Course No. 301 **ADVANCED FINANCIAL ACCOUNTING (AFAC IX)**

Marks: 80 **Hours: 40**

Objective: The basic aim of this paper is to acquaint the students with advanced topics in accounting.

Course Contents:

Unit I: **Accounts of Banking Companies :**Definition and meaning of banking terms, books to be maintained; classification of Advances, preparation of profit & loss A/C and Balance sheet.

20 : 10 hrs

Unit II: Accounts of Life Insurance Companies :Definition and elements of Insurance contract, meaning of various insurance terms, types of insurance, Books, maintained under life Insurance Business, Ascertainment of profit in life Insurance Business, Preparation of Revenue Account, Balance sheet and valuation Balance sheet of life Insurance company,

20 : 10 hrs

Unit III: Accounts of General Insurance Companies : Preparation of Revenue Account and Balance Sheet of General Insurance companies.

20 : 10 hrs

Unit IV: Investment Account : Meaning, meaning of cum-dividend and ex-dividend transactions, cum-interest and ex-interest transactions, brokerage, Accounting for investment.

20 : 10 hrs

Text and Reference Books :

1. Tulsiram: Financial Accounting. Pearson Education, New Delhi.
2. Rajaseharam: Financial Accounting. Pearson Education, New Delhi.
3. Mukherji & Hanif: Financial Accounting, Tata Mc. Graw Hill, New Delhi.
4. Paul: Advanced Financial Accounting, New Central Book Agency, Hyderabad.
5. Sukla, Grewal and Gupta: Advanced Accounts, S.Chand, New Delhi.

Unit – 4: Investment Accounts

Meaning of Investment and its types

The term 'Investment' refers to funds invested in various securities consisting of government and semi government loans, debentures of local authorities such as port trusts, municipal corporations and the like and debentures and shares of companies. Accounting Standard 13 issued by the Institute of Chartered Accountants of India defines investment as, "Investments are assets held by an enterprise for earning income by way of dividends, interests and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are non-investments". Securities may be fixed interest securities and variable yield securities. Fixed interest securities are those securities which carry a fixed rate of interest while the securities (such as shares of companies) on which dividend may fluctuate from year to year are called variable yield securities.

Investments may be a fixed asset or current asset. If the investments are held permanently for a long period time, they will be regarded as fixed assets and known as 'trade investments'. But where the object of the business is to buy and sell securities or these are held as a temporary investment of surplus liquid resources for not more than one year, then they will be regarded as current assets or marketable securities.

Investments Accounts

(a) As Trade Investments: The investments which are made permanently for a regular income outside the business is known as Trade Investment. These are treated as fixed assets. That is why if this type of investments are sold at a profit, profit on such sale of investment is transferred to Capital Reserve Account and not to Profit and Loss Account.

(b) As Marketable Securities: Sometimes a business wants to invest its idle cash purely on a temporary basis (of course, if the rate of earning is higher than cost of capital). This type of investment is known as Marketable Securities and is treated as Current Assets. That is why profit or sale of such investments is transferred to Profit and Loss Account and not to Capital Reserve.

Investment Accounts:

The accounts of investments are kept in the same way as the accounts of any other asset. A separate investment account should be opened for each kind of security and on the head of the account particulars regarding the nature of the security, dates when interest or dividend is due, the date of redemption etc.

should be stated. When the number of investments carried is large, a separate investment Ledger is employed for recording all investment accounts.

Features of Investment accounts:

1. It is a real account.
2. Investment account is divided into three columns. First column show nominal value of investment, second column show interest and dividend and third column shows cost of investment or sale proceeds of investment.

Purpose of maintaining an investment ledger is as follows:

1. It helps in keeping a record of each investment separately.
2. It helps to ascertain the value of securities at the end of the account period.
3. It is helpful in collection of interest and dividend as and when they become due.
4. It is helpful in ascertaining the amount of accrued income at the end of the accounting period.
5. It facilitates the determination of the profit or loss on sale of any security.

Preparation of Investments Account

Concerns holding a large number of investments may find it more convenient to use a separate ledger called an Investment Ledger, for keeping the accounts of all their investments. Such a ledger is kept on the columnar system and is ruled differently from an ordinary ledger. As the issuing authority of a security pays interest to the holder at a certain rate calculated on its face value, it is desirable that the face value (also known as the nominal value) as well as the interest or dividend received should appear side by side with the capital invested in it. Therefore, the investment Ledger is provided with three columns on either side headed 'Nominal Value',' Interest or Dividend' and 'Capital or Principal'. The name of each investment is written at the tip of the account followed by the rate of interest or dividend and the dates on when it is payable; when an investment is purchased "cum-dividend", 'ex-dividend" its cost is analyzed into the nominal price and the dividend or interest accrued and as entry is made on the credit side of the Cash Book, from where it is posted to the respective columns on the debit side of the particular Investment Account in the Investment Ledger. When the whole or part of the investment is sold, the price received, similarly split up into the nominal price and the dividend or interest accrued, is entered on the debit side of the Cash Book, from where it is posted to the respective columns on the credit side of the particular Investment Account in the Investment Ledger. Expenses by way of brokerage, stamps etc., will be debited to the capital account. When dividend or interest accrued on an investment is received, it is first entered on the debit side of the Cash Book and then posted to the credit side of the particular Investment Account in the 'Dividend or Interest' column in the investment Ledger. At the close of the financial year, the dividend or interest accrued on different investments, but not received, is brought into account by crediting the 'Dividend or Interest' columns of the different Investment accounts in the Investment Ledger and bringing down such balances as an asset after the accounts have been balanced.

The first column is of Nominal Value and in it on the credit side is entered the nominal value of investments on hand and the totals on both sides will then agree.

The second column is of Interest or Dividend and it will always show a credit balance representing interest or dividend on investments for the period and it will be carried to Profit and Loss Account.

The third column is for Capital or Principal. In this column against the closing balance will be entered the value of securities is hand and the difference of the two sides will show profit or loss on the sale of investments during the period. Value of securities in hand is the lower of cost and fair values as per Para 14 of AS – 13.

Balancing the Investment Account

When the whole of an investment has been sold, the difference between the two sides of an Investment Account will be profit or loss on the sale. Where only part of an investment has been sold during the year, the cost of the remaining investment will be brought down as a balance in the Investment Account and the difference between its two sides will be profit or loss on the investments sold. When the investment is a fixed asset, any profit or loss made on the sale thereof will be of a capital nature and should be treated accordingly.

Treatment of Bonus shares, Rights Shares and Brokerage in investment account

Bonus Shares: When successful companies issue bonus shares to capitalize their reserves, the shareholders are not required to pay any amount for such shares. The number of shares will be entered in the number column and nothing will be added in the amount of principal or capital column. When bonus shares are sold, the profit on such shares is calculated by deducting average cost of shares sold from sale price of bonus shares. Valuation of investment in shares should be made at market value or average cost price of shares, whichever is lower.

Right shares: If shares are first offered to the existing shareholders as a matter of their right, such shares are called right shares. Such shares may be purchased by the shareholder or the right may be renunciated in favour of a third party for a consideration. If the shares are purchased, the number of shares & amount paid will be entered in the number & principal columns actively. If the shares are not subscribed for but are sold in the market, the amount received will be entered only in the profit and loss account.

Brokers and Brokerage: Brokers are primarily Commission agents and act as an intermediary between buyer & seller of securities. They do not purchase & sell securities on their behalf. They bring together buyers & seller and help them making a deal. They charges commission from both parties. Such commission is called brokerage. Brokerage is added with cost of investments and deducted with sale proceeds of investments.

Concept of Jobbers and Brokers and their difference

Jobbers: Jobbers are security merchants dealing in shares, debentures as independent operators. They buy & sell securities on their own behalf and try to earn through price changes. They directly deal with brokers who make transactions on the behalf of public. They generally quote two price, one – for purchase and other for sell. The difference between the two prices constitutes his remuneration. This system enables specialisation in the dealings and each jobber specialises is certain group of securities. It also ensures smooth and prompt execution of transactions. The double quotation of a jobber assures fair-trading to investors.

Brokers: Brokers are primarily Commission agents and act as an intermediary between buyer & seller of securities. They do not purchase & sell securities on their behalf. They bring together buyers& seller and help them making a deal. They charges commission from both parties. They are experts in estimating prices and advise their clients in getting gain. They get orders from public and execute the orders through jobbers.

Difference between Jobber and Broker

Basis	Jobber	Broker
Meaning	**Jobber is a dealer who deals in buying and selling of securities.**	**Broker is an agent who deals in buying and selling of securities on behalf of his client.**
Specialisation	**Jobber is a specialist**	**Broker is a general mercantile**

Basis	Jobber	Broker
	mercantile agent.	**agent.**
Nature of trading	**A jobber carries out trading activities only with the broker.**	**A broker carries out trading activities with the jobber on behalf of his investors.**
Restrictions on dealings	**A jobber is prohibited from buying or selling securities directly in the stock exchange. Also he cannot directly deal with the investors.**	**A broker Acts as a link between the jobber and the investors. He trades i.e. buyers and sells securities on behalf of its investors.**
Agent	**Jobber is an independent dealer or a merchant willing to buy and sell securities.**	**Broker is merely an agent to buy or sell on behalf of his clients.**
Form of consideration	**A jobber gets consideration in the form of profit.**	**A broker gets consideration of commission or brokerage.**
Price Quotations	**Jobbers quote two prices to the broker, one for buying and one for selling. Sale quotation is higher than the purchase quotations.**	**Broker has to negotiate terms and conditions of sale or purchase and safeguard his client's interest.**

Contango and Backwardation: Contango and backwardation are two technical terms used in the futures market. These terms are used to describe the position of futures price in comparison with the spot price

Contango: Futures markets, by definition, are predicated on the future price of a commodity. Analyzing where the future price of a commodity is heading is what futures trading is all about. Because futures contracts are available for different months throughout the year, the price of the contracts changes from month to month. In a normal market, futures price would be greater than the spot price due to the effect of cost of carry. This situation is generally referred to as a 'Contango' market. The market is also in contango when the price of the front month is higher than the spot market, and also when late delivery months are higher than near delivery months.

Backwardation is just the opposite of Contango. In some special situations, the futures prices may be decided by factors other than cost of carry. In such cases, futures may trade below the spot. Such situations, where the spot price minus futures price (basis) is a positive figure, is generally termed as 'backwardation' market. It occurs normally in an "inverted futures curve" environment. Essentially, on the maturity date, the futures price will converge higher to the spot rate. This means that a commodity is worth more right now than it is in the future.

Difference between Contango and Backwardation

Basis	Contango	Backwardation
Definition	**Contango refers to the situation where the Future prices of stock are higher than the current spot price**	**It refers to the market situation where the Future prices are lower than the current spot prices for a particular commodity.**
Future Curve	**If a commodity market is in contango, the future price curve is considered to be in an "upward-sloping" or normal market.**	**If a commodity market is in Backwardation, the future price curve is considered to be in an"downward-sloping" or inverted market**
Price Difference	**Future Price is more than the Spot Price.**	**Future Price is less than the Spot Price.**
Most Happen in Case of	**Contango mostly happens in Commodity market**	**Backwardation commonly happens in Oil market**
Driving factors	**Contango is a supply driven market situation.**	**Backwardation is a demand driven market situation.**

Cum-interest and Ex-interest price

The term 'Cum' and 'Ex' are latin words. 'Cum' means with and 'Ex' means without. The term 'Cum-interest' and 'Ex-interest' relate to debentures and bonds. Cum-interest can be expanded as inclusive of interest and Exinterest can be expanded as exclusive of interest. Cum interest is the amount of interest accrued in the duration between the last interest date and the settlement date or transaction date. The cum-interest price includes not only the cost but also includes the interest accrued upto the date of purchase, and when interest becomes due it would be the right of the buyer to claim interest. Conversely, the quotation, Ex-interest, covers only the cost of the debentures and the buyer is liable to pay additional amount as interest accrued upto the date of purchase of debentures.

Difference between Cum-interest and Ex-interest Meaning

Basis	Cum-interest	Ex-interest
Meaning	**It means the price of debentures with interest**	**It means price of debentures without interest.**
Right to interest	**The buyer gets the right to received interest paid after the sale.**	**The seller retains the right to receive interest accrued during his holding.**
Price	**The price is higher than what would have to be paid otherwise.**	**The price is lower than what would have to be paid otherwise**
Accrued interest	**In case of cum-interest nothing is payable for interest accrued.**	**In case of ex-interest, accrued interest is payable.**

Cum-interest and Ex-interest price

The term 'Cum' and 'Ex' are latin words. 'Cum' means with and 'Ex' means without. The term 'Cum-dividend' and 'Ex-dividend' relates to shares. Cum-dividend can be expanded as share price inclusive of dividend and Exdividend can be expanded as share price exclusive of dividend. Cum dividend is the amount of dividend accrued in the duration between the dividend declaration date and the settlement date or transaction date. The cum-dividend price includes not only the cost of investment but also includes the dividend accrued upto the date of purchase, and when dividend is declared it would be the right of the buyer to claim dividend. Conversely, the quotation, Exdividend, covers only the cost of the investment and the buyer is liable to pay additional amount as dividend accrued upto the date of purchase of debentures.

Difference between Ex-dividend and cum-dividend

Basis	Ex-dividend	Cum-interest
Meaning	It means price of shares without dividend.	It means price of shares with dividend.
Right to dividend	The seller retains the right to receive any dividend declared or paid after sale.	The buyer gets the right to dividend received dividend declared or paid after the sale.
Price	The price is lower than what would have to be paid	The price is higher than what would have to be paid otherwise.

	otherwise.	
Accrued Dividend	In case of cum-Dividend nothing is payable for interest Dividend.	In case of ex-dividend, accrued dividend is payable.