AS 1 "Disclosure of Accounting Policies"

1. Accounting Policies Means

Specific accounting principles & Methods of applying such principles adopted in preparation and presentation of financial statements.

Selection of accounting policies is the responsibility of the management.

In selection of accounting policies, management should consider the following:

Primary consideration

Financial statements should give True & Fair view after applying selected policies

Other Major consideration

Prudence

- It means management should be careful while selecting accounting policies.
- Management should apply knowledge i.e. nature of business, legal requirements, accounting standards, etc. in the selection of policies.

Substance over

- It is Reality over Legality.
- Management should select the accounting policies which help to present a accurate picture of financial statements rather than legality

Materiality

- Financial Statement should disclose all material Items i.e. those items which affect decision making of users

2. Fundamental Accounting Assumption in preparation of financial statements

Going concern

It is assumed that business would continue for foreseeable period.

Consistency

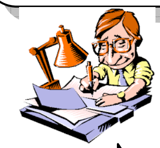
it is always assumed that same accounting policies would be followed every year.

Accrual Assumption

It is assumed that entity record all income & exp. on period basis. They are not recorded on payment basis

AS – 2 Valuation of Inventories (Chart)

Inventory is an asset held for sale in the ordinary course of business (Finished goods), which is used in the process of production (Raw Material) or consumed in the process of production (Consumables and Loose tools)



Valuation of Inventory

1. ***Inventory is valued at COST (or) NRV whichever is LOWER***

*Let us understand **"What Cost of Inventory Includes"***

Cost of Purchase

Particulars	₹
Purchase price i.e. Basic price of material	--
Add	
NON refundable taxes & duties	--
Carrying Cost i.e. inward freight cost	--
Inward Insurance cost	--
All other costs incurred directly related to acquisition and bringing it to warehouse.	--
Less	
Trade discounts Quantity discounts	--
Duty drawbacks & other similar items	--
	--
Cost of Purchase	--

Cost of Conversion

This includes the costs incurred to convert the raw materials into finished goods. (I.e. Factory Overheads)

Absorption of Factory Overheads

- ***Fixed OHs***
  - *Actual Capacity > Normal Capacity* → *Absorb based on Actual Capacity*
  - *Actual Capacity < Normal* → *Absorb based on Normal Capacity*
- ***Variable OHs***
  - *Absorb based on actual capacity utilisation*

Example

Other Cost

All other costs incurred to bring the inventory to the present location and condition. E.g. R & D cost, Packaging cost, Administration OHs in relation to production activities

Cost of inventory should be ascertained in following manner

1. If stock in hand is unique not similar to each other, use Specific Identification Method.
2. If stock in hand is similar to each other, then use following two methods of stock valuation FIFO Method, Weighted Average Method

Following Cost should be Excluded from Cost – 1) Abnormal Loss 2) Storage Cost (Unless those cost are necessary for production process) 3) Administrative selling & distribution cost 4) Borrowing cost (Interest)

2.

Let us see "How to Calculate Net Realisable Value

Net Realisable Value of

Finished Goods	Work in Progress	Raw Material
Expected SP - Selling cost	Expected SP of FG - Expected cost to complete - Selling Cost	Strictly, No need to determine NRV

3.

Valuation of Raw Material

Its valuation is fully based on the valuation of Finished Goods

If finished goods is sold or expected to be sold at cost or above cost	If finished goods is sold or expected to be sold below the cost
Raw material should be valued at Cost	Raw material should be valued at Replacement Cost

Examples

Or

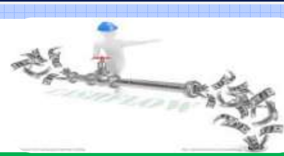
4.

Disclosure Requirements – The financial statement should disclosed

1. *The accounting policies adopted in measuring inventories, including the cost formula used. The accounting policies adopted in measuring inventories, including the cost formula used*
2. *The total carrying amount of inventories and its classification appropriate to the enterprise.*

Cash Flow Statement

1. Cash Flow Statement Means



Presentation of Flow of Cash & Cash Equivalents during the year , it includes following cash activities

Cash Inflow/ Outflow from Operating Activity

These are the principal/ Main revenue generating activities of the enterprise.

Cash Inflow –
1. Cash Sales 2. Cash received from Debtors /Commission and Fees etc....

Cash Outflow
1. Cash Purchases. 2. Cash operating expenses. 3. Payment of wages/ Income Tax.

Cash Inflow/ Outflow from Investing Activity

It include the purchase and sale of long term assets and other investments than cash equivalents.

Cash Inflow-
1. Sale of fixed assets 2. Sale of investment
3. Interest received
4. Dividend received

Cash Outflow
1. Purchase of fixed assets
2. Purchase of investment

Cash Inflow/ Outflow from Financing Activity

Activities that result in change in the size and composition of the capital (including Preference share capital in the case of a company) and borrowings of the enterprise

Cash Inflow-
1. Issue of shares/debentures 2. Proceeds from long term, short term Loans/ borrowings

Cash Outflow
1. Cash repayments of amounts of Loan. 2. Redemption of shares & debentures. 3. Interest Dividends paid

2. Presentation of Cash Flow Statement

Statement can be prepared with the help of following two methods.

Difference is there only in presentation of operating activities
(Other activities are presented in the same way in both Methods)

Direct Method

Major classes of gross cash receipts & cash payments are disclosed.

Indirect Method

Reconciles from net income to cash provided by operating activities Indirect Method

1. Net Profit before tax 2. +/- Non cash & Non operating
3. +/- Changes in Working Capital 4. - Tax paid & extra ordinary items

3. *Disclosure Required*

- Components of Cash & Cash Equivalents
- Reconciliation of the amounts in CFS with amounts reported in Balance Sheet.
- Management comments on special areas.

AS 10 – PROPERTY, PLANT AND EQUIPMENT (PPE)

1.

Let us see "What is PPE"

It is Tangible Assets

Expected to be used during more than a period of 12 months

Held for use in

Producing Goods

Providing Services

Rental to others

For Administration Purpose

2.

Recognition of Plant, Property and Equipments

How entity should do "Recognition of PPE" i.e. (Recording of PPE in the books of account)

Initial Recognition & Measurement

Asset is acquired by

Payment of Cash/Credit

Asset is recognised at Purchase Price + Expenses incurred on asset to make asset ready to use

Purchase price	xx
+Freight	xx
+Non refundable taxes	xx
+PV of restoration	xx
+All direct exp Inc till ready to use	xx
+ 16- Borrowing cost	xx
-Discount	xx
-Govt. Grants	xx
	xx

Self construction

Asset is recognised at Cost of Construction + Expenses Borrowing cost incurred before asset is ready to use. (Avoid internal profits on stores used and abnormal loss of material and labour)

Exchange with another assets & by issue of

1. Asset received is recognised at Fair value of either
(a) Asset given up
(b) Asset acquired.

2. If it is reliable measurement of fair value of asset given up or Asset received is not possible then new asset received is to be recorded at Carrying amount of Asset given

Subsequent Recognition & Measurement

Does subsequent expenditure (including spare parts) increase the future economic benefits? In other words it is PPE if it satisfies the recognition criteria

Yes → Capitalise along with PPE

&

No → Charge to P&L Statement

It is recognised as PPE if it is expected to generate Future economic benefit to Entity

3.

Important Points

1. *Major assets replacement & overhauling should be capitalised and depreciated over its useful life, if it satisfies PPE recognition criteria.*
2. *If deferred credit terms are involved, it should be recognised at present value and it would be unwinded over the period. PPE should be recognised at cash price (Present Value) on the date of Recognition.* ***Interest = Total Payment – Cash Price should be debited to P& L unless asset is qualifying asset as per AS -16***
3. *Useful life, Residual value & depreciation method should be reviewed every year end.*
4. *Any change in price. Life, Realisable Value & method of depreciation - Account prospectively.*
5. *Select Cost or revaluation model for the entire class of items. Select and apply consistently.*
6. *If any major components is replaced then component to be recognised separately by*

4.

Retirement of PPE

1. ***PPE is retired from active use and it is held for disposal - such PPE should be stated in balance sheet Carrying amount (Net book value); or Net realisable value (NRV) Whichever is LOWER***

Replaced By →

2. ***Disclose such items separately in the financial statements. Any expected loss should be recognised immediately in the profit and loss statement.***

5.

Accounting disposal

COST Model

Profit/loss on disposal should be transferred to P & L

Revaluation Model & Revaluation surplus exist

Profit/Loss on disposal should be transferred to P&L;
After disposal, if any Revaluation surplus exists - transfer to General reserve (Revenue reserves)

After disposal of a PPE, it should be completely eliminated from the financial statements i.e. gross value and accumulated depreciation related to the asset:

AS - 11 - The Effects of Changes in Foreign Exchange Rates

This AS discusses how to convert the foreign currency transaction into reporting currency i.e.

- ***Which exchange rate should be used to convert it into Rupees*** *and*
- ***How to account for the changes in foreign currency (Forex) rates in financial statements.***

This Standard guides in

- ***Recording of Foreign currency transactions entered by the entity***
- ***Translation of financial statements of foreign operations***
- ***Accounting for forward exchange contracts***

1. *What is Monetary & Non – Monetary Item*

Monetary items

Monetary items are money held assets and liabilities to be received or paid in determinable amounts of money.

Therefore following items are monetary items:

- 1. Money held (i.e. cash and cash equivalents held by the entity).
- 2. Assets which are receivable in terms of money.
- 3. Liabilities which are payable in terms of money.

Non monetary items

Non monetary items are those items in which benefit is receivable in Kinds, Goods or services.

Example :Prepaid expenses, Advances given to suppliers.

In above examples, we will receive either service or goods in return.

2. *Let us understand An entity can have foreign currency transactions in two ways*

- Transactions in foreign currency directly by the entity i.e. imports, exports, foreign currency loans, etc.
- Foreign currency transactions by its foreign branch or subsidiary, etc. (Indirectly)

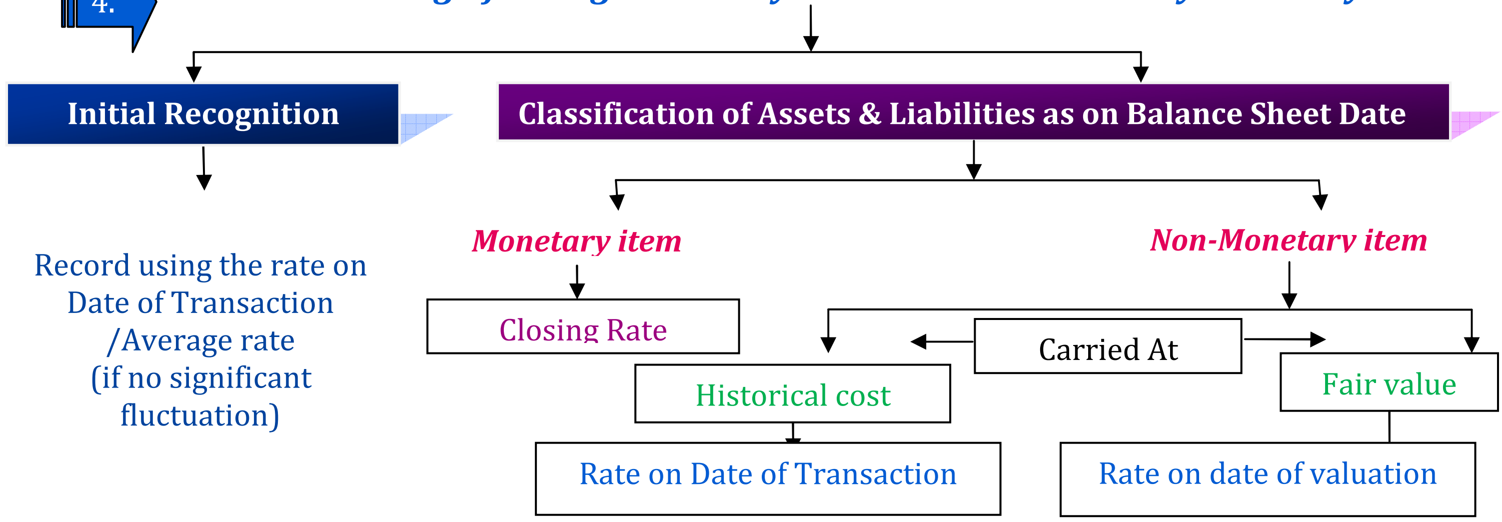
3.

Currency

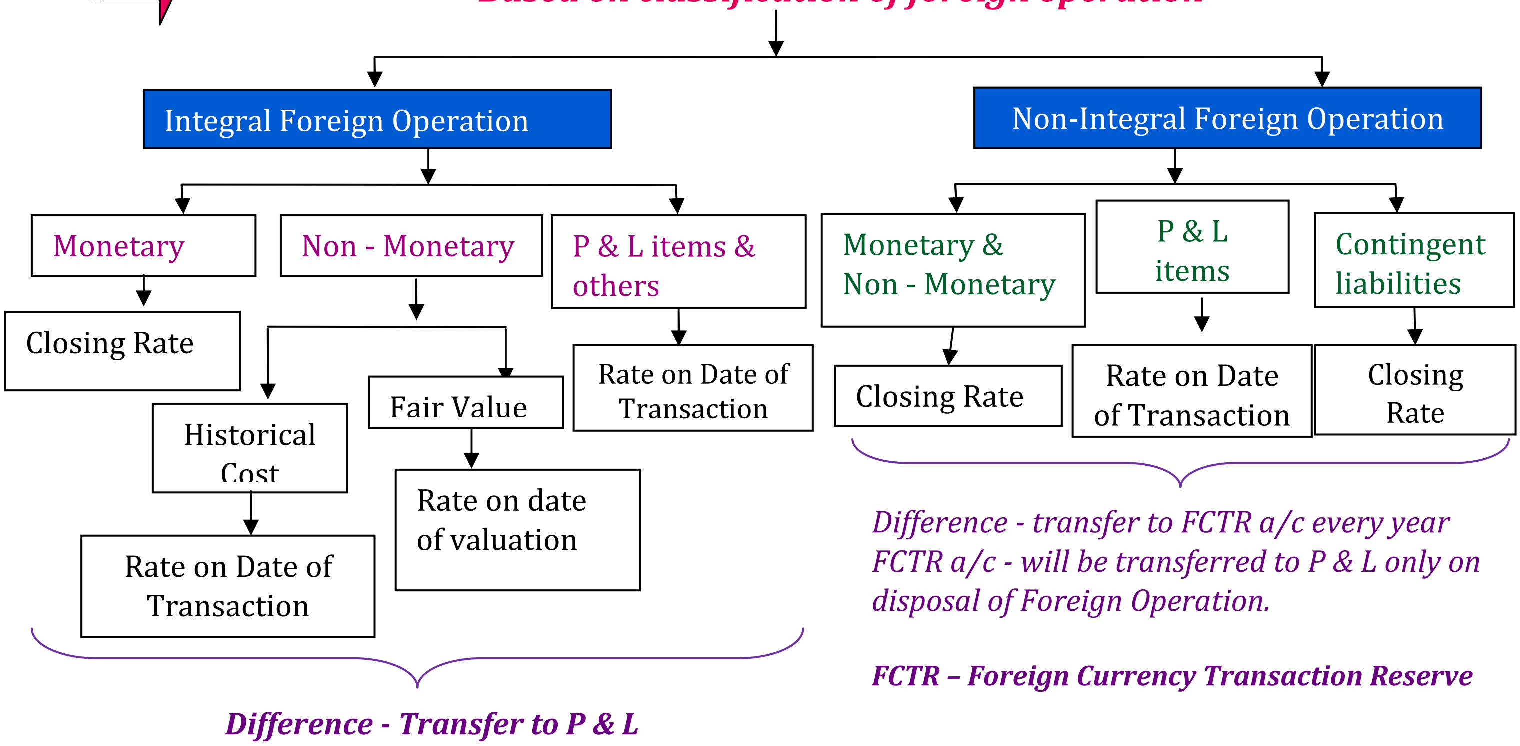
- **Reporting Currency** - currency in which financial statements are presented.

- **Foreign currency - currency is other than the reporting currency.**

4. *Recording of Foreign currency transactions entered by the entity*



5. *Based on classification of foreign operation*



6.

Types of Forward Contract

Forward Contract entered for its own purpose

1. Premium or discount arising at the inception of the contract should be amortised as an expense or income over the life of the contract.
2. Exchange difference on such contract should be recognised in P&L.
3. Any profit or loss arising on cancellation or renewal of such forward contract should be recognised as income or expense for the period.

Forward Contract entered for Trading/ Speculation

1. Premium or Discount on such contracts need not be recognised.
2. As the forward contract is held for trading or speculation purpose it should be valued at the balance sheet rate.
3. Gain or loss as on the Balance sheet date should be recognised in P&L for the period.
4. Gain or loss = Forward rate available on the reporting date for the remaining maturity of the contract LESS Forward rate fixed at the inception.

AS 12 - Accounting for Government Grants

Government Grants are Govt. assistance in cash/kind for compliance of future/past conditions

Two conditions must be satisfied for recognition of Government Grant

1. *There is reasonable assurance that the entity will comply with the conditions*
2. *Ultimate collection is reasonably certain.*

Now Let us see "What will be the Accounting treatment for Grant Received"

1. *Govt. Assistance /Grant in form of Cash*

Grant Received - related to Specific Asset

- **Depreciable Assets**
  - **Alternative ONE**
    1. *Amount received is deducted from the gross value of the asset;*
    2. *The reduced amount of fixed asset is depreciated over its useful life*
  - **Alternative Two**
    1. *Amount received is treated as deferred income*
    2. *Deferred income is recognised in P&L a/c on a systematic and rational basis over the useful life of the asset;*
    3. *Apply depreciation method to recognise deferred income in P&L a/c;*
- **Non - Depreciable Assets**
  - **No conditions to be fulfilled** → Credit to capital reserve
  - **Conditions to be fulfilled** → Credit to P & L in a systematic Manner

Grant Received - related to Revenue Expenses

- Credit to P & L A/c as other income in a systematic basis (Matching Concept)

2. Govt. Assistance /Grant in form of kind

- **Received at Free of cost, Record at Nominal Value**
- **Received at Concessional Price, Record it at acquisition Rate**

Refund of Government Grant

Government grants are generally refundable when the entity does not fulfil certain conditions. Refund of grant is treated as an extraordinary item as per AS 5

Related to Revenue

- ***Apply first against unamortized deferred GG.***
- ***Balance (if any) - Debit P & L.***

Relating to promoters Related to Fixed Asset

Debit Capital Reserve

Related to fixed Asset

- ***Debit to FA &***
- ***Depreciate the Revised Book Value prospectively over the remaining useful life.***
- ***Debit from Capital Reserve/ Deferred GG. (If any)***

Disclosure under Accounting Standard - 12

- **Accounting Policy followed for government Grants.**
- **Nature & Extent of Government Grants recognized in Financial Statement.**

AS 13 - Accounting For Investments

1.

Investment is a

Asset (Not held as Stock in Trade)

- Held for earning Income
  - By the way of
    - Dividend
    - Rental
    - Interest
- Held for Capital Appreciation
- Held for Other Benefits

2. Recognition and Measurement of Investment

Initial Recognition

Recognise at Cost i.e.	
Purchase Price	*XX*
+ Incidental expenses	*XX*
- Pre acquisition income	*XX*
	XX

Subsequent measurement on BS date

Based on classification

Current Investment

Two conditions to be satisfied

1. It is readily realisable
2. Intention to hold for not more than one year from date of investment

Measures at Cost OR Fair value whichever is lower (on Individual Investment Basis)

Any reduction to fair value and any reversals of such reductions are transferred to P&L a/c

Long term Investment

Which is not a current investment

Always valued at COST
Exception: Reduce carrying amount if

Any reduction to Cost and any reversals of such reductions are transferred to P&L a/c

3. *Sale of Investments*

Profit or Loss on sale of investments should be recognised in the P&L alc.
Profit / (Loss) = Sale proceeds (Net of selling expenses) - Carrying amount (book value).

4. Classification of Income from Investments

PRE Acquisition Income

1. Income Accrued during the PRE acquisition period.
2. But received by the investor after the acquisition.
3. It shall be treated as recovery of cost of investment as it is assumed that Price paid for investment includes pre acquisition income.

Deduct the pre-acquisition income from the cost of investment.

POST Acquisition Income

Income earned and accrued AFTER the acquisition and received after the acquisition.

Recognise the income and credited to P & L A/c

But in case of equity shares it is difficult to make allocation in Pre and post Acquisition Income.

5 What is Accounting Treatment for Right Issue and Rights share?

Right Issue

If the existing share holders exercise the option

Investment A/c .... Dr.

To Cash/Bank A/c

Rights shares

If the rights are sold, then amount received is an income and it should be taken to P&L A/c.

Exception to the above rule - when the following two conditions are satisfied, the accounting treatment differs:

1. The investments must be acquired on cum-right basis; and
2. Market value of such investments came down below the cost of investment immediately after the issue of right shares;

(Under above 2 situations, income received by sale of rights is credited to investment account in cost column to bring the carrying amount to the market price.)

4. Disclosure

1. A/c policies of the entity
2. Classsification of investent into current & long term
3. Total amount of Quoted & Unquoted investment
4. Total market value of quoted investment
5. Profit or loss on the sale of current and long term investments and adjustment of carrying amount in investment a/c.
6. Other Disclosures etc.,

AS – 16 Borrowing Cost

This Accounting Standard Prescribes rules for accounting treatment for borrowing costs

Whether the borrowing costs should be capitalised along with the assets OR charged to profit and loss statement.

Borrowing costs are interest and other costs incurred in connection with the borrowing of funds.

1. Commitment charges

2. Amortisation of discounts/premiums on loan

3. Finance leases charges

4. Ancillary costs

5. Exchange differences arising from foreign currency borrowings

Let us see how to "Recognise Borrowing Cost"

Borrowing costs directly related to

Acquisition of | **Construction of** | **Production of**

Qualifying Asset → **Capitalise along with Asset**

If Asset is not Qualifying → **Charge to P & L**

What is Qualifying Asset......? → **Asset that takes a substantial period of time to get ready for Its intended Use or Sale**

Examples of Qualifying

A. Tangible - plant and machinery, Building
   Intangible Assets: Patent
B. Investment Property.
C. Inventories that require a substantial period.

Capitalisation of Borrowing Costs

The standard has given guidance on the following points:

Commencement of Capitalisation (When to start capitalisation)

When ALL of the following conditions are satisfied

(a) Expenditure on qualifying asset being incurred;
(b) Borrowing costs are being incurred; &
(c) Activities are in progress.

Suspension of Capitalisation (When to suspend)

When there is NO active development or active development is interrupted.

Stop or cease of Capitalisation (When to stop)

When substantially all necessary activities are complete i.e. the asset is ready for its intended use or sale.

How much amount should be capitalised?

If funds are specifically borrowed for obtaining a qualifying asset

Capitalization rate on basis of actual costs

Actual borrowing costs incurred on borrowing during the period	XXX
Less: Any income on the temporary investments of the borrowed amount	XX
Amount to be capitalised	**XXX**

If funds are borrowed generally and used for obtaining a qualifying asset

Compute capitalisation rate based on weighted average rate of costs; total capitalization cannot increase actual borrowing cost incurred

Disclosures

The entity should disclose the following in its financial statements:

(a) The accounting policy adopted for borrowing costs; &
(b) The amount of borrowing costs capitalised during the period.