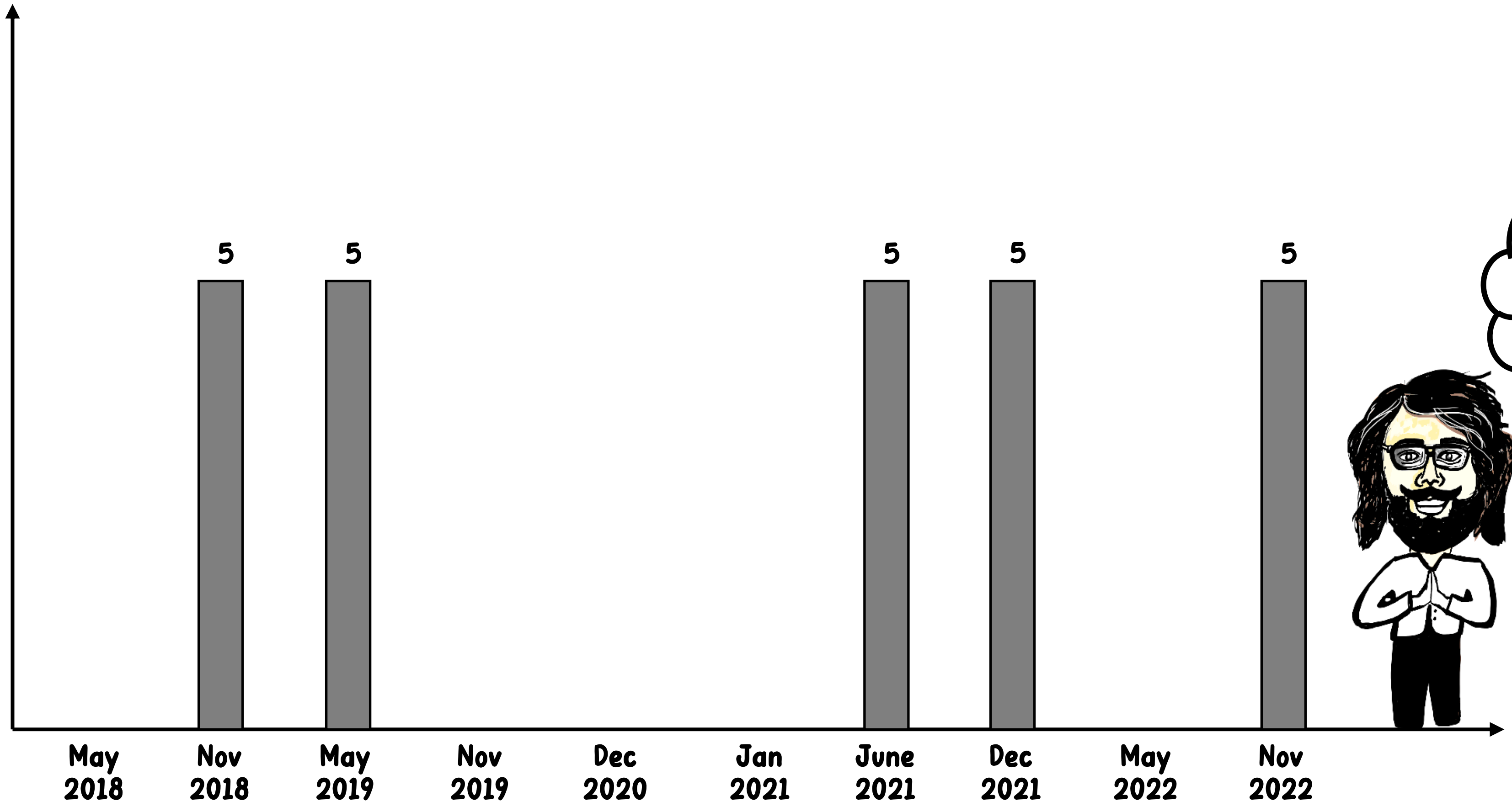
AS 4 - CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS		5	5				5	5		5



OBJECTIVES

AS 4 - ensures to give the full disclosure to the users in taking decision

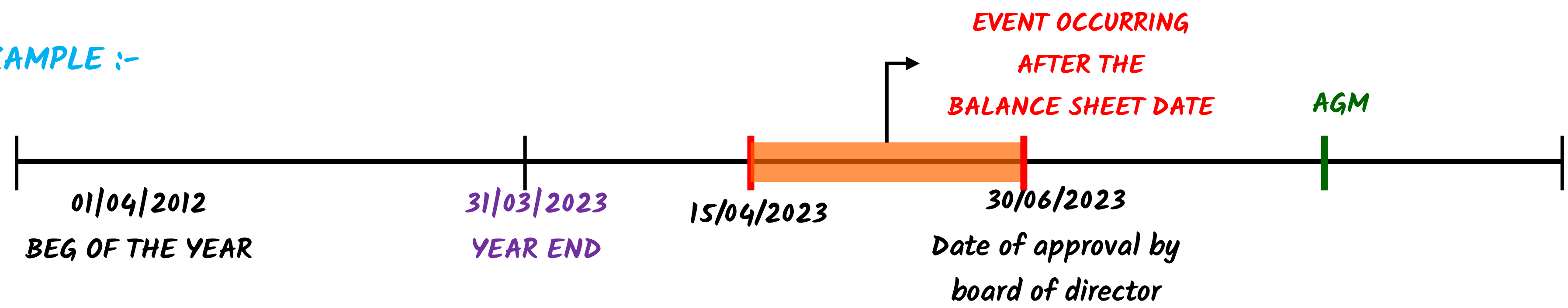
AS- 4 DEALS WITH TREATMENT IN THE FINANCIAL STATEMENTS OF

- CONTINGENCIES
  Covered in AS- 29
- EVENTS OCCURRING AFTER THE BALANCE SHEET

EVENTS OCCURRING AFTER THE BALANCE SHEET

- those significant events
- both favourable and unfavourable events
- that occur between the balance sheet date and the date on which the financial statements are approved.
- by the BOD / the owners / the corresponding approving authority.

EXAMPLE :-



2 TYPES OF EVENTS THAT CAN BE INDENTIFIED

ADJUSTING EVENT

(i) Which **provides further evidence of conditions that existed at Balance Sheet date**

for eg- Accounting for bad debt loss when later on the declarations of insolvency of debtors confirms the same.

(ii) Event though occurred after the Balance Sheet date if **affects the fundamental assumption of going concern** itself, then the same have to be considered in the accounts.

(iii) **Assets and liabilities should be adjusted by charging loss to P&L.** In this case they need not be relating to conditions existing as on Balance Sheet date

NON-ADJUSTING EVENT

(i) Which **are indicative of conditions that arose subsequent to the Balance Sheet date.**

(ii) These events are **not reflected** in the financial statements.

(iii) But if the events is significant, they may be required to be **disclosed in the report of approving authority to** enable users of Financial Statements to make proper evaluations and decisions.

EXAMPLES ON ADJUSTING AND NON ADJUSTING EVENTS

ADJUSTING EVENTS	NON ADJUSTING EVENTS
1. Loss on a trade receivable which is confirmed by insolvency of a customer. 2. Discovery of fraud and error that show that financial statements were incorrect. 3. Sale of inventories after the balance sheet date may provide evidence about their NRV as at that date. 4. Resolution of a court case which confirms that the enterprise had already had a present obligation at the balance sheet date. 5. The receipt of information concerning clarification of tax law.	1. Takeover of other business unit 2. Decline in market value of investment 3. Destruction a major production plant by fire **so long as going concern is not affected.** 4. Retirement of sales director. 5. Amalgamation effected after the balance sheet date 6. Initial disclosure event as regard discontinuing operation which occurs after the balance sheet [refer As-24] 7. Allotment of shares & debentures 8. Strikes and other labour disputes.

ATTENTION !!!

IDENTIFY THE EVENT AS ADJUSTING OR NON ADJUSTING

TAKING SCENARIO OF CHAMPA LTD.

CASE 1 →

MR. GOLI'S FINANCIAL POSITION WAS VERY POOR BEFORE 31ST MARCH,2021 AND HE WAS UNABLE TO CLEAR THE PAYMENT DURING THAT TIME

ANSWER

EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

01/04/2021 BEGINNING OF THE YEAR

31/03/2022 BALANCE SHEET DATE

20/05/2022 Mr. GOLI WAS DECLARED INSOLVENT

Date of Approval by BOD 30/06/2022

CASE 2

MR. GOLI'S WAS FINANCIALLY SOUND AND WAS MAKING PAYMENTS ON TIME

ANSWER

EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

01/04/2022 BEGINNING OF THE YEAR

31/03/2022 BALANCE SHEET DATE

20/05/2022

EARTHQUAKE OCCURRED MR. GOLI SUFFERED A HEAVY LOSS AND WAS UNABLE TO MAKE THE PAYMENTS TO THE CREDITORS. HENCE , HE WAS DECLARED INSOLVENT

Date of Approval by BOD 30/06/2022

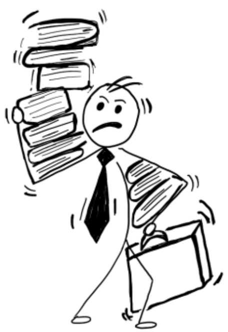
DISCLOSURES

Events occurring after Balance Sheet date which do not affect the figure stated in financial statements would not normally require disclosure in Financial Statements, but they may require to be disclosed in the report of approving authority to enable users of Financial Statements to make proper evaluations and decisions.

Eg- Take over of other business unit

If disclosure of events occurring after Balance Sheet date in the report of approving authority is required the following information Should be provided.

1. Nature of Event
2. Estimate of financial effect or statements that such estimate cannot be made.



EXCEPTION

STATUTORY REQUIREMENT

OR

ITEM OF SPECIAL

(ONLY FOR INFORMATION)

By its very nature Accounting Standard cannot override the statutes (laws).

If any statute require the accounting in a particular manner, entity should follow the guidance of the statute. Accounting standard should **NOT BE APPLIFD** in that situation.

EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

If any event occurring after the Balance Sheet date affects the going concern assumption of the entity, such events should be **CONSIDERED** and financial statement should be **ADJUSTED** as on the Balance Sheet date.

If the entity doesn't have going concern assumption, it should prepare Financial Statements on Liquidation basis (i.e NRV) as discussed in **AS – I**

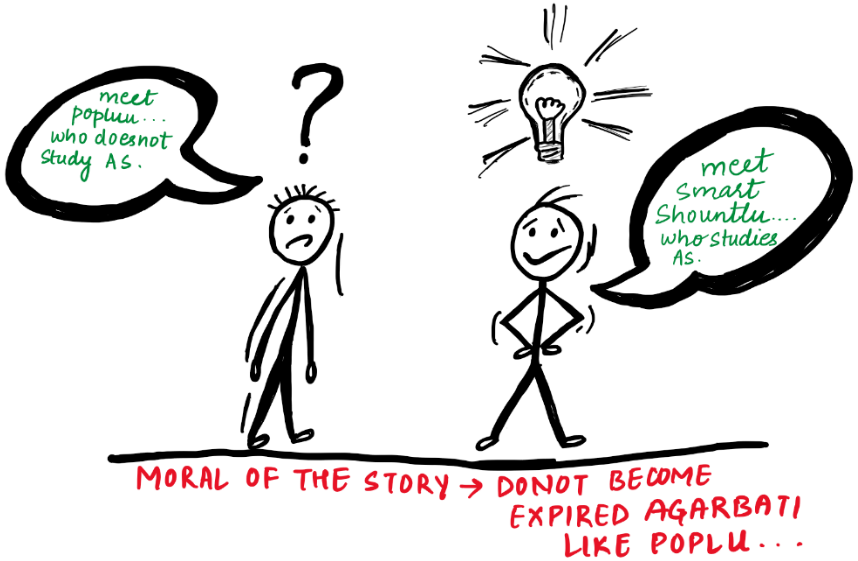
Important Points

- If a debtor who was regularly delaying the payments, has been declared insolvent after the Balance Sheet date, the loss should be provided for because situations leading to insolvency would have already started before the Balance Sheet date.

Elements that constitute the principle	Example
Condition already existing on Balance Sheet date	Non- payment by a debtors
Additional evidence surfacing after Balance Sheet date	Debtor rendered insolvent, as per courts' declaration
Post Balance Sheet event	Insolvency
Quantification of amount	Debts due, less share of dividends likely to be paid by receivers.
Adjustment to be made	Provision for losses.

- If the market value of investments have gone down since Balance Sheet date, decrease in value reflect the conditions which was occurred in subsequent period and need not be provided for in the Balance Sheet.
- If a voluntary retirement scheme has been offered to the employee on the date of balance sheet, there should be a provision of an appropriate amount payable to the employees who are expected to opt for VRS.
- If there is a loss to an asset (building, machine, furniture, etc.) due to fire, nature calamities, after the Balance Sheet date, then no adjustment is required in the Balance Sheet as the event do not relate to a condition existing at the Balance Sheet date.
  Exception – if it affects the going concern
- If, on the date of the Balance Sheet, a revision of the post wages was probable and the final amount of wage liability for expired period was subject to settlement with workers, it is evident that the conditions existed at the Balance Sheet date and liability arising from the wage revision in respect of expired period, subsequent to balance sheet date should be provided in the balance sheet.

*Note: - the provision of this standard to the extent it deals with treatment of "Contingencies" will stand. Withdrawn effective 01/04/2004. The same is to be dealt with as per AS-29. **"Provisions, contingent Liabilities and contingent Assets"** w.e.f. 01/04/2004.*



AS 4

Significant event (favourable / unfavourable) occurring post Balance Sheet date but before approval of financial statements by BOD Eg. Debtors becoming insolvent

ADJUSTING EVENTS

- Conditions exiting on Balance Sheet date
- Events occurring after the Balance Sheet date provides an additional information on the conditions existing on the Balance Sheet date.
- The additional information materially affects the amounts on the Balance Sheet date.

↓

Adjust the balance of assets and liabilities as on balance sheet date.

NON - ADJUSTING EVENTS

- No conditions exists on Balance Sheet date.
- Subsequent events does not affects amount on the Balance Sheet date.

↓

If it is SIGNIFICANT, then DISCLOSE in approving authority's report and NOT IN FS

↓

DO NOT adjust balances as on Balance sheet date.

QUICK SUMMARY

DISCLOSURES

The following information should be provided :-

1. Nature of the Event.
2. Estimate of financial effect or statement that such estimate cannot be made.

AS 5 - NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

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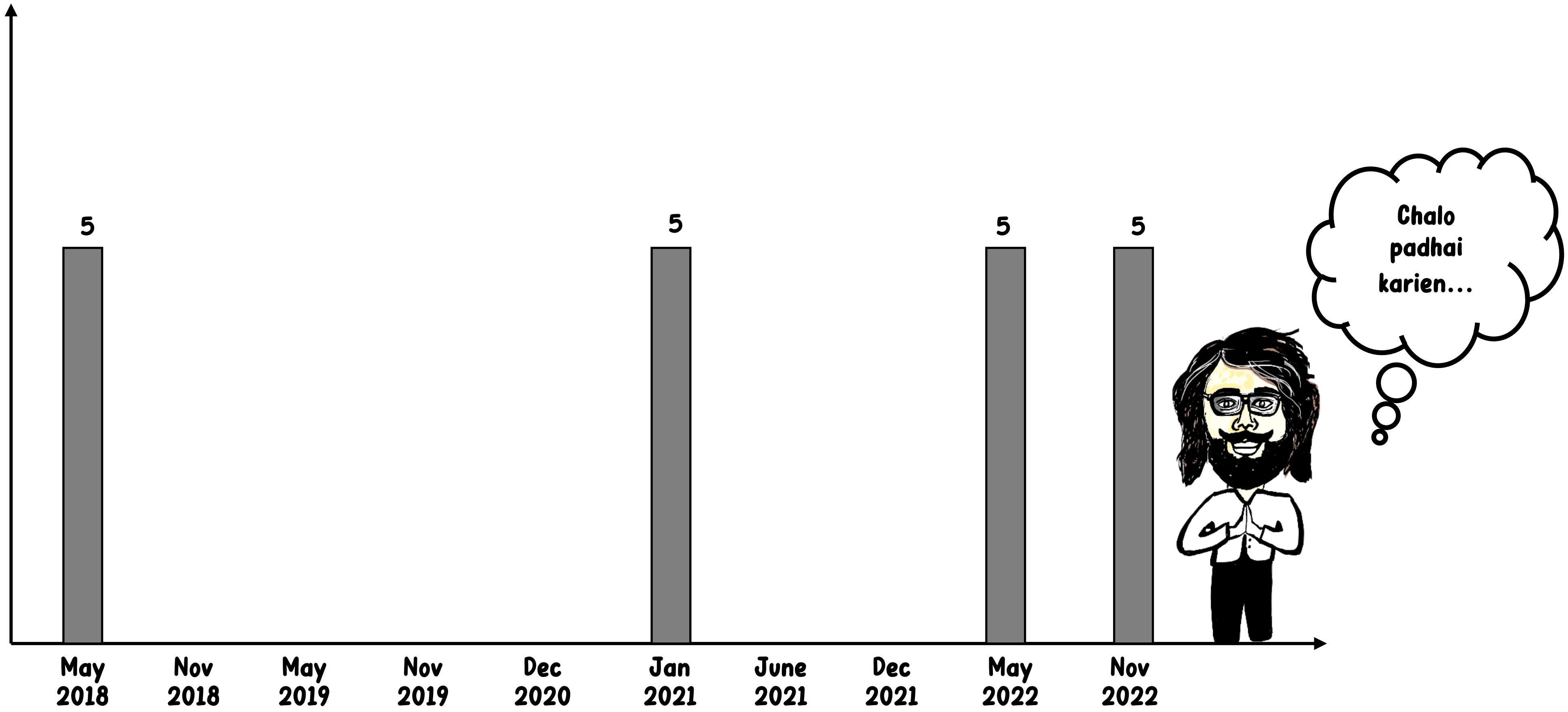


SCOPE & OBJECTIVE

The objective is to **provide uniformity in preparation and presentation of financial statements** by providing requirements as to accounting and disclosure with regard to following -

- **Ordinary activities including significant items**
- **Extra-ordinary activities**
- **Prior period items**
- **changes in accounting estimates**
- **changes in accounting policy.**

NET PROFIT OR LOSS FOR THE PERIOD

- Profit or loss arises on account of
  a. Ordinary Activities
  b. Extraordinary Items
- Both these components should be disclosed
  a. Separately and
  b. on the face of the statement of Profit and loss.

ORDINARY ACTIVITIES

Ordinary Activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprises engages in furtherance of, incidental to, arising from these activities.

Example

a) Introduction of VRS for employees for reduction of staff.
b) If an Automobile co. purchases a factory for manufacturing tyres or enters into a JV for diesel engines.
c) Restricting of enterprise's activities.
d) write-down of inventories to NRV as well as the reversal of such write-down.
e) Sale of fixed Assets
f) Disposal of long term investments.
g) Legislative changes having retrospective effect.
h) Litigation settlement.
i) Reversal of provisions

Items of income loss should be disclosed separately considering the

- Size
- Nature
- Incidence

REASONS FOR DISCLOSURE OF ORDINARY EXCEPTIONAL ITEMS

1. To make projections
2. To analyse the financial positions of the enterprise.
3. To understand the performance of the enterprise.

DISCLOSE → Separate disclosure of nature and amount

EXTRAORDINARY ITEMS

Extra Ordinary items are incomes or expenses that arises from events or transactions that are clearly distinct from the ordinary activities of the enterprises and therefore, are not expected to recur frequently or regularly.

Eg: loss from earthquake, Refund of govt. grant

1. Primary Question to be asked is

"whether the item arises from a source or activity which is distinct from ordinary activity"

2. Extraordinary items are very rare like , Eg:

a) loss due to Natural disasters

b) Acquisition of assets by government.

c) Loss sustained as a result of enemy action.

d) Fire in the factory.

An event that is extraordinary for one enterprise may be ordinary for another enterprise.

Disclosure of extraordinary items: Disclosure should be in a manner that its impact on current profit or loss can be identified.

Extraordinary items form part of the net profit and loss of the period.

DISCLOSURE → Separate disclosure nature and amount also ensure that impact on current project or loss be clearly

ATTENTION EXAMPLE HERE!!!

Bela Ltd. has vacant land measuring 20000 squints; which it had no intention to use in the future. The company decided to sell the land to tide over its liquidity problems and made a profit of Rs. 10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory Shed valued at Rs. 8 lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of Rs. 2 lakhs was disclosed as net profit from sale of assets. You are required to examine the treatment and the disclosure done by the company and advise the company in line with AS-5

SOLUTION:

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the factory does not constitute ordinary activities of the company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are **Extraordinary Items.**

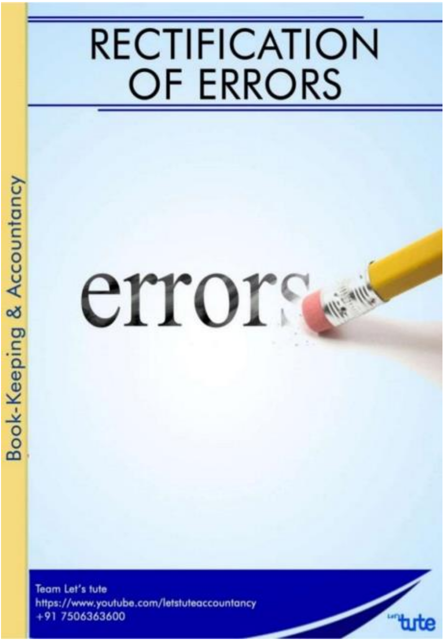
Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss .

PRIOR PERIOD ITEMS

Prior Period items are incomes or expenses which arises in the current period as a result of errors or omissions in the preparation of financial statement of one or more prior periods

a) Does not include normal or recurring adjustments like arrears paid to workers in current year on account of revision of wages with retrospective effect.

b) Does not include changes / corrections in accounting estimates.



Examples→

a) mathematical mistakes

b) misapplications of accounting policy

c) misinterpretation of facts

d) oversight

DISCLOSURE

a) Prior period items are to be disclosed separately in P&L a/c.

b) Disclose separately in a manner that the impact of the item on current years profits perceived.

c) The effect may be given below the line [After PAT] or above line [Before PAT].

ATTENTION EXAMPLE HERE !!!

CHAMPA Ltd. finds that the inventory sheets of 31.3.20X1 did not include two people containing details of inventory worth Rs. 14.5 Lakhs. State, how you will deal with the following matters in the accounts of champa ltd. for the year ended 31st March, 20X2.

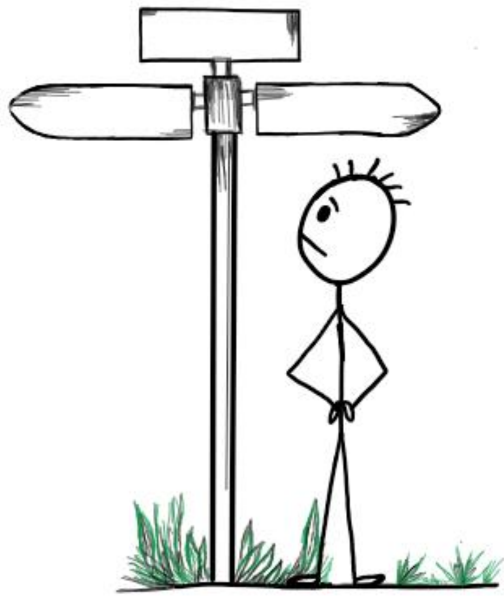
SOLUTION:

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "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". Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

CHANGES IN ACCOUNTING ESTIMATES (AE)

An accounting estimate is approximation of the amount of an item in the absence of proper means of measurement.

Examples→



1. Depreciation
2. Provision for taxation
3. Provision for Bad debts
4. Provision for losses due to litigation
5. Provision for warranty expenses.

Revision may be due to

1. New information arising
2. Experience Gained
3. Subsequent developments or change in circumstances

Changes in accounting estimates is neither a prior period item nor an extra ordinary item.

DISCLOSURE : nature and amount of change in AE, if has material effect on current year profit or future years profits, it should be disclosed. If not quantifiable then fact be disclosed.

It should be included under the same classification in which original amount was included.

CHANGES IN ACCOUNTING POLICIES

DEFINITION

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Changes in accounting policy should be made only if.

1. It is **required by a statute** (eg: Change in revenue recognition policy insurance premium by insurance companies to comply with new IRDA regulations)
2. To **comply** with an accounting standard [eg: Changing form completed contract method of accounting for construction contracts to percentage of completion method to comply with **AS-7** (Revised)]
3. If **change** would **result** a **more appropriate presentation** of the financial statements.

SPECIAL POINT

- **Change in inventory valuation method ,** say, from FIFO to weighted average method. Change in accounting policy for **adoption of new accounting standard** should be accounted as per transitional provisions contained in that standard. Eg. Changing accounting policy for income tax to bring it in line with **(As -22)** should be accounted as per transitional provisions in **(AS-22).**

When a change is not treated as changes in accounting policies

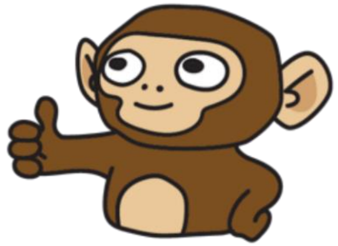
1. In case events or transactions occurs which have not occurred earlier then it cannot be said to be change in Accounting policy. Eg, Introduction of a formal retirement gratuity scheme to replace adhoc ex-gratia payment.
2. If transactions differ substantially from earlier ones also, it is not change in Accounting policy.

DISCLOSURES

1. **Changes** in accounting policy together with its impact on financial statements should be disclosed.
2. Any change having material **impact on the financial position, performance or cash flow** should be disclosed clearly.
3. In case the change **doesn't have material impact now but will be material in later periods** then disclosures is required in the period in which the change is adopted.
4. Also state if **quantification of impact of** change is not practicable.

IMPORTANT POINTS

1. Attachment of a property by a court or loss of an asset in a natural calamity of extraordinary items.
2. Theft of inventory in the previous year, but detected in current year. Wrong counting of closing stock for previous year i.e., opening stock. for current year, are prior period items.
3. Profit or loss on sale of asset Investment, non-admission of a claim by a tax authority writing off goodwill or preliminary expense are not extraordinary items. However, these may be shown as exceptional items



PROFORMA INCOME STATEMENT

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
Revenue from operations		XXX	XXX
Other income		XXX	XXX
Total Revenue (I + II)		XXX	XXX
Expenses:			
Cost of materials consumed		XXX	XXX
Purchases of Stock-in-Trade		XXX	XXX
Changes in inventories of finished goods work-in-progress and Stock-in-Trade		XXX	XXX
Employee benefits expense			
Finance costs			

Depreciation and amortization expense Other expenses			
Total expenses		XXX	XXX
Profit before exceptional and extraordinary items and tax (III-IV)		XXX	XXX
Exceptional items		XXX	XXX
Profit before extraordinary items and tax (V - VI)		XXX	XXX
Extraordinary Items		XXX	XXX
Profit before tax (VII- VIII)		XXX	XXX
Tax expense: (1) Current tax		XXX	XXX
(2) Deferred tax		XXX	XXX
Profit (Loss) for the period from continuing operations (VII-VIII)		XXX	XXX
Profit/(loss) from discontinuing operations		XXX	XXX
Tax expense of discontinuing operations		XXX	XXX
Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)		XXX	XXX
Profit (Loss) for the period (XI + XIV)		XXX	XXX
Earnings per equity share: (1) Basic		XXX	XXX
(2) Diluted		XXX	XXX

Depreciation method changed from WDV to SLM	Change in an accounting policy
Useful life reduced based on new management estimates – depreciation amount increased because asset is depreciated over a reduced life – depreciation method unchanged.	Change in an accounting estimate
Mathematical error in computing depreciation	Prior period item
Depreciation fraudulently or through over-sight not correctly aggregated or computed	Prior period item
Fixed assets destroyed in an earthquake	Extra-ordinary item
Major disposal of fixed assets	Ordinary activity (Exceptional items)

AS-5

OBJECTIVE

To prescribes the criteria for classification & disclosure of certain items, such as Prior Period items, Extra ordinary items, changes in accounting policies, etc in profit & loss account to enhance its comparability.

NET PROFIT OR LOSS FOR THE PERIOD

Profit or Loss arises on account of Ordinary Activities and Extraordinary items. Both these components should be disclosed separately and on the face of the statement of Profit and loss

EXTRAORDINARY ITEMS

Items of income or expenses that arise from events or transactions clearly distinct from the ordinary activities of the enterprise and therefore, are not expected to recur frequently or regularly.

DISCLOSURE

Disclosed in the statement of profit and loss as a part of net profit or loss for the period. Nature and amount of each item separately disclosed in a manner that its impact on current profit or loss can be perceived.

ORDINARY ACTIVITIES

Activities normally undertaken as part of business & incidental Activities.

Activities of special size, nature or incidence to be considered

DISCLOSURE

when items of income and expenses within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain performance of entity, Nature and amount of such items should be disclosed separately.

QUICK SUMMARY

CHANGES IN ACCOUNTING POLICIES

A change in the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of FS.

DISCLOSURE

Disclose the -

- Change
- Impact & resulting adjustment, in the period of change
- If impact not ascertainable then, such fact.
- No material impact in the current period but has a material in later periods, facts of change in the year of change.

Allowed only if :-

- Required by statute, or
- Required by Accounting standard, or
- Leads to more appropriate presentation of FS

PRIOR PERIOD ITEMS

Income or expenses arising in current period as a result of errors or omissions in preparation of FS of prior periods. It is infrequent & different from changes in accounting estimates.

DISCLOSURE

The nature and amount of prior period items should 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.

QUICK SUMMARY

CHANGES IN ACCOUNTING ESTIMATE

An estimate may have to be revised consequent to Changes occurring in the circumstances based on which the estimate was made, or new information,

DISCLOSURE

Disclose in the year of change

- Nature and amount of change
- If not practicable to quantify the amount, disclose such fact

AS 7 - CONSTRUCTION CONTRACTS

INDEX

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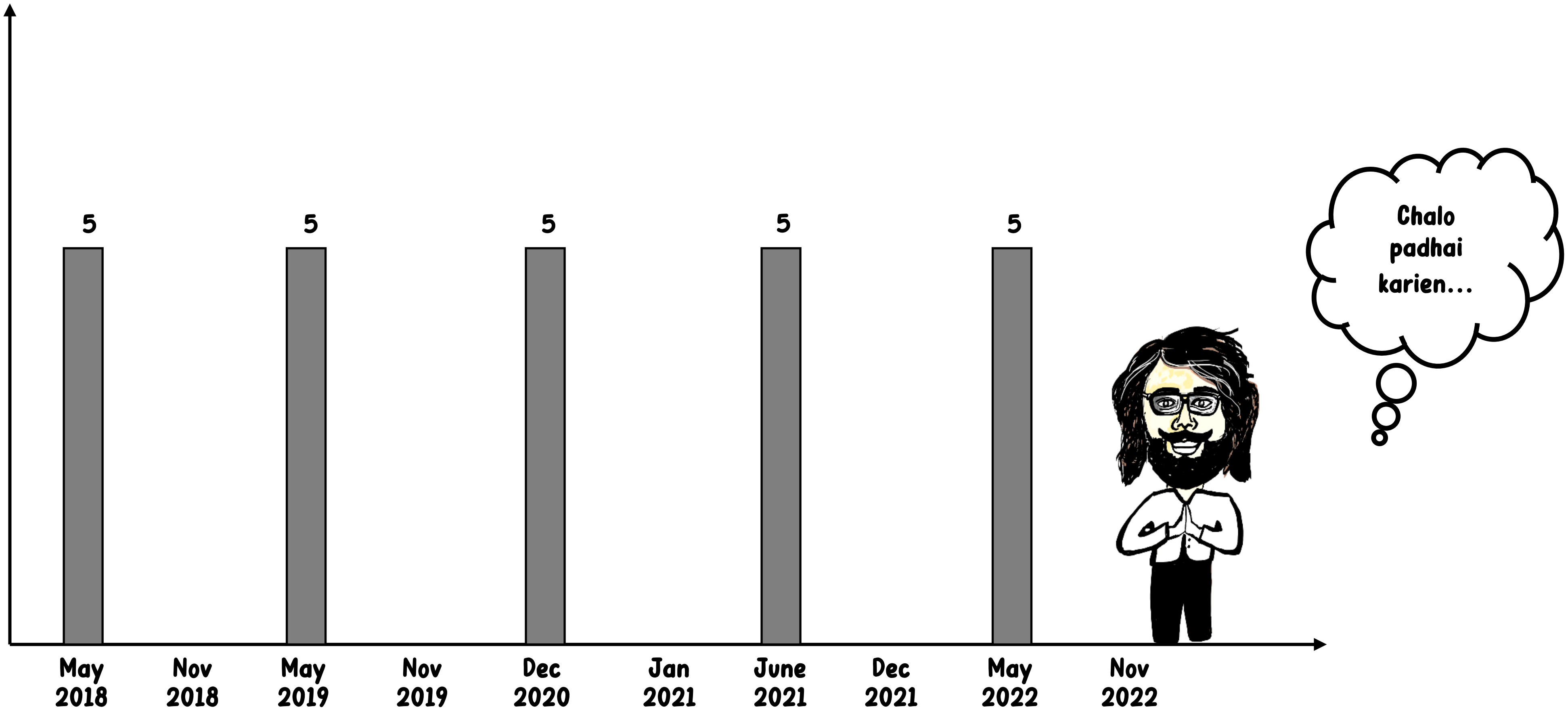


OBJECTIVE

To establish the ground rules for recognition of revenue and cost, relating to construction contracts, in different accounting periods in which construction work is performed.

SCOPE

This standard should be applied in accounting for construction contracts in the financial statements of contractors.

DEFINITIONS

CONSTRUCTION CONTRACT

- A construction contract is a **contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.**
- A construction contract may be **negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel.** A construction contract may **also deal with the construction of a number of assets which are closely interrelated or interdependent** in terms of their **design, technology and function or their ultimate purpose** or use; **examples of such contracts include those for the construction of refineries and other complex pieces of plant or equipment.**
- For the purposes of this Standard, **construction contracts include:**
  - ✓ Contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
  - ✓ Contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

TYPES OF CONSTRUCTION CONTRACT

FIXED PRICE CONTRACT

A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

RECOGNITION

In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(a) total contract revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(c) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

COST PLUS CONTRACT

A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.

RECOGNITION

In the case of a cost plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

a) it is probable that the economic benefits associated with the contract will flow to the enterprise; and

b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

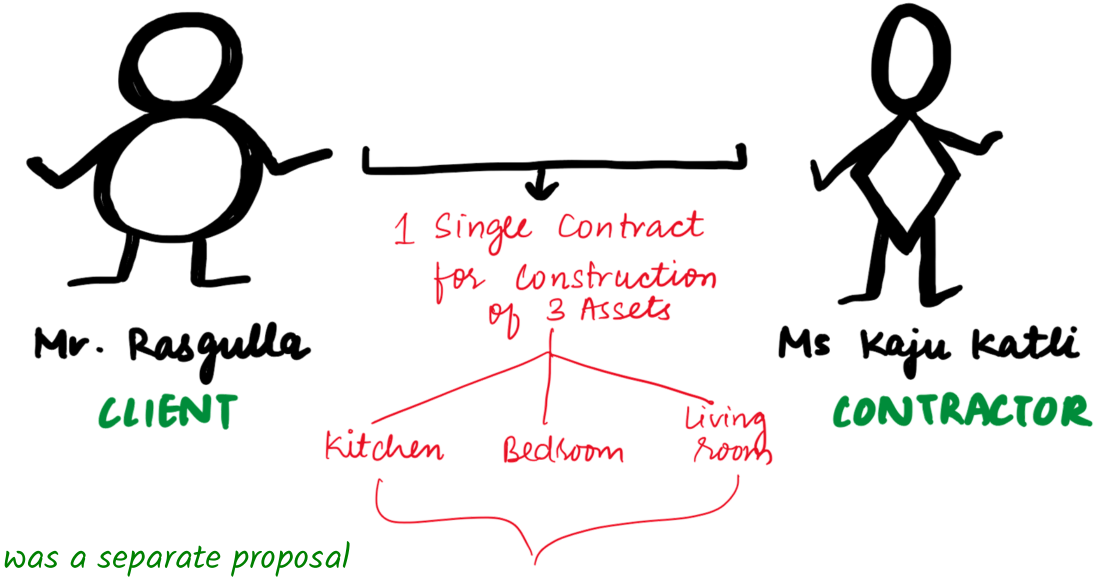
SEGMENTING OF CONTRACTS

When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

a) Separate proposals have been submitted for each asset;

b) Each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

c) The costs and revenues of each asset can be identified.



- For, each asset there was a separate proposal
- Separate identification of cost and revenue of each asset
- Contractor can accept or reject each part of the contract relating to particular asset

EXAMPLE:

J Ltd negotiates with Bharat petroleum for construction of franchisee retail petrol outlet stations. Based on proposals submitted to different Zonal offices of BP, the final approval for one outlet each in Bangalore, Vadodara, Pune and Patna is awarded to J Ltd. one contract is entered into with BP for Rs.245 lakhs. The agreement lays down values of each of the four outlets (44+66+80+55) in addition to individual completion time.

In this situation each asset is treated as a separate construction contract notwithstanding the fact that there is only one contract.

COMBINING OF CONTRACT

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

(a) The **group of contracts is negotiated as a single package;**

(b) The **contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin;** and

(c) The **contracts are performed concurrently or in a continuous** sequence.

CONSTRUCTION OF ADDITIONAL ASSET

A contract may provide for the construction of an additional asset at the option of the customer of or may be amended to include the construction of an additional asset.

The construction of the additional asset Should be treated as a separate construction contract when:-

The asset differs significantly in design, technology or function from the asset or assets covered by the original contract

OR

The price of the asset is negotiated without regard to the original contract price

CONTRACT REVENUE

Contract Revenue should comprise of :-

- The **initial amount of revenue agreed in the contract;** and
- **Variation in contract work, claims and** incentive payment.
- To the **extent that it is probable that they will result in revenue;** and
- They **are capable of being reliably measured.**

VARIATION

- Is an instruction by the customer for a change in the scope of the work to be performed.
- May lead to increase or a decrease in contract revenue.

Examples →

- Changes in the specification or design of the asset
- Changes in duration of contract.

RECOGNITION

- Probable that customer will approve the variation and the amount of revenue arising from the variation
- The amount of revenue can be reliably measured.

CLAIM

- An amount which the contractor seeks to collect from the customer or any third party for costs that are not included in the contract.

Examples →

- Customer caused delays
- Errors in specification

RECOGNITION

- Negotiation have reached an advanced stage such that it is probable that customer will accept the claim; and
- The amount that it is probable will be accepted by the customer can be measured reliably

INCENTIVE

- Payment are additional amounts payable to the contractors if specific performance standard are met or exceeded.

Examples →

- Early completion of the contract work.

RECOGNITION

- The contract is sufficiently, advanced that it is probable that the specified Performance Standard will be met or exceeded; and
- The amount of the incentive payment can be measured reliably.

RECOGNITION OF CONTRACT REVENUE AND EXPENSES

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

- When the outcome of a construction contract cannot be estimated reliably:
  a) Revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and
  b) Contract costs should be recognised as an expense in the period in which they are incurred.

  An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.
- When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 21 rather than in accordance with paragraph 31.
- When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

CONTRACT COST

Cost that relate directly to the specific contract.

(a) Site labour costs, including site supervision;
(b) Claims from third parties.

Costs that are attributable to contract activity in general and can be allocated to the contract

(a) Insurance;
(b) Construction overheads.

Such other costs as are specifically chargeable to the customer under the terms of the contract

May include general administration and development cost for which reimbursement is specified in the contract.

EXCLUDES

- General administration for which reimbursement is not specified.
- Selling Cost
- Research and development costs for which reimbursement is not specified in the contract.
- Depreciation of idle plant and machinery not used in the construction contract

METHODS OF DETERMINATION OF THE STAGE OF COMPLETION

Methods to be chosen depending upon the nature of the contract

- Proportion that contract costs incurred for work performed upto the reporting date to the estimated total contract costs
- Surveys of work performed
- Completion of a physical proportion of the contract work.

CHANGES IN ESTIMATES

The percentage of completion method is **applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs.** Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies). The **changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.**

DISCLOSURE

1. **An enterprise should disclose**
    a. amount of revenue recognised
    b. methods used to determine amount of revenue recognised
    c. methods used to determine stage of completion
2. **An enterprise should disclose the following for contracts in progress at the reporting date**
    a. the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
    b. the amount of advances received (it is the amount received before the related work in completed); &
    c. The amount of retentions.
3. **An enterprise should present :**
    a. the gross amount due from customers for contract work as an asset; and
    b. the gross amount due to customers for contract work as liability.
4. **The gross amount due from customers for contract work is the net amount of :**
    a. costs incurred plus recognised profits; less
    b. The sum of recognised losses and progress billings.

For the contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds a progress billing.

5. **The gross amount due to customers for contract work is the net amount of :**
    a. the sum of recognised losses and progress billings; less
    b. costs incurred plus recognised profits.

For all contracts in progress for which progress billings exceeds costs incurred plus recognised profits (less recognised losses).

6. An enterprise discloses any contingencies in accordance with AS-4, contingencies and events occurring after the Balance Sheet Date. Contingencies may arise from such items as warranty costs, penalties or possible losses.

IMPORTANT POINTS

- Under AS-7, the contract revenues are recognised on percentage of completion method. **It may be noted that the completed contract method is not allowed by AS-7.**
- **Percentage of completion method :**

The recognition of contract revenue and costs with reference to stage of completion is known as percentage of completion method. In this method:

$$\% \text{ of completion} = \frac{\text{Costs incurred till date}}{\text{Costs incurred till date} + \text{Estimated costs to complete}} \times 100$$

Contract revenue to be recognized in current year

= (Contract price x % of completion) – Revenue recognized till last year.

Contract Costs to be recognized in current year

= Total costs incurred so far – Costs recognized till last year.

AS -7

OBJECTIVE

To establish the ground rules for recognition of revenue and cost, relating to construction contracts, in different accounting periods in which construction work is performed

FOCUS & COVERAGE

- Focuses accounting in the financial statements of contractors
- Apart from normal construction contracts, also covers
  - ✓ Contracts for rendering of services directly related to construction of the asset
  - ✓ Contracts for destruction or restoration of assets
  - ✓ Contracts for restoration of environment following demolition of assets

TYPES

FIXED PRICE

Contract price or rate per unit of output is fixed
(Cost escalation clause could be present)

COST PLUS

Revenue = Cost + Some percentage or fixed fee

METHOD ALLOWED

Percentage completion

COMBINING & SEGMENTING

Construction Contracts

COMBINE IF, Contracts

- Can be treated as a single package
- Part of single project, and
- Performed concurrently or in a continuous sequence

SEGMENT IF

- Separate proposals submitted for each asset
- Each asset has been subject to separate negotiation and can be accepted or rejected, and
- Costs & revenue of each asset can be identified

CONSTRUCTION OF ADDITIONAL ASSETS

COMBINE IF

- Assets don't differ significantly in design, technology or function from assets in original contract, or
- Price negotiated with regard to original contract price

ELSE, SEGMENT

CONTRACT REVENUE & EXPENSES

CONTRACT REVENUE

- Initial amount agreed
- Variations in contract work, claims and incentive payments provided
  - ✓ Measurable
  - ✓ Probable

CONTRACT EXPENSES

- Direct Costs
- Allocable Costs
- Costs specifically chargeable to the customer

RECOGNITION CRITERIA

When outcome of contract:

a) Can be estimated reliably

b) Can't be estimated reliably

CONTRACT REVENUE

a) Percentage completion method

b) To the extent of such contract costs incurred the recovery of which is probable

CONTRACT EXPENSES

(a) Percentage completion method

✓ Any expected loss also to be charged off

(b) Treat as period expense

✓ Any expected loss also be charged off

CHANGES IN ESTIMATES

✓ Of contract revenue/costs

✓ Of outcome of contract

TREAT AS CHANGE IN ACCOUNTING ESTIMATES, APPLY AS 5 (Revised)

DISCLOSURES

Contract revenue recognized, methods used to determine the contract revenue and stage of completion

For contracts in progress at the reporting date

- Aggregate amount of costs incurred and recognized profit (less recognized losses) upto the reporting date
- Advances received and retentions

Gross amount due from customers as an asset and gross amount due to customers as liability

Contingencies as per AS 4 (Revised)

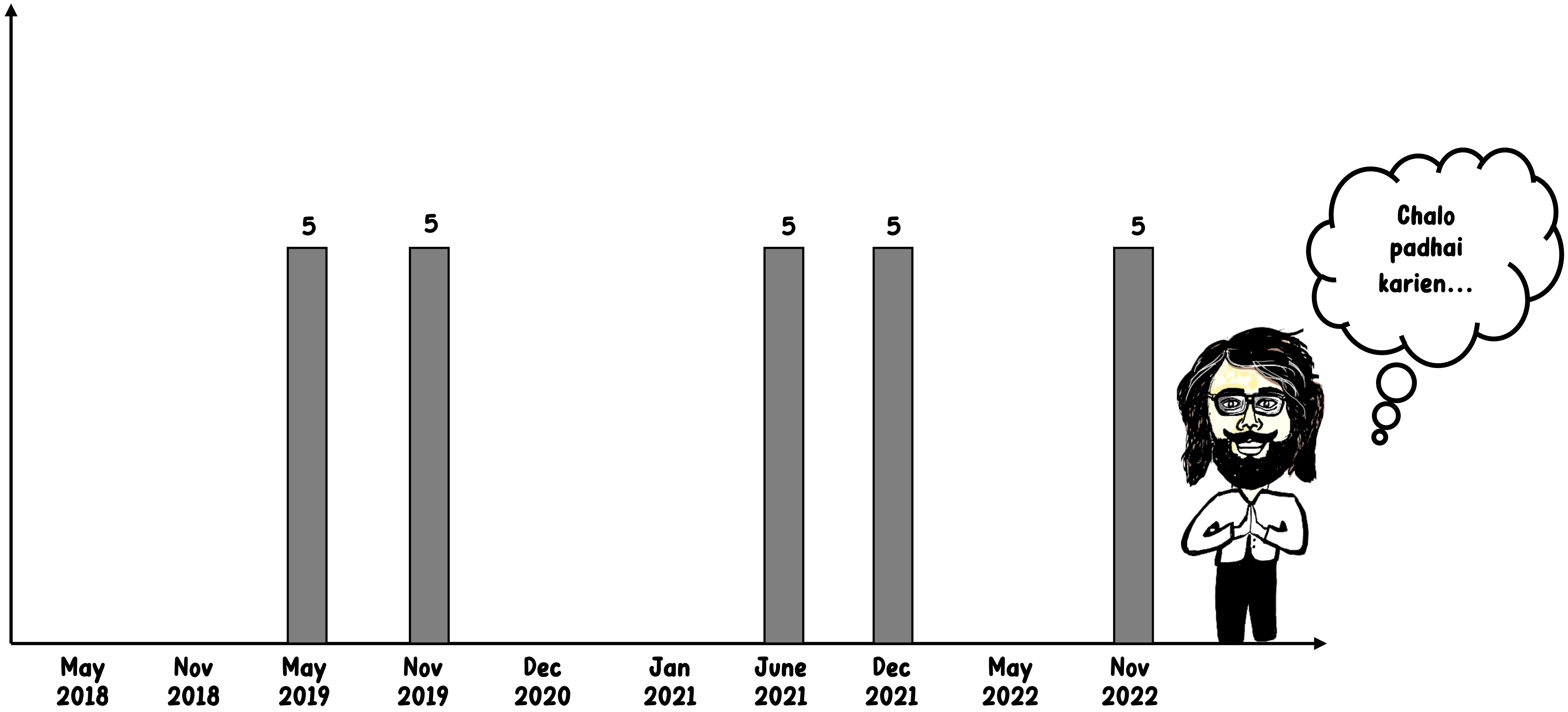
AS 9 - REVENUE RECOGNITION

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS			5	5			5	5		5



INTRODUCTION

This standard **deals** with the bases for recognition of revenue in the statement of profit and loss of an enterprise. The standard is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from-

- the sale of goods,
- the rendering of services , and
- the use by others of enterprise resources yielding interest, royalties and dividends

This standard **does not deal** with the following aspects of revenue recognition to which special considerations apply:

i. Revenue arising from construction contracts ;
ii. Revenue arising from hire-purchase, lease agreements ;
iii. Revenue arising from government grants and other similar subsidies ;
iv. Revenue of insurance companies arising from insurance contracts.

Examples of items not included within the definition of 'revenue' for the purpose of this standard are:

i. Realized gains resulting from the disposal of, and unrealized gains resulting from the holding of , non current assets eg. Appreciation in the value of fixed assets ;
ii. Unrealized holding gains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products :
iii. Realised or unrealized gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;
iv. Realised gains resulting from the discharge of an obligation at less than its carrying amount ;
v. Unrealized gains resulting from the restatement of the carrying amount of an obligation.

DEFINITION

Revenue is the

- Gross inflow of cash, receivables and others consideration
- Arising in the course of ordinary activities of an enterprise.
- From: -
  - ✓ sale of goods
  - ✓ Rendering of services, and
  - ✓ use by others of enterprise resources yielding interest, royalties and dividend.

Source → itcportal.com

Enduring Value

Notes to the Financial Statements

1. Significant Accounting Policies (Contd.)

Financial Liabilities

Borrowings, trade payables and other financial liabilities are initially recognised at the value of the respective contractual obligations. They are subsequently measured at amortised cost. Any discount or premium on redemption/settlement is recognised in the Statement of Profit and Loss as finance cost over the life of the liability using the effective interest method and adjusted to the liability figure disclosed in the Balance Sheet.

Financial liabilities are derecognised when the liability is extinguished, that is, when the contractual obligation is discharged, cancelled or on expiry.

Offsetting Financial Instruments

Financial assets and liabilities are offset and the net amount is included in the Balance Sheet where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

Equity Instruments

Equity instruments are recognised at the value of the proceeds, net of direct costs of the capital issue.

Revenue

Revenue is measured at the fair value of the consideration received or receivable for goods supplied and services rendered, net of returns and discounts to customers. Revenue from the sale of goods is shown to include Excise Duties and National Calamity Contingent Duty which are payable on manufacture of goods but excludes taxes such as VAT and Goods and Services Tax which are payable in respect of sale of goods and services.

Revenue from the sale of goods and services is recognised when the Company performs its obligations to its customers and the amount of revenue can be measured reliably and recovery of the consideration is probable. The timing of such recognition in case of sale of goods is when the control over the same is transferred to the customer, which is mainly upon delivery and in case of services, in the period in which such services are rendered.

Accordingly, government grants:

(a) related to or used for assets, are deducted from the carrying amount of the asset.

(b) related to incurring specific expenditures are taken to the Statement of Profit and Loss on the same basis and in the same periods as the expenditures incurred.

(c) by way of financial assistance on the basis of certain qualifying criteria are recognised as they become receivable.

In the unlikely event that a grant previously recognised is ultimately not received, it is treated as a change in estimate and the amount cumulatively recognised is expensed in the Statement of Profit and Loss.

Dividend Distribution

Dividends paid (including income tax thereon) are recognised in the period in which the interim dividends are approved by the Board of Directors, or in respect of the final dividend when approved by shareholders.

Employee Benefits

The Company makes contributions to both defined benefit and defined contribution schemes which are mainly administered through duly constituted and approved Trusts.

Provident Fund contributions are in the nature of defined contribution scheme. In respect of employees who are members of constituted and approved trusts, the Company recognises contribution payable to such trusts as an expense including any shortfall in interest between the amount of interest realised by the investment and the interest payable to members at the rate declared by the Government of India. In respect of other employees, provident funds are deposited with the Government and recognised as expense.

The Company makes contribution to defined contribution pension plan. The contribution payable is recognised as an expense, when an employee renders the related service.

The Company also makes contribution to defined benefit pension and gratuity plan. The cost of providing benefits under the defined benefit obligation is calculated by independent actuary using the projected unit credit method

GROSS INFLOW

Example → Gains realized from an obligation discharged at less than its carrying value: there is no gross inflow, only saving in outflow hence not revenue.

EXCEPTION → In an agency relationship, amount of commission & not the gross inflow will be considered as revenue.

CASH, RECEIVABLES & OTHER CONSIDERATION

- Cash implies that revenue can arise out of cash transactions.
- Receivables implies that revenue can arise out of the credit transaction.
- Consideration implies that revenue arises only from a third party [i.e. Revenue cannot arise within an enterprise.]

Example

Cash a/c……	**Dr.**	**Receivables a/c……**	**Dr.**
To Sales a/c		**To Sales a/c**	

SALE OF GOODS

Sale of goods is that the **seller has transferred the property** in the goods to the buyer **for consideration.** The transfer of property in goods, in most cases , results in or coincides with the **transfer of significant risks and rewards of ownership to the buyer.** However, there may be situations where transfer of property in goods doesn't coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognized at the time of transfer of significant risks and rewards of ownership to the buyer.

Example → Sale of Investments, fixed assets are not sale of goods.

We will study this in detail in following pages

REVENUE RECOGNITION FROM SALE OF GOODS

PERFORMANCE :

- The seller has **transferred** to the buyer all **significant risks & rewards of ownership,**
- The seller **retains no effective control of the goods** to a degree usually associated with ownership

Example → If the seller takes bill of lading [document of title of goods] in his name rather than in the name of the customer, it may show that he retains effective control of goods associated with ownership.

MEASUREMENT : There is **no significant uncertainty regarding the amount of consider**ation that will be derived from the sale of goods.

COLLECTIBILITY : At the time of performance it **is not unreasonable to expect ultimate collection.**

EFFECT OF UNCERTAINTIES ON REVENUE RECOGNITION (IMPORTANT)

- Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.
- Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.
- When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.
- An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.
- When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

ILLUSTRATION

These illustration do not form part of the Accounting standard. Their purpose is to illustrate the application of the standard to a number of commercial situations in an endeavour to assist in clarifying application of the standard.

DELAYED AT BUYER'S REQUEST

Delivery is **delayed at buyer's request and buyer takes title and accepts billing**

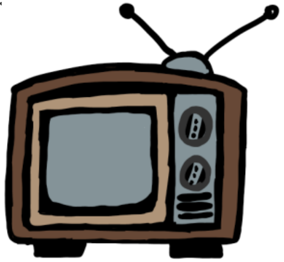
Revenue should be recognised notwithstanding that **physical delivery has not been completed** so long as there is very expectation that delivery will be made.

- **Items must be on hand, identified & ready for delivery to the buyer at the time sale is recognised.**
- Rather than there being simple intention to acquire or manufacture the goods in time for delivery.
- **Delivery is delayed at buyer's request.**
- Buyer takes title & accepts billing.

GOODS SOLD SUBJECT TO INSTALLATION, INSPECTION ETC.

Revenue **not to be recognized until the customer accepts delivery and installation and inspection are complete**. In some cases, however, the installation process may be so simple in nature that it may be appropriate to recognize the sale notwithstanding that installation is not yet completed.

Example→ Installation of factory-tested television received normally only requires unpacking and connecting of power and antennae.



★ **In case where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.**

GOODS SOLD ON APPROVAL

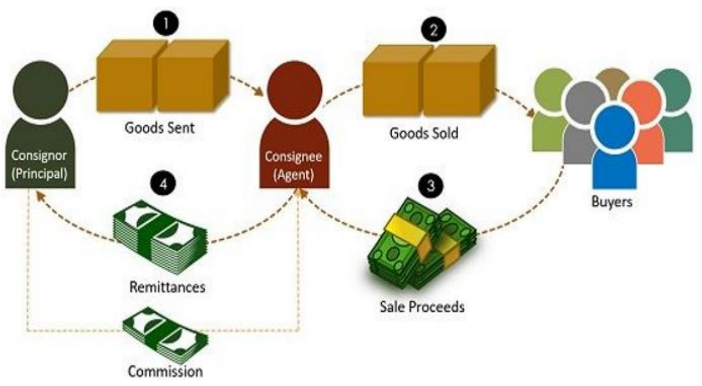
Revenue should **not be recognized until** the **goods** have been **formally accepted by the buyer or the buyer has done an act adopting the transaction** or the **time period for rejection has elapsed** or where **no time has been fixed, a reasonable time has elapsed.**

GOODS SOLD ON GUARANTEE i.e. delivery is made giving the buyer an unlimited right of return

Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience.

CONSIGNMENT SALES i.e. delivery is made whereby the recipient undertakes to sell the goods on behalf of the consignor.

Revenue should not be recognised until the goods are sold to a third party



CASH ON DELIVERY SALES

Revenue should not be recognized until cash is received by the seller or his agent.

SOME SPECIAL CASES

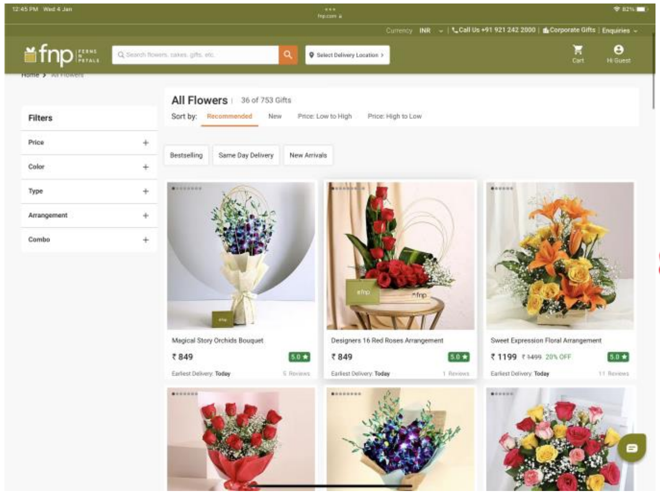
a. **Sales where the purchaser makes a series** of **installment payments** to the seller, and the seller delivers the goods only **when the final payment is received**

- Revenue from such sales should not be recognized until goods are delivered.
- However, when experience indicates that most such sales have been consummated revenue may be recognized when a significant deposit is received.

b. **Partial payments →** Special orders and shipments i.e. **where payment** (or partial payment) is **received for goods not presently held in stock** eg. the stock is **still to be manufactured** or it is **to be delivered directly to the customers from a third party.**

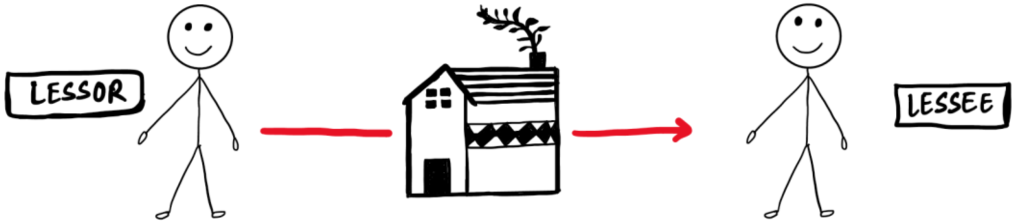
- Revenue from such sales should not be recognized until goods are manufactured, identified and ready for delivery to the buyer by the third party.

ON 14TH FEBRUARY RASGULLA HAD TO IMPRESS HIS GF.... HE GAVE SPECIAL ORDER FOR FLOWERS



c. **Sales / Repurchase agreement** → i.e. where seller concurrently agrees to repurchase the same goods at a later date.

- Such transaction that are in substance a financing agreement,
- The resulting cash inflow is not revenue as defined and should not be recognised.

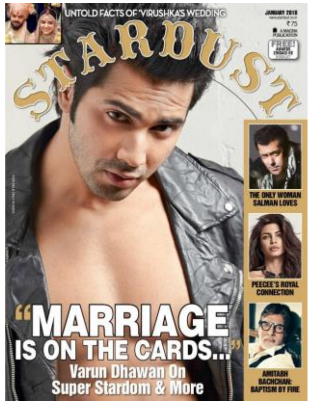


House leased for 20 years for Rs. 5 crores and
agreement for repurchase also made for Rs. 8 crores

d. **Sales to intermediate parties** i.e. where goods are sold to distributors, dealers or others for resale.

- Revenue from such sales can generally be recognised if significant risks of ownership have passed;

- However in some situations the buyer may in substance be an agent and in such cases the sales should be treated as a consignment sale.

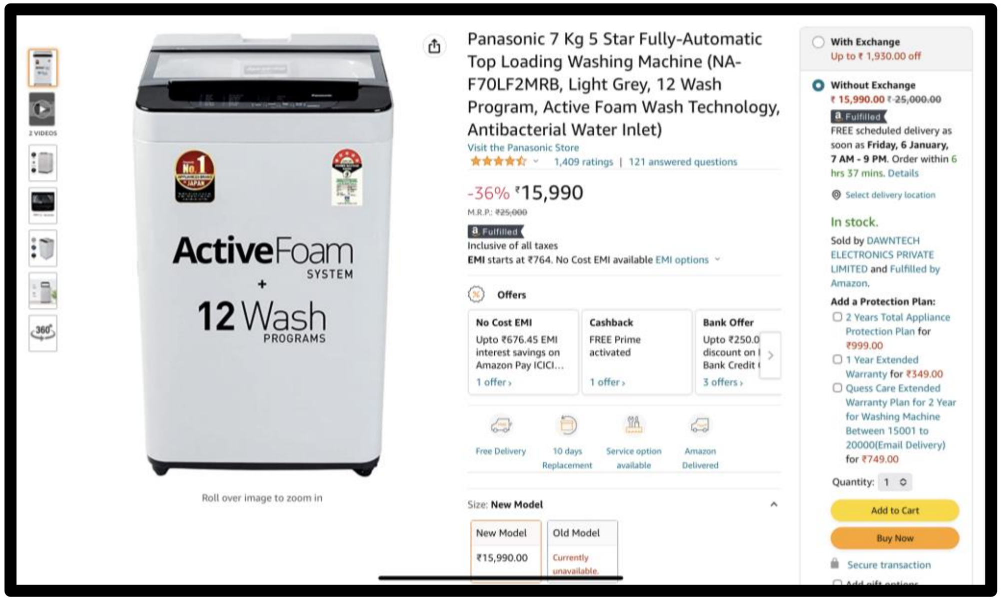


SUBSCRIPTIONS FOR PUBLICATION

- Revenue received or billed should be **deferred.**
- **Recognise either on a straight line basis over time** or,
- Where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value.

INSTALLMENT SALES

- Revenue attributable to the sales price exclusive of interest should be recognised at the date of sale.
- The interest element should be recognised as revenue, proportionately to the unpaid balance due to the seller.



TRADE DISCOUNTS AND VOLUME REBATES

- Trade discounts and volume rebate given should be deducted in determining revenue.

RENDERING OF SERVICES

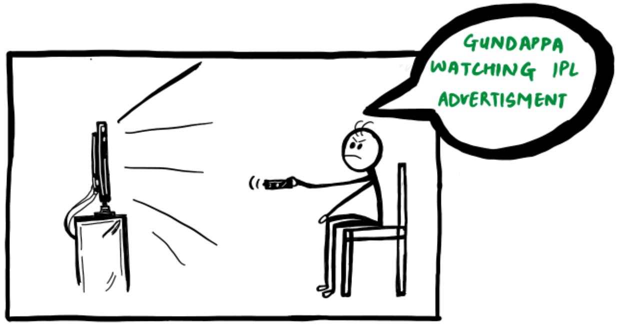
In a transaction involving the rendering of services, **performance should be measured either under the completed services contract method or under the proportionate completion method** which ever related revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the services.

Some Examples of rendering of services:- Installation fees, Financial Services, Commissions, Admission Fees, Tuition Fees, Entrance Fees and Membership Fees.

ADVERTISING AND INSURANCE AGENCY COMMISSIONS

IMP

- Revenue should be recognized when the service is completed.
- For advertising agencies, **media commissions will be recognized when the advertisement or commercial appears before the public and the necessary intimate is received by the agency.**
- **Insurance agency commission** should be recognised on the effective commencement or renewal date of the related policies.



Revenue arising from the use by others of Enterprise resources yielding interest , royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

- **Interest :-** On a time proportion basis taking into accounts the amount outstanding and the rate applicable;
- **Royalties : -** On an accrual basis in accordance with the terms of the relevant agreement;
- **Dividends** from Investment in shares :- when the owner's right to receive payment is established.

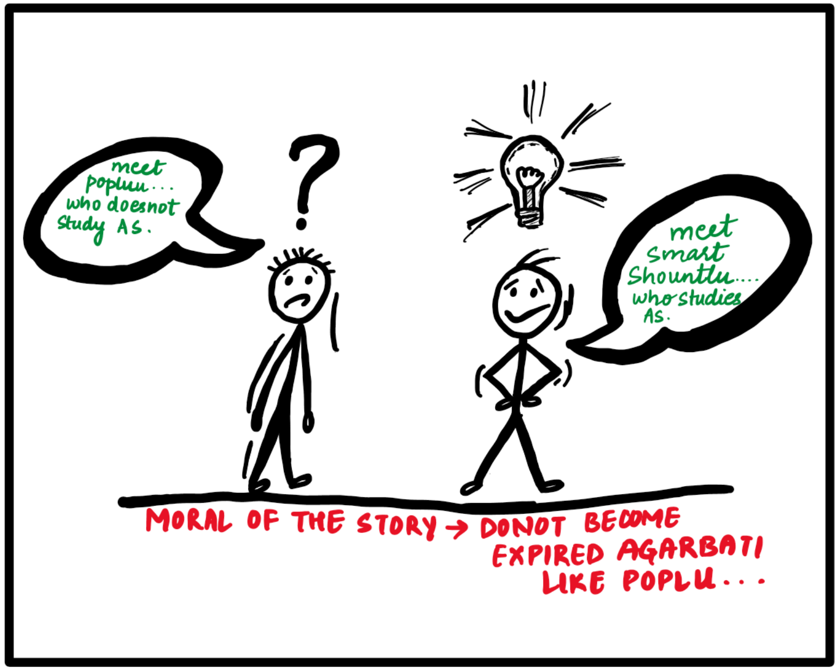
DISCLOSURE

In addition to the disclosure required by Accounting standard-1 on disclosure of Accounting policies [AS -1], an enterprise should also **disclose the circumstances** in which **revenue recognition has been postponed** pending the resolution of significant uncertainties.

Important points from Exam Point of view [SUMMARY]

1. In case of sale of goods, the **physical delivery of goods is not important** for revenue recognition. What is **relevant is the transfer of significant risk and reward.**
2. In case of rendering of services the **revenue** should be **recognised** in such a way to **match the services rendered. Completed contract method** or the **proportionate completion** method **may be used** to find out the relevant revenue.
3. In case of revenue from **rent, royalty, interest** etc. it should be **recognized** on time proportion/ **accrual basis.**
4. In case of dividend Income, when it is declared by that other company (i.e. when the right to receive dividend is established.)
5. In case of **consignee**, travel agent, or other intermediaries , the revenue amount to be **recognised** is the **commission only** and **not the gross value of the transaction.**
6. In case of **insurance claims lodged,** the revenue from claims should be recognised only when the amount of **claims** can be **reliably measured** and the **receipt of chain amount is certain.**
7. **After delivery** of goods or services, **full sales value be recognised,** even if some sales value is retained by buyer till the satisfactory performance of goods or services [Retention money)
8. Additional revenue arising out of price revision may be recognized as revenue in the current year, if there is a reasonable certainty of collection.
9. In case of **installment** sale, the **pure price** (cash price portion] should be **recognized on the date of sale,** but the **interest** should be recognized in **proportion to the unpaid balance due to the seller.**

10. **Interest on over dues** should be recorded on **accrual basis.** If there is uncertainty of collection of an overdue balance, interest on such overdue should be recognized only when received.
11. If the **work on** a contract has started and only an **insignificant portion** of the total work is done so far, **the profit on** such contract **need not be recognised.**
12. **Inter-division transfers** and **goods for self-consumption do not generate revenue.** Hence, the revenue on such transaction is not recognised in the profit and loss a/c.



AS - 9

OBJECTIVE

To lay down the bases for recognition of revenue arising in the course of ordinary activities of an enterprises from sale of goods, rendering of services & use by others of enterprise resources yielding interest , royalties & dividends.

REVENUE

Gross inflow of cash, receivable or other consideration in the course of ordinary activities from an enterprise.

From sale of goods, rendering of services and use by others of enterprises resources yielding interest, royalties & dividend.

REVENUE RECOGNITION FROM SALE OF GOODS

PERFORMANCE

- The seller has transferred to the buyer all significant risks & rewards of ownership,
- The seller retains no effective control of the goods to a degree usually associate with ownership

MEASUREMENT

- There is no significant uncertainty regarding the amount of consideration that will be derived from the sale of goods.

COLLECTABILITY

- At the time of performance it is not unreasonable to expect ultimate collection.

DISCLOSURE

- Revenue Recognition Policy
- Changes in accounting policies, if any, and the impact thereof.
- Circumstances in which revenue recognition has been postponed.
- Gross turnover, excise duty & net turnover

USE OF ENTERPRISE RESOURCES BY OTHER PARTIES

Use of enterprise resources by others may yield revenue in the form of interest, royalties and dividends.

RECOGNITION OF REVENUE WHEN ENTERPRISE RESOURCES ARE USED BY OTHERS

- Interest time basis
- Royalties Accrual basis depending upon the terms of agreement
- Dividends when right to receive the payment is establishment

QUICK SUMMARY

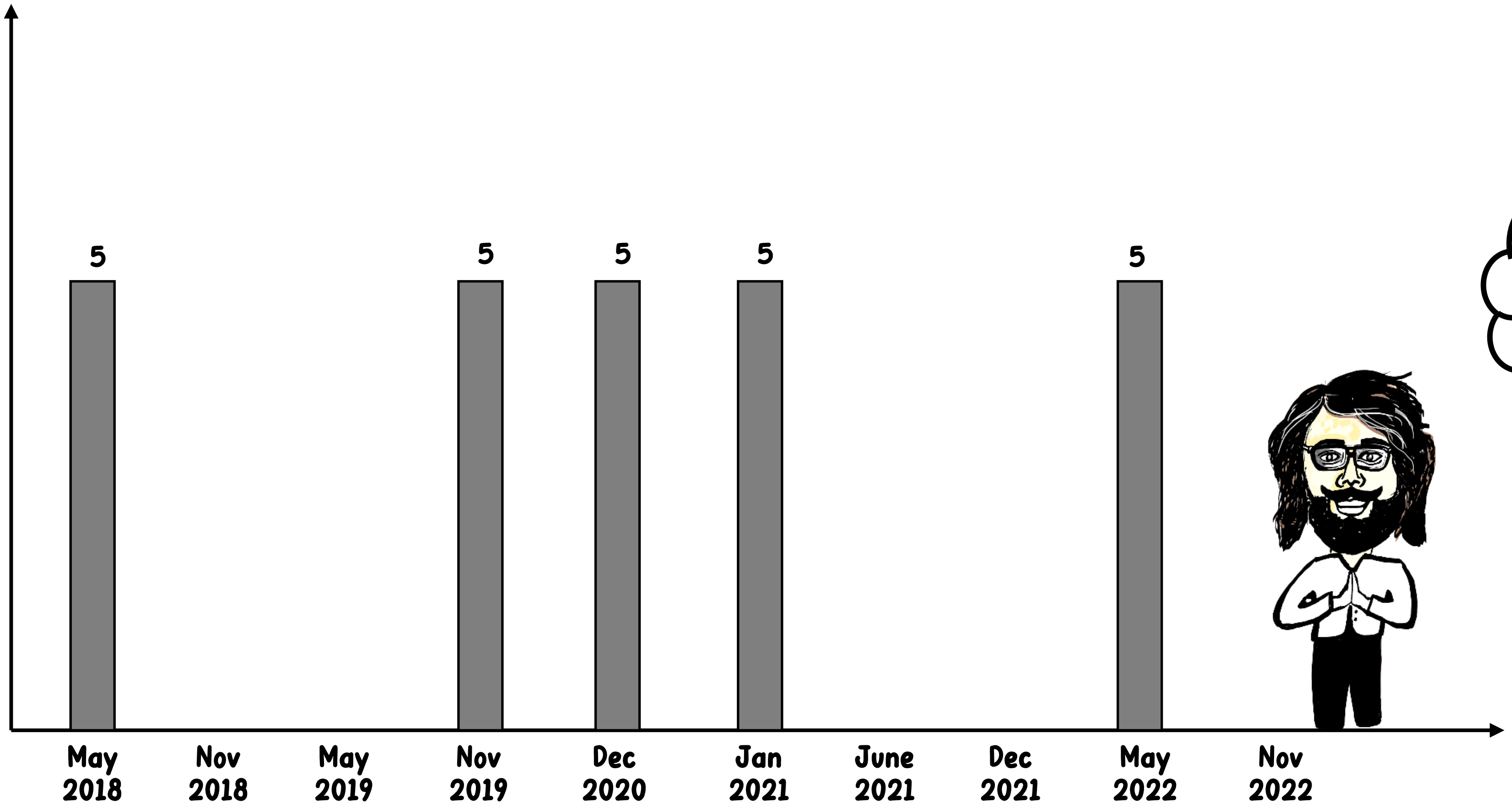
AS 17 - SEGMENT REPORTING

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS	5			5	5	5			5	



OBJECTIVES

To establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Such information helps users of financial statements in:

a) Better understanding of performance of the enterprise

b) Better assessing the risks and returns of the enterprise

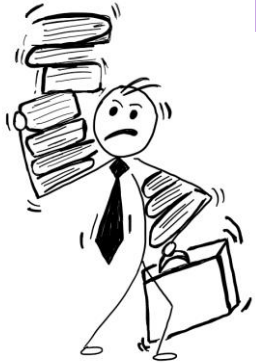
c) Making more informed judgements about the enterprise as a whole.

SCOPE

It should be applied in presenting general purpose financial statements

An Enterprise should comply with the requirements of his statement fully and not selectively.

If a single financial report contains both consolidated financial statements and the separate financial statement of parent, segment information needs be presented only on the basis of the consolidated financial statements.



FOR BETTER UNDERSTANDING REFER THE EXAMPLE

This is not an exhaustive list, only selected brands are included.

28. Segment Reporting

(₹ in Crores)

	2022 External	2022 Inter Segment	2022 Total	2021 External	2021 Inter Segment	2021 Total
1. Segment Revenue - Gross						
FMCG - Cigarettes	23451.39	–	23451.39	20333.12	–	20333.12
FMCG - Others	15964.75	29.74	15994.49	14708.64	19.59	14728.23
FMCG - Total	**39416.14**	**29.74**	**39445.88**	**35041.76**	**19.59**	**35061.35**
Hotels	1279.33	5.67	1285.00	623.59	3.92	627.51
Agri Business	12126.05	4070.02	16196.07	7866.06	4716.18	12582.24
Paperboards, Paper and Packaging	6279.57	1362.05	7641.62	4619.85	998.70	5618.55
Segment Total	**59101.09**	**5467.48**	**64568.57**	**48151.26**	**5738.39**	**53889.65**
Eliminations			(5467.48)			(5738.39)
Gross Revenue from sale of products and services			**59101.09**			**48151.26**
2. Segment Results						
FMCG - Cigarettes			14869.07			12720.41
FMCG - Others			923.22			832.73
FMCG - Total			**15792.29**			**13553.14**
Hotels			(183.09)			(534.91)
Agri Business			1031.15			820.74
Paperboards, Paper and Packaging			1700.00			1098.68
Segment Total			**18340.35**			**14937.65**
Eliminations			14.01			44.76
Total			**18354.36**			**14982.41**
Unallocated corporate expenses net of unallocated income			874.28			829.53
Profit before interest etc. and taxation			**17480.08**			**14152.88**
Finance Costs			41.95			47.47
Interest earned on loans and deposits, income from current and non-current investments, profit and loss on sale of investments etc. - Net			2391.40			3058.78
Profit before tax			**19829.53**			**17164.19**
Tax expense			4771.70			4132.51
Profit for the year			**15057.83**			**13031.68**

3. Other Information	2022 Segment Assets	2022 Segment Liabilities	2021 Segment Assets	2021 Segment Liabilities
FMCG - Cigarettes	6654.58	4684.28	6737.04	4469.56
FMCG - Others	11444.16	2273.87	11405.18	2534.32
FMCG - Total	**18098.74**	**6958.15**	**18142.22**	**7003.88**
Hotels	6538.40	835.94	6525.59	769.31
Agri Business	4699.08	1746.29	5004.19	1158.87
Paperboards, Paper and Packaging	8486.49	1326.06	7244.53	1080.26
Segment Total	**37822.71**	**10866.44**	**36916.53**	**10012.32**
Unallocated Corporate Assets/Liabilities	37269.79	2826.49	34663.83	2563.42
Total	**75092.50**	**13692.93**	**71580.36**	**12575.74**

28. Segment Reporting (Contd.)

(₹ in Crores)

	2022 Capital expenditure	2022 Depreciation and amortization	2021 Capital expenditure	2021 Depreciation and amortization
FMCG - Cigarettes	137.25	263.19	79.95	263.74
FMCG - Others	336.27	525.75	475.07	484.13
FMCG - Total	**473.52**	**788.94**	**555.02**	**747.87**
Hotels	257.90	261.12	201.08	266.31
Agri Business	113.36	80.63	38.57	75.36
Paperboards, Paper and Packaging	896.72	410.97	775.40	359.81
Segment Total	**1741.50**	**1541.66**	**1570.07**	**1449.35**
Unallocated	126.94	110.49	71.96	112.48
Total	**1868.44**	**1652.15**	**1642.03**	**1561.83**

	2022 Non Cash expenditure other than depreciation	2021 Non Cash expenditure other than depreciation
FMCG - Cigarettes	6.25	21.87
FMCG - Others	6.66	60.46
FMCG - Total	**12.91**	**82.33**
Hotels	–	4.71
Agri Business	3.20	0.07
Paperboards, Paper and Packaging	27.59	38.25
Segment Total	**43.70**	**125.36**

GEOGRAPHICAL INFORMATION

	2022	2021
1. Revenue from external customers		
– Within India	49782.80	42974.37
– Outside India	9318.29	5176.89
Total	**59101.09**	**48151.26**
2. Non-current assets		
– Within India	26915.71	26752.87
– Outside India	...	0.01
Total	**26915.71**	**26752.88**

NOTES:

(1) The Company's corporate strategy aims at creating multiple drivers of growth anchored on its core competencies. The Company is currently focused on four business groups : FMCG, Hotels, Paperboards, Paper and Packaging and Agri Business. The Company's organisational structure and governance processes are designed to support effective management of multiple businesses while retaining focus on each one of them.
The Operating Segments have been reported in a manner consistent with the internal reporting provided to the Corporate Management Committee, which is the Chief Operating Decision Maker.

(2) The business groups comprise the following :

FMCG : Cigarettes	–	Cigarettes, Cigars, etc.
: Others	–	Branded Packaged Foods Businesses (Staples & Meals; Snacks; Dairy & Beverages; Biscuits & Cakes; Chocolates, Coffee & Confectionery); Education and Stationery Products; Personal Care Products; Safety Matches and Agarbattis; Apparel.
Hotels	–	Hoteliering.
Paperboards, Paper and Packaging	–	Paperboards, Paper including Specialty Paper and Packaging including Flexibles.
Agri Business	–	Agri commodities such as wheat, rice, spices, coffee, soya and leaf tobacco.

(3) The geographical information considered for disclosure are:
– Revenue within India.
– Revenue outside India.

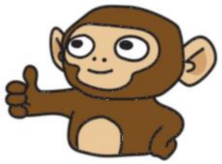
(4) Segment results of 'FMCG : Others' are after considering significant business development, brand building and gestation costs of the Branded Packaged Foods businesses and Personal Care Products business.

(5) As stock options and stock appreciation linked reward units are granted under the ITC ESOS and ITC ESARP respectively to align the interests of employees with those of shareholders and also to attract and retain talent for the enterprise as a whole, the charge thereof do not form part of the segment performance reviewed by the Corporate Management Committee.

(6) The Company is not reliant on revenues from transactions with any single external customer and does not receive 10% or more of its revenues from transactions with any single external customer.

SOURCE → www.itcportal.com

DEFINITION



BUSINESS SEGMENT

A business segment [it is a segment based on products and services it provides] is a component of an enterprise which satisfies the following conditions:

1. It is a **distinguishable component** of an enterprise.
2. It is engaged in providing an **individual product or service or a group of related products or services and**
3. It is subject to **risks and returns that are different** from those of other business segments.

Factors that should be considered in determining whether products or services are related include :

a. the nature of the products or services,
b. the nature of the production processes;
c. the type or class of customers for the products or services of,
d. the methods used to distribute the products or provide the services; and
e. if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

QUESTION - 1

Sugar factory produces levy sugar as well as sugars for free market sale. Free market sugar is refined and subject to market risk. It is supplied to premium market segment at higher or price. Should these two types of sugar be classified into different business segments?

Answer :- In this case risk and returns associated with levy sugar and different, types of customer are different , production processes are different, and they are subjected to different regulatory requirements. So these two types of sugar should be classified into different business segments.

GEOGRAPHICAL SEGMENT

A Geographical segment (it is the area or location in which products and services are manufactured or marketed] is a component of an enterprise, which satisfies the following conditions:

1. It is **a distinguishable component of an enterprise.**
2. It is **engaged in providing products or services within a particular economic environment and**
3. It is **subject to risks and returns that are different** from those of components operating in other economic environments.

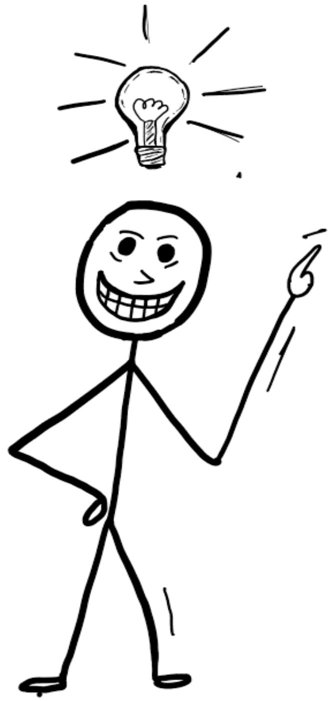
Factors that should be considered in identifying geographical segments include :

a) similarity of economic and political conditions;
b) relationship between operations in different geographical areas;
c) proximity of operations;
d) Special risks associated with operations in a particular area;
e) exchange control regulations; and
f) the underlying currency risks

GEOGRAPHICAL SEGMENT

It can be based on

Location of Customers (Destination of Sales)	Location of Assets (Point of Sales)



REPORTABLE SEGMENTS

are either business segment [i.e. component of an enterprise according to product or services it sells] or geographical segment [i.e. different regions or countries] for which segment information is required to be disclosed by this statement. Geographical segments are further either based on location of its facilities i.e. producing centres or based on location of its customers i.e. sales area.

ENTERPRISE REVENUE

Enterprise revenue is revenue from sales to external customers as reported in the statement of profit and loss.

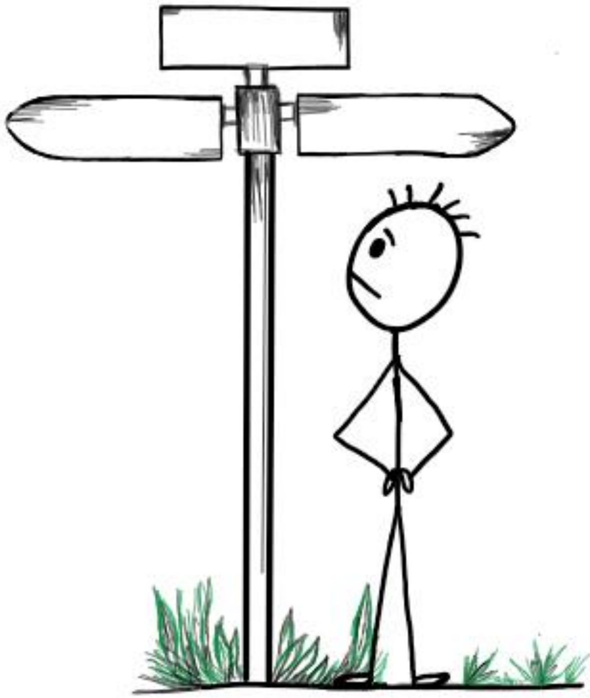
SEGMENT REVENUE

IS AGGREGATE OF

Portion of enterprise revenue that is directly attributable to a segment,

Relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and

Revenue from transaction with other segments of the enterprise



DOES NOT INCLUDE

Extraordinary items as defined in AS-5

Interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature, and

Gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature

SEGMENT EXPENSE

IS AGGREGATE OF

Expense resulting from the operating activities of a segment that is directly attributable to the segment. &

Relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment,

Expense relating to transactions with other segments of the enterprise

DOES NOT INCLUDE

Extraordinary items as defined in AS-5

Interest expense, including interest incurred on advances or Loans from Other segments, unless the operations of the segment are primarily of a financial nature

losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature

Income tax expenses

general administrative expenses, head office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole.

SEGMENT ASSETS

OPERATING ASSETS

that are employed by a segment in its operating activities and

that either are directly attributable to the segment or.

Can be allocated to the segment on a reasonable basis.

INCLUDE

If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets.

DO NOT INCLUDE

Income tax assets:

Assets used for general enterprise or head office purposes

NOTE:-

Segment assets are determined after deducting related allowances/ provisions that are reported as direct offsets in the balance sheet of the enterprise

SEGMENT LIABILITIES

OPERATING LIABILITIES

that result from the operating activities of a segment and that either are directly attributable to
the segment or can be allocated to the segment on a reasonable basis

INCLUDES

If the segment result of a segment includes interest expense, its segment liabilities include the related interests bearing liabilities

EXAMPLES

trade and other payables, accrued liabilities, customer advances, product warranty provisions, and other claims relating to the provision of goods and services

DOES NOT INCLUDE

Income tax liabilities:

borrowings and other liabilities that are incurred for financing rather than operating purposes

NOTE:-

Assets and labilities that relate jointly to two or more segment should be allocated to segments if, and only if, their related revenue and expense are allocated to those segments.

Segment accounting policies :- are the accounting policies adopted for preparing and presenting the financial statement reporting.

SEGMENT RESULT = SEGMENT REVENUE – SEGMENT EXPENSES
(It will also include transaction between segments)

REPORTABLE SEGMENT

A segment should be reportable segment if.

a) Its total revenue is 10% or more of total revenue of all segments. It includes inter segment transaction, or

b) It's results whether profit or loss is 10% or more of total of results of all segments which are in profit or all segments which are in loss whichever is higher, or

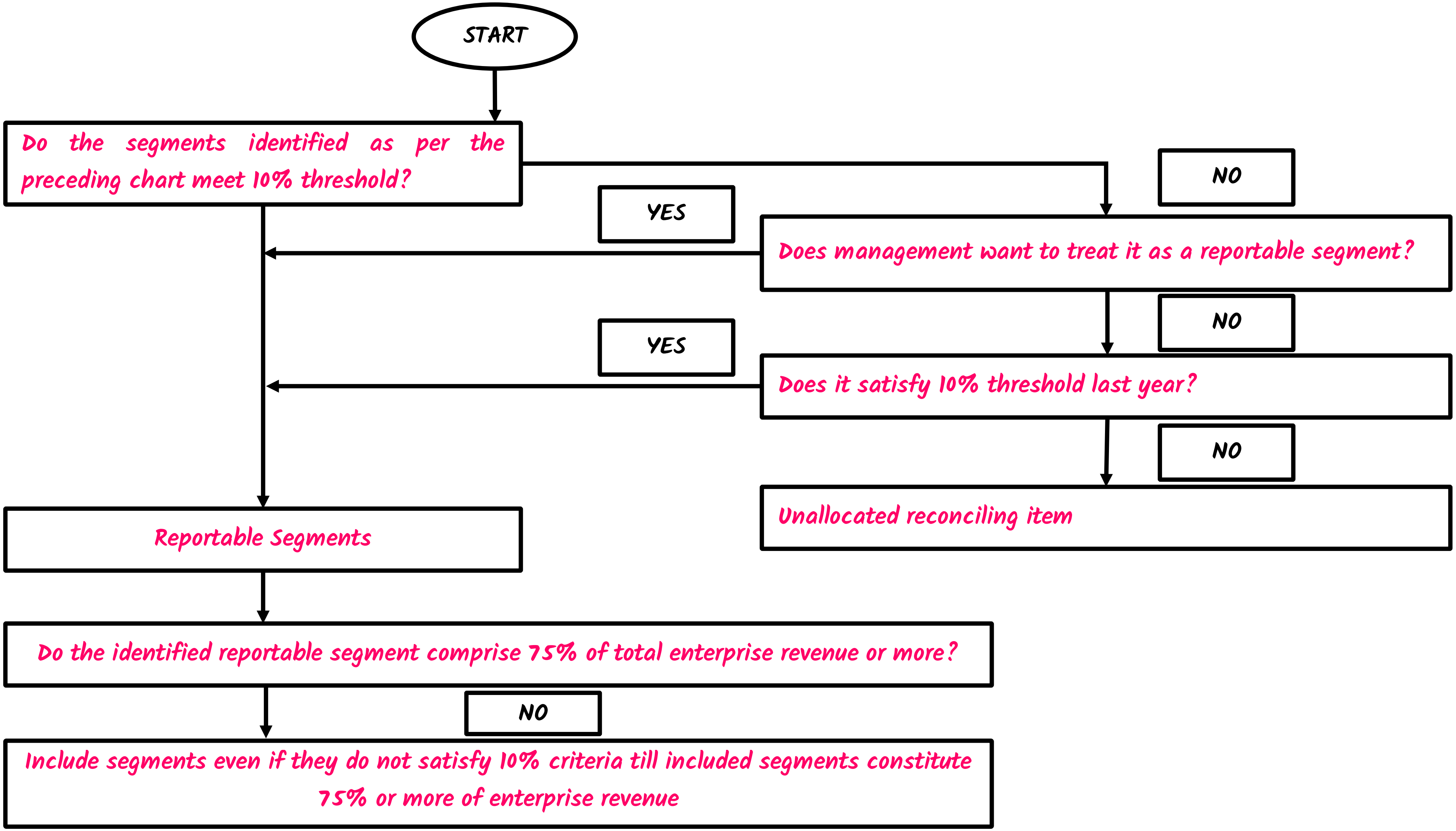
c) It's assets are 10% or more of total assets of all segments.

Important Point -

- Those which are not reportable segments as per above criteria are either included as reportable segments at the discretion of the management or included in unallocated reconciling items.
- The total revenue from external customers of all reportable segments must be 75% or more of the total enterprise revenue [external revenue] otherwise further segments will be added to reportable segments.

FLOWCHART

SELECTION OF REPORTABLE SEGMENTS



IDENTIFICATION OF REPORTABLE SEGMENT

PRIMARY AND SECONDARY SEGMENT REPORTING FORMATS.

a) The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments.

b) If the risks and returns of an enterprise are affected predominantly by the **differences in the products and services it produces** then business segment will be its primary reporting segment and geographical segment will be secondary segment

c) Similarly if the risks and returns are predominantly affected by the fact that it operates in different countries or other geographical areas then geographical segment will be primary segment and business segment will be secondary segment.

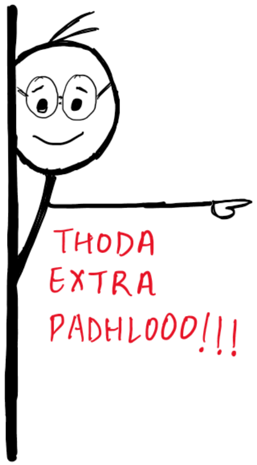
d) If risk and returns of an enterprise are strongly affected both by differences in the products and services it produces and **differences in the geographical areas in which it operates,** the enterprise should use business segment as its primary segment reporting formats and geographical segments as its secondary reporting format.

SEGMENT IDENTIFIED AS REPORTABLE IN PREVIOUS YEAR

A segment identified as a reportable segment in the immediately preceding period **because it satisfied the relevant 10% thresholds**

Should continue to be a reportable segment for the current period not withstanding that its revenue, result, and assets all no longer meet the 10% thresholds.

SEGMENT INDENTIFIED AS REPORTABLE FOR THE FIRST TIME



If a **segment is identified as a reportable segment in the current period because it satisfies the relevant 10% thresholds.**

Preceding period segment data that is presented for comparative purposes should, unless it is impractical to do so, be restated to reflect the newly reportable segment as a separate segment

Even if **that segment did not satisfy the 10% threshold in the preceding period.**

REPORTING FOR PRIMARY SEGMENT

Current year and previous year data should be given for each reportable segment regarding its :-
[only total values need to be reported]

- External Revenue
- Revenue from other segment;
- Total Revenue
- Segment results,
- Operating Assets: Tangible, Intangible fixed assets, current assets
- Cost incurred for addition to fixed assets [tangible as well as intangible] during accounting period
- Segment liabilities
- Reconciliation of each figure of enterprise
- Depreciation and amortization and any other significant non-cash expenses included in segment expenses should also be disclosed.

DISCLOSURE OF SEGMENT CASH FLOW THOUGH NOT MANDAFORY IS ENCOURAGED

- Matrix presentation i.e. business segment and Geographical segment both as primary segment is also allowed.
- Geographical segment by location of asset and customer can be same also.
- This is a minimal disclosure. More disclosure can be made.
- The information to be disclosed in all cases whether business segments or geographical segment is primary segment.
- Basis of pricing inter-segment transfers and any change therein.
- Changes in segment accounting policies.
- Types of product and services in each business segment.
- Composition of each geographical segment.
- ASI-20: In case by applying the definitions, it is concluded that there is neither more than one business segment not more than one geographical segment, AS 17 shall not apply.

IMPORTANT POINTS

- Segment information should be prepared in conformity with the accounting policies being adopted for the enterprise as a whole.
- Export incentive received by a particular segment is part of segment revenue and expense.
- Intersegment transfers should be measured on the basis that the enterprise actually used to price those transfers.
- If interest is added to the cost of inventories [As -16], then such interest is a past of a segment information
- Disclosure is required only for reportable segments

AS - 17

OBJECTIVE

To establish principle for reporting segment wise financial information to enable uses of FS to assess risks & returns of a diversified and / or multi-locational enterprises.

SEGMENT

Distinguishable component of an enterprise could be business segment or geographical [based on location of assets or location of customers] segment.

REPORTING SEGMENT

Is a business segment or a geographical segment identified on the basis of definitions of business segment and geographical segment for which segment information is required to be disclosed by this standard.

TO BE REPORTED IN

Primary & Secondary reporting format

Business Segment Primary & Geographic secondary when there are:

- Difference in products & services that enterprise produces, or
- There are difference in products & services as well as geographic location

Geographic segment primary & business segment secondary when there are:

Difference in geographical location [of assets or customers]

To be reportable if any one or more conditions applicable

- Revenue Atleast 10%
- Profit of Loss Atleast 10%
- Segment Assets Atleast 10%

Those which are not reportable segment as per above criteria are either included as reportable segments at the discretion of the management or included in unallocated reconciling items

Total Revenue attributed less than 75%

ACCOUNTING POLICIES

Segment information to be prepared in conformity with accounting policies adopted for FS of enterprises as a whole.

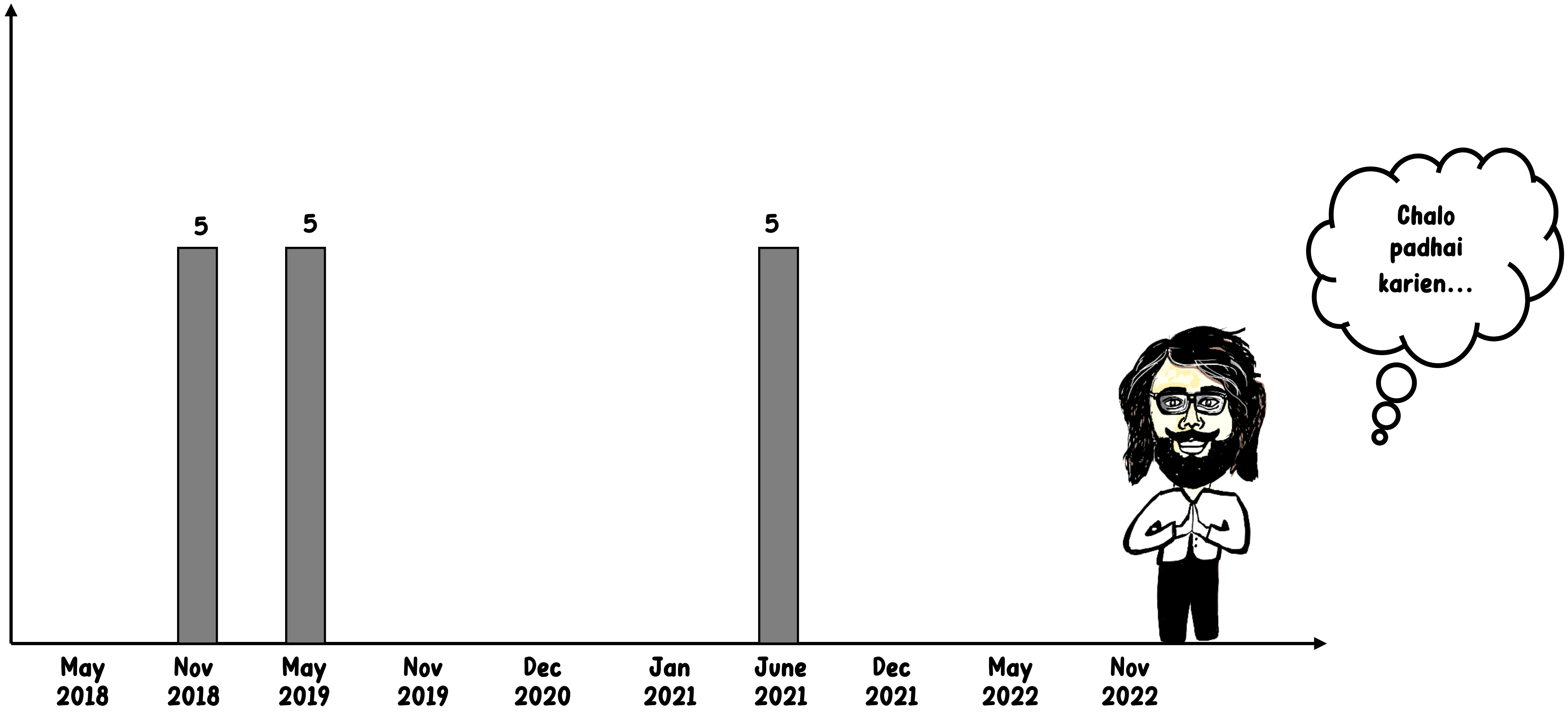
AS 18 - RELATED PARTY DISCLOSURE

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

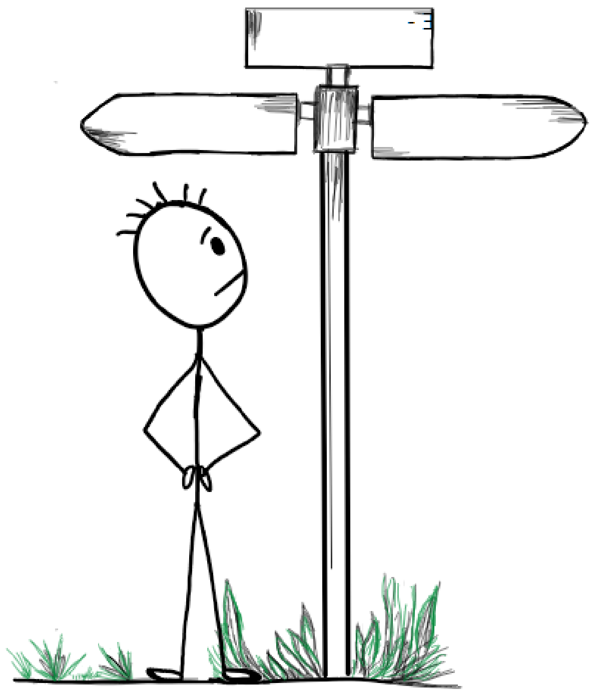
ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS		5	5				5			



OBJECTIVE

- Disclosures under AS-18 convey to the reader that certain related party transactions have taken place and the results of these transactions are incorporated in financial statements.
- Related parties may enter into transactions which unrelated parties would not enter into.
- Transaction may not have taken at arm's length.
- No price may be charged in related party transaction.



APPLICABILITY

- Independent financial statements of reporting enterprise
- Consolidated financial statement except for intra group transactions.

AS 18 Deals with

Related Party relations & Transactions between the reporting enterprise & its related parties

RELATED PARTY

Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and / or operating decisions.

AN ASSOCIATE

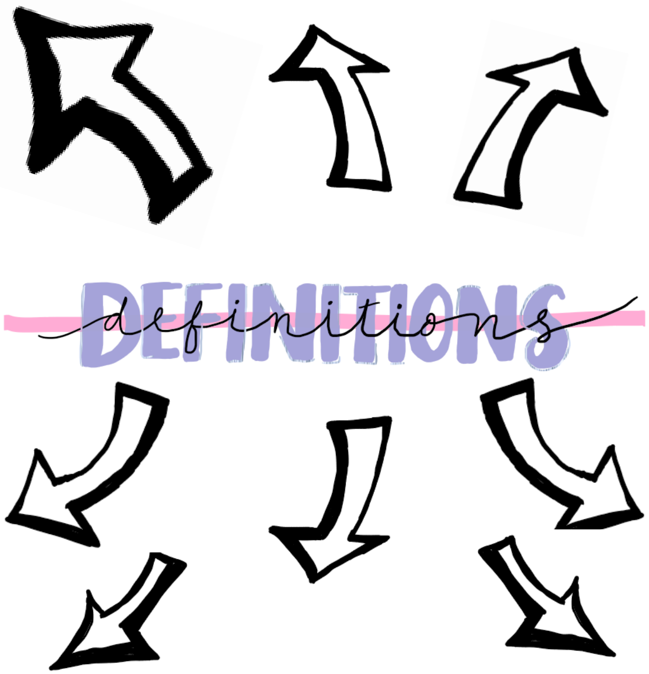
An enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.

A JOINT VENTURE

A contractual arrangement whereby two or more parties undertakes an economic activity which is subject to joint contract.

RELATED PARTY TRANSACTION

A transfer of resources of obligations between related parties, regardless of whether or not a price is charged.



KEY MANAGEMENT PERSONNEL

Those persons who have the authority & responsibility for planning directing and controlling the activities of the reporting enterprise

SIGNIFICANT INFLUENCE

Participation in the financial and / or operating policy decisions of an enterprise, but not control of those policies.

CONTROL

a) Ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or
b) Control of the composition of the board of directors in the case of a company or of the composition the corresponding governing in case of any other enterprise; or
c) A substantial interest in voting power and the power to direct, by statute or agreement, the financial and / or operating policies of the enterprise.

JOINT CONTROL

The contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

RELATIVE

In relation to an individual, means the spouse, Son, Daughter, Brother, Sister, Father and Mother who may be expected to influence, or influenced by, that individual in his/her dealing with the reporting enterprise.

JUST FOR INFORMATION

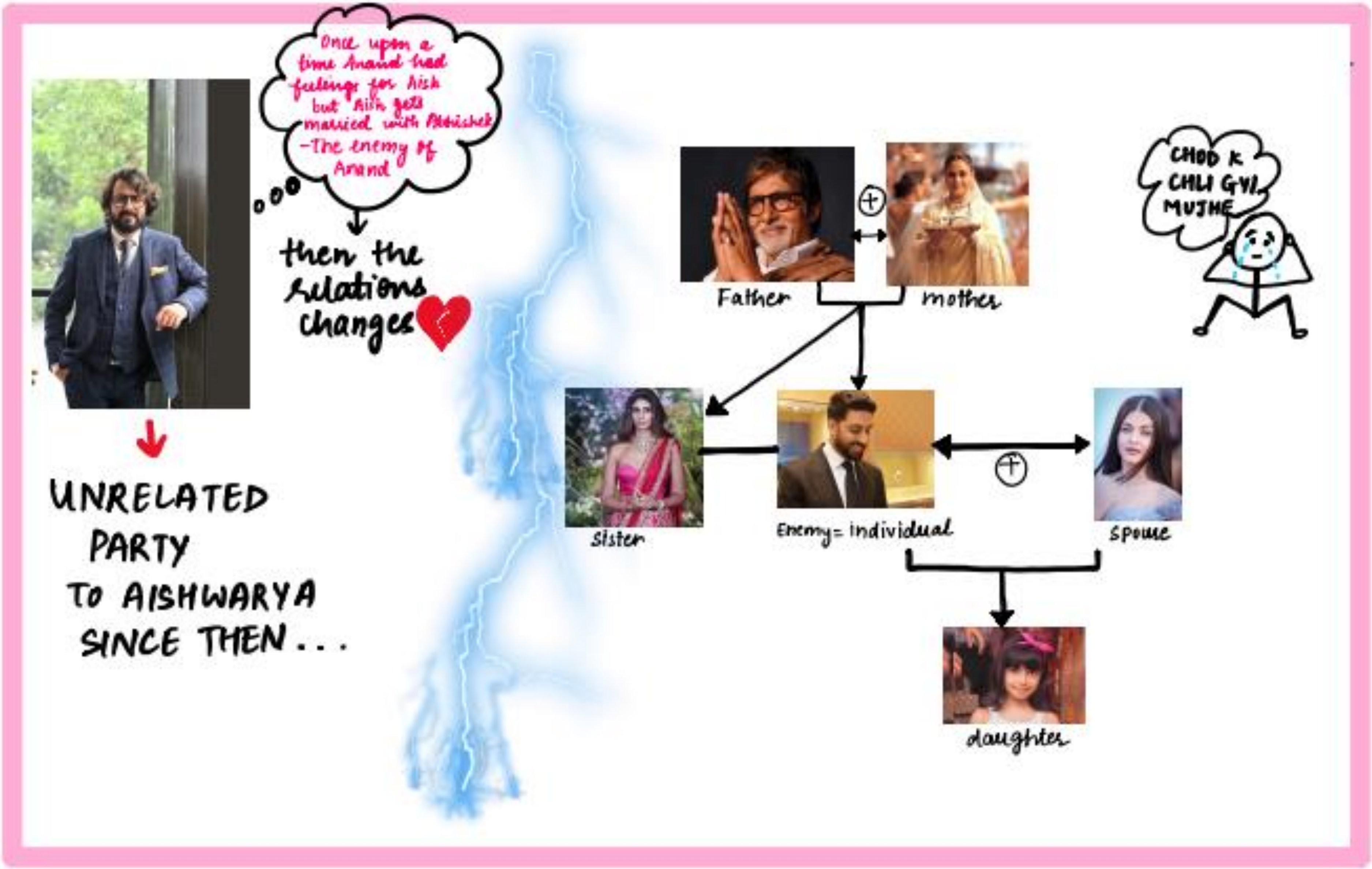
As per SA 550 – Related Parties

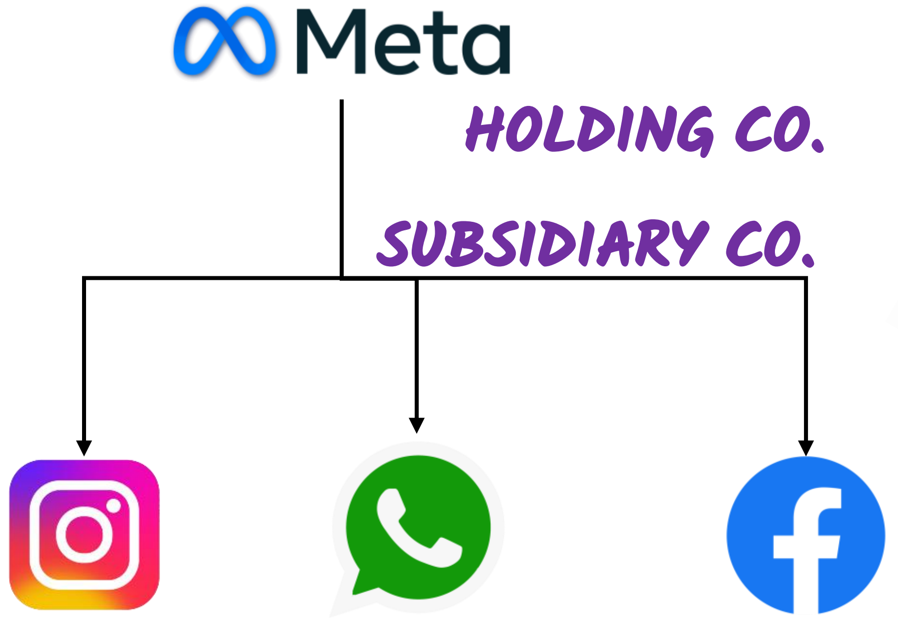
Definition of Related Party:

A party that is either:

i. A related party as defined in the applicable financial reporting framework; or
ii. Where the applicable financial reporting framework established minimal or no related party requirements:
   a. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
   b. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries ; or
   c. Another entity that is under common control with the reporting entity through having:
      - Common controlling ownership;
      - Owners who are family members; or
      - Common key management.

STORY OF HOW ANAND BECAME AN UNRELATED PARTY TO AISH





FELLOW SUBSIDIARY CO.

HOLDING COMPANY

A Company having one or more subsidiaries

SUBSIDIARY

A Company

In which another company [the holding company] holds, either by itself and/ or through one or more subsidiaries the composition of its board of directors.

Of which another company [the holding company] controls, either by subsidiaries, the composition of its board of directors.

FELLOW SUBSIDIARY

A company is considered to be a fellow subsidiary of another company if the same holding company.

STATE CONTROLLED ENTERPRISE

An enterprise which is under control of the control government and / or any state government (s).

FOR THE PURPOSE OF THIS STATEMENT, AN ENTERPRISE IS CONSIDERED TO CONTROL THE COMPOSITION OF BOARD OF DIRECTORS

i. The board of director of a company, if it has the power, without the consent or concurrency of any other person, to appoint or remove all or a majority of directors if any of that company an enterprise is deemed to have the power to appoint a director if any of the following

   a) A person cannot be appointed as director without the exercise in his favor by that enterprise of such a power as aforesaid; or

   b) A person's appointment as director follows necessarily from his appointment to position held by him in that enterprise; or

   c) The director is nominated by that enterprise; in case that enterprise is a company, the director is nominated by that company / subsidiary thereof:

ii. The governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any other person, to appoint or remove all or a majority of member of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member if any of the following conditions is satisfied:

   a) A person cannot be appointed as member of the governing body without the exercise in his favor by that other enterprise of such a power as aforesaid ; or.

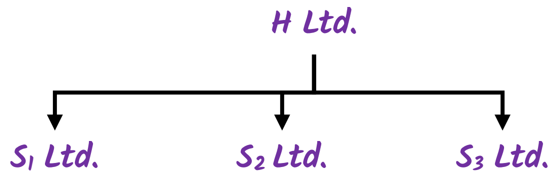
   b) A person's appointment as member of the governing body follows necessarily from his appointment to a position held by him in that other enterprise; or

   c) The member of the governing body is nominated by that other enterprise.

THIS STATEMENT DEALS ONLY WITH RELATED PARTY RELATIONSHIPS DESCRIBED IN (A) TO (E) BELOW:

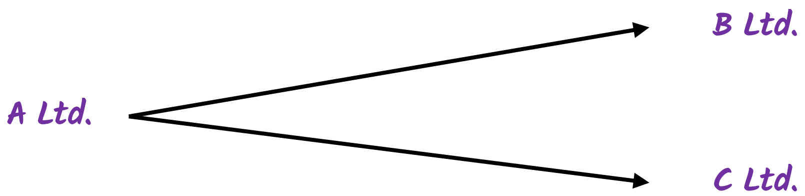
a) *Enterprises that directly, or indirectly through one or more intermediaries, controls, or are controlled by, or are under common control with, the reporting enterprise* **THIS INCLUDES HOLDING COMPANIES, SUBSIDIARIES AND FELLOW SUBSIDIARIES;**

Example 1:-



H Ltd. Controls S1, S2, S3
S1, S2 and S3 are controlled by H
S1, S2 and S3 are under common control.

Example 2:-



b) Associate and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture;

c) Individuals owning, directly or indirectly, an interest in voting power of the reporting enterprise that govern them controls or significant influence over the enterprise, and relatives of any such individual;

d) Key management personnel and relatives of such personnel; and

e) Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

IN CONTEXT OF THIS STATEMENT, THE FOLLOWING ARE DEEMED NOT TO BE RELATED PARTIES:

a) Two companies simply because they have a director in common, notwithstanding paragraph 1(d) or (e) above [unless the director is able to affect the policies of both companies in mutual dealings];

b) A single customer, supplier, franchises, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence ; and

c) The parties listed below, the course of their normal dealing with an enterprise by virtue only of those dealings [although they may circumscribe the freedom of action of the enterprise or participate in its decision – making process];

i. Providers of finance;
ii. Trade unions;
iii. Public utilities;
iv. Government departments and government agencies including government sponsored bodies.

DISCLOSURES

- *Related party disclosures requirement as laid down in this statement do not apply in circumstances where providing such disclosures would conflict with the reporting enterprises duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.*
- *No disclosure is required in consolidated financial statements in respect of intra group transactions.*
- *No disclosure is required in the financial statements of state controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.*
- *No disclosure is required in the financial statements of state controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.*
- ***If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:***

  i. the name of the transacting related party;
  ii. a description of the relationship between the parties;
  iii. a description of the nature of transactions;
  iv. volume of the transactions either as an amount or as an appropriate proportion;
  v. any other elements of the related party transactions necessary for an understanding of the financial statements;
  vi. the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
  vii. amounts written off or written back in the period in respect of debts due from or to related parties.
- ***The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:***

  a) Purchases or sales of goods (finished or unfinished);
  b) Purchases or sales of fixed assets;
  c) Rendering or receiving of services;
  d) Agency arrangements;

e) Leasing or hire purchase arrangements;

f) Transfer of research and development;

g) Licence agreements;

h) Finance (including loans and equity contributions in cash or in kind);

i) Guarantees and collaterals; and

j) Management contracts including for deputation of employees.

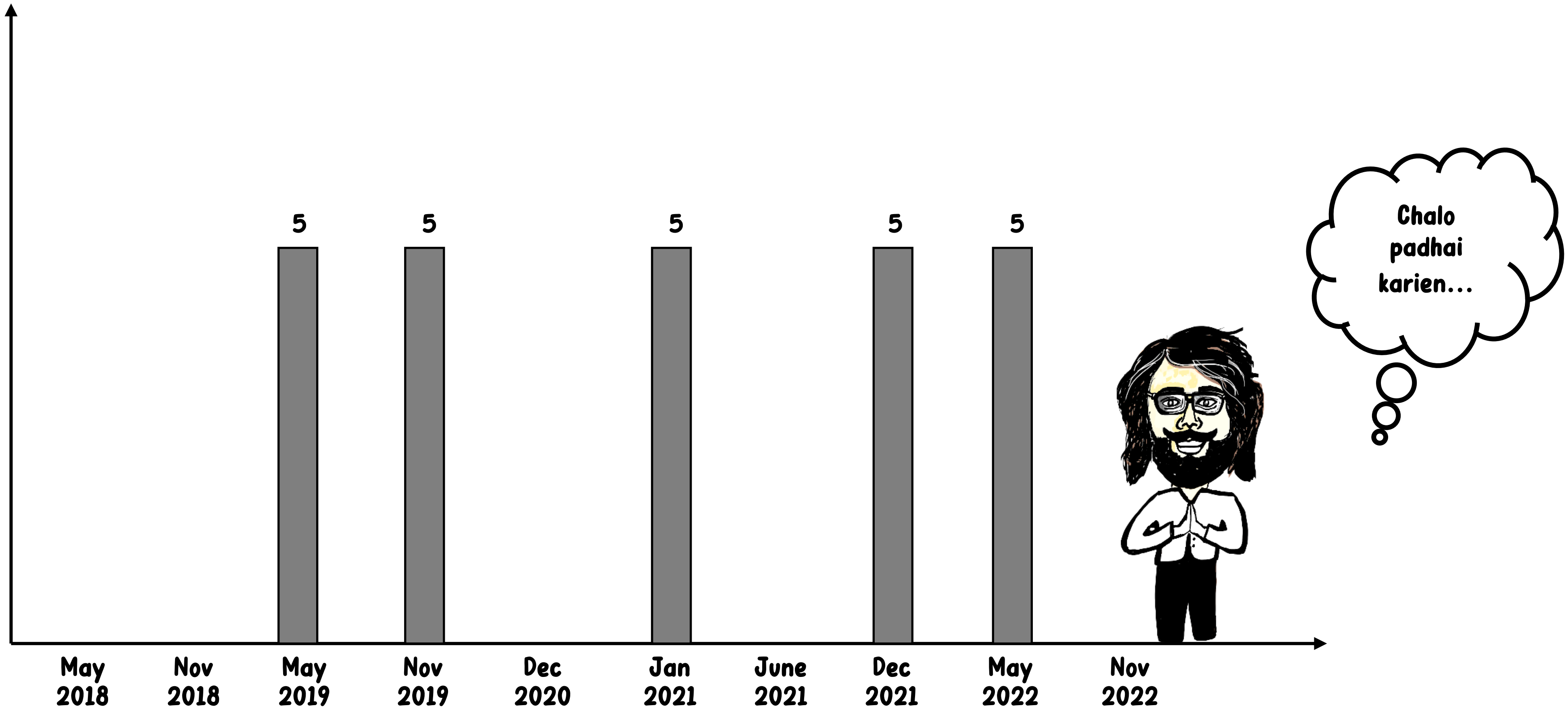
AS 19 - ACCOUNTING FOR LEASES

INDEX

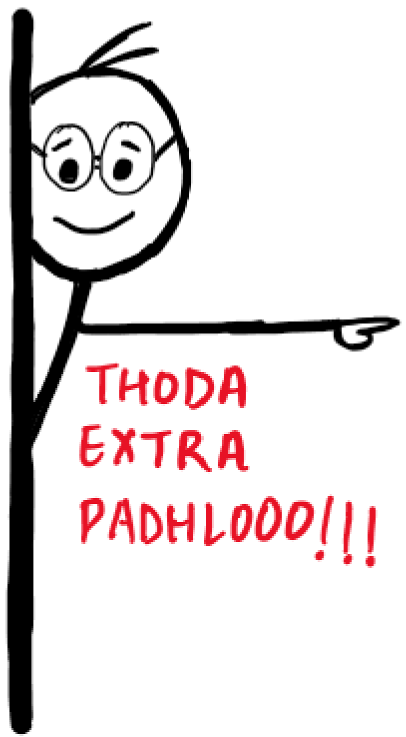
SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS			5	5		5		5	5	



Some concepts that are pre-requisite for AS-19



DISCOUNTING TECHNIQUES

- **NET PRESENT VALUE (NPV)**
- **INTERNAL RATE OF RETURN (IRR)**

DETERMINING DISCOUNT RATE

It is a rate of return used to discount future cash flows back to their present value. This rate is often a company's weighted Average cost of capital [WACC), required rate of return, or the hurdle rate that investors expect to earn relative to risk of the investment.

WHY IS DISCOUNT RATE USED?

A Discount rate is used to calculate the Net Present value [NPV] of a business as part of a Discounted cash Flow [DCF] analysis. It is also utilized to :

- Account for the time value of money
- Account for the riskiness of an investment
- Represent opportunity cost for a firm
- Act as a hurdle rate for investment
- Make different investments more comparable

NET PRESENT VALUE

The Net present value technique is a discounted cash flow method that considers the time value of money in evaluating capital investments Net present value [NPV] is the difference between the present value of cash inflows and the present value of cash outflows over a period of time. NPV is used in Capital budgeting and investment planning to analyze the profitability of a projected investment or project.
NPV is the result of the calculations that find the current value of a future Stream of payments using the proper discount rate.

Net Present Value = Present value of net cash inflow – Total net initial investment

Since it might be possible that some additional investment may also be required during the life time of the project, then appropriate formula shall be:

Net Present value = Present value of cash inflows -Present value of cash outflows

It can be expressed as below:

$$\text{NPV} = \left[\frac{C1}{(1+k)} + \frac{C2}{(1+k)2} + \frac{C3}{(1+k)3} + \underline{\hspace{3cm}} + \frac{Cn}{(1+k)n}\right] - I$$

$$\text{NPV} = \sum_{t=1}^{n} \frac{Ct}{(1+k)t} - 1$$

Where,

C = Cash flow of various years

K = Discount rate

N = Life of the project

I = Investment

Steps for calculating Net Present value [NPV]

STEP 1 → **DETERMINE** the net cash inflow in each year of the investment.

STEP 2 → **SELECT** the desired rate of return or discounting rate or weighted Average cost of capital

STEP 3 → **FIND** the discount factor for each year based on the desired rate of return selected.

STEP 4 → **DETERMINE** the present values of the net cash flows by multiplying the cash flow by respective discount factors of respective period called Present value [PV] of cash flows.

STEP 5 → Total the amounts of all PVs of cash flows.

ILLUSTRATION

Compute the net present value for a project with a net investment of Rs. 1,00,000 and net cash flows for year one is Rs.55,000; for year two is Rs. 88, 000 and for year three is Rs. 15,000. Further, the company's cost of capital is 10%
[PVIF @ 10% for three years are 0.909, 0.826 and 0.751]

SOLUTION:

Year	Net Cash Flows (Rs.)	PVIF @ 10%	Discounted Cash Flows (Rs.)
0	[1,00,000]	1.000	[1,00,000]
1	55,000	0.909	49,995
2	80,000	0.826	66,080
3	15,000	0.751	11,265
Net Present Value [NPV]			27,340

RECOMMENDATION – Since the net present value of the project is positive, the company should accept the project.

INTERNAL RATE OF RETURN [IRR]

IRR Definition : Internal rate of return for an investment proposal is **the rate that equates the present value of the expected cash inflows with the initial cash outflow.**

This IRR is then compared to a criterion rate of return that can be the organization's desired rate of return for evaluating capital investments

CALCULATION OF IRR

The procedures for computing the internal rate of return vary with the pattern of net cash flows over the useful life of an investment.

LETS TAKE A SCENARIO

When the cash inflows are not uniform over the life of the investment , the determination of the discount rate can involve trail and errors and interpolation between discounting rates as mentioned above. However, IRR can also be found out by using following procedure :

STEP 1: Discount the cashflow at any random rate, say 10% , 15% or 20%

STEP2: If resultant NPV is negative, then discount cashflows again by lower discounting rate to make NPV positive. Conversely, if resultant NPV is positive, then again discount cash flows by higher discounting rate to make NPV negative.

STEP 3: Use following interpolation formula :

$$IRR = LR + \frac{NPV\ at\ LR}{NPV\ at\ LR - NPV\ at\ HR}\ X\ [HR - LR]$$

Where,

LR = Lower Rate

HR = Higher Rate

ILLUSTRATION

Calculate the internal rate of return of an investment of Rs. 1,36,000 which yields the following cash inflows:

Year	Cash Inflows (Rs.)
1	30,000
2	40,000
3	60,000
4	30,000
5	20,000

SOLUTION:

Let us discount cash flows by 10%

Year	Cash Inflows (Rs.)	Discounting Factor at 10%	Present Value
1	30,000	0.909	27,270
2	40,000	0.829	33,040
3	60,000	0.751	45,060
4	30,000	0.683	20,490
5	20,000	0.621	12,420
Total Present Value			1,38,280
Less: Initial Investment			1,36,000
NPV			+2,280

The NPV calculated @ 10% is positive. Therefore, A higher discount rate is suggested, say, 12%

Year	Cash Inflows (Rs.)	Discounting Factor at 12%	Present Value
1	30,000	0.893	26,790
2	40,000	0.797	31,880
3	60,000	0.712	42,720
4	30,000	0.636	19,080
5	20,000	0.567	11,340
Total Present Value			1,31,810
Less: Initial Investment			1,36,000
NPV			- 4,190

The internal rate of return is, thus, more than 10% but less than 12%. The exact rate can be obtained by interpolation:

$$IRR = LR + \frac{NPV\ at\ LR}{NPV\ at\ LR - NPV\ at\ HR}\ X\ [HR - LR]$$

$$IRR = 10 + \frac{2280}{2280[-4190]}\ X\ [12 - 10]$$

$$IRR = 10 + \frac{2280}{6470}\ X\ [12 - 10]$$

$$IRR = 10 + 0.704$$

$$\mathbf{IRR = 10.704\%}$$

AS-19 आरम्भ

OBJECTIVES

To PRESCRIBE,

- The appropriate accounting policies and disclosures in relation to finance leases and operating leases for lessees and lessors

SCOPE

This standards does not apply to

i. Lease for exploration or use of natural resources like oil, Gas, Timber, metal & other mineral rights.
ii. Lease/ license for items like motion picture films, video recordings, plays, manuscripts, patents, copyrights and
iii. Lease for use of land.

It also does not apply to services which do not transfer the right to use the asset.

LEASES

A lease is an agreement whereby the Lessor [owner] conveys to the lessee [user] in return for a payment or series of payments the right to use an asset for an agreed period of time.

FAIR VALUE *is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction*
[Fair Value = Cash Sale Price]

Lease Term = 40 Years for Rs. 20 Crores

LEASE TERM is the non-cancellable period for which the lessee has agreed to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

Useful life of a leased asset is either:

I. The period over which the leased asset is been used by the lessee; or
II. Number of production or similar units is expected to be obtained from the use of the asset by the lessee.

Some Important concepts

Anand

i. Lease rental received
ii. Guaranteed residual value by the lessee or related to lessee or
iii. Any residual value guaranteed to the lessor by an independent party

Mr. Anand as LESSOR

Ms. Champa as LESSEE

Champa is paying

i. Lease rental paid
ii. Any residual value guaranteed by or on behalf of the lessee

Reimbursement of various expenses [Not a part of MLP]

FOR LESSOR

Minimum lease payment [MLP] = Lease Rent + Guaranteed Residual value by Lessee & Independent third party + Option price

FOR LESSEE

Minimum Lease Payment (MLP) = Lease Rental over the Lease Term + Guaranteed Residual value or option price by Lessee

FOR LESSOR

MINIMUM LEASE PAYMENTS

are the payments over the lease term that the lessee is required to make excluding contingent rent, costs for services and taxes to be paid by and reimbursement to the Lessor , together with :

a) In the case of the lessor, any residual value guaranteed to the lessor :

b) by or on behalf of the lessee; or

c) By an independent third party financially capable of meeting the guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercised, the minimum lease agreements comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

FOR LESSEE

MINIMUM LEASE PAYMENTS

are the payments over the lease term that the lessee is required to make excluding contingent rent, costs for services and taxes to be paid by and reimbursement to the Lessor , together with :

a) In the case of the lessee, any residual value guaranteed by or on behalf of the lessee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercised, the minimum lease agreements comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

GROSS INVESTMENT IN THE LEASE is aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accusing to the lessor.

Gross Investment in the lease = Minimum lease payment + Unguaranteed residual value

Gross investment in the lease in case of lessee is NOT APPLICABLE

Unearned finance Income is the difference between-

a) The gross investment in the lease

b) The present value of

I. The minimum lease payments under a finance lease from the standpoint of the lessor; and

II. Any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease

Unearned finance income in case of lessee is NOT APPLICABLE

Unearned Finance Income = Gross Investment – Present Value of Gross [at implicit int. rate]

INTEREST RATE IMPLICIT IN THE LEASE [IRR]

is the discount rate that, at the inception of the lease, causes the aggregate present value of

a. The minimum lease payments under a finance lease from the standpoint of the lessor; and
b. Any unguaranteed residual value accruing to the lessor to be equal to the fair value of the leased asset.

It is IRR from lessor's point of view

Net Investment in the lease = Gross investment -Unearned finance Income.

= Gross Investment [Gross investment - present value (at implicit interest rate) of gross Investment]

=Present value [at implicit rate] of gross investment

RATE OF INTEREST

Is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

LEASES

FINANCE LEASE

A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership

SITUATIONS LEADING TO FINANCE LEASE

a) Ownership of the asset transferred to the lessee by the end of the lease term;
b) The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value.
c) The lease term is for the major part of the economic life of the asset.
d) At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fails value of the leased asset.
e) The leased asset is of a specialized nature such that only the lessee can use it. [eg. power, plant, boiler]

OPERATING LEASE

An operating lease is a lease other than a finance lease

SITUATIONS LEADING TO OPERATING LEASE

a) Similar to hiring arrangement
b) Leasing of general asset.
c) Lease may not be over a long period.
d) Ownership of the asset is not transferred.

INDICATIONS OF SITUATIONS LEADING TO FINANCE LEASE

Paragraph 9 of the standard describes certain situations, which individually or in combination may indicate that the concerned lease is a finance lease. These are:

a) If the lessee can cancel the lease and the losses associated with the cancellation are borne by the lessee;
b) If gains or losses from the fluctuations in the residual value accrue to the lessee [for example : if the lessor agrees to allow rent rebate equaling most of the disposal value of the leased asset at the end of the lease]; and
c) If the lessee can continue the lease for a secondary period at a rent, which is substantially lower than market rent.

NOTE:

Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 5 to 9 had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

JUST FOR INFORMATION

Examples based on situations leading to finance

a) **ASSET WAS SOLD AT AN INCEPTION OF THE LEASE**

Year 0	Year 1	Year 2	Year 3	Year 4
Value of an asset at year 0 = 10 Lakh	Lease rent = 75,000	Lease rent = 75,000	Lease rent = 75,000	SOLD = 9.75 Lakh

b)

Year 0	Year 1	Year 2	Year 3	Year 4
Value of an asset at year 0 = 10 Lakh	Lease rent = 75,000	Lease rent = 75,000	Lease rent = 75,000	Value of an asset = 5 Lakh

LESSEE HAS OPTION TO PURCHASE THE ASSET AT THE PRICE EXPECTED LOWER THAN THE FAIR VALUE c)

Lease term of the car is = 6 Years

At a fair value ₹ 3 crore

Useful life of the car is 7 years

CAR IS LEASED FOR THE MAJOR PART OF ITS ECONOMIC LIFE OF AN ASSET

d)

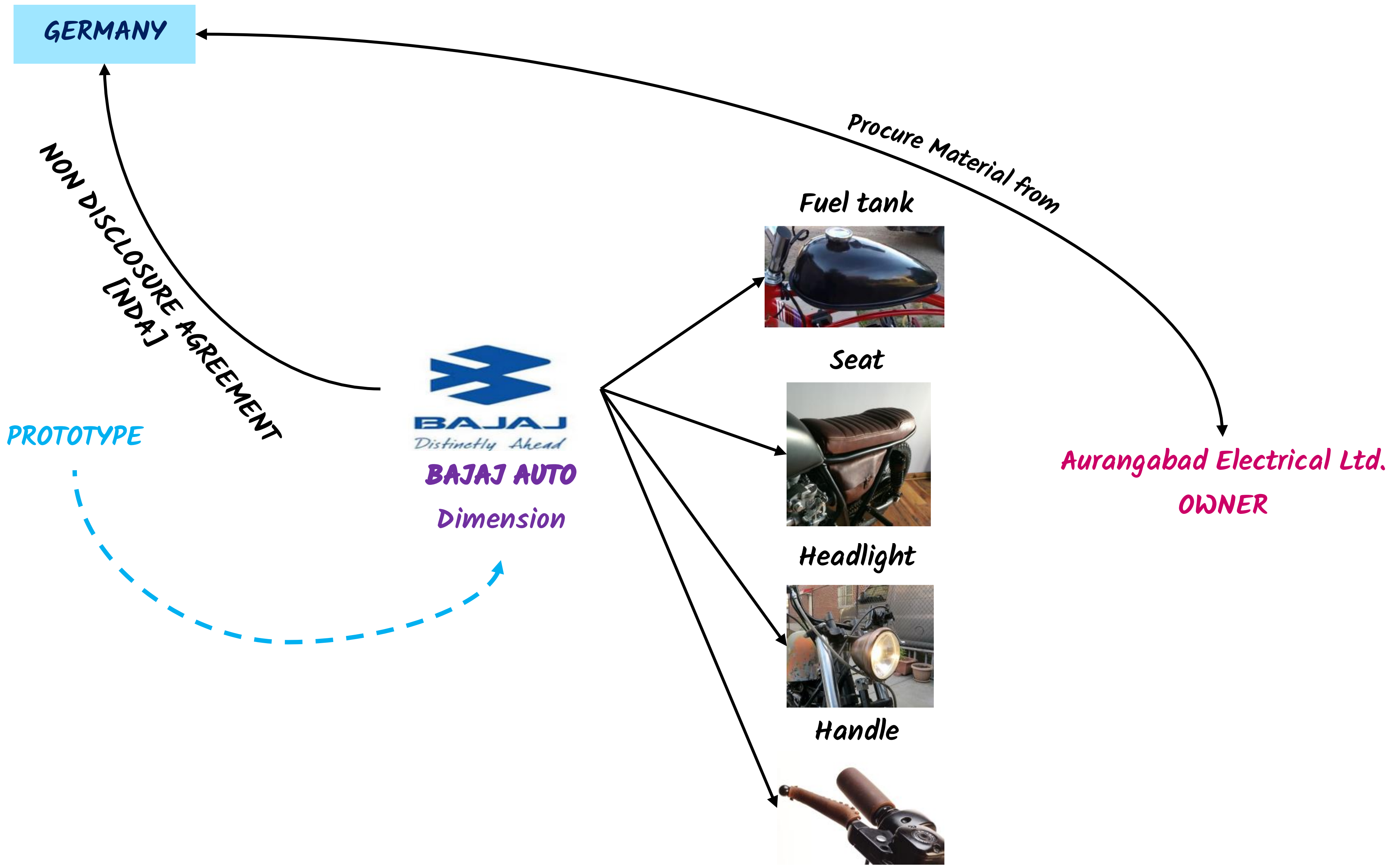
Year 0	Year 1	Year 2	Year 3	Year 4
Fair Value = 10 Lakh	Lease rent = 4 Lakh	Lease rent = 4 Lakh	Lease rent = 4 Lakh	PV of minimum lease payment = 9.9 Lakhs / 10 Lakhs

Total → 12 Lakhs

10 Lakh + Interest

Year	Cash Inflows	Discounting Factor @ 10%	Present Value
1	4,00,000	0.829	3,31,600
2	4,00,000	0.751	3,00,400
3	4,00,000	0.683	2,73,200
			9,05,200

e)


GERMANY
NON DISCLOSURE AGREEMENT [NDA]
Procure Material from
PROTOTYPE
BAJAJ
Distinctly Ahead
BAJAJ AUTO
Dimension
Fuel tank
Seat
Headlight
Handle
Aurangabad Electrical Ltd.
OWNER

ACCOUNTING TREATMENT

FINANCE LEASE

LESSOR

1. Lessee A/c To Asset A/c To Profit [Net Investment] [Some more complications can be there]	Dr.
2. No Entry [as asset is treated as sold]	
3. Lessee A/c To Interest A/c [Interest Due]	Dr.
4. Cash / Bank A/c To Lessee [Interest Paid]	Dr.
5. Interest A/c To Profit & Loss A/c [Interest rate = Implicit in the lease]	Dr.

LESSEE

1. Asset A/c To Lessor A/c [Fair value or present value of minimum lease payment whichever is lower]	Dr.
2. Depreciation A/c To Asset A/c	Dr.
3. Interest A/c To Lessor [Interest Due]	Dr.
4. Lessor A/c To Cash / Bank A/c [Interest Paid]	Dr.
5. Profit/Loss A/c To Depreciation A/c To Interest A/c [Interest Rate = Interest rate implicit in lease, Incremental borrowing rate]	Dr.

OPERATING LEASE

LESSOR

1. Cash/ Bank A/c To Lease Rent [SLM / Systematic pattern of user's benefit)	Dr.
2. Depreciation A/c To Asset	Dr.

LESSEE

Lease Rent A/c To Cash/ Bank A/c [SLM / Systematic pattern of user's benefit]	Dr.

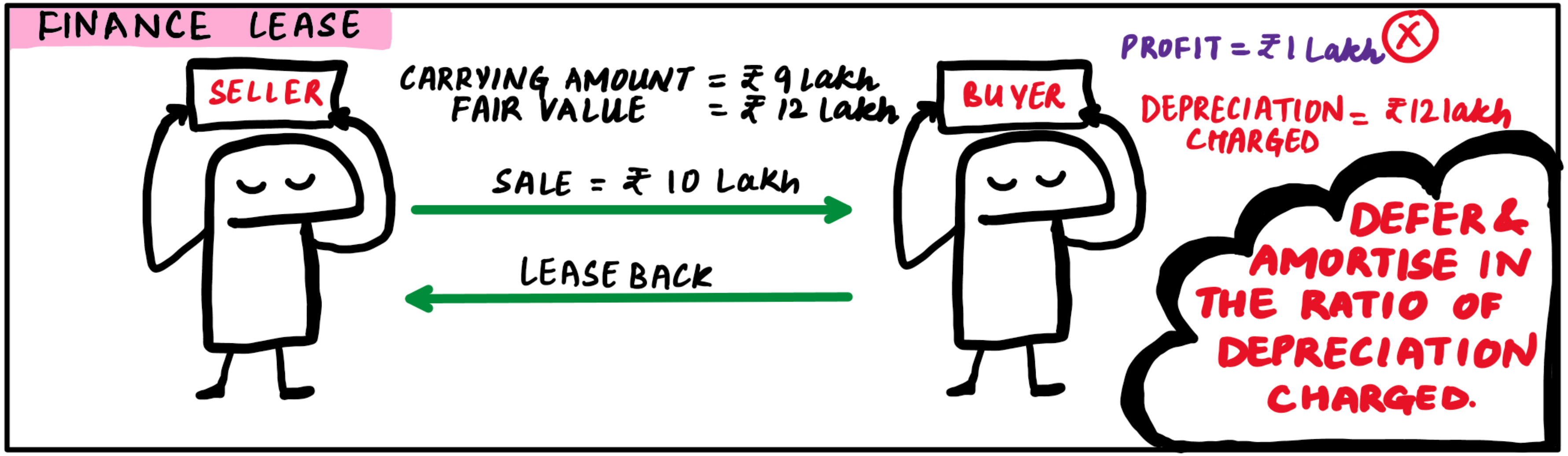
SALE AND LEASE BACK

Sale of an asset by vendor and leasing of the same asset back to vendor.

CASE 1 : Sale and Leaseback is a finance lease

If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortized over the lease term. Similarly, it is not appropriate to regard a deficiency as loss. Such deficiency is deferred and amortized over the lease term.

Defer and amortize any excess or deficiency **of sale proceeds over carrying amount of an asset over the lease term in proportion to depreciation of the leased asset.**



CASE 2 : Sale and Leaseback transactions results in an operating lease.

SITUATION 1: - SALE VALUE = FAIR VALUE

It is clear that the transaction is established at fair value, any profit or loss should be recognized immediately.

SITUATION 2: SALE VALUE > FAIR VALUE

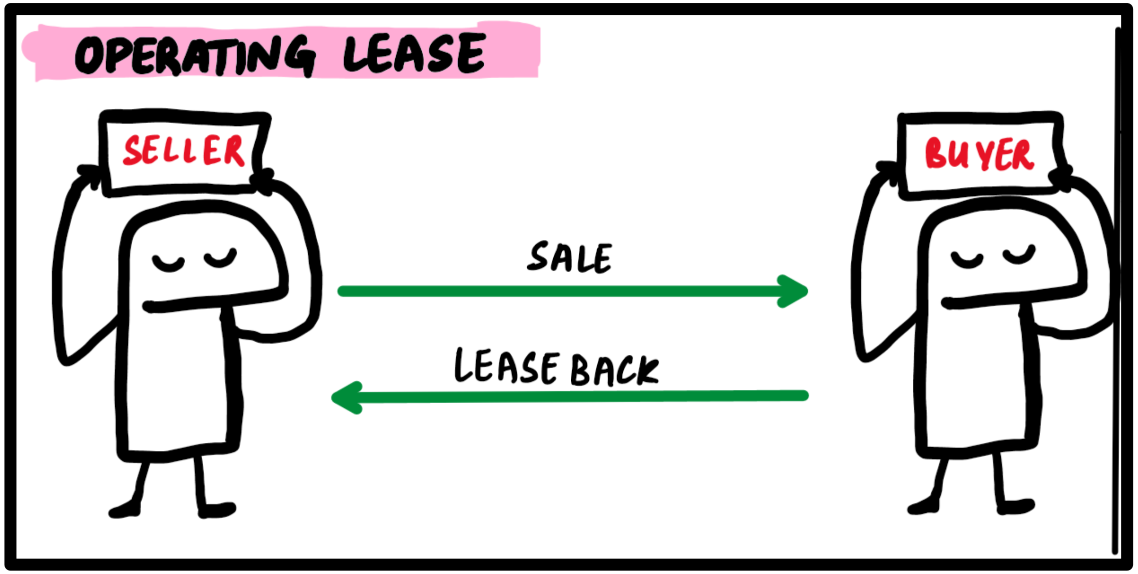
If the sale price is above fair value, the excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

SITUATION 3: SALE VALUE < FAIR VALUE

If the sale price is below fair values any profit or loss should be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

SPECIAL CASE →

For operating lease, if the fair value at the time of sale and leaseback transaction is less than the carrying amount of the asset, a loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the amount of the difference between the carrying amount and fair value be recognized immediately.



SITUATION	CARRYING AMOUNT	SALE VALUE [SV]	FAIR VALUE [FV]	PROFIT / LOSS
SV = FV	100	120	120	Recognise
SV > FV	100	120	115	Defer and amortise
SV < FV	100	100	130	Recognise

AS - 19

OBJECTIVE

To prescribe appropriate accounting treatment in relation to finance & operating lease in the books of lessor & lessee.

LEASE

A lease is an agreement whereby the lessor [owner]. Conveys to the lessee [user] in return for a payment or services of payments the right to use an asset for an agreed period of time.

FINANCE LEASE

A Finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

SITUATIONS

Ownership of the asset transferred to the lessee by the end of the lease term;

The lease has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value.

The lease term is for the major part of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

The leased asset is of a specialised nature such that only the lease can use it.

[e.g. Power, Plant, Boilen]

OPERATING LEASE

An operating lease is a lease other than a finance lease.

SITUATIONS

a) Similar to hiring arrangement.
b) Leasing of general asset.
c) Lease may not be over a long period.
d) Ownership of the asset is not transferred.

MINIMUM LEASE PAYMENTS

Anand

iv. Lease rental received

v. Guaranteed residual value by the lessee or related to lessee or

vi. Any residual value guaranteed to the lessor by an independent party

Champa is paying

iii. Lease rental paid

iv. Any residual value guaranteed by or on behalf of the lessee

Reimbursement of various expenses [Not a part of MLP]

FOR LESSOR

Minimum lease payment [MLP] = Lease Rent + Guaranteed Residual value by Lessee & Independent third party + Option price

FOR LESSEE

Minimum Lease Payment (MLP) = Lease Rental over the Lease Term + Guaranteed Residual value or option price by Lessee

SALE & LEASE BACK TRANSACTIONS

FINANCE LEASE

Defer any excess or deficiency of sale proceeds over carrying amount & amortise it over lease term in proportion of depreciation on leased asset.

OPERATING LEASE

Sale Price
Fair Value

Sale Price = Fair Value

- Recognise profit or loss immediately

Sale Price > Fair Value

- Defer excess over fair value & amortise it over a period for which asset is expected to be used

Sale Price < Fair Value

- If loss is compensated by future lease payments at below market price then defer it & amortise in proportion to lease payments over expected period of use
- Else, recognise it immediately

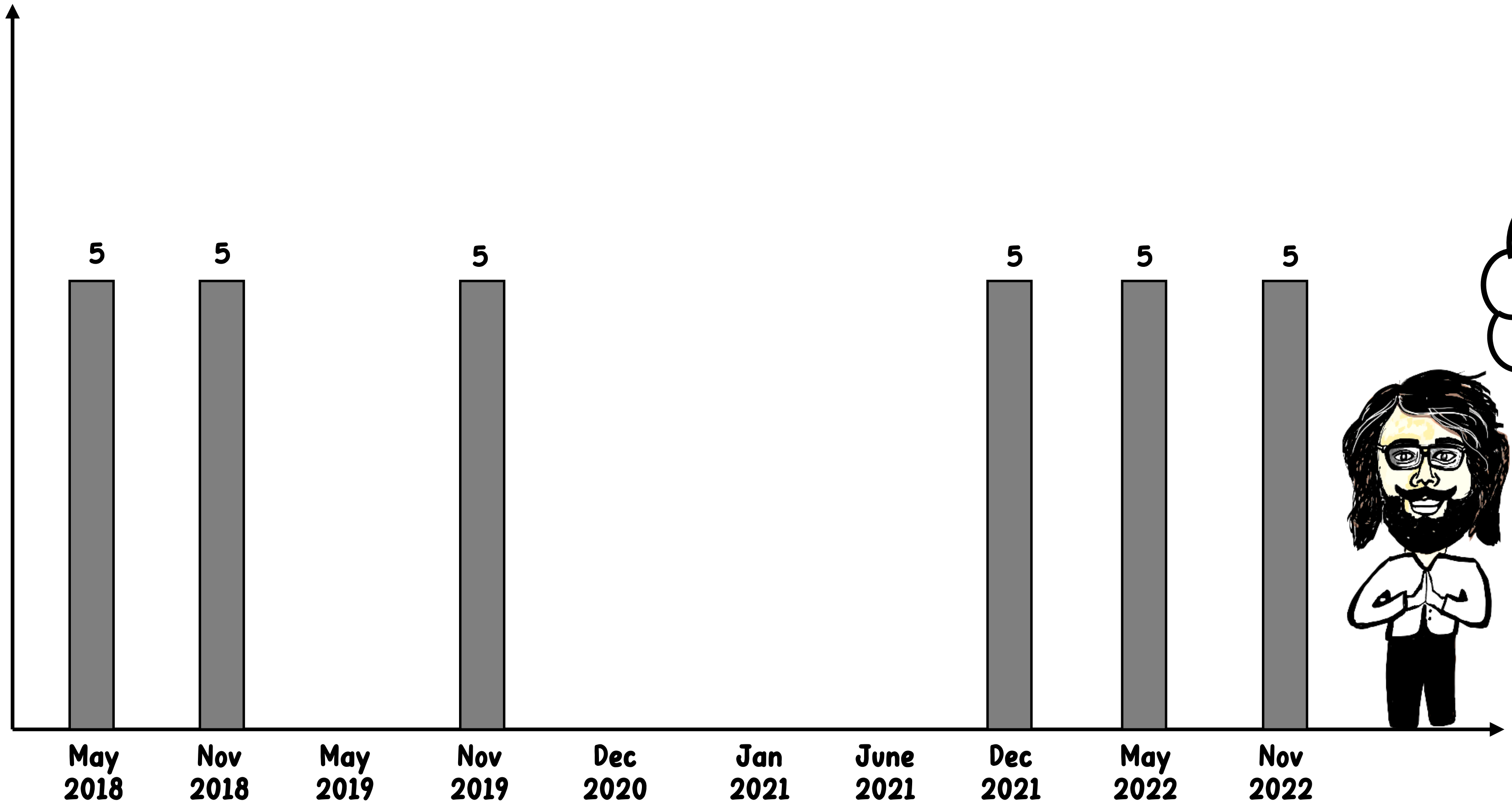
AS 20 - EARNING PER SHARE

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS	5	5		5				5	5	5



OBJECTIVE

- To prescribe principles for determination and presentation of Earning Per share [EPS] which will improve comparison of performance.
- The focus of statement is on denominator of the EPS

SCOPE

- Applicable to enterprises whose equity shares or potential equity shares are listed on a recognized stock exchange in India
- Applicable to enterprise which has equity shares which are not listed but discloses EPS
- In consolidated financial statements, the information by this statement should be presented on the basis of consolidated information

(₹ in crore)

	2021-22	2020-21
33. Earnings Per Share (EPS)		
Face Value per Equity Share (₹)	10	10
Basic Earnings per Share (₹) - After Exceptional Item	59.24	49.66
Basic Earnings per Share (₹) - Before Exceptional Item	59.24	42.97
Net Profit after Tax as per Statement of Profit and Loss attributable to Equity Shareholders (₹ in crore) - After Exceptional Item	39,084	31,944
Net Profit after Tax as per Statement of Profit and Loss attributable to Equity Shareholders (₹ in crore) - Before Exceptional Item	39,084	27,640
Weighted Average number of Equity Shares used as denominator for calculating Basic EPS	6,59,81,11,978	6,43,28,74,848
Diluted Earnings per Share (₹) - After Exceptional Item	58.49	48.90
Diluted Earnings per Share (₹) - Before Exceptional Item	58.49	42.31
Net Profit after Tax as per Statement of Profit and Loss attributable to Equity Shareholders (₹ in crore) - After Exceptional Item	39,084	31,944
Net Profit after Tax as per Statement of Profit and Loss attributable to Equity Shareholders (₹ in crore) - Before Exceptional Item	39,084	27,640
Weighted Average number of Equity Shares used as denominator for calculating Diluted EPS	6,68,16,52,444	6,53,21,38,901
Reconciliation of Weighted Average Number of Shares Outstanding		
Weighted Average number of Equity Shares used as denominator for calculating Basic EPS ^	6,59,81,11,978	6,43,28,74,848
Total Weighted Average Potential Equity Shares *	8,35,40,466	9,92,64,053
Weighted Average number of Equity Shares used as denominator for calculating Diluted EPS	6,68,16,52,444	6,53,21,38,901

* Dilutive impact of Employee Stock Option Scheme and Partly paid Rights Issue Shares
^ Refer Note 14.9

SOURCE – RELIANCE INDUSTRIES LIMITED

PRESENTATION

- This statement requires an enterprise to present basic and diluted earnings per share on the face of statement of profit or loss of each class of equity share.
- Negative basic and diluted EPS are also to be presented.
- Basic and diluted EPS should be presented with equal prominence

Examples		
Example 1	**Example 2**	**Example 3**
M Ltd., a listed company, has not disclosed Basic/Diluted Earnings Per Share on the face of its Profit and Loss Account as it has incurred a loss during the year. Comment on this practice followed by the company.	M Ltd., a listed company, has disclosed only Basic Earnings Per Share on the face of its Profit and Loss Account. Comment on this practice followed by the company.	M Ltd. a listed company, has disclosed Basic and Diluted Earnings Per Share in the notes to the Account. Comment on this practice followed by the company
The practice followed by the company is not in line with AS 20.		

DISCLOSURE OF EPS IN THE BOOKS OF TATA MOTORS

XVIII.	**Earnings/(loss) per share (EPS)**						
	Earnings/(loss) per share from continuing operations (EPS)						
	(a) Ordinary shares (face value of ₹2 each)						
	(i) Basic EPS	₹	**1.07**	(1.66)	0.42	**(4.54)**	(6.31)
	(ii) Diluted EPS	₹	**1.07**	(1.66)	0.42	**(4.54)**	(6.31)
	(b) 'A' Ordinary shares (face value of ₹2 each)						
	(i) Basic EPS	₹	**1.17**	(1.66)	0.52	**(4.54)**	(6.31)
	(ii) Diluted EPS	₹	**1.17**	(1.66)	0.52	**(4.54)**	(6.31)
	Earnings/(loss) per share from discontinued operations (EPS)						
	(a) Ordinary shares (face value of ₹ 2 each) :						
	(i) Basic	₹	**-**	2.11	3.95	**0.90**	(0.28)
	(ii) Diluted	₹	**-**	2.10	3.95	**0.90**	(0.28)
	(b) 'A' Ordinary shares (face value of ₹ 2 each) :						
	(i) Basic	₹	**-**	2.21	3.95	**1.00**	(0.28)
	(ii) Diluted	₹	**-**	2.20	3.95	**1.00**	(0.28)
	Earnings/(loss) per share from continuing and discontinued operations (EPS)						
	(a) Ordinary shares (face value of ₹ 2 each) :						
	(i) Basic	₹	**1.07**	0.45	4.37	**(3.63)**	(6.59)
	(ii) Diluted	₹	**1.07**	0.44	4.37	**(3.63)**	(6.59)
	(b) 'A' Ordinary shares (face value of ₹ 2 each) :						
	(i) Basic	₹	**1.17**	0.55	4.47	**(3.63)**	(6.59)
	(ii) Diluted	₹	**1.17**	0.54	4.47	**(3.63)**	(6.59)
			Not annualised				

SOURCE – TATA MOTORS LIMITED

BASIC EARNING PER SHARE

$$\textbf{BASIC EPS} = \frac{\text{NET PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS}}{\text{WEIGHTED AVERAGE NUMBER OF SHARES}}$$

Basic EPS should be calculated by dividing the net profit or loss for the period attributable to equity shareholders [i.e. after preference dividend and direct Tax] by the weighted average number of equity shares outstanding during the period.

NET PROFIT OR LOSS FOR THE PERIOD ATTRIBUTABLE TO THE EQUITY SHAREHOLDERS

PARTICULARS	₹
NET PROFIT OR LOSS FOR THE PERIOD	
LESS:-	
PREFERENCE DIVIDEND	
TAX ON PREFERENCE DIVIDEND	
NET PROFIT ATTRIBUTABLE TO THE EQUITY SHAREHOLDERS	

NET PROFIT

The net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividend and any attributable tax thereto for the period.

All items of income and expense which are recognized in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period unless an accounting standard requires or permits otherwise.

TREATMENT OF PREFERENCE DIVIDENDS

Amount of preference dividends deducted from net profit for the period.

- The amount of any preference dividends on non-cumulative preference shares provided for the period.
- The full amount of the required preference dividends for cumulative preference shares for the period, [whether or not the dividend have been provided for.]

Note: The amount of preference dividend for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

QUESTION 1:

Calculate Weighted Average Number of Equity Shares

Date	Particulars	No. of shares Issued	No. of shares bought back	No. of shares outstanding
01.04.14	Opening bal.	10,000		
30.06.14	Issue Cash	5,000		
01.01.15	Buy back	-	1,000	
31.03.15	Closing bal.	15,000	1,000	

SOLUTION:

Enduring Value

Statement of Profit and Loss for the year ended 31st March, 2022

		Note	For the year ended 31st March, 2022 (₹ in Crores)	For the year ended 31st March, 2021 (₹ in Crores)
I	Revenue From Operations	21A, 21B	59745.56	48524.56
II	Other Income	22	2589.97	3250.99
III	**Total Income (I+II)**		**62335.53**	**51775.55**
IV	**EXPENSES**			
	Cost of materials consumed		16064.50	13605.07
	Purchases of Stock-in-Trade		10734.48	6896.41
	Changes in inventories of finished goods, Stock-in-Trade, work-in-progress and intermediates		(566.46)	(526.86)
	Excise duty		3404.29	3039.43
	Employee benefits expense	23	3061.99	2820.95
	Finance costs	24	41.95	47.47
	Depreciation and amortization expense		1652.15	1561.83
	Other expenses	25	8113.10	7167.06
	Total expenses (IV)		**42506.00**	**34611.36**
V	**Profit before exceptional items and tax (III-IV)**		**19829.53**	**17164.19**
VI	Exceptional Items		–	–
VII	**Profit before tax (V+VI)**		**19829.53**	**17164.19**
VIII	**Tax expense:**			
	Current Tax	26	4833.88	4035.36
	Deferred Tax	26	(62.18)	97.15
IX	**Profit for the year (VII-VIII)**		**15057.83**	**13031.68**
	Other Comprehensive Income			
	A (i) Items that will not be reclassified to profit or loss:			
	– Remeasurements of the defined benefit plans	27(v)	31.62	(30.10)
	– Equity instruments through other comprehensive income		545.25	252.00
	– Effective portion of gains/(losses) on designated portion of hedging instruments in a cash flow hedge		(11.90)	(6.64)
	(ii) Income tax relating to items that will not be reclassified to profit or loss	26	(4.96)	0.49
	B (i) Items that will be reclassified to profit or loss:			
	– Debt instruments through other comprehensive income		3.71	–
	– Effective portion of gains/(losses) on designated portion of hedging instruments in a cash flow hedge		14.78	40.76
	(ii) Income tax relating to items that will be reclassified to profit or loss	26	(4.65)	(10.26)
X	**Other Comprehensive Income [A (i-ii)+B (i-ii)]**		**573.85**	**246.25**
XI	**Total Comprehensive Income for the year (IX+X)**		**15631.68**	**13277.93**
XII	Earnings per equity share (Face Value ₹ 1.00 each):	27(i)		
	(1) Basic (in ₹)		12.22	10.59
	(2) Diluted (in ₹)		12.22	10.59

The accompanying notes 1 to 30 are an integral part of the Financial Statements.

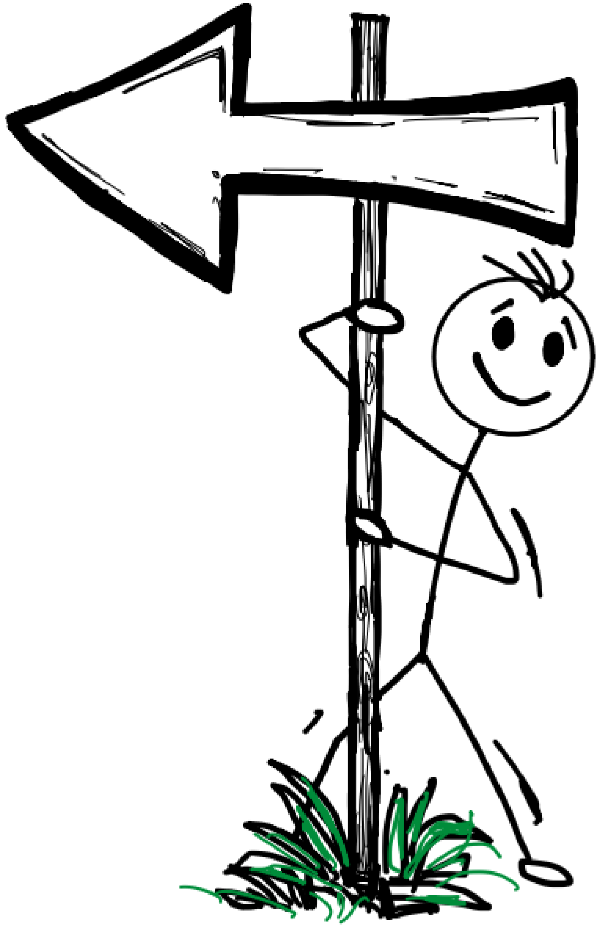
In terms of our report attached
For S R B C & CO LLP
Chartered Accountants
Firm Registration Number: 324982E/E300003
Sudhir Soni
Partner

Mumbai, May 18, 2022

On behalf of the Board

S. PURI *Chairman & Managing Director*
R. TANDON *Director*
S. DUTTA *Chief Financial Officer*
R. K. SINGHI *Company Secretary*

Kolkata, May 18, 2022



SOURCE – ITC LIMITED

PARTLY PAID EQUITY SHARES

Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period.

MORE THAN ONE CLASS OF EQUITY SHARES

If an enterprise has more than one class of Equity shares , net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights where an enterprise has equity share of different nominal values but with same dividend rights , the number of equity shares are calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

QUESTION 2: Calculate Weighted Average Number of Equity Shares- Partly Paid Shares

Date	Particulars	No. of shares Issued	Face value per share	Paid up value per share
01.04.14	Opening balance	10,000	Rs. 10	Rs. 10
30.06.14	Issue cash	5,000	Rs.10	Rs. 5

SOLUTION:

QUESTION 3:

The equity share are of two types:

A. Voting equity shares 3000 shares of Rs 100 each;

B. Non-voting equity shares 2000 shares of Rs100 each entitled for dividend at 50% more than on 'A' type share.

Net profit attributable to equity shareholders- Rs. 1,40,000.

Calculate EPS for both classes of shares.

SOLUTION:

DATE FROM WHICH THESE EQUITY SHARES ARE INCLUDED IN THE WEIGHTED AVERAGE

In most cases the shares are included in the weighted average no. of equity shares from the date the consideration is receivable.

No	Issue of equity shares	Date from which these equity shares are included in the weighted average
1.	Equity shares issued in exchange for cash	When cash is receivable
2.	Equity shares issued as a result of conversion of debt into equity shares	As of the date of conversion
3.	Equity shares issued in lieu of interest or principal on other financial instruments	As of the date interest ceases to accrue.
4.	Equity shares issued in exchange for the settlement of liability of the enterprise	As of the date the settlement becomes effective
5.	Equity shares issued as consideration for the acquisition of an asset other than cash	As of the date on which the acquisition is recognized
6.	Equity shares issued for rendering services to the enterprise.	As the date the services are rendered
7.	Equity shares issued as part of the consideration in an amalgamation in the nature of purchase	As of the date of the acquisition
8.	Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger.	From the beginning of the reporting period. *
9.	Contingently issuable equity shares	From the date on which the necessary conditions under the contract have been satisfied, whether shares have been issued or not.

* This is because the financial statements of the combined enterprise for the reporting period are prepared as if the combined entity had existed from the beginning of the reporting period.

Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

QUESTION 4: Compute EPS from the given information relating to equity shares of A Ltd. and B Ltd. Two companies amalgamated w.e.f. 1.10.2023. A Ltd. issued the required no. of shares on the basis of the agreed valuation.

NO. OF OUTSTANDING EQUITY SHARES AS ON 1.4.2023	A Ltd.	B Ltd.
(NO. IN LAKHS)	500	200
Agreed value per share for acquisition	120	30
Date of acquisition 1.10.2023		
Profit after tax (Rs. in lakhs) of which	1200	350
Profit after tax of B Ltd. during 1.10.2023 – 31.3.2024 (Rs. in lakhs)		200

SOLUTION:

CHANGE IN NUMBER OF SHARES WITHOUT CHANGE IN RESOURCES

Examples:

- Bonus shares
- Bonus element in right issue
- Share split
- Reverse share split (In case of bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration.)

The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events , other than the conversion of potential equity shares, that have changed the number of equity shares outstanding, without a corresponding change in resources

QUESTION 5: Compute EPS: Bonus Shares

Net profit 2013-14	
Net profit 2014-15	
No. of equity shares till 31.12. 2014	
Bonus issue as on 1.1. 2015	
EPS 2013-14 (Restated)	
EPS 2014-15	

SOLUTION:

QUESTION 6

ABC Ltd. has 10,000 equity shares outstanding on 1-1-14. Find out the weighted average number of equity shares for the year 2014, for the purpose of calculation of Basic EPS in each of the following cases :

a. The company issued 2,000 equity shares for cash on 1-1-14
b. The company issued 2,000 equity shares for cash on 1-4-14
c. The company issued 2,000 equity shares for cash on 1-10-14
d. The company issued 2,000 equity shares for cash, 50% paid up, on 1-10-14
e. The company issued 2,000 equity shares as Bonus shares on 1-4-14
f. The company issued 2,000 equity shares for cash on 1-7-14 and 3,000 Bonus shares on 1-10-14.

SOLUTION:

Weighted Average Number of equity shares.

a) 10,000 + 2,000 = 12,000 shares

b) Weighted Average No. of equity shares = 10,000 + 2,000 x 9/12
= 11,500 shares

c) Weighted Average No. of equity shares = 10,000 + 2,000 x3/12
= 10,500

d) Weighted Average No. of equity shares = 10,000 + (2,000 x 50%) x 3/12
= 10,250 shares

e) Weighted Average No. of equity shares = 10,000 + 2,000
= 12,000 shares

f) Weighted Average No. of equity shares = 10,000 + 3,000 + 2,000 x 6/12
= 14,000 shares

QUESTION 7:

Find out the Basic EPS for the year 2014 from the following particulars :

Shares outstanding on 1-1-14	5,00,000
Issue of shares for cash on 1-7-14, fully paid up	1,70,000
Bonus shares on 1-4-14 in the ratio	1:2
Profit for the year	15,00,000

SOLUTION:

Particulars	Rs.
Profit for the year	15,00,000
No. of shares at the end of the year	
Shares as on 1.1.14	5,00,000
Bonus shares 5,00,000/2	2,50,000
Issue of shares for cash 1,70,000 x 6/12	85,000
	8,35,000

$$EPS = \frac{Profit\ for\ the\ year}{Weight\ Average\ No.of\ Shares\ outstanding}$$

$$EPS = \frac{15,00,000}{8,35,000}$$

$$EPS = 1.80$$

QUESTION 8:

Calculate Basic EPS for the year from the following information :

No. of Equity Shares in the beginning	6,00,000
12% Preference Share Capital in the beginning	15,00,000
10% Debentures	20,00,000
Fresh issue of shares at the end of 3rd month	1,20,000
Profit for the year (after tax)	21,00,000

SOLUTION:

Calculation of EPS

	Particulars		Rs.
A	Profit for the year (after tax)		
	Less : Preference dividend	15,00,000 x 12%	
	Profit available to equity shareholders		
B	No. of equity shares in the beginning		
	Add: Fresh issue of shares at the end of 3rd month	1,20,000 x 9/12	
C	EPS A/B		

QUESTION 9:

Calculate Basic EPS from the following :

Net Profit before tax for the year	Rs. 15,00,000
Number of shares outstanding on Jan. 1	1,00,000
10% Preference Share Capital	Rs. 5,00,000

Issue of Bonus Shares to Equity Shareholders on (Oct. 1)	50,000
Fresh issue of equity shares fully paid on Nov. 1	60,000
Buy-back of Equity shares on Dec. 1 (Number)	12,000
Tax rate	30%

Note: Calendar year has been adopted as financial year by the company.

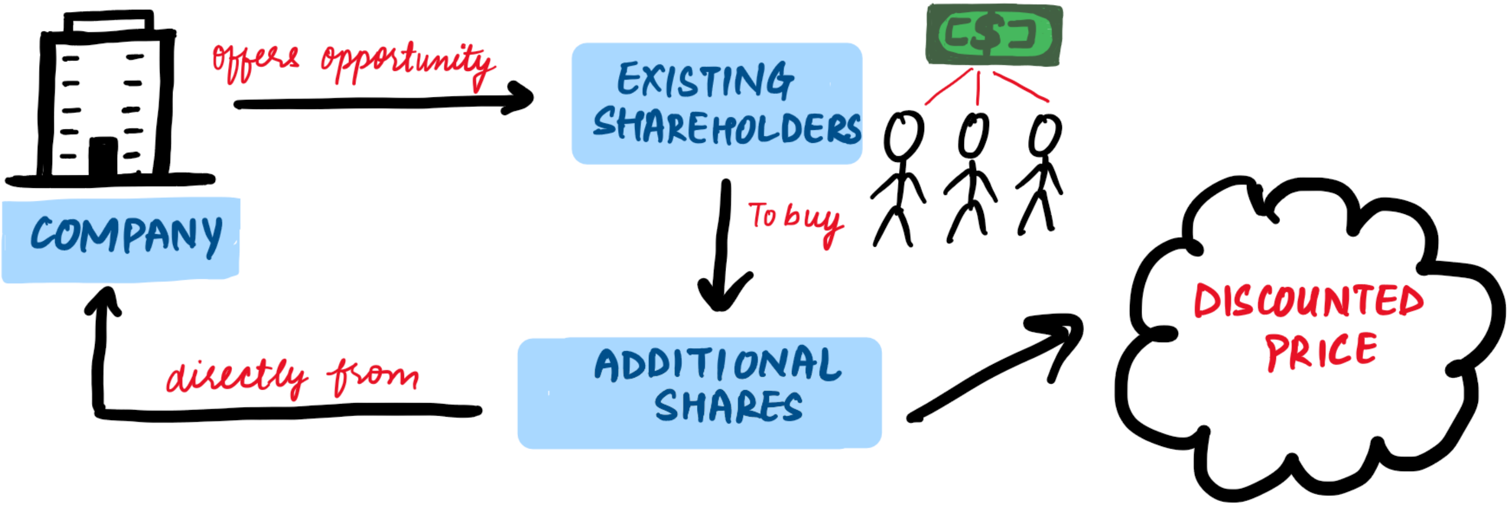
SOLUTION :

Calculation of EPS :

	Particulars	Rs.
A	Net profit before tax	
	Less : Tax @ 30%	
	Profit after tax	
	Less : Preference dividend	
	10% x 5,00,000	
	Profit available to equity shareholders	
B	No. of equity shares on 1st January	
	Issue of Bonus shares	
	Issue of equity shares 60,000 x 2/12	
	Less : Buy back of equity shares	
	12,000 x 1/12	
C	EPS A/B	

RIGHT SHARES [VERY IMP]

In case of right issue, the exercise price is often less than the fair value of the shares. A right issue usually includes a bonus element.



CALCULATION THEORETICAL EX-RIGHT FAIR VALUE PER SHARE:

$$\frac{\textit{Fair value of the shares prior to right} + \textit{amount received from exercise of right}}{\textit{No. of shares outstanding prior to right issue} + \textit{Share issued on exercise on right}}$$

CALCULATION OFADJUSTMENT FACTOR =

$$\frac{\textit{FAIR VALUE PER SHARE IMMEDIATELY PRIOR TO THE EXERCISE OF RIGHTS}}{\textit{THEORITICAL EX} - \textit{RIGHTS FAIR VALUE PER SHARE}}$$

- *Share restated for right issue*
  = No. of Equity Shares outstanding prior to issue X Adjustment Factor

QUESTION 10 :

PQR Ltd. has 5,00,000 shares outstanding in the beginning of the year. The fair value of the share was Rs. 45. It issued Right shares in the ratio of 2 : 5 @ Rs. 36 per shares midway during the year. Find out the Basic EPS for the year given that the company earned a net profit of Rs. 25,00,000 for the year.

SOLUTION :

$$Theoretical\ ex-right\ price\ =\ \frac{F.V.of\ existing\ shares\ +\ amount\ realized\ on\ right\ shares}{Total\ no\ of\ shares}$$

$$Theoretical\ ex-right\ price\ =\ \frac{5,00,000\ x\ 45\ +\ 2,00,000\ x\ 36}{5,00,000\ +\ 2,00,000}$$

$$Theoretical\ ex-right\ price\ =\ 42.43$$

$$Adjustment\ Factor\ =\ \frac{F.V.}{Theoretical\ ex-right\ price}$$

$$Adjustment\ Factor\ =\ \frac{45}{42.43}$$

$$Adjustment\ Factor\ =\ 1.06$$

$$Basic\ EPS\ =\ \frac{Net\ Profit}{Weighted\ average\ no\ of\ shares}$$

$$Basic\ EPS = \frac{25,00,000}{\left(5,00,000\ X\ 1.06\ X \frac{6}{12}\right) + \left(7,00,000\ X \frac{6}{12}\right)}$$

$$Basic\ EPS = \frac{25,00,000}{6,15,000}$$

$$Basic\ EPS = 4.06$$

QUESTION 11:

R Ltd. has 100,000 equity shares outstanding in the beginning of the year. After 3 months, it issued Right shares in the ratio of 1 : 5 @ Rs.20 per share. The fair value of shares before Right issue was Rs.30 per share. Net profit for the current year is Rs.18,00,000 and for the previous year was Rs.14,00,000. Find out the Basic EPS for the current year and restate Basic EPS for the previous year.

SOLUTION:

$$Theoretical\ ex - right\ price = \frac{F.V.\ of\ existing\ shares\ +\ amount\ realized\ on\ right\ shares}{Total\ no\ of\ shares}$$

$$Theoretical\ ex - right\ price = \frac{30\ X\ 1,00,000 + 20\ X\ 20,000}{1,00,000 + 20,000}$$

$$Theoretical\ ex - right\ price = \frac{34,00,000}{1,20,000}$$

$$Theoretical\ ex - right\ price = 28.33$$

$$Adjustment\ Factor = \frac{F.V.}{Theoretical\ ex - right\ price}$$

$$Adjustment\ Factor = \frac{30}{28.33}$$

$$Adjustment\ Factor = 1.06$$

$$Basic\ EPS = \frac{Net\ Profit}{Weighted\ average\ no\ of\ shares}$$

$$Basic\ EPS = \frac{18,00,000}{\left(1,00,000\ X\ 1.06\ X\ \frac{3}{12}\right) + \left(1,20,000\ X\ \frac{9}{12}\right)}$$

$$Basic\ EPS = \frac{18,00,000}{1,16,500}$$

$$Basic\ EPS = 15.45$$

$$Previous\ Year\ Basic\ EPS = \frac{14,00,000}{1,00,000\ X\ 1.06}$$

$$Previous\ Year\ Basic\ EPS = 13.21$$

DETERMINATION OF DILUTIVE AND ANTI-DILUTIVE POTENTIAL EQUITY SHARES

In considering whether potential equity shares are dilutive or antidilutive, each issue or series of potential equity shares is **considered separately** rather than in aggregate.

The **sequence** in which potential equity shares are considered **may affect** whether or not they are dilutive.

In order to maximise the dilution of basic earnings per share, each issue of potential equity shares is considered in sequence from the most dilutive to the least dilutive.

- For the purpose of determining the sequence from most dilutive to least dilutive potential equity shares, the earnings per incremental share is the least, the potential equity share is calculated.
- Where the earnings per incremental share is **the least,** the potential equity share is considered **most dilutive** and vice-versa.

EARNINGS – DILUTED

For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders should be adjusted for following :

a) Any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders.
b) Interest recognized in the period for the dilutive potential equity shares ; and
c) Adjust for the after tax amount of any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

INSTANCES OF POTENTIAL EQUITY SHARES

Conversion of debentures into equity shares → Conversion of preference shares into equity shares → Conversion of term loan into equity shares

NO. OF EQUITY SHARES FOR DILUTED EPS CALCULATION

For the purpose of calculating diluted earnings per share, the no. of equity shares should be:

Aggregate of the weighted average number of equity shares calculated as for Basic EPS

Refer Basic EPS at Page – AS 20.5

+

Weighted average number of equity shares which would be issued on the conversion of **ALL the dilutive potential equity shares into equity shares** (determined from the terms of the potential equity shares)

↓

Dilutive potential equity shares should be **deemed to have been converted** into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares

↓

The computation assumes the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential equity shares.

QUESTION 12 : Convertible Debentures – Diluted / Ant diluted EPS

S.NO.	PARTICULARS	SITUATION 1	SITUATION 2
A	Net profit for 2014-15 (Rs) No. of equity shares outstanding	7,50,000 1,50,000	7,50,000 1,50,000
B	Basic EPS		
C	No. of 10% convertible debentures of Rs.100 each		
D	Conversion ratio		
E	No. of equity shares on conversion		
F	Interest expenses (Rs.)		
G	Income Tax relating to interest @ 35% (Rs)		
H	Adjusted net profit for the year (Rs).		
I	Total No. of equity Shares		
J	Revised EPS (Rs)		
K	Effect		
L	Reported EPS 2014 - 15 Basic EPS Diluted EPS (Rs)		

QUESTION 13:

Vidya Ltd. provides the following information for the year :

No. of shares outstanding 5,00,000

Net Profit for the year (after tax) Rs. 11,00,000

The company had 1,00,000 15% Debentures of Rs. 100 each. These debentures are compulsorily convertible into 4 equity shares per debenture. Find out the Basic EPS and Diluted EPS given that the tax rate is 35%.

SOLUTION:

$$Basic\ EPS = \frac{Net\ Profit}{Weighted\ average\ no\ of\ shares}$$

$$Basic\ EPS = \frac{11,00,000}{5,00,000}$$

$$Basic\ EPS = 2.2$$

Calculation of Diluted EPS

Saving in debenture interest	= (1,00,000 x 100) x 15%
	= 15,00,000
Loss of Tax shield on interest	= 15,00,000 x 35%
	= 5,25,000
Effective profit	= 11,00,000 + 15,00,000 – 5,25,000
	= 20,75,000

$$Diluted\ EPS = \frac{20,75,000}{5,00,000 + (1,00,000\ X\ 4)}$$

$$Basic\ EPS = 2.31$$

In the given problem the potential equity shares are anti-dilutive as the diluted EPS i.e. 2.31 is more than the basic EPS i.e. Rs. 2.20. The company should not disclose anti-dilutive EPS. Therefore, Company will disclose 2.20 as basic as well as diluted EPS.

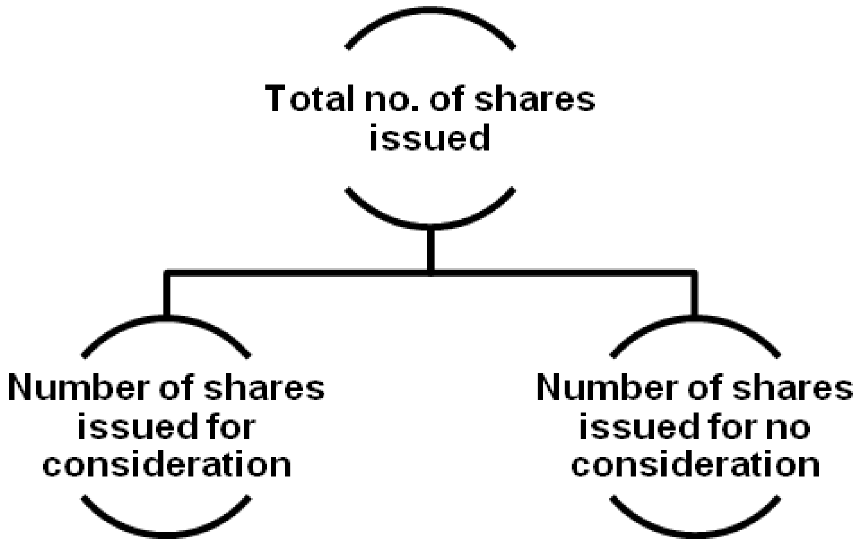
EFFECT OF SHARE OPTION ON DILUTED EPS

For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise.

The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value.

Number of shares issued for consideration $= \frac{Expected\ \ issue\ proceeds}{Fair\ value\ \ per\ share}$

The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.



QUESTION 14:

Vidya Ltd. has given option to its employees to subscribe 1,00,000 Equity Shares @ Rs. 15 within a period of one year. At present, the fair value of the share is Rs. 25. The company has 5,00,000 Equity Shares outstanding and the net profit for the current year is Rs. 16,00,000. Find out the Basic EPS and the Diluted EPS for the year.

SOLUTION: BASIC EPS

	Rs
Net Profit	
Weighted average no of shares	
EPS	

Calculation of diluted EPS

No of shares issued without consideration

A	No. of shares to be issued under option	1,00,000
B	No. of shares that would have been issued at FV 1,00,000x15/25	60,000
C	Shares issued without consideration	40,000

$$\textbf{Diluted EPS} = \frac{16{,}00{,}000}{5{,}40{,}000}$$

$$\textbf{Diluted EPS} = 2.96$$

OPTIONS

Each dilutive option and other share purchase arrangement is treated as consisting of:

A contract to issue a certain number of equity shares at their average fair value during the period. These shares to be issued at average fair value are neither dilutive nor anti-dilutive and are ignored in the computation of diluted earnings per share;

and

A contract to issue the remaining equity shares for no consideration. Such equity shares generate no proceeds and have no effect on the net profit attributable to equity shares outstanding are dilutive and are added to the number of equity shares outstanding in the computation of diluted earnings per share.

DILUTED EPS IN CASE OF SHARE OPTIONS

Options and other share purchase arrangements are dilutive when they would result in the issue of equity shares for less than fair value.

The amount of the dilution is fair value less the issue price.

To calculate diluted earnings per share, each such arrangement is treated as consisting of:

A contract to issue a certain number of equity shares at their **average fair value** during the period.

↓

The shares to be so issued are fairly priced

↓

They are assumed to be neither dilutive nor anti-dilutive

↓

They are ignored in the computation of diluted earnings per share

A contract to issue the remaining equity shares **for no consideration.**

↓

These Equity shares generate no proceeds and have no effect on the net profit attributable to equity shares outstanding

↓

shares are considered as **dilutive**

↓

They are added to the number of equity shares outstanding in the computation of diluted earnings per share

Note: To the extent that partly paid shares are not entitled to participate in dividends during the reporting period they are considered the equivalent of warrants or options.

QUESTION 15:

XYZ Ltd. has 10,00,000 Equity Shares outstanding and the net profit attributable to these shares is Rs. 35,00,000. The average fair value of the share during the year is Rs. 75. The company had issued the following potential equity shares :

a. 1,00,000 10% Preference Shares of Rs. 100 each to be converted into 2 Equity Shares.
b. Options to subscribe 2,50,000 Equity shares at Rs. 60 each
c. 2,00,000 12% Convertible Debentures of Rs. 100 each to be converted into 3 shares.

Find out the Basic EPS and Diluted EPS given that the Corporate Dividend Tax is 10% and the income tax applicable to the company is 30%.

(RTP MAY 2013)

SOLUTION:

Increase in earnings available to equity share holders on conversion of Potential Equity Shares.

Particulars	Increase in Earnings	Increase in No. of Equity shares	EPS incremental	Rank
10% Preference shares (1,00,000 x 100) x 10% + 10,00,000 x 10%				
Options [2,50,000 – (2,50,000 x 60/75)]				
12% Convertible Debentures [(2,00,000 x 100) x 12%] – 30%				

Calculation of Diluted EPS

Particulars	Net profit	No. of Equity shares	EPS (Rs.)	Remarks
Net Profit as Reported				
Option				
12% Convertible Debentures				
10% Pref. shares				

QUESTION 16:

From the Books of A Ltd., following information's are available as on 1.4.2001 and 1.4.2002 :

1. Equity shares of Rs. 10 each outstanding 1,00,000
2. Partly paid Equity shares of Rs. 10 each Rs. 5 paid 1,00,000
3. Options outstanding at an exercise price of Rs. 60 for one equity Shares Rs. 10 each. Average Fair value of equity share during both Years Rs. 75. - 10,000
4. 10% convertible preference shares of Rs. 100 each Conversion ratio 2 equity shares for each preference share - 80,000
5. 12% convertible debentures of Rs. 100 conversion ratio 4 equity shares for each debenture - 10,000
6. 10% dividend tax is payable for the years ending 31.3.2003 and years ending 31.3.2002.
7. On 1.10.2002 the partly paid shares were fully paid up.
8. On 1.1.2003 the company issued 1 bonus share for 8 shares held on that date.

Net profit attributable to the equity shareholders for the years ending 31/3/2003 and 31/3/2002 were Rs. 10,00,000.

Calculate :

a. Earnings per share years ending 31.3.2003 and 31.3.2002.
b. Diluted earnings per share years ending 31/3/2003 and 31/3/2002.
c. Adjusted earnings per share and diluted EPS for the year ending 31/3/2002, assuming the same information for previous year, also assume that partly paid shares are eligible for proportionate dividend only.
d. Tax Rate = 30%

SOLUTION:

Calculation of Basic EPS for the year ended 31.3.2002 **Rs.**

A. Net profit

B. Weighted Avg. no. of shares (1,00,000 + 1,00,000 x 5/10)

C. Basic EPS

Calculation of Basic EPS for the year ended 31.3.03 **Rs.**

A. Net profit for the year

Weighted Avg. no. of shares

1,00,000 + [1,00,000 x 5/10 x 6/12 + 1,00,000 x 6/12 + 1/8 x 2,00,000]

Basic EPS

Diluted EPS

Increase in earnings attributable to equity shareholders on conversion of Potential Equity Shares.

	Increase in Earning	Increase in No. of Equity shares	EPS (Incremental)	Rank
Option				
10% convertible preference shares				
12% Convertible Debenture				

Calculation of Diluted EPS

Particulars	Net profit attributable to equity shares	Year ending 31.3.2003		Year ending 31.3.02	
		No. of shares	Net profit per share	No. of shares	Net profit per share
Net Profit as reportable					
Option					
12% Debentures					
10% Pref. shares					

Diluted EPS for year ending 31.3.2003 =

Diluted EPS for year ending 31.3.2002 =

Restated Basic EPS Rs.

a) Net Profit

b) No. of shares [1,50,000 + 25,000 (Bonus shares)]

Re-stated Basic EPS

Re-stated diluted EPS for the year ending 31.3.2002

Particulars	Net Profit Attributable to Equity share holder	No. of shares	EPS Rs.
Net Profit as Reported			
Option			
12% Convertible Debenture			
10% Preference shares			

Diluted EPS (Restated) for the year ending 31.3.2002 = Rs.

RESTATEMENT

If the number of equity or potential equity shares outstanding

Increases as a result of a bonus issue or share split

OR

Decreases as a result of a reverse share split (consolidation of shares)

The calculation of basic and diluted earnings per share should be adjusted for all the periods presented.

If these changes **occur after the balance sheet** date **but before** the date on which the financial statements are **approved by the board of directors**

The per share calculations for those financial statements and any prior period financial statements presented **should be based on the new number of shares.**

An enterprise is encouraged to provide **a description of equity share transactions or potential equity share transactions,** other than bonus issues, share splits and reverse share splits (consolidation of shares) **which occur after the balance sheet date** when they are of such importance that **non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.**

EXAMPLES OF SUCH TRANSACTIONS INCLUDE:

(a) the issue of shares for cash;

(b) the issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;

(c) the cancellation of equity shares outstanding at the balance sheet date;

(d) the conversion or exercise of potential equity shares, outstanding at the balance sheet date, into equity shares;

(e) the issue of warrants, options or convertible securities; and

(f) the satisfaction of conditions that would result in the issue of contingently issuable shares.

Note: Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements. Although they may be of such significance that they **may require a disclosure** in the **report of the approving authority** to enable users of financial statements to make proper evaluations and decisions.

DISCLOSURES

1. The amounts used as the numerators in calculating basic and diluted EPS, and a reconciliation of those amounts to the net profit or loss for the period;
2. The weighted average number of equity shares sued as the denominator in calculating basic and diluted EPS and a reconciliation of these denominators to each other; and
3. The nominal value of shares along with the EPS figures.

Note: If a component of net profit is used which is not reported as a line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss. **Basic and Diluted EPS amounts should be disclosed with equal prominence.**

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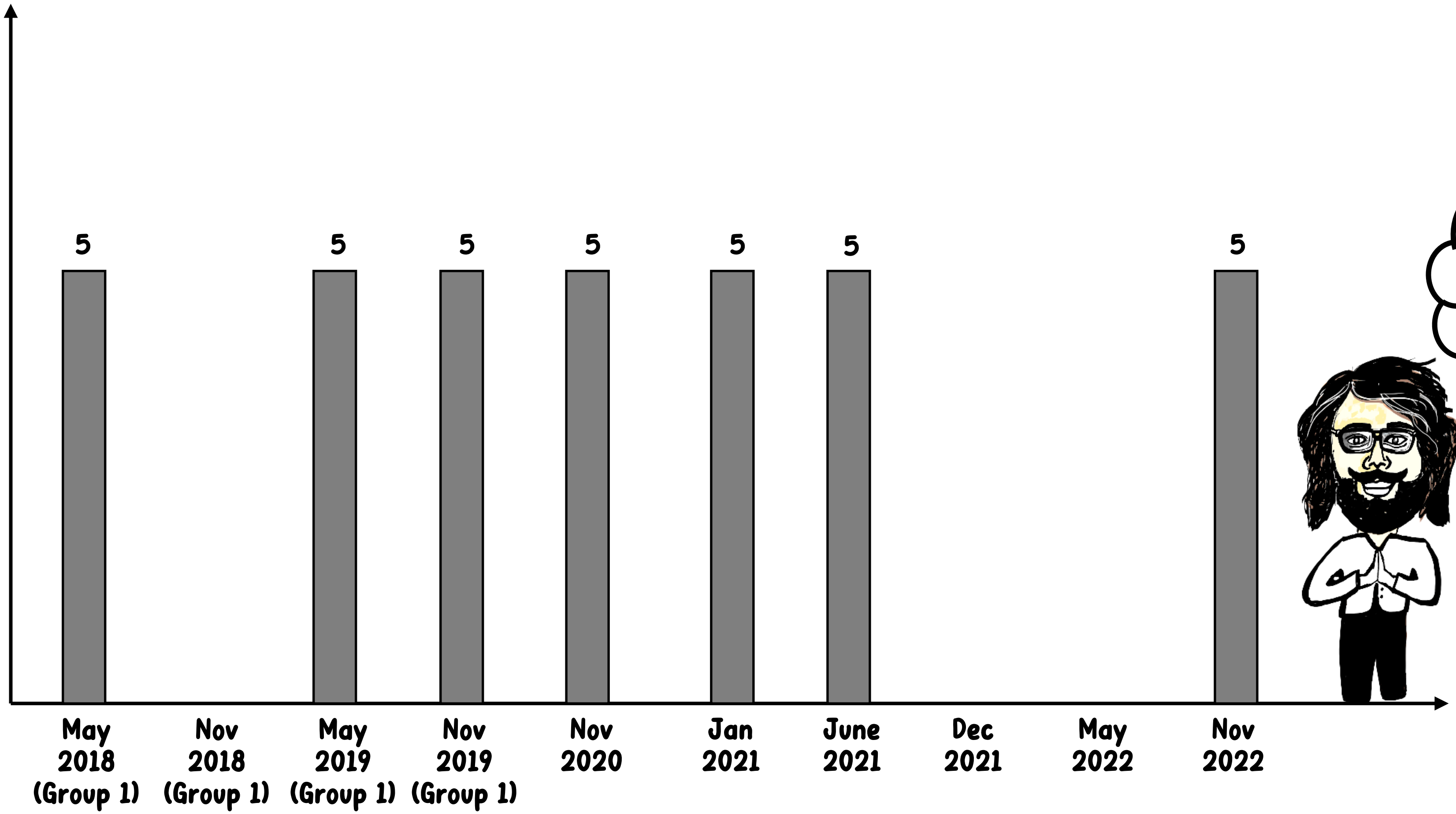
AS 22 - ACCOUNTING FOR TAXES ON INCOME

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018 (Group 1)	Nov 2018 (Group 1)	May 2019 (Group 1)	Nov 2019 (Group 1)	Nov 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS	5		5	5	5	5	5	5		5



WHY AS 22 ?

1. **MATCHING CONCEPT : -**

In accordance with matching concept, taxes on incomes are accrued in the same period as the revenue and expenses to which they relate.

2. **ACCRUAL CONCEPT: -**

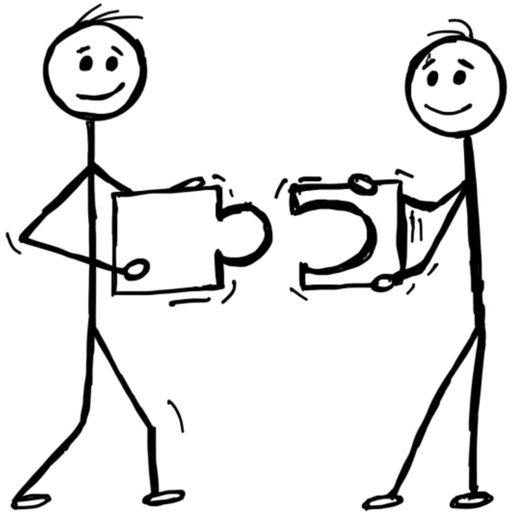
Taxes should be accounted on accrual basis and not on payment basis. This statement requires recognition of deferred tax for all the timing difference. This is based on the principles that the financial statements for a period should recognize the tax effect, whether current or deferred, of all the transactions occurring in that period [Thus accrual concept is to be applied for tax expense also.]

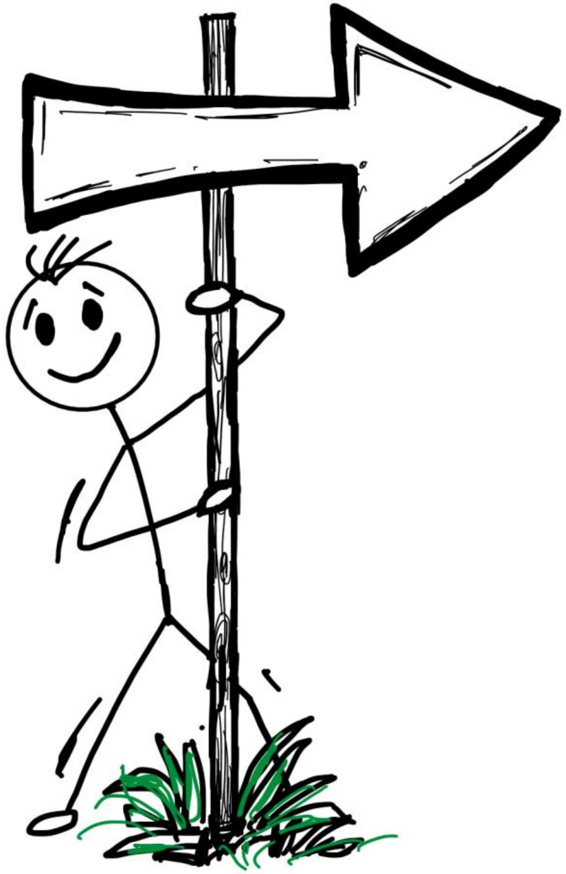
3. **CONCEPT OF PRUDENCE : -**

Concept of Prudence requires that any foreseeable future liability be provided for in current year by a charge against profit. such provisioning retains fund in business to meet the liability in future by restricting current dividend

SCOPE

- This standard should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.
- For the purposes of this standard, taxes on income include all domestic and foreign taxes which are based on taxable income.
- This standard does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividend and other distributions made by the enterprise





Statement of Profit and Loss for the year ended 31st March, 2015

	Note	For the year ended 31st March, 2015 (₹ in Crores)	For the year ended 31st March, 2014 (₹ in Crores)
Gross Income	19	**51932.14**	**48175.80**
Gross Revenue from sale of products and services	20	49964.82	46712.62
Less: Excise Duty		13881.61	13830.06
Net Revenue from sale of products and services		36083.21	32882.56
Other operating revenue		424.19	356.04
Revenue from operations	21	36507.40	33238.60
Other income	22	1543.13	1107.14
Total Revenue		**38050.53**	**34345.74**
Expenses			
Cost of materials consumed	23	10987.83	10263.28
Purchases of Stock-in-Trade	24	3898.66	3021.47
Changes in inventories of finished goods, Work-in-progress, Stock-in-Trade and Intermediates	25	(214.53)	(128.41)
Employee benefits expense	26	1780.04	1608.37
Finance costs	27	57.42	2.95
Depreciation and amortisation expense		961.74	899.92
Other expenses	28	6581.85	6019.05
Total Expenses		**24053.01**	**21686.63**
Profit before tax		**13997.52**	**12659.11**
Tax expense:			
Current tax	29	4020.99	3791.13
Deferred tax	30	368.80	82.77
Profit for the year		**9607.73**	**8785.21**
Earnings per share (Face Value ₹ 1.00 each)	31 (i)		
Basic		₹ 12.05	₹ 11.09
Diluted		₹ 11.93	₹ 10.96

The accompanying notes 1 to 34 are an integral part of the Financial Statements.

In terms of our report attached
For Deloitte Haskins & Sells
Chartered Accountants

SHYAMAK R TATA
Partner

Kolkata, 22nd May, 2015

On behalf of the Board

K. N. GRANT *Director* Y. C. DEVESHWAR *Chairman*

R. TANDON *Chief Financial Officer* B. B. CHATTERJEE *Company Secretary*

DEFINITIONS

ACCOUNTING INCOME [LOSS]:-

The net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving [PBT].

TAXABLE INCOME [TAX LOSS]:-

The amount of income [loss] for a period, determined in accordance with the tax laws based upon which income tax payable or recoverable is determined.

CURRENT TAX:-

Current tax is the amount of the income tax determined to be payable [recoverable]
in respect of the taxable income [tax loss] for a period

DEFERRED TAX:-

Deferred tax is the tax effect of the timing difference

ACCOUNTING INCOME ≠ TAXABLE INCOME

DIFFERENCE

PERMANENT DIFFERENCE

The difference between taxable income and accounting income for a period that originate **in one period and do not reverse subsequently**

FOR EXAMPLE:

- Penalty paid for infringement of law
- Donations disallowed as per section 80G of the Income Tax Act
- Tax holiday profits
- Taxable income based on presumptive taxation Sec 44 AD.

NOTE: Permanent differences do not result in deferred assets or deferred tax liabilities.

TIMING DIFFERENCE

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

FOR EXAMPLE:

- Expenditure mentioned in section 43B.
- Difference in method / rate of depreciation.
- Amortisation of preliminary Expenses 35AD.
- Carry forward of loss.
- Expenses incurred for amalgamation.
- Provision for doubtful debts.
- Voluntary retirement compensation.
- Municipal Taxes on House Property.

NOTE: Timing differences result in deferred tax assets or deferred tax labilities.

DEFERRED TAX ASSET [DTA]

DEFERRED TAX LIABILITY [DTL]

ILLUSTRATION I (Just for information)

EXAMPLES OF TIMING DIFFERENCES

Note: This illustration does not form part of the Accounting Standard. The purpose of this illustration is to assist in clarifying the meaning of the Accounting Standard. The sections mentioned hereunder are references to sections in the Income-tax Act, 1961, as amended by the Finance Act, 2001.

1. Expenses debited in the statement of profit and loss for accounting purposes but allowed for tax purposes in subsequent years, e.g.
   a) Expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis but allowed for tax purposes in subsequent years on payment basis.
   b) Payments to non-residents accrued in the statement of profit and loss on mercantile basis, but disallowed for tax purposes under section 40(a)(i) and allowed for tax purposes in subsequent years when relevant tax is deducted or paid.
   c) Provisions made in the statement of profit and loss in anticipation of liabilities where the relevant liabilities are allowed in subsequent years when they crystallize.
2. Expenses amortized in the books over a period of years but are allowed for tax purposes wholly in the first year (e.g. substantial advertisement expenses to introduce a product, etc. treated as deferred revenue expenditure in the books) or if amortization for tax purposes is over a longer or shorter period (e.g. preliminary expenses under section 35D, expenses incurred for amalgamation under section 35DD, prospecting expenses under section 35E).
3. Where book and tax depreciation differ. This could arise due to:
   a) Differences in depreciation rates.
   b) Differences in method of depreciation e.g. SLM or WDV.
   c) Differences in method of calculation e.g. calculation of depreciation with reference to individual assets in the books but on block basis for tax purposes and calculation with reference to time in the books but on the basis of full or half depreciation under the block basis for tax purposes.
   d) Differences in composition of actual cost of assets.
4. Where a deduction is allowed in one year for tax purposes on the basis of a deposit made under a permitted deposit scheme (e.g. tea development account scheme under section 33AB or site restoration fund scheme under section 33ABA) and expenditure out of withdrawal from such deposit is debited in the statement of profit and loss in subsequent years.
5. Income credited to the statement of profit and loss but taxed only in subsequent years e.g. conversion of capital assets into stock in trade.
6. If for any reason the recognition of income is spread over a number of years in the accounts but the income is fully taxed in the year of receipt.

DEFERRED TAX ASSET

- Deferred Tax Asset arises when taxable income is more than Accounting Income.
- It means the tax paid in current year as per tax laws is more than the tax to be paid as per books of accounts.
- Deferred Tax Asset arises when business anticipates a future tax saving.
- PAY NOW SAVE LATER

1. CREATE Deferred Tax Liability (DTL)	
Tax Expenses A/c	Dr.
To Deferred Tax Liability (DTL)	
[When difference originate]	
2. REVERSAL OF Deferred Tax Liability (DTL)	
Deferred Tax Liability (DTL) A/c	Dr.
To Tax Expense	

DEFERRED TAX LIABILITY

- Deferred tax liability arises when taxable income is less than accounting income.
- It means the tax paid in current year as per tax laws is less than the tax to be paid as per books of accounts.
- SAVE NOW PAY LATER

1. CREATE Deferred Tax Asset (DTA)	
Deferred Tax Asset (DTA) A/c	Dr.
To Tax Expense A/c	
[When difference originate]	
2. REVERSAL OF Deferred Tax Asset (DTA)	
Tax expense A/c	Dr.
To Deferred Tax Asset (DTA) A/c	

DEFERRED TAX ASSET	DEFERRED TAX LIABILITY
ACCOUNTING INCOME < TAXABLE INCOME	ACCOUNTING INCOME > TAXABLE INCOME
OR	OR
ACCOUNTING EXPENDITURE > TAXABLE EXPENDITURE	ACCOUNTING EXPENDITURE < TAXABLE EXPENDITURE

TAX EXPENSE

= Current Tax + Deferred Tax Liability or Current Tax – Deferred Tax Asset

TAX EXPENSE AND TAX SAVING MATHEMATICS

Deferred Tax = Timing differences X Rate of Tax

Deferred Tax Asset = Timing differences [Accounting Income < Taxable Income] X Rate of Tax

Deferred Tax Liability = Timing differences [Accounting Income > Taxable Income] X Rate of Tax

PRUDENCE FOR RECOGNIZING DEFERRED TAX ASSET

Unabsorbed depreciation or carry forward of losses - Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available.

Nature of evidence should be disclosed in the notes to account.

Other Cases: Except in the situations stated above, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.

Note: Deferred tax liabilities will be provided without exception.

ASI 9: MEANING OF 'VIRTUAL CERTAINTY' SUPPORTED BY CONVINCING EVIDENCE

The expression 'virtual certainty supported by convincing evidence' for the purpose of paragraph 17 of AS-22 has been defined by ASI – 9 issued by ICAI.

ASI 9 makes the following points regarding **'virtual certainty'**

Determination of virtual certainty is a matter of judgement. It will have to be evaluated on a case to case basis.

1) Virtual certainty is the extent of certainty, which, for all practical purposes, can be considered certain.
2) Virtual certainty cannot be based merely on forecasts of performance such as business plans.
3) Virtual certainty is not a matter of perception. It should be supported by convincing evidence. To be convincing,
4) the evidence should be available at the reporting date in a concrete form, **for example,**
   a. a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party.
   b. In the case of a pharmaceutical company, virtual certainty may be demonstrated through the successful patent of a block buster drug.
   c. In the case of oil company, it may be demonstrated through the successful discovery of oil fields.
5) A projection of the future profits made by an enterprise based on the future capital expenditures or future restructuring etc., submitted even to an outside agency, e.g. to a credit agency for obtaining loans and accepted by that agency cannot, in isolation, be considered as convincing evidence. This is because the enterprise may change its plans on the basis of subsequent developments.

SUMMARY		
Sr.No.	Nature of timing difference resulting in deferred tax asset	Prudence considerations
1	Unabsorbed losses\depreciation under tax laws	Only to the extent there is **VIRTUAL CERTAINTY** supported by convincing evidence
2	Others (Eg. Amortization of Preliminary Expenses – Sec 35D)	Only to the extent there is **REASONABLE CERTAINTY** about availability of future taxable income

RE-ASSESSMENT OF UNRECOGNISED DEFERRED TAX ASSET

At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises previously unrecognised deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which such deferred tax assets can be realised. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

REVIEW OF DEFERRED TAX ASSET

a) The carrying amount of deferred tax assets should be reviewed at each balance sheet date.

b) An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which deferred tax asset can be realised.

c) Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available.

MEASUREMENT

a) Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

b) Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

c) When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

d) Deferred tax assets and liabilities should not be discounted to their present value.

DISCLOSURE

Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under separate heading in the balance sheet of the enterprises, separately from current assets and current liabilities.

The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

AS 17 – DISCLOSURE OF DEFERRED TAX ASSETS AND LIABILITIES BY A COMPANY

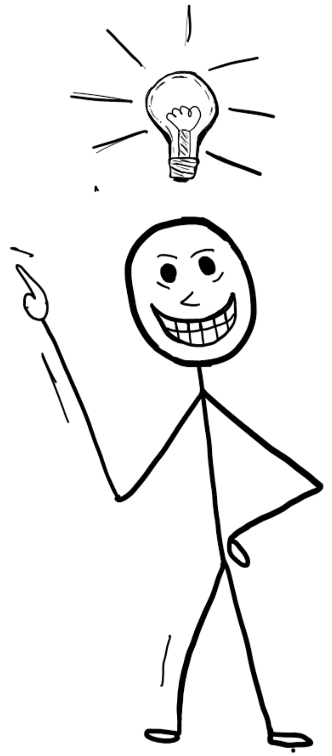
As per Schedule III, DTA would be shown under the head Non-current assets and DTL would be shown under the head Non-current Liabilities.

ACCOUNTING STANDARDS INTERPRETATIONS [ASI]

ASI 3 & 5 : DEALING WITH TAX HOLIDAY

1) The deferred tax (assets and liabilities) in respect of timing differences which originate during the tax holiday period and reverse during tax holiday period should not be recognized to the extent the enterprise's gross total income is subject to deduction or income is exempt during the tax holiday period.
2) The deferred tax asset or liability for timing differences which originate during the tax holiday period and reverse after tax holiday period should be recognized in the period in which they originate. The recognition of deferred tax assets will be subject to fulfilment of the virtual certainty criterion or the reasonable certainty criterion, as the case may be, laid down in paras 15-18 of AS – 22.
3) For the purpose of (1) and (2), timing differences which originate first should be assumed to reverse first (i.e. First originate first reversed or FIFR)

RATIONALE FOR THE ABOVE TREATMENT



According to the Framework for the Preparation and Presentation of Financial Statement, an asset should be recognized in the balance sheet when –

1. It is probable that future economic benefits associated with it will flow to the enterprise; and
2. Its cost / value can be reliably measured.

According to the Framework, a liability should be recognized in the balance sheet when –

a) It is probable that a settlement of present obligation will result into outflow of economic resources.
b) The amount at which settlement is expected to take place can be measured reliably.

A deferred tax asset or liability for timing difference which originates and reverses during the tax holiday period does not meet the above recognition criteria for asset / liability. Because, there is no flow to the enterprise of economic benefits nor outflow of economic benefits from settlement of obligation due to tax liability.

EXAMPLE:

Your client is a full tax free enterprise for the first 10 years and is in the second year of operations. Depreciation timing difference resulting in a deferred tax liability in Year 1 & 2 is Rs. 100 million and Rs. 200 million respectively. From the 3rd year and onwards it is expected that the timing difference would reverse each year by Rs. 5 million. Determine deferred tax liability at the end of 2nd year and the charge to the P & L A/c. if any. Assume tax rate @ 35%. **(NOV RTP 2012), (NOV 2012(5 marks)**

SOLUTION:

In case of tax free companies, no deferred tax liability is recognised in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability (or asset) is created in respect of timing difference that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method. Of the Rs. 100 million, Rs. 40 million will reverse in the tax holiday period. Therefore, deferred tax liability will be created on Rs. 60 million at the tax rate of 35%, i.e. Rs. 21 million. In the second year, the entire Rs. 200 million will reverse only after the tax holiday period; therefore, deferred tax charge in the profit and loss account will be Rs. 70 million (200 x 35%) and deferred tax liability in the balance sheet will be Rs. 91 million (70 + 21).

ASI 4: LOSSES UNDER THE HEAD CAPITAL GAINS

If profit and loss account includes loss which can be set off for taxation purposes in future against income under the head capital gains it is a timing difference. Recognition of Deferred Tax Asset in respect of such loss will be as per table below:

Sr. No.	Situation	Criteria for recognition and carry forward of deferred tax asset in respect of 'loss' under the head "Capital Gains" (Considerations of prudence)
1	Where an enterprise has unabsorbed depreciation or carry forward of business losses under the tax laws.	The deferred tax asset in respect of 'loss' under the head 'Capital gains' should be recognized and carried forward only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available under the head 'Capital gains' against which such loss can be set-off as per the provisions of the Act.
2	In other situations	The deferred tax asset should be recognized and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Act.

If there is a difference between the amounts of 'loss' recognized for accounting purposes and tax purposes because of cost indexation under the Act in respect of long-term capital assets, the deferred tax asset should be recognized and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act.

EXAMPLE:

Y sold a piece of land on 12/01/05 for Rs.14 lakh. The land was purchased on November 14, 1979 for Rs.1 lakh. The market value of the land on 01/04/81 was Rs.3 lakh. The cost inflation index for financial year 2004-05 was 480. The rate is 20% on long-term capital gains and 40% for other cases. Profit before tax is Rs.16 lakh. Compute current and deferred tax.

SOLUTION:

Loss on sale of land as per IT Act= 3 x (480 / 100) – 14 = Rs.0.4 lakh

Profit on sale of land as per books = Rs.14 lakh – Rs.1 lakh = Rs.13 lakh

Current tax = (16 – 13) x 0.4 = Rs.1.2 lakh

Deferred Tax (Asset) = 0.40 x 0.2 = Rs.0.08 lakh

NOTE:

Long-term capital loss can be set-off against long-term capital gains only. Since Y did not earn any capital gain in current year, the long-term capital loss shall be carried forward for set-off against future long-term capital gains. Deferred tax asset can be recognised provided, earning of sufficient future long-term capital gain is reasonably certain.

OBJECTIVE

At times, table income differs significantly from accounting income due to timing & permanent differences. Objective of AS 22 is to lay down treatment of such differences & to prescribe accounting treatment for other issues relating to taxes on income

Deferred Tax

Arises out of Permanent & Timing differences (relating to tax liability) on accounting income

Permanent Differences

Originate in one period but don't reverse subsequently

IGNORE

Timing Differences

Originate in one period get reversed in one more later periods

Deferred Tax Asset (DTA)	Deferred Tax Liabilities (DTL)
Tax in subsequent years lower	Tax in subsequent years higher
P & L A/c – Credit Balance Sheet - Asset	P & L A/c – Debit Balance Sheet - Liability

Tax Expenses Means

Deferred Tax + Current Tax

MEASUREMENT

OFFSETTING

Current Tax

Based on taxable income as per Income Tax Laws

- State it at the amount expected to be paid or recovered, using tax rates & tax laws enacted
- Offset current tax assets & Liability if
- Enterprise has a legally enforceable right to set off the recognised amounts &
- Enterprise intends to settle the asset & liabilities on a net basis

- Use tax rate & tax laws enacted or substantially enacted by the balance sheet date
- Don't discount DTA or DTL to their present Value

Offset DTA & DTL if

- Enterprise has a legally enforceable right to set off assets against current tax liabilities &
- DTA & DTL relate to taxes on income levied by same governing tax laws

RECOGNITION ISSUES FOR DEFERRED TAX

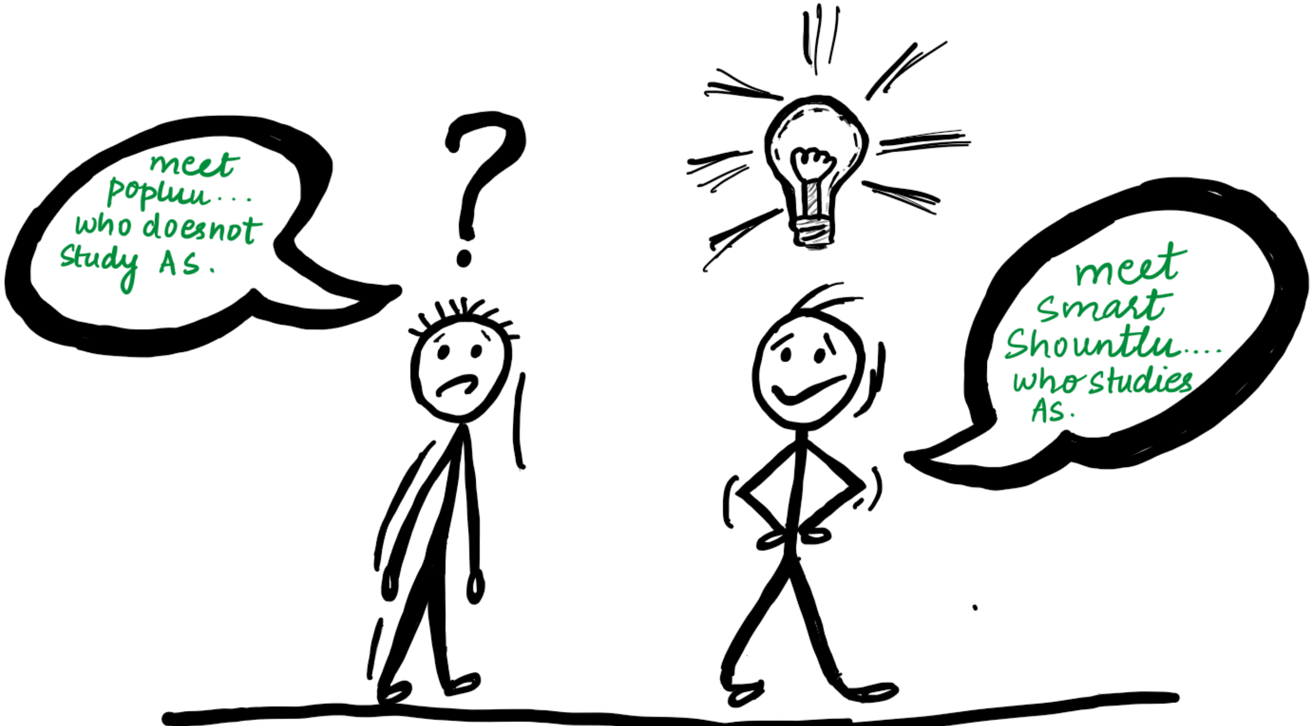
- Consider prudence
- Recognise & c/f DTA when there is reasonable certainty
- For unabsorbed depreciation & off of tax losses, recognise & c/f DTA when there is virtual certainty
- Review DTA at each balance sheet date & write down if required
- Reassess unrecognised DTA at each balance sheet date
- Ignore timing differences originating & reversing during tax holiday · Recognise DTA for timing differences originating during tax holiday but reversing after tax holiday period is over
- Recognise DTA for loss a capital gain subject to consideration of prudence If tax paid under MAT, recognise DTA or DTL using regular tax rates and not MAT rates

DISCLOSURES

- Distinguish DTA & DTL from current tax assets & liabilities
- DTA & DTL under a separate heading in balance sheet
- Break up of DTA & DTL into major components in notes to accounts
- If DTA relating to unabsorbed depreciation & c/f of losses recognised, nature of supporting evidence

TRANSITIONAL PROVISIONS

- Determine accumulated deferred tax in the first period by comparing opening balance of assets & liabilities for accounting & tax purposes
- Credit opening balance of revenue reserves (and debit in case of DTL) in case of DTA



MORAL OF THE STORY → DONOT BECOME EXPIRED AGARBATI LIKE POPLU...

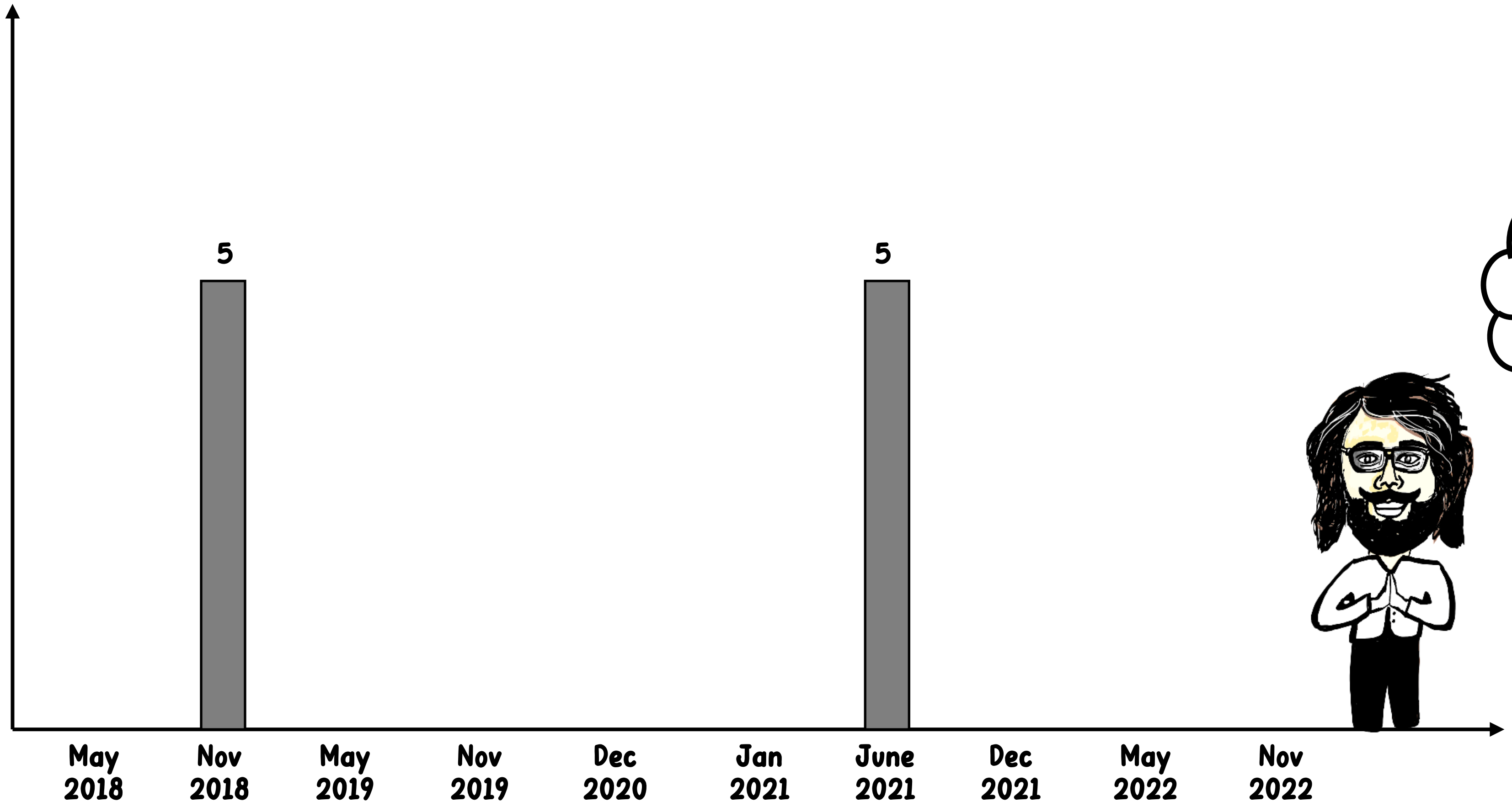
AS 24 - DISCONTINUING OPERATIONS

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS		5					5			



OBJECTIVE

- To Establish principles for reporting information about discontinuing operations.
- Objective is to enhance the ability of users of financial statements.
  - ✓ to make projections of an enterprise cashflows
  - ✓ earning capacity and
  - ✓ financial position by segregating information about discontinuing operation

SCOPE

- This statement applies to all discontinuing operations of an enterprise
- The requirement relates to cash flow statement contained in this standard are applicable where an enterprise prepares and presents a cash flows statement

WHEN IS AN OPERATION CONSIDERED A COMPONENT.

An operation which is a component

- which is either a major line of business or
- which is a business in a particular geographical area.

WHEN IS A COMPONENT CONSIDERED DISTINGUISHABLE FOR OPERATIONAL BY FINANCIAL REPORTING PURPOSES.

- when the operations Assets & liabilities can be directly attributed to it
- Its revenue can be directly attributed to it
- A majority of its expenses can be directly attributed to it.

MEANING OF DISCONTINUING OPERATIONS

COMPONENT OF THE ENTITY WHICH

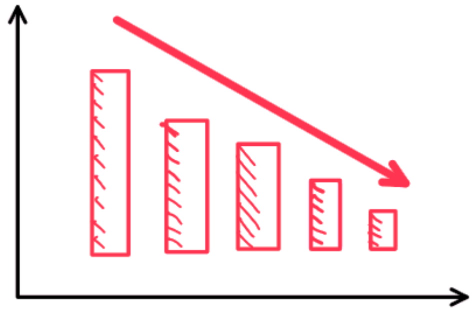
1

Represents;

- Separate major line of business

OR

- Geographical area of operations



2

Can be distinguished for;

- Operational purpose

and

- financial reporting purpose.

3

- Is discontinued as SINGLE PLAN by

Selling SUBSTANTIALLY IN TOTAL either in

- Single transaction
- Demerger
- Spinoff.

Selling off components assets

- INDIVIDUALLY (piecemeal disposal]

and settling its liabilities also individually

Termination through ABANDONEMENT [Stopping with an intention to sell later]

DISCONTINUED OPERATIONS OF REEBOK BY ADIDAS

After 15 years it bought the US fitness label to help compete with arch rival nike german sportswear maker advanced its plan to sell or spin off its underperforming brand reebok

Adidas said it had decided to begin a formal process aimed at divesting reebok as a part of a 5 year strategy it plans to present on march 10 when the company will also publish its 2020 results.

It will report reebok as a discontinued operation from the first quarter of 2021. This business could be worth around 1.2 Billion Dollars the company bought boston-based reebok for 3.8 billion dollar in 2006 but it's sluggish performance led to repeated calls from investors to dispose of the brand,

In the meantime adidas managed to eat into nike's dominance in the US with its core brand helped by partnership with celebrities like Kayne West, Beyonce and Williams

Reebok net sales fell 7% percent in third quarter of 2020 to 403 million euros or 488 million dollars after falling as much as 44% the preceding quarter in 2019 Adidas wrote down reebok's book value by nearly half compared with 2018 to 842 million euros

Important Point!!!

DISCONTINUING OPERATIONS V/S DISCONTINUING PRODUCT LINE

If an entity discontinues a product line, it will not be considered a discontinuing operations and hence no disclosure is required under this standard

Example→ TATA DISCONTINUING NANO

Component sold substantially in its Entirely.

- A binding sale agreement is entered into on a specific date,
- The actual transfer of possession and control of discontinuing operations may occur at a later date
- Also, payments to the seller may occur
    - at the time of the agreement.
    - at the time of the transfer, or
    - over an extended future period.

Piecemeal sale-of Assets

- An enterprise may discontinue and dispose of the component by selling its assets and settling its liabilities **piecemeal** [individually or in small groups].
- Rather, the sales of assets and settlements of liabilities may occur over a period of months or perhaps even longer.
- Disposal of a component may be in progress at the end of a financial reporting period.
- To qualify as a discontinuing operation, the disposal **must be pursuant to a single coordinated plan.**

Abandonment

- An Enterprise may **terminate an operation by abandonment without substantial sales of assets.**
- However, changing the scope of an operations or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.

Attention Example here!!!

Eg 1

Bharat Newspaper Ltd.

Publishes

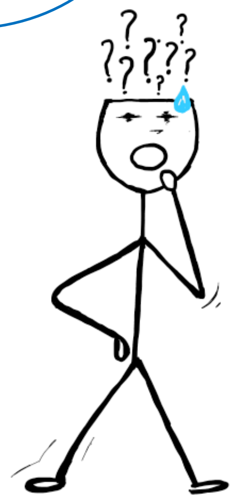
English Newspaper

Hindi Newspaper

Wishes to discontinue & hire it off to a new company

The discontinuance will involve hiring off the press and other operating facilities to the new company

Is the hindi newspapers a discontinuing operations??



SOLUTION→

Eg 2

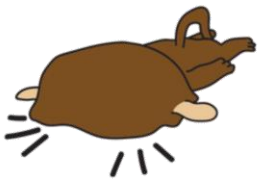
A Ltd is having
- Food division
- Cloth division
- Beverage division

The beverage division accounts for 8% of total assets, 90% of enterprise revenue and 90% of combined profits of all divisions. it is proposed to be de-merger by BOD pursuant to a single plan. It is distinguishable component operationally and financially. Is it a discontinuing operation as per AS-24?

SOLUTION:-

Eg 3

ABC Ltd
- X division
- Y division
- Z division



A sale agreement has been entered into between the prospective buyer and ABC Ltd. to transfer division as a going concern for a predefined price after 6 month. Is it a case of discontinuing operations? Will it make any difference if the assets of the assets of the division Y are to be sold to different parties?

SOLUTION:-

Fundamental Assumption regarding going concern

Simply because a component is reported as discontinuing operation can not by itself affect the fundamental assumption regarding going concern

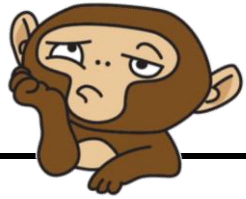
FOLLOWING ARE NOT NECESSARILY DISCONTINUING OPERATIONS

In the context of CFS sale of a subsidiary with activities similar to parent or another subsidiary.

Eg→ A holding co. engaged in manufacture of textiles disposed off its investment in one of its subsidiaries which is also engaged in the same line of business.

Gradual or evolutionary phasing out of product line or class of service

Eg→ till last year, a company was engaged in the production of black and white TV sets Now, it has just entered into the production of colour TV Sets.



Closing down of a facility to a achieve productivity improvement or cost savings.

Eg:→ A company belonging to the process industry carried out three consecutive processes. The output of the first process is taken as input of the second process, & the output of the second process is taken as input of third processes. The final product emerges out of the third process. It is also possible to outsource the intermediate products. It has been found that over a period a time cost of production of the first process is 10% higher than the market price of the intermediate product available freely in the market The company has decided to close down the first process as a measure of cost saving.

Shifting of production or marketing activity, from one location to another.

Eg→ A company was having its production plant in location A. To achieve economies of scale , the company wishes to shift to Location Y

Discontinuing, even if relatively abruptly several products within an ongoing line of business;

Eg→ A company has three market areas-government, local, exports. The company finds that it may not be able to sell to government in the coming years, due to change in government procurement policy.

Eg 4 [RTP May 18]

A healthcare goods producer has changed the product line as follows:

MONTH	WASHING SOAP	BATHING SOAP
JANUARY 2012 – SEPTEMBER 2012 PER MONTH	2,00,000	2,00,000
OCTOBER 2012 – DECEMBER 2012 PER MONTH	1,00,000	3,00,000
JANUARY 2013 – MARCH 2013 PER MONTH	0	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The board of directors of the company has passed a resolution condition in march 2012 to this effect. The company follows calendar year as its accounting year. Should it be treated as discontinuing operations?

SOLUTION:-

WHEN SHOULD AN ENTITY DISCLOSE INTIAL DISCLOSURE EVENT

Entity should disclose discontinuing operations from earlier of the following:-

- Entered into **a binding sale agreement for substantially all of the assets** of the discontinuing operations

OR

- Board of directors / similar governing body has;
  - ✓ **Approved a detailed , formal plan for discontinuance** AND
  - ✓ **Made an announcement of the** formal plan for discontinuance.

DETAILED FORMAL PLAN

Formal plan includes determination of

Assets to be disposed → Expected method of disposal → Target period → Affected location → Compensation and Salvage

PUBLIC ANNOUNCEMENT

A public announcement is deemed to be made, where the BOD announces the detailed features of the plan to those affected by it, namely, creditors , lender, shareholders etc.

INITIAL DISCLOSURE EVENT AFTER THE BALANCE SHEET DATE

- Apply AS 4
- It will be treated as non-adjusting event

RECOGNITION & MEASUREMENT

This accounting Standard does not prescribes when and how to recognize and measure the assets, Liabilities, revenue, expenses , gains, losses and cash flow, the same will be as per other accounting standard like

- AS - 1 GOING CONCERN CONCEPT
- AS - 4 CONTINGENCIES AND EVENTS OCCURRING AFTER BALANCE SHEET DATE
- AS - 15 EMPLOYEE BENEFIT
- AS - 28 IMPAIRMENT OF ASSETS

INITIAL DISCLOSURE REQUIREMENT

When initial disclosure event occurs, beginning from the financial statement of that period in which event occurs, the following disclosure shall be made.

A description of discounting operations

↓

Segment in which it is reported as per AS-17

↓

Date and nature of initial disclosure event

↓

Date or period in which discontinuation is expected to be completed

↓

Carrying amount as of the balance sheet date of the total assets to be disposed of the total liabilities to be settled

↓

Revenue and expenses in respect of the ordinary activities attributable to the discontinuing operations

↓

Amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation and the income tax expense related there to ; and

↓

Amounts of net cash flows attributable to the
1. Operating 2. Investing, and 3. Financing activities of the discontinuing operation

OTHER DISCLOSURE

when asset is disposed of or liability is settled which are attributable to the discontinuing operation or a binding agreement for the same is made, the following disclosure should be made.

The amount of pre-tax gains or loss which is recognized and income tax relating there to

The net selling price or range of prices, of these net assets for which binding agreement are made, the expected time of receipt of cash flow and carrying amount of such asset on balance Sheet date

Note → This disposal, settlement or binding agreement may occur in the period of initial disclosure or in later period.

UPDATING THE DISCLOSURES

An enterprise should include, in its financial statement statements, for periods subsequent to the one in which the initial disclosure event occurs, **a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled** and the events causing those changes

DISCLOSURE UNTIL DISCONTINUATION IS COMPLETED

This disclosure will continue in all the reporting period until the discontinuation is substantially completed or abandoned, though full payment may not have been received.

PLAN IS ABANDONED OR WITHDRAWN

If a previously reported discontinuation plan is abandoned or withdrawn, the same shall be reported together with reasons and effects. Provision made for impairment loss or other provisions shall have to be reversed.

SEPARATELY FOR EACH DISCONTINUING OPERATIONS

All the disclosure shall be made separately for each discontinuing operations when more than one operations are being discontinued.

DISCLOSURE IN NOTES TO ACCOUNTS

Information required to be disclosed as pes above paras shall be disclosed in notes to accounts except the following which shall be disclosed on face of profit & loss statement.

DISCLOSURE IN NOTES TO ACCOUNTS

Information required to be disclosed as pes above paras shall be disclosed in notes to accounts except the following which shall be disclosed on face of profit & loss statement.

a

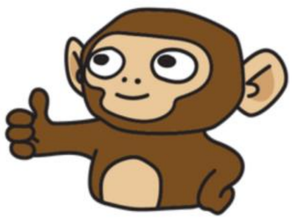
amount of pre-tax or loss ordinary activities and income take related to it

and

b

Amount of pre-tax gain or loss recognized on the disposal of assets settlement of liabilities and income tax related to it

REFER SCHEDULE III FOR BETTER UNDERSTANDING



COMPARATIVE PRIOR PERIOD INFORMATION

Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities , revenue, expenses and cash flows of continuing and discontinuing operations in a manner similar to that required by earlier disclosures

DISCLOSURE IN INTERIM FINANCIAL REPORTS [ONLY FOR INFO]

Any significant activities or events since the end of the most recent annual reporting period relating to a discounting operations.

and

Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

AS -24

OBJECTIVE

To prescribe for reporting information about operations of an enterprises.

FOLLOWING ARE NOT NECESSARILY DISCONTINUING OPERATIONS

- Gradual or evolutionary phasing out of product line or class of service
- Closing down of a facility to a achieve productivity improvement or cost savings
- Shifting of production or marketing activity, from one location to another
- Discontinuing, even if relatively abruptly several products within an ongoing line of business.
- The context of CFS sale of a subsidiary with activities similar to parent or another subsidiary.

DISCONTINUING OPERATION

Is a component of an which

Represents

- Separate major time of business

Can be distinguished for

- Operational Purpose and
- Financial Reporting Purpose

Is discontinued as SINGLE PLAN by

Selling substantially in total either in

- Single transaction
- Demerger
- Spin off

Selling off components assets

- Individually [Piecemeal disposal]

And setting its liabilities also individually

Termination through abandonment [Stopping with an intention to sell later]

INITIAL DISCLOSURE EVENT [EDE]

Earliest of

- The enterprise having entered into a binding sale agreement for substantially all of the assets attributable to discontinuing operations
- The enterprises board of directors or similar governing body having both
  - i. Approved a detailed, formal plan for the discontinuance, and
  - ii. Made ab announcement of the plan

RECOGNITION & MEASUREMENT CRITERION

Use principles of recognition & measurement specified in other accounting standards

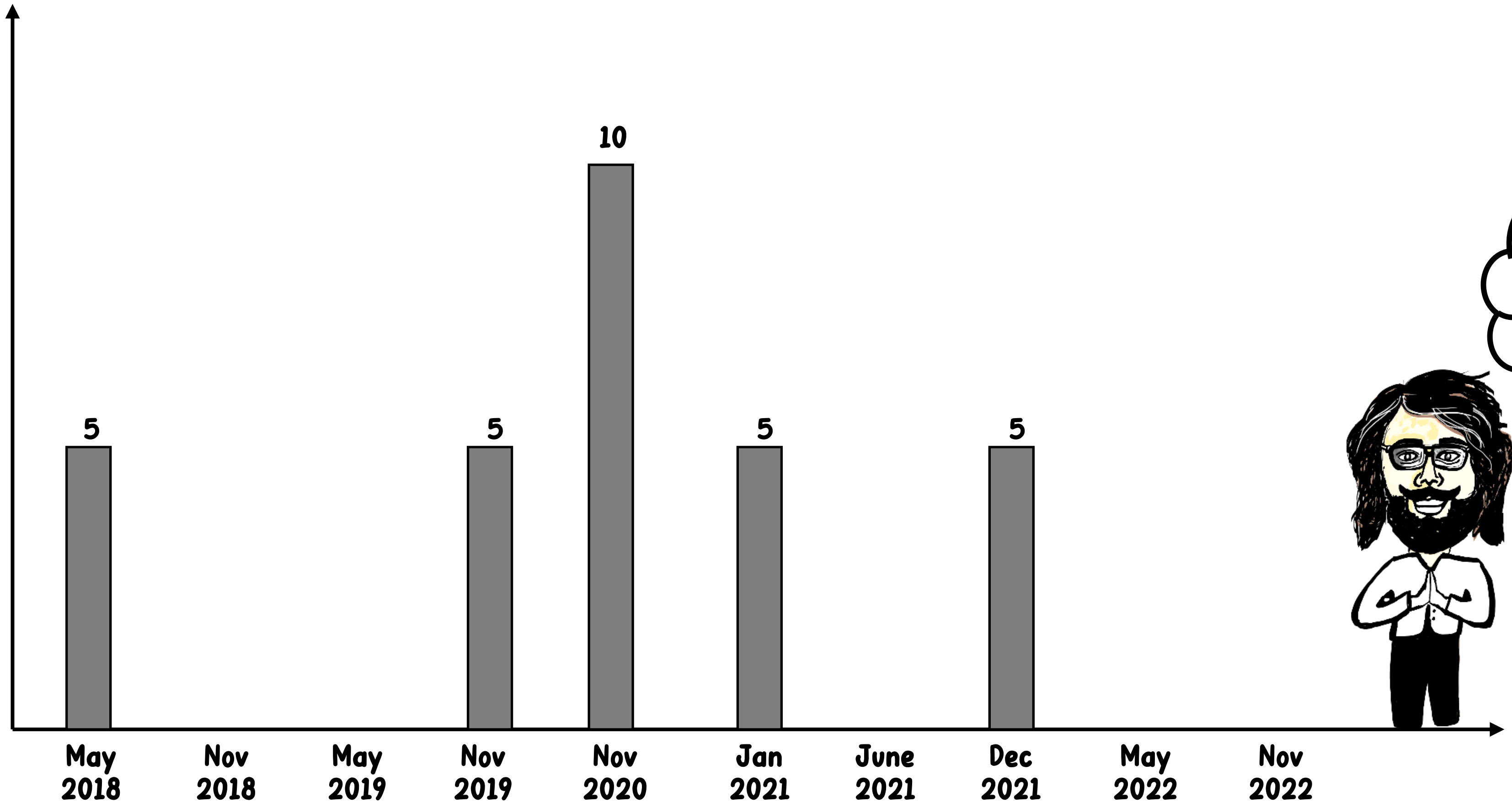
AS 26 - INTANGIBLE ASSETS

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Nov 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS	5			5	10	5		5		



INTRODUCTION

The purpose of this standard is to prescribe the recognition and measurement criteria for intangible assets that are not covered by other standards. This standard will enable users of financial statements to understand the extent of an entity's investment in such assets and the movements therein.

The principal issues involved relate to nature and recognition of intangible assets, determining their costs, and assessing the amortization and impairment losses that need to be recognized.

SCOPE

AS - 26 should be applied by all enterprises in accounting for intangible assets **EXCEPT**

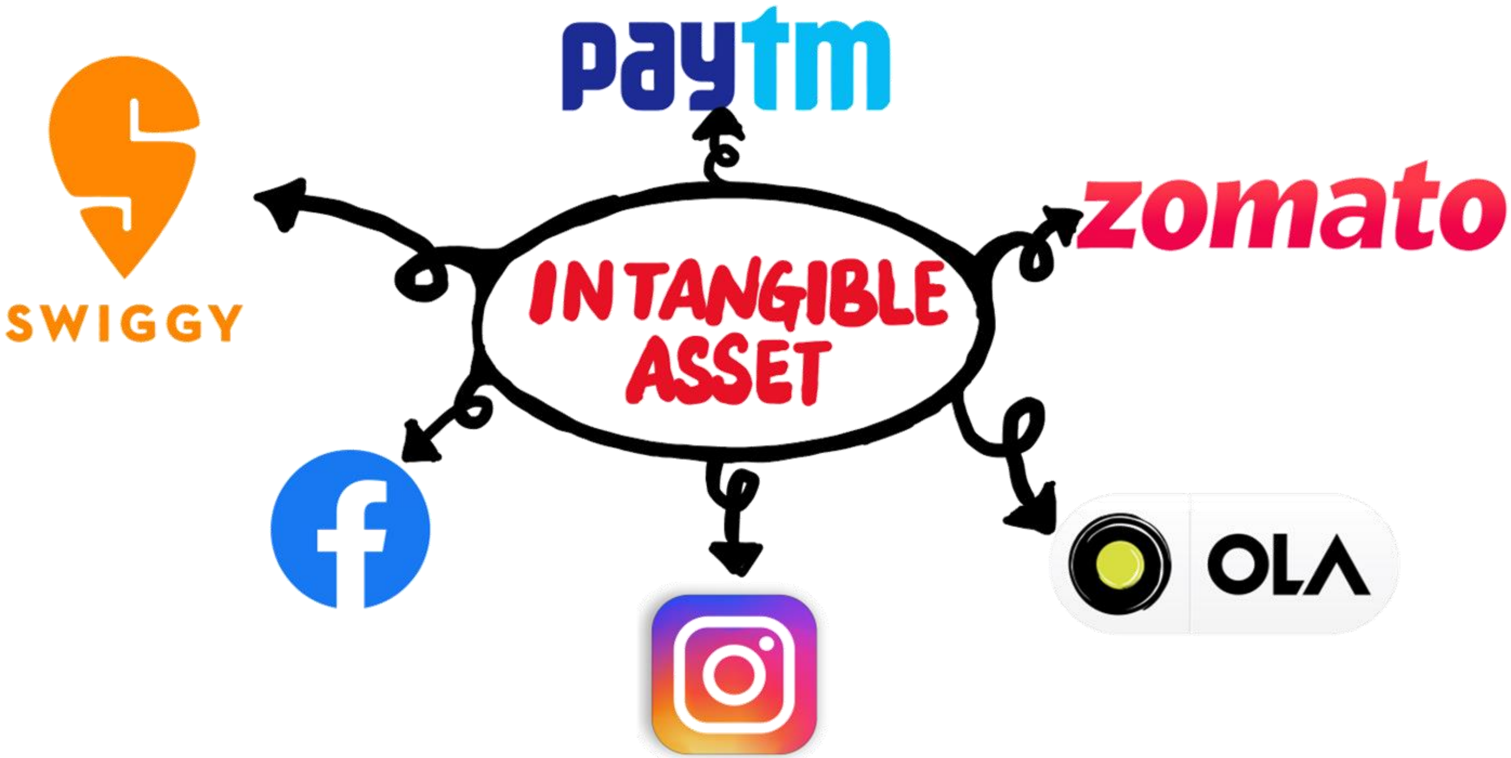
- Intangible assets that are covered by another Accounting standard
- Financial Assets.
- Mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources.
- Intangible assets arising in insurance enterprises from contracts with policyholders.

AS 26 does not apply to

If another Accounting Standard deals with a specific type of intangible asset, an enterprise applies that Accounting Standard instead of this Standard. For example, this Standard does not apply to:

- Intangible assets held by an enterprise for sale in the ordinary course of business (see AS 2, Valuation of Inventories, and AS 7, Construction Contracts);
- Deferred tax assets (see AS 22, Accounting for Taxes on Income);
- Leases that fall within the scope of AS 19, Leases; and
- Goodwill arising on an amalgamation (see AS 14, Accounting for Amalgamations) and goodwill arising on consolidation (see AS 21, Consolidated Financial Statements).

COMPANIES WHICH USE INTANGIBLE ASSETS



Let's further look at the case of Zomato to get more inside of Intangible Assets.

Significant Accounting Policies to the Standalone Financial Statements

for the year ended March 31, 2022

CIN : L93030DL2010PLC198141

mentioned useful lives for different classes of assets:

- The useful life of electrical equipments, furniture and fittings, computers, air conditioners, telephone instruments and plant & equipment are estimated as 3,3,2,3, 2 and 10 years respectively. These lives are lower than those indicated in schedule II to Companies Act 2013.
- Improvements to leasehold buildings not owned by the Company are amortized over the lease year or estimated useful life of such improvements, whichever is lower.

The management has estimated the useful lives and residual values of all property, plant and equipment and adopted useful lives based on management's technical assessment of their respective economic useful lives. The residual values, useful lives and methods of depreciation of property, plant and equipment are reviewed at each financial year end and adjusted prospectively, if appropriate.

Depreciation on the assets purchased during the year is provided on pro rata basis from the date of purchase of the assets. Individual assets costing less than INR 5,000 are fully depreciated in the year of purchase.

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement when the asset is derecognised.

vii. Intangible assets

Goodwill represents the cost of acquired business as established at the date of acquisition of the business in excess of the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities less accumulated impairment losses, if any. Goodwill is tested for impairment annually or when events or circumstances indicate that the implied fair value of goodwill is less than the carrying amount.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition.

Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses. Internally generated intangibles, excluding capitalised development costs, are not capitalised and the related expenditure is reflected in profit or loss in the year in which the expenditure is incurred.

The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets (other than those acquired in business combination) with finite lives are amortised on a straight line basis over the estimated useful economic life being 1-2 years. All Intangible assets (other than goodwill) are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation year and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting year. Changes in the expected useful life or the expected pattern of consumption of future economic

Significant Accounting Policies to the Standalone Financial Statements

for the year ended March 31, 2022

CIN : L93030DL2010PLC198141

benefits embodied in the asset are considered to modify the amortisation year or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of profit and loss unless such expenditure forms part of carrying value of another asset.

An intangible asset is derecognised upon disposal (i.e., at the date the recipient obtains control) or when no future economic benefits are expected from its use or disposal. Any gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss when the asset is derecognised.

Intangible assets acquired in business combination, include brand, technology platform, trademarks and non-compete which are amortized on a straight line basis over their estimated useful life which is as follows:

Nature of Assets	Life
Brand	2 -3 years
Technology platform	5 years
Trademarks	5 years
Non-Compete	3 years

The amortisation year and method are reviewed at least at each financial year-end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation year is changed accordingly.

viii. Leases

The Company assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a year of time in exchange for consideration.

Company as a lessee

The Company applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Company recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

i) Right-of-use assets

The Company recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and accumulated impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the shorter of the lease term and the estimated useful lives of the assets the Company has lease contracts for office premises having a lease term ranging from 1-9 years.

If ownership of the leased asset transfers to the Company at the end of the lease term or the cost reflects the exercise of a purchase option, depreciation is calculated using the estimated useful life of the asset.

The right-of-use assets are also subject to impairment. Refer to the accounting policies in section (xvii) Impairment of non-financial assets.

ii) Lease liabilities

At the commencement date of the lease, the Company recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments

Notes to the Standalone Financial Statements

for the year ended March 31, 2022

CIN : L93030DL2010PLC198141

4 Other intangible assets and Goodwill

(INR million)

Particulars	Intangible assets						Goodwill
	Software and website	Trademarks	Brand	Tech platform	Non compete	Total	
At cost or deemed							
Gross carrying value							
As at April 01, 2020	**40**	**17**	**1,248**	**603**	**1,354**	**3,262**	**12,093**
Additions	55	1	-	-	-	56	-
Exchange fluctuation reserve*	(0)	-	-	-	-	(0)	-
As at March 31, 2021	**95**	**18**	**1,248**	**603**	**1,354**	**3,318**	**12,093**
Additions	2	-	-	-	-	2	-
Exchange fluctuation reserve*	0	-	-	-	-	0	-
As at March 31, 2022	**97**	**18**	**1,248**	**603**	**1,354**	**3,320**	**12,093**
Amortisation							
As at April 01, 2020	**40**	**16**	**93**	**257**	**88**	**494**	**-**
Charge for the year	0	2	411	122	452	987	-
Exchange fluctuation reserve*	(0)	-	-	-	-	(0)	-
As at March 31, 2021	**40**	**18**	**504**	**379**	**540**	**1,481**	**-**
Charge for the year	55	0	412	121	452	1,040	-
Exchange fluctuation reserve*	0	-	-	-	-	0	-
As at March 31, 2022	**95**	**18**	**916**	**500**	**992**	**2,521**	**-**
Net carrying value							
As at March 31, 2021	**55**	**0**	**744**	**224**	**814**	**1,837**	**12,093**
As at March 31, 2022	**2**	**0**	**332**	**103**	**362**	**799**	**12,093**

*Adjustment represent amount of foreign exchange fluctuation on conversion of non-integral foreign branch.

Impairment assessment

The Company evaluates for impairment if cash generating units (CGUs) have identified impairment triggers. Impairment is recognised, when the carrying amount of CGUs including goodwill, exceeds the estimated recoverable amount of CGU. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to the cash generating unit (CGU), which benefit from the synergies of the acquisition. CGUs which have goodwill allocated to them are tested for impairment at least annually.

The recoverable value of India food ordering and delivery CGU, being the only material CGU for Company, is determined based on the market value of the Company.

The estimated recoverable amount of CGU exceeded its carrying amount and accordingly, no impairment was recognised.

ASSET

AN ASSET IS A RESOURCE :

a. **Controlled** by an enterprise

b. As a result of past events and

c. From which future economic benefits are excepted to flow to the enterprise.

TYPES OF ASSET

- **MONETARY ASSETS**
- **NON-MONETARY ASSETS**

DEFINITION

INTANGIBLE ASSETS

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

- For an intangible asset to be identifiable, it should be clearly distinguished from goodwill
- An intangible asset can be clearly distinguished from goodwill if asset is separate
- An asset is separable if the enterprise could sell, rent or exchange the specific future economic benefits attributable to the assets.
- An intangible asset is identifiable when the asset arises from contractual or other legal rights , regardless of whether the asset is separable or not.

FOR EXAMPLE:

License to operate buses on a route is separately identifiable as it arises from a legal right

Mining rights granted by government to a mining company is separately identifiable as it arises from a legal right.

FUTURE ECONOMIC BENEFIT

Flowing from an intangible asset may include revenue from

- ✓ The sale of products or services
- ✓ Cost Savings
- ✓ Or other benefits resulting from the use of the asset by the enterprise.

FOR EXAMPLE

The use of intellectual property in a production process may reduce future production costs rather than increase future revenue.

CONTROL:- An enterprise control an asset if

The enterprise has the power to obtain the future economic benefits flowing from the underlying resource and It can also restrict any one else to enjoy that benefit

The power normally items from a legal rights e.g. copyright but the legal right is not necessary conditions, because an entity may be able to control the future economic benefit in some other way.

EXAMPLE 1: PATENT RIGHT

A patent right gives production right of a specified drug to a company which gives it future economic benefit and also nobody else can use the said formula to launch a new product.

EXAMPLE 2: MARKET SHARE

- Not controlled by the enterprise
- No direct economic benefit
- So it is not an intangible as per AS-26

EXAMPLE 3 :TRAINING TO SKILLED STAFF

- Not controlled by the enterprise
- So it is not an intangible as per AS-26

EXAMPLE 4 :SPECIFIC MANAGEMENT AND TECHNICAL TALENT

- The entity usually does not have the power over the employees to force him to stay with the entity.
- Not controlled by the enterprise
- So it is not an intangible as per AS-26

EXAMPLE 5: CUSTOMER PORTFOLIO

- Not controlled by the enterprise
- No legal rights to protect or other ways to control customer loyalty.
- So it is not an intangible as per AS-26

RECOGNITION AND INITIAL MEASUREMENT OF AN INTANGIBLE ASSET

The recognition of an item as an intangible asset requires an enterprise to demonstrate.

- It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise
- The cost of the asset can be measured reliably.

An intangible asset should be measured initially at cost.

ACQUISITION AND MEASUREMENT

ACQUISITION AS A PART OF AN AMALGAMATION

- Intangible asset acquisition in an amalgamation in the nature of purchase is accounted for in accordance with AS 14 (Revised)
- A transferee recognizes an intangible asset that meets the recognition criteria , even if that intangible asset had not been recognized in the financial Statements of the transferor and
- If the cost [i.e. fair value] of an intangible asset acquired as part of an amalgamation in nature of purchase cannot be measured reliably, that asset is not recognized as a separate intangible asset but is included in goodwill.

SEPARATE ACQUISITION

If an intangible asset is acquired separately; cost of the intangible assets can usually be measured reliably

Cost of an intangible asset comprises its purchase price including any import duties and other taxes [other than those subsequently recoverable by the enterprise from the taxing authorities] an any directly attributable expenditure on making the asset ready for its intended use

Purchase Price Import duties and other taxes, if any net of refundable duties; Directly attributable expenditure which makes the intangible ready for its intended use	
Less: Trade discounts and rebates	

ACQUIRED IN EXCHANGE OF SHARES OR OTHER SECURITIES

If an intangible asset is acquired in exchange for shares or other securities of reporting enterprise: asset is recorded at its fair value or the fair value of the securities issued whichever is clearly evident.

ACQUISITION BY WAY OF A GOVERNMENT GRANT

- If an intangible asset is acquired free of charge,
- or for nominal consideration,
- it should be accounted for on the basis of their acquisition cost or for nominal consideration
- by way of a government grant

INTEGRALLY GENERATED INTANGIBLE ASSETS

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into.

RESEARCH PHASE

- 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 should be recognized. Expenditure on research or on the research phase should be recognized as an expense when it is incurred.

SPECIAL CASE

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

DEVELOPMENT PHASE

- Development
  - Application of research findings or other knowledge
  - to a plan or design for the production of new or substantially improved materials, device, products, processes, systems or services.
  - Prior to the commencement of commercial production or use.

An intangible asset arising from development phase can be recognized if and only if it can demonstrate:

- The technical feasibility
- Its intention to complete it
- Its ability to sale or use it
- Its capability to generate economic benefit like existence of market for it or for products generated from it
- Its ability to reliably measure the expenditure during development.

Internally generated brands, maserheads, publishing title, customers list and items similar in substance should not be recognized as intangible asset because expenditure on it cannot be distinguished from cost of developing the business as a whole.

TYPES OF INTANGIBLE ASSET

- PURCHASED
- INTERNALLY GENERATED

INTERNALLY GENERATED GOODWILL

- Is not recognised as an asset
- Because it is not an identifiable resource
- Controlled by the enterprise
- That can be measured reliably at cost

Internally generated brands, masterhead, publishing titles customer lists and items similar in substance should not be recognised as intangible assets.

EXAMPLE 4: Vidya. Ltd.'s net worth is Rs400 crores. The market capitalisation is Rs.560 crores. Will the difference of Rs.160 crores be recognised as goodwill?

ANSWER : The difference between net worth and market capitalisation may be due to range of factors affecting the enterprise value. Such differences cannot be considered to represent the cost of intangible asset controlled by the enterprise.

COST OF INTANGIBLE ASSET

Should be recognised initially at cost

RECOGNITION OF INTERNALLY GENERATED INTANGIBLE ASSETS

Sr. No.	Type of internally generated intangible assets	Recognition criteria	Remarks
1.	Goodwill	Should not be recognized as an asset	Internally generated goodwill should not be recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.
2.	Brands, mast-heads, publishing titles, customers lists and similar items	Should not be recognized as an asset	These items, in substance, cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.
3.	Others (e.g. software for internal use, website developed by enterprise for its use)	Recognise an asset subject to fulfilment of recognition criteria specified in AS-26. If recognition criteria is fulfilled, recognize an asset. Subsequent to initial recognition, measure at cost less accumulated amortization less accumulated impairment losses. If recognition criteria is not fulfilled recognize an expense. Do not reinstate the expense as an asset even if subsequently recognition criteria is fulfilled.	

COST OF INTERNALLY GENERATED INTANGIBLE ASSETS

Cost of internally generated intangible asset shall include expenditure from the time recognition condition is met. Expenditure recognised as expense in previous annual or interim financial report cannot be reinstated.

Cost of internally generated intangible asset will include expenditure that can be directly attributed or allocated on a reasonable and consistent basis. Allocation of overhead should be as per AS-2. Borrowing costs as per AS-16 can be included.

Cost of internally generated intangibles includes	Costs not to be included
➢ Expenditure on materials and services ➢ Salaries, wages and other employment related costs ➢ Any expenditure that is directly attributable to the generation of intangible asset; ➢ Overheads are necessary for the generation of the asset and that can be allocated on reasonable basis.	➢ Selling, administrative and other general overheads unless such overheads are directly attributable in the generation of the intangible, ➢ Inefficiencies and initial operating losses incurred before an asset achieves planned performance, and ➢ Expenditure on staff training

EXAMPLE 5:

Vishnu Ltd. is engaged in research on a new process design for its product. It had incurred an expenditure of Rs.265.37 lakhs on research upto 31st March, 2003. The development of the process began on 1st April, 2003 and the Development Phase Expenditure was Rs.180 lakhs upto 31st March, 2004. From 1st April, 2004 the Company will implement the new process design which will result in a after-tax cost saving of Rs.40 lakhs per annum for the next five years. The Company's Cost of Capital is 10%. At what cost should the asset be recorded and what is its amortisation amount?

ANSWER:

Research Expenditure: As per Para 41 of AS-26, the expenditure on research Rs.265.37 lakhs should be expensed in the year in which it is incurred. It is presumed that the entire expenditure of Rs.265.37 lakhs is incurred in financial year 2002-2003. Hence, it should be written off as an expense in that year itself.

Development Expenditure: As per para 44 of AS-26, the expenditure on development can be treated as an asset only if all the conditions listed in that paragraph are satisfied. It is presumed that the company has duly complied with this requirement.

Cost of internally generated intangible asset: Para 53 specifies the items which can be included in the cost of an internally generated intangible asset, while Para 54 specifies the exclusions therefrom. It is presumed that the expenditure of Rs.180 lakhs is determined in accordance with Para 53 and 54 of AS-26.

Discounting Future Cash Flows: As per Para 30 of AS-26, fair value of an intangible asset can be estimated by discounting estimated future net cash flows. Even if this paragraph is primarily related to estimation of fair value of an intangible asset acquired in the course of amalgamation in the nature of purchase, the concept can be extended for internally generated intangible asset also.

Cost savings from the new process design for five years = Rs.40 lakhs per annum

Company's Cost of Capital = 10%

Once P & L, always P & L

Annuity Factor at 10% for five years (from the annuity tables) = 3.7908

Present value of future cash flows = Rs.40 x 3.7908 = Rs.151.63 lakhs Carrying Amount of the Asset: Since the Present Value of Future Cash Flows is only Rs.151.63 lakhs, (which is lower than the cost of Rs.180 lakhs), it is prudent to recognise an impairment loss of Rs.180.00 lakhs – Rs.151.63 lakhs = Rs.28.37 lakhs in the financial year 2003-2004.

Amortisation Period and Amount: The Company can amortise Rs.151.63 lakhs over a five year period by charging Rs.30.33 lakhs per annum from the financial year 2004-2005 onwards.

RECOGNITION AS AN EXPENSE

Expenditure on intangible item is charged as an expense when incurred unless it is recognized as an asset as per earlier paras or in case of amalgamation in the nature of purchase when it is recognised as a separate asset or gets included as part of goodwill / capital reserve.

Once P & L, always P & L

Certain expenditure though incurred to provide future economic benefits but does not create any intangible or other asset, is recognised as an expense. **Ex. Expenditure on research, start-up cost, preliminarily expense, pre-opening expense, pre-operative expense, expenditure on training, advertising, promotional activities and on re-locating or re-organizing part or all of an enterprise.**

PAST EXPENSE

Expenditure on intangible item once charged as expense in annual or interim financial report shall not be treated as asset later on.

SUBSEQUENT EXPENDITURE

Expenditure incurred subsequent to purchase or completion of intangible asset shall be treated as expenses except in following case when it will be capitalized.

1. If it will result into future economic benefits higher than originally assessed standard performance and
2. The expenditure can be measured and attributed to the asset reliably.

EASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

EXAMPLE : As a Company Auditor how would you react to the following situations?

Rs.5 lakhs paid by a pharma company to the legal advisor defending the patent of a product treated as Capital Expenditure.(Nov. 2002)

SOLUTION:

Legal expenses incurred by the company : Legal expense of Rs. 5 lakhs incurred to defend the patent of a product of the pharma company is revenue expenditure pertaining to the asset since by this expenditure neither any endurable benefit can be obtained in future in addition to what is presently available nor the capacity of the asset would be increased. Payment of legal fees is normally revenue expenditure irrespective of the amount involved unless same is incurred to bring any new asset into existence. Hence, treating such expenditure as capital expenditure is incorrect. This would result in overstatement of the value of asset and profit and calls for qualification in the audit report.

AMORTISATION

Amortisation is the systematic allocation or depreciable amount of an intangible asset over its useful life

AMORTISATION PERIOD

The depreciable amount of an intangible asset should be amortised on a systematic basis over the best estimate of its useful life which in general shall not exceed 10 years from the date when asset is available for use.

When best estimate of useful life over 10 years is considered for amortisation then

1. ***Estimate the recoverable amount*** *atleast annually and provide for the impairment loss if any and*
2. ***Disclose the reason*** *why life exceeding 10 years is justified and factors considered in determining the useful life.*

EXAMPLE: *An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years.. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.*

EXAMPLE: *An enterprise has purchased an exclusive right to operate a toll motorway for thirty years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least thirty years.*

EXAMPLE : *On January 2, 2009, Devansh Co. Ltd. bought a trademark from Induga Co. for Rs.10,00,000. Devansh Co. Ltd. hired an independent consultant, who estimated the trademark's remaining life to be 20 years. Its unamortized cost on* **Induga** *Co.'s accounting records was Rs.5,00,000. Devansh Co. Ltd. decided to amortize the trademark over the maximum period allowed. In Devansh Co. Ltd.'s December 31, 2009 balance sheet, what amount should be reported, as accumulated amortization?*

SOLUTION:

As per para 23 of AS 26 'Intangible. Assets' intangible assets should be measured initially at cost. Therefore, Devansh Co. Ltd. should amortise the trademark at its cost of Rs.10,00,000. The unamortised cost on the seller's books (Rs.5,00,000) is irrelevant to the buyer. Although the trademark has a remaining useful life of 20 years, intangible assets are generally amorised over a maximum period of 10 years per AS 26. Therefore, for the year 2009, amortisation expense and accumulated amortisation is 1,00,000 (Rs.10,00,000 ÷ 10 years).

AMORTIZATION PERIOD IN CASE OF LEGAL RIGHTS

Useful life of an intangible asset can exceed its legal life only if

1. The legal rights are renewable and
2. Renewal is virtually certain.

AMORTISATION METHOD

The amortisation method used should reflect the **pattern in which the assets economic benefits are** consumed by the enterprise. If that pattern cannot be determined reliably, the **straight-line method** should be used.

The amortised amount should be treated as an expense unless another accounting standard (like AS-2, AS-10, AS-26) permits or requires it to be included in the carrying amount of another asset.

RESIDUAL VALUE SHOULD BE TAKEN AS ZERO UNLESS

There is commitment by a third party to purchase the asset at the end of its useful life, or

There is an active market for the asset and such market is expected to exist at the end of its useful life and residual value can be determined by reference to such market.

REVIEW OF AMORTISATION PERIOD & METHOD

Both amortisation method and period should be reviewed at least at each financial year end if the previously estimated life or expected pattern of economic benefit has significantly changed then the change in life or method of amortisation should be made and accounted in accordance with AS-5 (in case of change in life whether to give effect prospectively or retrospectively is not clarified in accounting standard. Taking AS-6 as basis we can divide it prospectively).

EXAMPLE: Vidya Ltd. has spent a substantial amount on purchase of Goodwill, Trademarks and Copyrights of which 95% of the amount has been spent on the purchase of Trademarks and Copyrights. Schedule XIV of the Companies Act, 1956 does not give any rate of depreciation for these assets. The Company is not willing to amortise these Intangible Assets in the financial records on the contention that these are permanent in nature and do not require any amortization. Comment.

SOLUTION:

1. Principle: The future economic benefits contained in an asset are used over time, hence the carrying amount is reduced to reflect that consumption.
2. Allocation: The Depreciable Amount should be allocated on a systematic basis over the best estimate of the asset's useful life.
3. Commencement: Amortisation should commence when the asset is available for use.
4. Conclusion: Hence the Company should provide for amortisation.

EXAMPLE : In the past year, Vidya Ltd. had spent and carried forward in the books a total of Rs. 5,00,000 on developing a cure for cancer. During the current year, it is decided to terminate this product as test results in the current year have proved adverse. Comment on the accounting treatment.

SOLUTION:

1. **Situation:** There is an Intangible Asset appearing in the Company's Balance Sheet on account of deferral of R&D Expenditure. (Development Expenditure can be recognised as an asset subject to certain conditions).
2. **Year-end review:** As per AS – 26, the amortisation period and the method should be reviewed atleast at the end of every accounting period. If the expected useful life of the asset is significantly different from the previous estimates, the amortisation period should be changed accordingly.
3. **Analysis:** In this case, since the Company had decided in the current year to terminate the product, because of adverse test result, deferral of the costs incurred on it cannot be justified. Hence, the entire unamortized expenditure of Rs.5 lakhs should be expensed off in the current year and charged to P & L Account.
4. **Conclusion:** The change in amortisation period should be treated as a change in accounting estimate in accordance with AS – 5 and disclosed accordingly.

EXAMPLE

An intangible item is appearing in the Balance Sheet of A Ltd. at Rs.15 lakhs on 1-4-2010. The item was acquired for Rs.25 lakhs on 1-4-2008. The enterprise has been following a policy of amortizing the intangible item over a period of 5 yeas on straight line basis. Applying paragraph 63 of AS 26 the enterprise determines the amortization period to be 8 years, being the best estimate of its useful life, from the date when the item was available for use i.e., April, 1, 2008. Comment. (Suggested Nov, 2010 (Old) (4 Marks)

SOLUTION:-

Since AS 26 'Intangible Assets' was mandatory for the period when the intangible asset was acquired i.e. 1st April 2008, the revision of amortization period from 5 years to 8 years is a change in Accounting estimate and accordingly, para 78 of AS 26 would apply in this case. According to this para, if the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. AS 5 provides that in case of change in estimate, the effect should be given prospectively over the remaining useful life of the intangible asset i.e. 6 years.

Note: It is assumed that since the date of purchase of intangible item, the enterprise has been following a policy of amortizing the intangible asset over a period of 5 years on straight line basis by applying paragraph 63 of AS 26 i.e. being the best estimate of its useful life. On 1.4.2010, the company again reviewed the useful life of the intangible asset.

IMPAIRMENT LOSSES

Review of carrying amount, ascertainment of recoverable amount and recognition or reversal of impairment loss will be as per AS-28.

If an intangible asset was acquired in Amalgamation in the nature of purchase and impairment loss occurs before the end of 1st accounting period, then the value of intangible asset (credited) and goodwill / capital reserve (debited) shall be adjusted by the amount of impairment loss unless the impairment is caused by some specific events which occurs after the date of acquisition in that case it will be accounted as per AS-28.

In following cases recoverable amount shall be estimated at least at each financial year and even if there is no indication of impairment loss.

1. An intangible asset which is not yet available for use and
2. An intangible asset which is being amortized for a period exceeding 10 years from the date asset is available for use (It will apply even when the life which was originally less than 10 years is increased and aggregating to over 10 years)

If any impairment loss is found it should be recognized as per AS-28.

RETIREMENT AND DISPOSAL

An intangible asset which is disposed of or from which no future economic benefit or disposal value is expected should be written off and resultant gain / loss should be charged to profit and loss account.

Net disposal proceeds > carrying amount	Recognise as income in P & L A/c
Net disposal proceeds < carrying amount	Recognise as expense in P & L A/c

DISCLOSURE

In the financial statement, for each class (like brand names, patents, computer software etc.) of intangible asset, separately for internally generated and others, the following shall be disclosed.

- useful life or amortization rate
- amortization method
- gross carrying amount (gross block), and accumulated amortization including accumulated impairment losses at the beginning and end of the year.
- Reconciliation of carrying amount at the beginning and end of the year showing :
  - Additions, indicating separately those from internal development or amalgamation.
  - Retirement and disposals.
  - Impairment loss recognized / reversed.
  - Amortization recognized.
- Other changes in the carrying amount.

The financial statement should also disclose :

1. Why life exceeding 10 years is assumed if any and the significant factors considered for determining such life.
2. A description, carrying amount and remaining amortisation period of an intangible asset that is material (significant) to the financial statement as a whole.
3. Carrying amount of intangible assets whose title is restricted and those which are pledged as security for liability.

Amount of commitment for the acquisition of intangible assets.

Disclose aggregate amount of Research & Development expenditure recognised as an expense.

Description of a fully amortised asset which is still in use, though not required, but enterprise is encouraged to give.

AS - 26

OBJECTIVE

To lay down the criteria for recognition , accounting treatment& ascertaining amount of intangible assets & to prescribe required disclosures.

INTANGIBLE ASSET

An intangible asset is defined as an identifiable non-motherly asset, without physical substance, held for sale in production or supply of goods or services, rental to others or administrator purpose.

CONDITIONS

- Identifiable non-monetary asset without physical substance.
- Control over a resource When there is control over future economic benefits from intangible assets.
- Expectations of future economic benefit flowing to the entity

IDENTIFIABLE

↓

Asset is sold to be identifiable if it is separable from other assets and if enterprise could rent, sell, exchange or distribute the specific future benefits of this assets used in revenue earning activity.

PHYSICAL SUBSTANCE

Intangible assets has no physical substance, however some intangible assets may have physical substance like compact disk containing software but the cost of physical substance is insufficient as compared to intangible

NON-MONETARY ASSET

Means the value to be received against the assets is not fixed by contract or otherwise.

Example of monetary assets → Bills receivables, and advance etc.

Example of non-monetary assets → Goodwill, Patent and Trademark

ASSETS GENERATION PROCESS

RESEARCH PHASE

It is the activity that aimed at inventing or creating a new product, method or system

Research Cost

Treated as expense Charged to P & L A/c

DEVELOPMENT PHASE

It is the activity that convert the results of research to a marketable product

Development Cost

If development phase generate the intangible asset, then such asset should be capitalised. If,

- ✓ It meets intangible asset recognition criteria, and
- ✓ Other criteria
  - Technical feasibility of product
  - Availability of product for use or sale
  - Identification of cost incurred
  - Probability of external market
  - The realistic expectation that there will be sufficient future revenue to cover cost

RECOGNITION CRITERIA OF INTANGIBLE ASSET

Probable future economic benefit flow to the enterprises

Management should make estimate of future benefit on reasonable and supportive assumption

Cost of intangible asset can be measured reliably

AMORTISATION DEFINITION

Amortisation is the systematic allocation or depreciable amount of an intangible asset over its useful life

AMORTISATION PERIOD

The depreciable amount of intangible asset should be amortised on systematic basis over the best estimate of its useful life which is generally shall not exceed 10 years from the date when assets is available for use.

When best estimated useful life over 10 years is considered for amortisation then estimate the recoverable amount at least annually and provide for impairment loss if any and disclose the reason why life exceeding 10 years is justified and factors considered for determining the useful life.

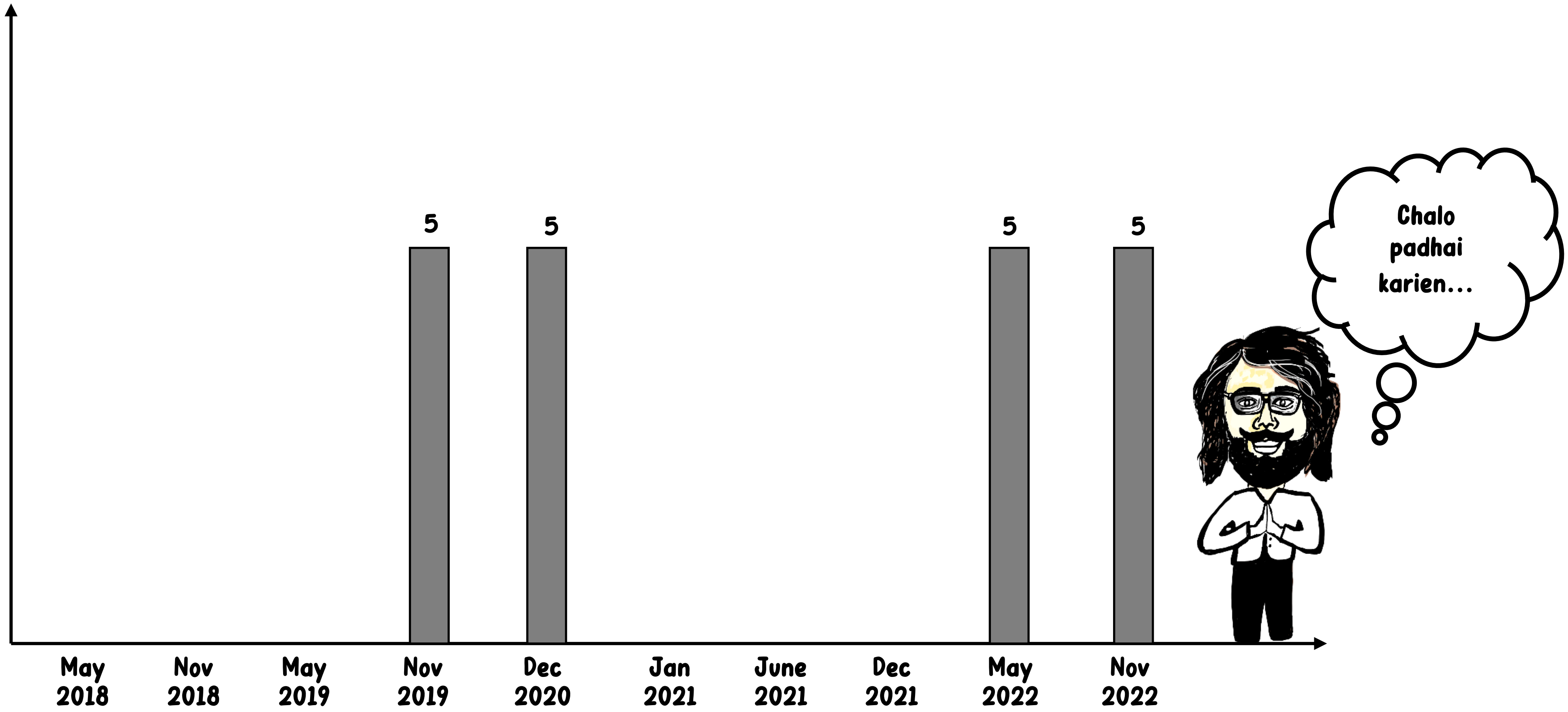
AS 29 - PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

INDEX

SR. NO.	NAME OF THE CONCEPT	QUESTIONS TO CONCEPT	REVISE ONE DAY BEFORE

ATTEMPT WISE ANALYSIS

ATTEMPT	May 2018	Nov 2018	May 2019	Nov 2019	Dec 2020	Jan 2021	June 2021	Dec 2021	May 2022	Nov 2022
MARKS				5	5				5	5

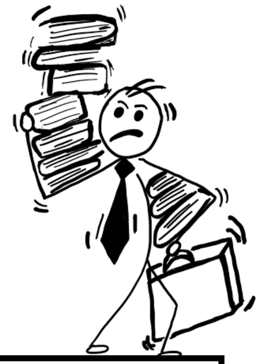


INTRODUCTION

As a finance manager of your company, you will have to determine which liabilities to be provided for and reflected in the financial statements. You will also have to identify the contingent liabilities to be disclosed in the accounts. In the absence of a standard on provision, a company could manipulate its financial results and financial position.

APPLICABILITY OF THIS STANDARD

- PROVISIONS
- CONTINGENT LIABILITY
- CONTINGENT ASSETS
- PROVISION FOR RESTRUCTURING COST



SCOPE

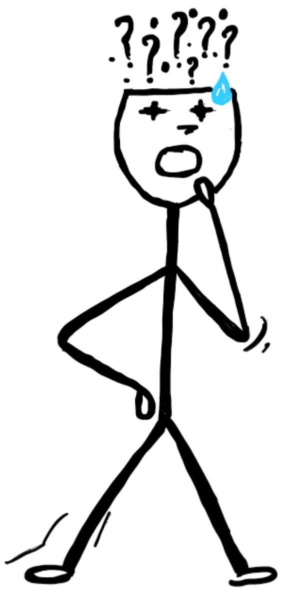
This Accounting standard is **Not Applicable** To –

- Financial instruments carried at fair value (but applies which are not carried at fair value].
- **Those resulting from executory contract other than onerous contract-**contract under which neither party has performed any of its obligations or both parties have partially performed their obligation to an equal extent.
- **Insurance enterprise-**arising out of insurance contract with policy holders. However, it applies to insurance enterprise other than those arising from contracts with policyholders.
- **Those covered by the another accounting standards** _
  (i) AS-7-Construction Contracts
  (ii) AS -22 Accounting for taxes on Incomes
  (iii) AS -19 Leases
  (iv) AS -15 Employee Benefit

CONCEPT PAPER

LIABILITY

A Liability is **present obligation** of the enterprise **arising from past events** the settlement of which is expected to result in an **outflow from the enterprise of resources embodying economic benefits.**



OBLIGATING EVENT

An obligating event is an event that creates an obligation that **results in an enterprise having no realistic alternatives to settling that obligation.**

PRESENT OBLIGATION

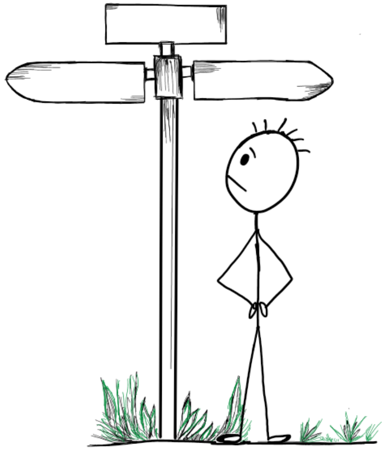
An obligation is a present obligation is **based on evidence available** its existence on the balance sheet **date is considered probable i.e. more likely than not.**

POSSIBLE OBLIGATION

An obligation is a possible obligation if **based on the evidence available,** its existence at the balance sheet date is **considered not probable.** It must be noted that for **contingent liability the existence of possible obligation should be 'Not Probable' whereas for 'provision' it should be 'Probable'.**

PROVISION

Provision is a liability, which can be **measured** only by using a **substantial degree of estimation.**



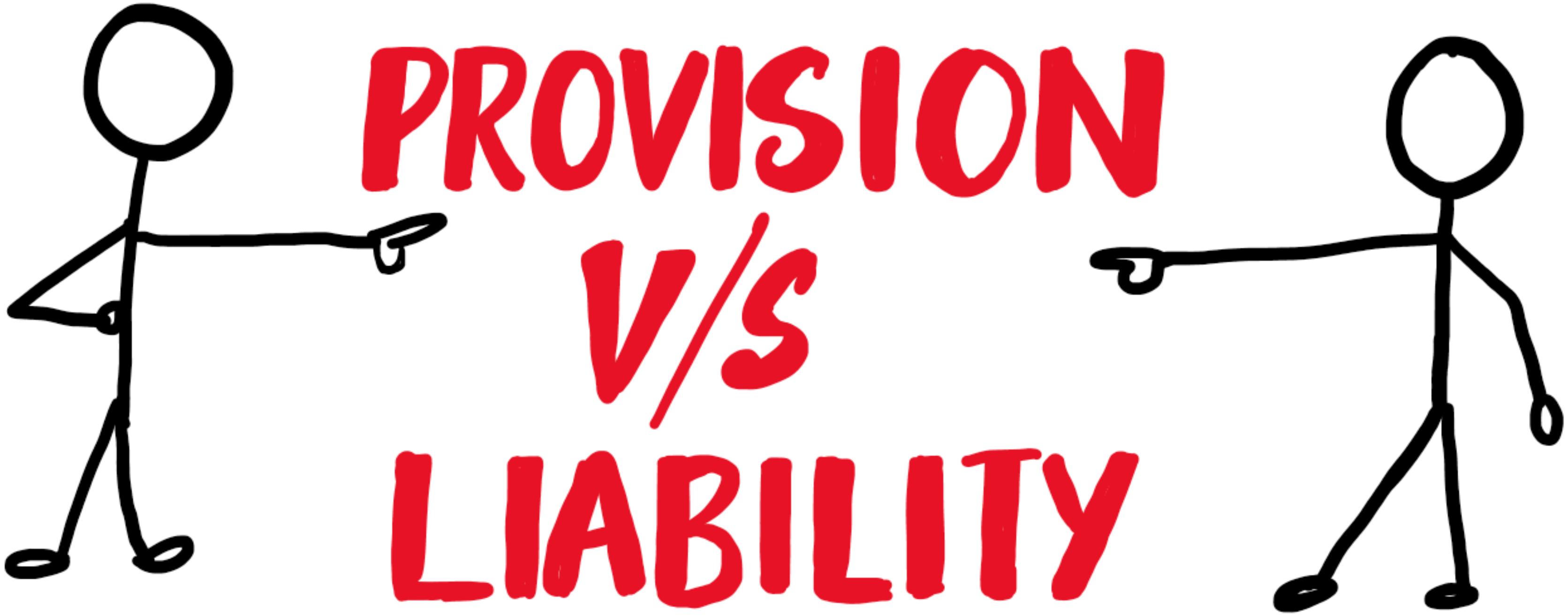
WHEN TO RESCOGNISE THE PROVISION?

CONDITION 1
Enterprise has a present obligation as a result of past events.

CONDITION 2
Present obligation must exist on the balance sheet date.

CONDITION 3
Present obligation must be probable causing outflow of resources embodying economic benefits.

CONDITION 4
It is necessary that reliable estimate of the obligation can be made. In other words if amount cannot be estimated reliably, provision cannot be recognised.



Provision can be distinguished from other liabilities such as trade payables and accruals because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement. By contract : -

a) Trade payables are liabilities to pay for goods or services that been received or supplied and have been invoiced or formally agreed with the supplier ; and

b) Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees. Although it is sometimes necessary to estimate the amounts of accruals, the degree of estimation is generally much less than that for provisions.

MEASUREMENT OF AMOUNT OF THE PROVISION

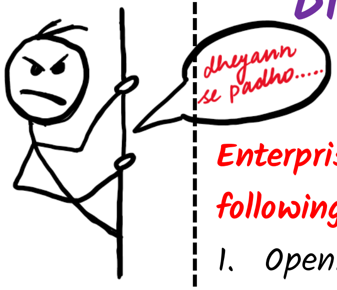
While making estimate of amount of the provision, the following points should be considered:

Provision should be **the best estimate** of the expenditure required to settle the present obligation.

1. **No discounting** of provision amount to be paid in future to its present value.
2. Provision should be **measured before tax.**
3. **Risk and uncertainties** that surrounds the events and circumstances should be taken into account.
4. **Profit on expected disposal of assets,** even if closely linked with the provision **should not be deducted** from the amount of provision.
5. **Future events** may effect the provision. For example, enterprise may believe that the cost in technology [not new technology] provision or cleaning up cost can be made on the basis of changes in technology [not on the basis of new technology expected). However, it should be supported by sufficient objective evidence.
6. **NO provision** for cost that needs to be incurred to operate in the **future or future operating losses**
7. It is not necessary to identify the party to whom obligation is owned it may be public at large.
8. when obligation arises due to changes in the law, provision should be recognized only when **the legislation is virtually certain to be enacted.**
9. **When there are a number of similar obligation** [example-product warranties] to consider the outflow of resources 'probable' **the class of obligation us a whole should be taken** and 'probable' outflow of resources should not be considered on case-to-case basis.
10. **NO provision** for that **future expenditure which can be avoided by future action** is made because there is no present obligation for that future expenditure.
11. **Additional evidence** provided by events after balance sheet date should be considered

REIMBURSEMENT OF THE EXPENDITURES [PROVISIONS]

Where some or all the **expenses requires settling, the provision is expected to be reimbursed by another party.** Amount of reimbursement against the provision may be **presented net of the reimbursement in the profit and loss statement if reimbursement is virtually certain.** The amount of provision **outstanding at the end shown in Liability side without netting off** reimbursement, if any, the reimbursement expected should be shown as an asset in the balance sheet.



DISCLOSURE OF PROVISION IN FINANCIAL STATEMENT

Enterprise should disclose for each class of provision the following. -

1. Opening balance
2. Additional to and use of the provision
3. Unused amount written back
4. Closing balance of the provision

Besides these the following other disclosures are required -

1. A brief description of provision.
2. Major assumption about future events made while measuring the provision and indication of uncertain items
3. The expected reimbursement recognized as an asset

Provisions

Rupees crores

Particulars	Non-Current		Current	
	2022	2021	2022	2021
Provision for Employee Benefits	**574.64**	722.73	**116.04**	114.39
Provision for Warranty	**308.31**	274.02	**257.08**	298.27
Provision for Service Coupons	**29.71**	18.67	**80.49**	79.58
Total Provisions	**912.66**	1,015.42	**453.61**	492.24

Provision for warranty relates to provision made in respect of sale of certain products, the estimated cost of which is accrued at the time of sale. The products are generally covered under a free warranty period ranging from 8 months to 5 years.

Provision for employee benefits includes gratuity, provident fund, post retirement benefits, compensated absence etc.

The movement in provision for warranty and service coupon is as follows:

Rupees crores

Particulars	Warranty		Service coupons	
	2022	2021	2022	2021
Opening Balance	**572.29**	614.13	**98.25**	130.87
Additional net provisions recognised during the year	**251.94**	160.70	**116.46**	46.90
Amounts utilised during the year	**(282.53)**	(233.48)	**(107.61)**	(86.80)
Unwinding of discount	**23.69**	30.94	**3.10**	7.28
Closing Balance	**565.39**	572.29	**110.20**	98.25

SOURCE: Mahindra & Mahindra Ltd. Year 2021-22

USE OF THE PROVISION

Provision should be used only for those expenditure for which the provision was originally recognised / created.

ACCOUNTING TREATMENT

The amount of provision should be shown as an expense in profit and loss statement expenses relating to provision should be shown in profit and loss statement net of reimbursement.

Warranty A/c	Dr.
To Provision for warranty A/c	

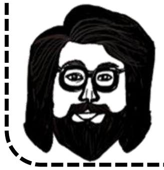
REVIEW OF THE PROVISIONS

At each balance sheet date the amount of provision made should be reviewed and adjustment for increment/decrement is made after considering the current best estimate.

If is no longer probable that outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

APPLICATION OF THE RECOGNITION AND MEASUREMENT RULES FUTURE OPERATING LOSSES

- Provisions should not be recognised for future operating losses.
- Future operating losses do not meet the definition of a liability in paragraph 10 and the general recognition criteria set out for provisions in paragraph 14.
- An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An enterprise tests these assets for impairment under



EXAMPLES

EXAMPLE 1 : WARRANTIES

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repairs or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable [i.e. more likely than not] that there will be some claims under the warranties.

The present obligating as a result of a past obligating event – The obligation event is the sale of the product with a warranty, which gives rise to an obligation.

Outflow of resources embodying economic benefits in settlement - Probable for the warranties a whole.

Conclusion - A provision is recognized for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.

EXAMPLE 2 : CONTAMINATED LAND – LEGISLATION VIRTUALLY CERTAIN TO BE ENACTED

An enterprise in the oil industry causes contamination but does not clear up because there is no legislation required cleaning up. and the enterprise has been contaminating land for several years. At 31st March, 2005 it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Present obligation as a result of a past obligating event - The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement – Probable

Conclusion – A provision is recognised for the best estimate of the cost of the clean - up.

EXAMPLE 4 : REFUNDS POLICY

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

An outflow of resources embodying economic benefit in settlement - Probable, a proportion of goods are returned for refund.

Conclusion - A provision is recognized for the best estimate of the cost of refunds.

EXAMPLE 3 : REFUND POLICY

A company follows a policy of refunding money to the dissatisfied customers if they claim within thirty days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.25% of the customers claim refunds. The company sold goods amounting to RS. 10 lacs during the last month of the the last month of the financial year. Is there any contingency?

SOLUTION → Company should make a provision of 10,00,000 X 0.25% = Rs. 2500

EXAMPLE 5 : STAFF RETRAINING AS A RESULT OF CHANGES IN THE INCOME TAX SYSTEM.

The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date; no retraining of Staff has taken place.

Present obligation as a result of a past obligating event - There is no obligation because no obligating event [retraining] has taken place.

Conclusion – No provision is recognised.

CONTINGENT LIABILITY

A Contingent Liability is:

a) A possible obligation that **arises from past events** and the **existence** of which will be **confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or**

b) A present obligation that arises from past events **but is not recognised** because

1. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
2. A reliable estimate of the amount of the obligation cannot be made.

EXAMPLES

1. Lawsuit
2. Product Warranty
3. Pending Investigation or Pending Cases
4. Book Guarantee
5. Lawsuit for theft of patent / know how
6. Change of Govt. Policies
7. Change in foreign Exchange
8. Liquidate Damages

RECOGNITION PRINCIPLE OF CONTINGENT LIABILITY

An enterprise should not recognize the contingent liability but it **should be disclosed in financial statement.** The following conditions should be fulfilled for disclosure of contingent liability in financial statement -

- There should be **present obligation** arising out of past event, but not recognized as a provision.
- It is **not probable that an outflow of resources embodying economic benefit** will be required to settle the obligation.
- The **possibility of an outflow** of resources embodying economic benefit **is not remote.**
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In **some case** , an **enterprise is jointly and severally liable for an obligation in that case, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.**

SHIFTING FROM CONTINGENT LIABILITY TO PROVISIONS

Contingent liabilities are continuously assessed and if it becomes probables that an outflow of future economic benefits will be required to settle obligation, which is previously assessed as contingent liability, a provision is recognised.

DISCLOSURE OF CONTINGENT LIABILITY

A enterprise should disclose for each class of contingent liability at the balance sheet date.

- A brief description of the nature of the contingent Liability where practicable.
- An estimate of the amount as per measurement principles as prescribed for provision.
- Indications of the uncertainties relating to outflow.
- The possibility of any reimbursement
- where any of the information required as above is not practicable to do so, that fact should be stated.

EXAMPLE 6 : A SINGLE GUARANTEE

During 2004-05, Enterprise A gives a guarantees of certain borrowings of Enterprises B, whose Financial condition at that time is sound. During 2005-06, the financial condition of Enterprise B deteriorates and at 30th September 2005 Enterprise B goes into liquidation.

(a) At 31st March, 2005

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rises to an obligation.

An outflow of resources embodying economic benefits in settlement -No outflow of benefits is probable at 31st March 2005.

Conclusion - No provision is recognised. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31st March, 2006

Present Obligation as a result of a past obligating event-the obligating event is the giving guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - At 31st March 2006, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion - Provision is recognised.

EXAMPLE 7 : A COURT CASE

After a wedding in 2004-05 , ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the date of approval of the financial statements for the year 31st March 2005, the enterprise lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31st March 2006, its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable.

a) **At 31st March,2005**

Present obligation as a result of a past obligating event - on the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.

Conclusion -Not provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

b) **At 31st March, 2006.**

Present obligation as a result of a past obligating event-on the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the amount to settle he obligation.

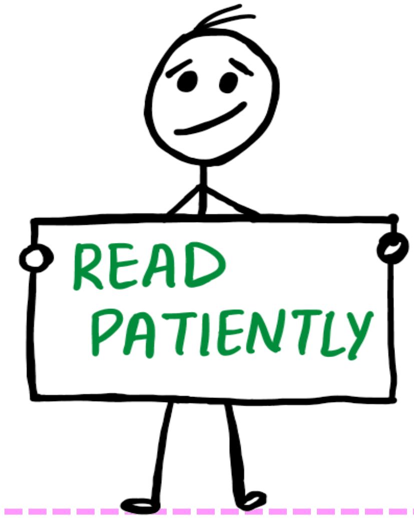
EXAMPLE 8 : A COURT CASE

The sales tax authority ordered an additional demand on the company for under payment of sales tax on the basis of under-invoicing of goods. The company contested the case. The lawyer advised the company as on 31/3/2004 that there would be no liability. As on 31-03-2005, the lawyer advised the company that on the basis of latest development in the case, a liability would arise. Advise disclosure.

SOLUTION - For the year ended 31 March 2004, There is no present obligation. The company should not make a provision that should disclose it as a contingent liability unless the probability of any outflow is regarded as remote.

For the year ended 31st March 2005.

On the basis of the evidence there is a present obligation and therefore a provision is recognised for the best estimate of amount to settle the obligation.



EXAMPLE 9 : A COURT CASE [CA FINAL EXAM QUESTION]

A company has at its financial year ended 31st March, 2004 fifteen law suit outstanding, none of which has been settled by the accounts are approved by the directors. The directors have estimated that the possible out-comes are as below:

Result	Probability		Amount of Loss (Rs.)	
For First ten cases:				
WIN	0.6			
Lose – Low Damages	0.3		90,0000	
Lose – High Damages		0.1		1,60,000
For remaining five cases:				
WIN	0.5		-	
Lose – Low Damages	0.3		60,000	
Lose – High Damages		0.2		95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

SOLUTION → As per AS-29 contingent liability should be disclosed in financial statements if following conditions are satisfied : -

- There should be present obligation arising out of past event but not recognised as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an out flow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five case 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an out flow of resources embodying economic benefit is not remote rather there is reasonable possibility of loss , therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under :

Expected loss in first ten cases = ₹ 90,000 X 0.3 + ₹ 1,60,000 X 0.1

= ₹ 43,000 X 10

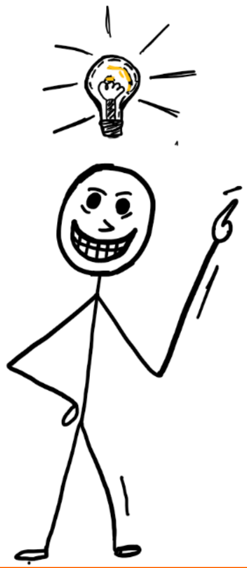
= ₹ 4,30,000

Expected loss in remaining five cases = ₹ 60,000 X 0.3 + ₹ 95,000 X 0.2

= ₹ 37,500 X 5

= ₹ 1,85,000

Total contingent liability = ₹ 4,30,000 + ₹ 1,85,000 = ₹ 6,15,000



PROVISIONS AND CONTINGENT LIABILITY

QUICK SUMMARY

There is a present obligation that probable requires an outflow of resources and are liable estimate can be made of the amount of obligation	There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.	There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.
A provision is recognized	No provision is recognized. Disclosures are required for the contingent liability.	No provision is recognized. No disclosure is required.

CONTINGENT ASSETS

Contingent asset is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within control of the enterprise.

To be called a 'Contingent Asset' the following conditions must be fulfilled.

- Possible asset as a result of past events.
- Existence of contingent assets is to be confirmed by occurrence and non- occurrence of one or more future events.
- Future events not wholly within the control of the enterprise.

EXAMPLES

1. Lawsuits
2. Warranties
3. Estate Settlements
4. Mergers and acquisitions

RECOGNITION PRINCIPLE OF CONTINGENT ASSETS

An enterprise should not recognize a contingent asset because it may result in the recognition of income that may never be realized. However, if realization is virtually certain then the related asset is recognised.

WHETHER DISCLOSURE IS REQUIRED OF CONTINGENT ASSETS

Contingent Assets are not required to be disclosed in financial statement. Generally Board of Directors report discloses such contingent assets.

RESTRUCTURING COST

Restructuring is a **programme that is planned and controlled by management and materially changes** either-

- The scope of a business undertaken; or
- The manner in which that business is conducted.

Some Examples of Restructuring Cost -

- Sale or termination of line of business
- The closure of business locations in country or regions
- Relocation of business activities from one country or region to another
- Change in management structure
- Fundamental re-organisation that has material effect on the nature and focus of the enterprise operations

RESTRUCTURING DOES NOT INCLUDE

- Restraining or relocating continuing staff.
- Marketing
- Investment in new system and distribution networks.

RESTRUCTURING COST PROVISION

A provision for restructuring costs is **recognised only when the recognition criteria for provisions are met.** Provision for restructuring cost should **include only the Direct Expenditures arising from restructuring** and not associated with the ongoing activities of the enterprises.

ONEROUS CONTRACT [ACCOUNTING STANDARDS INTERPRETATION – 30]

An **"Onerous Contract"** is a **contract in which the unavoidable** cost of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.

APPLICABILITY

If an enterprise has a contract that is onerous, the present obligation under the contact Should be recognized and measured as a provision as per As -29

The unavoidable costs under an onerous contract reflect the least net cost of existing from the contract, which is the lower of the cost of fulfilling it and compensation or penalties arising from failure to fulfil it

AS - 29

OBJECTIVE

To lay down recognition criteria, measurement bases and disclosure requirements relating to provisions & contingent liabilities

PROVISIONS

MEANING

A Liability which can be measured only by using a substantial degree of estimation

RECOGNITION

- Present obligation as a result of past event
- Probable that outflow of resources embodying economic benefits will be required to settle the obligation
- Reliable estimate can be made of the amount.

MEASUREMENT

- Using best estimate of the expenditure required to settle the present obligation at balance sheet date
- Should not be discounted
- Should consider related risks and uncertainties
- Related future events to be considered when there is sufficient objective evidence that they will occur.
- Gains from disposal of asset not to be considered.
- Consider reimbursements.

REVIEW

At each balance sheet date and adjust the provisions to reflect the current best estimate. If appropriate, reverse the provision

CONTINGENT LIABILITIES

- Not to be recognized
- Requires disclosure, unless the possibility of an outflow of resources is removed.
- Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.
- To be reviewed continually, if it becomes probable that an outflow of future economic benefits will be required, recognize the contingent liability as a provision.

CONTINGENT ASSET

- Not to be recognized
- Not to be disclosed in FS, usually disclosed in director's report
- To be reviewed continually, if it becomes virtually certain that an inflow of economic benefits will arise, recognize the assets and related income

RESTRUCTURING

Restructuring is a programme that is planned and controlled by management and materially changes either:-

- The scope of a business undertaken ; or
- The manner in which that business is conducted

Some Examples Are

- Sale or termination of line of business
- Closure of business location in a country or region or the relocation of business activities
- Changes in management structure
- Fundamental re-organisation that have materially effect on the nature and focus of the enterprises operations

ONEROUS CONTRACT

In which unavoidable costs of meeting the contract exceed the economic benefits expected to be received under it