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Accounting Standard - 1 DISCLOSURE OF ACCOUNTING POLICIES

Objective of AS 1

- To facilitate better understanding of financial statements.
- To facilitate meaningful comparison between financial statements of different enterprises

Meaning of Accounting Policies

- Specific accounting principles &
- Methods of applying those principles adopted by the enterprise
- In preparation of financial statements

Valuation of Fixed Assets, Methods of Depreciation, Valuation of Inventories are the different areas where different accounting policies can be used.

AS 1 is **mandatory** in nature for

ALL ENTERPRISE

Considerations in the Selection of Accounting Policies

CONSIDERATION

Primary

The financial statements should represent a true and fair view of the state of affairs of the enterprise

Secondary

Prudence

- ✓ profits are not anticipated
- ✓ Provision is made for all known liabilities and losses

Substance over form

The accounting treatment & presentation of transactions & events in financial statements
- ✓ should be governed by their substance &
- ✓ not merely by their legal form

Materiality

- ✓ Financial statements should disclose all 'Material Items'

The items the knowledge of which might influence the decisions of the user of the financial statement.

Fundamental Accounting Assumption

1) Going Concern
2) Consistency
3) Accrual

If they are not followed, disclosure is required in financial statements

DISCLOSURE OF ACCOUNTING POLICIES

Going Concern Concept

- ✓ Enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations.
- ✓ Assets are shown at books values (i.e. On cost less depreciation basis).
- ✓ Expenses and incomes related to future period are carried forward and only the incomes or expenses related to current year are considered while calculating profit and loss.

Consistency

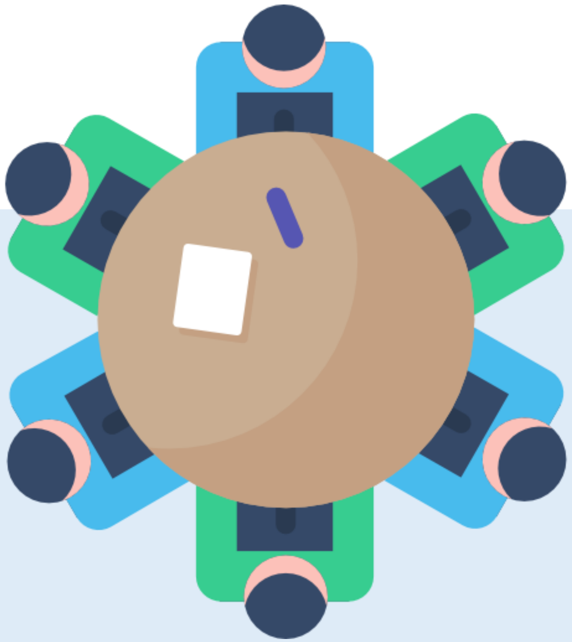
- ✓ The accounting policies are followed consistently from one period to another.
- ✓ Improves comparability of financial statements through time.

Any change in the accounting policy which has

- Material effect in the current period or in the subsequent period - disclosed to the extent it is ascertainable.
- If the amount is not ascertainable - the fact should be disclosed.

Accruals

- ✓ Accrual means recognition of revenue and costs as they are earned or incurred and not as money is received or paid.
- ✓ The actual **date of payment of cash is immaterial** for the purpose of recognition



Disclosures of Accounting Policies

- ✓ All significant accounting policies adopted should be disclosed
- ✓ The disclosure should form part of the financial statements
- ✓ Any change in the accounting policies which has a material effect in the current period should be disclosed along with amount of effect
- ✓ If fundamental accounting assumptions is not followed, the fact should be disclosed
- ✓ Disclosure of accounting policies, or changes therein cannot rectify wrong or inappropriate accounting policies followed.

Objective of AS 2

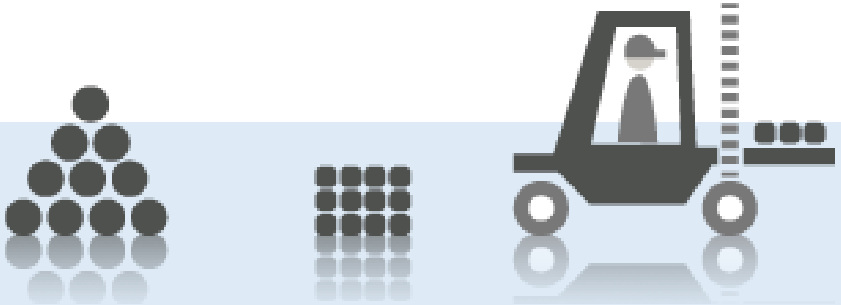
- Specifies the principals for valuing the inventory
- Disclosure of the specific policies adopted by the management for the valuation of inventory

Applicability

- This statement should be applied in accounting for inventories other than
- WIP under construction contract
- WIP arising in case of service providers.
- Shares, debentures and other financial instruments held as stock-in-trade;
- inventories of livestock, agricultural and forest products, and mineral oils, ores and gases (valued at net realisable value)

VALUATION OF INVENTORIES

According to AS -2



Inventories are assets

- **Held for sale** in the ordinary course of business **(Finished Goods)**
- Used in the **process of production** for such sale **(WIP)**
- Used **in the form of materials or supplies** to be consumed in the production process or in the rendering of services **(Raw Material)**

The valuation of inventory is crucial because of its **direct impact on profit/loss for an accounting period**

Inventory should be valued **at lower of**

COST | **NET REALISABLE VALUE**

To ignore the anticipated profit

Measurement of Inventories

COST OF INVENTORY

Raw Materials

At Cost (If finished goods are sold at or above cost), otherwise at replacement cost

Finished Goods and Work in progress

Lower of following

Cost

Cost of purchase

- Purchase price
- Import duty & tax
- freight inwards and other expenditure directly attributable to the acquisition

Cost of conversion

- Refer Chart below

Other costs

- Tax payable on manufacturing of goods, if any
- Customs duties on imported goods lying in bonded warehouse
- Cost of designing product for specific customers

Net Realizable Value

Realizable value less Selling Expenses less estimated cost of completion

Cost excluded from the valuation of inventories

- Abnormal costs
- Storage costs
- Administrative costs
- Selling & distribution costs
- Borrowing costs
- Exchange Differences.

Raw materials and WIP are not for sale and hence the NRV cannot be estimated. They needs to be valued at cost.

CONVERSION COST

- **Factory Overheads**
  - **Fixed**
    - At Normal Capacity*
    - At actual Production**
  - **Variable**
    - At actual Production
- **Direct labour**
- **Joint Cost**
  - **Main/Joint*****
    - Sale Value at Separation
    - Sale Value at Completion
  - **By Products**
    - Measured at NRV. This NRV is deducted from cost of main / Joint products

* When actual production is almost equal or lower than normal capacity.

** When actual production is higher than normal capacity.

*** Allocation at reasonable and consistent basis.

Borrowing Cost

Interest and other borrowing costs are not usually considered as part of inventories. **Except**

As per AS 16, for inventories that are qualifying assets, any directly attributable borrowing costs (for acquisition, construction or production) should be capitalized as part of their cost

Net Realisable Value

Net Realisable Value = Estimated selling price in the ordinary course of business - estimated costs of completion - the estimated costs necessary to make the sale.

Cost Formula

COST FORMULA

- **Specific Identification Method**
- **Where specific identification method is not applicable**
  - FIFO
  - Weighted average cost
- **When it is impractical to calculate the cost**
  - Standard cost
  - Retail Method

Disclosures

- Accounting policies adopting measuring inventories
- Cost formula used
- Total carrying amount of inventories
- Classification of the inventories into raw materials and components, work in progress, finished goods, stores and spares, and loose tools

Objective of AS 3

- Cash flow statement exhibits the flow of incoming and outgoing cash
- Assess the ability of enterprise to generate cash and to utilize the cash
- Tool for assessing the liquidity and solvency of the enterprise

Applicability

- This standard applies to the following entities
- Which have a turnover of more than Rs. 50 crores in a preceding financial year
- Borrowing more than Rs. 10 crores at any time during the immediately preceding accounting period.
- Financial institution
- Banks including co-operative banks
- Insurance companies
- Holding and subsidiary enterprises of any of the above at any time during the accounting period.

Cash and Cash Equivalents

- Held for the purpose of meeting short-term cash commitments
- Readily convertible in cash and be subject to an insignificant risk of changes in value.
- Investments in shares are excluded unless they are, in substance, cash equivalents

Presentation of Cash Flow Statements

Cash movement under three different heads

- **Operating Activities**
- **Investing Activities**
- **Financing Activities**

- An enterprise presents its cash flows from operating, Investing and financing activities in a manner which is most appropriate to its business
- A single transaction may include cash flows that are classified differently.

Operating activity

- Cash flow statement exhibits the flow of incoming and outgoing cash
- Assess the ability of enterprise to generate cash and to utilize the cash
- Tool for assessing the liquidity and solvency of the enterprise

Elements of Operating Activity

- Cash receipts from sale of goods and rendering services.
- Cash receipts from royalty, fees, commissions and other revenue.
- Cash payments to suppliers for goods and services.
- Cash payments to and on behalf of employees.
- Cash receipts & payments by an insurance enterprise for premiums ,claims, annuities etc.
- Cash payments and refunds of income taxes
- Cash receipts and payments relating to contracts held for dealing or trading purposes.
- Cash flow from dealing in securities when enterprise holds securities for such purpose.

Investment activity

- Acquisition and disposal of long-term assets and other investments not included in cash equivalents

Elements of Investing Activity

- Cash payments for acquisition of fixed assets including intangibles.
- Cash receipts from disposal of fixed assets.
- Cash payments to acquire shares, warrants or debt instruments of other enterprise.
- Cash receipts from disposal of shares, warrants or debt instruments of other enterprise.
- Cash advances and loans made to third parties.
- Cash receipts from repayments of advances and loans made to third parties.
- Cash payments for future, forward, option and swap contracts.
- Cash receipts from future, forward, option and swap contracts.

Financing Activity

- Activities which results in changes in the size and composition of the owners capital and borrowing of organization.

Elements of Financing Activity

- Cash proceeds from issuing shares or other equity instruments.
- Cash payments to owners to acquire or redeem the enterprise’s shares.
- Cash proceeds from issuing debentures, & other short & long term borrowings.
- Cash repayments of amounts borrowed.
- Cash payments by a lease for the reduction of the outstanding liability relating to a finance lease.

Investing and financing transactions that do not require the use of cash equivalents should be excluded from a cash flow statement.

Foreign currency cash flows

- Transactions in a foreign currency should be recorded in an enterprise's reporting currency.
- A rate that approximates the actual rate may be used if the result is substantially the same.
- The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

Extraordinary Item

- classified in operating, investing and financing activity. If such categorization is not possible then show it in operating activity.

Income taxes

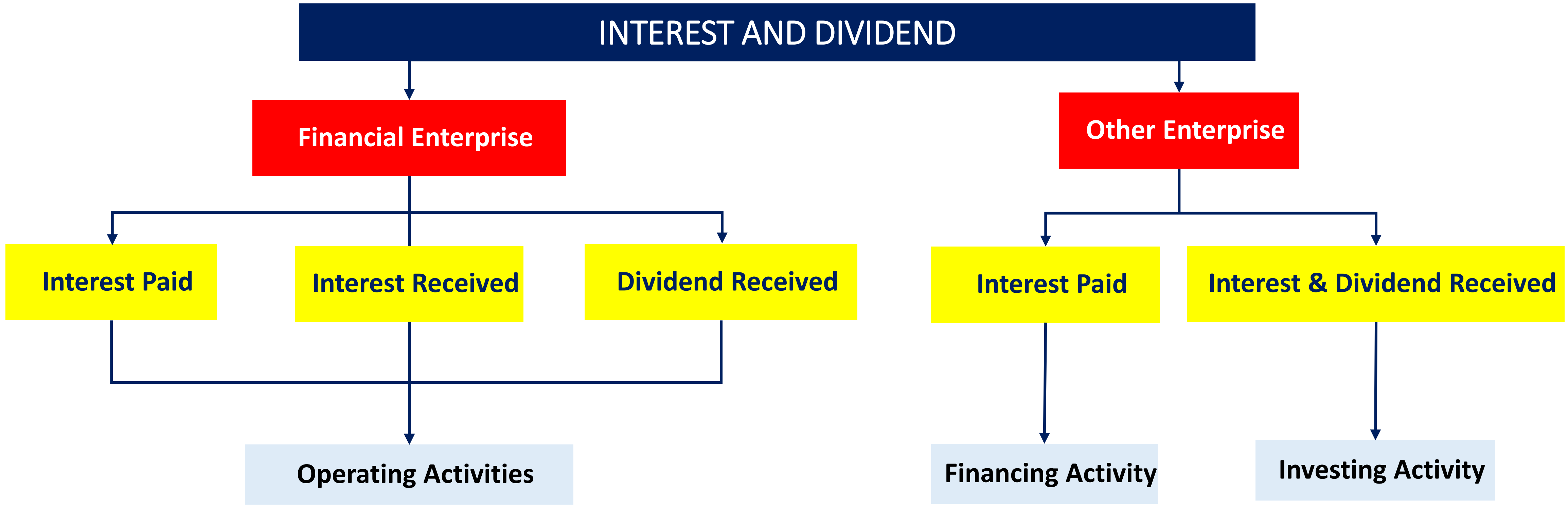
- Operating activities unless they can be specifically identified with financing & investing activity.

Sale of non – current asset

- Investing activity.

Acquisitions and disposal of subsidiaries and other business units:

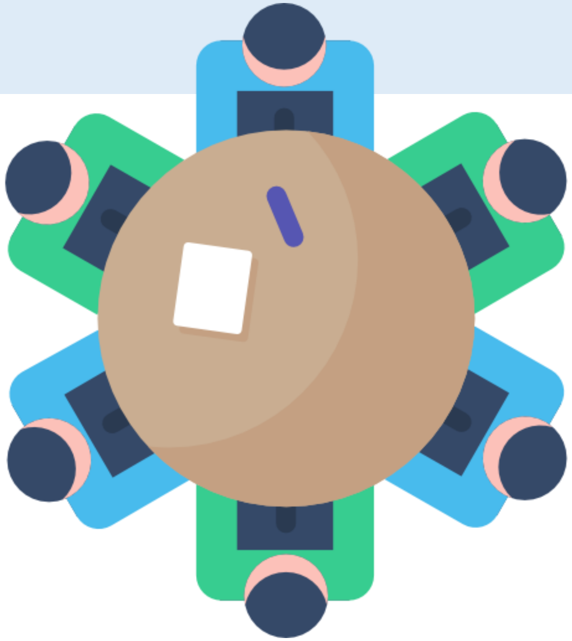
- Presented separately and classified as investing activities.



- Dividend paid should be classified as cash flow from financing activities

Disclosures

- An enterprise should disclose the component of cash and cash equivalent and should present a reconciliation of the amount in the cash flow statement with the equivalent items reported.
- An enterprise should disclose amount of significant cash and cash equivalent balance held by enterprise that are not available for use by it with explanation of management



CONTINGENCIES AND EVENTS OCCURRING AFTER BALANCE SHEET DATE

Objective of AS 4

- Prescribe the Accounting of contingencies and
- Events which takes place after Balance sheet date but before it's approval by BOD

Applicability

This standard does not apply to

- Liability of life assurance and general insurance
- Obligation under retirement benefit plans. (AS - 15)
- Commitments arising from long-term lease contracts (AS 19)

Standard Deals with
- Events occurring after balance sheet date
- Contingencies

Contingency

- Existing condition / situation
- Result of which is not known on the balance sheet date
- Result would be known only on happening or non-happening of certain event in future
- Result may be either gain or loss

- Outcome and financial effect of contingencies are determined by the management on the basis of information available up to the date.
- Ex. Liability on account of outstanding forward exchange contracts, Guarantees, Bill discounted, Disputed claims, Warranties.

CONTINGENCIES AND EVENTS OCCURRING AFTER BALANCE SHEET DATE

Estimation of Contingencies

- Existing situation or condition on balance sheet date
  - **Expected outcome**
    - **Contingent gain**
      - **AS 29**
    - **Contingent loss**
      - **If loss is probable the provision should be made**
        - **If there is no counter claim or claim against third party, provision in full for probable loss should be made**
        - **If there is counter claim or claim against third party, provision should be made after taking into account the probable recovery under the claim**
      - **If loss is reasonably possible, disclosure is made in accounts by the way of notes**
      - **If expected loss is remote, it will be ignored**
- Condition or situation **after** the balance sheet date
  - **No accounting treatment is required**

Events Occurring After Balance Sheet Date

Events occurring after the balance sheet date are

- those significant events,
- both favorable and unfavorable,
- that occur between the balance sheet date and the date on which the financial statements are approved by approving authority

Events occurring after the Balance Sheet Date

Adjusting event

- ✓ **Provides additional information, which materially affects the determination of amounts relating to conditions existing at the balance sheet date.**
- ✓ **Event affecting going concern assumption.**

Loss should be accounted in accounts and assets and liabilities to be adjusted

Non-adjusting event

Events not related to circumstances existing on Balance sheet date

Disclosure by the way of notes to accounts only, no adjustment in accounts.

Events Occurring After Approval of Accounts

- Event occurring
- after the Balance Sheet Date and
- also after the approval of accounts by Board of Directors of Company,
- such event should be disclosed in Director's Report, if Material.

Disclosure

- **If disclosure of contingencies is required by this Standard, the following information should be provided:**

  (a) the nature of the contingency;

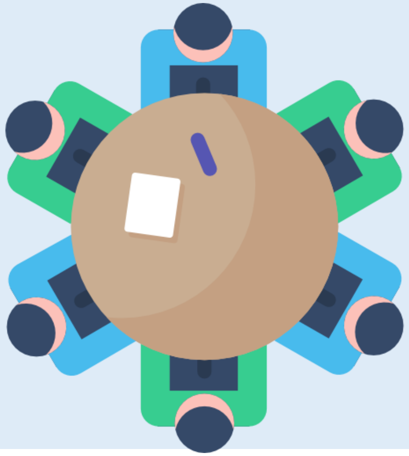
  (b) the uncertainties which may affect the future outcome;

  (c) an estimate of the financial effect, or a statement that such an estimate cannot be made.

- **If disclosure of events occurring after the balance sheet date then the following information should be provided:**

  (a) the nature of the event;

  (b) an estimate of the financial effect, or a statement that such an estimate cannot be made.



Accounting Standard - 5

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

Objective of AS 5

- To provide uniformity in preparation & presentation of Financial Statement
- To enhance the comparability of the financial statement
- To provide common accounting technique and practices to be followed

Ordinary Activities

- Activities normally undertaken as a part of business & incidental activities
- Item of income or loss is considered separately considering the size, nature and incidence
- Separate disclosure of nature and amount

Example:

- VRS scheme for employees
- Sale of fixed assets

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

Extra-ordinary Activities

- Income or expenses from transactions that are distinct from ordinary activities.
- do not recur frequently.
- Separately disclosed in Profit and loss A/c
- Extra ordinary activity is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise

Example:
Loss due to earthquakes
Attachment of property

Prior Period Items

- Income or expenses which arise in current period as a result of error or omission in the preparation of financial statement of one or more prior periods.
- should be separately disclosed

Does not include
other adjustments necessitated by circumstances
which related to prior periods,
But are determined in the current period

Change in Accounting Estimate

- The accounting estimates is revised due to change in circumstances or conditions on which estimate was based.
- Effect of change in Accounting estimate be disclosed in net profit or loss

Example:
Estimation of provision for sundry debtors
Computing Income tax provision
Estimating the useful life of Fixed assets

Change in Accounting Policy

- Accounting policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements.
- The areas for different accounting policies -----
  - Treatment of Goodwill
  - Valuation of Inventories
  - Valuation of Investments
  - Valuation of Fixed Assets

Consideration in selection of Accounting Policies

- Prudence,
- Materiality, and
- Substance Over Form

- Effect of change in accounting policy should be disclosed in financial statement in the year of change.
- If the effect of change is not ascertainable then facts should be disclosed.

Changes in Accounting Policies

Situations where change in accounting policy is allowed

- Change is required by standard
- Change is required by law
- For better and Appropriate presentation of financial statement

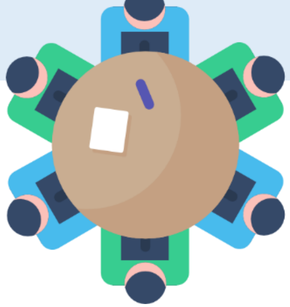
Changes in Accounting Policies

Events not considered for change in Accounting Policy

- **Event which did not occur previously**
- **Events that are different in substance from previously occurring event**

Disclosures:

- Any change in an accounting policy which has a material effect should be disclosed.
- If a change has no material effect on the financial statements for the current period may have a material effect in later periods, the fact should be appropriately disclosed.



Objective of AS 7

AS 7 prescribes the principles of accounting for construction contracts in the financial statements of contractors. The focus of the standard is on allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.

WHAT ARE CONSTRUCTION CONTRACTS?

- Contracts specifically negotiated for the construction of an asset or combination of assets that are closely interrelated.
- Contracts for rendering of services related to construction of assets.
- Contracts for destruction or restoration of assets.

CONSTRUCTION CONTRACT

Construction contracts can be classified into two categories

TYPES OF CONSTRUCTION CONTRACTS

FIXED PRICE CONTRACT

Contractor agrees to a fixed contract price or fixed rate per unit of output, which in some cases is subject to cost escalation.

COST PLUS CONTRACT

Contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.

IF THE FINAL OUTCOME OF THE CONTRACTS

Can be estimated reliably

Revenue and costs recognised as per percentage of completion method considering the stage of completion of contract at reporting date.

Can not be estimated reliably

Revenue should be recognised only to the extent of contract costs incurred, of which recovery is probable.

Contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.

Note : Any expected loss (when contract cost > contract revenue) on the construction contract should be recognised as an expense immediately in both the situations.

OUTCOME OF CONTRACTS CAN BE ESTIMATED RELIABLY WHEN

In fixed price contract

- Total contract revenue can be measured reliably.
- It is probable that the economic benefits associated with the contract will flow to the enterprise.
- Both contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably.
- Contract costs attributable to contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

In cost plus contract

- It is probable that the economic benefits associated with the contract will flow to the enterprise.
- Contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

PERCENTAGE COMPLETION METHOD

This method of accounting is also called as the stage of completion method.

Construction contract take more than one year to complete. Hence the final Profit & loss of a construction contract can be determined only after a number of years from the year of commencement of construction are over.

The percentage completion method may suffer from a serious drawback viz. Anticipation of profit.

According to AS 7 Percentage of completion method should not used unless it is possible to make a reasonable estimate of final outcome of the contract.

TREATMENT OF COST RELATING TO FUTURE ACTIVITIES

The contract costs that relate to future activity on the contract are however recognized as an assets provided it is probable that they will be recovered. such costs represent an amount due from the customer and are often classified as contract work in progress.

UNCOLLECTABLE CONTRACT REVENUE

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

Methods for Determination of Stage of Completion of Contracts

This method of accounting is also called as the stage of completion method.

(Method to be chosen depending on the nature of the contract)

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

As per the standard, Contract revenue and Contract costs comprise of the following:

CONTRACT REVENUE	
Initial amount of revenue agreed in the contract.	**Variations in contract work, claims and incentive payments if** (i) it is probable that they will result in revenue. (ii) they are capable of being reliably measured.

CONTRACT COSTS		
Costs that relate directly to the specific contract.	**Costs that are attributable to contract activity in general and can be allocated to the specific contract.**	**Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract.**
include: 1. site labour costs, including site supervision; 2. costs of materials used in construction; 3. depreciation of plant and equipment used on the contract; 4. costs of moving plant, equipment and materials to and from the contract site; 5. costs of hiring plant and equipment; 6. costs of design and technical assistance that is directly related to the contract; 7. the estimated costs of rectification and guarantee work, including expected warranty costs; and 8. claims from third parties.	**include:** 1. insurance; 2. costs of design and technical assistance that is not directly related to a specific contract; and 3. construction overheads. The allocation of indirect cost should be based on normal level of construction activity. The allocable cost may include borrowing cost as per AS 16	**include:** 1. general administration costs for which reimbursement is not specified in the contract; 2. selling costs; 3. research and development costs for which reimbursement is not specified in the contract; and 4. depreciation of idle plant and equipment that is not used on a particular contract.

CONSTRUCTION CONTRACT

CHANGES IN ESTIMATES

- Application of percentage of completion on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs.
- Effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate.
- The changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.

WHEN A CONTRACT COVERS A NUMBER OF ASSETS, EACH CONTRACT SHOULD BE TREATED AS SEPARATE CONTRACT IF

- Separate proposals have been submitted for each asset.
- Each asset has been subject to separate negotiation and contractor are able to accept or reject that part of the contract relating to each asset.
- Costs and revenues of each asset can be identified.

CONSTRUCTION CONTRACT

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

- Group of contracts is negotiated as a single package.
- Contracts are performed concurrently or in a continuous sequence.
- Contracts are performed concurrently or in a continuous sequence.

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

CONSTRUCTION OF THE ADDITIONAL ASSET SHOULD BE TREATED AS A SEPARATE CONSTRUCTION CONTRACT WHEN	
• Asset differs significantly in design, technology or function from the asset or assets covered by the original contract	• Price of the asset is negotiated without regard to the original contract price

DISCLOSURES IN FINANCIAL STATEMENTS	
General	**Specific for contracts in progress**
Amount of contract revenue recognised as revenue in the period	Amount of advances received
Methods used to determine the stage of completion of contracts in progress	Amount of retentions

- **Retentions:** are the amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified

An enterprise should present gross amount for contract work in the financial statements

- **Due to customers** — **As an asset**
- **Due from customers** — **As a liability**

Particulars	Amount
Cost incurred	xxx
Plus : Recognized Profit	xxx
Plus : Recognized Losses	xxx
Less : Progress Billings	xxx
Total Amount	xxx

REVENUE RECOGNITION

Objective of AS 9

- **AS – 9** explain when the revenue should be recognised in profit and loss account and also state the circumstances in which revenue recognition can be postponed.
- It lays down criteria for recognition of revenue most suited to prepare of financial statement of enterprise engaged in varied activities.

Applicability

AS – 9 NOT Applies to

- Insurance Contract (Separate statute)
- Construction Contract (AS – 7)
- Hire - Purchase Agreement (AS – 19)
- Govt Grant and Subsidies (AS - 12)

Revenue

Gross inflow cash, receivable or other consideration arising in the course of ordinary activities from

- Sale of Goods
- Rendering of Service
- Use of the enterprise resources by others yielding interest, royalties and dividends

Revenue does not Include …

Revenue does not Include

Unrealised gains from

- ❖ Holding of non-current assets/ current assets,
- ❖ Natural increases in herds and agricultural or forest products, or
- ❖ Restatement of carrying amount of an obligation.

Realised gains from

- ❖ Disposal of Fixed assets
- ❖ Discharge of an obligation at less than carrying amount.
- ❖ Realised gains resulting from the disposal of non current assets.

Realised or Unrealised gains from

- ❖ Changes in foreign exchange rates and adjustments arising on translation of foreign currency financial statements.

Revenue from Sale of Goods

When to recognise the revenue from sale…

- Transfer of ownership of goods to buyer for a price
- Seller does not retain any effective control of ownership.
- No significant uncertainty in collection of the amount of consideration

Revenue Recognition when delivery of goods is subject to condition

Condition	Revenue Recognised
Delivery of goods delayed at buyers request	Revenue recognised immediately
Installation and Inspection	When the goods are installed at Buyer's Place to his satisfaction or goods are inspected and accepted by buyer.
Sale on approval	When the buyer confirms his desire to buy such goods by communication.
Guaranteed sales	As per the substance of the agreement of sale after the reasonable period has expired.
Warranty Sales	Sales should be recognised immediately but the provision should be made to cover unexpired warranty.
Consignment Sales	Only when the goods are sold to the third party.
Special Order or Shipment	When the goods are identified and are ready for delivery.
Subscription for publication	✓ Items delivered vary in value from period to period - On the basis of sale value of items delivered ✓ Items delivered do not vary in value from period to period - Treatment: Recognised on straight line basis over time
Installment sale	✓ Revenue of sale price excluding interest should be recognised on the date of sale & Interest is recognised proportionately to the unpaid balance

Special Cases

Sale to Intermediate Parties

Revenue from Sale to Intermediate Parties is recognised if **significant risks of ownership have passed**

Sale Repurchase Agreement

where seller agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash in flow is **not revenue**

Trade Discounts and Volume Rebates

Trade discounts and volume rebates given should be **deducted in determining revenue.**

Revenue Recognition from Services

Revenue from services is generally recognised as the service is performed.

When to recognise the revenue from Service

Completed Service contract Method

1. Recognition of revenue in the Statement of P&L only when the rendering services under a contract is completed or substantially completed.
2. Service become chargeable.
3. Performance consists of the executive of a single act.

Proportionate completion method

1.Recognition of revenue in the Statement of P&L Proportionately with the degree of completion of services under a contract.
2. Performance consists of the execution of more than one act.
3. Revenue is recognized proportionately as per performance of each act

Revenue Recognition norms for Rendering of service under special condition

Condition	Revenue Recognised
Installation fee	On completion of installation and accepted by the clients.
Advertising commission	When the advertisement appears before public.
Insurance agency commission	On effective commencement/renewal of the policies
Admission Fees	When event take place.
Tuition Fees	Revenue should be recognised over the period of instruction.
Entrance and Membership Fees	Entrance fees - capitalised and Membership Fees - Recognised on systematic and rational basis
Financial service commission	✓ Commission charged for arranging or granting loan and other facilities should be recognised when loan is sanctioned and accepted by borrower. ✓ Commitment facility or loan management fee which relates to continuing obligation or services should be recognised over the life of the loan

Revenue from enterprise resources

Revenue from interest

Revenue from Interest should be recognised on time proportion basis.

Revenue from royalties

On accrual basis as per the terms of the agreement.

Revenue from divided

When the declaring company declares the dividend.

Effect of Uncertainties on Revenue Recognition

If uncertainty exist then revenue recognition is postponed to next periods when this uncertainty will be over.

If uncertainty arises after the initial recognition of revenue then it will not be reversed, only appropriate provision to cover losses will be made.

Disclosures

When revenue recognition is postponed, the disclosure of the circumstances necessitating the postponement should be made.

Objective of AS 10

OBJECTIVES OF AS 10 (REVISED)

Prescribe "Accounting Treatment for PPE"

Help the User of Financial Statements to understand

- Information about Investment in PPE
- Changes in such Investment

Scope

✓ This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

Scope of Standard

This standard does not apply to:

- ✓ Biological assets related to agricultural activity other than bearer plants.
- ✓ Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources.

Definitions

- **PPE (Tangible Items)**
  - **Condition 1: Held for**
    - Use in Production or Supply of Goods or Services
    - For rental to others
    - For Administrative purposes
  - **Condition 2: Expected to be**
    - Used for more than 12 month

Recognition Criteria

The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

- ✓ it is probable that future economic benefits associated with the item will flow to the enterprise and
- ✓ Cost of the item can be measured reliably.

RECOGNITION OF SPARE PARTS AND STAND-BY EQUIPMENT

If the recognition criteria is met	**If recognition criteria is not satisfied**
Accounted as per AS 10 (Revised)	Accounted as per AS 2 'Valuation for Inventories'

Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

The cost of PPE includes;
Initial Cost: cost incurred initially to acquire or construct the PPE
Subsequent Cost: costs incurred subsequently to add to, replace part of, or service it.

COST OF AN ITEM OF PPE

Includes

- **Purchase Price**
- **Any Directly Attributable Costs**
- **Decommissioning, Restoration and similar Liabilities**

Any Directly Attributable Costs:

1. Costs of employee benefits (AS 15) arising directly from the construction or acquisition of the item of PPE
2. Costs of site preparation
3. Initial delivery and handling costs
4. Installation and assembly costs
5.Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment)
6. Professional fees

Excludes

1. Cost of opening a new facility or business (Such as, Inauguration costs)
2. Costs of introducing a new product or service (including coasts of advertising and promotional activities)
3. Costs of conducting business in a new location or with a new class of customer (including costs of staff training)
4. Administration and other general overhead costs

Self Constructed Assets

- Same principles as for an acquired asset.
- The cost of the asset is usually the same as the cost of constructing an asset for sale.
- Any internal profits are eliminated in arriving at such costs.
- The cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost
- Any borrowing cost which can be capitalized can be included in the cost of PPE.
- Bearer plants are accounted for in the same way as self-constructed items of PPE before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Measurement of cost

- If payment is deferred beyond normal credit terms:

Total payment minus Cash price equivalent

  - is recognised as an interest expense over the period of credit
  - unless such interest is capitalised in accordance with AS 16

- PPE acquired in Exchange for a Non-monetary Asset or Assets or A combination of Monetary and Non-monetary Assets:

Cost of such an item of PPE is measured at fair value unless:

  - Exchange transaction lacks commercial substance; Or
  - Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable

MEASUREMENT AFTER RECOGNITION

Cost Model

Cost- Any Accumulated Depreciation- Any Accumulated Impairment losses

Revaluation Model

Fair value at the date of the revaluation	XXX
Less: Any subsequent accumulated depreciation	(XXX)
Less: Any subsequent accumulated impairment losses	(XXX)
Carrying value	**XXX**

Revaluation

- If an item of PPE is revalued the entire class of PPE to which this asset belongs should be revalued.

Frequency of Revaluations

(Sufficient Regularity)

Items of PPE experience significant and volatile changes in Fair value

Annual revaluation should be done.

Items of PPE with only insignificant changes in Fair value

Revaluation should be done at an interval of 3 or 5 years

Accounting treatment Revaluation

REVALUATION

- **Increase**
  - Credited Directly to owner's interests under the heading of Revaluation surplus
  - Exception: When it is subsequently Increased (Initially Decreased)
    - Recognised in the statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of profit and loss
- **Decrease**
  - Charged to the statement of profit and loss
  - Exception: When it is subsequently Decreased (Initially Increased)
    - Decrease should be debited directly to owner's interests under the heading of Revaluation surplus to the extent of any credit balance existing in the Revaluation surplus in respect of that asset

DEPRECIATION

- Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Component cost approach is to be followed - i.e., Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.

Methods of Depreciation

- The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

METHODS OF DEPRECIATION

Straight line Method
Results in a constant charge over the useful life if the residual value of the asset does not change

Diminishing Balance Method
Results in a decreasing charge over the useful life

Units of Production Method
Results in a charge based on the excepted use or output

Review of Residual Value, Useful life & Method of Depreciation

- AS 10 (Revised) required that the residual value, useful life and method of depreciation used should be reviewed at least at each financial year.
- In case of method of depreciation, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.
- In case of residual value and useful life, , if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5.

Commencement of period for charging Depreciation

- Depreciation of an asset begins when it is available for use

Cessesation of Depreciation

1. Depreciation ceases to be charged when asset's residual value exceeds its carrying amount
2. Depreciation of an asset ceases at the earlier of:
    - The date that the asset is retired from active use and is held for disposal,and
    - The date that the asset is derecognised

IMPAIRMENT

An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

To determine whether an item of property, plant and equipment is impaired, an enterprise **applies AS 28, Impairment of Assets.**

Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable.

RETIREMENTS

- Items of PPE retired from active use and held for disposal should be stated at the lower of their carrying amount and net realisable value.
- Any write-down in this regard should be recognised immediately in the statement of profit and loss.

De-Recognition

The carrying amount of an item of PPE should be derecognised:

- On disposal
  - By sale
  - By entering into a finance lease, or
  - By donation, Or
- When no future economic benefits are expected from its use or disposal

Accounting Treatment:

- Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss.

Gain or loss arising from de-recognition of an item of PPE

= Net disposal proceeds (if any) - Carrying Amount of the item

Note: Gains should not be classified as revenue, as defined in AS 9 'Revenue Recognition'

Important Disclosure Requirements

The financial statements should disclose, for each class of property, plant and equipment:

- The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount.
- The depreciation methods used.
- The useful lives or the depreciation rates used.
- The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

A reconciliation of the carrying amount at the beginning and end of the period showing:

1. additions;
2. assets retired from active use and held for disposal;
3. acquisitions through business combinations ;
4. increases or decreases resulting from revaluations and from impairment losses recognised or reversed directly in revaluation surplus in accordance with AS 28;
5. impairment losses recognised in the statement of profit and loss in accordance with AS 28;
6. impairment losses reversed in the statement of profit and loss in accordance with AS 28;
7. depreciation;
8. the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and
9. other changes.

PROPERTY PLANT AND EQUIPMENT

The financial statements should also disclose:

the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

the amount of contractual commitments for the acquisition of property, plant and equipment;

if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and

the amount of assets retired from active use and held for disposal.

If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:

the effective date of the revaluation;

whether an independent valuer was involved;

the methods and significant assumptions applied in estimating fair values of the items;

the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm’s length terms or were estimated using other valuation techniques; and

the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Objective of AS 11

- ✓ To Prescribe the selection of exchange rate for foreign currency transaction and operations
- ✓ To Prescribe the treatment of effect of change in exchange rates.

Applies to…..

- In accounting for transaction in foreign currency.
- In translating the financial statement of foreign operations – Integral as well as non-integral.
- Forward exchange contracts.

Not Applies to…..

- Re- statement of enterprise financial statements from its reporting currency into another currency
- The presentation in cash flow statement
- Exchange differences arising from foreign currency borrowings to the extent of adjustment to interest cost.

THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATE

Important Definitions

Reporting Currency	Reporting currency is the currency used in presenting the financial statements.
Foreign Currency	Currency other than reporting Currency is called foreign currency
Exchange Rate	The rate at which foreign currency is converted into reporting currency or vice versa.
Average Rate	It is the mean of exchange rate in force during the period. Period may be week, fortnight, months, etc.
Forward Rate	Agreed Exchange rate between two parties for exchange of two currencies at a specified future date.
Closing Rate	Exchange rate at the balance sheet date.
Foreign Operations	Operational activities conducted in a country other than the country of the reporting enterprises by the reporting enterprises.
Monetary Items	Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amount of money. For example -cash, receivable and payable.
Non-Monetary Items	Non-monetary items are assets and liabilities other than monetary items. For example, fixed assets, inventories, and investment in equity shares.
Foreign Currency Transactions	Transactions denominated in a foreign currency or require settlement in foreign currency are called as Foreign Currency Transactions

THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATE

Transactions are classified as....

Foreign Currency Transactions

- ✓ Buying or selling the goods or services.
- ✓ Lending & borrowing in foreign currency.
- ✓ Acquisition & disposition of asset in foreign currency.

Foreign Operations

- ✓ Foreign branch
- ✓ An associate
- ✓ Joint venture
- ✓ Foreign subsidiary

Forward Exchange Contract

- ✓ For managing risk/hedging.
- ✓ For trading and speculation

Initial Recognition of Foreign Currency Transactions

- Alternatively average rate for a week or a month can be used if there is no significant fluctuation in the exchange rate.
- Transactions are recorded by applying an exchange rate between the reporting currency and the foreign currency at the date of transaction.

Valuation at the Balance Sheet Date

FOREIGN CURRENCY TRANSACTIONS

Monetary items

Monetary items are Debtors, Creditors, Cash, Loans etc.

These are converted at closing exchange difference rate.

i.e. exchange rates on balance sheet date.

There can be exchange fluctuation gain or loss, which is the difference of the closing exchange rate and exchange rate used for initial recognition.

Non-Monetary items

Items Carried at Historical Cost

Fixed assets, long term investments for which transactions are made in foreign currency are reported at the actual rate used for initial recognition.

Items Carried at Fair Value

Non-monetary items such as inventory , current investment for which transactions are made in foreign currency which are carried at fair value.

Generally fair value is determined at the balance sheet date. Therefore conversion is made using exchange rate of balance sheet date.

Treatment of Exchange difference

Reasons for exchange difference

Reported at different rate from the rate at which it is initially recorded.

Transactions are settled at a rate different from the one taken for the reporting in the last financial statement

Transaction, monetary or non-monetary item being settled at a rate different from the rate at which it is initially recorded

Accounting Treatment of Contingent Liability

Contingent Liability

These liabilities are reported at the exchange rate of the balance sheet date.

THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATE

FOREIGN CURRENCY TRANSACTIONS

Integral Foreign Operations

A foreign operation which are carried out as if it were extension of the reporting enterprise.

Activities

- Dependent Branches
- Sales Depot
- Foreign arm which produces raw material and transfers it to head office
- Foreign operations only raises finance to help reporting enterprise

Translation of accounts

Transactions of foreign branch are translated as if all these transactions had been entered into by the reporting enterprise.

Non- Integral Foreign Operations

The operations which are not "integral foreign operations"

- ✓ Foreign operation activities are carried independently.
- ✓ Transactions with the reporting enterprise are not a high proportion of the foreign operation's activities.
- ✓ The activities of the foreign operation are financed mainly from its own operations or local borrowings.
- ✓ Costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency.
- ✓ The foreign operation's sales are mainly in currencies other than the reporting currency.
- ✓ Cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation.
- ✓ There is an active local sales market for the foreign operation's products.
- ✓ Sales prices for the foreign operation's products are not responsive to changes in exchange rates.

Translation of Financial Statement Non Integral Foreign

- The assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the closing rate;
- Income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions, and
- All resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.

Translation of accounts of Non-Integral Foreign operations

Non-Integral Foreign Operations

- **Balance sheet item**
  - For both Monetary and Non-monetary items – Apply closing rates
- **Items of incomes and Expenses**
  - Actual Exchange rate on the date of transactions
- **Resulting Exchange difference**
  - Accumulated in a "Foreign Currency Translation Reserve" until the disposal of "net investment in non-integral foreign operations"
- **Contingent Liability**
  - At closing rate

Disposal of non-integral foreign operations

Disposal includes:

- Sales ,Liquidation
- Repayment of its share capital by non-integral foreign operation
- Abandonment of all or part of the foreign operation by reporting enterprise
- Payment of dividend by the non-integral foreign operation if it is treated as return on investment by the reporting enterprise.

Treatment of foreign currency translation reserve:

- On partial disposal, proportionate foreign currency translation reserve is recognized as income or expenses.
- On full disposal, whole foreign currency translation reserve is recognized as income or expenses.

Consolidation Procedure

when non-integral foreign subsidiary is consolidated with the reporting enterprise

- ✓ Goodwill/capital reserve arising on the acquisition, as a result of consolidation is translated using closing rate.
- ✓ Intra-group transactions are eliminated as per AS-21 and AS-27.
- ✓ Exchange difference arising on intra-group monetary item - recognize as income or expense in consolidated financial statements. If exchange difference arising on monetary items that in substance form part of net investment in non-integral foreign operation, it should be accumulated in currency translation reserve.

Change in Classification

Change in classification from....

Integral to Non-integral

- ✓ Translation procedure applicable to non-integral shall be followed from the date of change.
- ✓ Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.

From non-integral to integral

- ✓ Translation procedure as applicable to integral should be applied from the date of change.
- ✓ Translated amount of non-monetary items at the date of change is treated as historical cost.
- ✓ Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

Forward Exchange Contract

A forward contract is an agreement between two parties whereby one parties agrees to buy from or sell to the other party an asset at future date for an agreed price. **In case of foreign exchange contract the assets is foreign currency.**

Accounting Treatment of Forward Exchange Contract

Forward Exchange contract entered for Managing Risk/hedging

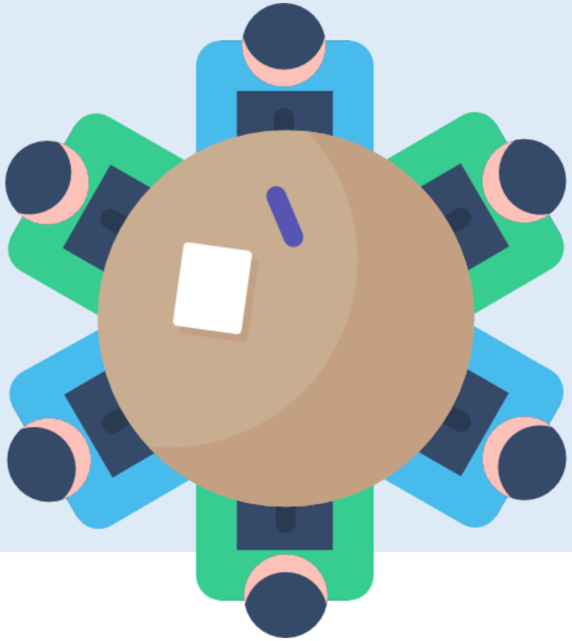
- **The premium or discount that arises on entering into the contract is measured by the difference between the exchange rate at the date of the inception of the forward**
- **If forward exchange contract is cancelled/renewed the profit or loss arising on cancellation/ renewal is recognised in P & L a/c for the period.**
- **To minimize the risk due to fluctuation in exchange on the date of the settlement of the transaction is the contract for managing the risk.**

Forward Exchange contract entered for Trading/speculation

To earn profit by trading or speculation in foreign exchange.
As per the accounting standard premium or discount on such forward contract is not to be recognized, in other words, is to be ignored.
At each balance sheet date the value of contract is marked, so its current market value, gains or loss on the contract is recognized.

Disclosure

- An enterprise should disclose-
- Amount of exchange difference included in the net *profit* or loss.
- Amount accumulated in foreign exchange translation reserve.
- Reconciliation of opening and closing balance of foreign exchange translation reserve.
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- **A change in classification of signification of foreign operation needs following disclosures-**
  - Nature of change in classification
  - The reason for the change
  - Effect of such change on shareholders fund
  - Impact on change in net profit or loss for each prior period presented
  - The disclosure is also encouraged of an enterprise's foreign currency risk management policy.



Objective of AS 12

- To provide the guidelines for classification of Government Grant
- To prescribe the accounting treatment of Government Grant

Government Grant

✓ It is assistance by the government in the form of cash / kind to an enterprise in return for past or future compliance with certain condition.

AS – 12 does not apply to

- **Government assistance** → Which cannot be measured reasonably i.e. Tax holiday, Tax exemption.
- **Government participation** → Investment by Government as equity in the enterprise

ACCOUNTING FOR GOVERNMENT GRANTS

Analysis

Nature of Incentive

Capital Approach

If incentive is in nature of promoter's contribution

Capital Subsidy

Income Approach

If related to revenue

Credited to P&L

sales-tax exemption available to the unit is not an assistance in cash or kind and is therefore not a government grant

Recognition of Government Grant

Government grant recognised only when…

The enterprise will comply with the condition attached to them

The grants will be received

Only receipt of grant is not conclusive evidence that condition attaching to the grant have been or will be fulfilled.

ACCOUNTING FOR GOVERNMENT GRANTS

Approaches

Capital Approach

Grant is treated as part of shareholder fund

- They are given with reference to the total investment in an undertaking, or
- By way of contribution towards its total capital outlay and
- No repayment is ordinarily expected in the case of such grants.
- Since they are not earned but represent an incentive provided by government without related costs.

Income Approach

Grant is taken as income for one or more period

- Grant are given subject to compliance of condition and cost is incurred to fulfill such condition hence grant is credited to income statement along with associated cost.
- In case grants are credited to shareholders' funds, no correlation is done between the accounting treatment of the grant and the accounting treatment of the expenditure to which the grant relates.

Accounting of grant should be on the basis of nature of relevant grant.

Grant having characteristic of promoter should be transferred to shareholder fund.

Other grants are transferred to income statement.

Monetary and Non Monetary Grant

Accounting treatment of government grants

- **Monetary Grant**
  - **Capital approach**
    - Grant treated as part of share holders fund Grant is credited to capital reserve
  - **Income approach**
    - Treated as income over one or more years i.e. treated as deferred income, Credited to P & L a/c or deducted from related expenses
- **Non-Monetary Grant**
  - **Concessional Rate**
    - Assets are accounted for at their acquisition cost
  - **Free of cost**
    - Assets are recorded at nominal value

Grant related to Specific Fixed Assets

Grant related to Specific Fixed Assets

Primary Conditions

- Purchase
- Construct or
- Otherwise acquire such assets.

Other Conditions

- Type of Asset
- Location of Assets
- Period during which they are acquired

Presentations in Financial Statements

Deductive Approach

- ✓ When the grant is lower than the cost of assets, then it is shown at reduction from the cost of such assets.
- ✓ When grant is equal to the value of assets then it is shown at Nominal Value.

Deferred Income Approach

- ✓ Type of assets
- ✓ Location of assets
- ✓ Period during which they are acquired on held

ACCOUNTING FOR GOVERNMENT GRANTS

Accounting Treatment

Grants related to specific fixed assets

Non-depreciable fixed assets

On fulfilment of Conditions - Credited to Capital Reserve a/c

If condition is yet to be fulfilled

- Grants are credited to income over the same period over which the cost of meeting such condition is charged to income.
- Un-apportioned deferred income is disclosed on the balance sheet as "Deferred Government Grant"

Depreciable fixed assets

Alternative 1

- Grant credited to asset a/c and reduce net book value
- Provide depreciation on net book value
- If grant equals the whole or virtually the whole of the assets, record the assets at its nominal value.

Alternative 2

- Grant treated as deferred income.
- Provide depreciation on carrying amount of fixed assets
- Transfer deferred income to P & L a/c at the same proportion as depreciable bears to depreciation amount.

Presentation of Grant Related to Revenue

- Grant Related to Revenue
  - Presented as a credit in the profit and loss statement
    - Separately
    - Under General Heading like Other Income
  - Grant is deducted in reporting the related expenses

Refund of Government Grants

❖ Government grant become refundable due to **non-fulfilment of condition** attached to the grant.

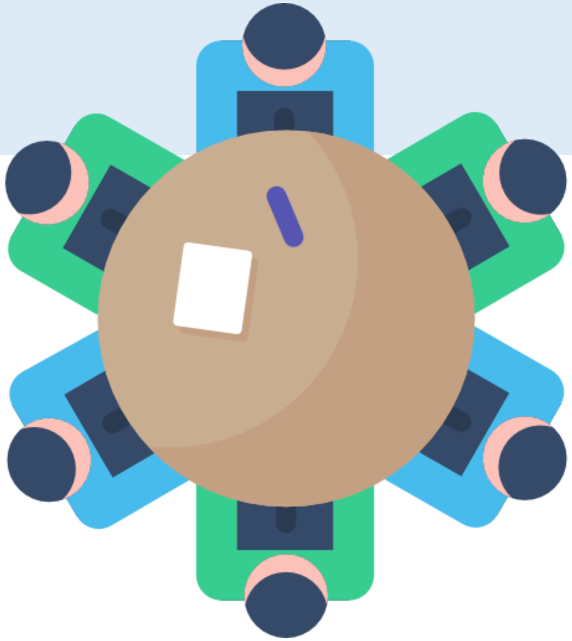
❖ A government grant that become refundable is treated as **an extraordinary item under AS 5.**

Refund of government grant

- **Related to revenue**
  - ✓ The amount of refund be adjusted against any unamortised "deferred government grant",
  - ✓ Remaining balance amount of refund should be charged to P & L a/c as extraordinary item.
- **Related to specific fixed asset**
  - **When the grant was received**
    - **It is deducted from gross value of assets**
      - ✓ Refund should be recorded by increasing the book value of the asset
      - ✓ Depreciation on the revised book value should be provided prospectively over the residual useful life of asset
    - **It is treated as deferred income**
      - Refundable amount should be adjusted with unamortised deferred income.
    - **It is credited to capital reserve**
      - Refundable amount should be adjusted with the capital reserve.

Disclosures

- The accounting policy adopted for government grants including the method of presentation in the financial statement.
- The nature and extent of government grant recognised in the financial statement including grants of non-monetary assets given at a concessional rate or free of cost.



Accounting Standard - 13

ACCOUNTING FOR INVESTMENTS

Objective of AS 13

- Every organization makes some investments either for short duration or long term purpose.
- It is very important component of balance sheet
- Income on it shall be correctly recorded to have correct calculation of profit.

- **Assets held as a stock in trade is not Investment.**
- **Shares, debentures and other securities held as stock in trade, are accounted for & disclosed in Financial Statement in a manner that is applicable to Current Investments.**

- **Investments are asset held by enterprise for earning income by the way of Dividend, Interest, Rental, Capital Appreciation, for Other Benefits**

Accounting Standard - 13

ACCOUNTING FOR INVESTMENTS

Applicability

Not applies to

- Mutual funds, venture capital fund and/ or the related asset management companies, banks and public financial Institutions (Guidance note by ICAI)
- The basis for Recognition of Interest, dividend & rentals earned on Investment (AS – 9)
- Operating or finance Leases (AS – 19)
- Investment of Retirement benefit plans and life insurance enterprise (AS - 15)

Classification of Investment

Current Investment

- Readily realisable
- Intended to be held **for not more than one year**

Long term Investment

Investment **other than current investment**

Investment Property

Investment in land or building that is not intended to be occupied **for use in their operation** → Valued at cost as per **AS 10**

ACCOUNTING FOR INVESTMENTS

Cost of Investment = Purchase Price + Acquisition charges

Brokerage, Fees & Duties payable

Finance & Borrowing cost is part of cost of Investment Property subject to AS 16

Other Important Point

Investment acquired in exchange of another asset

Cost of Investment = Fair value of asset given up or fair value of investment acquired whichever is more clearly evident

Investment acquired by issue of shares or other securities

Cost of Investment = Fair value of securities issued

Pre-acquisition interest

Interest accrued in pre-acquisition period & was included in cost of investment at the time of acquisition (cum – interest price) then subsequent receipt of such pre acquisition interest is deducted from the cost of Investment

Dividend

Dividend declared from Pre- acquisition profits & Later on received by the purchaser of investment, then such amount of dividend is deducted from The cost of investment

ACCOUNTING FOR INVESTMENTS

Carrying Amount of Investments

Current Investment

Carried at lower of

- Cost
- Fair Value

Determined on individual basis or by category of investment

1. Reduction in realisable value - Dr. to P & L A/c
2. Increase in realisable value – Upto Cost of investment - Cr. to P & L A/c & excess portion ignored.

Long Term Investment

At cost

Provision for permanent diminution shall be made to recognize the decline, other than temporary.

- ✓ Usually valued at cost
- ✓ Temporary increase / decrease in value of investment is not recognised
- ✓ Permanent change in value is charged /credited to P & L a/c

Right Shares Issue

Right Shares Issue

- **Right share Offered are subscribed**
  - Cost of right shares is added to the carrying amount of investment
- **Right share Offered are not subscribed but right sold In the market**
  - Original shares on which right is received is not acquired at cum- right
    - Sale proceed credited to P & L A/c
  - Original shares on which right is received is acquired at cum- right
    - Cost of investment is reduced by the amount received on sale of rights

Earning From Investments

- ✓ Interest and dividends on investment are to be treated as income.
- ✓ when the purchase is made on cum-interest or cum-dividend terms, interest or dividend received need to be allocated between capital and revenue as appropriate.

Disposal of Investment

Disposal of Investment

Complete investment is disposed

Difference between carrying amount & net sale proceed is recognised in Profit & Loss Account

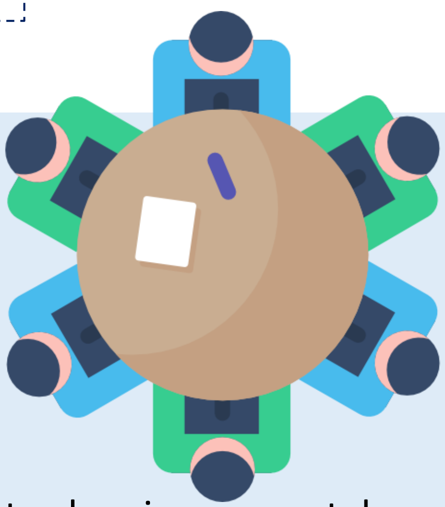
Only part of total investment is disposal off

- ✓ Calculate carrying amount of part of investment
- ✓ Difference in Carrying amount & net sale proceed is recognised in P & L a/c

Reclassification

Long term to current	Current to Long term
Take date of transfer as base	Take date of transfer as base
Determine carrying amount on such date	Determine fair value on such date
Determine cost	Determine cost
Apply lower of cost & carrying amount	Apply lower of cost & fair value

Disclosure



The following information should be disclosed in the financial statements:

(a) the accounting policies for determination of carrying amount of investments;

(b) classification of investments.

(c) the amounts included in profit and loss statement for:

(i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;

(ii) profits and losses on disposal of **current investments** and changes in the carrying amount of such investments; and

(iii) profits and losses on disposal of **long term investments** and changes in the carrying amount of such investments;

(d) significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;

(e) other disclosures as specifically required by the relevant statute governing the enterprise.

Accounting Standard - 14

Accounting for Amalgamation

Introduction

In order to obtain economies of large scale production or to take advantages of monopolistic or near monopolistic conditions, combination takes place either in the form of

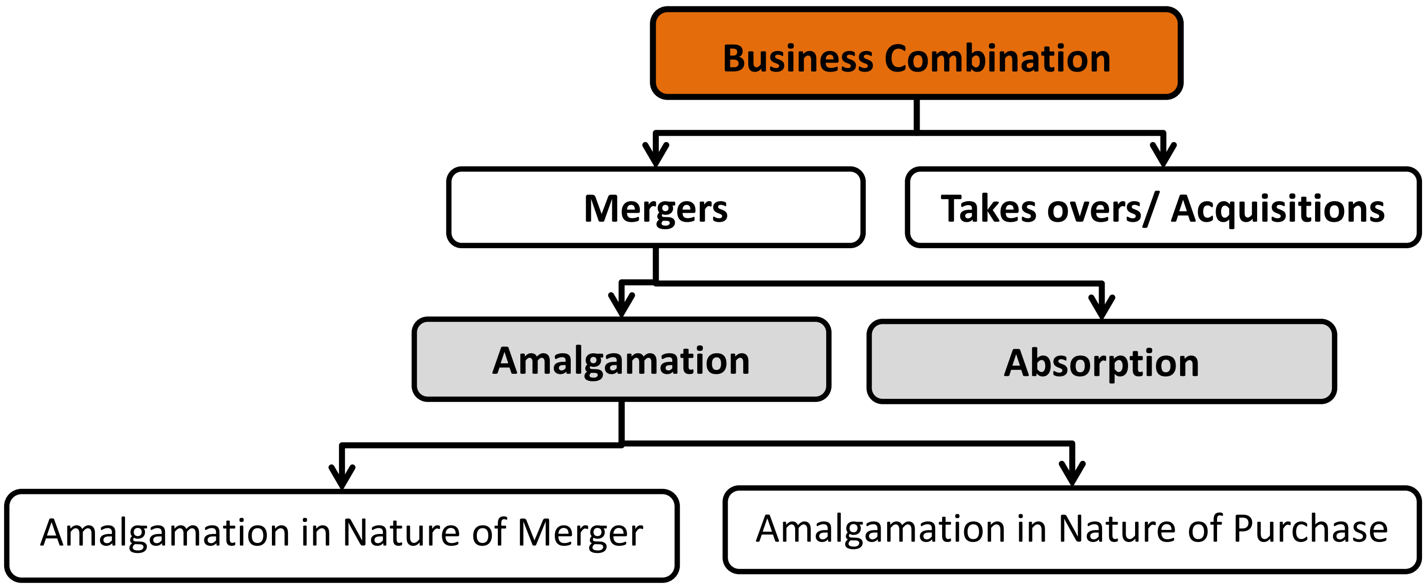
- ✓ Holding company device or merger, or
- ✓ Absorption or Amalgamation.

Section 232 of the Companies Act 2013, facilitates amalgamation, absorption and external reconstruction

Objectives of Amalgamation

- ✓ Shareholders value creation
- ✓ Synergies of operating economies
- ✓ Diversifications of business
- ✓ Taxation benefits
- ✓ To create competitive advantages
- ✓ Compulsory or regulatory reasons
- ✓ Geographical expansion
- ✓ Survival option

Types of Business Combination



Types of Amalgamation

Amalgamation in Nature of Merger

There is a genuine pooling

- not merely of the assets and liabilities of the amalgamated companies
- but also of the shareholders' interest and of the businesses of these companies

AS 14 provides five conditions. Aamalgamation shall be treated as amalgamation in nature of Merger if all five conditions are satisfied.

Amalgamation in Nature of Purchase

- Mode by which one company acquires another company .
- The shareholders of the company which is acquired normally do not have a proportionate share in the equity of the combined company.
- The business of the company which is acquired is not intended to be continued.

If any of the conditions attaching to Merger are not satisfied, then it is a case of amalgamation in nature of purchase.

Conditions To Be Fulfilled In Case Of "Amalgamation In The Nature Of Merger

- All the assets and liabilities of the transferor company become the assets & liabilities of the transferee company & they are incorporated in the financial statements of the Transferee Company at ***book values*** except to ensure uniform accounting policies.

- Shareholders of Transferor Company holding not less than 90% of the "face value" of equity shares becomes the shareholders of Transferee Company by virtue of amalgamation.

- The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

- The business of the Transferor Company is intended to be carried on, after the amalgamation, by the Transferee Company.

Distinguish between Amalgamation & Absorption

	Amalgamation (does not cover acquisition)	Absorption
1	Status of a separate legal entity of two or more entities vanishes – a new entity emerge	Status of a separate legal entity of one or more entity vanishes – one existing entity takes over
2	If X Ltd. and Y Ltd. are liquidated and a newly formed Company Z Ltd. acquires the two businesses, it is termed as amalgamation.	If X Ltd. is taken over by Y Ltd. it is referred to as 'absorption'. Here there is no formation of a new entity, but there are one or more liquidations.
3	X Ltd. and Y Ltd. are transferors, Z Ltd. is transferee	X Ltd. Is transferor; Y Ltd. is transferee.

Methods of Accounting

Method of Accounting

- Amalgamation in Nature of Merger
  - Pooling of Interest Method
- Amalgamation in Nature of Purchase
  - Purchase Method

No	Amalgamation in the nature of merger	Amalgamation in the nature of Purchase
	Pooling of Interest Method	Purchase Method
1	All assets and liabilities of transferor co. should be recorded at their existing carrying amount	All or some assets and liabilities of transferor are taken over and accounted at Book value or at fair value.
2	All reserves of transferor co. should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation.	Only statutory reserves of transferor co. should be recorded by debiting Amalgamation Adjustment A/c Statutory Reserves will be shown in Reserves & Surplus.
3	The difference between Purchase consideration and the amount of share capital of the transferor company should be adjusted in reserves	The difference between Purchase consideration & the Net Assets should be adjusted in Goodwill or Capital Reserves. If PC > Net assets, Debit Goodwill If PC< Net assets, Credit Capital Reserve
4	No goodwill will arise out of Amalgamation in the nature of merger	Goodwill arising on Amalgamation should be amortised over a period not exceeding 5 years, unless a longer period can be justified
5	Following items are adjusted against Reserves ➢ Provision for unrealised profit on stock held ➢ Liquidation expenses to be borne by transferee company	Following items are adjusted against Goodwill or Capital Reserves ➢ Provision for unrealised profit on stock held ➢ Liquidation expenses to be borne by transferee company

Purchase Consideration

The consideration paid for the purpose of amalgamation is termed as Purchase Consideration (PC). AS 14 on Accounting for Amalgamations defines the term 'consideration' as 'the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Consideration may be in the form of
- Securities
- Cash
- Other Assets

Debenture holders are outsiders. Thus Consideration for debenture holder will not form part of Purchase Consideration.

Purchase Consideration

Net Payment Method

Aggregate of Assets taken over at fair values Less Liabilities taken over at agreed amounts

Net Asset Method
On the basis of valuation of assets and liabilities taken over

Aggregate consideration paid to Shareholders (Equity and Preference) in various form (Shares, securities and cash)

Net Payment Method

Under this method Purchase Consideration is the added sum of the considerations agreed to be given to shareholders.

Calculation of Purchase Consideration

No.	Particulars	Details	Amount
1	For Equity Share holders		
2	For Preference Share holders		
	Total Purchase Consideration		

Net Asset Method

PC = Assets taken over at Agreed Value - Liabilities Taken over at Agreed Value

No.	Particulars	Remark
1	Assets	Only agreed value of the assets of the vendor company should be added.
2	Fictitious assets	Fictitious assets, Expenditure to be written off, Profit and Loss A/c debit balance, Preliminary expenses, Discount or Commission on issue of shares and debentures will not be taken into consideration for computation of assets taken over.
3	Liabilities	Only agreed value of those liabilities which are assumed by the purchasing company are to be deducted.
4	Undistributed profits and Reserves	Undistributed profits like Credit balance of Profit and Loss Account, General Reserve, Reserve Fund, Securities Premium Account, Sinking Fund and Capital Reserve A/c are not to be deducted.
5	Cash	Include cash when cash is taken over by the purchasing company.
6	Staff Provident Fund, Employees Profit Sharing Fund etc,	Staff Provident Fund, Employees Profit Sharing Fund and other liabilities to employees of the company are treated as liabilities to outsiders.

Accounting Entries: Books of Transferor Company

Transfer of books value of the assets

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
1	Realisation A/c	Dr		xxx	
	To sundry assets (Individually)				xxx

Transfer of liabilities / provision

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
2	Sundry liabilities / provision A/c (Individually)	Dr		xxx	
	To Realisation A/c				xxx

Transfer of amount due to preference shareholders

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
3	Preference Share Capital A/c	Dr		xxx	
	Realisation A/c (Arrears of dividend/ premium payable)	Dr		xxx	
	To Preference shareholders A/c				xxx

Transfer of Equity Share Capital, Reserves and surplus balances

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
4	Equity Share Capital A/c	Dr		xxx	
	Reserves A/ (Individually)	Dr		xxx	
	Profit and Loss A/c	Dr		xxx	
	To Equity Shareholders A/c				xxx

Transfer of liabilities / provision

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
5	a) Transfer of amount due to debenture holders				
	b) Debenture holders liability taken over by transferee company				
	Debentures A/c	Dr		xx	
	Realisation A/c (Premium payable on redemption)	Dr		xxx	
	To Debenture holders A/c				xxx
	Debenture holders A/c	Dr		xxx	
	To Realisation A/c				xxx
	OR				
	Debentures A/c	Dr		xxx	
	To Realisation A/c (face value transferred)				xxx

Transfer of fictitious assets, write offs, accumulated losses etc.

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
6	Equity shareholders A/c	Dr		xxx	
	To Profit and Loss A/c				xxx
	To Discount on Issue of shares A/c				xxx
	To Preliminary Expenses A/c				xxx
	To Other Accounts (Individually)				xxx

Purchase Consideration due

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
7	Transferee Company's A/c	Dr		xxx	
	To Realisation A/c				Xxx

Discharge of Purchase Consideration

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
8	Cash / Bank A/c	Dr		xxx	
	Equity shares in Transferee Company A/c	Dr		xxx	
	Preference shares in Transferee Company A/c	Dr		xxx	
	To Transferee Company's A/c				xxx

Disposal of assets not taken over by the Transferee Company.

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
9	Cash / Bank A/c	Dr		xxx	
	To Realisation A/c				Xxx

Liquidation Expenses

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
10	Realisation A/c	Dr		xxx	
	To Cash / Bank A/c				Xxx

Transfer of profit or loss on realisation Profit Loss

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
11	Realisation A/c	Dr		xxx	
	To Bank A/c				Xxx

Settlement of Debenture holders dues (Debentures not taken over by Transferee Company)

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
12	Realisation A/c	Dr		xxx	
	To Cash / Bank A/c	Dr			xxx

Settlement of preference shareholders dues

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
13	Preference shareholders A/c	Dr		xxx	
	To Preference Shares in Transferee Com. A/c				Xxx
	To Equity Shares in Transferee Com. A/c				xxx

Transfer of profit or loss on realisation Profit Loss

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
14	Realisation A/c	Dr		xxx	
	To Equity shareholders A/c				Xxx
	Equity shareholders A/c	Dr		xxx	
	To Realisation A/c				xxx

Settlement of Equity shareholders accounts (dividend under liquidation)

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
15	Equity shareholders A/c	Dr		xxx	
	To Cash / Bank A/c				xxx
	To Equity shares in Transferee Company				xxx
	To Pref. shares in Transferee company				xxx
	To Debentures in Transferee company				xxx

- ✓ If Cash and Bank balances are not taken over by the transferee company, the cash and bank balance should not be transferred to Realisation Account.
- ✓ The term' Assets' does not include expenses and losses appearing in the balance sheet not yet written off. The assets however include prepaid expenses.
- ✓ Transfer debtors and creditors to Realisation Account with gross sum. Provision for Bad and Doubtful debts or provision for discounts are separate accounts and hence should be separately transferred to realisation account. Similar treatment is also required for Gross Fixed Assets and Accumulated Depreciation thereon.
- ✓ When the transferor company bears the liquidation expenses, Realisation Account is debited. However, if the expenses are to be borne by transferee company, the payment of expenses may be made directly by the transferee company or transferor company will get the expenses reimbursed from transferee company.

Accounting Entries in the Books of Transferee Company

Purchase of business

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
1	Business Purchase A/c	Dr		xxx	
	To Liquidator of Transferor Company A/c				xxx

Recording of assets and Liabilities

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
2	a) Purchase Method [Assets and Liabilities. at fair value]	Dr		xxx	
	Respective assets A/c (Fair Value)	Dr		xxx	
	Goodwill A/c (Balancing Fig.)				
	To Respective Liability A/c (Fair Value)				xxx
	To Business Purchase A/c				xxx
	To Capital Reserve A/c (Balancing Fig.)				xxx
	b) Pooling of Interest Method				
	Respective Asset A/c (Book Value)	Dr			
	Reserve A/c *	Dr			
	To Respective Liability A/c (Book Value)				xxx
	To Respective Reserve A/c (Book Value)				xxx
	To Business Purchase A/c				xxx
	To Reserve A/c #				xxx

* Difference between purchase consideration and paid up capital of Transferor Company.
# Difference between paid up capital of transferor company and purchase consideration.

Discharge of purchase consideration

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
3	Liquidator of Transferor Company A/c	Dr		xxx	
	Discount on issue of shares A/c	Dr		xxx	
	To Cash / Bank A/c				xxx
	To Equity Share Capital A/c				xxx
	To Preference Share Capital A/c				xxx
	To Debentures A/c				xxx
	To Securities Premium A/c				xxx

Liquidation Expenses (if to be borne by transferee company)

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
4	a) paid by Transferee Company				
	Goodwill and I or Capital Reserve A/c	Dr		xxx	
	Reserve A/c	Dr		xxx	
	To Cash / Bank A/c				xxx
	b) paid by Transferor Company				
	Goodwill and I or Capital Reserve A/c			xxx	
	To Liquidator of Transferor Company A/c				xxx

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
	Reserve A/c	Dr		xxx	
	Liquidator of Transferor Company A/c	Dr		xxx	
	To Cash / Bank A/c				xxx

Statutory Reserves of Transferor Company to be recorded in the books of Transferee Company under purchase method

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
5	Amalgamation Adjustment A/c	Dr.		xxx	
	To Respective Statutory Reserve A/c				xxx

Provision for unrealised profit on stock held out of inter-company purchases

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
6	a) Pooling Interest Method:				
	Revenue Reserves / Profit and Loss A/c	Dr		xxx	
	To Stock Account				xxx
	b) Purchase Method:				
	Goodwill and /or Capital Reserve A/c	Dr		xxx	
	To Stock Account				xxx

Inter - Company Owings

Sundry Debtors - Sundry Creditors

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
1	Sundry Creditors A/c.	Dr		xxx	
	To Sundry Debtors A/c.				xxx

Bills Receivable – Bills Payable

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
2	Bills Payable A/c.	Dr.		xxx	
	To Bills Receivable A/c.				xxx

Current Accounts

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
3	Current A/c. (Credit balance)	Dr		xxx	
	To Current A/c. (Debit balance)				xxx

Intern Company loans

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
4	Loan Received A/c.	Dr		xxx	
	To Loan Given A/c.				xxx

Interest receivable – Interest payable

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
5	Interest Payable A/c.	Dr		xxx	
	To Interest Receivable A/c.				xxx

In the books of transferee company

For elimination of inter-company dues, an asset of one company is set-off against a liability of another

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
1	Respective Liability A/c	Dr		xxx	
	To Respective Asset A/c				xxx

Provision for unrealised profit on stock held out of inter-company purchases

Pooling Interest Method

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
1	Profit and Loss A/c / Revenue Reserves A/c	Dr		xxx	
	To Stock Account				xxx

Purchase Method

No.	Particulars		LF	(Dr.) Rs	(Cr.) Rs
1	Goodwill and/or Capital Reserve A/c	Dr		xxx	
	To Stock Account				xxx

Disclosure

In first financial statement of transfer company the following disclosure for all amalgamation should be made:

- Names and general nature of business of amalgamation companies
- Effective date of amalgamation
- Method of accounting used.
- Particulars of scheme sectioned under a statue.

Amalgamation accounted under pooling interest method-

- Method of accounting used.
- Particulars of scheme sectioned under a statue.

Amalgamation accounted under purchase method-

- consideration for the amalgamation.
- difference between consideration and net asset acquired and treatment thereof including period of amortization of goodwill.

Objective of AS 16

- Appreciate the basis for recognising borrowing costs
- Identify the nature of specific and general borrowings, & treatment of related borrowing costs
- Ensure when to Commence capitalisation, Suspend capitalisation, Cease capitalisation

Applicability

Not Applicable to

- Actual cost of owners' equity - including preference share capital and
- Imputed cost of such equity
- And such other items forming part of equity and not classified as a liability

BORROWING COST

Borrowing cost

Money borrowed by enterprise for

- Purchasing fixed asset
- Acquiring land
- Working capital
- Constructing Building

These assets take time to make them useable or saleable.
Enterprise incur cost on borrowing i.e. interest and other cost
Standard deals with accounting of borrowing cost.

Interest + **Other cost** = **Borrowing cost**

Other cost include –

- ✓ Commitment charges on borrowing.
- ✓ Amortization of discounts or provision relating to borrowing.
- ✓ Amortization of ancillary costs incurred in connection with arrangement of borrower.
- ✓ Finance charges when the asset acquired under finance leases.
- ✓ Exchange difference arising from foreign currency borrowing to the extent that they are regarded as an adjustment to interest costs.
- ✓ Amortisation means dividation of total ancillary expenses in the ratio of usage amount.

BORROWING COST

Qualifying Asset

QA is an asset which takes substantial period of time to get ready for its
- ✓ intended use (Fixed assets or investment properties) or
- ✓ sale (Inventory)

Examples

- **Any tangible fixed assets, which are in construction process or acquired tangible fixed assets, which are not ready for use or resale, such as plant and machinery.**
- **Any intangible assets, which are in development phase or acquired but not ready for use or resale, such as patent.**
- **Investment property.**
- **Inventories that require a substantial period to bring them to a saleable value.**

✓ Substantial Period of Time is the period of 12 month.

Longer or shorter period may also be justified based on the circumstances of the case

Following is not a QA
- **Inventories routinely manufactured**
- **Inventories produced in large quantities on repetitive basis**
- **Assets ready for intended use at the time of acquisition**

Accounting treatment of Borrowing cost

As per AS – 16, borrowing cost, which is directly related to the acquisition, construction or production of qualifying asset should be capitalized.

Capitalization of borrowing cost

- Borrowing cost directly attributable to the acquisition, construction/Production of qualifying asset
- Borrowing cost would have been avoided if the expenditure on qualifying asset had not been made
- Qualifying asset will give future benefit to enterprise.
- Cost to be capitalised can be measured reliably.

- **If any of the above conditions does not satisfy then it is charged to P & L A/c**
- **If all the conditions are satisfied, Capitalise the Borrowing cost.**

Types of Borrowing

Types of Borrowing

- **Specific Borrowing**
  - Borrowed specifically for expenditure on qualifying asset.
  - Amount of borrowing cost to be capitalised = Actual borrowing cost – income on temporary investment
- **General Borrowing**
  - Borrowing is wholly or partly for expenditure incurred on qualifying asset
  - Borrowing cost to be capitalised = Apply capitalisation rate to the expenditure on that asset

    Capitalisation rate = Weighted average of borrowing cost

Borrowing cost capitalised should not exceed actual cost incurred during the period.

When the carrying amount of qualifying assets exceeds its recoverable amount of NRV, the carrying amount is written down in accordance with requirement of other AS

Difference between Specific Borrowing and General Borrowing :

Specific Borrowing	General Borrowing
Money borrowed specifically for the purpose of obtaining a particular QA	A range of debt instruments are used to borrow funds at varying rate of interest and such borrowing are not readily identifiable with a specific QA.
BC on QA can be readily identified	BC on QA requires exercise of judgement.
Actual borrowing Cost xxx **(-) Income on temporary investment (xxx)** **Amount to be capitalized xxx**	• Calculate a weighted average borrowing rate. • Calculate the amount to be capitalized • Amount of BC capitalized during the period should not be more than actual BC.

Stages of Capitalization

- Commencement
- Suspension
- Cessation

Commencement of Capitalization

Conditions

- Activity should be in Progress
- Borrowing cost is incurred
- Expenditure for acquisition, construction or production of a qualifying asset is being incurred

Suspension of Capitalisation

Capitalization is suspended during extended period in which active development is interrupted

Delay

- Temporary or Normal → No suspension should be done.
- Not Temporary or Abnormal → Suspension should be made

Example : The extended period during which higher water levels delay construction of a bridge.

Expenditure on a qualifying asset includes:

- Expenditure that has resulted in payment of cash
- Transfers of other assets or the assumption of interest bearing liabilities.

Expenditure is reduced by:

- Any progress payments received and
- Grants received in connection with the asset.

Exception

Capitalization of borrowing cost is not suspended

- During a period when substantial technical and administrative work is being carried out
- When a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

  Example: Capitalization should continue during the extended period needed for inventories to mature, or the extended period during which high water levels delay the construction of a bridge.

Cessation of capitalization

✓ Capitalization of borrowing cost should cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale are completed.

✓ Items of administrative work or finishing touches to be completed happen to be minor in nature

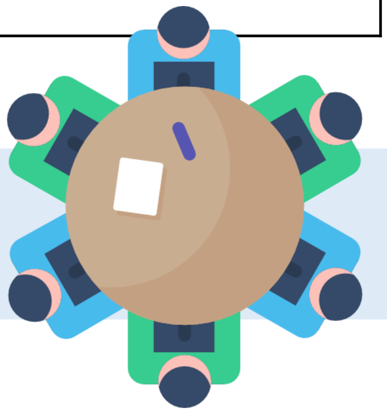
✓ Construction of the qualifying asset is carried out in parts / phase and each part / phase can be used independently, required activities are completed for such phase and it is ready for intended use or sale, capitalization of borrowing cost for such phase / part will cease.

Divisible and Indivisible Indivisible Projects : These situations are analysed below :

Particulars	Asset completed in parts (i.e. Divisible Projects)	Assets completed in full (i.e. Indivisible Projects)
(a)Description	When construction of a Qualifying Asset is completed in parts and a completed part is capable of being used while construction continues for the other parts.	When the Qualifying Assets consists of a number of parts which can be used only in total, i.e. a completed part cannot be used until construction of all parts is complete.
(b)Example	A Business Park comprising several buildings, each of which can be used individually, is a Qualifying Asset for which each part is capable of being used while construction continues for the other parts.	An Industrial Plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a Steel Mill, is a Qualifying Asset that needs to be complete in all respects before any part can be used.
(c)Cessation of Capitalisation	Capitalisation of Borrowing Costs in relation to a part should cease when substantially all the activities necessary to prepare that part of the asset for its intended use or sale are complete.	Capitalisation of Borrowing Costs should cease only when substantially all the activities necessary to complete the whole of the assets for its intended use or sale, is complete.

Disclosures

- The accounting policy adopted for borrowing cost.
- The amount of borrowing cost capitalised during the period.



Accounting Standard - 17 — SEGMENT REPORTING

Objective of AS 17

- Better understand the performance of the enterprise
- Better assess the risks, returns & future prospects of the enterprise
- Make more informed judgments about the enterprise as a whole

Scope

Lays down the principles for reporting financial information about -

- Different products or services an enterprise produces or renders
- Different Geographical areas in which it operates.

Applicability

This standard applies to the presentation of

- General purpose financial statements and Consolidated Financial Statements
- If a single financial report contains both Consolidated Financial Statements and separate Financial Statements of the parent, segment information need be presented only on the basis of Consolidated Financial Statements
- The compliance with this statement has to be total and is mandatory.

Business Segment

Business Segment (based on products and services it provides)

- Distinguishable component of an enterprise
- Engaged in providing an individual product or service or a group of related products or services
- Subject to risks and returns that are different from those of other business segments

Factors to be considered in identifying business segments include:

- The nature of the products or services;
- The nature of the production processes;
- The type or class of customers for the products or services;
- The methods used to distribute the products or provide the services; and
- If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

Geographical Segment

Geographical Segment

- **Distinguishable component of the enterprise**
- **engaged in providing products or services within a particular economic environment**
- **Subject to risks and returns that are different from those components operating in other economic environments**

It can be based on :

- Location of Customers (destination of sales)
- Location of Assets (point of sales)

Factors to be considered in identifying geographical segments include:

Similarity of economic and political conditions (Democracy Vs Miltary Rule)

Relationships between operations in different geographical areas

Proximity of operations (Guiding Factor to identify)

Special risks associated with operations in a particular area

Exchange control regulations (Partial Vs Fully Convertible Currency)

Underlying currency risks (Euro Vs Dollor)

Reportable Segment

- A business segment or geographical segment
- Identified on the basis of foregoing definitions
- For which segment information is required to be disclosed by this statement

Enterprise Revenue

- Revenue from sales to external customers as reported in the statement of profit and loss
- Intra-company sale (between divisions or units) is not regarded as revenue for purpose of financial reporting
- Enterprise revenue ignores in-house sales that represent revenue to one segment and expense to another

Segment Revenue

It means revenue of particular segment.

Includes	Excludes
• Direct revenue • Inter segment income • Allocated income of enterprise revenue	• Extra ordinary item (AS 5) • Interest / dividend income except they represent financial segment. • Gain on sale of investment or redemption of liability except segment information is financial in nature.

Segment Expenses

It represents expense of particular segment.

Includes	Excludes
• Expenses directly attributable • Expenses on transaction with other segment. • Allocated expenses of enterprise expenses.	• Extra ordinary item (AS 5) • Interest including interest on loan from other segment unless segment operation are of financial nature primarily. • Income Tax Expenses • Losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature. • General administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole.

Segment Assets

- Those assets that are employed by a segment in its operating activities and which are either directly attributable or can be allocated on reasonable basis.

Includes	Excludes
• If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets • Includes goodwill if that can be directly attributable to a segment, or if it can be attributed on reasonable basis.	• Income tax assets i.e. advance tax. • Corporate assets. (Assets used for general enterprise or head office purposes)

NOTE :
Segment assets are to be considered at amount net of provision or allowances.
Ex. : Fixed assets less depreciation debtor less provision etc.

Segment Liabilities

Those operating liabilities

- That result from the operating activities of a segment
- That either are directly attributable to the segment
- Can be allocated to the segment on a reasonable basis

Includes	Excludes
• Trade & Other payables • Accrued Liabilities • Customer Advances • Product Warranty Provision • Other Claims	• Provision for tax • Corporate level borrowing.

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

Segment Results

This denotes the difference between

- Segment Revenue
- Segment Expenses and

Represents the segment profit or loss

Segment Accounting Policies

Represent Accounting Policies used in

- Preparing & presenting the financial statements of the enterprise
- those accounting policies that relate specifically to segment reporting

Identification of Segment – Primary and Secondary

Process of Selection of Primary and Secondary Segment as follows:
Identification of "predominant source of risks and returns"
Enquiry into Internal organisation, management structure, system of internal reporting

Characteristics

Primary - Business Segment

If the risks and returns of an enterprise are affected predominantly by differences in the products and services it produces

Primary - Geographical Segment

if the risks and returns of the enterprise are by the fact that it operates in different countries or other geographical areas

Primary & Secondary Segments

Dominant	Primary	Secondary
Product and Services	Business	Geographical
Geographical Area	Geographical	Business
Both	Business & Geographical	
Not available	Business (assumed)	Geographical

It is important to identify primary and secondary segment because disclosure requirement is different.

Criteria for Reportable Segments

- Revenue Test
- Result Test
- Assets Test
- Management Choice
- The 75% Test

Previous Year Base

If a segment is reportable in previous year by Method – 1 but not in Current Year then it should be reported in current year.

Rule to be applied except for Method 2 and Method 3 :

Particulars	PV	CV	Treatment in Current Year	Treatment in Next Year
(i) Reportable on the basis of Method – 1	✓	X	Continue as reportable in current year	Ceases to be reported
(ii) Reportable on the Basis of Method – 1	X	✓	Restate previous year Information.	Report

Revenue Test

If a segment revenue is greater than or equal to 10% of total revenue of all segments, comprising both external and inter-segment sales - it is a reportable segment

Inter-unit sales will be reckoned for this test.

Result Test

Its segment result, whether 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

Assume that in a company there are eight divisions, three of which are loss making, and five profit making. For result test, 10% of total losses of three divisions (say X) and 10% of total profit of five divisions (say Y) will have to be considered for this test, and higher of X and Y will be taken as the base

Assets Test

If segment assets is greater than or equal to 10% of the total assets of all segments- it is a reportable segment

The total assets of all segments may not aggregate to total assets of the enterprise since there would be unallocated assets

Management Choice

Even if a segment does not meet any of these three tests, management may at its discretion name a segment as a reportable segment.

- new ventures with good future prospects or
- for ventures that carry high risk-return relationship

The 75% Test

If the external revenue of reportable segments is less than 75% of the enterprise revenue - more segments will be added until the 75% condition is met

This is a test check to ensure that only a small portion gets into reconciliation or non reporting component

Management Choice

- Revenue from external Customers.
- Revenue from transactions with other segments.
- Segment result
- Cost to acquire tangible and intangible fixed assets.
- Depreciation and amortization expenses.
- Carrying amount of segment assets.
- Segment liabilities.
- Non-cash expenses other than depreciation and amortization.
- Reconciliation of revenue, result, assets and liabilities.

Primary Disclosure

Primary Segment information to be disclosed by the entity

- Segment Revenue with external and external sales
- Segment Result
- Segment Assets
- Capital expenditure i.e. expenditure on purchase of fixed assets during year
- Segment Liability
- Depreciation on segment fixed assets
- Non-cash expenses except depreciation in case of fixed

NOTE :
Disclosure of segment depreciation and non-cash item is not required if the entity prepare cash flow of the segment.

SEGMENT REPORTING

Format of Primary Reporting

	A	B	C	Inter Segment Elimination	Total
(i) Segment Revenue					
External Sales	xxx	xxx	xxx		xxx
Internal Sale	xxx	xxx	xxx	(xxx)	—
Total	xxx	XXX	xxx		xxx
(ii) Segment Result	XXX	XXX	xxx	xxx	xxx
(+) Interest and dividend income					xxx
Extra ordinary item					xxx
(-) Interest exp.					(xxx)
(-) Administration exp.					(XXX)
(-)Tax					(xxx)
Profit after Tax					xxx
(iii) Segment Assets					
Fixed Assets	xxx	xxx	xxx		xxx
Working Capital	xxx	xxx	xxx		xxx
(+) Unallocated assets					xxx
Enterprise assets					xxx
(iv) Segment Liabiliites	xxx	xxx	xxx		xxx
(+) Unallocaed Liabilities					xxx
Enterprise Liabilities					xxx
(v) Capital expenditure	xxx	xxx	xxx		xxx
(vi) Depreciation	xxx	xxx	xxx		xxx
(vii) Non-cash expenditure	xxx	XXX	xxx		xxx

Secondary Segment Disclosure

Case A	Case B	Case C
Business Segment are primary (i) Disclosure 7 points for Business segment (i) Secondary (a) Segment Revenue of. Geographical segment by location of customer (b) Segment Assets of Geographical segment by location of assets (c) Segment capital expenditure of geographical segment by location of Assets.	Geographical segment based on location of customer are primary. (i) Disclosure 7 points for geographical segment by location of customer. (ii) Secondary (a) Segment Revenue of Business segment (b) Segment Assets of Business segment (c) Segment capital expenditure of Business segment (d) Segment Assets of geographical segment based on location of assets. (e) Segment Capital expenditure of geographical segment based on location of assets.	Geographical segment based on location of assets are primary. (i) Disclosure 7 points for geographical segment by location of assets. (ii) Secondary (a) Segment Revenue of Business segment (b) Segment Assets of Business segment (c) Segment capital expenditure of Business segment (d) Segment Revenue of geographical segment based on location of customer

Usefulness & Problem of Segment Reporting

❖ Usefulness

- Comparative assessment of segmental risks & returns Enables more informed judgements about entity as a whole
- Investors are aided in forecasting consolidated sales & net income
- Comparative analysis of company with its competitors
- Enables better understanding of entity's past performance
- Segment information is also valuable to employees, creditors & governments

❖ Problems

- Risk of information being passed to competitors
- Inconsistency in determination of segments
- Burden for smaller companies
- Difficulty in allocating revenue expenses to different segments

Secondary Segments are those whose sale is 10% or more or Assets are 10% or more of Total Enterprise Revenue/Assets.

Objective of AS 18

- **Irrespective of whether there were any transactions with such parties.**

- To provide additional information pertaining to related parties, who exercise control, or on whom control is exercised. i.e. disclosure about related party relationships
- To provide additional information pertaining to parties, and transactions with such parties involving related party relationship either in the form of control or in the form of significant influence i.e. transactions between a reporting enterprise and its related parties

Applicability

This standard is applicable to both

- Independent financial statements of Reporting Enterprise
- Consolidated Financial Statements (except for intra group transactions)

Related Party

Parties are 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.

Related Party Transactions

A transaction is transfer of resource between related parties,

regardless of whether or not a price is charged.

Even if no consideration is paid or received,

transactions, if any, between related parties must get reported.

Related Party Relationships

- Associates & Joint Venture of Reporting Enterprises
- Individuals owning interest in voting power & their Relatives
- Key management personnel and their Relatives
- Enterprise over which any person above is able to exercise significant influence.
- Enterprises (External Parties)

Voting Power gives them control or significant influence over enterprise

Key management personnel

Eg. Managing Director, Whole-time Director and Manager under Companies Act

Persons who have the **authority and responsibility for planning, directing and controlling the activities of reporting enterprise**

- Key Management Personnel is a related party under AS 18
- Remuneration paid to KMP requires disclosure under AS 18

A non executive director of a company is not considered as a Key Management Person

Relatives

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 or her dealings with the reporting enterprise

Control - Control arises from

ownership, directly or indirectly, of more than 50% of the voting power of an enterprise

In case of Company control of the composition of the BOD

In case of any other enterprise, composition of governing body

a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise, if that individual or an enterprise owns 20 % or more interest in the voting power of the other enterprise

An enterprise has deemed control on another if the first enterprise has power to appoint or remove director / governing body of another

Significant Influence

- It means participation in financial and/or operating policy decisions of an enterprise, but not in the control of those policies.
- Test of Significant Influence
  - By representation of BOD
  - Participation in policymaking process
  - Material inter company transaction
  - Interchange of managerial personnel
  - Dependence on technical information

Significant influence has a direct linkage with shareholding or voting power

↓

ownership of shares directly or indirectly through intermediaries

- **greater than 20% of voting power** → **Significant Influence Exists**
- **less than 20% of voting power** → **No Significant Influence Exists**

Joint Control

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

Holding Company

- The company having one or more subsidiary

Holding Company

A Company

- In which the holding company holds, either by itself and/or through one or more subsidiaries, more than one-half in nominal value of its equity shares capital; or
- Of which the holding company controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors

Exceptions to related party

Exceptions of related party

- Two companies have a director in common but director is not able to influence the mutual dealing between the companies.
- A single customer or supplier or franchiser or distributor or general agent with whom enterprise's transactions are in significant volume.
- Providers of finance
- Trade union
- Government departments and agencies
- State controlled enterprises as regards related party relationship with other state controlled enterprises.

Disclosures - Exempted under AS 18

Intra group transactions need not be disclosed in Consolidated Financial Statements

Related party relationships (RPR) and transactions between two or more state controlled entities

Where disclosure of RPR and transactions with such enterprises would come in conflict with the duties of confidentiality, of the reporting enterprises, e.g. Banks

State controlled enterprise is under the control of the Central Government and/or any State Government.

Disclosures under AS 18

- **Of detailed information about the parties and nature of relationship, where control exists**
- **Of information on all material related party transactions**

- **Name of related party, and relationship**
- **Nature of transaction**
- **Volume of transaction -**
- **Receivables due from and/or provisions made if any for doubtful debts**
- **Amounts written off or written back**
- **Examples are: HP or lease transaction, or services rendered**

Reporting Format

	HC	Sub	Fel. Sub	Ass	KMP	Relative of KMP	Total
Purchase of goods							
Sale of goods							
Purchase of fixed assets							
Sale of fixed assets							
Rendering of services							
Agency Arrangements							
Leasing of hire purchase							
Transfer of R & D							
License agreements							
Finance (loans and equity in cash or kind)							
Guarantees and collaterals							
Management contracts including for deputation of employees							

- Party wise disclosure is made of related party.
- The related party transactions which are in excess of 10% of total related party transactions of same type is considered

Leases

- Define the essential characteristics of a lease
- Describe and apply the method of determining a lease type (i.e. an operating or finance lease)
- Account for operating leases in financial statements
- Account for finance leases in the financial statements of the lessor and lessee

Elementary concepts

Lease financing is based on the observation made by Donald B. Grant:
"Why own a cow when the milk is so cheap? All you really need is milk and not the cow."

What is a lease?

A lease is an agreement

- between the owner of the asset (the lessor) and its user (the lessee)
- for the right to use the asset during a specified period
- in return for a mutually agreed payment or series of payments (lease rental)

Scope of the standard

- Licensing agreements for items such as option picture films, video recordings, plays, patents and copyrights.
- Lease agreements to use lands.
- Agreements that are contracts for services, that do not transfer right to use assets from one contracting party to the other.
- Lease agreements to explore for or use of natural resources such as oil, gas, timber metals
- and other mineral rights.

Key Terms

Non-cancellable lease is a lease that is cancellable.

Upon the occurrence of some remote contingency; or

With the permission of the Lessor; or

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

Upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

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.

Some important concepts...

- **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.
- **Useful Life:** Useful life of a leased asset is either Period over which the leased asset is expected to be used by the OR Number of production or similar units expected to be obtained from the use of the asset by the lessee.
- **Residual Value: Residual value** is the estimated fair value at the end of the lease term.
- **Guaranteed Residual Value :**
- **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 (the amount of the guarantee being the maximum amount that could, in any event, become payable).
- **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.
- **Unguaranteed Residual Value:** Amount by which the residual value of the Asset Exceeds Its guaranteed residual value.

Some important concepts...

1. The economic life of an asset.

Economic life is either:

- the period over which an asset is expected to be economically usable by one or more users; or
- the number of production or similar units expected to be obtained from the asset by one or more users.

2. The degree / extent of transfer of risks and rewards which are incidental to the ownership of leased asset by the lessor to the lessee

Risk incidental to ownership

- possibilities of losses from idle capacity or technological obsolescence
- variations in return because of changing economic conditions

Rewards incidental to ownership

- Expectation of profitable operation over the assets economic life
- Realisation of a residual value
- Gain from appreciation in value

Realisation of a residual value

Example

- A tractor has an estimated life of 10 years and an estimated residual value of Rs999. Peter pays rent to William and uses the tractor for 10 years. However, William will realise the residual value of the tractor.

Hence William is the person who enjoys the rewards incidental to ownership of the tractor

Some more important terms

1.The lease term

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

2. Lease payments

Instalments which the lessee pays to the lessor in return for the right to use an asset.

Minimum lease payments

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) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or

b) for a lessor, any residual value guaranteed to the lessor by

i. the lessee;

ii. a party related to the lessee; or

iii. a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

Finance lease - definition

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred

Substantial risks and rewards transferred From lessor to lessee

lessor

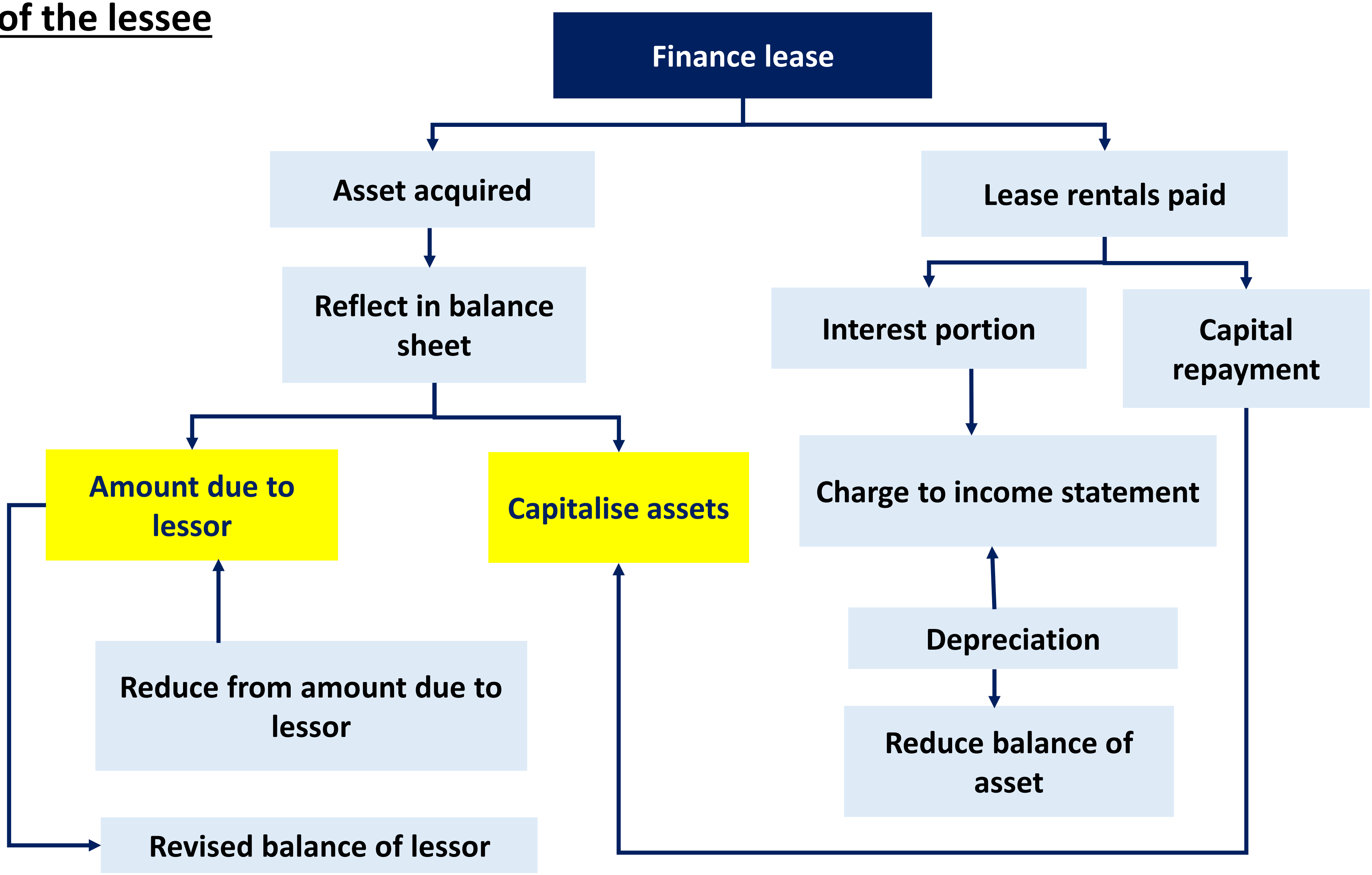
The person who transfers the right to use an asset for anagreed period of time

lessee

The person who acquires the right to use an asset for an agreed period of time

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

Finance lease in the books of the lessee



A lease is classified as a finance lease when any one or all of the following conditions are fulfilled:

1. The lease transfers ownership of the asset to the lessee by the end of the lease term
2. the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value of the asset, at the date the option becomes exercisable.
3. the lease term is for the major part of the economic life of the asset, even if the title is not transferred;
4. at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
5. the leased assets are of such a specialised nature that only the lessee can use them without major modifications.
6. if the lessee can cancel the lease, then the lessor's losses associated with the cancellation are borne by the lessee.
7. gains or losses from the fluctuation in the fair value of the residual accrue to the lessee
8. the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Disclosures made by the Lessee in case of Finance Lease:

(a) Assets acquired under finance lease as segregated from the assets owned;

(b) For each class of assets, the net carrying amount at the balance sheet date;

(c) Reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(d) Contingent rents recognized as expense in the statement of profit and loss for the period;

(e) Total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date; and

(f) General description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Accounting for Finance Leases (Books of Lessor)

The lessor should recognize assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease. In a finance lease, the lessor recognizes the net investment in lease which is usually equal to fair value as receivable by debiting the Lessee A/c.

Disclosure:

The lessor should make the following disclosures for finance leases:

(a) Reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) Unearned finance income;

(c) Unguaranteed residual values accruing to the benefit of the lessor;

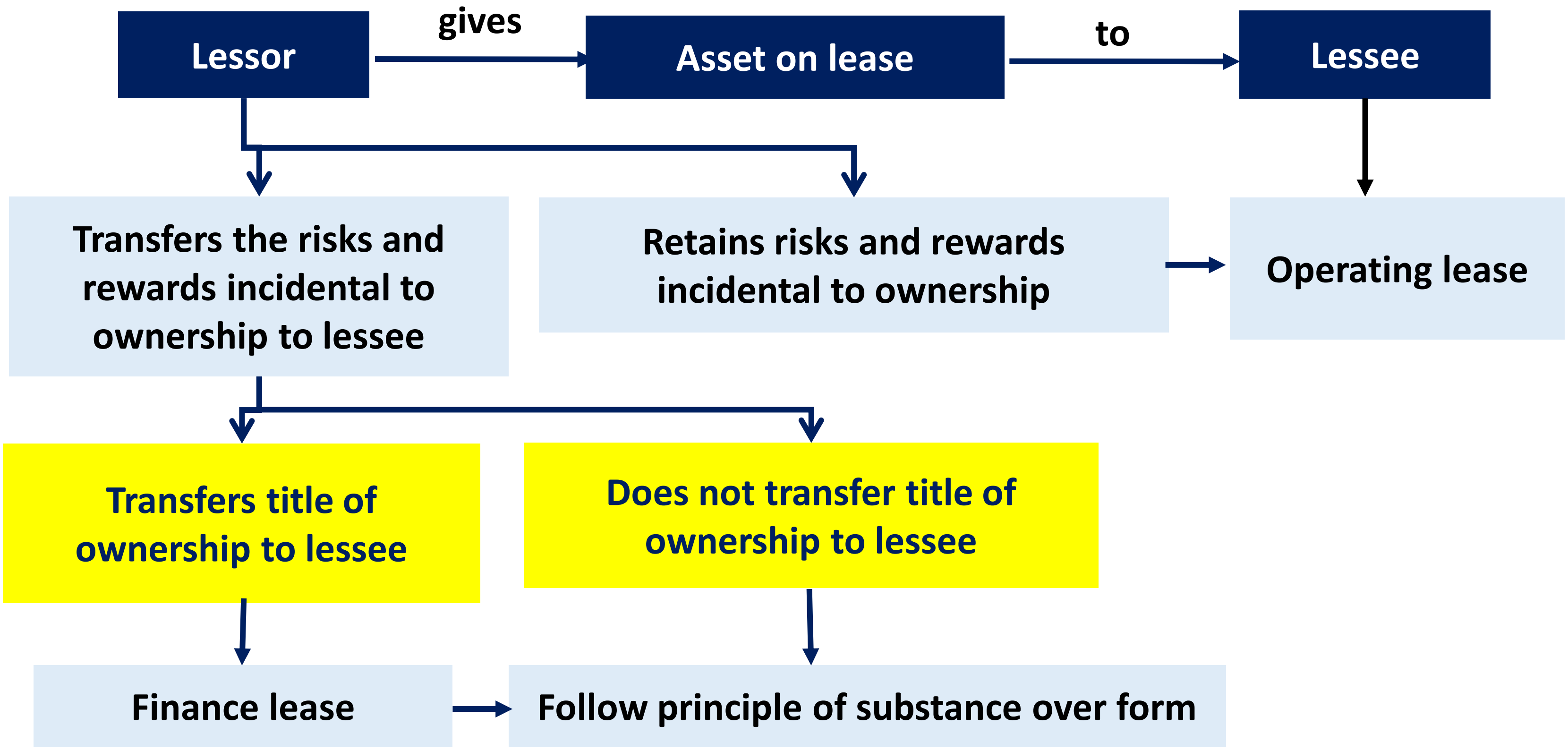
(d) Accumulated provision for uncollectible minimum lease payments receivable;

(e) Contingent rents recognized in the statement of profit and loss for the period;

(f) General description of the significant leasing arrangements of the lessor;

(g) Accounting policy adopted in respect of initial direct costs

Method of determining a lease type



Operating lease - In the books of the lessee

The lease rentals which the lessee pays periodically, when he acquires an asset under an operating lease, are debited to the income statement as an expense.

Operating lease - Accounting treatment in books of lessee

Operating lease

Asset used	Lease rentals paid
Not shown as a non-current asset in BS	Charged to income statement

Disclosures by Lessees:

Lessees are required to make following disclosures for operating Leases:

(a) Total of future minimum lease payments under non-cancelable operating leases for each of the following periods:(i) not later than one year; (ii) later than one year and not later than five years; (iii) later than five years;

(b) Total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date;

(c) Lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) Sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) General description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing

Disclosures by Lessors

As per AS 19, the lessor should, in addition to the requirements of AS 10 (Revised)* and the governing statute, make the following disclosures for operating leases:

(a) For each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment (i) the depreciation recognised in the statement of profit and losses at the balance sheet date; and loss for the period;

(ii) impairment losses recognised in the statement of profit and loss for the period;

(iii) impairment losses reversed in the statement of profit and loss for the period;

(b) Future minimum lease payments under non-cancelable operating leases in the aggregate and for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(c) Total contingent rents recognised as income in the statement of profit and loss for the period;

(d) General description of the lessor's significant leasing arrangements; and

(e) Accounting policy adopted in respect of initial direct costs.

Finance lease in the books of the lessee

1) Capitalise the asset

The journal entry to capitalise the asset is:

Dr Asset

Cr Lessor

Being asset acquired by a finance lease

The amount to be recorded is the lower of the fair value of the asset and the present value of the minimum lease payments.

The depreciation policy for depreciable leased assets should be consistent with the normal depreciation policy of the lessee for similar assets (as per the requirements of IAS 16 and IAS 38) and should be calculated over the shorter of:

- ❖ The life of the lease; and
- ❖ The useful life of the asset.

2) Split the lease rental into interest portion and the capital portion

Methods to split lease rental
- Actuarial method
- Sum-of-digits method

Interest rate used spreads income derived from lease over the period of the lease

The sum–of–digits method

1. A digit is assigned to each instalment.
2. The last instalment is assigned the digit 1, the second last one 2, and so on.
3. Add all the digits, using the formula:

Sum of digits = n (n+1) / 2,
where n is the number assigned to the interest bearing instalments.

4. Calculate the interest portion included in each instalment by using the formula:

Interest portion = digit applicable to the instalment / sum of digits

The journal entries to record the lease rental payment are for the lease rental repayment (inclusive of both the interest and capital repayment portion):

Particulars	Amount	Amount
Lessor Dr.	XXX	
To Cash / bank		XXX
(Being the total rental payment paid to the lessor.)		

For recording the interest

Particulars	Amount	Amount
Lease interest Dr.	XXX	
To Lessor		XXX
(Being the interest accrued on the total lease amount outstanding.)		

Accounting Standard - 20 EARNING PER SHARE (EPS)

Objective of AS 20

- To bring about consistency in computation of EPS
- To facilitate Inter-firm comparisons and Intra-firm comparisons.
- To prescribe the principles for determination and presentation of EPS.

Applicability

This standard applies to

all companies and all non-corporate entities

SMCs, Level II and Level III entities are exempted from certain disclosure of diluted earnings per share.

Earning Per Share

Earning Per Share (EPS). . .

- Gives information about earning available to each equity share
- Important for assessing the state of market price of share
- Required for comparison between different enterprises
- Applicable to the enterprises whose equity share or potential equity shares are listed in stock exchange

Earning per Share - Measurement

Earning Per Share

- **Basic EPS**: Available for distribution against a given number of shares this leads to Basic Earning Per Share
- **Diluted EPS**: Available for distribution against a no. shares including those not issued this leads to Diluted Earnings Per Share

Basic Earning Per Share

$$\text{Basic EPS} = \frac{\text{Net profit / loss attributable to equity share holder for the period}}{\text{Weighted average no. of equity shares outstanding during the period}}$$

Calculation of Net Profit / Loss attributable to equity share holder for the period

Net profit / loss for the period + Prior period , extraordinary item (AS – 5) - Tax Expenses - Preference Dividend = Net Profit attribute to ESH

profits appropriated to such mandatory reserves should be included in the numerator, for computation of EPS

If an enterprise has more than one class of equity shares, net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights.

Preference Dividend

Non-cumulative preference shares

Preference dividend already declared or provided.

Cumulative preference shares

- Preference dividend payable whether provided or not.
- As the EPS calculation is confined to current year net earnings only - Arrears of preference dividends should not be deducted as the EPS calculation is confined to current year net earnings only.

Calculation of Net Profit / Loss attributable to equity share holder for the period

Weighted average outstanding equity shares should be computed by adjusting for the change in equity shares

Basic Earning Per Share

Sr. No.	List of Shares issued which are to be adjusted	Weight to be considered from
A	For cash	Cash is receivable
B	Conversion of debt	Date of conversion
C	In lieu of interest or principal	Date on which interest ceases to accrue
D	Settlement of liability	Date the settlement becomes effective
E	Acquisition of asset	The acquisition is recognized
F	For rendering service	As the service is rendered
G	Contingently issuable shares	Date when conditions are met
H	Amalgamation in nature of purchase	On the date of acquisition
I	Amalgamation in the nature of merger	Beginning of reporting period
J	Partly paid up share	Partly paid up equity should be counted as fraction of equity shares in the ratio of amount paid up to the total face value of the share.
K	Right issue	Adjusted with Right factor.
L	Bonus shares	Shares included in weighted average from the beginning of the reporting period

Concept of Equivalent Units: Partly Paid Shares

Partly paid shares are treated as a fraction of an equity share to the extent that they are entitled to participate in dividends relative to a fully paid equity share.

If the partly paid shares were not entitled to participate in dividends they would be treated as an option.

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

Bonus Issue

- A bonus issue has the effect of increasing the number of shares in issue without generating new earnings.
- For current year, total number of shares "after the issue" is used in the EPS computation.
- No weightage should be assigned for timing of issue.
- PY EPS figures need to be scaled down by the ratio of "number of shares before bonus" to "number of shares after bonus."

Right Issue

- Generally made at a price lower than fair value of share
- Therefore, right issue usually include bonus element

No. of equity shares to be used in calculations basic EPS for all prior to right issue = **No. of equity shares outstanding prior to the issue multiplied by Right Factor**

Right Factor

$$\text{Right factor} = \frac{\text{Fair value per share immediately prior to right issue}}{\text{Theoretical ex-right fair value per share}}$$

$$\text{Theoretical Ex- right fair value} = \frac{\text{Aggregate fair value of share immediately prior to the exercise of the rights.} + \text{Proceeds from exercise of the right}}{\text{Number of shares outstanding immediately after the right issue}}$$

Share Split / Reverse Share Split

- A share split means sub-division of shares. Reverse share split means consolidation of shares
- The event of share split (sub division) or consolidation - does lead to a change in the number of shares.
- Date of share split or consolidation is immaterial
- EPS should be computed from "the beginning of the period"
- The computation should be made taking the number of shares "after the event"
- Previous year EPS should be adjusted

Diluted Earning Per Share

$$\text{Diluted Earning Per Share} = \frac{\text{Net profit attributable to equity shareholder (after adjustment for diluted earning)}}{\text{Average number of weighted equity shares outstanding during the period (assuming the conversion of diluted potential equity shares)}}$$

Diluted Earning Per Share

Net profit / loss for the period + Dividend along with distribution tax on convertible preference shares + Interest net of tax effect charged on convertible debenture or loans = Net Profit attribute to ESH

Potential equity Share

A financial instrument or other contract that entitles, or may entitle, its holder to equity shares

Convertible debentures

Convertible preference shares.

Share warrants, or Options including ESOP

Contingently issuable shares

Potential equity Share

Dilutive

Dilutive shares would arise when the exercise of options is at a price less than fair value. The conversion of shares with dilutive potential leads to reduction in EPS

Non Dilutive

Non-Dilutive shares represent new shares issued at fair price

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.

When to consider Potential Equity Shares Dilutive

If conversion of Potential equity Shares into Equity Shares	
Reduces the EPS	Increases the EPS

Options

- Options are considered for Basic Earnings Per Share only after the exercise of the option.
- They are considered dilutive to the extent that they are issued at less than fair value.
- To the extent the options have been issued at fair value they are not considered dilutive.
- Partly paid shares not entitled to participate in dividends are considered as option.

Restatement

- If the number of equity shares or potential equity shares outstanding is increased as a result of bonus issue, share spilt, consolidation of shares, the calculation of basic and diluted equity per share should be adjusted for all the period presented.
- If changes occur after the balance sheet date but before the approval of financial statements by competent authority, the EPS calculation for these financial statement and prior period financial statement should be restated on the basis of new number of shares.

Disclosure

- The amount used as numerator for calculating basic and diluted EPS and its reconciliation with net profit or loss for the period
- Weighted average number of shares used as denominator for calculating basic and diluted EPS and reconciliation of their denominators to each other.
- Nominal value of shares along with EPS.
- Basic EPS computed on the basis of earnings excluding extraordinary items.
- Diluted EPS computed on the basis of earning excluding extraordinary items.

Presentation of EPS

- An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period.
- An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented.
- This Standard requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).

Consolidated Financial Statements

Introduction

- ✓ Lays down principles and procedures for preparation and presentation of Consolidated financial statements
- ✓ Consolidated financial statements presented by a parent (Holding Company) to provide financial information of the group as a single economic entity
- ✓ Parent preparing consolidated financial statements should present their statements in accordance with this standard
- ✓ In separate financial statement of parent, investment in subsidiaries should be accounted as per AS 13

Objective

- ✓ Provide financial information regarding economic resources controlled by its group
- ✓ Represents results achieved with using these resources.

Financial Statements

Parent company prepares two sets of financial statements:

- ✓ One for only its own affairs
- ✓ One for taking the whole group as one unit in the form of consolidated financial statement

Consolidated financial statements comprises

Parent company prepares two sets of financial statements:

- ✓ One for only its own affairs
- ✓ One for taking the whole group as one unit in the form of consolidated financial statement

Scope

Statement applies to the financial statement prepared by the parent company including the financial information of all its subsidiaries taken as one single financial unit

This statement does not deal with:

- ✓ Methods of accounting for amalgamations and their effects on consolidation, including Goodwill arising on amalgamation (AS 14)
- ✓ Accounting for Investments in Associates (AS 13) and
- ✓ Accounting for Investments in joint ventures (AS 27)

Definitions

Concept	Definition
Subsidiary	It is an enterprise that is controlled by another enterprise (known as the parent)
Parent	It is an enterprise that has one or more subsidiaries
Group	It is a parent and all its subsidiaries
Equity	It is the residual interest in the assets of an enterprise after deducting all its liabilities
Minority Interest	It is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary (ies), by the parent
Consolidated Financial Statements	These are the financial statements of a group presented as those of a single enterprise

Preparation of Consolidated Financial Statements

Consolidated Financial statements will be prepared by the parent company for all the companies that are controlled by the parent company either directly or indirectly, situated in India or abroad except in the following cases:

(A) Control is intended to be temporary when:

- The subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future.
- In view of the above, merely holding the shares as 'stock in trade' is not sufficient to be considered as temporary control.
- One should note the intention at the time of making the investment,
- if the intention is to continue with the equity for a longer period then even though it is disposed off within 12 months, investee company would still be considered as subsidiary.

(B) Control is intended to be temporary when:

- Subsidiary company operated under severe long term restrictions, which significantly impair its ability to transfer funds to the parent.
- When the parent company has some restrictions on bringing the resources of the subsidiary company to its main resources then consolidated financial statement is not required, as the control is not resulting in extra cash flow to the parent company other than as mere investment in share of any other company i.e. dividend, bonus shares etc.

Therefore, in both cases above, investment of the parent company in the share of its subsidiary company is treated as investment according to AS 13.

Subsidiaries with Dissimilar activities

A company cannot be treated as outside the group just because the main business of the subsidiary company in not in line with the business of parent company

If parent retains control over subsidiary

Consolidate books of subsidiary with that of the parent

Information about the different nature of activities of subsidiary

Disclose in accordance with AS 17 Segment Reporting

Loss of Control Existence

When a parent loses control, the investee no longer meets the definition of subsidiary, and hence it is no longer consolidated

Parent loses control over subsidiary

Accounted as per AS 13 – Accounting for Investments from the date of loss of control

However, if investor retains significant influence

Accounted as per AS 23 – Accounting for Investments in Associates

Existence of Control

Control exists when Parent company has either:

The ownership, directly or indirectly through subsidiary (ies), of more than one-half of the voting power of an enterprise

Or control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from subsidiary company's activities

Consolidation procedures

The financial statements of the parent and subsidiary are combined on a line by line basis by adding together items of:

- Assets
- Liabilities
- Income and expense

And then certain adjustments are made

Adjustments include but are not restricted to:

- ❖ Elimination of the cost of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary
- ❖ Identification of minority interest in the profit or loss of consolidated subsidiaries for the reporting period
- ❖ Identification of minority interest in the net assets of consolidated subsidiaries for the reporting period

Recognition of goodwill or capital reserve, depending on whether cost of the parent's investment in each subsidiary is:

- ✓ Greater than, or
- ✓ Less than
    - ❖ The parent's portion of equity of each subsidiary at the date on which investment in the subsidiary is made
    - ❖ Elimination of all intra-group balances, intra-group transactions and resulting unrealized profits and losses
    - ❖ Adjustment of the consolidated results for dividends related to outstanding cumulative preference shares of a subsidiary that are held by minority interests regardless of whether the dividends have been declared

Cost of Control

- ✓ Cost of investment of the parent in each of its subsidiaries and the parent's share in equity of each subsidiary should be eliminated
- ✓ For this purpose, equity and investment as on the date of each investment is taken
- ✓ On the date of investment, if the cost of investment to the parent is more than share of equity in that particular subsidiary
- ✓ Difference is taken as Goodwill in the consolidated statement
- ✓ On the date of investment, if the cost of investment to the parent is less than share of equity in that particular subsidiary
- ✓ Difference is taken as Capital Reserve in the consolidated statement

Where the carrying amount of investment in the subsidiary is different from its costs, the carrying amount is considered for the purpose of above computations.

Goodwill and Capital Reserve of different subsidiaries can be adjusted to a net figure.

Goodwill need not be written off to consolidated profit and loss account but test of impairment (Refer to AS 28) is made each time a consolidated financial statement is prepared.

When share application money and allotment money is paid separately on different dates, then as per AS 21, date on which investment led to control of subsidiary should be taken as date of investment i.e. date of allotment.

If control is gained in the subsidiary by a series of investments, then the date of investment which led to holding subsidiary relationship is taken into consideration and step by step calculations are made for each following investments.

Minority Interest

- From the net income of the subsidiary, amount proportionate to minority interest is calculated and deducted from profit and loss account balance and added to minority interest, so that income of the group belonging to the parent can be identified separately
- Adjust cumulative preference dividends and profits belonging to the preference shares (if any) in the minority interest for the preference shares not held by the consolidated group.
- The adjustment should be made irrespective of whether or not dividends have been declared.
- Minority interests in the net assets of consolidated subsidiaries should be identified and presented separately from liabilities and equity of the parent's shareholders
- Minority interest in net assets consist of
  - The amount of equity attributable to minorities at the date on which investment in subsidiary is made and
  - he minorities share of movements in equity since the date the parent- subsidiary relationship came into existence
- If carrying amount and cost of investment are different, carrying amount is considered for the purpose.
- The losses attributable to minority interest are deducted from the minority interest unless minority interest is NIL.
- Any further loss is adjusted with the consolidated group interest except to the extent that the minority has a binding obligation to, and is able to, make the losses good

Other general rules to Consolidation

AS 21 requires Intra-group transactions (including sales, expenses and dividends) and the resulting unrealized profits and losses be eliminated in full

Liabilities due to one group enterprise by another will be set off against the corresponding asset in the other group enterprise's financial statements

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.

To the extent that the buying enterprise has further sold the goods in question to a third party, the eliminations to sales and cost of sales are all that is required, and no adjustments to consolidated profit and loss or net assets is needed

Unrealized profits in Inventories

- Where a group enterprise sells goods to another, the selling enterprise, as separate legal enterprise, records profits made on those sales.
- If these goods are still held in inventory by the buying enterprise at the year end, however, the profit recorded by the selling enterprise, when viewed from the standpoint of the group as a whole, has not yet been earned, and will not be earned until the goods are eventually sold outside the group.
- Therefore, on consolidation the unrealized profit on closing inventories will be eliminated from the group's profit and the closing inventories of the group will be recorded at cost to the group
- Where the goods are sold by a parent to a subsidiary *(downstream transaction)* or by a subsidiary to a parent *(upstream transaction),* the whole of the unrealized profit should also be eliminated

Unrealized profits on "Transfer of non current assets

- Unrealized *inter-company profits arising from intra-group transfers of fixed assets* are also to be *eliminated* from consolidated financial statements
- *Effect of losses* from inter group transactions *need not be eliminated only when the cost is not recoverable*

Reporting date for the purpose of consolidation

- ❖ For the purpose of consolidation, the financial statements of all subsidiaries should, wherever practicable, be prepared:
  - ✓ To the same reporting date ; and
  - ✓ For the same reporting period as of the parent
- ❖ If practically it is not possible to draw up the financial statements of one or more subsidiaries to a common date as parent, then adjustments should be made for significant transactions or other events that occur between those dates and the date of the parent's financial statements.
- ❖ In any case, the difference between reporting dates should not be more than six months

Differing Accounting Policies

- ❖ Accounting policies should be uniform for like transactions and other events, in similar transactions
- ❖ If accounting policies are not uniform, then adjustments should be made in the items of the subsidiaries to bring them in line with the accounting policy of the parent

Disclosures

- In the consolidated financial statements, a list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held
- In consolidated financial statements, where applicable:
  - The nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than one-half of the voting power of the subsidiary
  - The effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and
  - The names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates

Transitional provision

- On the first occasion that consolidated financial statements are presented, comparative figures for the previous period need not be presented
- In all subsequent years full comparative figures for the previous period should be presented in the consolidated financial statements

Accounting for Taxes on Income in the Consolidated Financial Statements

- The amount of tax expense appearing in the separate financial statements of a parent and its subsidiaries do not require any adjustments for the purpose of consolidated financial statements
- While preparing consolidated financial statements, tax expense to be shown in the consolidated financial statements is the aggregate of the amounts of tax expense appearing in the separate financial statements of the parent and its subsidiaries

Objective of AS 22

- Income tax liability is determined in accordance with the prevailing tax laws
- A business entity may recognise various items of income or expense in an accounting period
- But for tax purposes, they may be considered in a different period
- Results in a tax expense/liability not matching with the items of income/expense recognized in that period.

Profit and Loss A/c

To Opening Stock	By Sales
To Purchases	By Closing stock
To Interest	
Add : O/s Interest.	
To Net profit	

Profit and Loss A/c

To Opening Stock	By Sales
To Purchases	By Closing stock
To Salaries	
Add : O/s salary	
To Net profit	

Differences between Accounting income and taxable income for a period

Permanent Difference

Differences which originate in one Period and do not reverse subsequently

- Ex. Permanent difference include expenses disallowed u/s 40A.
- No accounting treatment is required for such permanent differences.
- Excluded from consideration in determining tax expense.

Timing Difference

Differences which originate in one Period and are capable of reversal in one or more subsequent periods

Items

43B item (bonus)

Amounts

Depreciation (SLM/WDV)

Impact of Timing Differences

- Tax of initial years being higher & subsequent years being lower.
- Tax of initial years being lower & subsequent years being higher

Amount not deductible in respect of unpaid liabilities. [Sec. 43B]

Section 43B is applicable only if the taxpayer maintains books of account on the basis of mercantile system of accounting.

Expenses deductible on payment basis :-

Any sum payable by way of tax, duty, cess or fee (by whatever name called under any law for the time being in force);

Any sum payable by an employer by way of contribution to provident fund or superannuation fund or any other fund for the welfare of employee.

Any sum payable as bonus or commission to employees for service rendered;

Any sum payable as interest on any loan or borrowing from a public financial institution (i.e. ICICI, IFCI, IDBI, LIC and UTI) or a state financial corporation or a state industrial investment corporation.

Interest on any loan or advance taken from a scheduled bank including a co-operative bank and

Any sum payable by an employer in lieu of leave at the credit of his employee.

Expenses are deductible only in the year in which payment is actually made.

Scope

Standard prescribes the accounting treatment for taxes on income, with a focus on the need to adhere to the fundamental principle of **MATCHING CONCEPT**

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

The standard does not deal with Corporate Dividend tax or Wealth Tax payable by reporting entities.

ACCOUNTING FOR TAXES ON INCOME

Accounting Income (Loss)

- ✓ The net profit or loss for a period,
- ✓ As reported in the statement of profit and loss,
- ✓ Before deducting income tax expense or adding income tax saving. (PBT)
- ✓ Schedule III of Companies Act.

Taxable Income (Tax Loss)

- ✓ Taxable Income (Tax Loss) is
- ✓ The amount of income (loss) for a period,
- ✓ Determined in accordance with the tax laws,
- ✓ Based upon which income tax payable (recoverable) is determined.
- ✓ Computation as per Income Tax Return.

Tax Expense (Tax Saving)

- ✓ Tax Expense (tax savings) is
- ✓ the aggregate of current tax and deferred tax
- ✓ charged or credited to the statement of profit and loss for the period.

Current Tax

- ✓ Current Tax is
- ✓ the amount of income tax determined to be payable (recoverable)
- ✓ in respect of the taxable income (tax loss)
- ✓ for a period as per tax laws.

Deferred tax

The tax effect of timing differences. i.e. Temporary difference.

ACCOUNTING FOR TAXES ON INCOME

Recognition

Recognition

Tax Expenses = Current Tax + Deferred Tax.

Current Tax

Amount of income-tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

Deferred Tax

Deferred tax is the tax effect of timing difference.

Tax expenses (on accrual basis) - current tax liability (as per income-tax act) = Deferred tax (assets / liability).

1. Permanent differences do not result in deferred tax assets or deferred tax liabilities.
2. Tax Expenses should be included in determination of net profit or loss for the period.
3. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.

Measurement

Measurement

Current Tax

Measured at the amount expected to be paid to (recovered from) taxation authorities using applicable tax rates and tax laws.

Deferred Tax

Deferred tax should be measured using the rates and tax laws that have been enacted or substantially enacted by the balance sheet date.

Deferred Tax Assets and Liabilities should not be discounted to present value.

Measurement

Deferred Tax Liabilities

Is recognized for timing differences that will result in taxable amounts in future years.

Deferred Tax Assets

Deferred Tax Asset

Recognised for timing differences that will result in deductible amounts in future year and for carry forward.

General Items e.g. falling u/s 43B of IT Act can be recognised subject to

↓

Reasonable Certainty

Reasonable certainty can be deemed to exist if the probability of future taxable income is greater than say 50%.

Unabsorbed depreciation and Carry forward losses can be recognised subject to

↓

Virtual Certainty

Virtual certainty can be taken to exist only when the evidence gathered establish beyond doubt that the enterprise will be able to generate adequate future taxable income.

Virtual Certainty

- ✓ Is a matter of judgment
- ✓ Will have to be evaluated on case to case basis
- ✓ Should be supported by convincing evidence
- ✓ Cannot be based on forecasts
- ✓ Is not matter of perception

Recognition of Deferred Tax Assets & Liabilities

- Tax expenses for the period, includes both current tax as well as deferred tax for the determination of net profit or loss for the period.
- Deferred tax should be recognised for all the timing differences, subject to consideration of prudence in respect of deferred tax assets.

Situation	Status
(i) Accounting Income > Taxable Income	❖ **Create Deferred Tax Liability** Profit & Loss Account Dr. To Deferred Tax Liability A/c
(ii) Accounting Income < Taxable Income	❖ **Create Deferred Tax Assets** Deferred Tax Assets A/c Dr. To Profit & Loss A/c
(iii) Accounting Loss and Taxable Income	❖ **Create Deferred Tax Assets for disallowance of expenses** Deferred Tax Assets A/c Dr. To Profit & Loss A/c
(iv) Accounting Income and Taxable Loss	❖ **Create Deferred tax Liability for surplus allowance of expenses.** Profit & Loss Account Dr. To Deferred Tax Liability A/c

Situation	Status
(iv) Accounting Income and Taxable Loss	❖ **Create Deferred Tax Assets for Tax Loss subject to Prudence.** Deferred Tax Assets A/c Dr. To Profit & Loss A/c
(v) Accounting loss > Taxable Loss	❖ **Create Deferred Tax Assets for disallowance of expense and taxable loss subject to prudence.** Deferred Tax Assets A/c Dr. To Profit & Loss A/c
(vi) Accounting Loss < Taxable Loss	❖ **Create Deferred Tax Liability surplus allowane of expense** Profit & Loss Account Dr. To Deferred Tax Liability A/c ❖ **Create deferred tax assets for taxable loss subject to prudence** Deferred Tax Assets A/c Dr. To Profit & Loss A/c
(vii) Accounting Loss = Taxable Loss	❖ **Create Deferred Tax Assets for Taxable Loss subject to prudence.** Deferred Tax Assets A/c Dr. To Profit & Loss A/c

Reassessment of Deferred Tax Asset

Deferred Tax Assets

- **Previously Recognized**
  - Conditions underlying reasonable certainty or virtual certainty are reviewed and found to be
    - Valid → carried forward
    - Invalid → write down the DTA to the extent of reversing timing differences
- **Not Previously Recognized (Find out the category under which it falls)**
  - Reasonable Certainty
  - Virtual Certainty
  - If Exists – Recognise DTA
    If Doesn't Exists – Don't Recosgnise DTA

Tax Holiday

- The deferred tax in respect of timing differences which reverse during the tax holiday period, should not be recognized to the extent the gross total income of the enterprise is subject to such deductions.
- The deferred tax in respect of timing difference which reverse after the tax holiday period should be recognized in the year in which the timing differences originate, subject to consideration of prudence.
- Timing differences which originate first should be considered as reversing first.

Disclosure

- The break-up of deferred tax asset / liability should be disclosed.
- In case of deferred tax asset arises out of unabsorbed depreciation or loss, evidence supporting recognition should be disclosed.
- Deferred tax asset / liability should be disclosed separately from current asset / liabilities.
- Deferred tax asset and liability should be set off if permissible under the tax laws but to be shown separately if not permissible.

Objective of AS 24

- To establish principles for reporting information about discontinuing operations
- To enhances the ability of financial statements users to make accurate projections by segregating information and discontinuing operations.
- Projections would generally include enterprise's cash flows, earnings generating capacity and financial position.

Discontinuing Operation

- **That the enterprise, is**
- **Should represent a separate major line of business (product or service) or geographical area of operations**
- **Can be distinguished operationally and for financial reporting purposes**

Discontinuing Operation

Discontinuing operation

That the enterprise, is Disposing of substantially in its entirely by demerger or spin off of ownership of the component to the enterprise shareholders

Disposing it piecemeal, such as by selling off the components assets and setting its liabilities individually or

Terminating through abandonment, and

Should represent a separate major line of business (product or service) or geographical area of operations

Can be distinguished operationally and for financial reporting purposes

Frequency of discontinuing operations

- Should occur infrequently
- Should not be common in regular course of business
- Should be significant enough to impact the performance of the enterprise for that period.

Methods of disposing an operation

Method

- **Substantial portion in its entirety**
  - In single transaction
  - Spin off of ownership of the operation
  - By demerger
- **Piecemeal disposal**
  - Disposal over period of months or longer
- **Terminating through abandonment**
  - Need not necessarily have sale of assets

Substantial sale of component

- Sale of a component substantially in its entirety
- The result can be a net gain or net loss.
- A binding sale agreement must be entered.
- The actual transfer of possession and control of the discontinuing operation may occur at a later date.
- Payments to the seller may occur at the time of the agreement, at the time of the transfer, or over an extended future period.

Piecemeal Disposal

- Disposal of the component by selling its assets and settling its liabilities in piecemeal (individually or in small groups).
- While the overall result may be a net gain or a net loss, the sale of an individual asset or settlement of an individual liability may have the opposite effect.
- No specific date at which an overall binding sale agreement is entered into.
- Sale of assets and settlements of liabilities may occur over a period of months.
- Disposal of a component may be in progress at the end of a financial reporting period.
- To qualify as a discontinuing operation, the disposal must be pursuant to a single coordinated plan.

Operational Or Financial Segregation For Reporting Purposes

- The operating assets and liabilities of the component can be directly attributed to the component / operations being discontinued
- Its revenue can be directly attributed
- At least a majority of its operating expenses can be directly attributed to it

Abandonment and discontinuing

Does every business enterprise which close facilities, abandon products or even product lines, and change the size of their work force in response to market forces result in discontinuing operations?	Does identifying discontinuing operation question the continuity or going concern of the entity?
❖ NO ❖ Only if the transaction fulfills the definition of discontinuing operation, it will be covered under this standard. ❖ Changing the scope of an operation or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.	❖ NO ❖ Unless the requirements of classifying the entity as going concern is affected.

Examples of what is not covered under discounting operations

- ✓ Gradual or evolutionary phasing out of a product line or class of service
- ✓ Discontinuing, even if abruptly, several products within an ongoing business
- ✓ Shifting of some production or marketing activities for a particular line of business from one location to another
- ✓ Closing of a facility to achieve productivity improvements or other cost savings

Reportable business segment or geographical segment

- ✓ Satisfy the segment definition as per AS 17
- ✓ Discontinued segment could be in full or a portion of the segment
- ✓ Should be a substantial portion in its entirety
- ✓ Subject to a coordinated plan of action.
- ✓ In a single business or geographical segment, a major product or service line may also satisfy the criteria of the definition.

Separating The Discontinuing Operations From Financials

Following can be directly attributed for the discontinuing operations:

- Assets and Liabilities
- Revenue and Expenses

These numbers will be eliminated from the company's financial statements, when the component is sold, abandoned or otherwise disposed of.

Disclosure

Discontinuing operations need to be disclosed if either of the following events occur earlier:

- the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation
- the enterprise's board of directors or similar governing body has both

(i) approved a detailed, formal plan for the discontinuance and

(ii) made an announcement of the plan

Formal Plan Of Discontinuance Includes

- Identification of the major assets to be disposed of
- Expected method of disposal
- Period expected to be required for completion of the disposal
- Principal locations affected
- Location, function, and approximate number of employees
- Who will be compensated for terminating their Services
- Estimated proceeds or salvage to be realised by disposal
- Plan should been announced by the board of directors or entity's governing body

Recognition and Measurement

AS 24 does not establish any recognition and measurement principles.

An enterprise should apply the principles of recognition and measurement that are set out in other Accounting Standards for the purpose of deciding as to when and how to recognise and measure the:

- ✓ changes in assets and liabilities and the revenue, expenses, gains, losses
- ✓ and cash flows relating to a discontinuing operation.

What needs to be disclosed

- ❖ Description of the discontinuing operation(s);
- ❖ The business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;
- ❖ The date and nature of the initial disclosure event;
- ❖ The date or period in which the discontinuance is expected to be completed if known or determinable;
- ❖ The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- ❖ The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- ❖ The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- ❖ The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Disclosure on the discontinuing operations has to be made

- When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation
- Enters into binding agreements for the sale of such assets or the settlement of such liabilities

For the purpose of presentation

- The items of assets, liabilities, revenues, expenses, gains, losses, and cash flows can be attributed to a discontinuing operation only if they will be disposed of, settled, reduced, or eliminated when the discontinuance is completed.
- To the extent that such items continue after completion of the discontinuance, they are not allocated to the discontinuing operation.
- If an initial disclosure event occurs between the balance sheet date and the date on which the financial statements for that period are approved by the approving authority, disclosures as required by AS 4 are made.

Initial information to be disclosed

(a) for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation,

- (i) the amount of the pre-tax gain or loss and
- (ii) income tax expense relating to the gain or loss; as defined in Accounting Standard (AS) 22, Accounting for Taxes on Income.

(b) the net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements,

- (i) the expected timing of receipt of those cash flows and
- (ii) the carrying amount of those net assets on the balance sheet date.

Additional information to be disclosed

An enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs,

- ✓ A description of any significant changes in the amount or
- ✓ timing of cash flows relating to the assets to be disposed or liabilities to be settled and
- ✓ the events causing those changes
- ✓ the nature and terms of binding sale agreements for the assets, a demerger or
- ✓ spin-off by issuing equity shares of the new company to the enterprise's shareholders &
- ✓ legal or regulatory approvals.

If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation,

- ✓ For periods up to and including the period in which the discontinuance is completed.
- ✓ A discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

The disclosures should continue in financial statements

- ✓ that fact,
- ✓ reasons therefor and its effect should be disclosed.
- ✓ Disclosure of the effect includes reversal of any prior impairment loss or provision that was recognised with respect to the discontinuing operation.

Other Disclosure

- The asset disposals, liability settlements, and binding sale agreements referred to in the preceding paragraph may occur:
- concurrently with the initial disclosure event, or
- in the period in which the initial disclosure event occurs, or
- in a later period.
- If some of the assets attributable to a discontinuing operation:
- have actually been sold or
- are the subject of one or more binding sale agreements entered into between the balance sheet date and the date on which the financial statements are approved by the board of directors in case of a company or
- by the corresponding approving authority in the case of any other enterprise,
- the disclosures required by Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date, are made.

Separate Disclosure for each discontinuing operation

- ✓ Any disclosures required by this Standard should be presented separately for each discontinuing operation.
- ✓ The disclosures required on the details of the transaction should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

(a) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

(b) the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

INTANGIBLE ASSET

Applicability

Item not covered	Explanation
Financial assets like – Cash, ownership interest in another enterprise.	In so far as these are investments, will be covered by AS -13.
Intangible asset that are covered by another standard.	✓ Computer software can be an inventory item for an enterprise. This will be covered by AS 2, ✓ Deferred tax asset will be covered by AS 22, ✓ Goodwill on consolidation will be covered by AS 21, and ✓ Goodwill on amalgamation will be covered by AS 14.
Mineral rights and expenditure for exploration of oil, natural gas etc. and intangible assets arising in insurance enterprises from contracts with policy holders.	However, a computer software used in exercise of such rights, or start up costs, would be covered under AS 26.
Voluntary separation costs, termination benefits paid to employees on retirement	To be dealt with in AS 15 which is presently under revision.
Share issue expenses, discount allowed on the issue of shares.	

In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee deals with an intangible asset held under finance lease under this standard.

Scope

AS 26 should be applied by all enterprises in accounting for intangible assets Except:

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

AS 26 applies to:

- Other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises.
- Goodwill.
- Expenditure on advertising, training, start – up cost
- Research and development activities
- Trademarks & Patents , copyrights
- Right under licensing agreements for items such as motion Picture films , video recording

INTANGIBLE ASSET

Type of Assets

Tangible Asset

Assets having physical substance and can be seen and touched. E.g. Building, plant and Machinery etc.

Intangible Asset

An intangible asset is defined as an identifiable non-monetary asset, without physical substance, held for use in production or supply of goods or services, rental to others, or for administrative purpose.

Conditions

- Identifiable non-monetary asset without physical substance.
- Control over a resource
  - When there is control over future economic benefit from intangible asset
- Expectation of future economic benefit flowing to the entity

Identifiable

Asset is said to be identifiable if it is separable from other assets and if enterprise could rent, sell, exchange or distribute the specific future benefits of this assets used in revenue earning activity.

Issue	Explanation
Separability is not "a necessary" condition	Intangible asset is acquired along with a group of assets **(Goodwill under AS 14)**
An internal project may provide certain "legal rights" and the nature of these rights may help identify underlying Intangible asset	Intangible asset arising from research and development projects.
An asset may be identifiable only along with another asset.	Yet, if the entity is able to identify the future economic benefits from that "specific" asset, it falls under Intangible asset.

Non-monetary Asset

Non-monetary assets means the value to be received against the assets is not fixed by contract or otherwise.

Examples of monetary assets:- Debtors, Bills-receivable, and advances etc.

Examples of non-monetary assets:- Goodwill, patent and trademark

Physical substance

Intangible Assets has no physical substance, however some intangible asset assets may have physical substance like compact disk containing software but the cost of physical substance is insignificant as compared to intangible.

Recognition criteria of Intangible asset

- **Probable future economic benefit must flow to the enterprise**
  - Management should make estimate of future benefit on reasonable and supportive assumption.
- **Cost of intangible asset can be measured reliably.**

Initial measurement of Intangible asset

Measurement should be done if…

Definition Criteria

- ✓ Non-monetary
- ✓ Identifiable
- ✓ Without physical substance
- ✓ Controlled by enterprise
- ✓ For future economic benefit

Recognition criteria

- ✓ Probable future economic benefit flows to enterprise.
- ✓ Cost can be measured reliably.

Once all these criteria are fulfilled. As per standard, intangible asset should be shown at **COST.**

Cost of Intangible assets - Separate Acquisition, Exchange of Asset, By Issue of Shares or Securities

Separate acquisition:

❖When intangible asset acquired separately, its cost can be measured separately.

❖Its cost consist of purchase price, any import duties and non-refundable purchase taxes and directly attributable expenses.

Exchange of assets:

The cost of intangible asset shall be fair value of asset given up.

By issue of share or securities:

The asset should be recorded at fair value of intangible acquired or fair value of share or securities issued, whichever is more clearly evident.

Cost of Intangible assets Acquisition in amalgamation

Goodwill

Purchase consideration (Less) fair value of assets acquired.

Other than goodwill

- ✓ **Recognised only if it meets criteria of intangible asset recognition. (Even if that asset is not recognised in books of transferor company)**
- ✓ **Cost of intangible asset can not be measured reliably, same shall be included in the value of goodwill.**

Cost of Intangible assets - Acquisition through Government Grants

Enterprise acquires an intangible asset in the form of license to operate radio or T.V. station, telecom operation right, airport landing right, access to resource etc. free of cost or at nominal value.

Initial Recognition → **Recognised at cost of acquisition**

As per AS 12, "Accounting for Government Grant"

- ✓ Non-monetary asset acquired free of cost
- ✓ Non-monetary asset acquired at nominal cost

→ **Recognised at nominal value + attributable cash cost**

→ **Recorded at nominal cost only**

Cost of Intangible assets - Internally generated goodwill

Goodwill generated in the process of doing business in called Internally Generated Goodwill.
Goodwill may be generated because of factors like good business practices, good and trained employee, advertisement, continuous training to employees etc.
To generate goodwill internally involves cost.

Internally generated goodwill does not meet recognition criteria (cost can not be measured reliably).
So internally generated goodwill should not be recognised.
Certain other asset should not be recognised.
e.g. Brands, Mastheads, Publishing titles, Customers list, & items of similar nature.

Cost Of Intangible Assets - Other Internally Generated Intangible Asset

Assets Generation Process

Research phase

It is the activity that aimed at inventing or creating a new product, method or system

Research Cost

Treated as expense
Charged to P & L a/c

Development phase

It is the activity that convert the results of research to a marketable product

Development Cost

If development phase generate the intangible asset, then such asset should be capitalised. If,

- ✓ It meets intangible asset recognition criteria, and
- ✓ Other criteria
  - Technical feasibility of product
  - Availability of product for use or sale
  - Identification of cost incurred
  - Probability of external market
  - The realistic expectation that there will be sufficient future revenue to cover cost

Subsequent Expenditure on Intangibles

Subsequent expenditure

Increases future economic benefit of intangibles → Included in cost of intangibles

Separate asset can be recognised and measured reliably → Expense should be capitalised

If expenses made do not fall in any of the above condition then it is charged to P & L a/c

Carrying Amount of Intangibles

Carrying Amount of Intangibles = Cost - Any Accumulated Amortisation - Any Accumulated Impairment Losses

Amortization

It is the process of allocating an amount to expenses over the period of beneficial life. (same as depreciation of fixed asset.)
Accounting standard states that depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates of its useful life.
Amortisation should starts when the asset is available for use.

Depreciable Amount

$$\boxed{\text{Depreciable amount}} = \boxed{\text{Cost of intangible asset}} - \boxed{\text{Residual value}}$$

Residual value generally taken as zero, unless it is evident that at the end of useful life, it can sold and market value can reasonably estimated.

Amortisation Period

Amortisation period:

- The depreciable amount of intangible asset should be amortised on systematic basis over the best estimate of its useful life which is generally shall not exceed 10 years from the date when assets is available for use.
- When best estimated useful life over 10 years is considered for amortisation then estimate the recoverable amount at least annually and provide for impairment loss if any and disclose the reason why life exceeding 10 years is justified and factors considered for determining the useful life.

Amortisation method

Intangible assets amortised by applying matching concept which requires that the benefit derived (consumed) from the intangible in the form of increased profitability should be matched with the cost.

If the pattern of benefit and cost can be determined reliably then the enterprise should amortize the intangible as per the pattern.

Otherwise straight line method is followed.

Amortisation is generally recorded as an expense in financial statement.

However sometimes economic benefit consumed out of intangible asset is used to produce other asset, in this case the amortisation expenses is added in the cost of other asset rather than showing it as an expenses AS 2 ‘valuation of inventory’

Review Of Amortisation Method

Amortisation method is reviewed at the end of each financial year and if

✓The amortisation period and the amortisation method should be reviewed at least at each financial year end.

✓If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly.

✓If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5

Impairment losses

- ✓ Impairment losses is the amount by which the carrying amount of an asset exceeds its **recoverable amount.**
- ✓ Such exceed is to be treated as loss and is to be provided for.
- ✓ Recoverable amount as per the standard on impairment of asset means higher of the:
  - ➢ Value in use and net selling price,
  - ➢ Value in use is the present value of future cash inflow to be derived from the asset.
- ✓ Mandatory Impairment Assets: Mandatory impairment test is required in following cases
  - ➢ When useful life is more than 10 year
  - ➢ When subsequent expenditure extend the life of intangible assets.

Retirements and Disposal

An intangible asset should be derecognised (eliminated from the balance sheet) if
•disposal or
•when no future economic benefits are expected from its use and subsequent disposal.
Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

Intangible asset should be recognised/ eliminated from balance sheet if –

An intangible asset is disposed **(disposal).**

No future economic benefit are expected from the use of intangible asset. **(retirement).**

Treatment

- **Disposal** → **Profit or loss recognised in P & L A/c.**
- **Retirement** → **Carried In balance sheet at its carrying cost subject to impairment.**

Disclosure

The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

1. the useful lives or the amortisation rates used;
2. the amortisation methods used;
3. the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
4. a reconciliation of the carrying amount at the beginning and end of the period showing:
    a. additions, indicating separately those from internal development and through amalgamation;
    b. retirements and disposals;
    c. impairment losses recognised in the statement of profit and loss during the period (if any);
    d. impairment losses reversed in the statement of profit and loss during the period (if any);
    e. amortisation recognised during the period; and
    f. other changes in the carrying amount during the period.

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Objective of AS - 29

- To Ensure that appropriate recognition criteria & measurement bases are applied to provisions and contingent liabilities and
- To ensure that sufficient information is disclosed in the notes to the financial statements to enable the users to understand their nature, timing and amount
- To lay down appropriate accounting for contingent assets

Non-Applicability

- ➢ Financial instruments carried at fair value
- ➢ Those resulting from executory contract, except where the contract is onerous
- ➢ Insurance enterprise – arising out of insurance contract with policyholders.

- ➢ Those covered by the another AS
- ✓ AS-7 – Construction Contract
- ✓ AS-22 – Accounting for taxes on incomes
- ✓ AS-19 – Leases
- ✓ AS-15 – Retirements Benefits

Meaning of Onerous Contract

- Onerous Contract = Unavoidable costs of meeting the obligations under the contract > economic benefits expected to be received under it.

Unavoidable costs = Least of net cost of exiting from the contract, cost of fulfilling it and any compensation or penalties arising from failure to fulfil it

- If an enterprise has a contract that is onerous, the present obligation under the contract is recognised and measured as a provision as per this Standard.

Definitions

PROVISION

- liability which can be measured only by using a substantial degree of estimation
- Liability
- present obligation arising from past events, the settlement of which result in an outflow of resources embodying economic benefits

OBLIGATING EVENT

- an event that creates an obligation that results in an enterprise having not realistic alternative to settling that obligation

PRESENT OBLIGATION

- an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable

POSSIBLE OBLIGATION

- an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable

CONTINGENT ASSET

- is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the enterprise
- Restructuring
- It is a programme that is planned and controlled by management, and materially changes either:
- (a) the scope of a business undertaken by an enterprise; or
- (b) the manner in which that business is conducted.

Recognition of Provisions

Enterprise has a Present Obligation as a result of Past events.
Outflow of resources embodying economic benefits will be required to settle the obligations
Reliable estimate of the obligation can be made

Analysis of Present Obligation

PRESENT OBLIGATION

Based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

LEGALLY ENFORCEABLE

Obligation also arise from normal business practice, customs and desire to maintain good business relation or act in equitable manner

IDENTITY OF THE PARTY IS NOT RELEVANT

It is not necessary to know the identity of the party to whom the obligation is owed. The obligation may be to the public at large

PROVISION BASED ON NEW LAW

Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted

Analysis of Past Event

In all most all the cases it will be clear whether a past event has given rise to present obligation.
No Provision is required for future cost
Example: An Airline is required by law to overhaul its aircraft once in every three years. A company which operates aircrafts does not provide any provision as required by law in its final account.
As there is no present obligation hence no provision is required.
No Provision is recognised for costs that need to be incurred to operate in the future.

Analysis of Probable Outflow of Resources

Probability of outflow of resources must be certain
Where there are a number of similar obligations
(eg: Product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

An enterprise recognizes a provision for the decommissioning costs of an oil installation to the extent that the enterprise is obliged to rectify damage already caused.

Analysis of Reliable Estimate of the Obligation

The use of estimates is an essential part of the preparation of Financial statements and does not undermine their reliability
Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes

In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability

Measurement of Provision

The amount recognised as a provision should be the
- best estimate of the expenditure
- required to settle the present obligation
- at the balance sheet date

The amount of a provision should not be discounted to its present value.

The provision is measured before tax

- Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate.
- If no probable outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

estimates of outcome and financial effects are determined

- by the judgement of the management
- supplemented by experience of similar transactions
- in some cases reports from independent experts

Reimbursement

Where expenditure required to settle a provision is reimbursed by another party, the reimbursement should be recognised when

- it is virtually certain that
- reimbursement will be received
- if the enterprise settles the obligation.

Reimbursements

- Separate Asset
- amount of reimbursement should not exceed the amount of the provision
- Provision is shown net of the amount recognised for a reimbursement in P & L A/c.

Summary: Characteristics of Provisions

- Provision is a liability
- A liability is a present obligation not future obligation
- Settlement of liability should result in an outflow from enterprise of resources
- Liability is a result of obligating event, and
- There is no realistic alternative settlement of that obligating event.

Summary Measurement of provisions

- Provision should be the best estimate of the expenditure required to settle the present obligation.
- No discounting of provision amount to be paid in future to its present value.
- Provision should be measured before tax.
- Risk and uncertainties should be taken into account.
- Profit on expected disposal of assets should not be deducted.
- Future events may affect the provision.
- Additional evidence provided by event after balance sheet date should be considered.

Shown as an expense in profit and loss statement

At each balance sheet date the amount of provision made should be reviewed and adjustment for increment/decrement is made.

Contingent Liability

- Possible asset as a result of past events.
- Confirmed by occurrence and non- occurrence of one or more future events.
- Future event not wholly within the control of the enterprise.

Summary of Contingent Liability

Possible obligation

- ➢ Arises from past event
- ➢ Existence of obligation will be confirmed
- ➢ By one or more uncertain future event
- ➢ That future event not wholly within the control of the enterprise

Present obligation

- ➢ Probability of outflow of resources is very low

Or

- ➢ Reliable estimate of the amount of the present obligation cannot be made

Contingent Liability

- An enterprise should not recognise a contingent liability
- A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.
- Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.
- The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.
- Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable.
- If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

Summary Contingent Liability

- There should be present obligation arising out of past event, but not recognized as a provision.
- An enterprise should not recognise the contingent liability but it should be disclosed in financial statement.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The amount of the obligation cannot be measured with sufficient reliability to be recognised as provision.
- The possibility of an outflow of resources embodying economic benefits is not remote.

Contingent liabilities are continuously assessed and if it becomes probable that an outflow of future economic benefits will be required to settle obligation, which is previously assessed as contingent liability, a provision is recognised.

Restructuring Cost

Examples

- Sale or termination of line of business.
- The closure of business locations in a country or region
- Relocation of business activities from one country or region to another.
- Change in management structure
- Fundamental reorganization that has material effect on the nature and focus of the enterprises operations.

Restructuring

Restructuring is a programme that is planned and controlled by management and materially changes either

- **The scope of a business undertaken ; or**
- **The manner in which that business is conducted.**

Restructuring cost should not include

- The cost of retraining or relocating continuing staff
- Marketing cost
- Investment in new system and distribution network
- Expected loss on sale of assets due to restructuring.

Disclosure of Provisions

- Opening balance
- Addition to and use of the provision
- Unused amount written back
- Closing balance of the provision
- A brief description of provision
- Major assumption about future event made while measuring the provision and indication of uncertain items.
- The expected reimbursement recognised as an asset.

Disclosure of Contingent Liability

- A brief description of the nature of the contingent liability
- And where practicable an estimate of the amount as per measurement principles as prescribed for provision.
- Indications of the uncertainties relating to outflow
- The possibility of any reimbursement
- Where any of the information required as above is not disclose because it is not practicable to do so, that fact should be stated.

Disclosure of Contingent Assets

An enterprise should not recognize a contingent asset.