



CA INTERMEDIATE • PAPER 1 • ADVANCED ACCOUNTING

Scanner Notes 2.0

Topic by Topic • October 2026 Edition



15 Chapters • 16 Units • 81 Topics • 483 Classified Questions

Based on the ICAI Study Material (2026 July) and the Scanner, 2026 October Edition (V6)

How this book works

For each topic, first read the Study Material paragraphs named in the “Read first” line. Then work down the skill bands — each band names the skill the examiner has actually used on that topic, and lists the exact Scanner questions to practise at it.

The section that follows the Contents — **How to Use These Notes** — explains the question lines, ICAI’s Manner of Assessment, and what the skill mix should change about your preparation. Read it once before you begin.

Contents

How to Use These Notes.....	5
Topic Ranking — Exam Weightage Guide.....	8
Chapter 1: Introduction to Accounting Standards (Importance: D).....	12
Topic 1: Introduction.....	12
Topic 2: Standard Setting Process — concept base.....	13
Topic 3: Need for Convergence Towards Global Standards.....	15
Topic 4: International Accounting Standard Board (IASB) — concept base.....	16
Topic 5: International Financial Reporting Standards (IFRS) As Global Standards — concept base.....	16
Topic 6: Becoming IFRS Compliant — concept base.....	17
Topic 7: What Are Carve Outs/Ins in IND AS.....	18
Topic 8: Convergence of IFRS in India — concept base.....	19
Topic 9: Ind AS — concept base.....	20
Chapter 2: Framework for Preparation and Presentation of Financial Statements (Importance: D).....	21
Topic 1: Introduction — concept base.....	21
Topic 2: Purpose of the Framework — concept base.....	22
Topic 3: Components of Financial Statements — concept base.....	22
Topic 4: Objectives and Users of Financial Statements — concept base.....	23
Topic 5: Fundamental Accounting Assumptions.....	24
Topic 6: Qualitative Characteristics of Financial Statements.....	26
Topic 7: Elements of Financial Statements.....	27
Topic 8: Measurement of Elements of Financial Statements.....	29
Topic 9: Capital Maintenance.....	30
Chapter 3: Applicability of Accounting Standards (Importance: D).....	33
Topic 1: Status of Accounting Standards.....	33
Topic 2: Applications of Accounting Standards.....	35
Chapter 4: Presentation & Disclosures Based Accounting Standards (Importance: A).....	38
Topic 1: AS 1- Disclosures of Accounting Policies.....	38
Topic 2: AS 3- Cash Flow Statement.....	41
Topic 3: AS 17- Segment Reporting.....	43
Topic 4: AS 18- Related Party Disclosures.....	45
Topic 5: AS 20- Earnings Per Share.....	47
Topic 6: AS 24- Discontinuing Operations.....	50
Topic 7: AS 25- Interim Financial Reporting.....	51
Chapter 5: Assets Based Accounting Standards (Importance: A).....	53
Topic 1: AS 2-Valuation of Inventories.....	53
Topic 2: AS 10-Property Plant and Equipment.....	55
Topic 3: AS 13-Accounting For Investment.....	58
Topic 4: AS 16-Borrowing Costs.....	61
Topic 5: AS 19-Leases.....	63
Topic 6: AS 26-Intangible Assets.....	66
Topic 7: AS 28-Impairment of Assets.....	69
Chapter 6: Liabilities Based Accounting Standards (Importance: B).....	72
Topic 1: AS 15-Employee Benefits.....	72
Topic 2: AS 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets.....	74

Chapter 7: Accounting Standards Based on Items Impacting Financial Statements (Importance: A).....	78
Topic 1: AS 4-Contingencies and Events Occurring After the Balance Sheet Date.....	78
Topic 2: AS 5-Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.....	80
Topic 3: AS 11-The Effects of Changes in Foreign Exchange Rates.....	83
Topic 4: AS 22-Accounting for Taxes on Income.....	86
Chapter 8: Revenue Based Accounting Standards (Importance: B).....	89
Topic 1: AS 7-Construction Contracts.....	89
Topic 2: AS 9-Revenue Recognition.....	91
Chapter 9: Other Accounting Standards (Importance: C).....	95
Topic 1: AS 12-Accounting Standards for Government Grants.....	95
Topic 2: AS 14-Accounting for Amalgamation.....	98
Chapter 10: Accounting Standards for Consolidated Financial Statements (Importance: B).....	101
Topic 1: AS 21-Consolidated Financial Statements.....	101
Topic 2: AS 23-Accounting for Investments in Associates in Consolidated Financial Statements.....	104
Topic 3: AS 27-Financial Reporting of Interests in Joint Ventures — concept base.....	106
Chapter 11: Financial Statements of Companies.....	108
Unit 11.1: Preparation of Financial Statements (Importance: B).....	108
Topic 1: Meaning of a Company — concept base.....	108
Topic 2: Maintenance of Books of Accounts — concept base.....	109
Topic 3: Statutory Books — concept base.....	110
Topic 4: Annual Returns — concept base.....	110
Topic 5: Final Accounts.....	111
Topic 6: Distributed Profit.....	113
Unit 11.2: Cash Flow Statements (Importance: C).....	115
Topic 1: Elements of Cash.....	115
Topic 2: Classification of Cash Flow Activities — concept base.....	116
Topic 3: Calculation of Cash Flow from Operating Activities.....	117
Topic 4: Calculation of Cash Flow from Investing Activities — concept base.....	118
Topic 5: Calculation of Cash Flow from Financing Activities — concept base.....	119
Topic 6: Calculation of Cash Flow by Direct Method.....	120
Topic 7: Calculation of Cash Flow by Indirect Method.....	121
Topic 8: Calculation of Cash Flow by Direct and Indirect Method.....	122
Chapter 12: Buy Back of Securities (Importance: C).....	124
Topic 1: Introduction — concept base.....	124
Topic 2: Provision of Section 70 of the Companies Act, 2013.....	125
Topic 3: Buy Back: Practical.....	127
Chapter 13: Amalgamation of Companies (Importance: A).....	130
Topic 1: Meaning of Amalgamation.....	130
Topic 2: Types of Amalgamation — concept base.....	131
Topic 3: Purchase Consideration.....	132
Topic 4: Methods of Accounting for Amalgamations.....	133
Chapter 14: Accounting for Reconstruction of Companies (Importance: B).....	136
Topic 1: Meaning of Reconstruction — concept base.....	136
Topic 2: Methods of Internal Reconstruction.....	137
Topic 3: Entries In Case of Internal Reconstruction.....	138
Chapter 15: Accounting for Branches Including Foreign Branches (Importance: B).....	141

Topic 1: Introduction — concept base.....	141
Topic 2: Difference Between Branch Accounts and Departmental Accounts — concept base.....	142
Topic 3: Accounting for Dependent Branches.....	142
Topic 4: Methods of Charging Goods to Branches.....	144
Topic 5: Accounting for Independent Branches.....	145
Topic 6: Adjustment and Reconciliation of Branch and Head Office Accounts.....	146
Topic 7: Incorporation of Branch Balance in Head Office Books — concept base.....	147
Topic 8: Incomplete Information in Branch Books.....	148
Topic 9: Accounting for Foreign Branches — concept base.....	150
Topic 10: Techniques For Foreign Currency Translation — concept base.....	151

BEFORE YOU START

How to Use These Notes

Every question in the Scanner has been read and classified — **483 of them in this paper** — against the skill framework ICAI itself publishes. These notes are built around that classification rather than around the syllabus order. Ten minutes spent on this page will change how you use the rest of the book.

1. How a topic is laid out

Read it like this	
Read first	The exact Study Material paragraphs the topic rests on. Open the Study Material and read them before the notes — the notes assume you have.
Notes	What the topic actually turns on, written for the examination rather than for coverage. Short, and meant to be re-read the night before.
Skill bands	One band for each skill the examiner has actually used on that topic, each with a few lines of guidance and the exact Scanner questions to practise. Work down the bands in the order printed: they run from the least demanding skill to the most.
Concept base	A topic the examiner has not yet reached. It is not optional — it has simply not been asked, and it is examinable.

2. Reading a question line

PQ 1.2 • PYQ 2024-Sep [1] (b) {C} • 5M • Pg 347 **LEVEL II Application** **Easy**

Part of the line	What it tells you
PQ 1.2	The Scanner's own question number. PQ is a practical question, TQ a theory question.
PYQ 2024-Sep [1] (b)	Where it was asked — PYQ past examination, MTP mock test paper, RTP revision test paper — then the sitting, and its number in that paper.
{C}	A case-scenario question.
5M	Marks, as printed in the Scanner. Blank where the source does not print them — RTPs do not.
Pg 347	The page of the Scanner where the question and its answer are printed.
LEVEL II Application	ICAI's skill level, and the sub-skill within it. Section 3 explains these.

Part of the line	What it tells you
Easy	How demanding the question is — judged on the marks it carries and the number of separate things it asks for.

3. The Manner of Assessment — what each skill asks of you

ICAI publishes a **Skill Assessment Specification Grid**. It states three skill levels, and in its **Manner of Assessment of Skills** column it describes each level as two distinct skills. Those six skills are the band headings that run through this book.

Skill	Rolls up to	What the examiner is asking you to do	Directive verbs to watch for
Remembering	Level I	Reproduce what you have learnt, as you learnt it.	Define · List · State · Name · Enumerate · Recognise
Understanding	Level I	Explain it, and place it in context — show you have grasped why the rule is what it is.	Describe · Explain · Distinguish · Identify · Illustrate · Outline
Application	Level II	Use or demonstrate the knowledge, concept or technique. Work the problem.	Apply · Calculate · Determine · Prepare · Reconcile · Record · Perform · Use · Conduct · Demonstrate
Analysis	Level II	Examine the interrelationships between distinct areas to identify root causes and find evidence that supports a judgement.	Analyse · Discuss · Compare and Contrast · Examine · Develop · Monitor · Prioritise · Produce · Align · Communicate
Evaluation	Level III	Assess the problem and use judgement to reach a conclusion.	Advise · Evaluate · Recommend · Review · Select · Assess
Synthesis	Level III	Integrate data and information, separating the relevant facts from the irrelevant.	ICAI lists no verb for synthesis.

ICAI prints the verbs for **Application** and **Analysis** as two separate lists, so that division is the Institute's own. For Level I and for Level III it prints one combined list each — so the line between **Remembering and Understanding**, and between **Evaluation and Synthesis**, follows ICAI's description of the manner of assessment rather than a published list of verbs.

CA Intermediate is assessed at **Levels I and II only** — Evaluation & Synthesis begins at Final. Where a question in this paper is worded as an evaluation, the skill is shown as the question reads and the level tag shows **Level II**, the level the paper is actually assessed at.

4. What the skill mix should change about your preparation

ICAI grades this paper **Level I 5–15%** and **Level II 85–95%** of marks. Two things follow that are easy to miss.

- **Do not read "Analysis & Application" as an even split.** In this paper Application carries about **95%** of the Level II marks and Analysis about **5%**. The work is overwhelmingly working the problem, not writing about it.
- **The paper's balance is not each chapter's balance.** Every chapter opens with its own **ICAI Skill Profile** panel, showing how that chapter's marks actually divide and what that means for preparing it. Some chapters are a third theory; others carry almost none. Read the panel before you start the chapter.

5. Two guides at the front of the book

What it is for	
Study Priority Guide	Every examined topic ranked by its share of the classified Scanner questions, and graded A, B or C on cumulative coverage. Category A carries the first 60% of all questions — secure those to full command first.
Importance grade	The A-D grade printed against each chapter in the Contents. This is ICAI's syllabus weightage signal, and it is separate from the question-frequency ranking. Where the two disagree, prepare the chapter to the higher of the two.

STUDY PRIORITY GUIDE

Topic Ranking — Exam Weightage

Read first: Every topic in this booklet that the examiner has actually asked is ranked below by its share of the 483 classified Scanner questions (2026 October Edition, V2), aggregated across all 16 Units — and graded A, B or C on cumulative coverage. **Category A (ranks 1–16)** covers the first 60% of all classified questions: with the passing standard at 50%, a student who prepares the A-topics to full command holds a clear margin above it. **Category B (ranks 17–23)** adds the next 15%, taking coverage to about 75% — work through these as time allows. **Category C (ranks 24–55)** is the remaining 25%: a long tail that is slower to mine for marks, much of which gets covered automatically while preparing A and B. The **Pg.** column cross-references the page on which that topic's study notes begin.

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
1	A	Assets Based Accounting Standards	AS 13-Accounting For Investment	5.6%	5.6%	58
2	A	Accounting Standards for Consolidated Financial Statements	AS 21-Consolidated Financial Statements	4.3%	9.9%	101
3	A	Buy Back of Securities	Buy Back: Practical	4.1%	14.1%	127
4	A	Assets Based Accounting Standards	AS 16-Borrowing Costs	3.9%	18.0%	61
5	A	Accounting Standards Based on Items Impacting Financial Statements	AS 11-The Effects of Changes in Foreign Exchange Rates	3.9%	21.9%	83
6	A	Revenue Based Accounting Standards	AS 9-Revenue Recognition	3.9%	25.9%	91
7	A	Financial Statements of Companies	Final Accounts	3.9%	29.8%	111
8	A	Accounting for Reconstruction of Companies	Entries In Case of Internal Reconstruction	3.9%	33.7%	138
9	A	Presentation & Disclosures Based Accounting Standards	AS 20- Earnings Per Share	3.7%	37.5%	47
10	A	Assets Based Accounting Standards	AS 2-Valuation of Inventories	3.7%	41.2%	53
11	A	Assets Based Accounting Standards	AS 19-Leases	3.7%	44.9%	63
12	A	Amalgamation of Companies	Methods of Accounting for Amalgamations	3.7%	48.7%	133

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
13	A	Accounting for Branches Including Foreign Branches	Accounting for Dependent Branches	3.3%	52.0%	142
14	A	Assets Based Accounting Standards	AS 10-Property Plant and Equipment	3.1%	55.1%	55
15	A	Other Accounting Standards	AS 12-Accounting Standards for Government Grants	3.1%	58.2%	95
16	A	Assets Based Accounting Standards	AS 26-Intangible Assets	2.9%	61.1%	66
17	B	Accounting Standards Based on Items Impacting Financial Statements	AS 5-Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	2.7%	63.8%	80
18	B	Accounting Standards Based on Items Impacting Financial Statements	AS 22-Accounting for Taxes on Income	2.5%	66.3%	86
19	B	Presentation & Disclosures Based Accounting Standards	AS 18- Related Party Disclosures	2.3%	68.5%	45
20	B	Accounting Standards Based on Items Impacting Financial Statements	AS 4-Contingencies and Events Occurring After the Balance Sheet Date	2.3%	70.8%	78
21	B	Presentation & Disclosures Based Accounting Standards	AS 3- Cash Flow Statement	2.1%	72.9%	41
22	B	Liabilities Based Accounting Standards	AS 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets	2.1%	74.9%	74
23	B	Revenue Based Accounting Standards	AS 7-Construction Contracts	2.1%	77.0%	89
24	C	Financial Statements of Companies	Calculation of Cash Flow by Indirect Method	2.1%	79.1%	121
25	C	Presentation & Disclosures Based Accounting Standards	AS 1- Disclosures of Accounting Policies	1.9%	81.0%	38
26	C	Presentation & Disclosures Based Accounting Standards	AS 17- Segment Reporting	1.9%	82.8%	43
27	C	Other Accounting Standards	AS 14-Accounting for Amalgamation	1.7%	84.5%	98
28	C	Accounting for Branches Including Foreign Branches	Incomplete Information in Branch Books	1.4%	85.9%	148
29	C	Framework for Preparation and Presentation of Financial Statements	Capital Maintenance	1.2%	87.2%	30
30	C	Assets Based Accounting Standards	AS 28-Impairment of Assets	1.2%	88.4%	69
31	C	Liabilities Based Accounting	AS 15-Employee Benefits	1.2%	89.6%	72

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
		Standards				
32	C	Framework for Preparation and Presentation of Financial Statements	Elements of Financial Statements	1.0%	90.7%	27
33	C	Presentation & Disclosures Based Accounting Standards	AS 24- Discontinuing Operations	1.0%	91.7%	50
34	C	Financial Statements of Companies	Calculation of Cash Flow from Operating Activities	0.8%	92.5%	117
35	C	Amalgamation of Companies	Purchase Consideration	0.8%	93.4%	132
36	C	Framework for Preparation and Presentation of Financial Statements	Qualitative Characteristics of Financial Statements	0.6%	94.0%	26
37	C	Applicability of Accounting Standards	Applications of Accounting Standards	0.6%	94.6%	35
38	C	Financial Statements of Companies	Distributed Profit	0.6%	95.2%	113
39	C	Financial Statements of Companies	Calculation of Cash Flow by Direct and Indirect Method	0.6%	95.9%	122
40	C	Accounting for Branches Including Foreign Branches	Accounting for Independent Branches	0.6%	96.5%	145
41	C	Framework for Preparation and Presentation of Financial Statements	Fundamental Accounting Assumptions	0.4%	96.9%	24
42	C	Accounting Standards for Consolidated Financial Statements	AS 23-Accounting for Investments in Associates in Consolidated Financial Statements	0.4%	97.3%	104
43	C	Introduction to Accounting Standards	Introduction	0.2%	97.5%	12
44	C	Introduction to Accounting Standards	Need for Convergence Towards Global Standards	0.2%	97.7%	15
45	C	Introduction to Accounting Standards	What Are Carve Outs/Ins in IND AS	0.2%	97.9%	18
46	C	Framework for Preparation and Presentation of Financial Statements	Measurement of Elements of Financial Statements	0.2%	98.1%	29
47	C	Applicability of Accounting Standards	Status of Accounting Standards	0.2%	98.3%	33
48	C	Presentation & Disclosures Based Accounting Standards	AS 25- Interim Financial Reporting	0.2%	98.6%	51
49	C	Financial Statements of	Elements of Cash	0.2%	98.8%	115

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
Companies						
50	C	Financial Statements of Companies	Calculation of Cash Flow by Direct Method	0.2%	99.0%	120
51	C	Buy Back of Securities	Provision of Section 70 of the Companies Act, 2013	0.2%	99.2%	125
52	C	Amalgamation of Companies	Meaning of Amalgamation	0.2%	99.4%	130
53	C	Accounting for Reconstruction of Companies	Methods of Internal Reconstruction	0.2%	99.6%	137
54	C	Accounting for Branches Including Foreign Branches	Methods of Charging Goods to Branches	0.2%	99.8%	144
55	C	Accounting for Branches Including Foreign Branches	Adjustment and Reconciliation of Branch and Head Office Accounts	0.2%	100.0%	146

Share % is a question-frequency signal drawn from the Scanner — what has actually been asked. The **Importance** grade (A–D) printed against each Chapter and Unit heading is ICAI's own weightage signal, taken from the CA L2 P1 2026 Oct Chapter Priority Table (with Sep 2026) — ICAI marks over the 8 papers set under the 2023 scheme, including September 2026. The two measure different things, and where they diverge, prepare to the higher of the two standards. A further **26 topics** are declared in the Scanner's frequency tables but carry no question yet; they are badged **CONCEPT BASE** in the notes and are not ranked here.

CHAPTER 1

Introduction to Accounting Standards

9 Topics · 3 Classified Questions · Importance: D

ICAI SKILL PROFILE Level I 5-15% · Level II 85-95% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **100.0%** 15 of 15 marks

Level II — Analysis & Application **0.0%** 0 of 15 marks

Above the paper's Level I ceiling: 100% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. This chapter is examined mainly as theory. The problems are the smaller half of it, and reading is the greater part of the preparation — the reverse of the paper as a whole. Read the split with care: the chapter carries only 3 classified questions, so a single question moves it several points.

Topic 1: Introduction

L2P1-C1-U1-T01

Read first Read §1 Introduction, Study Material 2026 July, Chapter 1, pages 1.2–1.7 — GAAP, what an Accounting Standard is, the four aspects standards deal with, and the three benefits.

NOTES

GAAP is a common set of accepted accounting principles, standards and procedures that a reporting entity must follow when it prepares and presents its financial statements — a combination of authoritative standards set by policy boards and the commonly accepted ways of recording and reporting. Internationally those authoritative standards are the IFRS; in India they are the **Accounting Standards (AS)** and the **Indian Accounting Standards (Ind AS)**.

What an Accounting Standard is: an authoritative pronouncement on recognition, measurement, presentation and disclosure. For **non-corporate entities** AS are issued by the ICAI; for **companies** AS/Ind AS are prescribed or notified by the Central Government/MCA under **section 133 of the Companies Act, 2013**. Getting this split right is worth a mark on its own.

The four aspects AS deal with — learn them as a set: (i) **recognition** of events and transactions in the financial statements; (ii) **measurement** of those transactions and events; (iii) **presentation** of them in a manner meaningful and understandable to the reader; (iv) the **disclosures** that let the public, stakeholders and potential investors see what the statements are trying to reflect, so they can take prudent and informed business decisions.

Purpose: standard-setting bodies exist to promote the dissemination of timely and useful financial information to investors and other stakeholders with an interest in the entity's economic performance. Standards do this by **reducing the accounting alternatives** within the bounds of rationality, which is what makes different enterprises comparable.

Benefit 1 — standardisation of alternative accounting treatments: confusing variation in

treatment and presentation is reduced or eliminated to a reasonable extent. Because no single set of policies suits every enterprise, compliance must be **accompanied by disclosure of the policies actually adopted** — for example which permitted cost formula (FIFO, weighted average) was used for inventory (see AS 1).

Benefit 2 — requirements for additional disclosures: in areas where statute requires no disclosure, the standards may still call for the accounting policies followed and other information to be disclosed, so the reader can understand the treatment given to items in the statements.

Benefit 3 — comparability: standardisation improves both **intra-enterprise** comparison (the same enterprise over a number of years, possible only if it uses the same policies each year) and **inter-enterprise** comparison (different enterprises for the same period, possible only where comparable enterprises use similar policies, or disclose the differences so the reader can adjust).

Two limits to state in any answer on benefits: the standards are **principle-based**, so their application to complex transactions is judgemental; and where an AS conflicts with a statutory requirement the **statute prevails** — though the statements should still aim at a true and fair view within the legal framework.

Creative accounting is the twisting of accounting policies to produce statements favourable to a particular interest group — overstating profit and assets by capitalising revenue expenditure, or understating them by writing capital expenditure off against current revenue. Standards curb it by framing policies for exactly the borderline cases where divergent views are possible.

Understanding explain it, and place it in context • 1 question

- Be able to define an Accounting Standard and, in the same breath, name the four aspects it deals with — recognition, measurement, presentation, disclosure. Examiners award the definition and the four aspects separately.
- For 'objectives and advantages' questions, structure the answer as objectives first (harmonising diverse policies, aiding comparability, building faith and reliability) then advantages (comparable statements, prevention of misleading treatments, curbing manipulation).
- Always close with the two limits: application is judgemental because the standards are principle-based, and the statute prevails in a conflict.

TQ 1.1 • PYQ 2025-May [6] (a) • DESC • 4M • Pg 3

LEVEL I
Understanding

Easy

Topic 2: Standard Setting Process

L2P1-C1-U1-T02

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §2 Standards Setting Process (pages 1.7–1.10), §3 How Many Accounting Standards?

(1.10–1.14) and §4 Status of Accounting Standards (page 1.14).

NOTES

Who sets them: the ICAI, as the premier accounting body in the country, constituted the **Accounting Standards Board (ASB) in 1977**. Its composition includes representatives of industry and industry associations (ASSOCHAM, CII, FICCI), regulators, academicians and government departments. Although the ASB is constituted by the Council of the ICAI, it is **independent in the formulation of standards**.

The ASB considered the IAS/IFRS while framing Indian standards and tried to integrate them in the light of the applicable laws, customs, usages and business environment of the country.

The eight steps of the standard-setting procedure — reproduce them in order: **I** identification of the broad area; **II** constitution of study groups to prepare a preliminary draft (objective and scope, definitions, recognition and measurement principles, presentation and disclosure requirements), considered and revised by the ASB; **III** circulation of the revised draft to Council members and specified outside bodies — MCA, SEBI, C&AG, CBDT, SCOPE; **IV** a meeting with representatives of those bodies to ascertain their views; **V** finalisation and issue of the **exposure draft** inviting public comments; **VI** consideration of the comments received and finalisation by the ASB for submission to the Council; **VII** consideration by the Council and modification, if necessary, in consultation with the ASB; **VIII** issue of the standard — by the ICAI for non-corporate entities, and prescribed/notified by the Central Government/MCA under section 133 for companies.

Section 133: the Central Government may prescribe the standards of accounting, or any addendum, as recommended by the ICAI, **in consultation with and after examination of the recommendations of NFRA**.

Accounting Standard Interpretations (ASIs): the ASB used to issue these after the standard they related to, to address questions arising in application; their authority was the same as that of the AS concerned. The consensus portions have since been **merged as 'Explanations' to the relevant AS paragraphs**, so that the ICAI's ASs for non-corporates and the MCA's notified ASs for corporates stay harmonised.

How many standards: **AS 6** Depreciation Accounting was withdrawn on the revision of AS 10 Property, Plant and Equipment, and **AS 8** Accounting for Research and Development on the issue of AS 26 Intangible Assets. **There are effectively 27 Accounting Standards.**

The Rules: MCA's Companies (Accounting Standards) Amendment Rules, 2016 were superseded by the **Companies (Accounting Standards) Rules, 2021**, notified 23 June 2021 and applying to accounting periods beginning on or after 1 April 2021. AS 2, 4, 10, 13, 14, 21 and 29 were revised to align them with the corresponding Ind AS so far as possible.

Status — the point the examiner tests: the ICAI is not a legislative body, so it can enforce its standards only on **its members**, and the standards **cannot override laws and local regulations**. The standards are nevertheless mandatory from the dates specified in them. The practical implication

of that mandatory status therefore depends on **whether the statute governing the enterprise requires compliance**. Companies not following Ind AS apply the AS notified under the 2021 Rules.

Topic 3: Need for Convergence Towards Global Standards

L2P1-C1-U1-T03

Read first Read §5 Need for Convergence towards Global Standards, pages 1.14–1.16 — the four key aspects, in order.

NOTES

The setting: the last decade has seen a sea change in the global economic scenario; trans-national corporations searching for money, not only to fuel growth but to sustain ongoing activities, have had to raise capital from all parts of the world, cutting across frontiers. That is the sentence to open a convergence answer with.

Aspect 1 — raising funds from international markets: every country has its own rules for accounting and financial reporting. An enterprise raising capital outside its own country becomes subject to that other country's rules, so it must understand the differences between the two regimes. Translation and restatement therefore matter enormously in a rapidly globalising world, and the standards must be robust enough for society to have confidence in the statements put forward.

Aspect 2 — comparability of financial statements: international analysts and investors want to compare statements drawn on similar standards, which has driven the need for an internationally accepted set for cross-border filings. Harmonisation raises investor confidence in the information they use to make decisions and assess risk.

Aspect 3 — uniformity, comparability, transparency: legislation felt a strong need for uniformity, rationalisation, comparability, transparency and adaptability. A multiplicity of standards is against the public interest: if accounting for the same events produces different reported numbers depending on the system used, accounting is discredited in the eyes of those using the numbers — it creates confusion, encourages error and may facilitate fraud. The cure is **a single set of global standards of the highest quality, set in the public interest**.

Aspect 4 — global investment: convergence contributes to the free flow of global investment. It improves investors' ability to compare investments globally and so lowers their risk of errors of judgment; it eases accounting and reporting for companies with global operations and removes costly requirements such as restatement; it creates a new standard of accountability and greater transparency for all market participants including regulators; and it reduces operational challenges for accounting firms. It matters most for companies with **joint listings** in a domestic and a foreign market.

Understanding explain it, and place it in context • 1 question

- The answer is the four aspects — raising funds from international markets, comparability, uniformity/transparency, global investment — each with two lines of explanation. Naming them without explaining is a half answer.
- Open with the trans-national corporation sentence: it earns the context mark and costs one line.

TQ 3.1 • PYQ 2026-May [6] (a) • DESC • 4M • Pg 4

LEVEL I
Understanding

Easy

Topic 4: International Accounting Standard Board (IASB)

L2P1-C1-U1-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §6 International Accounting Standard Board, pages 1.16–1.17 — and fix the three dates: 1973, 1997–1999, 1 April 2001.

NOTES

Formation: the London-based **International Accounting Standards Committee (IASC)** was established in **June 1973**, comprising professional accountancy bodies from various countries, and was responsible for developing **International Accounting Standards (IAS)**.

Purpose: the IASC was set up in the public interest to formulate and publish IASs to be followed in the preparation and presentation of financial statements, and to promote their acceptance and observance worldwide. Its members undertook to support those standards and to propagate them in their own countries.

Restructuring: the IASC issued IASs between 1973 and 2001. Between **1997 and 1999** it restructured itself, which produced the **IASB**; the changes took effect on **1 April 2001**, when the IASB replaced the IASC as the standard-setting body. The IASB publishes its standards in a series called **IFRS**.

The date rule to memorise: standards issued by the IASC **up to 31.03.2001** are IASs; standards issued by the IASB **from 01.04.2001** are IFRSs. The IASB has **not rejected** the IASC's standards — those pronouncements continue to be designated IAS.

Topic 5: International Financial Reporting Standards (IFRS) As Global Standards

L2P1-C1-U1-T05

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §7 International Financial Reporting Standards as Global Standards, pages 1.17–1.18 — the four components of the term IFRS.

NOTES

The term IFRS has four components — this is the answer to 'what does IFRS comprise': (1) IFRS issued by the IASB; (2) IAS issued by the IASB and adopted by the IASB; (3) interpretations issued by the **Standing Interpretations Committee (SIC)** on IAS; and (4) interpretations issued by the **IFRS Interpretations Committee (IFRIC)** of the IASB.

Character: IFRS are a **principles-based** set of standards — they establish broad rules rather than dictating specific treatments. That single word, principles-based, is what distinguishes them in an answer.

Reach: many jurisdictions require or permit IFRS for listed or public-interest entities, though adoption and convergence models differ from one jurisdiction to another. A large number of authorities permit public companies to use IFRS for stock-exchange listing, and banks, insurance companies and stock exchanges may use them for statutorily required reports.

Beyond listing: the use of IFRS is not confined to listing requirements or statutory reporting — many lenders, regulators and government bodies look to IFRS to satisfy local financial reporting obligations tied to financing or licensing. The requirement reaches thousands of enterprises, including their subsidiaries, equity investors and joint venture partners.

Topic 6: Becoming IFRS Compliant

L2P1-C1-U1-T06

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §8 Becoming IFRS Compliant, pages 1.18–1.19 — the two techniques and the four benefits of convergence.

NOTES

A country can become IFRS compliant by exactly two techniques. Name both, define both, then say which India chose.

Technique I — adoption: the country sets a specific timetable by which specified entities are required to use **IFRS as issued by the IASB**. Nothing is rewritten; the standards are taken as they stand.

Technique II — convergence: the country develops **high quality, compatible** accounting standards, aligning its standards with those of the international standard setter **with a certain rate of**

compromise, adopting the requirements either fully or partially.

Where India stands: Ind AS are **substantially converged** with IFRS, subject to carve-outs, carve-ins and terminology changes considered necessary in the Indian context.

The four benefits of convergence: it improves investor confidence across the world through transparency and comparability; it improves inter-unit, inter-firm and inter-industry comparison; it makes **group consolidation easy**, because every company in the group uses the same standard wherever it sits; and it makes financial statements acceptable to stock exchanges across the globe, which eases the listing of Indian companies on international exchanges.

Topic 7: What Are Carve Outs/Ins in IND AS

L2P1-C1-U1-T07

Read first Read §9 What are Carve Outs/Carve-Ins in Ind AS?, pages 1.19–1.21 — the three kinds of departure, and which one alone produces a carve-out.

NOTES

The decision: the Government of India, in consultation with the ICAI, decided to **converge and not to adopt** the IFRS issued by the IASB — taken after detailed analysis of the IFRS requirements and extensive discussion with stakeholders.

Three kinds of departure were made while formulating Ind AS. The examiner wants all three named, and then wants you to say which of them actually produces a carve-out.

Departure 1 — terminology differences: changes made for consistency with the terminology used in Indian law — '**statement of profit and loss**' in place of 'statement of comprehensive income', '**balance sheet**' in place of 'statement of financial position'.

Departure 2 — removal of options: options available in IFRS have been removed in Ind AS to maintain consistency and comparability between statements prepared under Ind AS. **These changes do not result in carve-outs.**

Departure 3 — difference in economic environment: changes made because India's economic conditions differ from those IFRS presumes. **These deviations from the accounting principles and practices stated in IFRS are what is meant by 'carve-outs'.**

Carve-ins: additional guidance or requirements included in Ind AS **over and above** IFRS. Carve-out takes something away or deviates; carve-in adds. Students lose marks by treating every departure as a carve-out — only the third kind is.

Understanding explain it, and place it in context · 1 question

- The whole topic turns on one distinction: only a departure arising from a difference in economic environment is a carve-out. Terminology changes and the removal of options are not.

- Name all three kinds of departure, then say which one produces a carve-out, then define a carve-in. Four sentences, four marks.
- Give one worked example of each departure — the examples are what separate a full answer from a bare list.

TQ 7.1 · RTP 2024-May [3] · DESC · Pg 5

LEVEL I
Understanding

Hard

Topic 8: Convergence of IFRS in India

L2P1-C1-U1-T08

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read §10 Convergence to IFRS in India, pages 1.21–1.22 — and the definitions of adoption against convergence.

NOTES

The position: in a globalised economy India cannot isolate itself from accounting developments elsewhere. The ICAI, NFRA and regulators such as SEBI and the RBI aim to **comply with IFRS to the extent possible**, so as to formulate sound reporting standards for globally accepted financial statements.

The ICAI, being a member of the **International Federation of Accountants (IFAC)**, considered the IFRS and tried to integrate them so far as possible in the light of the laws, customs, practices and business environment prevailing in India.

The commercial driver: the recent stream of overseas acquisitions by Indian companies created a need for high-quality standards to convince foreign enterprises of the **financial standing, disclosure and governance** of Indian acquirers. Recognising the need for full convergence, the ICAI constituted a **Task Force** to examine the issues involved.

Definitions to keep apart — the marks are in the distinction: **adoption** means using IFRS as issued by the IASB; **convergence** means aligning national standards with IFRS, with modifications where necessary. **Full convergence would eliminate substantive differences, but it is still not the same as legal adoption of IFRS as issued.**

The outcome: for convergence, the ASB in consultation with the MCA decided there would be **two separate sets of accounting standards** — (i) Ind AS converged with IFRS, framed by eliminating the differences against IFRS, and (ii) the existing notified AS.

Topic 9: Ind AS

L2P1-C1-U1-T09

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read §11 What are Indian Accounting Standards? (1.22–1.23), §12 History of IFRS-converged Ind AS (1.23–1.24), §13 List of Ind AS (1.24–1.27) and §14 Roadmap for Implementation: A Snapshot (1.27–1.29).

NOTES

What they are: Ind AS are **IFRS-converged standards notified by the MCA/Central Government** under the Companies Act framework. They are formulated through the ICAI standard-setting process and notified after the statutory consultation and recommendation process involving **NFRA**, which recommends them to the MCA.

Numbering rule: Ind AS are named and numbered in the same way as the corresponding IAS. For an Ind AS corresponding to an **IFRS**, **add 100 to the IFRS number** — IFRS 1 becomes Ind AS 101. A one-line question on numbering is answered by that sentence alone.

History — the dates: the ICAI began moving towards IFRS in **2006** to enhance the acceptability and transparency of Indian corporate reporting, a move later accepted by the Government of India. Ind AS were originally expected from **2011**, but the MCA postponed implementation while tax and other issues were resolved. The **July 2014** Budget speech announced the urgency of convergence.

The Rules: the MCA issued the **Companies (Indian Accounting Standards) Rules, 2015** by notification dated **16 February 2015** — Ind AS **voluntary from 1 April 2015** and **mandatory from 1 April 2016** for companies other than banking companies, insurance companies and NBFCs, for which **separate roadmaps** were prescribed.

The mapping table: know the Ind AS against IFRS/IAS against AS correspondence — Ind AS 101/IFRS 1 First-time Adoption; 102/IFRS 2 Share Based Payment; **103/IFRS 3 Business Combinations against AS 14 Accounting for Amalgamations**; **105/IFRS 5 Non-current Assets Held for Sale against AS 24 Discontinuing Operations**; **108/IFRS 8 Operating Segments against AS 17 Segment Reporting**; **110/IFRS 10 against AS 21 Consolidated Financial Statements**; **111/IFRS 11 Joint Arrangements against AS 27**. These pairings are the ones that come back as one-mark fill-ins and as parts of larger questions.

Roadmap: read **14** for the phase-wise thresholds — which class of company comes in from which financial year, and the separate treatment of banking, insurance and NBFC entities.

CHAPTER 2

Framework for Preparation and Presentation of Financial Statements

9 Topics • 17 Classified Questions • Importance: D

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **23.2%** 19 of 82 marks

Level II — Analysis & Application **76.8%** 63 of 82 marks

Above the paper's Level I ceiling: 23% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. The theory here is not padding around the problems — it is a fifth or more of what the chapter is worth. Do not prepare this chapter by working sums alone.

Topic 1: Introduction

L2P1-C2-U2-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §1 Introduction (Study Material 2026 July, Chapter 2, pages 2.2–2.3) together with §3 Status and Scope of the Framework (page 2.3) — what the Framework is, and the eight areas it covers.

NOTES

What the Framework is: the development of accounting standards needs a foundation of underlying principles. The **Accounting Standards Board of the ICAI issued the Framework in July 2000**; it provides the fundamental basis both for developing new standards and for reviewing existing ones.

The eight principal areas it covers — a clean list to reproduce: (a) components of financial statements; (b) objectives of financial statements; (c) assumptions underlying financial statements; (d) qualitative characteristics; (e) elements of financial statements; (f) criteria for recognition of those elements; (g) principles for their measurement; (h) concepts of capital and capital maintenance.

Context: the Framework is relevant in the context of the **Companies (Accounting Standards) Rules, 2021**, which replaced the 2006 Rules, and of the Accounting Standards issued by the ICAI.

Status — two sentences that carry marks: the Framework applies to **general-purpose** financial statements, usually prepared annually for external users, by all commercial, industrial and business enterprises, public or private sector. **Special-purpose reports**, such as computations prepared for tax purposes, are outside its scope, though it may be applied to them so far as it is not inconsistent

with their requirements.

The Framework is not itself an Accounting Standard, and nothing in it overrides a specific Accounting Standard. Where the two conflict, **the requirements of the Accounting Standard prevail.** Learn that sentence exactly — it is the single most quotable line in the chapter.

Topic 2: Purpose of the Framework

L2P1-C2-U2-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read §2 Purpose of the Framework, pages 2.3–2.4 — the six parties the Framework assists, plus the closing caution.

NOTES

The Framework sets out the concepts underlying the preparation and presentation of general-purpose financial statements prepared for **external users**. Its main purpose is to **assist** — and the answer to any question here is the list of who it assists, with the reason attached to each.

(a) Enterprises — in preparing statements that comply with the Accounting Standards, and in dealing with topics **not yet covered** by any standard. That second half is the part students drop.

(b) the ASB — in its task of developing and reviewing Accounting Standards.

(c) the ASB again — in promoting harmonisation of regulations, standards and procedures, by providing a basis for **reducing the number of alternative accounting treatments** permitted by the standards.

(d) Auditors — in forming an opinion as to whether financial statements conform to the Accounting Standards.

(e) Users — in interpreting financial statements.

(f) Anyone interested in the ASB's work — with information about its approach to formulating standards.

And the caution: the Framework is **not itself an Accounting Standard**. Close every answer on purpose with that line.

Topic 3: Components of Financial Statements

L2P1-C2-U2-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read §4 Components of Financial Statements, pages 2.4–2.5 — what a complete set contains and what each component tells the reader.

NOTES

A **complete set** normally consists of a **Balance Sheet**, a **Statement of Profit and Loss** and a **Cash Flow Statement**, together with **notes, other statements and explanatory material** that form an integral part of the financial statements.

Why they are read together: all components are **interrelated**, because they reflect different aspects of the same transactions or events. Each provides different information, but **none in isolation** serves any single purpose, and no one of them provides everything a user needs.

Balance Sheet — portrays the value of the economic resources controlled by the enterprise and the claims against those resources, that is liabilities and equity. It also carries information about **liquidity and solvency**, useful in predicting the enterprise's ability to meet its financial commitments as they fall due.

Statement of Profit and Loss — presents the result of operations for an accounting period; it depicts **performance**, in particular profitability.

Cash Flow Statement — shows how the enterprise generated cash and how it was used in the period, and helps in evaluating the **investing, financing and operating** activities of the reporting period.

Notes and other statements — present supplementary information explaining items in the statements: disclosure of accounting policies, segment reporting, related party disclosures, earnings per share and so on.

For companies, the components are subject to the requirements of the **Companies Act, 2013** and the applicable exemptions.

Topic 4: Objectives and Users of Financial Statements

L2P1-C2-U2-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §5 Objectives and Users of Financial Statements, pages 2.5–2.7 — the objective in one sentence, then the seven user groups with the information need of each.

NOTES

The **objective** of financial statements is to provide information about the **financial position, performance and cash flows** of an enterprise that is useful to a wide range of users in making

economic decisions. That single sentence is the opening of every answer in this topic.

Seven user groups — investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public. Name all seven; the marks are usually one for the list and one for the needs.

Investors — providers of risk capital, concerned with the **risk and return** of their investment, and with the enterprise's ability to **pay dividends**.

Employees — interested in the **stability and profitability** of their employer, and in its ability to provide **remuneration, retirement benefits and employment opportunities**.

Lenders — whether their **loans and the interest** on them will be paid when due.

Suppliers and other trade creditors — whether amounts owing will be paid when due. They are typically interested over a **shorter period** than lenders, unless dependent on the enterprise as a major customer.

Customers — the **continuance** of the enterprise, especially where they have a long-term involvement with it or depend on it for goods and services.

Governments and their agencies — allocation of resources, regulation of activities, **taxation policy**, and the basis for national income statistics.

Public — the enterprise's contribution to the local economy, employment and patronage of local suppliers; statements assist by showing **trends and recent developments** in prosperity and the range of activities.

The limit to state at the end: financial statements suit the **common needs of most users**; they cannot and do not intend to provide all information that may be needed — for example they carry **no non-financial data**, even where it would be relevant to a decision.

Topic 5: Fundamental Accounting Assumptions

L2P1-C2-U2-T05

Read first Read §6 Fundamental Accounting Assumptions, pages 2.7–2.11, including Illustration 1 (the going-concern versus not-going-concern balance sheet) and Example 1 (cash basis against accrual basis).

NOTES

Three fundamental assumptions: going concern, accrual and consistency. Users believe these have been applied, so **no separate disclosure is necessary** as long as they have been followed. **If any one of them is not followed, that fact must be specifically disclosed.** That disclosure rule is the examinable point.

Going concern: statements are normally prepared on the assumption that the enterprise will

continue in operation in the foreseeable future, with neither an intention nor a necessity to **liquidate or materially curtail** operations. Statements on that basis recognise the need to retain enough profit to replace assets consumed in operation and to provide adequately for settlement of liabilities. If a different basis is used — assets stated at net realisable value, for instance — **the basis used must be disclosed**.

What changes when going concern fails — this is the whole of the practical question. Assets come down to **net realisable value**; **deferred expenditure is written off in full** rather than amortised; provisions are made for amounts whose recovery depends on the business continuing; liabilities are restated at their **settlement** amount, including any **early repayment penalty** on a loan; and a payable expected to settle at a discount is taken at the discounted figure. Work Illustration 1 both ways side by side until the pattern is automatic.

Accrual: revenues and costs are **accrued** — **recognised as they are earned or incurred, and not as money is received or paid** — and recorded in the statements of the periods to which they relate. **Section 128(1) of the Companies Act, 2013** makes accrual mandatory for companies. It need not be expressly stated; but **if any income or expense is recognised on a cash basis, that fact must be stated**.

Why accrual and not cash: Example 1 in the Study Material shows a trader posting a ₹58,000 profit in period 1 and a ₹47,500 loss in period 2 on the cash basis, against a single coherent result on the accrual basis. Quote that contrast rather than describing it abstractly.

Consistency: the same accounting policies are used for similar transactions in every period, unless a change is required by statute, by an accounting standard, or for more appropriate presentation.

Application use the rule — work the problem · 2 questions

- Every question in this band is the same exercise: prepare the Profit and Loss Account and the Balance Sheet twice, once assuming going concern and once not. Set the two cases in adjacent columns from the start — the examiner is comparing them, and so should your answer.
- Work through the adjustments in a fixed order so nothing is missed: property, plant and equipment to NRV, inventory, receivables and doubtful debts, deferred expenditure, payables and any settlement discount, the loan and its early repayment penalty. Six of those seven change between the two cases.
- State the assumption you are applying before the figures. A mark is available for saying why deferred expenditure is written off in full when going concern is abandoned; none is available for the number alone.

PQ 5.2 · PYQ 2020-Nov [6] (d) · 5M · Pg 12

LEVEL II
Application

Easy

PQ 5.1 · PYQ 2019-May [6] (b) · 5M · Pg 11

LEVEL II
Application

Medium

Topic 6: Qualitative Characteristics of Financial Statements

L2P1-C2-U2-T06

Read first Read §7 Qualitative Characteristics of Financial Statements, pages 2.11–2.13, and §8 True and Fair View, page 2.13.

NOTES

Four characteristics: understandability, relevance, comparability, reliability. Name all four before explaining any of them.

Understandability: information must be presented so as to be readily understandable by users with **reasonable knowledge** of business, economic activities and accounting. The standard is a reasonably informed reader, not an expert and not a novice.

Relevance: more information is not always better — a mass of irrelevant information creates confusion and can be **more harmful than non-disclosure**. Information is relevant if it is **likely to influence the economic decisions** of users, by helping them evaluate past, present or future events or confirm or correct past evaluations.

Materiality is how relevance is judged. Information is material if its misstatement — omission or erroneous statement — **could influence the economic decisions** of a user taken on the basis of the financial information. It depends on the **size and nature** of the item or error in the circumstances.

Materiality is a threshold or cut-off point, not a primary qualitative characteristic in its own right. That distinction is regularly examined.

Two constraints, both examinable: timeliness — undue delay in reporting may cost information its relevance, and reporting before every aspect of a transaction is known impairs reliability, so management must balance the two, with the overriding consideration being how best to satisfy users' needs. **Balance between benefit and cost** — a pervasive constraint rather than a characteristic: the benefits derived from information should **exceed the cost of providing it**, and the evaluation is substantially judgemental.

Reliability: information must be **free from material error and bias**. It is not reliable unless transactions and events are **faithfully represented**; reported on the principle of **substance over form**; **neutral**, that is free from bias; reported with **prudence** where the outcome is uncertain; and **complete**. Five conditions — learn them as five.

Comparability: statements should permit both **inter-firm and intra-firm** comparison, and one essential requirement is **disclosure of the financial effect of a change in accounting policy**. But comparability must not be confused with **mere uniformity** and must not become an impediment to improved standards — it is inappropriate to keep accounting the same way when the policy no longer serves relevance and reliability, or when more relevant and reliable alternatives exist.

True and fair view: the Framework **does not deal directly** with the concept. Applying the principal qualitative characteristics together with the appropriate Accounting Standards **normally results in**

statements that portray a true and fair view. Note both hedges — 'does not deal directly' and 'normally results'.

Remembering reproduce what you have learnt • 2 questions

- Name the four characteristics first, then expand. An answer that explains three of them well but never lists the fourth loses the list mark and the content mark together.
- Keep the five conditions of reliability — faithful representation, substance over form, neutrality, prudence, completeness — as a memorised set; they are asked as a set.

TQ 6.3 • MTP 2026-Apr S2 [6] (a) (i) • DESC • 2M • Pg 16

LEVEL I
Remembering

Easy

TQ 6.2 • PYQ 2020-Nov [6] (b) • DESC • 5M • Pg 14

LEVEL I
Remembering

Medium

Evaluation judge it against the standard • 1 question

- When asked whether a treatment is acceptable, name the characteristic it offends before you reach a conclusion. Most answers here turn on relevance against reliability, or on comparability against the introduction of a better policy.
- The Study Material gives you the resolution for the comparability conflict explicitly: it is inappropriate to leave a policy unchanged when more relevant and reliable alternatives exist. Quote it — it settles the question rather than merely discussing it.

TQ 6.1 • PYQ 2018-Nov [6] (b) • DESC • 5M • Pg 14

LEVEL II
Evaluation

Hard

Topic 7: Elements of Financial Statements

L2P1-C2-U2-T07

Read first Read §9 Elements of Financial Statements, pages 2.14–2.22, including Examples 2 to 4 and the closing relationship $CE = OE + C + \text{Profit} - D$.

NOTES

Five elements, in five groups: asset, liability, equity, income, expenses. Gains and losses are not separate elements — they may or may not arise in the ordinary course of business, but except for the way they arise their economic characteristics are the same as income and expenses respectively.

Asset: a resource controlled by the enterprise as a result of **past events** from which **future economic benefits are expected to flow**. Six points hang off that definition and they are what the marks are for.

Asset, point by point: it need not have physical substance — it may be a right, such as a patent, copyright or trade receivable. **Control matters, not ownership** — under a finance lease the lessee recognises the asset even though the lessor owns it, and the lessor does not, because despite ownership he does not control it. **Insufficient control means no asset** — the specific talent of an employee cannot be recognised, whereas a resource protected by a legal right such as copyright can. The benefit must be **probable and must extend beyond the current period** — machinery bought for resale by a dealer is **inventory**, not an asset of that kind, and its cost becomes cost of goods sold on sale; unsold items at the year end are recognised as **closing stock** because the benefit is expected next period. The resource must have a **cost or value measurable reliably**. And where the flow of benefit beyond the current period is **improbable**, the expenditure is recognised as an **expense**, not an asset.

Liability: a **present obligation** arising from **past events**, the settlement of which is expected to result in an **outflow of resources embodying economic benefits**. A present obligation may be legally enforceable under a binding contract or statute, or may arise from normal business practice, custom, or a desire to maintain good business relations.

The damages-suit test, which the examiner uses repeatedly: recognise a **liability** — a provision, by charge against profit — if it is **probable that the enterprise will lose** the suit and the amount can be ascertained with **reasonable accuracy**. In other cases it is a **contingent liability**, which **does not meet the definition of a liability**. A provision is defined as a liability that can be measured only by using a **substantial degree of estimation**.

Two traps on liabilities. First, **provisions for doubtful debts, depreciation and impairment losses represent a diminution in the value of assets, not obligations, and are not liabilities**. Second, **a future commitment is not a liability** — a management decision to acquire assets in future does not of itself create a present obligation; the obligation normally arises only when the asset is **delivered** or the enterprise enters an **irrevocable agreement** to acquire it.

Equity, income and expenses complete the set, and the arithmetic is worth memorising because it converts a definition question into a calculation: closing equity = closing assets – closing liabilities, and **Profit = CE – OE – C + D**, where C is capital introduced and D is drawings. Equivalently **Profit = (CA – CL) – (OA – OL) – C + D**.

What that relationship tells you: profit depends on the values placed on assets and liabilities. Since **historical cost** is mostly used, reported profit is largely a historical-cost figure — and reported profit **changes with the valuation basis**. That observation is the bridge into capital maintenance, and examiners like to see the link made.

Remembering reproduce what you have learnt · 1 question

- Definitions here must be quoted, not paraphrased. 'A resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow' is worth its own mark, and a loose restatement is not.
- Remember that gains and losses are deliberately not separate elements, and be able to say why.

TQ 7.1 · PYQ 2017-May [7] (a) · SN · 4M · Pg 16

LEVEL I
Remembering**Easy****Understanding** explain it, and place it in context · 1 question

- Explain the control-not-ownership point using the finance lease, and the insufficient-control point using employee talent. Two examples, two marks, four lines.
- When the question is why an item fails to be an asset or a liability, work the definition clause by clause and say which clause fails. That structure earns more than a general discussion.

TQ 7.2 · PYQ 2025-Sep [6] (Or) (a) · DESC · 4M · Pg 17

LEVEL I
Understanding**Easy****Application** use the rule — work the problem · 2 questions

- These are classification questions: for each item, state the element, the clause of the definition that decides it, and the treatment. Set them out item by item — the examiner marks item by item.
- Watch for the three standing traps: a provision for doubtful debts or depreciation is not a liability; a future commitment is not a liability until delivery or an irrevocable agreement; and machinery bought for resale is inventory.

PQ 7.2 · PYQ 2021-Dec [6] (a) · 5M · Pg 19

LEVEL II
Application**Easy**

PQ 7.3 · PYQ 2022-Nov [6] (b) · 5M · Pg 20

LEVEL II
Application**Easy****Evaluation** judge it against the standard · 1 question

- Where you are asked whether an item should be recognised, give the probability test and the measurability test separately, then conclude. Both must be satisfied, and an answer that tests only one is half an answer.
- For a damages suit, say plainly whether it is a provision or a contingent liability and why — 'probable and reliably measurable' against 'does not meet the definition of a liability'.

PQ 7.1 · RTP 2020-May [15] · Pg 18

LEVEL II
Evaluation**Medium**

Topic 8: Measurement of Elements of Financial Statements

L2P1-C2-U2-T08

Read first Read §10 Measurement of Elements of Financial Statements, pages 2.22–2.24, with Example 5 (the machine at ₹7,00,000 and the ₹5,00,000 loan).

NOTES

Measurement is the process of determining the money value at which an element can be recognised in the balance sheet or the statement of profit and loss. The Framework recognises **four alternative measurement bases**, and they relate explicitly to the valuation of **assets and liabilities** — the valuation of income and expenses, that is profit, is **implied** by the change in assets and liabilities.

The four bases: historical cost, current cost, realisable value, present value.

Historical cost means **acquisition price**. Assets are recorded at the cash or cash equivalent paid, or the fair value of the asset at the time of acquisition — so an invoice price of ₹7,00,000 with ₹1,00,000 of installation charges gives a historical cost of **₹8,00,000**. Liabilities are recorded at the **amount of proceeds received in exchange for the obligation**, or in certain circumstances at the amount expected to be paid to satisfy the obligation in the normal course of business — which is how an income tax liability, settled later in the assessment year, is recorded.

In practice: all or any of the bases may be used in varying combinations, subject to the requirements of the Accounting Standards. But **the standards largely use historical cost**, permitting other values for some items — inventory is recorded at historical cost on acquisition and then valued at the **lower of cost and net realisable value** at the year end. That example is the one to give.

The point the examiner is testing is that a later change in what an asset would cost does not disturb the historical-cost figure: a machine bought for ₹7,00,000 stays at ₹7,00,000 even when replacing it would cost ₹25,00,000.

Understanding explain it, and place it in context · 1 question

- Name all four bases before explaining the one the question is about; the list carries its own mark.
- Anchor historical cost with the two-part rule — acquisition price for assets, proceeds received for liabilities — and then give the inventory example to show where the standards depart from it.

TQ 8.1 · PYQ 2016-Nov [7] (c) · DESC · 4M · Pg 21

LEVEL I
Understanding

Easy

Topic 9: Capital Maintenance

L2P1-C2-U2-T09

Read first Read §11 Capital Maintenance, pages 2.24–2.29, working Examples 8 and 9 and Illustration 2 — the same trader under all three conventions.

NOTES

The idea: the value of retained profit depends on how assets and liabilities are valued. Capital

maintenance asks whether **retained profit is negative** — that is, whether the business still has the funds to carry on as before. Three bases are used to answer it.

Financial capital maintenance at historical cost: opening and closing assets are stated at their **respective historical costs** to give opening and closing equity. If retained profit is **zero or positive**, capital is maintained at historical cost, and the business has enough funds to replace its assets **at historical cost**. That holds only as long as prices do not rise — say so, because it is the limitation the next basis exists to fix.

Financial capital maintenance at current purchasing power: opening and closing equity at historical cost are **restated at closing prices using average price indices**. A positive retained profit then means the business can replace its assets **at the average closing price**. Its weakness, which the examiner wants named: **prices of individual assets do not move at the average rate** — a machine may rise 30% while the average rises 20%.

Physical capital maintenance at current costs: the historical costs of opening and closing assets are restated at closing prices using **specific price indices applicable to each asset**, and liabilities are restated at the resources needed to settle them at the closing date. Equity is then the excess of current-cost assets over current-cost liabilities. A positive retained profit here **ensures funds for replacing each asset at its own closing price** — the strongest of the three tests.

The worked pattern to memorise (Examples 8 and 9): a trader starts with ₹12,000 as 6,000 units at ₹2, sells at ₹3 and withdraws ₹6,000. At historical cost, closing equity ₹12,000 against opening ₹12,000 gives retained profit **nil** — capital maintained. Restate opening equity at a closing index of 120 and it becomes ₹14,400, so retained profit is **(₹2,400)** — capital **not** maintained, and drawings should have been restricted to ₹3,600.

How to close an answer: state whether capital has been maintained, and if it has not, say by how much drawings should have been restricted. The examiner is looking for that second sentence.

Application use the rule — work the problem · 6 questions

- Lay the answer out in the same order every time: opening equity, closing equity, restate whichever of them the convention requires, then retained profit as the difference. Most lost marks here are from restating the wrong side.
- Say which convention you are applying and, in one line, what a positive retained profit would mean under it — replacement at historical cost, at average closing price, or at each asset's own closing price. That line is a mark on its own.
- Where the question gives both a general index and specific indices, it wants more than one convention. Answer each in its own short section rather than running them together.
- Finish with the conclusion in words: capital maintained or not, and the drawings the trader should have restricted himself to.

PQ 9.3 • PYQ 2021-Jul [6] (a) • 5M • Pg 24	LEVEL II Application	Easy
PQ 9.4 • MTP 2022-Sep [6] (b) • 5M • Pg 25	LEVEL II Application	Easy
PQ 9.1 • RTP 2018-Nov [15] (b) • Pg 22	LEVEL II Application	Medium
PQ 9.6 • RTP 2024-May [4] • Pg 27	LEVEL II Application	Medium
PQ 9.5 • PYQ 2023-May [6] (d) • 5M • Pg 26	LEVEL II Application	Hard

CHAPTER 3

Applicability of Accounting Standards

2 Topics • 4 Classified Questions • Importance: D

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **26.1%** 6 of 23 marks

Level II — Analysis & Application **73.9%** 17 of 23 marks

Above the paper's Level I ceiling: 26% of this chapter's marks are Comprehension and Knowledge, against 5-15% for the paper. The theory here is not padding around the problems — it is a quarter or more of what the chapter is worth. Do not prepare this chapter by working sums alone. Read the split with care: the chapter carries only 4 classified questions, so a single question moves it several points.

Topic 1: Status of Accounting Standards

L2P1-C3-U3-T01

Read first Read §1 Status of Accounting Standards (Study Material 2026 July, Chapter 3, pages 3.2-3.6) — the three applicability questions, the implication of mandatory status, materiality, and the relationship with the Income Tax Act including the ten ICDSs.

NOTES

The three questions that decide whether a standard applies, and they must be answered in this order: **(a) does it apply to the enterprise concerned?** If yes — **(b) does it apply to the financial statement concerned?** If yes — **(c) does it apply to the financial item concerned?** The Preface to the Statements of Accounting Standards answers all three.

Which enterprises: the standards apply to **any enterprise** — corporate, co-operative or other form — engaged in **commercial, industrial or business activities**, whether or not profit-oriented, and even if established for charitable or religious purposes.

The exclusion, and how narrow it is: the standards do not apply to enterprises **solely** carrying on activities that are not commercial, industrial or business in nature — collecting donations for flood relief, for example. Exclusion is permissible only if **no part** of the activity is of that nature. **Even a very small proportion** of commercial activity brings the standards to bear on **all** the enterprise's activities, including the non-commercial ones. That last sentence is the examinable point.

Mandatory status where the statute is silent — a partnership firm, say: members of the Institute, in discharging their **attest function**, must examine whether the statements comply, and where there is a deviation they have a duty to make **adequate disclosure in their report** so users are aware of it. **Responsibility for preparing the statements and making adequate disclosure remains the management's;** the auditor's responsibility is to form and report an opinion.

Mandatory status for companies — the three sections: **Section 129(1)** requires companies to

present statements in accordance with the standards notified under **Section 133**; **Section 143(3)(e)** requires the auditor to report whether in his opinion the statements comply with those standards; and **Section 129(5)** requires a company that does not comply to disclose **the deviation, the reasons for it, and the financial effects** arising from it.

The saving provision: statements are **not** to be treated as failing to give a true and fair view merely because they do not disclose matters not required to be disclosed by the **Insurance Act, 1938 / IRDA Act, 1999** (insurance companies), the **Banking Regulation Act, 1949** (banking companies), the **Electricity Act, 2003** (generation or supply of electricity), or any other law governing the company.

Which financial items: the standards apply **only to items which are material**. An item is material if its omission or misstatement is **likely to affect the economic decision** of the user. **Materiality is not necessarily a function of size — it is the information content that matters**. A ₹50,000 penalty for breach of law is small for a company turning over crores, yet material because of what it conveys. A material item must be **shown separately**, not clubbed — penalties are not clubbed with legal charges.

Accounting Standards and the Income Tax Act, 1961: the standards reduce diversity and improve comparability; deductions and exemptions in computing taxable income are a matter of **fiscal policy**. So an **expense required to be charged by a standard is not always deductible for tax** — depreciation on an asset taken on finance lease is charged by the lessee under AS 19 but allowed for tax to the **lessor** as legal owner. Equally, **revenue cannot be left unrecognised in the accounts merely because it is exempt under Section 10**.

ICDS: Section 145(2) empowers the Central Government to notify **Income Computation and Disclosure Standards**. Ten are notified, applicable from **A.Y. 2017-18** to all assessees following the **mercantile system** (other than an individual or HUF not required to have accounts audited under Section 44AB), for income under '**Profits and gains of business or profession**' and '**Income from other sources**'. The ten: I Accounting Policies · II Valuation of Inventories · III Construction Contracts · IV Revenue Recognition · V Tangible Fixed Assets · VI Effects of Changes in Foreign Exchange Rates · VII Government Grants · VIII Securities · IX Borrowing Costs · X Provisions, Contingent Liabilities and Contingent Assets.

Remembering reproduce what you have learnt · 1 question

- The three questions — enterprise, statement, item — are the spine of this topic. Give them in order before anything else; they organise the rest of the answer for you.
- Learn the three Companies Act sections as a trio: 129(1) present in accordance, 143(3)(e) auditor reports, 129(5) disclose deviation, reasons and financial effect.
- The ten ICDSs are a list question. If you can name them in order you have the marks; if you can only describe what ICDS is for, you have half.

Topic 2: Applications of Accounting Standards

L2P1-C3-U3-T02

Read first Read §2 Applicability of Accounting Standards, pages 3.6–3.18 — the MSME and Large classification for non-company entities effective 1 April 2024, Annexure 1, and the SMC exemptions for companies under the June 2021 MCA notification.

NOTES

Two separate schemes, and the examiner will tell you which one applies by naming the entity. Companies are classified under the **Companies (Accounting Standards) Rules, 2021** into **SMCs** and **Non-SMCs**. Non-company entities are classified under the ICAI's revised scheme into **MSMEs** and **Large entities**. Deciding which scheme applies is the first mark in every question here.

The revised non-company scheme was approved at the Council's **433rd meeting, 13–15 August 2024**, and applies to accounting periods commencing **on or after 1 April 2024**, superseding the March 2021 announcement.

MSME means a non-company entity meeting all five conditions: (i) its **equity or debt securities are not listed**, and not in the process of listing, on any stock exchange in India or outside; (ii) it is **not a bank, financial institution or insurance company**; (iii) its **turnover excluding other income does not exceed ₹250 crore** in the immediately preceding accounting year; (iv) it **does not have borrowings exceeding ₹50 crore** at any time during the immediately preceding accounting year; and (v) it is **not a holding or subsidiary of an entity that is not an MSME**. The conditions are tested **as at the end of the relevant accounting period**.

A **Large entity** is simply a non-company entity that is not an MSME, and **Large entities comply in full with all the Accounting Standards**.

Not applicable to MSMEs in their entirety: **AS 3** Cash Flow Statements, **AS 17** Segment Reporting, **AS 20** Earnings per Share, **AS 24** Discontinuing Operations. And **AS 18** Related Party Disclosures and **AS 28** Impairment of Assets are not applicable in their entirety to an MSME whose **turnover does not exceed ₹50 crore**, whose **borrowings do not exceed ₹10 crore**, and which is not a holding or subsidiary of an MSME outside those limits.

Relaxations rather than exclusions apply to MSMEs under **AS 10** (encouraged disclosures), **AS 11**, **AS 15**, **AS 19**, **AS 22**, **AS 26**, **AS 28** and **AS 29**. **AS 14** and jointly controlled operations and assets under **AS 27** are treated as not applicable to MSMEs because such transactions generally do not arise — **but if they do arise, the entity must apply the standard**.

The four disclosure conditions attached to availing MSME relief — these are regularly asked: (1) an MSME availing exemptions must **disclose by note** that it is an MSME and has complied so far as applicable; (2) an entity that **ceases** to be an MSME applies the relevant standards from the current period, need not revise the previous period's figures, but must **disclose both facts**; (3) an entity that **becomes** an MSME is **not qualified for relief until it has remained an MSME for two consecutive years**; (4) an MSME availing relief for some but not all standards must **disclose which**

standards it has availed relief on.

For companies — the SMC position: AS 17 Segment Reporting is the only standard not applicable to SMCs in its entirety. Relaxations are given under **AS 15** (short-term accumulating non-vesting compensated absences; discounting beyond 12 months; defined benefit plans, though the accrued liability must still be determined actuarially by the **Projected Unit Credit Method** with the discount rate by reference to market yields on **government bonds**), **AS 19** (certain disclosures), **AS 20** (**diluted EPS disclosure exempted**), **AS 28** (value in use on a **reasonable estimate** rather than by present value technique) and **AS 29** (paragraphs 66 and 67 disclosures).

AS 25 Interim Financial Reporting does not require any company to present an interim report — it applies only where a company is **required by a regulator or elects** to do so. Only certain Non-SMCs are required, for example quarterly results under SEBI, and the recognition and measurement requirements then apply to them.

Non-SMCs comply with all the standards in their entirety. That is the sentence to open a company-classification answer with.

Analysis break it down and examine the interrelationships · 2 questions

- Classification questions are worked condition by condition. Take the five MSME tests in order, state the figure given against each, and say which one fails — an entity fails MSME status the moment any single condition is not met.
- Say which scheme you are applying before you classify. Applying the SMC criteria to a partnership, or the MSME criteria to a company, loses the whole answer however good the arithmetic.
- Where the question gives figures for more than one entity, answer each in its own short paragraph with a stated conclusion. The examiner marks each entity separately.

TQ 2.1 · PYQ 2021-Jan [6] (d) · DESC · 5M · Pg 31

LEVEL II
Analysis

Medium

PQ 2.1 · RTP 2024-May [5] · Pg 32

LEVEL II
Analysis

Medium

Evaluation judge it against the standard · 1 question

- When asked whether an entity may avail a relaxation, deal with eligibility and with the disclosure conditions as two separate limbs. Most candidates answer the first and forget that the relief carries a disclosure obligation.
- The two-consecutive-years rule and the ceasing-to-be-an-MSME rule are the traps. If the question tells you an entity has just crossed or just fallen below a threshold, that is what it is testing.
- State the conclusion plainly — applicable, not applicable, or applicable with relaxation — and name the standard. A discussion that never lands on an answer scores poorly here.

TQ 2.2 · PYQ 2023-Nov [6] (Or) (b) · DESC · 5M · Pg 31

LEVEL II

Hard

Evaluation

CHAPTER 4

Presentation & Disclosures Based Accounting Standards

7 Topics • 63 Classified Questions • Importance: A

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **19.3%** 70 of 362 marks

Level II — Analysis & Application **80.7%** 292 of 362 marks

Above the paper's Level I ceiling: 19% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. The theory here is not padding around the problems — it is a fifth or more of what the chapter is worth. Do not prepare this chapter by working sums alone.

Topic 1: AS 1- Disclosures of Accounting Policies

L2P1-C4-U4-T01

Read first Read Chapter 4 Unit 1, AS 1 Disclosure of Accounting Policies, Study Material pages 4.1–4.19 — §1.3 Accounting Policies, §1.4 Selection of Accounting Policy, §1.5 Disclosure of Changes and §1.6 Disclosure of Deviations from Fundamental Accounting Assumptions.

NOTES

What an accounting policy is: the **specific accounting principles and the methods of applying those principles** adopted by an enterprise in preparing and presenting its financial statements. Inventory costed on FIFO or weighted average, a cash flow statement by the direct or indirect method — each is a policy choice, and the list is endless.

Why policies differ between enterprises: accounting is both science and art. The principles are tested and universal, but **their application depends on the judgement of each accountant**, so different enterprises in the same industry follow different policies. The ICAI and the Government have reduced the number of alternatives but **cannot reduce them to one**, and the policy adopted has a considerable effect on the reported result — which is what makes two sets of statements hard to compare.

Three considerations govern the selection of a policy — this is the three-part answer the examiner wants: **prudence, substance over form and materiality.**

Prudence: in view of the uncertainty attaching to future events, **profits are not anticipated but losses are provided for**. Provision is made for all known liabilities and losses even where the amount cannot be determined with certainty and is only a best estimate. Prudence ensures that **profits are not overstated, losses are not understated, assets are not overstated and liabilities are not understated** — four limbs, and the examiner expects all four.

The classic illustration of prudence is valuing inventory at the **lower of cost and net realisable value**: 500 units bought at ₹10, 400 sold at ₹15. If NRV of the unsold 100 is ₹15 the stock stays at ₹10 and the ₹500 of next year's profit is **ignored**; if NRV is ₹8 the stock comes down to ₹8 and the ₹200 possible loss is **recognised now**. Profit ₹2,000 in the first case, ₹1,800 in the second.

The limit on prudence, which is examined as often as prudence itself: prudence does not permit the creation of hidden reserves by understating profits and assets or overstating liabilities and losses. No provision for damages should be made unless **the probability of losing the suit exceeds the probability of not losing it**.

Substance over form: transactions and events are accounted for and presented **in accordance with their substance and financial reality, not merely their legal form**. The Study Material's example is a sale and leaseback: a company 'sells' a building for ₹5 crore and leases it back for 20 years, the building's whole remaining life, with payments that return the bank its money plus a return. In substance this is **a loan secured on the building, not a sale** — the building stays on the seller's balance sheet, the ₹5 crore is a financial liability, **no profit on sale is recognised**, and interest is charged over the lease term.

Disclosure of a change in policy — learn the decision tree, because the question is almost always which branch applies: a change that has a **material effect in the current period** must be disclosed, together with **the amount by which any item is affected, to the extent ascertainable**; where that amount is **not ascertainable wholly or in part, the fact must be indicated**. A change that is **not material now but is reasonably expected to have a material effect in a later period** must still be disclosed **in the current period**.

What a good disclosure looks like: not merely 'the policy has been changed', but the old method, the new method, why the new one is better and the effect in figures — 'the company has changed to weighted average, which better reflects the consumption pattern of inventory, from the earlier practice of FIFO; the change has reduced profit and the value of inventory by ₹20,000'. Reproduce that shape in the answer; a bare statement of change earns little.

Deviation from the fundamental assumptions: if going concern, consistency and accrual **are** followed, **no specific disclosure is required**. If any one is **not** followed, **the fact must be disclosed**.

Understanding explain it, and place it in context · 1 question

- Almost every question here is answered in the same three moves: state the AS 1 requirement, apply it to the facts, then give the disclosure in the company's own words. The third move is where most marks are lost.
- Where prudence is the issue, give all four limbs — profits not overstated, losses not understated, assets not overstated, liabilities not understated — and then the hidden-reserve limit.
- For substance over form, name the substance first and the legal form second, and say which one the accounts must follow.

TQ 1.1 · RTP 2025-May [4] · DESC · Pg 39

LEVEL I
Understanding**Hard****Application** use the rule — work the problem · 2 questions

- A change-in-policy question is a two-part answer: the figures showing the effect, and the drafted disclosure note. Write the note out in full — it is worth as much as the calculation.
- Where the amount of the effect is not ascertainable, say so explicitly and state that the fact must be indicated. That is the answer, not a failure to answer.

PQ 1.3 · MTP 2022-Mar [1] (a) {C} · 5M · Pg 43

LEVEL II
Application**Easy**

PQ 1.4 · PYQ 2023-May [6] (a) · 5M · Pg 44

LEVEL II
Application**Hard****Analysis** break it down and examine the interrelationships · 5 questions

- Distinguish a change in accounting policy from a change in estimate before anything else; the disclosure consequences are different and the examiner is often testing exactly that boundary.
- Where several changes are listed together, deal with each separately and say for each whether it is a policy change, an estimate change, or neither.

PQ 1.1 · PYQ 2018-Nov [1] (c) {C} · 5M · Pg 40

LEVEL II
Analysis**Easy**

PQ 1.2 · PYQ 2021-Dec [1] (d) {C} · 5M · Pg 41

LEVEL II
Analysis**Easy**

PQ 1.6 · PYQ 2023-Nov [5] (b) · 5M · Pg 46

LEVEL II
Analysis**Easy**

TQ 1.2 · MTP 2025-Aug S2 [6] (c) · DESC · 4M · Pg 40

LEVEL II
Analysis**Medium**

PQ 1.5 · RTP 2023-May [16] (a) · Pg 45

LEVEL II
Analysis**Medium****Evaluation** judge it against the standard · 1 question

- When a board changes policies to convert a deficit into the surplus it projected, the answer is not merely arithmetic. Say whether each change is a genuine policy change properly disclosed or a device to manufacture a result, and use the hidden-reserve limit and the true and fair view requirement to justify the conclusion.
- State plainly whether the treatment is acceptable under AS 1. An answer that lists considerations without concluding scores poorly.

PQ 1.7 · RTP 2025-Sep [5] · Pg 47

LEVEL II
Evaluation**Hard**

Topic 2: AS 3- Cash Flow Statement

L2P1-C4-U4-T02

Read first Read Chapter 4 Unit 2, AS 3 Cash Flow Statements, Study Material pages 4.20–4.47 — §2.3 Cash and cash equivalents, §2.5 Types of cash flow, §2.7 Direct and indirect method, §2.8 Reporting on a net basis, §2.10 Exchange gains and losses and §2.11 Disclosures.

NOTES

Cash and cash equivalents for this purpose are (a) **cash in hand and deposits repayable on demand** with any bank or other financial institution, and (b) **cash equivalents — short-term, highly liquid investments readily convertible into known amounts of cash and subject to insignificant risk of change in value**. A short-term investment is one due for maturity within three months from the date of acquisition. That three-month test is the single most examined line in the unit.

Investments in shares are not normally cash equivalents, because of the uncertainty attaching to their realisable value.

Cash and cash equivalents is at least three balance sheet items — cash in hand, demand deposits, and investments regarded as cash equivalents — which is why AS 3 requires a **break-up of opening and closing cash**, given as a note to the statement.

Three types of cash flow, and why the split matters: operating, investing, financing. The implication of each is different — cash from disposing of a useful fixed asset is likely to harm future performance and is nothing like cash from operating income — and they interact: borrowed cash spent on operating expenses is not the same as borrowed cash spent on a useful fixed asset.

Operating activities are the principal revenue-producing activities, and operating cash flows are those generated by them or by anything that is not investing or financing.

Direct method: gross receipts from sales, trade receivables and other operating inflows, less gross payments for purchases, creditors and other expenses, **ignoring all non-cash items** such as depreciation and provisions. **Indirect method:** start from net profit or loss, **eliminate non-cash, investing and financing items** — add back depreciation, provisions, interest paid, loss on sale of assets; deduct interest received — then adjust for changes in working capital, ignoring cash and cash equivalents.

Which is preferred, and why: the direct method, because it gives a clear picture of the sources of inflows and outflows, which helps in estimating future cash flows. Say 'preferred' and give that reason — it is a standing one-mark question.

Netting is forbidden for investing and financing activities: ₹50,000 paid for machinery and ₹10,000 realised on furniture is **not** shown as a net ₹40,000 outflow. **Two general exceptions** — receipts and payments **on behalf of customers** (a bank's acceptances and repayment of demand deposits), and items where **turnover is quick, amounts are large and maturities short** (an investment company buying and selling investments). **Three further exceptions for financial enterprises**,

including fixed deposits with a fixed maturity date and placements and withdrawals of deposits.

Exchange gains and losses — the point students miss: foreign currency monetary items are recorded at the transaction-date rate and restated at the balance sheet date rate, with the difference taken to the statement of profit and loss. Foreign currency cash balances are restated the same way, **but the change in cash arising from exchange differences is not a cash flow**. So the net increase or decrease shown in the cash flow statement is **stated exclusive of exchange gains and losses**, and the resulting difference against the balance sheet figure is **reconciled in the note**.

Disclosures: the amount of **significant cash and cash equivalent balances not available for use**, with a management commentary — bank balances held abroad under exchange control, for instance. AS 3 **encourages** disclosure of **undrawn borrowing facilities** available for future operating activities and capital commitments, with any restrictions, and of cash flows required for **maintaining** operating capacity separately from those that **increase** it.

Application use the rule — work the problem · 6 questions

- Follow the printed AS 3 format and label every subtotal. Marks are given for the structure — cash from operating, investing and financing, then net increase, then opening and closing balances — as much as for the arithmetic.
- Under the indirect method, work in a fixed order: net profit before tax and extraordinary items, non-cash adjustments, investing and financing items removed, working capital changes, tax paid. Deviating from that order is where errors creep in.
- Interest and dividends need a stated policy: say where you have classified them and stay consistent throughout the statement.
- Do not net investing or financing flows. Show the purchase and the sale separately even when the question presents them together.

PQ 2.2 · PYQ 2019-Nov [1] {C} · 5M · Pg 51	LEVEL II Application	Easy
PQ 2.3 · PYQ 2021-Dec [1] (b) {C} · 5M · Pg 52	LEVEL II Application	Easy
PQ 2.4 · MTP 2022-Mar [1] (c) {C} · 5M · Pg 53	LEVEL II Application	Easy
PQ 2.6 · MTP 2023-Mar [1] (a) {C} · 5M · Pg 56	LEVEL II Application	Easy
PQ 2.7 · MTP 2023-Mar [5] (a) · 15M · Pg 57	LEVEL II Application	Hard
PQ 2.9 · PYQ 2026-Sep [4] (a) · 10M · Pg 60	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 4 questions

- Classification questions are answered item by item: name the activity — operating, investing, financing or cash equivalent — and give the one-line reason. Never give the list without the reasons.
- The three-month maturity test decides most cash-equivalent questions. Quote it.
- When asked whether an item belongs in operating, investing or financing, test it against the definition of operating activities first — principal revenue-producing activities — and only then consider the other two.
- Exchange differences on cash balances are the standard trap: restate the balance, but keep the difference out of the cash flows and reconcile it in the note.

PQ 2.1 · PYQ 2018-May [6] (e) · 5M · Pg 50	LEVEL II Analysis	Easy
PQ 2.5 · PYQ 2022-Nov [1] (b) {C} · 5M · Pg 55	LEVEL II Analysis	Easy
TQ 2.1 · RTP 2024-Sep [4] · DESC · Pg 49	LEVEL II Analysis	Medium
PQ 2.8 · RTP 2025-Jan [4] · Pg 59	LEVEL II Analysis	Medium

Topic 3: AS 17- Segment Reporting

L2P1-C4-U4-T03

Read first Read Chapter 4 Unit 3, AS 17 Segment Reporting, Study Material pages 4.48–4.77 — §3.4 Definitions, §3.5 Treatment of interest, §3.6 Allocation, §3.7 Primary and secondary segments, §3.9 Identifying reportable segments, §3.11–3.13 Disclosures.

NOTES

The quantitative thresholds — the whole of the practical work in this unit. A business or geographical segment is a **reportable segment** if **any one** of three tests is met: (a) its **revenue** from external customers and from transactions with other segments is **10% or more** of the total revenue, external and internal, of all segments; or (b) its **segment result**, profit or loss, is **10% or more** of the combined result of all segments in profit, or of all segments in loss, **whichever is greater in absolute amount**; or (c) its **segment assets** are **10% or more** of the total assets of all segments.

Read test (b) carefully. The comparison is against the greater in absolute amount of the combined profit of the profit-making segments and the combined loss of the loss-making segments — **not** against the net figure. Getting that denominator wrong is the commonest error in the whole unit.

Management discretion: a segment that fails all three tests **may still be designated** reportable at the discretion of management. If it is not so designated, it is **included as an unallocated**

reconciling item.

The 75% test — Step II, and it is not optional: if the total **external** revenue attributable to reportable segments is **less than 75% of total enterprise revenue**, **additional segments must be identified as reportable**, even though they fail the 10% thresholds, **until at least 75% of total enterprise revenue is included**.

So the method is two steps, always in this order: Step I apply the 10% materiality test, any one of the three sufficing; Step II check the 75% coverage test and add segments until it is satisfied. An answer that stops after Step I is incomplete however accurate its percentages.

Primary and secondary formats: the dominant source and nature of the enterprise's risks and returns decides whether **business segments** or **geographical segments** are primary; the other becomes secondary. The primary format carries the fuller disclosure, the secondary format a reduced set.

Interest: 3.5 of the Study Material sets out when interest is included in segment revenue and expense — read it before attempting a segment result computation, because interest is the item most often misallocated.

Allocation: segment revenue, expense, assets and liabilities are determined **before intra-group balances and transactions are eliminated**, except where they are within a single segment. Items that cannot be allocated on a reasonable basis are **unallocated** and are reconciled, not forced into a segment.

Remembering reproduce what you have learnt · 1 question

- The three 10% tests and the 75% test are a memorised set. Write them down before touching the figures — candidates who compute first and recall the rule afterwards routinely use the wrong denominator.

PQ 3.7 · PYQ 2023-Nov [1] (d) {C} · 5M · Pg 68

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 4 questions

- Explain why any ONE of the three tests suffices, and why the 75% test exists — to stop an enterprise reporting so few segments that the disclosure loses its purpose.
- Set the work out as a table: segment, revenue and its percentage, result and its percentage, assets and their percentage, then a reportable yes or no with the test that carried it. The examiner marks the table.
- For the result test, compute the combined profit of profit-making segments and the combined loss of loss-making segments separately, state which is greater in absolute amount, and use that as the denominator. Show that step — it carries its own mark.
- Finish with the 75% check and say whether any further segment must be added.

PQ 3.3 • PYQ 2020-Nov [1] (c) {C} • 5M • Pg 64	LEVEL I Understanding	Easy
PQ 3.5 • PYQ 2022-May [6] (a) • 5M • Pg 67	LEVEL I Understanding	Easy
TQ 3.2 • RTP 2024-Sep [13] • DESC • Pg 63	LEVEL I Understanding	Medium
TQ 3.1 • RTP 2022-May [15] (a) • DESC • Pg 62	LEVEL I Understanding	Hard

Evaluation judge it against the standard • 4 questions

- Where the question asks whether the enterprise's identification of segments is correct, work the tests yourself and then say plainly which segments were wrongly included or omitted.
- Management's discretion to designate a segment reportable is a real answer where the facts point to it — but say what happens if it is not designated: an unallocated reconciling item.

PQ 3.1 • PYQ 2018-May [6] (d) • 5M • Pg 63	LEVEL II Evaluation	Easy
PQ 3.4 • PYQ 2021-Jan [1] (c) {C} • 5M • Pg 66	LEVEL II Evaluation	Easy
PQ 3.6 • PYQ 2023-May [1] (d) {C} • 5M • Pg 67	LEVEL II Evaluation	Easy
PQ 3.2 • RTP 2018-May [20] (a) • Pg 64	LEVEL II Evaluation	Medium

Topic 4: AS 18- Related Party Disclosures

L2P1-C4-U4-T04

Read first Read Chapter 4 Unit 4, AS 18 Related Party Disclosures, Study Material pages 4.78–4.102 — §4.3 Related party relationships, §4.4 Who are not deemed related parties, §4.5 Exemptions, and §4.8 the list of related party transactions and disclosures.

NOTES

The definition: parties are related if **at any time during the reporting period** one party has the ability to **control** the other, or to exercise **significant influence** over it, in making **financial and/or operating decisions**. Note 'at any time during the reporting period' — a relationship that existed for part of the year still brings the disclosure.

AS 18 applies to a definitive list of five relationships, and nothing outside it: (a) enterprises that **directly or indirectly through intermediaries control, are controlled by, or are under common control with** the reporting enterprise — holding companies, subsidiaries and fellow subsidiaries; (b) **associates and joint ventures** of the reporting enterprise, and the investing party or venturer in respect of which the reporting enterprise is an associate or joint venture; (c) **individuals owning an**

interest in the voting power that gives them control or significant influence, and their relatives; (d) **key management personnel** and their relatives; and (e) **enterprises over which any person in (c) or (d) is able to exercise significant influence**.

Who is NOT a related party — the examiner's favourite territory: (a) **two companies merely having a director in common — unless that director is able to affect the policies of both companies in their mutual dealings**, in which case the relationship does exist; (b) **a single customer, supplier, franchiser, distributor or general agent** with whom the enterprise transacts a significant volume of business **merely by virtue of the resulting economic dependence**; (c) the other parties the Study Material lists at 4.4.

The common-director point is a conditional exclusion, not an absolute one. Answer it in two sentences: mere commonality is not enough; ability to influence both companies' policies in their mutual dealings makes them related.

Exemption from disclosure: the requirements **do not apply where disclosure would conflict with the reporting enterprise's duties of confidentiality** as specifically required by statute, by a regulator or by a similar competent authority. Banks obliged by law to maintain customer confidentiality are the standing example.

What must be disclosed: the **name of the related party** and the **nature of the relationship** where control exists, **irrespective of whether there have been transactions** — that last clause is regularly tested. Where there have been transactions, disclose the **nature of the transactions and of the outstanding items**, the **volume** either as an amount or as a proportion, the **amounts written off or written back** in respect of debts due from or to related parties, and any other elements necessary for understanding.

Aggregation: items of a similar nature may be disclosed in aggregate **by type of related party**, except where separate disclosure is necessary to understand the effect on the financial statements.

Understanding explain it, and place it in context · 6 questions

- Answer 'who is a related party' with the five categories, then the exclusions. Both halves are marked.
- The control-or-significant-influence test and the 'at any time during the reporting period' qualifier should both appear in the opening sentence.
- The common-director and the economic-dependence exclusions are what most of these questions turn on. Look for them first, then check whether the facts take the case back out of the exclusion.
- Watch for relatives of key management personnel and for enterprises over which a KMP has significant influence — they are inside the definition and often overlooked.

TQ 4.3 · PYQ 2026-Sep [6] (a) · DESC · 4M · Pg 71

LEVEL I
Understanding

Easy

PQ 4.1 · PYQ 2018-Nov [1] (c) {C} · 5M · Pg 72

LEVEL I

Easy

	Understanding	
PQ 4.2 · PYQ 2019-May [1] (d) {C} · 5M · Pg 72	LEVEL I Understanding	Easy
TQ 4.2 · RTP 2026-Jan [14] · DESC · Pg 70	LEVEL I Understanding	Medium
TQ 4.1 · RTP 2022-May [16] (a) · DESC · Pg 69	LEVEL I Understanding	Hard
PQ 4.7 · PYQ 2025-Jan [6] (a) · 4M · Pg 77	LEVEL I Understanding	Hard

Application use the rule — work the problem · 3 questions

- Identification questions are worked case by case: state the relationship, decide related or not, and name the limb of the definition or the exclusion that decides it. One line each, in the order the question gives them.
- Where control exists, say that the name and nature of the relationship must be disclosed even if there were no transactions in the year. That is a mark on its own.

PQ 4.3 · PYQ 2021-Jul [1] (d) {C} · 5M · Pg 73	LEVEL II Application	Easy
PQ 4.6 · MTP 2023-Sep [1] (c) {C} · 5M · Pg 77	LEVEL II Application	Easy
PQ 4.8 · RTP 2025-Jan [13] · Pg 78	LEVEL II Application	Medium

Evaluation judge it against the standard · 2 questions

- Where a company claims an exemption, test it against the confidentiality provision — required by statute, regulator or similar competent authority — and say whether the claim holds.
- Conclude on each party named in the question. A general discussion of AS 18 without a party-by-party conclusion loses most of the marks.

PQ 4.4 · MTP 2023-Mar [1] (a) {C} · 5M · Pg 74	LEVEL II Evaluation	Easy
PQ 4.5 · PYQ 2023-May [1] (c) {C} · 5M · Pg 75	LEVEL II Evaluation	Easy

Topic 5: AS 20- Earnings Per Share

L2P1-C4-U4-T05

Read first Read Chapter 4 Unit 5, AS 20 Earnings Per Share, Study Material pages 4.103–4.136 — \$5.3 Earnings-basic, \$5.4 Per share-basic, \$5.5 Shares issued in a scheme, \$5.6–5.9 Diluted EPS, \$5.10 Restatement, \$5.11–5.12 Presentation and disclosure.

NOTES

Basic EPS — the numerator: all items of income and expense recognised in the period, **including tax expense and extraordinary items**, enter net profit or loss unless AS 5 requires otherwise. From that, **preference dividends and any attributable tax are deducted** to reach the profit attributable to equity shareholders.

The preference dividend rule, which differs by type of share and is examined constantly: for **non-cumulative** preference shares, deduct the amount **provided for** in respect of the period; for **cumulative** preference shares, deduct **the full amount of the required dividend for the period, whether or not it has been provided for or declared**.

Basic EPS — the denominator: the **weighted average number of equity shares outstanding** during the period — shares at the beginning, adjusted for shares **issued or bought back** during the period, multiplied by a **time-weighting factor** of days outstanding over days in the period. The Standard defines the factor on a daily basis but **accepts a reasonable approximation** in many circumstances.

Events that change the number of shares without changing resources — a **bonus issue**, a **share split** or a **consolidation** — are treated as if they had occurred **at the beginning of the earliest period reported**, and **prior period EPS is restated**. No time-weighting applies to them. **A rights issue is different:** it carries a bonus element, so the shares before the rights issue are multiplied by the **bonus adjustment factor** — fair value immediately before exercise divided by theoretical ex-rights fair value.

Diluted EPS — adjust both halves. The **numerator** is increased by dividends recognised on dilutive potential equity shares, by interest recognised on them, and by any other change in income or expense that would follow conversion — each **as adjusted for the attributable change in tax**. The **denominator** is increased by the weighted average number of shares that would be issued on conversion of all dilutive potential equity shares.

Dilutive means dilutive. Potential equity shares are included only if their conversion would **decrease net profit per share from continuing ordinary operations**; **anti-dilutive potential shares are ignored**. Test each class separately and in order of dilution — the most dilutive first.

Presentation and disclosure: basic and diluted EPS are presented **on the face of the statement of profit and loss, with equal prominence**, for every period presented, **even where the amounts are negative**. Disclose the amounts used as numerators and their reconciliation to net profit, and the weighted average number of shares used as denominators and their reconciliation to each other.

SMC relief to remember from Chapter 3: disclosure of **diluted EPS is exempted for SMCs** — both including and excluding extraordinary items.

Application use the rule — work the problem · 18 questions

- Build the answer in four visible steps: earnings attributable to equity shareholders, weighted average number of shares, basic EPS, then the diluted computation. Label each; the examiner awards them separately.

- Deal with the preference dividend before anything else, and say whether the shares are cumulative or non-cumulative — the treatment differs and stating the reason earns the mark.
- For a bonus issue, split or consolidation, restate from the beginning of the earliest period presented and say so in words. For a rights issue, compute the theoretical ex-rights price and the adjustment factor as a separate working.
- Show the weighted average calculation as a small table of dates, shares and time-weighting factors rather than as a single line of arithmetic. It is easier to mark and easier to correct.
- Test each potential equity share for dilution and state the conclusion. Including an anti-dilutive instrument is a substantive error, not an arithmetic slip.
- Present basic and diluted EPS together at the end, with equal prominence, even where one of them is negative.

PQ 5.1 · PYQ 2018-May [1] (b) {C} · 5M · Pg 80	LEVEL II Application	Easy
PQ 5.2 · PYQ 2018-Nov [1] (a) {C} · 5M · Pg 81	LEVEL II Application	Easy
PQ 5.3 · PYQ 2019-Nov [1] (d) {C} · 5M · Pg 82	LEVEL II Application	Easy
PQ 5.5 · PYQ 2021-Dec [6] (d) · 5M · Pg 85	LEVEL II Application	Easy
PQ 5.8 · PYQ 2022-Nov [1] (c) {C} · 5M · Pg 88	LEVEL II Application	Easy
PQ 5.11 · PYQ 2024-May [6] (Or) (a) · 4M · Pg 91	LEVEL II Application	Easy
PQ 5.13 · PYQ 2025-Jan [1] (a) {C} · 5M · Pg 94	LEVEL II Application	Easy
PQ 5.15 · PYQ 2026-Jan [1] (c) {C} · 5M · Pg 97	LEVEL II Application	Easy
TQ 5.1 · RTP 2021-May [17] · DESC · Pg 79	LEVEL II Application	Medium
PQ 5.4 · RTP 2020-May [17] (b) · Pg 83	LEVEL II Application	Medium
PQ 5.6 · PYQ 2022-May [1] (b) {C} · 5M · Pg 85	LEVEL II Application	Medium
PQ 5.7 · RTP 2022-May [18] (a) · Pg 87	LEVEL II Application	Medium
PQ 5.9 · PYQ 2023-Nov [1] (a) {C} · 5M · Pg 89	LEVEL II Application	Medium
PQ 5.10 · RTP 2023-Nov [17] · Pg 90	LEVEL II Application	Medium
PQ 5.14 · RTP 2025-Jan [15] · Pg 96	LEVEL II Application	Medium

PQ 5.16 · RTP 2026-Jan [16] · Pg 98

LEVEL II
Application

Medium

PQ 5.17 · PYQ 2026-Sep [1] (c) {C} · 4M · Pg 99

LEVEL II
Application

Medium

PQ 5.12 · RTP 2024-Sep [14] · Pg 93

LEVEL II
Application

Hard

Topic 6: AS 24- Discontinuing Operations

L2P1-C4-U4-T06

Read first Read Chapter 4 Unit 6, AS 24 Discontinuing Operations, Study Material pages 4.137–4.152 — §6.2 Discontinuing operation, §6.3 Initial disclosure event, §6.4 Recognition and measurement, §6.5–6.9 Presentation, disclosure and restatement.

NOTES

A discontinuing operation is a component of an enterprise that satisfies all three limbs. (a) Pursuant to a single plan the enterprise is disposing of it **substantially in its entirety** — by sale in a single transaction, demerger or spin-off — or **piecemeal**, by selling assets and settling liabilities individually, or is **terminating it through abandonment**; (b) it **represents a separate major line of business or geographical area of operations**; and (c) it **can be distinguished operationally and for financial reporting purposes**.

All three limbs must be satisfied. The Study Material's example makes the point: a chain of restaurants sells its stake in **one** restaurant contributing about **5%** of revenue, with no intention of selling others. That is neither disposal under a single plan of a substantial entirety nor a separate major line of business — **so it is not a discontinuing operation**. Quote that reasoning; the examiner sets the same fact pattern repeatedly.

The initial disclosure event is the **earlier** of: (a) the enterprise entering into a **binding sale agreement** for substantially all of the assets attributable to the discontinuing operation; or (b) the **board of directors or similar governing body** having **both approved a detailed formal plan and announced it**. Both conditions in (b) are required — approval alone is not the event.

What a detailed formal plan normally contains: identification of the **major assets to be disposed of**, the **expected method of disposal**, the **period expected to be required for completion**, and the further particulars the Study Material lists at **6.3**. **A plan missing these elements is not a detailed formal plan.**

Recognition and measurement are not changed by AS 24 — the standard governs **presentation and disclosure**. Impairment is assessed under AS 28, provisions under AS 29, and so on. Say this when asked what AS 24 requires to be recognised: it is a disclosure standard.

Separate disclosure is required for each discontinuing operation, and the disclosures are **updated in each subsequent period** until the discontinuance is completed. Prior period figures are **restated**

to segregate the continuing and discontinuing amounts.

In interim financial reports, the AS 24 disclosures continue to be given — the link back to AS 25 is worth a line in an answer.

Remembering reproduce what you have learnt • 1 question

- The three limbs of the definition and the two alternatives for the initial disclosure event are quotable. Write them out before applying them.

TQ 6.1 • PYQ 2026-Jan [6] (a) • DESC • 4M • Pg 100

LEVEL I
Remembering

Easy

Evaluation judge it against the standard • 4 questions

- These questions give facts and ask whether there is a discontinuing operation. Take the three limbs in order, say which is or is not satisfied and why, then conclude — do not conclude first.
- Where the question turns on timing, identify the initial disclosure event precisely and give the date, remembering that board approval without announcement is not enough.
- A component that is significant in revenue but is not a separate major line of business still fails the test. Say so rather than being drawn by the percentage.

PQ 6.1 • RTP 2018-May [18] • Pg 101

LEVEL II
Evaluation

Medium

PQ 6.2 • RTP 2021-May [19] (a) • Pg 103

LEVEL II
Evaluation

Medium

PQ 6.4 • PYQ 2026-May [5] (b) • 10M • Pg 105

LEVEL II
Evaluation

Medium

PQ 6.3 • PYQ 2021-Jul [1] (b) {C} • 5M • Pg 104

LEVEL II
Evaluation

Hard

Topic 7: AS 25- Interim Financial Reporting

L2P1-C4-U4-T07

Read first Read Chapter 4 Unit 7, AS 25 Interim Financial Reporting, Study Material pages 4.153–4.171 — §7.3 Content, §7.6 Periods to be presented, §7.7 Materiality, §7.9 Accounting policies, §7.10 Seasonal revenue and §7.11 Costs incurred unevenly.

NOTES

AS 25 does not require anyone to produce an interim report. It applies **only where an enterprise is required by a regulator, or elects, to prepare one** — quarterly results under SEBI, for example. Open any answer on applicability with that sentence.

Periods to be presented — the table is the answer: **balance sheet** as at the end of the current interim period, with a comparative as at the **end of the immediately preceding financial year**; **statement of profit and loss** for the current interim period **and cumulatively for the year to date**, with comparatives for the **comparable interim period and year-to-date of the immediately preceding financial year**; **cash flow statement** cumulatively for the year to date, with the comparable year-to-date comparative.

Note what the balance sheet comparative is: the end of the **preceding financial year**, not the corresponding interim date. That single asymmetry is the most frequently examined point in the unit.

Accounting policies: the same policies are applied in the interim statements as in the annual statements, except for changes made after the date of the most recent annual statements that are to be reflected in the next annual statements.

Revenue received seasonally or occasionally — dividend revenue, royalties, government grants, or a retailer's seasonal takings — **must not be anticipated or deferred at an interim date if anticipation or deferral would not be appropriate at the year end**. Such revenues are recognised when they occur.

Costs incurred unevenly during the year are **anticipated or deferred for interim reporting purposes if, and only if, it would also be appropriate to anticipate or defer that type of cost at the year end**. A cost that does not meet the definition of an asset at the end of an interim period is **not deferred** — neither to await future information about whether it will become an asset, nor to smooth earnings between interim periods.

Materiality is judged **in relation to the interim period financial data**, not to the annual figures. Interim measurements may rely on estimates to a greater extent than annual measurements, but the reliability of the information must not be compromised.

Remember the applicability position from Chapter 3: AS 25 does not require a company to present an interim report; only certain Non-SMCs are required by their regulators to do so, and the recognition and measurement requirements then apply to them.

Application use the rule — work the problem · 1 question

- Set out the periods in the table form the Study Material uses — statement, current period, comparative period. It is faster to write and it is what the examiner expects to see.
- Where the question concerns a seasonal receipt or an uneven cost, state the year-end test first — would anticipation or deferral be appropriate at the year end? — and let the answer follow from it.
- Say explicitly that a cost failing the definition of an asset is not deferred to smooth earnings. That sentence is usually the mark.

CHAPTER 5

Assets Based Accounting Standards

7 Topics • 117 Classified Questions • Importance: A

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **on profile**

Level I — Comprehension & Knowledge

13.5%

92 of 686 marks

Level II — Analysis & Application

86.5%

594 of 686 marks

This chapter sits inside the paper's own profile — 13% Level I against a 5–15% band. Prepare it in the paper's proportions: a little theory, a great deal of application.

Topic 1: AS 2-Valuation of Inventories

L2P1-C5-U5-T01

Read first Read Chapter 5 Unit 1, AS 2 Valuation of Inventories, Study Material pages 5.1–5.27 — §1.3 Measurement, §1.4–1.8 Costs, §1.9 Exclusions, §1.10 Cost formula, §1.12–1.14 Net realisable value, §1.15 Disclosures.

NOTES

The rule in one line: inventories are valued at the **lower of cost and net realisable value**. NRV is the **estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale**. The principle behind it: **no asset should be carried at a value in excess of what is realisable by its sale or use**.

Cost of inventories comprises **costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition**. Everything in a costing question is decided by that last phrase — ask of each item whether it helped bring the goods to their present location and condition.

Four exclusions, and they are the marks in most costing questions: (a) **abnormal** amounts of wasted materials, labour or other production costs; (b) **storage costs, unless the production process requires such storage**; (c) **administrative overheads that do not contribute** to bringing inventories to their present location and condition; (d) **selling and distribution costs**. Note the two conditional ones — storage that the process requires **is** included, and administrative overheads that **do** contribute are included.

Cost formula: where units can be identified, **specific identification is best**. Otherwise cost is determined by **FIFO or weighted average**. The formula chosen **should reflect the fairest possible approximation to the cost incurred** in bringing the items to their present location and condition. **LIFO is not permitted**.

The comparison of cost with NRV is made item by item, though it may be appropriate to **group similar or related items**. It is never made on a **global basis** — comparing total cost with total NRV

is the classic wrong answer, because it lets a gain on one item mask a loss on another.

Materials held for use in production are not written down below cost if the finished product in which they will be incorporated is expected to sell at or above cost. Where the finished goods are expected to sell below cost, the materials are written down, and **replacement cost may be the best available measure of their NRV.**

NRV is reassessed at each balance sheet date, so a write-down made in an earlier year is revisited rather than carried forward untouched.

Disclosure: the **accounting policy adopted**, including the cost formula used, and the **total carrying amount** with the classifications appropriate to the enterprise.

Understanding explain it, and place it in context · 1 question

- Quote the definition of NRV in full — estimated selling price, less estimated costs of completion, less estimated costs necessary to make the sale. All three limbs carry marks.
- Be able to say why the comparison is item by item and not global.

TQ 1.1 · RTP 2022-May [17] (c) · DESC · Pg 110

LEVEL I
Understanding

Medium

Application use the rule — work the problem · 16 questions

- Build the cost figure as a visible schedule: purchase cost, conversion cost, other costs, then each excluded item shown as excluded with its reason. The examiner marks the exclusions as much as the inclusions.
- Abnormal wastage, storage that the process does not require, non-contributing administrative overheads and selling and distribution costs come out. Say so item by item rather than silently omitting them.
- Do the cost-versus-NRV comparison item by item and present it as a three-column table — cost, NRV, inventory value. Never total the columns first.
- For raw materials, decide first whether the finished product will sell at or above cost. If it will, the material stays at cost however low its own replacement price has fallen — and that reasoning is the answer, not the number.

PQ 1.1 · MTP 2019-Mar [1] (d) {C} · 5M · Pg 112

LEVEL II
Application

Easy

PQ 1.3 · PYQ 2021-Jan [1] (c) {C} · 5M · Pg 114

LEVEL II
Application

Easy

PQ 1.4 · PYQ 2021-Jul [1] (a) {C} · 5M · Pg 115

LEVEL II
Application

Easy

PQ 1.6 · MTP 2022-Sep [1] (a) {C} · 5M · Pg 118

LEVEL II
Application

Easy

PQ 1.7 • PYQ 2022-Nov [1] (a) {C} • 5M • Pg 118	LEVEL II Application	Easy
PQ 1.9 • MTP 2023-Mar [1] (c) {C} • 5M • Pg 120	LEVEL II Application	Easy
PQ 1.11 • PYQ 2023-Nov [1] (c) {C} • 5M • Pg 122	LEVEL II Application	Easy
PQ 1.15 • PYQ 2025-Sep [1] (b) {C} • 5M • Pg 127	LEVEL II Application	Easy
TQ 1.2 • PYQ 2024-Sep [6] (Or) (a) • DESC • 4M • Pg 111	LEVEL II Application	Medium
PQ 1.2 • PYQ 2019-May [6] (e) • 5M • Pg 113	LEVEL II Application	Medium
PQ 1.8 • RTP 2022-Nov [16] • Pg 120	LEVEL II Application	Medium
PQ 1.10 • RTP 2023-May [16] (b) • Pg 121	LEVEL II Application	Medium
PQ 1.12 • RTP 2023-Nov [16] • Pg 123	LEVEL II Application	Medium
PQ 1.13 • PYQ 2024-May [1] (b) {C} • 7M • Pg 124	LEVEL II Application	Medium
PQ 1.14 • RTP 2024-Sep [3] • Pg 126	LEVEL II Application	Medium
PQ 1.5 • PYQ 2022-May [1] (b) {C} • 5M • Pg 117	LEVEL II Application	Hard

Evaluation judge it against the standard • 1 question

- Where a company has valued inventory on a global comparison or included selling costs, name the paragraph of AS 2 it has offended, quantify the effect, and state the correct value.
- Conclude on whether the valuation is acceptable. A discussion of AS 2 that never says yes or no scores poorly.

TQ 1.3 • RTP 2026-Jan [3] • DESC • Pg 111	LEVEL II Evaluation	Hard
---	------------------------	------

Topic 2: AS 10-Property Plant and Equipment

L2P1-C5-U5-T02

Read first Read Chapter 5 Unit 2, AS 10 Property, Plant and Equipment, Study Material pages 5.28–5.85 — §2.3–2.4 Definitions, §2.5 Recognition criteria, §2.6–2.7 Measurement and initial recognition, §2.8 Self-constructed assets, §2.9 Exchange of assets, §2.10 Subsequent costs.

NOTES

Recognition — two conditions, both required: the cost of an item of PPE is recognised as an asset **if and only if** (i) it is **probable that future economic benefits associated with the item will flow** to the enterprise, and (ii) **the cost of the item can be measured reliably**.

Two practical notes on recognition that the examiner uses: it may be appropriate to **aggregate individually insignificant items** — moulds, tools and dies — and apply the criteria to the aggregate; and an enterprise **may expense an item that could otherwise be capitalised where the amount is not material**.

Cost comprises the **purchase price** including import duties and non-refundable taxes, net of trade discounts and rebates; **directly attributable costs** of bringing the asset to the location and condition necessary for it to operate as intended; and the **initial estimate of dismantling, removing and site restoration costs** where the obligation is incurred.

Self-constructed assets are costed on the same principles as an acquired asset. **Internal profits are eliminated**, and **abnormal amounts of wasted material, labour or other resources are not included** in the cost.

Subsequent costs — the distinction the whole unit turns on. **Day-to-day servicing** — primarily labour and consumables, and possibly small parts, usually described as repairs and maintenance — is **not** recognised in the carrying amount and is **charged to the statement of profit and loss as incurred**.

Replacement of parts is different: where parts of an item require replacement at regular intervals — a furnace relining, aircraft seats and galleys, major parts of a conveyor — the cost of the replacement **is recognised in the carrying amount** if the recognition criteria are met, and the **carrying amount of the replaced part is derecognised**. That derecognition is the half of the answer most candidates omit.

Major inspections carried out as a condition of continuing to operate an asset are capitalised in the same way, with any remaining carrying amount of the previous inspection derecognised.

Depreciation is allocated on a systematic basis over the useful life; the **residual value and useful life are reviewed at least at each financial year end**, and a change is accounted for as a **change in accounting estimate** under AS 5 — not as a prior period item.

Revaluation: where an item is revalued, **the entire class** to which it belongs must be revalued. An increase is credited to **revaluation reserve**, except to the extent it reverses a previous decrease charged to profit and loss; a decrease is charged to profit and loss, except to the extent of a credit balance in the revaluation reserve for that same asset.

Remembering reproduce what you have learnt · 1 question

- The two recognition conditions are quotable and are worth stating verbatim before any application.

Understanding explain it, and place it in context · 1 question

- Explain the difference between day-to-day servicing and replacement of a part using the Study Material's own examples — furnace relining, aircraft seats. Concrete examples read as knowledge; abstractions read as guesswork.
- Where useful life or residual value changes, say explicitly that it is a change in estimate applied prospectively.

PQ 2.1 · MTP 2018-Aug [1] (b) {C} · 5M · Pg 129

LEVEL I
Understanding**Easy****Application** use the rule — work the problem · 13 questions

- Set out the cost build-up line by line, marking each item capitalised or expensed with its reason. That layout is what earns the marks.
- On a replacement, do both halves: capitalise the new part and derecognise the carrying amount of the old one. Show the derecognition as a separate working.
- For a revaluation, remember the class rule and the reserve mechanics — increase to revaluation reserve unless reversing an earlier charge, decrease to profit and loss unless there is a reserve for that same asset.

PQ 2.2 · MTP 2018-Aug [6] (Or) (d) · 5M · Pg 130

LEVEL II
Application**Easy**

PQ 2.3 · PYQ 2018-Nov [1] (a) {C} · 5M · Pg 130

LEVEL II
Application**Easy**

PQ 2.4 · PYQ 2020-Nov [1] (a) {C} · 5M · Pg 131

LEVEL II
Application**Easy**

PQ 2.5 · PYQ 2021-Jul [1] (b) {C} · 5M · Pg 133

LEVEL II
Application**Easy**

PQ 2.7 · PYQ 2022-May [1] (c) {C} · 5M · Pg 134

LEVEL II
Application**Easy**

TQ 2.1 · RTP 2022-May [18] (a) · DESC · Pg 128

LEVEL II
Application**Medium**

PQ 2.8 · RTP 2022-Nov [17] · Pg 135

LEVEL II
Application**Medium**

PQ 2.10 · RTP 2023-May [17] · Pg 138

LEVEL II
Application**Medium**

PQ 2.11 · RTP 2025-Jan [8] · Pg 139

LEVEL II
Application**Medium**

PQ 2.12 · PYQ 2025-May [1] (a) {C} · 7M · Pg 140

LEVEL II
Application**Medium**

PQ 2.13 · RTP 2025-Sep [12] · Pg 141

LEVEL II
Application**Medium**

PQ 2.9 · PYQ 2023-May [1] (a) {C} · 5M · Pg 136

LEVEL II**Hard**

Application

PQ 2.14 · RTP 2026-Jan [9] · Pg 142

LEVEL II
Application

Hard

Topic 3: AS 13-Accounting For Investment

L2P1-C5-U5-T03

Read first Read Chapter 5 Unit 3, AS 13 Accounting for Investments, Study Material pages 5.86–5.122 — §3.4 Classification, §3.5 Cost, §3.6 Carrying amount, §3.7 Investment properties, §3.8 Disposal, §3.9 Reclassification, §3.10 Disclosure.

NOTES

Classification: a **current investment** is one that is **by its nature readily realisable and is intended to be held for not more than one year** from the date the investment is made — and **the intention is judged at the time of purchase**. A **long-term investment** is any investment other than a current investment. That 'judged at the time of purchase' qualifier decides many questions.

Cost of an investment includes **acquisition charges such as brokerage, fees and duties**. An investment of ₹200 lakh with ₹1 lakh of brokerage is carried at **₹201 lakh**. Where an investment is acquired wholly or partly by the **issue of shares or other securities**, the acquisition cost is the **fair value of the securities issued**, which may not equal their nominal or par value.

Carrying amount — the two rules to keep apart: **current investments at the lower of cost and fair value; long-term investments at cost**, reduced for a **decline other than temporary** in value. Valuing current investments on an **overall or global basis is not appropriate**; category-wise is sometimes used, but **the more prudent and appropriate method is to carry them individually at the lower of cost and fair value**.

Any reduction of a current investment to fair value is debited to the statement of profit and loss. For a long-term investment, only a decline that is **other than temporary** is recognised, and it is determined and made **for each investment individually**.

Investment property is an investment in **land or buildings not intended to be occupied substantially for use by, or in the operations of, the investing enterprise**. It is accounted for under the **cost model in AS 10**. The cost of shares in a co-operative society or company whose holding is directly related to the right to hold the property is added to the carrying amount.

Reclassification — **learn the two directions separately, because they are not symmetrical: long-term to current**, transfer at the **lower of cost and carrying amount** at the date of transfer; **current to long-term**, transfer at the **lower of cost and fair value** at the date of transfer.

Disposal: the difference between the carrying amount and the **net disposal proceeds** is charged or credited to the statement of profit and loss. Where part of a holding is disposed of, the carrying amount of the part sold is determined on an **average carrying amount** basis.

Interest, dividends and rentals: amounts received that are **pre-acquisition** are deducted from the cost of the investment rather than taken to income — the single most common error in an investment account question.

Cum-interest and ex-interest purchases and sales must be split into the capital element and the interest element before anything is posted. Work that split as an explicit step.

Remembering reproduce what you have learnt · 1 question

- The classification test — readily realisable and intended to be held not more than one year, judged at the time of purchase — and the two carrying-amount rules are quotable material.

PQ 3.27 · RTP 2026-Jan [11] · Pg 197

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 4 questions

- Say why current and long-term investments are valued differently, and why the current-investment comparison is made investment by investment rather than globally.
- The two reclassification directions are asked as a pair. Give both, and say which value governs each.

PQ 3.8 · MTP 2022-Mar [3] (a) (ii) · 4M · Pg 157

LEVEL I
Understanding

Easy

PQ 3.11 · PYQ 2022-Nov [1] (d) {C} · 5M · Pg 161

LEVEL I
Understanding

Easy

PQ 3.15 · RTP 2023-May [19] (b) · Pg 168

LEVEL I
Understanding

Medium

PQ 3.22 · RTP 2024-Sep [11] · Pg 184

LEVEL I
Understanding

Hard

Application use the rule — work the problem · 18 questions

- In an Investment Account, run three columns — nominal, income (interest or dividend) and capital (cost) — and post every transaction to the right one. Most lost marks here are postings to the wrong column, not arithmetic.
- Split cum-interest and ex-interest amounts before posting, and show the split as a working.
- Deduct pre-acquisition interest and dividends from cost. State that you are doing so; it is a mark.
- On a partial disposal, use the average carrying amount of the holding and show the calculation.
- Close the account with the valuation rule appropriate to the classification, and say which rule you applied.

PQ 3.3 · PYQ 2020-Nov [1] (c) {C} · 5M · Pg 148

LEVEL II
Application

Easy

PQ 3.19 · MTP 2024-Mar [1] (a) {C} · 5M · Pg 180	LEVEL II Application	Easy
PQ 3.21 · PYQ 2024-Sep [6] (a) · 4M · Pg 183	LEVEL II Application	Easy
PQ 3.1 · RTP 2018-May [8] · Pg 144	LEVEL II Application	Medium
PQ 3.4 · RTP 2021-May [9] · Pg 149	LEVEL II Application	Medium
PQ 3.7 · MTP 2022-Mar [3] (a) (i) · 8M · Pg 153	LEVEL II Application	Medium
PQ 3.9 · RTP 2022-May [9] · Pg 157	LEVEL II Application	Medium
PQ 3.12 · RTP 2022-Nov [19] (b) · Pg 162	LEVEL II Application	Medium
PQ 3.13 · MTP 2023-Mar [5] (b) · 5M · Pg 163	LEVEL II Application	Medium
PQ 3.14 · RTP 2023-May [9] · Pg 165	LEVEL II Application	Medium
PQ 3.17 · PYQ 2023-Nov [3] (a) · 10M · Pg 174	LEVEL II Application	Medium
PQ 3.18 · RTP 2023-Nov [8] · Pg 178	LEVEL II Application	Medium
PQ 3.20 · RTP 2024-May [9] · Pg 181	LEVEL II Application	Medium
PQ 3.23 · PYQ 2025-May [1] (b) {C} · 7M · Pg 185	LEVEL II Application	Medium
PQ 3.24 · RTP 2025-May [14] · Pg 190	LEVEL II Application	Medium
PQ 3.26 · PYQ 2026-Jan [3] (b) · 7M · Pg 196	LEVEL II Application	Medium
PQ 3.16 · MTP 2023-Sep [5] (a) · 15M · Pg 169	LEVEL II Application	Hard
PQ 3.25 · MTP 2025-Aug S2 [5] · 14M · Pg 192	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 4 questions

- Reclassification questions give you cost, carrying amount and fair value together, and expect you to pick the right pair. Write out the direction of transfer first, then the rule, then the figure.
- Where several investments are reclassified, answer each separately with its own conclusion.

PQ 3.2 · PYQ 2019-May [1] (b) {C} · 5M · Pg 146	LEVEL II Analysis	Easy
PQ 3.5 · PYQ 2021-Jan [1] (b) {C} · 5M · Pg 151	LEVEL II	Easy

	Analysis	
PQ 3.6 • PYQ 2021-Dec [1] (c) {C} • 5M • Pg 152	LEVEL II Analysis	Medium
PQ 3.10 • RTP 2022-May [19] (b) • Pg 160	LEVEL II Analysis	Medium

Topic 4: AS 16-Borrowing Costs

L2P1-C5-U5-T04

Read first Read Chapter 5 Unit 4, AS 16 Borrowing Costs, Study Material pages 5.123–5.149 — §4.2 Definitions, §4.4 Costs eligible for capitalisation, §4.6 Specific borrowings, §4.7 General borrowings, §4.9 Commencement, §4.10 Suspension, §4.11 Cessation, §4.12 Disclosure.

NOTES

The whole standard in one sentence: borrowing costs **directly attributable to the acquisition, construction or production of a qualifying asset** — or that **could have been avoided** had the expenditure not been made — are **capitalised** as part of its cost; **all other borrowing costs are recognised as an expense** in the period incurred.

A qualifying asset is one that **necessarily takes a substantial period of time to get ready for its intended use or sale**. Assets ready for use when acquired, and inventories routinely produced over a short period, are not qualifying assets.

Specific borrowings: the amount eligible is the **actual borrowing costs incurred on that borrowing during the period, less any income on the temporary investment of those borrowings**. The deduction of temporary investment income is regularly forgotten.

General borrowings — the two-step method: **Step 1**, compute the **capitalisation rate**, being the weighted average of the borrowing costs applicable to the borrowings outstanding during the period, other than borrowings made specifically for a qualifying asset. **Step 2**, apply that rate to the expenditure on the asset. The amount capitalised in a period must not exceed the borrowing costs actually incurred in that period — state that cap; it carries a mark.

Commencement of capitalisation requires **all** of: expenditure on the asset is being incurred; borrowing costs are being incurred; and activities necessary to prepare the asset for its intended use or sale are in progress. **Expenditure includes only that which has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities**, and is **reduced by progress payments and grants received**.

Suspension: capitalisation is **suspended during extended periods in which active development is interrupted** — those costs are costs of holding a partially completed asset. **But it is not normally suspended** during a period when substantial technical and administrative work is being carried on, or when a temporary delay is a necessary part of the process.

Cessation: capitalisation **ceases when substantially all the activities necessary to prepare the**

asset for its intended use or sale are complete. An asset is normally ready when **physical construction is complete even though routine administrative work continues**; if only **minor modifications** such as decoration to the user's specification are outstanding, that indicates substantially all activities are complete.

Excess over recoverable amount: where the carrying amount including capitalised borrowing costs **exceeds the recoverable amount or net realisable value**, the carrying amount is **written down or written off** in accordance with the requirements of the other standards.

Exchange differences on foreign currency borrowings are borrowing costs **to the extent they are regarded as an adjustment to interest cost** — read 4.3 for the computation.

Understanding explain it, and place it in context · 4 questions

- Define a qualifying asset before anything else; whether the asset qualifies decides the whole answer.
- Explain the difference between specific and general borrowings and say why the capitalisation rate excludes specific borrowings.
- For commencement, suspension and cessation, give the rule and then the qualification — the qualifications are where the marks sit: not suspended during substantial technical and administrative work; ceased even though routine administrative work continues.

TQ 4.1 · RTP 2020-Nov [20] (b) · DESC · Pg 199	LEVEL I Understanding	Medium
TQ 4.2 · RTP 2022-May [20] (a) · DESC · Pg 199	LEVEL I Understanding	Hard
TQ 4.3 · RTP 2025-Sep [16] · DESC · Pg 200	LEVEL I Understanding	Hard
TQ 4.4 · RTP 2026-Jan [12] · DESC · Pg 201	LEVEL I Understanding	Hard

Application use the rule — work the problem · 14 questions

- Lay the answer out in the standard's own order: identify the qualifying asset, classify the borrowings, compute eligible costs, then apply the commencement, suspension and cessation dates to arrive at the period of capitalisation.
- On specific borrowings, deduct income from temporary investment of the funds and show it as a separate line.
- On general borrowings, show the capitalisation rate as an explicit weighted-average working, then apply it to the expenditure, then test against the cap of actual borrowing costs incurred.
- State the dates from which and to which costs are capitalised, with the reason for each. A correct total with unexplained dates loses marks.

PQ 4.2 · PYQ 2020-Nov [1] (d) {C} · 5M · Pg 204	LEVEL II	Easy
---	----------	------

	Application	
PQ 4.6 • PYQ 2023-May [1] (d) {C} • 5M • Pg 209	LEVEL II Application	Easy
PQ 4.14 • PYQ 2026-Jan [1] (a) {C} • 5M • Pg 222	LEVEL II Application	Easy
PQ 4.1 • PYQ 2019-May [1] (a) {C} • 5M • Pg 202	LEVEL II Application	Medium
PQ 4.3 • PYQ 2022-May [1] (d) {C} • 5M • Pg 205	LEVEL II Application	Medium
PQ 4.4 • RTP 2022-Nov [20] • Pg 206	LEVEL II Application	Medium
PQ 4.7 • RTP 2023-May [20] • Pg 210	LEVEL II Application	Medium
PQ 4.8 • PYQ 2023-Nov [1] (a) {C} • 5M • Pg 212	LEVEL II Application	Medium
PQ 4.9 • RTP 2023-Nov [20] • Pg 214	LEVEL II Application	Medium
PQ 4.11 • RTP 2024-May [10] • Pg 217	LEVEL II Application	Medium
PQ 4.12 • RTP 2024-Sep [12] • Pg 218	LEVEL II Application	Medium
PQ 4.13 • RTP 2025-Jan [11] • Pg 221	LEVEL II Application	Medium
PQ 4.10 • PYQ 2024-May [1] (a) {C} • 7M • Pg 214	LEVEL II Application	Hard
PQ 4.15 • PYQ 2026-Sep [1] (a) {C} • 5M • Pg 224	LEVEL II Application	Hard

Evaluation judge it against the standard • 1 question

- Where a company has capitalised through an idle period or beyond completion, say which rule is breached, quantify the over-capitalisation and give the corrected figure.
- Distinguish an extended interruption from a temporary delay that is a necessary part of the process — that distinction is usually what the question is testing.

PQ 4.5 • MTP 2023-Mar [6] (c) • 5M • Pg 208	LEVEL II Evaluation	Easy
---	-------------------------------	-------------

Topic 5: AS 19-Leases

L2P1-C5-U5-T05

Read first Read Chapter 5 Unit 5, AS 19 Leases, Study Material pages 5.150–5.195 — §5.3 Definitions, §5.4 Types of leases, §5.5–5.7 Indicators and conditions, §5.8 Finance leases, §5.9 Operating leases, §5.10 Sale and leaseback.

NOTES

The classification test: a lease is a **finance lease** if it transfers substantially all the risks and rewards incident to ownership; title may or may not eventually be transferred. It is an **operating lease** if it does not. Classification depends on the substance of the transaction rather than its form — that sentence belongs in every lease answer.

Classification is made at the inception of the lease and is not revisited merely because estimates change.

Situations that normally lead to a finance lease include: the lease **transfers ownership** by the end of the term; the lessee has a **bargain purchase option** — a price expected to be sufficiently below fair value at the date the option becomes exercisable that, at inception, it is reasonably certain it will be exercised (the Study Material's car at ₹20,000 against a ₹2,00,000 market value); the lease term is for the **major part of the economic life** even if title is not transferred; the **present value of the minimum lease payments amounts to at least substantially all of the fair value** at inception; and the asset is of a **specialised nature** such that only the lessee can use it without major modification.

In the lessee's books — finance lease: recognise an **asset and a liability at the lower of the fair value of the leased asset and the present value of the minimum lease payments** at inception. Each payment is **apportioned between the finance charge and the reduction of the outstanding liability**, and the finance charge is allocated so as to produce a **constant periodic rate of interest** on the remaining balance. **Depreciate the asset** on the same basis as owned assets; if there is no reasonable certainty that ownership will pass, depreciate over the **shorter of the lease term and the useful life**.

In the lessee's books — operating lease: lease payments are recognised as an **expense on a straight line basis over the lease term**, unless another systematic basis is more representative of the time pattern of the user's benefit.

Sale and leaseback — the treatment follows the classification, and this is the examinable part. If the leaseback is a **finance lease**, any **excess of sale proceeds over the carrying amount is deferred and amortised over the lease term** — it is **not** recognised as income immediately. If the leaseback is an **operating lease**, the answer depends on price: at **fair value**, profit or loss is recognised immediately; **below fair value**, profit or loss is recognised immediately **except** that a loss compensated by future lease payments below market price is **deferred and amortised** in proportion to the lease payments; **above fair value**, the **excess over fair value is deferred and amortised** over the period of expected use.

Disclosure differs for lessee and lessor and for each type of lease; **5.8 and 5.9** set out the schedules of minimum lease payments by period band.

Remembering reproduce what you have learnt • 1 question

- The two definitions and the substance-over-form sentence are quotable. State them before classifying anything.

TQ 5.1 • PYQ 2022-May [6] (c) • DESC • 5M • Pg 225

LEVEL I
Remembering**Medium****Understanding** explain it, and place it in context • 1 question

- When asked to classify, take the indicators one at a time against the facts and say which are met. A lease can be a finance lease on any one of them.
- Explain the depreciation rule for a finance lease in full, including the shorter-of rule where ownership is not reasonably certain to pass.

PQ 5.7 • RTP 2022-May [17] (b) • Pg 231

LEVEL I
Understanding**Hard****Application** use the rule — work the problem • 14 questions

- Compute the present value of the minimum lease payments and compare it with fair value before anything else; the lower figure is what goes into the books, and showing that comparison is a mark.
- Build the amortisation table with columns for opening liability, finance charge, payment and closing liability. It answers several sub-questions at once and is quick to check.
- Where an annuity factor is given, use it and say so. Where it is not, discount explicitly.
- For a sale and leaseback, state the classification first, then apply the matching profit rule. The classification decides the answer; getting to it late is what causes errors.

PQ 5.2 • PYQ 2019-May [1] (c) {C} • 5M • Pg 227

LEVEL II
Application**Easy**

PQ 5.5 • PYQ 2021-Jan [6] (a) • 5M • Pg 229

LEVEL II
Application**Easy**

PQ 5.8 • MTP 2022-Sep [1] (a) {C} • 5M • Pg 232

LEVEL II
Application**Easy**

PQ 5.9 • MTP 2023-Sep [1] (d) {C} • 5M • Pg 234

LEVEL II
Application**Easy**

PQ 5.10 • MTP 2024-Mar [1] (b) {C} • 5M • Pg 235

LEVEL II
Application**Easy**

PQ 5.11 • PYQ 2024-May [6] (a) • 5M • Pg 236

LEVEL II
Application**Easy**

PQ 5.12 • PYQ 2025-Jan [1] (b) {C} • 5M • Pg 237

LEVEL II
Application**Easy**

PQ 5.14 • PYQ 2026-Jan [6] (Or) (a) • 4M • Pg 240

LEVEL II
Application**Easy**

PQ 5.1 · RTP 2018-May [16] (b) · Pg 226	LEVEL II Application	Medium
PQ 5.13 · RTP 2025-Jan [14] · Pg 238	LEVEL II Application	Medium
PQ 5.15 · RTP 2026-Jan [15] · Pg 241	LEVEL II Application	Medium
PQ 5.16 · MTP 2026-Apr S2 [2] (a) · 7M · Pg 242	LEVEL II Application	Medium
PQ 5.6 · PYQ 2021-Dec [6] (c) · 5M · Pg 230	LEVEL II Application	Hard
PQ 5.17 · PYQ 2026-Sep [1] (b) {C} · 5M · Pg 243	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 2 questions

- Where the question gives a lease that looks operating in form but finance in substance, say so and give the indicators that decide it. That is the point being tested.
- For sale and leaseback at a price different from fair value, separate the three cases — at, below, above fair value — and identify which applies before computing.

PQ 5.3 · PYQ 2019-Nov [6] (e) · 5M · Pg 228	LEVEL II Analysis	Easy
PQ 5.4 · RTP 2020-Nov [16] (a) · Pg 229	LEVEL II Analysis	Medium

Topic 6: AS 26-Intangible Assets

L2P1-C5-U5-T06

Read first Read Chapter 5 Unit 6, AS 26 Intangible Assets, Study Material pages 5.196–5.231 — §6.3–6.6 Definitions, identifiability, control and future benefits, §6.7 Recognition, §6.12–6.16 Internally generated intangibles, §6.19–6.23 Amortisation, §6.26 Disclosure.

NOTES

Definition: an intangible asset is an **identifiable non-monetary asset, without physical substance, held for use** in the production or supply of goods or services, for rental to others, or for administrative purposes. **Identifiability, control and future economic benefits** are the three tests, and **6.4 to 6.6** take them in turn.

Recognition — the same two conditions as any asset: it is **probable that the expected future economic benefits will flow** to the enterprise, and the **cost can be measured reliably**.

Internally generated goodwill is never recognised as an asset — it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. Say that flatly; it is a standing

one-mark question.

Research and development — the distinction the unit is built on. Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. No intangible asset arising from research or from the research phase is recognised; expenditure on research is recognised as an expense when incurred.

Examples: activities aimed at obtaining new knowledge; the search for and evaluation and final selection of applications of research findings; the search for alternatives for materials, devices, products, processes, systems or services.

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 commencement of commercial production or use.

An intangible asset arising from development is recognised if and only if the enterprise can demonstrate **ALL of the following** — and the examiner expects all of them: (a) the **technical feasibility** of completing the asset so that it will be available for use or sale; (b) its **intention to complete** and use or sell it; (c) its **ability to use or sell it**; (d) **how it will generate probable future economic benefits**; (e) the availability of adequate **technical, financial and other resources** to complete it; and (f) its ability to **measure the expenditure attributable to it reliably**.

Where the research phase cannot be distinguished from the development phase, the whole expenditure is treated as research — that is, expensed.

Expenditure once recognised as an expense cannot be reinstated as an asset in a later period. This is absolute, and it catches candidates who want to capitalise earlier costs once a project succeeds.

Amortisation: the depreciable amount is allocated on a **systematic basis over the best estimate of useful life**, and amortisation **commences when the asset is available for use**. AS 26 adopts a **rebuttable presumption that useful life will not exceed ten years** from the date the asset is available for use. **Amortisation is recognised whether or not the asset's fair value or recoverable amount has increased**.

Residual value is presumed to be zero unless there is a commitment by a third party to purchase the asset at the end of its useful life, or an active market exists from which residual value can be determined and it is probable such a market will exist at the end of the useful life.

Understanding explain it, and place it in context · 2 questions

- Define research and development separately and in the standard's own words before applying them. The whole answer turns on which phase the expenditure falls in.
- State that internally generated goodwill is never recognised, and that expenditure once expensed cannot be reinstated.

	Understanding	
PQ 6.9 · RTP 2022-May [20] (b) · Pg 252	LEVEL I Understanding	Medium

Application use the rule — work the problem · 8 questions

- Take the expenditure item by item, allocate each to research or development, and for development items test all six conditions before capitalising. Show the test.
- Where the phases cannot be distinguished, say so and expense the whole amount — that is the correct answer, not a fallback.
- Amortisation starts when the asset is available for use, not when expenditure is incurred. State the start date explicitly.

PQ 6.1 · PYQ 2018-May [1] (c) {C} · 5M · Pg 244	LEVEL II Application	Easy
PQ 6.4 · PYQ 2020-Nov [1] (b) {C} · 5M · Pg 247	LEVEL II Application	Easy
PQ 6.6 · PYQ 2021-Jan [1] (a) {C} · 5M · Pg 249	LEVEL II Application	Easy
PQ 6.11 · PYQ 2023-Nov [6] (e) · 5M · Pg 253	LEVEL II Application	Easy
PQ 6.13 · PYQ 2024-Sep [1] (a) {C} · 4M · Pg 255	LEVEL II Application	Easy
PQ 6.12 · RTP 2023-Nov [19] · Pg 255	LEVEL II Application	Medium
PQ 6.5 · PYQ 2020-Nov [6] (c) · 5M · Pg 248	LEVEL II Application	Hard
PQ 6.7 · PYQ 2021-Dec [1] (c) {C} · 5M · Pg 250	LEVEL II Application	Hard

Evaluation judge it against the standard · 3 questions

- Where a company has capitalised research costs or reinstated previously expensed amounts, name the rule breached and give the corrected profit and carrying amount.
- If a useful life beyond ten years is claimed, say that the presumption is rebuttable and what would be needed to rebut it, then conclude on the facts given.

PQ 6.2 · MTP 2019-Mar [1] (b) {C} · 5M · Pg 245	LEVEL II Evaluation	Easy
PQ 6.3 · PYQ 2019-Nov [1] (b) {C} · 5M · Pg 246	LEVEL II Evaluation	Easy
PQ 6.8 · RTP 2022-May [20] (a) · Pg 251	LEVEL II Evaluation	Medium

Synthesis integrate the material and construct · 1 question

- Where you are asked to frame a policy or a note for intangibles, build it from the recognition conditions, the amortisation basis and period, and the disclosure requirements at **6.26 — in that order.**

PQ 6.14 · RTP 2025-Jan [19] · Pg 256

LEVEL II
Synthesis

Medium

Topic 7: AS 28-Impairment of Assets

L2P1-C5-U5-T07

Read first Read Chapter 5 Unit 7, AS 28 Impairment of Assets, Study Material pages 5.232–5.269 — \$7.3 Assessment, \$7.4 Measurement of recoverable amount, \$7.7 Recognition and measurement of an impairment loss, \$7.8 Cash-generating units, \$7.10 Goodwill, \$7.13–7.16 Reversal, \$7.18 Disclosure.

NOTES

The three definitions that decide every question: an **impairment loss** is the amount by which the **carrying amount exceeds the recoverable amount**. **Recoverable amount** is the **higher of net selling price and value in use**. **Net selling price** is the amount obtainable from sale in an **arm's length transaction between knowledgeable, willing parties, less the costs of disposal**, where costs of disposal are **incremental costs directly attributable to the disposal, excluding finance costs and income tax expense**.

Higher of, not lower of. The asset is worth keeping if either selling it or using it recovers the carrying amount, so the better of the two governs. Candidates lose whole questions by taking the lower.

Value in use is the present value of the estimated future cash flows expected from continuing use and from ultimate disposal, discounted at a **pre-tax rate reflecting current market assessments of the time value of money and the risks specific to the asset**. 7.5 and 7.6 set out what the estimates may and may not include.

Recognition — two cases. If **recoverable amount exceeds carrying amount**, the difference is **ignored** and the asset is carried on at the same book value; there is **no upward adjustment**. If **recoverable amount is less than carrying amount**, the difference is the **impairment loss** and is recognised.

Even where no impairment loss is recognised, an indication of impairment may mean the **remaining useful life, depreciation method or residual value need review and adjustment under AS 10**. That sentence is a free mark and is almost always available.

How the loss is taken: charged to the **statement of profit and loss**, unless the asset is carried at a revalued amount, in which case it is treated as a **revaluation decrease** to the extent of any revaluation surplus for that same asset. **After recognition, depreciation is adjusted** to allocate the revised carrying amount, less residual value, over the remaining useful life.

Cash-generating units: where recoverable amount cannot be estimated for an individual asset, it is estimated for the **smallest identifiable group of assets generating cash inflows largely independent of those from other assets**. An impairment loss for a unit is allocated **first to goodwill**, then **pro rata to the other assets on the basis of their carrying amounts** — and **no asset is reduced below the highest of its net selling price, its value in use, and zero**.

Reversal: at each balance sheet date the enterprise assesses whether an impairment loss recognised in prior periods **may no longer exist or may have decreased**, and if so estimates the recoverable amount. A loss is reversed **only if there has been a change in the estimates used** to determine the recoverable amount since the last loss was recognised. **The increased carrying amount must not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised**.

An impairment loss recognised for goodwill is not reversed in a subsequent period unless the loss was caused by a specific external event of an exceptional nature not expected to recur and subsequent events have reversed its effect.

SMC and MSME relief, from Chapter 3: such entities may measure value in use on a **reasonable estimate** instead of by the present value technique, in which case the provisions on discount rate do not apply.

Application use the rule — work the problem · 5 questions

- Answer in four visible steps: carrying amount, net selling price, value in use, recoverable amount as the higher of the last two — then the impairment loss. Label them; each is marked.
- State the recoverable amount as a conclusion in words before computing the loss. That prevents the higher-of error and shows the examiner you have the rule.
- After recognising the loss, revise the depreciation charge over the remaining useful life and show it. Questions usually ask for it in the same breath.
- Where the asset is carried at a revalued amount, take the loss against the revaluation surplus for that asset first and only then to profit and loss.
- For a cash-generating unit, allocate to goodwill first and then pro rata, and check the floor — no asset below the highest of net selling price, value in use and zero.

PQ 7.1 · MTP 2024-Mar [1] (c) {C} · 5M · Pg 257

LEVEL II
Application

Easy

PQ 7.3 · PYQ 2025-May [6] (Or) (a) · 4M · Pg 259

LEVEL II
Application

Easy

PQ 7.5 · PYQ 2026-May [1] (b) {C} · 5M · Pg 262

LEVEL II
Application

Medium

PQ 7.4 · PYQ 2025-Sep [3] (b) · 7M · Pg 260

LEVEL II
Application

Hard

PQ 7.6 · PYQ 2026-Sep [4] (b) · 4M · Pg 265

LEVEL II

Hard

Application

Analysis break it down and examine the interrelationships · 1 question

- Where the question asks whether an asset is impaired at all, work through the indications in **7.3 before any computation, and say which are present.**
- On a reversal, establish first that the estimates have changed, then apply the ceiling — the carrying amount that would have been determined had no loss been recognised. Both limbs are required.

PQ 7.2 · RTP 2024-Sep [17] · Pg 258

LEVEL II
Analysis**Medium**

CHAPTER 6

Liabilities Based Accounting Standards

2 Topics • 16 Classified Questions • Importance: B

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **22.1%** 19 of 86 marks

Level II — Analysis & Application **77.9%** 67 of 86 marks

Above the paper's Level I ceiling: 22% of this chapter's marks are Comprehension and Knowledge, against 5-15% for the paper. The theory here is not padding around the problems — it is a fifth or more of what the chapter is worth. Do not prepare this chapter by working sums alone.

Topic 1: AS 15-Employee Benefits

L2P1-C6-U6-T01

Read first Read Chapter 6 Unit 1, AS 15 Employee Benefits, Study Material pages 6.1–6.29 — §1.3 Meaning of employee benefits, §1.4 Short-term benefits, §1.5 Defined contribution against defined benefit, §1.6 The gratuity question, §1.7 Accounting treatment, §1.10 Actuarial gains and losses, §1.11 Other long-term benefits, §1.12 Termination benefits.

NOTES

Who is an employee: AS 15 **does not define the term**, but states that an employee may provide services on a **full-time, part-time, permanent, casual or temporary** basis, and that **employees include directors and other management personnel**. The intention is therefore wider than persons holding a contract of employment, since casual and temporary staff frequently have none.

Four categories of benefit run through the whole standard: **short-term, post-employment, other long-term** and **termination** benefits. Naming the category correctly is the first step in every question, because the accounting differs entirely between them.

Short-term employee benefits are those (other than termination benefits) **payable within twelve months after the end of the period in which the service is rendered**. Accounting for them is straightforward because **no actuarial assumptions are required**. Four sub-categories: **regular period benefits** (wages, salaries); **short-term compensated absences** (paid annual leave, maternity leave, sick leave); **profit sharing and bonuses** payable within twelve months; and **non-monetary benefits** (medical care, housing, cars).

Compensated absences split two ways, and the split is examinable: **accumulating** absences carry forward and can be used in future periods — the cost is recognised **when the employees render the service that increases their entitlement**, whether the entitlement is **vesting** (payable in cash on leaving) or **non-vesting**. **Non-accumulating** absences lapse, and the cost is recognised **when the absence occurs**.

Post-employment plans — the distinction that decides everything: a **defined contribution plan** commits the enterprise to a fixed contribution and no more, so the expense is simply the contribution payable; a **defined benefit plan** leaves the enterprise carrying the **actuarial and investment risk**, so the obligation must be measured actuarially.

Insured plans — the gratuity question the examiner keeps returning to. Where an enterprise pays insurance premiums to fund a post-employment plan, it **treats the plan as a defined contribution plan unless** it will have an obligation either (a) to **pay the employee benefits directly when they fall due**, or (b) to **pay further amounts if the insurer does not pay all future benefits** relating to service in the current and prior periods. If either obligation exists, **it is a defined benefit plan** however it is labelled — an LIC-administered gratuity scheme usually falls this way.

The defined benefit liability in the balance sheet is the **net total** of: (a) the **present value of the defined benefit obligation** at the balance sheet date; **minus** (b) any **past service cost not yet recognised**; **minus** (c) the **fair value of plan assets** at the balance sheet date out of which the obligations are to be settled directly.

Where plan assets exceed the obligation the net amount is an **asset**, and AS 15 caps it: the resulting asset is measured at the **lower** of the amount so determined and the **present value of economic benefits available as refunds from the plan or reductions in future contributions**. That ceiling is regularly tested.

Termination benefits are payable as a result of **either the enterprise's decision to terminate employment before the normal retirement date, or the employee's decision to accept voluntary redundancy** in exchange for those benefits — VRS payments are the standing example. They are recognised as a **liability and an expense only when** the enterprise has (i) a **detailed formal plan for the termination, duly approved**, and (ii) a **reliable estimate can be made** of the obligation. Both conditions, and both must be stated.

SMC and MSME relief, from Chapter 3: such entities are relieved of the recognition and measurement provisions for defined benefit plans, **but must still determine and provide for the accrued liability actuarially using the Projected Unit Credit Method**, with the discount rate by reference to **market yields on government bonds**.

Application use the rule — work the problem · 5 questions

- Classify the benefit before computing anything — short-term, post-employment, other long-term or termination. State the classification in words; it is a mark and it dictates the rest.
- For an insured or LIC-administered scheme, apply the two-limb test in **1.6 explicitly and say whether the plan is defined contribution or defined benefit. That conclusion is usually the substance of the question.**
- Build the defined benefit liability as the three-line net total — present value of obligation, less unrecognised past service cost, less fair value of plan assets — and label each line.
- Where plan assets exceed the obligation, apply the asset ceiling and say which of the two amounts is lower and why.

- For compensated absences, decide accumulating or non-accumulating first, then vesting or non-vesting, and recognise accordingly.

PQ 1.2 · PYQ 2024-Sep [1] (b) {C} · 5M · Pg 271	LEVEL II Application	Easy
PQ 1.3 · PYQ 2025-Jan [1] (c) {C} · 4M · Pg 272	LEVEL II Application	Easy
PQ 1.5 · PYQ 2026-Jan [1] (b) {C} · 4M · Pg 274	LEVEL II Application	Easy
PQ 1.4 · MTP 2025-Nov S1 [4] (a) · 6M · Pg 273	LEVEL II Application	Medium
PQ 1.6 · PYQ 2026-May [1] (a) {C} · 5M · Pg 275	LEVEL II Application	Medium

Evaluation judge it against the standard · 1 question

- Where a company has treated a gratuity scheme as defined contribution, test it against the two obligations in 1.6 and say plainly whether the treatment stands.
- For a VRS or other termination benefit, check both conditions — approved detailed formal plan and reliable estimate — and say which is missing if the provision is premature.

PQ 1.1 · MTP 2024-Jul [6] (b) · 4M · Pg 270	LEVEL II Evaluation	Easy
---	------------------------	------

Topic 2: AS 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets

L2P1-C6-U6-T02

Read first Read Chapter 6 Unit 2, AS 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets, Study Material pages 6.30–6.54 — §2.3 Definitions, §2.4–2.8 Recognition, §2.9 Contingent liabilities, §2.10 Contingent assets, §2.11–2.14 Measurement, §2.15 Reimbursements, §2.17–2.18 Changes in and use of provisions, §2.19 Application of the rules, §2.20 Disclosure.

NOTES

A provision is recognised when all three conditions are met: (a) the enterprise has a **present obligation as a result of a past event**; (b) it is **probable that an outflow of resources embodying economic benefits will be required to settle it**; and (c) a **reliable estimate can be made** of the amount. **If these conditions are not met, no provision is recognised.** Quote the three; almost every question in this unit is answered by working them in order.

Is there a present obligation? The enterprise takes account of **all available evidence, including the opinion of experts**. Where it is **more likely than not that a present obligation exists**, it recognises a provision if the other criteria are met. Where it is **more likely that no present obligation exists**, it **discloses a contingent liability** — unless the possibility of an outflow is **remote**, in which case

nothing is disclosed either.

That gives the three-way ladder to apply and to state: **probable** outflow and reliable estimate — provide; **possible** but not probable — **disclose as a contingent liability**; **remote** — **neither provide nor disclose**.

Contingent liabilities are never recognised, only disclosed. Where an enterprise is **jointly and severally liable**, the part expected to be met by others is treated as a **contingent liability**, and a **provision is recognised for the part for which outflow is probable** — except in the extremely rare case where no reliable estimate can be made. Contingent liabilities are **assessed continually**, and if an outflow becomes probable, a provision is recognised in the period of the change.

Contingent assets are neither recognised nor disclosed in the financial statements. They arise from unplanned or unexpected events — a claim being pursued through legal process, for instance — and recognising one may result in **recognising income that is never realised**. **Where realisation of income becomes virtually certain, the asset is no longer a contingent asset and recognition is appropriate**. A contingent asset is **usually disclosed in the report of the approving authority**, not in the statements themselves. The asymmetry against contingent liabilities is deliberate and is often the question.

Measurement: the amount is the **best estimate of the expenditure required to settle the present obligation at the balance sheet date**, determined by the **judgement of management**, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

Discounting: a provision is not discounted to present value, except for decommissioning, restoration and similar liabilities recognised as a cost of property, plant and equipment. Where discounting applies, the rate is a **pre-tax rate reflecting current market assessments of the time value of money and the risks specific to the liability**. That exception is narrow — do not discount a warranty or a legal claim.

Reimbursements: where the enterprise can recover part or all of the expenditure from another party — an **insurance contract**, an **indemnity clause**, a **supplier's warranty** — the reimbursement is recognised **only when it is virtually certain to be received on settlement of the obligation**, and it is treated as a **separate asset, not netted against the provision**. The amount recognised **must not exceed the provision**.

Changes and use: provisions are **reviewed at each balance sheet date and adjusted to the current best estimate**, and **reversed if an outflow is no longer probable**. A provision is **used only for the expenditure for which it was originally recognised** — adjusting a different expenditure against it would **conceal the impact of two different events**.

Future operating losses: **no provision is recognised**, because they do not meet the definition of a liability or the general recognition criteria. This is a standing one-mark answer.

Restructuring: examples include **sale or termination of a line of business, closure or relocation of business locations, changes in management structure such as eliminating a layer of**

management, and fundamental reorganisations materially affecting the nature and focus of operations. A restructuring provision is recognised only when the general criteria are met, and **no obligation arises on the sale of an operation until there is a binding sale agreement** — until then the enterprise can change its mind. The provision includes **only the direct expenditure arising from the restructuring**.

Remembering reproduce what you have learnt • 2 questions

- The three recognition conditions and the probable / possible / remote ladder are quotable. Write them before applying them.
- Learn the contingent asset rule as a pair with the contingent liability rule — not recognised and not disclosed in the statements, against not recognised but disclosed.

PQ 2.6 • RTP 2022-May [20] (c) • Pg 282

LEVEL I
Remembering

Medium

PQ 2.10 • RTP 2025-Jan [20] • Pg 288

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 1 question

- Explain why contingent assets and contingent liabilities are treated asymmetrically: recognising a contingent asset risks recognising income that is never realised.
- Be able to state the no-discounting rule and its single exception in one sentence.
- For reimbursements, say that the asset is separate and is not netted off, and that it cannot exceed the provision.
- Joint and several liability, restructuring and future operating losses are the three fact patterns that carry their own rules. Recognise which one you are in before applying the general criteria.
- For restructuring, look for the binding sale agreement; without it there is no obligation for the sale of an operation.

PQ 2.2 • PYQ 2020-Nov [6] (e) • 5M • Pg 278

LEVEL I
Understanding

Easy

Application use the rule — work the problem • 6 questions

- Work each item through the three conditions in order and state which one fails when nothing is provided. An answer that jumps to 'contingent liability' without testing present obligation loses the reasoning marks.
- Where the question gives several independent situations, answer each in its own short paragraph with a stated conclusion — provide, disclose, or neither.
- Give the amount as well as the treatment where a best estimate can be made, and say it is a best estimate.

PQ 2.1 · PYQ 2019-Nov [1] (a) {C} · 5M · Pg 277	LEVEL II Application	Easy
PQ 2.3 · MTP 2021-Oct [1] (a) {C} · 5M · Pg 279	LEVEL II Application	Easy
PQ 2.5 · PYQ 2022-May [1] (c) {C} · 5M · Pg 281	LEVEL II Application	Easy
PQ 2.7 · PYQ 2022-Nov [6] (d) · 5M · Pg 284	LEVEL II Application	Easy
PQ 2.9 · PYQ 2025-Jan [3] (a) · 7M · Pg 287	LEVEL II Application	Medium
PQ 2.8 · RTP 2024-Sep [18] · Pg 285	LEVEL II Application	Hard

Evaluation judge it against the standard · 1 question

- Where a company has provided for future operating losses, or netted a reimbursement against a provision, or used a provision for a different expenditure, name the rule and give the corrected treatment and figures.
- Conclude on each situation. The examiner marks conclusions here, not general discussion of AS 29.

PQ 2.4 · MTP 2022-Mar [6] (Or) (b) · 5M · Pg 280	LEVEL II Evaluation	Easy
--	------------------------	------

CHAPTER 7

Accounting Standards Based on Items Impacting Financial Statements

4 Topics • 55 Classified Questions • Importance: A

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **18.4%** 57 of 309 marks

Level II — Analysis & Application **81.6%** 252 of 309 marks

Above the paper's Level I ceiling: 18% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. The theory here is not padding around the problems — it is a fifth or more of what the chapter is worth. Do not prepare this chapter by working sums alone.

Topic 1: AS 4-Contingencies and Events Occurring After the Balance Sheet Date

L2P1-C7-U7-T01

Read first Read Chapter 7 Unit 1, AS 4 Contingencies and Events Occurring After the Balance Sheet Date, Study Material pages 7.1–7.14 — §1.2 Contingencies, §1.3 Events occurring after the balance sheet date, §1.4 Adjusting events, §1.5 Non-adjusting events, §1.6 Disclosure.

NOTES

Events occurring after the balance sheet date are those, favourable or unfavourable, occurring **between the balance sheet date and the date on which the financial statements are approved** by the approving authority. Fix both ends of that window before answering anything — many questions turn on an event falling outside it.

Adjusting events: adjustments to assets and liabilities **are required** for events that **provide additional information materially affecting the determination of amounts relating to conditions existing at the balance sheet date**. The Study Material's example: a **loss on a trade receivable confirmed by the insolvency of the customer occurring after the balance sheet date** — the customer's weakness existed at the year end; the insolvency merely confirmed it.

Non-adjusting events: adjustment is **not appropriate** where the event **does not relate to conditions existing at the balance sheet date**. The standing example is a **decline in the market value of investments** between the balance sheet date and the date of approval — **ordinary fluctuations in market value do not normally relate to the condition of the investments at the balance sheet date** but reflect circumstances of the following period.

The test is therefore always the same: did the condition **exist** at the balance sheet date, with the later event merely giving evidence of it? If yes, adjust. If the event **arose** after the balance sheet date, do not adjust. Say which limb applies before giving the treatment.

Disclosure of a non-adjusting event: such events **do not normally require disclosure in the financial statements**, but where they are of such **significance that non-disclosure would affect the ability of users to make proper evaluations and decisions**, disclosure is made in the report of the approving authority — the **nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.**

Two events that are always adjusted, whatever their timing: a **proposed dividend** is dealt with as required by the standard and by Schedule III, and **events that indicate the going concern assumption is no longer appropriate** require the statements to be redrawn on a different basis altogether — a fundamental adjustment rather than a line-item one.

Contingencies: AS 4's contingency provisions now stand largely displaced by **AS 29** for provisions, contingent liabilities and contingent assets; AS 4 continues to govern **events occurring after the balance sheet date**. Where a question mixes the two, say which standard governs which limb — it is worth a mark and it prevents a confused answer.

Remembering reproduce what you have learnt · 1 question

- The definition of events occurring after the balance sheet date, and the window they fall in, are quotable. State both before classifying anything.
- Keep the two standing examples ready: insolvency of a debtor confirming a year-end condition (adjusting), and a fall in market value of investments (non-adjusting).

PQ 1.2 · PYQ 2019-May [1] (d) {C} · 5M · Pg 296

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 1 question

- Open with the definition and the window — between the balance sheet date and the date of approval. Then apply the condition-existed test to each event separately.
- Give the reason, not just the label. 'Non-adjusting, because the fall in market value reflects circumstances of the following period, not the condition of the investment at the year end' earns the mark; 'non-adjusting' alone does not.

TQ 1.1 · RTP 2022-Nov [12] · DESC · Pg 294

LEVEL I
Understanding

Medium

Application use the rule — work the problem · 1 question

- These questions list several events and expect a treatment for each. Answer them in the order given, one short paragraph each, ending with adjust or do not adjust and the disclosure consequence.
- Where an event is non-adjusting but significant, say that disclosure is made in the report of the approving authority, with the nature of the event and an estimate of the financial effect or a statement that none can be made.

- Watch for going concern. If an after-date event undermines it, the answer is not an adjustment to one figure but a change in the basis of preparation.

PQ 1.10 · RTP 2026-Jan [4] · Pg 308

LEVEL II
Application**Medium****Evaluation** judge it against the standard · 8 questions

- Where a company has adjusted for an event that arose after the year end, or ignored one that confirms a year-end condition, name the limb it has misapplied and give the corrected treatment and figures.
- Say whether disclosure in the report of the approving authority is required, and what that disclosure must contain — the nature of the event and an estimate of the financial effect, or a statement that none can be made.
- Where going concern is in doubt, the conclusion is that the statements must be redrawn on a different basis, not that a provision should be made. Say so plainly.

PQ 1.1 · PYQ 2018-Nov [1] (d) {C} · 5M · Pg 295

LEVEL II
Evaluation**Easy**

PQ 1.3 · PYQ 2021-Jul [1] (c) {C} · 5M · Pg 297

LEVEL II
Evaluation**Easy**

PQ 1.4 · MTP 2021-Oct [6] (b) · 5M · Pg 299

LEVEL II
Evaluation**Easy**

PQ 1.6 · MTP 2022-Sep [1] (c) {C} · 5M · Pg 302

LEVEL II
Evaluation**Easy**

PQ 1.7 · PYQ 2022-Nov [1] (d) {C} · 5M · Pg 304

LEVEL II
Evaluation**Easy**

PQ 1.8 · RTP 2024-May [14] · Pg 305

LEVEL II
Evaluation**Medium**

PQ 1.9 · RTP 2024-Sep [5] · Pg 306

LEVEL II
Evaluation**Medium**

PQ 1.5 · PYQ 2021-Dec [1] (a) {C} · 5M · Pg 301

LEVEL II
Evaluation**Hard**

Topic 2: AS 5-Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

L2P1-C7-U7-T02

Read first Read Chapter 7 Unit 2, AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, Study Material pages 7.15–7.31 — §2.2 Net profit or loss for the period, §2.3 Prior period items, §2.4 Changes in accounting estimates, §2.5 Changes in accounting policies.

NOTES

All items of income and expense recognised in a period enter net profit or loss unless an Accounting Standard requires or permits otherwise. The net profit or loss comprises two components, **each of which must be disclosed on the face of the statement of profit and loss: profit or loss from ordinary activities and extraordinary items.**

Ordinary activities are those undertaken as part of the business and related activities in furtherance of, incidental to, or arising from them — profit on sale of merchandise, loss on sale of unsold inventory at the end of a season.

Extraordinary items are income or expenses arising from **events or transactions clearly distinct from the ordinary activities** of the enterprise, and therefore **not expected to recur frequently or regularly.** The test is the nature of the event, not its size — a large but ordinary loss is not extraordinary.

Separate disclosure within ordinary activities: where items of income or expense from ordinary activities are of such **size, nature or incidence** that their disclosure is relevant to explaining the performance of the enterprise, their **nature and amount are disclosed separately.** This is the correct home for most large one-off items that candidates wrongly label extraordinary.

Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Errors may arise from **mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.** Their nature and amount must be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

Changes in accounting estimates are not prior period items and not extraordinary items. An estimate is revised where **circumstances change, or as a result of new information, more experience or subsequent developments,** and the revision by its nature does not bring the adjustment within the definition of an extraordinary item or a prior period item. Estimates are approximations that may need revision as additional information becomes known — so income or expense recognised on the outcome of a contingency that previously could not be estimated reliably is not a prior period item.

The three-way distinction is the whole unit, and every question tests it: an error or omission in an earlier period is a **prior period item**; a revision of an approximation is a **change in estimate**, taken prospectively in the current and, if relevant, future periods; a **change in the basis of accounting** itself is a **change in accounting policy.** Say which of the three you are dealing with, and why, before giving any treatment.

Effect of a change in estimate is included in the determination of net profit or loss in the **period of the change** if it affects that period only, or in the **period of the change and future periods** if it affects both. Where the effect is material, its **nature and amount are disclosed.**

Change in accounting policy is made only if **required by statute, for compliance with an Accounting Standard, or if it would result in a more appropriate presentation.** The amount by

which any item is affected is disclosed to the extent ascertainable; where not ascertainable, wholly or in part, the fact is indicated — the same discipline as AS 1.

Remembering reproduce what you have learnt · 2 questions

- The definitions of extraordinary item, prior period item and change in estimate are quotable and are what the classification rests on.

PQ 2.3 · PYQ 2021-Jan [1] (b) {C} · 5M · Pg 312

LEVEL I
Remembering

Easy

PQ 2.10 · RTP 2025-Sep [9] · Pg 319

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- Answer classification questions by naming the category, giving the definition it satisfies, and then the treatment and disclosure. Three sentences per item.
- State clearly that a change in estimate is applied prospectively and never restated as a prior period item.

PQ 2.8 · PYQ 2023-Nov [1] (b) {C} · 5M · Pg 317

LEVEL I
Understanding

Easy

PQ 2.2 · RTP 2020-May [14] (b) · Pg 312

LEVEL I
Understanding

Medium

Application use the rule — work the problem · 3 questions

- Where the question gives a list of items, produce a short table — item, classification, treatment, disclosure. It is quick to write and easy to mark.
- For a change in accounting policy, give the effect in figures and draft the disclosure note, as under AS 1.
- Extraordinary items are rarer than candidates think. Before labelling one, ask whether the event is clearly distinct from ordinary activities; if it is merely large, it belongs in separate disclosure within ordinary activities.

PQ 2.1 · PYQ 2018-May [1] (d) {C} · 5M · Pg 310

LEVEL II
Application

Easy

PQ 2.11 · PYQ 2025-Sep [6] (a) · 4M · Pg 320

LEVEL II
Application

Easy

PQ 2.12 · RTP 2026-Jan [6] · Pg 321

LEVEL II
Application

Medium

Analysis break it down and examine the interrelationships · 2 questions

- The distinguishing question — prior period item, change in estimate, or change in policy — is asked in almost every sitting. Build the answer around the definitions and give one example of each.

- An amount arising because a contingency has now become measurable is a change in estimate, not a prior period item. That single example is worth memorising.

PQ 2.4 · PYQ 2022-May [1] (a) {C} · 5M · Pg 314	LEVEL II Analysis	Easy
PQ 2.9 · RTP 2025-Jan [5] · Pg 318	LEVEL II Analysis	Medium

Evaluation judge it against the standard · 4 questions

- Where an item has been shown as extraordinary, test it against 'clearly distinct from ordinary activities' rather than against its size, and reclassify it into separate disclosure within ordinary activities if that is where it belongs.
- Where a revised estimate has been treated as a prior period item, say that a change in estimate is applied prospectively and restate the effect on the current year.
- Conclude with the corrected presentation on the face of the statement of profit and loss.

PQ 2.5 · MTP 2022-Sep [1] (c) {C} · 5M · Pg 314	LEVEL II Evaluation	Easy
PQ 2.6 · PYQ 2022-Nov [1] (a) {C} · 5M · Pg 315	LEVEL II Evaluation	Easy
PQ 2.13 · PYQ 2026-May [6] (b) · 4M · Pg 322	LEVEL II Evaluation	Easy
PQ 2.7 · RTP 2022-Nov [13] (a) · Pg 316	LEVEL II Evaluation	Medium

Topic 3: AS 11-The Effects of Changes in Foreign Exchange Rates

L2P1-C7-U7-T03

Read first Read Chapter 7 Unit 3, AS 11 The Effects of Changes in Foreign Exchange Rates, Study Material pages 7.32–7.59 — §3.2 Definitions, §3.3 Initial recognition, §3.4 Reporting at each balance sheet date, §3.5 Recognition of exchange differences, §3.6–3.9 Foreign operations, §3.11 Forward exchange contracts.

NOTES

Initial recognition: a foreign currency transaction is recorded in the reporting currency by applying the **exchange rate at the date of the transaction**. A rate that **approximates the actual rate** may be used — a weekly or monthly average, for instance — **but not where exchange rates fluctuate significantly**.

At the balance sheet date the treatment depends on two questions: is the item **monetary or non-monetary**, and if non-monetary, is it carried at **historical cost or fair value**? Answer both before

applying any rate.

The three rules: **monetary items** at the **closing rate**; **non-monetary items** carried at **historical cost** at the **rate at the date of the transaction**; **non-monetary items** carried at **fair value** at the **rates that existed when the values were determined**.

The closing-rate exception: where the closing rate **does not reflect with reasonable accuracy** the amount likely to be realised or disbursed — restrictions on remittances, or an unrealistic rate at which an exchange cannot actually be effected — a more appropriate rate is used.

Recognition of exchange differences: differences arising on the **settlement of monetary items**, or on **reporting monetary items at rates different from those at which they were initially recorded** or reported previously, are **recognised as income or expense in the period in which they arise**. There is no deferral for ordinary transactions.

Integral against non-integral foreign operations — the classification decides the whole answer. An **integral** operation's items are translated **as if its transactions had been entered into by the reporting enterprise itself**: tangible fixed assets and their depreciation at the **rate at the date of purchase** (or of valuation, if carried at valuation), inventories at the **rates when those costs were incurred**, recoverable amount or realisable value at the **rate when that amount was determined** — and the resulting differences go to **profit and loss**.

A **non-integral operation** is translated quite differently: **all assets and liabilities, monetary and non-monetary, at the closing rate**; **income and expense items at the rates at the dates of the transactions**; and **all resulting exchange differences accumulated in a foreign currency translation reserve until the disposal of the net investment**. That reserve is the single most examined feature of the unit.

On a **change of classification**, the translation procedures for the new classification are applied **from the date of the change** — prospectively, not by restating earlier periods.

Forward exchange contracts not intended for trading or speculation: the **premium or discount** arising at inception is **amortised as expense or income over the life of the contract**; **exchange differences on the contract** are **recognised in the statement of profit and loss in the reporting period in which the exchange rates change**; and any **profit or loss on cancellation or renewal is recognised as income or expense for the period**. Three separate rules — a complete answer gives all three.

Where a contract IS intended for trading or speculation, the treatment differs: the gain or loss is computed by reference to the forward rate and recognised in profit and loss, with no amortisation of premium or discount.

Remembering reproduce what you have learnt · 1 question

- The three balance sheet rules — **monetary at closing rate**, **non-monetary at historical cost at transaction-date rate**, **non-monetary at fair value at the rate when the value was determined** — are the spine of the unit. Write them out first.

- For non-integral operations, remember the trio: assets and liabilities at closing rate, income and expense at transaction-date rates, differences to the foreign currency translation reserve.

PQ 3.4 • PYQ 2018-Nov [6] (c) • 5M • Pg 329

LEVEL I
Remembering**Easy****Understanding** explain it, and place it in context • 2 questions

- Answer any translation question by stating the classification first — monetary or non-monetary, integral or non-integral — and then the rate that follows from it.
- Explain why non-integral differences go to a reserve rather than to profit and loss: they relate to the net investment, not to the reporting enterprise's own transactions.

PQ 3.6 • PYQ 2021-Jan [1] (d) {C} • 5M • Pg 331

LEVEL I
Understanding**Easy**

PQ 3.10 • RTP 2022-Nov [18] • Pg 337

LEVEL I
Understanding**Medium****Application** use the rule — work the problem • 13 questions

- Set the work out as a schedule: item, classification, rate applied, translated amount. The examiner is checking the rate against the item, and the schedule shows both.
- Take exchange differences on monetary items straight to profit and loss, and say so. Deferring them is a substantive error.
- For a forward contract, deal with the premium or discount, the period exchange differences and any cancellation separately. Each is a mark.
- Where a question spans two years, restate at each balance sheet date and recognise the difference each year rather than only on settlement.

PQ 3.1 • MTP 2018-Mar [6] (a) • 5M • Pg 326

LEVEL II
Application**Easy**

PQ 3.2 • PYQ 2018-May [1] (b) {C} • 5M • Pg 327

LEVEL II
Application**Easy**

PQ 3.3 • PYQ 2018-Nov [1] (b) {C} • 5M • Pg 327

LEVEL II
Application**Easy**

PQ 3.5 • PYQ 2019-Nov [1] (b) {C} • 5M • Pg 330

LEVEL II
Application**Easy**

PQ 3.7 • PYQ 2021-Dec [1] (a) {C} • 5M • Pg 333

LEVEL II
Application**Easy**

PQ 3.9 • PYQ 2022-Nov [1] (c) {C} • 5M • Pg 336

LEVEL II
Application**Easy**

PQ 3.8 • RTP 2022-May [18] (b) • Pg 334

LEVEL II
Application**Medium**

PQ 3.12 • RTP 2023-May [18] • Pg 339	LEVEL II Application	Medium
PQ 3.13 • PYQ 2023-Nov [1] (b) {C} • 5M • Pg 340	LEVEL II Application	Medium
PQ 3.14 • MTP 2024-Jul [6] (c) • 6M • Pg 341	LEVEL II Application	Medium
PQ 3.15 • RTP 2024-Sep [9] (a) • Pg 343	LEVEL II Application	Medium
PQ 3.17 • RTP 2025-May [12] • Pg 344	LEVEL II Application	Medium
PQ 3.18 • PYQ 2026-May [6] (Or) (a) • 4M • Pg 346	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships • 1 question

- The integral against non-integral judgement is what most of these questions are really about. Set out the indicators, reach the classification, then translate — never the other way round.
- On a change of classification, apply the new procedures from the date of change and say that earlier periods are not restated.

TQ 3.1 • RTP 2023-Nov [18] • DESC • Pg 325	LEVEL II Analysis	Medium
--	----------------------	--------

Evaluation judge it against the standard • 2 questions

- Where a company has taken non-integral translation differences to profit and loss, or capitalised ordinary exchange losses, name the paragraph, quantify the effect and give the correct treatment.

PQ 3.11 • PYQ 2023-May [1] (b) {C} • 5M • Pg 338	LEVEL II Evaluation	Easy
PQ 3.16 • RTP 2025-Jan [9] • Pg 344	LEVEL II Evaluation	Medium

Topic 4: AS 22-Accounting for Taxes on Income

L2P1-C7-U7-T04

Read first Read Chapter 7 Unit 4, AS 22 Accounting for Taxes on Income, Study Material pages 7.60–7.76 — §4.3 Definitions, §4.4 Recognition, §4.5 Measurement, §4.6 Re-assessment of unrecognised deferred tax assets, §4.7 Review of previously recognised assets, §4.9 Disclosure, §4.10 Explanations.

NOTES

The idea: taxes on income are an **expense incurred in earning income** and are **accrued in the same period as the revenue and expenses to which they relate**. Because taxable income and accounting income are computed differently, that matching produces **timing differences**, whose

tax effects become **deferred tax assets or liabilities** in the balance sheet.

Tax expense for the period comprises **current tax and deferred tax**, and both are included in determining net profit or loss.

Timing differences against permanent differences — get this right first or the whole answer fails.

Timing differences originate in one period and reverse in one or more subsequent periods — depreciation rates differing between the books and the Act, expenses allowed on payment under section 43B, and so on. **Permanent differences do not reverse** — a disallowed penalty, or income exempt under section 10 — and **no deferred tax is recognised on a permanent difference**.

Recognition, with prudence built in: deferred tax **liabilities** are recognised for all timing differences. Deferred tax **assets** are **recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available** against which they can be realised.

The stricter test for losses: where the enterprise has **unabsorbed depreciation or carry-forward of losses under tax laws**, deferred tax assets are recognised **only to the extent that there is virtual certainty supported by convincing evidence** that sufficient future taxable income will be available. **Reasonable certainty for ordinary timing differences; virtual certainty supported by convincing evidence for losses.** The examiner tests that pair constantly.

Measurement: **current tax** at the amount **expected to be paid to or recovered from the taxation authorities**, using applicable rates and laws. **Deferred tax** using the **tax rates and tax laws enacted or substantively enacted by the balance sheet date** — and the Study Material notes that certain government **announcements** of rates and laws may have the **substantive effect of actual enactment**, in which case those announced rates are used.

Deferred tax assets and liabilities are not discounted to present value.

Re-assessment and review work in both directions, and both are examinable. At each balance sheet date the enterprise **re-assesses unrecognised deferred tax assets** and recognises them to the extent it has become reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available. Equally, it **reviews previously recognised deferred tax assets** and **writes them down** to the extent it is no longer reasonably or virtually certain that they will be realised.

Presentation: deferred tax assets and liabilities are disclosed **separately from current tax** and are **distinguished from assets and liabilities representing current tax**. They are **offset only where the enterprise has a legally enforceable right of set-off and they relate to taxes on income levied by the same governing taxation laws**.

Remembering reproduce what you have learnt · 1 question

- The two certainty tests are a memorised pair: reasonable certainty for ordinary timing differences, virtual certainty supported by convincing evidence where there is unabsorbed depreciation or carried-forward loss.

- Deferred tax arises on timing differences only. Be able to give two examples of each of timing and permanent differences without thinking.

TQ 4.1 · RTP 2022-Nov [19] (a) · DESC · Pg 348

LEVEL I
Remembering**Medium****Application** use the rule — work the problem · 11 questions

- Work the answer as a schedule: item, book treatment, tax treatment, difference, timing or permanent, deferred tax at the applicable rate. Everything the examiner wants is visible in that table.
- State the tax rate you are using and why — enacted or substantively enacted at the balance sheet date.
- Show the deferred tax balance and the movement for the year separately; questions usually ask for the charge in the statement of profit and loss as well as the balance sheet figure.
- Do not discount. Do not create deferred tax on a permanent difference. Those two errors cost more marks than arithmetic.

PQ 4.1 · PYQ 2018-May [1] (c) {C} · 5M · Pg 348

LEVEL II
Application**Easy**

PQ 4.2 · PYQ 2020-Nov [1] (d) {C} · 5M · Pg 349

LEVEL II
Application**Easy**

PQ 4.3 · PYQ 2021-Jan [1] (d) {C} · 5M · Pg 350

LEVEL II
Application**Easy**

PQ 4.4 · PYQ 2021-Jul [6] (a) · 5M · Pg 351

LEVEL II
Application**Easy**

PQ 4.6 · PYQ 2022-Nov [1] (b) {C} · 5M · Pg 353

LEVEL II
Application**Easy**

PQ 4.7 · PYQ 2023-Nov [1] (c) {C} · 5M · Pg 355

LEVEL II
Application**Easy**

PQ 4.8 · PYQ 2024-Sep [1] (c) {C} · 5M · Pg 356

LEVEL II
Application**Easy**

PQ 4.10 · PYQ 2025-Sep [1] (a) {C} · 5M · Pg 360

LEVEL II
Application**Easy**

PQ 4.5 · RTP 2022-May [19] (a) · Pg 352

LEVEL II
Application**Medium**

PQ 4.9 · RTP 2025-Jan [16] · Pg 357

LEVEL II
Application**Medium**

PQ 4.11 · PYQ 2026-May [1] (c) {C} · 4M · Pg 361

LEVEL II
Application**Medium**

CHAPTER 8

Revenue Based Accounting Standards

2 Topics • 29 Classified Questions • Importance: B

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**Level I — Comprehension & Knowledge **21.7%** 35 of 161 marksLevel II — Analysis & Application **78.3%** 126 of 161 marks

Above the paper's Level I ceiling: 22% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. The theory here is not padding around the problems — it is a fifth or more of what the chapter is worth. Do not prepare this chapter by working sums alone.

Topic 1: AS 7-Construction Contracts

L2P1-C8-U8-T01

Read first Read Chapter 8 Unit 1, AS 7 Construction Contracts, Study Material pages 8.1–8.35 — §1.3 Combining and segmenting, §1.4 Types of contract, §1.5 Contract revenue and costs, §1.6 Percentage completion method, §1.7 Costs relating to future activity, §1.8 Uncollectable contract revenue, §1.9 Stage of completion, §1.10 Changes in estimates, §1.11 Disclosure.

NOTES

Two types of contract: a **fixed price contract**, where the contractor agrees to a **fixed contract price** or a **fixed rate per unit of output**, in some cases **subject to cost escalation** clauses; and a **cost plus contract**, where the contractor is **reimbursed for allowable or otherwise defined costs**, plus a percentage of those costs or a fixed fee.

Contract revenue comprises (i) the **initial amount of revenue agreed in the contract**, and (ii) **variations, claims and incentive payments** — but only to the extent that it is **probable they will result in revenue** and they are **capable of being reliably measured**.

Build contract revenue in the Study Material's own order: agreed price (fixed or cost-plus), **plus** agreed cost escalation, **plus** claims, **plus** incentive payments, **less** penalties, **adjusted for** variations. **Claims are included only when it is probable the customer will accept them and the amount can be measured reliably;** incentives only on the same **probable-and-measurable test**; penalties, usually for late completion, **reduce revenue**.

The percentage of completion method recognises revenue in proportion to the progress of work, matched with the costs incurred in that year. It is **consistent with the accrual and matching concepts**, and it gives useful information on the extent of contract activity and performance in a period. **AS 7 prescribes that it should not be used unless it is possible to make a reasonable estimate of the final outcome of the contract.**

Stage of completion may be determined in several ways, and the enterprise uses the method that

measures reliably the work performed: (a) the proportion that contract costs incurred for work performed to date bear to estimated total contract costs; (b) surveys of work performed; or (c) completion of a physical proportion of the contract work. Progress payments and advances received from customers may not necessarily reflect the work performed — that caution is examined, because questions often supply progress billings as a distractor.

Costs relating to future activity — materials delivered to site but not yet used, advances to subcontractors — are **excluded from costs incurred to date** when computing the stage of completion, and are carried as an asset. Including them inflates the percentage and is the commonest error in the unit.

An expected loss is recognised immediately and in full. When it is probable that **total contract costs will exceed total contract revenue**, the **expected loss is recognised as an expense immediately**, irrespective of whether work has commenced, of the stage of completion, and of the profits expected on other contracts that are not treated as a single contract.

Where the outcome cannot be estimated reliably: revenue is recognised **only to the extent of contract costs incurred of which recovery is probable**, and **contract costs are recognised as an expense in the period incurred** — no profit is taken.

Changes in estimates: the method is applied **on a cumulative basis in each period to the current estimates** of contract revenue and costs. A change in estimate of revenue, of costs, or of the outcome is accounted for as a **change in accounting estimate under AS 5** — taken in the current and future periods, **never as a prior period item**.

Uncollectable contract revenue: where an amount already included in contract revenue becomes uncollectable, it is recognised as an **expense** rather than as an adjustment of contract revenue.

Remembering reproduce what you have learnt · 1 question

- The composition of contract revenue — agreed price, plus escalation, plus claims, plus incentives, less penalties, adjusted for variations — is a list answer. Learn it in that order.
- The three ways of measuring stage of completion, and the caution that progress payments do not measure work performed, are worth a mark on their own.

PQ 1.9 · RTP 2024-Sep [7] · Pg 376

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- State the two contract types and the composition of contract revenue before any computation; both carry marks in their own right.
- Be able to say why the percentage completion method is consistent with accrual and matching, and what condition AS 7 attaches to using it.

PQ 1.5 · RTP 2022-May [13] (b) · Pg 371

LEVEL I
Understanding**Medium****Application** use the rule — work the problem · 7 questions

- Work in a fixed order: total contract revenue, total estimated contract costs, costs incurred to date, stage of completion, revenue and costs for the period, profit or loss recognised. Label each step.
- Strip out costs relating to future activity before computing the percentage, and show that you have done so.
- Test for an expected loss before recognising any profit. If total costs exceed total revenue, the whole loss goes in immediately — the percentage does not apply to it.
- Where the outcome cannot be estimated reliably, recognise revenue only to the extent of recoverable costs incurred and say why no profit is taken.
- For a multi-year question, apply the method cumulatively and deduct what was recognised in earlier years to arrive at the current year's figure. That subtraction is where most errors occur.

PQ 1.2 · PYQ 2020-Nov [1] (a) {C} · 5M · Pg 367

LEVEL II
Application**Easy**

PQ 1.3 · PYQ 2021-Jul [1] (a) {C} · 5M · Pg 369

LEVEL II
Application**Easy**

PQ 1.6 · MTP 2022-Sep [6] (c) · 5M · Pg 372

LEVEL II
Application**Easy**

PQ 1.4 · PYQ 2022-May [1] (d) {C} · 5M · Pg 370

LEVEL II
Application**Medium**

PQ 1.8 · PYQ 2024-May [3] (a) · 7M · Pg 374

LEVEL II
Application**Medium**

PQ 1.10 · RTP 2025-Jan [6] · Pg 377

LEVEL II
Application**Medium**

PQ 1.7 · PYQ 2023-May [1] (a) {C} · 5M · Pg 373

LEVEL II
Application**Hard****Evaluation** judge it against the standard · 1 question

- Where a contractor has deferred an expected loss or spread it over the remaining term, say that AS 7 requires immediate recognition in full and give the corrected figure.

PQ 1.1 · PYQ 2019-May [1] (a) {C} · 5M · Pg 366

LEVEL II
Evaluation**Easy**

Topic 2: AS 9-Revenue Recognition

L2P1-C8-U8-T02

Read first Read Chapter 8 Unit 2, AS 9 Revenue Recognition, Study Material pages 8.36–8.59 — §2.2 Definition of revenue, §2.3 Agency relationship, §2.4–2.5 Sale of goods and timing, §2.6 Rendering of

services, §2.7 Interest, royalties and dividends, §2.8 Conditions for sale of goods, §2.9 Effect of uncertainties, §2.10 Disclosure.

NOTES

Revenue is the **gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities** of an enterprise from the **sale of goods**, the **rendering of services**, and the **use by others of enterprise resources yielding interest, royalties and dividends**. Three sources — every question falls in one of them, so name the source first.

Agency relationship: in an agency relationship the revenue is **the amount of commission**, not the gross inflow collected on behalf of the principal. Amounts collected for the principal are **not revenue of the agent**.

Sale of goods — the three conditions for performance: (i) the seller has **transferred to the buyer the property in the goods for a price**, or (ii) **all significant risks and rewards of ownership have been transferred and the seller retains no effective control** to a degree usually associated with ownership; and (iii) **no significant uncertainty exists regarding the amount of consideration** that will be derived. Note the structure: (i) or (ii), and (iii) in every case.

And one condition over all of them: revenue is recognised **provided that at the time of performance it is not unreasonable to expect ultimate collection**. If at the time of raising the claim it is unreasonable to expect ultimate collection, revenue recognition is postponed.

Rendering of services — two methods: the **proportionate completion method**, which recognises revenue **proportionately with the degree of completion** where performance consists of the **execution of more than one act**; and the **completed service contract method**, where revenue is recognised **on completion or substantial completion**, performance consisting of a **single act** or of acts so significant that completion is essential.

Interest, royalties and dividends — three different bases, and the examiner asks them together: **interest** on a **time proportion basis**, taking into account the amount outstanding and the rate applicable; **royalties** on an **accrual basis in accordance with the terms of the relevant agreement**; **dividends** when the owner's right to receive payment is established.

Uncertainty arising at the time of the claim against uncertainty arising later — this distinction is the heart of the unit. Where the ability to assess ultimate collection **with reasonable certainty** is lacking at the time of raising the claim, revenue recognition is postponed to the extent of the uncertainty. Where the uncertainty as to collectability **arises after the sale or the rendering of the service**, it is more appropriate to make a **separate provision** than to **adjust the revenue originally recorded**.

An essential criterion for recognition is that the **consideration receivable is reasonably determinable**. Where it is not determinable within reasonable limits, **recognition is postponed**.

Disclosure: where revenue recognition is postponed pending the resolution of significant

uncertainties, the **circumstances** must be disclosed.

Remembering reproduce what you have learnt · 1 question

- The three conditions for the sale of goods, and the three bases for interest, royalties and dividends, are list answers. Learn them as lists and reproduce them before applying anything.

PQ 2.9 · MTP 2024-Mar [3] (a) · 4M · Pg 390

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 3 questions

- Name the source of revenue first — goods, services, or use of resources — because the recognition rule follows from it.
- Explain the postponement rule and the provision rule as a contrast: uncertainty at the outset postpones revenue; uncertainty arising later calls for a provision, leaving the revenue intact.

TQ 2.2 · PYQ 2022-Nov [6] (a) · DESC · 5M · Pg 379

LEVEL I
Understanding

Medium

TQ 2.4 · RTP 2024-Sep [8] · DESC · Pg 381

LEVEL I
Understanding

Medium

TQ 2.3 · RTP 2022-Nov [14] · DESC · Pg 380

LEVEL I
Understanding

Hard

Application use the rule — work the problem · 6 questions

- Answer situation-based questions one situation at a time, stating the condition satisfied or failed and then the amount and timing of recognition.
- For services, decide between proportionate completion and completed service by asking whether performance is one act or more than one, and say which method you have chosen and why.
- For an agency arrangement, recognise commission only, and say expressly that the gross collections are not the agent's revenue.
- Where consideration is not reasonably determinable, postpone recognition and say that the circumstances must be disclosed.

PQ 2.2 · PYQ 2019-Nov [1] (c) {C} · 5M · Pg 383

LEVEL II
Application

Easy

PQ 2.4 · PYQ 2021-Jul [6] (c) · 5M · Pg 385

LEVEL II
Application

Easy

PQ 2.11 · MTP 2024-Nov [1] (c) {C} · 5M · Pg 393

LEVEL II
Application

Easy

PQ 2.15 · PYQ 2026-Sep [6] (Or) (a) · 4M · Pg 397

LEVEL II
Application

Easy

PQ 2.10 · RTP 2024-May [16] · Pg 391	LEVEL II Application	Medium
PQ 2.12 · RTP 2025-Jan [7] · Pg 394	LEVEL II Application	Medium

Analysis break it down and examine the interrelationships · 2 questions

- Sale-or-return, goods on consignment, and instalment sales are the standard fact patterns. Test each against transfer of property and transfer of significant risks and rewards separately — they can give different answers, and the standard accepts either limb.

PQ 2.3 · MTP 2020-Oct [1] (b) {C} · 5M · Pg 384	LEVEL II Analysis	Easy
PQ 2.13 · PYQ 2025-Sep [1] (c) {C} · 4M · Pg 395	LEVEL II Analysis	Easy

Evaluation judge it against the standard · 7 questions

- Where a company has reversed earlier revenue because a customer later became doubtful, say that a separate provision is the correct treatment and that the original revenue stands.
- Where revenue has been recognised despite significant uncertainty at the outset, name the condition breached and state the corrected treatment and its effect on profit.

PQ 2.1 · PYQ 2019-May [1] (b) {C} · 5M · Pg 381	LEVEL II Evaluation	Easy
PQ 2.5 · PYQ 2021-Dec [1] (b) {C} · 5M · Pg 386	LEVEL II Evaluation	Easy
PQ 2.6 · MTP 2023-Mar [1] (b) {C} · 5M · Pg 388	LEVEL II Evaluation	Easy
PQ 2.7 · PYQ 2023-May [1] (b) {C} · 5M · Pg 389	LEVEL II Evaluation	Easy
PQ 2.8 · RTP 2023-May [14] · Pg 390	LEVEL II Evaluation	Medium
PQ 2.14 · RTP 2026-Jan [8] · Pg 397	LEVEL II Evaluation	Medium
TQ 2.1 · RTP 2022-May [14] (a) · DESC · Pg 378	LEVEL II Evaluation	Hard

CHAPTER 9

Other Accounting Standards

2 Topics • 23 Classified Questions • Importance: C

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **theory-heavy**Level I — Comprehension & Knowledge **21.8%** 27 of 124 marksLevel II — Analysis & Application **78.2%** 97 of 124 marks

Above the paper's Level I ceiling: 22% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. The theory here is not padding around the problems — it is a fifth or more of what the chapter is worth. Do not prepare this chapter by working sums alone.

Topic 1: AS 12-Accounting Standards for Government Grants

L2P1-C9-U9-T01

Read first Read Chapter 9 Unit 1, AS 12 Accounting for Government Grants, Study Material 2026 July Chapter 9.1, pages 9.1–9.23 — §1.2 Government grants, §1.4 Recognition, §1.5 Non-monetary grants, §1.6 Grants related to specific fixed assets, §1.7 Grants related to revenue, §1.8 Grants of the nature of promoters' contribution, §1.9 Refund, §1.10 Disclosure.

NOTES

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

Recognition — two conditions, both required: a grant is **not recognised until there is reasonable assurance that** (i) the enterprise **will comply with the conditions attaching to it**, and (ii) **the grant will be received**. **Receipt of a grant is not of itself conclusive evidence that the conditions have been or will be fulfilled** — that sentence is the answer to a whole family of questions where the money has arrived but compliance is doubtful.

Non-monetary grants: where the grant takes the form of a non-monetary asset such as land, given at a **concessional rate**, it is usual to account for the asset at its **acquisition cost**. A non-monetary asset given **free of cost is recorded at a nominal value**. Market value does not come into it — that is the trap.

Grants related to specific fixed assets are those whose **primary condition is that the enterprise should purchase, construct or otherwise acquire such assets**; other conditions may restrict the type or location of the assets, or the periods in which they are to be acquired or held. Two presentations are permitted: **deduct the grant from the gross value of the asset** to arrive at its book value, **or** treat it as **deferred income**, recognised in profit and loss on a **systematic and**

rational basis over the useful life of the asset.

Grants related to revenue are presented either as a credit in the statement of profit and loss, separately or under a general heading such as 'Other Income', or deducted in reporting the related expense. Both are acceptable — say which you have chosen.

Grants of the nature of promoters' contribution: where a grant is given with reference to the total investment in an undertaking, or by way of contribution towards its total capital outlay — a central investment subsidy scheme, for instance — and **no repayment is ordinarily expected**, it is treated as capital reserve, which can **neither be distributed as dividend nor considered as deferred income**. That last clause is regularly examined.

Refund of a government grant is treated as an **extraordinary item under AS 5**. For a **revenue grant**, the refundable amount is applied **first against any unamortised deferred credit** remaining, and any excess — or the whole, where no deferred credit exists — is **charged immediately to the statement of profit and loss**. For a grant related to a **specific fixed asset**, the refund is recorded by **increasing the book value of the asset or by reducing the deferred income balance**, as appropriate.

Where the book value of the asset is increased on refund, depreciation on the revised book value is provided **prospectively over the residual useful life** of the asset.

Refund of a promoters' contribution grant is applied **first against any capital reserve** created in respect of it, and any excess is charged to the statement of profit and loss.

Disclosure: the **accounting policy adopted**, including the methods of presentation; and the **nature and extent** of grants recognised, including grants of non-monetary assets given at a concessional rate or free of cost.

Remembering reproduce what you have learnt · 1 question

- The definition, the two recognition conditions, and the three classes of grant — specific fixed asset, revenue, promoters' contribution — are quotable and decide the treatment.

PQ 1.8 · PYQ 2022-May [1] (a) {C} · 5M · Pg 410

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 3 questions

- Classify the grant first. Almost every mark in this unit follows from getting the class right, and stating it costs one line.
- Where two presentations are permitted, give both and say which you have adopted. An answer that gives only one is incomplete.

PQ 1.1 · PYQ 2018-May [1] (a) {C} · 5M · Pg 402

LEVEL I
Understanding

Easy

PQ 1.10 · MTP 2023-Mar [1] (b) {C} · 5M · Pg 412	LEVEL I Understanding	Easy
PQ 1.14 · RTP 2024-Sep [10] · Pg 417	LEVEL I Understanding	Medium

Application use the rule — work the problem · 7 questions

- Pass the journal entries and show the presentation in the statement of profit and loss and the balance sheet. Questions almost always ask for both.
- For a grant related to a fixed asset, show the deferred income being released over the useful life, or the reduced book value and the revised depreciation — whichever presentation you chose.
- On a refund, apply it first against the unamortised deferred credit or the capital reserve as the case requires, and charge only the excess to profit and loss. Show that order of set-off.
- Treat the refund as an extraordinary item and say so; it is a separate mark.

PQ 1.3 · MTP 2020-May [1] (c) {C} · 5M · Pg 404	LEVEL II Application	Easy
PQ 1.4 · PYQ 2020-Nov [1] (b) {C} · 5M · Pg 405	LEVEL II Application	Easy
PQ 1.5 · PYQ 2021-Jan [1] (a) {C} · 5M · Pg 406	LEVEL II Application	Easy
PQ 1.12 · PYQ 2023-Nov [1] (d) {C} · 5M · Pg 415	LEVEL II Application	Easy
PQ 1.2 · RTP 2019-Nov [18] (b) · Pg 403	LEVEL II Application	Medium
PQ 1.9 · RTP 2022-May [19] (a) · Pg 411	LEVEL II Application	Medium
PQ 1.11 · PYQ 2023-May [1] (c) {C} · 5M · Pg 413	LEVEL II Application	Hard

Evaluation judge it against the standard · 4 questions

- Where a grant has been recognised on receipt alone, quote the rule that receipt is not conclusive evidence of compliance, and say whether recognition was premature.
- Where a promoters' contribution grant has been taken to income or treated as deferred income, say that it belongs in capital reserve and can be neither distributed nor deferred.

PQ 1.7 · PYQ 2021-Jul [1] (c) {C} · 5M · Pg 408	LEVEL II Evaluation	Easy
PQ 1.6 · RTP 2021-May [19] (a) (i) · Pg 407	LEVEL II Evaluation	Medium
PQ 1.13 · RTP 2023-Nov [19] · Pg 416	LEVEL II Evaluation	Medium
PQ 1.15 · RTP 2026-Jan [10] · Pg 418	LEVEL II	Medium

Topic 2: AS 14-Accounting for Amalgamation

L2P1-C9-U9-T02

Read first Read Chapter 9 Unit 2, AS 14 Accounting for Amalgamations, Study Material 2026 July Chapter 9.2, pages 9.24–9.47 — §2.3 Types, §2.4–2.5 Merger and purchase conditions, §2.6 Methods of accounting, §2.7 Consideration, §2.8–2.10 Reserves, §2.11 Goodwill, §2.13 Disclosures, §2.14 Amalgamation after the balance sheet date.

NOTES

Two categories: merger, where there is a **genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses**; and **purchase**, which is **in effect a mode by which one company acquires another**, with the consequence that the shareholders of the acquired company **normally do not continue to have a proportionate share** in the combined business.

Amalgamation in the nature of merger requires ALL five conditions — and the examiner will remove one of them to see whether you notice: (i) **all the assets and liabilities of the transferor become those of the transferee**; (ii) **shareholders holding not less than 90% of the face value of the equity shares** of the transferor (other than shares already held by the transferee or its subsidiaries or their nominees) **become equity shareholders of the transferee**; (iii) the **consideration to those equity shareholders who agree to become equity shareholders is discharged wholly by the issue of equity shares**, except for cash for fractional shares; (iv) the **business of the transferor is intended to be carried on** by the transferee; and (v) **no adjustment is intended to the book values of the assets and liabilities** of the transferor, except to align accounting policies.

If any one condition fails, it is an amalgamation in the nature of purchase. State the failing condition by name — that is where the marks are.

The two methods follow the two categories: pooling of interests for a merger, **purchase method** for a purchase.

Pooling of interests: the object is to account for the amalgamation **as if the separate businesses were intended to be continued**, so only **minimal changes** are made in aggregating the individual financial statements. **Assets, liabilities and reserves of the transferor are recorded at their existing carrying amounts.**

Purchase method: assets and liabilities are recorded either at their **existing carrying amounts** or by **allocating the consideration to individual identifiable assets and liabilities on the basis of their fair values** at the date of amalgamation.

Consideration means the **aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee to the shareholders of the transferor.**

In determining its value, an **assessment is made of the fair value of its elements**. Note the definition carefully: it is what is given **to the shareholders**, so payments to debenture holders or creditors are not part of it.

Two methods of computing it: the **Net Payment Method** and the **Net Assets Method**. The Study Material is explicit — **compute by the Net Payment Method; only if it cannot be computed that way does the Net Assets Method apply**. Say which you are using and why.

Reserves — the difference between the two methods is the whole of many questions. In a **merger**, the **identity of the reserves is preserved**: the General Reserve of the transferor becomes the General Reserve of the transferee, the Capital Reserve becomes the Capital Reserve, and so on. In a **purchase**, the **identity of the reserves is not preserved, other than statutory reserves**.

The balancing figure differs too. Under **pooling of interests**, the difference between the amount recorded as share capital issued (plus any additional consideration in cash or other assets) and the amount of share capital of the transferor is **adjusted in reserves**. Under the **purchase method**, the consideration is **deducted from the value of the net assets acquired**: if the result is **negative**, the **difference is debited to Goodwill**; if **positive**, it is **credited to Capital Reserve**.

Statutory reserves in a purchase are preserved by recording them with a corresponding debit to '**Amalgamation Adjustment Account**', shown as a separate line item under assets, and reversed when the statutory obligation ends.

Goodwill arising on amalgamation represents a **payment made in anticipation of future income** and is treated as an **asset amortised to income on a systematic basis over its useful life**. Because that life is hard to estimate, the estimate is made **on a prudent basis**, and it is considered appropriate to **amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified**.

Amalgamation after the balance sheet date: where it is effected **after the balance sheet date but before the issuance of the financial statements** of either party, **disclosure is made in accordance with AS 4 but the amalgamation is not incorporated in the financial statements**. It may nevertheless provide information affecting the statements — for instance by allowing the **going concern assumption to be maintained**.

Understanding explain it, and place it in context · 1 question

- Classify the amalgamation first, condition by condition, and name the one that fails if it is a purchase. Everything else follows from the classification.
- Be able to contrast the two methods in three respects: valuation of assets, treatment of reserves, and the balancing figure.

Application use the rule — work the problem · 7 questions

- Compute purchase consideration by the Net Payment Method unless it cannot be computed that way, and say which method you used. Show the elements at fair value.
- Remember that consideration is what goes to the shareholders. Payments to debenture holders, creditors or for liquidation expenses are not part of it.
- In a purchase, strike the difference between consideration and net assets and take it to Goodwill or Capital Reserve, stating which and why.
- In a merger, carry reserves across unchanged and put the balancing difference through reserves — not through goodwill.
- Preserve statutory reserves in a purchase through the Amalgamation Adjustment Account, and show it as a separate item on the assets side.
- Where goodwill arises, state the amortisation policy and the period, with the five-year limit and any justification for exceeding it.

PQ 2.1 · PYQ 2018-Nov [1] (b) {C} · 5M · Pg 420	LEVEL II Application	Easy
PQ 2.2 · PYQ 2021-Dec [1] (d) {C} · 5M · Pg 421	LEVEL II Application	Easy
PQ 2.3 · PYQ 2022-Nov [6] (e) · 5M · Pg 422	LEVEL II Application	Medium
PQ 2.4 · MTP 2024-Jul [3] (b) · 4M · Pg 423	LEVEL II Application	Medium
PQ 2.5 · RTP 2025-Jan [10] · Pg 424	LEVEL II Application	Medium
PQ 2.6 · RTP 2025-Sep [15] · Pg 424	LEVEL II Application	Medium
PQ 2.7 · PYQ 2026-Sep [2] (b) · 4M · Pg 425	LEVEL II Application	Hard

CHAPTER 10

Accounting Standards for Consolidated Financial Statements

3 Topics • 23 Classified Questions • Importance: B

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **problems only**

Level I — Comprehension & Knowledge **3.3%** 8 of 245 marks

Level II — Analysis & Application **96.7%** 237 of 245 marks

Below the paper's Level I floor: only 3% of this chapter's marks are Comprehension and Knowledge, against 5-15% for the paper. There is almost no theory to fall back on. Every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: AS 21-Consolidated Financial Statements

L2P1-C10-U10-T01

Read first Read Chapter 10 Unit 1, AS 21 Consolidated Financial Statements, Study Material 2026 July Chapter 10.1, pages 10.1-10.115 — §1.6 Control, §1.7 Exclusion from consolidation, §1.10 Consolidation procedures, §1.12 Minority interests, §1.14 Consolidation adjustments, §1.17 Uniform accounting policies, §1.18 Subsidiary with preference share capital.

NOTES

Control — two independent tests, and either one is enough: control exists when the parent **owns, directly or indirectly through subsidiaries, more than one-half of the voting power** of an enterprise; **control also exists** when an enterprise **controls the composition of the board of directors** — or of the corresponding governing body where the enterprise is not a company — **so as to obtain economic benefits from its activities**. Questions frequently give a shareholding below 50% with board control, and the second limb is the answer.

Exclusion from consolidation — only two grounds: (a) **control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future**; or (b) **it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent**. In consolidated statements, investments in such subsidiaries are accounted for under **AS 13**. Dissimilarity of activities is **not** a ground for exclusion.

Procedure: the individual balances of parent and subsidiaries are combined **line by line** — cash with cash, trade receivables with trade receivables — and then the **consolidation adjustments** are made. **Rule 6 of the Companies (Accounts) Rules, 2014** requires consolidation in accordance with **Schedule III** and the applicable standards.

The core eliminations: the **cost of the parent's investment is offset against the parent's portion**

of equity in the subsidiary at the date of acquisition, producing goodwill or capital reserve; intra-group balances and intra-group transactions are eliminated in full; and unrealised profit on intra-group stock and fixed asset transfers is eliminated.

Capital against revenue profits — the distinction on which every consolidation question turns.

The subsidiary's **pre-acquisition** profits and reserves are **capital profits** and go into the cost-of-control computation; **post-acquisition** profits are **revenue profits**, divided between the group and the minority.

Minority interest is that part of the net assets of a subsidiary attributable to interests held by outsiders. Minority interest in the net income of consolidated subsidiaries is **identified and adjusted against the income of the group** to arrive at the net income attributable to the parent's shareholders. In the balance sheet it is **presented separately from liabilities and from the equity of the parent's shareholders** — a third category, not a liability.

Revaluation of the subsidiary's assets: where the parent revalues the subsidiary's assets for consolidation — a revaluation **not made in the subsidiary's own separate statements** — the **profit or loss on revaluation is treated as a capital profit or loss**. But if the fall in value occurs after the date of acquisition, the loss is a revenue loss. Depreciation on the changed value must be given effect to, and depreciation on the revalued portion is treated as capital.

Uniform accounting policies: consolidated statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. Where a group company uses different policies, **appropriate adjustments are made to its financial statements** when they are used in preparing the consolidation.

Subsidiary with preference share capital: outstanding **cumulative** preference shares issued by a subsidiary and **held outside the group** are considered in the same manner as any other liability, such as debentures. So in computing its share of the subsidiary's profit or loss, the parent **adjusts for the preference dividend on those shares whether or not it has been declared**.

Presentation: goodwill arising on consolidation is shown as an asset; capital reserve as a reserve. Where both arise on different subsidiaries, **they are not netted off** unless the question directs otherwise.

Application use the rule — work the problem · 21 questions

- Work the standard four schedules before touching the balance sheet: analysis of the subsidiary's profits into capital and revenue, cost of control (goodwill or capital reserve), minority interest, and consolidated profit and loss. Every mark in the question sits in one of them.
- Split the subsidiary's reserves and profits at the date of acquisition first. Getting the capital-revenue split right is worth more than any other single step.
- Eliminate intra-group balances and unrealised profit in full, then charge the minority with its share of the unrealised profit only where the selling company is the subsidiary.
- Where the parent revalues the subsidiary's assets, treat the revaluation as capital, adjust depreciation on the revised value, and remember that a post-acquisition fall is a revenue loss.

- For cumulative preference shares held outside the group, deduct the preference dividend before computing the parent's share, whether or not it has been declared.
- Present minority interest as a separate line, not within liabilities, and show goodwill and capital reserve without netting.

PQ 1.1 · MTP 2020-Oct [2] (b) · 4M · Pg 430	LEVEL II Application	Easy
PQ 1.4 · MTP 2022-Sep [4] (b) · 5M · Pg 436	LEVEL II Application	Easy
PQ 1.2 · RTP 2021-May [11] · Pg 431	LEVEL II Application	Medium
PQ 1.5 · RTP 2022-Nov [10] · Pg 437	LEVEL II Application	Medium
PQ 1.7 · RTP 2023-Nov [11] · Pg 442	LEVEL II Application	Medium
PQ 1.10 · RTP 2024-May [17] · DESC · Pg 454	LEVEL II Application	Medium
PQ 1.16 · PYQ 2025-May [5] (a) · 10M · Pg 473	LEVEL II Application	Medium
PQ 1.17 · PYQ 2025-May [5] (b) · 4M · Pg 476	LEVEL II Application	Medium
PQ 1.20 · PYQ 2026-May [5] (a) · 10M · Pg 487	LEVEL II Application	Medium
PQ 1.3 · MTP 2022-Mar [5] (a) · 15M · Pg 432	LEVEL II Application	Hard
PQ 1.6 · PYQ 2023-Nov [3] (a) · 15M · Pg 440	LEVEL II Application	Hard
PQ 1.8 · MTP 2024-Mar [5] · 14M · Pg 445	LEVEL II Application	Hard
PQ 1.9 · PYQ 2024-May [5] · 14M · Pg 449	LEVEL II Application	Hard
PQ 1.11 · MTP 2024-Jul [5] · 14M · Pg 455	LEVEL II Application	Hard
PQ 1.12 · PYQ 2024-Sep [5] · 14M · Pg 459	LEVEL II Application	Hard
PQ 1.13 · MTP 2024-Nov [5] · 14M · Pg 463	LEVEL II Application	Hard
PQ 1.14 · PYQ 2025-Jan [5] · 14M · Pg 466	LEVEL II Application	Hard
PQ 1.15 · MTP 2025-Mar S1 [2] · 14M · Pg 470	LEVEL II Application	Hard
PQ 1.18 · PYQ 2025-Sep [5] · 14M · Pg 477	LEVEL II Application	Hard

PQ 1.19 · PYQ 2026-Jan [5] · 14M · Pg 482

LEVEL II
Application

Hard

PQ 1.21 · PYQ 2026-Sep [5] · 14M · Pg 490

LEVEL II
Application

Hard

Topic 2: AS 23-Accounting for Investments in Associates in Consolidated Financial Statements

L2P1-C10-U10-T02

Read first Read Chapter 10 Unit 2, AS 23 Accounting for Investments in Associates in Consolidated Financial Statements, Study Material 2026 July Chapter 10.2, pages 10.116–10.140 — §2.3 Definitions, §2.4 Associates accounted for using the equity method, §2.5 Circumstances under which the equity method is followed, §2.6 Application of the equity method, §2.7 Contingencies, §2.9 Disclosure.

NOTES

An **associate** is an enterprise in which the investor has **significant influence** and which is **neither a subsidiary nor a joint venture** of the investor. **Significant influence** is the power to **participate in the financial and/or operating policy decisions** of the investee **but not control** them.

The **20% presumption, and it works both ways**: holding **20% or more of the voting power** is presumed to give significant influence **unless it can be clearly demonstrated otherwise**; holding **less than 20%** is presumed not to, **unless significant influence can be clearly demonstrated**. Say which presumption applies and whether the facts rebut it.

The **equity method** is a method whereby the investment is **initially recorded at cost, identifying any goodwill or capital reserve arising at the time of acquisition**. The **carrying amount is adjusted thereafter for the post-acquisition change in the investor's share of the net assets of the investee**, and the consolidated statement of profit and loss reflects the investor's share of the results of operations.

AS 23 applies only in consolidated financial statements. In the investor's **separate** statements the investment continues to be accounted for under **AS 13**. That is a standing one-mark point and candidates lose it constantly.

When the equity method is NOT followed — the same two grounds as AS 21: (a) **control or the investment is intended to be temporary because it is acquired and held exclusively with a view to its subsequent disposal in the near future**; or (b) the associate **operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor**. In those cases the investment is carried under AS 13.

Applying the method: the investment is recorded under the equity method **from the date the relationship comes into effect**. Any **difference between cost and the investor's share of equity at the date of acquisition is goodwill or capital reserve** — the Study Material's Case 1 has a 22% holding costing ₹33,000 against total equity of ₹2,00,000, giving a share of ₹44,000 and therefore a

capital reserve.

Goodwill or capital reserve arising on an associate is included in the carrying amount of the investment and is disclosed separately — it is not shown as a separate asset in the consolidated balance sheet.

Post-acquisition adjustments: the investor's share of the associate's **profits or losses** adjusts the carrying amount and enters consolidated profit and loss; **distributions received reduce the carrying amount**; and adjustments are also made for changes in the associate's equity that have not passed through its profit and loss, such as a **revaluation reserve** — those go to the corresponding reserve in the consolidated statements.

Losses: where the investor's share of losses **equals or exceeds the carrying amount of the investment, the investor discontinues recognising further losses** and the investment is reported at nil. Further losses are provided for only to the extent the investor has incurred obligations or made payments on behalf of the associate.

Uniform policies and unrealised profits: adjustments are made for **differences in accounting policies** where practicable, and **unrealised profits and losses on transactions between the investor and the associate are eliminated to the extent of the investor's interest** — to the extent of the interest, not in full, which is the difference from AS 21.

Contingencies: the investor discloses its **share of the contingencies and capital commitments of the associate**, and those for which it is contingently liable.

Remembering reproduce what you have learnt · 1 question

- The definition of significant influence and the 20% presumption in both directions are quotable. State them before classifying the holding.
- Remember that AS 23 operates only in consolidated statements; AS 13 governs the separate statements.

PQ 2.1 · RTP 2024-Sep [15] · Pg 492

LEVEL I
Remembering**Medium****Application** use the rule — work the problem · 1 question

- Work in order: establish significant influence, compute the investor's share of equity at acquisition, strike goodwill or capital reserve, then adjust for post-acquisition share of profits, distributions and other equity movements.
- Include goodwill in the carrying amount of the investment and disclose it separately rather than showing it as a separate asset.
- Eliminate unrealised profit on transactions with the associate to the extent of the investor's interest only.
- Where accumulated losses have reduced the investment to nil, stop recognising further losses and say why.

PQ 2.2 · RTP 2025-Jan [17] · Pg 493

LEVEL II
Application

Medium

Topic 3: AS 27-Financial Reporting of Interests in Joint Ventures

L2P1-C10-U10-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read Chapter 10 Unit 3, AS 27 Financial Reporting of Interests in Joint Ventures, Study Material 2026 July Chapter 10.3, pages 10.141–10.176 — §3.3 Definitions, §3.4 Contractual arrangement, §3.5 Forms of joint venture, §3.6–3.8 JCO, JCA and JCE, §3.9 Consolidated financial statements, §3.10 Transactions between a venturer and the joint venture, §3.13 Disclosure.

NOTES

Definition: a joint venture is a **contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control**. Two essential conditions follow: **two or more parties coming together** — individuals or any form of business organisation, a body of individuals, an association of persons, a company or a firm — and **a contractual arrangement establishing joint control**.

Joint control is the **contractually agreed sharing of control** over an economic activity, and it is what distinguishes a joint venture from an associate or a subsidiary. **Without a contractual arrangement there is no joint venture**, however equal the shareholdings.

Three forms, and the reporting differs entirely between them: **Jointly Controlled Operations (JCO)**, **Jointly Controlled Assets (JCA)** and **Jointly Controlled Entities (JCE)**.

Jointly Controlled Operations: **no separate entity is created**. Each venturer uses **its own resources**, raises its own funds, incurs its own expenses and realises its own sales, and uses the **same assets and employees for the joint venture and for its own business**. The agreement provides how the revenue from the jointly produced product and any shared expenses are divided.

Reporting a JCO: the venturer recognises in its own statements **the assets it controls, the liabilities it incurs, the expenses it incurs, and its share of the income** from the joint venture. **No adjustment or consolidation procedure is required** — that is the point of the form.

Jointly Controlled Assets: again **no separate legal entity**; the venturers **own the assets jointly** and use them to generate economic benefits for each of them, taking up expenses and liabilities per the contract. Three features to state: **no separate legal identity, common control over the joint assets, and use of the asset for each venturer's own benefit**.

Reporting a JCA: the venturer recognises **its share of the jointly controlled assets, classified according to their nature; any liabilities it has incurred; its share of any liabilities incurred jointly;**

any income from the sale or use of its share of the output, together with its share of expenses; and **any expenses it has incurred in respect of its interest**.

Jointly Controlled Entities: the venturers **create a new entity** — a corporation, partnership or other entity in which each venturer has an interest — with a **contractual arrangement establishing joint control**. The entity **purchases its own assets, incurs its own liabilities and expenses, and makes its own sales**.

Reporting a JCE: in **consolidated financial statements** the venturer reports its interest using **proportionate consolidation** — combining its share of each of the assets, liabilities, income and expenses line by line. In its **separate financial statements** the interest is accounted for as an investment under **AS 13**.

Transactions between a venturer and the joint venture — the asymmetry is the examinable point. When a venturer **sells or contributes assets to** the joint venture, it recognises **only that portion of the gain or loss attributable to the interests of the other venturers**; but it recognises the **full amount of any loss** where the transaction provides **evidence of a reduction in the net realisable value of current assets or an impairment loss**. When a venturer **purchases assets from** the joint venture, it does **not recognise its share of the profit** until it **disposes of the assets** to an independent party; losses are recognised on the same basis as above.

CONCEPT BASE: the Scanner declares this topic but carries no question for it in this edition. It remains examinable, and the three forms with their reporting treatments are the most likely form of question.

CHAPTER 11

Financial Statements of Companies

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **problems only**

Level I — Comprehension & Knowledge

0.0%

0 of 375 marks

Level II — Analysis & Application

100.0%

375 of 375 marks

Below the paper's Level I floor: none of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. There is almost no theory to fall back on. Every mark here is earned by working the problem, so preparation is practice, not reading.

Unit 11.1: Preparation of Financial Statements (Importance: B)

6 Topics • 22 Classified Questions

Topic 1: Meaning of a Company

L2P1-C11-U11.1-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read Chapter 11 Unit 1, §1.1 Meaning of Company, Study Material 2026 July pages 11.2–11.4 — the Section 2 definitions of the various types of company.

NOTES

Section 2(20): a **company** means a company **incorporated under the Companies Act, 2013 or under any previous company law** — the Companies Act, 1956, for instance.

Section 2(21) — company limited by guarantee: a company having the liability of its members **limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.**

Section 2(22) — company limited by shares: a company having the liability of its members **limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.**

Other definitions to have ready: **private company** (Section 2(68)), **public company** (Section 2(71)), **One Person Company** (Section 2(62)), **small company** (Section 2(85)), **holding** and **subsidiary** company (Sections 2(46) and 2(87)), **listed company** (Section 2(52)) and **government company** (Section 2(45)).

Why the classification matters for accounts, which is the angle the examiner takes: the type of company determines **which financial statements must be prepared** — a One Person Company,

small company and dormant company **need not include a cash flow statement** — and determines the **applicability of the Accounting Standards** through the SMC criteria in Chapter 3.

CONCEPT BASE: the Scanner declares this topic but carries no question for it in this edition. It underpins the rest of the chapter, so read it once and move on.

Topic 2: Maintenance of Books of Accounts

L2P1-C11-U11.1-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read §1.2 Maintenance of Books of Account, Study Material pages 11.4–11.7 — Section 128 and the conditions attaching to it.

NOTES

Section 128: every company shall **prepare and keep at its registered office** books of account and other relevant books and papers **and financial statements for every financial year** which **give a true and fair view of the state of the affairs of the company**, including that of its branch offices.

The four requirements built into that sentence — and questions are usually built on one of them: the books must be kept **at the registered office**; they must be for **every financial year**; they must be on the **accrual basis and according to the double entry system**; and they must give a **true and fair view**.

Books may be kept at another place in India if the Board so decides, provided the company **files a notice in writing with the Registrar within seven days** giving the full address of that place.

Books may be kept in electronic mode in the prescribed manner.

Where the company has a branch office, in or outside India, it is deemed to have complied if **proper books of account relating to the transactions effected at the branch are kept at that office** and **proper summarised returns are sent periodically to the registered office** or the other place where the books are kept.

Preservation: the books of account, together with the vouchers relevant to any entry, must be kept in good order for **not less than eight financial years immediately preceding the relevant financial year** — or, where the company has been in existence for less than eight years, for all preceding years.

CONCEPT BASE: declared by the Scanner but not yet examined in this edition. The eight-year preservation rule and the seven-day notice are the two most quotable facts.

Topic 3: Statutory Books

L2P1-C11-U11.1-T03

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §1.3 Statutory Books, Study Material pages 11.7–11.8 — the registers and the section under which each is maintained.

NOTES

Learn these as pairs of register and section — that is how they are asked:

Register of Investments of the company held in its own name — **Section 187.**

Register of Charges — **Section 85.**

Register of Members — **Section 88.**

Register of Debenture-holders and other Security holders — **Section 88.**

Minute Books — **Section 118.**

Register of Contracts or arrangements in which directors are interested — **Section 189.**

Register of Directors and Key Managerial Personnel and their shareholding — **Section 170.**

Register of Loans and Investments by the company — **Section 186.**

Register of Renewed and Duplicate Share Certificates and the **Register of Deposits** complete the usual list; check 1.3 for the full set as printed.

CONCEPT BASE: declared but not examined in this edition. It is a list question if it comes, so learn the list rather than the narrative.

Topic 4: Annual Returns

L2P1-C11-U11.1-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §1.4 Annual Return, Study Material pages 11.8–11.10 — Section 92, who signs, and the filing deadlines.

NOTES

Section 92: every company shall **prepare an annual return in the prescribed form, signed by a director and the company secretary** or, where there is no company secretary, **by a company**

secretary in practice.

The relaxation for small entities: for a **One Person Company** and a **small company**, the annual return is **signed by the company secretary or, where there is none, by the director** of the company. Note that a practising company secretary is not required.

Filing: the annual return is filed with the **Registrar within 60 days from the date of the annual general meeting**; or, where **no AGM is held** in a year, **within 60 days from the date on which the AGM should have been held, together with a statement of the reasons why it was not held.**

The two deadlines are a standing question: sixty days from the AGM, or sixty days from the date it ought to have been held, with reasons.

CONCEPT BASE: declared but not yet examined in this edition.

Topic 5: Final Accounts

L2P1-C11-U11.1-T05

Read first Read §1.5 Final Accounts, Study Material pages 11.10–11.18, together with the Schedule III formats — Section 129 and the components of financial statements under Section 2(40).

NOTES

Section 129: at the annual general meeting the **Board of Directors shall lay financial statements before the company**, and those statements must give a **true and fair view** and comply with the **Accounting Standards notified under Section 133**, being in the form provided in **Schedule III**.

Financial statements under Section 2(40) comprise: (i) a **balance sheet** as at the end of the financial year; (ii) a **profit and loss account**, or an **income and expenditure account** for a company carrying on activity not for profit; (iii) a **cash flow statement**; (iv) a **statement of changes in equity, if applicable**; and (v) any **explanatory note** annexed to or forming part of those documents.

The exemption to remember: the financial statements of a **One Person Company, small company and dormant company** may not include the cash flow statement.

Schedule III discipline — where most marks are won and lost in this topic. Present the balance sheet under **Equity and Liabilities** then **Assets**, each split into the prescribed heads; classify every item as **current or non-current**; and put the detail in **Notes to Accounts**, cross-referenced by note number from the face of the statement.

Current against non-current is decided by the operating cycle, expected realisation or settlement within twelve months, whether the asset is held primarily for trading, and whether the company has an unconditional right to defer settlement for at least twelve months. Apply the test item by item rather than by habit.

The items that most often go wrong: **calls in arrear** deducted from subscribed capital; **provision**

for tax and **proposed dividend** treated as required by the Act and the standards; **trade receivables outstanding more than six months** disclosed separately; a **non-Scheduled Bank balance** disclosed separately from other bank balances; and **preliminary and share issue expenses** written off rather than carried as an asset.

Depreciation is provided as specified in **Schedule II**, and where assets are **sold, discarded, demolished or destroyed** in any financial year, the **excess of written down value over sale proceeds as scrap must be written off in that same financial year**.

Application use the rule — work the problem · 17 questions

- Prepare the answer in Schedule III order and label every head and sub-head. A correct trial balance transcribed into a non-Schedule III format loses presentation marks that cost more than any arithmetic slip.
- Do the notes to accounts properly and number them, then cross-reference from the face of the balance sheet and the statement of profit and loss. Questions almost always ask for the notes and they carry substantial marks.
- Work the adjustments in a fixed order — depreciation, provision for tax, transfers to reserves, proposed or interim dividend, then anything specific to the question — and show a working for each.
- Classify every item as current or non-current explicitly. Where the classification is debatable, state the test you applied.
- Watch the standing traps: calls in arrear, a bank balance with a non-Scheduled Bank, receivables over six months, and any preliminary expenses still sitting in the trial balance.

PQ 5.15 · PYQ 2025-Jan [6] (Or) (a) · 4M · Pg 547	LEVEL II Application	Easy
PQ 5.1 · RTP 2019-Nov [1] (a) · Pg 498	LEVEL II Application	Medium
PQ 5.2 · PYQ 2019-Nov [5] (a) · 10M · Pg 503	LEVEL II Application	Medium
PQ 5.7 · PYQ 2023-May [4] (a) · 10M · Pg 520	LEVEL II Application	Medium
PQ 5.8 · RTP 2023-Nov [1] · Pg 523	LEVEL II Application	Medium
PQ 5.11 · RTP 2024-May [18] · Pg 536	LEVEL II Application	Medium
PQ 5.4 · MTP 2020-Oct [2] (a) · 16M · Pg 507	LEVEL II Application	Hard
PQ 5.5 · PYQ 2021-Jul [4] · 20M · Pg 511	LEVEL II Application	Hard
PQ 5.6 · PYQ 2022-Nov [4] · 20M · Pg 515	LEVEL II Application	Hard

PQ 5.9 • PYQ 2023-Nov [4] • 20M • Pg 526	LEVEL II Application	Hard
PQ 5.10 • MTP 2024-Mar [2] • 14M • Pg 532	LEVEL II Application	Hard
PQ 5.12 • PYQ 2024-Sep [2] • 14M • Pg 539	LEVEL II Application	Hard
PQ 5.13 • MTP 2024-Nov [2] • 14M • Pg 543	LEVEL II Application	Hard
PQ 5.16 • PYQ 2025-May [2] • 14M • Pg 549	LEVEL II Application	Hard
PQ 5.17 • PYQ 2025-Sep [2] • 14M • Pg 553	LEVEL II Application	Hard
PQ 5.18 • PYQ 2026-May [2] • 14M • Pg 557	LEVEL II Application	Hard
PQ 5.19 • PYQ 2026-Sep [2] (a) • 10M • Pg 561	LEVEL II Application	Hard

Evaluation judge it against the standard • 2 questions

- Where a company has mis-classified an item or omitted a required disclosure, name the Schedule III head, state the correct presentation and quantify the effect on the totals.
- Conclude on whether the statements give a true and fair view, and say what would have to change for them to do so.

PQ 5.3 • PYQ 2019-Nov [6] (a) • 5M • Pg 506	LEVEL II Evaluation	Easy
PQ 5.14 • MTP 2024-Nov [6] (Or) (a) • 4M • Pg 547	LEVEL II Evaluation	Easy

Topic 6: Distributed Profit

L2P1-C11-U11.1-T06

Read first Read §1.6 Distributable Profit, Study Material pages 11.18–11.28 — the meaning of dividend, Section 123(1) to (3), Section 123(2) and Schedule II, and the Companies (Declaration and Payment of Dividend) Rules, 2014.

NOTES

Why the topic exists: the profit disclosed by the profit and loss account is **not in every case available for distribution**. Availability depends on the **composition of the profits and on the provisions and appropriations that must be made out of them in priority**.

Meaning of dividend: a **distribution of divisible profit among the members according to the number of shares held and the rights attaching to them**. Such a distribution may or may not

entail a release of assets — it does where cash is paid; **where profits are capitalised and applied towards bonus shares issued free, no assets are released**, because profits are merely capitalised and the paid-up capital increased. **Section 2(35) — 'dividend' includes interim dividend.**

Section 123(1) — the four permitted sources, and nothing else: (a) **out of the profits of the company for that financial year arrived at after providing for depreciation** under Section 123(2); (b) **out of the undistributed profits of any previous financial years** arrived at after providing for depreciation; (c) **out of both**; or (d) **out of moneys provided by the Central or a State Government** for the payment of dividend in pursuance of a guarantee given by that government.

And the proviso: no dividend shall be declared or paid from reserves other than free reserves.

The two principles to state at the head of any answer: dividends cannot be declared except out of profits, and capital cannot be returned to shareholders by way of dividend. Paying from any other source amounts to payment of dividend out of capital.

Depreciation: declaration presupposes a trading profit or surplus **after providing for depreciation not only for the year in which the profits were earned but also for any arrears of depreciation of past years.** Section 123(2) requires depreciation to the extent specified in **Schedule II.** Where assets are **sold, discarded, demolished or destroyed**, the **excess of written down value over sale proceeds as scrap is written off in the same financial year.**

Interim dividend — Section 123(3): the Board may declare interim dividend during any financial year **out of the surplus in the profit and loss account and out of profits of the financial year in which it is declared.** **Proviso:** where the company has incurred a loss during the current financial year up to the end of the quarter immediately preceding the date of declaration, the interim dividend **shall not be declared at a rate higher than the average dividends declared during the immediately preceding three financial years.**

Dividend out of accumulated profits in a year of inadequate or absent profits — the Companies (Declaration and Payment of Dividend) Rules, 2014, and the conditions are cumulative: (1) the **rate declared shall not exceed the average of the rates at which dividend was declared in the three immediately preceding years** — this does not apply to a company that has **not declared any dividend in each of those three years**; (2) the **total amount drawn from accumulated profits shall not exceed one-tenth of the sum of paid-up share capital and free reserves** as appearing in the latest audited financial statement; (3) the amount so drawn shall **first be used to set off the losses incurred in the financial year** in which dividend is declared; and (4) the **balance of reserves after such withdrawal shall not fall below fifteen per cent of paid-up share capital** as appearing in the latest audited financial statement.

Order of working, which is what a good answer shows: start from profit for the year, provide depreciation including arrears, apply any mandatory transfers, test the source against Section 123(1), then apply the Rules if accumulated profits are being drawn on — testing each of the four conditions in turn.

Application use the rule — work the problem · 2 questions

- Compute the amount available for distribution step by step: profit for the year, less depreciation including arrears, less mandatory appropriations, then the balance available. Label the steps.
- Where accumulated profits are drawn on, test all four conditions of the 2014 Rules separately and show the arithmetic for the one-tenth limit and the fifteen per cent floor. Those two are where the marks are.
- For an interim dividend where the company has a loss up to the preceding quarter, compute the average of the three preceding years' rates and cap the declaration at it.
- State the source relied on under Section 123(1) in words. An answer that produces a number without naming the source is incomplete.

PQ 6.2 · PYQ 2025-May [6] (b) · 4M · Pg 565

LEVEL II
Application**Easy**

PQ 6.3 · PYQ 2026-Jan [6] (b) · 4M · Pg 567

LEVEL II
Application**Easy****Evaluation** judge it against the standard · 1 question

- Where a company proposes a dividend out of a revaluation reserve or another non-free reserve, say that the proviso to Section 123(1) forbids it, and that it would amount to payment out of capital.
- Where depreciation arrears have not been provided, say that declaration presupposes provision for arrears as well as for the current year, and recompute the distributable amount.

PQ 6.1 · PYQ 2024-May [6] (Or) (b) · 4M · Pg 564

LEVEL II
Evaluation**Easy**

Unit 11.2: Cash Flow Statements (Importance: C)

8 Topics · 19 Classified Questions

Topic 1: Elements of Cash

L2P1-C11-U11.2-T01

Read first Read Chapter 11 Unit 2, §2.2 Elements of Cash, Study Material pages 11.80–11.82, alongside AS 3 in Chapter 4 Unit 2.

NOTES

Cash comprises cash on hand and demand deposits with banks. Cash equivalents are short-term, highly liquid investments readily convertible into known amounts of cash and subject to an insignificant risk of change in value.

The three-month test: an investment normally qualifies as a cash equivalent only when it has a

short maturity of, say, three months or less from the date of acquisition. Apply it to the date of acquisition, not to the balance sheet date.

Equity investments are excluded from cash equivalents unless they are in substance cash equivalents — for example **preference shares acquired shortly before their specified redemption date.**

Bank borrowings are generally financing activities; but **bank overdrafts repayable on demand that form an integral part of an enterprise's cash management** are included as a **component of cash and cash equivalents.** That inclusion is regularly examined because it changes the closing balance.

Movements between items of cash and cash equivalents are not cash flows — transferring money from the current account to a three-month deposit changes the composition, not the total. This is the single most common error in an otherwise correct statement.

Evaluation judge it against the standard • 1 question

- Where an item has been included in or excluded from cash equivalents, test it against the three-month rule and the insignificant-risk condition and say plainly whether the treatment is right.
- For a bank overdraft, ask whether it is repayable on demand and forms an integral part of cash management. If it does, it belongs inside cash and cash equivalents, not in financing.

PQ 1.1 • PYQ 2017-May [1] (b) {C} • 5M • Pg 574

LEVEL II
Evaluation

Easy

Topic 2: Classification of Cash Flow Activities

L2P1-C11-U11.2-T02

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §2.3 Classification of Cash Flow Activities, Study Material pages 11.82–11.85.

NOTES

Three activities: operating — the **principal revenue-producing activities** of the enterprise and other activities that are not investing or financing; **investing** — the **acquisition and disposal of long-term assets and other investments not included in cash equivalents**; **financing** — activities that result in **changes in the size and composition of the owners' capital and borrowings.**

Why the split matters: the amount of cash flows from **operating** activities is a key indicator of whether operations have generated **sufficient cash to repay loans, maintain operating capability, pay dividends and make new investments without recourse to external sources.**

Interest and dividends — **state a policy and hold it:** for a **financial enterprise**, interest paid and

interest and dividends received are classified as **operating**. For **other enterprises**, **interest paid** is classified as **financing**, and **interest and dividends received** as **investing**. **Dividends paid** are classified as **financing**.

Taxes on income are classified as **operating** unless they can be **specifically identified with financing and investing activities**.

Non-cash transactions are excluded from the cash flow statement — acquiring an asset by issuing shares or by a finance lease, or converting debt to equity — and are **disclosed elsewhere in the financial statements** so that all the relevant information about investing and financing activity is provided.

CONCEPT BASE: declared by the Scanner but not carrying a question in this edition. It is nevertheless the foundation of every question in the unit.

Topic 3: Calculation of Cash Flow from Operating Activities

L2P1-C11-U11.2-T03

Read first Read §2.4 Calculation of Cash Flows from Operating Activities, Study Material pages 11.85–11.95, with the worked formats.

NOTES

Two methods: the **direct method**, which discloses **major classes of gross cash receipts and gross cash payments**; and the **indirect method**, which starts from **net profit or loss** and adjusts it. **The direct method is preferred**, because it shows the sources of receipts and payments and so helps in estimating future cash flows.

The indirect method in a fixed order — follow it every time: start with **net profit before tax and extraordinary items**; **add back** non-cash and non-operating charges — depreciation, amortisation, provisions, loss on sale of assets, interest expense; **deduct** non-operating credits — interest and dividend income, profit on sale of assets; that gives **operating profit before working capital changes**; then adjust for **changes in trade and other receivables, inventories, and trade and other payables**; then deduct **income taxes paid** to arrive at **net cash from operating activities**.

The working capital rule: an **increase in a current asset is an outflow** and a **decrease is an inflow**; an **increase in a current liability is an inflow** and a **decrease is an outflow**. Getting a sign wrong here is the commonest single error in the paper.

Exclude cash and cash equivalents from the working capital adjustments — they are the subject of the statement, not an input to it.

Provisions and reserves: a **provision for doubtful debts** is added back and the receivables movement taken gross, or the movement is taken net and no add-back made — do one or the other consistently and say which.

Extraordinary items arising from operating, investing or financing activities are **classified in the activity to which they relate and disclosed separately**.

Application use the rule — work the problem • 4 questions

- Use the printed format and label every subtotal — operating profit before working capital changes, cash generated from operations, net cash from operating activities. The subtotals carry marks in their own right.
- Take net profit BEFORE tax and extraordinary items as the starting point, and deduct tax paid as a separate line lower down. Starting from profit after tax is a substantive error.
- Work the working capital changes in a fixed order and check each sign as you go.
- Where an item is both non-cash and non-operating — a profit on sale of a fixed asset, say — remove it once from operating and show the sale proceeds in full under investing.

PQ 3.1 • MTP 2024-Mar [6] (b) • 4M • Pg 576

LEVEL II
Application

Easy

PQ 3.2 • PYQ 2024-May [3] (b) • 7M • Pg 577

LEVEL II
Application

Medium

PQ 3.3 • PYQ 2025-Jan [3] (b) • 7M • Pg 578

LEVEL II
Application

Medium

PQ 3.4 • PYQ 2025-Sep [3] (a) • 7M • Pg 580

LEVEL II
Application

Medium

Topic 4: Calculation of Cash Flow from Investing Activities

L2P1-C11-U11.2-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §2.5 Calculation of Cash Flows from Investing Activities, Study Material pages 11.95–11.99.

NOTES

Investing activities are the **acquisition and disposal of long-term assets and other investments not included in cash equivalents**. They matter because the cash flows represent **the extent to which expenditures have been made for resources intended to generate future income and cash flows**.

Typical inflows: proceeds from the sale of property, plant and equipment and of intangibles; proceeds from the sale of investments in shares, debentures and other securities; interest and dividends received (for a non-financial enterprise); **repayment of loans and advances made to**

third parties.

Typical outflows: payments to acquire property, plant and equipment, intangibles and other long-term assets, including capitalised development costs and self-constructed assets; payments to acquire investments; loans and advances made to third parties.

Show gross, not net. Purchases and sales of fixed assets and investments are **not offset** — a payment of ₹50,000 for machinery and a receipt of ₹10,000 on furniture are two lines, not a net ₹40,000.

The fixed asset account is the working the examiner wants to see. Reconstruct it — opening balance, additions, depreciation, disposals at written down value, closing balance — to derive the purchase and sale figures, and show that working.

CONCEPT BASE: declared but not carrying a question in this edition; the figures nonetheless appear in every full cash flow question in the unit.

Topic 5: Calculation of Cash Flow from Financing Activities

L2P1-C11-U11.2-T05

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read §2.6 Calculation of Cash Flows from Financing Activities, Study Material pages 11.99–11.103.

NOTES

Financing activities are those that result in changes in the size and composition of the owners' capital, including preference share capital in the case of a company, and borrowings. Their separate disclosure is useful in predicting claims on future cash flows by the providers of funds.

Typical inflows: proceeds from the issue of shares or other similar instruments; proceeds from the issue of debentures, loans, notes, bonds and other short or long-term borrowings.

Typical outflows: repayment of amounts borrowed; redemption of preference shares and buy-back of equity shares; dividends paid; interest paid (for a non-financial enterprise); payment of the principal element of a finance lease liability.

Two points that are frequently missed: share issue proceeds are taken net of issue expenses paid, and securities premium received is part of the financing inflow, not a separate item.

Interest paid belongs here for a non-financial enterprise, and it must be removed from operating by adding it back to profit. Do both halves or the statement will not balance.

CONCEPT BASE: declared but not carrying a question in this edition; as with investing, the figures

appear in every full question.

Topic 6: Calculation of Cash Flow by Direct Method

L2P1-C11-U11.2-T06

Read first Read §2.4 again for the direct method presentation, Study Material pages 11.85–11.90, with the illustrative format.

NOTES

The direct method discloses **major classes of gross cash receipts and gross cash payments** — cash received from customers, cash paid to suppliers and employees, and so on — and is **preferred by AS 3** because it shows where the cash actually came from and went.

The conversion is the work: **cash received from customers** = sales, **plus** opening trade receivables, **less** closing trade receivables, adjusted for bad debts written off and any provision movement.

Cash paid to suppliers = cost of goods sold, **plus** closing inventory, **less** opening inventory, **plus** opening trade payables, **less** closing trade payables. **Cash paid to employees and for other operating expenses** is derived the same way, adjusting the charge for opening and closing outstandings and prepayments.

Strip out non-cash items entirely — depreciation and provisions never appear in a direct-method operating section.

Then deduct income taxes paid and show **net cash from operating activities** — the same figure the indirect method would produce. Where a question asks for both methods, that agreement is itself a mark.

Where the question gives a statement of profit and loss and two balance sheets, build each line as a small T-account or a three-line working. Attempting it in your head is where the errors come from.

Application use the rule — work the problem · 1 question

- Show a separate working for every line of the direct method — customers, suppliers, employees, other expenses. The workings carry as many marks as the statement.
- Reconcile to the same net cash from operating activities as the indirect method would give, and say so if the question asks for both.
- Never let depreciation, provisions or profit on sale of assets appear in a direct-method operating section.

Topic 7: Calculation of Cash Flow by Indirect Method

L2P1-C11-U11.2-T07

Read first Read §2.4 and the illustrations at §2.7, Study Material pages 11.90–11.145 — the indirect method worked in full.

NOTES

The **indirect method** starts from **net profit or loss before taxation and extraordinary items** and adjusts it for **non-cash items, for items of income or expense associated with investing or financing cash flows, and for changes in working capital**.

The **standard sequence, and answers should follow it visibly**: net profit before tax and extraordinary items → adjustments for depreciation, amortisation, impairment, provisions, loss or profit on sale of assets, interest expense, interest and dividend income, foreign exchange loss or gain → **operating profit before working capital changes** → movements in inventories, trade and other receivables, trade and other payables → **cash generated from operations** → **income taxes paid** → **net cash from operating activities**.

Deriving the figures you are not given is most of the work. Reconstruct the **fixed asset account** for purchases, sales and depreciation; the **provision for tax account** for tax paid; the **profit and loss appropriation** for dividends paid; and the **loan accounts** for proceeds and repayments. Each reconstruction should appear as a labelled working.

Non-cash transactions are excluded — an asset acquired under a finance lease, shares issued for consideration other than cash, conversion of debentures — and are **disclosed separately** so the reader still sees them.

Common traps in this unit: using profit **after** tax as the starting point; forgetting to add back interest paid and then show it under financing; netting purchases against sales of fixed assets; treating a transfer between bank and short-term deposit as a cash flow; and omitting the reconciliation of opening and closing cash and cash equivalents at the foot of the statement.

Application use the rule — work the problem · 10 questions

- Lay out the three sections in order with a clear net figure for each, then the net increase or decrease in cash, then opening and closing cash and cash equivalents. The closing figure must agree with the balance sheet; if it does not, say so rather than forcing it.
- Give every derived figure its own labelled working — fixed assets, tax, dividends, loans. An unexplained number scores nothing even when it is right.
- Add back interest paid in operating and show it as an outflow in financing. Do both, and check the statement still balances.
- Deal with the non-cash transactions by note rather than by omission, and say why they are excluded.

PQ 7.4 • PYQ 2022-May [6] (d) • 5M • Pg 593	LEVEL II Application	Easy
PQ 7.3 • RTP 2022-May [3] • Pg 591	LEVEL II Application	Medium
PQ 7.5 • PYQ 2023-May [4] (b) • 10M • Pg 594	LEVEL II Application	Medium
PQ 7.6 • RTP 2022-Nov [3] • Pg 597	LEVEL II Application	Medium
PQ 7.8 • PYQ 2025-May [3] (a) • 7M • Pg 602	LEVEL II Application	Medium
PQ 7.9 • RTP 2025-May [6] • Pg 605	LEVEL II Application	Medium
PQ 7.10 • PYQ 2026-May [3] (a) • 6M • Pg 607	LEVEL II Application	Medium
PQ 7.1 • PYQ 2020-Nov [4] (a) • 10M • Pg 586	LEVEL II Application	Hard
PQ 7.2 • PYQ 2021-Jan [4] (b) • 12M • Pg 588	LEVEL II Application	Hard
PQ 7.7 • RTP 2023-May [3] • Pg 600	LEVEL II Application	Hard

Topic 8: Calculation of Cash Flow by Direct and Indirect Method

L2P1-C11-U11.2-T08

Read first Read §2.7 Illustrations, Study Material pages 11.103–11.145 — the questions worked under both methods.

NOTES

Where a question asks for both methods, the **investing and financing sections are identical** and only the **operating section differs**. Prepare the operating section twice and the rest once — candidates lose time by rebuilding the whole statement.

The two operating sections must agree to the same net cash from operating activities. That agreement is the internal check on the whole answer; do it before you write anything else down as final.

Choosing between them when the question leaves it open: the **direct method is preferred by AS 3**, but the **indirect method is usually faster** where the question gives a statement of profit and loss and two balance sheets rather than a cash book summary. State which you have adopted and why.

Presentation carries marks in its own right: a heading naming the enterprise and the period, the three sections in order, labelled subtotals, the net increase or decrease, opening and closing cash and cash equivalents, and a note giving the **break-up of cash and cash equivalents** as AS 3

requires.

Finish with the disclosures where the facts call for them: **significant cash and cash equivalent balances not available for use**, with a management commentary, and the encouraged disclosures on **undrawn borrowing facilities** and on cash flows for **maintaining as against increasing operating capacity**.

Application use the rule — work the problem • 3 questions

- Build the investing and financing sections once, then the operating section under whichever method or methods are asked for.
- Check that both operating sections reconcile to the same figure before finalising, and that the closing cash agrees with the balance sheet.
- Include the break-up of cash and cash equivalents as a note. It is required by AS 3 and it is routinely forgotten.

PQ 8.2 • PYQ 2021-Jul [1] (d) {C} • 5M • Pg 611	LEVEL II Application	Easy
PQ 8.1 • PYQ 2019-May [5] (b) • 10M • Pg 609	LEVEL II Application	Medium
PQ 8.3 • PYQ 2024-Sep [3] (a) • 7M • Pg 613	LEVEL II Application	Medium

CHAPTER 12

Buy Back of Securities

3 Topics • 21 Classified Questions • Importance: C

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **on profile**

Level I — Comprehension & Knowledge

5.7%

10 of 174 marks

Level II — Analysis & Application

94.3%

164 of 174 marks

This chapter sits inside the paper's own profile — 6% Level I against a 5–15% band. Prepare it in the paper's proportions: a little theory, a great deal of application.

Topic 1: Introduction

L2P1-C12-U12-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read Chapter 12 §1 Introduction, Study Material 2026 July pages 12.1–12.3 — what buy-back is, why companies do it, and the three permitted sources under Section 68(1).

NOTES

What it is: buy-back means the **purchase by a company of its own shares**. Shares bought back **must be cancelled**, so a buy-back **reduces the share capital** of the company. **A company cannot buy its own shares for the purpose of investment** — that sentence disposes of a whole class of question.

Five objectives or advantages — a clean list answer: (a) to **increase earnings per share**, since the buy-back reduces the outstanding number of shares and there is no dilution in earnings; (b) to **increase promoters' holding**, the bought-back shares being cancelled; (c) to **discourage a hostile takeover bid**, the buy-back having increased the promoters' holding; (d) to **support the share price** on the stock exchanges where management considers it below worth, especially in a depressed market; and (e) to **pay surplus cash to shareholders** where the company does not need it for the business.

Section 68(1) — the three permitted sources, and only these three: **free reserves**; the **securities premium account**; or the **proceeds of the issue of any shares or other specified securities**.

The restriction on that third source: no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or securities. So if equity shares are to be bought back, the proceeds of a **preference share issue** may be used, but not those of an earlier equity issue.

Free reserves includes the securities premium account for the purposes of Section 68 —

Explanation II. And **revaluation reserve represents unrealised profit and cannot be used for buy-back**, which is the standing trap in the computation questions.

CONCEPT BASE: the Scanner declares this topic but carries no question for it in this edition. It is the foundation of the two topics that follow, so read it once and carry the three sources and the five objectives forward.

Topic 2: Provision of Section 70 of the Companies Act, 2013

L2P1-C12-U12-T02

Read first Read Chapter 12 §2 Provisions of Section 70 of the Companies Act, 2013, Study Material pages 12.3–12.12 — Section 68(2) conditions, the three tests, Section 69, Section 70 prohibitions, and the SEBI regulations.

NOTES

Section 68(2) — the conditions for a buy-back: it must be **authorised by the articles**; a **special resolution** must be passed in general meeting; **all the shares or securities bought back must be fully paid-up**; a listed-company buy-back must comply with the **SEBI regulations**; and an unlisted one with the **prescribed guidelines**.

The Board-resolution relaxation: where the buy-back is **ten per cent or less of the paid-up equity capital plus free reserves**, it may be authorised by a **board resolution passed at a duly convened meeting** — **no article authority and no special resolution are needed**. Watch for the ten per cent figure in a question; it changes the required authority.

The three tests, and every computation question turns on them: **Resource Test** — the buy-back must be **equal to or less than 25% of the total paid-up capital and free reserves**; **Share Outstanding Test** — the buy-back in any financial year must not exceed **25% of the total paid-up capital and free reserves**; **Debt-Equity Ratio Test** — the ratio of debt owed by the company, both secured and unsecured, after the buy-back must not be more than twice the total of its paid-up capital and free reserves. Debt here includes both long-term and short-term debt, and the Central Government may prescribe a higher ratio for a class of companies.

One buy-back a year: no offer of buy-back shall be made within a period of one year from the date of closure of a previous offer. And every buy-back must be completed within twelve months from the date of passing the special resolution or the board resolution.

Methods: the buy-back may be **from existing security holders on a proportionate basis**, **from the open market**, or **by purchasing securities issued to employees under a stock option or sweat equity scheme**.

Declaration of solvency: before a buy-back authorised by special resolution, the company must **file with the Registrar and with SEBI a declaration of solvency**, verified by affidavit, that the Board has made a **full inquiry into the affairs of the company** and formed the opinion that it is **capable**

of meeting its liabilities and will not be rendered insolvent within one year. It is signed by at least two directors, one of whom shall be the managing director, if any. No declaration is filed with SEBI by a company whose shares are not listed.

After the buy-back: the securities must be **extinguished and physically destroyed within seven days** of the last date of completion; a **register** of the securities bought back, the consideration paid, the dates of cancellation and destruction must be maintained; and a **return must be filed with the Registrar and SEBI within thirty days** of completion — again, **not with SEBI for an unlisted company**.

The six-month bar: after completing a buy-back the company **shall not make a further issue of the same kind of shares or securities within six months, except** by way of **bonus issue** or in discharge of **subsisting obligations** such as conversion of warrants, a stock option scheme, sweat equity, or conversion of preference shares or debentures into equity.

Section 69 — Capital Redemption Reserve: where a company purchases its own shares **out of free reserves or the securities premium account**, a **sum equal to the nominal value of the shares so purchased shall be transferred to the Capital Redemption Reserve Account**, and details disclosed in the balance sheet. The **CRR may be applied in paying up unissued shares to be issued to members as fully paid bonus shares** — that is its only permitted use.

Premium on buy-back — the excess of the buy-back price over par — is **adjusted against free reserves and/or the securities premium account**. **Revaluation reserve, being unrealised profit, cannot be used.**

Section 70 — when a company must not buy back at all: through any subsidiary company, including its own subsidiary companies; through any investment company or group of investment companies; or if a **default is subsisting** in repayment of deposits or interest, redemption of debentures or preference shares, payment of dividend, or repayment of a term loan or interest to a financial institution or bank — **provided the buy-back is not prohibited if the default is remedied and three years have elapsed since the cessation of the default.**

And the compliance bar: no buy-back where the company has not complied with **Section 92** (filing of annual return), **Section 123** (payment of dividend within 30 days of declaration), **Section 127** (failure to distribute dividend) or **Section 129** (preparation of financial statements).

SEBI regulations to note: **no open-market offer for fifteen per cent or more** of paid-up capital and free reserves; **no offer within one year** of the closure of a preceding offer; and **at least fifty per cent of the amount earmarked must be utilised** for buying back.

Understanding explain it, and place it in context · 1 question

- Name the three tests before applying them, and state which one the facts fail. An answer that computes without naming loses the structure marks.
- Distinguish the special-resolution route from the ten per cent board-resolution route, and say which applies on the facts.

- For Section 70, deal with the three prohibitions and the compliance bar separately, and remember the three-year cure for a remedied default.

TQ 2.1 · PYQ 2023-May [6] (a) · DESC · 5M · Pg 618

LEVEL I
Understanding

Medium

Topic 3: Buy Back: Practical

L2P1-C12-U12-T03

Read first Read Chapter 12 §3 onwards and the illustrations, Study Material pages 12.12–12.52 — the maximum permissible buy-back computation and the journal entries.

NOTES

The shape of every practical question: compute the **maximum number of shares that can be bought back** under each of the three tests, take the **lowest**, and then pass the entries for that number. The lowest figure governs — say so explicitly.

Resource Test: 25% of (paid-up capital + free reserves) gives the maximum **amount** that can be spent; divide by the buy-back price per share to get a share count.

Share Outstanding Test: 25% of the total paid-up capital and free reserves in that financial year — apply it to **equity shares of the same class** and express it as a number of shares.

Debt-Equity Ratio Test: after the buy-back, **debt must not exceed twice (paid-up capital + free reserves)**. Work it backwards — the minimum post-buy-back equity is $\text{debt} \div 2$; the maximum reduction in funds is present equity less that minimum; convert to shares at the buy-back price. This is the test candidates most often set up the wrong way round.

Free reserves for these computations include the **securities premium account** but **exclude revaluation reserve**. Excluding revaluation reserve is worth a mark on its own; say why.

The journal entries, in order: (1) amount due to shareholders on buy-back — **Equity Share Capital A/c Dr** with nominal value, **Premium on Buy-back A/c Dr** with the excess, credit **Equity Shareholders A/c**; (2) payment — **Equity Shareholders A/c Dr**, credit **Bank**; (3) premium adjusted — **Securities Premium A/c and/or Free Reserves Dr**, credit **Premium on Buy-back A/c**; (4) transfer to CRR — **Free Reserves or Securities Premium A/c Dr**, credit **Capital Redemption Reserve A/c** with the **nominal value of shares bought back out of free reserves or securities premium**.

Where the buy-back is financed by a fresh issue, the CRR transfer is required only for the portion **not** funded out of the proceeds of that fresh issue. Identify the funding split before computing the CRR.

Then redraw the balance sheet showing the reduced share capital, the CRR, the reduced reserves and the reduced bank balance. Questions almost always ask for the post-buy-back balance sheet, and it is where the presentation marks are.

Remembering reproduce what you have learnt • 1 question

- The three tests by name, and the rule that the lowest governs, are the frame for every question here. Write them down first.
- The CRR transfer rule and the exclusion of revaluation reserve are single-sentence facts that earn marks wherever they appear.

PQ 3.14 • PYQ 2023-Nov [6] (b) • 5M • Pg 658

LEVEL I
Remembering**Easy****Application** use the rule — work the problem • 18 questions

- Show all three tests as separate labelled workings, then state the maximum permissible number of shares as the lowest of the three.
- Set the Debt-Equity Ratio Test out backwards from the required minimum post-buy-back equity. Show that step; it is the one the examiner looks for.
- Pass the four journal entries in order and narrate them briefly. Then show the CRR transfer at nominal value, adjusted for any portion funded by a fresh issue.
- Redraw the balance sheet after the buy-back with the CRR shown separately, and check that it balances.
- Exclude revaluation reserve from free reserves and say why.

PQ 3.5 • PYQ 2021-Jan [6] (e) • 5M • Pg 633

LEVEL II
Application**Easy**

PQ 3.9 • PYQ 2022-Nov [6] (b) • 5M • Pg 644

LEVEL II
Application**Easy**

PQ 3.18 • PYQ 2025-Jan [6] (b) • 4M • Pg 666

LEVEL II
Application**Easy**

PQ 3.1 • RTP 2018-May [2] • Pg 619

LEVEL II
Application**Medium**

PQ 3.2 • PYQ 2018-May [2] (a) • 10M • Pg 622

LEVEL II
Application**Medium**

PQ 3.3 • PYQ 2019-May [2] (a) • 10M • Pg 625

LEVEL II
Application**Medium**

PQ 3.8 • PYQ 2022-May [5] (a) • 10M • Pg 642

LEVEL II
Application**Medium**

PQ 3.10 • RTP 2023-May [4] • Pg 646

LEVEL II
Application**Medium**

PQ 3.12 • PYQ 2023-May [5] (a) • 10M • Pg 651

LEVEL II
Application**Medium**

PQ 3.13 • RTP 2023-Nov [4] • Pg 655

LEVEL II
Application**Medium**

PQ 3.15 • RTP 2024-May [19] • Pg 660

LEVEL II
Application**Medium**

PQ 3.16 • PYQ 2024-Sep [3] (b) • 7M • Pg 662	LEVEL II Application	Medium
PQ 3.17 • RTP 2024-Sep [19] • Pg 664	LEVEL II Application	Medium
PQ 3.20 • PYQ 2026-Jan [3] (a) • 7M • Pg 668	LEVEL II Application	Medium
PQ 3.4 • PYQ 2019-Nov [2] (a) • 15M • Pg 628	LEVEL II Application	Hard
PQ 3.6 • PYQ 2021-Jul [2] (a) • 15M • Pg 634	LEVEL II Application	Hard
PQ 3.7 • PYQ 2021-Dec [5] (a) • 10M • Pg 637	LEVEL II Application	Hard
PQ 3.11 • MTP 2023-Mar [4] (a) • 15M • Pg 649	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships • 1 question

- Where the question asks whether a proposed buy-back is permissible rather than for a maximum, run the three tests plus the Section 68(2) and Section 70 conditions, and say which one it fails.
- Look for a previous buy-back within the last year, a subsisting default, or a proposed further issue within six months — each is a complete answer on its own.

PQ 3.19 • MTP 2025-Jul S1 [2] (b) • 4M • Pg 667	LEVEL II Analysis	Easy
---	-----------------------------	-------------

CHAPTER 13

Amalgamation of Companies

4 Topics • 23 Classified Questions • Importance: A

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **problems only**

Level I — Comprehension & Knowledge

1.6%

5 of 313 marks

Level II — Analysis & Application

98.4%

308 of 313 marks

Below the paper's Level I floor: only 2% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. There is almost no theory to fall back on. Every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Amalgamation

L2P1-C13-U13-T01

Read first Read Chapter 13 §1 Introduction and §2 Meaning of Amalgamation, Study Material 2026 July pages 13.1–13.5, together with AS 14 in Chapter 9 Unit 2.

NOTES

Amalgamation means the **merger of two or more companies into one**, either by one company absorbing the others or by a new company being formed to take them all over. The company whose business is taken over is the **transferor** (or vendor) company; the one taking it over is the **transferee** (or purchasing) company.

Absorption against amalgamation in the strict sense: in an **absorption** an **existing** company takes over the business of another and **no new company is formed**; in an **amalgamation** proper, a **new company is formed** to take over two or more existing companies, which are then wound up. Both are governed by AS 14 and both are examined under the same head.

External reconstruction is the third member of the family: a **new company is formed to take over the business of an existing company** which is in financial difficulty, and the existing company is wound up. It is accounted for as an amalgamation **in the nature of purchase**.

Why companies amalgamate: to **achieve economies of scale**, to **eliminate competition**, to **secure a source of supply or a market**, to **obtain tax advantages**, and to **rescue a company in financial difficulty**.

The governing standard is AS 14, and the whole of the accounting follows from the **classification into merger or purchase** — the five conditions are in Chapter 9 Unit 2 and should be revised alongside this chapter.

What AS 14 does not cover: it does not deal with cases where the transferor company's business is acquired but the transferor **continues to exist** — those are dealt with under the ordinary rules

for acquisition of a business.

Understanding explain it, and place it in context · 1 question

- Where the question asks you to identify the type of combination, name it — absorption, amalgamation, or external reconstruction — and then classify it under AS 14 as a merger or a purchase. Both steps carry marks.
- Test all five AS 14 merger conditions and name the one that fails. If any fails, it is a purchase, and the accounting follows from that.

TQ 1.1 · PYQ 2019-May [6] (a) · DB · 5M · Pg 674

LEVEL I
Understanding

Medium

Topic 2: Types of Amalgamation

L2P1-C13-U13-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read Chapter 13 §3 Types of Amalgamation, Study Material pages 13.5–13.9, with the five conditions in AS 14 §2.4.

NOTES

Two types only: amalgamation **in the nature of merger** and amalgamation **in the nature of purchase**.

Merger requires all five conditions — miss one and it is a purchase: (i) **all assets and liabilities of the transferor become those of the transferee**; (ii) shareholders holding **not less than 90% of the face value of the equity shares** of the transferor, other than shares already held by the transferee or its subsidiaries or their nominees, **become equity shareholders of the transferee**; (iii) the consideration to those who agree to become equity shareholders is **discharged wholly by the issue of equity shares**, except cash for fractional shares; (iv) the **business of the transferor is intended to be carried on** by the transferee; and (v) **no adjustment is intended to the book values of the assets and liabilities** except to align accounting policies.

Read condition (ii) carefully. The 90% is of the **face value of equity shares**, and shares **already held by the transferee** are excluded from the computation. Both refinements are used by examiners to turn an apparent merger into a purchase.

Read condition (iii) carefully too. The consideration must be **wholly in equity shares** to those who agree to become equity shareholders — **cash is permitted only for fractional shares**. Any other cash element defeats merger treatment.

Amalgamation in the nature of purchase is one which does not satisfy any one or more of those

conditions. It is **in effect a mode by which one company acquires another**, and the shareholders of the acquired company **normally do not continue to have a proportionate share** in the combined business.

The consequences of the classification, which is what you must be able to state: merger uses the **pooling of interests method**, assets, liabilities and reserves carried at **existing carrying amounts**, the identity of reserves **preserved**, and the difference **adjusted in reserves**. Purchase uses the **purchase method**, assets and liabilities at carrying amounts **or at fair values**, reserves **not preserved except statutory reserves**, and the difference taken to **goodwill or capital reserve**.

Topic 3: Purchase Consideration

L2P1-C13-U13-T03

Read first Read Chapter 13 §4 Purchase Consideration, Study Material pages 13.9–13.18, with AS 14 paragraph 3(g).

NOTES

Definition — AS 14 paragraph 3(g): purchase consideration is the **aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company**. In plain terms, **the price payable by the transferee for taking over the business**.

The point that decides most questions: only amounts paid to the equity shareholders and preference shareholders count. Purchase consideration **does not include sums the transferee pays directly to the debenture-holders or creditors** of the transferor. Where a liability is **not taken over**, it is **discharged by the transferor company** and appears in the transferor's own books.

Three methods of computation: Lumpsum method — a fixed amount is agreed and payable to the shareholders; **Net Payment method** — the individual payments to equity and preference shareholders, whether in cash, shares or debentures, are added up; **Net Assets method** — **the agreed value of the assets taken over less the outside liabilities taken over**, excluding share capital and reserves.

Under the Net Assets method, values are those agreed between the parties; if no value is agreed, assets and liabilities are taken at book value. Say which you are using.

Which method to use: the Study Material's guidance in AS 14 is to **compute by the Net Payment method, and to use the Net Assets method only where it cannot be computed that way**. State the method chosen at the head of the working.

Fair value governs the elements: the consideration **depends upon the fair value of its elements** — where it includes securities, the value fixed by the statutory authorities or the market value is used, not the nominal value. **Nominal value is not fair value**, and confusing the two is the standing

error.

Watch the four recurring traps: payments to **debenture-holders** are not consideration; **liquidation expenses** borne by the transferee are not consideration; **amounts payable to workmen or for outside liabilities** are not consideration; and where shares are issued **at a premium**, the consideration is the **issue price**, with the premium credited to Securities Premium in the transferee's books.

Application use the rule — work the problem · 4 questions

- State the method first, then build the consideration line by line — equity shareholders, preference shareholders, cash, shares at fair value, debentures at fair value — and total it.
- Exclude payments to debenture-holders, creditors and liquidation expenses, and say expressly that they are excluded. That exclusion is a mark.
- Where shares are issued at a premium, value them at issue price and carry the premium to Securities Premium in the transferee's entries.
- If the question gives both a list of payments and a list of assets and liabilities, use the Net Payment method and say why the Net Assets method is not needed.

PQ 3.3 · PYQ 2023-Nov [6] (a) · 5M · Pg 685

LEVEL II
Application

Easy

PQ 3.1 · RTP 2022-May [6] · Pg 675

LEVEL II
Application

Medium

PQ 3.2 · RTP 2022-Nov [6] · Pg 680

LEVEL II
Application

Medium

PQ 3.4 · PYQ 2026-May [4] · 14M · Pg 687

LEVEL II
Application

Hard

Topic 4: Methods of Accounting for Amalgamations

L2P1-C13-U13-T04

Read first Read Chapter 13 §5 Methods of Accounting, §6 Journal entries to close the books of the vendor company and §7 Entries in the books of the purchasing company, Study Material pages 13.18–13.102, with the illustrations.

NOTES

Two methods, following the classification: **pooling of interests** for a merger, **purchase method** for a purchase.

Pooling of interests: the transferor's **assets, liabilities and reserves are recorded by the transferee at their existing carrying amounts**; the **identity of the reserves is preserved**; and the **difference between the consideration and the share capital of the transferor is adjusted in**

reserves, not taken to goodwill.

Purchase method: assets and liabilities taken over are recorded **at the agreed values**, and where there is no agreed value, **at book values**. The **consideration is compared with the net assets acquired**: a **shortfall of net assets against consideration is Goodwill**; an **excess is Capital Reserve**. **Statutory reserves** are preserved with a corresponding debit to **Amalgamation Adjustment Account**, shown separately on the assets side.

Goodwill arising on amalgamation is **amortised over a period not exceeding five years unless a longer period can be justified** — the AS 14 rule, and it is asked as often as the computation.

In the books of the transferor — closing the books: open a **Realisation Account**; transfer **assets at book value to the debit** and **liabilities taken over at book value to the credit**; **credit the purchase consideration receivable** to Realisation; on **receipt**, debit the consideration to the **Equity and Preference Shareholders' accounts**; and transfer the **balance of the Realisation Account, profit or loss, to the Equity Shareholders' Account**.

Assets and liabilities not taken over by the transferee but **settled by the transferor** are shown in the transferor's books only — do not put them through the transferee's entries.

In the books of the transferee — the standard sequence: (1) **Business Purchase A/c Dr, To Liquidator of the transferor company** with the purchase consideration; (2) **debit the assets acquired at the values placed on them and credit the liabilities taken over**, with **Business Purchase A/c** credited and the balancing figure to **Goodwill** (debit) or **Capital Reserve** (credit); (3) **Liquidator of the transferor company A/c Dr, To Share Capital / Securities Premium / Bank** on discharge of the consideration; (4) entries for **liquidation expenses**, for **debentures taken over**, and for the **elimination of inter-company owings**.

Inter-company items must be eliminated — mutual debtors and creditors, and unrealised profit on stock held by one from the other. Where the transferee holds shares in the transferor, or the transferor holds shares in the transferee, the treatment differs and the Study Material illustrations set it out; work those before the exam.

Then draw the balance sheet of the transferee after amalgamation, in Schedule III form. That is usually the largest single part of the marks.

Application use the rule — work the problem • 18 questions

- Fix the classification and the method before writing a single entry. Everything downstream depends on it, and stating it earns the first mark.
- In the transferor's books, work the Realisation Account in a fixed order: assets at book value, liabilities taken over, purchase consideration, then the profit or loss to equity shareholders.
- In the transferee's books, follow the four-entry sequence and let Goodwill or Capital Reserve emerge as the balancing figure — do not compute it separately and then force the entry.

- Under pooling of interests, carry reserves across unchanged and put the difference through reserves. Under the purchase method, do not carry reserves across except statutory reserves through the Amalgamation Adjustment Account.
- Eliminate inter-company debtors, creditors and unrealised profit before drawing the balance sheet.
- Present the post-amalgamation balance sheet in Schedule III form with notes, and check it balances.

PQ 4.1 • PYQ 2018-May [3] • 20M • Pg 692	LEVEL II Application	Hard
PQ 4.2 • PYQ 2019-May [3] (a) • 10M • Pg 697	LEVEL II Application	Hard
PQ 4.3 • PYQ 2020-Nov [3] (a) • 15M • Pg 701	LEVEL II Application	Hard
PQ 4.4 • PYQ 2021-Jan [2] • 20M • Pg 705	LEVEL II Application	Hard
PQ 4.5 • PYQ 2021-Jul [5] (a) • 10M • Pg 709	LEVEL II Application	Hard
PQ 4.6 • PYQ 2021-Dec [2] (b) • 15M • Pg 712	LEVEL II Application	Hard
PQ 4.7 • PYQ 2022-May [2] • 20M • Pg 717	LEVEL II Application	Hard
PQ 4.8 • MTP 2022-Sep [2] (a) • 15M • Pg 722	LEVEL II Application	Hard
PQ 4.9 • MTP 2023-Mar [3] (a) • 16M • Pg 726	LEVEL II Application	Hard
PQ 4.10 • PYQ 2023-May [2] • 20M • Pg 730	LEVEL II Application	Hard
PQ 4.11 • MTP 2024-Mar [4] • DESC • 14M • Pg 733	LEVEL II Application	Hard
PQ 4.12 • PYQ 2024-May [4] • 14M • Pg 738	LEVEL II Application	Hard
PQ 4.13 • PYQ 2024-Sep [4] • 14M • Pg 742	LEVEL II Application	Hard
PQ 4.14 • PYQ 2025-Jan [4] • 14M • Pg 748	LEVEL II Application	Hard
PQ 4.15 • PYQ 2025-May [4] • 14M • Pg 752	LEVEL II Application	Hard
PQ 4.16 • PYQ 2025-Sep [4] • 14M • Pg 757	LEVEL II Application	Hard
PQ 4.17 • PYQ 2026-Jan [4] • 14M • Pg 761	LEVEL II Application	Hard
PQ 4.18 • PYQ 2026-Sep [3] • 14M • Pg 767	LEVEL II Application	Hard

CHAPTER 14

Accounting for Reconstruction of Companies

3 Topics • 20 Classified Questions • Importance: B

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **problems only**

Level I — Comprehension & Knowledge **0.0%** 0 of 192 marks

Level II — Analysis & Application **100.0%** 192 of 192 marks

Below the paper's Level I floor: none of this chapter's marks are Comprehension and Knowledge, against 5-15% for the paper. There is almost no theory to fall back on. Every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Reconstruction

L2P1-C14-U14-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read Chapter 14 §1 Meaning of Reconstruction, Study Material 2026 July pages 14.2-14.5.

NOTES

Why reconstruction becomes necessary: when a company has been **making losses for several years** its balance sheet no longer presents a true and fair view. **Assets are generally overvalued**, and the balance sheet carries **fictitious assets, unrepresented intangible assets and a debit balance in the profit and loss account** carrying forward the losses. The company **shows a higher net worth than it has** — in short it is **over-capitalised** — and that is what reconstruction cures.

Reconstruction is the process by which the affairs of a company are **reorganised by revaluation of assets, reassessment of liabilities and by writing off losses already suffered**, reducing paid-up capital where necessary.

Two kinds, and the distinction opens every answer: **internal reconstruction**, where the **same company continues** and its capital structure is reorganised internally; and **external reconstruction**, where a **new company is formed to take over the business** of the existing one and the existing company is **wound up**. External reconstruction is accounted for as an **amalgamation in the nature of purchase** under AS 14.

Internal reconstruction requires alteration of the memorandum or articles as the case demands, a **special resolution**, and — for a reduction of capital — **confirmation by the Tribunal**. The Study Material's phrase is that the scheme is adopted **through special resolution confirmed by the Court**.

The object is to bring the books into line with reality: write off the accumulated losses and fictitious assets, bring overvalued assets down to true value, and leave a balance sheet that shows the company's real position, so it can carry on.

CONCEPT BASE: the Scanner declares this topic but carries no question for it in this edition. The definitions nevertheless open every answer in the chapter, so learn them here.

Topic 2: Methods of Internal Reconstruction

L2P1-C14-U14-T02

Read first Read Chapter 14 §2 Methods of Internal Reconstruction, Study Material pages 14.5–14.12 — alteration of share capital under Section 61, variation of shareholders' rights, reduction of share capital, and compromise or arrangement with creditors.

NOTES

Four methods, generally used together: alteration of share capital, variation of shareholders' rights, reduction of share capital, and compromise or arrangement with creditors and other outside liabilities.

Alteration of share capital — Section 61: a limited company may alter its share capital if authorised by its articles, by passing an ordinary resolution in general meeting. The permitted alterations are: (a) increase of authorised share capital; (b) consolidation and sub-division into shares of larger or smaller denominations; (c) conversion of all or any shares into stock or vice versa; and (d) cancellation of shares which have not been taken or agreed to be taken by any person.

Sub-division and consolidation may be made so long as the proportion between the paid-up and unpaid amount on the shares continues unchanged. That proviso is regularly examined.

Cancellation under (d) is not a reduction of capital, because the shares were never taken up. Distinguish it from a reduction under the reduction provisions — the accounting is quite different.

Variation of shareholders' rights — changing the rate of preference dividend, converting cumulative preference shares into non-cumulative, and similar changes — is effected under the articles and the Act.

Reduction of share capital is the substantive step: extinguishing or reducing liability on partly paid shares, cancelling paid-up capital that is **lost or unrepresented by available assets**, or paying off capital that is **in excess of the company's wants**. It requires a **special resolution and confirmation by the Tribunal**.

Compromise or arrangement with debenture-holders, creditors and other outside liabilities — a partial waiver, a conversion of debt into shares, or an extension of time — is the fourth limb, and the sacrifice made by those parties is credited to the reconstruction account.

The critical accounting distinction, and the whole of 3 turns on it: alteration of share capital and variation of shareholders' rights do NOT involve the Capital Reduction Account. **It is only under** reduction of share capital, unrepresented reserves, compromise or arrangement with outside liabilities, and surrender of shares **that a Capital Reduction (or Reconstruction) Account is opened.**

Application use the rule — work the problem · 1 question

- Identify which of the four methods each part of the scheme uses before passing any entry, because that decides whether the Capital Reduction Account is involved at all.
- For a sub-division or consolidation, check that the proportion between paid-up and unpaid amounts is unchanged, and say so.
- Cite Section 61 for an alteration and note that it needs only an ordinary resolution, against the special resolution and Tribunal confirmation required for a reduction.

PQ 2.1 · MTP 2025-Aug S2 [6] (b) · 5M · Pg 774

LEVEL II
Application

Hard

Topic 3: Entries In Case of Internal Reconstruction

L2P1-C14-U14-T03

Read first Read Chapter 14 §3 Entries in case of Internal Reconstruction, Study Material pages 14.12–14.73, working the illustrations in full.

NOTES

The four rules the Study Material sets out, and they answer nearly every question:

Rule 1: alteration of share capital and variation of shareholders' rights do not involve opening the Capital Reduction Account. Those entries simply move balances between capital accounts.

Rule 2: it is only under reduction of share capital, unrepresented reserves, compromise or arrangement with outside liabilities, and surrender of shares that a Capital Reduction (or Reconstruction) Account is used, to which the unrepresented assets and liabilities are transferred as per the arrangement.

Rule 3: an appreciation in the value of an asset, or a reduction in the amount of a liability, is debited to the account concerned and credited to the Capital Reduction Account.

Rule 4: eliminate the debit balance of the profit and loss account and all over-valuation of assets by crediting the accounts concerned and debiting the Capital Reduction Account. Any reserve appearing in the books may be used for this purpose, and any balance left in the Capital Reduction Account is transferred to Capital Reserve.

So the Capital Reduction Account is credited with everything sacrificed — capital written down, creditors' and debenture-holders' waivers, appreciation in assets, reduction in liabilities — **and**

debited with everything written off — accumulated losses, fictitious assets, over-valuation of assets, and the cost of the scheme. **The balance goes to Capital Reserve**, never to the profit and loss account.

Typical entries to have at your fingertips: Equity Share Capital A/c (old) Dr, To Equity Share Capital A/c (new), To Capital Reduction A/c on a reduction; Creditors A/c Dr, To Capital Reduction A/c on a waiver; Capital Reduction A/c Dr, To Profit and Loss A/c / Goodwill / Preliminary Expenses / Patents on writing off; Fixed Assets A/c Dr, To Capital Reduction A/c on appreciation; and Capital Reduction A/c Dr, To Capital Reserve A/c for the balance.

Watch the arrears of preference dividend. Where arrears are **waived**, nothing is written off in the books — they were never a liability — but where they are **settled by an issue of shares**, the issue is recorded and the sacrifice, if any, credited to Capital Reduction.

Contingent liabilities crystallising as part of the scheme — a pending suit settled, for instance — are **provided for by debiting the Capital Reduction Account**, since the scheme is bearing them.

Then redraw the balance sheet after reconstruction, in Schedule III form. It should show the reduced capital, the Capital Reserve (if any), assets at their revised values, and no fictitious assets. That balance sheet is where most of the marks sit.

Application use the rule — work the problem · 19 questions

- Open the Capital Reduction Account early and post to it as you go, rather than trying to assemble it at the end. Every sacrifice is a credit and every write-off a debit.
- Deal with the scheme item by item in the order the question gives, passing the entry and posting to Capital Reduction where the four rules require it.
- Do not put alterations of capital or variations of rights through the Capital Reduction Account. That is the single most common error in the chapter.
- Transfer any balance left in the Capital Reduction Account to Capital Reserve — never to the profit and loss account — and show the transfer.
- Redraw the balance sheet in Schedule III form and check that no fictitious asset survives. If the balance sheet still carries preliminary expenses or a debit balance in profit and loss, the scheme has not been fully applied.
- Where the question asks for the Capital Reduction Account itself, present it as a proper T-account with both sides totalled.

PQ 3.4 · MTP 2021-Mar [6] (b) · 5M · Pg 784

LEVEL II
Application

Easy

PQ 3.5 · PYQ 2021-Jul [6] (e) · 5M · Pg 786

LEVEL II
Application

Easy

PQ 3.13 · PYQ 2024-Sep [6] (b) · 4M · Pg 815

LEVEL II
Application

Easy

PQ 3.16 · PYQ 2025-Sep [6] (b) · 4M · Pg 825	LEVEL II Application	Easy
PQ 3.1 · PYQ 2018-Nov [3] (b) · 10M · Pg 776	LEVEL II Application	Medium
PQ 3.3 · MTP 2020-Oct [5] (b) · 8M · Pg 782	LEVEL II Application	Medium
PQ 3.9 · RTP 2023-Nov [7] · Pg 802	LEVEL II Application	Medium
PQ 3.11 · MTP 2024-Mar [3] (b) · 10M · Pg 810	LEVEL II Application	Medium
PQ 3.12 · RTP 2024-May [20] · Pg 813	LEVEL II Application	Medium
PQ 3.14 · MTP 2024-Dec S2 [3] (b) · 10M · Pg 816	LEVEL II Application	Medium
PQ 3.18 · PYQ 2026-May [3] (b) · 8M · Pg 831	LEVEL II Application	Medium
PQ 3.2 · PYQ 2019-Nov [3] (a) · 15M · Pg 778	LEVEL II Application	Hard
PQ 3.6 · PYQ 2022-Nov [2] · 20M · Pg 787	LEVEL II Application	Hard
PQ 3.7 · RTP 2022-Nov [7] · Pg 791	LEVEL II Application	Hard
PQ 3.8 · PYQ 2023-Nov [2] · 20M · Pg 796	LEVEL II Application	Hard
PQ 3.10 · PYQ 2024-May [2] · 14M · Pg 806	LEVEL II Application	Hard
PQ 3.15 · PYQ 2025-Jan [2] · 14M · Pg 819	LEVEL II Application	Hard
PQ 3.17 · PYQ 2026-Jan [2] · 14M · Pg 826	LEVEL II Application	Hard
PQ 3.19 · PYQ 2026-Sep [6] (b) · 4M · Pg 834	LEVEL II Application	Hard

CHAPTER 15

Accounting for Branches Including Foreign Branches

10 Topics • 28 Classified Questions • Importance: B

ICAI SKILL PROFILE Level I 5-15% • Level II 85-95% — this chapter reads **problems only**

Level I — Comprehension & Knowledge **2.0%** 4 of 203 marks

Level II — Analysis & Application **98.0%** 199 of 203 marks

Below the paper's Level I floor: only 2% of this chapter's marks are Comprehension and Knowledge, against 5–15% for the paper. There is almost no theory to fall back on. Every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Introduction

L2P1-C15-U15-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read Chapter 15 §1 Introduction, Study Material 2026 July pages 15.1–15.3.

NOTES

Why branch accounts exist: where a business operates from more than one place, the head office needs to know **the result of each branch separately** — its profitability, the stock and cash it holds, and how much it owes to or is owed by the head office. Branch accounting is the machinery for producing that.

The primary classification, and everything in the chapter follows from it: branches are either **dependent** — business policies and administration **wholly controlled by the head office**, which also maintains the accounts — or **independent**, maintaining a **complete double-entry record** of their own. A third category, **foreign branches**, cuts across both and adds a translation problem.

What the head office wants from the system: ascertainment of **branch profit or loss, control over branch stock and cash**, and the **incorporation of branch results and balances** into the accounts of the business as a whole.

CONCEPT BASE: declared by the Scanner but not carrying a question in this edition. Read it once for the vocabulary — dependent, independent, foreign — because the rest of the chapter assumes it.

Topic 2: Difference Between Branch Accounts and Departmental Accounts

L2P1-C15-U15-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read Chapter 15 §2 Distinction between Branch Accounts and Departmental Accounts, Study Material pages 15.3–15.5.

NOTES

This is a table question — learn it as a table, basis by basis.

Maintenance of accounts: branch accounts may be maintained either at the branch or at the head office; departmental accounts are maintained at one place only.

Apportionment of common expenses: for branches, the expenses of each branch **can be identified**, so the apportionment problem largely **does not arise**; for departments, **common expenses must be distributed among the departments on some equitable basis**.

Location: branches are **geographically separated** from the head office; departments are **located in the same premises**.

Reconciliation: branch accounts **require reconciliation** of the branch and head office accounts before final accounts are prepared; departmental accounts **do not**, since there are no converse accounts to reconcile.

Foreign currency: a **foreign branch** raises a **translation** problem; a department never does.

CONCEPT BASE: declared but not carrying a question in this edition. If it is asked it will be as a distinguish-between, so keep the bases in a fixed order.

Topic 3: Accounting for Dependent Branches

L2P1-C15-U15-T03

Read first Read Chapter 15 §3 Dependent Branches and §5 Accounting for Dependent Branches, Study Material pages 15.5–15.35, including the Debtors, Stock and Debtors, and Final Accounts methods.

NOTES

A **dependent branch** is one whose **business policies and administration** are wholly controlled by the head office, which also maintains its accounts out of the **reports and returns received from the branch**. The branch does **not maintain a complete record** of its transactions.

Three types the Study Material names: (a) a branch set up **merely for booking orders** executed by

the head office, which only **transmits orders**; (b) a branch at a commercial centre **for the sale of goods supplied by the head office**, with **all collections made by the head office**; and (c) a branch for the **retail sale of goods supplied by the head office**.

Three methods of ascertaining the result of a dependent branch where goods are invoiced at cost or at selling price: the **Debtors method**, the **Stock and Debtors method**, and the **Trading and Profit and Loss (Final Accounts) method**. Where goods are invoiced at **wholesale price** to a retail branch, the **Wholesale Branch method** is used.

Debtors method — suitable for a small branch. A single **Branch Account** is opened in the head office books, debited with opening balances of stock, debtors, petty cash and fixed assets, goods sent to branch and expenses paid by the head office, and credited with the closing balances, returns, and cash and remittances received. **The balancing figure is the branch profit or loss.**

Stock and Debtors method — used where **closer control** is wanted and goods are invoiced at a loaded price. Separate accounts are kept: **Branch Stock A/c**, **Branch Debtors A/c**, **Branch Expenses A/c**, **Branch Adjustment A/c** for the loading, and **Goods Sent to Branch A/c**. The **Branch Adjustment Account** absorbs the loading and the **Branch Profit and Loss Account** produces the result.

The loading is the heart of the Stock and Debtors method. Load on **opening stock**, on **goods sent**, on **returns** and on **closing stock** must each be removed. **Surplus or shortage of stock** is found through the Branch Stock Account and analysed between its cost and its loading.

Final Accounts method — a **Branch Trading and Profit and Loss Account** is prepared **at cost**, which gives the **true profit of the branch** rather than the notional figure produced under the Debtors method. Where the question asks for the **true profit**, this is the method to use.

Normal and abnormal losses: a **normal loss** — wastage, leakage — is absorbed in the cost of goods sold and no separate entry is needed beyond adjusting the stock; an **abnormal loss** — pilferage, fire — is **taken out separately at cost** and, under Stock and Debtors, its **loading is written back through the Branch Adjustment Account**.

Goods in transit and cash in transit at the year end must be brought into the branch account before the result is struck. They are the standing reconciliation items.

Application use the rule — work the problem · 16 questions

- Decide the method before you start — Debtors, Stock and Debtors, or Final Accounts — and say why. Where the question asks for the true profit of the branch, use the Final Accounts method.
- Under Stock and Debtors, open all five accounts and post to them as you go. Trying to compute the loading at the end is where the errors come from.
- Strip the loading from opening stock, goods sent, returns and closing stock separately, and show each as a working.
- Distinguish normal from abnormal loss and treat them differently. An abnormal loss comes out at cost, with its loading reversed through the Branch Adjustment Account.

- Bring goods in transit and cash in transit into the accounts before striking the profit, and say that you have done so.

PQ 3.1 · PYQ 2018-May [3] (b) · 10M · Pg 839	LEVEL II Application	Medium
PQ 3.2 · MTP 2020-Oct [5] (b) · 6M · Pg 841	LEVEL II Application	Medium
PQ 3.3 · PYQ 2020-Nov [2] (a) · 10M · Pg 842	LEVEL II Application	Medium
PQ 3.4 · PYQ 2021-Jul [3] (a) · 10M · Pg 845	LEVEL II Application	Medium
PQ 3.5 · PYQ 2021-Dec [3] (a) · 10M · Pg 848	LEVEL II Application	Medium
PQ 3.6 · PYQ 2022-May [5] (b) · 10M · Pg 849	LEVEL II Application	Medium
PQ 3.7 · PYQ 2022-Nov [3] (a) · 10M · Pg 851	LEVEL II Application	Medium
PQ 3.8 · PYQ 2023-Nov [3] (b) · 10M · Pg 853	LEVEL II Application	Medium
PQ 3.9 · RTP 2023-Nov [12] · Pg 856	LEVEL II Application	Medium
PQ 3.10 · MTP 2024-Mar [6] (c) · 6M · Pg 858	LEVEL II Application	Medium
PQ 3.11 · PYQ 2024-Sep [6] (c) · 6M · Pg 860	LEVEL II Application	Medium
PQ 3.12 · RTP 2024-Sep [20] · Pg 861	LEVEL II Application	Medium
PQ 3.13 · PYQ 2025-May [6] (c) · 6M · Pg 862	LEVEL II Application	Medium
PQ 3.14 · PYQ 2025-Sep [6] (c) · 6M · Pg 864	LEVEL II Application	Medium
PQ 3.16 · PYQ 2026-Sep [6] (c) · 6M · Pg 869	LEVEL II Application	Medium
PQ 3.15 · PYQ 2026-Jan [6] (c) · 6M · Pg 867	LEVEL II Application	Hard

Topic 4: Methods of Charging Goods to Branches

L2P1-C15-U15-T04

Read first Read Chapter 15 §4 Methods of Charging Goods to Branches, Study Material pages 15.9–15.12.

NOTES

Goods may be invoiced to a branch in three ways: at cost; at selling price; or, in the case of retail branches, at wholesale price.

At cost: the simplest, and the branch account then shows the true cost of goods sent. The trading result can be ascertained by the Debtors method, the Stock and Debtors method or the Final Accounts method.

At selling price: adopted where the goods would be sold at a fixed price by the branch — the Study Material's examples are **dealers in tea, petrol and ghee**. Greater control can be exercised over the working of the branch, because the branch balance in the head office books is then always composed of the value of unsold stock at the branch and remittances or goods in transit. That sentence is the answer to 'why invoice at selling price'.

At wholesale price to a retail branch: the head office is treated as making a **wholesale profit** on the transfer and the branch a **retail profit** on the sale. This separates the profit that the head office would have made anyway from the profit genuinely attributable to retailing, so the **stock reserve is created against the loading** to avoid taking unrealised profit.

The consequence for stock valuation, which is where the marks are: where goods are invoiced above cost, the **closing stock at the branch contains unrealised profit**, and a **stock reserve must be created** for the loading. **Only the cost element may remain in the consolidated accounts.**

Understanding explain it, and place it in context • 1 question

- Name all three methods, then explain the one the question asks about, and finish with the control or profit-measurement reason for using it.
- For the selling price method, quote the control point — the branch balance in head office books consists only of unsold stock and remittances or goods in transit.
- Whenever goods are invoiced above cost, say that a stock reserve is needed against the loading in closing stock. That link earns a mark even in a theory answer.

TQ 4.1 • MTP 2024-Dec S2 [6] (c) • DESC • 4M • Pg 870

LEVEL 1
Understanding

Easy

Topic 5: Accounting for Independent Branches

L2P1-C15-U15-T05

Read first Read Chapter 15 \$6 Accounting for Independent Branches, Study Material pages 15.36–15.48.

NOTES

An independent branch arises where the **size of the business** makes it desirable that the branch

maintain complete records of its transactions, so that a **separate trial balance** can be prepared for it.

The four salient features — this is the list answer: (1) the branch maintains its **entire books of account under the double entry system**; (2) the branch opens a **Head Office Account** in its books to record all transactions between head office and branch, while the **head office maintains a Branch Account** for the same transactions; (3) the branch prepares its **trial balance and trading and profit and loss account** at the period end and **sends copies to the head office for incorporation**; and (4) the head office **reconciles** the two accounts after receiving the final statements.

The Head Office Account in the branch books and the Branch Account in the head office books are converse of each other and should agree once all items in transit are adjusted. They are **not** assets or liabilities of the combined entity — they cancel on incorporation.

Inter-branch transactions are usually routed **through the head office**: a transfer from Branch A to Branch B is recorded by each branch against the Head Office Account, and by the head office against both branch accounts. Recording it directly between the branches is the common error.

Depreciation on branch fixed assets kept in the head office books is charged by the head office and advised to the branch; where the assets are in the branch books, the branch charges it. Say which arrangement the question uses before you post it.

Application use the rule — work the problem • 3 questions

- Post every head-office-to-branch transaction to the Head Office Account in the branch books and to the Branch Account in the head office books, and check that the two are converse before going further.
- Route inter-branch transfers through the head office unless the question says otherwise.
- Where a branch trial balance is given, prepare the branch trading and profit and loss account first, then incorporate — do not try to consolidate directly from the trial balance.

PQ 5.1 • PYQ 2021-Jan [6] (c) • 5M • Pg 871

LEVEL II
Application

Easy

PQ 5.2 • PYQ 2025-Jan [6] (c) • 6M • Pg 872

LEVEL II
Application

Medium

PQ 5.3 • PYQ 2026-May [6] (c) • 6M • Pg 873

LEVEL II
Application

Medium

Topic 6: Adjustment and Reconciliation of Branch and Head Office Accounts

L2P1-C15-U15-T06

Read first Read Chapter 15 §7 Adjustment and Reconciliation of Branch and Head Office Accounts, Study Material pages 15.48–15.55.

NOTES

The problem: the branch and head office accounts are **converse of each other**, and if they do not tally they must be reconciled before the final accounts of the concern as a whole are prepared.

The four standing reasons for a difference — look for these first in any question: goods in transit; cash or remittances in transit; expenses or income recorded by one party and not yet advised to the other — depreciation charged by the head office, for instance; and errors or omissions in either set of books.

The Study Material's worked example: the head office has sent goods worth ₹50,000 but the branch has received only ₹40,000 by the closing date. The branch treats ₹10,000 as goods in transit and passes: **Goods in Transit A/c Dr 10,000, To Head Office A/c 10,000.**

And the point most candidates miss: there is no entry in the head office books, because that is the point at which the event has already been recorded in full. Adjust only the side that has not yet recorded it.

Cash in transit is handled the same way, in whichever set of books has not yet recorded the receipt.

Where the item in transit is to be shown in the final accounts of the business as a whole, it appears as an **asset — goods in transit or cash in transit** — and the two inter-company accounts then cancel exactly.

Method: take each difference, decide **which set of books has not recorded it**, pass the adjusting entry there only, and then check that the two accounts agree. Present the reconciliation as a statement if the question asks for one.

Application use the rule — work the problem · 1 question

- Work through the differences one at a time and, for each, state which set of books needs the entry and why the other does not.
- Show goods in transit and cash in transit as assets in the combined balance sheet, and confirm that the Branch and Head Office accounts then cancel.
- If the question asks for a reconciliation statement, present it as a statement with a stated opening figure, the adjustments, and the agreed closing figure.

PQ 6.1 · MTP 2024-Nov [6] (c) · 6M · Pg 875

LEVEL II
Application

Medium

Topic 7: Incorporation of Branch Balance in Head Office Books

L2P1-C15-U15-T07

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read Chapter 15 §8 Incorporation of Branch Balance in Head Office Books, Study Material pages 15.55–15.60.

NOTES

Which method to use depends on what is to be prepared: (a) a **standalone profit and loss account and balance sheet for each branch**, or (b) a **consolidated statement of branch and head office**.

Method I — separate statements for each branch: the branch computes its profit and **transfers it to the head office in the branch books**, and the **converse entry is passed in the head office books**: **Branch A/c Dr, To Profit and Loss A/c**. A **separate balance sheet is then prepared for the branch and for the head office** — the **branch balance sheet shows the amount advanced by the head office as 'Capital'**, and the **head office books show the same amount as 'Advance to Branch'**.

Method II — consolidated statements: the individual assets, liabilities, incomes and expenses of the branch are **incorporated item by item** into the head office books, and the **Branch Account and Head Office Account are eliminated** against each other.

Two levels of incorporation are possible under Method II: incorporate only the **branch trading and profit and loss result** as a single figure, or incorporate the **detailed balances** — stock, debtors, creditors, expenses, and so on. The question will indicate which by what it asks for.

Whatever the method, three things must be done before incorporation: adjust **items in transit**; eliminate **unrealised profit in branch closing stock** by creating a **stock reserve** where goods were invoiced above cost; and eliminate the **inter-company accounts**.

CONCEPT BASE: declared by the Scanner but not carrying a question in this edition. It is nonetheless the step that completes every independent-branch question, so work the Study Material illustrations.

Topic 8: Incomplete Information in Branch Books

L2P1-C15-U15-T08

Read first Read Chapter 15 §9 Incomplete Information in Branch Books, Study Material pages 15.60–15.65.

NOTES

Why the situation arises: where the head office wants the **profitability of the branch kept secret from the branch staff**, it **holds back key information** — the **amount of opening stock** and the **cost of goods sent to the branch**, for instance.

What the head office does instead: it maintains a record of goods sent by passing **Goods Supplied**

to the Branch A/c Dr, To Purchases A/c, and the value of the closing stock is also adjusted only in the head office books.

What the branch does: at the year end it simply **transfers the various balances** it holds to the Head Office Account, without computing a result — it cannot, because it does not have the cost information.

So the working method in an exam question is reconstruction. You are given fragments — sales, expenses, remittances, some balances — and must **work back to the missing figures**. Use the **memorandum branch stock account** and the **branch debtors account** as the two reconstruction vehicles.

The standard derivations: **credit sales** from the Branch Debtors Account (opening debtors + credit sales – cash received – returns – bad debts – discount = closing debtors); **total sales** = cash sales + credit sales; **closing stock** from the Branch Stock Account at invoice price (opening stock + goods sent – returns – sales – shortage = closing stock); and **goods sent** or **opening stock** where either is the missing figure instead.

Then compute the profit in the head office books, adjusting for the loading on opening and closing stock and for any shortage or surplus. The branch never sees this computation — which is the point of the arrangement.

Application use the rule — work the problem · 7 questions

- Identify what is missing before you start, and choose the account that will yield it — Branch Debtors for sales figures, Branch Stock for stock and goods-sent figures.
- Draw the reconstruction accounts as memorandum accounts and label them as such. The examiner expects to see the working, not just the derived number.
- Keep invoice price and cost strictly apart. The Branch Stock Account runs at invoice price; the profit computation needs cost.
- Deal with shortage or surplus explicitly, splitting it between cost and loading.
- Finish by computing the branch profit in the head office books and say why it could not be computed in the branch books.

PQ 8.2 · MTP 2020-Oct [5] (c) · 4M · Pg 879

LEVEL II
Application

Easy

PQ 8.5 · PYQ 2023-May [5] (c) · 5M · Pg 885

LEVEL II
Application

Easy

PQ 8.3 · MTP 2021-Mar [3] (a) · 8M · Pg 880

LEVEL II
Application

Medium

PQ 8.6 · RTP 2023-May [13] · Pg 887

LEVEL II
Application

Medium

PQ 8.7 · PYQ 2024-May [6] (c) · 6M · Pg 891

LEVEL II
Application

Medium

PQ 8.1 · PYQ 2019-May [3] (b) · 8M · Pg 877

LEVEL II
Application

Hard

PQ 8.4 · MTP 2023-Mar [3] (a) · 12M · Pg 883

LEVEL II
Application

Hard

Topic 9: Accounting for Foreign Branches

L2P1-C15-U15-T09

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read Chapter 15 §10 Foreign Branches and §11 Accounting for Foreign Branches, Study Material pages 15.65–15.70, with AS 11 in Chapter 7 Unit 3.

NOTES

Foreign branches generally maintain independent and complete records in the currency of the country in which they operate. So the problem of incorporating their balances is mainly one of translating foreign currency into Indian rupees, because the exchange rate of the rupee is not stable against other currencies.

The reassuring point to state: the accounting principles that apply to inland branches apply equally to a foreign branch, once the trial balance of the foreign branch has been converted into Indian currency. Translate first, then account exactly as for an independent branch.

AS 11 (revised 2003) classifies foreign operations into two types, and the classification governs the whole translation: **Integral Foreign Operation (IFO)** and **Non-Integral Foreign Operation (NFO)**.

Integral Foreign Operation is a foreign operation the activities of which are an integral part of those of the reporting enterprise — the business is carried on as if it were an extension of the reporting enterprise's operations. The Study Material's example is the sale of goods imported from the reporting enterprise and remittance of the proceeds back to it.

Non-Integral Foreign Operation is a foreign operation that is **not integral** — it accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings substantially in its local currency, and its day-to-day activities are carried on with a significant degree of autonomy from the reporting enterprise.

Indicators of a non-integral operation include: transactions with the reporting enterprise are a low proportion of its activities; its activities are financed largely from its own operations or local borrowings; its costs are settled primarily in the local currency; its sales are mainly in currencies other than the reporting currency; and its cash flows are insulated from the day-to-day cash flows of the reporting enterprise.

CONCEPT BASE: declared but not carrying a question in this edition. The classification is

nonetheless what every foreign-branch computation turns on, so learn the indicators.

Topic 10: Techniques For Foreign Currency Translation

L2P1-C15-U15-T10

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read Chapter 15 §12 Techniques for Foreign Currency Translation and §13 Change in Classification, Study Material pages 15.70–15.106, with AS 11 §3.7 and §3.8.

NOTES

Integral Foreign Operation — translate as if the transactions were the reporting enterprise's own. (1) All transactions are translated at the rate prevailing on the date of the transaction; a weekly or monthly average rate is permitted where there are no significant variations in the rate. (2) At the balance sheet date: **monetary items at the closing rate**; **non-monetary items** — the **cost and depreciation of tangible fixed assets at the rate at the date of purchase** where the asset is carried at cost, or at the **rate at the date of valuation** where it is carried at a valuation; **inventories at the rates when those costs were incurred**; and the **recoverable amount or realisable value at the rate when that amount was determined**.

The resulting exchange differences for an IFO go to the statement of profit and loss.

Non-Integral Foreign Operation — translate the branch as a net investment. (a) All assets and liabilities, both monetary and non-monetary, at the closing rate; (b) income and expense items at the rates at the dates of the transactions, with average rates permitted where appropriate; and (c) all resulting exchange differences accumulated in a Foreign Currency Translation Reserve until the disposal of the net investment.

That reserve is the defining feature of NFO translation, and the question is usually testing whether you take the difference to profit and loss or to the reserve. IFO — profit and loss. NFO — reserve.

On disposal of a non-integral operation, the cumulative amount of the exchange differences deferred in the reserve and relating to that operation is recognised as income or expense in the same period as the gain or loss on disposal.

Change in classification — apply the new procedures from the date of the change, prospectively. **Integral to non-integral**: the non-integral translation procedure is followed from the date of change, and the exchange difference arising on translating the non-monetary assets at the date of reclassification is accumulated in the foreign currency translation reserve. **Non-integral to integral**: the integral procedure is applied from the date of change, and the translated amounts of non-monetary items at the date of change are treated as their historical cost.

The foreign currency translation reserve is not reversed on a change from non-integral to integral — it remains until disposal of the operation. That asymmetry is examinable.

CONCEPT BASE: declared by the Scanner but not carrying a question in this edition. It is the technical core of every foreign-branch question, so the two translation tables should be learned as a pair.