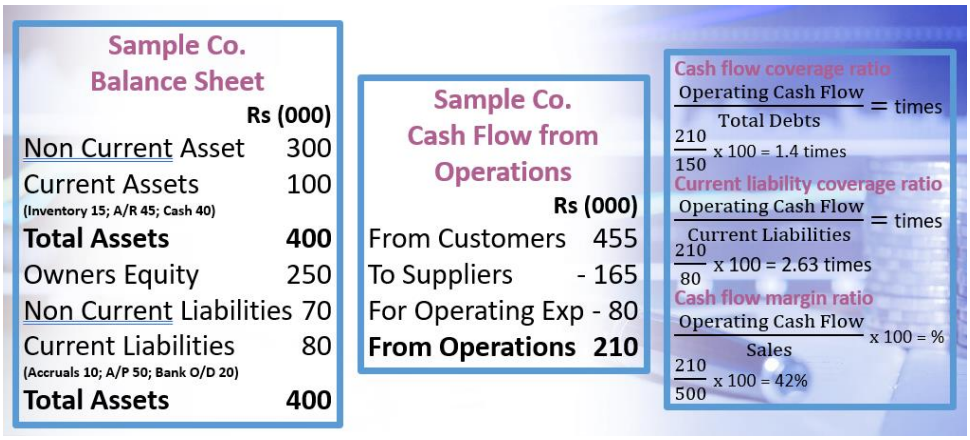
Cash Flow Ratios

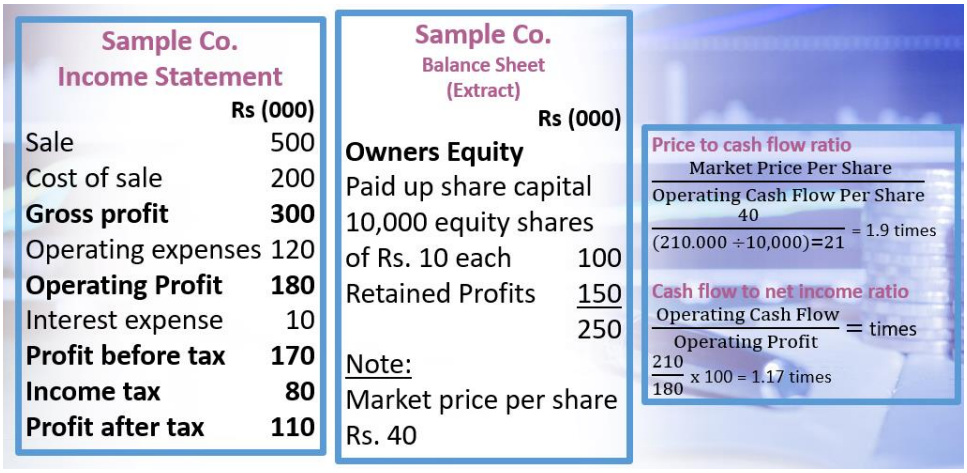
Cash flow ratios compare cash flows to other elements of an entity's financial statements.

These ratios are especially important when evaluating entities whose cash flows diverge substantially from their reported profits.

Ratios Include

- Cash flow coverage ratio
- Current liability coverage ratio
- Cash flow margin ratio
- Price to cash flow ratio
- Cash flow to net income





Indicator

A higher level of cash flow indicates a better ability to withstand declines in operating performance, as well as a better ability to pay dividends to investors.

Topic 182 – Limitations in Financial Statement Analysis

Limitations
Financial Statement analysis is used to compare relative information and to gain an analytical understanding of financial position, financial performance and cash flows of an entity.
This analysis is a useful tool, however, there are a number of limitations.

Historical
Information used in the analysis is derived from actual historical results.
This does not mean that the same results will be carried forward in the future.

Historical Vs. Current Cost
Information on the income statement is stated in current costs (or close to it), whereas many elements of the balance sheet are stated at historical cost.
This disparity may result in unusual ratio results.
For example, assets turnover ratio.

Inflationary effect
If the rate of inflation has changed in any of the periods under review, this can mean that the numbers are not comparable across periods.

For example, if the inflation rate was 100% in one year, sales would appear to have doubled over the preceding year, whereas in fact sales did not change at all.

Accounting policies and estimates
Different entities in a similar industry may have different policies for recording the same accounting transaction.

For example, one entity may use reducing balance method while another entity uses straight-line method for depreciation.

Interpretation
It can be quite difficult to ascertain the reason for the results of a ratio.
For example, an "acid-test ratio of 1.2:1" might appear to be excellent, until one realizes that the entity just sold a large amount of its stock to bolster its cash position.

Chapter – 15

Accounting for Incomplete Records

Sr. No	Chapter outline - Topics
183	Accounting For Incomplete Records
184	Accounting For Small Entities Accounting System
185	Statement Of Profit or Loss
186	Statement Of Affairs
187	Practice-Accounting For Incomplete Records-I
188	Practice-Accounting For Incomplete Record-II
189	Conversion of Single Entry into Double Entry
190	Conversion - Mapping Income Statement With Source Documents
191	Conversion - Mapping Balance Sheet With Source Documents
192	Source Record for Mapping
193	Conversion into Double Entry Practice - Question
194	Conversion into Double Entry Practice - Answer
195	Conversion into Double Entry Missing Information
196	Conversion into Double Entry - Markup and Margin
197	Use of Markup Ratio
198	Use of Margin Ratio
199	Conversion of Margin Into Markup
200	Conversion of Markup Into Margin

Topic Videos 183-200 are mandatory part of this chapter

Topic 183 – Accounting for Incomplete Records

Accounting Cycle

- Accounting Phenomena
    - Transactions
    - Events
    - Conditions
- Source Documents
- Voucher
- Journals /Day books
- Ledgers
- Trial Balance
- Financial Statements
- Analysis

Accounting System

- Single Entry Accounting

- Double Entry Accounting

Scale of Business Entities

- Small scale entities
    - Single entry
- Medium scale entities
    - Single / Double entry
- Large scale entities
    - Double entry

Cash Vs. Accrual Basis

- Cash based accounting
    - Single entry
- Accrual based accounting
    - Double entry

Single Entry

Accounting for incomplete records is in fact “Single Entry Accounting”.

Topic 184 – Accounting System for Small Scale Business Entities

Small Entities

- Single owner
- Little setup
- Limited resources
- Less transactions
- No bank account
- Few credit transactions
- One person many rolls

Accounting Needs

- Financial Performance
- Financial Position
- Taxation matters

Accounting System

- Assets and Liabilities at the start and end of the year
- Cash and non-cash capital introduced during the year
- Cash and non-cash drawings during the year

Accounting Equations

Opening Owners' Equity
Op. Assets – Op. Liabilities

Closing Owners' Equity
Cl. Assets – Cl. Liabilities

Profit for the year
Closing Owners' Equity + Drawings – Opening Owners' Equity – New/Fresh Capital.

Topic 185 – Statement of Profit or Loss for Small Entities

Statement of Profit or Loss

- It does not contain Incomes and Expenses
- The result is exactly the same had it been prepared on double entry basis

Owner's Equity On the Reporting Date	
Opening Owner's Equity	**
Fresh Capital	+**
Profit for the year	+ **
Drawings	- **
Closing Owner's Equity	***

Statement of Profit or Los For the Reporting Period	
Closing Owner's Equity	**
Opening Owner's Equity	- **
Fresh Capital	- **
Drawings	+**
Profit for the year	***

Question

	Rs.
Opening Owner Equity	100
Closing Owner Equity	150
Drawings during the year	140
Fresh capital introduced during the year	25

Prepare Statement of Profit or loss for the reporting year

Answer

Statement of Owner's Equity
On the Reporting Date

	Rs.
Opening Owner's Equity	100
Profit for the Year	+ ?
Fresh Capital	+ 25
Drawings	-140
Closing Owner's Equity	150

Answer

Statement of Owner's Equity
On the Reporting Date

	Rs.
Opening Owner's Equity	100
Profit for the Year	+ ?
	265
Fresh Capital	+ 25
	290
Drawings	-140
Closing Owner's Equity	150

Answer

Statement of Owner's Equity
On the Reporting Date

	Rs.
Opening Owner's Equity	100
Profit for the Year ?	+165
	265
Fresh Capital	+ 25
	290
Drawings	-140
Closing Owner's Equity	150

Answer

Statement of Owner's Equity
On the Reporting Date

	Rs.
Opening Owner's Equity	100
Profit for the Year ?	+165
	265
Fresh Capital	+ 25
	290
Drawings	-140
Closing Owner's Equity	150

Answer

Statement of Profit or Loss
For the Reporting Year

	Rs.
Closing Owner's Equity	150
Opening Owner's Equity	- 100
Fresh Capital	- 25
Drawings	+140
Profit for the year	165

Simple Technique

For small entities, which are not preparing proper books of accounts and cannot extract a trial balance, the technique to know the profit for the reporting period is very simple i.e., to come **Other Way Round**.

Topic 186 – Statement of Affairs

Statement of Affairs

It is a statement containing balances of assets and liabilities of an entity on a specific date.

Assets	Amount (Rs)	Liabilities	Amount (Rs)
Furniture & Fixture	xxx	Loans taken	xxx
Equipments	xxx	Trade payables	xxx
Inventories	xxx	Payable expenses	xxx
Trade Receivables	xxx	**Owner's equity**	
Prepaid expenses	xxx	**(Balancing figure)**	xxx
Bank balance	xxx		
Cash in hand	xxx		
	xxx		xxx

Net Assets

The balance of Owner's Equity can also be termed as Net Assets as it is the balance of assets after subtracting all liabilities.

SOA Vs. SOFP

SOFP is balance sheet of the entity that shows financial position on a specific date by presenting "Resources" against the "Claims/Sources". There is no balancing figure in SOFP.

Whereas, in SOA all liabilities are subtracted from all the assets on a specific date to know the Net Assets.

Topic 187 – Accounting for Incomplete Records – Practice (Part A)

Practice Question

Burhan and Bilal are partners in **Sample Developers** sharing profits and losses in the ratio of 3:2. They do not keep proper books of accounts. On 31 December, 20X1, the following Statement of Affairs was extracted from their record:

Assets	Rs	Liabilities		Rs
Plant & Machinery	30,000	Loan from Bilal		25,000
Inventories	20,000	Trade Payables		30,000
Trade Receivables	35,000	Owners' Equity		45,000
Cash at Bank	15,000	Burhan	25,000	
		Bilal	20,000	
	100,000			100,000

Practice Question – cont.....

On 31st December, 20X2, their assets and liabilities were:

Plant & Machinery Rs 50,000; Trade Receivables Rs 40,000; Inventories Rs 30,000; Other Receivables Rs 5,000; Cash at Bank Rs 25,000; Trade Payables Rs 25,000; Loan from Bilal Rs 25,000. Prepare a Statement of Profit or Loss for the year ended 31st December, 20X2 and Balance Sheet on that date after taking into consideration the following facts:

a) Plant and machinery is to be depreciated by Rs. 4,000.
b) Inventories are to be reduced at NRV Rs. 25,000.
c) A provision for bad debts is to be raised at 5% on Trade Receivables
d) Interest on loan is due at 6% p.a.
e) During the period Burhan and Bilal withdrew Rs 5,000 and Rs 3,000 respectively.

Solution

Ascertainment of Net Assets as on December 31, 20X2
Statement of Affairs

Assets	Rs	Rs	Liabilities	Rs	Rs
Plant & Machinery	50,000		Loan from Bilal	25,000	
Less: Depreciation	- 4,000	46,000	Add: Interest due	+ 1,500	26,500
Inventory	30,000		Trade Payables		25,000
Less: written-down	- 5,000	25,000	Owners' Equity		
Trade Receivables	40,000		(Balancing figure)		87,500
Less: Provision	- 2,000	38,000			
Other Receivable		5,000			
Cash at bank		25,000			
		139,000			**139,000**

Steps to follow

1. Ascertain opening and closing balances of Net Assets / Owners' Equity
2. Ascertain Profit for the year
3. Prepares partners' current account
4. Prepare Balance Sheet

Topic 188 – Accounting for Incomplete Records – Practice (Part B)

Practice Question

Burhan and Bilal are partners in **Sample Developers** sharing profits and losses in the ratio of 3:2. They do not keep proper books of accounts. On 31 December, 20X1, the following Statement of Affairs was extracted from their record:

Assets	Rs	Liabilities		Rs
Plant & Machinery	30,000	Loan from Bilal		25,000
Inventories	20,000	Trade Payables		30,000
Trade Receivables	35,000	Owners' Equity		45,000
Cash at Bank	15,000	Burhan	25,000	
		Bilal	20,000	
	100,000			100,000

Practice Question – cont.....

On 31st December, 20X2, their assets and liabilities were:

Plant & Machinery Rs 50,000; Trade Receivables Rs 40,000; Inventories Rs 30,000; Other Receivables Rs 5,000; Cash at Bank Rs 25,000; Trade Payables Rs 25,000; Loan from Bilal Rs 25,000.

Prepare a Statement of Profit or Loss for the year ended 31st December, 20X2 and Balance Sheet on that date after taking into consideration the following facts:

a) Plant and machinery is to be depreciated by Rs. 4,000.
b) Inventories are to be reduced at NRV Rs. 25,000.
c) A provision for bad debts is to be raised at 5% on Trade Receivables
d) Interest on loan is due at 6% p.a.
e) During the period Burhan and Bilal withdrew Rs 5,000 and Rs 3,000 respectively.

Solution

Ascertainment of Net Assets as on December 31, 20X2
Statement of Affairs

Assets	Rs	Rs	Liabilities	Rs	Rs
Plant & Machinery	50,000		Loan from Bilal	25,000	
Less: Depreciation	- 4,000	46,000	Add: Interest due	+ 1,500	26,500
Inventory	30,000		Trade Payables		25,000
Less: written-down	- 5,000	25,000	Owners' Equity		
Trade Receivables	40,000		(Balancing figure)		87,500
Less: Provision	- 2,000	38,000			
Other Receivable		5,000			
Cash at bank		25,000			
		139,000			**139,000**

Solution

Ascertainment Profit for the year ended December 31, 20X2
Statement of Profit or Loss

	Rs	Rs
Owners' Equity / Net Assets on 31 Dec 20X2		87,500
Owners' Equity / Net Assets on 31 Dec 20X1		- 45,000
Less Fresh capital introduced during the year 20X2		0
Add Drawings (Burhan and Bilal) during the year 20X2		+ 8,000
Profit for the year		50,500
Burhan's share in profits (50,500 x 3/5)	30,300	
Bilal's share in profits (50,500 x 2/5)	20,200	

Solution

Statement of Partners' Current Accounts
for the Year December 31 20X2

	Burhan Rs.	Bilal Rs.
Owners' Equity / Net Assets on 31 Dec 20X1	25,000	20,000
Profit for the year	30,300	20,200
Drawings (Burhan and Bilal) during the year 20X2	- 5,000	- 3,000
Owners' Equity / Net Assets on 31 Dec 20X2	50,300	37,200

Solution

Statement of Financial Position
As on December 31, 20X2

Assets	Rs	Rs	Liabilities	Rs	Rs
Non Current Assets			Owners' Equity		
Plant & Machinery	50,000	46,000	Burhan	50,300	
Less: Depreciation	- 4,000		Bilal	37,200	87,500
Current Assets			**Non Current Liabilities**		
Inventory	30,000	25,000	Loan from Bilal	25,000	
Less: written-down	- 5,000		Add: Interest due	+ 1,500	26,500
Trade Receivables	40,000	38,000	**Current Liabilities**		
Less: Provision	- 2,000	5,000	Trade Payables		25,000
Other Receivable		25,000			
Cash at bank		**139,000**			**139,000**

Treatment of year-end adjustments

Year-end adjustments are accounted for in the statement of profit or loss, rather these are taken into account for ascertaining closing balances of assets and liabilities only.

Topic 189 – Conversion of Single Entry into Double Entry

Medium Size Entities

- Sizeable business
- Sole or partnership
- Availability of resources
- Cash and Credit transactions
- Maintain bank account
- Different rolls are assigned to certain personnel

Accounting Needs

- Financial Performance
- Financial Position
- Statement of Cash Flows
- Taxation requirements

Accounting System

a) Cash and Bank Book
b) Trade Receivables Ledger
c) Trade Payables Ledger
d) Statement of Affairs (Op.)
e) Year-end adjustments:
    - Inventory count
    - Depreciation policy
    - Provision for doubtful debts
    - Accruals & prepayments

Topic 190 – Conversion Mapping Income Statement with source documents

Preparing Income Statement

Income Statement (SOPL) can be prepared with the help of a set of incomplete records.
Mapping is important from students' point of view.

Income Statement	Source
Sales	
Cash sales	Cash book receipt side
Credit sales	Trade receivable Dr. side
Cost of goods sold	
Opening inventory	Opening SOA
Purchases	
Cash purchases	Cash book payment side
Credit purchases	Trade payable Cr. side
Closing inventory	Year end adjustment
Gross Profit	

Income Statement	Source
Operating expenses	
Cash based expense	Cash book payment side
± Accrued & Prepaid	SOA op. & Year-end adj.
Receivable based exp.	Trade receivable account
± Provisions	SOA op. & Year-end adj.
Fixed asset based exp.	
Depreciation	Year-end adjustment
Loss on disposal	SOA op & Year-end adj.
Profit from operations	

Income Statement	Source
Other income	
Cash based income	Cash book receipt side
Accrued/unearned ±	SOA op/Year-end adj.
Discount Received	Trade payable account
Gain on disposal	SOA op/Year-end adj.
Profit for the year	

Topic 191 – Conversion – Mapping Balance Sheet with source documents

Preparing Balance Sheet

Balance Sheet (SOFP) can be prepared with the help of a set of incomplete records. Mapping is important from students' point of view.

Balance Sheet	Source	Balance Sheet	Source
Noncurrent Assets		**Owners' Equity**	
Fixed assets op bal.	Opening SOA	Opening balance	Opening SOA
Fixed assets addition	Cashbook payment	Fresh capital	Cashbook receipts side
Fixed assets disposal	Year end adj & cashbook	Profit for the year	Income statement
Accumulated Dep.	Op SOA & Year end adj.	Drawings	Cashbook payment & Adj
Investment op bal.	Opening SOA	**Noncurrent Liabilities**	
Investments addition	Cash book payment side	Opening balance	Opening SOA
Investments disposal	Year end adj & cashbook	Further loan taken	Cashbook receipts side
Current Assets		Loan repayment	Cashbook payment side
Inventories	Year end adjustment	**Current Liabilities**	
Trade Receivables	Trade receivable account	Trade payables	Trade payable account
Prepaid expenses	Year end adjustment	Accrued expense	Year end adjustment
Accrued incomes	Year end adjustment	Unearned income	Year end adjustment
Bank and Cash	Cashbook cash & bank	Bank overdraft	Cashbook (bank column)
Total Resources		**Total Claims**	

Balance Sheet

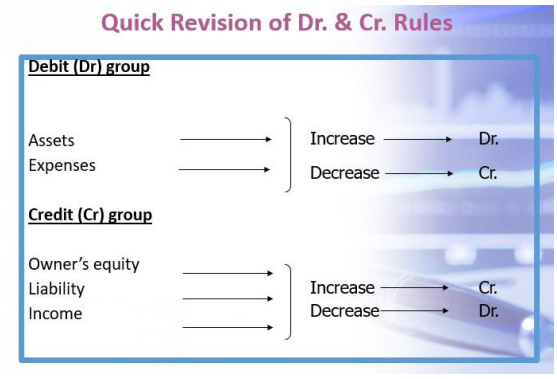
Closing balance of all assets and liabilities can be worked out from:

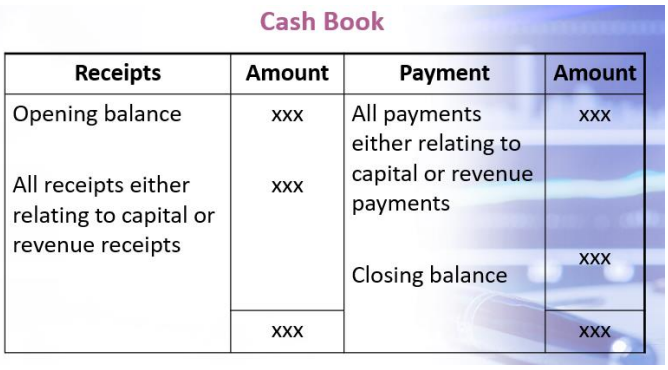
1. Opening SOA
2. Cash book (Cash & Bank)
3. Trade Receivables
4. Trade Payables
5. Year-end Adjustments

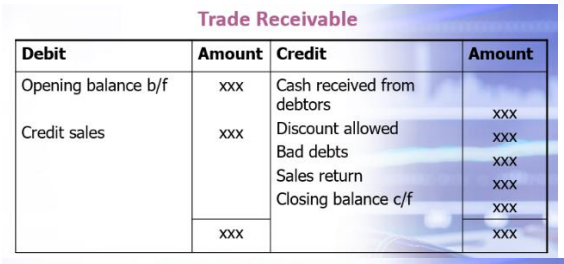
Topic 192 – Source Record for Mapping

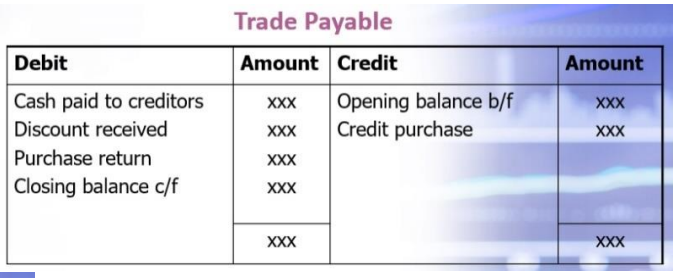
Source Record

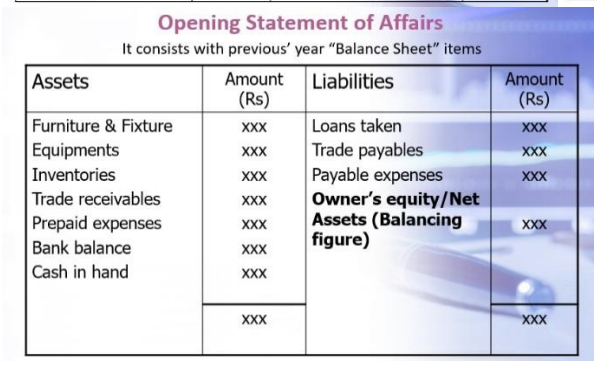
a) Cash and Bank Book
b) Trade Receivables Ledger
c) Trade Payables Ledger
d) Statement of Affairs (Op.)
e) Year-end adjustments:
    - Inventory count
    - Depreciation policy
    - Provision for doubtful debts
    - Accruals & prepayments











Year End Adjustments

- Inventory count
- Depreciation policy
- Provision for doubtful debts
- Accruals & prepayments

It may include certain other adjustments to reflect changes in amounts from previous year

Topic 193 – Conversion into Double entry Practice – Question (Part A)

Practice Question

Sample Departmental Store does not follow double entry bookkeeping. Its accountant provides following records for the year ending on 31st December 20X2:

1. Statement of Affairs 1-1-20X1
2. Cash book (Two Column)
3. Trade Receivables
4. Trade Payables

Statement of Affairs
1st January 20X2

Assets	**Rs.**
Fixtures	800
Current Assets	
Inventories	1,590
Trade Receivable	1,100
Bank	1,130
Cash	80
Total Assets	**4,700**
Less liabilities	
Trade Payable	- 400
Net Assets/Owner's Equity	**4,300**

Cash Book

Receipts	Cash Rs.	Bank Rs.	Payments	Cash Rs.	Bank Rs.
Opening balance b/f	80	1,130	Supplier (Payment to creditors)	0	7,200
Receipts from debtors	0	9,500	Rent	50	200
Cash sales	500		General expenses	0	180
			Drawings	520	0
			Closing balance c/f	**10**	**3,050**
	580	10,630		580	10,630

Trade Receivables Account

	Rs.		Rs.
Opening balance b/f	1,100	Cash received from debtors	9,500
Credit sales	9,720	Closing balance c/f	1,320
	10,820		10,820

Trade Payables Account

	Rs.		Rs.
Cash paid to creditors	7,200	Opening balance b/f	400
Closing balance	650	Credit Purchase	7,450
	7,850		

Year End Adjustments
31st December 20X2

- Closing Inventory Rs. 1,700
- Rent owing Rs. 50
- Depreciation on fixture 10% pa.

Prepare Income statement for the year ended 31st December 20X2 and Balance Sheet as on that date.

Topic 194 – Conversion into Double entry Practice – Answer (Part B)

Answer

Sample Departmental Store
Income Statement
For the Year ended 31st December 20X2

	Rs.	Rs.
Sales		
Credit sales	9,720	
Cash sales	500	10,220
Cost of goods sold		
Opening inventory	1,590	
Add purchases	7,450	
Less closing inventory	1,700	- 7,340
Gross profit		2,880
Operating expenses		
Rent	300	
General expenses	180	
Depreciation fixture	80	560
Profit for the year		2,320

Sample Departmental Store
Income Statement
Working Notes

Note 1	Rs.
Rent expense	
(cash 50 + Bank 200 + Due 50)	300
Note 2	
Depreciation fixture (800 x 10%)	80

Sample Departmental Store
Balance Sheet
As on 31st December 20X2

Assets		Amount Rs.	Owner's Equity & Liabilities		Amount Rs.
Fixed Assets			Owner's equity	4,300	
Fixtures	800		Profit for the year	2,320	
Depreciation	80		Less drawings	- 520	
		720			6,100
Current Assets			**Liabilities**		
Closing inventory		1,700	Trade payables	650	
Trade receivable		1,320	Rent Due	50	
Bank		3,050			700
Cash		10			
		6,800			6,800

Outcome of Conversion

End result of double entry accounting system is to extract a trial balance and preparation of financial statements.

Whereas, when conversion is worked out from single entry to double entry then trial balance is not extracted else the end result is same.

Topic 195 – Conversion into Double entry – Missing Information

Missing Information

In some questions all the sufficient information is not provided that is needful to convert single entry into double entry.

For example; credit sales could be missing despite the fact that cash was received from credit customers during the reporting period.

Tracing Missing Information

Finding out the reciprocal Dr. or Cr. effect in the set of five source records.

1. Cash and Bank Book
2. Trade Receivables Ledger
3. Trade Payables Ledger
4. Statement of Affairs (Op.)
5. Year-end adjustments

Cash Book

Receipts	Amount	Payment	Amount
Opening balance	xxx	All payments either relating to capital or revenue payments	xxx
All receipts either relating to capital or revenue receipts	xxx		
		Closing balance	xxx
	xxx		xxx

Trade Receivable

Debit	Amount	Credit	Amount
Opening balance b/f	xxx	Cash received from debtors	xxx
Credit sales	xxx	Discount allowed	xxx
		Bad debts	xxx
		Sales return	xxx
		Closing balance c/f	xxx
	xxx		xxx

Trade Payable

Debit	Amount	Credit	Amount
Cash paid to creditors	xxx	Opening balance b/f	xxx
Discount received	xxx	Credit purchase	xxx
Purchase return	xxx		
Closing balance c/f	xxx		
	xxx		xxx

Opening Statement of Affairs

It consists with previous' year "Balance Sheet" items

Assets	Amount (Rs)	Liabilities	Amount (Rs)
Furniture & Fixture	xxx	Loans taken	xxx
Equipments	xxx	Trade payables	xxx
Inventories	xxx	Payable expenses	xxx
Trade receivables	xxx	**Owner's equity/Net Assets (Balancing figure)**	xxx
Prepaid expenses	xxx		
Bank balance	xxx		
Cash in hand	xxx		
	xxx		xxx

Year End Adjustments

- Markup and Margin
- Inventory count
- Depreciation policy
- Provision for doubtful debts
- Accruals & prepayments

Topic 196 – Conversion into Double entry – Markup and Margin

Markup

It is the % age of gross profit over cost of goods sold.

$\frac{Gross\ profit}{Cost\ of\ goods\ sold}$ *x 100 = %*

Sales	**125%**
Cost of Sales	**100%**
Gross Profit	**25%**

$\frac{160,000}{640,000}$ *x 100 = 25%*

Margin

It is the % age of gross profit over Sales.

$\frac{Gross\ profit}{\text{Sales}}$ *x 100 = %*

		Rs.
Sales	**100%**	800,000
Cost of Sales	**80%**	640,000
Gross Profit	**25%**	160,000

$\frac{160,000}{800,000}$ *x 100 = 20%*

Use of Markup and Margin

In some questions the missing information is traced by applying markup or margin ratios. For example:

- Sales
- Cost of sales
- Gross profit

Topic 197 – Conversion into Double entry – Use of Markup Ratio

Scenario 1

Goods are sold at 15% profit on cost. The selling price is Rs. 34,500. Calculate gross profit.

$\frac{Gross\ profit}{Cost\ of\ goods\ sold} x\ 100 = \%$

		Rs.
Sales	**115%**	34,500
Cost of Sales	**100%**	?
Gross Profit	**15%**	?

$\frac{34,500}{115} x\ 15 = 4,500$

Rule of Thumb

- Base information is always equal to 100%.
- Information provided in absolute form is divided by its own % age and multiplied by the % age of required information.

Scenario 2

Goods are sold at 25% profit on cost. If the gross profit is Rs. 75,000. Calculate the amount of Sales.

$\frac{Gross\ profit}{Cost\ of\ goods\ sold} x\ 100 = \%$

		Rs.
Sales	**125%**	?
Cost of Sales	**100%**	?
Gross Profit	**25%**	75,000

$\frac{75,000}{25} x\ 125 = 375,000$

Scenario 3

Goods are sold at 40% markup. If the gross profit is Rs. 120,000. Calculate the amount of Cost of Sales.

$\frac{Gross\ profit}{Cost\ of\ goods\ sold} x\ 100 = \%$

		Rs.
Sales	**140%**	?
Cost of Sales	**100%**	?
Gross Profit	**40%**	120,000

$\frac{120,000}{40} x\ 100 = 300,000$

Learning outcome

1. Construct suitable % age structure.
2. Place information given in absolute form in front of its % age.
3. Divide the given information with its own % age.
4. Multiply the product with the % age of required information.

Topic 198 – Conversion into Double entry – Use of Margin Ratio

Scenario 1

Goods are sold at 35% profit on sales. The cost of goods sold is Rs. 260,000. Calculate gross profit.

$\frac{Gross\ profit}{\text{Sales}}$ *x 100 = %*

		Rs.
Sales	**100%**	?
Cost of Sales	**65%**	260,000
Gross Profit	**35%**	?

$\frac{260,000}{65}$ *x 35 = 140,000*

Scenario 2

Goods are sold at 25% profit on sales. If the gross profit is Rs. 80,000. Calculate the amount of Sales.

$\frac{Gross\ profit}{\text{Sales}}$ *x 100 = %*

		Rs.
Sales	**100%**	?
Cost of Sales	**75%**	?
Gross Profit	**25%**	80,000

$\frac{80,000}{25}$ *x 100 = 320,000*

Scenario 3

Goods are sold at 40% margin. If the gross profit is Rs. 120,000. Calculate the amount of Cost of Sales.

$\frac{Gross\ profit}{\text{Sales}}$ *x 100 = %*

		Rs.
Sales	**100%**	?
Cost of Sales	**60%**	?
Gross Profit	**40%**	120,000

$\frac{120,000}{40}$ *x 60 = 180,000*

Learning outcome

1. Construct suitable % age structure.
2. Place information given in absolute form in front of its % age.
3. Divide the given information with its own % age.
4. Multiply the product with the % age of required information.

Rule of Thumb

- Base information is always equal to 100%.
- Information provided in absolute form is divided by its own % age and multiplied by the % age of required information.

Topic 199 – Conversion of Margin Ratio into Markup Ratio

Scenario

Sample Co. follows the policy to sell goods at 25% margin. Calculate its markup rate.

	Margin	Markup
Sales	**100%**	**?**
Cost of Sales	**75%**	**100%**
Gross Profit	**25%**	**?**

Markup rate $\frac{100}{75}$x 25 = 33.33%

Sales rate $\frac{100}{75}$x 100 = 133.33%

Scenario

Sample Co. follows the policy to sell goods at 25% margin. Calculate its markup rate.

	Margin	Markup
Sales	**100%**	**?**
Cost of Sales	**75%**	**100%**
Gross Profit	**25%**	**?**

Alternatively

Markup rate $\frac{25}{75}$x 100 = 33.33%

Remember

Gross profit = 1/4th	=	25%
Gross profit = 1/5th	=	20%
Gross profit = 1/3rd	=	33.33%
Gross profit = ½	=	50%

Chapter – 16

Accounting for Non-Profit Organization

Sr. No	Chapter outline - Topics
201	Accounting for Non-Profit Organization
202	Accounting System for Small NPOs
203	Accounting System for Medium NPOs
204	Income and Expenditure Account
205	Incomes of NPO (Subscription)
206	Incomes of NPO (Membership fee) Practice
207	Incomes and expenditure account practice part-A (Question)
208	Incomes and expenditure account practice part-B (Answer)
209	Incomes and expenditure account practice part-C (Answer)
210	Incomes and expenditure account Large NPO part-A (Question)
211	Incomes and expenditure account Large NPO part-B (Answer)
212	Incomes and expenditure account Large NPO part-C (Answer)

Topic Videos 201-212 are mandatory part of this chapter

Topic 200 – Conversion of Markup Ratio into Margin Ratio

Scenario
Sample Co. follows the policy to sell goods at 25% markup. Calculate its margin rate.

	Margin	Markup
Sales	**125%**	**100%**
Cost of Sales	**100%**	**?**
Gross Profit	**25%**	**?**

Margin rate $\frac{100}{125}$x 25 = 20%

Cost of Sales rate $\frac{100}{125}$x 100 = 80%

Scenario
Sample Co. follows the policy to sell goods at 25% markup. Calculate its margin rate.

	Margin	Markup
Sales	**125%**	**100%**
Cost of Sales	**100%**	**?**
Gross Profit	**25%**	**?**

Alternatively

Margin rate $\frac{25}{125}$x 100 = 20%

Remember

In case of profit, the sales %age will always be greater than the cost %age.

125 S – 100 C = 25 Profit

100 S – 80 C = 20 Profit

In case of loss, the cost %age will always be greater than the sales %age.

100 S – 125 C = – 25 Loss

80 S – 100 C = – 20 Loss

Topic 201 – Accounting for Non-Profit Organizations

Not for Profit Organizations
Organizations that do not aim to earn profits rather to extend welfare services.
For example; Hospital, Clinic, Library, Masjid, Church, Sports Club, Social Work etc.

Accounting Phenomena
Regardless of the motive, NPOs enter into certain transactions for running its operations.
For example; staff salaries, utility bills, building rent etc.

Source of Income
NPOs generate income from charities, donations, subscriptions, membership fee, registration fee, admission fee etc.

Commercial Activities
Few NPOs create a small business activity to generate funds for day-to-day operations.
For example; stationery shop in a Masjid, Juice shop in a Club, dispensary in a clinic etc.

Accounting System
Depending upon the size of organization, single entry or double entry accounting system is adopted to meet accounting and reporting needful.

Topic 201 – Accounting System for Small NPOs

Small NPOs

Normally NPOs are small in size and are not involved in complex transactions like trading and manufacturing activities.

Number of transactions are also very few in a month.

Accounting System

- Small NPOs
  - Single Entry
- Medium NPOs
  - Singly Entry / Double Entry
- Large NPOs
  - Double Entry

Receipt & Payment Account

NPOs maintain a simple cash book in chronological sequence.

On reporting date, a summary is prepared for all the receipts and payments made under different heads, such summary is known as "**Receipt and Payment Account"**.

Memorandum Record

NPOs having a large number of members maintain a memorandum record of members. Where the NPO is providing free medicines or providing library facilities or running a sports club then it will also be maintaining memorandum record for the inventory items.

Topic 203 – Accounting System for Medium NPOs

Medium Size NPO

NPOs that grow in size and expand their operations enter into numerous transactions, have assets in their control and might have some obligations.

Accounting System

Conversion of single entry into double entry

- Cash book
- Receipt and payment account
- Year-end adjustments

Financial Statements

- Income and Expenditure Account
- Balance Sheet

Financial Statements

- Income and Expenditure Account *(replacement of SOPL)*
- Balance Sheet *(same SOFP)*

Topic 204 – Income and Expenditure Account

Accrual Basis

Income and Expenditure account is prepared on accrual basis.

All incomes and expenses are passed through the filter of accruals, means adjusted for opening and closing balances of owing and prepayments.

Incomes of NPO

Incomes of a non-profit organization mainly include:

- Subscription
- Donation
- Entrance fee
- Lockers rent
- Membership fee etc.

Subscription Income on accrual basis

Sample Library received Rs. 55,000 as subscription during the year ending on 31 Dec 20X1. Few members did not pay subscription that is still due Rs 5,000 whereas, few members paid their subscription in advance for the year 20X2 Rs. 2,000.

Subscription Income	**Rupees**
Received during the year	55,000
Subscription due on closing date	+ 5,000
Subscription advance on closing date	- 2,000
Subscription income for the year 20X1	**58,000**

Expenses of NPO

Payments for revenue expenditures appearing in the Cash Book (Receipt and Payment Account) are adjusted with the opening and closing balances of owing and prepaid to get the amount of expense.

Depreciation of fixed asset is worked out to account for in the Income and Expenditure account.

Expenses of NPO	**Rs.**
Expenses paid DTY	***
Op advance	+ ***
Cl advance	- ***
Op owing	- ***
Cl owing	+ ***
Expenses FTY	*******

Incomes of NPO	**Rs.**
Income received DTY	***
Op advance	+ ***
Cl advance	- ***
Op owing	- ***
Cl owing	+ ***
Income FTY	*******

Topic 205 – Incomes of NPO – Practice Subscription Account

Practice Question

Below is the information pertaining to subscription income of Sample Club for the year 20X2.

Subscription received during the year 20X2	Rs. 12,000
Subscription received in advance for 20X3	Rs. 1,600
Subscription outstanding at the beginning of 20X2	Rs. 2,000
Subscription outstanding at the closing 20X2	Rs. 700

Calculate the amount of subscription income for the year 20X2.

Practice Question (Same information asked in different way)

Below is the information pertaining to subscription income of Sample Club for the year 20X2.

Subscription received during the year – for 20X2	Rs. 8,400
Subscription received during the year – for 20X3	Rs. 1,600
Subscription received during the year – for 20X1	Rs. 2,000
Subscription received in previous year – for 20X2	Rs. 1,000
Subscription due/owing at the end of year 20X2	Rs. 1,700

Calculate the amount of subscription income for the year 20X2.

Answer

Subscription Received during the year 20X2	Rs. 12,000
Less Opening due	- 2,000
Less Closing advance	- 1,600
Add Closing due	+ 700
Income for the year 20X2	**Rs.9,100**

Subscription Income Account

Date	Particulars	Rupees	Date	Particulars	Rupees
1 Jan 20X2	Opening due	2,000	DTY	Subscription received	
31 Dec 20X2	Closing advance	1,600	31 Dec 20X2		12,000
31 Dec 20X2	**Income for the year**	**9,100**		Closing due	700
		12,700			**12,700**

Measurement of Income

Focus on the income that belongs to the reporting period regardless of the amount received or not.

Topic 205 – Incomes of NPO – Practice Membership Fee Account

Practice Question

Following information relates to membership fee of Sample Club for the accounting year ending on 31 March 2002.

1. Cash received in the year totaled Rs. 100,000.
2. On 1 April 20X1; Rs. 2,000 was in arrears for 31 March 20X1 and Rs. 800 was received in advance for the year ending on 31 March 20X2.
3. On 31 March; received Rs. 1,500 towards the next year's fee and the amount still recoverable was Rs. 1,700.

Calculate "Membership Fee" for the year 20X2

Practice Question (Same information asked in different way)

Sample Club receives Rs. 1,000 annually from each member. Below is the information for the accounting year ending on 31 March 20X2.

1. Received membership fee from 100 members.
2. On 1 April 20X1; fee was due from 20 members and 8 members had already paid their fee in advance for the next year ending on 31 March 20X2.
3. On 31 March 20X2; received fee from 15 members towards the next year's fee and the amount of fee was still recoverable from 17 members.

Calculate "Membership Fee" for the year 20X2.

Answer

Membership fee received during the year	Rs. 100,000
Less Opening due	- 2,000
Add Closing due	+ 1,700
Add Opening advance	+ 800
Less Closing advance	- 1,500
Income for the year 20X2	Rs.9,100

Membership Fee Income Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1 Apr 20X1	Opening due	2,000	1 Apr 20X1	Opening advance	800
31 Mar 20X2	Closing advance	1,500	DTY	Fee received	100,000
31 Mar 20X2	**Income for the year**	**9,100**	31 Mar 20X2	Closing due	1,700
		12,700			**12,700**

Measurement of Income

Focus on the income that belongs to the reporting period regardless of the amount received or not.

Topic 207 – Income and Expenditure Account – Practice

Practice Question

Prepare Income & Expenditure Acct and Balance Sheet of Sample Health Club from the information provided for the year ending on 31/03/20X2.

On 1 April 20X1 the club assets and liabilities were: Furniture and Equipment Rs. 48,000; Restaurant stocks Rs. 2,600; Stock of prizes Rs. 800. Rs 5,200 was owing for restaurant supplies.

On 31 March 20X2 the restaurant Stock was Rs. 3,000 and stock of prizes was Rs. 500; the club owed Rs. 5,600 for restaurant supplies.

Subscription fee was found un-paid Rs. 1,000 on March 31, 20X2, and the amount of Rs. 29,720 shown in cash book included Rs. 700 in respect of previous year and Rs. 400 received in advance for the following year. Fixed assets are subject to 10% depreciation.

Practice Question – Cont.

Following Receipts & Payments Account was prepared by the treasurer of Sample Club.

Receipts	Rs.	Payment	Rs.
Cash in hand on 1 April 20X1	4,740	Wages-Outdoor staff	13,380
Member's subscription	29,720	Restaurant purchases	50,400
Entrance fee	3,200	Rent-18 months (June 30, 20X2)	7,500
Restaurant fee	56,800	Rates and taxes	2,200
Games competition receipts	13,640	Secretary salary	3,120
Dues to secretary for petty expenses	80	Lighting, cleaning & sanitary	7,700
		Competition prizes	4,000
		Printing, postage & sundries	6,000
		Fixed deposit in the bank	8,000
		Cash balance on 31 March 20X2	5,880
	108,180		**108,180**

How to Solve

- Prepare opening Statement of Affairs
- Prepare trading account for commercial activities
- Pass revenue nature of receipts and payments through the filter of accruals
- Calculate depreciation
- Prepare Income and Expenditure Account
- Prepare Balance Sheet

Topic 208 – Income and Expenditure Account – Practice (Answer)

Statement of Affairs
As on 1st April 20X1

Assets	Rs	Liabilities	Rs
Furniture & Equipment	48,000	Restaurant Creditors	5,200
Inventory Prizes	800	Capital Fund	
Inventory Restaurant	2,600	(Balancing figure)	**51,640**
Subscription owing	700		
Cash at bank	4,740		
	56,840		**56,840**

Restaurant Creditors Account

Debit	Rs	Credit	Rs
Cash paid	50,400	Op Bal b/f	5,200
Cl Bal c/f	5,600	Purchases	**50800**
	56,000		**56,000**

Restaurant Trading Account

		Rs.
Sales		56,800
Cost of Sales		
Opening Inventory	2,600	
Purchases	50,800	
Closing Inventory	3,000	50,400
Restaurant Profit		**6,400**

Commercial Activities

- There may be more than one commercial activities in an NPO.
- Separate trading account will be prepared for each commercial activity.

Topic 209 – Income and Expenditure Account – Practice (Answer)

Sample Health Club
Income and Expenditure Statement

	Rs.	Rs.
Incomes		
Subscription Fee		
Received	29,720	
Opening Due	- 700	
Closing Due	1,000	
Closing Advance	- 400	29,620
Entrance Fee		3,200
Games Competition		13,720
Restaurant Profit		6,400
Total		**52,940**
Expenditures		
Salaries and Wages		16,500
Rent 18 months	7,500	
Prepaid 6 months	- 2,500	5,000
Rates and taxes		2,200
Lighting and cleaning		7,700
Printing and postage		6,000
Competition prizes		
Purchases	4,000	
Opening Stock	800	
Closing Stock	- 500	4,300
Depreciation		4,800
Surplus (Balancing figure)		**6,440**
Total		**52,940**

Sample Health Club
Balance Sheet
As on 31st March 20X2

Assets	Rs	Liabilities		Rs
Furniture & Equipment	48,000	Capital Fund	51,640	
Less Depreciation	- 4,800	Surplus	6,440	58,080
	43,200			
Fixed Deposit	8,000	Restaurant Creditors		5,600
Inventory Prizes	500	Subscription advance		400
Inventory Restaurant	3,000			
Subscription owing	1,000			
Prepaid rent	2,500			
Cash at bank	5,880			
	64,080			**64,080**

Topic 210 – Income and Expenditure Account – Large NPO – Practice

Accounting System

Large NPOs follow double entry accounting system and proper books of accounts are maintained there. Examination question provides a trial balance to prepare financial statements.

Sample Welfare Society – Trail Balance – For the Year 30 June 20X2

	Dr. Rupees	Cr. Rupees
General fund		30,000
Cash in hand	2,000	
Cash at bank	3,000	
Entrance fee receivable	2,400	
Accrued expenses		1,500
Loan @ 15% (1-10-20X1)		20,000
Furniture & Fixture	10,000	
Building	40,000	
Opening stock clod drink	500	
Rent	6,000	
Rate, Taxes & Insurance	600	
Secretary Honorarium	1,200	
Entrance fee	1,000	
Subscription received in advance		1,500
Salaries & Wages	5,800	
Extension of building	10,000	
Printing & Stationary	1,000	
Legal charges	500	
Annual subscription		30,000
Card & Billiard room receipts		4,000
Sundry expenses	1,600	
Cold drink sales		5,000
Repair of building and furniture	400	
Utility expenses	1,000	
Purchase of clod drink	4,000	
Interest on Loan	1,000	
Total	**92,000**	**92,000**

Additional Information

1. Subscription for the year end outstanding Rs. 2,000
2. Write off depreciation @10% per annum on furniture and 2% on building including the extension.
3. Stock of clod drinks Rs. 1,000

Topic 211 – Income and Expenditure Account – Large NPO – Practice (Answer)
Sample Welfare Society
Income and Expenditure Account – For the Year Ended 30 June 20X2

Expenditure	**Rs.**	**Income**			**Rs.**
Rent	6,000	Subscriptions		30,000	
Rates, taxes & insurance	600	Add: Outstanding		2,000	32,000
Secretary's honorarium	1,200	Card & Billiard Room Receipts			4,000
Entrance fees	1,000	Cold Drinks Sales		5,000	
Salaries & wages	5,800	Cold Drink Purchase	4,000		
Printing and Stationary	1,000	Cold Drink opening stock	500		
Legal charges	500	Cold Drink closing stock	1,000	3,500	1,500
Sundry expenses	1,600	Cold Drink Profits			
Repairs to building and furniture	400				
Utility Bills	1,000				
interest on loan 1,000					
Add: Outstanding 1,250	2,250				
Depreciation	2,000				
Excess of income over Expenditure (Surplus)	**14,150**				
Total	**37,500**	**Total**			**37,500**

Important
Take care of the accounting for accruals that has already been done and appearing in the trial balance.

Topic 212 – Income and Expenditure Account – Large NPO – Practice (Answer)

Sample Welfare Society
Balance Sheet – As on 30 June 20X2

Assets		**Rs.**	**Capital Fund and Liabilities**		**Rs.**
Club House	40,000		Capital Fund	30,000	
Add: Extension	10,000		Add: Surplus	14,150	44,150
Less: Depreciation	- 1,000	49,000			
Furniture & Fixture	10,000		15% Loan		20,000
Less: Depreciation	- 1,000	9,000	Interest on loan (Outstanding)		1,250
Stock in hand Cold Drink		1,000	Subscriptions received in advance		1,500
Entrance fee receivable		2,400	Accrued expenses		1,500
Subscription due		2,000			
Cash at Bank		3,000			
Cash in hand		2,000			
Total		**68,400**	**Total**		**68,400**

Double Entry Accounting
Large NPOs follow double entry accounting system.