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Accounting Standards

BENCHMARK

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CA- Intermediate
Advanced Accounting Fast-track
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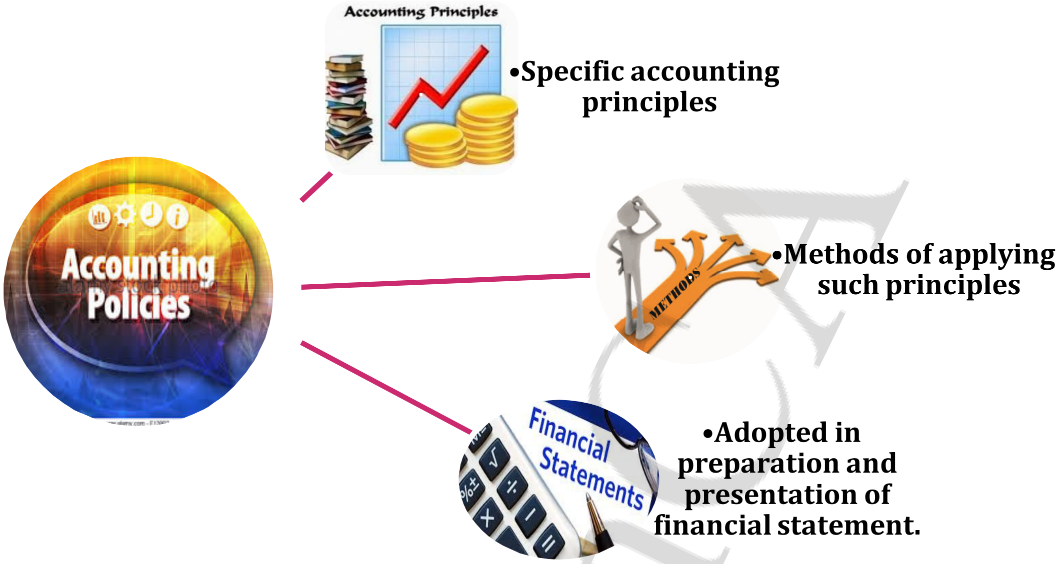
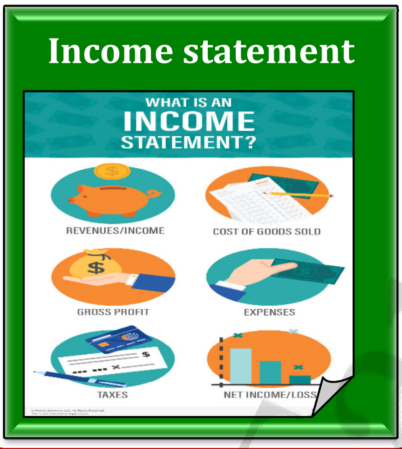
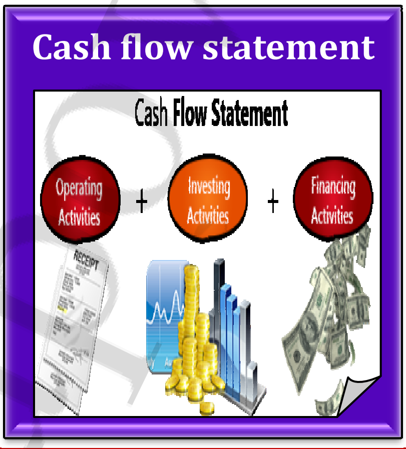
Concept No. 1 - Accounting policies means

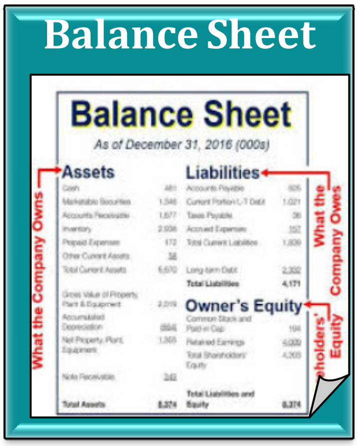


Definition: - Accounting Policies are Specific accounting principles & Methods of applying such principles adopted in preparation and presentation of financial statements.

Financial Statements Means







Examples of Accounting Policies

Purpose/Principle	Methods for applying Principles
Providing Depreciation	Straight Line method, Written down value method etc.
Valuation of Inventory	FIFO, Weighted Average and Standard Cost method etc.
Valuation of Fixed Assets	Cost model, Revaluation model
Treatment of Government grants	Recognising as Income or reduction from cost of asset

Concept No. 2 - Conditions to be satisfied for adopting accounting policy

"Policies selected should give true and fair view of business through Financial Statements" therefore following points becomes important for selection of accounting policies.

1. Prudence

1. Prudence means Caution and this means management should be cautious (careful) while selecting accounting policies.
2. Wrong selection of Accounting Policies may lead to excessive Profits, overvaluation or undervaluation of Assets and liabilities.
3. As per prudence / conservatism, Probable loss is to be recognised but probable income is not to be recognised unless it is virtually certain.
4. In other words, expect and record all future losses and don't expect and record future gains.

Example: Inventories are valued at cost or net realisable value whichever is lower.
Probable losses shall be provided immediately.

2. Substance Over Form

1. Reality is more important than legal form.
2. Transactions and other events should be accounted for and presented in accordance with their substance and financial reality not merely with their legal form.
3. Example: In case of hire purchase, the hire vendor is owner till the payment of last installment. Irrespective of this, Hire purchaser records the asset in his books and hire vendor records hire purchase transaction as sale as the final intention of hire purchase is to sale goods.

3. Materiality

1. Facts which are not of material nature need not be disclosed separately.
2. Material items are those items which affects decision making of users.
3. Materiality depends on Size and nature of business.

Concept No. 3 - Disclosure of Accounting Policy

All Accounting Policies shall be disclosed at one place

Accounting Policies shall be selected after complying with above conditions because just disclosure is not remedy for wrong selection of accounting Policy

Why disclosure of Accounting Policy is required?

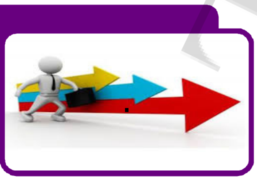
It helps users of accounting information:

- In better understanding of financial information.
- For comparison of financial statements with other entities.

Concept No. 4_Fundamental Accounting Assumptions (F.A.A.)

Fundamental Accounting Assumption

- **Going concern**



- **Consistency**

- **Accrual Assumption**

Explanation of Fundamental Accounting Assumption.

Going concern

- It is assumed that business would continue for foreseeable period.
- There is no necessity or decision to curtail/close down of entity.
- Entity is assumed to be a going concern unless there is clear situation of winding up of business.
- **Example -** Plant 1,00,000 life 10 years, scrap 10,000. Calculate Depreciation for first year. **Solution -** 9,000 on the assumption that business would continue for 10 year.

Consistency

- It means it is always assumed that same accounting policies would be followed every year.
- **Example: -** plant 1,00,000 life 10 years, scrap 10,000 Calculate Depreciation for second year. Solution: - 9,000 every year on the assumption of going concern and consistency.

Accrual Assumption

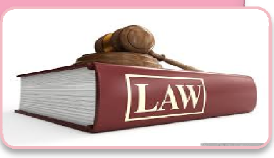
- It is assumed that entity record all income & exp. on period basis. They are not recorded on payment basis.
- As per accrual, all expenses shall be recorded when it is incurred and all incomes shall be recorded when it is earned,
- This concept helps in calculation of true income of business for each accounting period.
- Even section 128 of Companies Act, 2013 requires that Accounts of companies shall be maintained on accrual basis,
- **In Trial Balance following balance are shown.**
- Salary 1,00,000. Outstanding salary 10,000.
- **Solution: -** In P&L salary 1,00,000 Add:- Outstanding salary (it is added because it is related to current period even though it is not paid in current year) and shown on liability side of Balance Sheet .

Concept No. 5_Change in Accounting Policy

As per consistency, entity shall follow same accounting policy year by year but entity may change accounting policy in following cases:

Entity may change accounting policy

- **If change in accounting policies is required to comply with**
  - **Statute (Law)**



  - **Accounting Standards.**

- **If it is considered That change in Accounting Policy results in appropriate presentation of Financial Statements.**

Additional Points on Change in Accounting Policies:

-Any change in accounting policy should be disclosed.
-The effect of such a change should be quantified.
-If quantification is not possible the facts should be disclosed.
-The change is to be disclosed in the year or years in which it has an impact on financial statements.

Example:
1. Change in method of depreciation.
2. Change in the method of valuation of inventories.

AS – 2 Valuation of Inventories

Concept No. 1 - Objetives of AS Valuation of Inventories

1. To formulate the method of calculation of Inventories/Stock
2. To determine the carrying amount of inventories in Financial Statements (FSs). This includes determination of cost of inventory and any amount to be written off to bring it to Net Realisable Value (NRV).

This Standard is very important as it impacts both P&L as well as Balance sheet i.e. if closing stock is overvalued/ undervalued; it impacts CY profits as well as asset value in the Balance sheet.

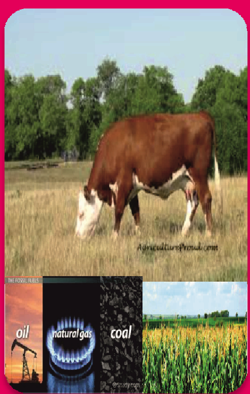
Concept No. 2 - Applicability of AS - Inventory Valuation

This standard is not applicable to the following.

WIP of service provider

If the entity holds shares, debentures and other financial instruments as stock-in-trade ; (It is discussed in AS 13.)

Work-in-progress (WIP) arising under construction contracts; (It is discussed in AS 7)



1. Inventories of livestock,

2. Agricultural and forest products,

3. Mineral oils, ores and gases to the extent that they are measured at NRV in accordance with well established practices in those industries.

Concept No. 3 - Definitions

Finished goods (FG) -
Held for sale in the Ordinary course of business

Raw Material, WIP -
Used in the process of production for such sale

Consumables & Loose tools, etc..
To be consumed in the process of production or in rendering the services

Chart Presentation Inventories includes

Inventories consist of

- Held for sale in the Ordinary course of business i.e. Finished goods (FG).
- Used in the process of production for such sale i.e. raw material, WIP etc.
- To be consumed in the process of production or in rendering the services e.g. consumables and loose tools, etc.

Concept No. 4 Measurement of Inventories

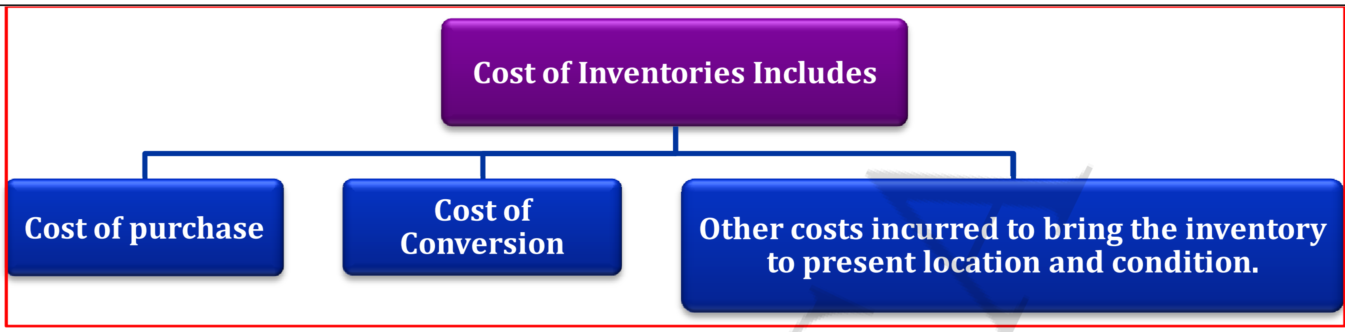
Major points for valuation of Inventories

1. Determination cost of Inventories
2. Determination Net Realisable Value of Inventories
3. Comparison between the Cost and Net Realisable Value

Inventory is valued at COST (or) NRV Whichever is LOWER

Concept No. 5 What is Cost of Inventories

Chart Presentation Cost of Inventories includes



5. (1) Cost Of Purchase

Cost of purchase includes all costs incurred to purchase the material.

The following items are directly related to the purchase of material.

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

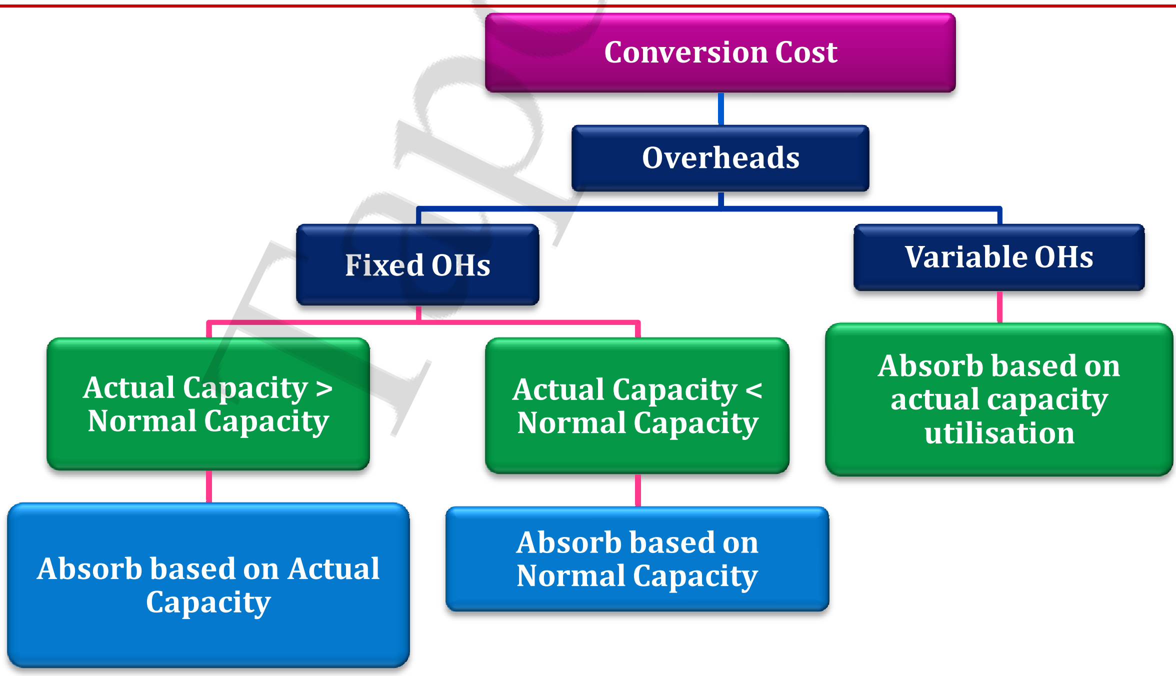
5 (2) Cost of Conversion

This includes the costs incurred to convert the raw materials into finished goods.

For example major costs like Labour, Factory rent, fuel costs, power expenses (factory overheads) and other items.
The overheads (OH) should be absorbed in the following manner:
Factory overheads can be divided into two types based on its nature i.e. variable overheads and fixed OH.

Variable expenses – which vary (change) along with the volume of production;
Fixed expenses – which do not vary with volume of production.

Chart Presentation



Normal Capacity (Meaning)

Normal Capacity is the number of units of production on an average over a period under normal Circumstances after considering loss of capacity under normal circumstances.
(Normal capacity = Total capacity Less planned maintenance)

Actual capacity (Meaning)

Actual capacity is **actual production** of goods.

1. Fixed Production Overhead will be taken in actual cost on recovery basis

$$\text{Overhead Recovery Rate} = \frac{\text{Production Overhead}}{\text{Normal Production}}$$

Overhead Recovered = Rate X Units Produced

2. If Actual production is very high, then take the actual production as denominator.

$$\text{Overhead Recovery Rate} = \frac{\text{Production Overhead}}{\text{Actual Production}}$$

Overhead Recovered = Rate X Units Produced

Examples of factory cost and these should be absorbed in the calculation of per unit cost.

1. Consumable stores and spares;
2. Depreciation of plant and machinery, factory building etc…
3. Lease rent of production assets;
4. Repair and maintenance of plant and machinery, factory building etc...
5. Indirect employees cost connected with production activities;
6. Drawing and Designing department cost;
7. Insurance of plant and machinery, factory building, stock of RM & WIP etc.
8. Amortized cost of jigs, fixtures, tooling etc.
9. Service department cost such as Tool Room, Engineering & Maintenance etc.

5 (3) Other Costs

All other costs incurred to bring the inventory to the present location and condition. Examples:

1. Quality control cost - quality control employee cost and other costs of that dept;
2. R&D cost incurred for the development and improvement of the process or product;
3. Administration OHs in relation to production activities; (General admin OHs should NOT be included);
4. Packaging cost - primary and secondary package cost should be included, etc.

Concept No. 6 Following cost should be excluded From "COST"

1. **Abnormal Loss** (Loss due to Fire, waste of materials, labour or other production costs)

2. Storage costs, unless those costs are necessary in the production process prior to a further production stage. (E.g. Electricity used for cold storage)	
3. Administrative, Selling and Distribution costs. (Expenses such as rent, staff salary, Electricity Bill)	
4. Borrowing costs (Interest)	

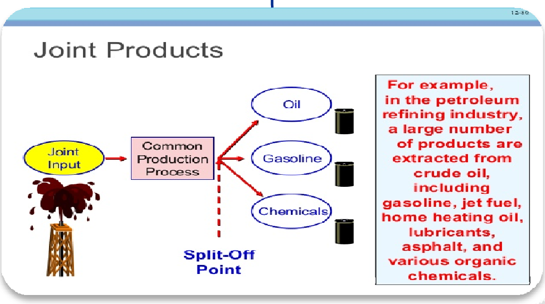
Concept No. 7 Allocation of costs in special situations:

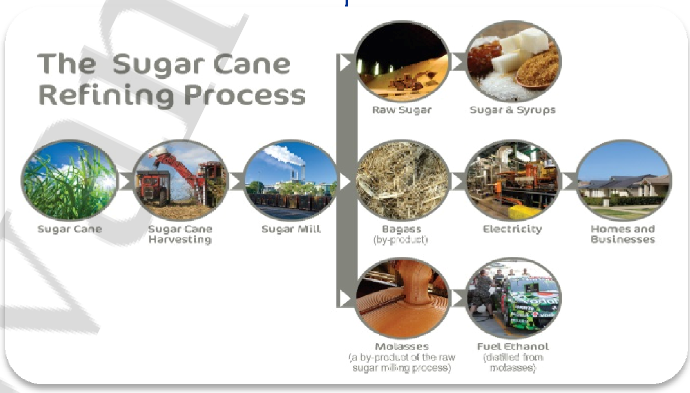
Points	Joint Products	By Products
Meaning	Two or more outputs generated simultaneously, by a single manufacturing process using common input, and being substantially equal in value.	It is a secondary or incidental product in a process of manufacture and generally it has insignificant value.
Example	(1) Butter, cheese, and cream from milk, (2) Fuel oil, gasoline, and kerosene from crude oil.	In manufacture of Sugar - Sugar is main product and molasses is by product.
Allocation of Cost	In this case, the joint costs (common costs) are allocated between the products on a rational and consistent basis. a) On the Sales value of each product when the products become separately identifiable; (b) On the sale value after completion of production;	1. Find out the joint costs of main product & by products. 2. Compute Net realisable value of by product at the time of separation. 3. Cost of main product = total joint costs of main product & by product Less NRV of by product.

What Is Joint Product & By Product

Raw Material

- **Product A**
- **Product B Is it Significant**
  - **Yes** → **Joint Product**: Two or more outputs generated simultaneously, by a single manufacturing process using common input, and being substantially equal in value.
  - **No** → **By Product**: It is a secondary or incidental product in a process of manufacture and generally it has insignificant value.





Concept No. 8 - Methods of Ascertaining of Cost of Inventories

Cost of inventory should be ascertained in following manner

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

Concept No. 9 – Net Realisable Value

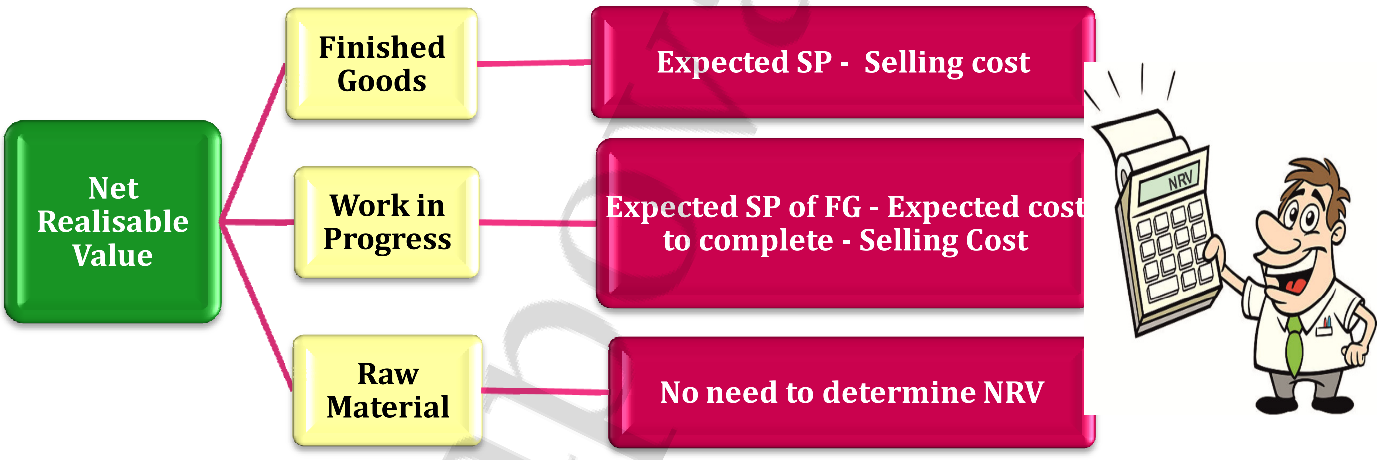
Calculation of NRV

Expected Selling Price − Expected Selling Expenses − Expected Cost Of Completion = NRV

Expected Selling Price in ordinary course of business	xxx
Less:- Expected Selling Expenses	xxx
Less:- Expected Cost Of Completion	xxx
Net Realisable Value	**xxx**

Expected means management estimated, can be made due to contract received. It can be general price also.

Diagrammatical Presentation



9.1 NRV Of Work – In - Progress

WIP is the one which is not completed or partially completed. Finding out expected selling price for WIP is not possible as nobody purchases the WIP product. It is meant to be converted into FG and to sell as FG. Hence we start computing the NRV of WIP with Expected selling price of FG and deduct the costs to be incurred to complete it as FG & Costs incurred to sell.

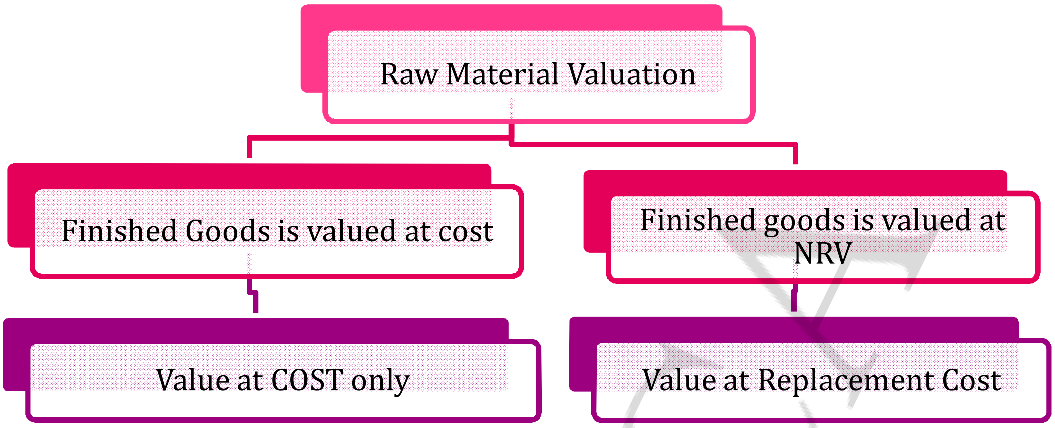
9.(2) Valuation of Raw Material Stock

Valuation of Raw Material is **NOT based on Cost (or) NRV whichever is less.**

Its valuation is fully based on the valuation of finished goods as the entity is purchasing raw material not to sell in the ordinary course of business as raw material BUT to use it for producing the finished goods.

Raw Material	Finished Goods	Valuation of Raw Material
		1. Stock of Raw material (wool) is valued at cost price, if finished goods(Sweater) in which such raw material used is valued at cost price. 2. Stock of Raw material (wool) is valued at Replacement Cost, if a finished goods (Sweater) is valued at NRV.
		1. Stock of Raw material (Leather) is valued at cost price, if finished goods(Shoes)in which such raw material used is valued at cost price. 2. Stock of Raw material (Leather) is valued at Replacement Cost, if a finished goods (Shoes) is valued at NRV.

Chart Presentation of Raw Material Valuation



Disclosure Requirements Under AS - 2

Concept No. 10_Disclosure Requirements

The financial statement should disclosed

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

Concept No. 1 Objectives of Cash Flow statement

1. Cash flow statement aims at highlighting the **cash generated from operating activities.**
2. To help in **planning of repayment of loan** schedule and replacement of fixed assets, etc.
3. To ascertain the **liquid position** of the firm in a better manner.
4. Cash flow Statement helps in **efficient and effective management of cash.**

It is very useful in the evaluation of cash position of a firm.

Concept No. 2 Cash and relevant terms as per AS-3

2.1 Cash fund

Cash fund: It includes

- Cash in hand
- Demand deposits with banks
- Cash equivalents - It is short-term, highly liquid investments, readily convertible into cash.

2.2 The statement of cash flow

Categories of Cash Flows

- **Operating activities**: These are the principal/ Main revenue generating activities of the enterprise.
- **Investing activities**: It include the purchase and sale of long term assets and other investments than cash equivalents.
- **Financing activities**: Activities that result in change in the size and composition of the capital (including Preference share capital in the case of a company) and borrowings of the enterprise

Concept No. 3 - The statement of cash flow shows

Concept No. 4 - Methods *of calculating cash flow from Operating Activities*

There are two namely Direct method and Indirect method. SEBI (Securities Exchange Board of India) Guidelines recommend for only direct method.

Concept No. 4 (1) Cash Inflow/ Outflow from Operating Activity as per AS-3 (Direct Method)

It is main revenue producing activity except investing or financing activity.

Cash Inflow

- Cash Sales
- Cash received from Debtors.
- Cash Received from Commission and Fees
- Royalty & Other revenue.

Cash Outflow

- Cash Purchases.
- Payment to creditors.
- Cash operating expenses.
- Payment of wages.
- Payment of Income Tax.

Concept No. 4 (2) Cash Inflow/ Outflow from Investing Activity as per AS-3

Helps to Estimate the future Operating cash because of current year Investing Activities

Cash Inflow

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

Cash Outflow

1. Purchase of fixed assets
2. Purchase of investment

Concept No. 4 (3) Cash Inflow/ Outflow from Financing Activity as per AS-3

It is Useful to predict Future claims by Providers of funds

Cash Inflow

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

Cash Outflow

1. Cash repayments of amounts of Loan.
2. Redemption of shares & debentures.
3. Dividends paid on equity & preference share capital
4. Interest paid on loans/debentures

Points to be noted:

Period for the Cash Flow Statement is the same as P& L Account and Balance Sheet.

Concept No. 5 – Preparation of *Cash Flow Statement*

Cash Flow Statement can be prepared by

- **Direct Method**
  - Reports all cash receipts and cash payments from operating activities
- **Indirect Method**
  - Reconciles from net income to cash provided by operating activities

Picture presentation of Cash Flow Statement

Concept No. 6 *Other Important Items & Disclosure*

1. Income tax

Income tax payment shall be separately disclosed under operating activities

(if nature of tax is not specified then it is assumed that the tax is paid on income generated from operating activity)

If it is practicable to separate the tax payments among different activities, it should be separated and presented under respective activity like operating, investing or financing activity.

2. Extraordinary/ Exceptional items
Cash flow from extraordinary items should be disclosed separately under appropriate activity based on the nature of Cash flows Example: Cash received against insurance claim is treated as Cash flow from operating activity whereas cash received against insurance claim for loss of asset is shown in investing activity,

Concept No.7

Format for Cash flow Statement
Direct method

Particulars	Amount
(i) Cash flow from operating activities	
A. Operating cash receipts	
– Cash sales	
– Cash received from customers	
– Trading commission received	
– Royalties received	
B. Less : Operating cash payment	
– Cash purchase	
– Cash paid to the supplier	
– Cash paid for business expenses like office, production, selling expenses	
C. Cash generated from operation (A – B)	
D. Less Income tax paid (Net of tax refund received)	
E. Cash flow before extraordinary items	
Net cash flow from Operating activity	
(ii) Cash from investing accounting	
Add :	
– Proceeds from sale of fixed assets	
– Proceeds from sale of investments	
– Proceeds from sale of intangible assets	
– Interest and dividend received	
– Rent income	
Less :	
– Purchase of fixed assets and investment	
– Purchase of intangible assets like goodwill	
Net cash flow from investing activities	
(iii) Cash flows from financing activities	
Add :	
- Proceeds from issue of shares and debentures	
- Proceeds from other long term borrowings	
Less :	
- Final dividend paid	
- Interest dividend paid	
- Interest on debentures and loans paid	

- Repayment of loans - Redemption of debenture preference shares Adjust extraordinary items (+/−) **Net cash flow from Financing activities** **(iv) Net increase/Decrease in cash and cash equivalent (i + ii + iii)** **(v) Add : cash and cash equivalents in the beginning of the year** **(vi) cash and cash equivalents in the end of the year**	

Format for Cash flow Statement
Indirect Method

Particulars	Amount
(i) Cash flow from operating activities **A.** Net Profit as per Profit and Loss A/c or difference between closing balance and opening balance of Profit and Loss A/c Add : Transfer to reserve Proposed dividend for current year Interim dividend paid during the year Provision for tax made during the current year **Net profit before taxation and Extra ordinary items** **Adjustment for Non-Cash and Non-Operating Items.** **B. Add** : – Depreciation – Preliminary expenses – Interest on borrowings and debentures – Loss on sale of fixed assets – Discount on issue of shares and debentures written off **C. Less :** – Interest income/received – Dividend income received – Rental income received – Profit on sale of fixed asset **D. Operating profits before working capital changes (A + B – C)** **E. Add** - Decrease in current assets - Increase in current liabilities **F. Less** : - Increase in current assets - Decrease in current liabilities	

G. Cash generated from operations (D + E – F) **H. Less : Income tax paid (Net tax refund received)** **I. Cash flow from before extraordinary items** Adjusted extraordinary items (+/–) **Net cash flow from Operating activity** **(ii) Cash from investing accounting** **Same as Direct Method** **(iii) Cash flows from financing activities** **Same as Direct Method** **(iv) Net increase/Decrease in cash and cash equivalent (i + ii + iii)** **(v) Add : cash and cash equivalents in the beginning of the year** **(vi) cash and cash equivalents in the end of the year**	

Note: Direct and Indirect Methods are not methods of preparing Cash Flow Statement but it is method to find out Cash flow from Operating Activity.

In Other words, Cash Flow from operating activity can be calculated from Direct Method or Indirect Method and remaining calculation of Investing and financing activity is same in direct and indirect Method.

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

Concept No. 1 - Objectives of AS 4

1. Meaning & Accounting of Contingencies
2. Meaning & Accounting of Events Occurring after Balance Sheet Date but before approval of balance sheet by Board of Directors.

Concept No. 2 – Applicability of AS - 4

This AS is Not applicable to

Liabilities of life assurance and General insurance.

Obligation under retirement benefit plans.

Commitments arising from long term lease contracts.

Concept No. 3 - AS 4 deals only with

Contingencies Meaning

1. Existing condition or situation at the Balance Sheet Date

2. Whose ultimate outcome is gain (ignored) or loss

3. Which will be known after occurrence or non occurrence (happening or non happenning) of one or more uncertain event.

❖ Example of Accounting Contingencies

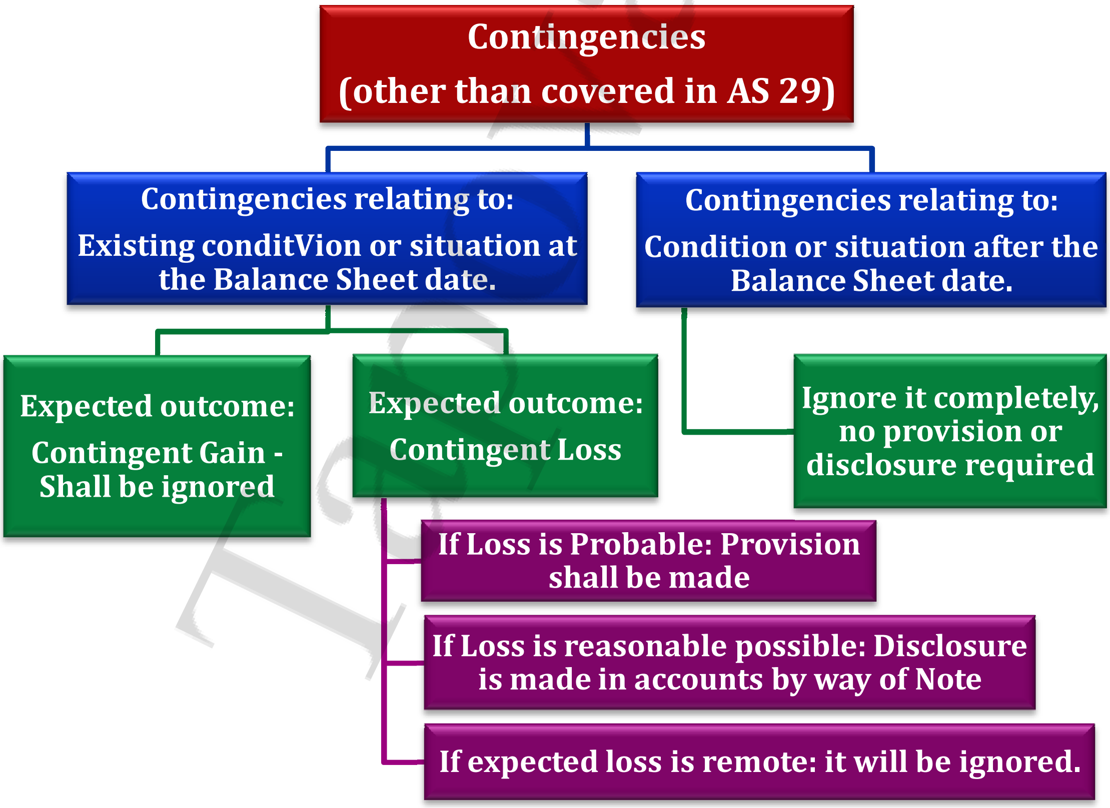
A Company filed case against the debtor from whom 50 lakh is receivable as on 31st March, 2017. As per opinion of expert chances of recovery is doubtful then company should make provision for bad and doubtful debts as situation of non-recovery is existing on balance sheet date.

❖ Important Note

This Accounting Standard covers only **Provision for Doubtful debts** other provisions like Provisions for taxation which are shown on liabilities side is covered under "AS-29 Provisions, Contingent liabilities and Contingent Assets.

PART 2

Concept No. 4 Events Occurring after Balance Sheet Date



Meaning of Events Occurring after Balance Sheet Date

1. **Significant events: -** Significant events are Material (important) events, which can influence the economic decisions of the users of financial statements.
2. **Which occur between the balance sheet date and financial statements approval date?**
3. **Events can be favorable or unfavorable to the entity.**

Main Discussion under Part 2 of AS-4:

When to record Events occurring after Balance Sheet date?

1. On Balance Sheet Date, or
2. Next Year

To understand above point we will first understand the steps of company related to approval of financial statement every year:

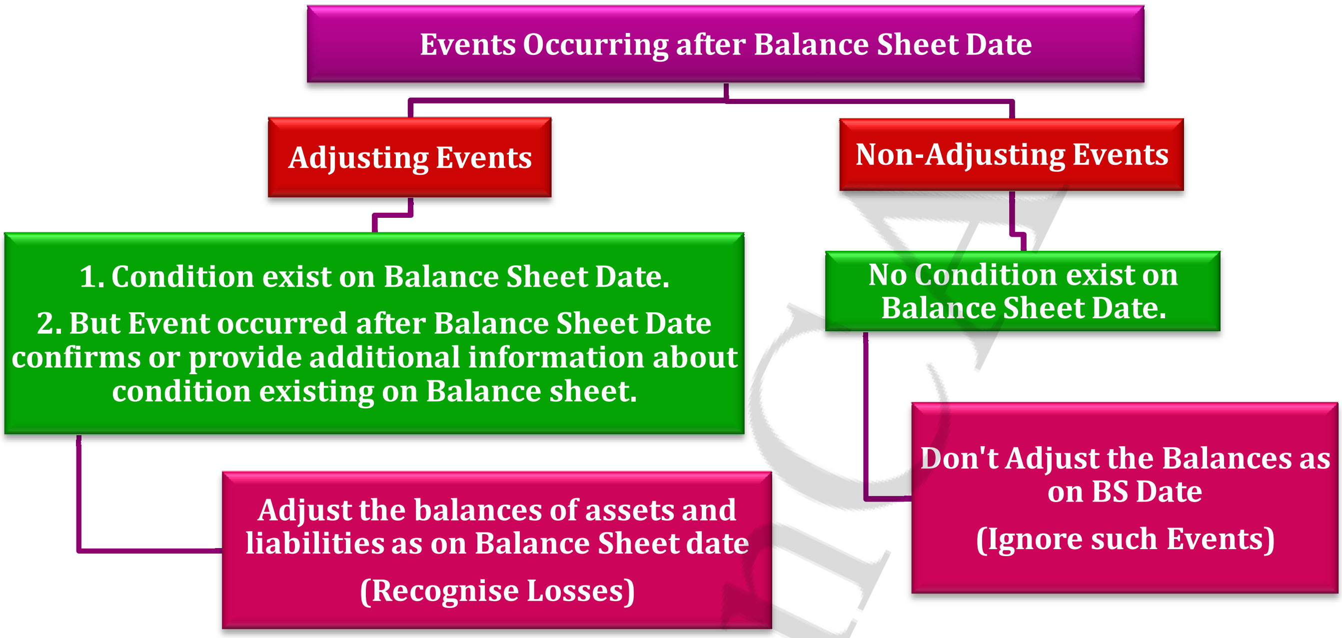
Step 1: End of Accounting Period i.e. Assume that it is 31st March, 2017 (it is Balance Sheet Date)
Step 2: Management/ Board of Directors will prepare **financial statement (FS)** for the year ended 31st March, 17.
Step 3: Audit is conducted by Auditor and Auditor will issue report on financial statements prepared.
Step 4: Board of Directors (BOD) meeting to approve FS and for calling of Members meeting (AGM).
Step 5: Audited financial statements are adopted/ approved by Members in AGM.

In the above diagram, we are mainly concerned with events occurring after 31-3-2015 to 15-08-2015. These events can be recorded after 31st March but before 15th August (approval of FS).

If events qualify following conditions then it shall be recorded in books of accounts and in FS and if it doesn't then such events shall be ignored while preparing Financial Statements (FS) for year ending 31st March, 2017.

Events occurring after the balance sheet date but before date of approval of FS by BOD are classified into two Categories i.e. adjusting events and non adjusting even

Chart Presentation of Events Occurring after Balance Sheet Date



Note: If Non adjusting events are SIGNIFICANT then it can be disclosed in Board of Directors report.

Concept No. 5 - Adjusting Events and Non Adjusting Events

5.1 Meaning	
Adjusting Events	**Non Adjusting Events**
1. Insolvency of customer: Conditions: a. Condition of insolvency existed on balance sheet date. b. Customer is not yet declared Insolvent on Balance sheet date. c. He is declared insolvent after Balance sheet date but before Approval of FS by BOD. Then Balances of Debtors shall be adjusted accordingly. However insolvency caused due to major fire in factory after Balance Sheet date is not adjusting event as condition of insolvency was not existing on Balance Sheet date.	1. Decline in market value of investment. 2. Major Business combination after Balance Sheet date. 3. Announcing plan to discontinue operations. 4. The distraction of a major production plant by a fire after reporting period. 5. Announcing or commencing the implementation of a major restructuring. 6. Abnormally large changes after Balance Sheet date in asset prices or foreign exchange rates. 7. Commencing major litigation arising solely out of events that occurred after the reporting period. 8. Changes in tax rates announced after Balance sheet date.

5.2 Exception To Non Adjusting Event

1. If it is a STATUTORY requirement OR it is of special nature; (AS cannot override Law)

2. If events occurring after the balance sheet date affects the GOING CONCERN ASSUMPTION of the entity

Means in the above two cases event should be adjusted as on balance sheet date even though event occurred after Balance Sheet date.

If Any event occurring after the Balance Sheet date affects the going concern assumption of the entity, such event 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 statement on liquidation basis (i.e. at NRV).

Concept No. 6 Proposed Dividend

If an enterprise declares dividend to shareholders after the balance sheet date then enterprise should not recognise those dividend as a liability at the balance sheet date unless it is required by Act. Such dividend should be disclosed in notes.

Concept No. 1 Objectives of AS – 5

Issues Discussed in AS-5

- Presentation & Disclosure of
  - Certain Ordinary Activities
  - Extraordinary Activities
  - Prior Period Items.
- Presentation and Accounting Treatment of
  - Changes in Accounting Estimates
  - Changes in Accounting Policies

This Standard doesn't deal with tax effect of the above items.

Important Concepts in AS – 5

Concept No. 2 Net profit or loss for the period includes:

These components shall be disclosed separately in statement of profit and loss.

Concept No. 3 Ordinary Activities

Activities which are Related & incidental to entity's main business activities.
These activities arise in the normal course of business, so the frequency of the activities is regular.

1. Sale of goods, providing services,
2. Sale of scrap, interest income/expense
3. Salary expense, provisions.
4. Profit or loss on sale of fixed assets, etc.

Concept No. 4.- Exceptional Items

Exceptional Items: (It Is Treated As Ordinary Items Under This AS)

These items are expected to occur as part of a business. But due to size, nature or incidence of transactions those activities require separate disclosure.

These items are expected to occur as part of a business. But due to size, nature or incidence of transactions those activities require separate disclosure.

1. The writing down of inventories to net realisable value (NRV) as well as the reversal of the same;
2. A restructuring of the activities of an entity and the reversal of any provisions for the costs of restructuring; (Restructuring means changing the nature of business or structure of the company)
3. Profit or loss on disposal of fixed assets;
4. Profit or loss on disposal of long-term investments;
5. Legislative changes having retrospective application;
6. Litigation settlements;
7. Reversals of provisions;
8. Embezzlement (stealing) of cash, pilferage (stealing) of stock
9. voluntary retirement expense,
10. A suit for damages for breach of contract etc.

Concept No. 5 - Extraordinary Items

EXTRAORDINARY ITEMS.

Extra Ordinary Activities which are clearly distinct from the ordinary activities of the entity.

- **These are not expected to occur as part of business.**
- Generally frequency of such transactions is rare/low. frequency is not main criteria, professional judgement is required to decide whether it is ordinary or extra ordinary item.
- **Following are the Examples of Extra ordinary Items.**
- 1. An earthquake and loss by flood
  (Note: It is not extra ordinary item for Insurance company therefore Events may be extraordinary for one entity and may not be for another.
- 2. Attachment of Property.
- 3. Government grants becoming refundable. (as per AS-12)
- 4. Seizure of assets by the government, etc..
- Above situations are not expected to occur as a part of business.
- **Note: Extraordinary activities should be separately disclosed in Profit &Loss account so as to show the impact on profit and loss as well as separate disclosure helps the users to understand the performance & position of the company.**

What should be disclosed?
Disclose the **nature & amount** of the transactions separately in P&L account and relevant information in notes on accounts.

Concept No. 6 Prior Period Items

Meaning
- Prior period items are income or expense 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.

Disclosure
- Prior period items should be disclosed separately in the Profit and Loss a/c so as to show the impact of prior period items in the current year

Examples:
- Omission to record for income and expenditure.
- Non provision of expenses which are already incurred or due.
- Depreciation rate was incorrect.
- Treating operating lease as finance lease

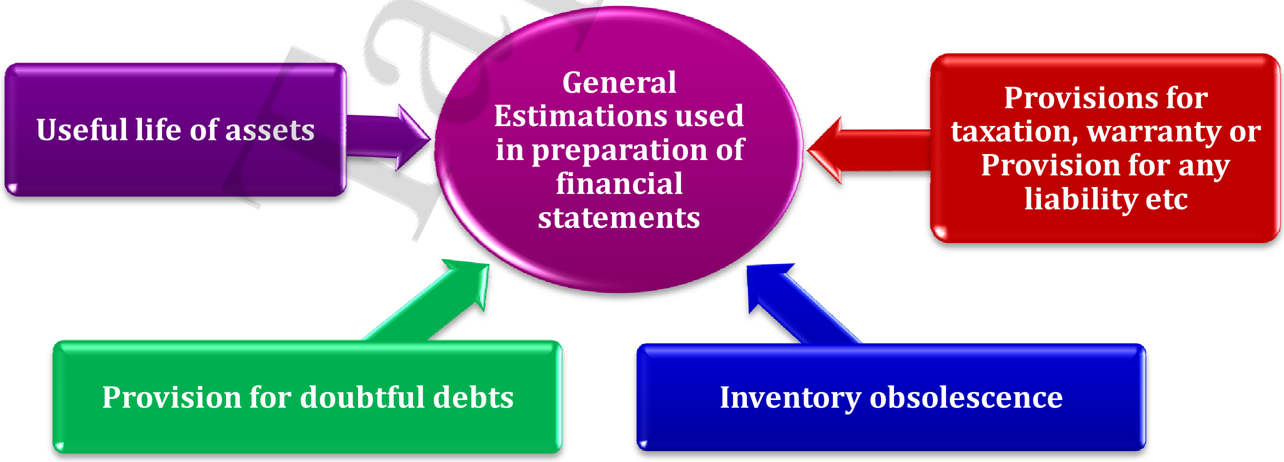
Changes in Accounting Estimates

Concept No. 8 Changes In Accounting Estimates

Estimation means **it is judgment of the amount** on the basis of future expectations. In other words it is an approximate calculation.

Many items in accounting cannot be measured accurately or exactly then we need to **make reasonable estimates** of amount.

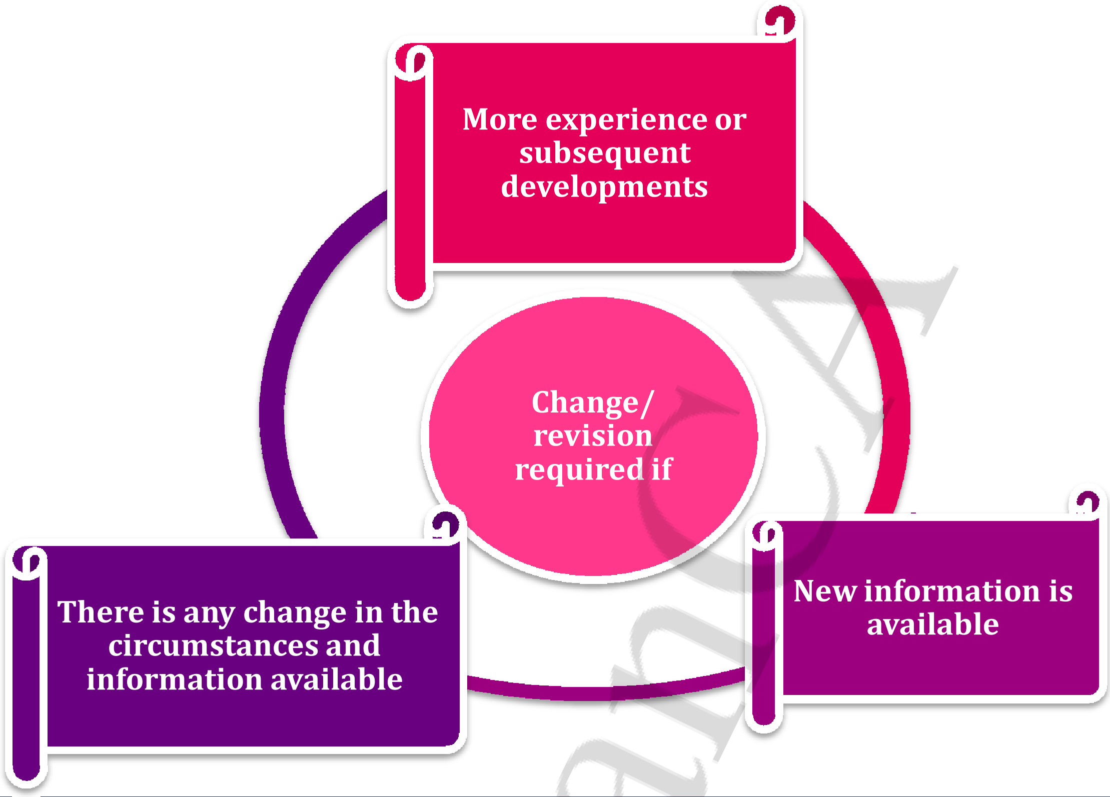
Note: Usage of estimates doesn't reduce the reliability of financial statements.



Professional judgment is required for reliable estimation.

Estimation is judgment or approximate amount therefore actual results may be different and in such case we shall revise estimation which is known as change in accounting estimates.

Change/ revision in accounting estimates may be required if:



Revision in estimation is expected to occur, hence it is an ordinary activity therefore it is not extraordinary item.

Estimations are revised in the above circumstances but not because of errors or omissions. Hence revision of estimation is NOT a prior period item.

Changes in accounting estimate should be accounted prospectively.

Disclosure of change in accounting estimates :(only if effect is significant)

a. Nature of change
b. Amount of change
c. Any change in an accounting estimate which is expected to have a material effect in later periods should also be disclosed.

Concept No. 9 Changes In Accounting Policy

As per AS 1, Entity should follow the accounting policies consistently

The entity can change accounting policies in the following circumstances:

For the compliance of statute

For the compliance of Accounting standard

For better and appropriate presentation of financial statements

Concept No. 10 Accounting for change in accounting policy:

Meaning	**Accounting policy means Principle and Methods used to prepare financial statements.**
Example	**Depreciation provided on SLM basis is accounting policy for company and if company changed method from SLM to WDV then it is change in accounting policy.**
Accounting for change in Policy	**AS 5 does not specify the accounting in case of change in policy.**
Retrospective effects	**As per IND AS 8- change in accounting policy is accounted Retrospectively.** **Note – AS Per AS – 10, changes in depreciation method shall be treated as change in accounting estimate & Prospective effect shall be given & not retrospective effect.**
Change in Estimates Change in Accounting Policies	**When the entity is not able to distinguish the change in estimate and change in accounting policy – It should treat the change as change in accounting estimate only.**
Not Treated as change in Accounting Policies	**The following are NOT changes in accounting policy:** **(a) Adoption of new accounting policy; and** **(b) The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions;**

Concept No. 11 – Disclosure under as - 5

1. If change in accounting policy has material effect it should be disclosed in the year of change.
2. If the impact is not ascertainable, the entity should disclose the fact in financial statements.
3. If there is no impact in the year of change but there is material impact in the future years, the fact of such impact should be disclosed in the year of change in policy.
4. As part of better practice, entity should disclose the reason for change in policy.

Objective of AS – 7

1. This Standard prescribes the accounting treatment of revenue and costs related to construction contracts. Generally the construction activities take a long period and usually fall into different accounting periods.
2. The primary issue in construction contracts is - how to allocate the total contract revenue and costs among the accounting periods.
3. The Standard gives guidance on such allocation/recognition of contract revenue and contract costs in the P&L statement for the accounting periods in which construction work is performed.

Scope of AS – 7

The standard is applicable only for Contractors

This Standard does not apply to customer

Would not be applicable to construction project undertaken by enterprise on its own account as a commercial venture in the nature of production activities.

[In the books of contractee, the asset constructed will be treated as a fixed asset, inventory or investment and AS 10, AS 2 or AS 13 are applicable respectively]

Definitions & Meaning

Construction Contract

Construction Contract is a contract specifically negotiated for the construction of assets closely interrelated or interdependent
E.g. Contract for contraction o bridges, building, dam, pipeline road, etc...

Construction contracts include

(a) Service contracts which are directly related to the construction of the asset; Example The services of project managers and architects; &

(b) Contracts for destruction or restoration of assets, and the restoration of the environment after the demolition of assets.

Types of Contracts

Types of Contracts

- ***Fixed price contract***
  - In these contracts contractor agrees for fixed price of the contract or a fixed rate per unit of output.
  - E.g. Contractor receives Rs. 5 crore after construction of building or he receives Rs. 5 crore per building constructed.
- ***Cost plus contract***
  - In these contracts, contractor is reimbursed all allowable/defined costs as defined plus fixed percentage of fee/profit.
  - Contractor receives amount spent for construction + 2 % of amount spent OR receives amount spent for construction + 5 lakh.

Recognition of Contract Revenue and Expenses

Recognition of revenue and costs in P&L is depending upon the reliability of estimation of outcome.

Can outcome be estimated reliably?

Yes

- Recognise revenue and costs based on percentage of completion.

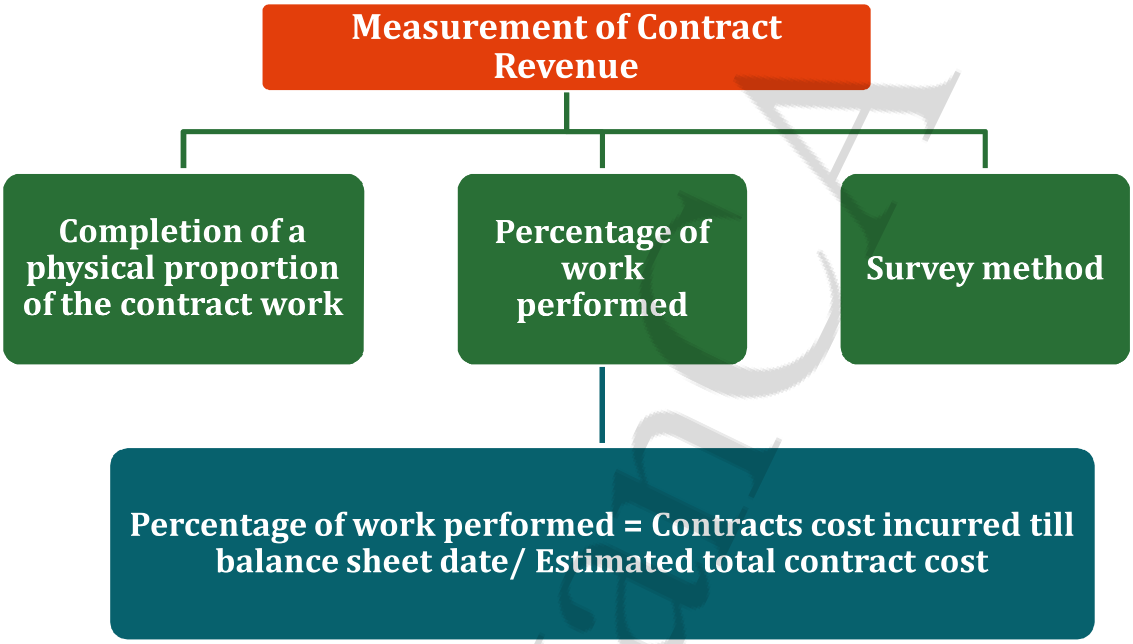
No

- Recognise revenue ONLY to the extent of costs incurred, if the revenue is recoverable;
- Recognise the costs as expense in the period in which it is incurred

Measurement of Contract Revenue

It can be determined in a number of ways. The following are the methods available in the industry:

Based on the costs incurred;



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Calculation of Contract Revenue:

It includes –

Initial Contract Amount	XXX
Add:- Variations in contract work	XXX
Add:- Incentives receipts received by contractor	XXX
Add/Less :- Increase/Decrease in Escalation	XXX
Add:- Claims Amount , raised on customer for delay caused, errors design, etc..	XXX
Add:- Penalties due to delay caused by contractor	XXX
Total Revenue	**XXXX**

Contract Cost

It includes **Direct Cost Incurred on contract + Indirect Cost Incurred.**

Specific Cost (Direct Cost)	Attributable & Allocable Cost (Indirect Cost)
1) Site labour costs, including site supervision; 2) Costs of materials used in construction; 3) Depreciation of plant and equipment used on the	1) Insurance 2) Costs of design and technical assistance that is not directly

contract; 4) Costs of moving plant, equipment and materials to and from site; 5) Costs of hiring plant and equipment; 6) Costs of design and technical assistance 7) The estimated costs of rectification and guarantee. 8) These costs may be reduced by any incidental income that is not included in contract revenue	related to a specific contract; 3) Construction overheads.

Cost Not Recognised

1) General administration costs for which reimbursement is not specified in the contract;
2) Selling costs;
3) Research and development costs for which reimbursement is not specified in the contract; and
4) Depreciation of idle plant and equipment that is not used on a particular contract

Combining & Segmenting construction contracts

Combining

If the contract satisfies ALL of the following conditions, a group of contracts (irrespective of number of customers) should be treated as a single construction contract:

(a) All contracts are negotiated as a single package;

(b) Contracts are so closely interrelated with an overall profit margin; and

(c) Contracts are performed at the same time or one contract after another.

Segmenting

If the contract satisfies ALL of the following conditions, construction of each asset should be treated as separate construction contract

(a) Separate proposals have been submitted for each asset;
(b) Each asset is subject to separate negotiation and parties can accept or reject any contract; &
(c) Costs and revenues of each asset can be identified;

Expected Loss:

Whenever any contract is expected to have loss then provision should be made for expected loss in future.

Provision for Loss: Total Revenue – Total Cost – Loss Recognised

Note:

When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the statement of profit and loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.

Progress payments and advances received from customers may not necessarily reflect the work performed.

Calculation of Degree of Completion:

On Cost Basis: Cost Incurred / Total Cost x 100

Total Cost = Cost Incurred + Future Cost

On Time Basis: Time Spent / Total Time x 100

Total Time = Time spent + Future Time required for completion.

Disclosure Requirements in Notes to Accounts:

An entity should disclose:

(a) The amount of contract revenue recognised in the period;

(b) The methods used to determine the contract revenue; and

(c) The methods used to determine the percentage of completion;

An entity should disclose the following for contracts in progress at the balance sheet date:

(a) The total amount of costs incurred and recognised profits (less recognised losses) up to the balance sheet date;

(b) The amount of advances received; and

(c) The amount of retention money with the contractee.

Objective of AS “Revenue recognition”

- This standard deals with the recognition (recording) of revenue in the profit and loss statement of an entity.
- Revenue means Gross Inflow of ash, Receivables or other consideration arising in the course of ordinary activities of an enterprise.
- This standard focuses on the **timing of recognition** i.e. when to record in the books.
- Also States the circumstances in which revenue recognition can be postpone
- Generally the amount of revenue is determined by agreement between the parties involved in the transaction.

Scope

This Standard discusses ONLY the following revenues arising in the ordinary course of business:

Revenue means gross inflow of cash and receivable from

1. Sale of goods,
2. Rendering of services,
3. Interest, dividend & royalty.

This AS does not deal with

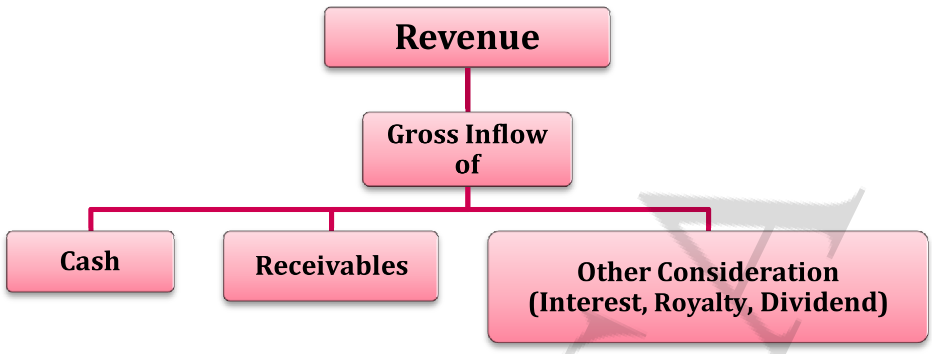
1. Revenue From Construct contract (It is Dealt in AS – 7)
2. Revenue From Government Grants (It is Dealt in AS – 12)
3. Revenue From Lease (H.P.) (It is Dealt in AS – 19)
4. Revenue From insurance contracts of insurance companies; (As per regulatory requirements)

The following revenues are also EXCLUDED from this standard

5. Profit on sale of fixed assets (Realised gains); (It is dealt in AS 10)
6. Unrealised gains of non-current assets (revaluation of fixed assets); (It is dealt in AS 10)
7. The natural increases in herds and agricultural and forest products; (accounted as per industry Standards)
8. Realised/unrealised gains arising from fluctuation of foreign currency and gain on translation of financial statements of foreign operation; (It is dealt in AS 11)
9. Gains on settlement of a liability by paying less than its carrying amount; (general principles of accounting)
10. Unrealised gains on restatement of the carrying amount of a liability. (general principles of accounting)

Meaning & Definition of Revenue

Revenue



Sale OF Goods

Condition must be fulfilled

1. Ownership of goods have been transferred
2. Risk and rewards has been transferred
3. There is no uncertainty regarding consideration (i.e. Cash or Receivables) at the time of recognition

The following table explains the situations and guidance on recognition of revenue under different situations.

Delivery of goods is delayed at buyer's request and buyer takes title and accepts billing. (i.e. Goods are with seller)	Recognise the revenue when it is expected that delivery will be I made & it should satisfy the following conditions 1. Goods must be in hand; 2. The buyer's goods should be identified; & 3. Goods must be ready for delivery at the time recognition. (i.e. in packed condition)
Delivered subject to conditions: Subject to installation and" inspection	Recognise the revenue only when customer accepts the delivery & installation and inspection is complete. If installation is a simple process, recognise the revenue when goods are delivered.
▪ Subject to approval of customer (Sale on approval)	Recognise only when 1. Goods are formally accepted by the buyer; OR 2. Time period allowed is elapsed; OR 3. Reasonable time period is elapsed - in case NO specific period is mentioned;
▪ Consignment sales	Recognise revenue only when goods are sold to a third party by the consignee.
▪ Cash on delivery sales	Recognise revenue only when cash is received either by the seller or his agent.

▪ Guaranteed sales i.e. goods are delivered by giving an unlimited right to return to buyer.	Depends on the substance of the agreement In case of retail sales, if the entity offers a guarantee of "money back if not completely satisfied" - It may be appropriate to recognise revenue for full invoice amount at the time of sale of goods & the entity can create an appropriate provision for expected goods returns based on the previous experience.
▪ Installment sales	1. Recognise revenue on the date of sale to the extent attributable to sale price excluding interest amount. 2. Interest should be recognised on time basis in proportion to receivable balance. (Interest recognition is discussed below)
▪ Sale/ purchase agreements i.e. as per the agreement seller agrees to repurchase the sold goods from buyer at a later date.	Observe the transaction carefully before you come to a decision. Why do someone buy and sell the same goods at different dates. These transactions are in substance financing (a kind of loan) agreements; the resulting cash inflow is NOT revenue as defined and should NOT be recognised as revenue.
▪ Subscriptions for publications	1. Advance Received should be recognised as liability (and revenue should be recognised on a straight line basis over time; 2. If the value of the items differs from period to period, revenue should be recognised in proportion to the value of the items delivered to the total sale value of all items covered by the subscription.

Revenue from Rendering Services

Revenue from services is generally recognised as service is performed. The performance of service measured by two methods as under

1. Service should be PERFORMED.
2. NO significant uncertainty in ultimate collection at the time of recognition.

Methods to determine the performance of services

- **Proportionate completion method**
  - **This method is applicable**
    - When performance consists of execution of more than one act.
  - **How to recognise revenue under this method**
    - Revenue is recognised based on the percentage of completion of work.
  - **Basis for calculation of percentage of completion**
    - It can be assessed based on
      1. Contract value;
      2. Associated costs;
      3. Number of acts (works); or
      4. Any other reasonable and rational basis.
- **Completed service method**
  - **This method is applicable**
    - When performance consists of execution of single act. OR Performance consists of more than one single act and the services yet to be performed are significant to the whole performance.
  - **When to recognise revenue under this method**
    - Revenue is recognised when the sole or final act takes place and the service becomes chargeable to customer.

Situations and guidance on recognition of revenue under each situation.	
Situation	**Guidance on recognition**
Installation fees.	Recognise only when installation is completed and accepted by the customer; (Above guidance is applicable when an entity is providing installation services only and it is NOT a service along with sale of goods)
Advertisement income	Recognise the revenue when the related advertisement appears before the public.
Insurance agency commission	Insurance Commission Recognise on the effective commencement or renewal dates of the related insurance policies.
Admission fees on artistic performances, banquets or any special programs.	■ Recognise revenue when event takes place. ■ When a subscription received is for number of events, the fee received should be allocated to each event on a systematic and rational basis.
Tuition fees	Recognise over the period of instruction on SLM basis.
Entrance fees	■ Revenue recognition depends on the nature of the services being provided. ■ Entrance fee received is generally capitalised. (It is not related to any particular year hence it is appropriate to capitalise)
Membership fees	■ If the membership fee permits only membership to the member, recognise when it is received. ■ If the membership fee entitles the membership and other services or publications during the year, it should be I recognised on a systematic and rational basis by considering the timing and nature of all services provided.
Financial service commissions	■ Recognition of Revenue depends upon: 1. Whether the service has been provided "once for all" or on a "continuing" basis; 2. The incidence of costs relating to service; 3. When the payment for the service will be received. ■ If commission is related to 'granting/arranging loan or other facilities' recognise the revenue - when loan is granted or the other facilities are provided. ■ If such commitment or facilities fees relates to continuing obligations or services- then revenue should be recognised I over the life of such loan or facility in a systematic and rational basis to match with the related costs incurred. (Matching concept)

Other Consideration

1. Interest

Meaning

- Interest is income received by the entity as its cash resources are used by other entities.

Recognition

- Interest is recognised on time proportion basis based on the outstanding amount and rate applicable; &
- There should NOT be any significant uncertainty in ultimate collection at the time of recognition. If any uncertainty exists, recognition should be postponed till the time there is NO uncertainty.

2. Royalty Income

Meaning

- Royalty income is received as the intangible assets like know-how, patents, trade-marks and copy rights of the entity are used by the other entity.

Recognition

- Royalty is recognised on accrual basis in accordance with the terms of agreement.
- There should NOT be any significant uncertainty in ultimate collection at the time of recognition.
- If any uncertainty exists, recognition should be postponed.

3. Dividend Income

Meaning

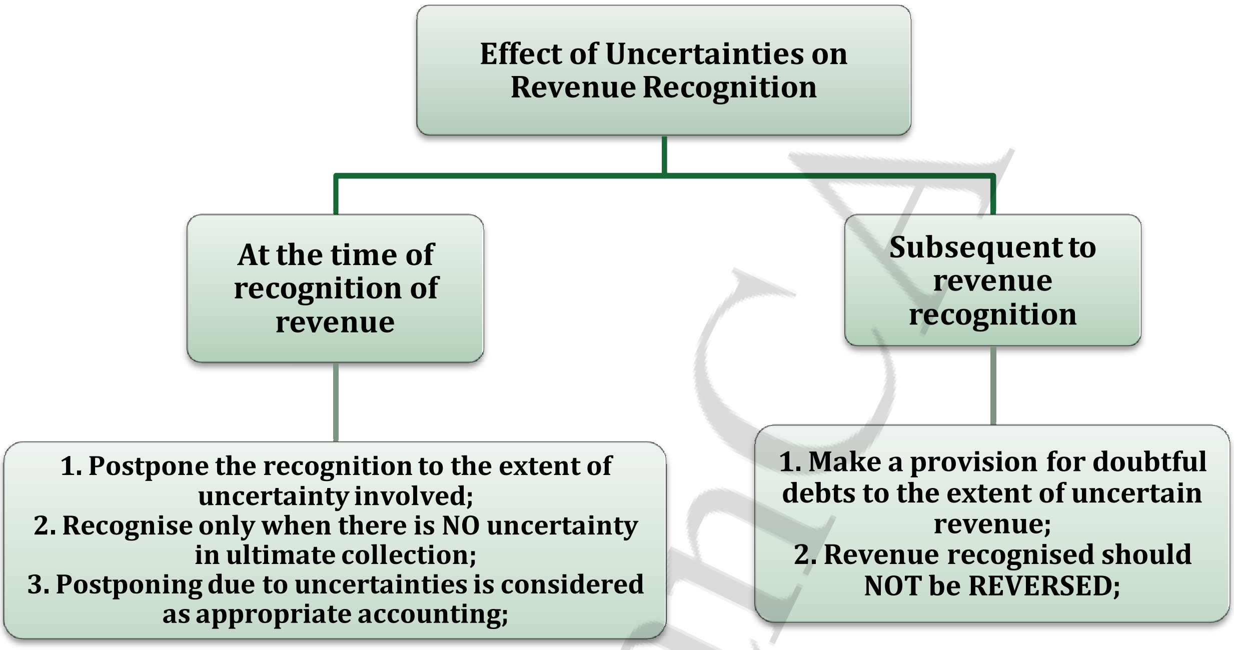
- Dividend is a reward from holding of investments in shares.

Recognition

- Dividend income is recognised only when a right to receive dividend is established irrespective of the year it is relating to.
- The investor gets the right to receive dividend only when the dividend is declared by the members in the General Meeting. Hence it should be recognised only on the date of declaration by General Meeting.
- There should NOT be any significant uncertainty in ultimate collection at the time of recognition. If any uncertainty exists, recognition should be postponed.

Effect of Uncertainties on Revenue Recognition

The uncertainties in revenue recognition will be considered depending on the time it arises.



Disclosure Requirements

1. Revenue reorganisation policy should be disclosed.
2. Revenue should be disclosed

Concept No. 1 Objectives of AS –(PPE)

This standard discusses

1. Whether expenditure incurred should be capitalised as PPE or charged to P&L statement,
2. Depreciation
3. Retirement of PPE and
4. Disposal accounting.

Concept No. 2 Applicability Of AS - 10

PPE is not Applicable to

1. **Biological Assets: -** It means living animal or plant and man income producing asset of agricultural activity. **This standard applies to bearer plants but it does not apply to the produce on bearer plants**

   Bearer Plant is a plant that:

   1. is used in the production / supply of agricultural produce;
   2. is expected to bear produce for more than a period of twelve months (in a way the life of the plant is more than 12 months); and
   3. Has a remote likelihood of selling the bearer plant as an agricultural produce, except for incidental scrap sales. E.g.

Bearer Plant - Mango Tree → Agricultural Produce - Mango

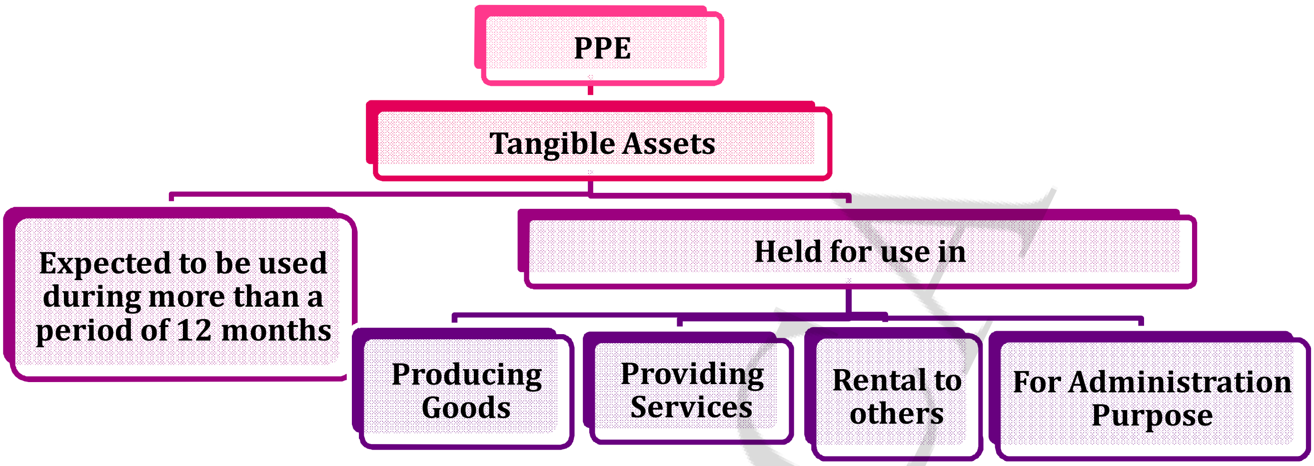
2. **Wasting Assets: -** It Means Mine, (All Natural Recourses)

Wasting assets including mineral rights, expenditure on exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources.

Mine

3. **Investment Property:** Investment property is not PPE and it should be accounted for only in accordance with the cost model prescribed in this standard.

Concept No. 3 – Meaning and Definition of PPE





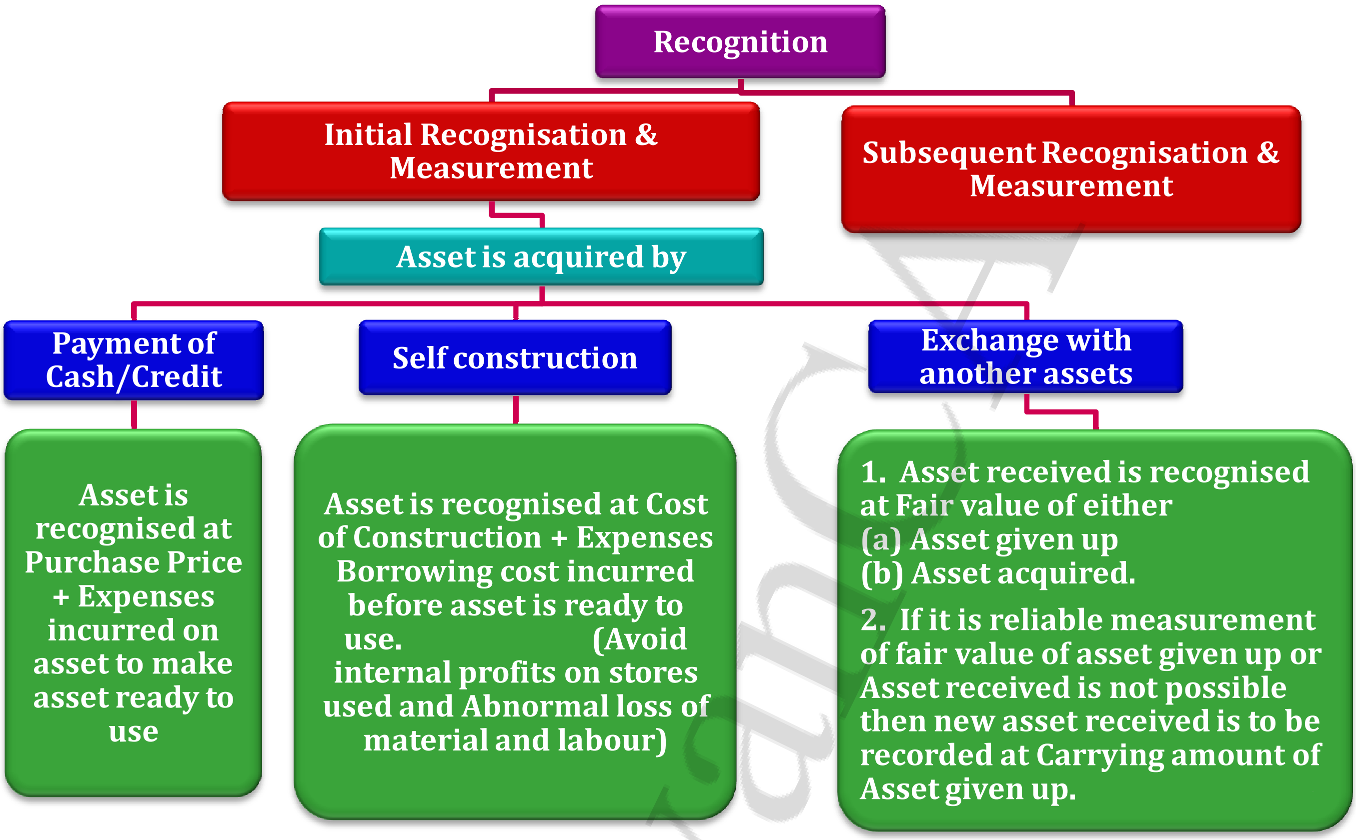

E.g.

Asset	Tangible	Held for use in abovementioned Activity	Life more than 1 year	Conclusion
Machine, computer, camera	Yes	Yes	Yes	PPE
Land, Building, Furniture	Yes	Yes	Yes	PPE
Computer Software	No	Yes	Yes	Not PPE
Stock	Yes	No	Yes /No	Not PPE

Concept No. 4 Recognition and Measurement of PPE

PPE Should recognised (recorded in the books of account) in financial statements if following conditions are satisfied.
1. Future economic benefits should flow to entity.
2. Cost can be reliably measured.

Chart Presentation of Recognition and Measurement of PPE



(A) ASSET IS ACQUIRED BY PAYMENT OF CASH /FOR CREDIT

Cost of Assets Includes following:-

Particulars	Rs.
Net Purchase price (Basic price after deduction of discount)	XXX
(+) Non refundable taxes & duties	XXX
(+) Delivery and handling costs	XXX
(+) Site preparation cost &Installation costs& Trial Run Cost.	XXX
(+) Professional fees (e.g. fees of architects and engineers)	XXX
(+) PRESENT VALUE of Decommissioning, restoration costs.	XXX
(+) Any directly attributable cost to bring the asset to the location & condition necessary to operate for its intended purpose	XXX
(-) Trade discounts and rebates (if included in above items)	XXX
(-) Government grants (As per AS 12)	
Cost of PPE to be capitalised	

Note:

1. General administration and other overhead expenses are usually excluded from the cost as of asset.
2. **Subsequent Addition or increase is to be recognised in same way as above.**

Cost of Decommissioning.

The elements of cost to be incorporated in the initial recognition of an asset are to include the estimated costs of its eventual dismentalment .

This is, the cost of the asset is grossed up for these estimated costs, with the offsetting credit being posted to a liability account.



C. PPE IS ACQUIRED BY EXCHANGE OF ASSETS:

Rules are given in above Diagram. Please refer recognition Tree Diagram.

Example of PPE acquired by exchange of assets

Concept No. 5 Other Important Terms

Deferred credit period

- PPE should be recognised at **CASH PRICE equivalent on the date of recognition** (Present value).
- Deferred credit period means excess period than the normal credit period.
- The difference between the cash price and the total payment should be recognised as interest..
- **In general, the interest should be charged to P&L as an expense.**
- **But if the asset is a qualifying asset as per AS 16 where asset takes substantial period of time to get ready for intended use then interest should be capitalised with the PPE.**

Machinery spares

1. If such spares do not satisfy the PPE definition, it should be classified as inventory and charged to P&L statement when it is issued for usage;
2. If these are recognised as PPE, the total cost incurred should be depreciated in a systematic basis over the useful life;
3. When the principal PPE is either discarded or sold, the net carrying amount of spares should be written off to P&L.

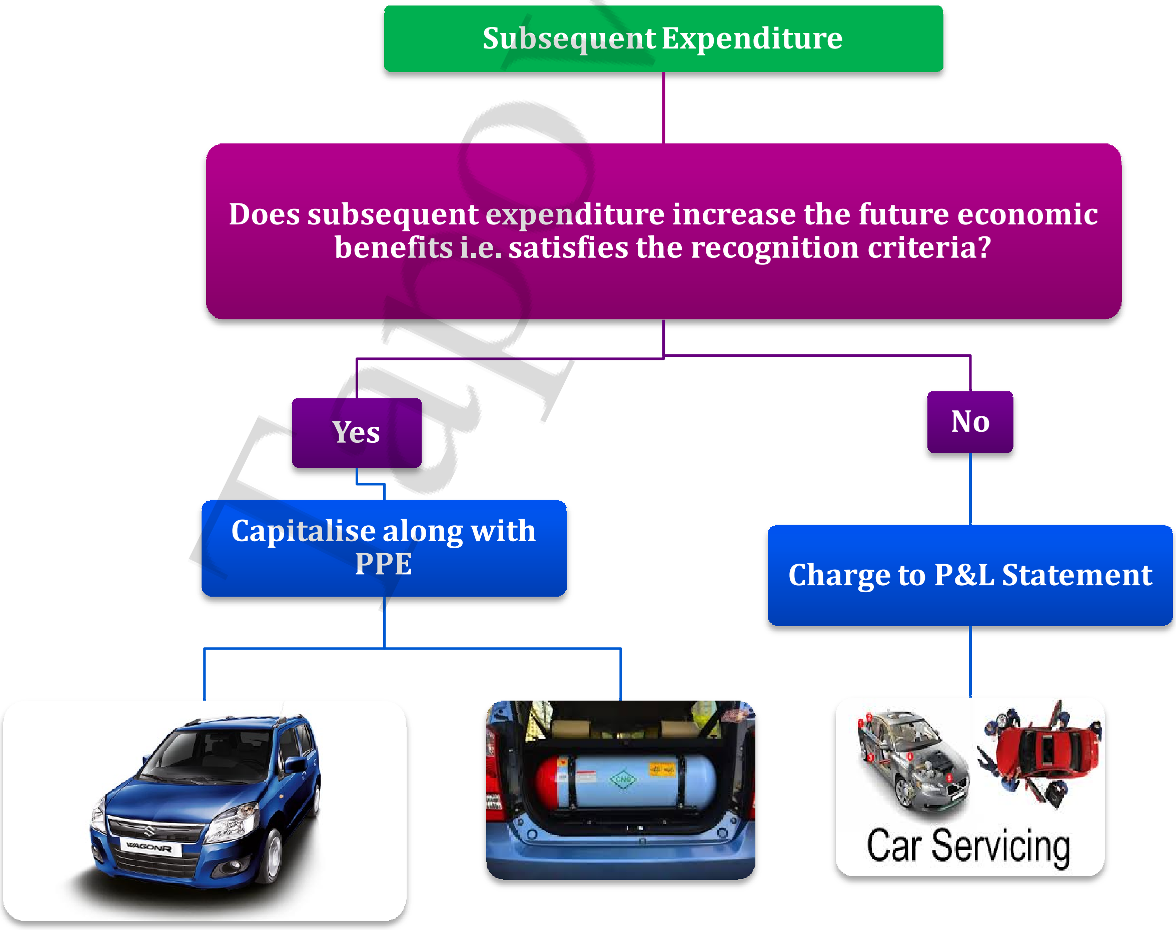
Concept No. 6 Subsequent expenditure on PPE.

IMP Point: Subsequent recognised in the same way as initial recognition.

Subsequent expenditure is the expenditure, which is incurred after the initial recognition i.e. after the asset is ready to use or being used.

If the subsequent expenditure increases the future economic benefits i.e. it satisfies the recognition criteria of an asset and PPE - such expenditure should be recognised as a separate component and depreciated over its useful life.

Here Future economic benefits includes :- increase in number of goods produced, reduction in cost, improvement efficiency of PPE



Replacement of some parts of PPE

Parts of some items of PPE may require replacement at regular intervals.

Under the recognition criteria given in the Standard, an entity should capitalise the cost of replacement as a component of PPE and depreciate such cost over its useful life.

The carrying amount of those parts that are replaced (old component) should be derecognised.

Major inspections parts of the PPE(Not for minor inspections)

A condition of continuing to operate an item of PPE (For example, an aircraft or a ship) may be performing regular major inspections for faults regardless of whether parts of the item are replaced.

When each major inspection is performed, its cost is capitalised as a part of PPE as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.




Accounting treatment for Major Component of Assets

If assets consists of

a. **Two or more significant components,**
b. **With major difference in useful life of each components.**

Then such components are to be recognised separately and Depreciation is charged on component basis.

IF any component is replaced then old component is removed from books of accounts making its value Nil and cost of new components is to be capitalised.

Concept No. 7 Subsequent expenditure on PPE.

An entity may select anyone of the two models and follow the same consistently.

Accounting Models

Cost Model

If this model is chosen - PPE should be measured every year at

Cost	xxx
(-) Accumulated depreciation	xx
(-) Accumulated Impaired loss	xx
Net carrying amount	xxx

Revaluation Model

If this model is chosen by this model should be chosen to the PPE, where FAIR VALUE can be measured reliably.

PPE should be measured at

Fair Value of PPE	xxx
(-) Subsequent accumulated depreciation	xx
(-) Subsequent accumulated impairment loss	xx
Net carrying amount	xxx

Concept No. 8 Revaluation of PPE

Revaluation Model of Accounting policy is an option given to the entity (NOT mandatory).

It is the management who takes decision about model to be adopted for measurement.

1. Frequency of Revaluation

Revaluation should be performed whenever there is a material difference between

(a) The carrying amount and

(b) Its fair value as on the balance sheet date.

It should be checked regularly & shall be performed by a professionally qualified valuer. If there is no material difference in carrying amount and fair value on balance sheet date, then fair value calculation is to be ignored.

2. Method of Revaluation

Usually fair value is determined from market-based evidence by appraisal method.

If market based evidence for fair value is not available, an entity may need to estimate fair value using:

1. An income approach e.g. based on discounted cash flow projections Or
2. A depreciated replacement cost approach i.e. If the same potential PPE is acquired/constructed what would be the cost i.e. replacement cost.

3. Revaluation model for ALL or only SELECTED PPE?

It is not compulsory to revaluate all PPE's at on time but if revaluation of any class of PPE is adopted then revaluation shall be done for ENTIRE CLASS of PPE. i.e. if the entity is willing to revalue its Machinery then it should revalue ALL machinery of the entity.

In other words Revaluation of selective assets within same class is NOT permitted.

Conclusion: Entity can follow revaluation model for selective CLASS of PPE and for remaining PPE, it can follow cost model.

4. Limit on revalued amount

The revalued amount should not be more than recoverable amount i.e. recoverable from sale or its usage over the life.

Concept No. 9 Revaluation Accounting

A. First Time Revaluation:

1. Upward revaluation is transferred to Revaluation Reserve

PPE A/C ....Dr.
To Revaluation Profit/ Reserve
(Being asset Revalued)

2. Downward revaluation is charged to P&L

P&L A/c ....Dr.
To PPE Asset A/c
(Being asset downward Revalued)

B. **Subsequent revaluation of existing PPE**

The following accounting treatment is based on the first time revaluation (upward/downward):

1. If first time is upward revaluation

a) Next time also upward revaluation - Further increase should be transferred to revaluation surplus. Journal Entry is same as upward revaluation.
b) Next time downward revaluation - Utilise the revaluation surplus to the extent available in the balance sheet and the remaining balance should be charged to P&L alc.

Revaluation surplus a/c.................... Dr

P&L a/c ....Dr (balancing fig)

To PPE a/c

2. If first time is downward revaluation

a) Next time also downward revaluation- Further decrease should be transferred to P&L statement. JE is same as downward revaluation.

b) Next time upward revaluation- Credit the P&L statement to the extent it was charged to P&L in earlier revaluation and remaining balance should be credited to revaluation surplus.

PPE a/c ………….Dr   **To P&L a/c (to the extent charged earlier)**   **To Revaluation surplus (balancing figure)**

Concept No. 10 Retirement of PPE	
PPE is retired from active use and it is held for disposal - such PPE should be stated in balance sheet at **Carrying amount (Net book value); or Net realisable value (NRV)** **Whichever is LOWER** Disclose such items separately in the financial statements. Any expected loss should be recognised immediately in the profit and loss statement.	

Concept no. 11 (Disposal) of PPE

The following diagram helps to understand the accounting treatment of disposal of PPE.

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

Accounting disposal

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

In case of Revaluation Model, Transfers from revaluation surplus to the general reserves should not be made through the statement of P&L. It means, the entity can record the following entry only

Revaluation surplus a/c ..... Dr
To General reserves a/c

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

Depreciation on PPE

Meaning

- Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount

Historical cost OR revalued amount	XXX
Less: Estimated residual value-	XX
Depreciable amount	XXX

Useful life of the asset

- The period over which a depreciable asset is expected to be used by the entity i.e. time/number of years; or
- The number of unit's production or similar units expected to be obtained from its use.
- Determination of the useful life is a matter of estimation and is normally based on various factors including experience with similar types of assets.

Depreciation of an addition/ extension to an existing asset

- If the addition/extension is an integral part of the existing asset - Depreciate the cost of integral part over the remaining life of existing asset.

Methods of Depreciation

- It Should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the entity
- It Should be reviewed at least at each financial year-end
- AS - 10 Does not prescribe any specific method of depriciation to be followed by orgnisation.
- If there is change in future consumption or future benefit pattern then method should be changed and such change in method shall be accounted as change in Accounting estimates. (Prospective effect)
- If depreciable asset is immaterial then such assets shall be debited to P & L Account (Means it can be fully depreciated at once).

Estimated residual value

- It is an estimated amount, which can be recovered from the asset at the end of its useful life .
- Initially, the estimation is made by the entity's management at the time of acquisition/installation;
- If estimated residual value is insignificant (immaterial) - Normally considered as NIL.

Concept No. 12 Disclosure Requirements

1. PPE Should Disclosed
   - Gross Book Value cost
   - Accumulated Depreciation
   - Addition of PPE
   - Deletion of PPE
2. Depreciation Method
3. Useful life of asset should be disclosed.
4. If company is following revaluation model, fact should be disclosed.

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

Concept No. 1 Important Terms:

Currency

Currency

- **Reporting currency**
  - Reporting currency is the currency in which financial statements are presented.

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

Note:

Normally an entity uses the currency of the country in which it is registered i.e. Indian entities present the financial statements in rupees. If entity is not using rupees as reporting currency, it has to disclose the reason.

Monetary items and Non Monetary Items

Monetary items

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

Therefore following items are monetary items:

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

Non monetary items

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

Example :Prepaid expenses, Advances given to suppliers.

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

PRE-PAID EXPENSE

Concept No. 2 Need of this standard

Suppose, one entity is running its business in India then such entity shall prepare its financial statement in Indian currency.

Due to export, import or other reason, entity may have the transactions in other currency also i.e.US $. In such cases, entity shall convert amount of transaction in foreign currency to Indian currency to record it in financial statements prepared in Indian Currency.

When transactions are taking place in foreign currency, these are to be converted into rupees as Indian entity's reporting currency is Rupees.

This standard discusses how to convert the foreign currency transaction into reporting currency i.e. which exchange rate should be used to convert it into Rupees and how to account for the changes in foreign currency (Forex) rates in financial statements.

An entity may have foreign currency transactions in two ways:

1. **Direct Transactions by entity: Imports, exports, foreign currency loans etc. by entity.**

2. **Indirect Transactions by entity: Transactions by its foreign branch or subsidiary or associate, etc.**

Concept No. 3 Scope & Applicability

This standard is applicable to:

1. Transactions entered by the entity in Foreign currency;

2.Translation of financial statements of foreign operations, and

3. Accounting for forward exchange contracts.

Concept No. 4 RECOGNITION AND MEASUREMENT

Foreign currency Transactions

- **Initial Measurement**
  - **Recognise using the rate on the date of transaction**
    - **Classification is not relevant**
- **Subsequent Measurement**
  - **Depends on Classification of items.**

1. What is foreign currency transaction?

It is a transaction which is denominated in or requires settlement in a foreign currency.

Concept No. 5 Initial Recognition & Measurement:

All foreign currency transactions should be recognised **using the rate on the date of transaction.**

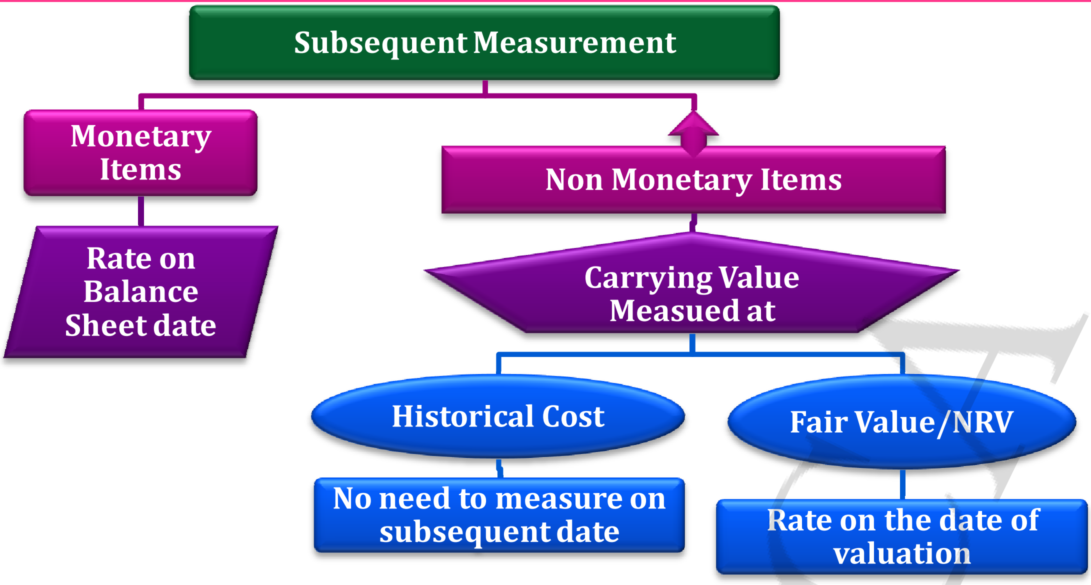
Foreign currency transactions Includes

- Purchase or sale of Goods or services
- Borrowing or lending funds
- Acquisition or disposal of assets
- Incurring or settling liabilities, etc.

Subsequent measurement:

After initial recognition of the transaction, if any asset or liability (which is created out of initial recognition) continues till the balance sheet date, the entity should remeasure its value on the balance sheet date i.e. subsequent measurement.

Subsequent measurement depends on the classification of monetary and non monetary.



Foreign currency contingent liabilities should be measured using the closing rate. (Rate on the date of Balance sheet)

Non-monetary items which are measured at historical cost	**Non-monetary items which can be measured at fair value or NRV**	
1. Fixed assets, 2. Long term investments, 3. Prepaid expenses, 4. Advances given to suppliers, etc.- Re-measurement of these items are not required on balance sheet date therefore **initially recognised amount will continue.**	**If Inventory is valued at cost** Consider the rate on the date of transaction; **If it is measured at NRV –** Rate on the date of valuation. i.e. **closing rate.**	**If a Current Investment is valued at cost** Consider the rate on the date of transaction; **If it is measured at Fair value –** Rate on the date of valuation i.e. **closing rate.**

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Concept No. 6 - Treatment of Foreign exchange rate difference

Exchange rate difference arises because of:

1. Transaction is initially recorded at one rate and it is settled at another rate. (Settlement means payment or receipt of consideration)

2. Transaction is initially recorded at one rate & its subsequent measurement rate is another rate. (as it is not settled till the balance sheet date)

3. Transaction is subsequently measured at one rate and later settled at another rate.

All types of foreign exchange difference (gain or loss) shall be charged to Profit and Loss alc as exchange gain or loss in the year in which it occurs.

Exception to charging exchange difference to P&L Account

1. Where an entity has a **foreign branch** and the operation of foreign branch is treated as **non-integral** foreign operation the exchange differences should be **accumulated in foreign currency translation reserve** till disposal of net investment in non-integral foreign operation. (Non – integral foreign operation discussed further)
2. This reserve is **to be shown in Reserves and Surplus**
   In case of partial disposal, only the proportionate share of related accumulated "Foreign Currency Translation Reserve A/c"
3. If the entity has exercised the option to capitalise the exchange difference on long term foreign currency monetary items.

Note: **Any foreign currency loan taken for acquisition of fixed assets and the foreign exchange difference arising from such loan should be charged to Profit and Loss Alc.** Loan taken is a monetary item and it requires to be restated on the balance sheet date using the closing rate. Reason for taking loan does not change the recognition manner.

Concept 7: Translation of Financial Statements of Foreign Operations (F.O)

What is a foreign operation?

Examples of Foreign Operation as per AS - 11

- Foreign Branch
- Foreign Subsidiary
- Foreign Joint Venture
- Foreign Associates

Foreign Branch: it is also Discussed in Branch Accounting chapter of CA Intermediate syllabus.

Foreign operations are classified into two, i.e. 1. Integral foreign operation; 2. Non integral foreign operation;

Classification of Foreign Operations

It requires professional judgment for classification between Integral and Non integral foreign operations.

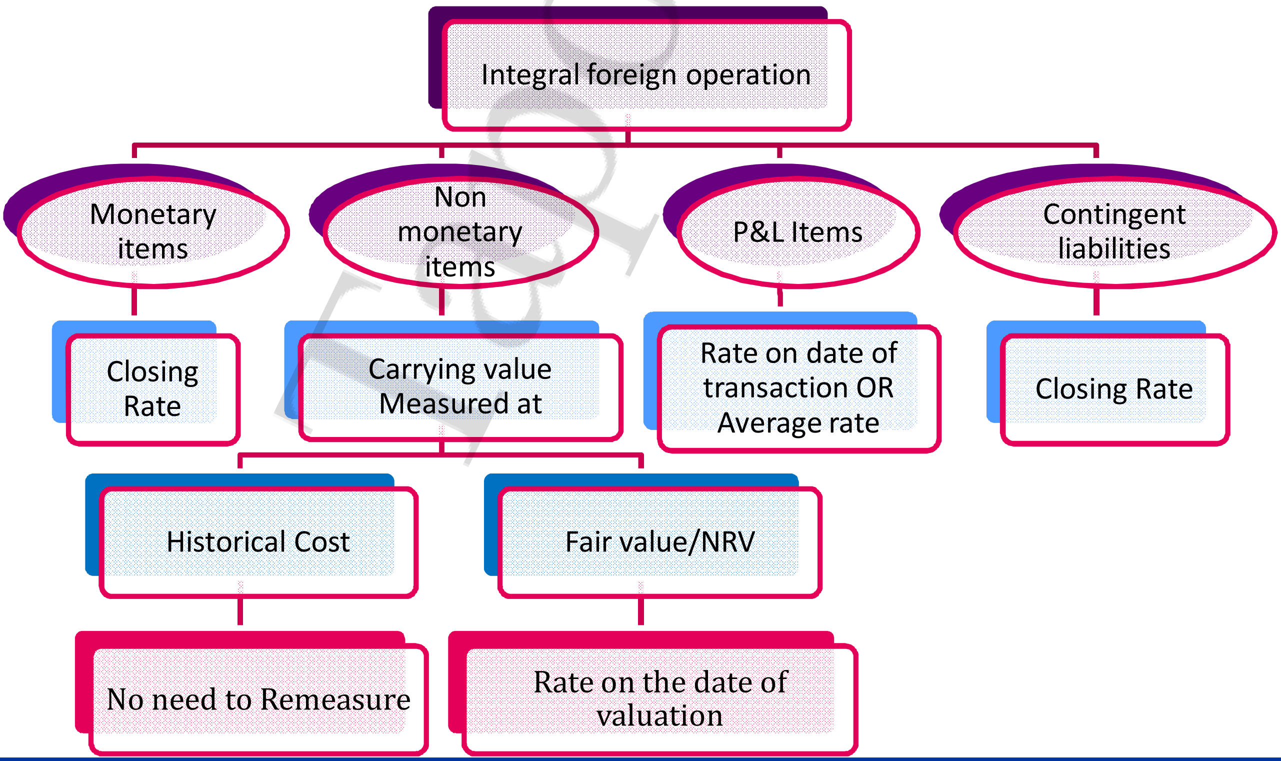
Classification must be based on substance over form (by considering reality).

Following explanation will help you in judgment.

Integral Foreign Operation	Non - Integral Foreign Operation
1. A foreign operation does its business outside India as if an extension to the business.	1. A foreign operation does business independently and accumulates cash and other monetary items and remits foreign currency occasionally. 2. As there are NO frequent cash flows, changes in forex rates will have little or NO direct effect on the operating cash flows of the reporting entity.
Example: 1. If a foreign branch is importing the goods from India, sell the goods in foreign country and remit the foreign currency collected from customer to Head Office in India. 2. If foreign branch duty is to find customer in that country and forward the order or Head Office.	**Example:** 1. If a foreign branch procures the raw material & pays in its local currency, 2. Cost of material, labour and other expenses are settled in foreign currency. 3. Sales are mainly in foreign currency. 4. Activities are funded either from profit from its own operations or from local borrowing but not from reporting entity

Concept No. 8 Conversion/ Translation of financial statement of An Integral Foreign Operation

As it is an extension to the Reporting entity's business, we need to convert all the items of financial statements as they are of the reporting entity;



Conversion/ Translation of financial statement of A Non - Integral Foreign Operation

NON Integral foreign operation

Monetary & Non Monetary items	P&L Items	Contingent liabilities
At Closing Rate	Rate on date of transaction OR Average rate	At Closing Rate

Concept No. 9 Change in Classification of foreign Operation

Re-Classification foreign operation may be as follows:

1. From integral to Non-Integral or,
2. From Non - Integral to Integral

Classification change	Accounting treatment
Integral to Non integral	Exchange gain or loss from the date of reclassification should be transferred to Foreign Currency Translation Reserve A/c.
Non integral to Integral	Exchange gain or loss from the date of reclassification should be transferred to P&L A/c & The balance in Foreign Currency Translation Reserve A/c will continue in the balance sheet till the date of sale of foreign operation.

Concept 10 - Forward Exchange

It is an agreement to exchange different currencies at a specified future date at a predetermined rate i.e. rate is determined on the contract date.

Need of forward contracts:

1. For managing or minimizing the foreign exchange fluctuation risks;
2. For trading or speculation purposes.

Premium or Discount on forward exchange contract:

Exchange rate on the date of Contract (known as Spot Rate)	xxxx
Less: Forward Rate	xxxx
Premium or Discount	**xxxx**

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Accounting Treatment of Forward Exchange Contracts

Forward Contract entered for its own purpose

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

Forward Contract entered for Trading/ Speculation

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

Concept No. 11- Disclosures

(a) The amount of exchange differences included in the net profit or loss for the period;

(b) Net exchange differences accumulated in Foreign Currency Translation Reserve should be shown separately in Reserves and Surplus.

(c) When the reporting currency is other than Rupees, the reason for using a different currency should be disclosed.

Concept No. 12 Notification issued by Ministry of Corporate Affairs (MCA)

- Company shall follow given option (not mandatory) with prospective effect.
- It should be exercised by the company in FY 2011-12. Once exercised, should continue with the same and it cannot discontinue the same.

Long term foreign currency monetary item:

These are assets or liabilities which are expressed in foreign currency and that have a term of 12 months or more from the starting date of such asset or liability. (Not from the balance sheet date)

As per the notification - All long term foreign currency monetary items (LTFCMI) (Monetary assets or monetary liabilities) are **divided into two parts.**

Directly related to acquisition of depreciable asset. (Any Loan)

Difference arising from such monetary item should be added to or deducted from the cost of depreciable asset.

(But in general it should be recognised in P&L A/c)

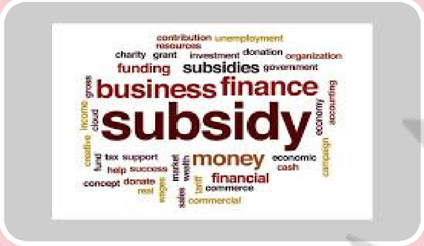
All other LTFCMI (Asset or liability), other than those related to acquisition of depreciable asset.

Foreign exchange fluctuation gain or loss from such items should be transferred to "Foreign currency monetary item translation difference account" (FCMITD A/c).

- **FCMITD A/c balance should be amortised over the balance period of the asset or liability.**
- **Amortised amount should be recognised as income or expenditure in P&L.**

AS 12 - Accounting for Government Grants

Concept No. 1 -Meaning of Government grants



Government grants are assistance by the Government in the form of cash or kind to an enterprise in return for past or future compliance with certain conditions.

Government grants are also called subsidies, cash incentives, duty drawbacks, etc.

Government means local, national or international government, government agencies and similar bodies.

Any government assistance, which cannot be reasonably valued, is excluded from this Standard.

Concept No. 2 - Scope of AS – 12

This standard is NOT applicable for the following:

(a) Government assistance other than in the form of government grants;

(b) Government participation in the ownership of the entity; (means Government is also the owner of entity)

Concept No. 3 - Criteria for Recognition of Grant :

Two conditions must be satisfied for recognition of Government Grant :

1. There is reasonable assurance that the entity will comply with the conditions

2 .Ultimate collection is reasonably certain.

Mere receipt of grant money is NOT the conclusive evidence

<u>Situation A</u>: Money is received + Reasonable assurance on compliance of conditions.

+

Entity should recognise grant and it should transfer it to P& L A/c or Capital reserve depending criteria for recognition given below.	Bank A/c ……………………………… Dr. To Capital Reserve A/c (If capital Approach is Adopted) Or, To Grant Income A/c (If Income Approach is Adopted) **(Capital Approach and Income Approach is explained in Next Discussion.)**

<u>Situation B:</u> Money is received + No reasonable assurance on compliance of conditions

+

Entity should NOT recognise grant but it should record the receipt as payable to government	1. Bank A/c ……………………………………… Dr. To Payable to Government A/c (Shown as Liability) 2. If Entity fulfils all conditions -Recognise it as Grant Payable to Government A/c………….. Dr. To Grant Income A/c (If treated as Income) 3. If Entity could not fulfill conditions and Grant is repaid: Payable to Government A/c………….. Dr. To Bank A/c

Concept No. 4 - Recognition & Accounting treatment

The accounting treatment should be based on the nature of the government grant.

Two Approaches for Accounting Government Grants

Capital approach

- Transferred to capital reserve
- When Grant is received or Becomes receivable
  Cash / Bank A/c .... Dr.
  Grant Receivable A/c......Dr.
  To Capital Reserve A/c
- If the grant is in the nature of the promoter's contribution
  If Government makes contribution towards the capital require-ments of the entity
  Generally received at the beginning stage of the business.
- Repayment is NOT expected in general and NO related costs to get these grants.
- These are NOT earned by the entity and received without relating costs, hence transferred to "capital reserve

Income approach

- Recognise in P&L statement over suitable period of time.
  (such items when received or becomes receivable shall be credited to Deferred Income A/c then it shall be Credited to P&L A/c over suitable period of time and remaining amount in Deferred Income account shall be disclosed separately in Reserves & Surplus A/c)
- When Grant is received or Becomes receivable
  Cash / Bank A/c .... Dr.
  Grant Receivable A/c......Dr.
  To Deferred Income A/c
- When Portion of grant transferred to P&L A/c on suitable basis
  Deferred Income A/c .... Dr.
  To Grant Income / P&L A/c
- 1. If the grant is not in the nature of the promoter's contribution
  2. These are received during the running stage and these grants are received only after compliance of conditions .
  3. Entity generally incurs expenditure to get these grants .
  4. It is logical to recognise as income in P&L A/c to match it with expenditure.
  5. The income tax Act or other Acts treat these grants as 'income' in general.

Concept No. 5

As per AS 5, Grant received should be presented as EXTRAORDINARY ITEM in the P&L statement in following two situations

Immediate financial support to only one entity in the industry	Received for previous year expense or losses
• It is not received for any specific expenditure; • It is received only by one entity but not by the whole Industry, and • The entity recorded such grant as income in P&L based on the circumstances existing at that time.	• Grant is received in the current year as compensation for the previous year expenses or losses; & • It is recognised as income in Current Year P&L statement.

These two items shall be separately disclosed as extraordinary to make the financial statements comparable with other.

Concept No. 6 Non-monetary Government Grants

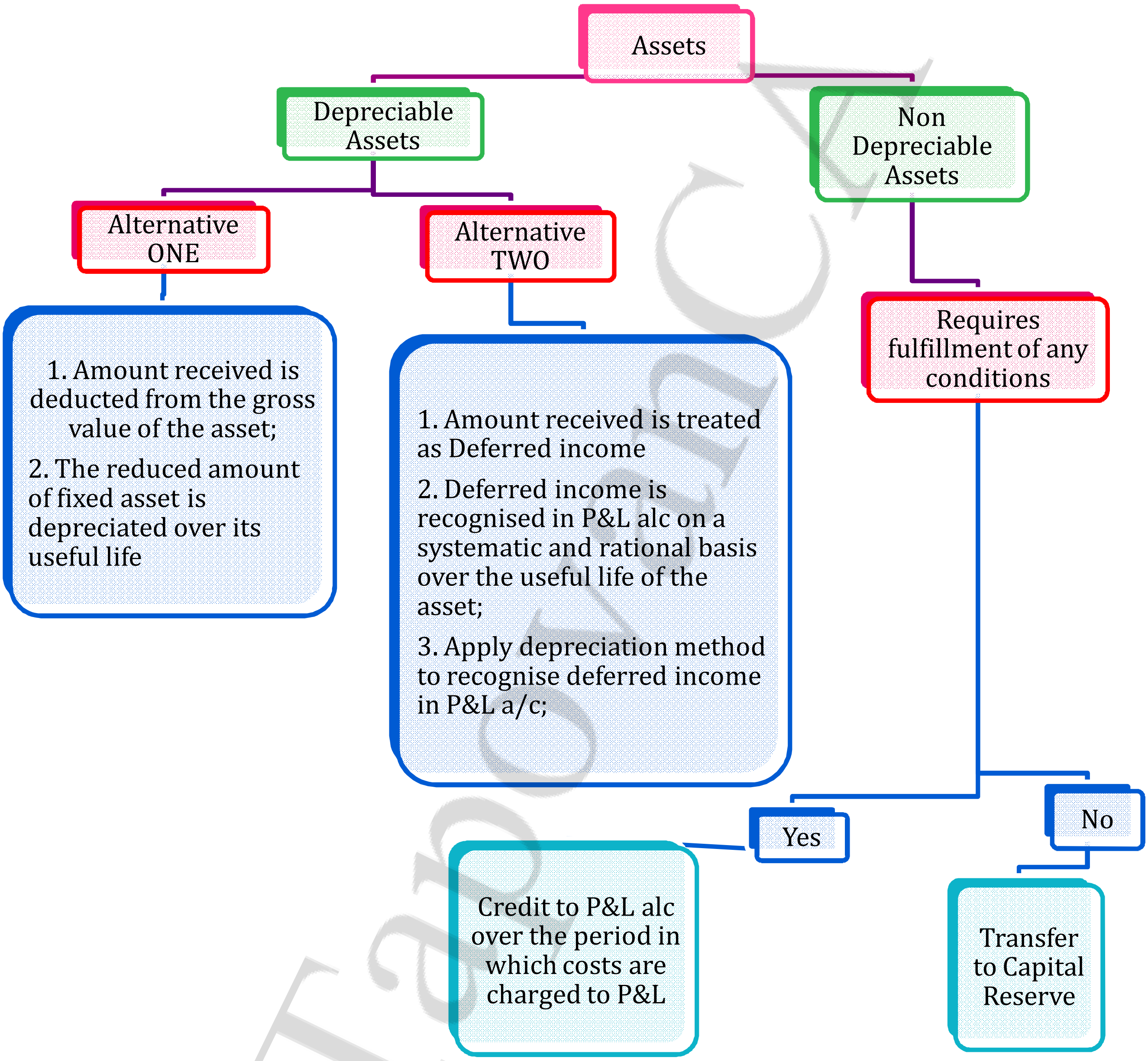
Grants may be received in the form of land, buildings or other resources (Known as non-monetary assets,)

Non-Monetary Asset received at Discounted / Concessional rate	Non-Monetary Asset received Free of Cost
In this case, such assets are recorded Acquisition Cost (Concessional price at which asset is acquired)	In this case, such assets are recorded Nominal Value (at negligible or immaterial value)

Concept No. 7 Grants Related to Specific Fixed Assets

Government may issue grant if entity purchases or constructs the asset as per the specifications made by government.

Accounting Treatment



If the asset is depreciable, two options are available. The entity can select anyone method and can apply the same consistently.

Concept No. 8 - Revenue grants presentation in P&L

1st Method	2odMethod
Present as income in the profit and loss statement as **OTHER INCOME.**	Grant received can be **deducted from the related expense** in P&L. .

Concept No. 9 Refund of Government grant

- Government grants are generally refundable when the entity does not fulfil certain conditions.
- Refund of grant is treated as an extraordinary item as per AS 5.
- Accounting for refund of grant is based on the initial recognition of government grant because the **previous treatments need to be REVERSED** at the time of refund.
- **To understand this point, REMEMBER THIS WORDS THAT "PREVIOUS TREATMENT NEED TO BE REVERSED".**

Grants	Initial Accounting	Refund Accounting Treatment
1. Revenue Grant	On receipt of grant, if it is initially transferred to Deferred government grant account and subsequently transferred to P&L in a systematic and rational basis over a period of time. (Matching concept)	**If balance is available in deferred government grant A/c :** • First reverse the existing balance in deferred government grant A/c. • Remaining amount should be charged to P&L. Deferred Govt. Grant A/c......Dr (to the extent of balance in A/c) P&L A/c....... Dr (balancing fig.) To Cash / Bank (Refunded amount) **If balance is not available in deferred government grant (i.e.it is fully transferred to P&L):** Charge total refunded amount to P&L alc. P&L A/c ....Dr (Refunded amount) To Cash / Bank (Refunded amount) .
2. Capital grant **(Capital approach):**	Initially it is transferred to capital reserve A/c	Capital reserve balance should be reversed. Capital reserve A/c........ Dr To Cash /Bank A/c (Refunded Amt.)

Concept No. 10 - Refund of Grant related to specific fixed asset.

A. In case of Depreciable Assets

Method 1

Initial Accounting

- Deducted from the gross value

Accounting at the time of Refund:

- Add the refunded amount to fixed asset carrying amount; and
- Depreciate the increased carrying amount over the remaining useful life of the asset **prospectively.**

Journal Entry

- Machinery A/c .... Dr.
  To Cash / Bank A/c (Refunded amount)

Method 2

Initial Accounting

- Grant received is credited to deferred Government Grant A/c and transferred to P&L A/c in systematic and rational basis over the useful life of asset

Accounting at the time of Refund:

- First utilise the balance existing in deferred government grant A/c and if any balance charge to P&L A/c.

Journal Entry

- Deferred Govt. Grant A/c........ Dr
  (Balance in BS)
  P&L A/c.................. Dr
  (Balancing fig.)
  To Cash / Bank A/c (Refunded amount)

B. In case of Non-Depreciable Assets

A. If previously credited to capital reserve if no conditions need to be satisfied.	**B.** If conditions need to be satisfied, initially recognised as deferred govt. grant and transferred to P&L in systematic and rational basis so as to match the revenue with expenditure.
Reverse the capital reserve with refunded amount. Capital reserve A/c..... Dr To Cash / Bank A/c (Refunded amount)	Same as Revenue grant refund as discussed above

Concept No. 11 - Disclosure under AS - 12

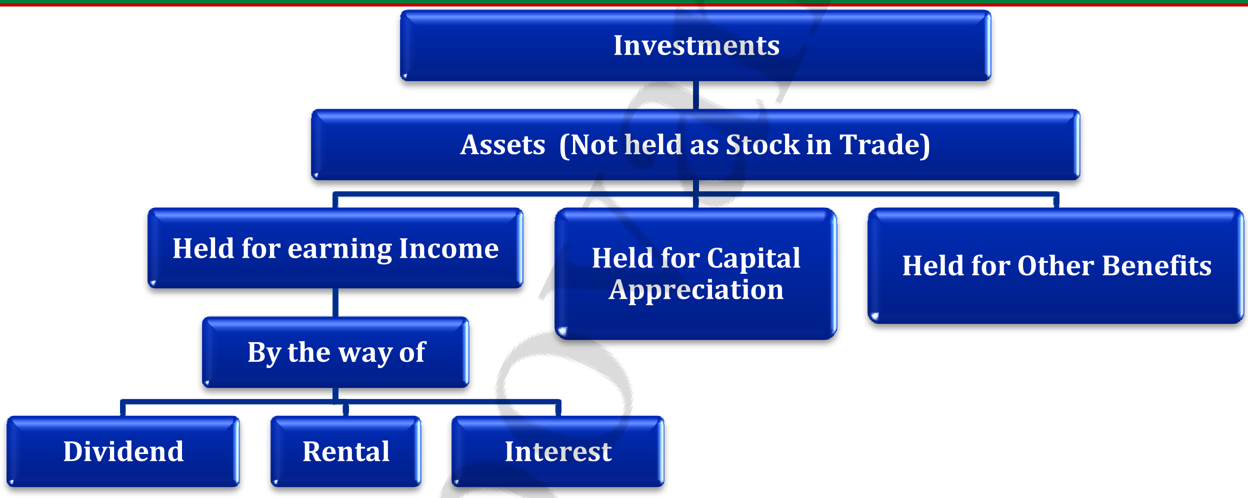
1. The accounting policy adopted for government grants
2. The nature and extent of government grants recognised in the financial statements

Concept No. 1 Introduction & Meaning

Investments are assets held by an enterprise for earning income by way of dividends, interest and rentals, for capital appreciation, or for other benefits to the investing enterprise. Investment Accounting is done as per AS-13 which deals with all kind of investments except:

1. Interest, dividends and rentals earned on investments.
2. Operating or financial leases
3. Investment of retirement benefit plans and life insurance enterprises
4. Mutual funds
5. Assets held as Stock-in-trade are not 'Investments'

(I) Meaning of Investments



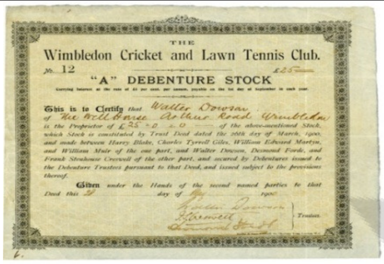
(II) Forms of Investment

Investments with physical form.

Investments with physical form - E.g. Land & building, gold, silver, etc.

Investments without physical form.

Investments without physical form (rights) and in the form of mere certificates or similar documents- E.g. Shares, debentures, etc.

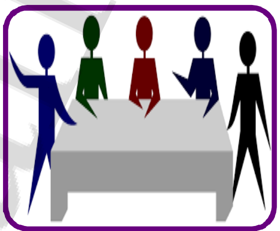


Concept No. 2 Market of Investment

Investments may or may not have an active market

Shares in listed companies have active market;

For shares in private limited companies, active market doesn't exist.



Concept No. 3. Recognition & Measurement

It is classified into two

- **Recognition & Measurement**
  - **Initial Measurement**
    - **Measured at COST**
      - **Classification is NOT relevant**
  - **Subsequent Measurement**
    - **Depends on Classification (Whether investment is treated as Short Term or Long Term)**

1. Initial Measurement of investment

Initial recognition means recognising the investment **at the time of acquisition. All investments whether current or long term should be initially recognised at COST. Cost of investments include**

Basic cost of investment + All direct costs incurred for acquisition.

(Direct Cost on investment Includes brokerage, fees, registration fees and duties, etc.)

Concept No. 4 Classification of Investments& Subsequent Measurement

Current Investment

- Two conditions to be satisfied
- 1. It is readily realisable
  2. Intention to hold for NOT more than one year from date of investment
- Measures at Cost OR Fair value Whichever is lower (on Individual Investment Basis)
- Any reduction to fair value and any reversals of such reductions are transferred to P&L a/c

Long term investment (Example: Investment Property)

- Which is NOT current investment
- Always valued at COST
  Exception: Reduce carrying amount if permanent diminution in value
- Any reduction to Cost and any reversals of such reductions are transferred to P&L a/c

Concept No. 5 Investment can be acquired

By Payment of cash/credit

- Cost of investment =
- **Amount Paid/ payable including incidental expenses** like Brokerage.

By issue of shares or other securities

- Cost of investment =
- **Fair value (FV) of shares** / other securities on the date of acquisition

By exchange of another asset of the entity (Barter)

- Cost of investment =
- 1. FV of asset given up Or
  2. FV of Investment acquired

  Whichever is clearly evident

Fair value is an arm's length price agreed between knowledgeable, willing parties in an open market. Generally market value can be taken as fair value with some adjustments.

Concept No. 6 Income from Investments

Interest, dividends and rent receivable in connection with an investment are generally regarded as income, as it is a return on the investment.

Classification of Income from Investments as follows

PRE Acquisition Income

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

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

POST Acquisition Income

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

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

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

Bonus shares

Bonus Shares represents shares issued by the company to the **existing equity share holders at free of cost by capitalising reserves**.

Cost of investment of bonus shares is always Nil but it increases number of shares.

Therefore there is **no need to pass any journal entry & only number of bonus shares received will be added** to the existing number of shares.

Right Issue and Rights shares

These are shares issued to existing shareholders of a company for consideration.

Existing shareholders are given the "right" to purchase new shares generally at a lesser price.

If existing shareholder is not interested in “rights" then they can sell the rights to anybody.

If the existing share holders exercise the option

Investment A/c .... Dr.

To Cash/Bank A/c

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

<u>Exception to the above rule</u>

when the following two conditions are satisfied, the accounting treatment differs:

1. The investments must be acquired on cum-right basis; and

2. Market value of such investments came down below the cost of investment immediately after the issue of right shares;

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

Concept No. 7 - Sale of Investments

Profit or Loss on sale of investments should be recognised in the P&L alc.

Profit / (Loss) = Sale proceeds (Net of selling expenses) - Carrying amount (book value).

If a part of an individual investment is disposed, the carrying amount is to be determined on the basis of the average carrying amount of the total holding of the investment and accordingly profit or loss on such disposal is to be determined. (NOT FIFO or LIFO or any other basis)

Concept No. 8 - Reclassification of Investments

Classification of investments can be changed by the entity at any point of time i.e. either from Long term to current OR current to long term.

The following points explain how to determine the carrying amount after reclassification.

Reclassification from Long term to Current

Carrying amount of current investments is lower of cost and carrying amount on the date of reclassification.

Reclassification from Current to Long term

Carrying amount of long term investments is lower of cost and fair value on the date of reclassification.

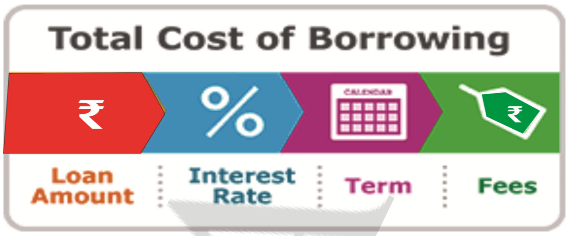
Concept No. 9 - Disclosure

Disclosure

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

Concept No. 1 Meaning of Borrowing cost

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



It includes the following cost and charges

Interest and commitment charges on any borrowing

Amortisation of discounts or premiums relating to borrowings
g: 1. Premium payable on redemption of debentures or Preference shares, 2. Discount on issue of debentures.

Amortisation of ancillary costs incurred for arrangement of borrowings

Finance charges when the assets under finance leases.

Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Note: Cost or charges paid for pre closure / prepayment of loan shall not be treated as Borrowing cost. As per opinion of Expert Advisory committee of ICAI prepayment fee paid for liquidating high cost debt and availing low cost debt in substitution of the high cost debt cannot be capitalised, as it is not borrowing cost as defined in AS – 16.

Concept No. 2 Objectives of this Standards:

This standard prescribes rules for accounting treatment for borrowing costs

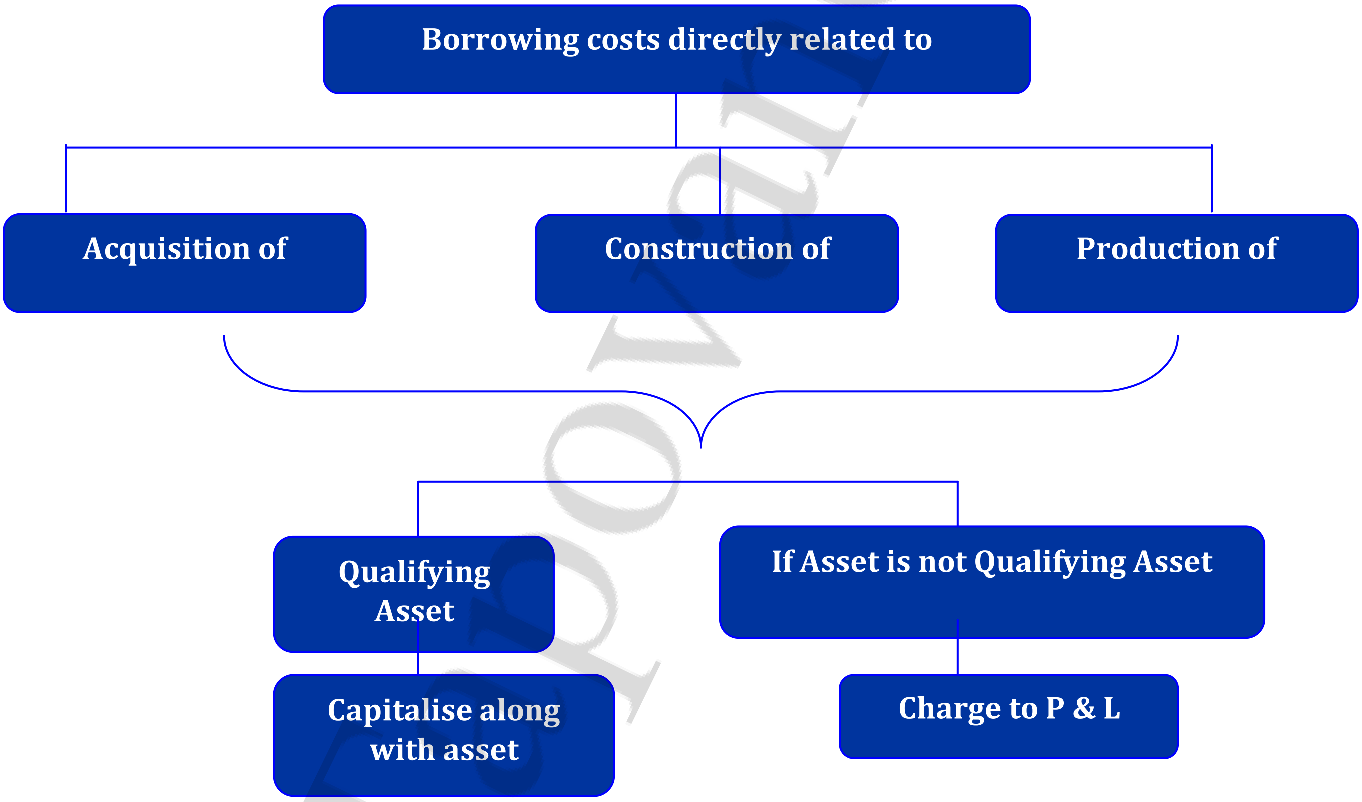
1. Whether the borrowing costs should be capitalised along with the assets OR charged to profit and loss statement.

In other words,

Whether the cost of borrowings should be included in cost of asset or to be charged to P&L A/c.

This standard deals with only borrowing costs and does **not deal with cost of owner's equity including preference capital** i.e. Dividend because it is not cost but it is just distribution of profit.

Concept No. 3 - Recognition



Borrowing Cost can be capitalised only when:

1. Those borrowing costs, which are directly attributable to the acquisition, construction and production of qualifying asset. (Directly attributable cost means which would have been avoided if asset would not have acquired, purchased or constructed.)
2. There are probable future economic benefit inflow,
3. Borrowing cost can be measured reliably.

Concept No. 4 - What is Qualifying Asset:

ASSET

That nessesarily takes a substantial period of time

To get ready for It's intended

Use

Sale

It depends on facts and circumstances of each case. Normally, period of 12 months is treated as substantial period of time unless shorter period can be justified

Examples of Qualifying Assets:	
1. Any tangible or intangible fixed assets, which are in construction/ development process or tangible or intangible asset acquired but not ready for use or resale. Such as: A. Tangible - plant and machinery, Building B. Intangible Assets: Patent	
2. Investment Property.	

3. Inventories that require a substantial period. (Normally more than one accounting period) to bring them in saleable condition.	

Concept No. 5 Commencement of capitalisation of borrowing Cost

Conditions for Capitalisation of borrowing costs

<u>Asset preparation and development activities shall be in process.</u>

Activities includes taking approval from government for construction or purchase, Designing, Physical construction of asset, technical work prior to commencement of physical asset

When necessary activities are not in progress, the interest incurred during that period should be charged to P&L statement.

Concept No. 6 - Suspension / Cessation of capitalisation

If the period of suspension of capitalisation and after cessation of capitalisation, borrowing cost shall be debited to P&L A/c

Suspension of Capitalisation

- Capitalisation of borrowing cost to be stopped for temporary period.
- Capitalisation of borrowing costs should be suspended during extended period in which active development is interrupted .
- If there is any temporary delay during construction or production for making the asset ready for its intended use or sale - interest incurred in that period should not be suspended.
- Capitalisation process will start once the interrupted work is resumed.

Cessation of Capitalisation

- Capitalisation of borrowing cost to be stopped for permanently.
- Capitalisation of borrowing costs should be stopped when substantially all necessary activities are complete i.e. the asset is ready for its intended use or sale.
- If minor modifications, like the decoration etc. are pending, it can be considered as substantially completed.

When a qualifying asset is completed in parts / phases - Capitalisation of borrowing costs should be stopped / ceased when any completed part is capable of being used.

1. How much amount should be capitalised?

1. If amount is specifically borrowed for obtaining a qualifying asset

In this case an entity should capitalise the following amount:

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

If funds are borrowed but not immediately required then such amount may be invested temporarily and income from such investments should be deducted from the borrowing costs incurred.

2. If amount is generally borrowed and used for the purpose of obtaining qualifying Asset.

Company may borrow amount through debentures, Bank Loan or other sources. This amount was borrowed for general business purpose and not borrowed specifically for construction or acquisition of assets.

Afterwards entity uses this amount for purchase or construction of qualifying asset.

In this case it is difficult to identify exact source of borrowing used for purchase or construction of asset.

Therefore Amount of borrowing cost should be determined by applying weighted average of borrowing cost which is also known as capitalisation rate.

In other words, capitalisation rate is weighted average rate of only general borrowings outstanding during the period.

Capitalisation Rate

$$\frac{\text{Borrowing cost incurred during the year}}{\text{Aggregate outstanding borrowings}} \times 100$$

Aggregate outstanding borrowings

$$\frac{\text{Amount of borrowings} \times \text{Number of months loan outstanding}}{12 \text{ Months}}$$

Interest to be capitalised

$$\text{Expenditure incurred on the asset} \times \text{capitalisation rate} \times \frac{\text{Period of utilisation}}{12 \text{ months}}$$

Note: Total amount of capitalised borrowing cost shall not exceed the actual borrowing cost incurred during the period.

Concept No. 7 - Disclosures

The entity should disclose the following in its financial statements:

(a) The accounting policy adopted for borrowing costs; &

(b) The amount of borrowing costs capitalised during the period.

Concept No. 8 Exchange differences arising on foreign currency borrowings

(Read AS 11 to understand this concept)

Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

This provision is applicable only if there is loss due to exchange difference from foreign currency borrowings & such loss is debited to P&L A/c.

Out of such fluctuation charge, some portion will be treated as borrowing costs as per this Standard subject to conditions.

Translate amount of loan in Indian Currency at closing rate x actual rate of interest on borrowing.

In Other words, (Loan outstanding in foreign currency x Closing rate) x actual rate of interest on borrowing.

Compute Interest that would have been paid if loan was taken in India (at interest rate applicable if loan is taken in India.)

Calculate increase in liability towards the principal amount due to increase in foreign currency rate.

Difference in loan amount to the extent of difference in interest rate (step 2 – step 1) shall be treated as borrowing cost in addition to actual borrowing cost paid under step 1.

Concept No. 1 Important Concepts

Questions	Answer
What is Segment Reporting 	Disclosure/Reporting of Information of product and Location of Entity based on Sales, Profit, Assets, and liabilities is known as Segment Reporting.
Core Element of AS – 17 	Core Element of this standard is reporting more than Accounting
By Whom 	**Reporting by Entity**
For Whom 	For Stakeholders
Why 	To gives very good understanding of the company to the stake holders, so that stake holders can take informed decisions. 1. Better understanding of the performance of the company; 2. Better assessment of risks and returns; 3. Make more informed judgments about the entity. Segment information is relevant to assess the risks and returns of a diversified or multi-Vocational entity.

Mandatory or Not?	
	This Standard makes it mandatory for entities to provide information by dividing / classifying it on product or location basis.

Concept No. 2 - Scope of AS - 17

- This standard is applicable to Level – I entity and non SME entity.
- This standard is applicable to the entities presenting

  (a) General purpose financial statements
  (b) Consolidated financial statements.

- Compliance of this standard is mandatory.

Concept No. 3 - Important Terms / Definitions

A. Types of Segment

Business Segment

Geographical Segment

Business Segment

Meaning	Segment is made on the basis of Products / Services with different risk and returns.
It is the segment which satisfies following conditions	1. It is a different (distinguishable) component compared to other components of an enterprise/organisation 2. It is subject to risk and returns that are different from those of other business segments. 3. It is engaged in providing an individual product or service or group of related products or services.

Factors to be considered in determining whether it is business segment or not:	(a) Nature of the products or services; E.g. Software, hardware, Steel, Jewellery, etc. (b) Nature of the production processes; e.g. Automated, Manual. (c) Type or class of customers for the products or services; E.g. Institutional or Retail (d) Methods used to distribute the products or provide the services; and E.g. Direct distribution to customers or through dealers; (e) Nature of the regulatory environment, E.g. banking, insurance, or public utilities.

Geographical Segment	
Meaning	Segment is made on the basis of its operation in different geographical areas, which are exposed to different risk and returns.
It is segment which satisfies the following conditions	• Basically it is a different/ distinguishable component considering the location of operations or its customers. • Risk & returns are influenced by the geographical location.
To identify a geographical segment, we should consider the following factors	(a) Similarity of economic and political conditions; e.g. Democracy, Feudalism (b) Relationships between operations indifferent geographical areas; (c) Proximity (closeness) of operations; (d) Special risks associated with operations in a particular area; e.g. Terrorism, Backward areas. (e) Exchange control regulations; and e.g. partial or fully convertible currency. (t) The underlying currency risks. e.g. Euro V s. Dollar

A. Reportable Segment
It is a business or a geographical segment for which segment information is required to be disclosed separately in the financial statements.

A segment is treated as reporting segment only when it satisfies the conditions given in the Standard.

Therefore A company may have many segments but all of them need not be reportable segments as per the Standard.

A Reportable segment needs to disclose segment revenue, expenses, assets & liabilities etc. as per the Standard.

B. Enterprise revenue

It is revenue from sales to **external customers** as reported in P&L A/c.

C. Segment Revenue

Segment revenue includes:

1. Revenue directly attributable to a segment;
2. Reasonable portion of enterprise revenue that can be allocated to segment.
3. Inter segment revenue transactions.

Segment revenue Excludes:

(a) Extraordinary items,
(b) Interest or dividend income including interest on loans given to other segments; (c) Gains on sales of investments or on extinguishment of debt.

(If segment is primarily of financial nature then point (b) & (c) shall be treated as part of segment revenue.)

D. Segment expense

Segment expense includes:

1. Expenses Directly Attributable to segment,

2. Reasonably portion of enterprise revenue that can be allocated to segment.

3. Cost incurred at enterprise level on behalf of segment.

Segment expense EXCLUDES:

(a) Extraordinary items,

(b) Interest expense including interest from loans and advances from other segments; if segment is primarily of financial nature then this interest expenses shall be treated as part of segment expenses.

(c) Losses on sales of investments or on extinguishment of debt;

(d) Income Tax;

(e) General administrative expenses, head-office expenses and other expenses which are incurred at the entity level and relate to the entity as a whole.

E. Segment result (Profit or Loss)
Segment revenue - Segment expense = **Segment result**

F. SEGMENT ASSET	
Segment assets are the assets:	• Used in its operating activities of the segment, • Which are directly attributable to the segment; • Which can be allocated to the segment on reasonable basis; (Includes tangible or intangible fixed assets and current assets) Note: 1. If a single asset is used by both the segments - it should be allocated between the two on a reasonable basis; 2. Goodwill that is directly attributable to a segment or that can be allocated to segment on the reasonable basis. 3. If a particular item of depreciation or amortisation is included in segment expense then related asset is also included in segment assets. 4. Segment assets are determined after deducting related depreciation of fixed assets and provisions from current assets like trade receivables.
Segment Assets not includes:	(a) Income-tax assets like deferred tax asset, Advance tax etc. (b) Asset used for general entity or head office purposes. (c) Loans, investments or other interest/dividend generating assets; these assets will be included only when the segment is primarily of financial nature.

G. SEGMENT LIABILITIES	
Segment liabilities are :	a. liabilities generated from the operating activities of the segment b. Which are directly attributable to the segment; and c. Which can be allocated to the segment on reasonable basis; Examples: Trade payables, outstanding liabilities, advances received from customers, provision for warranty or employee benefits like provident fund, gratuity of employees working with the segment.
Segment liabilities not includes	(a) Loans and other interest-bearing liabilities; these liabilities will be included

	only when the segment is primarily of financial nature. (b) Income-tax liabilities like deferred tax liability, provision for tax etc.

H. Reportable Segments

Segment is treated as reportable segment when it satisfies **any One of following conditions:**

Criteria 1	**Segment Revenue Criteria**
	Segment revenue = External + Inter segment transfers. Segment Revenue is 10 % or more of Total Revenue of ALL SEGMENTS (not Enterprise revenue - as it includes only external sales)

Criteria 2	**Segment Results Criteria:** (on the basis of profit or loss)
	Segment result is 10% or more of a. Total of segments profits only. b. Total of segments losses only. (whichever is Higher)

Criteria 3	**Segment Assets Criteria:**
	Segment assets is 10 % or more of Total assets of all segments

Management can designate a business or geographical segment as reportable segment even if it does NOT satisfy the above conditions.

Criteria 4	OVERALL external Revenue Criteria:
	all segments the above three criteria must be applied first and- 1. Further, Management may at its discretion choose any segment as reportable segment even if such segment does not fulfill the criteria stated above. 2. Ensure whether at least 75% of total external revenue should be in the reportable segments. 3. If 75% of total external revenue is not in the reportable segments, then additional reportable segments should be identified ignoring 10% threshold limits until at least 75% of total external revenue is included in reportable segments.

If any segment is not designated as a reportable segment under any of the above conditions, it should be included as an unallocated segments reconciling item.

Any segment, which was reportable segment in the previous year on fulfillment of 10% threshold limit, should be reportable segment during current year even if 10% threshold limit is not fulfilled in current year.

Concept No. 4 - Basis of classification

Conditions	Primary Reportable Segment	Secondary Reportable Segment
If risk and returns of a company is mainly affected by difference in product/ service.	Business Segment	Geographic Segment based on location of customers.
If risk and returns of a company is mainly affected by its operations in different geographical area 1. Based on location of assets and location of customers.	Geographic Segment	Business Segment
2. Based on location of assets only and if location of its customers is different from the location of its assets.	Geographic Segment (based on location of assets)	Business Segment + Customer based geographic segment sales
3. Based on location of customers and if the assets of the enterprise are located in different geographical area from its customers.	Geographic Segment (based on location of customers)	Business Segment + Assets based geographic segment - revenue, segment assets

If risk and returns of a company is mainly affected both by difference in product/ service it produces and its operations in different geographical area.	Business Segment	Geographic Segment

Concept No. 5 - Disclosures


Revenue from external customers


Revenue from transactions with other segments (Inter segment transfers)


Segment results


Carrying amount of segment assets

Segment liabilities


Depreciation and amortisation expense during the period.

Non-cash expenses other than depreciation and amortisation.

Reconciliation of revenue, result, assets and liabilities.

Objective:

The objective of this Standard Related Party Disclosures is to establish requirements for disclosure of:

Related party relationships; and

Transactions between a reporting enterprise and its related parties.

Scope:

This Standard deals only with related party relationships described in (a) to (e) below:

(a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);

(b) Associates 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 the voting power of the reporting enterprise that gives them control 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.

Applicable To

(a) Enterprises that controlled by the reporting enterprise

(e) Enterprises over which any person described in (c) or (d) is able to exercise significant influence

(b) Associates and joint ventures of the entity

(d) Key management personnel and relatives of such personnel

(c) Individuals who have control or significant influence directly or indirectly & their relatives

Definitions/Meaning

For the purpose of this Standard, the following terms are used with the meanings specified:

1) 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.

2) Related party transaction – a transfer of resources or obligations between related parties regardless of whether or not a price is charged.

3) Control –

Ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or

Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or

A substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

4) Significant influence – participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.

Does the entity has 20% or more voting power?

- **Yes** → **Does It exercise significant influence?**
  - **Yes** → It is an ASSOCIATE Disclose as required
  - **No** → It is an NOT an ASSOCIATE. NO need of disclosures. (It should be proved)
- **No** → **Does It exercise significant influence?**
  - **Yes** → It is an ASSOCIATE. Disclose as required (It should be proved)
  - **No** → It is an NOT an ASSOCIATE. NO need of disclosures

Examples of exercising significant influence:

Having investor's representative in the board of associate; (Representative can participate in BOD's discussions)
Participation in the policy-making process;
Material transactions between investor and associate
Interchange of managerial personnel;
Technical assistance required by associate is provided by the investor; (Technical dependence) etc.
In the above examples, investor can influence the company even though it does not control it.

5) A Joint venture –

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

6) Key management personnel

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

Example of key managerial personnel are Managing director, whole time director, Chief executive officer, and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

7) Relative

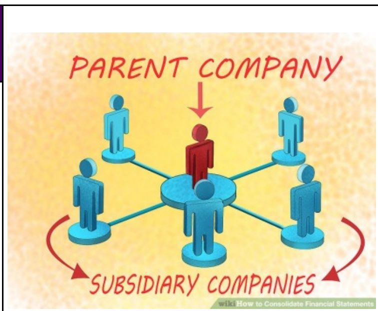
– in relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

8) Holding company – a company having one or more subsidiaries.

9) Subsidiary – a company:

In which another company (the holding company) holds, either by itself and/or through one or more subsidiaries, more than one-half in nominal value of its equity share capital; or

Of which another company (the holding company) controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors.



Disclosure

1) The statutes governing an enterprise often require disclosure in financial statements of transactions with certain categories of related parties. In particular, attention is focused on transactions with the directors or similar key management personnel of an enterprise, especially their remuneration and borrowings, because of the fiduciary nature of their relationship with the enterprise.

2) Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

3) If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

The name of the transacting related party;

- A description of the relationship between the parties;
- A description of the nature of transactions;
- Volume of the transactions either as an amount or as an appropriate proportion;
- Any other elements of the related party transactions necessary for an understanding of the financial statements;
- 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
- Amounts written off or written back in the period in respect of debts due from or to related parties.

4) **Items of a similar nature** may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

5) The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- Purchases or sales of goods (finished or unfinished);
- Purchases or sales of fixed assets;
- Rendering or receiving of services;
- Agency arrangements;
- Leasing or hire purchase arrangements;
- Transfer of research and development;
- License agreements;
- Finance (including loans and equity contributions in cash or in kind);
- Guarantees and collaterals; and
- Management contracts including for deputation of employees.

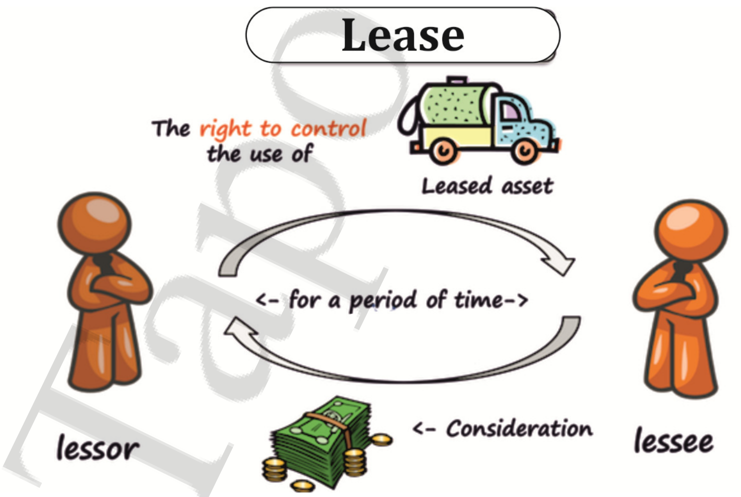
AS – 19 Leases

This standard is the best example of 'substance over form'.

Objective of AS - 19
To Prescribe 1. The accounting treatment for leases in the books of lessee & lessor and 2. Accounting policies and disclosures.

Scope of AS - 19
This Standard is applicable to ALL leases other than (a) Lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; (No AS exists and industry rules are followed) (b) Licensing agreements for such as motion picture films, video recordings, plays, manuscripts, pate and copyrights; and (All these are intangible assets - AS 26 is applicable) (c) Lease agreements to use lands. (d) This standard is also not applicable to cancellable lease (Where leasee has a right to cancel the lease)

Important concepts and definitions



Lease means
Lease is an agreement WHICH GIVES RIGHT TO USE AN ASSET to for lessee an agreed period of time BY single payment or series of payments

Non-Cancellable Lease
A non-cancellable lease is a lease that is not cancellable during the lease term. Even though the lease is cancellable, under the following situations - it is treated as non-cancellable

lease:

Even if cancellable-

(a) Upon the occurrence of some remote (rare) contingencies (like earthquakes, floods, etc.); or (b) With the permission of the lessor; or

(c) If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) Upon huge payment of penalty by the lessee (because it is huge payment, it is certain at the inception that lease will be continued till the end of the lease term).

Lease term
Lease term is the non-cancellable period agreed upon + any further period (renewal term): Renewal period can be included in the lease term only when it satisfies the following conditions - (a) Option to renew must be given in the lease agreement (with OR without further payment); and (b) Renewal of the lease should be reasonably certain at the inception of the lease agreement.

Inception of the lease
Lease agreement date or Date of commitment by the parties on important terms whichever is earlier

Classification of Leases

Leases are broadly classified into two

↓

The classification of leases is based on risk and rewards incidental to ownership of the asset.

↓

If the risks and rewards incidental to ownership lie with the Lessee - it is called as

↓

Finance lease

If the risks and rewards incidental to ownership lie with the Lessor - it is

↓

Operating lease

(Risks include the losses from changes in income, technological obsolescence, idle capacity etc.

Rewards include gain from appreciation in the value of the asset, increase in residual value, an increase in the economic life of the asset etc.)

Operating Lease:

It is a lease which does not transfer substantially all the risk and reward incidental to ownership

Accounting for operating lease

In the books of Lessor:

1. Record lease out asset as the fixed assets in the balance sheet
2. Charge depreciation as per AS 6
3. Recognise lease income in P & L account using straight-line method.
4. Other cost of operating lease should be recognized as expenses in the year in which they are incurred.
5. Initial direct cost of lease may be expensed out immediately or deferred as per lease term.

In the books of lessee:

1. Lease payments should be recognized as an expense in the P & L account on a straight-line basis over the lease term.

Finance Lease

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the Lessor but not the legal ownership.

Accounting for Finance Lease

In the books of Lessor:

1. Recognise asset given under finance lease as receivable at an amount equal to net investment in the lease and corresponding credit to sale of assets.

Net Investment: Gross investment – unearned finance income

Gross Investment: Minimum lease payment from Lessor point of view + unguaranteed residual value

Unearned Finance Income: Gross investment - PV of gross investment

2. Recognition of Finance Income: On the basis of constant periodic return on the net investment outstanding in respect of finance lease.

In the books of lessee:

1. **Lease assets as well as liability for lease should be recognized at the lower of:**
   a. Fair value of the leased assets at the inception of lease, or
   b. PV of minimum lease payment from the lessee's point of view.
2. **Apportionment of lease payment:**
   a. Principal Amount: is reduced from the outstanding liability.
   b. Finance charges: is allocated over lease term in such a manner that it would produce a constant rate of return on the remaining principal balance.
3. **Charge depreciation on finance lease assets**

Other Terms used in Lease

Guaranteed residual value:

In respect of lessee: residual value which is guaranteed by or on behalf of lessee.
In respect of Lessor: residual value which is guaranteed by or on behalf of lessee or by an independent third party.

Unguaranteed residual value

The difference between residual value of assets and its guaranteed residual value is unguaranteed residual value.

Minimum Lease payment:

1. For Lessor:

Total lease rent to be paid by lessee over the lease terms

+Any guaranteed residual value
- Contingent rent
- Cost for service and tax to be paid
+Residual value guaranteed by the third party

2. For Lessee:

Total lease rent to be paid by lessee over the lease terms

+Any guaranteed residual value
- Contingent rent
- Cost for service and tax to be paid by and reimbursed to lessor

Contingent Rent

Lease rent fixed on the basis of percentage of sales, amount of uses, price indices, market rate of interest is called contingent rent.

PV of leased assets

PV of minimum lease payment + unguaranteed residual value

❖ When a manufacturer or dealer of the asset gives the asset on lease

- They offer their customers an option of either buying the asset or taking it on lease.
- If customers go for lease, such lease may be a finance lease or an operating lease.
- Accounting treatment.

Finance lease

Manufacturer will have two kinds of income
1. Profit on sale from an outright sale at normal selling price; and 2. Finance Income over the lease term;
Sales Recognition
➢ Sales revenue should be recognised at Fair value of the asset or Present value of MLPs Whichever IS LOWER
➢ When Manufacturers quote artificially low rate of interest to attract the customers - In such a case - the entity should apply a market rate of interest.
➢ Cost of sale = Cost of the leased asset Less present value of unguaranteed residual value.
➢ The difference between the sales revenue and cost of sales should be recognised as profit at the inception of the lease.
➢ Initial direct costs (brokerage, etc.) are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit. (Should not be deferred)

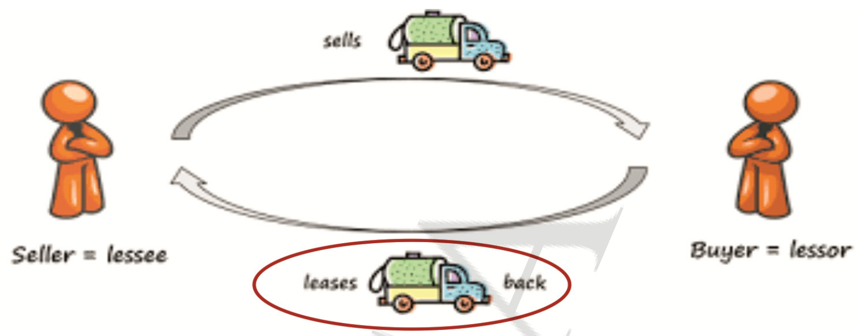
Operating Lease

Manufacturer's Income
The lease rentals (MLP's) received by the manufacturer/dealer should be recognised as income. (Whatever treatment is applicable for an operating lease should be followed)
Sales Recognition
When the lease is an operating lease, the Lessor should recognise the leased asset as fixed asset at cost of manufacturing as per AS 10 (in case of self generated asset - Internal profit should not be recognised).

❖ Sale and Lease back transactions

In this transaction one party sells an asset to another party and the buyer of the asset leases it back to the seller immediately by entering into another agreement.

There is no movement in the place of the asset



There are two agreements

1. For sale of the asset; 2. Lease agreement.

The lease payments and the sale price are usually interdependent as they are negotiated as a package by both the parties.

Accounting treatment of a sale and leaseback transaction

When it is a finance lease

The risks and rewards are with the seller only as the asset is leased back to the seller

- The accounting treatment should reflect the substance of the transaction rather than its form. (AS 1 - Substance over form);
- The profit or loss on sale of the asset should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

When it is an Operating lease

If the sale price is equal to fair market value
Any profit or loss should be recognised immediately.

If the sale price is below fair market value

- Any profit or loss should be recognised immediately, except that, if the loss is compensated by future lease payments at below market price
- If the loss is compensated by future lease payments at below market price, the profit or loss should be deferred and amortised in proportion to the lease payments.

If the sale price is above fair market value

- The excess over fair value should be deferred and amortised over the period for asset is expected to be used.
- Further, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

Disclosure Requirements

In case of financial lease:

In the books of lessee	In the books of Lessor
a) Assets acquired under finance lease b) Reconciliation between the total of minimum lease payments and their present value as at the balance sheet date with following segregation - Not later than one year - Later than one year and not later than five years - Later than five years c) Contingent rents recognised as an expense. **d) Future minimum sublease payments expected to be received under non-cancellable subleases** **e) General description of the leasing arrangements**	a) General description of the significant leasing arrangement b) Accounting policy for initial direct cost c) Reconciliation of total gross investment in lease and present value of minimum lease payment (MLP) receivable at the balance sheet date. **d) MLP receivable in following categories** - Not later than one year - Later than one year and not later than five years - Later than five years

In case of operating lease

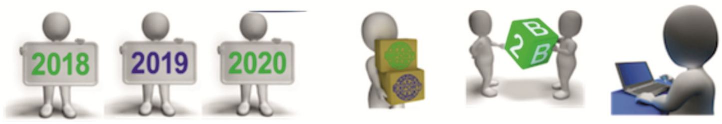
In the books of lessee	<u>In the books of Lessor</u>
(a) General description of the significant leasing arrangement b) Total of future minimum lease payments in the following period - Not later than one year later than one year and not later than five years - Later than one year and not later than five years - Later than five years c) Lease payments recognised in profit & loss account for the period.	a) General description of the significant leasing arrangement b) Accounting policy for the initial direct payment c) Future lease payments in aggregate classified as: - Not later than one year - Later than one year and not later than five years later than five years - Later than five years

AS – 20 Earnings Per Share

Objective of AS - 20

=> To specify the principles for presenting of EPS to improve comparisons:

Over Time | Between Different Entities



Objective

1 To Prescribes the principles for computation of **Earnings Per Share** (EPS)
2. To give presentation guidance of **Earnings Per Share** (EPS) which helps user to compare the performance among different entities and performance

Scope of AS – 20

Applicable to an entity

1. Whose equity shares or potential equity shares are listed on a recognised stock exchange in India
2. Any entity (listed or not listed) who wants to disclose EPS voluntarily; or
3. If EPS disclosure is required by any statute.
4. If the entity is presenting consolidated financial statements, then EPS should be calculated based on the consolidated earnings.

Definitions

1. Potential Equity Share (PES)

It is a financial instrument or other contract, which entitles or may entitle the holder to equity shares. E.g.
(a) Convertible debentures or convertible preference shares;
(b) Share warrants;
(c) Employee stock option plans;
(d) Loan agreement, if the borrower has to issue equity shares in case of default of conditions.

2. Share warrants or Options

These are financial instruments which give the holder a right to acquire equity shares of the entity.

Presentation of Earning Per Share

An entity should present Basic EPS and **Diluted** EPS on the face of P&L alc.

Basic & Diluted EPS should be presented separately for each class of equity shares that has a different right in sharing the net profit.

Basic EPS = $\dfrac{\text{Net Profit or Loss for the period attributable to Equity share holders}}{\text{Weighted average number of equity shares outstanding during the period}}$

Let us see how to get following the amounts

1. Net profit or Loss for the period attributable to Equity share holders

In calculation of profit/loss available to Equity shareholders the entity should consider (add/less) the following:
Income Tax expense;
Profit/loss from exceptional items;
Profit/loss from extraordinary items (Refer AS 5 for detailed discussion)
Profit/loss from prior period items;
Preference dividend
(a) In case of non cumulative preference dividend, it should be deducted only if it is declared/ provided by the entity during the period.
(b) In case of cumulative preference dividend, it should be deducted every year whether or not declared/provided by the entity.
All items of income & expenditure which are recognised in P&L;

2. Weighted average number of equity shares outstanding during the period

It should be computed in the following manner-

Number of equity shares outstanding at the beginning of the period	xx
Add/ Less: No. of equity shares issued/ bought back during the period time weight factor	(xx)
Weighted average number of shares	**xx**

Generally shares are included in the calculation of weighted average number of shares only from the date the consideration is receivable.

The standard's guidance on the time of inclusion in calculation of weighted average number of shares

	Included when?
For cash	Cash is receivable
On conversion of debentures	From the date of conversion
In lieu of interest or principal of financial instrument	The date from where interest stops to accrue (as per the agreement)
For the settlement of a liability	Date of settlement or as agreed upon
For other than cash consideration	The asset received is recognised in the books
For rendering services	When services are rendered
Amalgamation in the nature of purchase	From the date of acquisition
Amalgamation in the nature of merger	From the beginning of the period as if combined entity had existed from the beginning of the reporting period.

Other important Concepts

Partly paid up equity shares

If the entity has partly paid up equity shares, then those are converted to equivalent shares based on its entitlement to participate in dividends compared to fully paid up equity shares.

Different nominal values/class of shares

Where an entity has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

Calculation of basic EPS in case of Bonus issue / Share split & Share consolidation

In case of **bonus issue**, shares are issued to existing shareholders for no additional consideration. Share capital increases without an increase in the resources.

Share split means dividing the face value of share into small values. Because of this, number of shares increase but total share capital does not change. No consideration is received from the share holders.

Share consolidation (Reverse split) is exactly opposite to share split i.e. two or more shares with smaller face value are combined to make it one share of higher face value. No consideration is received from the share holders.

Calculation of Basic EPS in case of Rights issue

In case of bonus issue, as there is increase in number of shares without increase in resources, we have restated the PY basic EPS.

Right shares are generally issued at less than fair value it means that there is bonus element in rights issue also.

Whenever bonus element is involved, the treatment remains same i.e. we should restate (adjust) previous year basic EPS. The previous year's number of shares should be multiplied with the bonus factor. The entity needs to perform the following calculations.

Bonus Factor =

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

Theoretical ex - rights FV per share=

$$\frac{\text{Fair value of shares outstanding before rights issue + Amount received on issue of rights}}{\text{Total number of shares after rights issue}}$$

Diluted Earnings Per Share

Diluted EPS is computed in the following manner

$$= \frac{\text{Net profit or loss attributable to equity share holders after giving effect of potentially dilutive equity shares}}{\text{Weighted average number of shares outstanding after giving effect of potentially dilutive equity shares}}$$

In computing the diluted EPS, the entity should assume that.

1. Profits available to equity share holders after issue of equity shares to Potential Equity Shareholders
2. How many number of equity shares would be there after such issue
3. It issued equity shares to all potential equity share holders at fair value; If the shares are issued at less than the fair value, the difference between the number of shares issuable at fair value and shares issued at actual price should be treated as an issue of equity shares for no consideration. Such issue dilutes the EPS

Determination of whether a potential equity share is Dilutive or Anti-dilutive

A potential equity share is said to be dilutive only when earnings per share decrease after conversion into equity shares.

If the earnings per share increase, such potential equity shares are called anti· dilutive and not considered for the calculation of diluted EPS.

The standard gives the following guidance on the sequence of usage of PES:

Step 1: Identify the potential equity shares;

Step 2: Determine the increase in earnings after conversion;

Step 3: Determine the increase in number of shares to be issued on conversion;

Step 4: Calculate earrings per Incremental potential equity share i.e. $\frac{\text{Increase in earnings (Step 2)}}{\text{Increase in no. of shares (Step 3)}}$

Step 5: Give ranks based on incremental PES, least incremental share gets first rank as it is considered most dilutive.

Step 6: Based on the ranks, start calculating dilutive EPS step by step. If the EPS is decreased from one step to another, such PES is treated as dilutive and if EPS is increased at any level such PES are treated as anti-dilutive and stop calculating diluted EPS.

Disclosures

Entity should disclose

1. Basic & Diluted EPS with and without extraordinary items (Refer AS 5 for the meaning of extraordinary items);
2. Face/Nominal value of shares
3. Details about the weighted average number of shares

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AS 22 Accounting For Taxes on Income

Concept No. 1 - Introduction & Objective

Due to provisions of Income tax Act, accounting income differs from taxable income& due to this, sometimes current year incomes and expenses are recognised in the next year.

This standard is mainly based on Accrual & Matching concept.

According to this standard, current years income should be taxed in the current year & income tax is considered to be an expense incurred by the entity in earning income and are accrued/recognised in the same period irrespective of actual payment of Tax.

Concept No. 2 - Scope:

Taxes on income include all domestic and foreign taxes, which are based on taxable income.

+

Taxes in income exclude tax payable on distribution of dividend and other distribution made by enterprise.

Concept No. 3 – Meaning and Definitions:

1. Current tax:

Current Tax is the amount of income tax payable or recoverable in respect of the taxable income / loss for a period.

2. Accounting income & taxable income

INCOME

- **Accounting Income**
  - **Profit or loss for a period before deducting tax expense**
- **Taxable income**
  - **The income for a period determined in accordance with the rules established by the taxation Laws, upon which income tax is payable**

3. Reasons for differences between accounting income and taxable income

1.Timing difference

This type of difference arises in one period and capable of reversal in one or more subsequent period.

Example:

1. Difference due to rate of depreciation.

2. Difference due to method of depreciation.

3, Expenses debited in P& L A/c of current year but allowed for tax purpose in subsequent period. Like section 43B of Income Tax Act, 1961.

2. Permanent difference

This type of difference arises in one period and not capable of reversal subsequently.

In other words, Reversal of such item is permanently disallowed.

The following items are income or expense either for accounting or income tax purpose and it will never be reversed in life. Hence the entity need NOT defer the tax expense for future years.

(a) Agricultural Income;

(b) Expenses disallowed U/S 40A;

(c) Dividend income; (It is shown as income in accounting but it won't be taxed)

(d) Penalties or fines;

(g) Employers' contribution to unapproved

provident fund.

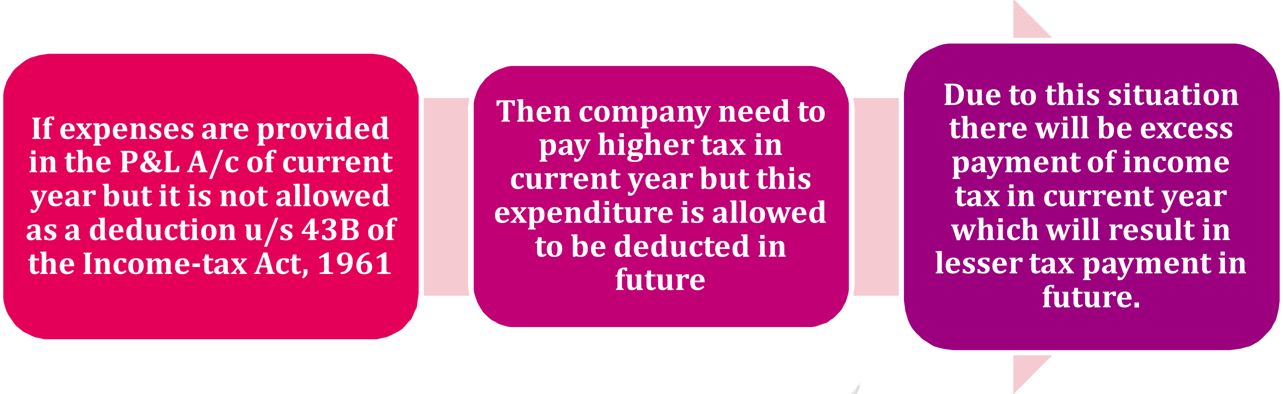
Note: Permanent difference do not result in deferred tax asset or deferred tax liability.

5. Deferred Tax Asset

It is recognised when taxes of initial years are higher and subsequent years are lower.

In other words, Deferred Tax Asset should be recognised when expenses are deductible in future years as per Income Tax Act & the entity is going to receive income tax benefit in the future years.

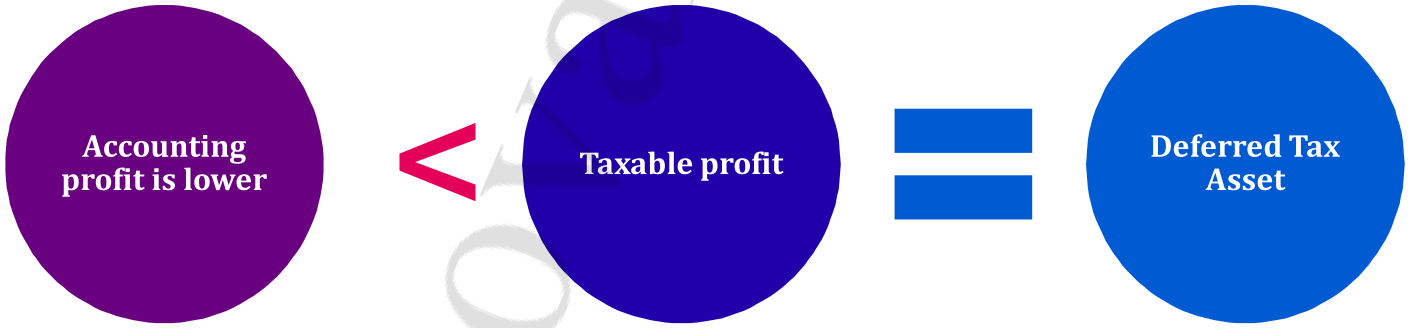
Example:



In above case extra tax payment in current year resulted in tax saving in future tax therefore payment made can be treated as asset.

Deferred Tax Asset should be recognisedand carried forward only to the extent that there is a reasonable certainty that company will get sufficient future taxable income to set-off disallowed expenses of current year.

Reasonable certainty can be deemed to exist if chances of having future taxable income are greater than 50%.



Technically speaking, If accounting profit is lower than taxable profit then Deferred Tax Asset shall be recognised subject to condition of reasonable certainty.

In case there is no sufficient future income to recover

journal entry for creation of Deferred Tax Asset:

Deferred Tax Asset A/c……… Dr. **To Profit and Loss A/c (Deferred tax income)**

6. UNABSORBED DEPRECIATION OR CARRY FORWARD OF LOSSES :

Unabsorbed depreciation

- As per Income Tax Act, Any unabsorbed depreciation and Losses can be set off against future profits within eight years' time limit.
- If the entity has unabsorbed depreciation or losses (carried forward) as per the tax laws, it can set-off it against future taxable income and pay less tax in the future.
- Therefore this Unabsorbed depreciation or losses as per the tax laws will generate a future economic benefit for entity by reducing the future income tax payments and due to this reason entity shall create (recognise) a deferred tax asset.
- Once again remember the rule that entity shall recognise Deferred tax asset only if there is reasonable certainty of future taxable income.
- The entity should disclose the convincing evidence based on which it created Deferred Tax Asset in notes on accounts.

Concept No. 4 - Re-assessment of Unrecognised Deferred Tax Assets

On every balance sheet date, an entity should reassess unrecognised Deferred Tax Asset.

If it becomes reasonably certain that such unrecognised deferred tax asset will be realised then such unrecognised Deferred Tax Asset shall be recognised immediately.

Concept No. 5 - Recognition of deferred tax liability

Technically speaking, If accounting profit is higher than taxable profit then Deferred Tax Liability shall be recognised.

For recognition of Deferred tax liability there is no need to analyse any certainty level.

Concept No. 6 - Review of Deferred Tax Asset:

If it is evident that any portion of deferred tax asset already recognised is not recoverable then Deferred Tax Assets shall be written down to that extent.

Concept No. 7- Measurement of Deferred Tax Asset and Liability:

It should be measured using the applicable tax rates and tax laws that have been enacted OR substantively enacted as on the balance sheet date.

When different tax rate is applicable for two different level of taxable income then average rate should be used.

Concept No. 8 - Minimum Alternate Tax

The concept of Minimum Alternate Tax (MAT) was introduced under Income Tax Act to tax companies making high profits and declare dividends to their shareholders but have no significant taxable income because of exemptions, deductions and incentives

The payment of tax under section 115JB of the Income-tax Act, 1961 is a current tax for the period.

Even though the company pays tax U/S 115JB, Deferred Tax Asset or Liability should be recognised and measured using the regular tax rates and not using MAT rate.

Regular tax rates should be used even if the company expects the reversal of deferred taxes during MAT period because it is an expectation and cannot be known with a reasonable degree of certainty.

This is to bring the uniformity between pre and post MAT period.

Mat Credit

MAT credit is the excess amount of MAT paid over and above normal income tax for the assessment year

MAT credit can be carried forward for set off in 7 years in which the company is liable to pay tax

It should be recognised as an asset only when the entity has reasonable certainty that it can get the benefit of set off.

Concept No. 9 - Tax Holidays:

Meaning

Period under which a government gives incentive to applicableentities not to pay tax for certain activities.

Treatment under AS-22

- The deferred tax in respect of timing differences arising and reversing during tax holiday period should not be recognised to the extent the gross total income of the enterprise is subject to such deduction.
- The deferred tax in respect of timing difference which will reversed after tax holiday period should be recognised in the year in which it is originated subject to condition of certainty.
- Timing differences which originate first should be reversed first.

AS 24 - Discontinuing Operation

Objective Of AS - 24

The objective of this Statement is –

To establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position **by segregating information about discontinuing operations from information about continuing operations.**

E.g. RN Company is engaged in business like Electronics and Two Wheeler Manufacturing is planning to sell (discontinuing operation) its Two wheeler division.

As per this AS the company should disclose the revenue, profit, assets, liabilities and other information of that discontinuing operation (Component – Two wheeler division) in the financial statements

Scope of AS - 24

This Statement applies to all discontinuing operations of an enterprise. The requirements related to cash flow statement contained in this Statement are applicable where an enterprise prepares and presents a cash flow statement.

Discontinuing of operation - Explanation with Chart

A Discontinuing Operation is a component of an enterprise/Entity Which

Represents separate major line of business or geographical area of operations

Can be separated / discontinued for

- **Operational Purpose**
- **Financial reporting purpose**

Is discontinued (as per a single plan) by

Methods of Discontinuing

- **Selling substantially in total either in single transaction or demerger or spin off**
- **Selling off component's assets individually (piecemeal disposal) and settling its liabilities also individually.**
- **Terminating through abandonment; i.e. stopping the operations (as it is) without selling its assets/components. (Stopping with an intention to sell)**

Definition

A **<u>discontinuing operation</u>** is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:
   - Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or
   - Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or
   - Terminating through abandonment; and

b. That represents a separate major line of business or geographical area of operations; and

c. That can be distinguished operationally and for financial reporting purposes.

Initial Disclosure Event

With respect to a discontinuing operation, the <u>initial disclosure event</u> is the occurrence of one of the following, whichever occurs earlier:

a. The enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

b. The enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan.

Recognition and Measurement

An enterprise should apply the principles of recognition and measurement that are set out in other Accounting Standards for the purpose of deciding as to when and how to recognise and measure the changes in assets and liabilities and the revenue, expenses, gains, losses and cash flows relating to a discontinuing operation.

This Statement does not establish any recognition and measurement principles. Rather, it requires that an enterprise follow recognition and measurement principles established in other Accounting Standards.

<u>Presentation and Disclosure</u>

<u>Initial Disclosure</u>

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

1. A description of the discontinuing operation(s);
2. The business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;

3. The date and nature of the initial disclosure event;
4. The date or period in which the discontinuance is expected to be completed if known or determinable;
5. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
6. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
7. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, & the income tax expense related thereto; and
8. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Other Disclosures

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

a. For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss; and

b. The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

Updating the Disclosures

An enterprise should include, in its financial 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.

The disclosures required above should continue in financial statements for periods up to and including the period in which the discontinuance is completed. Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefore and its effect should be disclosed. For this purpose, disclosure of the effect includes reversal of any prior impairment loss or provision that was recognised with respect to the discontinuing operation.

Separate Disclosure for Each Discontinuing Operation

Any disclosures required by this Statement should be presented separately for each discontinuing operation

.

Restatement of Prior Periods

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

Disclosure in Interim Financial Reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, Interim Financial Reporting, including:

a. Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation; and

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

Accounting Standard 26: Intangible Assets

Objective of AS - 26

Objective of AS – 26 is to

- **Recognition criteria of AS - 26**
- **Measurement basis of AS - 26**
- **Disclosure requirement of AS - 26**

Scope

The following intangibles are NOT covered by this Standard:
(a) Intangible assets that are covered by another Accounting Standard;

1. Goodwill arising on amalgamation - dealt by AS 14;
2. Goodwill arising on consolidation - dealt by AS 21;
3. Intangible assets held for sale in the ordinary course of business - dealt by AS 2; etc.
4.

When any intangible asset is specifically dealt by any other Accounting Standard, entities should follow that standard only.

(b) **Financial asset;** (Dealt by AS 109,32 & 107)

(c) **Mineral rights and expenditure** on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; (Dealt by Industry standards)

(d) **Intangible assets** arising in insurance enterprises from contracts with policyholders; and

(e) **Expenditure in respect of employee termination benefits**; (Dealt by AS 15)

(f) **Voluntary retirement benefits (VRS)** are specifically excluded; (Dealt by general principles of accounting)

This AS is mandatory in nature and all companies and non-companies should be applying this standard.

Meaning of Intangible Assets
Intangible Assets are assets, without physical substance, which are identifiable, non-monetary in nature and held for use in Production of Goods and Services. <u>NOTE:</u> • Identifiable means capable of sales • Without physical substance means non-substance of its own. They can have storage device • Such assets is not held for sale as stock • Such assets is non-monetary means its realisation is not fixed.
These are not considered as Intangible Assets and written off • Preliminary Expenses • Advertisement Expenses • Underwriting Expenses • Pre-Operative Expenses • Voluntary Expansion Expenses • Discount on issue of shares • Relocation/Shifting Expenses

Intangible assets with or without physical substance
• A compact disk (in the case of computer software); • Legal documentation (in the case of a licence or patent); or • Film (in the case of motion pictures). The container value is usually immaterial. Even though the container has physical substance, its value is commonly treated as a part of the intangible asset (included in the cost of intangible asset). In case of some assets, an asset may have both intangible and tangible elements and these are practically not separable. In that case, professional judgement is required to assess which element is predominant. If intangible element is important to the asset, the entire asset is treated as intangible asset and accounted as per this Standard. If tangible element is important to the asset it is treated as tangible asset and accounted as per AS 10 (subject to fixed asset definition).

Intangible Assets can be recognised

(a) By purchasing/Acquisition

(b) By Government grants

(c) By exchange with other assets

(d) By self generating such assets

Purchased intangible assets

It means intangible assets have been purchased from market.

In such cases cost of such intangible should be

Purchase Price	xxx
Add:- Taxes on Purchase,	xxx
Less:- Refundable Taxes on Purchase,	xxx
Add:- Expenses on Valuation,	xxx
Add:- Expenses on obtaining Title,	xxx
Cost of Intangible Asset	**xxx**

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Intangible Assets by way of Government grant

Wherever intangible assets are obtained through Government grant, then such assets should be recorded at actual concessional price paid to Government or at nominal value if obtained free of Government.

Intangible assets obtained on Exchanges

If intangible assets are obtained through exchange of assets, then value of such intangible should be

(i)Fair value of assets given or

(ii)Fair value of assets obtained, whichever is more clearly evident.

For Exam Purpose, consider lower value as more evident.

Self Generated Intangible Assets

It means, where intangible assets are generated by contract or own Labour.

- Goodwill, Brands, Masthead, Title, Publishing Titles should NOT be recorded Intangible Assets, since actual cost cannot be determined.
- Other intangible assets should be recorded at actual cost incurred.

Research Phase

Expenses incurred in research should be written off in P&L. It means planned investigation for gaining knowledge.

Development Phase

Expenses incurred on Development should be capitalized. It means application of gained knowledge.

***NOTE:* Development phase begins if following conditions are satisfied:**

(i) Technical feasibility has been established
(ii) Resources for development of it.

(iii) Market research shows future economic benefits
(iv) Management has approved its development.

Value of intangible assets should not exceed expected future economic benefits.

Amortisation of Intangible Assets

Intangible assets should be amortised in ration of expected future benefits. Such ration should be latest and best estimate.
If ratio of future benefits cannot be identified, then assume such ratio to be equal. It means apply Straight Line Method basis for amortisation.

- Life of Intangible Assets (under SLM) for website and software : 3-5 years
- Life of Intangible Assets (under SLM) for others : 10 years

Always assume scrap value to be zero.

Disclosure Requirement

1. Intangible Assets, cost, Amortisation, life should be disclosed.
2. Additions / Deletion in Intangible Assets should also be disclosed.

AS – 29 Provisions, Contingent Liabilities and Contingent Assets

Objective of AS - 29

Objective of AS – 29 is to

- Recognition criteria of
- Measurement basis of
- Disclosure requirement of

- Provisions
- Contingent liabilities
- Contingent Asset

Applicability of AS - 29

Not applicable to Provisions arising from/In

1. financial instruments which are carried at fair value
2. Executory contracts (A contract where both the parties to the contract have not performed any obligations (or) performed equally)
3. Insurance enterprises from contracts with policyholders
4. Covered by another accounting standard E.g. For the provisions required as per AS 7, AS 22, AS 19, etc.

Important Concepts

Provision

Provision is a liability which can be measured only by using a substantial degree of estimation

Liability

It is a present obligation arising from past events, the settlement of which is expected to result in an outflow of future economy benefits from the entity.

Present

Which is in existence as on the balance sheet date & it is 'probable' based on the evidence available on the balance sheet date.

Probable

- **It means "more likely than not" i.e. the probability of occurrence is greater than non occurrence. In other words, there are more than 50% chances to get an obligation.**

Obligation

- **Obligation is a duty or responsibility to act in a certain way arising from binding contracts Statutes Business practice/ customs to maintain good relationship.**

Past Events

- **Past activities are obligating events, where the entity doesn't have an alternative to skip such an obligation.**
- **All past events are not obligating events. A past event which leads to a present obligation is called obligating event.**

Difference between liabilities, provisions and contingent liability

Liability

- It is liability to make future payments
- For goods/services already received or obligations already created
- Or accruals - whole or part of the expense pertains to the current period

Provision

- Provision is not an existing liability
- Substantial Degree of estimation is required
- Where degree of estimation required is less, we create a liability

Contingent

- Things are to happen in future whereby a liability may arise
- It is conditional, contingent upon such things happening or not happening
- Hence the liability is not recognised as such

1. Provision

Recognition of Provision

*Recognised Provision only **when** it satisfies all of the following conditions*

1. *The entity should have a present obligation arising from **past events.***

2. *Outflow of **future economic benefits** should be probable; and*

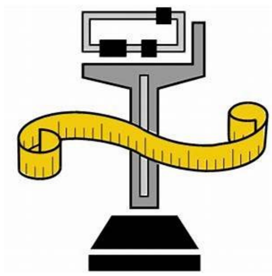
3. *Provision should be measured reliably by using a substantial degree of **estimation.***

Example

Estimation: Measurement of the provision requires a substantial degree of estimation. Estimation involves professional judgment.

Measurement of the provision

The estimation should be based on the best estimation available on the balance sheet date and the entity should consider the following while estimating:



- Sufficiency of evidence available;
- Events occurring after the balance sheet date (AS 4);
- Experiences of the management on similar transactions;
- Independent expert's opinion; (Lawyer, Engineer, etc.)
- Risks and uncertainties of the items;

Changes in Provisions

1. Provisions should be **reviewed** at each balance sheet date
2. Should be **Adjusted based** on the best evidence /estimate available as on that date.
3. If there is no outflow of future economic benefits as on the subsequent balance sheet date, the provision **should be reversed.**

Provision Specific Situation

Provision - Specific Situation

Future operating losses

↓

No Liability

↓

No provision

↓

Assets of the operation may be impaired.

Discounting of a provision

↓

Amount of a provision should not be discounted to its present value, **except** decommissioning, restoration and similar liabilities recognised as cost of PPE

- Use before tax borrowing rate as discount rate.
- The rate used should be based on risks involved in the liability.
- Periodic unwinding of discount should be recognised in the statement of profit and loss.

2. A Contingent Liability

Contingent Liability

Present Existence

But cannot recognise provision because of

- Future Economic Benefits out flow is not probable
- Amount cannot be measured reliably

Possible Existence

↓

Existence confirmed by

↓

Occurrence OR Non Occurrence of One or More

↓

Not controlled by entity

Meaning of contingent liability

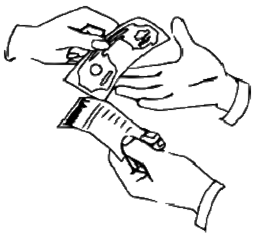
A Contingent liability is

(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, which are not fully within the control of the entity; OR

(b) A present obligation arising from past events but it is not recognised as a provision because:

(i) Outflow of future economic benefits are not probable; or
(ii) A reliable estimate of the obligation cannot be made.

Examples: - Bills Discounted, Guarantees Given, Tax disputes pending, and other legal cases pending before the court.



Recognition of contingent liability

It should be disclosed in financial statements in notes to accounts, if outflow of future economic benefits is not remote (rare).

3. Contingent Asset

Meaning of Contingent Assets

Contingent assets — possible asset (probable) — existence confirmed only by — occurrence or non-occurrence of — One or more — Future Events

Which is not controlled by the entity.

Contingent asset usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise.

Recognised Contingent Asset only when it satisfies all of the following conditions

*1. Inflow of **future economic benefits** is probable; and*

2. Cost or value can be measured reliably

Example

A claim that an entity is going through legal processes, where the outcome is uncertain.

Reimbursements of Expenses

In some cases an entity may receive the reimbursement of expenses from another party, if it settles the obligation (for which provision is already created).

The reimbursement should be recognised as an asset only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.

Example :

- An insurance contract arranged to cover a risk;
- An indemnity clause in a contract; or
- A warranty provided by a supplier.

Restructuring Provision

Restructuring is a Programme Planned Controlled by Management which materially changes The scope of business OR The manner in which that business is conducted

1. Sale or termination of a line of business
2. The closure of business locations in a country or region or the relocation of business activities from one country or region to another
3. Changes in management structure, for example, eliminating a layer of management
4. Fundamental re-organisations that have a material effect on the nature and focus of the enterprise's operations

A restructuring provision should include only the direct expenditures arising from the restructuring:

(a) Obligation is arising as a consequence of the restructuring; and

(b) Which is not associated with the ongoing activities of the enterprise.

Disclosure related Provision	***Disclosure related Contingent liability***
1) Brief description of the nature of the provision and timing of Future Economic Benefits outflow; 2) Assumptions made and uncertainties involved. 3) Opening balance of the provision; 4) Additions made during the year; 5) Amount used (i.e. Amount incurred or charged against) during the period; 6) Unused amounts reversed during the period. 7) Closing balance of the provision;	An entity should disclose the following for each class of contingent liability at the balance sheet date 1) A brief description of the nature; 2) An estimation of its financial effect; 3) An indication of the uncertainties relating to any outflow; and 4) Any possibility of reimbursement.

AS 15 - Accounting for Employee Benefits

This AS helps to

- **Define**
  'Employee benefits',
  'Short-term employee benefits',
  'Post- employment benefits' and
  other related terms used in the Standard

- **Specify various types of employee benefits**

- **Recognise and measure**
  - **Short-term Employee Benefits,**
  - **Short-term Compensated Absences and**
  - **Profit-sharing and Bonus Plans along with the accounting thereof**

- **Classify the post-employment benefits into defined contribution plans and defined benefit plans**

- **Examine the various aspects inherent in post-employment benefit plans and**

- **Recognize and measure the obligations under these plans i.e. post-employment benefit plans**

- **Apply the actuarial valuation methods and assumptions while valuing the obligations under Defined benefit plans**

- **Calculate the actuarial gains and losses on such plans**

- **Recognise gains or losses on the curtailment or settlement of a defined benefit plan**

- **Recognise and measure other long-term benefit and termination benefits**

- **Understand the disclosure requirement of these employee benefits and comply with the same.**

Introduction & Objective

Accounting for employee benefits like salaries or wages is simple and straight forward but when it comes retirement employee benefits is a challenging task as amount is material, time period is long and estimations complex. This standard prescribes the accounting and disclosure for employee benefits.

The standard requires an entity to recognise:

(a) a liability for employee benefits to be paid in the future; and
(b) an expense related to employee benefits when an entity consumes the economic benefit/arising from the services provided by an employee;

Scope

This Standard should be applied by an employer in accounting for all employee benefits, except employee share- based payments; (As it is governed by the guidance note on employee share based payments)

It includes all formal plans, agreements, as per legislative requirements and other informal practices which give rise to an obligation; Employee benefits include benefits provided to either employees or family and paid directly to employees or to others like trusts, insurance companies;

Employee includes full time, part time, permanent, casual employees. Whole time directors or other management personnel also are included in the word "employee".

What are Employee Benefits?

Employee benefits include all forms of consideration given by an entity in exchange for service rendered by employees.

In addition the standard includes following **four benefits in the term "employee benefits":**

Employee Benefits

Short-term employee benefits	Those that fall wholly within 12 months after the end of the period in which the employee renders the service (Other than termination benefits) E.g. Salaries, Wages, Paid annual leaves, Car facility, etc.
Post-employment benefits	Those that are payable after the completion of employment. (Other than termination benefits) E.g. Gratuity, Pension, Post employment medical facilities. etc.
Other long-term employee Benefits	Those that do not fall wholly within 12 months after the end of the period in which the employee renders the service (Other than post-employment and termination benefits) E.g. Long service leave, Jubilee benefits, long-term disability benefits and residuary section i.e. an employee benefit which is not short-term, post-employment & termination benefits.
Termination benefits	Those that are payable as a result of either the (a) entity's decision to terminate the employment before normal retirement date (b) employee's decision to accept a voluntary retirement package in exchange) for those benefits

Part I-Short-term employee benefits

Short-term employee benefits are employee benefits (other than termination benefits) **which fall due wholly within 12 months after the year end in which the employees render the related service**. This topic is further divided into the following sub-topics:

(a) Wages, salaries and social security contributions;
(b) Short-term compensated absences (such as paid annual leave-leave encashment) where the absences an expected to occur within 12 months after the year end in which services are rendered (generally we observe this in medical industry);
(c) profit-sharing and bonuses payable within 12 months after the end in which services are rendered; and
(d) non-monetary benefits (such as medical care, housing, cars and free or subsidized goods or services like Sodexo coupons) for current employees.

FY 20X1-X2	FY 20X2-X3
Employees served in this period.	The above benefits become DUE in this period;

Recognition and Measurement

The entity shall recognize the undiscounted amount of all short-term employee benefits when an employee has rendered the service to an entity during an accounting period. These benefits are accounted on accrual basis irrespective of cash flows. Cash flows need not be discounted as it is short-term (i.e. payable within 12 months) and the effect of discounting will be immaterial.

Short-term employee benefits P&L Statement

Balance Sheet

- As a liability for accrued expenses; OR
- As a prepaid expenses to the extent of excess payments

P & L Statement

- Recognised as an expense in general;
- It can be capitalised (included in the cost of an asset) if permitted by another AS e.g. AS-10, AS-26, etc..

Short-term compensated absences (Leave encashment)

An entity may compensate employees for absence for various reasons including

- vacation,
- sickness and
- short-term disability, and
- maternity or paternity leave.

Entitlement to compensated absences falls into two categories

Compensated absences

Accumulating

(Where employee is entitled to carry forward i.e. if he has not used the leaves this year, these can be used in next year(s).

Vesting

(Entitlement for cash payment on leaving the enterprise-leave encashment.)

Non-Vesting

(NOT an entitlement for cash payment on leaving the enterprise)

The entity should recognise the expected cost as expense & liability which is expected to be paid to employees in the future years (See Note below)

Non Accumulating

(Where employee is not entitled to carry forward the unused leaves to the future periods)

It is like employee worked for 350 days and salary is paid for 365 days in the current year and the same is accounted for in the year.

No separate accounting required.

Exception

- Small and Medium-sized Company and Micro, Small and Medium-sized Enterprises (Levels IV, III and II non- corporate entities) may not comply with short-term absences to the extent they deal with recognition and measurement of absences which are non-vesting.

Profit-sharing and Bonus Plans

Under some profit-sharing plans, employees receive a share of the profit only if they remain with the entity for a specified period.

Such plans create an obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period.

Hence in measurement of such obligations employer should consider the employees leaving the entity without receiving this bonus.

An enterprise should recognise the expected cost of profit-sharing and bonus payments when and only when:

(a) the entity has a present obligation to make such payments as a result of past events (where there is no realistic alternative to skip the obligation); and

(b) A reliable estimate of the obligation can be made. (If you observe, these conditions are similar to provision conditions as per AS-29)(t is possible when there is a formal plan discussing the bonus or profit sharing or past practice)

This payment to employees but not to the owners of the entity; hence it is an expense and **not an appropriation of profit.**

If Profit-sharing and bonus payments are not due wholly within 12 months after the end of the period in which the employees provided the related service, those payments are other long-term employee benefits.

Disclosures

Although this standard does not require any specific disclosures about short-term employee benefits, other Accounting Standards may require disclosures. For example, where required by AS-18 Related Party Disclosures an entity discloses information about employee benefits for key management personnel.

Part II - Post-employment Benefits

Post-employment benefits are employee benefits (other than termination benefits), which are payable after the completion of employment i.e. retirement benefits like

- gratuity,
- pension,
- life insurance and
- medical service after employment.

These benefits may be provided to one or more employees under formal or informal. arrangements.

Employees are entitled to these benefits at the time of rendering the service and receipt of benefit will be at a later date;

Such benefits may be paid to the employees.

(a) at the time of retirement like provident fund, gratuity, superannuation benefits;

(b) on a continuing basis i.e. periodical basis like pension;

Post-employment benefits are of two types, i.e.,

- Defined Contribution Plans (DCP) and
- Defined Benefits Plane (DBP).

Here plan means an arrangement between employer and employees. The classification is depending on the economic substance of the plan i.e. based on its principal terms and conditions.

Post-employment benefits

Defined Contribution plans (DCP)	Defined Benefit plans (DBP)
Under this classification • Entity's (Employer's) responsibility is limited to the amount of contribution to a fund (it may be post-employment plan or to an insurance company); **Example:** provident fund contribution to PF department -Say it is 12% of (Basic + DA) and total Basic + DA of all the employees is 10 crore. Obligation is 1.2 crore; • It means, there are no obligations to pay further contribution to the fund in case of insufficiency of assets with the fund. • In consequence the actuarial risk and investment risk falls on EMPLOYEE. (See below for meaning)	• Entity's obligation is to provide agreed benefits to current and former employees; like gratuity liability = [(Basic Pay +D. A) x 15 days x No. of years of service] / 26. • In such cases, amount of benefits payable to employees are NOT known clearly during the current year; • The amount of benefits depends on the variable factors like Length of service of the employee; Last drawn salary; etc. Hence significant degree of estimation is required. • **Actuarial risk and investment risk**, in substance falls on the EMPLOYER (Entity). (See below for meaning)

Important Concepts

Actuarial risk (uncertainty) is the difference between expected amount of benefits and actual amount of benefits. In case of DBP, if there is any difference in estimated gratuity and actual gratuity payable, it has to be borne by the employer only.

Investment risk is that assets invested are insufficient to pay the expected benefits due to the employees.

Accounting of Defined Contribution Plans

As per the initial understanding of DBP, entity's obligation is to provide agreed benefits to current and former employees; The employees are entitled because of the services rendered during the current year (i.e. accrued in CY- hence the entity should recognise the obligation) and the actual out flow of cash takes place at / after the retirement like gratuity;

These agreed benefits are normally depends on some variables like

- Length of the employee service;
- Last drawn salary; (E.g. in case of gratuity, benefits are based on last drawn Basic + DA)
- Employee turnover ratio (if employee leaves the entity before the specified period, he is not eligible for benefits hence it should be considered); etc.

Measurement of such an obligation is complex; hence the entity takes the help of a qualified actuary (an expert in projections and estimations of this nature). Actual out flow of cash will be taking place at a future date, hence while recording the obligation in the current year it should be discounted (i.e. determine in present value terms);

Some entities transfer the obligation amount to a separate legal entity/fund & that entity will manage the amount and from which the employee benefits are paid. So naturally there will be some profits or losses on such fund investments.

There is an inverse relationship between the obligation and plan assets - if plan assets are managed well, the net obligation comes down and vice versa.

Current service costs

The defined benefit obligation increases over time: each day that the employee works increases this obligation. The current cost is measured at the present value of the obligation arising from services provided by the employee in the current year.

Past service costs

The employer may introduce a new defined benefit plan after an employee has already provided a few years of service.

Alternatively, if the defined benefit plan already exists, it may also be possible for an employer to adjust the terms of the plan such that there is either:

- an increase in the obligation (improved benefits for the employee);
- a decrease in the obligation (reduced benefits for the employee).

The effect of these changes should be accounted for in accordance with the change in the plan (we will discuss the accounting part in the subsequent topics)

Accounting of DBP Accounting of DBP involves the following six steps.

Step 1: Estimating the obligation of employee benefits as on balance sheet date (Total payable to employees for their services during CY & PYs).

Step 2: Discounting the benefits using Projected Unit Credit Method (PUCM) in order to determine the Percent value of defined benefit obligations and current service cost:

Step 3: Determine the fair value of plan assets (i.e. investments);

Step 4: Determine the actuarial gain or loss;

Step 5: Determine the Past Service Cost due to introduction of new things or change in the existing plan;

Step 6: Where plarn has been curtailed or settled, determine the resultant gain or loss.

Presentation of calculation in balance sheet and the statement of profit and loss:

Balance sheet presentation

Liabilities side	
Present value of the defined benefit obligation at the balance sheet date **(WN# 1)**	
Less: Past service cost not yet recognised (to be discussed below)	
Less: Fair value of plan assets **(WN # 2)**	
Obligation to be presented in Balance sheet	

Present value of the defined benefit obligation as on BS date will be computed in the following manner:

WN 1: Computation of Closing defined benefit obligation at the end of Year 2

(Considering the numbers from the first example for understanding)

Particulars	
Opening balance of obligation (closing balance of Year 1)	
Add: Interest cost (upgrading from year 1 to year 2)	
Add: Current year obligation	
Less: Actual payment of employee benefits during the year (imaginary number)	
Add: Actuarial loss	
Present value of the closing defined benefit obligation	

WN 2: Net fair value of plan assets

Particulars	
Opening fair value of assets	
Add: Return on the assets	
Add: Contributions from the entity during the period	
Less: Actual payment of employee benefits during the year	
Net fair value of plan assets at the end of the year	

Presentation in the statement of profit and loss

An entity should recognise the net total of the following amounts in the statement of profit and loss unless it is required to be capitalised along with an asset as per any Accounting standard.

	Particulars	₹	₹
(a)	current service cost (i.e. related to current year);	XX	
(b)	interest cost (for upgrading the present value from PY to C);	XX	
(c)	the expected return on any plan assets and on any reimbursement; (i.e. growth in fund)	XX	
(d)	actuarial gains and losses (i.e. difference in expected return to actual & changes actuarial in assumptions);	XX	
(e)	past service cost to the extent that requires an entity to recognise it; (discussed below)	XX	
(f)	the effect of any curtailments or settlements (discussed below); and	XX	

(g) The effect of the limit i.e., the extent to which the amount determined (if negative) exceeds the amount determined. (refer below concept capsule)	XX	
Amount to be presented in Profit & Loss		**XX**

All these 6 steps are not applicable fully to SMC. However, such a company should actuarially determine and provide. for the accrued liability in respect of defined benefit plans as follows:

(a) The method used for actuarial valuation should be the Projected Unit Credit Method.

(b) The discount rate used should be determined by reference to market yields at the balance sheet date on Government bonds.

Disclosures

An entity should disclose information that enables the users to evaluate the nature of defined benefit plan and the financial effect of changes in those plans during the period. It should disclose the following information (students are requested to refer ICAI study material for detailed disclosure requirement).

(a) Accounting policy for recognising actuarial gain or loss;

(b) Description of plan;

() A Reconciliation of defined benefit plan opening balance to closing balance;

(d) A Reconciliation of plan assets opening balance to closing balance;

(e) Total expense recognised in the P&L statement;

(f) The principal actuarial assumptions used as at the balance sheet date;

(g) The effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates; etc.

Other Long-term Employee benefits

Other long-term employee benefits include, for example:

(a) long-term leave encashment such as **long- service or sabbatical leave;**
(b) jubilee or other long-service benefits E.g. if an employee works for 20 years, the entity may give a diamond ring or foreign trip, etc.;
(c) long-term disability benefits i.e. medical costs are borne by the entity in case of disability;
(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

Recognition & Measurement and Disclosures

It is identical to defined benefit plan (DBP) i.e. all the above six steps should be applied and no need to additionally.

Termination benefits

This Standard deals with termination benefits separately from other employee benefits because entity gets the obligation only on account of termination of employment but not due to employee service.

Termination benefits are employee benefits payable as a result of either:

(i) entity's decision to terminate an employee's employment before the normal retirement date: or
(ii) an employee's decision to -accept voluntary redundancy in exchange tor those benefits (voluntary retirement).

An entity may need to pay these termination benefits as required by legislation, by contractual or other agreements with employees or their representatives or by an obligation based on business practice, custom or a desire to act equitably, to make Payments (or provide other benefits) to employees when it terminates their employment.

Generally these termination benefits are payable immediately. A provision & expense should be recognised for the same when the entity satisfies the following three conditions given in AS-29:

(a) The entity has a present obligation as a result of a past event;

(b) Outflow of future economic benefits outflow is probable; and

(c) The obligation should be measured reliably.

AS 15 Employee Benefits – Chart

All forms of consideration given for the services rendered. (Including accrued during the employment but payment may be later}

Short-term employee benefits [EB]:-
- Due within 12 months from YE.
- E.g. Wages/leave etc.
- Recognise the expense & liability in the year of an service/accrual basis.
- NO Discounting

Other Long-term EB:-
- Due during service period but paid after 2 Yrs from YE.
  E.g. Silver jubilee gifts etc.
- Same as post employee benefits.

Post EB:-
- Due after completion of service E.g. gratuity, superannuation etc.)
- Time difference may exist, therefore consider time value of money.

Temporary benefits:-
- After service (Either VRS/Termination).
- If paid immediately - NO PV calculation.
- Otherwise bring to no present value & provide the same

Post Employment Benefits Plans

Defined Contribution Plans (DCP)

- Responsibility is limited to contribution only;
- No further responsibility
- No actuarial & investment risk on entity
- Recognise expense & Liability in the year of service i.e. accrual basis
- No present value calculation

Defined Benefit plan (DBP)

- Responsibility is to provide agreed benefits after retirement.
- Accrued during the service. But payment after retirement.
- Actuarial risk & Investment risk is with employer.
- Time difference exists, hence present value computation required.
- **Follow below mentioned steps for calculations:-***

Steps for calculating Defined Benefit plan (DBP)

Step 1: Estimate employee benefit obligations as on BS Date;
Step 2: Discount the benefits using PUCM (Projected Unit Credit Method);
Step 3: Find out fair value of plan assets;
Step 4: Determine the actuarial gain /loss;
Step 5: Determine past service cost due to change / introduction of new things in plan;
Step 6: When plan is stopped-recognise gain or loss.

Other Important Points:

(a) Use Yield of government bonds as at BS Date.
(b) Fair value-take market value if not available - estimate value.
(c) Actuarial gain/losses should be recognised immediately in P&L.
(d) Based on market expectations -expect return on plan Assets.

Balance Sheet Presentations:

Particulars	₹
PV of DBP as computed Less: Past service cost not yet recognised Less: Fair value of plan assets	

Fair Value of Plan Assets:

Particulars	₹
Opening Fair value of Assets Add: Return on the Assets Add: Contributions Less: Actual payment to employee	

Definition of Holding Company

"Any company who controls other company is called holding company."

In other words, if any company has any one power from following three powers, then that company will be holding company:-

1. If any company has 51 % shares of other company, then this company becomes holding Company of other.

   Or

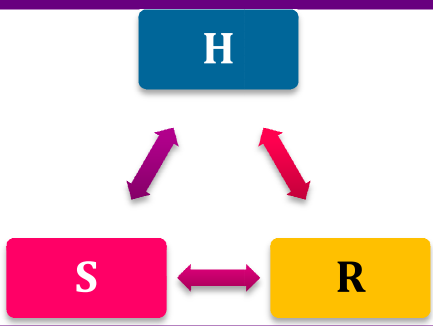
2. If any company has power to appoint board of directors of other company, then this company becomes holding company of other company.

   Or

3. Main holding company also wills the holding company of all subsidiaries' subsidiary companies.

Explanation with Example

H is holding company of S because 51 % shares are of H in S. S is also of holding Company of R because S have power to appoint the board of directors of R Company and then H is also holding Company of R.



Main features of Holding Company

Holding Company provides the power to work independently to subsidiary company. Because relationship of holding and subsidiary company is not amalgamation or merge but both company joins for cutting the cost of competition and getting the benefits of monopoly.

Holding company can also deal with subsidiary company and it is also recorded in both books.

Under Company act of India, it is required to attach the copy of final accounts of subsidiary company with the annual report of holding company

Subsidiary Company

Subsidiary company is that company which is controlled by any other company.

If any company invested his money to buy other company's shares and has bought 51% or more shares or share capital, then that company can become holding or parent company.

The company, whose shares are bought, will be subsidiary company.

Purpose of preparing the Consolidated Financial Statements

Consolidated financial statements are the financial statements of a ‘group’ presented as those of a single enterprise, where a ‘group’ refers to a parent and all its subsidiaries. Parent company needs to inform the users about the financial position and results of operations of not only of their enterprise itself but also of the group as a whole.

Consolidated Financial Statements are intended to show the financial position of the group as a whole - by showing the economic resources controlled by them, by presenting the obligations of the group and the results the group achieves with its resources.

Consolidated balance sheet of Holding Company AND Subsidiary Company's Balance Sheet

Subsidiary company's balance sheet's assets and liabilities will become the part of consolidated balance sheet of holding company.

Liabilities

- **All the liabilities of subsidiary company will be added in the consolidated balance sheet of subsidiary company. But Share capital of subsidiary company in holding company will not shown in the consolidated balance sheet in the books of holding company. Because, this share capital automatically adjust with the amount of the investment of holding company in to subsidiary company.**

Assets

- **Add all the assets of subsidiary company with the assets of holding company. But Investment of holding company in Subsidiary company will not shown in consolidated balance sheet because, investment in subsidiary company will automatically adjust with the amount of share capital of subsidiary company in holding company.**

Minority interest

- **3. Add minority interest in liability side. First of all we should know what minority interest is. Minority interest is the shareholder but there is not holding company’s shareholder. So, when holding company shows consolidated balance sheet, it is the duty of accountant to show minority interest in the liability side of consolidated balance sheet.**

Requirement as per Companies Act

- Under Indian Company Act, there is no need to prepare combined or consolidated final accounts of holding and subsidiary company in the books of holding company.
- But holding company attaches the copy of balance sheet , one copy of profit and loss account and one copy of audit report of subsidiary company with his final accounts . But for showing true financial position, often holding company prepare consolidated balance sheet.

Difficulty Level of Preparation of consolidated Balance sheet

- It is easy to understand that consolidated balance sheet is a balance sheet in which all the assets and liabilities of holding company and subsidiary company are added with each other but practically, it is tough to make consolidated balance sheet of holding and subsidiary company.

Steps for preparing consolidated balance Sheet of the holding company and its subsidiary company.

1. Add all the assets of subsidiary company with the assets of holding company
2. Add all the liabilities of subsidiary company with the liabilities of holding company
3. Calculate of Minority Interest
4. Calculate cost of capital / Goodwill or Capital Reserve
5 Treatment of Pre – Acquisition of reserve and profit

6. Calculate post acquisition profits

7. Elimination of common transactions

8. Treatment of Unrealized profit

9. Treatment of Dividends

1st Step

Addition of all the assets of subsidiary company with the assets of holding company.

But Investment of holding company in Subsidiary company will not shown in consolidated balance sheet because, investment in subsidiary company will automatically adjust with the amount of share capital of subsidiary company in holding company.

2nd step

Addition of all the liabilities of subsidiary company with the liabilities of holding company.
But Share capital of subsidiary company in holding company will not shown in the consolidated balance sheet in the books of holding company. Because, this share capital automatically adjust with the amount of the investment of holding company in to subsidiary company.

3rd Step

Calculation of Minority Interest

First of all we should know what minority interest is. Minority interest is the shareholder but there is not holding company's shareholder. So, when holding company shows consolidated balance sheet, it is the duty of accountant to show minority interest in the liability side of consolidated balance sheet.

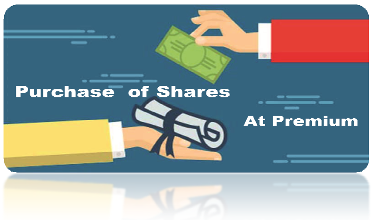
We can calculate minority interest with following formula

Total share capital of Subsidiary company	XXX
Less: Investment of Holding company in to subsidiary company	XXX
Add: Proportionate minority share of the subsidiary company's profit and Reserves or increase in the value of assets	XXX
Less: Proportionate minority share of the subsidiary company's loss and decrease in the value of total assets of company	XXX
Value of Minority Interest	**XXX**

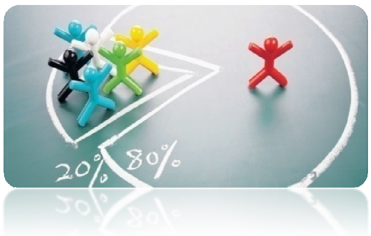
4th Step

Calculate Cost of capital / Goodwill or Capital Reserve

If holding company purchases shares of subsidiary company at Premium, then the value of premium will be deemed as goodwill or cost of capital and shows as goodwill on the assets side of consolidated balance sheet.



If holding company purchases the shares of subsidiary company at discount, then this value of discount will be capital reserve and show in the liability side of consolidated balance sheet.



5th Step

Treatment of Pre – Acquisition of reserve and profit

Pre – acquisition profit and reserve of subsidiary company will be shown as capital reserve in consolidated balance sheet but the value of minority interest's profit or reserves deducts from it and adds in minority interest value.

Total profit before acquisition of subsidiary company	XXX
Less: share of minority interest	XXX
Less: Value of profit X minority interest's value of shares in subsidiary company / total share capital of subsidiary company.	XXX
Pre – acquisition profit and reserve shown as capital reserve	XXX

Calculation of post acquisition profits

After the date of purchasing the shares of subsidiary company , profit of subsidiary company will also deem of holding company and it include in the profit of holding company and we also separate the part of profit of minority interest and add in minority interest's value and shown in liability side .

7th Step

Elimination of common transactions/ Intra-Group Transactions

All common transaction between holding company and subsidiary company will not show in the consolidated balance.

There following common transaction

- Goods sold and goods purchase on credit and the value of debtor or creditor either subsidiary company or holding company, will not shown in consolidated balance sheet

- Value of bill payable or bill receivable of holding company on subsidiary company will also not shown but if some bills value is discounted from third party then either of both company's payable value shown as liability in the consolidated balance sheet

- Unrealized profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventories and tangible fixed assets, are eliminated in full

8th Step

Treatment of Unrealized profit

If subsidiary company sells the goods to holding company or holding company sells the goods to subsidiary company at profit and if such goods will not sold in third party , then the profit will not realized.

So such unrealized profit will not be credited to profit and loss account.

At this time a stock reserve account is opened and all amounts of unrealized profit transfers to this account and this accounts total amount is deducted from closing stock of consolidated balance sheet.

9th Step

Treatment of Dividends

If holding company gets the dividends from subsidiary company, then this will divide into two parts.

Subsidiary company declare dividend out of

- Capital profits → Add in capital reserves in consolidated balance sheet
- Revenue gains → Add in general profit and loss account and will be shown in the liability side of consolidated balance sheet.

Preparation of Consolidated Profit And Loss Account

1.

- **All the items of profit and loss account are to be added on line by line basis and from the consolidated revenue items inter-company transactions should be eliminated.**
- **For example, a holding company may sell goods or services to its subsidiary, receives consultancy fees, commission, royalty etc. These items are included in sales and other income of the holding company and in the expense items of the subsidiary.**

2.

- **Alternatively, the subsidiary may also sell goods or services to the holding company. These inter-company transactions are to be eliminated in full.**

3.

- **If there remains any unrealised profit in the inventory, of any of the Group Company, such unrealised profit is to be eliminated from the value of inventory to arrive at the consolidated profit.**

AS-23 Contains

- Objective
- Scope
- Equity Method
- Unrealised profits and losses
- Different reporting periods
- Uniform accounting policies
- Discontinuation of Equity Method
- Contingencies
- Disclosure

Objective

The objective of this Standard is to ***prescribe the accounting for investments in associates*** in consolidated financial statements (CFS) and recognising the financial effects in consolidated financial statements.
By having business relationships like associates, entities will have an access to other entities economic resources.

Scope

This Standard should be applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor this standard does not deal with accounting for investments in associates in separate (Standalone) financial statements by an investor.

But as per Section 129(3) of the Companies Act, 2013, "Where a company has one or more subsidiaries, it shall, prepare a consolidated financial statement of the company". For this sub-section, the word **"subsidiary" shall include *ASSOCIATE COMPANY*** also.

As per the Companies Act, 2013, every company who has only an associate also should prepare Consolidated Financial Statements and account for investment in associate using Equity method as described in this Standard. It means even though the entity does not have a subsidiary it should prepare Consolidated Financial Statements.

Equity Method

The equity method is accounting method.

Investor should account for investment in associates in Equity method in its consolidated financial statements.

Equity method of accounting follows like this

A. Investment is initially recorded at COST (purchase consideration).

B. Determine the proportionate value of net assets (equity) as on the date of acquisition of investment.

C. Compare the cost of investment with the proportion of equity and the difference is either goodwill or capital reserve. If step (A) > step (B), it is goodwill otherwise the difference is capital reserve.

D. Determined Goodwill or capital reserve as determined in the above step should be included in the carrying amount of the investments with a separate disclosure. (GW/CR should not be recognised separately);

E. Carrying amount is increased or decreased to recognise the post-acquisition change in the equity of the investee (Associate) to the extent of percentage of share;

F. Distributions (dividend) received from the associate should be reduced from the carrying amount of the investment; if it is pre-acquisition dividend, it should be deducted from the cost of investment.

The following are the other important points of equity method:

(a) If an associate has outstanding cumulative preference shares held outside the group **(i.e., which are NOT issued to group companies)**, the investor should ***compute its share of profits or losses after adjusting for the preference dividends*** whether or not the dividends have been declared. (In case of non-cumulative preference shares, it should consider only when preference dividend is declared)

(b) Where an associate presents consolidated financial statements, the results ***and net assets are to be taken from the associate's consolidated financial statements*** (i.e., in such situation, investor should not consider the standalone financial statements of associate company)

(c) If associate made a loss during any financial year, ***Investor should decrease the carrying amount of investment in associate with the proportionate losses.***

If investor's share of losses of an associate equal or exceeds the carrying amount of the investment, ***the investor ordinarily discontinues recognising its share of further losses and the investment is reported at NIL value.***

If the associate subsequently reports profits, the ***investor records the profits*** (add to the carrying amount of investment) ***only when the profits crosses the losses which were NOT recognised earlier.*** (Please read the Minority share of losses in AS-21- this is exactly same try to compare with that)

(d) ***Losses over and above the carrying amount are recorded as liability*** (Provision for share in the losses of associate) only when investor has committed to make payments (obligations) on behalf of the associate as per the agreement or else,

The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary in the value of the investment (i.e., permanent diminution in value-recall AS-13). Such reduction should be determined and provided for each investment individually.

Equity method should not be followed when- (These exceptions are similar to AS-21 exceptions)

(a) The investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or (Refer AS-21 for the explanation of "near future")

(b) The associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

Under these circumstances, investment should be accounted for as per AS-13. In this case, reasons for not applying equity method should be disclosed in the consolidated financial statements.

Unrealised profits and losses

In equity method, unrealised profits and losses arising from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate.

Generally, unrealised losses should not be eliminated. Unrealised losses can be eliminated only when the cost cannot be recovered from the sale of the asset to an independent buyer. (In case of AS-21, 100% unrealised profits should be eliminated but as per equity method unrealised profits only to the extent of investor's interest are eliminated)

Different reporting periods

Usually financial statement of associate are drawn up to the same date as the financial statements of the investor .

When the reporting dates of the investor and the associate are different, the associate often prepares financial statements as at the same date as the financial statements of the investor.

When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. In ***such situation, financial statements should be adjusted for the effects of any significant events or transactions between the investor (or its consolidated subsidiaries) and the associate that occur between the date of the associate's financial statements and the date of the investor's consolidated financial statements.***
In case of different reporting dates, ***reporting periods should be consistent from period to period in the case of difference in the reporting dates.***

Unlike AS-21, this Standard does not discuss about maximum six months difference between two financial reporting periods. An entity can follow voluntarily the same criteria in this case also.

As this standard does not mention about the maximum difference between two financial reporting periods, ***one can apply equity method even the difference is more than six months*** but if the ***difference is too long***, the objective of reflecting the performance of associate in CFS cannot be achieved; hence application of six months' ***condition voluntarily is appreciated.***

Uniform accounting policies

The investor usually prepares consolidated financial statements using uniform accounting policies for the like transactions and events in similar circumstances. In case an associate is using different accounting policies for like transactions and events, appropriate adjustments are made to the associate's financial statements to ensure uniformity and such adjusted financial statements should be used by the investor in applying the equity method. If it is not practicable to make such adjustments, the fact should be disclosed along with a brief description of the differences between the accounting policies.

Discontinuation of Equity Method

An investor should ***discontinue (stop) equity*** method from the date:

(a) Significant influence in associate is ceased but retains, either in whole or in part, its investment; or
(b) The use of the equity method is no longer appropriate because the associate operates under severe long- term restrictions that significantly impair its ability to transfer funds to the investor. (one of the exceptions discussed above)

From the date of discontinuing the use of the equity method, investments in such associates should be accounted as **per AS-13- Accounting** for Investments in the consolidated financial statements. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Contingencies

As per AS-29, the investor discloses in the CFS-

1. its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and
2. Those contingencies that arise because the investor is severally liable for the liabilities of the associate.

Disclosure

In addition to the disclosures as discussed in the above paragraphs,

1. An appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements.

2. Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet.

3. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss.

4. The investor's share of any extraordinary or prior period items should also be separately disclosed. The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.

5. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with brief description of the differences in the accounting policies.

AS – 23 Accounting for Investment in association in Consolidated Financial Statements

Apply only when the entry has a subsidiary & Preparing Consolidated Financial Statements

↓

Associate?

↓

The one who has significant influence

↓

How to get?

↓

By statute	Share ownership generally	By Shareholders' agreement

Share ownership generally:

20 % ↑	20 % ↓
Assumed in general unless otherwise proved negatively	Should be proved

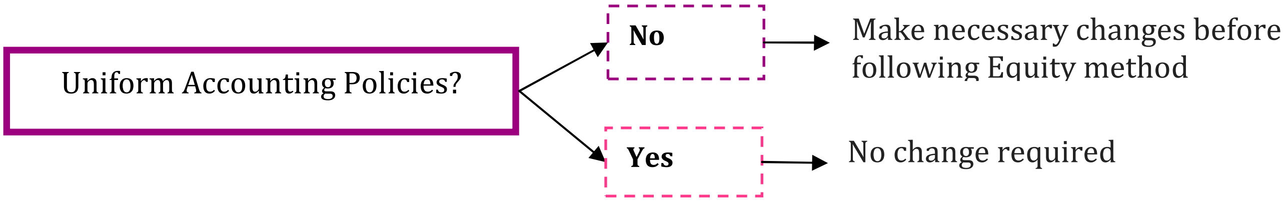
↓

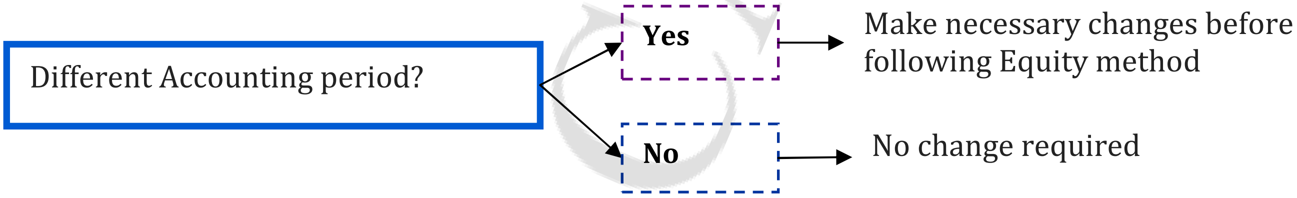
It has significant influence Apply AS-23-Equity method to account for investment

Equity Method

- Initially recognise investment at cost;
- Identify GW/CR on acquisition but do not recognise it & disclose;
- Investor's share of post-acquisition profit/loss should be adjusted to investment;
- Any distribution received-deduct from investment
- The investment in associate should not be negative. It can be NIL;

- Eliminate unrealised profit/loss - from transaction between investor & associate - to the extent of investor share.





AS 25 – Interim Financial Reporting

Objective of AS 25

Timely and reliable interim financial reporting (IFR) improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows, its financial condition and liquidity.

The objective of this Standard is to prescribe

(a) the minimum content in an IFR;

(b) form and content of IFR, including materiality;

(c) recognition and measurement aspects;

(d) Restatement of items which were previously presented in interim periods, etc.

Scope of AS 25

This Standard does not mandate which entities should be required to present interim financial reports, how frequently or soon after the end of an interim period. If an entity is required or elects to prepare and present interim financial report, it should comply with this Standard.

- An entity which is governed by a statute, or a regulator may need to prepare and present interim financial report at an interim date which may be different in form and content (i.e., presentation and disclosure) of this Standard.
- In such case, such entities need not to comply with this Standard. However, recognition and measurement principles can be applied if in case it is specified in the governing statute or by the regulator.
- Say, a lender is asking for 6 months interim financial statements as per the loan agreement. The company is preparing as required by the loan agreement - it can comply with AS-25 in its IFR preparation.
- If an entity is preparing cash tlow statement for its annual financial reporting purpose, it should prepare cash flow statement for interim purpose also.

Definitions

Interim financial report means a financial report containing either a complete set of financial statements or a condensed set of financial statements (as described in this Standard) for an interim period. (It is an option to the entity)

Interim period is a financial reporting period shorter than a full financial year.

Interim Financial Report

Complete set of financial statements

Normally this includes

(a) balance Sheet;
(b) statement of profit and loss;
(c) cash flow statement;
(d) notes on accounts.

❖ Form and content of these complete set of financial statements should confirm the requirements of

ANNUAL complete set of financial statements, i.e, it should provide detailed information.

Condensed set of financial statements

This should include

(a) Condensed balance sheet;

(b) Condensed statement of profit and loss;

(c) Condensed cash flow statement;

(d) Selected explanatory notes;

❖ Considering the timeliness, cost and repetition of previously reported information, it is preferable.

❖ Objective of condensed set of financial statements is to give an update on financial position and performance from the last reported financial statements; hence it should focus on NEW activities events and circumstances without duplicating the information.

❖ These financial statements should include each Heading, sub-heading and selected explanatory notes (as required by this AS - See below for detailed discussion);

Say Heading is Fixed assets & sub-headings are tangible assets and intangible assets; No need to provide details of classification, i.e., land & building, Plant and machinery, etc.

❖ Additional line items or notes should be included if their omission would mislead the users.

Selected explanatory notes

Explanatory notes should focus on significant areas and explanation on significant events and transactions which are useful to understand the change in financial position and performance of the entity. However, the following items should be included mandatorily

(a) **Accounting policies:**

Entity should confirm that the accounting policies are followed in the IFR are same as followed in the most recent annual financial statements: or if those policies have been changed, a description of E the nature and financial effect of such changes;

(b) Seasonality of interim operations:

Some entities business are seasonal like agricultural businesses, crackers business, tourism oriented companies. The entity should give explanatory comments about the reasonability of its operations.

(c) Unusual and extraordinary items:

If there are any exceptional and extraordinary items (as per AS -5) occurred during the interim period, the entity should disclose the nature and financial effects on assets, liabilities, equity, income, expense and cash flows.

(d) Change in estimates:

If there are any material changes in accounting estimates during the interim periodcompared to previous financial years or prior IFR, notes should include the nature of change and financial effect.

(e) Change in capital and borrowing :

Notes should include the information of change in the composition of capital and borrowings, i.e., during the interim period, if the entity issued, bought back, repaid or restructuredany of its debt, equity and potential equity shares, it should provide the same information in notes.

(f) Dividends:

Dividend payment information separately for equity shares and other shares should be included in explanatory notes;

(g) Segment information (AS-17):

If the entity is disclosing segment information in its annual financial statements, it should give the following segment information only for its primary basis of segments in its

IFR that could be a business segment or geographical segment.

(i) Segment revenue;

(ii) Segment capital employed, i.e., Segment assets minus segment liabilities; and

(iii) Segment results.

(h) Events occurring after the interim period:

Material events occurred after the interim period, which have not been reflected in IFR should be disclosed.

(i) Changes in the composition: the effect of changes in the composition of the enterprise during the interim period, such as amalgamations, acquisition or disposal of subsidiaries and long-term investments,restructurings, and discontinuing operations; and

Contingent liabilities

Material changes in contingent liabilities from the last annual balance sheet date should be disclosed.

Generally the above information should be reported on a financial year-to-date basis (i.e., events occurred between the previous balance sheet date and IFR date. However, the entity should also disclose separately any events or transactions that are material to an understanding of the current interim period.

Periods for which Interim Financial Statements are required to be presented

Interim reports should include interim financial statements (condensed or complete) for periods as follows; following examples are based on the Assumption that financial year ends on 31st March & the entity is preparing Quarter 2 ending i.e. 30th Sep. financial statements)

Points	Current period	Comparative period
Balance Sheet	BS as at the end of current Interim period; e.g. 30th September, 2025	As at the end of immediate previous financial year; E.g. 31st March, 2025
Profit and Loss statement	i) P&L for the current interim period; ii) P&L cumulatively for the current financial year to date; and iii) P&L for 12 months period (Only if the entity is engaged in highly seasonal business)	Comparable interim periods for all the three situations. For the period in Previous Year, P&L cumulatively for the PY financial year to date and P&L for 12 months period.
Example 1	Assume interim Report period has been assumed to be September, 2025 (2nd Quarter ending)	

Example 2	i) 3 months ending Sep. 2025 (P&L period is July to Sep. 2025)& ii) 6 months ending Sep. 2025 (P&L period is Apr to Sep. 2025)-(P&L cumulatively)	(a) 3 months ending Sep. 2024 (P&L period is July to Sep. 2025) & (b) 6 months ending Sep. 2024 (P&L period is Apr to Sep. 2024)
	If the entity is Engaged in highly seasonal business:	
	(i) 3 months ending Sep. 2025 (P&L period is July to Sep. 2025) (i) 6 months ending Sep. 2025 (P&L period is Apr. to Sep. 2025) - (P&L cumulatively) & (iii) 12 months ending Sep. 2025 (P&L for the period Oct. 2024 to Sep. 2025)	(i) 3 months ending Sep. 2024 (P&L period is July to Sep. 2024) (ii) 6 months ending Sep. 2024 (P&L period is Apr. to Sep. 2024) – (P&L cumulatively) & (iii)12 months ending Sep. 2024 (P&L for the period Oct 2023 to Sep. 2024)
Cash flow statements (CFS)	6 months ending Sep. 2025 (CFS period is Apr. to Sep. 2025)	6 months ending Sep. 2024 (CFS period is Apr. to Sep. 2024)
	If the entity is Engaged in highly Seasonal business:	
	12 months ending Sep. 2025 (CFS for the period Oct. 2024 to Sep. 2025)	12 months ending Sep. 2024 (CFS for the period Oct 2023 to Sep. 2024)

Materiality in preparation and presentation

As per preface to accounting standards "An amount or information is said to be material if its misstatement (omission or erroneous statement) can influence the economic decisions of the users of financial statements".

Accounting standards are applicable to all material items. Professional judgement is always required for assessing the materiality for financial reporting. In preparation of IFR, entities rely upon estimates to a greater extent compared to preparation of annual financial statements.

One should consider materiality to recognise, measure, classify or disclose an item in IFR and at the same time they should remember that IFR should include all the reliable information that is relevant to understand the entity's financial position and performance during the interim period

Last interim period reporting

Generally an entity may not prepare separate IFR for the last interim period (e.g. last quarter) as it is going to prepare and present audited annual financial statements. In such case, if an estimate of an amount reported in an interim period is changed significantly during the final interim period, the entity should disclose the nature and amount of that change in estimate in a note to the annual financial statements. Examples of such changes include change in estimation of provision for doubtful debts, inventory write downs, restructuring or impairment losses.

Say the entity has provided 100 crore for loss ofan excise duty legal case, the same is reduced to 80 crore as it is settled during the last quarter. The same information should be given in the notes on accounts.

Recognition and Measurement

In preparation of interim financial statements, an entity should use the same accounting policies which were applied in its annual financial statements. In case of any change in accounting policies.

The principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements. Let us understand the same in detail (Please read once again the chapter "framework for preparation of financial statements" before going through the below lines). Read this carefully, as these items will not be recognised in interim financial statements when it does not satisfy the below discussed conditions:

- ✓ **Asset:** An asset should be recognised (recorded in books of account) when it satisfies the two conditions i.e., 1. Future economic benefits inflow should be probable and 2. Costs or value should be measured reliably. The same conditions should be satisfied even on interim date like annual accounts. If it doesn't satisfy the conditions it cannot be recognised.
- ✓ **Liability:** It should be recognised only when the obligation is present (exists) as on interim date.
- ✓ **Income:** Recognise when there is an increase in future economic benefits either by way of increase in an asset or decrease of a liability and it should be measured reliably.
- ✓ **Expense**: Recognise when there is a decrease in future economic benefits either by way of decrease in an asset or an increase of a liability and it should be measured reliably.
- ✓ In case of annual accounts, they measure the above items on year to date basis, i.e., cumulatively by considering the information from the beginning of the accounting year till the balance sheet date..
- ✓ If an entity is preparing interim financial statements more frequently, it should measure income and expense in the same manner, i.e. year to date basis i.e., if there are any changes in estimates during the current interim, such changes should be adjusted in the current interim financial statements and prior interim periods need NOT be restated retrospectively. Only disclosure of nature and amount in notes on accounts is sufficient.
- ✓ Use the best estimates in the preparation of interim financial statements.

Illustration

(a) It means the principles which are applicable for writing down inventories, restructuring or impairment loss are same as those used if the entity prepares only annual financial statements.

(b) If any cost does not satisfy the definition of asset as of interim date, **it should not be recognised as asset** without waiting for future information and whatever incurred till that date should be charged to profit and /loss statement. **Deferring such amount is not permitted.**

Change in accounting policy requires restatement of prior interim periods

- A change in accounting policy should be reflected by restating the financial statements of prior interim periods of the current financial year. (NO need to restate previous financial year interim periods).
- The objective is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year.
- The effect of the principle requires that within the current financial year any change in accounting policy be applied retrospectively to the beginning of the financial year.
- If any accounting policy is changed in Quarter 3 of a financial year - we should present it in such a way that the policy is changed at the beginning of the current financial year.

Revenues received seasonally or occasionally

In case of Seasonal business, entities will have major income only during those seasons and during the other interim periods they may not have a great income. Examples include dividend revenue, royalties and Government grants. Additionally, some entities consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognised when they occur.

Costs incurred unevenly during the financial Year

Generally costs that are incurred unevenly during an entity's financial year should be recognised whenever they are incurred. Deferring or anticipated costs are permitted only when deferring or anticipating that type of costs is appropriate at the end of the financial year.

Measurement of Income-tax EXPENSE for IFR (As per the guidance note issued by ICAI)

AS-25 requires an enterprise to apply the same accounting policies in its interim financial reports as in its annual financial statements. Among other expenses, income-tax expense is an important item of interim and annual financial reports. Hence, correct measurement of income-tax expense is very important for reporting purposes

As per the Standard "Income-tax expense should be recognised at each interim period based on the best estimates of the weighted average annual income-tax rate expected for the full financial year. Tax expense recognised in one interim period may be adjusted (changed) in the subsequent period if the estimated rate changes".

Such estimated average annual effective tax rate should be applied on income before tax to get income-tax expense.

The following steps should be followed to find the weighted average annual effective tax rate:

(a) An entity should first estimate its annual accounting income. Such estimate should consider future events and transactions only when there is a reasonable certainty that such transactions would take place during the financial year. Examples of such transactions include depreciation on expected expenditure on acquisition of fixed assets, profits from sale of fixed assets/investmernts, etc.

(b) Next estimate its taxable income and tax liability for the financial year. For tax liability, an entity can use the enacted or the substantively enacted tax rate on the taxable income and it should consider the estimated deductions, allowances, etc., that would be available to the entity, provided there is a reasonable certainty for the same. The entity would also have to estimate the deferred tax assets/liabilities by applying the principles of AS-22.

(i) Where brought forward losses from PY BUT deferred tax asset is NOT CREATED considering theprudence of AS-22:

In such situation, the brought forward losses should be deducted from the estimated annual accountingincome for determining current tax liability. off during the year, those would not have any tax consequence in future periods. (Refer the below concept capsule for better understanding)

(ii) Where brought forward losses from PY BUT deferred tax asset is CREATED considering the prudence of AS-22:

Current income-tax should be computed in the same manner as explained above, i.e., brought forward losses will be deducted from the estimated accounting income.

As deferred tax asset is created, one should consider the reversal of deferred tax asset in the current year.

(c) Calculate the weighted average annual effective tax rate. This tax rate would be determined by dividing the estimated tax expense as arrived at step (b) above by the estimated annual accounting income as arrived at step (a) above.

(d) Where different tax rates are applicable to different portions of the estimated annual accounting income, e.g., normal tax rate and a different tax rate for capital gains, the weighted average annual effective tax rate would have to be calculated separately for such portions of estimated annual accounting income without considering the different income like capital gain. Weighted average rate should be applied on normal taxable income and different rate should be applied to different income.

Transitional provision

When an entity preparing the IFR for the first time it NEED NOT BE PRESENT in respect of all the interim periods of the current financial year:

(a) **Comparative statements of P&L** for the comparable interim periods (current and year-to-date) of the immediately preceding financial year; and

(b) **Comparative cash flow statement** for the comparable year-to-date period of the immediately preceding financial year.

AS 25 – Interim Financial Reporting {Chart}

Can be

Complete set

Same as annual FSs

Condensed set

- It is to give an update on financial position & performance.
- Only heading and sub-heading; Selected explanation. Notes; like change in accounting policies, Seasonality, Unusual items, segment info etc.

IFR Period

BS

Year to Date

CFS

Year to Date

P&L

- Current Interim
- Cumulative -Year to date
- P&L for 12 months

Unseasonal – I & ii
Seasonal – All 3

Other important Points

Consider materiality concept;

- Last quarter reporting is not required, if entity is preparing & presenting audited FS;
- Recognition & Measurement: No separate rules. Apply the same concept of Asset, liability, income & expense;
- Think that we are preparing Annual FS i.e., the Key.
- Change in the accounting policy - say during third quarter - Restate all quarters of current FY.
- (No need to change PY FS)
- Cannot defer or anticipate Costs/Income - when it cannot be done at year end;

Income Tax Expense

↓

Apply best estimate of weighted average annual Income Tax rate
For full financial year

↓

Step 1: Estimate annual accounting Income; by considering future Income with certainty.

Step 2: Calculate taxable income & liability -using enacted / substantially enacted tax rates – Calculate DTA / DTL as per AS-22.

- If carried forward losses exist-but not created DTA, Set off in computing CY Tax Expenses
- If carried forward losses exist- DTA also created. Same as above & reverse DTA to that extent.

Step 3: Weighted average tax rate = Step 2 /Step 1.

Step 4: Apply on accounting Income.

Step 5: Different tax rates are given. Ex Capital Gains, apply separately.

Objective

You would have come across many examples where 2 or more entities would have worked together to ahicev certain purpose. Hindustan Unilever Ltd (HUL), Tata Starbucks Ltd, Tata SlA Airlines Ltd. (Vistara), etc. are popular examples of Joint Ventures. Entities enter into such arrangements considering sharing of risk and expense, collaboration of know-how and skill-set, while also impacted by different work-cultures and management style Depending on the contractual arrangement, the accounting and reporting for Joint Ventures is done.

This Standard sets

- rules and procedures for accounting for investment in joint ventures and
- Presenting joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors.

Scope

This Standard is mandatory for separate financial statements and consolidated financial statements of an entity

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

There are two types of parties to the Joint venture agreement based on the control. They are

1. Venturer; and 2. Investor.

A venturer has joint control over that joint venture and whereas an investor does not have joint control over that joint venture.

Joint control is the contractually agreed sharing of control over an economic activity. Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

Such contractual arrangement ensures that NO single venturer is in a position to unilaterally control the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.

The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies framed by the venturers in accordance with the contractual arrangement and delegated to the operator matters that are mentioned in general in contractual arrangement

Whatever its form, the contractual arrangement is normally in writing and deals with such matters

(a) Nature and duration of the economic activity;

(b) Appointment of Board of directors or equivalent governing body;

(c) Voting rights of the parties;

(d) Decisions on matters which require consent of all venturers and other matters which require majority of venturers;

(e) Capital contributions;

(f) Distribution of income, expense or results of operations;

(g) Mergers and acquisitions, sale of the entity;

(h) NO Single party can control the Joint venture, etc.

Joint Venture Vs Subsidiary

In Some exceptional cases, an entity establishes joint control by a contractual arrangement over an entity which is a subsidiary of that entity as per AS-21. In such cases, the entity is consolidated under AS-21 by the said entity and is not treated as a joint venture as per this Standard. The consolidation of such an entity does not necessarily practice other venturer(s) following such an entity as a joint venture.

Forms of Joint Ventures

Accounting treatment of interest in joint venture is based on forms of JVs. The following are the forms of JOINT VENTURES

Forms of Joint Ventures

- Jointly Controlled Operations (JCO);
- Jointly Controlled Assets (JCA);
- Jointly Controlled Entities (JCE).

All three should satisfy the following two conditions

(a) Two or more venturers are bound by the contractual arrangement; and

(b) The contractual arrangement establishes the Joint control.

Jointly Controlled Operations (JCO)

Explanation of above points

In this form of JV,

- Each venturer uses its own fixed assets and carries its own inventories.
- It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations.
- The joint ventures' activities may be carried out by the venturers, employees alongside the venturers, similar activities (i.e., without common employees).
- If any common expense to be incurred for the JCO, it will be shared among the venturers as per the joint venture agreement.
- JCO does not require any establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves.

Example of Jointly Controlled Operations

Mr. A (dealer in tiles and marbles), Mr. B (dealer in various building materials) and Mr. C (Promoter) enters into a joint venture business, where any contract for construction received will be completed jointly, say, Mr. A will supply all tiles and marbles, Mr. B will supply other materials from his godown and Mr. C will look after the completion of construction. As per the contractual agreement, they will share any profit/loss in a predetermined ratio. None of them are using separate staff or other resources for the joint venture business and neither do they maintain a separate account. Everything is recorded in their personal business only.

Venturer do not maintain a separate set of books, but they record only their own transactions of the joint venture business in their books. Any transaction of joint venture recorded separately is only for internal reporting purpose. Once all transactions recorded in venturer's financial statement, they don't need to be adjusted for in consolidated financial adjustment.

Try to understand in this example there is no separate legal entity like company, partnership firm etc. Every entity used its assets, employees and incurred the expenses with respect to manufacture and assembling and shared revenue as per the agreement.

Accounting treatment of interest in Jointly Controlled Operations in the books of venturers:

A venturer should record the following in its separate financial statements and CFS:

(a) the assets that it controls and the liabilities that it incurs; and
(b) the expenses that it incurs and its share of the income that it earns from the joint ventures.

Because the assets, liabilities, income and expenses are already recorded in the separate financial statements of the venturer, the same will be reflected in venturer's CFS automatically. NO adjustments or other consolidation are required in respect of these items procedures are required in respect of these items.

Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare accounts for internal management reporting

Purpose so that they may assess the performance of the joint venture.

Summary points of Jointly Controlled Operations

1. No separate legal entity;
2. No separate assets, employees or other resources are required for JV;(It is just an arrangement)
3. Assets, Liabilities, Expenses are accounted in their individual financial statements;
4. No Adjustments required in case of consolidation of financial statements;
5. Profit or Revenue is shared among venturers as per the contractual arrangement.

Jointly Controlled Assets (JCA)

In this form of JV, Venturers contribute either assets or money and with this money they acquire assets for the purpose of joint venture and these assets are dedicated for the purpose of the V. These assets are used to obtain future economic benefits for the venturers.

Each venturer takes share of the results / output / benefits from the assets and each bears an agreed share of the operating expenses incurred for the joint venture.

These joint ventures do not involve arny separate establishment of a company, a corporation, partnership or other form that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset.

Example of Jointly Controlled Assets:

A Ltd, B Ltd & C Ltd. companies are into oil distribution. These companies contributed and constructed an oil pipeline. The. oil pipeline is jointly controlled and operated by venturer companies. Each venturer uses the pipeline to transport its own product and bears operating expenses in an agreed proportion.

Another example of a JCA is when two entities jointly control a property, each taking a share of the rents received and bearing a share of the expenses.

In these examples there is no separate legal entity and the assets are acquired by the venturers and jointly control. The income or expenses are shared as per the agreement.

Accounting treatment of interest in JCA in the books of venturers:

In respect of its interest in JCA, a venturer should recognise the following in its separate financial statements and consequently in its consolidated financial statements so as to reflect the substance and economic reality of the business:

(a) Its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment; (Suppose in the above example A Ltd. contributed 20 crores for construction of oil pipeline, this amount should be recorded as fixed asset (as per AS-10) but NOT as investment(Not as per AS-13)
(b) Any liabilities s which it has incurred; (e.g. Borrowed for investing in JV)
(c) Its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) Any income from the sale or use of its share of the output of the JV, along with its share of any expenses incurred by the JV; and

(e) Any other expenses incurred which are directly related to the JV.

Because the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer, and consequently it will be taken into consolidated financial statements, no separate adjustments other consolidation procedures are required in vernturer's CFS.

Generally financial statements are not prepared for the joint venture as there is no separate legal entity and all the items of financial statements are directly recorded in the books of venturers. Venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the JV.

Summary points of JCA:

- ✓ No separate legal entity:
- ✓ Every venturer has joint control over the JCA to the extent of their share;
- ✓ JCAs are used to obtain future economic benefits:
- ✓ Every venturer takes their share of results and bears expense as per the contractual arrangement;
- ✓ As the assets, liabilities, share of income and expenses are already recorded No consolidation Adjustments are requiredin case of CFS;

JOINTLY CONTROLLED ENTITIES (JCE)

In this form of Joint venture,

- ❖ Venturers s form a separate legal entity likea company partnership, etc;
- ❖ venturer obtains interest/ stake in the established entity and they enter into a contractual arrangement which ensures the joint control over the JCE:
- ❖ The established entity operates in the same way as other entities, ie, controls the assets of JV, incurs liabilities, expenses, earns income, enters into agreement with other parties, borrows, etc.
- ❖ JCE maintains its own accounting records, prepares and presents financial statements in accordance with the laws applicable;
- ❖ Venturers are entitled to share the results as per the agreement;

Example of JCA:

Kinetic Limited is an Indian automotive manufacturer and was manufacturing two wheelers. It formed a Joint venture with Honda Motor Company to introduce Kinetic Honda scooters with electronic start and gearless transmission. Assume the veturers have 50:50 stakes. The Joint venture is a separate legal entity, and this arrangement clearly falls within the meaning of JCE.

Accounting treatment of interest in JCE in:

- **Separate financial statements of a venturer:**

  Each venturer usually contributes cash or other resources to the JCE. These contributions are accounted as Investment in JV as per AS-13 "Accounting for Investments".

- **Consolidated financial statements of a venturer**

Venturers should report its interest in JCE using PROPORTIONATE CONSOLIDATION in its consolidated financial statements.

The following Joint venturers are EXCLUDED from proportionate consolidation:

(a) when interest in JCE is acquired and held exclusively with an intention to sell in the near future; or

(b) when JCE operates under severe long-term restrictions which significantly impair its ability to transfer funds to the venturer.

Proportionate Consolidation

The following steps will help you to understand this method:

Step 1 - Determine the COST of investment in JCE for the venturer;

Step 2 - Determine the Venturer's share of equity in the JCE on the date of investment; Say Venturer Company has 40% interest in JCE. At first, we need to find the total equity of the JCE and multiply with 40%.

Step 3 - Determine Goodwill OR Capital reserve on the date of acquisition:

(a) If Cost f investment in CE (step l number) > Venturer's share of equity (Step 2 number). The difference should be treated as GOODWILL, and it will be recorded as goodwill and separately disclosed in the consolidated financial statements;

(b) If Venturer's share of equity (Step 2 number) > Cost of investment in JCE (step I number), the difference should be treated as CAPITAL RESERVE and will be recorded under the heading Reserves and surplus of consolidated financial statements

Step 4: Calculate profits of Venturer Company to present it in consolidated balance sheet:

Particular	₹
Profits of venture company	XXX
Add: Shares in post – acquisition profits of JCE	XX
Profits of venture company to be presented in consolidated balance sheet	**XXX**

Step No. 5

Prepare the consolidated balance sheet of the venturer by adding proportionate share of assets, liabilities by line. The carrying amount of investment in JCE will be eliminated from Venturer's balance sheet as we are bringing a proportionate share of the assets and liabilities of JCE into CFS.

Uniform accounting policies

The venturer usually prepares consolidated financial statements using uniform accounting policies for the similar transactions and events in similar circumstances. In case a JCE uses accounting policies other than those adopted for the CFS for like transactions and events in similar circumstances, appropriate adjustments should be made to the JCE's financial statements before using for proportionate consolidation. If it is not practicable to adjust JCE's financial statements, that fact is disclosed together with the proportions of the items in the CFS to which the different accounting policies have been applied.

Different reporting periods: (Same AS-21)

Usually the reporting dates (balance sheet dates) of the venturer and JCE are same. If the reporting date of any JCE (say JCE's reporting date is 31-12-2024) is different from the reporting date of Venturer Company (Say venturer company's reporting date is 31-03-2025), generally the JCE company prepares its financial statements as on venturer company's reporting date only for the proportionate consolidation purposes.

If such preparation of financial statements is impracticable, then the financial statements drawn up to different reporting dates may be used for consolidation after giving the necessary adjustments for the effects of significant transactions or events that occurred between those dates (ie. material transactions between 31-12-2024 & 31-03-2025, will be adjusted in the JCE's financial statements and such adusted financial statements are used for proportionate consolidation).

This is acceptable only when the difference in reporting dates is not more than Six months. The consistency principle requires that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.

Set off

Set off any assets/liabilities or any income/expenses unless the following two conditions are satisfied

(i) a legal right to set off exists; and

(ii) It is expected that the realisation takes place in net;

Losses of INVESTORS exceeding their interest in JCE:

This topic related to losses of I Investors, i.e., who is a party to joint venture but investor does NOT have any control on financial and operating policies of JV and they have only participating rights (Refer definitions once); hence investor should account its investment in JV as per AS-23.

This is similar to excess losses related to minority interest

The losses pertaining to one or more investors in a JCE may exceed their interests in the JCE Such excess loss and any future losses related to such investors should be recorded by (borne by) the venturers in the proportion of their Shares in the venture. Venturer need NOT to record such losses only when investor has an obligation to bear the losses as per the agreement.

Discontinuation of proportionate consolidation:

A venturer should discontinue the use of proportionate consolidation from the date that:

(a) it ceases to have joint control over a JCE but retains, either in whole or in part, its interest in JCE; or

(b) is operated under severe long-term restrictions that significantly impair its ability to transfer furnds to the venturer.

Under these circumstances, Venturer should follow-

- AS-21 - "Consolidated financial statements" if it gets unilateral control over JCE;
- AS-23 - "Accounting for investments in Associates" if it loses the joint control and holds significant influence over JCE i.e. If interest is 20% or more but upto 50%;
- AS-13- "Accounting for investments" - If the venturer is neither holding nor associate.

Sales by JOINT VENTURE to VENTURER

Assets sold by JV to Venturer

Arising PROFIT from the transaction:

Venturer should NOT recognise its shares of profits of JV from the transaction until it resells the same asset.

Arising LOSS from the transaction:

Venturer should NOT recognise its shares of loss from the transaction (When the venturer expects that value of asset increases in the near future) If the loss is of permanent in nature, recognise the loss immediately.

Operators of Joint Ventures

Operators or managers of a joint venture should account for any fees in accordance with Accounting Standard (AS-9), Revenue Recognition.

One or more venturers may act as the operator or manager of a joint venture. Operators are usually paid a management fee for such duties.

The fees are accounted for by the joint venture as an expense.

Disclosures -

A venturer should disclose the following information in its separate financial statements as well as in CES.

- A venturer should disclose the total amount of the following contingent liabilities separately from the amount of other contingent liabilities:

- A venturer should disclose the total amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

- A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of owner ship interest, name and country of incorporation or residence.

Only in separate financial statements:

A venturer should disclose the total amounts of each of the assets, liabilities, income and expenses related to its interests in the JCE.

AS –27 Financial Reporting of interest in Joint Venture

Forms of Joint Ventures

Jointly Controlled Operations (JCO);

- No separate legal entity
- Every venturer has its own
- assets, liabilities & Income and expenses
- No separate accounting & no adjustment required in CFS Venturer

(a) Jointly Controlled Assets

- Recognise to the extent of their share.
- No separate legal entity
- No separate accounting
- No adjustment in CFS

Jointly Controlled Entities (JCE).

- Separate legal entity
- Separate standalone FS are prepared
- Is venturer preparing CFS?

No → Recognise investment as per AS- 13

Yes → Consolidate using Proportionate consolidation method Except :-

(a) Temporary Interest
(b) Severe long-term restriction

Proportionate Consolidation Method:-

Line by line consolidation, only to the extent of Joint control of all assets, liabilities, income & expenses.

& Step 1:- Determine cost of investment
Step 2:- Venturer's share of equity in JCE at the DOA
Step 3:- Determine GW/CR
Step 4:- add post acquisition share of profits to venturer's profit.
Step 5:-Line by line add things and prepare CFS.

Step 1 >2 = GW

Step 2 > 1 = CR

Other important points:-

- Uniform A/C policies - Same as AS-21
- Different reporting periods- Same as AS-21
- Loss of Investors the interest in JCE-should be borne by investors in control proportion (Subsequent profits adjust first, same as AS-21.)

Transactions between venturer & JV

Sales by

In CFS recognise only portion of profit loss related to other venturers
Recognise full loss- When the loss on sale is permanent in nature.

JV to venturer
Check is it Profit or Loss: -
Profit:- Should not recognise its share till it resales;
Loss:- If loss is permanent recognise immediately if not permanent don't Recognise.

AS 28 - IMPAIRMENT OF ASSETS

Meaning of word Impairment of Asset –

Reduction in the estimated or nominal value of an asset.

Objective of Accounting Standard

1) To recognise impaired assets at not more than their recoverable amount.
2) An asset is said to be impaired if its carrying amount (book value) is greater than the amount to be recovered either by way of using the asset in its business or by selling the asset.
3) If the asset is impaired, the entity requires recognising an impairment loss, i.e., the amount by which the carrying amount of an asset exceeds its recoverable amount.

Scope

- This Standard is applicable for the impairment of all assets - except the following

- Inventories (as it is valued at the lower of cost or NRV as per AS-2)
- Assets arising from construction contracts (as expected loss on contract will be recognised immediately as per AS-7);
- Financial assets including investments (loss on permanent diminution of long-term investments will be recognised &t current investments are valued at the lower of cost or FMV whichever is lower) (other financial assets are covered by Ind AS-109, 32 & 107) and
- Deferred tax assets (as covered by AS-22)

Important concepts & Definitions

Impairment Loss

It is amount by which the carrying amount of an asset exceeds its recoverable amount (Carrying amount > recoverable amount).

Impairment loss = Carrying amount - recoverable amount;

Impairment Loss

Carrying amount > *Recoverable amount*

{Accounting Records} **{Face Value – cost to sell/value in use}**

Carrying Amount - Recoverable Amount = Impairment loss

Net selling price

Sale proceed of an asset at arm's length price between knowledgeable & willing parties	XXX
Less: Costs of disposal (Selling expenses)	XXX
Net selling price	XXX

Costs of disposal

These are incremental (additional) costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

Eg. Legal costs, costs of removing the asset, and direct costs to bring an asset into condition for its sale

Carrying amount (Book value)

Cost of the assets	XXX
Less: Accumulated depreciation/ amortization	XX
Less: Accumulated impairment losses (which were recognised in previous years)	XX
Carrying amount (This should be compared with recoverable amount)	XXX

Active market

It is a market where ALL the following conditions are satisfied:

(a) the items traded within the market are homogeneous (similar kind);

(b) we can find willing buyers and sellers at any time; and

(c) Prices information is available to the public.

The definitions of depreciation, depreciable amount & useful life e are same as AS-10. Actually we areleft with few more definitions, I would like to discuss at the relevant time,

Recognition & Measurement

If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should reduced to its recoverable amount. That reduction is an impairment loss. Asset is reduced by theloss amount and Impairment loss accounting is explained in the below diagram:

Was the asset revalued any time previous year?

No

Debit the impairment loss

Yes

Does revaluation reserve exist in BS?to P&L

Yes

Debit the impairment loss to the Revaluation reserve to the extent Available & remaining loss (if any)

No

Debit the impairment loss to P&L Should be debited to P&L

If impairment loss ***is greater than*** the carrving amount of the asset, = carrying amount of the assetshould be Nil.

Is the entity revalued assets using Market value

Yes

Are selling costs material?

Yes

In this case, there is a possibility of recoverable amount being less than the carrying amount

↓

Hence apply AS-28 i.e. on "Value in use"

↓

If there is any impairment loss first apply it with revaluation reserve and then transfer balance P&L.

No

If selling costs are negligible, Fair Maret Value = Net Ralisable Value

↓

It means the assets revalued amount is recoverable amount.

↓

Hence no need of AS-28.

No

It means the entity used other methods to revalue the assets.

↓

It is possible that revalued amount is less or more than recoverable amount.

↓

Hence apply AS-28 i.e. "value in use"

Net Selling Price (NSP)

How to calculate Net Selling Price

Net selling price when there is binding sale agreement →

Selling price as per the binding agreement	xxx
Less: Costs of disposal of the asset	(xx)
Net selling price	xxx

Net selling price when there is no binding sale agreement but asset is traded in active market

(Homogeneous items)

→ If you have current market /bid prices available →

Current market price	xxx
Less disposal cost s	(xx)
Net Selling Price	xxx

→ If you Don't have current market/bid prices available → Take recent transaction price & modify it considering significant change in economic circumstances from that date

Net selling price when there is no binding sale agreement and asset is **not** traded in active market (No Homogeneous items)

→ Compute NSP based on the best information available to reflect the amount the entity can get on disposal of the asset on the balance sheet date ***Less*** disposal costs;

Value In Use

Estimating value in use involves the following two steps:

(a) Estimating the future cash inflows and outflows arising from continuing usage of the asset during itsuseful life and cash inflows from its sale at the end of the useful life;

(b) Finding the appropriate discounting rate - to bring the net cash flows to present value;

Estimating future cash flows:

i. Cash flow projections ***should be based on reasonable and supportable assumptions;*** that should bethe best estimate based on the economic conditions that will exist over the remaining useful life ofthe asset.

ii. Consider the ***most recent financial budgets approved by the management***. Generally maximum five years projections make reliable and reasonable

iii. Cash flow projections beyond the budget period should be estimated by ***extrapolating the projections using a steady or declining growth rate*** for subsequent years.

iv. The growth rate used for extrapolating the projections ***should not exceed the long-term average growth rate of products, industry, country, etc.***

Foreign Currency Future Cash Flows

Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency.

An enterprise translates the present value obtained using the exchange rate at the balance sheet date, i.e., closing rate.

Discount Rate

As per the Standard, the discount rate should be a pre tax rate and which reflects time value of money and the risks specific to t the asset. (As we discussed earlier, we have estimated pre tax cash lows; hence we should use pre tax discount rate)

Risks specific to the asset means it is the rate of the return that an investor requires to earn to choose the asset (i.e., minimum rate of return considering the risks related to the asset. If the business with that asset or cash generating unit (CGU) is risky, the entity's expectation of minimum return will be high and vice versa).

It means the entity should use different rates for different assets or CGUs considering t the risks related to those. When an asset-specific rate is not directly available from the market, an entity uses other bases to estimate the discount rate.

As a starting point, the entity may use the following rates:

(a) the entity's weighted average cost of capital (WACC) determined using techniques such as the Capital Asset Pricing Model (CAPM);

(b) the enterprise's incremental borrowing rate (if the entity needs a new loan at what rate it can obtain); and

(c) other market borrowing rates.

The above rates can be adjusted:

(a) by adding the specific risks associated with the projected cash flows; and

(b) by excluding risks that are not relevant to the projected cash flows.

Consideration is given to risks such as country risk, currency risk, price risk and cash flow risk.

CASH GENERATING UNIT (CGU)

Sometimes it is not possible to estimate future cash flows from continuing use of it –we should group some assets and check whether the group can generate independent cash flows. If not, we should add few more assets and check the same. That group of identifiable assets which generate independent cash flows is called cash generating unit, i.e., CGU.

As per the definition of the standard - A CGU is the ***smallest identifiable group of assets*** that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groupsof assets.

Identification of CGU involves professional judgement. An entity considers various factors including

- how management monitors the enterprise's operations (such as by product lines (Segments),businesses, individual locations, districts or regional areas or in some other way); or
- how management makes decisions about continuing or disposing of its assets and operations.

CGUs should be identified consistently from period to period for the same asset or types of assets, unless achange is justified.

Let us look at the following examples to understand the concept of CGU:

Example 1

Say Sun academy is a CA coaching centre and it has four branches in Bangalore. Each branch has its own furniture and other facilities, etc. We cannot find the future estimated cash flows from the benches and other furniture items of the entity. So we should add all the assets of the branch and facilities and check, canwe generate cash flows independently (independent from other branches). Mostly the answer is YES. Then each branch is a CGU.

Example 2

A mining entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value (negligible value) and the private railway alone does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.

It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railway cannot be determined and it is probably different from scrap value. Therefore, the entity estimates the recoverable amount of the CGU to which the private railway belongs, that tis, the mine as a whole. In this example entire mine is a CGU.

Example 3

A bus company provides services under contract with a municipality that it should provide services at all the five routes mandatorily. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Because the entity ***does not have the option to curtail any one bus route,*** we cannot identify independentcash flows from each route. The management of the company has to look at all the routes as one. In this case, CGU is the bus company as a whole.

Recoverable and carrying amount of a CGU

There is No change in recoverable amount calculation from an individual asset to a CGU. The above discussionwas remain useful for CGU's recoverable amount.

How to find out carrying amount of a CGU?

Carrying amount of CGU

1) includes the carrying amount of only those assets that can be attributed directly, or allocated or reasonable and consistent basis, to the CGU and that will generate the future cash inflows estimated determining the CGUs value in use; and

2) does not include the carrying amount of any recognised liability in general, unless the recoverable amountof the CGU cannot be determined without consideration of this liability. (Refer below concept capsule)

Sometimes recoverable amount of a CGU includes the assets which are generally not part of the CGU e.g., receivable or other financial assets liabilities. In such cases, the carrying amount of the CGU, also should include the assets and liabilities.

Goodwill (GW)

As you know, only acquired goodwill should be recognised in financial statements. Self-generated goodwill does not satisfy the asset recognition conditions. Goodwill does not generate cash flows independently, therefore recoverable amount of goodwill as an individual asset cannot be determined.

If there is an indication that goodwill may be impaired, recoverable amount is determined for the CGU to which goodwill belongs. That amount should be compared to carrying amount of CGU for finding impairment.

The following diagram explains how to allocate the impairment loss in case of CGU

Have you recognised goodwill in Balance sheet?

No

Allocate the impairment loss on pro-rata basis of carrying amounts; Refer below concept

Yes

Compare recoverable amount of CGU with its carrying amount (including allocated GW)

If there is any impairment loss

Allocate the impairment loss in this order

(a) First apply on the goodwill which is allocated to CGU; (credit -goodwill a/c)

(b) Apply the remaining loss on all other assets of CGU on pro rata basis based on the carrying amount of each asset in CGU.

This is called BOTTOM-UP test
Refer below concept capsule

Yes

Can we allocate goodwill to the CGUs on a reasonable and consistent basis?

No

- If the entity finds it inappropriate or unreasonable to allocate any portion of GW to CGU (smallest group of assets generating independent cash flows);

- The entity will have to **move one-step up** further ie. from a smaller CGU to the next larger CGU

- ADD Some more assets / CGU to the existing group of assets and check - whether it can allocate GW on reasonable basis now?

- If the answer is NO it should add furthermore assets and check the same until GW is allocated or it is decided that GW is for the entity as a whole.

  (This procedure is called TOP-DOWN test)

If the answer is YES - Allocate impairment loss like the other option ***(Refer below capsule)***

Corporate assets

Corporate assets are assets other than goodwill that contribute to the future cash flows of both the CGUs under review and other CGUs. Corporate assets include group or divisional assets such as the headquarters building, EDP equipment or a research centre.

Corporate assets do not generate cash inflows independently and their carrying amount cannot be fully attributed to the CGU under review. Because corporate assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset.

lf there is an indication that a corporate asset may be impaired, recoverable amount is determined for the CGU to which the corporate asset belongs (after allocation of corporate assets to the CGU), compared to the carrying amount of this CGU and any impairment loss is recognised on pro rata basis of corporate assets and other assets of CGU.

Can corporate assets be allocated to CGU on reasonable and consistent basis?

Yes

The entity should apply bottom up test and allocate the corporate assets and test for impairment

No

The entity should apply bottom up test and top down tests as explained in case of goodwill

If the entity has goodwill and corporate assets, the impairment loss should be applied first on goodwill allocated to the CGU and the remaining impairment loss should be allocated between the corporate assets and other assets of CGU on pro rata basis of carrying amounts.

Reversal of an impairment loss

An entity should assess at every balance sheet date whether there is any indication that the impairment loss recognised in previous years may be decreased or no longer exist.
If any such condition exists, the entity should estimate recoverable amount of that asset.

Impairment Loss Reversal Indications

External source of information

1. Market value increased significantly
2. Significant changes in technological, market economic or legal environment - which have for positive effect on the entity;
3. Discount rate (return on investment rate) decreased;

Internal source of information

(a) Economic performance is higher than expectations, due to additional capital expenditure incurred for improvement;

(b) Withdrawal of commitment restructuring, discontinuing operations, disposal of assets, etc.

The impairment loss recognised should be reversed if there is a change in estimations of recoverable amount.

The impairment loss recognised should be reversed if there is a change in estimations of recoverable amount. Economic performance is higher than expectations, due to additional capital expenditure incurred for improvement;

A reversal of an impairment loss means an **increase in the estimated service potential of an asset, either from use or sale**, from the date of last recognition of an impairment loss for that asset. Hence before reversing the impairment loss, **the entity should enquire whether there is any betterment in service potentiality. If there is NO such increase, impairment loss should not be reversed.**

The topic is divided into three parts, i.e.,

Topic 1: Reversal of impairment loss in case of Individual Asset

Was it Revalued Earlier?

No

(a) Reverse the impairment loss by recording below Journal Entry;

Asset a/c……Dr
To Imapirment loss (P&L)

(b) Due to reversal of impairment loss – the carrying amount should NOT exceed what it would have been without impairment loss;(it means, maximum previously recognised loss can be reserved)

(c) Such reversal profit should be transffered to P&L;

Yes

(a) Reverse the impairment loss by recording below Journal Entry;

Asset a/c……Dr
To Revaluation reserve a/c
To impairment loss (P&L) (b/f)

(b) Due to reversal of impairment loss – the carrying amount should NOT exceed what it would have been without impairment loss;(it means, maximum previously recognised loss can be reserved)

(c) Credit the revaluation reserve only to the extent it was debited at the time of impairment loss and the remaining

After a reversal of an impairment loss---

Depreciation (amortisation) charge for the asset should be computed prospectively i.e., the revised carrying amount after deducting residual value, should be depreciated over the remaining useful lifeof the asset.

Topic 2: Reversal of impairment loss in case of Cash Generating Unit

A reversal of an impairment loss for a Cash Generating Unit **[CGU]**should be allocated in the following order:

1. first to ALL assets in CGU (other than goodwill) on a pro-rata basis based on the carrying amount;and
2. Allocation to goodwill only when it satisfies the conditions mentioned below (Refer topic 3).

These increase in carrying amounts should be treated as reversals of impairment losses for individualassets as discussed in topic 1.

In allocating a reversal of an impairment loss for a CGU, the carrying amount of an asset should not beincreased above the lower of:

(a) its recoverable amount (if determinable); and
(b) normal level of carrying amount as if impairment loss had not been recognised previously; The amount of the reversal of an impairment loss should be allocated to each asset on a pro rata basis.

Topic 3: Reversal of impairment loss in case of Goodwill

In general, an impairment loss recognised for goodwill should not be reversed in a subsequent periodunless:

(a) the original impairment loss was caused bya specific external event of an exceptional nature that isno expected to recur (E.g. new regulations which significantly affecting operating activities, decrease in profitability etc); and

(b) The subsequent (external) events occurred have reversed the initial effect of that event.

Hence, reversal of goodwill will take place only when there is a clear event which is reversing the initial effect otherwise it should not be reversed simply because of change in discount rate or timing offuture cash flows.

Impairment in case of Discontinuing Operations (requires understanding in AS-24)

The approval and announcement of a plan for discontinuance is an indication that the assets attributable to the discontinuing operation may be impaired or that an impairment loss previously recognised for those assets should be increased or reversed. In such situation, impairment test will beperformed and loss will be recognised in the following manner.

For example:

(a) if the entity sells the discontinuing operation substantially in its entirety, none of the assets of the discontinuing operation generate cash inflows independently from other assets within the discontinuing operation. Therefore, recoverable amount is determined for the discontinuing operationas a whole and an impairment loss, if any, is allocated among the assets of the discontinuing operationin accordance with this Standard;

(b) if the entity disposes of the discontinuing operation in other ways such as piecemeal sales, therecoverable amount is determined for individual assets, unless the assets are sold in groups; and

(c) if the entity abandons the discontinuing operation, the recoverable amount is determined forindividual assets as set out in this Standard.

The carrying amount (recoverable amount) of a discontinuing operation includes the carrying amount (recoverable amount) of any goodwill that can be allocated on a reasonable and consistent basis to that discontinuing operation.

Disclosure requirement

(a) The amount of impairment losses recognised directly against revaluation reserve during the period,

(b) the amount of impairment loss recognised or reversed in the P&L. during the period.

(C) the amount of reversals of impairment losses recognised directly in revaluation reserve during theperiod

(d) impairment loss elating to segment should be disclosed separately, while giving segment information under AS 17

(e) Notes to account should also disclose:

1) the events and circumstances that led to the recognition or reversal of the impairment loss.
2) method of calculating Impairment loss
3) method of calculating Net selling price, value in use and discount rate.

About the Author

TAPOVAN CA

CMA CS Rohan Nimbalkar (15+ Years Teaching Exp.)

- **Rohan Sir is among few CS in India who have completed CS just at the age of 21.**
- **Rohan Sir is known for Introducing India's First Accounts Marathon back in 2017 & also India's First Coloured Notes with Graphics for Accounts.**
- **Rohan Sir is one of the most Experienced Faculty with a immense teaching experience of 15+ years to CA students. In his entire career he has taught more than 25000+ CA & CMA Students till date.**
- **Easily understandable language, Bulleted Points, Picture Graphics, Charts, Images for Conceptual Clarity, of his notes makes the student's task easy. His notes are designed as per ICAI Guidelines with Exam Oriented Approach.**
- **During the course Rohan Sir also guides students regarding Meditation & Spirituality which helps students to Focus on their studies, Avoids distraction, Lowers Stress etc.**
- **He is one of the Most Loved Faculty, with whom students feel free to share their doubts, seek guidance & follows his advice.**

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Rohan Sir se Padhoge toh ye Guarantee hai...

AS **Sirf samjenge nahi**
Yaad Hoo Jayenge !!

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