

CA INTER

ADVANCED ACCOUNTING

The

Power Notes



**Confidence
Actions
Success**

Power Notes

CA Inter - Advanced Accounting

Your Ultimate Guide for Exam Success,

This book is a perfect blend of precision, clarity, and exam-oriented learning. Designed to offer a concise yet comprehensive approach, it focuses directly on the core areas of Advanced Accounting. Every concept is presented in a structured, pointwise manner, making it easy to understand, revise, and retain.

With around **230 pages**, this book covers the entire syllabus from the latest **ICAI May 2025 Study Material (SM)** without missing any concept. It is crafted to help students revise efficiently and build confidence for exams.

Key Features:

- **Comprehensive Yet Precise** - Covers all topics concisely without compromising clarity.
- **Revision Master** - Structured to facilitate quick and effective revision.
- **ICAI May 2025 SM Aligned** - Every concept is covered as per the latest syllabus.
- **Easy to Learn & Retain** - Simplified explanations and pointwise presentation for better retention.

Wishing you all the success in your journey! Happy Learning!

#008080 - Headings

#C84C32 - Key Words

#1F497D - Normal Text

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1. PREPARATION OF FINANCIAL STATEMENTS OF COMPANIES



1. Meaning of Company

1. Section 2(20)
"Company" means a company that is incorporated under:
 - ✓ The Companies Act, 2013, or
 - ✓ Any previous company law (the Companies Act, 1956).



2. Maintenance of Books of Account

1. Maintenance of Proper Books of Accounts and Financial Records
AS per S.128 of the CA, 2013 Every company should prepare & keep at its registered office
 - ✓ books of accounts, &
 - ✓ other relevant books and papers &
 - ✓ financial statements for every financial year
2. Fair View of Affairs
Books should give a true & fair view of the company's affairs, including branch offices.
3. Accrual Basis & Double Entry
Books should be kept on an accrual basis and follow the double entry system of accounting.
4. Retention of Books
Books must be kept for at least 8 financial years or for the years the company has existed (if less than 8 years).
5. Location of Books
Companies must keep books of account and financial statements at their registered office.



3. Statutory Books

	Statutory Book	Section
1.	Register of Investments	Section 187
2.	Register of Charges	Section 85
3.	Register of Members	Section 88
4.	Register of Debenture-holders and Security holders	Section 88
5.	Register of Minute Books	Section 118
6.	Register of Contracts/Arrangements in which Directors are Interested	Section 189
7.	Register of Directors and Key Managerial Personnel and their Shareholding	Section 170
8.	Register of Loans and Investments by Company	Section 186



9. Statistical Books to record transactions resulting in payment or basis for certain payments.
Share Application and Allotment Book, Share Call Book, Certificate Book, Register of Members, Share Transfer Book, and Dividend Register

-



4. Annual return.

1. Annual Return Preparation
 - ✓ Companies must prepare an annual return in the prescribed form, signed by a director and company secretary.
 - ✓ For One Person Companies and small companies, the return should be signed by the company secretary or the company director.
2. Filing of Return
 - ✓ The return must be filed with the Registrar within 60 days of the annual general meeting (AGM) or where AGM is not held with 60 days from the date on which AGM should have been held.



5. Final Accounts

1. Presentation of Financial Statements
U/S 129, BOD should lay financial statements before the company at the AGM.
2. Financial Statements (Section 2(40))
Financial statements include:
 - ✓ Balance sheet at year-end.
 - ✓ Profit and loss account or income and expenditure account for non-profit activities.
 - ✓ Cash flow statement for the year.
 - ✓ Statement of equity changes, if applicable.
 - ✓ Explanatory note incorporated in any document.

Note: One-person companies, small companies, dormant companies, or private companies (start-ups) may not need the cash flow statement.
3. Requisites of Financial Statements
 - ✓ It should give a true and fair view of the state of affairs of the company at the end of the financial year.
4. Provisions Applicable
 - Specific Act applies to insurance, banking, and electricity companies.
 - For all other companies applies Schedule III of the CA, 2013.
5.

Division	Applicable to
Division I	Companies required to apply AS notified under Section 133 of the Companies Act, 2013.
Division II	Companies required to apply Ind AS notified under Section 133 of the Companies Act, 2013.



	Division III	NBFCs required to apply Ind AS notified under Section 133 of the Companies Act, 2013.
6.	Points to be kept in mind while preparing Final Accounts ✓ Follow Schedule III of the Companies Act. ✓ other statutory requirements. ✓ Accounting Standards notified by MCA (AS 1 to AS 29). ✓ Statements and Guidance Notes by ICAI.	
7.	As per S 133 of the Companies Act, it is mandatory to comply with AS notified by the CG from time to time.	
8.	Section 129 ✓ Financial statements should give a true and fair view of the state of affairs of the company & ✓ Comply with accounting standards under Section 133 & ✓ Should be in the form provided in Schedule III of the Act.	



6. Schedule - III

PART I -BALANCE SHEET

Name of the Company.....

Balance Sheet as at.....

(Rupees)

		Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
		1	2	3	4
		EQUITY AND LIABILITIES			
1.		Shareholders' funds			
	a	Share capital			
	b	Reserves and Surplus			
	c	Money received against share warrants			
2.		Share application money pending allotment			
3.		Non-current liabilities			
	a	Long-term borrowings			
	b	Deferred tax liabilities (Net)			
	c	Other long-term liabilities			
	d	Long-term provisions			
4.		Current liabilities			
	a	Short-term borrowings			



	b		Trade Payables			
			(A) total outstanding dues of micro enterprises and small enterprises; and			
			(B) total outstanding dues of creditors other than micro enterprises and small enterprises.			
	c		Other current liabilities			
	d		Short-term provisions			
			Total			
			ASSETS			
1			Non-current assets			
	a	i	Property, plant and Equipment			
		ii	Intangible assets			
		iii	Capital Work-in-progress			
		iv	Intangible assets under development			
	b		Non-current investments			
	c		Deferred tax assets (Net)			
	d		Long-term loans and advances			
	e		Other non-current assets			
2			Current assets			
	a		Current investments			
	b		Inventories			
	c		Trade receivables			
	d		Cash and cash equivalents			
	e		Short-term loans and advances			
	f		Other current assets			
			Total			

General Instructions for Preparation & presentation of Balance Sheet

	Classification Criteria
1.	Current Assets An asset is classified as current if it satisfies any of the following conditions ✓ Expected to be realized or consumed in the company's normal operating cycle. ✓ Held primarily for trading. ✓ Expected to be realized within 12 months after the reporting date. ✓ Cash or cash equivalents, unless restricted from being used for at least 12 months after the reporting date.
2.	Non-current Assets ✓ Any assets that do not meet the above criteria.
3.	Operating Cycle



	✓ The time between acquisition of assets for processing and their realization in cash or cash equivalents. ✓ Assumed to be 12 months if not identifiable.
4.	Current Liabilities A liability is classified as current if it satisfies any of the following conditions ✓ Expected to be settled in the company's normal operating cycle. ✓ Held primarily for trading. ✓ Due to be settled within 12 months after the reporting date. ✓ No unconditional right to defer settlement of the liability for at least 12 months after the reporting date. If The terms of the liability provide option to the holder to take shares for settlement of liability could not affect the classification of liability.
5.	Non-current Liabilities ✓ Any liabilities that do not meet the above criteria.

Disclosures Required for Various Items:

SHARE CAPITAL

1.	Total number and value of shares authorized.
2.	Number of shares issued, subscribed, fully paid, and subscribed but not fully paid.
3.	Par (Nominal) value per share.
4.	Summary of shares outstanding at the beginning and end of the period.
5.	Rights, preferences, and restrictions on each class of shares (e.g., dividend limitations, capital repayment restrictions).
6.	Shares held by holding company, ultimate holding company, and their subsidiaries or associates (in aggregate).
7.	Details of shareholders owning more than 5% of shares, with their shareholding numbers.
8.	Shares reserved for issue under options, contracts, or other commitments, including terms and amounts.
9.	For the period of five years immediately preceding the date as at which the Balance Sheet is prepared: - Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash. - Aggregate number and class of shares allotted as fully paid up by way of bonus shares. - Aggregate number and class of shares bought back.
10.	Unpaid calls on shares, showing amounts unpaid by directors and officers.
11.	Original amount paid on any forfeited shares.

RESERVES AND SURPLUS

1.	Classification ✓ Capital Reserves ✓ Capital Redemption Reserve ✓ Securities Premium ✓ Debenture Redemption Reserve
----	---



	✓ Revaluation Reserve ✓ Share Options Outstanding Account ✓ Other Reserves (specify the nature and purpose of each reserve and the amount)
2.	Reserves Represented by Investments ✓ A reserve shown by earmarked investments is called a 'fund'.
3.	Surplus and Negative Balances ✓ If there is a debit balance in the Statement of Profit & Loss, it will be shown as a negative figure under Surplus. ✓ The total Reserves and Surplus, after adjusting any negative surplus, may show a negative balance.

LONG-TERM BORROWINGS

1.	Long-term Borrowings Classification ✓ Bonds/Debentures ✓ Term Loans ▪ From Banks ▪ From Other Parties ✓ Deferred Payment Liabilities ✓ Deposits ✓ Loans and Advances from Related Parties ✓ Long-term Maturities of Finance Lease Obligations ✓ Other Loans and Advances (specify nature)
2.	Secured and Unsecured Borrowings ✓ Borrowings should be classified as secured or unsecured. ✓ Specify the nature of security for each case.
3.	Loans Guaranteed by Directors/Others ✓ If loans are guaranteed by directors or others, the total amount for each head must be disclosed.
4.	Bonds/Debentures Details For Bonds/Debentures, show: ✓ Interest Rate ✓ Redemption or Conversion Details ✓ List by latest date first. ✓ If paid in instalments, use the first payment date as the maturity date.
5.	Term Loans and Other Loans ✓ Specify repayment terms for term loans and other loans.
6.	Loan Default Details ✓ Specify the period and amount of continuing default as on the balance sheet date for both loans and interest.



OTHER LONG-TERM LIABILITIES

- | | |
|----|--|
| 1. | Other Long-term Liabilities
✓ Trade Payables
✓ Others |
|----|--|

LONG-TERM PROVISIONS

- | | |
|----|---|
| 1. | Long-term Provisions
✓ Provision for Employee Benefits
✓ Others (specify nature) |
|----|---|

SHORT-TERM BORROWINGS

- | | |
|----|--|
| 1. | Short-term Borrowings Classification
✓ Loans repayable on demand
From Banks
From Other Parties
✓ Loans and Advances from Related Parties
✓ Deposits
✓ Other Loans and Advances (specify nature) |
| 2. | Secured and Unsecured Borrowings
✓ Borrowings should be sub-classified as secured or unsecured.
✓ Specify the nature of security for each case. |
| 3. | Loans Guaranteed by Directors/Others
✓ If loans are guaranteed by directors or others, disclose the aggregate amount of such loans for each head. |
| 4. | Loan Default Details
✓ Specify the period and amount of default as on the balance sheet date for both loans and interest. |
| 5. | Current Maturities of Long-term Borrowings
✓ Disclose the current maturities of long-term borrowings separately. |

OTHER CURRENT LIABILITIES

- | | |
|----|---|
| 1. | Classification
✓ Current Maturities of Finance Lease Obligations
✓ Interest Accrued but Not Due on Borrowings
✓ Interest Accrued and Due on Borrowings
✓ Income Received in Advance
✓ Unpaid Dividends
✓ Application Money Received for Allotment of Securities and Due for Refund, and Interest Accrued
✓ Unpaid Matured Deposits and Interest Accrued
✓ Unpaid Matured Debentures and Interest Accrued |
|----|---|



- ✓ Other Payables (specify nature)

SHORT-TERM PROVISIONS

1. Provisions
 - ✓ Provision for Employee Benefits
 - ✓ Others (specify nature)

PROPERTY, PLANT AND EQUIPMENT

1. Asset Classification
 - Land
 - Buildings
 - Plant and Equipment
 - Furniture and Fixtures
 - Vehicles
 - Office Equipment
 - Others (specify nature)
2. Assets Under Lease
Assets under lease should be specified separately under each asset class.
3. Reconciliation of Asset Values
Provide reconciliation of gross and net carrying amounts for each asset class, detailing:
 - Additions
 - Disposals
 - Business combination acquisitions
 - Revaluation changes (if 10% or more of net carrying value)
 - Other adjustments
 - Show related depreciation and impairment losses/reversals separately.

INTANGIBLE ASSETS

1. Asset Classification
 - Goodwill
 - Brands/Trademarks
 - Computer Software
 - Mastheads and Publishing Titles
 - Mining Rights
 - Copyrights, Patents, and Other Intellectual Property Rights
 - Recipes, Formulae, Models, Designs, and Prototypes
 - Licenses and Franchise
 - Others (specify nature)
2. Reconciliation of Asset Values
Provide reconciliation of gross and net carrying amounts for each asset class, detailing:
 - Additions



- Disposals
- Business combination acquisitions
- Revaluation changes (if 10% or more of net carrying value)
- Other adjustments
- Show related depreciation and impairment losses/reversals separately.

NON-CURRENT INVESTMENTS

1.	Non-current Investments Classification Trade investments and other investments further classified as: ✓ Investment Property ✓ Equity Instruments ✓ Preference Shares ✓ Government or Trust Securities ✓ Debentures or Bonds ✓ Mutual Funds ✓ Partnership Firms ✓ Other Non-current Investments (specify nature)
2.	For Investments in a Corporate Body ✓ Name of the Company or Entity ✓ Relationship Type (Subsidiary, Associate, Joint Venture) ✓ Nature and Amount of the Investment in Each Company ✓ Separate details for Partly Paid Investments
3.	For Investments in Partnership Firms ✓ Name of the Firm ✓ Names of All Partners ✓ Total Capital of the Firm ✓ Each Partner's Share in the Capital
4.	Investments Carried at Other Than Cost ✓ Basis for Valuation
5.	Additional Disclosures ✓ Aggregate Quoted Investments and Market Value thereof ✓ Aggregate Unquoted Investments ✓ Provision for Diminution in Value of Investments (Aggregate)

LONG-TERM LOANS AND ADVANCES

1.	Classification ✓ Capital Advances ✓ Loans and Advances to Related Parties ✓ Other Loans and Advances (specify nature)
2.	Sub-classification of Loans and Advances ✓ Secured, Considered Good ✓ Unsecured, Considered Good



	✓ Doubtful
3.	Allowance for Bad and Doubtful Loans ✓ Allowance for Bad and Doubtful Loans and advances should be disclosed separately under the relevant heads.
4.	Loans or Advances Owed by Directors or Officers ✓ Loans or Advances owed by Directors or Other Officers (whether individually or jointly with others) should be listed separately. ✓ Amounts Due from Firms or Private Companies in which a director is a partner, director, or member should also be shown separately.

OTHER NON-CURRENT ASSETS

1.	Classification 1. Long Term Trade Receivables (including receivables on deferred credit terms) 2. Security Deposits 3. Others (specify nature)
2.	Sub-classification of Long-term Trade Receivables ✓ Secured, Considered Good ✓ Unsecured, Considered Good ✓ Doubtful
3.	Allowance for Bad and Doubtful Debts Allowance for Bad and Doubtful Debts should be disclosed separately under the relevant heads.
4.	Debts Owed by Directors or Officers ➤ Debts Owed by Directors or Other Officers (whether individually or jointly with others) should be listed separately. ➤ Debts Owed by Firms or Private Companies in which a director is a partner, director, or member should be shown separately.

CURRENT INVESTMENTS

1.	Investments Classify as: a. Equity Instruments b. Preference Shares c. Government/Trust Securities d. Debentures/Bonds e. Mutual Funds f. Partnership Firms g. Other Investments ✓ Name of company, type (subsidiary/associate/joint venture), nature & amount of investment ✓ Separate details if investment is partly paid ✓ Basis of Valuation
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- ✓ Quoted Investments: Amount & market value
- ✓ Unquoted Investments: Total amount
- ✓ Provision for Diminution: Amount for depreciation or loss of value
- ✓ Partnership Firm Investments: Firm name, partners' names, total capital, and each partner's share in capital

INVENTORIES

1.	Classify as: a. Raw Materials b. Work-in-Progress c. Finished Goods d. Stock-in-Trade- Goods acquired for trading e. Stores and Spares f. Loose Tools g. Others Specify nature of the items
2.	Goods-in-Transit To be disclosed under the relevant sub-head of inventories.
3.	Mode of Valuation State the valuation method used for inventories.

TRADE RECEIVABLES

Trade Receivables ageing schedule

(Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment#					Total
	Less than 6 months	6 months -1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables - considered good						
(ii) Undisputed Trade Receivables - considered Doubtful						
(iii) Disputed Trade Receivables considered good						
(iv) Disputed Trade Receivables considered doubtful						

CASH AND CASH EQUIVALENTS

1.	Classify as: a. Balances with Banks b. Cheques, Drafts on Hand c. Cash on Hand d. Others Specify the nature of other cash equivalents.
2.	Earmarked Balances with Banks Separate Statement for earmarked balances (e.g., for unpaid dividend).
3.	Balances Held as Margin Money/Security Separate Disclosure for balances held as margin money or security against borrowings, guarantees, etc.
4.	Repatriation Restrictions Separate Statement for any repatriation restrictions on cash and bank balances.
5.	Bank Deposits with > 12 Months Maturity Separate Disclosure for bank deposits with maturity greater than 12 months.

SHORT-TERM LOANS AND ADVANCES

1.	Classify as: a. Loans and Advances to Related Parties b. Others Specify the nature of other loans and advances.
2.	Sub-classification of Loans and Advances a. Secured, Considered Good b. Unsecured, Considered Good c. Doubtful
3.	Allowance for Bad and Doubtful Loans/Advances Disclose the allowance for bad and doubtful loans and advances separately under the relevant heads.
4.	Loans/Advances Owed by Directors/Officers List separately loans or advances owed by directors or officers, whether owed alone or jointly.
5.	Loans/Advances Owed by Firms/Private Companies List separately loans or advances owed by firms or private companies where a director is a partner, director, or member.

OTHER CURRENT ASSETS (SPECIFY NATURE).

	All-Inclusive Heading for Current Assets Includes current assets that do not fit into any other specific asset categories.
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CONTINGENT LIABILITIES AND COMMITMENTS (TO THE EXTENT NOT PROVIDED FOR)

1.	Contingent Liabilities Classify as: a. Claims Against the Company Not Acknowledged as Debt b. Guarantees c. Other Money for Which the Company is Contingently Liable
2.	Commitments Classify as: ✓ Estimated Amount of Contracts on Capital Account remaining to be executed and not provided for. ✓ Uncalled Liability on Partly Paid Shares For shares and other investments partly paid. ✓ Other Commitments specify the nature of other commitments.

PART II -STATEMENT OF PROFIT AND LOSS

Name of the Company.....

Profit and loss statement for the year ended

(Rupees in)

Particulars		Note No.	Figures for the current reporting period		Figures for the previous reporting period	
1		2	3		4	
I.	Revenue from operations		xxx		xxx	
II.	Other income		xxx		xxx	
III.	Total Income (I + II)		xxx		xxx	
IV.	Expenses:		xxx		xxx	
	Cost of materials consumed		xxx		xxx	
	Purchases of Stock-in-Trade		xxx		xxx	
	Changes in inventories of finished goods work-in-progress and Stock-in-Trade		xxx		xxx	
	Employee benefits expense		xxx		xxx	
	Finance costs		xxx		xxx	
	Depreciation and amortization expense		xxx		xxx	
	Other expenses		xxx		xxx	
	Total expenses		xxx		xxx	
V.	Profit before exceptional and extraordinary items and tax (III-IV)		xxx		xxx	
VI.	Exceptional items		xxx		xxx	
VII.	Profit before extraordinary items and tax		xxx		xxx	



	(V - VI)				
VIII.	Extraordinary Items	xxx		xxx	
IX.	Profit before tax (VII- VIII)	xxx		xxx	
X	Tax expense:				
	(1) Current tax	xxx		xxx	
	(2) Deferred tax	xxx	xxx	xxx	xxx
XI	Profit (Loss) for the period from continuing operations (VII-VIII)	xxx		xxx	
XII	Profit/(loss) from discontinuing operations	xxx		xxx	
XIII	Tax expense of discontinuing operations	xxx		xxx	
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)	xxx		xxx	
XV	Profit (Loss) for the period (XI + XIV)	xxx		xxx	
XVI	Earnings per equity share:				
	(1) Basic	xxx		xxx	
	(2) Diluted	xxx		xxx	

GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS

- Revenue from Operations
Non-Finance Companies:
 - Sale of Products
 - Sale of Services
 - Grants or Donations (For Section 8 companies)
 - Other Operating Revenues
 Less:
Excise Duty
Finance Companies
 - Interest Income
 - Other Financial Services

Finance Costs

1.	Interest Expense
2.	Other Borrowing Costs
3.	Net Gain/Loss on Foreign Currency Transactions

Other income

1.	Interest Income For companies other than a finance company.
2.	Dividend Income
3.	Net Gain/Loss on Sale of Investments



4. Other Non-Operating Income

Additional Information-important points

1.	Significant Income/Expense Items Any item exceeding 1% of revenue or Rs. 1,00,000. Disclose it separately.
2.	Payments to Auditor Breakdown of payments for various auditor services.
3.	CSR Expenditure Amount spent on corporate social responsibility activities (for Section 135 companies).
4.	Exceptional and Extraordinary Items Details of any exceptional and extraordinary items.
5.	Prior Period Items Adjustments for past periods.
6.	Inventory and Purchases Detailed breakdown for manufacturing, trading, and service companies.
7.	Work-in-Progress Breakdown of works-in-progress.
8.	Major Expenditure Items Breakdown of expenses on stores, power, fuel, rent, repairs, insurance, rates, taxes, and miscellaneous expenses.
9.	Subsidiary Companies Dividends received and provisions for losses from subsidiary companies.
10.	Cryptocurrency or Virtual Currency For companies trading or investing in cryptocurrency or virtual currency: - Profit or Loss from Cryptocurrency Transactions - Amount of Cryptocurrency Held on Reporting Date - Deposits or Advances Received for Cryptocurrency

Practical Questions Related to Schedule-III

- In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of Rs. 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment.

Solution:

Schedule III has come into force for the Balance Sheet and Profit and Loss Account prepared for the financial year commencing on or after 1st April, 20X1. As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 20X2 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. **Schedule III does not require a company to disclose the source from which bonus shares have been issued.**



Therefore, non-disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

2. The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III.

Solution:

Schedule III to the companies Act does not require that the amounts of WIP at the beginning and at the end of the accounting period to be disclosed in the statement of profit and loss. Only changes in inventories of WIP need to be disclosed in the statement of profit and loss. Non-disclosure of such change in the statement of profit and loss by the company may not amount to violation of Schedule III if the differences between opening and closing WIP are not material.

3. Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 20X1:

Particulars	Amount Rs. in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of Rs. 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013.

Solution:

Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) should be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, should be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceed the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus, the presentation by the company is incorrect.

4. Sumedha Ltd. took a loan from bank for Rs. 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20X1 of Rs. 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III.

**Solution:**

In the given case, instalments due on 30.09.20X1 and 31.03.20X2 will be shown under the head 'short term borrowings' as current maturities of loan from bank as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Therefore, in the balance sheet as on 31.3.20X1, Rs. 8,00,000 (Rs. 1,00,000 × 8 instalments) will be shown under the heading 'Long term Borrowings' and Rs. 2,00,000 (Rs. 1,00,000 × 2 instalments) will be shown under the heading 'short term borrowings'.

5. Prince Ltd. presents its provisions for contingencies under "Reserves and Surplus" in Notes to Accounts in its financial statements. Whether this presentation is correct?

Solution:

The ICAI's Glossary of Terms Used in Financial Statements defines the term 'Reserve' as "the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability." 'Reserves' should be distinguished from 'provisions'. For this purpose, reference may be made to the definition of the expression 'Provision' in AS-29 Provisions, Contingent Liabilities and Contingent Assets. As per AS-29, a 'Provision' is "a liability which can be measured only by using a substantial degree of estimation". A 'liability' is "a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits." 'Present obligation' - "an obligation is a present obligation if, based on the evidence available, its existence at the Balance Sheet date is considered probable, i.e., more likely than not."

6. Anek Ltd. is a company that is required to present its financial statements as per the Division I of Schedule III. The company has trade receivables at the balance sheet date. What are the disclosures that are applicable with respect to trade receivables in the financial statements?

Solution:

Under Schedule III, trade receivables are required to be classified into long-term (non-current) trade receivables and short-term (current) trade receivables. Trade Receivables, shall be sub-classified as:

- i.
 - a. Secured, considered good.
 - b. Unsecured considered good.
 - c. Doubtful
- ii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- iii. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.



For trade receivables outstanding, following ageing schedule shall be given:

Particulars	Outstanding for following periods from due date of payment#					Total
	Less than 6 months	6 months - 1 year	1-2 years	2-3 years	More than 3 years	
i. Undisputed Trade Receivables - considered good						
ii. Undisputed Trade Receivables - considered doubtful						
iii. Disputed Trade Receivables - considered good						
iv. Disputed Trade Receivables - considered doubtful						



DISTRIBUTABLE PROFIT

1.	Meaning of Dividend ✓ Dividend is the distribution of a company's profits among its members (shareholders). ✓ A distribution may or may not involve giving away assets. ✓ Interim Dividend is included under "dividend".
2.	Section 123 of the Companies Act A company can declare or pay dividends only from: 1. Current Year's Profits - After providing for depreciation as per Section 123(2). 2. Past Profits - Undistributed profits from previous years, after providing for depreciation. 3. Both Current and Past Profits - A combination of both sources. 4. Government Funds - If the Central or State Government provides funds under a guarantee. Note: No dividend should be declared or paid by a company from its reserves other than free reserves.
3.	Section 124 - Interim Dividend ✓ Board of Directors can declare an interim dividend based on surplus profits. ✓ If there are losses in previous quarters, the interim dividend must not exceed the average dividend declared in the last three years. ✓ capital cannot be returned as a dividend.
4.	Depreciation Depreciation must be provided as per Schedule II of the Companies Act, 2013.
5.	Declaration and Payment of Dividend ✓ Dividends can be declared from accumulated profits from previous years if there are inadequate/no profits in the current year.



	subject to the fulfilment of the following conditions as per Companies (Declaration and Payment of Dividend) Rules, 2014: ✓ Dividend rate cannot exceed the average of the last three years' rates. ✓ Total amount to be drawn from accumulated profits should not exceed one-tenth of paid-up capital and free reserves. ✓ The balance of Reserves after such withdrawal must not fall below 15% of paid-up capital. ✓ The amount so drawn should first be utilised to set off the losses incurred in FY before equity dividends are declared. ✓ The company must set off the lower of past losses or unprovided depreciation against the current year's profit before declaring a dividend.
6.	The Board of Directors can transfer a portion of profits to reserves as per Section 123(1) of the Companies Act, 2013.
7.	Dividend on Partly Paid Shares A company may if authorised by its Article, pay a dividend in proportion to the amount paid on each share.
8.	Calls in Advance Calls in advance do not qualify for dividends.
9.	➤ Unpaid dividends must be transferred to the Unpaid Dividend Account within 7 days after 30 days of non-payment. ➤ Details of unpaid dividends must be published on the company's website and a government-approved platform within 90 days. ➤ Failure to transfer unpaid dividends attracts 12% interest per annum, benefiting shareholders. ➤ Shareholders can claim unpaid dividends from the Unpaid Dividend Account. ➤ Dividends unclaimed for 7 years must be transferred to the Investor Education and Protection Fund (IEPF). ➤ Shares linked to unclaimed dividends must also be transferred to IEPF. ➤ Penalties: Company - ₹5 lakh to ₹25 lakh, Officers - ₹1 lakh to ₹5 lakh



2. CASH FLOW STATEMENTS (AS-3)



1. Introduction

1.	Cash Flow Statement (CFS) ➤ CFS is an additional information that shows the sources (inflows) and uses (outflows) of cash by an enterprise during the accounting year. ➤ The CFS shows the changes in cash and cash equivalents by categorizing them into operating, investing, and financing activities.
2.	Purpose The information helps in evaluating a company's liquidity, earnings quality, and solvency, which aids in making decisions based on timing and certainty of cash generation.
3.	AS-3 Requirement AS-3 is mandatory for non-SMCs and Level I non-corporate entities at the end of the accounting period but is optional for others, though encouraged.
4.	Exemptions One Person Company, small company, dormant company, and private companies (start-ups) do not need to include the cash flow statement in their financials.
5.	Changes in Eligibility ✓ If a company wasn't required to prepare the cash flow statement in the previous year but qualifies this year, no need to show previous year's data. ✓ If a company was required previously but no longer qualifies, they must continue preparing the statement for two consecutive years.



2. Benefits/Uses of CFS

1.	Purpose of CFS Helps users: ➤ Identify the historical changes in the flow of cash and cash equivalents. ➤ Determine future requirements for cash and cash equivalents. ➤ Assess the ability of the enterprise to generate cash and cash equivalents. ➤ Estimate further needs for generating cash and cash equivalents. ➤ Compare the operational efficiency of different enterprises. ➤ Study the insolvency and liquidity position of the enterprise. ➤ Act as an indicator for the amount, timing, and certainty of future cash flows. ➤ Check the accuracy of past assessments of future cash flows. ➤ Examine the relationship between profitability and net cash flow, and the impact of changing prices. ➤ A very useful planning tool for businesses.
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3. Meaning of Terms Used In CFS

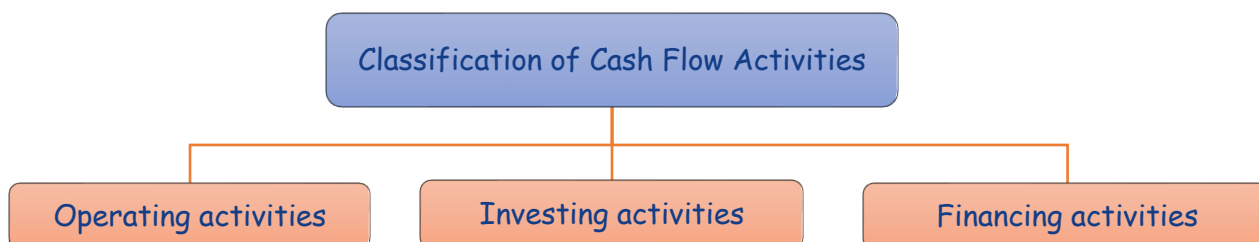
1.	Cash Cash includes:
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	✓ Cash in hand. ✓ Demand deposits with banks or other financial institution.
2.	Cash Equivalents Cash equivalents are: ➤ Short-term, highly liquid investments that are readily convertible into known amounts of cash & ➤ Are subject to insignificant risk of change in value. Short-term investments: Investments due for maturity within three months of acquisition. Note: Investments in shares are not cash equivalent, because of uncertainties associated with them as to realisable value.
3.	CFS Exclusion ➤ Cash flows are the inflows and outflows of cash and cash equivalents ➤ Any transaction which does not result in cash flow should not be reported in the CFS. ➤ Movements between cash or cash equivalents are not cashflows. e.g., cash deposited into bank are not cashflows.



4. Classification of Cashflow Activities



<u>Operating Activities:</u>	
1.	Principal Revenue-Generating Activities ✓ These are the principal revenue-generating activities of the enterprise.
2.	Other Activities ✓ Other activities that are not investing or financing activities.



Cash flows arising from operating activities

Key indicator of the extent to which the operations of the entity have generated sufficient cash flows to

- repay loans
- maintain the operating capability of the entity
- pay dividends
- make new investments without recourse to external sources of financing

Primarily derived from the principal revenue-producing activities of the entity

Generally result from the transactions and other events that have role in the determination of net profit or loss

Example

Cash from sales of goods and services.
Cash from royalties, fees, commissions, and other income.
Cash paid to suppliers for goods and services.
Cash paid to and for employees.
Cash from insurance premiums, claims, annuities, and other policy benefits.
Cash paid or refunded for income taxes, unless linked to investing or financing.
Cash from futures, forwards, options, and swaps for trading purposes.
Cash from buying and selling securities held for trading.
Cash advances and loans provided by financial institutions as part of their core business.

Investing activities

1. Acquisition and Disposal of Assets

The investing activities are the acquisition and disposal of long-term assets & other investments that are not considered cash equivalents.



Cash flows arising from investing activities

Represent the extent to which expenditures have been made for resources intended to generate future income and cash flows

Examples

Cash payments to acquire fixed assets, including intangibles and self-constructed or capitalized R&D assets.

Cash received from selling property, equipment, intangibles, and long-term assets.

Cash paid to acquire equity, debt instruments, or interests in joint ventures (excluding cash equivalents or trading instruments).

Cash received from selling equity, debt instruments, or interests in joint ventures (excluding cash equivalents or trading instruments).

Cash paid to give loans or advances to others (excluding financial institutions).

Cash received from loan or advance repayments (excluding financial institutions).

Cash paid for futures, forwards, options, and swaps (except when held for trading or financing).

Cash received from futures, forwards, options, and swaps (except when held for trading or financing).

Financing activities

1. Changes in Owner's Capital and Borrowings

Activities that result in changes in the size & composition of the owner's capital (including preference share capital) and the borrowings of the enterprise.

Cash flows arising from financing activities

useful in predicting claims on future cash flows by providers of capital to the entity

Examples

Cash received from issuing shares or other equity instruments.

Cash paid to owners to acquire or redeem the entity's shares.

Cash received from issuing debentures, loans, notes, bonds, mortgages, or other borrowings.

Cash repaid on borrowed amounts.

Cash paid by a lessee to reduce the outstanding liability on a finance lease.



5. Some Special Items

Loans/Advances given and Interests earned

Particulars	Non-Financing Entity	Financing Entity
Loans and advances given and interests earned on them in the ordinary course of business	-	Operating Cash Flows
Loans and advances given and interests earned on them	Investing Cash Flows	-
Loans and advances given to subsidiaries and interests earned on them	Investing Cash Flows	Investing Cash Flows
Loans and advances given to employees and interests earned on them	Operating Cash Flows	Operating Cash Flows
Advance payments to suppliers and interests earned on them	Operating Cash Flows	Operating Cash Flows
Interests earned from customers for late payments	Operating Cash Flows	Operating Cash Flows

Loans/Advances taken and interests paid

Particulars	Non-Financing Entity	Financing Entity
Loans and advances taken and interests paid on them in the ordinary course of business.	-	Operating Cash Flows
Loans and advances taken and interests paid on them	Financing Cash Flows	-
Loans and advances taken from subsidiaries and interests paid on them	Financing Cash Flows	Financing Cash Flows
Advance taken from customers and interests paid on them	Operating Cash Flows	-
Interests paid to suppliers for late payments	Operating Cash Flows	Operating Cash Flows
Interests taken as part of inventory costs in accordance with AS 16	Operating Cash Flows	-

Investments made and dividends earned

Particulars	Non-Financing Entity	Financing Entity
Investments made and dividends earned on them in the ordinary course of business	-	Operating Cash Flows
Investments made and dividends earned on them	Investing Cash Flows	-



Investments in subsidiaries and dividends earned on them	Investing Cash Flows	Investing Cash Flows
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Dividends Paid

Dividends paid are considered financing cash outflows for all enterprises.

Income Tax

If segregation of income tax is possible, classify it accordingly.

If segregation is not available, classify it under operating activity.

Insurance claims received

Particulars	Classification
Insurance claims received against loss of stock or loss of profits	Operating Cash Inflows
Insurance claims received against loss of fixed assets	Investing Cash Inflows

Extra-ordinary Items:

AS-3 requires the separate disclosure of extraordinary cash flows, classifying them as cash flows from operating, investing, or financing activities, as appropriate.



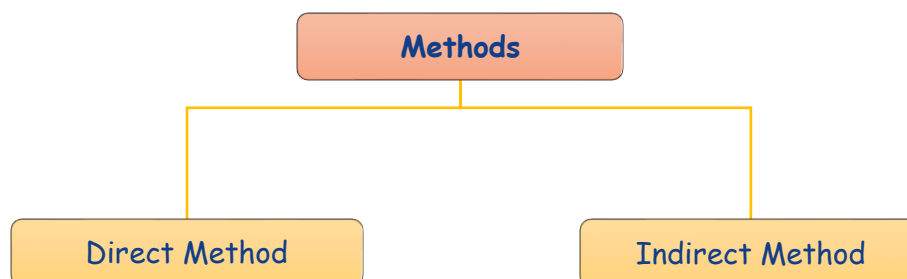
6. Presentation of CFS

Cash Flow Statement (Main heads only)

Category	Amount
(A) Cash flows from operating activities	XXX
(B) Cash flows from investing activities	XXX
(C) Cash flows from financing activities	XXX
Net increase (decrease) in cash and cash equivalents (A + B + C)	XXX
+ Cash and cash equivalents at the beginning	XXX
= Cash and cash equivalents at the end	XXX

Calculation of Cash Flows from Operating Activities

- An enterprise can determine cash flows from operating activities using either:



Direct Method

1.	Direct Method In 'Direct method' we take the
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	Gross receipts from sales, trade receivables and other operating inflows (-) Gross payments for purchases, creditors and other expenses &										
2.	Accrual to Cash ✓ Accrual basis is used in the statement of profit and loss. ✓ To convert it to cash basis, adjustments are made, such as: <table> <tr> <th>Item</th><th>Calculation</th></tr> <tr> <td>Cash receipts from customers</td><td>Revenue from operations + Opening trade receivables - Closing trade receivables.</td></tr> <tr> <td>Cash payments to suppliers</td><td>Purchases + Opening trade payables - Closing trade payables</td></tr> <tr> <td>Purchases</td><td>Cost of revenue from operations - Opening inventory + Closing inventory</td></tr> <tr> <td>Cash expenses</td><td>Expenses on an accrual basis + Opening prepaid expenses + Closing outstanding expenses - Closing prepaid expenses + Opening outstanding expenses.</td></tr> </table>	Item	Calculation	Cash receipts from customers	Revenue from operations + Opening trade receivables - Closing trade receivables.	Cash payments to suppliers	Purchases + Opening trade payables - Closing trade payables	Purchases	Cost of revenue from operations - Opening inventory + Closing inventory	Cash expenses	Expenses on an accrual basis + Opening prepaid expenses + Closing outstanding expenses - Closing prepaid expenses + Opening outstanding expenses.
Item	Calculation										
Cash receipts from customers	Revenue from operations + Opening trade receivables - Closing trade receivables.										
Cash payments to suppliers	Purchases + Opening trade payables - Closing trade payables										
Purchases	Cost of revenue from operations - Opening inventory + Closing inventory										
Cash expenses	Expenses on an accrual basis + Opening prepaid expenses + Closing outstanding expenses - Closing prepaid expenses + Opening outstanding expenses.										

	Exclusions
1.	Non-cash items ✓ Items like depreciation, discount on shares, etc., should be written off.
2.	Investing or Financing activities ✓ Items like interest received, dividend paid, etc., are classified as investing or financing activities and should not be considered.

Format for Cash Flow Statement (Illustrative):

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	xxx	
Cash received from Trade receivables	xxx	
Cash received from sale of services	xxx	xxx
Less: Payment for Cash Purchases	xxx	
Payment to Trade payables	xxx	
Payment for Operating Expenses (e.g. power, rent, electricity)	xxx	
Payment for wages & salaries	xxx	
Payment for Income Tax	xxx	xxx
Adjustment for Extraordinary Items		xxx
Net Cash Flow from Operating Activities		xxx



Indirect Method

Cash Flows from Operating Activities (Indirect Method)

Item	Amount
Net Profit/Loss before Tax and Extraordinary Items	XXX
+ Deductions already made in Statement of Profit and Loss on account of non-cash items such as Depreciation, Goodwill to be Written-off.	XXX
+ Non-operating items such as Interest.	XXX
- Additions (incomes) made in Statement of Profit and Loss on Account of Non-operating items such as Dividend received, Profit on sale of Fixed Assets.	XXX
Operating Profit before Working Capital changes	XXX
+ Decrease in Current assets	XXX
- Increase in Current assets	XXX
- Decrease in Current Liabilities	XXX
+ Increase in Current Liabilities	XXX
Cash Flows from Operating Activities before Tax and Extraordinary Items	XXX
- Income Tax Paid	XXX
+/- Effects of Extraordinary Items	XXX
Net Cash from Operating Activities	XXX

	Adjustment Description
1.	Non-cash items ✓ Items like depreciation, goodwill written-off, provisions etc., are added back.
2.	Investing/Financing activities ✓ Investing and financing incomes are deducted from net profit. ✓ Investing expenses are added back. Example: Finance cost (financing cash outflow) is added back, while interest received (investing cash inflow) is deducted.
3.	Changes in current assets and liabilities ✓ Increase in current assets and decrease in current liabilities are deducted. ✓ Increase in current liabilities and decrease in current assets are added back.
4.	Use of indirect method ✓ Indirect method is mostly used by companies to determine net cash flow from operating activities.



7. Other Points:

1.	Reporting cash flow on net basis a. Netting Prohibited ✓ AS 3 prohibits netting cash flows from investing and financing activities. Cash paid for asset purchases and cash received from asset sales must be shown separately. ✓ Example: Rs. 50,000 spent on machinery and Rs. 10,000 received from furniture disposal should not be netted as Rs. 40,000. b. Exceptions to Netting Rule Net reporting allowed for: ➤ Cash receipts & payments on behalf of customers e.g. cash received and paid by a bank against acceptances and repayment of demand deposits. ➤ High-turnover, large-value, short-maturity items e.g. purchase and sale of investments by an investment company. c. Financial Enterprises ✓ Financial enterprises can report cash flows on a net basis for: ▪ Acceptance and repayment of fixed deposits with a fixed maturity date. ▪ Placement and withdrawal of deposits with other financial enterprises. ▪ Loans/advances to customers and repayments received.
2.	Business Purchase When a company buys or sells a subsidiary or business unit, the related cash flows must be shown separately under investing activities in the cash flow statement. No Netting Off: Cash received from sales and cash paid for purchases should be reported separately, not combined. Disclosures The company must disclose, for both purchases and sales of subsidiaries/business units: • Total purchase or sale price • How much was paid/received in cash & cash equivalents Treatment of current assets and liabilities taken over on business purchase ➤ Business purchase is not operating activity. ➤ while taking the differences between closing and opening current assets and liabilities for computation of operating cash flows, the closing balances should be reduced by the values of current assets and liabilities taken over. ➤ This ensures that the differences reflect the increases/decreases in current assets and liabilities due to operating activities only.



3. Exchange Gains & Losses

- Foreign currency monetary items (e.g., bank balances, debtors, creditors) are revalued at the balance sheet date using the exchange rate on that date, and the resulting exchange gain/loss is recognized in the profit & loss statement.
- Exchange gains/losses on cash and cash equivalents are not considered cash flows, so cash flow statements exclude them, and a reconciliation note explains the difference.



3. BUY-BACK OF SECURITIES



1. Meaning of Buy Back

1. **Buy-back of shares**
 - ✓ Purchase of own shares with an intension of cancellation is called as buy back of shares.
 - ✓ No company is allowed for buyback of its own shares unless there is a consequent reduction of share capital.
2. **Investment option**
Buy back is Not an investment option, but a company with sufficient cash may choose to buy-back shares.



2. Objectives / Advantages of Buy-Back of Shares

1. Increase EPS if there is no dilution in the company's earnings.
2. Increase promoters' holding by cancelling bought-back shares.
3. Discourage hostile bid to take over the company by increasing promoters' holding.
4. Support share price when management believes it's undervalued, especially in a depressed market.
5. Pay surplus cash to shareholders when it's not needed for business.



3. Sources of Buyback (S.68)

1. Free reserves or
2. Securities premium account or
3. Proceeds of issue of any shares or other specified securities
4. **Note**
 - No buy-back of shares or securities can be made from the proceeds of an earlier issue of the same type of shares or securities.
For example, equity shares cannot be bought back using proceeds of equity shares.
 - Specified securities include employees' stock options and other securities as notified by the CG.
 - **Free Reserves**
Free reserves are reserves available for distribution as dividends, as per the latest audited balance sheet, excluding:
 - a. Unrealized gains, notional gains, or asset revaluation, even if shown as reserves.
 - b. Changes in the carrying amount of assets or liabilities recognized in equity, including profit and loss account surpluses from fair value measurements.



4. Limits for Buyback (S.68)

1. **Resource Test**
Buy-back should not exceed 25% of the total paid-up capital and free reserves of the company.



2. **Share Outstanding Test**
Buy-back of equity shares in any financial year should not exceed 25% of total paid-up equity share capital of that year.
 3. **Debt-Equity Ratio Test**
The debt (both secured and unsecured) after buy-back should not exceed 2 times the total of paid-up capital and free reserves.
- Maximum no. of shares to be bought back = Least of the above tests



5. Other Legal Provisions

1. Buy-back must be authorized by the company's articles.
2. A special resolution is required, unless the buy-back is 10% or less of paid-up equity and free reserves, then board approval is enough.
3. Only fully paid-up shares or securities can be bought back.
4. Shares or securities listed on a recognized stock exchange must comply with SEBI regulations.
5. Buy-back must be completed within 12 months of passing the special resolution or board resolution.
6. Buy-back can be conducted:
 - ✓ Proportionately from existing shareholders.
 - ✓ From the open market.
 - ✓ Securities issued to employees under stock options or sweat equity.
7. A declaration of solvency must be filed with the Registrar and SEBI before the buy-back, signed by at least two directors (including managing director).
8. Bought-back securities must be extinguished and physically destroyed within 7 days of completion.
9. No further issuance of the same kind of shares for 6 months post-buy-back, except for bonus issues or fulfilling existing obligations (e.g., stock options).
10. A return with details of the buy-back must be filed with the Registrar and SEBI within 30 days of completion.
11. Fines of ₹1 lakh to ₹3 lakhs for non-compliance. Officers in default may face imprisonment for up to 3 years or fines, or both.



6. CRR (S.69)

1. When a company buys back shares using free reserves or securities premium, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account, which is disclosed in the Balance Sheet.
2. The Capital Redemption Reserve can be used to issue fully paid bonus shares.
3. **Buy-back Premium Adjustment**
 - ✓ The buy-back premium (excess over par value) must be adjusted against free reserves or securities premium account.
 - ✓ Revaluation reserves cannot be used for buybacks.



7. Accounting Entries of Buy Back

Transaction	Journal Entry
1. If existing shares are partly called and paid	Equity share final call A/c Dr. To Equity share capital A/c Bank A/c Dr. To Equity Share final call A/c
2. Issue of New shares	Bank A/c Dr. To Preference share capital A/c To Securities Premium A/c
3. Sale of investments	Bank A/c Dr. P & L A/c (Loss) Dr. To Investment A/c To P & L A/c (Profit)
4. Amount due on Buyback on Equity Shares	Equity Share Capital A/c Dr. Premium on Buyback A/c Dr. To Equity Shareholders A/c
5. Sourcing / Providing for Premium payable on Buyback	Securities Premium A/c Dr. Profit and Loss A/c Dr. General Reserve A/c Dr. To Premium on Buyback A/c
6. Transferring Divisible Profit to Capital Redemption Reserve Account, to the extent of Nominal Value of Shares bought back	Profit and Loss A/c Dr. General Reserve / Revenue Reserves A/c Dr. Other Divisible Profits A/c Dr. (e.g. Dividend Equalisation Reserve) Dr. To Capital Redemption Reserve A/c
7. Payment to Equity Shareholders	Equity Shareholders A/c Dr. To Bank A/c



8. S. 70 of the CA, 2013

1.	Companies cannot buy back their own shares or specified securities: - Through subsidiary companies or investment companies. - It has outstanding defaults in repaying deposits, interest, debentures, preference shares, dividends, or term loans. - Even after clearing defaults, buyback is allowed only after three years.
2.	SEBI regulations state: A company cannot buy back 15% or more of its paid-up capital and free reserves from the open market.



- A new buyback offer cannot be made within one year of the previous buyback closure.
- At least 50% of the allocated funds must be used for the buyback.



4. AMALGAMATION OF COMPANIES (AS - 14)



1. Meaning of Important Terms

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and a new company is formed to take over their business. Example 1- Company A and Company B amalgamate to form Company C. Company A and Co B are called transferor companies and Company C is called as the transferee company- this strategy is called as AMALGAMATION.	In this case an existing company takes over the business of one or more existing companies. Example 2- Company A is taken over by Company B (purchased). Here, Company A is called as Transferor Company and Company B is Transferee Company. This strategy is called as ABSORPTION.	In this case, a newly formed company takes over the business of an existing company. Example 3- Company A has been suffering from losses for past 5 years, a new Company B is floated to take over the existing Company A. Here, Company A is the transferor company and Company B is Transferee Company. This strategy is termed as EXTERNAL RECONSTRUCTION.
Minimum number of Companies involved	At least three companies are involved.	At least two companies are involved.	Only two companies are involved.
Number of new resultant companies	Only one resultant company is formed.	No new resultant company is formed.	Only one resultant company is formed.
Objective	Amalgamation is done to cut competition & reap the economies in large scale.	Absorption is done to cut competition & reap the economies in large scale.	External reconstruction is done to reorganize the financial structure of the



company.



2. Types of Amalgamation

1.	Types of Amalgamation (AS-14) AS-14 defines two types of amalgamations: - Amalgamation in the nature of Merger - Amalgamation in the nature of Purchase
2.	Conditions for Amalgamation to be a Merger For an amalgamation to qualify as a merger, it must meet five conditions: Asset & Liability Transfer All assets and liabilities of the transferor company must become those of the transferee company. Shareholder Approval Shareholders holding not less than 90% of face value of the equity shares of the transferor company (excluding those owned by transferee or subsidiaries) must become equity shareholders of the transferee company. Consideration The consideration must be in the form of equity shares of the transferee company to those equity shareholders of the transferor company who agreed to become equity shareholders of the transferee company (except Cash can be paid for fractional shares). Business Continuity The business of the transferor company must continue under the transferee company. Book Value of Assets & Liabilities No changes should be made to the book value of assets and liabilities, except for consistent accounting policies (e.g., FIFO vs weighted average for inventory).
3.	Failure to Meet Conditions If one or more conditions are not met, the amalgamation is called amalgamation in the nature of purchase.

Difference between amalgamation in the nature of merger and amalgamation in the nature of purchase

Best of Distinction	Amalgamation in the Nature of Merger	Amalgamation in the Nature of Purchase
a. Transfer of Assets and Liabilities	All assets and liabilities are transferred.	Not all assets and liabilities need to be transferred.
b. Shareholders of transferor company	Equity shareholders holding 90% equity shares in transferor company become shareholders of transferee company.	Equity shareholders need not become shareholders of transferee company



c. Purchase Consideration	Purchase consideration is discharged wholly by issue of equity shares of transferee company (except cash only for fractional shares)	Purchase consideration need not be discharged wholly by issue of equity shares.
d. Same Business	The transferor's business continues under the transferee.	The transferor's business may or may not continue under the transferee.
e. Recording of Assets & Liabilities	The assets & liabilities taken over are recorded at their existing carrying amounts except where adjustment is required to ensure uniformity of accounting policies.	The assets & liabilities taken over are recorded at their existing carrying amounts or the basis of their fair values.
f. Method of Accounting	pooling of interest method	purchase method.



3. Purchase Consideration

1.	Purchase Consideration (PC) PC is the total value of shares, securities, cash, or other assets given by the transferee company to the transferor company's shareholders.								
2.	Payments Included ✓ Only payments made to equity and preference shareholders are included in PC. ✓ Payments to debenture holders or creditors are excluded.								
3.	Methods for Calculating PC Lumpsum Method The transferee company agrees to pay a lumpsum/fixed amount to the shareholders of the transferor company. Net Payment Method The transferee company makes individual payments to equity and preference shareholders (in cash, shares, or debentures). Aggregate all of those to arrive PC. Net Assets Method <table border="1"> <thead> <tr> <th>Particulars</th><th>Amount</th></tr> </thead> <tbody> <tr> <td>Agreed Value of Assets Taken Over</td><td>xxxx</td></tr> <tr> <td>Less: Agreed Value of Outside Liabilities Taken Over</td><td>xxxx</td></tr> <tr> <td>Net Assets Taken Over</td><td>xxxx</td></tr> </tbody> </table> Note: ➤ If there is no value agreed, then assets and liabilities taken at the book value.	Particulars	Amount	Agreed Value of Assets Taken Over	xxxx	Less: Agreed Value of Outside Liabilities Taken Over	xxxx	Net Assets Taken Over	xxxx
Particulars	Amount								
Agreed Value of Assets Taken Over	xxxx								
Less: Agreed Value of Outside Liabilities Taken Over	xxxx								
Net Assets Taken Over	xxxx								

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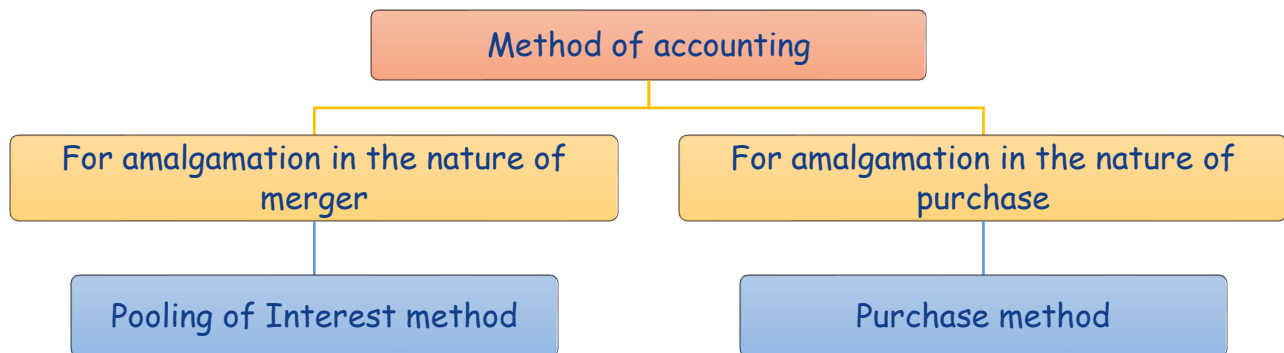
	Realization A/c Dr. xxx (Loss on Sale) To Asset A/c xxx (Book Value) To Realization A/c xxx (Profit on Sale)
6.	Discharge of Liabilities Not Taken Over Liabilities A/c Dr. xxx (Book Value/Payment) Realization A/c Dr. xxx (Loss on Payment) To Bank A/c xxx (Amount Paid) To Realization A/c xxx (Profit on Payment)
7.	Liquidation Expenses (a) Paid by Purchasing Company: No Entry (b) Paid by Selling Company: Realization A/c Dr. xxx To Bank A/c xxx (c) Reimbursed by Purchasing Company: Purchasing Company A/c Dr. xxx To Bank A/c xxx Bank A/c Dr. xxx To Purchasing Company A/c xxx
8.	Amount Payable to Preference Shareholders Pref. Share Capital A/c Dr. xxx (Paid Up) Realization A/c Dr. xxx (Excess Paid) To Pref. Shareholders A/c xxx (Amount Due) To Realization A/c xxx (Profit)
9.	Payment to Preference Shareholders Pref. Shareholders A/c Dr. xxx To Shares/Debentures in Purchasing Co. A/c xxx To Bank A/c xxx
10.	Closing Realization A/c (a) Profit: Realization A/c Dr. xxx To Equity Shareholder A/c xxx (b) Loss: Equity Shareholder A/c Dr. xxx To Realization A/c xxx
11.	Transferring Claims of Equity Shareholders Equity Share Capital A/c Dr. xxx Reserves & Surplus A/c Dr. xxx To Equity Shareholder A/c xxx
12.	Transferring Fictitious Assets & Losses Equity Shareholders A/c Dr. xxx To Preliminary Exp. A/c xxx To Disc. on Issue of Deb. A/c xxx To Profit & Loss A/c (Dr) xxx



13. Payment to Equity Shareholders

Equity Shareholders A/c Dr.	xxx	
To Shares in Purchasing Co. A/c		xxx
To Debentures in Purchasing Co. A/c	xxx	
To Bank A/c		xxx

In the books of transferee company:



Pooling of interest Method	Purchase Method																				
1. Due entry for business purchase <table> <tr> <td>Business purchase A/c</td><td>Dr.</td></tr> <tr> <td> To Liquidator of transferor company A/c</td><td></td></tr> </table>	Business purchase A/c	Dr.	To Liquidator of transferor company A/c		1. Due entry for business <table> <tr> <td>Business purchase A/c</td><td>Dr.</td></tr> <tr> <td> To Liquidator of transferor company A/c</td><td></td></tr> </table>	Business purchase A/c	Dr.	To Liquidator of transferor company A/c													
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2. Incorporation of assets and liabilities taken over <table> <tr> <td>Sundry Assets A/c (at Book Values) Dr.</td><td></td></tr> <tr> <td> To Sundry Liabilities A/c (at Book Values)</td><td></td></tr> <tr> <td> To Statutory Reserves of Selling Company A/c (if any)</td><td></td></tr> <tr> <td> To Reserves A/c (balancing figure, if any)</td><td></td></tr> <tr> <td> To Business Purchase A/c (Purchase Consideration)</td><td></td></tr> </table>	Sundry Assets A/c (at Book Values) Dr.		To Sundry Liabilities A/c (at Book Values)		To Statutory Reserves of Selling Company A/c (if any)		To Reserves A/c (balancing figure, if any)		To Business Purchase A/c (Purchase Consideration)		2. Incorporation of assets and liabilities taken over <table> <tr> <td>Assets A/c (Agreed Value)</td><td>Dr.</td></tr> <tr> <td>Goodwill A/c (balancing figure)</td><td>Dr.</td></tr> <tr> <td> To Liabilities A/c (Agreed values)</td><td></td></tr> <tr> <td> To Business Purchase A/c (Consideration)</td><td></td></tr> <tr> <td> To Capital reserve A/c (balancing figure)</td><td></td></tr> </table>	Assets A/c (Agreed Value)	Dr.	Goodwill A/c (balancing figure)	Dr.	To Liabilities A/c (Agreed values)		To Business Purchase A/c (Consideration)		To Capital reserve A/c (balancing figure)	
Sundry Assets A/c (at Book Values) Dr.																					
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To Liabilities A/c (Agreed values)																					
To Business Purchase A/c (Consideration)																					
To Capital reserve A/c (balancing figure)																					
Note: When Purchase Consideration > Share Capital of Selling Co. Excess consideration is adjusted against - (a) Free Reserves (incl. P & L) of Selling Co. (b) Free Reserves of Purchasing Co. and	Note: PC > Net Assets = Goodwill PC < Net Assets = Capital Reserve																				

(c) finally, against P & L A/c of Purchasing Co.
When Purchase Consideration < Share Capital
of Selling Co.
Shortfall in consideration is credited to
Capital Reserve A/c.

3. Discharge of Consideration

Liquidator of transferor company A/c Dr.

- To Share capital A/c
- To Securities premium A/c
- To Bank A/c (Fractional shares)

4. Cancellation of intercompany Owings

Creditors A/c	Dr.
To Debtors A/c	

5. Elimination of unrealised profits on goods sold by one company to the other and remaining unsold on the date of amalgamation

General Reserve / P & L A/c	Dr.
To Stock reserve / Stock A/c	

6. Liquidation /Realisation expenses

case 1: Incurred by purchasing company

General Reserve / P & L A/c	Dr.
To bank A/c	

case 2: Realisation expensed incurred by selling company

No Entry

case 3: Realisation expenses incurred by selling company but reimbursed by purchasing company

General Reserve / P & L A/c	Dr.
To Selling company A/c	
Selling Company A/c	Dr.
To Bank A/c	

Not applicable

3. Discharge of Consideration

Liquidator of transferor company A/c Dr.

- To Share capital A/c
- To Securities premium A/c
- To Bank A/c (Fractional shares)

4. Cancellation of intercompany Owings

Creditors A/c	Dr.
To Debtors A/c	

5. Elimination of unrealised profits on goods sold by one company to the other and remaining unsold on the date of amalgamation

Goodwill/ Capital reserve A/c	Dr.
To Stock reserve / Stock A/c	

6. Liquidation/ Realisation expenses

case 1: Incurred by purchasing company

Goodwill / Capital reserve A/c Dr.

To bank A/c

case 2: Realisation expensed incurred by selling company

No Entry

case 3: Realisation expenses incurred by selling company but reimbursed by purchasing company

Goodwill / Capital reserve A/c Dr.

To Selling company A/c

Selling Company A/c Dr.

To Bank A/c

7. incorporation of statutory reserves of selling company



Content

CA Sai Babu



5. INTERNAL RECONSTRUCTION



1. Meaning of Reconstruction

1. **Reconstruction**
A process where a company
 - revalue assets, reassesses liabilities, &
 - writes off past losses.
 - This may involve reducing share value or
 - modifying shareholder rights.
2. **Objective**
 - To reorganize capital or
 - settle with creditors,
 - helping the company recover without liquidation.
3. There may be external reconstruction which is covered in amalgamation chapter.

Difference Between Internal and External Reconstruction

Basis	Internal Reconstruction	External Reconstruction
Liquidation & New Company	No liquidation; capital and debt structure are reorganized.	Existing company is liquidated, and a new company is formed with the same shareholders.
Reduction of Capital & Rights	Capital may be reduced, and liabilities (e.g., debentures) may be adjusted.	No reduction of capital; fresh share capital is issued without altering shareholder rights.
Legal Position	Governed by Sections 61 & 66 of the Companies Act, 2013.	Governed by Section 232 of the Companies Act, 2013.
Legal Formalities	Requires court approval and legal procedures.	Less legal interference; no court approval needed.



2. Methods of Internal Reconstruction

1. **Alteration of Share Capital (Sec. 61)**
Modifying a company's share capital structure.
Types of Alteration
 - a. Increase in authorized capital
 - b. Subdivision of shares: when a company splits its existing shares into smaller denominations.
Consolidation of shares: is the opposite. It involves combining multiple smaller shares into a larger denomination.
Example: five ₹2 shares converted into one ₹10 share
Example: one ₹10 share split into two ₹5 shares
Why companies do this?
 - make shares more affordable



	➤ To increase liquidity ➤ To align with market trends c. Conversion of shares into stock or vice versa. d. Cancellation of unissued shares.
2.	Variation of Shareholders' Rights (Sec. 48) Companies can modify rights attached to different share classes (e.g., dividend rate, voting rights). Examples: Changing the dividend rate on preference shares. Converting cumulative preference shares to non-cumulative. Journal Entries: 1. Change in dividend rate - Debit: (Old)% Cumulative Preference Share Capital A/c - Credit: (New)% Cumulative Preference Share Capital A/c 2. Conversion to non-cumulative - Debit: % Cumulative Preference Share Capital A/c - Credit: % Non-Cumulative Preference Share Capital A/c
3.	Reduction of Share Capital (Sec. 66) As per S.66 of the Companies Act, 2013 reduction of share capital may be affected in one of the following ways: a. <u>When liability of the shareholders is extinguished or reduced in respect of unpaid amount on the shares held by them:</u> Here the shareholders are not called upon to pay the unpaid amount on shares held by them in future. For example, a company decides to reduce Rs. 10 per share, into Rs. 7.5 per share fully paid up, by cancelling the unpaid amount of Rs. 2.5 per share. The entry in this case would be - Share Capital (Partly Paid-Up) Account Dr. (Rs. 7.5 X No. of Shares) - To Share Capital (Fully Paid-up) Account (Rs. 7.5 X No. of Shares) b. <u>When excess paid up capital is paid off:</u> When it is not possible for the company to employ profitability of its paid-up capital, then in such case it may decide to refund the excess capital to its shareholders. For example, a company having fully paid-up share of Rs. 10 each, decides to pay-off Rs. 2 per share to make it of Rs. 8 fully paid-up, entries in that case would be - Share Capital Account (Rs. 10) Dr. (Rs. 10 X No. of Shares) - To Share Capital Account (Rs. 8) (Rs. 8 X No. of Shares) - To Sundry Shareholders Account (Rs. 2 X No. of Shares) - Sundry Shareholders Account Dr. (Rs. 2 X No. of Shares)



To Bank Account (Rs. 2 X No. of Shares)

c. When the paid-up capital which is lost or not represented is cancelled:

Reduction in paid up value only- Here the nominal value of the share remains the same and only the paid value is reduced.

For example, the shareholders may agree to reduce the paid capital of Rs. 100 per share to paid value of Rs. 10 per share. The sacrifice is Rs. 90 and the entry will be

Share Capital Account Dr. (Rs. 90 X No. of Shares)

To Capital Reduction Account (Rs. 90 X No. of Shares)

Reduction in both nominal and paid-up values- In this case, both the paid up capital and nominal value of the shares are reduced. Continuing the above example, the entry will be:

Share Capital Account (Rs. 100 Share) Dr. (Rs. 100 X No. of Shares)

To Share Capital (Rs. 10 Share) (Rs. 10 X No. of Shares)

To Capital Reduction Account (Rs. 90 X No. of Shares)

4. Compromise & Arrangements

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement therefore also involves sacrifices by shareholders, or creditors and debenture holders or by all.

Accounting treatment for some of the cases is as follows:

a) When equity shareholders give up their claim to reserves and accumulated profits:

Reserves Account Dr. (With the amount of reserves)
To Reconstruction Account

b) Settlement of outside liabilities at lesser amount: Liabilities such as sundry creditors may agree to accept less amount in lieu of final settlement.

Outside Liabilities Account Dr. (With the amount of sacrifice)
Provision Account, if any Dr. made by creditors, debenture holders etc.)
To Reconstruction Account

5. Surrender of Shares

➤ Surrender of shares occurs when shareholders voluntarily return their shares to the company.

➤ These surrendered shares may either be:

- Reissued to new or existing shareholders, or
- Cancelled to adjust against accumulated losses or liabilities.



Accounting Entries:

1. On surrender of shares:
Share Capital A/c Dr.
 To Share Surrendered A/c
2. On reissue of surrendered shares:
Share Surrendered A/c Dr.
 To Share Capital Account
3. on settlement of liability
Liabilities A/c Dr.
 To Capital Reduction A/c Dr. /Reconstruction A/c
4. On cancellation of surrendered shares:
Share Surrendered A/c Dr.
 To Capital Reduction A/c Dr. /Reconstruction A/c

6. Accounting Treatment
 - ✓ Equity shareholders forfeit claims on reserves: Adjusted via Reconstruction Account.
 - ✓ Liabilities settled at a lower amount: Creditors may agree to accept less in final settlement. The difference is transferred to the Reconstruction Account.



3. Entries in case of Internal Reconstruction

1. Reduction of Equity Share Capital
(Old) Equity Share Capital A/c → Dr.
 To (New) Equity Share Capital A/c
 To Capital Reduction A/c / Reconstruction A/c
2. Reduction of Preference Share Capital
(Old) Preference Share Capital A/c → Dr.
 To (New) Preference Share Capital A/c
 To Capital Reduction A/c / Reconstruction A/c
3. Reduction of Amount Due to Debenture Holders
Debenture Holders A/c → Dr.
 To Capital Reduction A/c / Reconstruction A/c
4. Reduction of Amount Due to Creditors
Creditors A/c → Dr.
 To Capital Reduction A/c / Reconstruction A/c
5. Appreciation in Asset Value
Assets A/c → Dr.
 To Capital Reduction A/c / Reconstruction A/c
6. Payment of Reconstruction Expenses
Reconstruction Expenses A/c → Dr.
 To Bank A/c
7. Utilization of Capital Reduction Account to Write Off Losses & Fictitious Assets



	Capital Reduction A/c / Reconstruction A/c → Dr. - To Profit & Loss A/c (losses) - To Preliminary Expenses - To Discount on Issue of Shares / Debentures - To Underwriting Commission - To Advertising Suspense A/c - To Reconstruction Expenses A/c - To Goodwill A/c - To Patents / Trademarks A/c - To Fixed Assets A/c (overvalued assets) - To Other Assets A/c - To Capital Reserves A/c (if balance remains)
8.	Balance Sheet Note The words "and Reduced" should be added after the company name only if ordered by the Court.



6. ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES



1. Introduction

1.	Branch An establishment that operates at a different location from the Head Office, carrying out the same or similar activities.
2.	Head Office Requirement A branch cannot exist without a Head Office, which is the principal place of business.
3.	Difference Between Branch & Department Branch Operates at a different location from the Head Office but performs the same or similar activities. Department A division within the same location handling different activities in a large organization.



2. Classification of Branches from Accounting Point of View

1.	Inland Branches Branches which are situated within the territories of a country. Inland branches are also known as home branches. They are further classified into Independent Branches Maintain their own independent accounting records. Dependent Branches All accounting records are maintained at the Head Office.
2.	Foreign Branches Foreign branches are the branches which are situated outside the country.



3. Dependent Branches

1.	Dependent Branch A branch fully controlled by the Head Office (H.O.), including business policies, administration, and accounts.
2.	Accounting All transactions related to the branch are recorded in the H.O. books, and the H.O. determines the branch's profit or loss.
3.	Branches maintain memorandum records like: - ➤ Stock Register ➤ Debtors Ledger ➤ Petty Cash Book ➤ Customers' Ledger



4. Types of Dependent Branches
- Order-Booking Branch**
Takes customer orders, but H.O. fulfils them.
 - Sales Branch**
Sells goods supplied by the H.O. and H.O. manages collections.
 - Retail Branch**
Directly sells goods to customers, supplied by the H.O.



4. Methods of Charging Goods to Branches

- At Cost**
Goods are sent to the branch at their actual cost price.
- At Selling Price**
Goods are invoiced at pre-determined selling prices.
- At Wholesale Price**
Goods are invoiced at the wholesale price, which is lower than the final selling price.
Used primarily for retail branches.



5. Accounting for Dependent Branches

Methods of Branch Accounting

If goods are sent at cost or at selling price

- Debtors Method
- Stock & Debtors Method
- Final Accounts Method

If goods send at whole sale price

- Wholesale Branch Method

A. Debtors Method

Suitable for Small Branches	➤ This method is used for small-sized branches. ➤ where the H.O. maintains a separate Branch Account. To determine the profit or loss of each branch.
Nature of Branch Account	The Branch Account is a nominal account, recording all transactions related to the branch.

Transaction	Journal Entry (In H.O. Books)
1. Opening Balances of Branch Assets	Branch A/c Dr. To Branch Opening Stock A/c To Branch Petty Cash A/c To Other Assets at Branch A/c
2. Opening Balances of Branch Liabilities	Branch Liabilities A/c Dr. To Branch A/c
3. Goods Sent to Branch	Branch A/c Dr.



	To Goods Sent to Branch A/c	
4. Cash/Draft Sent to Branch for Expenses	Branch A/c To Cash or Bank A/c	Dr.
5. Goods Returned by Branch to H.O.	Goods Sent to Branch A/c To Branch A/c	Dr.
6. Remittance from Branch (Cash Received from Branch)	Cash or Bank A/c Dr. To Branch A/c	
7. Goods Sold by Branch (Intimated to H.O.)	No Journal Entry	
8. Transfer of 'Goods Sent to Branch' to Trading/Purchases Account	Goods Sent to Branch A/c To Branch Trading (or Purchases) A/c	Dr.
9. Closing Balances of Branch Assets	Branch Stock A/c Branch Petty Cash A/c Branch Assets A/c (after depreciation) To Branch A/c	Dr. Dr. Dr.
10. Closing Liabilities of Branch	Branch A/c To Branch Creditors A/c To Branch Outstanding Expenses A/c	Dr.
11. Transfer of Branch Profit/Loss to H.O.	(A) For Profit: Branch A/c To Profit & Loss A/c (B) For Loss: Profit & Loss A/c To Branch A/c	Dr. Dr.

Proforma Branch Account

Particulars	Amount	Particulars	Amount
To Balance b/d (Assets in the beginning): Stock Petty Cash Debtors Furniture Prepaid Expenses To Goods sent to Branch A/c To Cash or Bank A/c (For Expenses) Salaries Rent Wages etc. To Balance of Branch Liability (if any)		By Balance b/d (Liabilities in the beginning) Creditors, Outstanding Expenses By Bank A/c (Remittances from the Branch) By Cash Sales By Cash received from debtors By Goods sent to Branch A/c (Goods returned by branch) By Balance c/d (Assets at the end) Stock Petty Cash Sundry Debtors	



To P & L A/c (if Profit)	Balancing figure	Prepaid Expenses Furniture By P & L (if Loss)	Balancing figure
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Example 1

XP Ltd opened a branch at Delhi and sent goods costing Rs.50,000 to Delhi branch. Delhi Branch sold entire goods on credit at Rs.62,000. No other transaction occurred at the branch. Prepare branch account in Head Office Books and find out the profit.

Solution:

We know that branch earned net profit of Rs.12,000, now see how same can be find out by branch account.

Branch Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening branch assets	Nil	By Closing branch assets	
To Goods sent to branch	50,000	Stock Nil	
To Net Profit	12,000	Debtor <u>62,000</u>	62,000
	62,000		62,000

Example 2

XP Ltd opened a new branch at Delhi. XP Ltd sent goods costing Rs.50,000 to Delhi branch. Delhi branch sold entire goods in cash at Rs.70,000. Branch paid expenses of Rs.8,000. No other transaction occurred at the branch. Prepare branch account in HO Books and find out the profit.

Solution:

We know that branch earned net profit of Rs.12,000 (i.e. Gross Profit Rs.20,000 less expenses of Rs.8,000), Let's see how same can be find out by branch account:

Branch Account

Particulars	Amount	Particulars	Amount
To Opening branch assets	Nil	By Closing branch assets	
		Stock Nil	
To Goods sent to branch	50,000	Debtor Nil	
To Net Profit transferred to General P&L A/c	12,000	Cash <u>62,000</u> (70,000 - 8,000)	62,000
	62,000		62,000

Example 3

Prepare branch account and find out profit earned by branch if transactions are as under:

Goods sent to branch	Rs.50,000
Furniture sent to branch	Rs.10,000 (at the beginning of year)
Credit sales at branch	Rs.62,000



Bad Debts	Rs.1,000
Other information:	
Closing stock at branch	Rs.10,000
Closing Debtor	Rs.61,000
Furniture (after depreciation@20%)	Rs.8,000

Solution:

Branch Account

Particulars	Amount	Particulars	Amount
To Opening branch assets- (Furniture)	10,000	By Closing branch assets- Stock	10,000
To Goods sent to branch	50,000	Debtor	61,000
To Net Profit transferred to General P & L A/c	19,000	Furniture	<u>8,000</u>
	79,000		79,000

Accounting for Goods Sent to Branch at Invoice Price

Procedure	The accounting process is the same as when goods are sent at cost, except for adjustments related to goods.
Need for Adjustments	➤ To accurately determine branch profit or loss, 'loading' adjustments must be made. ➤ Loading refers to the difference between Invoice Price and Cost Price of goods.

Adjustment Entries in H.O. Books (When Goods Sent at Invoice Price)

Transaction	Journal Entry
Goods Sent to Branch at Invoice Price	Branch A/c Dr. To Goods Sent to Branch A/c
Adjustment for 'Loading' (Invoice Price - Cost Price)	Goods Sent to Branch A/c Dr. To Branch A/c
Goods Returned to H.O. at Invoice Price	Goods Sent to Branch A/c Dr. To Branch A/c
Adjustment for 'Loading' on Goods Returned	Branch A/c Dr. To Goods Sent to Branch A/c
Adjustment for 'Loading' in Opening Stock	Stock Reserve A/c Dr. To Branch A/c
Closing Stock at Invoice Price	Branch Stock A/c Dr. To Branch A/c
Adjustment for 'Loading' in Closing Stock	Branch A/c Dr. To Stock Reserve A/c



B. Stock and Debtors Method

When Goods Are Sent at Cost

- This method is used to exercise detailed control over branch operations.
- The Head Office (H.O.) maintains separate accounts for different aspects of branch activities.
- Accounts Maintained by Head Office & Their Purpose

Account	Purpose
1. Branch Stock Account (or Branch Trading Account)	Ascertainment of shortage or surplus
2. Branch Debtors Account	Ascertainment of closing balance of debtors
3. Branch Expenses Account	Ascertainment of total expenses incurred
4. Goods sent to Branch Account	Ascertainment of cost of goods sent to branch
5. Branch Cash / Bank Account	Know about cash flow at branch
6. Branch Fixed Asset Account	Control over branch Fixed Assets
7. Branch Profit and Loss Account	Calculation of net profit or loss

Journal Entries in HO books

	Transaction	Account debited	Account credited
a.	Cost of goods sent to the Branch	Branch Stock A/c	Goods sent to Branch A/c
b.	Remittances for expenses	Branch Cash A/c	Cash A/c
c.	Any asset (e.g. furniture) provided by H.O.	Branch Asset (Furniture) A/c	Asset A/c
d.	Cost of goods returned by the branch	Goods sent to Branch A/c	Branch Stock A/c
e.	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
f.	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
g.	Return of goods by debtors to the Branch	Branch Stock A/c	Branch Debtors A/c
h.	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
i.	Discount & allowance to debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
j.	Remittances to H.O.	Cash A/c	Branch Cash A/c
k.	Branch Expenses directly paid by H.O.	Branch Expenses A/c	Cash A/c
l.	Expenses met by Branch	Branch Expenses A/c	Branch Cash A/c



Final Adjustments in Stock and Debtors Method

Transaction	Journal Entry	Explanation
Closing Stock	Branch Stock A/c Cr. (at cost)	Closing stock is credited to Branch Stock A/c and carried forward as opening stock for the next period.
Effect of Branch Stock A/c Balance	✓ Credit balance → Gross Profit ✓ Debit balance → Loss	The final balance in the Branch Stock Account helps determine gross profit or loss.
Transfer of Branch Stock A/c Balance to Branch P&L A/c	Branch Stock A/c Dr. To Branch Profit & Loss A/c	Any remaining balance in Branch Stock A/c is transferred to Branch P&L A/c.
Transfer of Branch Expenses to Branch P&L A/c	Branch Profit & Loss A/c Dr. To Branch Expenses A/c	All branch expenses are transferred to Branch P&L A/c to determine net profit or loss.
Transfer of Branch P&L A/c Balance to H.O. P&L A/c	Head Office P&L A/c Dr. To Branch P&L A/c	The final net profit/loss of the branch is transferred to the H.O. Profit & Loss A/c.
Transfer of Goods Sent to Branch A/c to H.O. Purchase/Trading A/c	Goods Sent to Branch A/c Dr. To H.O. Purchase A/c / Trading A/c	The credit balance in Goods Sent to Branch A/c is transferred to H.O. Trading/Purchase A/c for final accounting.

When Goods Are Sent at Invoice Price

- When goods are invoiced at selling price, an additional account called the **Branch Adjustment Account** is maintained.
- This helps adjust the **loading (difference between Invoice Price and Cost Price)** to reflect actual profit or loss.

Journal Entries

Transaction	Accounts debited	Accounts credited
a. Sale price of the goods sent from H.O. to the Branch	Branch Stock A/c (at selling price)	i. Goods sent to Branches A/c with cost of the goods sent. ii. Branch Adjustment A/c (with the loading i.e.,



				Difference between the selling and cost price).
b.	Return of goods By the Branch to H.O.	i. ii.	Goods sent to Branch A/c (with the cost of goods returned). Branch Adjustment A/c (with the loading)	Branch Stock A/c
c.	Cash sales at the Branch		Branch Cash/Bank A/c	Branch Stock A/c
d.	Credit Sales at the Branch		Branch Debtors A/c	Branch Stock A/c
e.	Goods returned to Branch by customer		Branch Stock A/c	Branch Debtors A/c (at selling price)
f.	Goods lost in Transit or stolen	i. ii.	Goods Lost in Transit A/c or Goods Stolen A/c (with cost of the goods) Branch Adjustment A/c (with the loading)	Branch Stock A/c

Adjustments for Goods Sent at Invoice Price

Transaction	Journal Entry	Purpose
Goods Sent to Branch at Invoice Price	Branch A/c Dr. To Goods Sent to Branch A/c	Records goods sent to branch at invoice (selling) price.
Adjustment for 'Loading' on Goods Sent	Goods Sent to Branch A/c Dr. To Branch Adjustment A/c	Records excess price (loading) to ensure profit is not overstated.
Goods Returned to H.O. at Invoice Price	Goods Sent to Branch A/c Dr. To Branch A/c	Adjusts for goods returned to H.O. at invoice price.
Adjustment for 'Loading' on Goods Returned	Branch Adjustment A/c Dr. To Goods Sent to Branch A/c	Reverses excess price (loading) on returned goods.
Adjustment for 'Loading' on Opening Stock	Stock Reserve A/c Dr. To Branch Adjustment A/c	Removes loading from opening stock to reflect actual cost.
Closing Stock at Invoice Price	Branch Stock A/c Dr. To Branch A/c	Records closing stock at invoice price.
Adjustment for 'Loading' on Closing Stock	Branch Adjustment A/c Dr. To Stock Reserve A/c	Removes loading from closing stock to reflect cost price.



Adjustments for Stock Discrepancies

Stock Loss (Due to Pilferage, Fire, or Other Reasons)	Dr. Goods Lost A/c (for cost value) Dr. Branch Adjustment A/c (for profit margin included in invoice price) Cr. Branch Stock A/c
Stock Surplus (Excess Stock Found During Physical Verification)	Dr. Branch Stock A/c Cr. Branch Adjustment A/c (for markup amount)
Stock Lost Due to Theft (Misappropriation of Sale Proceeds)	Dr. Loss by Theft A/c (instead of Goods Lost A/c) Dr. Branch Adjustment A/c (for profit margin) Cr. Branch Stock A/c

Example (Stock Loss of Rs.100 with 25% Profit Margin)

Account	Dr. (Rs.)	Cr. (Rs.)
Goods Lost A/c	80	-
Branch Adjustment A/c	20	-
To Branch Stock A/c	-	100

Elimination of Unrealized Profit in Closing Stock

To ensure the Branch Stock Account reflects stock at cost price, the profit margin (markup) needs to be removed.

Adjustment	Journal Entry
Removing Profit Element in Closing Stock	Dr. Branch Adjustment A/c Cr. Stock Reserve A/c (for markup amount)
Alternative Method (Direct Adjustment)	Dr. Branch Adjustment A/c Cr. Branch Stock A/c
Impact on Balance Sheet	The credit balance in Stock Reserve A/c is deducted from closing stock value, ensuring stock is shown at cost.

C. Branch Trading and Profit and Loss Account (Final Accounts Method)

1.	Profit & Loss Calculation The Branch Trading and Profit & Loss Account is prepared to determine branch profit or loss using standard accounting principles.
2.	Basis for Calculation The Trading & P&L Account is based on: ✓ Cost of opening and closing stock ✓ Cost of goods supplied to branch ✓ Goods transferred to and from the branch
3.	Nature of Branch Trading & P&L Account It is a memorandum account, it does not follow the double-entry system but is used for tracking branch profitability.



4. **Adjustments for Invoice Price**
If figures are at loaded price (invoice price), they must be converted to cost price by removing the loading (markup).
5. **Branch Account Classification**
Unlike the Branch Trading & P&L Account, the Branch Account is a personal account, tracking amounts owed to or by the branch instead of being a nominal account.

D. Wholesale Branch Method (Goods Invoiced at Wholesale Price to Retail Branches)

1. **Goods Supplied at Wholesale Price**
The H.O supplies goods to its retail branches at wholesale price, which includes cost + wholesale profit.
2. **Branch Profit Calculation**
 $\text{Profit} = \text{Sale Proceeds at Shop} - \text{Wholesale Price of Goods Sold}.$
3. **Manufacturer's Assumption**
It is assumed that the manufacturer could always sell at wholesale price,
 $\text{Manufacturer's Profit} = \text{Wholesale Price} - \text{Cost}.$
4. **Why Use This Method?**
Many businesses invoice goods at wholesale price to branches and determine branch profit or loss based on retail sales.

Entries in Branch Stock/Trading Account

Debits (Dr.)	Credits (Cr.)
Opening Stock at Wholesale Price	Sales at Shop
Price of Goods Sent to Branch at Wholesale Price	Closing Stock at Wholesale Price
	Goods Lost (Accident, Theft, etc.) at Wholesale Price

Result:

After these adjustments, the Branch Stock or Trading Account reveals the gross profit or loss, which is transferred to the Branch Profit & Loss Account.

Entries in Branch Profit & Loss Account

Debits (Dr.)	Credits (Cr.)
Shop Expenses	Gross Profit (Transferred from Branch Trading A/c)
Wholesale Price of Goods Lost	

Result: The final balance in Branch P&L A/c shows the net profit or loss at the branch.



6. Accounting for Independent Branches

Independent Branch Accounting System

1. **Independent Branches**
When a business is large, branches maintain complete records of their transactions and operate independently.
2. **Accounting System**



	Each independent branch maintains its own books of accounts and prepares a trial balance separately.
3.	Head Office Control The Head Office (H.O.) maintains one ledger account per branch, recording all transactions between H.O. and the branch.
Salient Features of Independent Branch Accounting	
1.	Double-Entry System The branch maintains its own books under the double-entry system for accurate financial tracking.
2.	Head Office & Branch Accounts ✓ The Branch opens a Head Office Account to record transactions with H.O. ✓ The H.O. maintains a Branch Account to track transactions with the branch.
3.	Independent Financial Statements The branch prepares its Trial Balance, Trading, and Profit & Loss Account at the end of the period and sends them to the H.O.
4.	Reconciliation Between H.O. & Branch The Head Office reconciles its Branch Account with the Head Office Account in the branch books.
5.	Journal Entries in H.O. Books After receiving the Branch Trial Balance, the H.O. records journal entries to incorporate branch financials into its books.

The Head Office Account in branch books and Branch Account in head office books is maintained respectively.

	Transactions	Head office books		Branch books	
i.	Dispatch of goods to branch by H.O.	Branch A/c To Good sent to Branch A/c	Dr.	Goods received from H.O. A/c To Head Office A/c	Dr.
ii.	When goods are returned by the Branch to H.O.	Goods sent to Branch A/c To Branch A/c	Dr.	Head Office A/c To Goods received from H.O. A/c	Dr.
iii.	Branch Expenses are paid by the Branch	No Entry		Expenses A/c To Bank or Cash A/c	Dr.
iv.	Branch Expenses paid by H.O.	Branch A/c To Bank or cash	Dr.	Expenses A/c To Head Office A/c	Dr.
v.	Outside purchases made by the Branch	No Entry		Purchases A/c To Bank (or) Creditors A/c	Dr.
vi.	Sales effected by the Branch	No Entry		Cash or Debtors A/c To Sales	Dr.



vii.	Collection from Debtors of the Branch recd. by H.O.	Cash or Bank A/c To Branch A/c	Dr.	Head office A/c To Sundry Debtors A/c	Dr.
viii.	Payment by H.O. for purchase made by Branch	Branch A/c To Bank	Dr.	Purchases (or) Sundry Creditors A/c To Head Office	Dr.
ix.	Purchase of Asset by Branch	No Entry		Sundry Assets To Bank (or) Liability	Dr.
x.	Asset purchased by the Branch but Asset A/c retained at H.O. books	Branch Asset A/c To Branch A/c	Dr.	Head office To Bank (or) Liability	Dr.
xi.	Depreciation on (x) above	Branch A/c To Branch Asset	Dr.	Depreciation A/c To Head Office A/c	Dr.
xii.	Remittance of funds by H.O. to Branch	Branch A/c To Bank	Dr.	Bank A/c To Head Office	Dr.
xiii.	Remittance of funds by Branch to H.O.	Reverse entry of (xii) above i.e.		Reverse entry of (xii) above	
xiv.	Transfer of goods from one Branch to another branch	(Recipient) Branch A/c To Supplying Branch A/c	Dr.	<u>Supplying Branch</u> H.O. A/c To Goods sent to H.O. A/c	Dr.
				<u>Recipient Branch</u> Goods Received from H.O. A/c To Head Office A/c	Dr.

Adjustment and Reconciliation of Branch and Head Office Accounts

1.	Need for Reconciliation If the Branch Account (in H.O. books) and Head Office Account (in Branch books) do not tally, they must be reconciled before finalizing accounts.
2.	Example - Goods in Transit If the H.O. sent goods worth Rs. 50,000 but the branch received only Rs. 40,000, the branch should record Rs. 10,000 as Goods in Transit.
3.	Journal Entry in Branch Books Dr. Goods in Transit A/c - Rs. 10,000 Cr. Head Office A/c - Rs. 10,000
4.	Journal Entry in Head Office Books No entry, as the event has already been recorded in full.



Reasons for Disagreement Between Branch and Head Office Accounts

1.	Goods Sent by H.O. but Not Received by Branch The goods are in transit or lost; the branch will record them once received.
2.	Goods Returned by Branch but Not Received by H.O. The returned goods might still be in transit or lost; the H.O. records them only upon receipt.
3.	Money Transfer in Transit If funds are sent but not yet received, they remain unrecorded until reflected in the recipient's books.
4.	Income or Expenses Directly Handled by H.O. or Branch If one entity directly handles an income/expense on behalf of the other, it may not be recorded until the adjustment is made.

Example:

	Head office		Branch	
	Dr.	Cr.	Dr.	Cr.
Goods sent to Branch		1,50,000	-	
Goods recd. from H.O. A/c		-	1,40,000	
Branch A/c	1,12,000			
Head office A/c	-	-	-	78,500

Reconciliation of Branch and Head Office Accounts

To reconcile the differences, necessary adjustment entries should be passed in the books of the branch and/or head office as required.

Analysis & Required Adjustments

Discrepancy	Adjustment Entry (In Branch or H.O. Books)	Explanation
Goods Sent by H.O. but Not Received by Branch (Rs. 10,000)	Branch Books: Dr. Goods in Transit A/c - Rs. 10,000 Cr. Head Office A/c - Rs. 10,000	Goods are in transit, so they must be recorded in branch books. No entry is needed in H.O. books.
Remittance of Rs. 15,000 by Branch Not Yet Received by H.O.	H.O. Books: Dr. Cash in Transit A/c - Rs. 15,000 Cr. Branch A/c - Rs. 15,000	The remitted amount is still in transit and should be recorded in H.O. books.
Direct Collection by H.O. from Branch Customer (Rs. 10,500) Not Informed to Branch	Branch Books: Dr. Head Office A/c - Rs. 10,500 Cr. Debtors A/c - Rs. 10,500	The H.O. collected money on behalf of the branch, so branch books need to reflect this.



Branch Paid Rs. 14,500 to H.O. Suppliers (Not Recorded by H.O.)	H.O. Books: Dr. Purchase / Supplier A/c - Rs. 14,500 Cr. Branch A/c - Rs. 14,500	The branch made the payment, but H.O. did not record it, so this adjustment is needed in H.O. books.
H.O. Allocated Rs. 12,000 as Expenses for Branch (Not Recorded by Branch)	Branch Books: Dr. Branch Expenses A/c - Rs. 12,000 Cr. Head Office A/c - Rs. 12,000	The expense allocation must be recorded in branch books. No entry needed in H.O. books as it has already recorded this.
FD Interest of Rs. 7,500 Received by Branch on Oral Instructions from H.O. (Not Recorded by H.O.)	H.O. Books: Dr. Head Office A/c - Rs. 7,500 Cr. Interest Income A/c - Rs. 7,500	The branch received FD interest, but H.O. did not record it, so an adjustment is needed in H.O. books.

			Head Office Books			Branch Books	
			Dr. Rs.	Cr. Rs.		Dr. Rs.	Cr. Rs.
i.	Goods in transit (Rs.10,000)	Cash in Transit A/c To Branch A/c	-	-	Goods in Transit A/c	10,000	
ii.	Cash in Transit:				To Head office A/c (No Entry)		10,000
			15,000				
iii.	Direct Collection by H.O. on behalf of the Branch	Sundry Creditors A/c To Branch A/c		15,000	Head Office A/c To Debtors A/c	10,500	10,500
iv.	Direct payment of Rs.14,500 by Branch on behalf of H.O		14,500				
				14,500			
v.	Expenditure Allocated to Branch				Branch Exp. A/c To H.O. A/c	12,000	12,000
vi.	Fixed Deposit interest of Rs.7,500 directly received by the Branch	Branch A/c	7,500				
		To Sundry Income		7,500			



In Branch Books Head Office Account

	Rs.		Rs.
To Sundry Debtors A/c	10,500	By Balance b/d	78,500
To Balance c/d	90,000	By Goods in transit	10,000
		By Branch expenses	12,000
	1,00,500		1,00,500
		By Balance b/d	90,000

In the Books of Head Office Branch A/c

	Rs.		Rs.
To Balance b/d	1,12,000	By Cash in Transit	15,000
To Sundry Income	7,500	By Sundry Creditors	14,500
		By Balance c/d	90,000
	1,19,500		1,19,500
To Balance b/d	90,000		

Important Points in Branch and Head Office Accounting

1. Reconciliation of Branch & Head Office Accounts

1.	Balance Agreement The Head Office A/c in Branch Books and Branch A/c in Head Office Books should match after adjustments.
2.	Adjustments Adjustments are only made when a transaction is missing in either books, not where it has already been recorded.

2. Inter-Branch Transactions

- ✓ Inter-branch transactions are routed through the Head Office to ensure smooth consolidation, especially when multiple branches exist.
- ✓ Example: If Kolkata Branch spends Rs. 1,000 on advertisement for Delhi Branch, the entries will be:

Books	Journal Entry
Kolkata Branch	Dr. Head Office A/c - Rs. 1,000 Cr. Cash A/c - Rs. 1,000
Delhi Branch	Dr. Advertisement A/c - Rs. 1,000 Cr. Head Office A/c - Rs. 1,000
Head Office	Dr. Delhi Branch A/c - Rs. 1,000 Cr. Kolkata Branch A/c - Rs. 1,000

3. Fixed Assets Accounting in Branch Books

- ✓ If the H.O. maintains fixed asset accounts, depreciation is charged by H.O. to the branch at year-end.

Books	Journal Entry
Head Office	Dr. Branch A/c Cr. Branch Fixed Asset A/c



Branch	Dr. Depreciation A/c Cr. Head Office A/c
--------	---

4. Head Office Expenses Charged to Branch

H.O. allocates expenses to branches for administrative support. The H.O. debits the Branch A/c and credits the respective expense account. The Branch debits its expense account and credits Head Office A/c.

Books	Journal Entry
Head Office	Dr. Branch A/c Cr. Salaries / General Expenses A/c
Branch	Dr. Expense A/c Cr. Head Office A/c

5. Incorporation of Branch Accounts into Head Office Books

The method that will be adopted for incorporating the trading result of the branch with that of the head office would depend on whether it is desired to prepare

- Standalone P&L & Balance Sheet for each Branch, or
- Consolidated statement of Branch & H.O.

Method I: Separate P&L & Balance Sheet for each Branch

- Amount of P&L is shown by Branch & is transfer to H.O. in Branch books & converse entry is passed in H.O. Books as:

Branch A/c Dr.

To Profit & Loss A/c

- In such a case, not only P&L but also separate Balance Sheet for Branch & H.O. is to be prepared.
- The Branch Balance Sheet would show the amount advanced by H.O. to it as "Capital." In H.O. Books such amount would be shown as "Advance to Branch"

Method II: Prepare a consolidated Profit & Loss Account and Balance Sheet

- The individual balances of all revenue accounts (such as sales and income) are transferred to the Head Office Account in the branch books. The opposite entries are made in the Head Office books.
- This process reflects the transfer of the branch's net profit or loss.
- If a consolidated balance sheet for the Head Office and branch is required, the balances of the branch's assets and liabilities need to be transferred to the Head Office books.

The adjusting entries that would be passed in this respect in the books of branch are shown below:

Head Office Account Dr.

To Asset (individual) Account

(Individual) Liability Account Dr.

To Head Office Account

Converse entries are passed in the head office books.

- It is obvious that after the above-mentioned entries have been passed, the Branch Account in the Head Office books and Head Office Account in the branch books will be

- In consequence, at the beginning of the following year, the under-mentioned entry is recorded by the branch:

Dr.

To H.O. Account (The difference between assets and liabilities)



Covered in AS 11



7. CONSOLIDATED FINANCIAL STATEMENTS (AS 21, 23 & 27)

AS 21: CONSOLIDATED FINANCIAL STATEMENTS:



1. Meaning of CFS

Consolidated Financial Statements (CFS)

- CFS are the financial statements of a group, presented as those of a single enterprise, where a group includes the parent and all its subsidiaries.
- The parent company must provide financial information for the entire group, not just itself, by preparing CFS.
- These statements show the financial position, performance, resources, obligations, and overall results of the parent and its subsidiaries as a single entity.
- AS 21 is mandatory if an enterprise presents CFS. AS does not mandate an enterprise to present CFS. However, if it chooses to do so for legal compliance or any other reason, it must follow AS 21 while preparing and presenting CFS.



2. Definitions

1. **Group**
A group consists of a parent and all its subsidiaries.
2. **Parent**
A parent is an enterprise that controls one or more subsidiaries.
3. **Subsidiary**
A subsidiary is an enterprise controlled by another enterprise (the parent).

Wholly owned & Partly owned Subsidiaries

S. No.	Wholly Owned Subsidiary Company	Partly Owned Subsidiary Company
1.	All shares owned by holding company.	Majority (more than 50%) of shares owned by holding company.
2.	100% voting rights with holding company.	More than 50% but less than 100% voting rights with holding company.
3.	No minority interest.	Minority interest exists.

Control

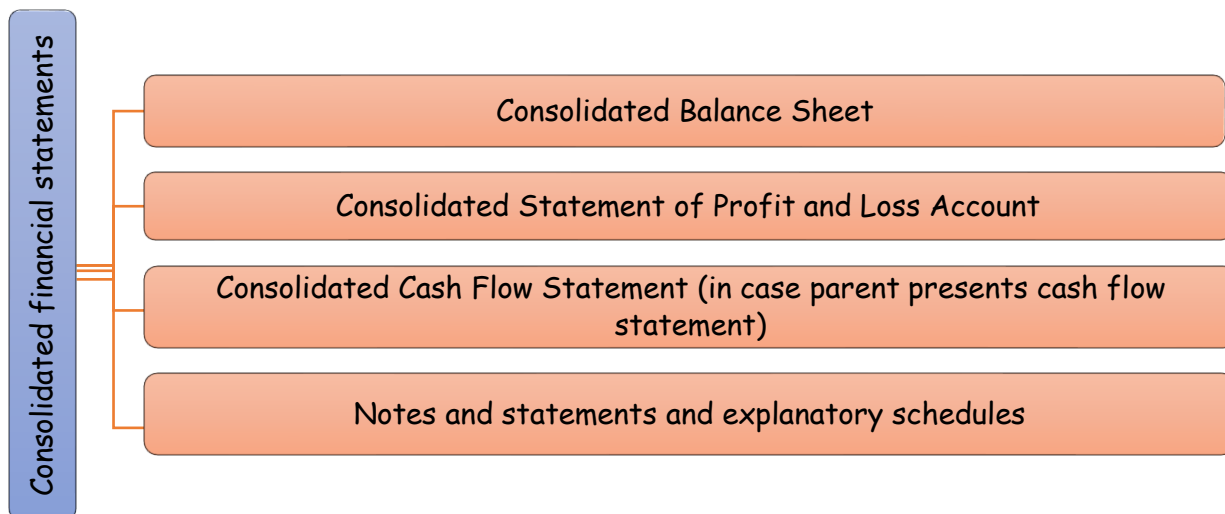
Control Exists

1. **Voting Power**
when one company holds more than 50% of the voting power in a subsidiary, either directly or through other subsidiaries.
2. **Board Control**
When one company has the ability to control the composition of the board of directors or the governing body of the subsidiary.



3. Components of Consolidated Financial Statements

As per AS 21, consolidated financial statements normally include the following



The CFS are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements.



4. Advantages of Consolidated Financial Statements

1.	Single Source Document CFS provide an overall view of the group's performance, including the parent and its subsidiaries.
2.	Intrinsic Value of Share The consolidated balance sheet helps calculate the real value of the holding company's shares.
3.	Acquisition of Subsidiary Minority interest in consolidated statements helps determine the amount owed to outside shareholders during a subsidiary acquisition.
4.	Evaluation of Holding Company CFS allow investors to assess the financial health of the holding company for investment or acquisition decisions.



5. Scope

1.	Application of the Standard This Standard should be applied in the preparation and presentation of CFS for a group under the control of a parent.
2.	Exclusions from the Standard This Standard does not cover: ➤ Methods of accounting for amalgamations and their effects on consolidation, including goodwill from amalgamation (AS 14). ➤ Accounting for investments in associates (AS 23). ➤ Accounting for investments in joint ventures (AS 27).



6. Exclusion from Preparation of Consolidated Financial Statements

A Subsidiary should be excluded from consolidation when

1. **Temporary Control**
If control is intended to be temporary, such as when the subsidiary is acquired for subsequent disposal in the near future.
2. **Severe Long-Term Restrictions**
It operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.
Example
For instance, if a parent company owns a subsidiary in a country with capital controls preventing fund transfers for a long period, the subsidiary might be excluded from consolidation.



7. Consolidation Procedures

Steps for Preparing Consolidated Balance Sheet

Step 1: Determine Date of Acquisition: Identify the acquisition date of the Parent in the Subsidiary. This helps distinguish pre- and post-acquisition profits for accurate profit analysis.

Step 2: Ascertain Shareholding Pattern

Establish the Subsidiary's shareholding as of the Consolidated Balance Sheet date.

Shareholding Pattern	No. of Shares	%
a. Parent	XXX	XXX%
b. Minority Interest	XXX	XXX%
c. Total (a + b)	XXX	XXX%

Note: This pattern is essential for apportioning subsidiary profits.

Step 3: Analysis of Subsidiary Reserves and Surplus

- Analyse reserves & surplus of the subsidiary company on the date of the Consolidation into Pre & post-acquisition profits with necessary adjustments.
- For apportionment of profits between pre & post acquisitions periods we follow time basis assuming profits are accruing evenly over time.
- While analysing the reserves & surplus of the subsidiary company we need to consider the effect of following items in particular
 - a. Revaluation of assets of subsidiary company.
 - b. Dividend given by subsidiary company
 - c. Intra group transactions between parent & its subsidiary
 - d. Bonus shares given by the subsidiary company

Each of these items are discussed below after the consolidation steps



Step 4: Apportionment of Profits

Apportion profits analysed in Step 3 among shareholders & b MI in the ratio in Step 2.

Profit Type	Pre-Acquisition Profit (Capital Profit - CP)	Post-Acquisition Profit (Revenue Reserves - RR)	Revenue Profits (RP)
a. General Reserve	XXX	XXX	
b. Other Reserves	XXX	XXX	
c. Profit and Loss	XXX	XXX	
d. Total	XXX	XXX	XXX
e. Parent	XXX	XXX	XXX
f. Minority Interest	XXX	XXX	XXX

Step 5: Minority Interest

MI is the aggregate of minority share in:

i. Share Capital		
ii. Capital Profits	(from Step 4)	xxx
iii. Revenue Reserves	(from Step 4)	xxx
iv. Revenue Profits	(from Step 4)	xxx
v. Equity Dividend		xxx
vi. Less: Stock Reserve	Minority share (if upstream)	xxx

Step 6: Cost of Control

Particulars	Rs.
a. Cost of Investment	
i. Amount invested (carrying value in Parent's Balance Sheet)	XXX
ii. Less: Pre-Acquisition Dividend Received from Subsidiary	(XXX)
Adjusted Cost of Investment	XXX
b. Value of Investment (Parent's share of Subsidiary's net assets)	
i. Share Capital	XXX
ii. Pre-Acquisition Profit (from Step 4)	XXX
c. Cost of Control = Goodwill/Capital Reserve (a - b)	XXX

Step 7: Inter-Company Transactions

A. Intercompany owing/debts

Item	Explanation
Usual Items	Debtors, creditors, loan given, loan taken, interest receivable, interest payable, fees receivable, fees payable, dividend receivable, dividend payable.
Adjustment	The adjustment involves a reduction of the amount from the aggregate of both receivable and payable.

B. Assets comprising goods or machinery purchased from the other Company

Particulars	Downstream	Upstream
Transaction Flow	From Parent to Subsidiary	From Subsidiary to Parent



Quantum of unrealised Profit to be eliminated from Asset	100%	100%
Adjustment against		
Parents' Reserves	100%	To the extent of parent share in subsidiary in step 7
Minority Interest	Nil	Step 5

Step-8: Reserves for Consolidated Balance Sheet

Particulars	CR	RR	Profit and Loss A/c
a. Reserves as appearing in Parents' Balance Sheet	XXX	XXX	XXX
b. Less: Dividend received from subsidiary out of Pre acquisition profits transferred to Investments (Step 6 a (ii))		(XXX)	(XXX)
c. Add: Parents' share of post-acquisition reserve and profits of subsidiary (Step 4)	XXX	XXX	(XXX)
d. Less: Reserve for unrealised profit created (Step 7B)		XXX	
e. Add: Capital Reserve (Step 6C)	XXX	XXX	XXX
f. The net result is the value of reserves to be shown in Consolidated Balance Sheet.	XXX	XXX	XXX

Step 9: Preparation of Consolidated Balance Sheet

a) Share Capital & Liabilities

1. Share Capital:	Only Parent
2. Reserves:	From Step 8
3. Minority Interest:	From Step 5
4. Other Liabilities, Loans, Current Liabilities and Provisions:	Aggregate both Companies' individual liabilities Less: Inter-company transactions (from Step 7)

b) Assets

1. Fixed Assets	Total of both Companies, adjusted for revaluation and unrealized profit. In the event of Goodwill, it forms part of Fixed Assets.
2. Investments	Total of outside investments of Parent and Subsidiary.
3. Current Assets, Loans, and Advances	Aggregate of both Companies' balances adjusted for inter-company owing.



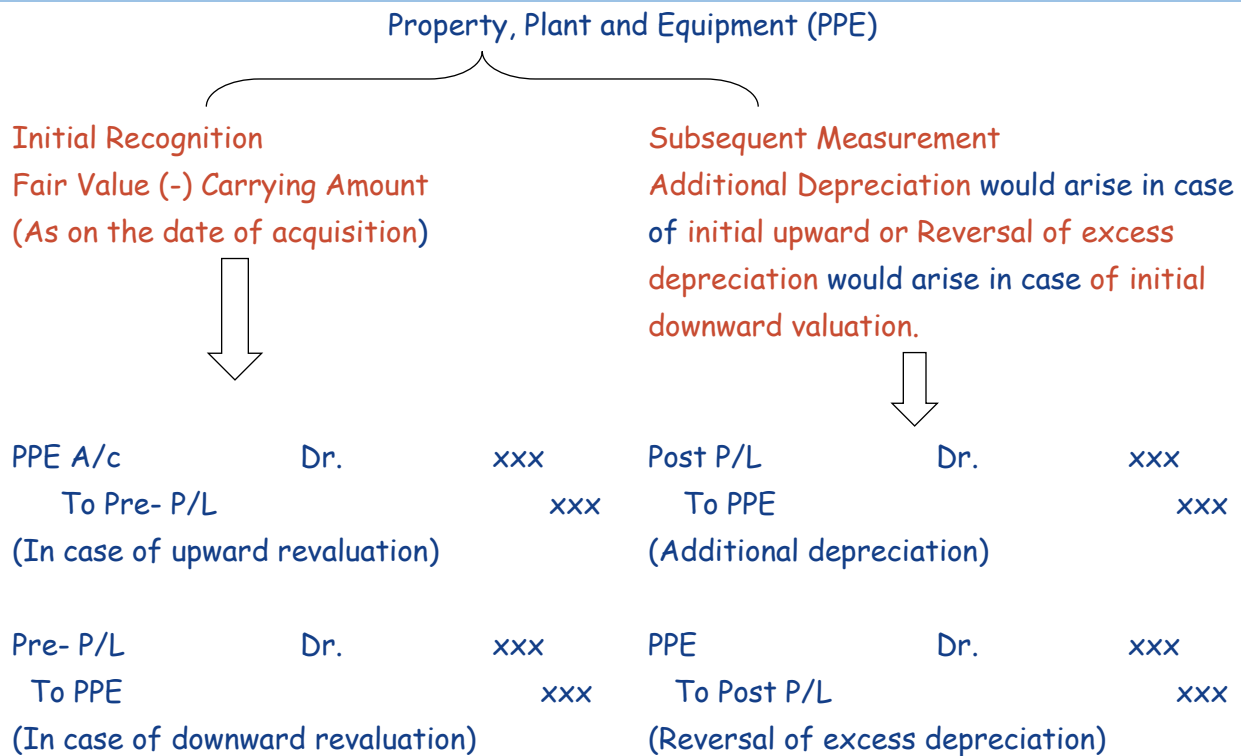
8. Important Adjustments

A. Revaluation of Assets of Subsidiary Company

- ✓ The parent may revalue the subsidiary's assets for consolidation, as their fair value may differ from book value.



- ✓ This revaluation is not done in the subsidiary's standalone financial statements.
- ✓ Any decline in asset value after acquisition is treated as a revenue loss.
- ✓ Depreciation adjustments are made in the subsidiary's profit and loss account.
- ✓ Depreciation on revalued assets is classified as capital or revenue based on the relevant period.

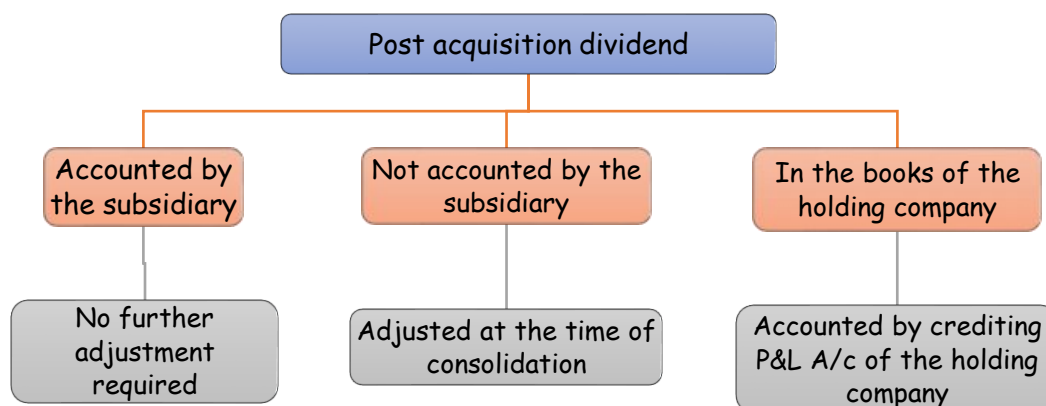


Note: The impact of revaluation can be recorded in the Revaluation Reserve (for an upward revaluation) or the Profit & Loss Account (for a downward revaluation). However, for consolidation, reserves are classified as pre-acquisition and post-acquisition, making the specific nature of reserves irrelevant.

B. Dividend Received from Subsidiary

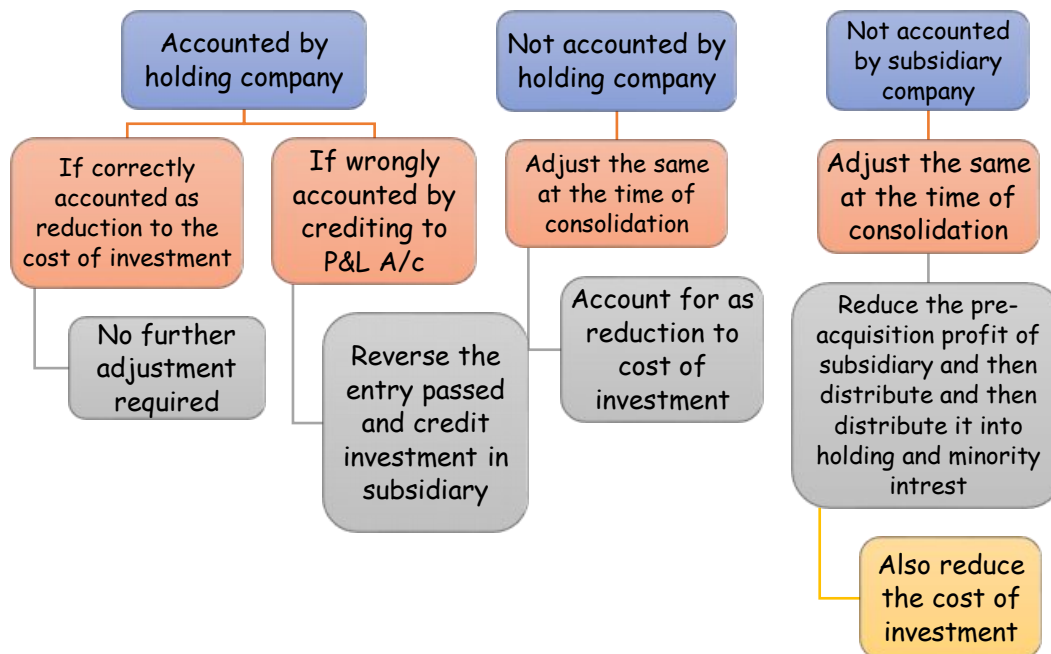
When holding company receives dividend from a subsidiary company, it must distinguish between the part received out of capital profits (i.e. pre-acquisition profits) and revenue profits (i.e. post-acquisition profits); capital profits are credited to Investment account (being capital receipts) and revenue profits are credited to the Profit & Loss Account.

Treatment in case of post-acquisition dividend





Treatment in case of pre-acquisition dividend



Note: Dividends received out of profits earned before purchase of investments normally also are credited to the Investment Account.

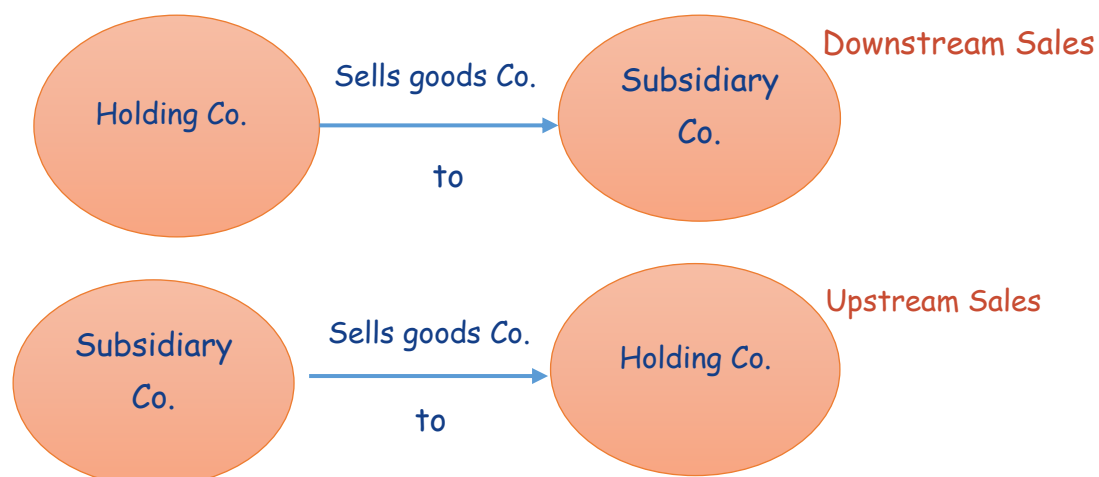
Example

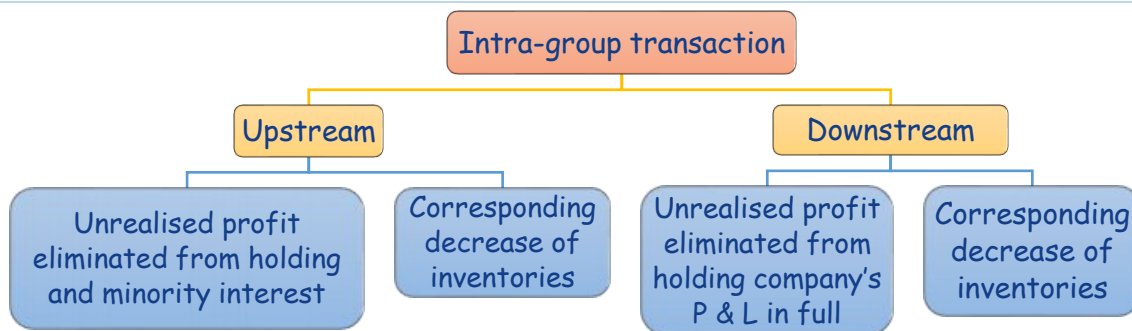
If shares in X Ltd., are purchased in January 2022 and in April 2022, X Ltd., declares a dividend in respect of 2021, the dividend received by the holder of the shares correctly should not be treated as income but as capital receipt and credited to Investment Account.

C. Elimination of Intra-Group Transactions

- ✓ AS 21 states that **intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full.**
- ✓ **Unrealized losses resulting from intragroup transactions should also be eliminated.**
- ✓ In consolidation, liabilities owed by one group entity to another are offset against the corresponding assets in the other entity's financials. sales made by one group enterprise to another should be excluded both from turnover and from cost of sales or the appropriate expense heading in the consolidated statement of profit and loss.

Unrealized profit in inventories:





Unrealized profit on transfer of non-current asset: Similar to the treatment described above for unrealized profits in inventories, unrealized inter-company profits arising from intra-group transfers of fixed assets are also eliminated from the consolidated financial statements.

Unrealized losses: Unrealized losses resulting from intra-group transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

Example:

If net realizable value (NRV) expected from sale of such goods is more than the actual cost of the goods, then unrealized loss should be reversed during consolidation process. However, if it is expected that NRV would not be sufficient to recover the loss incurred on transfer of goods from one entity to another, the unrealized loss should not be reversed.

D. Alignment of Reporting Dates

- ✓ To ensure accurate consolidation, the financial statements of the parent company and its subsidiaries should ideally have the same reporting date. However, if this is not feasible, certain adjustments are necessary
- ✓ **Maximum Difference:** The difference in reporting dates should not exceed six months.
- ✓ **Significant Events:** If there are significant transactions or events occurring between the different reporting dates, adjustments should be made to account for their impact.
- ✓ **Consistency:** The reporting periods and any differences in reporting dates should remain consistent from year to year.
- ✓ By adhering to these guidelines, companies can prepare reliable consolidated financial statements that provide a clear picture of the group's overall financial performance and position.



9. Preparation of Consolidated Statement of Profit and Loss

- ✓ **All the items of profit and loss account are to be added on line-by-line basis and inter-company transactions should be eliminated** from the consolidated figures.
For example, a holding company may sell goods or services to its subsidiary, receive 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. Alternatively, the subsidiary may also sell goods or services to the holding company. These inter-company transactions are to be eliminated in full.



- ✓ If there remains any unrealized profit in the inventory, of any of the Group Company, such unrealized profit is to be eliminated from the value of inventory to arrive at the consolidated profit.



10. Uniform Accounting Policies

- Uniform Accounting Policies**
To ensure accurate and consistent consolidated financial statements, use uniform accounting policies for like transactions and events across all group entities.
- Adjustments for Different Policies**
If a subsidiary uses different accounting policies than the parent, adjustments must be made to its financial statements before consolidation to ensure comparability.
Example
If a subsidiary uses the weighted average method for inventory, while the parent uses FIFO, adjust the subsidiary's inventory to match the parent's method for consistent consolidation.



11. Treatment of Subsidiary Company having preference Share Capital

- Cumulative Preference Shares**
Liability Treatment: These shares are treated as a liability of the group, similar to debentures.
Dividend Adjustment: The parent company adjusts its share of the subsidiary's profits or losses by the amount of potential preference dividends, even if not yet declared or paid.
- Non-Cumulative Preference Shares**
Dividend Recognition: Dividends are recognized only when declared and paid.
No Adjustment: No adjustments to the parent's share of the subsidiary's profits unless a dividend is paid.



AS 23: ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS



1. Objective

- This AS lays down the principles & procedures for recognizing investments in associates and its effect on the group's CFS.
- AS 23 is mandatory for companies following AS 21 and preparing CFS for their group.
- For disclosing investment in associates in the investor's separate financial statement, follow AS 13.



2. Definitions

1.	Subsidiary Parent Group Already Covered in AS 21.
2.	Equity The residual interest in the assets after deducting all liabilities.
3.	Associate An enterprise in which the investor has significant influence but is not a subsidiary or joint venture.
4.	Equity Method is a method of accounting whereby ➤ the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. ➤ The carrying amount of the investment is adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. ➤ The consolidated statement of profit and loss reflects the investor's share of the results of the operations of the investee.
5.	Significant Influence Power to participate in the financial and/or operating policy decisions of the investee but not control those policies.



3. Determining Significant Influence

1.	Significant Influence An investor has significant influence if it can: ➤ Hold 20% or more of the voting power directly or indirectly. ➤ Participate in policymaking, has board representation, or conducts substantial transactions with the associate.
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2. **Exceptions**
 - If holding is above 20% but no significant influence, it's not an associate.
 - Less than 20% holding with significant influence indicators can still be treated as an associate.

Example 1
A Ltd. holds 70% in C Ltd. (Parent), and B Ltd. holds 28% in C Ltd. B Ltd. has 20%+ but less than 50% in C Ltd., making C Ltd. an associate of B Ltd.

Example 2
A Ltd. holds 90% in B Ltd. (Parent) and 10% in C Ltd. B Ltd. holds 11% in C Ltd. Direct and indirect holding of A Ltd. in C Ltd. is 21%, so C Ltd. is an associate of A Ltd..



4. Associates Accounted for Using the Equity Method

1. **Equity Method**
The investment is initially recorded at cost. Any goodwill or capital reserve arising during the acquisition is identified.
2. **Carrying Amount Adjustment**
The carrying amount of the investment is adjusted based on changes in the investor's share of the investee's net assets after acquisition.
3. **Consolidated Profit & Loss**
Reflects the investor's share of the results of the investee's operations.
4. **Goodwill/Capital Reserve**
Any goodwill or capital reserve arising on the acquisition of an associate should be included in the investment amount but disclosed separately.



5. Circumstances under which Equity Method is Followed

1. **Equity Method Applicability**
The equity method is applied when an enterprise has significant influence over its associates.
2. **Cases Where Equity Method is Not Applied**
The equity method is not applied in the following cases
 - a. **Temporary Control**
If the investment is meant to be held temporarily for future disposal.
 - b. **Severe Long-Term Restrictions**
If the associate faces long-term restrictions impairing its ability to transfer funds to the investor.

In the above cases, investments are accounted for under AS 13 instead of the equity method.
3. **Discontinuing the Equity Method**
The equity method must be discontinued if:
 - a. **Loss of Significant Influence**
If significant influence is lost, even if part or all of the investment is retained.



	b. Long-term Restrictions If long-term restrictions impair fund transfers, making the equity method inappropriate.
4.	Post-Discontinuation Treatment After discontinuing the equity method, investments in the associate should be accounted for under AS 13. The carrying amount at that date becomes the cost thereafter.
5.	Disclosure Requirement The reasons for not applying the equity method should be disclosed in the CFS.



6. Application of the Equity Method

- ✓ Many of the rules followed under equity method for an associate is similar to consolidated financial statement rules as in case of subsidiary i.e. AS 21.
- ✓ Investment in an associate should be recorded as per the equity method from the date when such relation comes in effect.
- ✓ Investment in the associate is recorded at cost and any difference in the cost and investor's share in equity on the date of acquisition is shown as goodwill or capital reserve.

Case 1:

A Ltd. holds 22% share of B Ltd. on 1st April of the year and following are the relevant information as available on the date are Cost of Investment Rs.33,000 and Total Equity on the date of acquisition Rs.2,00,000.

A Ltd.'s share in equity ($2,00,000 \times 22\%$)	Rs. 44,000
Less: Cost of Investment	<u>Rs. (33,000)</u>
Capital Reserve	<u>Rs. 11,000</u>

Extract of Balance Sheet: ASSETS

Investment in Associate as per AS 23	Rs.	Rs.
Share of Net Assets as on 1 April	44,000	
Less: Capital reserve	(11,000)	33,000

Case 2:

A Ltd. holds 22% share of B Ltd. on 1st April of the year and following are the relevant information as available on the date are Cost of Investment Rs.55,000 and Total Equity on the date of acquisition Rs.2,00,000.

Cost of Investment	Rs.55,000
Less: A Ltd.'s share in equity ($2,00,000 \times 22\%$)	<u>Rs.44,000</u>
Goodwill	<u>Rs.11,000</u>

Extract of Balance Sheet: ASSETS

Investment in Associate as per AS 23	Rs.	Rs.
Share of Net Assets as on 1 April	44,000	
Add: Goodwill	<u>11,000</u>	55,000



7. Step Acquisition in Case of an Associate

- ✓ An enterprise having share of profits of more than 50% in other company, they are said to be in Parent-Subsidiary relationship. However, if the share in profits is more than 20% but up to 50% then this relationship is termed as associate relationship.
- ✓ This stake of 20% can be acquired either in one go or in more than one transaction. This share of stake can be increased further say from 25% to 30%. Adjustment should be made with each transaction.

Case 1: Conversion from a passive investor to an associate in the same year:

A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:

Cost of Investment for 10% Rs.1,00,000 and for 15% Rs.1,45,000

Net asset on April 01 Rs.8,50,000 and on October 01 Rs.10,00,000.

Calculations for April 01:

Cost of investment	Rs.1,00,000
10% share in net asset	<u>Rs.85,000</u>
Goodwill	<u>Rs.15,000</u>

Calculations for October 01:

15% share in net asset	Rs.1,50,000
Cost of investment	<u>Rs.1,45,000</u>
Capital Reserve	<u>Rs.5,000</u>
Total goodwill (15,000 - 5,000)	<u>Rs.10,000</u>

Case 2 - Conversion from a passive investor to an associate in the same year:

A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 of the same year. Other information is as follow:

Cost of Investment for 10% Rs.1,00,000 and for 15% Rs.1,55,000

Net asset on April 01 Rs.8,50,000 and on October 01 Rs.10,00,000.

Calculations for April 01:

Cost of investment	Rs.1,00,000
10% share in net asset	<u>Rs.85,000</u>
Goodwill	<u>Rs.15,000</u>

Calculations for October 01:

Cost of investment	Rs.1,55,000
15% share in net asset	<u>Rs.1,50,000</u>
Goodwill	<u>Rs.5,000</u>
Total goodwill (15,000 + 5,000)	<u>Rs.20,000</u>

Case 3 - Further acquisition in an associate in the same year:

A Ltd. acquired 25% stake of B Ltd. on April 01 and further 5% on October 01 of the same year. Other information is as follow:

Cost of Investment for 25% Rs.1,50,000 and for 5% Rs.20,000

Net asset on April 01 Rs.5,00,000.



Profit for the year Rs.90,000 earned in the ratio 2:1 respectively.

Calculations for April 01:

Cost of investment	Rs.1,00,000
25% share in net asset	<u>Rs.1,25,000</u>
Goodwill	<u>Rs.25,000</u>

Calculations for October 01:

Profits for the first half $(90,000/3) \times 2$	Rs.60,000
Additional share of A Ltd.	5%
Pre-acquisition profits i.e. capital reserve $(60,000 \times 5\%)$	Rs.3,000
5% share in net asset	Rs.25,000
Cost of investment	<u>Rs.20,000</u>
Capital Reserve	<u>Rs.5,000</u>
Cost of Investment on April 01	Rs.1,50,000
Less: Goodwill	<u>Rs.25,000</u>
Carrying Amount on April 01	Rs.1,25,000
Add: Additional Share in Net Asset on October 01	Rs.25,000
Add: Capital share of Profits for first half	Rs.3,000
Add: Revenue shares of Profits for first half $(60,000 \times 25\%)$	Rs.15,000
Add: Revenue shares of Profits for second half $(30,000 \times 30\%)$	<u>Rs.9,000</u>
Total Carrying Amount on March 31	<u>Rs.1,77,000</u>

Other important points

1.	Unrealized Profits on Inter-Company Transactions Unrealized profits from transactions between the investor and investee must be eliminated based on the investor's share. Losses are not eliminated if deemed non-recoverable.
2.	Recognition of Losses ➤ If the investor's share of losses exceeds or equals the investment's carrying amount, the investment is recorded at zero. ➤ Further losses are recognized only if the investor has assumed obligations for the associate. ➤ The investor resumes recognizing profits after offsetting the unrecognized net losses.
3.	Reporting Dates ➤ The financial statements of both the investor and investee should have the same reporting date. ➤ If this is not possible, significant transactions between the dates must be adjusted, and the difference should not exceed six months.
4.	Uniform Accounting Policies Consistent accounting policies must be used across the investor, investee, and consolidated statements for similar transactions. Adjustments should be made if policies differ.



5. **Decline in Investment Value**
If there is a permanent decline in value, the carrying amount of the investment should be reduced, assessed individually for each investment.



8. Why is Equity Method of Accounting Adopted for Investment in Associates?

1. **Investments in Associates**
Investments in associates (20% or more but less than 50% equity) cannot be treated as normal investments under AS 13. The intent is not just for dividends but to participate in decision-making.
2. **Income from Investment**
Income from an associate should not be based solely on dividends, as they may not reflect the associate's actual performance. The investor's share of results is included in the consolidated financial statements using the equity method.
3. **Equity Method**
The equity method gives a clearer picture of the investor's financial health, improving financial ratios and reporting net assets and net income accurately.
4. **Proposed Dividend in Associates**
When an associate proposes a dividend after the reporting period but within the same year, the investor should calculate their share of the operating results without considering the proposed dividend.
5. **Potential Equity Shares in Voting Power**
Potential equity shares held by the investor should not be included when assessing the voting power in the associate for classification purposes.

Note:

- ✓ **Proposed Dividend in Associates:** When an associate has provided for a proposed dividend after the reporting period (but for the current reporting year), the investor should calculate its share of the associate's operating results without considering the proposed dividend.
- ✓ **Potential Equity Shares in Voting Power Assessment:** Potential equity shares held by the investor should not be included when determining the investor's voting power in the associate for classification purposes.



AS 27: FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES



1. Introduction

1. **Joint Venture**
You would have come across many examples where 2 or more entities would have worked together to achieve a certain purpose.
Example
Hindustan Unilever Ltd (HUL), Tata Starbucks Ltd, and Tata SIA Airlines Ltd. (Vistara), are few popular examples of joint ventures.
2. **Reasons for Joint Ventures**
Entities enter joint ventures to share risks, expenses, collaborate on expertise, and combine skill sets, while facing challenges from different work cultures and management styles.
3. **Accounting for Joint Ventures**
Accounting and reporting for joint ventures depend on the contractual arrangement between the entities.
4. **AS 27 provides principles and procedures for accounting for interests in joint ventures.**
5. **Types of Joint Ventures**
This AS deals with three broad types of joint ventures:
 1. Jointly controlled operations
 2. Jointly controlled assets
 3. Jointly controlled entities



2. Scope

1. **Scope**
This Standard applies to accounting for joint ventures, covering assets, liabilities, income, and expenses of venturers and investors, regardless of the structure or form of the joint venture.
2. **Application to CFS**
The provisions of this AS are relevant for CFS only when the venturer prepares and presents a CFS.



3. Definitions

1. **Joint Venture**
A contractual arrangement where two or more parties work together on an economic activity, under joint control.
2. **Essential Conditions for a Joint Venture**
 - a. **Two or More Parties**
Can be individuals or business entities (e.g., BOI, AOP, Company, Firm).
 - b. **Economic Activity**
The venture is separate from the regular business of the venturers and aims for profit. It may have a separate legal identity.



	c. Joint Control Venturers influence operating and financial decisions and share the outcomes. d. Contractual Agreement The relationship is governed by a written agreement, which can be an official document, meeting minutes, or any written form.
3.	Joint Control Control shared contractually over an economic activity.
4.	Control Power to govern an economic activity's financial and operational policies for benefits.
5.	Venturer A party in a joint venture that has joint control.
6.	Investor in a Joint Venture A party in a joint venture but without joint control.
7.	Proportionate Consolidation A method where a venturer's share of assets, liabilities, income, and expenses of a jointly controlled entity is reported separately in their financial statements.



4. Contractual Arrangement

1.	Contractual Agreement (AS 27) A joint venture must have a contractual agreement to qualify under AS 27. Without it, the entity does not qualify. If it qualifies as a subsidiary under AS 21, then AS 21 applies instead.
2.	Forms of Agreement The contract can be in the form of a written document, meeting minutes, articles of concern, or by-laws of the joint venture.
3.	Key Elements of the Contract The contract must define: ✓ Activity, duration, and reporting obligations ✓ Board of directors & voting rights ✓ Capital contributions by venturers ✓ Sharing of output, income, expenses, or results
4.	Purpose of the Contract Ensures economic control is shared, preventing any one venturer from having unilateral control. Specifies decisions requiring consent of all or a majority.
5.	Operator or Manager Role One venturer may be the operator or manager, but they do not control the joint venture. They act as per agreed policies. A contract signed only to protect one party's rights does not make that party a venturer.
	Example 1: Investor Protection IDBI provided a loan to the joint venture of L&T and Tania Construction. As per the agreement, IDBI must be informed about key decisions, but this does not make IDBI a venturer—the agreement only protects its rights.



Example 2: Joint Venture Qualification

X Ltd, Y Ltd, and Z Ltd invested ₹200 crore in GFH Ltd to grow the business together. All investors can attend meetings, take decisions, and share returns. Since they actively run the business, GFH Ltd is a joint venture, and X Ltd, Y Ltd, and Z Ltd are venturers.

Example 3: Managerial Role

Mr. A, M/s B & Co., and C Ltd. entered a joint venture. The agreement states that all policy decisions will be made in meetings, and Mr. A will handle execution. Mr. A is both a venturer and the manager, but his managerial role does not disqualify him as a venturer.



5. Forms of Joint Ventures

1. Types of Joint Ventures

Joint ventures can take different forms and structures. They are classified into three broad types:

- ✓ Jointly Controlled Operations (JCO)
- ✓ Jointly Controlled Assets (JCA)
- ✓ Jointly Controlled Entities (JCE)

2. Characteristics of a Joint Venture

A structure qualifies as a joint venture if it meets both of these conditions:

- a. Two or more venturers are bound by a contractual arrangement.
- b. The contractual arrangement establishes joint control.



6. Jointly Controlled Operations (JCO)

Concept Simplified Explanation

1. Jointly Controlled Operations (JCO)

- ✓ Venturers do not create a separate entity. They use their own resources to run the joint venture, handling funds, expenses, and sales individually.

2. Key Features of JCO

- a. Each venturer operates their own business.
- b. No separate entity is created.
- c. Venturers own and maintain their own assets.
- d. Transactions are recorded only in individual books, not in separate joint venture accounts.
- e. A contractual agreement governs the joint venture.
- f. Venturers use their own assets and funds for the joint venture's operations.
- g. Revenue and income are shared as per the agreement.

3. Accounting Treatment

Since there is no separate legal entity, the assets and liabilities remain with the individual venturers. They must determine how to allocate proceeds and share expenses.

4. Financial Statement Recognition



	Each venturer must: - Recognize the assets they control and liabilities they incur. - Recognize the expenses they incur and their share of income from the joint venture.
5.	Separate Accounting Records No separate financial statements are required, but internal records may be maintained for management reporting and performance assessment.
6.	Example 4: JCO in Practice ✓ Mr. A (tiles & marbles dealer), Mr. B (building materials dealer), and Mr. C (promoter) enter a joint venture for construction projects. ✓ Mr. A supplies tiles & marbles, Mr. B supplies other materials, and Mr. C oversees construction. ✓ They share profits/losses as per the agreement. ✓ No separate staff, resources, or accounts are maintained—each venturer records only their own transactions in their individual books. ✓ If transactions are recorded separately, it is only for internal reporting purposes and does not impact consolidated financial statements.



7. Jointly Controlled Assets (JCA)

1.	Jointly Controlled Assets (JCA) A separate legal entity is not created, but venturers jointly own the assets used to generate economic benefits. They share expenses and liabilities as per the contract.
2.	Key Features of JCA - No separate legal identity exists. Joint control is exercised over the joint assets. Venturers use the joint asset to gain economic benefits. - Each venturer incurs separate expenses for their own transactions. Expenses on jointly held assets are shared as per the contract. - In financial statements, venturers report only their share of the asset, income, and expenses. - Since these assets, liabilities, income, and expenses are already recorded in individual financial statements, no additional consolidation adjustments are needed in CFS. . Separate financial statements for the joint venture are not required, but internal reports may be prepared for management assessment.
3.	Example 5: JCA in Practice ✓ ABC Ltd., BP Ltd., and HP Ltd. operate an oil refinery and have common customers. They decide to jointly construct and maintain a pipeline. ✓ They agree to share construction and maintenance costs in a 3:3:4 ratio. ✓ Pipeline usage time is divided in a 4:3:3 ratio.



- ✓ Each venturer records their share of the joint asset under its respective asset category, not as an investment.
- ✓ Expenses and revenues are recorded as per Jointly Controlled Operations (JCO).

Differences between JCO and JCA:

Feature	Jointly Controlled Operations (JCO)	Jointly Controlled Assets (JCA)
Asset Ownership	Venturers use their own assets.	Venturers jointly own the assets.
Purpose	Agreement to carry on operations to earn income.	Agreement to jointly construct and maintain an asset to generate revenue.
Revenue and Expenses	Both revenues and expenses are shared at an agreed ratio.	Only expenses on joint assets are shared at an agreed ratio.



8. Jointly Controlled Entities (JCE)

1.	Jointly Controlled Entity (JCE) Venturers create a new entity specifically for their joint venture business.
2.	Key Features of JCE - A contractual agreement grants joint control over the entity's economic activities. - Venturers pool resources, and the new entity independently purchases assets, creates liabilities, incurs expenses, and generates revenue. - Profits and losses are shared based on the agreed ratio. - Each venturer contributes cash or resources, recorded as investments in their separate financial statements. - The jointly controlled entity maintains its own accounting records. - The entity prepares and presents financial statements like any other enterprise, following applicable standards.
3.	Example: JCE in Practice ✓ A Ltd. and B Ltd., both infrastructure companies, formed AB Ltd. to bid for a ₹2,000 crore metro project. ✓ A Ltd. is responsible for machinery & equipment. ✓ B Ltd. manages and controls funding. ✓ Revenue and expenses are shared in a 60:40 ratio. ✓ AB Ltd. qualifies as a Jointly Controlled Entity (JCE).



9. Consolidated Financial Statements of a Venturer

1.	Proportionate Consolidation A method where the venturer reports its share of assets, liabilities, income, and expenses of a jointly controlled entity (JCE) as separate line items in its financial statements.
2.	Exceptions (When Not Used) This method is not followed if:



	✓ The investment is temporary and intended for disposal soon. ✓ The joint venture has severe long-term restrictions on transferring funds to venturers. ✓ In these cases, AS 13 applies.
3.	When to Stop Using Proportionate Consolidation A venturer discontinues this method when: ✓ It loses joint control but retains some or all investment. ✓ The joint venture operates under restrictions preventing fund transfers.
4.	Accounting Treatment After Discontinuation ✓ Ownership above 50% → AS 21 (Consolidated Financial Statements). ✓ Ownership between 20%-50% → AS 23 (Investments in Associates). ✓ Ownership below 20% → AS 13 applies. The investment's carrying amount at the end of the joint venture relationship is treated as cost.
5.	Key Features of Proportionate Consolidation - Focus on substance over form - emphasizes the venturer's share of profits/losses over the structure of the joint venture. - The venturer's share of assets, liabilities, expenses, and income is presented separately in CFS. - Similar to AS 21, with some differences. - The joint entity and venturer should ideally have the same reporting date. If not, adjustments must be made for significant transactions (max 6-month gap). - Accounting policies should be consistent. If different, adjustments should be made in the venturer's statements. - Assets & liabilities cannot be offset unless legally permissible. Income & expenses should not be netted unless obligations are settled. - If a venturer's share of net assets < cost of investment, the difference is goodwill. If net assets > cost, the difference is capital reserve. - If an investor does not have joint control, losses are treated as in AS 23. If losses exceed the investor's net asset share, the excess is still recognized, and future profits offset past losses.



10. Transactions Between a Venturer and Joint Venture

1.	Recognition of Gains from Asset Transfers When a venturer sells or transfers assets to a joint venture, they should only recognize the gain or loss that belongs to other venturers.
2.	Full Recognition of Losses ✓ A venturer recognizes the full loss only if it indicates: ✓ Reduction in the net realizable value of current assets. ✓ Impairment loss on the asset.
3.	Profits from Assets Purchased by the Joint Venture



	If a joint venture buys assets from a venturer, the venturer does not recognize their share of profit unless the assets are later sold or disposed of.
4.	Recognition of Losses Losses are recognized like profits, but if they represent a net realizable value reduction or impairment loss, they are fully recognized immediately.
5.	Application to Jointly Controlled Entities (JCEs) ✓ These rules apply only to consolidated financial statements. ✓ In the venturer's own books, profit or loss is recognized in full.

Example

A and B established a separate vehicle i.e., entity J, wherein each operator has a 50% ownership interest and each takes 50% of the output. On formation of the joint venture, A contributed a property with fair value of Rs. 110 crore and agreed to contribute his experience over the years towards this venture; and B contributed equipment with a fair value of Rs. 120 crore. The carrying values of the contributed assets were Rs. 100 crore and Rs. 80 crore, respectively.

Answer:

A - Gain in consolidated financial statements

A's share in the fair value of assets contributed by entity

B (50% × 120) 60

A's share in the carrying value of asset contributed by

A to the joint venture (50% × 100) (50)

Gain recognised by A 10



11. Reporting Interests in Joint Ventures in the Financial Statements of an Investor

1.	Investors without Joint Control Investors without joint control over the entity should recognize their share of net results and their investment in the joint venture as per AS 13.
2.	Recognition in Consolidated Financial Statements In CFS, recognition is done as per AS 13, AS 21, or AS 23, depending on the situation.



12. Operators of Joint Ventures

1.	Payment to Operators Payment to operators is recognized as an expense in CFS and in the operator's books as per AS 9 (Revenue Recognition).
2.	Operator as a Venturer If the operator is one of the venturers, any amount received by them as management fees for the service is recognized as stated above.



8. INTRODUCTION TO ACCOUNTING STANDARDS



1. What Is AS?

1.	Definition ➤ Accounting Standards are official policy documents issued by the Government with support from other regulatory bodies. ➤ Ministry of Corporate Affairs (MCA) issues ASs in consultation with the National Financial Reporting Authority (NFRA).
2.	Key Areas Covered ➤ Recognition: Identifying financial transactions in records. ➤ Measurement: Assigning a value to transactions. ➤ Presentation: Structuring financial data in statements. ➤ Disclosure: Providing necessary financial information to users.



2. What Are INDIAN ACCOUNTING STANDARDS (IND AS)?

1.	Definition Ind AS are IFRS-converged standards issued by the Central Government of India . Issued under the supervision of the Accounting Standards Board (ASB) of ICAI , in consultation with NFRA .
2.	Approval Process NFRA recommends Ind AS to the MCA , which then mandates them for Indian companies.
3.	Naming & Numbering Ind AS follows the IAS numbering system , but with a 100-digit prefix (e.g., IFRS 9 = Ind AS 109).
4.	Purpose & Benefits Supports globalization & liberalization . Improves financial statement transparency . Ensures comparability across companies . Enhances disclosure requirements .



3. Benefits of AS?

1.	Standardization of Alternative Accounting Treatments ➤ Ensures uniform recording and presentation of financial transactions/ events ➤ Reduces variations in accounting practices making financial statements consistent and clearer.
2.	Requirements for Additional Disclosures ➤ Mandates disclosure of key accounting policies. ➤ Improves transparency in financial reporting.

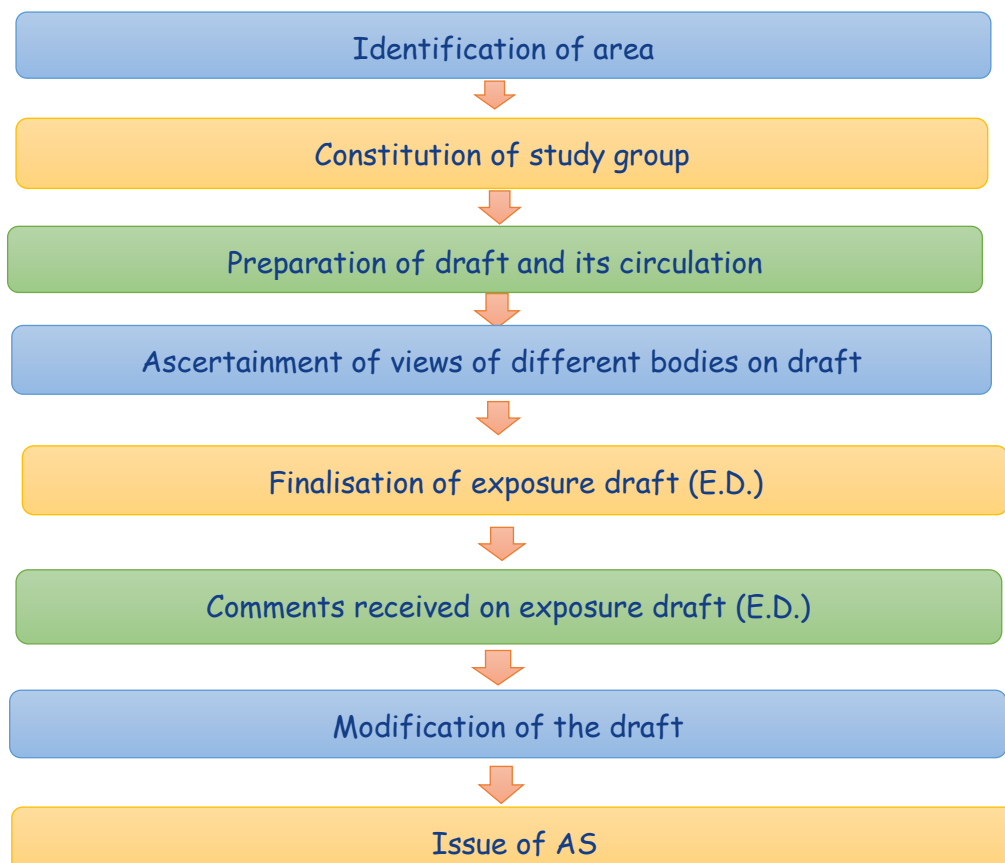


3.	Comparability of Financial Statements ➤ Helps compare financials across different periods. ➤ Aids in evaluating different companies effectively.
4.	Reduction of Scope for Creative Accounting ➤ Prevents manipulation of financial data. ➤ Sets clear guidelines for capitalization and expense recognition.



4. Standard Setting Process

1.	Establishment In 1977, ICAI as India's primary accounting body set up the ASB.
2.	Role in Standard Development ASB reviews IASs/IFRSs while considering Indian laws, business customs, and economic environment when developing ASs.
3.	Composition of ASB Includes representatives from industry, industry associations (e.g., ASSOCHAM, CII, FICCI), regulators, academics, and government departments.
4.	Autonomy Though established by the ICAI Council, the ASB operates independently in drafting accounting standards.
5.	Approval Process The NFRA recommends these standards to the MCA, which then mandates them for Indian companies.





HOW MANY ACCOUNTING STANDARDS?

The Institute of Chartered Accountants of India has, so far, issued 29 Accounting Standards.

Presentation & Disclosures based Accounting Standards		
AS 1	:	Disclosure of Accounting Policies
AS 3	:	Cash Flow Statements
AS 17	:	Segment Reporting
AS 18	:	Related Party Disclosures
AS 20	:	Earnings Per Share
AS 24	:	Discontinuing Operations
AS 25	:	Interim Financial Reporting
Assets based Accounting Standards		
AS 2	:	Valuation of Inventories
AS 10	:	Property, Plant and Equipment
AS 13	:	Accounting for Investments
AS 16	:	Borrowing Costs
AS 19	:	Leases
AS 26	:	Intangible Assets
AS 28	:	Impairment of Assets
Liabilities based Accounting Standards		
AS 15	:	Employee Benefits
AS 29	:	Provisions, Contingent Liabilities and Contingent Assets
Accounting Standards based on items impacting Financial Statements		
AS 4	:	Contingencies and Events Occurring After the Balance Sheet Date
AS 5	:	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
AS 11	:	The Effects of Changes in Foreign Exchange Rates
AS 22	:	Accounting for Taxes on Income
Revenue based Accounting Standards		
AS 7	:	Construction Contracts
AS 9	:	Revenue Recognition
Other Accounting Standards		
AS 12	:	Accounting for Government Grants
AS 14	:	Accounting for Amalgamations (excluding inter- company holdings)
Accounting Standards for Consolidated Financial Statements		
AS 21	:	Consolidated Financial Statements of single subsidiaries (excluding problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries).
AS 23	:	Accounting for Investment in Associates in Consolidated Financial Statements
AS 27	:	Financial Reporting of Interests in Joint Ventures

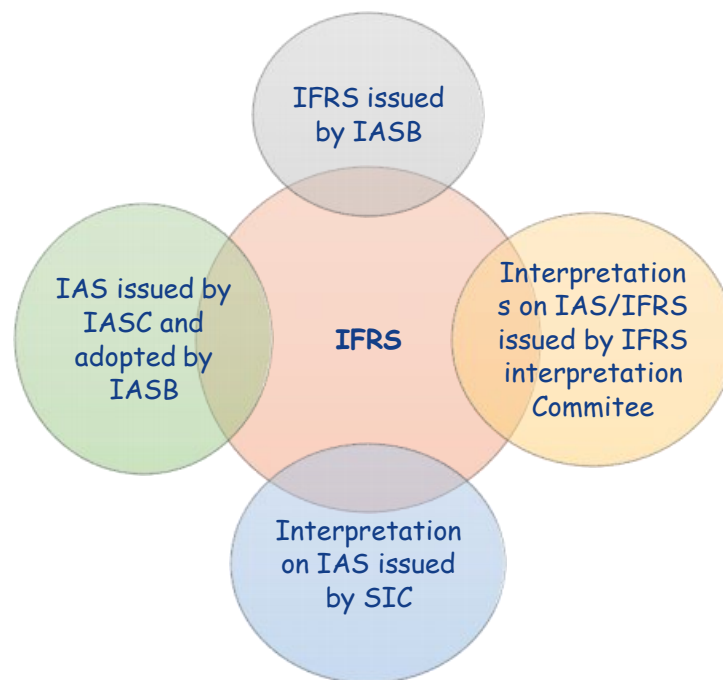


5. Need for Convergence towards Global Standards

1. **Raising Funds from International Markets**
 - Different countries have varied accounting rules.
 - Companies seeking international capital must adapt to foreign standards for investor confidence.
2. **Comparability of Financial Statements**
 - FS based on A consistent framework helps investors and analysts.
 - International standards enable better comparability, Improves trust & risk assessment.
3. **Uniformity, Comparability, and Transparency**
 - Multiple standards cause confusion and errors.
 - A global standard ensures reliability in cross-border investments and global listings more reliable.
4. **Global Investment**
 - Converging standards simplify international investments.
 - Reduces risks, costs, and enhances transparency.



6. International Financial Reporting Standards (IFRS) AS Global Standards



Component	Issued By	Explanation
IFRS (International Financial Reporting Standards)	IASB (International Accounting Standards Board)	Standards developed by IASB for global financial reporting.
IAS (International Accounting Standards)	IASC (International Accounting Standards Committee)	Older accounting standards, now largely replaced by IFRS but still applicable in some cases.

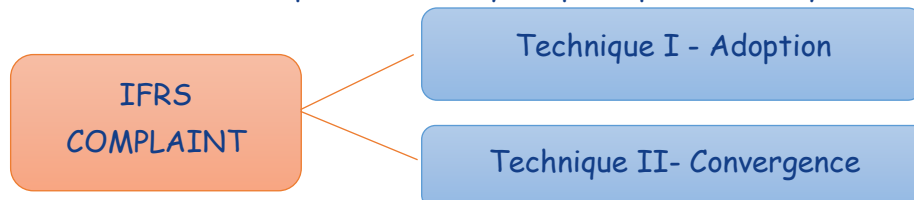


SIC Interpretations	Standard Interpretations Committee (SIC)	Interpretations issued to clarify existing IAS standards.
IFRIC Interpretations	IFRS Interpretations Committee (IFRIC) of IASB	Provides guidance on complex financial reporting issues under IFRS.

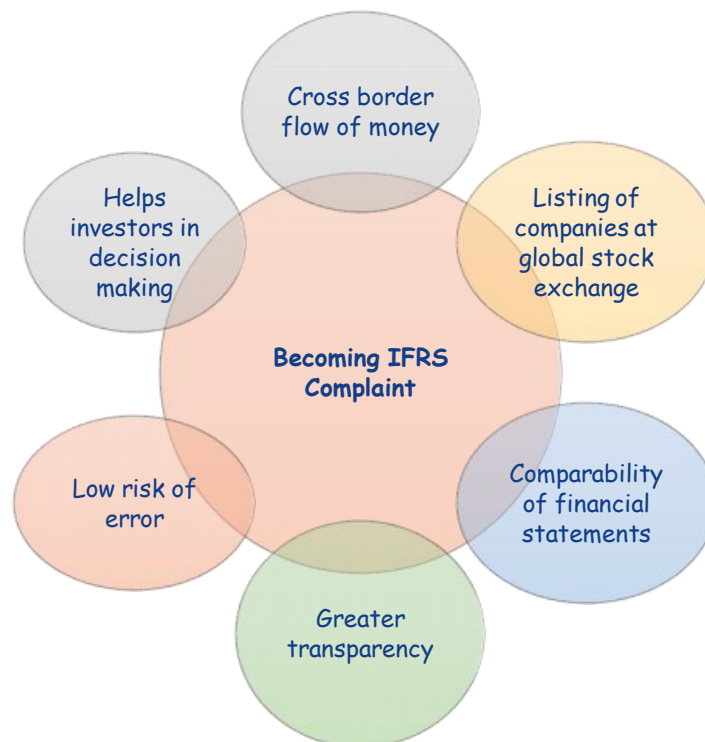


7. Becoming IFRS Compliant

Any country can become IFRS compliant either by adoption process or by convergence process.



Convergence with IFRS will result in following benefits:

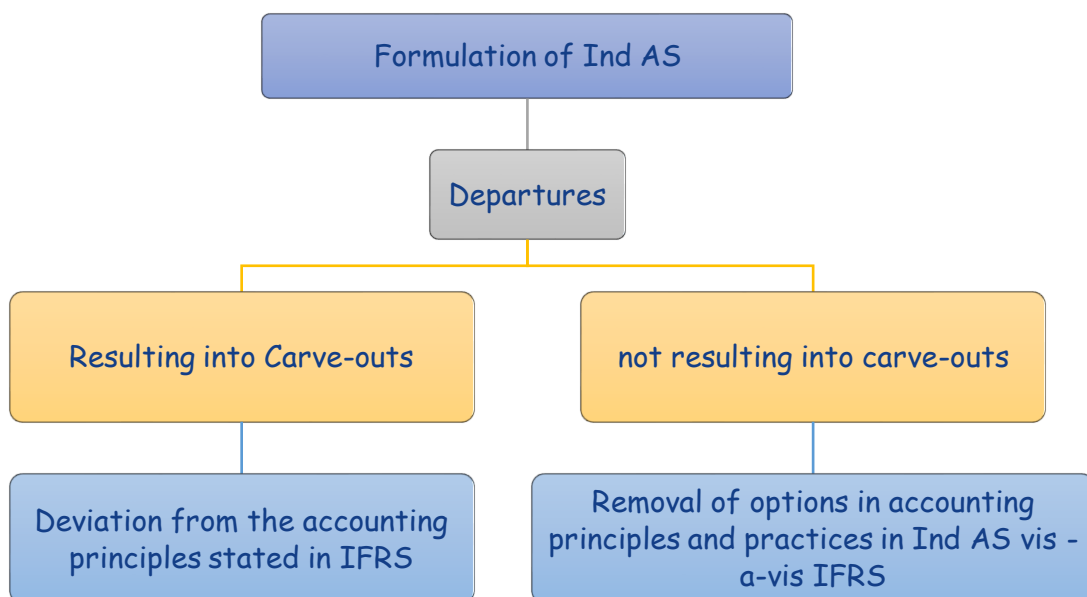


8. What are Carve Outs/Ins in Ind AS?

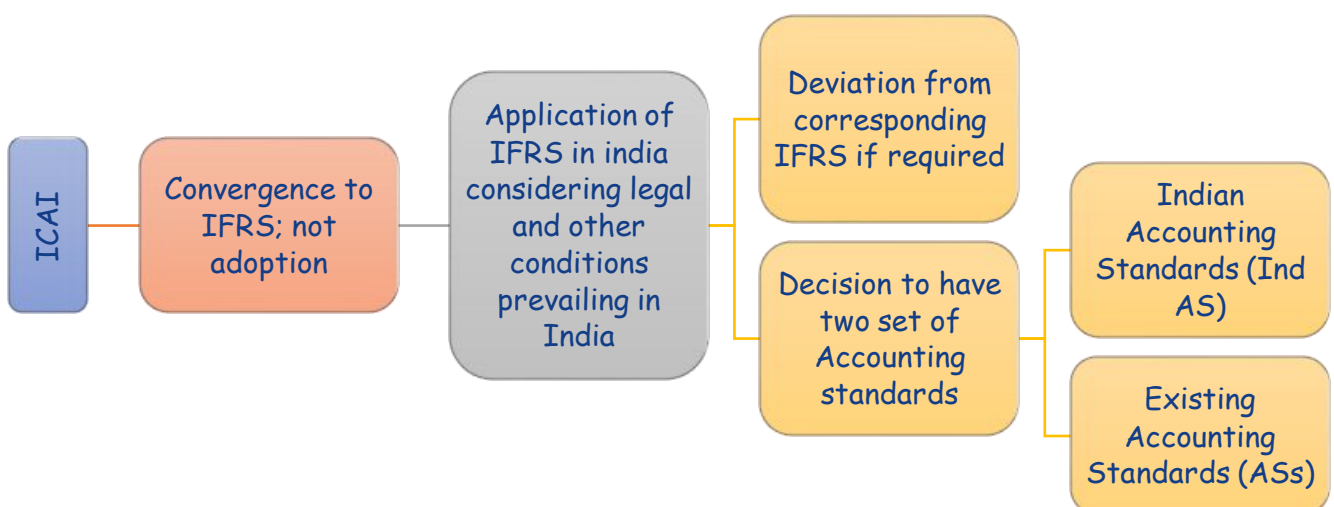
1.	India's Approach to IFRS The Government of India, in consultation with ICAI, chose to converge with IFRS instead of full adoption. This decision followed a detailed analysis and discussions with stakeholders.
2.	Ind AS Alignment Ind AS aligns closely with IAS/IFRS, with deviations only when necessary. These deviations are called "carve-outs".
Key Reasons for Carve-Outs	
1.	Terminology Differences Certain terms were modified to match Indian laws.



	Example: "Statement of Profit and Loss" instead of "Statement of Comprehensive Income", and "Balance Sheet" instead of "Statement of Financial Position".
2.	Removal of Accounting Options To ensure consistency, some accounting options under IFRS were removed in Ind AS, though these do not qualify as carve-outs.
3.	Differences in Economic Environment Adjustments were made to reflect India's economic conditions that differ from IFRS assumptions. These deviations are recognized as "carve-outs". Carve-In Additional guidance in Ind AS beyond what is provided in IFRS is termed as "Carve-In".



9. Convergence to IFRS in India





9. FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS



1. Introduction

Framework Issued by ASB

- Accounting standards need a strong foundation of basic principles.
- ASB of ICAI issued a framework in July 2000.
- This framework helps in developing new standards.
- It also guides the review of existing standards.

Principal Areas Covered

1.	Components of Financial Statements
2.	Objectives of Financial Statements
3.	Assumptions Underlying Financial Statements
4.	Qualitative Characteristics of Financial Statements
5.	Elements of Financial Statements
6.	Criteria for Recognition financial elements
7.	Measurement Principles
8.	Concepts of Capital & Capital Maintenance

Purpose of Framework

The framework defines concepts for preparing and presenting financial statements for external users.

Its main purposes are:

- Helping enterprises follow Accounting Standards and address topics not covered.
- Guiding ASB in developing and reviewing Accounting Standards.
- Promoting consistency by reducing different accounting methods.
- Assisting auditors in checking compliance with Accounting Standards.
- Helping users understand financial statements.
- Providing information on ASB's approach to setting standards.

Status & Scope of Framework

- Applies to general-purpose financial statements prepared annually by all businesses, whether public or private, for external users.
- Does not apply to special-purpose financial reports (e.g., tax reports) but can be used as a guide if it doesn't conflict with specific requirements.
- If there is a conflict between the framework and an Accounting Standard, the Accounting Standard will prevail.



2. Areas of Framework

Category	Key Elements	Explanation
1. Components of Financial Statements	Balance Sheet	Shows the economic resources controlled by an enterprise.



	Statement of Profit & Loss	Presents the operational results of an enterprise.
	Cash Flow Statement	Displays how an enterprise generates and utilizes cash.
	Notes & Explanatory Materials	Provides supplementary information explaining different items.
2. Users of Financial Statements	Investors	Assess performance, profitability, and financial position.
	Employees	Evaluate stability, continuity, and growth.
	Suppliers & Creditors	Determine the creditworthiness of the company.
	Customers	Analyse stability and profitability.
	Government	Review performance and social contributions.
	Lenders	Assess if loans and interest will be repaid.
	Public	Examine the company's contribution to the economy.
3. Fundamental Accounting Assumptions	Accrual	Transactions are recognized when they occur, not when cash is received/paid.
	Going Concern	Assumes the enterprise will continue operations in the foreseeable future.
	Consistency	Requires the same accounting policies to be used in all periods.
4. Qualitative Characteristics of Financial Statements	Understandability	Information should be easily understood by users with basic financial knowledge.
	Relevance	Financial statements must include only information that influences decisions.
	Reliability	Data should be free from material errors and bias.
	Comparability	Enables intra-firm and inter-firm comparisons.
5. Elements of Financial Statements	Asset	Resource controlled by an enterprise, expected to generate future economic benefits.
	Liability	A present obligation that requires outflow of resources for settlement.
	Equity	The residual interest in assets after deducting liabilities.



6. Measurement of Elements in Financial Statements	Income/Gain	Increase in economic benefits, either by inflow of assets or decrease of liabilities, excluding owner contributions.
	Expense/Loss	Decrease in economic benefits, either by outflow of assets or increase of liabilities, excluding owner distributions.
	Historical Cost	Assets and liabilities are recorded at their original acquisition price.
	Current Cost	Assets are recorded at the amount needed to acquire them today; liabilities at the amount required to settle them currently.
	Realisable (Settlement) Value	Assets recorded at the amount receivable on sale; liabilities at the actual amount needed for settlement.
	Present Value	Assets and liabilities recorded at the discounted value of future cash flows.

Concept of Capital Maintenance

1.	Definition of Capital ➤ Capital refers to the net assets of a business (Assets - Liabilities). ➤ A business must maintain sufficient net assets to continue operations at the same level each year.
2.	Importance of Capital Maintenance ✓ Dividends should not exceed profit after making provisions for asset replacement. ✓ The Companies Act requires businesses to provide for depreciation before distributing dividends. ✓ Rising prices can make it difficult to replace assets even after accounting for depreciation.



Capital Maintenance Approaches

Approach	Explanation	Example
1. Financial Capital Maintenance at Historical Cost	✓ Opening and closing assets are stated at historical cost. ✓ Capital is maintained if retained profit ≥ 0. ✓ Ensures the business has funds to replace assets at historical cost.	Example: ✓ A trader starts with Rs. 12,000 (6,000 units @ Rs. 2 per unit). ✓ Sells at Rs. 3 per unit, withdraws Rs. 6,000. - Closing equity remains Rs. 12,000 (entirely in cash). ✓ Retained Profit = Rs. 12,000 - Rs. 12,000 = Nil.



		✓ The trader can repeat operations indefinitely if purchase prices remain unchanged.
2. Financial Capital Maintenance at Current Purchasing Power	✓ Equity values are adjusted using average price indices. ✓ Ensures that the business has enough funds to replace assets at average closing price levels. ✓ Limitation: Not all asset prices change at the same rate.	Example: ✓ The average price index increases from 100 to 120. ✓ Adjusted Opening Equity = Rs. 14,400 instead of Rs. 12,000. ✓ Closing Equity remains Rs. 12,000, leading to a negative retained profit (- Rs. 2,400). ✓ The trader cannot repurchase 6,000 units at the new price of Rs. 2.40/unit. ✓ Solution: Drawings should have been Rs. 3,600 instead of Rs. 6,000 to maintain capital.
3. Physical Capital Maintenance at Current Costs	✓ Each asset is adjusted using specific price indices instead of an average index. ✓ Liabilities are adjusted based on the actual cost of settling them on the closing date. ✓ More precise approach than Financial Capital Maintenance at Current Purchasing Power.	✓ Ensures the business has enough funds to replace each asset at its respective closing price.



AS - 1: DISCLOSURE OF ACCOUNTING POLICIES

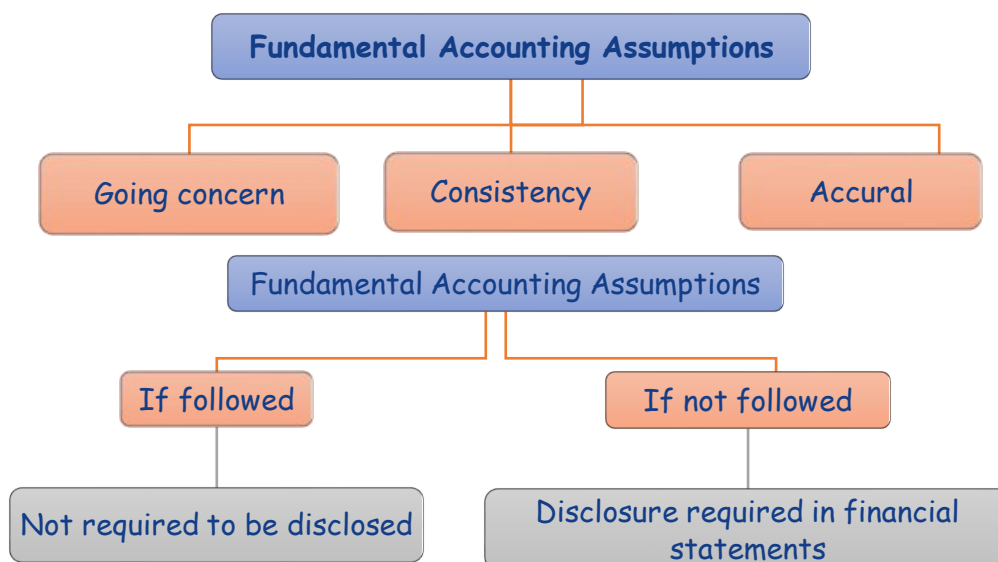


1. Objective/Need

1. **Objective**
Prescribes the principles for selecting and disclosing significant accounting policies in financial statements there by
 - ✓ Enhances understanding of financial statements.
 - ✓ Facilitates comparison between different enterprises for the same period.
2. **Need for Disclosure of Accounting Policies**
 - Diversity in Accounting Policies are unavoidable due to:
 - a. Limited coverage of standards - AS do not cover all areas, allowing enterprises to adopt reasonable policies where no standard exists.
 - b. Diverse business situations - A single set of policies cannot apply to all enterprises at all times.
 - AS allow multiple policies, even in covered areas.
 - Different policies lead to different financial results, even for the same transactions.
 - Comparability suffers due to variations in policies.
 - Compliance with standards alone is not enough; disclosure is necessary.
 - AS-1 requires disclosure of significant accounting policies used.
 - Users can understand differences and adjust their analysis accordingly.
3. **Changes in Accounting Policies**
This also mandates disclosing changes in accounting policies to facilitate period-to-period comparison.
4. AS 1 is applicable to all enterprises.



2. Fundamental Accounting Assumptions





Principle	
1.	Going Concern ✓ FSS are prepared on the assumption that an enterprise will continue its operations in the foreseeable future. ✓ No intention or need to materially curtail the scale operations. ✓ Recognizes the need to: a. Retain profits to replace used assets. b. Provide for adequate provision for liabilities.
2.	Consistency ✓ Same accounting policies should be used for similar transactions across all periods. ✓ Improves comparability over time. ✓ Changes in accounting policies are allowed if: a. Required by law (statute). b. Mandated by an accounting standard. c. Leads to better financial statement presentation.
3.	Accrual Basis of Accounting ➤ Transactions are recorded when they occur, irrespective of cash flow. ➤ Provides a better revenue-cost matching, ensuring accurate performance measurement. ➤ More logical than cash basis but risks recognizing income before actual receipt. ➤ Can overstate profits, leading to capital erosion if dividends are paid on unrealized income. ➤ Despite risks, accrual basis is widely used due to its logical approach. ➤ Revenue is recognized only when realization is reasonably certain. ➤ Mandated for companies under Section 128 of the Companies Act, 2013.



3. Accounting Policies

1.	Accounting Policies ➤ Specific accounting principles and methods used by the enterprise in preparing and presenting financial statements. ➤ Accountants choose from various options for recording and disclosing items in books of accounts. This list is not exhaustive i.e. endless. Example <table border="1"> <tr> <th>Items to be disclosed</th><th>Method of disclosure or valuation</th></tr> <tr> <td>Inventories</td><td>FIFO, Weighted Average etc.</td></tr> <tr> <td>PPE</td><td>Historical cost, market value, revaluation method etc</td></tr> </table> ➤ Policies cover valuation of assets/liabilities, revenue recognition, and expected losses etc., ➤ Policies impact financial results, making comparison between financial statements difficult	Items to be disclosed	Method of disclosure or valuation	Inventories	FIFO, Weighted Average etc.	PPE	Historical cost, market value, revaluation method etc
Items to be disclosed	Method of disclosure or valuation						
Inventories	FIFO, Weighted Average etc.						
PPE	Historical cost, market value, revaluation method etc						



4. Selection of Accounting Policy

Major Considerations for Selecting Accounting Policies

I.

Prudence

- ✓ Profits should not be anticipated, but potential losses must be accounted for.
- ✓ Requires provisions for all known liabilities and losses, even if amounts are uncertain.
- ✓ Ensures:
 - No overstatement of profits
 - No understatement of losses
 - No overstatement of assets
 - No understatement of liabilities

Example 1

Inventory Valuation: At lower of cost or net realizable value (NRV).

- ✓ If $NRV > \text{Cost}$, ignore future profit.
- ✓ If $NRV < \text{Cost}$, recognize potential loss immediately.

A company facing a damage lawsuit should recognize a provision only if the probability of losing is higher than winning.

Scenario 1: NRV is ₹15 per unit

Purchase Cost: $500 \text{ units} \times ₹10 = ₹5,000$

Sold: $400 \text{ units} \times ₹15 = ₹6,000$

Unsold Stock (100 units): Valued at ₹10 per unit (cost, since NRV is higher).

Profit Calculation: $(400 \times 15) - (500 \times 10 - 100 \times 10) = 6,000 - 4,000 = ₹2,000$

Future profit (₹500) is ignored, as it is not yet realized.

Scenario 2: NRV is ₹8 per unit

Unsold Stock (100 units): Valued at ₹8 per unit (NRV, since it is lower than cost).

Profit Calculation: $(400 \times 15) - (500 \times 10 - 100 \times 8) = 6,000 - 4,200 = ₹1,800$

Possible loss (₹200) is recognized immediately, following conservatism.

Example 2

Exercise of prudence does not permit creation of hidden reserve by understating profits and assets or by overstating liabilities and losses. Suppose a company is facing a damage suit. No provision for damages should be recognised by a charge against profit, unless the probability of losing the suit is more than the probability of not losing it.

II.

Substance Over Form

Transactions should be recorded based on their true economic impact, not just their legal form.

Example: A company sells an asset to a bank and immediately leases it back. Legally, it appears as a sale, but economically, the company still controls the asset. So, instead of recording it as a sale, it should be treated as a finance lease in the books.

III.

Materiality



- ✓ Financial statements must disclose all material items that could influence user decisions.
- ✓ Materiality is not always based on size but based on nature of items for example, a small fraud could indicate major internal control weaknesses.

Materiality Limits (as per Schedule III of the Companies Act, 2013)

- a) Any income/expenditure item exceeding 1% of revenue from operations or ₹1,00,000, whichever is higher, must be disclosed.
- b) **Shareholding disclosure:** Companies must disclose in **Notes to Accounts** the shares held by shareholders owning more than 5% of the company's shares.

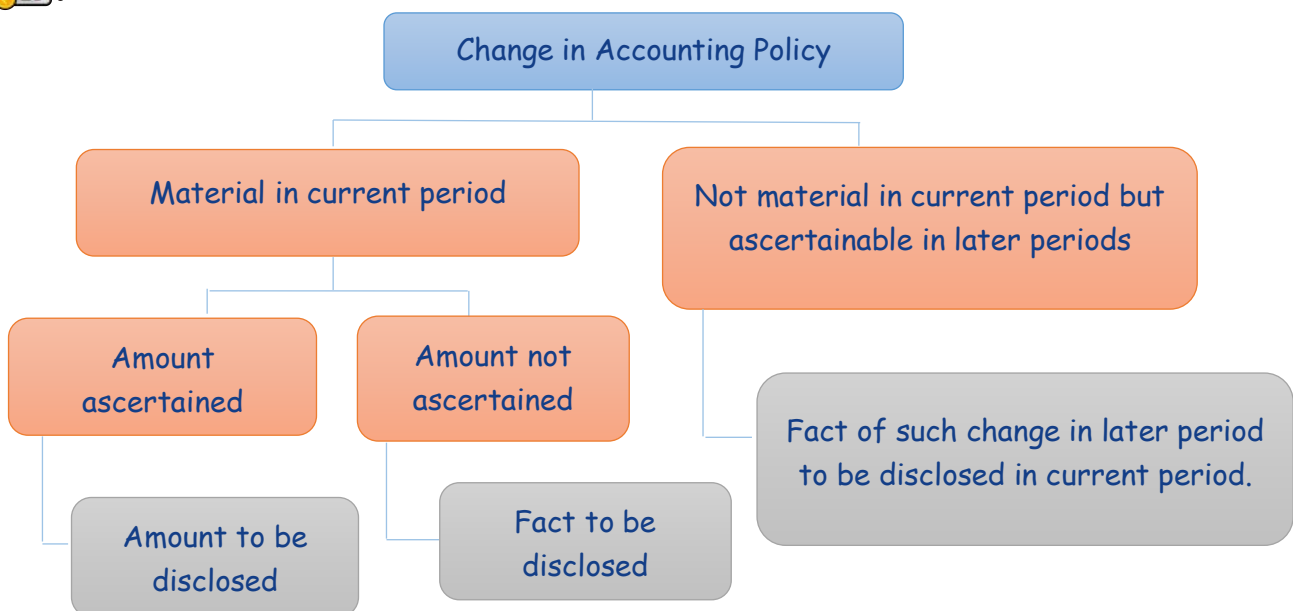


5. Manner of Disclosure

1. ✓ All significant accounting policies used in preparing and presenting financial statements must be disclosed.
- ✓ The disclosure should form part of the financial statements.
- ✓ All policies should be disclosed in one place for clarity.
- ✓ Disclosure is not a remedy for wrong accounting.



6. Disclosure of Changes in Accounting Policies



Example of Disclosure

A company switches from FIFO to weighted average method for inventory valuation, reducing profit and inventory value by Rs. 20,000.

Disclosure: "The company changed its policy to the weighted average method, which better reflects consumption. This change reduced profit and inventory value by Rs. 20,000."



AS - 2: VALUATION OF INVENTORIES



1. Objective

AS 2 provides guidance on how inventories should be valued in financial statements until revenue is recognised, including the cost formulas used.



2. Inventories

1.	Inventories are Assets Held for: ➤ For sale in the ordinary course of business, or ➤ In the process of production for sale, or ➤ For consumption in the production of goods or services for sale including maintenance supplies and consumables.
2.	Types of Inventories ➤ Goods purchased for resale (e.g., merchandise or land/property for resale). ➤ Finished goods, work-in-progress, and materials/supplies for production.
3.	Exclusions from Inventories ➤ Spare parts, servicing equipment, and standby equipment which are classified as PPE AS 10.
4.	Types of Inventories by Business ➤ Trading concerns: Products for resale, supplies like wrapping paper, cartons, and stationery. ➤ Manufacturing concerns: raw materials, work-in-process, and finished goods.



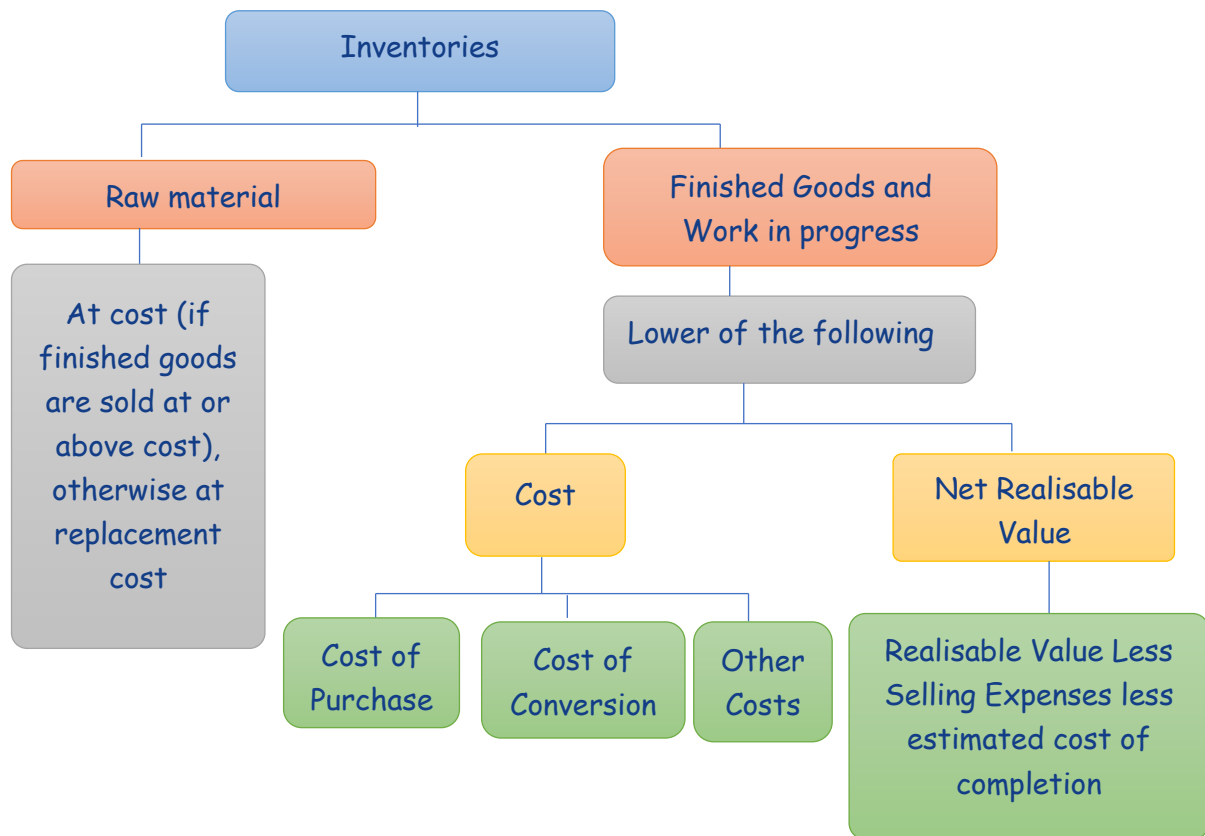
3. Scope (exclusions)

a.	Work in progress under construction contracts, including directly related service contracts being covered under AS 7. However, Inventory held for use in construction, e.g. cement lying at the site should however be covered by AS 2
b.	Work in progress in the ordinary course of business of service providers. For example, for a shipping company, fuel and stores not consumed at the end of accounting period is inventory but not costs for voyage-in-progress. WIP may arise for other services e.g. shipping, software development, consultancy, etc.
c.	Shares, debentures, and other financial instruments held as stock-in-trade. Excluded from AS 13 also.
d.	Producers' inventories of livestock, agricultural, forest products, and minerals measured at net realisable value based on industry practices. e.g. where sale is assured under a forward contract or a government guarantee or where a homogenous market exists and there is negligible risk of failure to sell.



4. Measurement of Inventories

1.	➤ Inventory is valued at the lower of cost and NRV ➤ Inventory valuation follows the concept of prudence ➤ If $NRV > Cost$, inventory is valued at cost, ignoring future profits. ➤ If $NRV < Cost$, inventory is valued at NRV, recognizing the potential loss.
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5. Costs of Inventory

Costs of Inventories

Comprise costs of purchase, costs of conversion, and other costs incurred to bring the inventory to its present location and condition.

a. Costs of Purchase

Particulars	Amount
Purchase Price	xxxx
Duties and Taxes (Non-refundable)	xxxx
Other Expenditure Directly Attributable to Acquisition	xxxx
Less: Trade Discounts, Rebates, Duty Drawbacks	xxxx
Less: Other Similar Items	xxxx
Total	xxxx

b. Costs of Conversion

- Includes costs directly related to production, such as direct labour and overheads (fixed and variable) incurred to convert raw materials into finished goods. Refer below chart.
- Fixed production overheads are allocated based on normal capacity (average expected production considering planned maintenance).
- If production is low, extra overhead costs are not added to each unit; instead, they are recorded as expenses.
- If production is high, overhead per unit is reduced to prevent overvaluation of inventory.
- Variable overheads are assigned based on actual usage of production facilities.

c. Other Costs



Only costs that help bring inventory to its current location and condition can be included.

- **Design Costs** - If a product is custom-made, design costs can be part of inventory cost.
- **Borrowing Costs (Interest)** - Normally not included, except for inventory that takes a long time to be ready (e.g., aging wine).
- **Amortisation of Intangibles** - If related to production (e.g., patents for manufacturing, copyrights for publishers), it may be included.
- **Exchange Rate Differences** - Not included in inventory costs.

Exclusions from cost of Inventories

- a. **Abnormal amounts of wasted materials, labour, or other production costs;**
- b. **storage costs** (unless necessary for production);
- c. **administrative overheads** not contributing to inventory condition;
- d. **selling and distribution costs.**

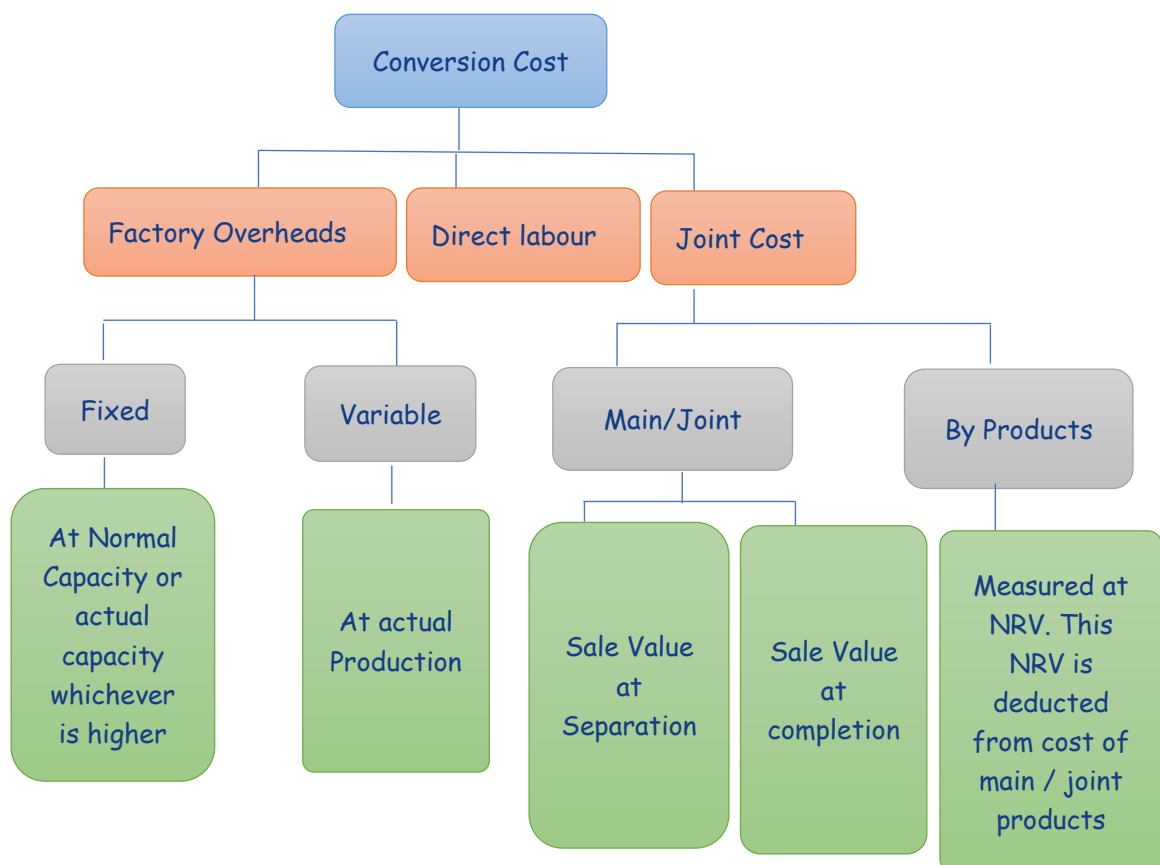
d. Joint or By-Products

Costs up to the split-off point should be allocated using a reasonable & consistent basis. This basis of allocation may be at sale value at split-off, sale value after further processing etc.

By-products, Scraps, and Wastes

These are valued at NRV.

The main product's cost = joint cost - NRV of by-products.





6. Cost Formula

1. When inventories are purchased or produced in different lots with varying costs- Specific identification cost method.
If specific identification isn't feasible, inventory cost should be determined using the First-In, First-Out (FIFO) or Weighted Average cost formula.
2. Chosen Method
The selected method should accurately represent the costs of bringing inventory to its current state and location.



7. Other Techniques of Cost Measurement

- a. Standard Costing Method
 - Instead of actual, the standard costs may be taken as cost of inventory.
 - Basis for Setting Standards - Should consider normal levels of:
 - Material consumption
 - Labour efficiency
 - Capacity utilisation
 - Standards should be reviewed and updated regularly to match current conditions.
- b. Retail Method
 - Used for businesses with large number of rapidly changing items are traded.
 - Tracking individual item costs is difficult.
 - Retailers usually have consistent gross margins.
 - Inventory cost = Sales value of unsold stock - Average gross margin %.
 - Simplifies inventory valuation without tracking each item separately.

Example:

A trader purchased certain articles for Rs.85,000. He sold some of articles for Rs.1,05,000. The average percentage of gross markup is 25% on cost. Opening stock of inventory at cost was Rs.15,000.

Cost of closing inventory is shown below:

	Rs.
Sale value of opening stock and purchase (Rs.85,000 + Rs.15,000) × 1.25	1,25,000
Sales	(1,05,000)
Sale value of unsold stock	20,000
Less: Gross Markup (Rs.20,000 / 1.25) × 0.25	(4,000)
Cost of inventory	16,000



8. Estimates of Net Realisable Value

- NRV of FG = Estimated selling price of FG - Estimated costs to sell.
- NRV of WIP = Estimated selling price of FG - Estimated costs to complete the WIP to FG and sell.

Example:



Cost of a partly finished unit at the end of 20X1-X2 is Rs.150. The unit can be finished next year by a further expenditure of Rs.100. The finished unit can be sold at Rs.250, subject to payment of 4% brokerage on selling price. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further. The value of inventory will be determined as below:

	Rs.
Net selling price	250
Less: Estimated cost of completion	(100)
	150
Less: Brokerage (4% of 250)	(10)
Net Realisable Value	140
Cost of inventory	150
Value of inventory (Lower of cost and net realisable value)	140

- NRV of Raw material is not relevant because RM is not meant for sale but for use in production.
 - a. RM in general valued at cost but
 - b. If the FG in which the RM is used valued below cost then RM is valued at Replacement cost provided it is less than Cost of RM.
- NRV considers price/cost changes after the balance sheet date if they confirm existing conditions on BS date.



9. Disclosures

Financial Statement Disclosures

- a. Accounting policies used to measure inventories, including the cost formula applied.
- b. The total inventory value and its classification based on the nature of the enterprise.
- c. Information on inventory classifications and changes in their values.
- d. Common classifications of inventories are
 - ✓ Raw materials and components,
 - ✓ Work in progress,
 - ✓ Finished goods,
 - ✓ Stock-in-trade (in respect of goods acquired for trading),
 - ✓ Stores and spares,
 - ✓ Loose tools, and
 - ✓ Others (specify nature).



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



1. Objective/Scope

Objective

- Deals with the treatment and disclosure of events occurring after the balance sheet date.
- Applies to contingencies not covered by other AS.

Example - Impairment of financial assets like receivables (provision for bad and doubtful debts) falls under this standard.



2. Contingencies

1. Contingency

A condition or situation where the outcome (gain or loss) is determined only by the occurrence or non-occurrence of uncertain future events.

2. Accounting Treatment of Contingent Loss

- The accounting treatment of a contingent loss depends on its expected outcome.
- If a loss is likely, it should be recorded in the financial statements.
- It is prudent to recognize a potential loss in advance rather than ignore it.

Example

ABC Ltd. has filed a case to recover Rs. 25 lakhs. If the legal team believes the chances of recovery are nil, ABC Ltd. should make a provision for doubtful debts.

- The amount of a contingent loss is estimated based on management's judgment.
- If the loss amount cannot be estimated due to conflicting or insufficient evidence, only its existence and nature are disclosed.
- Management considers all available information, including events after the balance sheet date, past experiences, and expert opinions.
- Guarantees, discounted bills, and similar obligations are disclosed in the financial statements, even if the risk of loss is very low.

3. Accounting Treatment of Contingent Gains

- ✓ Contingent gains are not recognized.
- ✓ If a gain is virtually certain, it should be recognized.
- ✓ The amount is based on information available at the FS approval date.



3. Events occurring after the Balance Sheet Date

Events After Balance Sheet Date

Significant events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are approved by the Board of Directors (or the corresponding approving authority for other entities).

Example



For the year ending 31st March 2020, the financial statements were approved by the Board of Directors on 04th September 2020. Events between 01st April 2020 to 04th September 2020 are considered events after the balance sheet date.



4. Types of Events Occurring after Balance Sheet

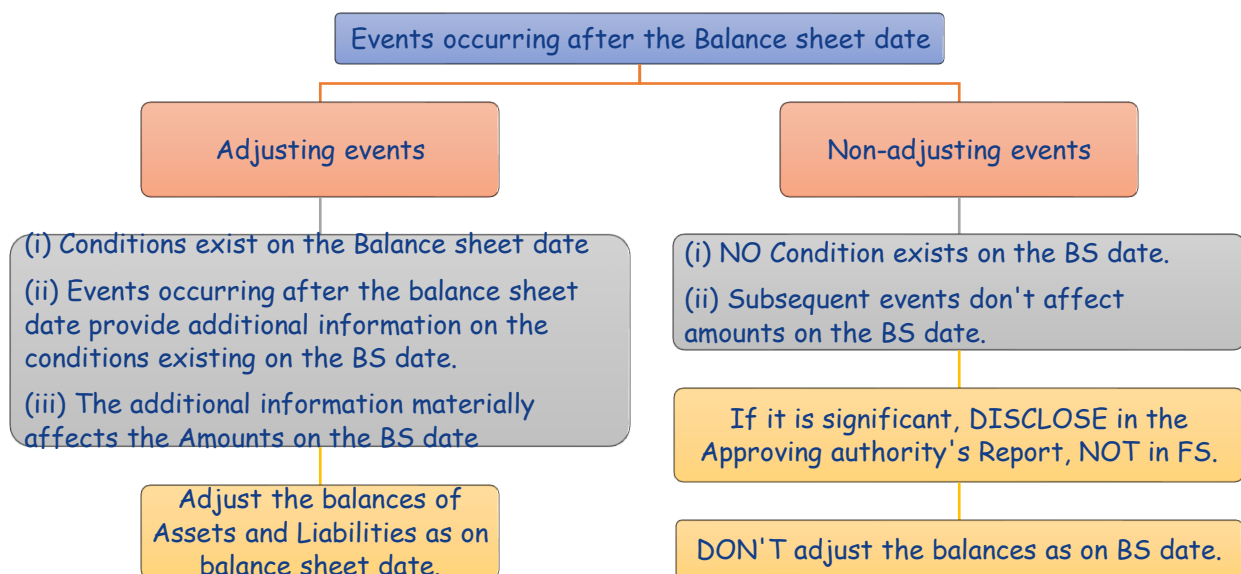
Adjusting Events

- Those which provide further evidence of conditions that existed at the balance sheet date.
- Adjustments to assets and liabilities are required for events occurring after the balance sheet date
 - that provide additional information
 - materially affecting the determination of the amounts
 - relating to conditions existing at the balance sheet date.

For example, an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

Non-Adjusting Events

- those which are indicative of conditions that arose subsequent to the balance sheet date. For example, plant got damaged due to occurrence of fire.
 - Adjustments to assets and liabilities are not required for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date.
- Example: A drop in market value of investments after the balance sheet date is not adjusted since it reflects new circumstances.
- If they are significant, mentioned in the report of the approving authority.





5. Disclosure

Disclosure of Non-Adjusting Events

Non-adjusting events occurring after the balance sheet date should be disclosed with the following details:

- ✓ Nature of the Event
- ✓ An estimate of the financial impact should be disclosed & if an estimate cannot be made, this fact should be clearly stated.



6. Exceptions

Exceptions to Adjusting Events

There are 2 exceptions to adjusting events:

1. **Statutory Requirement or Special Nature**
 If the event is due to a statutory requirement or is of a special nature.
Example: A law is enacted after the balance sheet date, requiring additional tax provisions for the previous year.
Dividends declared after BS date
 - Some events after the balance sheet date are disclosed due to legal requirements or their special nature.
 - Dividends declared after the balance sheet date are not recorded as a liability since there was no obligation at that time.
 - However, if required by law, they are mentioned in the notes to the financial statements.
 - From 31st March 2017 onwards, proposed dividends are only disclosed in the notes and not recorded as a liability.
2. **Going Concern Assumption**
 - If the event affects the Going Concern assumption of the entity.
 - If going concern assumption is not valid then FS are prepared on liquidation/NRV basis.

Example

- A company records cheques dated 31st March or earlier, received after 31st March, as cheques in hand under cash and cash equivalents.
- These cheques are deposited and realized in April.
- However, since they were received after 31st March, they do not reflect conditions existing on that date.
- AS 4 (Revised) does not allow recognizing such cheques as assets.
- Also, they do not significantly impact the company's financial position, so no disclosure is needed in the Directors' Report.
- An asset must be under the company's control on 31st March, but since the cheques were received later, they do not qualify as assets.



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



1. Objective

1. The objective is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises follow uniformity.
2. **Enhancing Comparability**
This standard enhances the comparability of an enterprise's financial statements over time and with those of other enterprises.
3. **Requirements of the Standard**
 - ✓ Classification and disclosure of extraordinary and prior period items.
 - ✓ Disclosure of certain items within profit or loss from ordinary activities.
 - ✓ Accounting treatment for changes in accounting estimates.
 - ✓ Disclosure of changes in accounting policies in the financial statements.



2. Scope

1. **Application of the Standard**
Same as requirements of the standard.
2. **Tax Implications**
This standard does not deal with the tax implications of the above items.



3. Net Profit or Loss for the Period

1. **Recognition of Income & Expense**
All income and expenses for a period should be considered in calculating net profit or loss unless an Accounting Standard requires otherwise.
Components of Net Profit or Loss
Net profit or loss consists of:
 - ✓ Profit or loss from ordinary activities
 - ✓ Extraordinary items.**Profit or Loss from Ordinary Activities**
Ordinary activities are any activities
 - which are undertaken by an enterprise as part of its business and
 - such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.
 For example, profit on sale of merchandise, loss on sale of unsold inventory at the end of the season.



2.	Extraordinary Items ✓ Extraordinary items are income or expense arising from transactions that are clearly distinct from ordinary activities. ✓ They are not expected to recur frequently. ✓ The nature of the event, not how often it occurs, determines if it is extraordinary. ✓ What is extraordinary for one business may not be for another. Example: Losses from an earthquake may be extraordinary for most businesses. However, for an insurance company covering earthquake risks, such claims are not extraordinary. Disclosure of Extraordinary Items ✓ The nature and amount of extraordinary items should be disclosed separately in the Profit and Loss Account or in the notes to accounts in a manner that its impact on current profit or loss can be perceived. Examples of Extraordinary Items ✓ Loss due to earthquakes ✓ Attachment of property ✓ Government grants becoming refundable ✓ Government grants for financial support ✓ Government grants as compensation for expenses or losses in previous periods. ✓ Seizure of assets by government.
3.	Exceptional Items ➤ When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, ➤ the nature and amount of such items should be disclosed separately. Circumstances which may give rise to the separate disclosure of items of income and expense include ✓ Write-down of inventories to net realizable value and reversal of write-downs. ✓ Restructuring activities and reversal of provisions. ✓ Disposals of fixed assets or long-term investments. ✓ Legislative changes with retrospective application. ✓ Litigation settlements. ✓ Other reversals of provisions.
4.	Prior Period Items Prior period items are income or expenses arising in cy as a result of errors or omissions in the preparation of financial statements of previous FYs. Errors may arise from: ✓ Mathematical mistakes ✓ Mistakes in applying accounting policies ✓ Misinterpretation of facts or oversight. Disclosure of Prior Period Items



- The nature and amount of prior period items should be disclosed separately in the statement of profit and loss.
- Prior period items are usually included in the current period's net profit or loss.
- Alternatively, they can be shown separately after determining the current profit or loss.
- The goal is to show their impact on the current financial results.

Examples of Prior Period Items

- ✓ Error in calculating expenditure or income.
- ✓ Omission of income or expenditure.
- ✓ Non-provision for expenses such as travel or salary.
- ✓ Applying incorrect rate of depreciation.
- ✓ Treating operating lease as finance lease.
- ✓ Capitalization of borrowing cost on working capital.



4. Changes in Accounting Estimates

1. **Accounting Estimates**
 - ✓ Accounting estimates are approximate value of a financial item.
 - ✓ These are made based on the circumstances & information available at the time of making estimation.
 - ✓ These estimations may be changed due to
 - a. New information
 - b. Change in circumstances
 - c. More experience etc
2. **Examples**
 - ✓ Sachin purchased a machine for Rs.10 lacs with an expected life of 10 years. Initially, depreciation was Rs.1 lac per year. After 5 years, the machine's useful life is revised to 2 more years, so depreciation is adjusted to Rs.2.5 lacs annually for the next 2 years. This change is treated as a change in accounting estimate, not a prior period item.
 - ✓ If depreciation was incorrectly calculated as Rs.60,000 in year 5 instead of Rs.1 lac, and corrected in year 6, then the Rs.1 lac depreciation for year 6 is correct, and the extra Rs.40,000 is a prior period item due to an error.
3. **Accounting Treatment of Change**

The effect of a change in an accounting estimate should be included in net profit or loss in:

 - ✓ The period of the change (if it affects only that period).
 - ✓ The period of the change and future periods (if it affects both).

Example: A change in bad debts estimate affects only the current period, while a change in useful life affects both current and future periods.
4. **Classification of Changes**
 - ✓ Changes in estimates should be classified the same as previous entries.



	✓ If previously classified as ordinary activity , it remains ordinary; if classified as extraordinary item , it remains so.
5.	Disclosure of Changes ✓ Material changes in estimates affecting the current or future periods should be disclosed, along with the nature and amount . ✓ If the amount can't be quantified, disclose that fact.
6.	Policy or Estimate Change If it's unclear whether a change is a policy change or estimate change , treat it as an estimate change with appropriate disclosure.



5. Changes in Accounting Policies

1.	Accounting Policies meaning Covered in AS 1
2.	When a Change is Allowed A change in accounting policy can occur only when: ✓ It is required by law or statute. ✓ It is necessary to comply with an Accounting Standard. ✓ The change results in a more appropriate presentation of financial statements.
3.	Not a Change in Accounting Policy The following are not changes in accounting policies: ✓ Adoption of a policy for events or transactions that differ in substance from previous ones (e.g., switching from ad-hoc ex-gratia payments to a formal retirement gratuity scheme). ✓ Adoption of a new policy for events or transactions that did not previously occur or were immaterial.
4.	Disclosure Requirements Covered in AS 1



AS 7 CONSTRUCTION CONTRACTS



1. Objective

1. Peculiar features of construction contracts.
 - Takes more than one accounting year to complete.
 - Long-term projects.
 - Allocation of contract revenue and contract cost to the accounting period in which construction work is performed.
 - Final outcome determined after no. of years from year of commencement of construction.
2. The main objective of this AS is to
 - This AS prescribe the criteria for allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.
 - The focus of the standard is to determine when the contractor should recognise contract revenue and contract costs in the statement of profit and loss.



2. Scope

Applicable to **contractors**, not the contractee (customer).



3. Definitions

1. **Construction Contract**
 - A contract **specifically negotiated** for constructing an asset or a combination of assets that are **interrelated or interdependent** in terms of design, technology, function, purpose, or use.
 - A construction contract can be for a single asset like a bridge, building, dam, road, ship, or tunnel. It can also cover multiple assets that are connected in design, technology, function, or purpose.

Examples: contracts for building refineries or complex machinery.
2. **construction contracts also include**
 - ✓ **contracts for the rendering of services which are directly related to the construction of the asset**
(e.g., services of project managers, architects).
 - ✓ **Contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.**

Example 1

Entity XY contracts with AB to construct 2 residential buildings in the same premises. The construction of both buildings will begin simultaneously. Building material, construction work, and other related activities will go on in parallel to provide cost savings to entity XY. This also helps AB achieve a timely completion of the two buildings and negotiate a consolidated price for the two buildings. The above example suggests that there is a single contract negotiated to construct two buildings that are closely



interrelated and interdependent in terms of their ultimate purpose and use. Therefore, this represents a Construction Contract.

Example 2

H, a sole-proprietor, contracts with M/s DM Construction, to dismantle his office premises and construct it from scratch. In the given case, the construction contract includes both demolition as well as construction of a new building.



4. Types of Contracts

1. Fixed Price Contract

- Construction contract in which the contractor agrees to a fixed contract price or a fixed rate per unit of output subject to cost escalation clauses.
- Fixed-price contracts are common in public tenders for projects like roads, flyovers, and office buildings.
- Such projects have a budget, and the public entity does not intend to exceed the tender amount.
- However, construction costs may increase due to factors like a sudden rise in wage rates or construction material prices.

2.

Cost Plus Contract

- Construction contract in which the contractor is reimbursed for allowable or defined costs, plus a percentage or fixed fee.
- Cost-plus contracts are used when there is uncertainty in measuring costs or completion time.
- In such cases, the contractor does not bear the loss due to these uncertainties.
- If the contract scope cannot be fully assessed, both parties may agree to a cost-plus contract.



5. Recognition of Contract Revenue & Expenses

Feature	Outcome of Construction Contract Can Be Estimated Reliably	Outcome of Construction Contract Cannot Be Estimated Reliably
Revenue Recognition	Contract revenue is recognized as revenue by reference to the stage of completion of the contract activity at the reporting date.	Revenue is recognized only to the extent of contract costs incurred of which recovery is probable.
Expense Recognition	Costs associated with the construction contract are recognized as expenses by reference to the stage of completion of the contract activity at the reporting date.	Contract costs are recognized as an expense in the period in which they are incurred.
Expected Loss	An expected loss on the construction contract is recognized as an expense	An expected loss on the construction contract is



	immediately.	recognized as an expense immediately.
The outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:	Fixed-Price Contract - Total contract revenue can be measured reliably. - Economic benefits will likely flow to the enterprise. - Contract costs to complete and stage of completion can be measured reliably. - Contract costs can be clearly identified and compared with prior estimates.	Cost-Plus Contract - Economic benefits will likely flow to the enterprise. - Contract costs (whether reimbursable or not) can be clearly identified and measured reliably.



6. Methods for Percentage of Completion

1.	Based on Costs Incurred Percentage of completion = actual cost incurred till year end / Total estimated contract cost. Total estimated contract cost = actual cost incurred + Estimated Future Costs
2.	Survey Method ➤ Percentage of completion determined through surveys. ➤ In government projects, a surveyor is appointed to monitor parameters such as quality of work, material used, etc. ➤ The surveyor assesses the percentage of work completed based on these parameters. ➤ The certification provided by the surveyor is used to determine the stage of completion of the project.
3.	Based on Physical Proportion ➤ This method is used for less complex construction work. ➤ The stage of completion is determined based on the physical work completed as a proportion of the total work. Example: If a contract involves placing tiles over 1,000 sq. ft., and 300 sq. ft. is completed, then 30% of the work is considered completed.



7. Contract Revenue

Steps for Computation of Contract Revenue	Amount
A. Initial Amount Agreed	XXXX
B. Add/Less: Variations in Contract Work [Note 1]	XXXX
C. Add/Less: Escalation Clause [Note 2]	XXXX
D. Add: Claim Amount [Note 3]	XXXX



E. Add: Incentives [Note 4]	XXXX
F. Less: Penalties [Note 5]	(XXXX)
G. Total Contract Revenue	XXXXX

Notes

- Variations in Contract:** Changes in the contract due to **customer instructions** (e.g., changes in specification or design).
Conditions:
 - ✓ Customer **approval is probable**;
 - ✓ Amount can be **measured reliably**.
- Adjustments in the contract due to **changes in cost** (e.g., price increase or decrease).
[Based on agreed terms; adjustments must be **measured reliably**]
- Claim Amount:** Amount raised for **delays caused by the customer, errors in specifications, design, etc.**
 - ✓ **Negotiations** have reached an **advanced stage**;
 - ✓ Customer **acceptance is probable**;
 - ✓ **Measured reliably**.
- Incentives:** Additional revenue for **meeting or exceeding specific performance standards**.
 - ✓ It's **probable** that performance standards will be met or exceeded;
 - ✓ Revenue must be **measurable reliably**.
- Penalties:** Deductions due to **delays caused by the contractor**. No specific conditions; **penalties are deducted** based on contract terms.



8. Contract Costs

Contract Cost Type	Details	Examples
Specific Costs	Costs directly related to a specific contract.	Material cost, site labour costs (including supervision), depreciation of plant and equipment, hiring plant and equipment, design / technical assistance costs, third-party claims specific to the contract.
Attributable & Allocable Costs	Costs incurred for all contracts, allocated systematically and rationally based on normal construction activity.	Insurance premiums, non-specific design and technical assistance, construction overheads (e.g., supervisor salary), borrowing costs (AS 16).
Costs Chargeable to the Customer as per Agreement	Costs added to contract costs if specified in the agreement .	General administration costs, R&D costs, or other costs specifically mentioned in the



		agreement.
Unallocable Costs	Costs that should not be allocated to contract costs unless specified in the contract.	General administration costs, selling costs, R&D costs, depreciation of idle plant / equipment not used for any particular contract.



9. Combining & Segmenting of Contracts

Scenario	Condition
Treating Each Asset as Separate Contract	(a) Separate proposals for each asset.
	(b) Each asset subject to separate negotiation and acceptance / rejection by both parties.
	(c) Costs and revenues of each asset can be identified.
Treating a Group of Contracts as a Single Contract	(a) Group of contracts negotiated as a single package.
	(b) Contracts are closely interrelated and form part of a single project with an overall profit margin.
	(c) Contracts are performed concurrently or in continuous sequence.
Treating Additional Asset as Separate Contract	(a) Additional asset differs significantly in design, technology, or function from the original asset(s).
	(b) Price of additional asset is negotiated separately from the original contract price.



10. Recognition of Expected Losses

1.	Expected Losses Recognize as an expense immediately when total contract costs exceed revenue, regardless of work status. The amount of such a loss is determined irrespective of: (a) whether or not work has commenced on the contract; (b) the stage of completion of contract activity; or (c) the amount of profits expected to arise on other contracts
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11. Disclosure Requirements

1.	An enterprise should disclose: 1. The amount of contract revenue recognized as revenue in the period. 2. The methods used to determine contract revenue recognized in the period. 3. The methods used to determine the stage of completion of contracts in progress. In respect of contracts in progress at the reporting date, an enterprise should disclose: 1. The aggregate amount of costs incurred and recognized profits (less recognized losses) up to the reporting date. 2. The amount of advances received.
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3. The amount of retentions.

- **Retentions:** Part of progress billings held back until contract conditions are satisfied or defects are rectified.
- **Progress Billings:** Amounts billed for work done, whether paid or unpaid by the customer.
- **Advances:** Amounts received before work is performed.

Enterprise should present

Category	Formula	Balance Sheet Treatment	Meaning
Gross Amount Due from Customers (Asset)	$(\text{Costs Incurred} + \text{Recognised Profits}) - (\text{Recognised Losses} + \text{Progress Billings})$	Shown as an Asset	When work done is more than the amount billed to customers.
Gross Amount Due to Customers (Liability)	$(\text{Recognised Losses} + \text{Progress Billings}) - (\text{Costs Incurred} + \text{Recognised Profits})$	Shown as a Liability	When the amount billed is more than the work completed.



AS - 9: REVENUE RECOGNITION

1. Objective

- Revenue (also called **Top Line**) or **Sales** is the backbone of any business.
- **Higher revenue** usually means a bigger market share, better growth opportunities, and a higher business value.
- **Many startups** focus more on increasing sales and reaching more customers rather than making profits in the beginning.
- So, it is important to have a standard that defines how and when companies should recognize revenue in a specific accounting period.
- AS 9 deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. AS 9 is mandatory for all enterprises.
- The standard covers revenue from:
 - a. Sale of goods
 - b. Rendering of services
 - c. Use by others of enterprise resources yielding interest, royalty & dividend.

2. Scope

Exclusions from the Standard

- | | |
|----|--|
| 1. | Revenue from construction contracts. |
| 2. | Revenue from hire-purchase or lease agreements. |
| 3. | Revenue from government grants and similar subsidies. |
| 4. | Revenue from insurance contracts by insurance companies. |

3. Definitions

Revenue

Revenue is the **gross inflow** of:

- ✓ Cash
- ✓ Receivables
- ✓ Other Consideration

arises from:

- ✓ Sale of Goods
- ✓ Rendering of Services
- ✓ Use by others of enterprise resources yielding interest, royalty & dividend.

Note:

In an **agency relationship**, revenue is the **commission earned**, not the total inflow.

Items Not Included as Revenue



1. Realized gains from the sale or unrealized gains from holding non-current assets, like appreciation in fixed assets.
2. Unrealized gains from changes in the value of current assets or.
3. natural increases in herds, agriculture, and forest products
4. Realized or unrealized gains due to foreign exchange rate changes or translation adjustments (AS-11).
5. Realized gains from discharging an obligation less than its carrying amount.
6. Unrealized gains from the restatement of the carrying amount of an obligation.

Example 1 Entity XY sells a machine being used at its factory at a price of ₹ 2 lakh. The carrying value of the machine is ₹ 1.80 lakh. The sale of the machine does not increase the revenue of XY but is an example of a capital receipt since transaction does not take place in the normal course of business. Such gain on sale of ₹ 20,000 (₹ 2 lakhs - ₹ 1.80 lakhs) is recognised as a part of profit & loss statement under Gain/(Loss) on disposal of asset.

Example 2 ST Ltd is a real-estate developer and builder. It is into the business of buying and selling properties. In 20X1, ST Ltd purchased a unit of land for ₹ 150 crore. It sold off that land after few months at a price of ₹ 240 crore. In the above case, the sale of land is a transaction that happens in the ordinary course of business (as he is a real estate developer and builder - properties will be an item of inventory in the financial statements) for ST Ltd. Hence, it should recognise a revenue of ₹ 240 crore when the land is sold.

Example 3 DL Ltd, a pharma company, has been conducting research on new medicine since last 2 years to increase the immunity levels of the people consuming it without any side effects. During the current year, it decides to sell the outcome of the research undertaken so far to another competitor, GH Ltd for ₹ 50 crore. DL has already incurred ₹ 30 crore on the ongoing research. In the above example, the sale of the research findings does not represent an increase in revenue. This is because DL Ltd's business is not to sell these research findings in the ordinary course of business. The amount of ₹ 50 crore will be a part of Other Income in the profit & loss statement.

Example 4 Trip Deal is a website that allows people to book airlines tickets. As a part of the business, it agrees to buy 100 tickets from an airline on a particular date and resells those tickets to customers. However, Trip Deal bears the loss for any unsold tickets. In the above example, the risks and rewards relating to tickets are borne by



Trip Deal. Hence, sales made for the tickets will be fully recognized as part of its revenue. Any unsold tickets will be charged as loss by the entity.

4. Recognition of Revenue from Sale of Goods

1. **Transfer of Property**
Revenue is recognized when the **property** in goods or all significant **risks and rewards of ownership** have been transferred to the buyer.
Notes
 - ✓ Usually, when goods are sold, both ownership and risk move to the buyer.
 - ✓ But sometimes, risk and ownership transfer at different times.
 - ✓ In such cases, revenue is recorded when the risk and rewards pass to the buyer.
 - ✓ If delivery is delayed due to the buyer or seller, the party at fault takes the risk.
 - ✓ Sometimes, buyers and sellers agree to transfer risk at a different time than ownership.
2. **Control**
The seller must retain **no effective control** of the goods, usually associated with ownership.
3. **Certainty in Price**
There should be **no uncertainty** in the price charged for the goods.
4. **Certainty in Collection**
There should be **no significant uncertainty** in collecting revenue from the sale.

Revenue Recognition with Delivery Delays

1. **Delayed Delivery at Buyer's Request**
If **delivery is delayed** at the buyer's request, revenue is recognized when:
 - ✓ Goods are in the **seller's possession, identified, and ready for delivery.**
 - ✓ **Buyer accepts billing.****Example 5**
 XY Ltd sells goods worth 50 lakh on 20 February 20X1 to AB Ltd. AB Ltd is facing storage capacity constraints at their warehouse. AB Ltd instructs XY Ltd to hold the goods at XY Ltd's warehouse and arrange for delivery on 15 March 20X1. However, all the risks and rewards associated with the sold goods are deemed transferred to AB Ltd. In the current scenario, delivery of goods sold is delayed at the request of buyer. XY Ltd can recognize revenue for sale of goods to AB Ltd on 20 February 20X1 provided that the goods sold to AB Ltd are held in XY Ltd's warehouse separately and are not clubbed with other inventory.



Revenue Recognition with Conditions

1.	Installation and Inspection Revenue is recognized when: ✓ Goods are installed at the buyer's place to their satisfaction. ✓ Goods are inspected and accepted by the buyer. ✓ Simple installation allows immediate recognition.
2.	Sale on Approval Basis Revenue is recognized when: ✓ Actual acceptance by buyer (through communication). ✓ Implied acceptance (if buyer adopts goods). ✓ Time period for rejection expires or no rejection occurs. Example 6 M/s XY sells goods worth ` 5 lakh on 30th of March 20X1 to M/s FT under Sale on approval basis. Under the arrangement, FT can return the goods back to XY within next 3 months. XY cannot reasonably determine whether FT will give the acceptance of goods before the expiry of 3 months. Under these circumstances, XY cannot recognize revenue until the goods are accepted by FT or on completion of 3 months, whichever is earlier.
3.	Consignment Sales Revenue is recognized only when goods are sold to third parties.
4.	Cash on Delivery Sales Revenue is recognized only when cash is received by the seller or agent.
Other Revenue Recognition Rules	
1.	Instalment Payments i.e., payments made over a period of time but delivery of goods takes places after all instalment's payment Revenue is recognized when goods are delivered.
2.	Special Orders/Shipments Revenue is not recognized until goods are manufactured, identified, and ready for delivery.
3.	Sale/Repurchase Agreements If the seller agrees to repurchase goods later, it's considered a financing agreement, not a sale. These cash flows do not count as revenue.
4.	Instalment Sales The sale price excluding interest is recognized on the sale date. Interest is recognized proportionally to the unpaid balance.
5.	Trade Discounts and Volume Rebates



Trade discounts and volume rebates are not included in revenue as they represent a reduction in cost. Discounts given should be deducted from revenue.

5. Recognition of Revenue from Rendering of Services

Service Revenue Recognition

1. Revenue from services is recognized as the service is performed.

2. Methods to Measure Performance

Service performance can be measured by the following methods:

1. Completed Service Contract Method

1. Performance consists of:

- ✓ A single act, or
- ✓ Multiple acts with one being the main act.

2. Revenue is recognised only

- ✓ after the service is fully or mostly completed and
- ✓ no significant uncertainties exist about collection.

If multiple steps are involved, but key services are still pending, revenue is not recognized until the final step is done.

2. Proportionate Completion Method

1. Performance consists of the execution of more than one act.

2. Revenue is recognized proportionately by reference to the performance of each act.

- ✓ Contract value
- ✓ Associated costs
- ✓ Number of acts, or
- ✓ Another suitable basis.

No significant uncertainties exist about collection.

Revenue Recognition Under Special Conditions

a. Installation Fees

Revenue is recognized when installation is completed and accepted by the client.

b. Advertising Commission

Revenue is recognized when the advertisement appears before the public.

c. Insurance Agency Commission

Revenue is recognized on the commencement or renewal date of the policy.

d. Admission Fees

Revenue from events (e.g., artistic performances, banquets) is recognized when the event takes place.

e. Tuition Fees

Revenue is recognized over the period of instruction.



- f. **Entrance and Membership Fees**
Recognition depends on the nature of services:
- ✓ Entrance fees are generally capitalized.
 - ✓ Membership fees are recognized on a systematic and rational basis, considering timing and nature of the service.

6. Recognition of Revenue from use by Others of Enterprise Resources Yielding Interest, Royalties and Dividends

- a. **Revenue from Interest**
- Interest is the charge for using money or for amounts due to a business.
 - Revenue from interest is recognized on a time proportion basis based on the outstanding amount and the applicable rate.
- b. **Revenue from Royalties**
- Royalties are charges for using assets like patents, trademarks, copyrights, or know-how.
 - Revenue is recognized on an accrual basis as per the terms of the agreement.
- c. **Revenue from Dividends**
- Rewards from the holding of investments in shares.
 - Revenue is recognized when the owner's right to receive payment is established.

Revenue from interest, royalties, and dividends should be recognized only when there is no major uncertainty in measuring or collecting the amount.

7. Effect of Uncertainties on Revenue Recognition

- a. **Uncertainty at the Time of Recognition**
If there is uncertainty in collecting revenue at the time of recognition, do not recognize the revenue. Postpone recognition until it is reasonably certain that collection will occur.
- b. **Uncertainty Arising After Recognition**
If uncertainty in collection arises after revenue recognition, make a provision but do not adjust the recognized revenue.

8. Disclosure

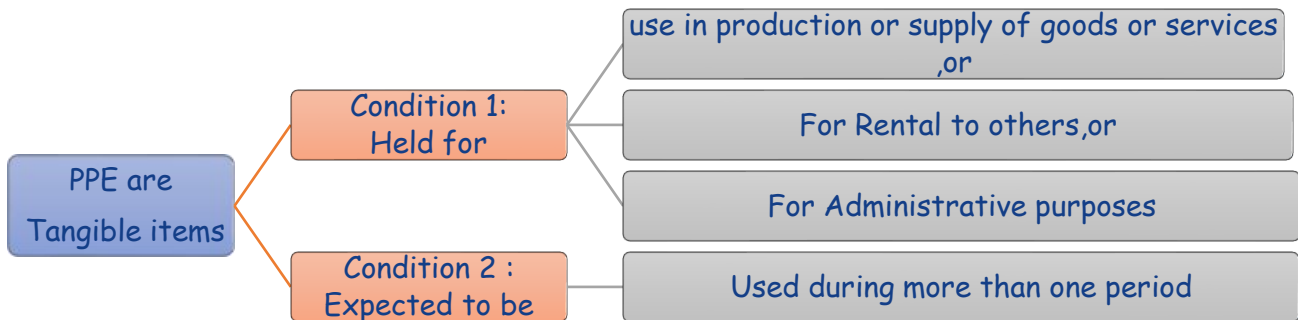
When revenue recognition is postponed, the circumstances causing the postponement must be disclosed.



AS - 10: PROPERTY, PLANT AND EQUIPMENT



1. Definition Of PPE



- Administrative Purposes**
includes all business purposes can be used for:
 - Selling and distribution
 - Finance and accounting
 - Personnel and other functions of an enterprise.
- If spare parts or standby equipment meet the definition of PPE, apply AS 10.



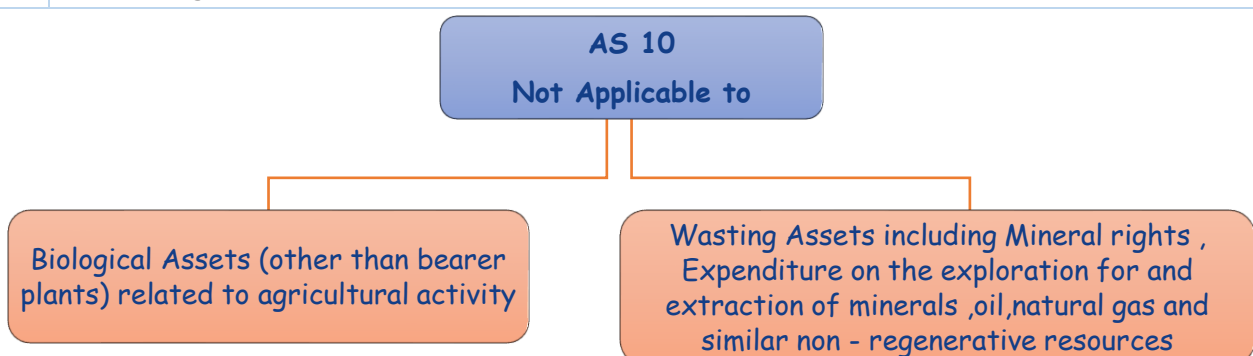
2. Objective

- Objective**
To prescribe the accounting treatment for PPE.
- Principal Issues**
The main issues in accounting for PPE are:
 - Recognition of assets
 - Carrying amounts determination
 - Depreciation charges and impairment losses to be recognised.



3. Scope of the Standard

- Application of the Standard**
This Standard applies to PPE accounting unless another Standard requires a different treatment.
- Example**
AS 19 assesses leased PPE based on risk transfer, while depreciation follows PPE accounting standards.



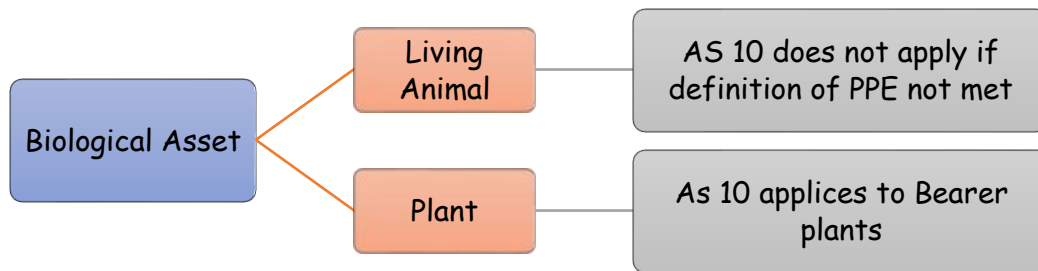


Note: AS 10 applies to Bearer Plants but it does not apply to the produce on Bearer Plants.



4. Other Definitions

1. Biological Asset:

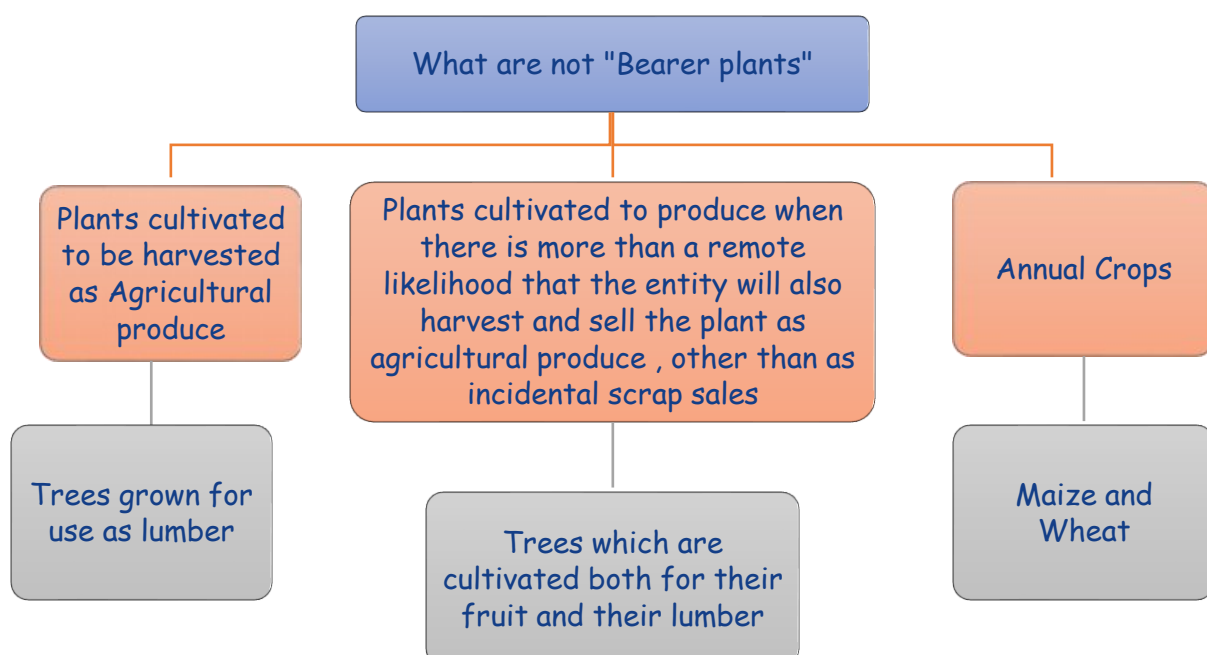


2. Bearer Plant: Is a plant that (satisfies all 3 conditions):



Note: When bearer plants are no longer used to bear produce, they might be cut down and sold as scrap.

For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.





5. Recognition criteria for PPE

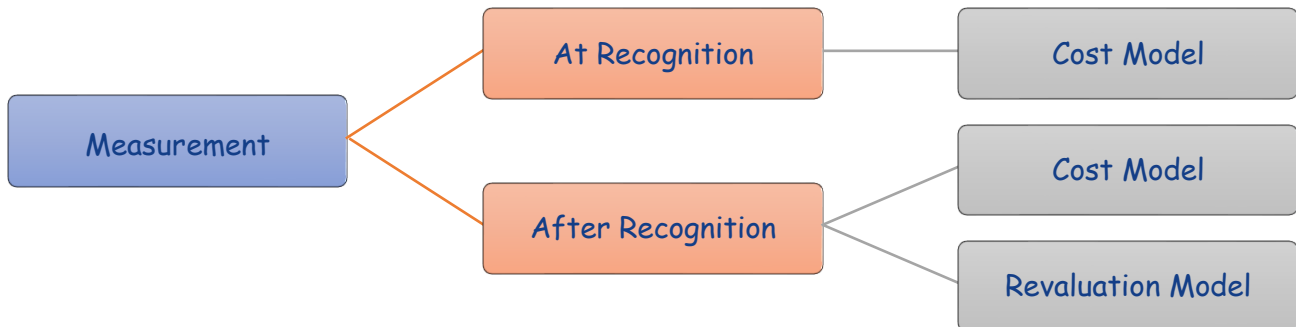
- Probable future economic benefits will flow to the enterprise from the asset.
- The cost of the asset must be measurable reliably.

Note:

- ✓ Small items like moulds, tools, and dies can be grouped, applying recognition criteria to the total.
- ✓ If the cost is immaterial, an enterprise may expense it instead of capitalizing as PPE.

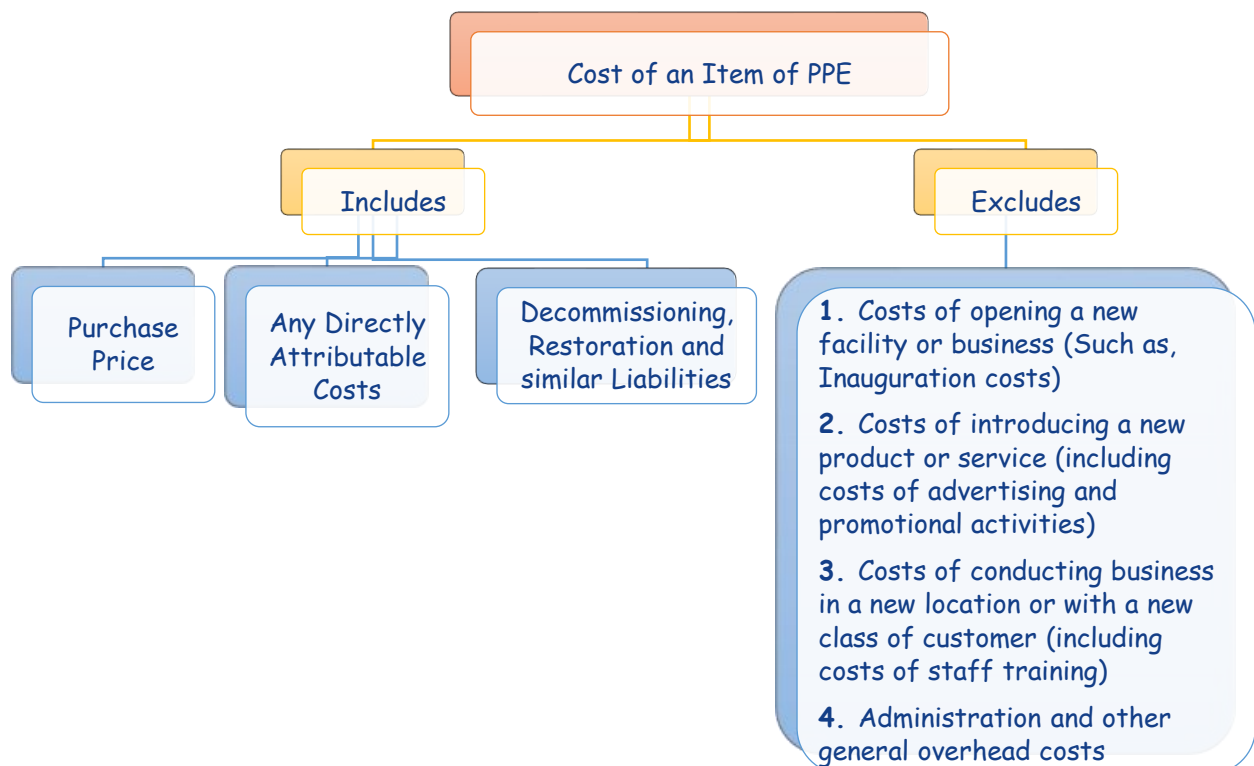


6. Measurement of PPE



7. Initial Recognition

An item of PPE that qualifies for recognition as an asset should be measured at its cost.
Cost of an item of PPE comprises:



A. Purchase Price

- Includes import duties and non-refundable purchase taxes.
- Trade discounts and rebates must be deducted.



B. Directly Attributable Costs

Costs directly related to bringing the asset to the location and condition necessary for it to operate as intended by management. Recognition stops once the item is ready for use.

Costs Not Included

- Costs incurred before the asset is fully operational or running at full capacity.
- Initial operating losses.
- Relocation or reorganization costs of operations.

Examples of Directly Attributable Costs

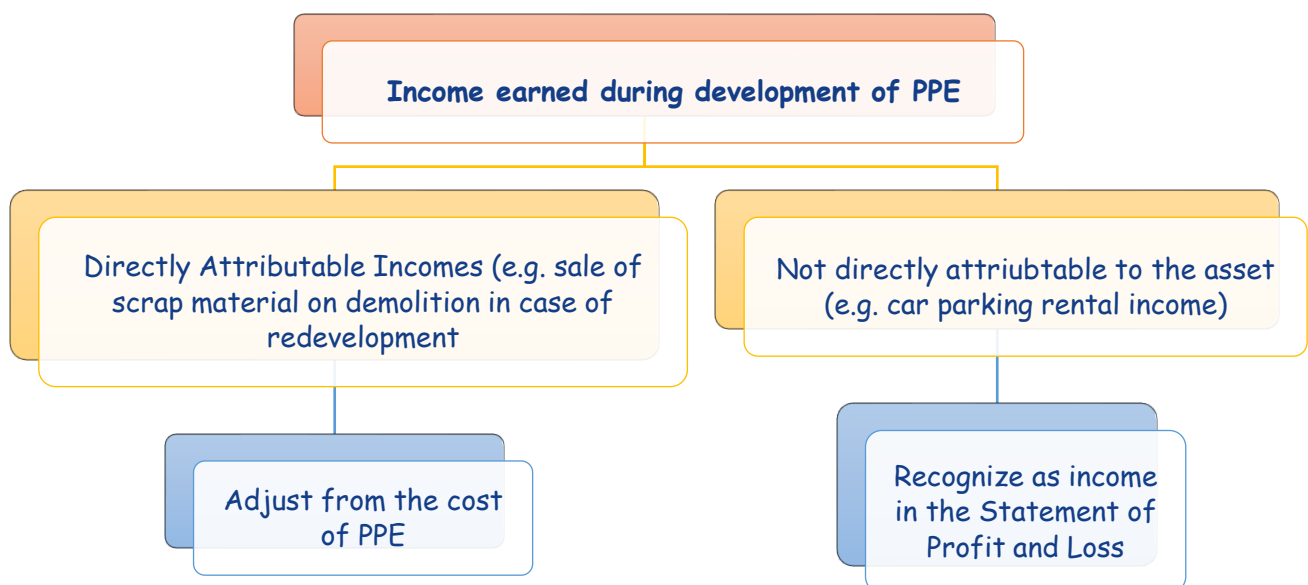
- Employee benefits (as per AS 15) directly linked to the construction or acquisition.
- Site preparation costs.
- Delivery and handling costs.
- Installation and assembly costs.
- Testing costs (after deducting proceeds from selling items produced during testing).
- Professional fees.

Examples of Costs Not Included

- Opening costs (e.g., inauguration cost).
- Costs for introducing new products/services (e.g., advertising).
- Costs for conducting business in a new location or with new customers (e.g., staff training).
- Administration and general overhead cost

Example:

Income from incidental operations, like using a site as a car park before construction, is recognized in the Statement of Profit and Loss, as it is not necessary to prepare the asset for its intended use.



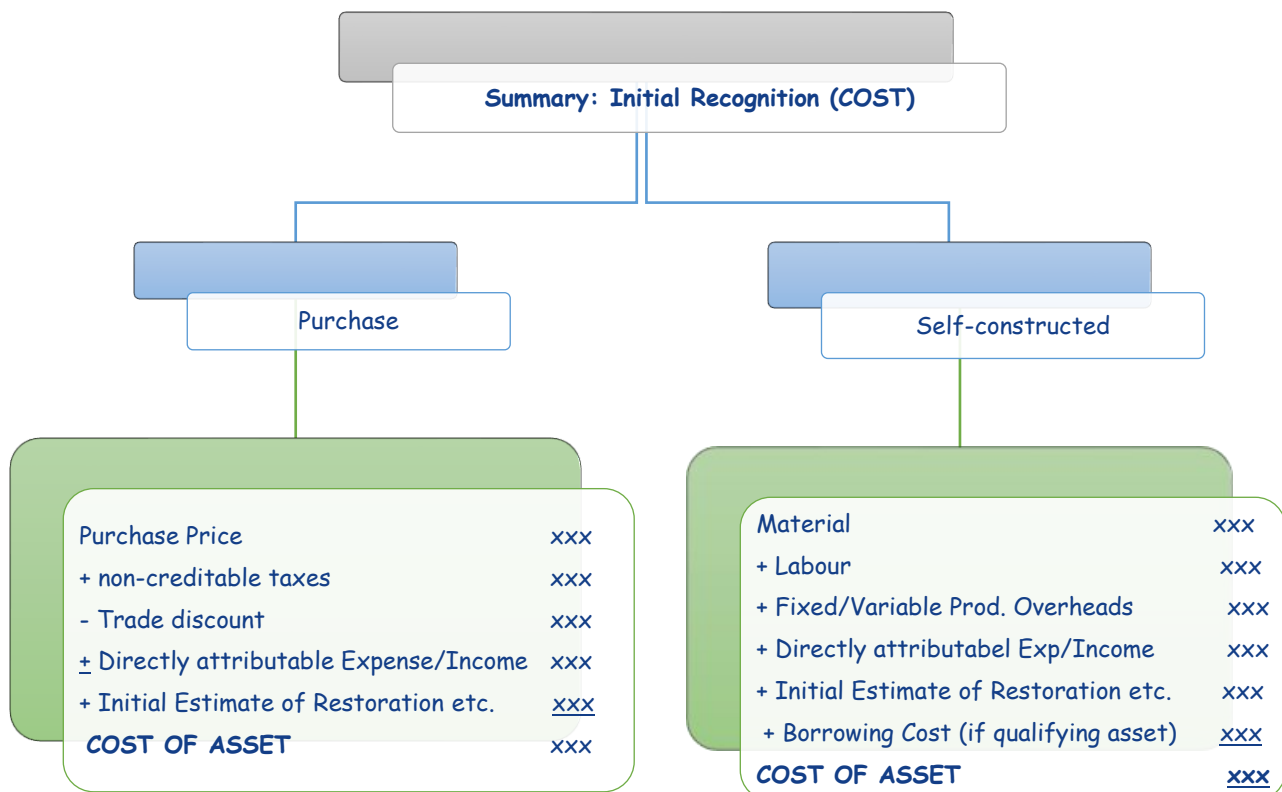


- C. **Decommissioning, Restoration, and Similar Liabilities**
Initial estimate of costs related to dismantling, removing the item, and restoring the site referred to as decommissioning, restoration, and similar liabilities.
Exception
 Costs for dismantling and site restoration, when **related to inventory production**, are **accounted for under AS 2 - Valuation of Inventories** instead of capitalizing as PPE.
Note: These **obligations are recognized and measured** in accordance with **AS 29**.



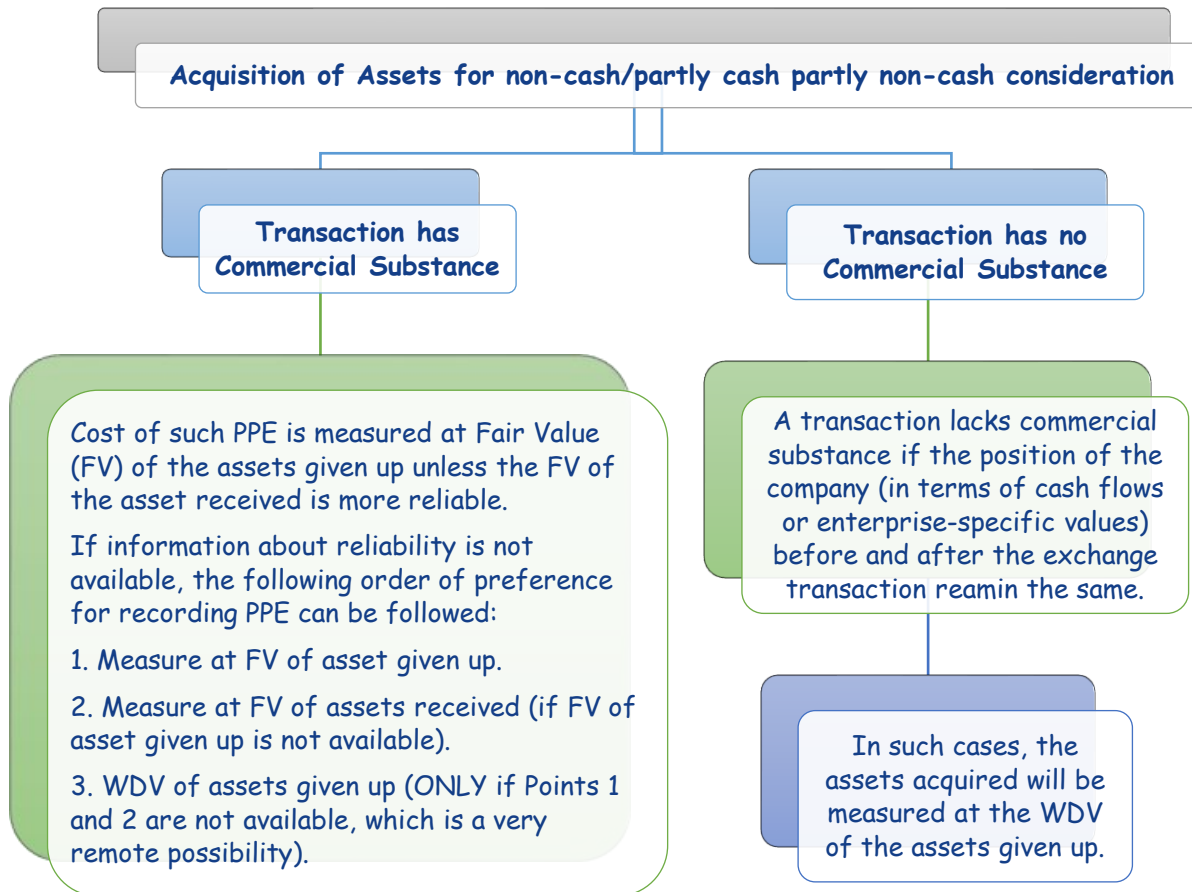
8. Cost of a Self-Constructed Asset

1. **Self-constructed Asset Cost**
 The cost of a self-constructed asset is determined using **the same principles as for an acquired asset**.
2. **Special Points**
 - **Internal profits are eliminated** in calculating the cost.
 - The cost of **abnormal amounts of wasted material, labour, or other resources** is **not included** in the cost of the asset.
 - **Borrowing costs** should be **included in PPE**, following AS 16
3. **Bearer Plants**
 Bearer plants are treated the same way as **self-constructed items of PPE**.





9. PPE Acquired in Exchange of Assets



Commercial Substance in Exchange Transaction

An exchange transaction has commercial substance if:

- a. **Cash Flow Configuration**
The configuration (risk, timing, and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred.
- b. **Enterprise-Specific Value**
The enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange.



10. Determination of Cost in Special Cases

- A. **Deferred Payment Beyond Normal Credit Terms**
Recognition of Interest
Total payment minus cash price equivalent is recognised as interest expense over the period of credit, unless the interest is capitalised in accordance with AS 16.
- B. **PPE Purchased for a Consolidated Price**
When several items of PPE are purchased for a consolidated price, the consideration is apportioned to the items based on their respective fair values at the acquisition date.
- C. **PPE Held Under Finance Lease**
The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19.

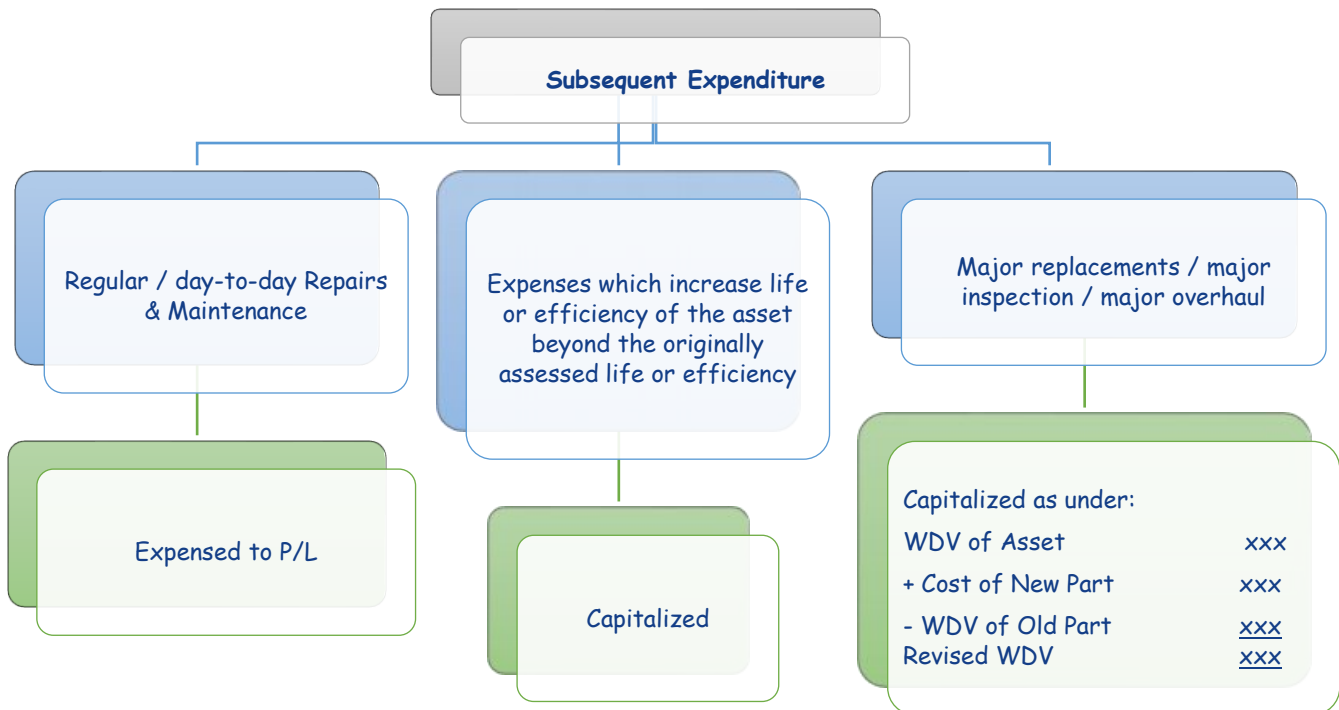


D. Government Grant Related to PPE

The carrying amount of PPE may be reduced by government grants in accordance with AS 12.



11. Treatment of Subsequent Costs



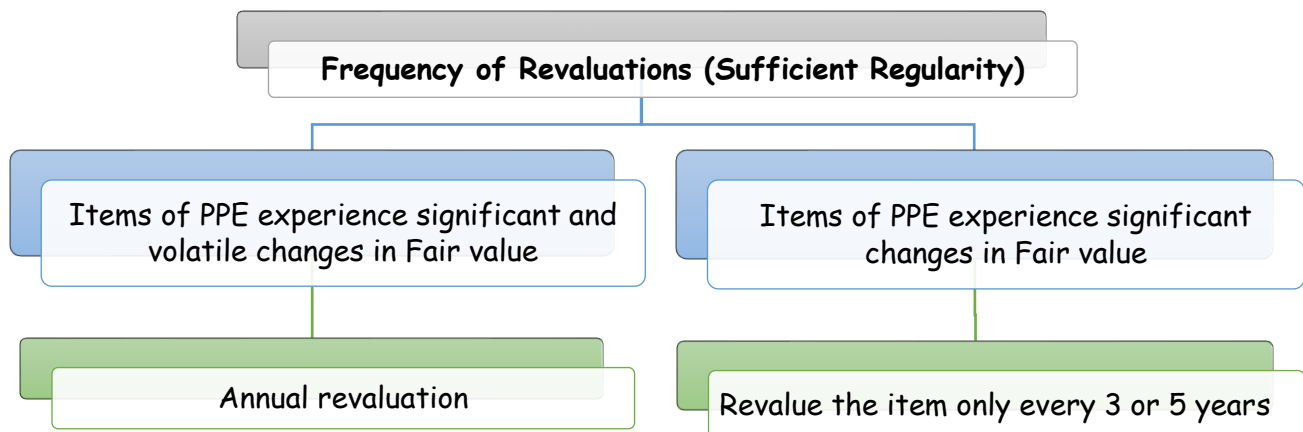
12. Measurement After Recognition

- Choice of Model**
An enterprise should choose either the Cost model or the Revaluation model as its accounting policy and apply it to an entire class of PPE.
- Class of PPE**
A class of PPE is a grouping of assets of similar nature and use in the operations of the enterprise.
Examples:
 - Land
 - Land and Buildings
 - Machinery
 - Ships
 - Aircraft
 - Motor Vehicles
 - Furniture and Fixtures
 - Office Equipment
 - Bearer plants
- Cost Model**
After recognition, an item of PPE should be carried at:



	Cost (-) Accumulated Depreciation (-) Accumulated Impairment Losses.
4.	Revaluation Model After recognition, an item of PPE whose fair value can be measured reliably should be carried at: Carrying Value = Fair value at the revaluation date - Subsequent Accumulated Depreciation - Subsequent Accumulated Impairment Losses. Revaluation for Entire Class of PPE If one item of PPE in a class is revalued, the entire class must be revalued.

Frequency of Revaluations



1.	Fair Value Determination Fair value is usually determined through market-based evidence by a professional appraiser. If there is no market-based evidence, fair value is estimated using: ➤ Income Approach (Discounted Cash Flow projections) ➤ Depreciated Replacement Cost Approach.
2.	Accounting Treatment of Revaluations When revalued, the carrying amount of the asset is adjusted to the revalued amount. <u>Technique 1: Adjust Gross Carrying Amount</u> PPE is revalued to Rs.1,500 consisting of Rs.2,500 Gross cost and Rs.1,000 Depreciation based on observable market data. Details of the PPE before and after revaluation are as follows:



Particulars	Cost/ Revalued Cost	Accumulated depreciation	Net book value
PPE before revaluation (assumed)	1,000	400	600
Fair Value			1,500
Revaluation Gain			900
Gain allocated proportionately to cost and depreciation	1,500 (900 x 1,000/600)	600 (900 x 400/600)	900
PPE after revaluation	2,500	1,000	1,500

The increase on revaluation is Rs.900 (i.e., Rs.1,500 - Rs.600).

The following journal entry will be passed:

PPE	Dr.	1,500	
To Accumulated Depreciation			600
To Gain on Revaluation*			900

Technique 2: Eliminate Accumulated Depreciation

Accumulated depreciation is eliminated against the gross carrying amount.

Details of the PPE before and after revaluation are as follows:

Particulars	Cost / Revalued Cost	Accumulated depreciation	Net book value
PPE before revaluation (assumed)	1,000	400	600
PPE after revaluation	1,500		1,500
Revaluation gain	500	400	

The increase on revaluation is Rs.900 (i.e., Rs.500 + Rs.400).

The following journal entries will be passed:

Accumulated Depreciation	Dr. 400	
To PPE		400

(Accumulated depreciation eliminate against gross carrying amount of asset)

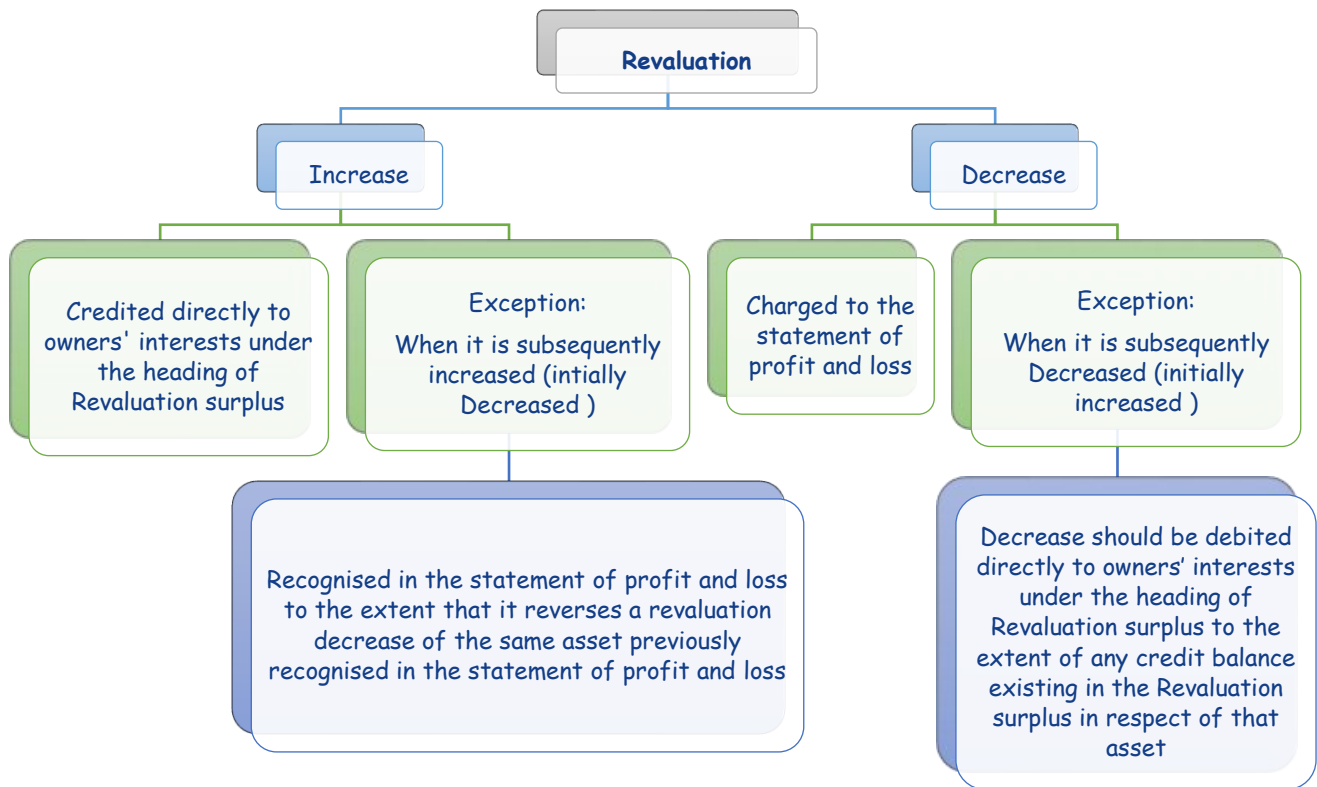
Therefore, carrying amount of asset is reduced to = 1,000 - 400 = 600

PPE	Dr. 900	
To Gain on Revaluation*		900

* Gain on Revaluation 1,500 - 600 = 900 recognized entirely in PPE



Revaluation - Increase or Decrease:



1.	Revaluation Surplus Transfer The revaluation surplus in owners' interests for an item of PPE can be transferred to Revenue Reserves when the asset is derecognized (retired or disposed).
2.	Case I: Whole Surplus Transfer The whole surplus is transferred to Revenue Reserves when the asset is: ➤ Retired, or ➤ Disposed of.
3.	Case II: Partial Surplus Transfer Some of the surplus may be transferred as the asset is used by the enterprise. The amount transferred is the difference between: ➤ Depreciation (based on revalued carrying amount) ➤ Depreciation (based on original cost).
	Note Transfers from revaluation surplus to revenue reserves are not made through the Statement of Profit and Loss.



13. Depreciation of PPE

1.	Depreciation Systematic allocation of the depreciable amount of an asset over its useful life.
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2.	Depreciable Asset Depreciable amount = Cost of asset - Residual value
3.	Residual Value The estimated amount an entity would obtain from disposing of the asset, after deducting the estimated disposal costs.
4.	Useful Life The period over which an asset is expected to be used by the entity or the number of production units expected to be obtained.
5.	Commencement of Depreciation Depreciation begins when the asset is available for use, i.e., when it is in the location and condition needed for operation.
6.	Cessation of Depreciation Depreciation stops at the earlier of: ✓ The asset is classified as held for sale ✓ The asset is derecognized.



14. Depreciation Method

1.	Depreciation Method The method used should reflect the pattern in which the asset's future economic benefits are consumed by the entity.
2.	Types of Depreciation Methods Straight Line Method (SLM): Constant charge over the useful life if residual value remains unchanged. Reducing Balance Method (WDV): Decreasing charge over the useful life. Units of Production Method: Charge based on expected use or output.
3.	Review of Depreciation Method The depreciation method is reviewed at least at each financial year-end.
4.	Change in Depreciation Method A change in depreciation method is treated as a change in accounting estimate as per AS 5 (Prospective accounting).
5.	Revenue-based Depreciation A depreciation method based on revenue generated by an activity involving the use of an asset is not appropriate because inflation can affect revenue but not asset consumption.



15. Retirements

1.	Retired PPE Held for Disposal Items of PPE retired from active use and held for disposal should be stated at the lower of: ✓ Carrying Amount ✓ Net Realisable Value
----	--



2. **Write-down**
Any write-down (reduction in value) should be **recognized immediately** in the **Statement of Profit and Loss**.



16. De-Recognition

1. **Derecognition of PPE**
The carrying amount of an item of PPE should be derecognised when:
 - **On disposal**
 - By sale
 - By entering into a finance lease
 - By donation
 - **When no future economic benefits are expected from its use or disposal.**
2. **Gain or Loss from Derecognition**
Gain or loss should be **included in the Statement of Profit and Loss** when the item is **derecognised**.
Gain or Loss = **Net disposal proceeds** - **Carrying amount of the item**.



17. Disclosures

1. **General Disclosures**
The financial statements should disclose for **each class of PPE**:
 - **Measurement basis**: Cost model or revaluation model.
 - **Depreciation details**: Methods used, useful life, or depreciation rates.
 - **Gross carrying amount & accumulated depreciation** at the start and end of the period.
 - **Reconciliation of the carrying amount, showing**:
 - Additions
 - Assets retired & held for disposal
 - Business combination acquisitions
 - Changes from revaluations or impairment losses
 - Impairment losses recognized/reversed
 - Depreciation
 - Exchange differences from foreign operations
 - Other changes
2. **Additional Disclosures**
 - **Restrictions on title** and PPE pledged as security.



	- Costs included in PPE under construction. - Contractual commitments for acquiring PPE. - Compensation from third parties for impaired or lost PPE. - Assets retired from active use and held for disposal.
3.	Disclosures for Revalued Assets If PPE is revalued, disclose: - Revaluation date and if an independent valuer was involved. - Methods and assumptions used for valuation. - Basis for determining fair value (market prices or valuation techniques). - Revaluation surplus, changes during the period, and any restrictions on its distribution. - Methods used for depreciation and useful lives. - Disclosures as per AS 5, if applicable. - Information on impaired PPE.
4.	Voluntary Disclosures Encouraged but not mandatory: - Carrying amount of temporarily idle PPE. - Fully depreciated PPE still in use. - PPE value under the cost model (if revaluation model is used). - PPE retired from active use but not held for disposal.



AS - 11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES



1. Objective

- A business can deal with foreign exchange in two ways.
 - a. It may have transactions in a foreign currency.
 - b. It may have operations in a foreign country.
- All foreign currency transactions & financial statements of foreign operations must be converted into the business's reporting currency.
- The principal issues here addressed by this AS are
 - ✓ to decide which exchange rate to use &
 - ✓ how to recognise in the FS's the financial effect of changes in exchange rates.

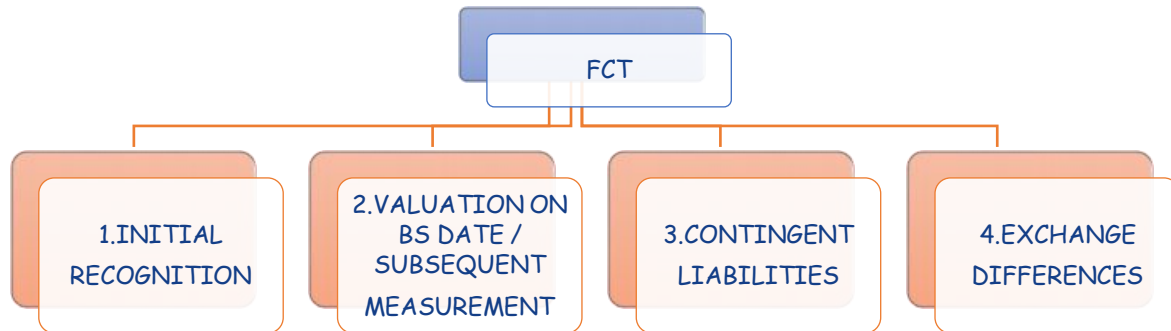


2. Scope

1. **Application of the Standard**
This standard should be applied:
 - a) In accounting for transactions in foreign currencies.
 - b) In translating the financial statements of foreign operations.
 - c) In accounting for foreign currency transactions related to forward exchange contracts.
2. **Exclusions from the Standard**
This standard does not:
 - a. Specify the currency in which an enterprise presents its financial statements.
 - ✓ Usually, the currency of the country where the company is based is used.
 - ✓ a different currency is used, the reason must be disclosed.
 - ✓ Indian companies are required to present financial statements in INR.
 - ✓ If an Indian company is a subsidiary of a U.S. company, it may report in USD U.S. Dollars with a disclosed reason.
 - b. Showing cash flows from foreign currency transactions in the cash flow statement.
 - c. Exchange differences on foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
 - d. Restatement of an enterprise's financial statements from its reporting currency into another currency just for user convenience.



3. Accounting of FCT



1. **A foreign currency transaction** is a transaction which is **denominated in or requires settlement in a foreign currency, including** transactions arising when an enterprise either
 - a. Involves **buying or selling goods or services** priced in a foreign currency.
 - b. Involves **borrowing or lending funds** in a foreign currency.
 - c. Involves entering into a **forward exchange contract**.
 - d. **Acquiring or disposing of assets or incurring liabilities** in a foreign currency.

2. **Initial Recognition**
FCTs are initially recognized by applying:
 - **Exchange rate on the date of the transaction.**
 - **Alternatively, the average rate of a week or month can be used if there is no significant fluctuation in the exchange rate.**

3. **Valuation on BS/Subsequent Measurement**
For valuation on the balance sheet date, **items arising from FCT are classified into:**

- a. **Monetary items**
- b. **Non-monetary items**

Monetary Items

Monetary items include:

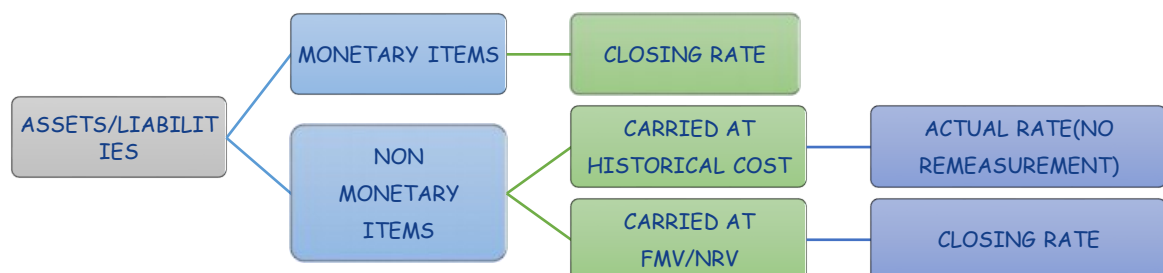
- **Money held**
- **Assets and liabilities to be received or paid in fixed or determinable amounts of money.**

For example, cash, receivables and payables.

Non-Monetary Items

Non-monetary items are assets and liabilities other than monetary items.

For example, fixed assets, advances for purchase of goods / fixed assets, inventories and investments in equity shares.





4. If the closing rate is unrealistic or remittance restrictions exist, the monetary item should be reported at the amount likely to be realized or required to settle at the balance sheet date.
5. **Contingent Liabilities**
Contingent liabilities are reported at the exchange rate on the balance sheet date.
6. **Exchange Differences**
Exchange differences are transferred to the Profit & Loss Account.



4. Special Option Available to Companies-Amendment to Para 46A

1. **Irrevocable Option**
 - Paragraph 46A of AS 11, introduced in December 2011, allows enterprises to follow this treatment for periods starting April 1, 2011, onwards.
 - Once exercised, the option is irrevocable and must be applied consistently to all such items.
2. **Long-Term Foreign Currency Monetary Items**
An asset or liability is designated as a long-term foreign currency monetary item if it has a term of 12 months or more from the date of origination.
3.

EXCHANGE
DIFFERENCE ON LTFCMI

RELATED TO ACQUISITION
OF A DEPRECIABLE ASSET

OTHERS

ADD/DEDUCT FROM COST OF
THE ASSET AND
DEPRECIATED OVER THE
BALANCE LIFE OF THE
ASSET

TRANSFER TO FCMITD A/C
AND AMORTISE OVER THE
BALANCE PERIOD OF SUCH
LONG TERM ITEM.

The debit or credit balance in FCMITDA shown under the head 'Reserves and Surplus' as a separate line item.



5. Foreign Operations

1. **Foreign Operations**
 - Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.
 - These are classified as either integral foreign operations (IFO's) or non-integral foreign operations (Non-IFO's).
2. **Integral Foreign Operations (IFO's)**
 - IFO is an operation whose activities are an essential part of the reporting enterprise's activities.
 - An IFO operates as an extension of the reporting enterprise.
3. **Non-Integral Foreign Operations (Non-IFO's)**
A non-integral foreign operation (Non-IFO) is not an integral part of the reporting enterprise.



4. Indications of Non-IFO

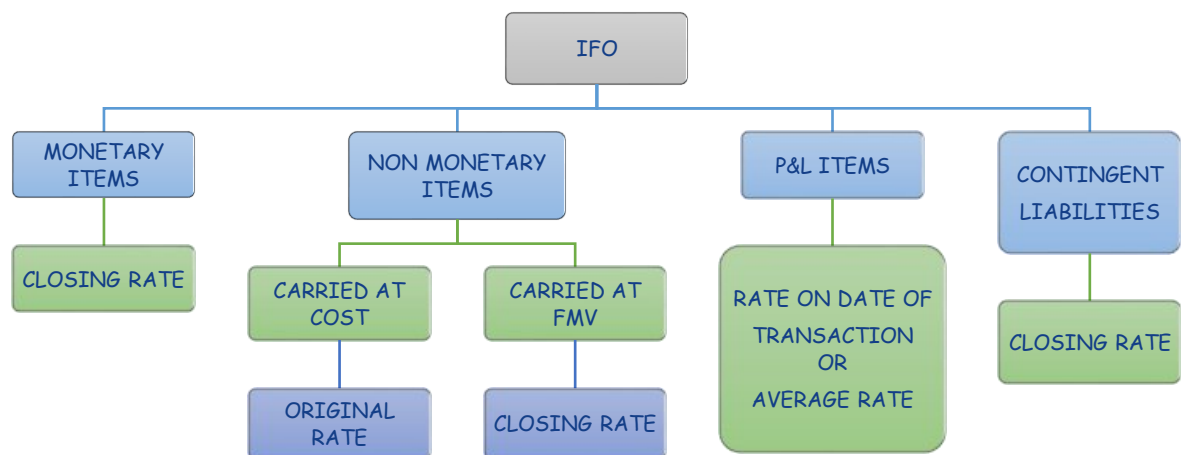
The following indicate a foreign operation is a Non-IFO:

- It operates **independently** from the **main enterprise**.
- **Transactions** with the **main enterprise** are **minimal**.
- It is **self-financed** or uses local borrowings.
- **Costs** (labour, materials) are **paid in local currency**.
- **Sales** are mainly in **other currencies**, not the reporting currency.
- The main enterprise's **cash flows** are **not affected** by **daily activities** of foreign operation.
- **Prices** depend on **local factors**, not exchange rates.
- It has a **strong local market**, even if it exports.



6. Translation of Fs's of IFO's

1. Translation of Financial Statements of Integral Foreign Operation (IFO)

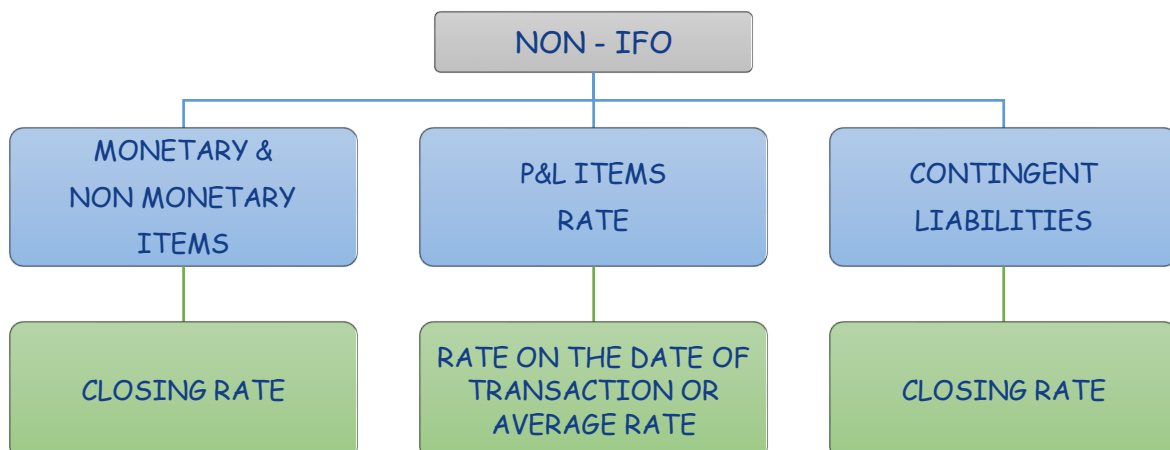


2. Exchange Differences

Any exchange differences arising from translating the financial statements of IFO are **transferred to the P&L account**.



7. Translation of Fs's of NON-IFO'S





1.	Exchange Difference on Conversion Exchange differences arising from the conversion of financial statements should be transferred to the FCTR.
2.	FCTR in Reserves & Surplus The FCTR account should be shown under reserves & surplus until the sale of the foreign operation.



8. Re-classification of Foreign operations

Integral to Non-Integral:

Exchange gain/loss after reclassification goes to FCTR.

Non-Integral to Integral:

- Exchange gain/loss after reclassification goes to Profit & Loss (P&L) account.
- Existing FCTR balance stays in the Balance Sheet until the foreign operation is sold.
- Partial Sale of Non-IFO

A proportionate amount from FCTR is transferred to P&L.



9. Forward Exchange Contracts

1.	Forward Exchange Contracts A forward exchange contract is a contract where one party agrees to buy from or sell to the other party an asset (in this case, foreign currency) at a future date for an agreed price.
2.	FC Types FC is entered into for: a. Managing or minimizing foreign exchange fluctuation risks (Hedging). b. Trading or speculation purposes.
3.	FC for Hedging ➤ Premium or discount at the inception FEC should be amortized over the contract period. ➤ Exchange differences are recognized in the P&L account. ➤ Profit or loss from cancellation or renewal of FEC is recognized in the P&L account.
4.	FC for Trading or Speculation ➤ The premium or discount on the FEC is ignored and not recognized separately. ➤ At each balance sheet date, the contract value is marked to its current market value, and the gain or loss on the contract is recognized. ➤ Gain/Loss on reporting date = foreign currency amount × (forward rate at reporting date for remaining maturity less contracted forward rate)



10. Disclosure

1.	Disclosure of Exchange Differences An enterprise should disclose: ➤ Disclose exchange differences included in net profit or loss.
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	➤ Show net exchange differences in the Foreign Currency Translation Reserve (FCTR) with a reconciliation of opening and closing balances.
2.	Reason for Using a Different Reporting Currency If the reporting currency differs from the country's currency, disclose the reason. If the reporting currency changes, disclose the reason for the change.
3.	Change in Classification of Foreign Operation: a) The nature of the change. b) The reason for the change. c) The impact of the change on shareholders' funds. d) Effect on net profit/loss in prior periods if applied earlier.



AS - 12: ACCOUNTING FOR GOVERNMENT GRANT



1. Objective/scope

1. **Objective**
This standard deals with accounting for government grants. GG can be in the form of subsidies, cash incentives, duty drawbacks, etc.
2. **Scope of the Standard**
 - Does not address/deals with
 - a. accounting for government grants in financial statements reflecting the effects of changing prices or similar supplementary information.
 - b. government assistance other than government grants.
 - c. government participation in the ownership of the enterprise.
 - Proper accounting is required when a government grant is received.
 - FS should indicate how much the enterprise has benefited from the grant during the reporting period.
 - Clear reporting helps in comparing financial statements across different periods and with other enterprises.



2. Definitions

1. **Government**
Government refers to government, government agencies and similar bodies whether local, national or international.
2. **Government Grants**
Government grants are assistance provided by the government, in cash or kind, to an enterprise for past or future compliance with certain conditions.
 - They exclude those forms of government assistance which cannot reasonably have a value placed upon them &
 - transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.



3. Accounting treatment of Government Grants

1. Two broad approaches may be followed for the accounting treatment of government grants:
2. **Capital Approach**
the 'capital approach', under which a grant is treated as part of shareholders' funds, and, suitable for grants similar to promoters' contributions.
3. **Income Approach**
The grant is recognized as income over one or more periods, typically used for other types of grants.



Choice of Approach

The choice of approach depends on the nature of the grant.



4. Recognition of Government Grants

1. Grant Recognition Conditions

A government grant is not recognised until there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it &
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Example

X Ltd applies for a grant from the local authority for a social cause. To receive the grant, X Ltd must meet certain conditions. There is reasonable assurance that the grant will be received on time. However, there is a possibility that X Ltd may not fulfill all the conditions. In such a case, X Ltd should not recognize the grant until it is reasonably assured that all conditions will be met.



5. Non-Monetary Government Grants

1. Government Grants in Non-Monetary Assets (e.g., land or other resources) non-monetary assets given

- at concessional rates - recorded at their acquisition cost.
- At free of cost - recorded at a nominal value.

Example

X Convent applies for a land grant to the State authority for building a school. The market value of the land is Rs. 20 crores, but the authority provides it at a nominal cost of Rs. 50 lakhs. X Convent should recognize the land at its acquisition cost of Rs. 50 lakhs.



6. Presentation of Grants Related to Specific Fixed Assets

1. Grants Related to Specific Fixed Assets

These grants are given to enterprises to purchase, construct, or acquire fixed assets.

Example

The Central Government aims to boost employment in rural and backward areas by providing grants to eligible entities. F Ltd applies for such a grant, which requires the company to construct a factory and employ at least 500 workers for the next five years. The estimated cost of construction is ₹50 crore, while the grant amount is ₹30 crore. F Ltd can recognize the grant in its books only if there is reasonable assurance that it will meet the condition of employing 500 workers for the required period.

2. Methods of Accounting for Grants

Two methods for presenting grants related to specific fixed assets in the financial statements:



Method I: Deduction method

- The grant is deducted from the gross value of the asset and balance asset value is depreciated over the remaining useful life of the asset.
- If the grant equals the entire cost of the asset, show the asset in the balance sheet at a nominal value.

Method II: Income Method

- For depreciable assets, treat the grant as deferred income, which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
- For non-depreciable assets, credit the grant to capital reserve.
- If a non-depreciable asset grant requires fulfilling obligations, the grant is credited to income over the same period as the cost of fulfilling the obligations.



7. Presentation of Grants Related to Revenue

1. ➤ These are the grants given to meet any specific expenditure (e.g salary, R&D etc) or as reimbursement to the previously incurred expenditure.
- These grants can be shown either as other income separately or deducted from the related expenses in the P&L account.
- If the grant is given as a reimbursement of previously incurred expenditure transfer it to capital reserve a/c.



8. Presentation of Grants of the Nature of Promoters' Contribution

1. ➤ Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and
- no repayment is ordinarily expected in respect thereof,
- the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.



9. Refund of Government Grants

1. **Refundable Government Grants**
Treated as extraordinary items (AS 5).
 1. For grants related to revenue:
 - Refunds are first applied against any unamortised deferred credit.
 - If refundable amount exceeds deferred credit, it is charged directly to profit and loss.
 2. For grants related to a specific fixed asset:
 - Refund is applied by increasing the asset's book value or reducing deferred income.
 - If book value is increased, depreciation is adjusted over the remaining useful life of the asset.



3. For promoters' contribution grants, if refundable:

- The refundable amount is deducted from the capital reserve.



10. Disclosure

- The accounting policy adopted for government grants should be disclosed, including methods of presentation in the financial statements.
- Disclose the nature and extent of government grants recognised in the financial statements, including non-monetary assets given at a concessional rate or free of cost.



AS - 13: ACCOUNTING FOR INVESTMENTS



1. Objective

1. ✓ Deals with accounting for investments in financial statements and related disclosure requirements.
- ✓ Shares, debentures, and other securities held for sale in the ordinary course of business are not considered investments under this standard. However, their accounting and disclosure are similar to current investments.
- ✓ The provisions of this standard related to current investments also apply to such stock-in-trade, with necessary modifications.



2. Scope

This AS does not cover

- a. Interest, dividends, and rentals earned on investments (covered by AS 9).
- b. Operating or finance leases. (covered by AS 19)
- c. Investments in retirement benefit plans and life insurance enterprises.
- d. Mutual funds, venture capital funds, asset management companies, banks, and public financial institutions.



3. Definitions

1. **Investments**
 - ✓ 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.
 - ✓ Assets held as stock-in-trade (inventory) are not 'investments'.



4. Forms of Investments

1. **Types of Investments**
Non-physical: Represented by certificates (e.g., shares).
Physical: Tangible form (e.g., buildings).
2. **Market Value Determination**
 Some investments have an active market where fair value can be easily determined, while others require alternative methods.



5. Classification of Investments

1. **Current Investment**
 A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The intent to hold for a short period is determined at the time of purchase.
2. **Long-term Investment**
 Any investment other than current investment.



Further classification of current and long-term investments should follow the applicable law.

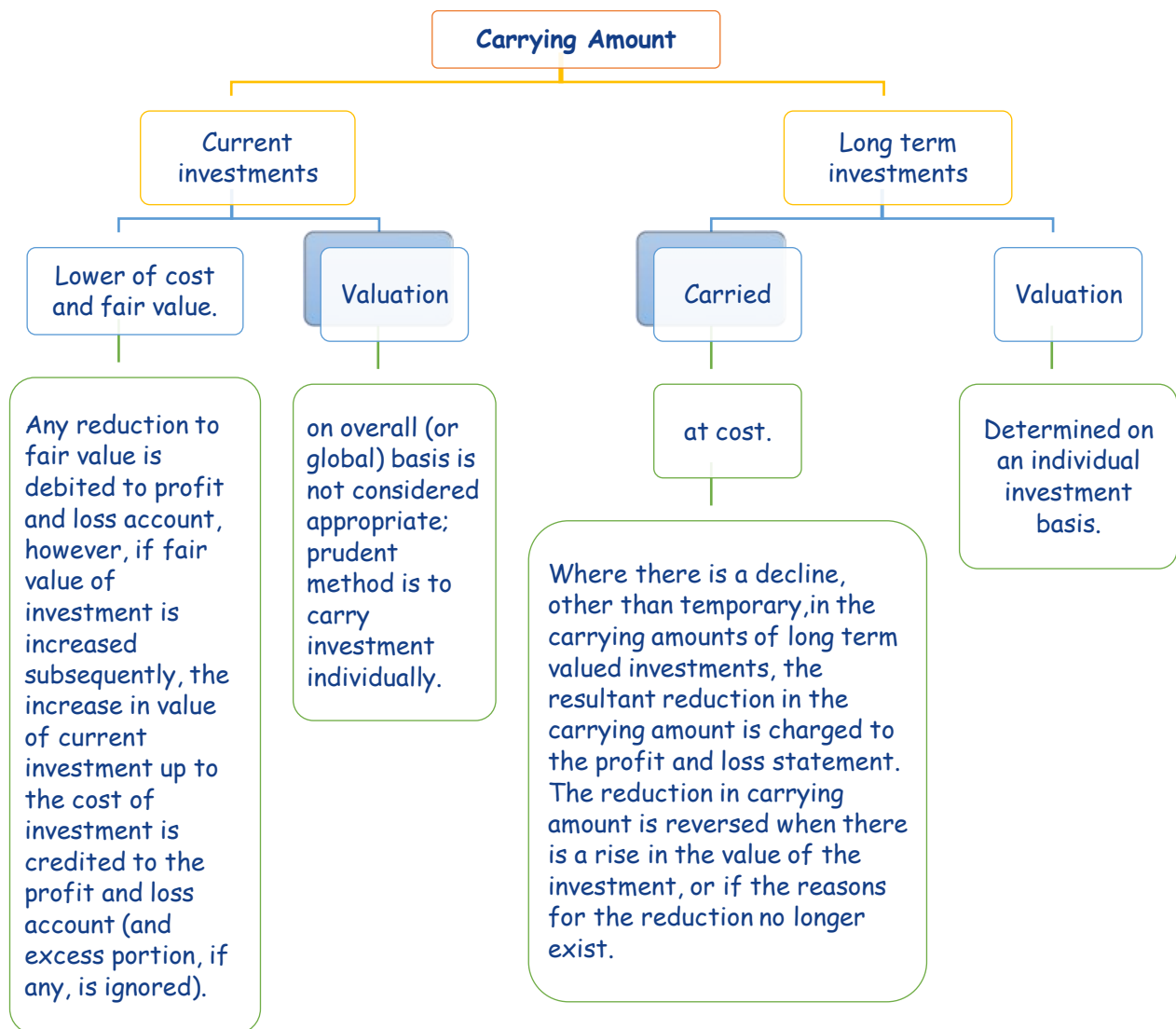


6. Cost of Investments

1. **Investment Acquired by Cash/Bank**
Cost includes acquisition charges like brokerage, fees, and duties.
Example:
X Ltd invests Rs. 200 lakhs, with a brokerage cost of Rs. 1 lakh, so the investment's total value is Rs. 201 lakhs.
2. **Investment Acquired by Issue of Shares or Securities**
Acquisition cost is the fair value of the securities issued.
3. **Investment Acquired in Exchange for Another Asset**
Acquisition cost is the fair value of either the asset given up or the investment acquired, whichever is more clearly evident.
4. **Interest, Dividends, and Rentals Receivable**
 - ✓ Generally, it is income from investment & credited to P&L A/c.
 - ✓ In some cases, these represent a recovery of cost, not income.
5. **Right Shares**
 - ✓ **Subscribed:** cost is added to the original holding's carrying amount.
 - ✓ **Rights sold:** sale proceeds recorded in profit and loss as income.
 - ✓ If shares are acquired on cum-right basis and after they become ex-right if the market value of shares falls below the cost of investments. Then sale proceeds from rights are adjusted against cost of investments.



7. Carrying Amount of Investments



Example of Decline other than temporary

- Cash Operating Losses**
The company in which investment is made is suffering cash operating losses, leading to a reduction in net worth.
- New Regulations**
A new regulation negatively impacts the working of the investee.
- Significant Reduction in Quoted Price**
A significant reduction in the quoted price of the investment.



8. Investment Properties

- Definition**
An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.
- Accounting for Investment Property**
Investment property is accounted for using the cost model as per AS 10.
- Shares in Co-operative or Company**



The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.



9. Disposal of Investments

1. **Disposal of Investment**
The difference between the carrying amount and disposal proceeds, net of expenses, is recognized in the profit and loss statement.
2. **Partial Disposal of Investment**
When part of the investment is sold, the carrying amount allocated to that part is based on the average carrying amount of the total holding.



10. Reclassification of Investments

1. **Long-term to Current Investment**
Transfer at the lower of cost and carrying amount at the date of transfer.
2. **Current to Long-term Investment**
Transfer at the lower of cost and fair value at the date of transfer.



11. Disclosure

- ✓ Disclose accounting policies for determining the carrying amount of investments.
- ✓ Report interest, dividends, and rental income.
- ✓ Recognize profits/losses from disposal and changes in investment value.
- ✓ Mention restrictions on ownership, realizability, or income remittance.
- ✓ Provide aggregate amounts for quoted and unquoted investments, including the market value of quoted ones.
- ✓ Include any additional disclosures required by law.
- ✓ Classify investments appropriately.



AS - 15: EMPLOYEE BENEFITS



1. Objective

1. Objective

- Prescribes accounting and disclosure for employee benefits.
- This standard is based on the premise that the costs associated with employee benefits should be matched with the timing of their services.



2. Scope

1. Applicability

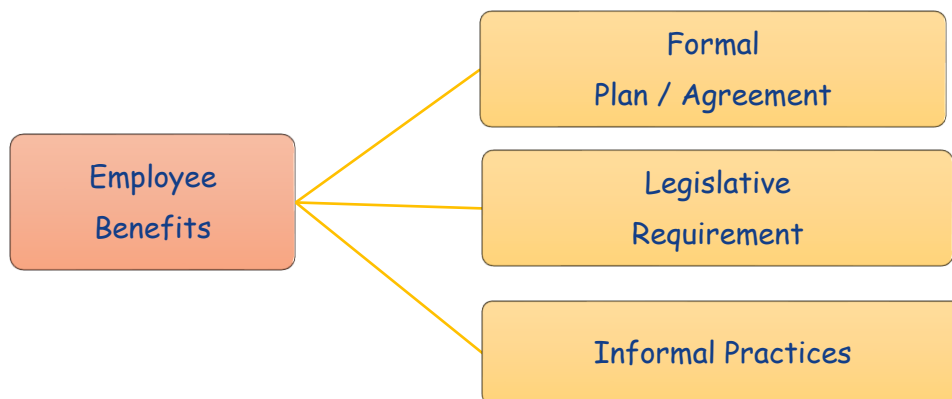
Applied by employers for all employee benefits, except

- a. share-based payments.
- b. accounting and reporting by employee benefit plans.

Note:

- Applicable to Level I enterprises.
- Certain exemptions are given to other than Level 1 enterprises, depending upon whether they employ 50 or more employees.

2.



3. Key Clarifications

- This AS is applicable to benefits provided to all types of employees (full-time, part-time, casual).
- Employee benefits can be paid in cash or in kind.
- Benefits include provided to employees and their dependents (spouses, children, others).
- Payments can be made directly to employees or their dependents or any other party (e.g., insurance companies, trust, legal heirs etc).

4. Types of Employee Benefits

1. Short-term Employee Benefits: (e.g., wages, paid leave, bonuses) payable within 12 months.
2. Post-employment Benefits: (e.g., pension, provident fund, medical care after employment).
3. Long-term Benefits: (e.g., long-service leave, long-term disability benefits).
4. Termination Benefits: (e.g., VRS payments).



3. Meaning of the Term "Employee"

- AS 15 does not specifically define "employee". but implies a broad application.
- Including full-time, part-time, permanent, casual, and temporary staff as well as directors & management personnel.
- The term extends beyond formal employment contracts.



4. Short-Term Employee Benefits

1. Payable within 12 months after the end of the period in which service is rendered.
2. Categories of Short-term Benefits
 1. Regular period benefits (e.g., wages, salaries)
 2. Short-term compensated absences (e.g., paid annual leave, maternity leave, sick leave, etc.)
 3. Profit sharing and bonuses payable within 12 months after the service is rendered.
 4. Non-monetary benefits (e.g., medical care, housing, cars, etc.)
3. General Recognition Criteria
 - Recognize as expense at the undiscounted amount for services already rendered.
 - Difference between recognized expense and cash payments is treated as liability or asset.

4. Short-term Compensated Absences

Category	Accumulating (Vesting)	Accumulating (non-vesting)	Non-Accumulating
Definition	Can be carried forward and paid if unused	Can be carried forward but not paid if unused	Cannot be carried forward; not linked to past service
Employee Entitlement on Exit	Cash payment for unused leave	No cash payment for unused leave	Not applicable
Cost Recognition	When employees provide service to earn entitlement	When employees provide service to earn entitlement	Only when the absence occurs
Measurement	Expected cost based on unused entitlement at balance sheet date	Expected cost based on unused entitlement at balance sheet date	No liability until leave is taken
Example	Earned leave, where 12 unused days create a liability	Sick leave that carries forward but is forfeited on exit	Maternity leave recognized when taken

Example

Scenario: An enterprise with 100 employees, each entitled to 5 days of leave per year. The unused leave may be carried forward for one calendar year. At year-end (31st



December 20X4), the average unused entitlement is 2 days per employee. The enterprise expects that 92 employees will take no more than 5 days of leave, and 8 employees will take an average of 6.5 days each in the following year.

Expected Additional Cost: The enterprise expects to pay an additional 12 days of pay (1.5 days for each of the 8 employees who take more leave).

Recognition: A liability of 12 days' pay is recognized at 31st December 20X4.

5. Profit-sharing and Bonus Plans

- Expense is recognized when the conditions are met:
 - a. **Present obligation** due to past events.
 - b. **Reliable estimate** of obligation can be made.
- Recognize **liability** and **expense** based on the **estimated amount**.

Example

A profit-sharing plan requires an enterprise to pay a specified proportion of its net profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3% of net profit. The enterprise estimates that staff turnover will reduce the payments to 2.5% of net profit.

The enterprise recognises a liability and an expense of 2.5% of net profit.



5. Post Employment Benefits: Defined Contribution vs Defined Benefits

Feature	Defined Benefit Plan (DBP)	Defined Contribution Plan (DCP)
Nature	➤ Employer guarantees a fixed benefit at retirement .	Employer contributes a fixed amount each year .
Who bears risk?	➤ Employer (because final payout depends on salary & service years).	Employee (since returns depend on investment performance).
Accounting Treatment	➤ Employer estimates DBO, CSC, Interest Cost , and records liability.	Employer simply records contribution expense each year.
Actuarial Assumptions Required?	➤ Yes , for salary growth, discount rate, and service period.	No actuarial calculations needed.



Note: Actuarial assumptions are estimates about future events (like salary hikes, employee turnover, and life expectancy) used to calculate employee benefit costs.

Why Current Service Cost (CSC) & Interest Cost (IC) Apply Only to DBP?

- In a DBP, the future liability (benefit payable at retirement) depends on salary growth, service years, and discount rate.
- Since the payout happens in the future, we must recognize:
 - CSC → Cost of benefits earned in the current year.
 - IC → Increase in liability due to the time value of money.
- This requires actuarial valuation and discounting.

Example of DBP:

A company promises to pay 50% of the last drawn salary to an employee after 20 years.

- The company must estimate future salary, payout, and present value.
- Every year, it records CSC (new benefits earned) and IC (growth of liability).

What Happens in a DCP?

- In a DCP, the employer simply contributes a fixed amount (e.g., 12% of salary to EPF).
- There is no future obligation for the employer, as benefits depend on fund performance.
- Hence, no need for CSC or IC—the employer just records the contribution expense each year.

Example of DCP:

An employer contributes ₹10,000 per month to an employee's retirement fund.

- The employer records ₹1,20,000 per year as an expense.
- No actuarial calculations, no CSC, and no IC.

What are Plan Assets?

- Plan Assets refer to the funds set aside by the employer to meet future obligations under a Defined Benefit Plan (DBP).
- These assets are typically held in a separate trust and managed to generate returns, which help reduce the employer's liability.
- Examples of Plan Assets
 - Investments in bonds, stocks, mutual funds, etc.
 - Bank deposits earmarked for employee benefits.
 - Any other assets held exclusively to settle employee benefits.

Expected Return on Plan Assets

Particulars	Formula / Explanation	Amount (₹)
Opening Fair Value of Plan Assets	Given in the question	X
Expected Return on Opening Assets	$X \times \text{Expected Rate}$	Y
Net Additional Contribution / (Benefit Paid)	Contributions - Benefits Paid	Z
Expected Return on Net Contribution	$Z \times \text{Expected Rate} / 2$ (if received mid-year)	A
Total Expected Return	$Y + A$	B



Actual Return on Plan Assets

Particulars	Formula / Explanation	Amount (₹)
Closing Fair Value of Plan Assets	Given in the question	P
Less: Opening Fair Value of Plan Assets	Given in the question	Q
Less: Contributions Received	Given in the question	R
Net Change in Plan Assets	P-Q-R	S
Add: Benefits Paid	Given in the question	T
Total Actual Return	S+T	U

Actuarial Gains & Losses

These should be recognized immediately in the profit and loss as income or expense.



6. Other Long Term Employee Benefits

- Long-service leave or sabbatical leave
- Benefits given for long-term service (e.g., jubilee benefits)
- Disability benefits for long-term incapacity
- Profit-sharing and bonuses payable 12 months or more after the end of the service period
- Deferred compensation paid 12 months or more after it is earned

other long-term employee benefits are accounted for similarly to defined benefit plans.



7. Termination Benefits

1. **When payable**
Termination benefits are payable when:
 - An enterprise terminates an employee before retirement.
 - An employee accepts voluntary redundancy.
2. **Recognition of liability and expense**
Recognize as a liability and expense when:
 - There's a formal approved plan.
 - The enterprise can reliably estimate the obligation
3. **Short-term benefits (due within 12 months)**
 - recognize at a undiscounted liability.
 - Charge the corresponding amount to the Profit & Loss Account.**Long-term benefits (due after 12 months)**
Discount using an appropriate discount rate.
4. **Measurement of benefits**
 - Termination benefits should be based on the expected number of employees who will accept voluntary redundancy.
 - If there's uncertainty about the number of employees accepting the offer, a contingent liability exists. Disclose as per AS 29.



AS - 16: BORROWING COSTS



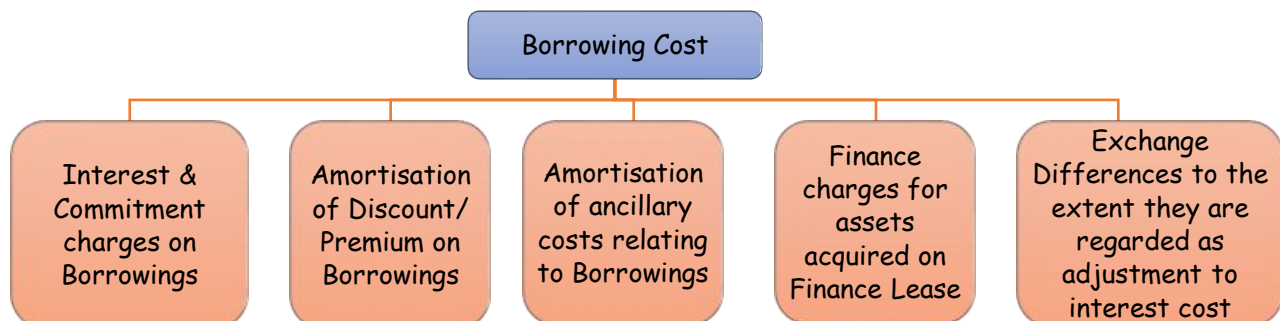
1. Objective & Scope

1.	Objective This AS provides accounting for borrowing costs.										
2.	Scope The Standard does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability. Clarification Chart: <table border="1"> <thead> <tr> <th>Particulars</th><th>Remarks - Is the fund covered by AS 16?</th></tr> </thead> <tbody> <tr> <td>Equity share capital</td><td>No</td></tr> <tr> <td>Retained earnings</td><td>No</td></tr> <tr> <td>Preference Share Capital classified as a liability</td><td>Yes</td></tr> <tr> <td>Preference Share Capital classified as equity</td><td>No</td></tr> </tbody> </table>	Particulars	Remarks - Is the fund covered by AS 16?	Equity share capital	No	Retained earnings	No	Preference Share Capital classified as a liability	Yes	Preference Share Capital classified as equity	No
Particulars	Remarks - Is the fund covered by AS 16?										
Equity share capital	No										
Retained earnings	No										
Preference Share Capital classified as a liability	Yes										
Preference Share Capital classified as equity	No										



2. Definitions

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing cost may include



1.	Qualifying Asset An asset that takes a substantial period of time to be ready for its intended use or sale Examples of Qualifying Assets ✓ Manufacturing plants, power generation facilities, and investment properties. ✓ Inventories that require substantial time to bring them to a saleable condition Non-qualifying assets include: ✓ Investments. ✓ Inventories produced quickly in large quantities. ✓ Assets that are ready for use or sale when acquired.
2.	Substantial Period of Time ➤ Substantial period of time depends on facts and circumstances of each case.



- Ordinarily, 12 months is considered substantial, unless a shorter or longer period can be justified.
- a rebuttable presumption of a period of twelve months is considered "substantial" period of time.
- The estimated period should consider the time needed for an asset to be technologically and commercially ready for use or sale.

3. Clarification Chart:

Particulars	Remarks - Is the fund covered by AS 16?
PPE (Property, plant and equipment)	Yes
Intangible assets	Yes
Investment Properties (Building meant for capital appreciation and earning rental income)	Yes
Inventory	Yes - If they require a substantial period of time to bring them to a saleable condition.
Investments (Financial assets)	No



3. Exchange Differences on Foreign Currency Borrowings

Particulars	Accounting Treatment
Exchange Gain	Credited to P&L
Exchange Loss	Lower of the following treated as borrowing cost:
	1. Actual exchange loss
	2. Difference between interest on local and foreign currency borrowings
Excess Exchange Loss	Charged to P&L

Understand this concept with example:

Loan Details

XYZ Ltd. took a loan of USD 10,000 on April 1, 20X1, at an interest rate of 5% p.a., payable annually.

Exchange Rates

On April 1, 20X1, the exchange rate was Rs. 45/USD.

On March 31, 20X2, the exchange rate was Rs. 48/USD.

Local Currency Interest Rate

The corresponding local currency loan interest rate was 11% p.a. as of April 1, 20X1.

Computation for Borrowing Costs (AS 16)

i. Interest for the Period



$$\text{USD } 10,000 \times 5\% \times \text{Rs. } 48/\text{USD} = \text{Rs. } 24,000$$

ii. Increase in Liability for Principal

$$\text{USD } 10,000 \times (48-45) = \text{Rs. } 30,000$$

iii. Interest if Loan was in Local Currency

$$\text{USD } 10,000 \times 45 \times 11\% = \text{Rs. } 49,500$$

iv. Difference in Interest (Local vs. Foreign Loan)

$$\text{Rs. } 49,500 - \text{Rs. } 24,000 = \text{Rs. } 25,500$$

Final Calculation of Borrowing Costs

Out of Rs. 30,000 increases in liability, only Rs. 25,500 is considered as borrowing costs.

Total borrowing cost = Rs. 24,000 (interest on foreign currency loan) + Rs. 25,500 (exchange difference).

Rs. 49,500 is considered as borrowing cost as per AS 16, and Rs. 4,500 is exchange difference under AS 11.

Alternative Scenario (13% Interest on Local Loan)

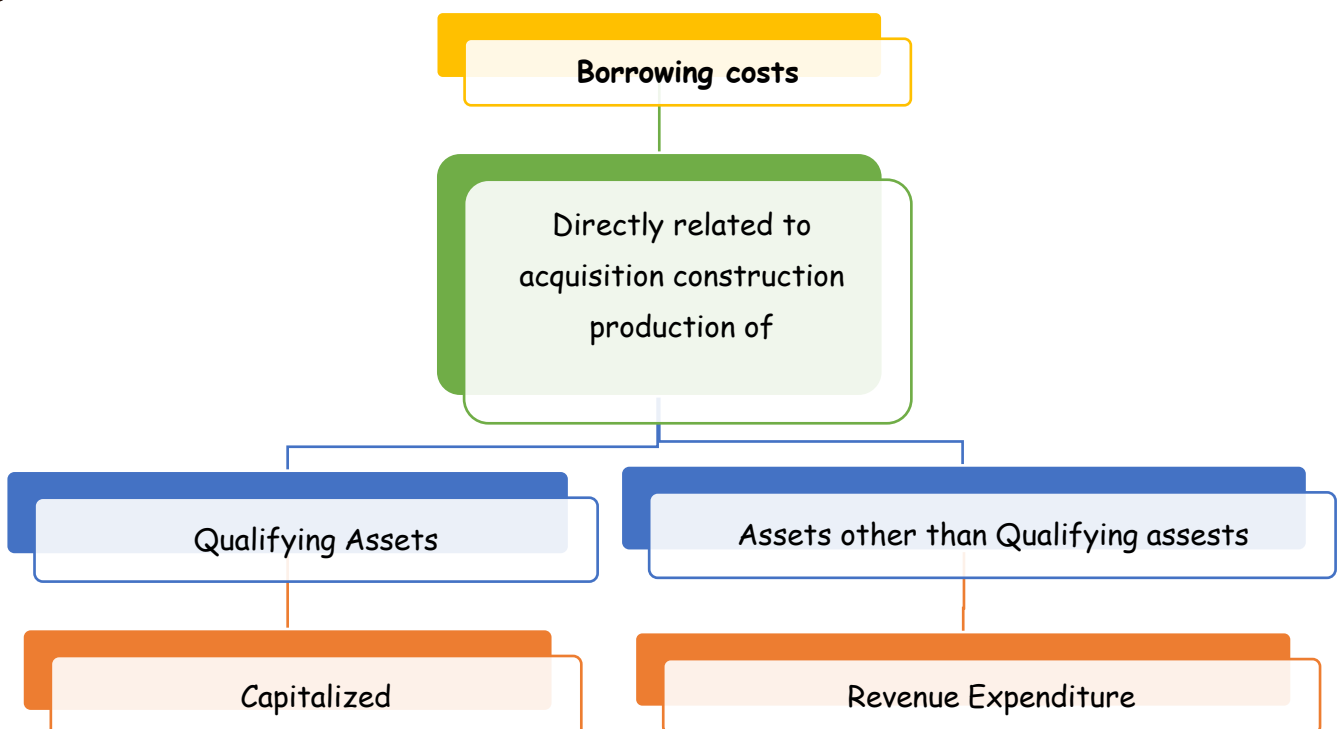
If the interest rate on the local currency loan is 13% instead of 11%, the entire exchange difference of Rs. 30,000 will be considered as borrowing costs.

Total borrowing cost = Rs. 24,000 + Rs. 30,000 = Rs. 54,000 under AS 16.

No exchange difference is recorded under AS 11.



4. Borrowing Costs Eligible for Capitalisation





5. Commencement of Capitalization

1. **Conditions for Capitalisation**
Capitalisation of borrowing costs should begin when all the following conditions are met:
 - a. Expenditures for the asset are incurred.
 - b. Borrowing costs (loan taken) are incurred.
 - c. Activities necessary to prepare the asset for its intended use or sale are in progress.
2. **Expenditures on a Qualifying Asset**
Expenditures include:
 - Cash payments, transfers of other assets, and assumption of interest-bearing liabilities.
 - Expenditures are reduced by progress payments received and grants related to the asset.
3. **Activities to Prepare Asset for Use/Sale**
 - Activities to prepare an asset for intended use or sale include more than just physical construction.
 - They also cover technical and administrative work before construction begins.
 - Excludes periods when the asset is held without any development or production activity.
 - Example:
 - Borrowing costs incurred during land development → Capitalized.
 - Borrowing costs incurred while holding land without development → Not capitalized.
4. **Example of Borrowing Cost Capitalisation**
X Ltd. is starting a construction project, financed by borrowing. The key dates are:
 - i. 15th May, 20X1: Loan interest related to the project starts incurring.
 - ii. 2nd June, 20X1: Technical site planning begins.
 - iii. 19th June, 20X1: Expenditure on the project starts incurring.
 - iv. 18th July, 20X1: Construction work begins.

Commencement Date for Capitalisation
The three conditions are:

 - a. Borrowing cost incurred: 15th May, 20X1
 - b. Expenditure incurred: 19th June, 20X1
 - c. Activities necessary to prepare the asset: 2nd June, 20X1

The commencement date for capitalisation of borrowing cost is the date when all three conditions are met: 19th June, 20X1.



6. Suspension of Capitalization

1. **Suspension of Capitalisation**
 - Capitalization of borrowing costs is suspended during extended periods when active development is interrupted.



- Costs incurred during such interruptions are considered holding costs and do not qualify for capitalization.
- Exceptions (Capitalization continues):
 - When technical or administrative work is ongoing.
 - When the delay is a normal or necessary part of development (e.g., inventories maturing, seasonal delays like high water levels affecting bridge construction).

2. **Example 1 (Suspension of Development)**

Construction suspended from October 20X1 to January 20X2 due to heavy equipment being moved to another site.

In this case, capitalisation of borrowing costs must be suspended since the active development was interrupted.

Example 2 (Temporary Delay)

Temporary delay of 20 days during the completion of construction due to technical reasons.

Capitalisation of borrowing costs shall continue during this temporary delay.



7. Cessation of Capitalization

1. **Cease Capitalisation of Borrowing Costs**

Capitalisation of borrowing costs should cease when substantially all activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Note: Even if some routine administrative work is pending in respect of an asset like decoration of the property still it is treated as substantially completed.

2. **Construction in Parts (Usable Separately)**

If an asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation ceases once substantially all activities are completed for that part.

Example 1 (Business Park)

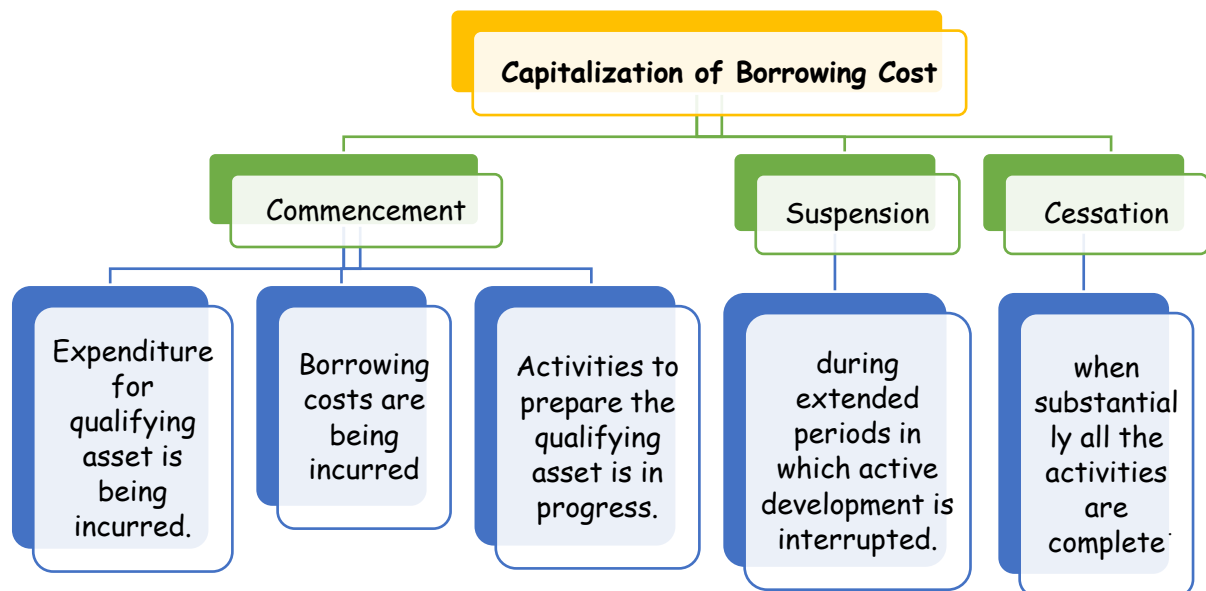
A business park with several buildings, each usable individually, is a qualifying asset. Capitalisation ceases when each part is ready for use.

3. **Construction in Parts (Not Usable Separately)**

If part of the asset cannot be used separately (e.g., industrial plant), capitalisation continues until the entire asset is complete.

Example 2 (Industrial Plant)

For an industrial plant (e.g., a steel mill) involving several processes carried out in sequence, capitalisation only stops when the entire plant is complete.



8. Amount of capitalization

1.	Conditions for Capitalisation Borrowing costs are capitalised when both conditions are met: 1. It is probable that the borrowing costs will result in future economic benefits to the entity. 2. The borrowing costs can be measured reliably.
2.	Other Borrowing Costs Other borrowing costs are recognised as an expense in the period in which they are incurred.
3.	Classification of Borrowings Borrowings are classified as: 1. Specific borrowings: Amount borrowed specifically for the acquisition or construction of a qualifying asset. 2. General borrowings: All other borrowings that are not specific, which can be used for any purpose.
4.	Calculation of specific Borrowing Costs Specific borrowing costs are calculated as: Actual borrowing costs incurred during the period Less Investment income on temporary investments made using those borrowings.
5.	Capitalisation of General Borrowing Costs When general borrowings are used for a qualifying asset (QA), the entity must determine the borrowing costs eligible for capitalisation by applying the capitalisation rate.
	Compute Capitalisation Rate Capitalisation rate = Borrowing cost on general borrowings ÷ weighted average of general borrowings outstanding during the period × 100
	Amount eligible for capitalisation =



	Expenditure on QA × Capitalisation rate
6.	Maximum Capitalisation The amount of borrowing costs capitalised during a period must not exceed the actual borrowing costs incurred during that period.
7.	Total Borrowing Costs to Capitalise on QA Total borrowing costs capitalised on QA = Specific borrowing costs + General borrowing costs



9. Excess of the Carrying Amount Over Recoverable Amount

1.	After capitalization of borrowing cost ➤ If the carrying amount or expected cost of a qualifying asset exceeds its recoverable amount or net realizable value, it must be written down or written off as per relevant accounting standards. ➤ In some cases, this write-down or write-off can be reversed if allowed by those accounting standards.
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10. Disclosure

a.	Amount of borrowing costs capitalised during the period
b.	accounting policy adopted for borrowing costs.



AS - 17: SEGMENT REPORTING



1. Objective

1. **Enterprise Operations**
Many enterprises offer
 - groups of products and services or
 - operate in different geographical areas
 that have varying profitability, growth opportunities, future prospects, and risks.
2. **Objective of the Standard**
The goal of this standard is to provide principles for reporting financial information about
 - the products and services an enterprise offers and
 - the geographical areas it operates in.
3. **Benefits of the Information**
This information helps users of financial statements:
 - Gain a better understanding of the performance of the enterprise.
 - Make better assessments of the risks and returns of the enterprise.
 - Make more informed judgements about the enterprise as a whole.



2. Scope

1. This AS must be applied when presenting general purpose financial statements.
2. An enterprise must comply with the requirements of this standard fully, not selectively.
3. If a financial report includes both consolidated financial statements and separate financial statements of the parent, segment information should be presented based on the consolidated statements.
4. This AS is mandatory for non-SMCs and level I entities.



3. Definitions

1. **Business Segment**
A business segment is a distinguishable component of an enterprise that:
 - Provides an individual product or service or a related group of products or services.
 - Faces different risks and returns compared to other segments.
2. **Factors for Determining Related Products/Services**
 - The nature of the products or services.
 - The nature of the production processes.
 - The type or class of customers.
 - The methods used to distribute products or provide services.
 - The nature of the regulatory environment, e.g., banking, insurance, or public utilities.
3. **Geographical Segment**
A geographical segment is:



	➤ A distinguishable component of an enterprise that provides products or services within a specific economic environment. ➤ Subject to different risks and returns compared to components operating in other economic environments.
4.	Factors for Identifying Geographical Segments ➤ Similarity of economic and political conditions. ➤ Relationships between operations in different areas. ➤ Proximity of operations. ➤ Special risks associated with operations in a specific area. ➤ Exchange control regulations and ➤ underlying currency risks.
5.	Reportable Segment A reportable segment is either a business segment or a geographical segment that requires segment information to be disclosed under AS 17.
6.	Segment Revenue is the aggregate of ➤ directly attributable to the segment. ➤ Part of the enterprise's revenue that can be reasonably allocated to the segment. ➤ Revenue from transactions with other segments of the enterprise. Segment Revenue does not include: ➤ Extraordinary items (as per AS 5). ➤ Interest/Dividend Income, including interest on loans/advances to other segments (except for financial segments). ➤ Gains on Investments/Debt Extinguishment, unless the segment is primarily engaged in financial operations.
7.	Segment expense is the aggregate of ➤ Direct operating expenses of the segment. ➤ Allocable enterprise expenses that can be reasonably attributed to the segment. ➤ Inter segment transaction expenses. But does not include ➤ Extraordinary items (AS 5). ➤ Interest expense, including interest on advances/loans from other segments (except for financial segments). ➤ Losses on investment sales or debt extinguishment, unless the segment is financial. ➤ Income tax expense. ➤ General Administrative & Enterprise-Level Expenses, unless directly related to the segment and reasonably attributable. E.g., general admin, head-office costs, etc.,
8.	Segment result is segment revenue less segment expense.
9.	Segment assets are - operating assets ✓ that are directly attributable to the segment or ✓ can be allocated to the segment on a reasonable basis.



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

Segment assets do not include

- ✓ income tax assets.
- ✓ General Enterprise or Head-Office Assets: Assets that are used for overall enterprise or head-office functions.

10. Segment liabilities are

a. operating liabilities

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

b. If the segment result includes interest expense, its segment liabilities include the related interest-bearing liabilities.

Segment liabilities do not include

- ✓ Income tax liabilities.
- ✓ Financing Liabilities: Borrowings and other liabilities incurred for financing rather than operating purposes.



4. Treatment of Interest for Determining Segment Expense

1. Exclusion of Interest Expense

Interest expense from overdrafts and other operating liabilities specific to a segment should not be included in segment expenses, unless:

- The segment's primary operations are financial in nature.
- The interest is included in the cost of inventories (AS 16 and AS 2).

2. Interest as Inventory Cost

If interest is capitalized as part of inventory cost, and those inventories are part of a segment's assets, the interest should be treated as a segment expense.

3. Disclosures: When segment results include such interest, disclose:

- ✓ The interest amount.
- ✓ A note stating that the segment result includes this interest to provide clarity.



5. Primary and Secondary Segment Reporting Formats

1. Risk and Return Basis

The primary segment reporting format (business or geographical) depends on which factor mainly influences the enterprise's risks and returns.

2.	Primary Segment	Condition	Secondary Information
	Business Segments	Risks & returns depend on different products/services.	Geographical areas



	Geographical Segments	Risks & returns depend on different locations (countries/regions).	Product/service groups
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6. Identifying Reportable Segments (Quantitative Thresholds)

1. **Reportable Segment Criteria**
 A business or geographical segment should be identified as a reportable segment if any of the following tests met:
 - a. **Revenue Test**
 Its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue (both external and internal) of all segments.
 - b. **Segment Result Test**
 Its segment result (profit or loss) is 10% or more of:
 - ✓ The combined result of all segments in profit, or
 - ✓ The combined result of all segments in loss, whichever is greater in absolute amount.
 - c. **Asset Test**
 Its segment assets are 10% or more of the total assets of all segments.
2. **Management Discretion**
 A segment that does not meet the above criteria can still be designated as a reportable segment at the discretion of management.
3. **75% Test (Overall Test) (Additional Segments for Revenue Test)**
 - If total external revenue from reportable segments is less than 75% of total enterprise revenue, additional segments should be identified as reportable,
 - even if they don't meet the 10% thresholds, until reportable segments cover at least 75% of total revenue.**Notes**
 - A previously reportable segment (meeting the 10% threshold in the prior period) remains reportable in the current period, even if it no longer meets the threshold.
 - If a segment meets the 10% threshold in the current period, it must be reported separately.
 - Prior-period data should be restated to include this segment for comparison, unless impracticable.
 - This applies even if the segment was not reportable in the previous period.



7. Disclosures Primary Reporting Segments

1. **Disclosure for Primary Reportable Segments**
 - a. Segment revenue, broken down into:
 - ✓ Revenue from sales to external customers.
 - ✓ Revenue from transactions with other segments.
 - b. The segment result.



- c. The total carrying amount of segment assets.
- d. The total amount of segment liabilities.
- e. The total cost incurred during the period to acquire segment assets (tangible and intangible fixed assets) that are expected to be used for more than one period.
- f. The total amount of depreciation and amortisation expense included in the segment result for the period.
- g. The total amount of significant non-cash expenses (other than depreciation and amortisation) included in the segment expense.



8. Disclosures Secondary Reporting Segments

1. Segment Reporting - Business Segments as Primary Format

Geographical Segment (if $\geq 10\%$)	Disclosures Required
Revenue	Segment revenue from external customers based on customer location.
Assets	Total carrying amount of segment assets based on geographical location.
Cost Incurred	Total cost incurred to acquire segment assets (tangible & intangible) expected to be used for more than one period.

Segment Reporting - Geographical Segments as Primary Format

Business Segment (if $\geq 10\%$)	Disclosures Required
Revenue	Segment revenue from external customers.
Assets	Total carrying amount of segment assets.
Cost Incurred	Total cost incurred to acquire segment assets (tangible & intangible) expected to be used for more than one period.

Other disclosures

- **Inter-Segment Transfers:** Should be recorded using the actual pricing method, and the pricing basis must be disclosed.
- **Accounting Policy Changes:** Any significant changes must be disclosed along with their financial impact.
- **Segment Identification Changes:** If the way segments are classified or how revenues and expenses are allocated changes, it should be explained.
- **Impact on Financials:** Changes in segment reporting may affect segment-level data but do not alter the overall financial statements.
- **Products & Services:** Enterprises should disclose the types of products and services in each business segment.
- **Geographical Segments:** The composition of primary and secondary geographical segments should be mentioned unless already included in the financial statements.



AS - 18: RELATED PARTY DISCLOSURES



1. Objective

1. The objective of this Standard is to establish requirements for disclosure of:
 - Related party relationships; and
 - Transactions between a reporting enterprise and its related parties.



2. Scope

1. This Standard should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties.
2. The requirements of this Standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.
3. This Standard applies only to related party relationships described in paragraph 3.



3. Why Disclosure is Needed

Related party relationships are common in business. Normally, transactions are assumed to happen at fair market terms between independent parties. However, related parties may transact differently on special terms, without charge, or in ways that affect financial results. For example:

- Free services or interest-free loans may be given.
- A company may change its business dealings due to influence from a related party.
- Some transactions may happen only because of the related party relationship.

As a result, financial statements may not always reflect transactions as they would between independent parties.



4. Para-3

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

- a. **Controlled Enterprises**
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 & Joint Ventures**
Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture
- c. **Individuals with Significant Influence**
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**
key management personnel and relatives of such personnel; and
- e. **Enterprises Under Influence**



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



5. Exemptions from related party disclosures under AS 18

1. **Confidentiality Requirements** - If disclosure would violate a legal or regulatory confidentiality duty, it is not required.
Example: Banks must keep customer transactions confidential, so AS 18 does not override this obligation.
2. **Consolidated Financial Statements** - No disclosure is needed for intra-group transactions in consolidated financial statements, as they treat the group as a single entity.
3. **State-Controlled Enterprises** - Related party disclosures are not required for transactions between government-owned enterprises



6. Definitions

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. **Subsidiary**
A company in which another company (the holding company) holds/control, either by itself and/or through one or more subsidiaries,
 - more than one-half, in nominal value of its equity share capital; or
 - the composition of its board of directors.
3. **Fellow Subsidiary**
A company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.
4. **Control**
Control by ownership-having more than 50% of voting power of an enterprise. (directly or indirectly) or
Control over composition of board of directors or governing body. (ability to appoint or remove either all or majority of directors) or
Control of substantial interest in the voting power and power to direct by statute or agreement the financial and/or operating policies of the enterprise.
Note: Substantial interest means having 20% or more voting power directly or indirectly.
5. **Significant Influence (SI)**



	"Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies". SI can be exercised in several ways • By representation of the board of directors • Participation in the policy making process. • Material inter-company transactions. • Interchange of managerial personnel • Dependence of technical information • Having 20% or more of voting power directly or indirectly, it is presumed that the investing party does have SI unless proved otherwise. Having less than 20% of the voting power of the enterprise, it is presumed that the investing party does not have SI unless proved otherwise.
6.	Associate An enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party. Therefore, an associate should not be a subsidiary neither a joint venture of that investing reporting enterprise.
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.	Joint Venture A contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.
9.	Joint Control The contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.
10.	Key Management Personnel (KMP) Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. Notes ➤ In a company, the following are usually considered key management personnel: a. Managing Directors b. Whole-time Directors c. Managers d. Anyone who directs the board's decisions ➤ AS 18 clarifies that a non-executive director is not considered key management personnel unless they have authority over planning, directing, and controlling the company's activities. ➤ Even if a non-executive director is involved in financial or operational decisions, AS 18 does not treat them as a related party unless they meet the defined related party criteria.



11. Related Party Transactions

It means a transfer of resource or obligations between related parties regardless of whether or not a price is charged



7. Para-4

The following parties are deemed not to be related parties

- Two companies are not considered related parties just because they have a common director, unless that director can influence both companies' policies in their mutual dealings.
- A company does not become a related party just because it depends economically on a major customer, supplier, or distributor.
- The following entities are not related parties simply because of their normal dealings with a company:
 - a. Lenders/Finance Providers
 - b. Trade Unions
 - c. Public Utilities (e.g., electricity, water suppliers)
 - d. Government bodies/agencies



8. Disclosures

For the purpose of disclosure related parties' relationship can be categorized as follows

1. When the existence of relationship is due to the concept of the control and there are no transactions between the related parties.
 - Name of the related party should be disclosed.
 - Nature of the related party relationship should be disclosed.
2. When the existence of relationship is due to the concept of the significant influence and there are no transactions between related parties.
No disclosures are required.
3. When the existence of relationship is either due to control or SI and there are related party transactions between related parties
 - Name of the related party.
 - Description of relationship.
 - Description of the nature of transaction.
 - Volume of transactions either as on amount or as an appropriate proportion.
 - Any other element of transactions, which is essential for understanding FS's.
 - Amount of outstanding items and provision for doubtful debts.
 - Amount written off or written back in the period in respect of debts due from /to related party.



AS - 19: LEASES



1. What is a Lease

Lease	An agreement where the Lessor (legal owner) conveys to the Lessee (user) the right to use an asset in exchange for lease rent (payment) for an agreed period of time . A lease includes hire agreements where the hirer has the option to acquire ownership upon meeting agreed conditions.
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2. Applicability of AS 19

The standard applies to all leases other than	
a.	Natural Resources Leases for exploration or use of natural resources such as oil, gas, timber, metals, and other minerals.
b.	Licensing Agreements Covers motion picture films, video recordings, plays, manuscripts, patents, and copyrights .
c.	Land Use Leases Agreements specifically for using land .



3. Definitions

1.	Non-Cancellable Lease A non-cancellable lease is a lease that is cancellable only: a. upon the occurrence of some remote contingency ; 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 payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain .
2.	Lease Term The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.
3.	Inception of Lease The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.
4.	MLP Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent , costs for services and taxes to be paid by and reimbursed to the lessor, together with:



	a. In the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or b. In the case of the lessor, any residual value guaranteed to the lessor: - by or on behalf of the lessee; or - by an independent third party financially capable of meeting this guarantee. If the lessee has an option to purchase the asset at a price that is expected to be significantly lower than the fair value when the option becomes exercisable, and it is reasonably certain to be exercised at the inception of the lease, the minimum lease payments include: ✓ The payments due over the lease term, plus ✓ The payment required to exercise the purchase option.
5.	Economic Life The total usable period of an asset across multiple users.
6.	Useful Life The depreciable life of an asset used by the lessee. (Always shorter than economic life).
7.	Residual Value Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.
8. :	Guaranteed residual value is: Guaranteed residual value is: - in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee and - in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.
9.	Unguaranteed residual value Unguaranteed residual value of a leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.
10.	Gross investment Gross investment in the lease is the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.
11.	Unearned finance income Unearned finance income is the difference between: - the gross investment in the lease; and - the present value of - the minimum lease payments under a finance lease from the standpoint of the lessor; and - any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

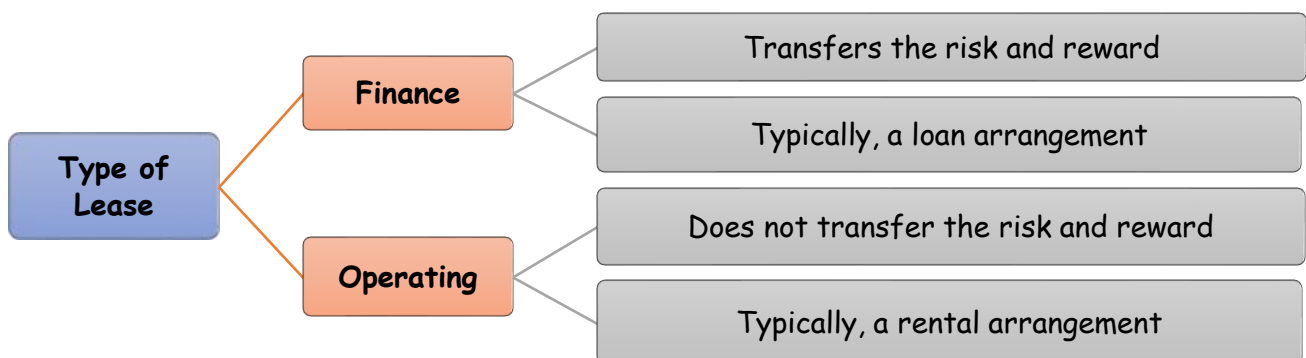


12.	Net investment Net investment in the lease is the gross investment in the lease less unearned finance income.
13.	Interest rate implicit in the lease The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of - the minimum lease payments under a finance lease from the standpoint of the lessor; and - any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.
14.	Lessee's incremental borrowing rate of interest The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.
15.	Contingent rent Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).



4. Types of Leases

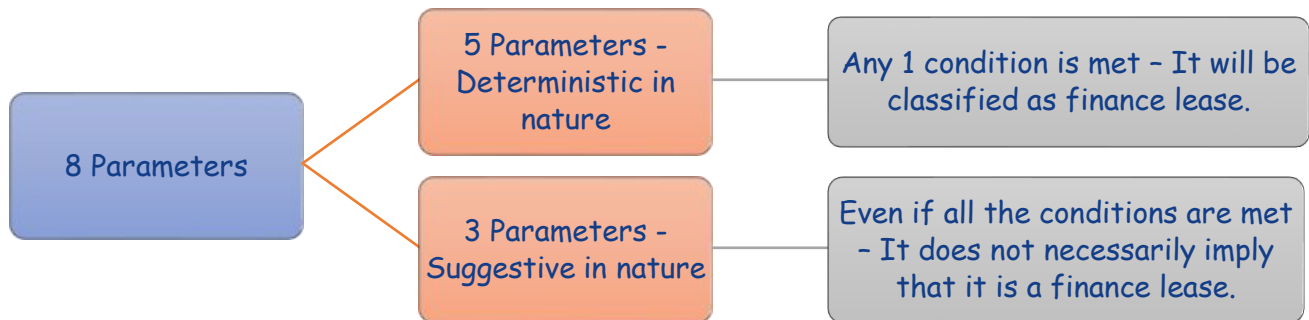
Lease Type	Definition
Finance Lease	A lease where substantially all risks and rewards of ownership are transferred .
Operating Lease	A lease where ownership risks and rewards are NOT transferred .
Classification Basis	Determined by the substance of the transaction , not just legal form.





5. Indicators of Finance Lease

AS 19 has given a total of **8 parameters** to decide whether it is a finance lease or not. These 8 conditions can be divided into following categories:



Finance Lease Classification: Deterministic & Suggestive Conditions

1. Deterministic Conditions (Normally Lead to Finance Lease Classification)

a.	The lease transfers ownership of the asset to the lessee by the end of the lease term ;
b.	The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease , it is reasonably certain that the option will be exercised; Example Mr. A has taken a car on lease for 5 years from XYZ. After 5 years of lease term Mr. A has the option to purchase this car for Rs.20,000, whereas it is assumed the car market value at the end of 5th year would be Rs.2,00,000. Considering the option to buy it at bargain price, it is reasonably certain that Mr. A would exercise that option.
c.	The lease term is for the major part of the economic life of the asset even if title is not transferred; Example XYZ has taken a property on lease for 32 years from ABC, expected economic life of the property is 40 years. Since XYZ is going to use the asset over major part of its economic life (80% in this case), it will meet the condition to be treated as finance lease.
d.	At the inception of the lease , present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset ; and
e.	The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made. Example PQR, a hospital ordered 10 ambulances, specially designed as per the requirement of PQR. These ambulances are taken on lease and it cannot be used by anyone else without major modifications. This would meet the condition of finance lease



2. Suggestive Conditions (Additional Indicators for Finance Lease Classification)

- | | |
|----|---|
| a. | If the lessee can cancel the lease and the lessor's losses associated with the cancellation are borne by the lessee; |
| b. | If the lessee benefits from fluctuations in the asset's residual value (e.g., receiving rent rebates based on disposal value). |
| c. | If the lessee continues the lease for a secondary period at a rent substantially lower than the market rate . |

3. Key Notes on Lease Classification

- | | |
|----|--|
| a. | Lease classification is determined at inception . |
| b. | If terms change (except renewals), a new lease classification applies. |
| c. | Changes in Estimates or Circumstances
Changes in economic life, residual value, or lessee default do not lead to reclassification . |



6. Accounting for Finance Leases (Books of Lessee)

1. Initial Recognition (At Inception of Lease)

Accounting Entry		Debit	Credit
Recognition of Asset & Liability		Leased Asset	Lessor
1.	Measurement Basis Lease recorded at lower of : ✓ Fair Value of the asset ✓ Present Value of MLP (Discounted at interest rate implicit in the lease or, if unavailable, lessee's incremental borrowing rate).		

2. Subsequent Accounting Treatment

a.	Lease Payments Apportioned between : ➤ Finance Charge (Interest Expense) ➤ Reduction of Lease Liability .
b.	Finance Charges Allocated across periods to maintain a constant interest rate on the outstanding liability.
c.	Depreciation ➤ Finance lease results in depreciation expense for the asset. ➤ Depreciation policy must align with AS 10 .

3. Depreciation Criteria

a.	Lessee Retains Asset Depreciated over its useful life .
b.	Asset is Returned to Lessor Depreciated over lease term or useful life, whichever is shorter .



4. Initial Direct Costs

- a. Included in asset cost as part of lease recognition.

5. Interest Rate Implicit in Lease

- a. The discount rate that equates: Present Value of Minimum Lease Payments (MLP) + Unguaranteed Residual Value (UGRV) = Fair Value of the Leased Asset.

Example 1

Annual lease rents = Rs.50,000 at the end of each year.

Lease period = 5 years;

Guaranteed residual value = Rs.25,000

Unguaranteed residual value (UGR) = Rs.15,000

Fair Value at the inception (beginning) of lease = Rs.2,00,000

Interest rate implicit on lease is computed below:

Interest rate implicit on lease is a discounting rate at which present value of minimum lease payments and unguaranteed residual value is Rs.2 lakhs.

PV of minimum lease payments and unguaranteed residual value at guessed rate 10%

Year	MLP + UGR Rs.	DF (10%)	PV Rs.
1	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150
5	50,000	0.621	31,050
5	25,000	0.621	15,525
5	15,000	0.621	9,315
			2,14,340

PV of minimum lease payments and unguaranteed residual value at guessed rate 14%

Year	MLP + UGR Rs.	DF (10%)	PV Rs.
1	50,000	0.877	43,850
2	50,000	0.769	38,450
3	50,000	0.675	33,750
4	50,000	0.592	29,600
5	50,000	0.519	25,950
5	25,000	0.519	12,975
5	15,000	0.519	7,785
			1,92,360

Interest rate implicit on lease is computed below by interpolation:

$$\text{Interest rate implicit on lease} = 10\% + \frac{14\% - 10\%}{2,14,340 - 1,92,360} \times (2,14,340 - 2,00,000) = 12.6\%$$

Example 2



Annual lease rents	=	Rs.50,000 at the end of each year.
Lease period	=	5 years;
Guaranteed residual value	=	Rs.25,000
Unguaranteed residual value (UGR)	=	Rs.15,000
Fair Value at the inception (beginning) of lease	=	Rs.2,00,000
Interest rate implicit on lease is	=	12.6%

Present value of minimum lease payment is computed below:

Year	MLP Rs.	DF (12.6%)	PV Rs.
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = Rs.1,91,500

Fair value of leased asset = Rs.2,00,000

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

	Rs.	Rs.
Asset A/c Dr.	1,91,500	
To Lessor (Lease Liability) A/c		1,91,500
(Being recognition of finance lease as asset and liability)		

Example 3

Using data for example 2 and assuming zero residual value, allocation of finance charge over lease period is shown below:

Year	Minimum Lease Payments Rs.	Finance Charge (12.6%) Rs.	Principal Rs.	Principal due Rs.
0	--	--	--	1,91,500
1	50,000	24,129	25,871	1,65,629
2	50,000	20,869	29,131	1,36,498
3	50,000	17,199	32,801	1,03,697
4	50,000	13,066	36,934	66,763
5	75,000	8,237*	66,763	
	2,75,000	83,500	1,91,500	

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:

	Rs.	Rs.
--	-----	-----



Finance Charge A/c To Lessor (Being finance charge due for the year)	Dr.	24,129	24,129
Lessor To Bank A/c (Being payment of lease rent for the year)	Dr.	50,000	50,000
P & L A/c To Finance Charge A/c (Being recognition of finance charge as expense for the year)	Dr.	24,129	24,129

Example 4

In example 2, suppose unguaranteed residual value is not determinable and lessee's incremental borrowing rate is 10%.

Since interest rate implicit on lease is discounting rate at which present value of minimum lease payment and present value of unguaranteed residual value equals the fair value, interest rate implicit on lease cannot be determined unless unguaranteed residual value is known. If interest rate implicit on lease is not determinable, the present value of minimum lease payments should be determined using lessee's incremental borrowing rate. Present value of minimum lease payment using lessee's incremental borrowing rate 10% is computed below:

Year	MLP Rs.	DF (10%)	PV Rs.
1	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150
5	50,000	0.621	31,050
5	25,000	0.621	15,525
			2,05,025

Present value of minimum lease payment = Rs.2,05,025

Fair value of leased asset = Rs.2,00,000

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

		Rs.	Rs.
Asset A/c To Lessor (Lease Liability) (Being recognition of finance lease as asset and liability)	Dr.	2,00,000	2,00,000

Since the liability is recognised at fair value Rs.2 lakh (total principal), we need to ascertain a discounting rate at which present value minimum lease payments equals Rs.2 lakh. The discounting rate can then be used for allocation of finance charge over lease period.

PV of minimum lease payments at guessed rate 12%.

Year	Minimum Lease Payments Rs.	DF (12.6%)	PV Rs.
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1	50,000	0.893	44,650
2	50,000	0.797	39,850
3	50,000	0.712	35,600
4	50,000	0.636	31,800
5	50,000	0.567	28,350
5	25,000	0.567	14,175
			1,94,425

Required discounting rate = $10\% + \frac{12\% - 10\%}{2,05,025 - 1,94,425} \times (2,05,025 - 2,00,000) = 10.95\%$

Allocation of finance charge over lease period is shown below:

Year	Minimum Lease Payments Rs.	Finance Charge (12.6%) Rs.	Principal Rs.	Principal due Rs.
0	--	--	--	2,00,000
1	50,000	21,900	28,100	1,71,900
2	50,000	18,823	31,177	1,40,723
3	50,000	15,409	34,591	1,06,132
4	50,000	13,066	36,934	66,763
5	75,000	7,247*	67,753	
	2,75,000	75,000	2,00,000	

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:

		Rs.	Rs.
Finance Charge A/c	Dr.	21,900	
To Lessor			21,900
(Being finance charge due for the year)			
Lessor	Dr.	50,000	
To Bank A/c			50,000
(Being payment of lease rent for the year)			
P & L A/c	Dr.	21,900	
To Finance Charge			21,900
(Being recognition of finance charge as expense for the year)			

7. Disclosures made by the Lessee

Lessee's Disclosure Requirements for Finance Leases

a.	Finance lease assets should be separately disclosed from owned assets.
b.	For each asset class, disclose the net carrying amount at the balance sheet date.
c.	Show a reconciliation between total MLP and their present value , including a breakdown for: ✓ Not later than one year ✓ Later than one year and not later than five years



	✓ Later than five years.
d.	Disclose contingent rents recognized as expense in the Profit & Loss Statement.
e.	Disclose total future minimum sublease payments under non-cancellable subleases at the balance sheet date.
f.	Provide key details of the lessee's leasing arrangements, including: ✓ Basis of contingent rent payments ✓ Renewal, purchase options, and escalation clauses ✓ Lease restrictions (e.g., dividends, additional debt, further leasing).



8. Accounting for Finance Leases (Books of Lessor)

1. Initial Recognition (At Lease Inception)

Accounting Entry	Debit	Credit
Purchase of Asset by Lessor	Asset (Fair Value)	Bank (Fair Value)
Recognition of Lease Receivable	Lease Receivable (at NI)	Asset (at NI)

2. Recognition of Finance Income

a.	Unearned Finance Income (UFI) Recognized systematically over the lease term .
b.	Income Allocation Method Ensures a constant periodic return on the net investment .
c.	Interest Rate Basis Based on Interest Rate Implicit in Lease or Commercial Interest Rate .

3. Initial Direct Costs

a.	Definition Includes commissions, legal fees, and other costs incurred to arrange the lease.
b.	Accounting Treatment ✓ Recognized immediately in Profit & Loss, or ✓ Allocated over lease term against finance income.

4. Review of Unguaranteed Residual Value (UGRV)

a.	Regular Review Lessor must regularly review UGRV.
b.	Reduction in UGRV Revise income allocation over remaining lease term; previously accrued income is adjusted immediately .
c.	Increase in UGRV Upward adjustments are NOT allowed .

5. Manufacturer or Dealer Lessor

a.	Sales Recognition Recognized in Profit & Loss as per normal sales policy .
b.	Low Interest Rate Quotes If an artificially low interest rate is used, profit should be restricted to a commercial rate .



- c. **Initial Direct Costs**
Recognized as an expense in Profit & Loss at lease inception.



9. Disclosures made by Lessor

Lessor's Disclosure Requirements for Finance Leases

- Show a reconciliation between total Gross Investment (GI) and Present Value (PV) of Minimum Lease Payments (MLP) receivable, with a breakdown for:
 - ✓ Not later than one year
 - ✓ Later than one year and not later than five years
 - ✓ Later than five years.
- Disclose the total unearned finance income (interest income not yet recognized).
- Report the unguaranteed residual value (UGRV) that benefits the lessor.
- Disclose the accumulated provision for uncollectible MLP receivables.
- Report contingent rents recognized as income in the Profit & Loss Statement.
- Provide a general description of the lessor's significant lease agreements.
- Disclose the accounting policy for initial direct costs (whether expensed immediately or allocated over lease term).
- Report Gross Investment Less Unearned Income for new leases added, after deducting cancelled leases.



10. Accounting For Operating Leases (Lessee Books)

- Recognition of Lease Payments**
Lease payments are recognized as an expense in the Profit & Loss Statement on a straight-line basis over the lease term, unless another method better reflects the benefit pattern.
- Requirement under AS 19**
To ensure a better revenue-cost match, AS 19 mandates that operating lease payments be recognized on a straight-line basis, unless another method better represents the benefit pattern.

Example

Suppose outputs from a machine taken on a 3-year operating lease are estimated as 10,000 units in year 1; 20,000 units in year 2 and 50,000 units in year 3. The agreed annual lease payments are Rs.25,000, Rs.45,000 and Rs.50,000 respectively.

The total lease payment Rs.1,20,000 in this example should be recognised in proportion of output as Rs.15,000 in year 1, Rs.30,000 in year 2 and Rs.75,000 in year 3. The difference between lease rent due and lease rent recognised can be debited / credited to Lease Equalisation A/c.

The accounting entries for year 1 in books of lessee are suggested below:

		Rs.	Rs.
Lease Rent A/c	Dr.	15,000	
Lease Equalization A/c	Dr.	10,000	



To Lessor (Being lease rent for the year due)		25,000
Lessor	Dr.	25,000
To Bank A/c (Being payment of lease rent for the year)		25,000
P & L A/c	Dr.	15,000
To Lease Rent A/c (Being recognition of lease rent as expense for the year)		15,000

Since total lease rent due and recognised must be same, the Lease Equalisation A/c will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or Current Liabilities" depending on the nature of balance.



11. Disclosures made by Lessee

Disclosures for Operating Leases by lessee

a.	Disclose payments due in: ✓ Not later than one year ✓ Later than one year and not later than five years ✓ Later than five years
b.	Disclose total sublease payments expected to be received at balance sheet date.
c.	Report lease payments recognized , with separate amounts for minimum lease payments and contingent rents.
d.	Report sublease payments received (or receivable).
e.	Disclose key lease terms , including: ✓ Basis of contingent rent payments ✓ Renewal, purchase options, and escalation clauses ✓ Restrictions on dividends, debt, further leasing



12. Accounting for operating leases (Lessor books)

a.	Recognition of Asset Asset given on lease remains in the books of the lessor as Property, Plant & Equipment (PPE).
b.	Lease Income Recognition Recognized in Profit & Loss Statement on a straight-line basis (SLM) unless another method better reflects the time pattern of benefit .
c.	Depreciation Charged as per AS 10 , following the lessor's normal depreciation policy.
d.	Impairment Losses Assessed and accounted for as per AS 28.

**Example:**

Suppose outputs from a machine of economic life of 6 years are estimated as 10,000 units in year 1, 20,000 units in year 2 and 30,000 units in year 3, 40,000 units in year 4, 20,000 units in year 5 and 5,000 units in year 6. The machine was given on 3-year operating lease by a dealer of the machine for equal annual lease rentals to yield 20% profit margin on cost Rs.5,00,000. Straight-line depreciation in proportion of output is considered appropriate.

$$\begin{aligned}\text{Total lease rent} &= 120\% \text{ of Rs.5 lakhs} \times \frac{\text{Output during lease period}}{\text{Total output}} \\ &= \text{Rs.6 lakhs} \times \frac{60,000 \text{ units}}{1,25,000 \text{ units}} = \text{Rs.2.88 lakhs}\end{aligned}$$

$$\text{Annual lease rent} = \text{Rs.2,88,000} / 3 = \text{Rs.96,000}$$

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 10: 20 : 30. Hence income recognised in years 1, 2 and 3 are Rs.48,000, Rs.96,000 and Rs.1,44,000 respectively.

Since depreciation in proportion of output is considered appropriate, the depreciable amount Rs.5 lakh should be allocated over useful life 6 years in proportion of output, i.e. in proportion of 10: 20 : 30 : 40 : 20 : 5. Depreciation for year 1 is Rs.40,000.

The accounting entries for year 1 in books of lessor:

		Rs.	Rs.
Machine given on Operating Lease	Dr.	5,00,000	
To Purchase			5,00,000
(Being machine given on operating lease brought into books)			
Lessee	Dr.	96,000	
To Lease Equalization A/c			48,000
To Lease Rent (Being lease rent for the year due)			48,000
Bank	Dr.	96,000	
To Lessee			96,000
(Being receipt of lease rent for the year)			
Lease Rent	Dr.	48,000	
To P & L A/c			48,000
(Being recognition of lease rent as income for the year)			
Depreciation	Dr.	40,000	
To Machine given on Operating Lease			40,000
(Being depreciation for the year)			
P & L A/c	Dr.	40,000	
To Depreciation			40,000
(Being depreciation for the year transferred to P & L A/c)			

Since total lease rent due and recognised must be same, the Lease Equalisation A/c will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or Current Liabilities" depending on the nature of balance.



13. Disclosures made by Lessors

a.	For each class of assets, disclose: ✓ Gross carrying amount ✓ Accumulated depreciation ✓ Accumulated impairment losses i. Depreciation in P&L Depreciation expense recognized during the period. ii. Impairment Losses in P&L Impairment losses recognized during the period. iii. Reversal of Impairment Losses in P&L Impairment losses reversed during the period.
b.	Disclose lease amounts for: ✓ Not later than one year ✓ Later than one year and not later than five years ✓ Later than five years
c.	Report contingent rent recognized as income in the Profit & Loss Statement.
d.	Provide a general description of the lessor's significant lease agreements.
e.	Disclose accounting policy for initial direct costs (whether expensed immediately or allocated over lease term).



14. Sale and Leaseback

Accounting of Sale and Leaseback

a.	A property owner sells an asset and leases it back from the buyer.
b.	The seller (lessee) receives cash upfront while retaining the asset's use.
c.	Lease payments and sale price are negotiated together.
d.	Accounting Treatment Depends on whether the lease is a Finance Lease or an Operating Lease.
I.	Where sale and leaseback results in finance lease The excess or deficiency of sales proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.
II.	Where sale and leaseback results in operating lease Case 1: Sale price = Fair Value Profit or loss should be recognised immediately. Case 2: Sale Price < Fair Value Profit and loss should be recognised immediately. However, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.



Case 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

Sale and Leaseback Accounting Summary

Sale Price at Fair Value	Carrying Amount = Fair Value	Carrying Amount < Fair Value	Carrying Amount > Fair Value
Profit	No profit	Recognize profit immediately	Not applicable
Loss	No loss	Not applicable	Recognize loss immediately

Sale Price below Fair Value	Carrying Amount = Fair Value	Carrying Amount < Fair Value	Carrying Amount > Fair Value
Profit	No profit	Recognize profit immediately	No profit (Asset written down to fair value)
Loss (Not Compensated by Below-Market Lease Payments)	Recognize loss immediately	Recognize loss immediately	Write down asset to fair value
Loss (Compensated by Below - Market Lease Payments)	Defer & amortize loss	Defer & amortize loss	Write down asset to fair value

Sale Price above Fair Value	Carrying Amount = Fair Value	Carrying Amount < Fair Value	Carrying Amount > Fair Value
Profit	Defer & amortize profit	Recognize difference between carrying amount & fair value immediately + Defer & amortize excess over fair value	Defer & amortize profit (Profit = Sale Price - Fair Value, since asset is written down to fair value)
Loss	No loss recognized	No loss recognized	Write down asset to fair value + Defer & amortize difference between sale price & fair value



AS - 20: EARNING PER SHARE



1. Objective

1. Establishes principles for determining and presenting EPS, enhancing comparability across different enterprises and periods.
2. Provides the methodology for computing and presenting Basic EPS, Diluted EPS



2. Scope

1. **Applicability**
 - AS 20 is mandatory for all companies.
 - Disclosure of diluted EPS is not mandatory for SMCs.
2. **Consolidated Financial Statements**
EPS information must be presented based on consolidated financial data.



3. Definitions

1. **Financial Instrument**
A contract that creates both: A financial asset for one enterprise, and A financial liability or equity share for another enterprise.
2. **Potential Equity Share**
A financial instrument or contract that may entitle the holder to equity shares.
Examples
 - Convertible debt instruments (debt/preference shares convertible into equity shares).
 - Share warrants.
 - Stock options (including employee stock option plans).
 - Contingently issuable shares (issued upon meeting specific conditions like business acquisition or loan default).

Note: Partly Paid-Up Shares
A partly paid-up share where the holder is not entitled to dividends is treated as a potential equity share for the purposes of computing Diluted EPS.
3. **Share warrants or options** are financial instruments that give the holder the right to acquire equity shares.
4. **Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.



4. Basic Earnings Per Share

Basic Earnings Per Share (EPS) =

$$\frac{\text{Net profit or loss attributable to the equity shareholders during the period}}{\text{Weighted average number of equity shares outstanding during the period}}$$



A. Net Profit or Loss Attributable to Equity Shareholders

PAT - Preference dividend or
PBT - Tax - preference dividend

Preference Dividends

- ☒ Non-cumulative Preference Shares → consider it only if provided in books.
- ☒ Cumulative Preference Shares → consider whether provided or not in books.

B. Weighted Average Number of Equity Shares (WANES)

The weighted average number of equity shares (WANES) is based on shares outstanding at the beginning of the period, adjusted for buybacks and issuances, multiplied by a time-weighting factor.

Effective Date for Inclusion in WANES

Situation	Date of Inclusion in Weighted Average Shares
Shares Issued for Cash	Date of cash receipt
Shares Issued for Debt Conversion	Date of conversion
Shares Issued for Interest / Principal Settlement	Date when interest ceases to accrue
Shares Issued for Liability Settlement	Effective date of settlement
Shares Issued for Asset Acquisition	Date of asset recognition
Shares Issued for Services Rendered	As services are rendered
Amalgamation (Nature of Purchase)	From acquisition date
Amalgamation (Nature of Merger)	From beginning of reporting period

C. Different situation in calculation of WANES

a)	Partly Paid Shares They are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period.
b)	Different Nominal Values Where an enterprise 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.
c)	Contingently Issuable Shares Shares that will be issued only if certain conditions in a contract are met are called contingently issuable shares. These shares are counted in basic earnings per share (EPS) from the date when all conditions are fulfilled.
d)	Bonus Issue / Share Split ➤ In a bonus issue or share split, additional shares are given to existing shareholders without any extra payment. ➤ This increases the number of shares without increasing company resources.



	➤ The number of shares outstanding before the event is adjusted as if the event happened at the start of the earliest reported period. ➤ This means the EPS calculation for previous years is also adjusted retrospectively.
e)	Right Issue ➤ Usually issued at a price below fair value, containing a bonus element. ➤ The number of shares used to calculate basic EPS for prior periods is adjusted using an adjustment factor. ➤ Adjustment Factor/bonus element = $\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical Ex-Rights Fair Value Per Share}}$ Theoretical Ex-rights fair value per share = $\frac{\text{Fair value of shares outstanding before right issue} + \text{amount received from issue of rights}}{\text{Total number of shares after right issue}}$



5. Diluted Earnings Per Share

Diluted Earnings Per Share (Diluted EPS) =

Net profit /loss attributable to equity shares holders after giving effect of potentially dilutive equity shares ÷ weighted average number of shares outstanding after giving effect of potentially dilutive equity shares

1. Adjustments to Net Profit	
1.	Dividends on Dilutive Potential Equity Shares Added back to net profit, adjusted for related tax effects.
2.	Interest on Dilutive Potential Equity Shares Added back to net profit, adjusted for related tax effects.
3.	Other After-Tax Adjustments Adjust net profit for expenses/income changes due to conversion of dilutive potential equity shares.

2. Adjustments to Weighted Average Number of Shares	
1.	Increase in Weighted Average Shares The weighted average number of shares is increased by the average number of additional shares that would have been outstanding if all dilutive potential equity shares were converted.

3. Treatment of Special Cases	
1.	Share Application Money Pending Allotment If the money is not kept separately and used in business, treat it as dilutive potential equity shares.
2.	Partly Paid-Up Shares If holders are not entitled to dividends, treat them as potential equity shares for diluted EPS calculation.



4. Timing of Potential Equity Shares Inclusion in WANES

Potential equity shares issued last year, not converted this year	Beginning of the year	End of the year
Potential equity shares issued last year, converted this year	Beginning of the year	Date of conversion (then included in both Basic & Diluted EPS)
Potential equity shares issued this year, not converted	Date of issue	End of the year
Potential equity shares issued last year, cancelled/lapsed this year	Beginning of the year	Date of cancellation/lapse

5. Diluted EPS for Share Options & Purchase Arrangements

- Assume all dilutive options and potential equity shares are exercised.
- Proceeds from the assumed exercise are treated as received at fair value.
- The difference between total issuable shares and shares issued at fair value is considered an issue of shares for no consideration.
- Options are dilutive if they result in issuing shares below fair value.
- Dilution is the difference between fair value and the issue price.
- Each arrangement is split into:
 - A contract to issue shares at fair value (ignored in diluted EPS).
 - A contract to issue remaining shares for no consideration (dilutive).



6. Dilutive Potential Equity Shares

Diluted EPS Consideration for Potential Equity Shares

Condition	Remarks	Included in Diluted EPS?
Conversion decreases EPS from continuing ordinary activities	Dilutive	Yes
Conversion increases EPS from continuing ordinary activities	Anti-dilutive	No
Conversion increases loss per share from continuing ordinary activities	Dilutive	Yes
Conversion decreases loss per share from continuing ordinary activities	Anti-dilutive	No



7. Disclosure

1.	If the Statement of Profit & Loss includes extraordinary items, disclose Basic & Diluted EPS computed excluding these items (net of tax).
2.	Disclose amounts used as numerators for Basic & Diluted EPS and provide a reconciliation to the net profit or loss for the period.
3.	Disclose weighted average number of equity shares used as denominators for Basic & Diluted EPS and provide a reconciliation between them.
4.	Report the nominal value of equity shares along with the EPS figures.



AS - 22: ACCOUNTING FOR TAXES ON INCOME



1. Objective

1. This standard prescribes the accounting treatment for taxes on income.
2. **Matching Concept**
In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate.
3. Taxable income may be significantly different from the accounting income.



2. Scope

1. This Standard applies to accounting for taxes on income.
2. Covers determining tax expense for an accounting period and its disclosure in financial statements.
3. Taxes on income includes all domestic & foreign taxes based on taxable income.



3. Key Terms

1. **AI (Accounting Income)**
Net profit or loss before tax.
2. **TI (Taxable Income)**
Income computed under tax laws, on which tax is payable.
3. **Tax Expense**
Current Tax + Deferred Tax.
4. **CT (Current Tax)**
Tax payable on taxable income for the period.
5. **DT (Deferred Tax)**
Tax effect of timing differences.
6. **Timing Differences**
Differences between taxable & accounting income that originate in one period and reverse in future periods.
Example
Machinery purchased for scientific research - fully deductible for tax in Year 1, but depreciated over years in accounting books. Creates a temporary difference, leading to a deferred tax asset or liability.
7. **Permanent Differences**
Differences that originate in one period and do not reverse later.
Example
Fine for late tax payment - considered an expense in profit & loss, but not allowed for tax computation. Since it never reverses, it is a permanent difference.



4. Recognition

1.	Tax on Income as an Expense Tax on income is considered as an expense for the period , (current tax and deferred tax), should be included in the determination of the net profit or loss for the period.
2.	Tax Effects of Timing Differences Shown in Statement of Profit & Loss as tax expenses & as DTA or DTL in the Balance Sheet .
3.	Recognition of Deferred Tax Assets (DTA) DTA should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.
4.	DTA for Unabsorbed Depreciation or Losses If an enterprise has unabsorbed depreciation or carry-forward losses , DTA can be recognized only when there is virtual certainty , backed by convincing evidence , that sufficient future taxable income will be available to utilize these assets.
5.	Criteria for Certainty in Recognizing Deferred Tax Assets - This reasonable level of certainty would normally be achieved by ➤ Examining the past record of the enterprise and ➤ by making realistic estimates of profits for the future. Virtual certainty cannot be based only on performance forecasts. ➤ It must be backed by strong evidence, such as: • A binding export order that ensures profits. • A contract where cancellation leads to heavy penalties for the defaulting party



5. Measurement

1.	Current Tax Measured at the amount expected to be paid to tax authorities using applicable tax rates & laws .
2.	Deferred Tax Assets & Liabilities Measured using tax rates & laws that are enacted or substantively enacted by the balance sheet date.
3.	Discounting of Deferred Tax Deferred tax assets & liabilities should not be discounted to their present value .



6. Re-Assessment of Unrecognised Deferred Tax Assets

Reassessment of Deferred Tax Assets (DTA)	
At each balance sheet date	Unrecognized DTAs are reassessed.
Future taxable income is reasonably or virtually certain	Recognize previously unrecognized DTAs.



7. Review of Previously Recognised Deferred Tax Assets

1. **Review of Recognized DTA**
Carrying value of recognized DTAs must be reviewed at each balance sheet date.
2. **Insufficient Future Taxable Income**
If future taxable income is unlikely, the DTA must be written down.
3. **Improved Future Taxable Income**
If taxable income becomes reasonably or virtually certain, the write-down can be reversed.



8. Presentation and Disclosure - Offsetting Assets and Liabilities

Offsetting Tax Assets & Liabilities

1. **Current Tax Assets & Liabilities**
Offsetting allowed if:
 - a. Legally enforceable right to set off exists.
 - b. Intent to settle on a net basis.
2. **Deferred Tax Assets & Liabilities**
Offsetting allowed if:
 - a. Legally enforceable right to set off exists.
 - b. Both relate to taxes levied by the same taxation laws.



9. Special Cases

Tax Holiday (Sections 10A, 10B, 80IA)

Timing differences originate & reverse within tax holiday period	No Deferred Tax is created.
Timing differences originate in tax holiday period but reverse after it	Deferred Tax is created.
Reversal Order	Timing differences originating first are considered to reverse first.

Accounting for Taxes under Section 115JB (MAT)

1. **Tax paid under Section 115JB**
Considered as current tax for the period.
2. **Deferred Tax Measurement**
DTAs & DTLs for timing differences during tax payment under 115JB must be measured using regular tax rates, not 115JB rates.
3. **Reversal of Timing Differences**
If timing differences of current period are expected to reverse in a period where tax under 115JB may apply, regular tax rates must be used for measuring DTAs & DTLs.



AS - 24: DISCONTINUING OPERATIONS



1. Objective

1. The objective of this Standard is to establish principles for reporting information about discontinuing operations.
2. Enhancing the ability of users of financial statements to make projections of an enterprise's
 - a. cash flows
 - b. earnings-generating capacity &
 - c. financial position
 by segregating information about discontinuing operations from information about continuing operations.



2. Scope

This Standard applies to all discontinuing operations of an enterprise.



3. Definitions

1. A discontinuing operation is a component of an enterprise:
 - a) that the enterprise, pursuant to a single plan, is:
 - i) 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
 - ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or
 - iii) 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.
2. **Methods of Discontinuation**
Selling Substantially in Total
 The enterprise sells all assets and liabilities of the component through a binding sale agreement.
Piecemeal Disposal
 The entity disposes of assets and liabilities individually there may be no specific sale date or binding agreement.
Abandonment of Operation
 The entity does not sell the component but stops operations. Not all abandonments qualify as discontinuing operations each case must be carefully assessed.
3.
 - A reportable business or geographical segment under AS 17 usually qualifies as a separate major line of business or geographical area.
 - A part of such a segment may also qualify if it meets the criteria.



	➤ For enterprises with a single business or geographical segment that do not report segment information, a major product or service line may still qualify.
4.	A component can be distinguished operationally and for financial reporting purposes - if all the following conditions are met: ➤ The operating assets and liabilities of the component can be directly attributed to it. ➤ Its revenue can be directly attributed to it. ➤ At least a majority of its operating expenses can be directly attributed to it.
5.	Example 1 Co XY owns a popular restaurant chain and decides to sell one of its restaurants, which contributes only 5% of total revenue. The company has no plans to sell any other restaurants. Since this sale does not involve a major business segment or a structured exit plan, it does not qualify as a discontinuing operation. Example 2 Group MN operates in multiple industries, including Hotels, Airlines, and Software. It decides to sell its Airline business to focus on other areas. As part of this plan, it starts selling aircraft and repaying related liabilities. During the year, it sells 5 out of 50 aircraft. The Airline business contributes 25% of the group's total revenue. Since the company is selling a major business segment under a single plan, the Airline business qualifies as a discontinuing operation. Example 3 Entity RT operates in a single state and trades in three products—X, Y, and Z. The financial details are: • Total Sales: ₹35,00,000 • Product Y Sales: ₹14,00,000 (~40% of total) • Profit Before Tax from Product Y: ₹1,50,000 RT decides to sell Product Y's business to another entity. Since Product Y is a major product, this sale may be considered a discontinuing operation.



4. Para-9

Examples of Activities That do not necessarily satisfy criteria (a) of Discontinuing Operations, but that might do so in combination with other circumstances

1.	Gradual or evolutionary phasing out of a product line or class of service.
2.	Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
3.	Shifting of some production or marketing activities for a particular line of business from one location to another; and
4.	Closing of a facility to achieve productivity improvements or other cost savings.
5.	An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries. In fact it is a case of disposing of investments in subsidiary.



5. Initial Disclosure Event

1.	Timing of Disclosure Information about planned discontinuance must be disclosed in the first set of financial statement immediately after the 'initial disclosure'.
2.	Initial Disclosure Event Initial disclosure event is the event out of these two whichever occurs earlier ➤ Entering into an agreement to sell substantially all the assets of the discontinuing operation. ➤ Approving and announcing of the discontinuance plan by BOD.
Key Elements of a Discontinuance Plan	
1.	Listing major assets to be disposed of.
2.	Specifying how the assets will be disposed of.
3.	Estimating the time required for completion.
4.	Identifying principal locations impacted.
5.	Stating the location, function, and number of employees to receive termination compensation.
6.	Estimating proceeds or salvage value expected from the disposal.



6. Disclosure

Disclosure Requirements for Discontinuing Operations	
1.	Details about the discontinuing operation.
2.	Business or geographical segment as per AS 17 (Segment Reporting).
3.	Date and nature of the initial disclosure event.
4.	Date or period for completion (if known).
5.	Total assets to be disposed of and liabilities to be settled (as of balance sheet date).
6.	Amounts from ordinary activities of the discontinuing operation during the financial period.
7.	Pre-tax profit or loss and related income tax expense.
8.	Operating, investing, and financing cash flows of the discontinuing operation.
Additional Disclosures on Asset Disposal & Liability Settlement	
1.	Gain or loss from disposal of assets or settlement of liabilities, including related income tax.
2.	Sale price for net assets under a binding sale agreement and expected timing.
3.	Carrying value of assets to be disposed.
Disclosure in Interim Financial Reports	
1.	Interim financial reports should disclose significant activities or events related to a discontinuing operation since the last annual report.
2.	Any major changes in the amount or timing of cash flows related to assets being disposed of or liabilities being settled should also be disclosed.



AS - 25: INTERIM FINANCIAL REPORTING



1. Introduction

1. **Applicability**
 - AS 25 does **not mandate** which enterprises must present interim financial reports, how **frequently**, or how **soon** after an interim period.
 - If an enterprise **chooses** or is **required** to present an **interim financial report**, it must **follow AS 25**.
2. **Minimum Reporting Requirements**
The Standard prescribes **minimum content** required for an **interim financial report**.
3. **Recognition & Measurement**
It provides **principles for recognition and measurement** in both **complete and condensed interim financial statements**.
4. **Importance of Interim Reporting**
Interim financial reporting **enhances understanding** of an enterprise's **earnings capacity, cash flows, financial condition, and liquidity**.
5. **Statutory & Regulatory Requirements**
A statute or regulator may require **different interim reporting formats** than AS 25. Even if different forms and content are required, the **recognition and measurement principles of AS 25** apply unless otherwise specified by the statute or regulator.



2. Definitions

1. **Interim Period**
A financial reporting period that is **shorter than a full financial year**.
2. **Interim Financial Report**
A financial report containing either:
 - A **complete set** of financial statements, or
 - A set of **condensed financial statements** for an interim period.
3. **First Year Financial Reporting**
If an enterprise's first-year financial reporting period is **shorter than a full financial year**, it is not considered an interim period.



3. Content of an Interim Financial Report

1. **Complete Set of Financial Statements**
A complete set of financial statements includes the **Balance Sheet, Statement of Profit & Loss, Cash Flow Statement, and Notes**.
2. **Timeliness vs. Detail**
AS 25 promotes timely interim reporting, **focusing on new activities, events and circumstances** rather than excessive details.
3. **Minimum Requirement for Interim Reports**



	At a minimum, interim reports should include condensed financial statements, avoiding repetition of previously disclosed information.
4.	Option to Present Complete Set Enterprises can present a full set of financial statements in interim reports if they choose.
5.	Recognition & Measurement Compliance If a complete set is presented, it must follow all required disclosures under AS 25 and other relevant standards.
6.	Complete vs. Condensed Financial Statements Complete set follows the format of annual financial statements. Condensed financial statements contain limited information as required by AS 25.



4. Form and Content of Interim Financial Statements

1.	Complete Set of Financial Statements If an enterprise presents a complete set in its interim report, it must align with the format of annual financial statements.
2.	Condensed Financial Statements Must include at least: ➤ Headings and sub-headings from the most recent annual financial statements. ➤ Selected explanatory notes as required by AS 25.
3.	Additional Disclosures Additional line items or notes must be included if their omission would make the interim financial statements misleading.
4.	Earnings Per Share (EPS) Requirement If an enterprise presents basic and diluted EPS in its annual financial statements (as per AS 20), it must also disclose basic and diluted EPS on the face of the Statement of Profit & Loss (whether complete or condensed) for the interim period.



5. Selected Explanatory Notes

Minimum Disclosures in Notes to Interim Financial Statements (AS 25)

1.	Accounting policies used (or changes with impact).
2.	Seasonality Impact on operations. Example: If a company usually earns 60% of its revenue in the October-December quarter due to festival demand, it must disclose this seasonality effect in interim reports.
3.	Unusual Items (AS 5) affecting assets, liabilities, equity, income, or cash flows
4.	Material changes in estimates from prior periods.
5.	Debt & Equity Transactions (issuances, buybacks, restructuring).
6.	Dividends (aggregate and per share).
7.	Segment Reporting (AS 17)
8.	Changes in Enterprise Composition (e.g., mergers, acquisitions, discontinuations).



9. Material changes in Contingent Liabilities



6. Periods For Which Interim Financial Statements are Required to be Presented

Statement	Current Period	Comparative Period
Balance Sheet	End of the current interim period	End of the immediately preceding financial year
Statement of Profit & Loss	Current interim period and cumulative year-to-date	Comparable interim period and year-to-date of the immediately preceding financial year
Cash Flow Statement	Cumulative year-to-date for the current financial year	Comparable year-to-date of the immediately preceding financial year

Example:

MNO Ltd. presents its quarterly financials for Q2 (July-Sept 2024).

- Balance Sheet as on 30th Sept 2024 compared with 31st March 2024.
- Statement of P&L for July-Sept 2024 and July-Sept 2023 (comparative).
- Cash Flow Statement for April-Sept 2024 vs. April-Sept 2023.



7. Accounting Policies

Accounting Policies & Measurement in Interim Financial Statements (AS 25)

- Same accounting policies as annual financials** should be applied.
Interim measurements should ensure accurate year-to-date reporting.

Examples:

 - Inventory write-downs and impairments follow annual principles.
 - Non-assets should not be deferred.
 - Income tax expense is based on estimated annual effective tax rate.
- Revenue & Cost Recognition in Interim Periods**

 - **Seasonal or occasional revenue** (e.g., dividends, royalties, government grants) should not be anticipated or deferred.
 - **Unevenly incurred costs** should be recognized only if allowed at year-end.
 - **Costs not meeting asset criteria** should not be deferred.

Example:
A company receives ₹5 crores in royalty income in Q1. It should recognize it in Q1 itself, rather than spreading it over the year.
- Restatement of Previously Reported Interim Periods**

 - **A consistent accounting policy** must be applied throughout the financial year.
 - **Any change in policy** during the year should be **retrospectively applied** from the start of the financial year.

Example:
If a company changes its depreciation method from SLM to WDV in Q3, it should restate Q1 & Q2 financials using WDV for consistency.



8. Applicability of AS 25 to Interim Financial Results

1. AS 25 applies only if an enterprise prepares an "interim financial report" as per its definition.
Quarterly financial results under Clause 41 of the Listing Agreement do not qualify as interim financial reports but must follow AS 25's recognition and measurement principles.
Example:
A listed company preparing quarterly financial results as per SEBI regulations must still follow AS 25's measurement principles (e.g., revenue, tax, depreciation).



AS - 26: INTANGIBLE ASSETS



1. Objective

1.	Objective To prescribe accounting treatment for intangible assets not specifically covered by other Accounting Standards.
2.	Recognition This AS provides when intangible asset is recognised and at what value it is measure. Also provides disclosures to be made in respect of intangible assets.



2. Scope

AS 26 applies to all enterprises for accounting intangible assets, except for:

- i. Intangible assets covered by another Accounting Standard, such as:
 - a) Intangible assets held for sale in the ordinary course of business (AS 2, Valuation of Inventories, AS 7, Construction Contracts)
 - b) Deferred tax assets (AS 22, Taxes on Income)
 - c) Leases covered by AS 19 (Leases)
 - d) Goodwill arising from amalgamation (AS 14 Revised) and consolidation (AS 21 Revised)
- ii. Financial assets
- iii. Mineral rights and costs for exploration or development of minerals, oil, natural gas, etc.
- iv. Intangible assets from insurance contracts with policyholders
- v. Expenditure related to termination benefits

AS 26 applies to other intangible assets, such as computer software and costs like start-up or research activities.

AS 26 applies to:

- i. Expenditure on advertising, training, start-up costs
- ii. Research and development activities



3. Definitions

1.	Intangible Asset Intangible Asset is ✓ an identifiable ✓ non-monetary asset ✓ without physical substance ✓ held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
2.	Intangible Assets in Tangible Substance ➤ Some intangible assets may be contained in physical substances (e.g., software on a CD, patent in legal docs). ➤ The cost of the physical substance is typically not significant and is part of the intangible asset.



3. **Assets with Both Intangible and Tangible Elements**
The **predominant element** must be assessed:
- Software embedded in a machine tool is treated as a **fixed asset** because it's **integral to the hardware**.
 - **Non-integral software** is treated as an **intangible asset**.



4. Identifiability

1. **Identifiability of Intangible Asset**
To become identifiable, it must be **clearly distinguished from goodwill**.
2. **Separation from Goodwill**
 - An intangible asset is distinct from goodwill if it is **separable**.
 - This means the enterprise can **Rent, sell, exchange, or distribute the future economic benefits from the asset** without disposing of benefits from other assets in the same revenue-generating activity.
3. **Identifiability without Separability**
 - Separability is **not always necessary** for an asset to be identifiable.
 - An intangible asset can still be identifiable if:
 - a. The asset is acquired with a group of assets, and **legal rights transfer to help identify it**.
 - b. The asset generates future economic benefits only in combination with other assets, but the enterprise can still **identify the specific benefits from the intangible asset itself**.



5. Control

1. **Control of Intangible Asset**
An enterprise controls an intangible asset if it has the power to:
 - Obtain **future economic benefits** from the asset, and
 - **Restrict others** from accessing those benefits.
2. **Legal Rights and Control**
Control over intangible assets comes from **legal rights enforceable in court**. However, legal enforceability is **not the only way** to control an asset.
3. **Control Without Legal Rights**
Examples where control can exist without legal rights:
 - **Market and technical knowledge**: If protected by legal means such as **copyrights, restraint-of-trade agreements, or confidentiality obligations**, the enterprise can still control the future economic benefits.
 - **Employee skill or customer loyalty**: These may generate future economic benefits but are **not controlled** by the enterprise:
 - a. Employees can **leave anytime**.
 - b. Loyal customers can **switch to other suppliers**.

**Example 1:**

Moon Limited has provided training to its staff on various new topics like GST, AS, Ind AS etc. to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?

In this case, it is clear that the company will obtain the economic benefits from the work performed by the staff as it increases their efficiency. But it does not have control over them because staff could choose to resign the company at any time. Hence the company lacks the ability to restrict the access of others to those benefits. Therefore, the staff training cost does not meet the definition of an intangible asset.

**6. Future Economic Benefits**

1. **Future Economic Benefits from Intangible Assets**
 - Revenue from the sale of products or services,
 - Cost savings, or
 - Other benefits resulting from the asset's use by the enterprise.
2. **Example**
The use of intellectual property in a production process may result in cost savings by reducing future production costs, instead of increasing future revenues.

**7. Recognition of an Intangible Asset**

1. **Conditions for Recognition**
An intangible asset should be recognised if:
 - a. It is probable that future economic benefits from the asset will flow to the enterprise; and
 - b. The cost of the asset can be measured reliably.

**8. Initial Measurement of Intangible Asset**

1. **Initial Measurement**
An intangible asset should be measured initially at cost.
2. **Modes of Arising Intangible Assets**
Intangible assets can arise through:
 - i. Separate acquisition
 - ii. Business combination
 - iii. Government grant
 - iv. Internally generated goodwill
 - v. Internally generated intangible assets
 - vi. Exchange of assets

**9. Separate Acquisition**

1. **Components of Cost**
The cost of an intangible asset includes:
 - Purchase price,

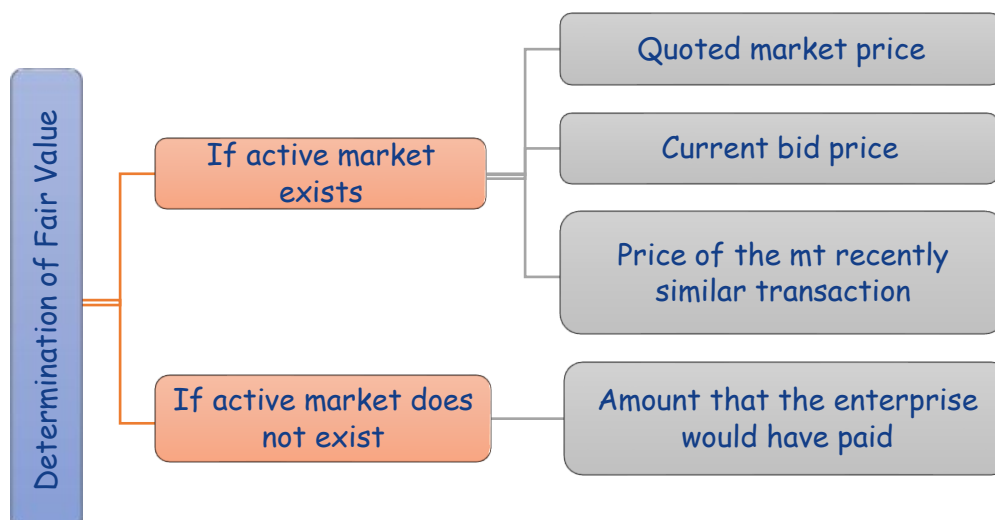


	➤ Import duties and other taxes (except those recoverable from authorities), ➤ Any directly attributable expenditure to make the asset ready for use (e.g., professional fees for legal services).
2.	Trade Discounts and Rebates Any trade discounts and rebates are deducted from the cost.



10. Acquisition as Part of an Amalgamation

1.	Recognition of Intangible Assets (AS 26) A transferee company must recognize an intangible asset acquired in an amalgamation if it meets the recognition criteria under AS 26, even if the asset wasn't recognized in the transferor company's financial statements.
2.	When Fair Value Cannot Be Measured Reliably ➤ If the fair value of the intangible asset cannot be measured reliably, it should not be recognized separately. ➤ It will be included in goodwill.
3.	Allocation of Consideration The consideration paid for the amalgamation is allocated to identifiable assets and liabilities based on their fair values at the amalgamation date.
4.	Judgment on Fair Value Measurement ➤ If quoted market prices are available, they provide the most reliable measure, using the current bid price. ➤ If no bid prices are available, fair value can be estimated based on the most recent similar transaction, provided there has been no significant change in economic conditions.
5.	When No Active Market Exists ➤ If there's no active market, the cost should reflect what the transferee would pay for it in an arm's length transaction at the acquisition date. ➤ The cost should not create or increase a capital reserve at the date of amalgamation.



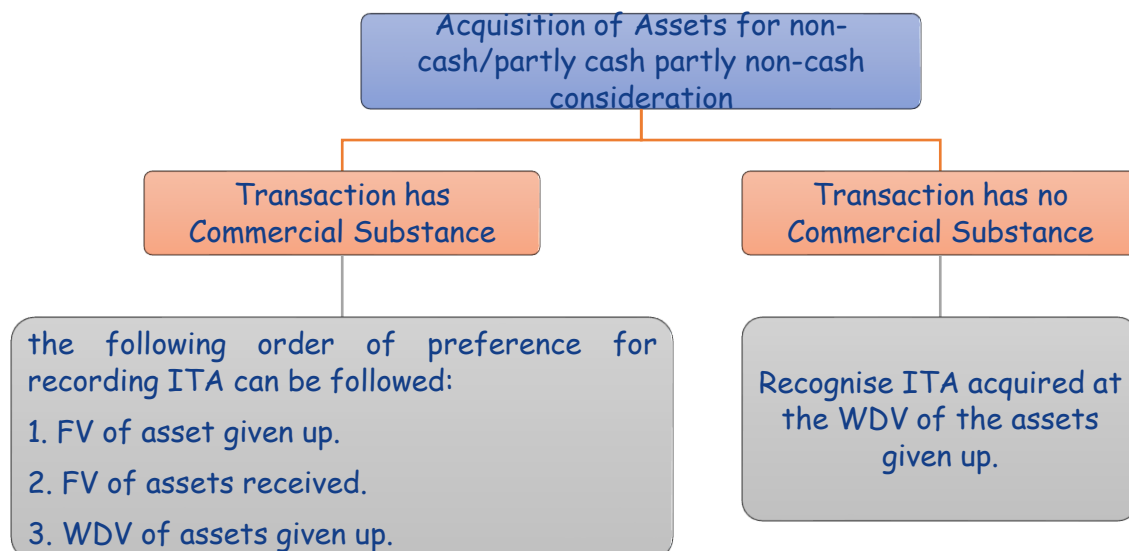


11. Acquisition by way of a Government Grant

1. **Acquisition of Intangible Assets through Government Grants**
Intangible assets may be acquired **free of charge** or for **nominal consideration** through a government grant.
Examples include:
 - Airport landing rights
 - Licences to operate radio/TV stations
 - Import licences or quotas
 - Rights to access restricted resources
2. **Recognition of Intangible Assets from Government Grants**
When an intangible asset is acquired through a government grant, it is recognized at:
 - **Nominal value** (if acquired free of charge or for nominal consideration), or
 - **Acquisition cost** (if acquired at concessional price if applicable).
3. **Attributable Costs**
Any costs directly related to making the asset ready for use (e.g., legal fees, registration fees) are **included in the cost** of the intangible asset.



12. Exchange of Assets



13. Internally Generated Goodwill

1. **Internally Generated Goodwill**
Internally generated goodwill is **not recognized** as an asset.
2. **Reason for Non-recognition**
It is **not an identifiable resource**, meaning it is:
 1. **Not separable**,
 2. It doesn't arise from **contractual or other legal rights**, and
 3. It **cannot be measured reliably at cost**.



14. Internally Generated other Intangible Assets

1. **Assessment of Internally Generated Intangible Assets**
An entity classifies the generation into:
 - a) Research phase
 - b) Development phase
2. **Distinguishing Research and Development Phases**
If an entity cannot distinguish the research phase from the development phase of an internal project, it treats the expenditure as if it were for the research phase only.
3. **Prohibited Recognition**
The recognition of internally generated goodwill and certain items like brands, mastheads, publishing titles, customer lists, and similar items is prohibited under this standard.
4. **Research Phase**
Research is an original, planned investigation aimed at gaining new scientific or technical knowledge.
 - No intangible asset arising from research should be recognized.
 - Expenditure on research should be recognized as an expense when incurred.**Examples of research activities:**
 - obtaining new knowledge
 - Searching for applications of research findings
 - Searching for alternatives (materials, products, processes, etc.)
 - Designing alternatives for new or improved materials, devices, products, etc.
5. **Development Phase**
Development is the application of research findings to a plan or design for producing new or improved materials, products, systems, or services before commercial production or use.
 Examples of development activities:
 - Designing and testing prototypes
 - Designing tools with new technology
 - Designing pilot plants for non-commercial production
 - Testing alternatives for new materials, products, etc.
6. **Recognition of Intangible Assets in Development**
An intangible asset from the development phase should be recognized only if:
 1. Technical feasibility of completing the asset for use or sale
 2. Intention to complete and use or sell the asset
 3. Ability to use or sell the asset
 4. The asset will generate probable future economic benefits (e.g., market for output or internal use)
 5. Adequate resources (technical, financial) to complete development
 6. Ability to measure reliably the expenditure during development
7. **Prohibited Reinstatement of Expenditure**



Expenditure previously recognized as an expense cannot be reinstated as an asset.



15. Cost of an Internally Generated Intangible Asset

Category	Cost Components (To be Capitalized)	Cost Components (To be Expensed)
Expenditure Directly Attributable to Creation	➤ Expenditure on materials and services used to generate the asset. ➤ Salaries, wages, and other employment-related costs for personnel directly engaged in generating the asset. ➤ Expenditure directly attributable to generating the asset (e.g., legal fees, amortization of related patents/licenses). ➤ Overheads necessary to generate the asset, allocated reasonably (e.g., overhead allocation based on AS 2 and AS 16).	➤ Selling, administrative, and general overheads (unless directly attributable to making the asset ready for use). ➤ Inefficiencies and initial operating losses before the asset achieves planned performance. ➤ Expenditure on training staff to operate the asset.
Expenditure After Recognition Criteria Met	➤ Expenditure incurred after the intangible asset meets the recognition criteria, and can be directly attributed or reasonably allocated to make the asset ready for its intended use.	➤ N/A
Reinstatement of Previous Expenses	➤ Prohibited: Reinstatement of expenditure previously recognized as an expense is not allowed.	➤ N/A

Example

An enterprise is developing a new production process. During the year 20X1, expenditure incurred was Rs.10 lacs, of which Rs.9 lacs was incurred before 1 December 20X1 and 1 lac was incurred between 1 December 20X1 and 31 December 20X1. The enterprise is able to demonstrate that, at 1 December 20X1, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs.5 lacs.

At the end of 20X1, the production process is recognised as an intangible asset at a cost of Rs.1 lac (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 20X1). The Rs.9 lacs expenditure incurred before 1 December 20X1 is recognised as an expense because the recognition criteria were not met until 1 December 20X1. This



expenditure will never form part of the cost of the production process recognised in the balance sheet.

During the year 20X2, expenditure incurred is Rs.20 lacs. At the end of 20X2, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs.19 lacs.

At the end of the year 20X2, the cost of the production process is Rs.21 lacs (Rs.1 lac expenditure recognised at the end of 20X1 plus Rs.20 lacs expenditure recognised in 20X2). The enterprise recognises an impairment loss of Rs.2 lacs to adjust the carrying amount of the process before impairment loss (Rs.21 lacs) to its recoverable amount (Rs.19 lacs). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in AS 28, are met.



16. Recognition of an Expense

1. **Expenditure on Intangible Items**
Expenditure on intangible items is generally **recognized as an expense** when incurred, unless it's part of the cost of an intangible asset that meets the **recognition criteria**.
2. **Expenditure in Amalgamation**
If expenditure is acquired in an amalgamation and cannot be recognized as an intangible asset, it should be **included in goodwill (capital reserve) at the acquisition date**.
3. **Expenditure without Recognizable Intangible Asset**
Expenditure that provides future economic benefits but doesn't create a recognizable intangible asset should be **expensed when incurred (e.g., research expenditure)**.
4. **Expenditure Always Expensed**
Start-up costs (legal, pre-opening, new products), **training activities**, **advertising and promotional costs**, and **relocation/reorganization expenses** should always be **expensed** when incurred.
5. **Past Expenses Not to Be Recognized as Asset**
Expenditure on intangible items initially recognized as an expense in past financial statements **cannot later be recognized as part of the cost of an intangible asset**.



17. Subsequent Expenditure

1. **Subsequent Expenditure on Intangible Asset**
Subsequent expenditure on an intangible asset should be **expensed when incurred, unless:**
 - a. It is **probable** the expenditure will enable the asset to generate **future economic benefits** exceeding its originally assessed performance.
 - b. The expenditure can be **measured** and **attributed** to the **asset reliably**.



18. Measurement Subsequent to Initial Recognition

After initial recognition, an intangible asset should be **carried at its cost less any accumulated amortisation and any accumulated impairment losses**.



19. Useful Life of an Intangible Assets

- An intangible asset should be amortized systematically over its estimated useful life.
- Amortization starts when the asset is ready for use.
- The longer the useful life, the less reliable the estimate.
- AS 26 assumes an intangible asset's useful life will not exceed 10 years, unless proven otherwise.
- Amortization is done regardless of any increase in the asset's fair value or recoverable amount.
- If there is strong evidence that an intangible asset's useful life is more than 10 years, the company must:
 - a. Amortize it over the best estimated useful life.
 - b. Check for impairment annually by estimating its recoverable amount.
 - c. Disclose why the 10-year presumption was not followed and what factors influenced the decision.

Example A: Hydroelectric Power

- A company buys the right to generate hydroelectric power for 60 years.
- Power generation is cheaper than other sources, and the demand in the area is expected to last for at least 60 years.
- The company amortizes the asset over 60 years unless proven otherwise.

Example B: Toll Motorway

- A company gets the exclusive right to operate a toll road for 30 years.
- No new roads are planned, and the toll road is expected to operate for 30 years.
- The company amortizes the asset over 30 years unless there's evidence of a shorter useful life.

Example C: Copyright for Safety Equipment

- Company X buys a 10-year copyright for a safety product.
- After 7 years, new environmental laws make the product obsolete.
- The company must write off the remaining value immediately in the year the law changes.



20. Amortisation Method

1. **Amortisation Method**
 - The amortisation method reflects how the asset's future economic benefits are expected to be consumed.
 - If the pattern can't be determined reliably, use the straight-line method (SLM).
2. **Amortisation Methods**

SLM: Constant charge over the useful life if the residual value does not change.

Reducing Balance Method (WDV): Decreasing charge over the useful life.

Units of Production Method: Charge based on expected use or output.
3. The selected method should be consistent unless there is a change in usage pattern.



4.	Amortisation is usually treated as an expense , unless another standard requires it to be included in an asset's value (e.g., in inventory costs).
5.	Residual Value The residual value of an intangible asset with a finite useful life is assumed to be zero unless : a) There is a commitment by a third party to purchase the asset at the end of its useful life , or b) There is an active market for the asset and: ➤ Residual value can be determined by reference to that market , and ➤ It is probable that the market will exist at the end of the asset's useful life.
6.	Review of Amortisation Method The amortisation method must be reviewed at least once a year.
7.	Change in Amortisation Method Changing the amortisation method is considered a change in accounting estimate and treated as per AS 5 (Prospective Accounting) .
8.	Revenue-Based Amortisation Method It's generally inappropriate to use an amortisation method based on revenue generated by the activity using the intangible asset. This is a rebuttable presumption .



21. Retirements and Disposals

1.	Derecognition of Intangible Asset An intangible asset should be derecognized (removed from the balance sheet) if: 1. It is disposed of , or 2. No future economic benefits are expected from its use and subsequent disposal.
2.	Gains or Losses from Disposal ➤ Gains or losses from the retirement or disposal of an intangible asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset. ➤ These gains or losses are recognised as income or expense in the statement of profit and loss .
3.	Asset Held for Disposal ➤ An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date it is retired.



22. Disclosure

1.	Disclose the useful lives or amortisation rates used for each class of intangible assets.
2.	Disclose the amortisation methods used for each class of intangible assets.
3.	Disclose the gross carrying amount and accumulated amortisation (including accumulated impairment losses) at the beginning and end of the period.
4.	Disclose a reconciliation of the carrying amount at the beginning and end of the period, showing:



	i. Additions (separate those from internal development and amalgamation). ii. Retirements and disposals. iii. Impairment losses recognised in the statement of profit and loss. iv. Impairment losses reversed in the statement of profit and loss. v. Amortisation recognised during the period. vi. Other changes in the carrying amount during the period.
5.	A class of intangible assets is a group of assets with similar nature and use in operations. Examples of separate classes include: a. Brand names b. Mastheads and publishing titles c. Computer software d. Licences and franchises e. Copyrights, patents, and other industrial property rights, service, and operating rights f. Recipes, formulae, models, designs, and prototypes g. Intangible assets under development



23. Other Disclosures

1.	➤ If an intangible asset is amortised over more than 10 years, disclose the reasons why the asset's useful life is expected to exceed 10 years. ➤ Describe the factors that played a significant role in determining the useful life.
2.	Disclose description, carrying amount, and remaining amortisation period of any individual intangible asset that is material to the enterprise's financial statements.
3.	➤ Disclose the existence and carrying amounts of intangible assets whose title is restricted. ➤ Disclose the carrying amounts of intangible assets pledged as security for liabilities.
4.	Disclose the amount of commitments for the acquisition of intangible assets.
5.	Disclose the aggregate amount of research and development expenditure recognised as an expense during the period.
6.	An enterprise is encouraged to describe any fully amortised intangible asset that is still in use.



AS - 28: IMPAIRMENT OF ASSETS



1. Introduction

1. **Applicability**
 From 1-4-2004:
 - Mandatory for **listed enterprises** or
 - those **planning to list** on a recognized stock exchange in India, and
 - for commercial, industrial, and business enterprises with a **turnover above ₹50 crores**.
 From 1-4-2005:
 Applicable to **all other enterprises**.
2. **Purpose of AS 28**
 Enterprise's assets are **not recorded at more than their recoverable amount**. It also provides guidelines for:
 - **Identifying impairment of assets**.
 - **Reversing impairment losses** when applicable.
 - **Disclosing information** about impaired assets in financial statements.



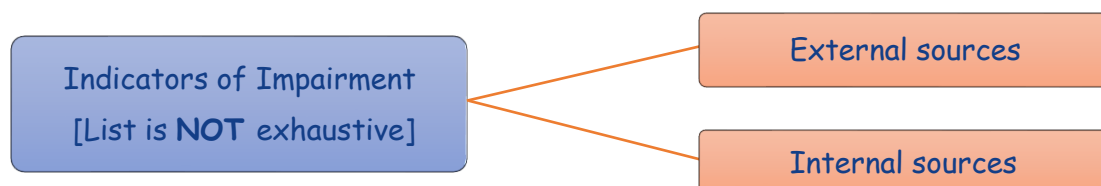
2. Scope

1. **Assets not covered by AS 28**
 The standard should be applied in accounting for impairment of all assets except
 - a. **Inventories (AS 2)**
 - b. **Assets under construction contracts (AS 7)**
 - c. **Financial assets** including investments (AS 13)
 - d. **Deferred tax assets (AS 22)**



3. Assessment

1. **Assess for Impairment**
 At each **balance sheet date**, the enterprise should **assess** if there are any **indications that an asset may be impaired**.
2. **Estimate Recoverable Amount**
 If there is an **indication of impairment**, the enterprise must **estimate** the asset's **recoverable amount**.
3. **Impairment Condition**
 An asset is considered impaired if **its carrying amount exceeds its recoverable amount**.





External Indicators	Internal Indicators
Significant decline in asset's market value beyond normal depreciation or usage	Evidence of obsolescence or physical damage to the asset
Adverse changes in technology, market, economy, or legal environment	Changes in asset usage, such as plans to discontinue, restructure, or dispose of the asset
Increase in market interest rates	Poor economic performance as shown in internal reports
Enterprise's net assets carrying amount exceeds its market capitalization	Cash flows for asset acquisition or maintenance significantly exceed budget
	Actual cash flows or operating profit significantly worse than budgeted
	Significant decline in budgeted cash flows or profits, or increase in budgeted loss
	Operating losses or cash outflows exceeding projections when aggregated

Note: If an asset may be impaired, the useful life, depreciation method, or residual value may also need to be reviewed and adjusted under AS 10, even if no impairment loss is recognized.



4. Measurement of Recoverable Amount

1.	Impairment Loss The amount by which the carrying amount of an asset exceeds its recoverable amount.
2.	Recoverable Amount The higher of an asset's net selling price and value in use.
3.	Net Selling Price The amount obtainable from the sale of an asset in an arm's length transaction, less costs of disposal.
4.	Costs of Disposal Incremental costs directly related to the asset's disposal, excluding finance costs and income tax. Examples include sales commissions, legal fees, etc.
5.	Value in Use The present value of future cash flows expected from the continued use of an asset and its disposal at the end of its useful life.
6.	Estimating Value in Use 1. Estimate future cash inflows and outflows. 2. Apply the appropriate discount rate to these future cash flows.
7.	Carrying Amount The amount at which an asset is recognized in the balance sheet after deducting accumulated depreciation (amortisation) and impairment losses.
	Note 1



- If no indication that value in use exceeds net selling price, use net selling price.
- If no sale price, use value in use.
- Net selling price may be estimated even without an active market.

Note 2

Recoverable amount is generally calculated for an individual asset, unless its cash inflows are interdependent with other assets.

8. Cash-Generating Unit (CGU)

When cash inflows are interdependent, recoverable amount is calculated for the CGU.

Exceptions:

1. If net selling price is higher than carrying amount.
2. If value in use closely matches net selling price and can be determined.



5. Composition of Estimates of Future Cash Flows

1. **Future Cash Flow Estimates**
Projections of:
 1. Net cash inflows from asset's continuing use.
 2. Cash outflows needed to generate these inflows.
 3. Net cash flows expected from asset disposal.
2. **Points to Consider when Estimating Future Cash Flows**
 - Include cash outflows needed before the asset is ready for use if not already accounted for in carrying amount.
 - Exclude cash inflows from assets that generate independent cash flows.
 - Exclude cash outflows for obligations already recognized as liabilities.
 - Exclude future cash flows from restructuring activities.
 - Exclude future capital expenditure for enhancing asset capacity.
 - Exclude cash inflows or outflows from financing activities and income tax receipts/payments.
3. **Cash Flows from Disposal**
Estimate net cash flow from disposal based on amount expected in an arm's length transaction, minus estimated disposal costs.
4. **Restructuring Considerations**
Future cash inflows and outflows should reflect cost savings and benefits from restructuring, based on approved financial budgets or forecasts.
5. **Foreign Currency Cash Flows**
Estimate future cash flows in the currency they'll be generated in. Discount using the appropriate rate for that currency and convert to reporting currency per AS 11.
6. **Discount Rate**
 - Reflects time value of money and any specific risks of the asset.
 - If no specific rate, use alternative rates like:
 1. Entity's incremental borrowing rate.
 2. Capital asset pricing model rate.



6. Recognition and Measurement of an Impairment Loss

Case	Explanation	Accounting Implications
Case I: Recoverable Amount > Carrying Amount	➤ If the recoverable amount of the asset is higher than its carrying amount, the difference is ignored. ➤ The asset is carried at the same book value.	➤ No impairment loss is recognized. ➤ Review of remaining useful life, depreciation method, and residual value under AS 10 may still be required.
Case II: Recoverable Amount < Carrying Amount	➤ When the recoverable amount is less than the carrying amount, the difference is an impairment loss.	Treatment of Impairment Loss: ➤ Written off immediately as expenses to Profit & Loss Account. ➤ If asset is carried at revalued figures, adjust the impairment loss against the revaluation surplus and the remaining balance is charged to Profit & Loss Account. Depreciation: ➤ Depreciation for future years recalculated based on new carrying amount, residual value, and remaining useful life as per AS 10.
Case III: Impairment Loss Exceeds Carrying Amount	➤ If the impairment loss is greater than the carrying amount of the asset, a liability should be recognized if required by another Accounting Standard.	➤ Liability recognized only if required by another standard.



7. Identification of the Cash Generating unit to Which an Asset Belongs

1.	Definition of Cash-Generating Unit (CGU) A CGU is the smallest group of assets that generates independent cash inflows from continuing use, separate from other assets or groups of assets.
2.	When Recoverable Amount Cannot Be Determined for an Asset If the recoverable amount of an asset cannot be determined individually (due to difficulty in estimating value in use or significant difference from scrap value), estimate the recoverable amount of the CGU it belongs to instead.
3.	Identifying the CGU When an asset's recoverable amount cannot be determined, identify the smallest group of assets (CGU) that generate independent cash inflows from continuing use.



4.	Output of Asset Used by Other Units Even if the output from an asset is used by other units, the asset or group of assets can still be considered a separate CGU if it can generate independent cash inflows and can be sold in an active market .
5.	Consistency of CGU Identification The identification of CGUs should be consistent from period to period unless a change is justified.

Example 1

A mining enterprise owns a private railway to support its mining activities. The private railway could be sold only for scrap value and the private railway 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 enterprise estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

Example 2

A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. 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. Since the enterprise does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

If an active market exists for the output produced by an asset or a group of assets, this asset or group of assets should be identified as a separate cash generating unit, even if some or all of the output is used internally.



8. Recoverable Amount and Carrying Amount of a Cash-Generating Unit

1.	Determining Carrying Amount of CGU The carrying amount of a CGU is calculated in line with how its recoverable amount is determined, including all assets within the CGU and related liabilities necessary for the recoverable amount calculation.
2.	Liabilities for Recoverable Amount If a liability is involved in determining the recoverable amount (e.g., if a liability is transferred in a CGU disposal), the net selling price of the CGU includes both assets and the liability, minus costs of disposal .
3.	Comparing Carrying Amount with Recoverable Amount When comparing the carrying amount to the recoverable amount of the CGU , deduct the liability's carrying amount from both the value in use and carrying amount of the CGU .



4. **Adjusting Carrying Amount with Non-CGU Assets or Liabilities**
For practical reasons, the recoverable amount of the CGU can include assets outside of the CGU or **liabilities already recognized**. Adjust the CGU's carrying amount by adding these non-CGU assets and subtracting recognized liabilities.

Example 3

A company operates a mine and is legally required to restore the site after mining. The cost of restoration (Rs. 50,00,000) was recorded as part of the mine's cost and is being depreciated over its useful life.

The company is testing for impairment and considers the mine as a whole as the cash-generating unit.

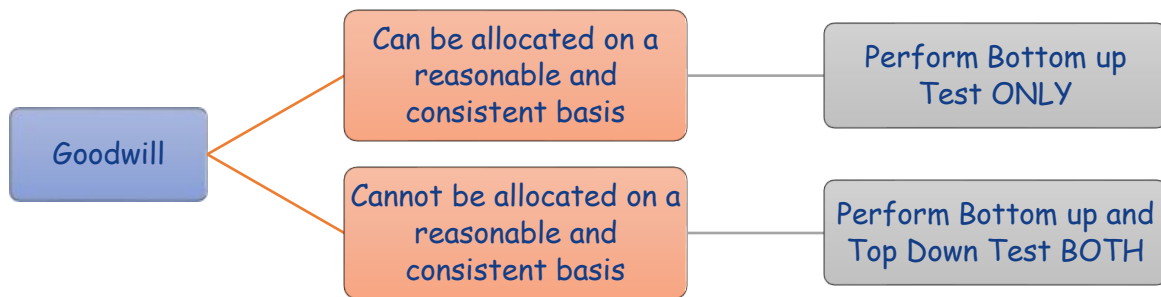
- Buyers are offering Rs. 80,00,000 for the mine, including the restoration obligation.
- The value in use (future earnings potential) is Rs. 1,20,00,000, but after deducting restoration costs, it is Rs. 70,00,000.
- The carrying amount of the mine is Rs. 1,00,00,000, but after deducting the restoration provision, it is Rs. 50,00,000.

Since the carrying amount (Rs. 50,00,000) is lower than both the net selling price (Rs. 80,00,000) and value in use (Rs. 70,00,000), no impairment loss is required.



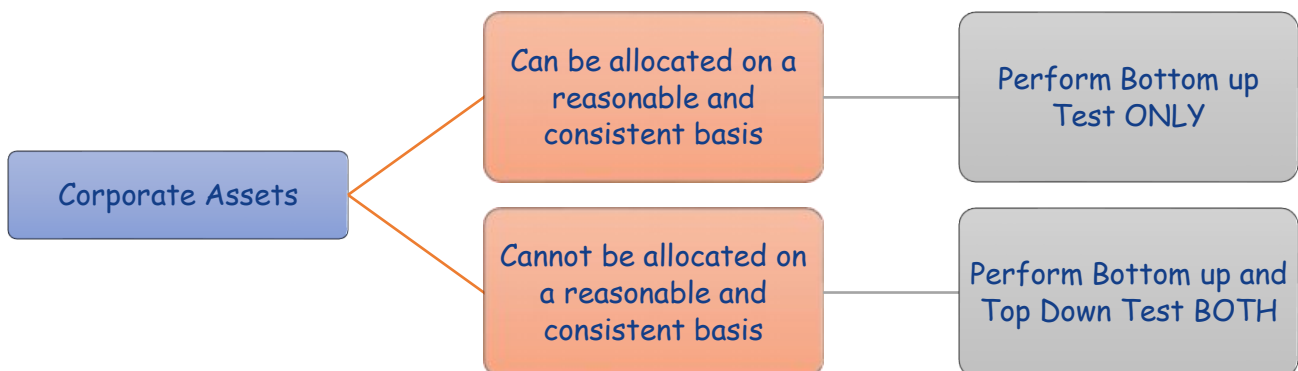
9. Goodwill

1. **Goodwill and Recoverable Amount**
Goodwill does not generate cash flows independently, so its **recoverable amount** cannot be determined on its own. If **goodwill** is impaired, the recoverable amount is assessed for the **CGU** it belongs to.
2. **Impairment Loss Recognition**
The recoverable amount of the **CGU** (including goodwill) is compared to the CGU's carrying amount. Any difference that represents a **loss** is recognized as an **impairment loss**.
3. **'Bottom-Up' Test (Allocating Goodwill)**
If **goodwill** can be allocated **reasonably** to a **CGU**, the enterprise applies the **'bottom-up' test**, where the recoverable amount of the CGU is determined and compared to its carrying amount.
4. **'Top-Down' and 'Bottom-Up' Tests (Non-Allocable Goodwill)**
If **goodwill** cannot be reasonably allocated, both the **'bottom-up' test** (recoverable amount of CGU) and the **'top-down' test** (starting from the enterprise level and assessing goodwill's effect on CGU) must be applied.



10. Corporate Assets

1. **Characteristics of Corporate Assets**
Corporate assets do **not generate cash inflows independently** and cannot be fully attributed to the **cash-generating unit (CGU)** being reviewed.
2. **Examples of Corporate Assets**
Examples include **headquarter buildings, EDP equipment, or a research center.**
3. **Testing a CGU for Impairment**
When testing a CGU for **impairment**, all **corporate assets** related to the CGU should be identified.
4. **Allocating Corporate Assets**
For each corporate asset:
 - a. **Allocable Corporate Assets**
If the **carrying amount** of a corporate asset can be allocated reasonably and consistently to the CGU, apply the **'bottom-up' test** only.
 - b. **Non-Allocable Corporate Assets**
If the **carrying amount** cannot be allocated reasonably to the CGU, apply both the **'bottom-up' and 'top-down' tests.**



11. Impairment Loss for a Cash Generating Unit

1. **Allocation of Impairment Loss**
Impairment loss should be allocated in the following order:
 - a. **Goodwill**
First, **reduce the goodwill** allocated to the **cash-generating unit (CGU)** (if any).
 - b. **Other Assets**



	Then, allocate the remaining impairment loss to the other assets of the unit on a pro-rata basis , based on the carrying amount of each asset.
2.	Minimum Carrying Amount The carrying amount of an asset should not be reduced below the highest of: - Net Selling Price - Value in Use - Zero
3.	Pro-rata Allocation If the asset's impairment loss is not fully allocated, the remaining amount should be allocated to other assets of the unit on a pro-rata basis .
4.	Liability for Remaining Impairment After allocating the impairment loss, if required by another Accounting Standard , liability for any remaining impairment loss should be recognized for the CGU.

Example 4

A machine has suffered physical damage but is still working, although not as well as it used to. The net selling price of the machine is less than its carrying amount. The machine does not generate independent cash inflows from continuing use. The smallest identifiable group of assets that includes the machine and generates cash inflows from continuing use that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The coverable amount of the production line shows that the production line taken as a whole is not impaired.

Assumption 1: Budgets/forecasts approved by management reflect no commitment of management to replace the machine.

- The recoverable amount of the machine alone cannot be estimated since the machine's value in use: may differ from its net selling price; and
- can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired, therefore, no impairment loss is recognised for the machine. Nevertheless, the enterprise may need to reassess the depreciation period or the depreciation method for the machine. Perhaps, a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are consumed by the enterprise.

Assumption 2: Budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future. Cash flows from continuing use of the machine until its disposal are estimated to be negligible.

The machine's value in use can be estimated to be close to its net selling price. Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (the production line). Since the machine's net selling price is less than its carrying amount, an impairment loss is recognised for the machine.



12. Reversal of An Impairment Loss

1. **Assessing for Reversal of Impairment Loss**
At each balance sheet date, the enterprise must assess if there are **indications** that a prior **impairment loss** may no longer exist or has decreased.
2. **Estimating Recoverable Amount**
If there are indications, the **recoverable amount** of the asset should be estimated.
3. **Reversal of Impairment Loss**
Impairment loss should be **reversed** if there is a change in estimates of **cash inflows**, **cash outflows**, or **discount rates** used to determine the asset's recoverable amount.
4. **Increasing Carrying Amount**
If a reversal occurs, the **carrying amount** of the asset should be **increased to its recoverable amount**.
5. **Reversal of Impairment Loss**
The increase in carrying amount is treated as a **reversal of an impairment loss**.
6. **Indications for Reversal**
The **indicators** for a potential decrease in impairment loss are the same **external** and **internal indicators** used for identifying impairment loss.
7. **Materiality Consideration**
The **concept of materiality** should be considered when deciding whether an impairment loss should be reversed.



13. Reversal of an Impairment Loss for an Individual Asset

1. **Case I: Impairment Loss Written off to P & L**
If the impairment loss was written off to the **profit and loss account**, the **reversal of the impairment loss** should be recognized as **income immediately**.
2. **Case II: Impairment Loss Adjusted with Revaluation Reserve**
 - If the impairment loss was adjusted against the **Revaluation Reserve**, the reversal should be **written back to the reserve account** to the extent of the adjustment.
 - Any **surplus** beyond this will be recognized as **revenue**.
3. **Limit on Increased Carrying Amount**
The increased **carrying amount** due to **impairment reversal** should not exceed the **carrying amount** that would have been determined had no impairment loss been recognized (net of **depreciation** or **amortization**).
4. **Depreciation Impact Post-Reversal**
After **reversal of impairment loss**, **depreciation** (or **amortization**) should be adjusted to allocate the revised carrying amount (less residual value, if any) **over its remaining useful life on a systematic basis**.



14. Reversal of an Impairment Loss for a Cash-Generating Unit

1. **Reversal Allocation Order**
The reversal of impairment loss for a cash-generating unit (CGU) should be allocated in the following order:
 - a. **Other Assets First**
First, allocate the reversal to assets other than goodwill on a pro-rata basis based on the carrying amount of each asset in the CGU.
 - b. **Goodwill Second**
Then, allocate the reversal to goodwill (if any) in the CGU, after other assets have been adjusted.
2. **Reversal Limit**
The carrying amount of an asset should not be increased above the lower of:
 - a. **Recoverable Amount**
Its recoverable amount (if determinable).
 - b. **Carrying Amount Without Impairment**
The carrying amount that would have been determined had no impairment loss been recognized (net of amortization or depreciation) in prior periods.
3. **Pro-rata Allocation**
Any reversal not allocated to an asset should be allocated to the other assets of the CGU on a pro-rata basis.



15. Reversal of an Impairment Loss for Goodwill

1. **Reversal of Impairment Loss for Goodwill**
Goodwill impairment loss cannot be reversed due to changes in estimates (e.g., discount rate or future cash flow projections).
2. **Exception to Reversal**
An impairment loss for goodwill may be reversed only if:
 - a. **Specific External Event**
The impairment loss was caused by a specific external event that is exceptional and not expected to recur.
 - b. **Reversal by Subsequent Event**
Subsequent external events must occur that reverse the effect of the original exceptional event.



16. Impairment in Case of Discontinuing Operations

1. **Discontinuance Plan**
The approval and announcement of a discontinuance plan may indicate that assets are impaired or that a previously recognized impairment loss should be adjusted.
2. **Recoverable Amount for Discontinuing Operation**
The recoverable amount is assessed either for individual assets or for the cash-generating unit (CGU) of the discontinuing operation.



3.	Sale of Entire Discontinuing Operation If the whole operation is sold, none of the assets generate independent cash inflows, so the recoverable amount is assessed for the entire operation. Any impairment loss is allocated accordingly.
4.	Piecemeal Sales For individual asset sales, the recoverable amount is assessed for each asset unless sold in groups.
5.	Abandonment If the operation is abandoned, the recoverable amount is assessed for individual assets.
6.	Further Impairment or Reversal After announcing the plan, negotiations or sale agreements may indicate further impairment or a reversal of previous impairment losses.



17. Disclosure

1.	Impairment Losses Recognized ➤ Disclose impairment losses in the statement of profit and loss. ➤ Indicate line items where these losses are included.
2.	Reversals of Impairment Losses ➤ Disclose reversals of impairment losses in the statement of profit and loss. ➤ Indicate line items where these reversals are included.
3.	Impairment Losses Against Revaluation Surplus Disclose impairment losses recognized directly against revaluation surplus.
4.	Reversals of Impairment Losses Against Revaluation Surplus Disclose reversals of impairment losses recognized directly in revaluation surplus.
5.	Reconciliation of Carrying Amount This information can be included in a reconciliation of the carrying amount of fixed assets as per AS 10.
6.	Segment Reporting (AS 17) ➤ For enterprises applying AS 17, Segment Reporting. ➤ Disclose impairment losses and reversals in profit and loss and revaluation surplus.
7.	Material Impairment Loss - Events and circumstances that led to the recognition or reversal. - The amount of the impairment loss or reversal. - For individual assets: Nature of the asset and the reportable segment. - For cash-generating units: Description of the unit, amount of impairment loss/reversal by asset class and reportable segment, and changes in asset aggregation. - Whether the recoverable amount is net selling price or value in use. - If recoverable amount is net selling price, the basis used to determine it. - If recoverable amount is value in use, the discount rates used for current and previous estimates.



8.	Material Impairment Loss (Main Classes & Events) Disclose: 1. Main classes of assets affected. 2. Main events and circumstances leading to recognition or reversal.
9.	Key Assumptions Encouraged to disclose key assumptions used to determine the recoverable amount of assets or cash-generating units.



AS - 29: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

1. Introduction

1.	Objective/Scope of AS-29 Provides guidance on the recognition, measurement, and disclosure of provisions, contingent liabilities, and contingent assets.
2.	Management & Auditors' Role ➤ Management estimates the provisions, and auditors verify the accuracy of the estimate. ➤ This ensures manipulation is prevented in the creation of provisions.
3.	Change from Prior Practice ➤ Before AS-29, companies did not recognize liabilities due to uncertainty about timing or amount. ➤ With AS-29, provisions must be recognized in the balance sheet when qualifying transactions occur.

Higher profits

Create provision while it is not required

Show less profits and avoid taxes

Lower profits

Do not create provision while it is required

Show high profits and higher EPS

Example 1

During 20X1, XY Enterprise has made lower amount of profits. However, to ensure that the Earnings Per Share do not decline significantly, XY Enterprise does not provide for a warranty amount which should have been provided for. XY is confident of higher amount of profits during later years, and would like to take this provision to the later stage. This ensures consistent performance for the company throughout the period. With AS 29, this anomaly stands removed.

Example 2

During 20X1, AB Shops has made huge profits during a particular year. This may have resulted in payment of taxes on these profits. Further, AB Shop's management foresees challenges in



operations in later years, and therefore, low profits. AB Shop did not create a provision during 20X2 which should have been otherwise made. However, to get the desired impact, AB Shop created the provision in 20X1. Since, the intention of management is not to reflect a true and fair view; AS-29 would ensure appropriate provisions are made in 20X2 only.

AS 29 helps to ensure transparency of information in Financial Statements.

Thus, an accounting standard on provisions is essential to rule out the potential scope for companies to manipulate profits and provisions are made on valid grounds (based on a recognition criterion being met).

2. Scope

AS-29 **does not apply** to the following:

1. Provisions or contingent liabilities arising from **financial instruments** carried at fair value.
2. Contingent liabilities from **executory contracts**, unless the contract is **onerous**.
3. Contingent liabilities from **contracts with policyholders in insurance enterprises**.
4. If **another Accounting Standard** (e.g., AS 7, AS 9, AS 15, AS 19, AS 22) covers a specific type of provision, contingent liability, or contingent asset, then that standard should be applied instead of AS-29.

3. Definitions

1. **Executory Contracts**
Contracts where neither party has **fully performed its obligations**, or both have **performed equally**.
2. **Provision**
A **liability** that can only be measured using a **significant degree of estimation**.
3. **Liability**
A **present obligation** of the enterprise from **past events**, the settlement of which is expected to lead to an **outflow of economic benefits**.
4. **Obligating Event**
An event that creates an obligation, leaving the enterprise with **no realistic alternative** to settling it.
5. **Present Obligation**
An obligation is present if, based on **available evidence**, its existence at the balance sheet date is **probable** (more likely than not).
6. **Possible Obligation**
An obligation is possible if, based on available evidence, its existence at the balance sheet date **is not probable**.
7. **Restructuring**
A **programme planned by management** that changes either:
 - a) The **scope** of the business, or
 - b) The **manner** of conducting the business.



8.	Contingent Liability a) A possible obligation from past events, confirmed only by future uncertain events not fully in the enterprise's control. b) A present obligation from past events, not recognized because: i) It's not probable that an outflow will occur, or ii) A reliable estimate can't be made.
9.	Contingent Asset A possible asset from past events, confirmed only by future uncertain events not fully in the enterprise's control.

4. Recognition of Provision

1.	Present Obligation The enterprise has a present obligation due to a past event.
2.	Probable Outflow It is probable that a resource outflow (economic benefits) will be needed to settle the obligation.
3.	Reliable Estimate A reliable estimate can be made of the amount of the obligation.
4.	No Provision If any of these conditions are not met, no provision should be recognized.

5. Present Obligation

1.	Present Obligation More Likely If it is more likely than not that a present obligation exists, the enterprise recognizes a provision (if recognition criteria are met).
2.	No Present Obligation More Likely If it is more likely that no present obligation exists, the enterprise discloses a contingent liability, unless the possibility of an outflow is remote.

Example 3

X Ltd sells refrigerators with a warranty of 6 months. The refrigerators would be repaired free of cost by X Ltd. if some problem arises during the next 6 months of sale. There is a present obligation for X Ltd because if some defect arises, X Ltd would need to incur expenses on repairs of the refrigerator. Thus, a provision is required to be made in the books of X Ltd.

Example 4

Z Ltd takes a building on lease for 10 years. The terms of the contract provide that Z Ltd must vacate the building in its original condition. Z Ltd expects that there is a likely cost of Rs. 10 lakhs to be spent at the end of 10 years for restoration. Since there is a present obligation on X Ltd at the time of entering into the lease contract, a provision to the extent of present value of this amount should be created.



6. Past Event

1.	Obligating Event A past event creates a present obligation and the enterprise has no realistic alternative to settle it.
2.	Financial Position Financial statements reflect the financial position at the end of the reporting period , not future positions.
3.	Liabilities Recognition Only liabilities existing at the balance sheet date are recognized. No provision is made for future operational costs .
4.	Provisions for Past Events Provisions are recognized for obligations from past events that exist independently of future actions, like penalties or decommissioning costs .
5.	No Provision for Future Expenditures No provision is made for future expenditures that can be avoided by future actions (e.g., operational changes).
6.	Obligating Event Due to New Laws An event can become an obligating event if new laws require rectifying past damage , even if no obligation existed at the time .
7.	Virtually Certain Legislation An obligation arises when proposed legislation is virtually certain to be enacted, not when details are still being finalized.



7. Probable Outflow of Resources Embodying Economic Benefits

1.	Liability Recognition A liability is recognized if there is a present obligation and a probable outflow of resources to settle it.
2.	Probability An event is regarded as probable if the likelihood of it occurring is greater than the likelihood of it not occurring.
3.	Contingent Liability If a present obligation is not probable , it is disclosed as a contingent liability , unless the possibility of an outflow is remote .
4.	Similar Obligations For similar obligations (e.g., product warranties), the probability of an outflow is assessed based on the whole class of obligations , not individual items.
5.	Provision for Class of Obligations Even if the probability of an outflow for a single obligation is small, a provision is recognized for the class of obligations as a whole, if other recognition criteria are met.

**Example 5**

Kell Ltd sells laptops with a replacement warranty of 1 year. If something happens to the laptop within 1 year of purchase, the company would replace the complete laptop. A few laptops during past years have been replaced by Kell Ltd.

In the above situation, Kell Ltd would incur some expenses to replace a laptop, if something goes wrong. There is an outflow of resources expected to settle the obligation that arises by virtue of sale of laptop (past event).

Example 6

AB Ltd has received a notice from one of the customers about health issues from using the products of AB Ltd. The customer in the notice claims damages of Rs. 5,00,000.

The conditions of past event (i.e. sale of goods resulting in damage) and reliable estimate (Rs. 5,00,000) have been met. However, whether an outflow of resources will be probable or not, cannot be confirmed since the customer may or may not win the case. This would be clear only when the decision will be taken by the court. Hence, in the above situation, no provision for damages will be made. However, a disclosure of the case filed is required to be made.

**8. Reliable Estimate of the Obligation**

1. **Use of Estimates**
Estimates are crucial in preparing financial statements and do not affect their reliability, even though provisions require a higher level of estimation.
2. **AS 29 on Estimates**
AS 29 (Revised) highlights that it's often possible to determine a range of possible outcomes and make a sufficiently reliable estimate to recognize a provision.
3. **Rare Cases of Unreliable Estimates**
Situations where a reliable estimate cannot be made are extremely rare.
4. **Disclosure of Contingent Liability**
If no reliable estimate can be made, the liability exists but cannot be recognized, and it should be disclosed as a contingent liability.
Example (XYZ Mining Company)
For example, if XYZ, a mining company, is legally required to restore the environment in 10 years, and the cost can be reliably estimated, XYZ must recognize a provision as it meets the criteria of a present obligation likely to require an outflow of resources.

**9. Contingent Liabilities**

1. **Recognition of Contingent Liability**
A contingent liability should not be recognized in the financial statements but should be disclosed, unless the possibility of an outflow of resources is remote.
2. **Joint Liability**
If an enterprise is jointly and severally liable for an obligation, the part expected to be met by other parties is treated as a contingent liability.
3. **Provision for Share of Obligation**



	The enterprise recognizes a provision for its share of the obligation if an outflow of resources is probable, except in rare cases where no reliable estimate can be made.
4.	Continuous Assessment of Contingent Liabilities Contingent liabilities are continuously assessed to check if the probability of an outflow becomes more likely.
5.	Provision upon Change in Probability If it becomes probable that an outflow will be required for an item previously treated as a contingent liability, a provision is recognized in the financial statements in the period when the change in probability occurs.

Example: 7

A customer of XYZ has filed a case against them for providing them wrong product and not returning the same. XYZ has taken legal advice from their lawyer who believes it is not probable yet that resources may be required to settle the same.

Since it is not meeting all the criteria of provision, it will be treated as contingent liability and will just be disclosed in the notes.



10. Contingent Assets

1.	Contingent Assets Contingent assets arise from unexpected events that may result in an inflow of economic benefits, like a legal claim with an uncertain outcome.
2.	Non-recognition A contingent asset should not be recognized in the financial statements to avoid recognizing income that may never be realized.
3.	Recognition of Income If the realization of income becomes virtually certain, the related asset is no longer a contingent asset, and its recognition becomes appropriate.
4.	Disclosure Contingent assets are not disclosed in the financial statements but may be disclosed in the report of the approving authority (e.g., Board of Directors).
5.	Continuous Assessment Contingent assets are continuously assessed, and once it is virtually certain that an inflow will occur, the asset and income are recognized in the financial statements for that period.



11. Measurement: Best Estimate

1.	Provision Amount The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.
2.	Estimation Process Estimates are determined by:



	✓ Management judgment ✓ Experience with similar transactions ✓ Reports from independent experts (if needed).
3.	No Discounting (Except for Specific Liabilities) Provisions should not be discounted to their present value, except for decommissioning, restoration, and similar liabilities related to Property, Plant, and Equipment.
4.	Discount Rate The discount rate used should be pre-tax rates that reflect the current market assessment of: ✓ Time value of money ✓ Risks specific to the liability (but not risks already adjusted in future cash flows).
5.	Unwinding Discount The periodic unwinding of the discount should be recognized in the statement of profit and loss.
6.	Tax Treatment Provisions are measured before tax, and the tax consequences are dealt with under AS 22.



12. Future Events

1.	Recognition of Provisions Provisions are recognized only for obligations arising from past events that are independent of the enterprise's future actions.
2.	Future Events Impact Future events affecting the amount required to settle an obligation should be reflected in the provision if there is sufficient objective evidence that they will occur.
3.	Example of Future Events For example, the cost of cleaning up a site at the end of its life may be reduced by future technological advancements. The recognized amount should reflect a reasonable expectation of such future technology, based on available evidence (e.g., cost reductions from experience or applying existing technology).
4.	New Technology Expectations An enterprise does not anticipate the development of completely new technology unless supported by sufficient objective evidence.
5.	Impact of Legislation The impact of possible new legislation on an existing obligation is considered when sufficient objective evidence shows that the legislation is virtually certain to be enacted.
6.	Timing of Legislation Impact Often, sufficient evidence of new legislation will not exist until it is actually enacted.



13. Expected Disposal of Assets

1. **Gains from Disposal**
Gains on the expected disposal of assets are not considered when measuring a provision, even if the disposal is closely linked to the event triggering the provision.
2. **Recognition of Gains**
Instead, gains from expected disposals of assets are recognized according to the relevant Accounting Standard that governs the treatment of the specific assets involved.



14. Reimbursements

1. **Reimbursement Source**
An enterprise may seek reimbursement for part or all of the expenditure from sources like insurance contracts, indemnity clauses, or supplier warranties.
2. **Reimbursement Asset Recognition**
A reimbursement asset is recognized only when it is virtually certain that it will be received upon settling the related obligation.
3. **Liability and Reimbursement**
If the enterprise is still liable for the full amount even if the third party doesn't pay, a provision is recognized for the full liability, and a separate asset is recognized for the expected reimbursement when it is virtually certain.
4. **Liability without Reimbursement**
If the enterprise is not liable for costs if the third party fails to pay, those costs are not included in the provision.

Reimbursement Scenarios

Condition	Obligation	Reimbursement Recognition	Disclosures
Reimbursement Expected and Virtually Certain	The enterprise has no obligation for the part of the expenditure to be reimbursed by the other party.	The reimbursement is recognized as a separate asset in the balance sheet and may be offset against the expense in the statement of profit and loss. Amount recognized does not exceed the liability.	No disclosure required.
Reimbursement Expected, Not Virtually Certain	The obligation remains with the enterprise.	The expected reimbursement is not recognized as an asset.	The expected reimbursement is disclosed.
No Reimbursement	The enterprise has no liability for the amount to be reimbursed.	No reimbursement recognized.	The reimbursement is disclosed together with the amount recognized.



15. Changes in Provisions

1. **Review of Provisions**
Provisions should be reviewed at each balance sheet date.
2. **Adjustment to Provisions**
Adjust provisions to reflect the current best estimate.
3. **Reversal of Provision**
If it is no longer probable that an outflow of resources will be required, the provision should be reversed.



16. Use of Provisions

1. **Use of Provision**
A provision should only be used for expenditures it was originally recognized for.
2. **Adjustment of Expenditures**
Expenditures must relate to the original provision and not be used for different purposes.
3. **Concealment of Impact**
Using a provision for another purpose would conceal the impact of two separate events.



17. Application of the Recognition and Measurement Rules

1. **Future Operating Losses**
Future operating losses are not considered a liability and should not be recognized as a provision.
2. **Examples of Restructuring Events**
Restructuring may include:
 - a. Sale or termination of a business line
 - b. Closure or relocation of business locations
 - c. Changes in management structure
Eliminating layers of management.
 - d. Fundamental re-organizations
Major changes affecting the nature and focus of operations.
3. **Provision for Restructuring Costs**
A provision for restructuring costs is only recognized when the recognition criteria for provisions are met.
4. **Sale of an Operation**
No obligation arises for the sale of an operation until there is a binding sale agreement.
5. **Direct Restructuring Costs**
Restructuring provisions should include only direct costs necessary for the restructuring, not ongoing activities.
6. **Excluded Restructuring Costs**
Costs not included in restructuring provisions:
 - ✓ Retraining or relocating staff



	Costs for retraining or relocating continuing staff. ✓ Marketing costs Costs related to marketing. ✓ Investment in new systems Costs for new systems or distribution networks.
7.	Future Operating Losses Before Restructuring Operating losses before restructuring are not included in the provision.
8.	Gains from Asset Disposal Gains from asset sales should not be considered in measuring the restructuring provision.



18. Disclosure

For each class of provision, an enterprise should disclose

a.	The carrying amount of the provision at the beginning and end of the period.
b.	Any new provisions made during the period, including increases to existing provisions.
c.	The amounts used (incurred and charged) against the provision during the period.
d.	Any unused amounts that were reversed during the period.
	Note for SMCs SMCs are exempt from the above disclosure requirements of AS 29 (Revised).
For each class of provision, an enterprise should disclose:	
a.	A brief description of the nature of the obligation and the timing of any resulting outflows.
b.	Uncertainties about those outflows, with major assumptions made concerning future events, if necessary.
c.	The amount of any expected reimbursement , including any recognized asset for that reimbursement.
	Note for SMCs SMCs are exempt from the above disclosure requirements of AS 29 (Revised).
For each class of contingent liability at balance sheet date, disclose:	
a.	A brief description of the nature of the contingent liability.
b.	An estimate of the financial effect of the contingent liability.
c.	Uncertainties regarding outflows and possibility of reimbursement. i. If disclosure is not practicable If the required information cannot be disclosed, the fact that it is not practicable should be stated. ii. In rare cases, information may prejudice the enterprise If disclosing information could seriously harm the enterprise's position in a dispute, it need not be disclosed. iii. Disclosure in case of dispute In such cases, the nature of the dispute and why the information was not disclosed should be stated.



APPLICABILITY OF AS



1. Applicability of Accounting Standards

Category	Issued By	Entity Classification	Applicability of Accounting Standards
Non-Corporate Entities	ICAI	➤ Level I ➤ Level IV, III, and II Entities (Referred to as Micro, Small, and Medium Entities (MSMEs))	All AS applicable Accounting Standards apply with certain exemptions based on entity level
Corporate Entities	Central Government	➤ Small and Medium-sized Companies (SMCs) ➤ Companies other than SMCs (Non-SMCs)	➤ SMCs: Exemptions/relaxations in some Accounting Standards ➤ Non-SMCs: Must comply with all Accounting Standards in full



2. Criteria for classification of Non-company Entities as decided by the Institute of Chartered Accountants of India

Classification of Non-Company Entities Based on Accounting Standards	
1.	Meeting & Decision The ICAI Council, in its 400th meeting, decided on the applicability of Accounting Standards to Non-company entities. The scheme is effective for accounting periods starting on or after April 1, 2020.
2.	Classification of Non-Company Entities Entities are classified into four levels: ➤ Level I - Large-size entities ➤ Level II - Medium-size entities ➤ Level III - Small-size entities ➤ Level IV - Micro-size entities Level II, III, and IV entities are collectively termed as MSMEs (Micro, Small, and Medium Size Entities).
3.	Level I (Large Entities) A non-company entity is classified as Level I if it meets any one or more of the following: ➤ Listed or in the process of listing (India or abroad) ➤ Banks (including co-operative banks) financial institutions, or insurance companies ➤ All entities engaged in commercial, industrial nor business activities, whose Turnover > ₹250 crore (excluding other income) in the immediately preceding accounting year ➤ All entities engaged in commercial, industrial nor business activities, having Borrowings > ₹50 crore (including public deposits) in the immediately preceding accounting year ➤ Holding or subsidiary of any of the above



4.	Level II (Medium Entities) A non-company entity is classified as Level II if it is not a Level I entity, but meets any one or more of the following: ➤ All entities engaged in commercial, industrial nor business activities, whose Turnover > ₹50 crore but ≤ ₹250 crore (excluding other income) in the immediately preceding accounting year ➤ All entities engaged in commercial, industrial nor business activities, having Borrowings > ₹10 crore but ≤ ₹50 crore (including public deposits) in the immediately preceding accounting year ➤ Holding or subsidiary of any of the above
5.	Level III (Small Entities) A non-company entity is classified as Level III if it is not a Level I or Level II entity, but meets any one or more of the following: ➤ All entities engaged in commercial, industrial nor business activities, whose Turnover > ₹10 crore but ≤ ₹50 crore (excluding other income) in the immediately preceding accounting year ➤ All entities engaged in commercial, industrial nor business activities, having Borrowings > ₹2 crore but ≤ ₹10 crore (including public deposits) in the immediately preceding accounting year ➤ Holding or subsidiary of any of the above
6.	Level IV (Micro Entities) A non-company entity is classified as Level IV if it does not fall under Level I, II, or III.
Applicability of the Accounting Standards to Level 1 Non- company entities Level I entities are required to comply in full with all the Accounting Standards.	
Applicability of Accounting Standards to Non-Company Entities for Level II,III,IV Fully Exempted (Not Applicable) • AS 3, 17, 20, 21, 23, 25, 27 Fully exempt for Level III & IV only: • AS 14, 18, 24, 28 (only for Level IV) Partially Exempted (Applicable with Exemptions/Relaxations) • AS 10, 11, 13, 15, 19, 22, 26, 28 (for Level II & III), 29 Fully Applicable (No Exemptions for Any Level) • AS 1, 2, 4, 5, 7, 9, 12, 16	

Example 1

M/s Omega & Co. (a partnership firm), had a turnover of Rs. 1.25 crores (excluding other income) and borrowings of Rs. 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.20X1. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI.



Solution:

The question deals with the issue of Applicability of Accounting Standards to a non-corporate entity. For availment of the exemptions, first of all, it has to be seen that M/s Omega & Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under 4 levels viz Level I, Level II, Level III and Level IV entities.

Non-corporate entities which meet following criteria are classified as Level IV entities:

- i. All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) does not exceed rupees ten crores in the immediately preceding accounting year.
- ii. All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) does not exceed rupees two crores at any time during the immediately preceding accounting year.
- iii. Holding and subsidiary entities of any one of the above.

As the turnover of M/s Omega & Co. is less than Rs. 10 crores and borrowings less than Rs. 2 crores, it falls under Level IV non-corporate entities. In this case, AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27 and AS 28 will not be applicable to M/s Omega & Co. Relaxations from certain requirements in respect of AS 10, AS 11, AS 13, AS 15, AS 19, AS 22, AS 26 and AS 29 are also available to M/s Omega & Co.



3. Criteria for classification of Companies under the Companies (Accounting Standards) Rules, 2021

1.	Small and Medium-Sized Company (SMC) A company qualifies as an SMC if it meets all the following conditions at the end of the relevant accounting period: ➤ Not listed or not in the process of listing (India or abroad) ➤ Not a bank, financial institution, or insurance company ➤ Turnover $\leq$ ₹250 crore (excluding other income) in the immediately preceding accounting year ➤ Borrowings $\leq$ ₹50 crore (including public deposits) in the immediately preceding accounting year ➤ Not a holding or subsidiary of a Non-SMC
2.	Non-SMC A company is classified as a Non-SMC if any one of the above conditions is not satisfied.
3.	For Non-SMC all AS are applicable
4.	For SMC Complete Exemption: AS 17 Partial Exemption: AS 15, AS 19, AS 20, AS 28, AS29, AS 25



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